LINKS: 14, 17

UNITED STATES DISTRICT COURT

FOR THE CENTRAL DISTRICT OF CALIFORNIA

CLASSIC DISTRIBUTING AND BEVERAGE GROUP, INC., a California corporation, Plaintiff, v. TRAVELERS CASUALTY AND SURETY COMPANY OF AMERICA, a Connecticut corporation, Defendant.	**CASE NO. CV 11–07075 GAF (RZx)** MEMORANDUM & ORDER REGARDING MOTIONS FOR SUMMARY JUDGMENT

I.

INTRODUCTION

This insurance coverage dispute arises out of an Employment Practices Liability policy issued by Defendant Travelers Casualty and Surety Company of America ("Travlers") to Plaintiff Classic Distributing and Beverage Group, Inc. ("Classic"). When Classic was sued for violations of the California Labor Code, Travelers refused to appoint independent counsel to defend the action, and reserved rights to deny coverage for all claims. After reaching a settlement agreement in the underlying action, Classic now seeks independent counsel fees; indemnification for amounts payable under the underlying settlement agreement, and damages for Travelers' purportedly bad faith handling of the claim.

Now pending before the Court are the parties' cross-motions for summary judgment. For the reasons set forth below, the motions are **GRANTED in part** and **DENIED in part**. The Court concludes that [1] the Wage and Hour Claim Exclusion endorsement included in the Policy is invalid and unenforceable; [2] the Policy provides indemnification coverage for the underlying claims arising under Cal. Labor Code § 2802; [3] the Policy provides no coverage other than Defense Expenses for the underlying claims arising under Cal. Labor Code § 226; [4] Classic was entitled to appointment of independent counsel; and [5] Classic is entitled to recover attorneys' fees and costs associated with covered claims. However, the Court concludes that triable issues of fact preclude entry of summary judgment on Classic's bad faith claim.

II.

BACKGROUND

A. THE POLICY

Travelers issued a "Wrap+ Policy" to Classic for the policy period of October 24, 2008 through October 24, 2009 ("the Policy"), which included Employment Practices Liability ("EPL") coverage. (Docket No. 21-1, Plaintiff's Separate Statement ("PSS") ¶ 1.)[1] The EPL coverage provided a $1 million Limit of Liability, a $1 million Additional Defense Limit of Liability, and a $50,000 retention. (Id. ¶ 2.) The Insuring Agreement of the EPL coverage provided that "[t]he Company shall pay on behalf of the Insured Loss for any Employment Claim first made during the Policy Period . . . for a Wrongful Employment Practice." (Id. ¶ 3.) Loss is defined as follows:

> G. "Loss" means Defense Expenses and money which an Insured is legally obligated to pay as a result of a Claim, including settlements; judgments; back and front pay; compensatory damages; punitive or exemplary damages or the multiple portion of any multiplied damage award if insurable under the applicable law most favorable to the insurability of punitive, exemplary, or multiplied damages; prejudgment and postjudgment interest; and legal fees and expenses awarded pursuant to a court order or judgment. "Loss" does not

[1] Classic initially purchased an insurance policy from Travelers in October, 2006. (Docket No. 25, Defendant's Reply Separate Statement ("DRSS") ¶ 1.) That policy covered the period from October 24, 2006 through October 24, 2007, and included coverage for EPL. (Id. ¶ 2.) Classic had previously renewed the policy for the period from October 24, 2007 through October 24, 2008. (Id. ¶ 4.)

include:

> 1. civil or criminal fines; sanctions; liquidated damages other than liquidated damages awarded under the Age Discrimination in Employment Act or the Equal Pay Act; payroll or other taxes; or damages, penalties or types of relief deemed uninsurable under applicable law . . . .

(Id. ¶ 4.) The Policy defines "Employment Claim," in relevant part, as "a civil proceeding commenced by service of a complaint or similar pleading . . . against an Insured by or on behalf of or for the benefit of a Claimant . . . for a Wrongful Employment Practice." (Id. ¶ 5.) "Wrongful Employment Practice" is defined to include "any actual or alleged . . . failure to create or enforce adequate workplace or employment policies and procedures . . . ." (Id. ¶ 6.)

Travelers contends that, as compared to previous versions of the policy, the Policy's EPL coverage was amended by the Wage and Hour Claim Exclusion endorsement (the "Endorsement"), which provides that:

> It is agreed that solely with respect to the Liability Coverage shown above:
>
> 1. Section III. EXCLUSIONS B.3. and the last sentence of Section III. EXCLUSIONS B. are deleted.
>
> 2. This Liability Coverage shall not apply to, and the Company shall have no duty to defend or to pay, advance or reimburse Defense Expenses for, any Claim for any actual or alleged violation of responsibilities, duties or obligations imposed on an Insured under any Wage and Hour Law; provided, that this exclusion shall not apply to Claims for Retaliation or any actual or alleged violation of the Equal Pay Act.
>
> 3. The second full paragraph of Section III. CONDITIONS P. ALLOCATION of the Liability Coverage Terms and Conditions is deleted.
>
> Nothing herein contained shall be held to vary, alter, waive or extend any of the terms, conditions, exclusions or limitations of the above-mentioned policy, except as expressly stated herein. This endorsement is part of such policy and incorporated therein.

