No. _____

In the Supreme Court of the United States

LEE INVESTMENTS LLC d.b.a. THE ISLAND,
a California limited liability company,
Petitioner,

v.

UNITED STATES FIDELITY & GUARANTY COMPANY,
a Maryland corporation, et al.,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI
Appendix Volume 1 of 2

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QUESTIONS PRESENTED

1. Whether a denial of summary judgment involving purely legal issues is reviewable on an appeal from a judgment entered after trial on the merits.

2. Whether a State workers' compensation tribunal's exclusive jurisdiction under state law bars original diversity jurisdiction of a workers' compensation insurer's federal court action to rescind the insurance policy filed after the injured employee has filed an action before the State's tribunal.

3. Whether the prohibition in 28 USC section 1445(c) against removal of state court civil actions arising under the State's workers' compensation laws bars original diversity jurisdiction of a workers' compensation insurer's federal court action to rescind the insurance policy filed after the injured employee has filed a state workers' compensation action.

LIST OF ALL PARTIES

Petitioner:

Lee Investments LLC d.b.a. The Island, a California limited liability company (hereinafter referred to as "Lee")

Respondents:

United States Fidelity and Guaranty Company (hereinafter referred to as "USF&G")

American Specialty Insurance Services, Inc.

American Specialty Risk Management Services, LLC

Aon Risk Services, Inc. of Central California Insurance Services

CORPORATE DISCLOSURE STATEMENT

Lee Investments LLC has no parent corporation and does not issue stock.

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The opinion of the United States Court of Appeals for the Ninth Circuit (App. 1a) is reported at *United States Fidelity and Guaranty Company v. Lee Investments LLC, DBA The Island, Defendant-Appellant, and American Specialty Insurance Services; American Specialty Risk Management Services LLC, Counter-defendants-Appellees, Aon Risk Services, Inc., Defendant-3d-party-plaintiff-counter-defendant-Appellee*, 641 F.3d 1126 (9th Cir. 2011), 76 Cal. Comp. Cases 472 (2011). The Order of the U.S. Court of Appeals for the Ninth Circuit denying Lee's Petition for Panel Rehearing and for Rehearing En Banc is not reported. App. 29a.

The Opinion and Order of the United States District Court for the Eastern District of California denying Lee's motions pursuant to Federal Rules of Civil Procedure, Rules 59(e) and 60(a)(b), is reported at 551 F. Supp. 2d 1069 (E.D. Cal. 2008). App. 168a. This District Court's Opinion and Order granting an injunction is reported at 2008 U.S. Dist. LEXIS 99974 (E.D. Cal. 2008). App. 174a, 213a. This District Court's Order denying Lee summary judgment on USF&G's complaint is not reported. App. 58a. The District Court's Order denying Lee's and the employee's motion to dismiss USF&G's complaint is not reported. App. 33a.

STATEMENT OF JURISDICTION

The Ninth Circuit entered judgment on April 18, 2011. The Ninth Circuit denied Lee's Petition for Panel Rehearing and Rehearing En Banc on May 27, 2011. App. 29a. This Court's jurisdiction is invoked

under 28 USC section 1254(1). Federal subject matter jurisdiction is disputed as discussed below.

KEY STATUTORY AND REGULATORY PROVISIONS INVOLVED[1]

California Labor Code section 5300(a) and (b) state:

> All the following proceedings shall be instituted before the appeals board and not elsewhere, except as otherwise provided in Division 4:
>
> (a) For the recovery of compensation, or concerning any right or liability arising out of or incidental thereto.
>
> (b) For the enforcement against the employer or an insurer of any liability for compensation imposed upon the employer by this division in favor of the injured employee, his or her dependents, or any third person.

California Insurance Code (hereinafter referred to as "Ins. Code") sections 11657, 11659 and 11660 respectively state:

§ 11657:

> Subject to the provisions of Sections 11659 and 11660, limited workers' compensation

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[1] Citations in this Petition to other Constitutional provisions, statutes, and regulations involved in this case are set forth in the Appendix.

policies may be issued insuring either the whole or any part of the liability of any employer for compensation, provided that the policy is previously approved, as to substance and form, by the commissioner. Subject to those provisions, the policy may restrict or limit the insurance in any manner whatsoever.

§ 11659:

Such approved form of policy, limited pursuant to Section 11657, shall not be otherwise limited except by indorsement [sic] thereon in accordance with a form prescribed by the commissioner or in accordance with rules adopted by the commissioner. Such indorsement [sic] form shall not be subject to Section 11658. Before prescribing such indorsement [sic] form or adopting such rule, the commissioner shall consult concerning it with the Workers' Compensation Appeals Board.

§ 11660:

Failure to observe the requirements of Sections 11657 and 11659 shall render a policy issued under Section 11657, and not complying therewith, unlimited.