(Id. ¶ 7.) "Section III. EXCLUSIONS B.3." and the last sentence of "Section III. EXCLUSIONS B." provided that "[t]he Company shall have no duty to pay Loss, other than Defense Expenses, for any Claim:

> for an alleged violation of responsibilities, duties or obligations imposed on an Insured under any Wage and Hour Law; provided, that this exclusion shall not

> apply to Claims for Retaliation or any actual or alleged violation of the Equal Pay Act.
>
> The Company's maximum aggregate limit of liability for all Defense Expenses resulting from Claims for an alleged violation of responsibilities, duties or obligations imposed on an Insured under any Wage and Hour Law, except for Claims for Retaliation or any actual or alleged violation of the Equal Pay Act shall be $100,000, which amount shall be part of and not in addition to, the applicable limit of liability set forth in the Declarations.

(Id. ¶ 8; Policy at POL045—46.) The second full paragraph of "Section III. CONDITIONS P. ALLOCATION of the Liability Coverage Terms and Conditions" provided that "the Insureds and the Company agree to use their best efforts to determine a fair and proper allocation of all covered Defense Expenses and uncovered defense expenses for Claims alleging a violation of responsibilities, duties, or obligations imposed under any Wage and Hour Law." (Id. ¶ 9; Policy at POL022—23.)

Under the Policy's Liability Coverage Terms and Conditions section, "Wage and Hour Law" is defined as "any federal, state, or local law or regulation governing or related to the payment of wages, including the payment of overtime, on-call time or minimum wages, or the classification of employees for the purpose of determining employees' eligibility for compensation under such law(s)." (Id. ¶ 10.)

B. THE AMEZQUITA ACTION

On April 21, 2009, Anthony Amezquita filed a class action complaint against Classic in Los Angeles County Superior Court (the "Underlying Action" or the "Amezquita Action"). (Id. ¶ 11.) The complaint asserted causes of action for [1] failure to reimburse work-related expenses, in violation of California Labor Code section 2802; and [2] unfair business practices related to said work-related expenses, in violation of California Business and Professions Code section 17200. (Id. ¶ 11.) The complaint contained general allegations concerning Classic's failure to reimburse work-related expenses, Cal. Labor Code § 2802, purportedly unlawful deduction of incentive wages, Cal. Labor Code. § 221, and failure to pay all wages due on termination, Cal. Labor Code § 201. (Id. ¶¶ 12—13.)

On July 6, 2009, Travelers advised Classic that a duty to defend arose only for Amezquita's Cal. Labor Code § 2802 claim, and that Travelers would retain the law firm of Petit, Kohn, Ingrassia & Lutz, P.C. ("PKIL") to defend Classic against the claims. (Id. ¶ 14.) Travelers also advised that it was reserving rights to disclaim liability for any damages awarded in violation of Cal. Labor Code § 2802 that did not qualify as "Loss," including any fines, penalties, or liquidated damages, and that there would be no coverage for Wage and Hour Law claims because such claims were excluded under the Endorsement. (Id.)

On April 7, 2010, Amezquita filed a First Amended Complaint ("FAC"), asserting causes of action for [1] failure to reimburse work-related expenses, Cal. Labor Code § 2802; [2] unlawful failure to pay overtime wages pursuant to Cal. Labor Code §§ 201, 221, 226, 510, 511, 558, 1194 and 1198; [3] unfair competition, Cal. Bus. & Prof. Code § 17200; and [4] statutory penalties under Cal. Labor Code §§ 2698 et seq. (Id. ¶ 15.) The FAC alleged that Classic engaged in numerous wilful violations of the California Labor Code, and sought class certification, compensatory and statutory damages, penalties and restitution, recovery of penalties under the Labor Code Private Attorneys General Act of 2004, an injunction preventing Classic from pursuing the policies, acts and practices complained of, reasonable attorneys' fees pursuant to Cal. Labor Code §§ 1194, 2802 and 2699, and pre- and post-judgment interest. (Id. ¶¶ 16—17.)

On July 21, 2010, Travelers responded to Classic's tender of the FAC, again citing the Wage and Hour Claim Exclusion endorsement, and informing Classic that except for the claim under Cal. Labor Code § 2802 for failure to reimburse work-related expenses, Travelers would not cover the Underlying Action. (Id. ¶ 19.) Classic was advised that Travelers would continue to provide a defense under a reservation of rights against the Cal. Labor Code § 2802 claim; that Travelers disclaimed coverage for any damages that did not qualify as "Loss" within the meaning of the Policy, along with any fines, penalties or liquidated damages awarded under the FAC; and that Travelers' duty

to defend the claims "may be extinguished at some point in the future if it can be determined that no coverage exists for this matter under the Policy." (Id.)

Classic retained Steven W. Brennan of the law firm of St. John, Wallace, Brennan & Folan LLP as independent counsel. (Id. ¶ 20.) On August 12, 2010, Classic, through counsel, sent a letter to Travelers asserting that Classic was entitled to independent counsel for the Underlying Action pursuant to California Civil Code section 2860; demanding that Travelers pay the fees of Classic's independent counsel; and arguing that the Policy covered the claims asserted in the FAC. (Id. ¶ 21.) On September 27, 2010, Travelers confirmed its position that the Wage and Hour Claim Exclusion endorsement applied to all Wage and Hour Law claims in the FAC; that coverage for indemnity had been denied for all causes of action in the FAC; and that Travelers' duty to defend arose only out of a potential obligation to indemnify based on the Cal. Labor Code § 2802 claim. (Id. ¶ 22.) Moreover, Travelers explained that because coverage for indemnity had been denied for all causes of action in the FAC, there was no conflict of interest giving rise to an obligation to appoint independent counsel, as there was nothing that defense counsel could do to steer the defense away from covered allegations to non-covered allegations. (Id.) On that basis, Travelers denied Classic's request to pay for independent counsel. (Id.)

In December 2011, Classic settled the Amezquita Action for $225,000 (the "Settlement"). (Id. ¶ 23.) The FAC was the operative pleading at the time of Settlement. (Id. ¶ 24.) Classic and Amezquita executed a formal settlement agreement (the "Settlement Agreement") in January, 2012, which contained five components: [1] the Individual Settlement Payments; [2] the Fees and Expense Award; [3] the Service Payment; [4] the Private Attorneys General Act ("PAGA") Payment; and [5] the Administration Costs. (Id. ¶ 25.) The Agreement provided that Individual Settlement Payments would be issued to eligible Class Members and that half of each Individual Settlement Payment would be treated as wages for which payroll deductions would be made for state and federal withholding taxes and any other applicable payroll

deductions, with the remaining half representing interest and penalties sought in the action. (Id. ¶ 26.) With respect to the Fee and Expense Award, the Agreement provided that Amezquita's counsel intended to request up to $75,000 in fees and up to $45,000 in costs related to the action. (Id. ¶27.) The Agreement also provided for a Service Payment of up to $15,000 for Amezquita, a $10,000 payment to PAGA, and approximately $10,000 in Administrative Costs. (Id. ¶28.)

As previously noted, Travelers agreed to defend the Amezquita Action and to appoint PKIL. (Id. ¶ 29.) To date, Travelers has paid Defense Expenses exceeding $150,000, namely attorneys' fees and costs incurred by PKIL, and Travelers will continue to pay Defense Expenses related to the settlement going forward. (Id. ¶ 30.)

C. THE PRESENT ACTION

Classic initiated this action against Travelers on August 26, 2011, seeking declaratory relief that any monies awarded under Cal. Labor Code § 2802 in the Underlying Action would not constitute a "fine" or "penalty," and would therefore be covered as "Loss" under the Policy. (Id. ¶ 31.) Classic further contends that the Endorsement, and therefore the Wage and Hour Claim Exclusion, are invalid because they contain a material change of the Policy's terms for which notice was not adequately provided. (Id. ¶ 32.) Classic thus asserts that the original policy's Wage and Hour Claim Exclusion is applicable, which provides up to $100,000 in Defense Expenses coverage for Wage and Hour Law claims, but no indemnification for "Loss" as a result of Wage and Hour Law claims. (Id. ¶ 33.) Classic further contends that it was entitled to independent Cumis counsel under Cal. Civ. Code § 2860. (Id. ¶ 34.)

On March 29, 2012, Classic filed a First Amended Complaint against Travelers for breach of contract and bad faith, alleging that Travelers [1] breached the Policy by refusing to indemnify Classic for amounts that Classic owed Amezquita under the Settlement Agreement and refusing to appoint independent counsel pursuant to Cal. Civ. Code § 2860; [2] breached the implied covenant of good faith and fair dealing by claiming that the Wage and Hour Claim Exclusion endorsement was valid, by claiming

that Amezquita's Cal. Labor Code § 2802 claim was not covered under the Policy, by refusing to appoint independent counsel, and by refusing to indemnify Classic for amounts owed under the Settlement Agreement. (Id. ¶ 35.)

III.

DISCUSSION

A. LEGAL STANDARDS GOVERNING SUMMARY JUDGMENT

Summary judgment is proper where "the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(a). Thus, when addressing a motion for summary judgment, the Court must decide whether there exists "any genuine factual issues that properly can be resolved only by a finder of fact because they may reasonably be resolved in favor of either party." Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 250 (1986). The moving party has the burden of demonstrating the absence of a genuine issue of fact for trial, which it can meet by presenting evidence establishing the absence of a genuine issue or by "pointing out to the district court . . . that there is an absence of evidence" supporting a fact for which the non-moving party bears the burden of proof. Celotex Corp. v. Catrett, 477 U.S. 317, 325 (1986). To defeat summary judgment, the non-moving party must put forth "affirmative evidence" that shows "that there is a genuine issue for trial." Anderson, 477 U.S. at 256–57. This evidence must be admissible. See Fed. R. Civ. P. 56(c), (e). The non-moving party cannot prevail by "simply show[ing] that there is some metaphysical doubt as to the material facts." Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574, 586 (1986). Rather, the non-moving party must show that evidence in the record could lead a rational trier of fact to find in its favor. Id. at 587. In reviewing the record, the Court must believe the non-moving party's evidence, and must draw all justifiable inferences in its favor. Anderson, 477 U.S. at 255.

B. INDEMNITY COVERAGE

The parties first dispute whether the Policy provides indemnity coverage for any of the claims asserted in the Amezquita Action. (D-Mem. at 10.) These arguments center largely around whether each claim and/or underlying provision of the California Labor Code [1] constitute "Wage and Hour Law[s]," or the violation thereof, within the meaning of the Endorsement; and [2] seeks or provides for remedies contained within the Policy's definition of "Loss."

The parties focus their argument on three issues: [1] the validity of the Endorsement; and whether Travelers was required to indemnify Classic for claims arising under [2] Cal. Labor Code § 2802; and [3] Cal. Labor Code § 226.

1. WAGE AND HOUR CLAIM EXCLUSION ENDORSEMENT

Classic contends that the Endorsement, and thus the "Wage and Hour Law" exclusion, are invalid because they contain a material change of the Policy's terms for which notice was not adequately provided.[2]

Although "an insured has a duty to read his policy, . . . [i]t is a long-standing general principle applicable to insurance policies that an insurance company is bound by a greater coverage in an earlier policy when a renewal policy is issued but the insured is not notified of the specific reduction in coverage." Fields v. Blue Shield of California, 209 Cal.Rptr. 781, 785 (Ct. App. 1985) (citing Industrial Indem. Co. v. Industrial Acc. Commission of Cal., 211 P.2d 857, 860 (Cal. 1949)); see also Steven v. Fidelity & Cas. Co. of New York, 377 P.2d 284, 295 (Cal. 1963) ("In standardized contracts, . . . the California courts have long been disinclined to effectuate clauses of limitation of liability which are unclear, unexpected, inconspicuous or unconscionable.") The Ninth Circuit has adopted and applied the "renewal rule" on more than one occasion. See, e.g., Lexington Ins. Co. v. Devaney, 50 F.3d 15, *1 (9th

[2] In its reply memorandum, Travelers claims that Classic has conceded the issue, pointing to various statements in Classic's separate statement. (D-Reply at 2.) In fact, Classic continues to dispute that the Endorsement constitutes part of the Policy, and notes only that the Endorsement exists. (PSS ¶ 7.)

Cir. 1995) ("[U]nless the notice of the reduction in coverage is 'conspicuous, plain and clear,' the 'insurance company is bound by a greater coverage in an earlier policy when a renewal policy is issued.'") (citing Allstate Co. v. Fibus, 855 F.2d 660, 663 (9th Cir. 1988)).

The parties address the issue summarily, and neither discuss the notice provided by the Policy and Endorsement at any length, or conduct any substantive analysis of the notice received in this case in light of the above case law.

Looking to the evidence without the benefit of the parties' guidance, the Court notes that the body of the Policy does not contain the relevant exclusions; rather, the Endorsement, along with other such modifications, are attached to the end of the Policy, with each such page labeled "THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY." (Policy at POL095—108.) The Endorsement bears the label "WAGE AND HOUR CLAIM EXCLUSION." (Id. at POL099.) Steven Spiegler, an authorized insurance broker for Classic, and the broker for the Policy, states in his declaration that "Travelers provided Classic with no specific notice separate from the Policy to direct Classic's attention to the Endorsement." (Spiegler Decl. ¶¶ 10—11.) Spiegler further avers that "when Travelers sent [him] a quote for a renewal of the Policy for the 2007—08 policy period, Travelers did not include the Endorsement as part of that quotation." (Id. ¶ 11.) Travelers addresses the issue summarily, asserting that Classic's broker, Spiegler, must have "had notice of the Endorsement" because he "admits that when the policy was renewed for the 2007—2008 policy period, the Endorsement was included." (D-Reply at 3.) That statement is something of a non-sequitur, and completely sidesteps the case law cited above concerning what constitutes adequate notice of material reductions in coverage.

In the absence of any additional evidence concerning the notice provided to Classic, the Court finds the Endorsement invalid under governing Ninth Circuit law. In Fibus, the Court of Appeals held that a paragraph printed on the first page of an eight-page "Amendatory Endorsement" was insufficiently conspicuous to provide the

requisite notice to the policyholder. 855 F.2d at 663. Addressing similar facts in Devaney, the Ninth Circuit found that the district court had properly concluded that the notice of coverage reduction was not plain, clear and conspicuous as a matter of law. 50 F.3d at *1. In that case, the new exclusion was contained in one of four paragraphs set out in a separate endorsement. Id. Although "the cover letter referred to 'changes' and the endorsement page used the term 'amended,' no document explicitly state[d] that there had been a 'reduction' or 'diminishment' of coverage . . . ." Id. In this case, the Endorsement was included as one of several such amendments, attached to the end of a nearly one hundred-page policy. Moreover, as noted above, the body of the Policy does not refer to the Endorsement, let alone in a "clear and conspicuous" fashion. Accordingly, the notice provided in this case was, if anything, less conspicuous than that provided in Fibus and Devaney, each of which held that the amendment was invalid as a matter of law.

In Fibus, the Ninth Circuit held that "Allstate's Amendatory Endorsement itself did not conspicuously notify Fibus of a reduction in coverage" as a matter of law, but nevertheless found that it was:

> unable to determine whether Allstate used means other than the Endorsement to notify Fibus. Since the record is silent on the point, we cannot rule as a matter of law. We therefore remand. The adequacy of the notice and whether any notification was sent to Fibus are both genuine issues of material fact upon this record.

855 F.2d at 663. In this case, as discussed above, only Classic has provided evidence concerning potentially alternative forms of notice; Travelers offers no evidence as to this issue.

The Court thus funds that [1] under Fibus and Devaney, notice of the Endorsement was inadequate; and [2] Travelers has left unrebutted Classic's evidence that no other notice was provided. Accordingly, the Court finds that, as a matter of law, the Endorsement is unenforceable.

2. CALIFORNIA LABOR CODE SECTION 2802

The parties do not dispute that the Cal. Labor Code § 2802 claims are not "Wage and Hour Law" claims. However, Travelers contends that because "Amezquita was seeking to recover for himself and other class members reimbursement of any necessary expenditures or losses expended during their employment, and which Classic was legally obligated to pay . . . any portion of the Settlement intended to resolve the § 2802 claim would be restitution and therefore not insurable 'Loss' under the Policy or California law." (D-Mem. at 13.) Classic contends that sums awarded under section 2802 are properly characterized as damages, and are therefore covered under the Policy's definition of "Loss."

The Amezquita FAC alleges that Classic violated section 2802 by "requir[ing] Plaintiff and those similarly situated to incur work related expenses during their employment," and "fail[ing] to reimburse Plaintiff and those similarly situated for said expenses." (PSS ¶ 16.) Cal. Labor Code § 2802 provides that:

> (a) An employer shall indemnify his or her employee for all necessary expenditures or losses incurred by the employee in direct consequence of the discharge of his or her duties, or of his or her obedience to the directions of the employer, even though unlawful, unless the employee, at the time of obeying the directions, believed them to be unlawful.
>
> (b) All awards made by a court or by the Division of Labor Standards Enforcement for reimbursement of necessary expenditures under this section shall carry interest at the same rate as judgments in civil actions. Interest shall accrue from the date on which the employee incurred the necessary expenditure or loss.
>
> (c) For purposes of this section, the term "necessary expenditures or losses" shall include all reasonable costs, including, but not limited to, attorney's fees incurred by the employee enforcing the rights granted by this section.

In the context of coverage disputes, the California Supreme Court has explained that "[d]amages describes a payment made to compensate a party for injuries suffered," whereas restitution refers "to situations in which the defendant is required to restore to the plaintiff that which was wrongfully acquired." Bank of the West v. Superior Court, 833 P.2d 545, 547 (Cal. 1992) (citing Jaffe v. Cranford Ins. Co., 214 Cal.Rptr. 567, 570—571 (Ct. App. 1985)).

Travelers contends that "Classic is being asked to return something that it wrongfully kept possession of . . . ." (D-Mem. at 15.) Classic contends that section 2802 "requires an employer to indemnify an employee for making a payment to a third party when the employee is required to make that payment on behalf of the employer"; that "restitution involves the concept of return"; and that "reimbursement for an expense is not the return of something, but a payment made to replace a payment made to another." (P-Opp. at 7—8.)

Although the Court was unable to find any case law addressing the precise issue of whether sums sought under Labor Code section 2802 constitute "restitution" or "damages,"[3] Travelers' characterization of awards under that section as "restitution" sweeps too broadly, and would apply even to standard breach of contract actions. Indeed, the Court finds that the recovery available under section 2802 is more akin to damages than restitution. It would be difficult to characterize the employer's payment as "restoring" anything given that the plaintiff can recover only if he establishes that his purchases were "necessary," that he was not reimbursed by employer, and that his "costs" were "reasonable." Cal. Civ. Code § 2802(c). That the employee must prove certain elements prior to being "indemnified" for such expenses sweeps section 2802 awards outside any plausible reading of the words "return" or "restore."

Accordingly, the Court finds that awards under section 2802 are properly characterized as "damages," and that Classic is therefore entitled to indemnification for these claims.

3. CALIFORNIA LABOR CODE SECTION 226

Travelers contends that the underlying Cal. Labor Code § 226 claims are excluded from coverage [1] as "Wage and Hour Law" claims under either the

[3] The California Court of Appeal has characterized "payment for uniform expenses under section 2802" as "a component of employee compensation," and thus properly considered "wages," In re Work Uniform Cases, 34 Cal.Rptr.3d 635, 642 (Ct. App. 2005), and some district courts in this jurisdiction have noted that "wages" are subject to restitutionary orders under the UCL, see, e.g., Woo v. Home Loan Group, L.P., 2007 WL 6624925, at *4 (S.D. Cal. Jul. 27, 2007). However, each point of law arises in a different context, and neither is applicable to the present question.

Endorsement or original policy; and [2] as civil penalties falling outside the Policy's definition of "Loss."

Section 226 pertains to itemized wage statements, and specifies the various information an employer must include on said statements. See Cal. Labor Code § 226(a). The FAC in the Amezquita Action broadly alleged that Classic had "failed to provide Plaintiff and Class Members itemized statements as required by California Labor Code section 226." (Defendant's Request for Judicial Notice, Ex. 2 [First Am. Compl.] ¶ 23.)

a. "Wage and Hour" Law

Although the Court finds that the Endorsement is invalid and unenforceable, the original policy, absent that modification, still provides that "[Travelers] shall have no duty to pay Loss, other than Defense Expenses, for any Claim:

> for an alleged violation of responsibilities, duties or obligations imposed on an Insured under any Wage and Hour Law; provided, that this exclusion shall not apply to Claims for Retaliation or any actual or alleged violation of the Equal Pay Act.
>
> The Company's maximum aggregate limit of liability for all Defense Expenses resulting from Claims for an alleged violation of responsibilities, duties or obligations imposed on an Insured under any Wage and Hour Law, except for Claims for Retaliation or any actual or alleged violation of the Equal Pay Act shall be $100,000, which amount shall be part of and not in addition to, the applicable limit of liability set forth in the Declarations.

(Id. ¶ 8; Policy at POL045—46) (emphasis added). Under the Policy's Liability Coverage Terms and Conditions section, "Wage and Hour Law" is defined as "any federal, state, or local law or regulation governing or related to the payment of wages, including the payment of overtime, on-call time or minimum wages, or the classification of employees for the purpose of determining employees' eligibility for compensation under such law(s)." (Id. ¶ 10.)

The Court finds that Cal. Labor Code § 226 and its numerous provisions governing itemized wage statements are, at the very least, "related to the payment of wages." The California Court of Appeal has recently and explicitly stated that section

226 was enacted "[a]s part of a comprehensive statutory scheme governing the payment of wages." Heritage Residential Care, Inc. v. Division of Labor Standards Enforcement, 120 Cal.Rptr.3d 363, 366 (Ct. App. 2011). Moreover, California Dairies Inc. v. RSUI Indem. Co., cited by Classic, is inapposite. 617 F.Supp.2d 1023 (E.D. Cal. 2009). That case addressed an insurance policy that excluded loss in connection with any claim "[f]or violation of any of the responsibilities, obligations or duties imposed by . . . the Fair Labor Standards Act . . . or any similar provision of federal, state or local statutory law or common law . . . ." Id. at 1028–1029. Because the court found that the Fair Labor Standards Act did not contain any provision analogous to Cal. Labor Code § 226, it held that claims under that section were not excluded by the policy. Id. at 1046. This case, by contrast, revolves around wholly different exclusionary language, which does not in any way rely on the Fair Labor Standards Act.

Accordingly, the Court finds that the Policy, absent the Endorsement, covers only "Defense Expenses" incurred in connection with the section 226 claims, and that Travelers has no duty to pay "Loss" associated with those claims.

C. INDEPENDENT COUNSEL

Both Classic and Travelers move for summary judgment as to whether Travelers was required to provide independent counsel for the Amezquita Action. Classic contends that the appointed counsel had the ability to affect Classic's coverage rights, and therefore that independent counsel should have been provided. (P-Mem. at 14.)

> California Civil Code section 2860 provides, in relevant part, that:
>
> (a) If the provisions of a policy of insurance impose a duty to defend upon an insurer and a conflict of interest arises which creates a duty on the part of the insurer to provide independent counsel to the insured, the insurer shall provide independent counsel to represent the insured unless, at the time the insured is informed that a possible conflict may arise or does exist, the insured expressly waives, in writing, the right to independent counsel. An insurance contract may contain a provision which sets forth the method of selecting that counsel consistent with this section.
>
> (b) For purposes of this section, a conflict of interest does not exist as to allegations or facts in the litigation for which the insurer denies coverage; however, when an insurer reserves its rights on a given issue and the outcome of that coverage issue can be controlled by counsel first retained by the insurer for

> the defense of the claim, a conflict of interest may exist. No conflict of interest shall be deemed to exist as to allegations of punitive damages or be deemed to exist solely because an insured is sued for an amount in excess of the insurance policy limits.

Cal. Civ. Code § 2860(a)—(b). "A mere possibility of an unspecified conflict does not require independent counsel. The conflict must be significant, not merely theoretical, actual, not merely potential." Dynamic Concepts, Inc. v. Truck Ins. Exchange, 71 Cal.Rptr.2d 882, 887 (Ct. App. 1998) (citation omitted). "The potential for conflict requires a careful analysis of the parties' respective interests to determine whether they can be reconciled (such as by a defense based on total nonliability) or whether an actual conflict of interest precludes insurer-appointed defense counsel from presenting a quality defense for the insured." Id. at 888. "Some of the circumstances that may create a conflict of interest requiring the insurer to provide independent counsel include:

> (1) where the insurer reserves its rights on a given issue and the outcome of that coverage issue can be controlled by the insurer's retained counsel; (2) where the insurer insures both the plaintiff and the defendant; (3) where the insurer has filed suit against the insured, whether or not the suit is related to the lawsuit the insurer is obligated to defend; (4) where the insurer pursues settlement in excess of policy limits without the insured's consent and leaving the insured exposed to claims by third parties; and (5) any other situation where an attorney who represents the interests of both the insurer and the insured finds that his or her 'representation of the one is rendered less effective by reason of his [or her] representation of the other.'"

James 3 Corp. v. Truck Ins. Exchange, 111 Cal.Rptr.2d 181, 186 (Ct. App. 2001) (internal citations omitted).

The parties' arguments follow largely from their prior contentions concerning indemnity coverage. Travelers contends that because "there [was] no indemnity coverage under the Policy for any part of the Settlement in the Amezquita Action, there [was] no opportunity for defense counsel to steer the defense towards a non-covered claim and away from a covered claim. (D-Opp. at 17—18.) Accordingly, Travelers contends that "an actual conflict of interest did not exist . . . ." (D-Mem. at 18—19.) By contrast, Classic contends that five potential conflicts of interest arose: [1] with respect to the initial complaint, Travelers refused to identify on which claims it was

reserving rights to deny coverage, presenting defense counsel with the opportunity to steer the defense away from covered claims and toward non-covered claims, as those claims were known to Travelers alone; [2] defense counsel had the ability to maneuver the case away from a substantive defense of Classic's employment practices, which would be covered under the Policy, and towards a denial that the plaintiff's alleged damages were the result of Classic's policies, a theory under which liability would not be covered; [3] defense counsel was able to steer proof of the case away from covered conduct, such as wrongful issuance of wage statements, and towards uncovered conduct, such as denial of overtime pay; [4] defense counsel had the ability to steer the defense toward "intentional" conduct, excluded from coverage under the Policy, and away from negligent conduct; and [5] Travelers specifically reserved rights to deny all coverage for "fines, penalties, or liquidated damages," and thus defense counsel had the ability to steer the settlement towards being comprised of such remedies. (P-Mem. at 17—19.)

As an initial matter, Travelers' argument is unpersuasive insofar as it is premised on the contention, already rejected by this Court, that the Policy does not provide indemnity coverage for any of the underlying claims. Accordingly, Travelers had the ability not only to steer coverage away from potentially covered claims, namely those arising under Cal. Labor Code § 2802, but also to steer any settlement toward awards that would be excluded under the Policy's definition of "Loss." Indeed, in light of Travelers' previous attempts to categorize recovered "wages" as "restitution," the language in the Settlement Agreement stating that the Individual Settlement Payments would be treated as "wages" and "penalties" may be read as an attempt to do just that. (PSS ¶ 26.) Therefore, the conflict was both "significant" and "actual." See Golden Eagle Ins. Co. v. Foremost Ins. Co., 25 Cal.Rptr.2d 242, 257 (Ct. App. 1993) (noting that "[a]ttorney control of the outcome of a coverage dispute is written into [California] Civil Code section 2860, subdivision (b) as an example of a conflict of interest which may require appointment of independent counsel.").

The Court therefore finds that independent counsel should have been appointed for the Amezquita Action.

D. ATTORNEYS' FEES AND COSTS

Travelers contends that "any award of attorneys' fees and costs in the Amezquita action would also not be covered under the Policy because there is no indemnity coverage for any of the claims in the Amezquita Action and courts in California have determined that attorneys' fees are not 'damages' under an insurance policy." (D-Opp. at 18—19.)

The Policy defines coverable "Loss" to include "money which an Insured is legally obligated to pay as a result of a Claim, including . . . legal fees and expenses of a Claimant or Outside Counsel awarded pursuant to a court order or judgment." (PSS ¶ 4.) Accordingly, although Travelers would not otherwise be required to pay fees and costs, see State Farm General Ins. Co. v. Mintarsih, 95 Cal.Rptr.3d 845, 849 (holding that insurer's obligation under policy provision promising to pay costs awarded against the insureds extends only to costs arising from claims that "were at least potentially covered" under the policy), because Travelers does not dispute that fees and costs are covered under the Policy for indemnified claims, and because the Court concludes above that Travelers is required to indemnify Classic for the section 2802 claims, the Court finds that Classic is entitled to recover fees and costs associated with covered claims.

E. IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING

Finally, Travelers contends that summary judgment should be entered on Classic's claim for breach of the implied covenant of good faith and fair dealing because [1] there was no predicate breach of contract; and [2] there was a genuine dispute as to coverage, precluding a finding of bad faith. (D-Mem. at 21—22.) Classic contends that Travelers' position with respect to the Cal. Labor Code § 2802 claims – that these claims are restitutionary in nature – is unreasonable. (P-Opp. at 16.) Similarly, Classic contends that "Travelers adopted a wholly irrational and unfounded

view of Classic's right to independent counsel," taking "the novel position, not recognized by any court in any jurisdiction, that if it simply denied indemnity coverage to all of the underlying claims, then it could be excused for not appointing independent counsel." (Id.) Finally, Classic requests, pursuant to Fed. R. Civ. P. 56(d)(1), that adjudication of the bad faith issue "await further factual development," namely outstanding discovery requests relating to Travelers' policies and practices in handling claims on behalf of other policyholders, which may shed light on the "reasonableness of Travelers' positions." (Id.)

"The mistaken [or erroneous] withholding of policy benefits, if reasonable or if based on a legitimate dispute as to the insurer's liability under California law, does not expose the insurer to bad faith liability." Chateau Chamberay Homeowners Ass'n v. Associated Intern. Ins. Co., 108 Cal.Rptr.2d 776, 784 (Ct. App. 2001) (citation omitted); see also Opsal v. United Services Auto. Assn., 10 Cal.Rptr.2d 352, 356—357 (Ct. App. 1991) ("It is now clear under California law that an insurer's erroneous failure to pay benefits under a policy does not necessarily constitute bad faith entitling the insured to recover tort damages. The ultimate test of bad faith liability in the first party cases is whether the refusal to pay policy benefits was unreasonable.") (internal quotation marks and citations omitted).

However, Travelers' argument with respect to Cal. Labor Code § 2802 merely asserts, without any actual support in the authorities, that awards under that statutory provision constitute "restitution." Without any support for that argument other than a seemingly stretched analogy to restitution, the Court cannot find that position "reasonable" as a matter of law. Accordingly, the Court finds that the bad faith claim cannot be summarily adjudicated in favor of Travelers.

IV.

CONCLUSION

For the reasons set forth above, the motions are **GRANTED in part** and **DENIED in part**. The Court finds that [1] the Wage and Hour Claim Exclusion endorsement included in the Policy is invalid and unenforceable; [2] the Policy provides indemnification coverage for the underlying claims arising under Cal. Labor Code § 2802; [3] the Policy provides no coverage other than Defense Expenses for the underlying claims arising under Cal. Labor Code § 226; [4] Classic was entitled to appointment of independent counsel; and [5] Classic is entitled to recover attorneys' fees and costs associated with covered claims. Finally, the Court concludes that triable issues of fact preclude entry of summary judgment on Classic's bad faith claim.

IT IS SO ORDERED.

DATED: August 29, 2012

Gary Allen Feess
United States District Judge