Cal. Code of Regs. tit. 10, § 2268 states:

No collateral agreements modifying the obligation of either the insured or the insurer shall be made unless attached to and made a part of the policy, provided, however, that if such agreements are attached and in any way

> restrict or limit the coverage of the policy, they shall conform in all respects with these rules.

Cal. Code of Regs. tit. 10, § 2259 states in relevant part:

> A limiting and restricting endorsement other than California Approved Form Endorsement No. 11 may be used only under one or more of the following circumstances:
>
> (e) Where the endorsement seeks to exclude only such liability of the employer for compensation as the latter affirms to the insurer in writing is otherwise secured or is lawfully uninsured (e.g., liability of the State and its political subdivisions and institutions).

Cal. Code of Regs. tit. 10, § 2265(a)(b) states:

> California Approved Form Endorsement No. 11 may be used only in those cases where other California Approved Form Endorsements are not applicable or may not be used. It shall accurately and unambiguously state the limitations or restriction and shall bear an appropriate side note descriptive of the limitations or restriction. It may be used only under one or more of the following circumstances:
>
> (a) Where use of the Form No. 11 Endorsement is in accordance with one or more of the guiding standards set forth in Section 2259 of these rules.

> (b) Where the employer's business is conducted in such a manner that it is impossible or impracticable to determine the nature, scope and extent of employment covered by the insurer without the use of a limiting and restricting endorsement.

28 USC § 1445(c) states:

> (c) A civil action in any State court arising under the workmen's compensation laws of such State may not be removed to any district court of the United States.

STATEMENT OF THE CASE

On March 15, 1999, Lee's severely injured employee filed her Application for Workers' Compensation benefits before the California Workers' Compensation Appeals Board ("WCAB") against Lee and the insurer's adjusting agency for injuries incurred while helping to erect a water slide at the employer's water park. App. 334a-338a, 376a. USF&G had delegated first level claims handling on its behalf to this adjusting agency through USF&G's managing general agent.[2]

On April 26, 1999, the insurer filed in the district court against Lee and its employee a complaint for rescission of its workers' compensation insurance

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[2] As required by Ins. Code section 11653, USF&G's policy provided, "Jurisdiction over you is jurisdiction over us for purposes of the workers compensation law. We are bound by decisions against you under that law . . . ." App. 315a, 366a.

policy and for reimbursement of workers' compensation benefits paid to the employee. The insurer alleged that in the application process, the employer had misrepresented that its water park employees would not do "construction." App. 344a-346a. The insurer shortly thereafter filed an objection to the WCAB's jurisdiction in the WCAB proceeding. On October 20, 1999, the WCAB overruled the insurer's objection to the WCAB's jurisdiction, which ruling was final when the California Supreme Court denied review on April 12, 2000. App. 375a-381a, 382a-383a, 384a.

Not long after the insurer filed its objection to the WCAB's jurisdiction, the injured employee and Lee filed a motion to dismiss or stay the district court action based on the exclusive jurisdiction of the WCAB. App. 372a-374a. The district court denied Lee's and the employee's motion to dismiss or stay on October 28, 1999. App. 33a.

Faced with defending the district court action, Lee filed a counterclaim on February 7, 2000. Unable to get the federal court action dismissed, the injured employee on January 24, 2001 entered into a stipulation with the insurer to be dismissed from the action in return for the employee's agreement to be bound by the federal court outcome. App. 388a-391a.

In May 2002, Lee and the insurer filed their respective motion and counter motion for summary judgment. Among other grounds, Lee asserted that as a matter of law, California law barred an insurer's rescission of a workers' compensation insurance policy based on the employer's alleged misrepresentation in the application process of the type of work its

employees would do when that restriction was not made part of the policy. App. 117a-122a. This legal issue was dispositive of USF&G's complaint because this alleged misrepresentation was the sole basis for the insurer's seeking rescission and restitution.

On July 30, 2004, the district court rejected this ground and denied Lee's motion for summary judgment. App. 122a. Lee raised this issue anew in its Federal Rules of Civil Procedure (hereinafter referred to as "FRCP") Rules 59(e) and 60(a)(b) motions to vacate, alter or amend the Partial Judgment that was entered in favor of the insurer on March 1, 2007 following a jury trial in early 2007. App. 168a-173a, 171a, ¶ 3. The district court denied that motion. App. *id*. In April 2007, the district court heard and took under submission a court trial phase of certain issues that the parties reserved for the court.

Meanwhile, before and after the district court jury trial, Lee sought to have the WCAB exercise its jurisdiction to determine whether the insurer was entitled to rescission and restitution. The insurer objected that Lee had allegedly waived the WCAB's jurisdiction by not seeking a WCAB determination until 2006. App. 394a. Lee contended that WCAB jurisdiction could not be waived as a matter of law. Lee also contended that the insurer's counsel had misled Lee to believe that this counsel represented Lee and that this counsel had erroneously told Lee the WCAB action was stayed. App. 400a-403a. The WCAB determined that all of these issues would need to be tried before the WCAB, which trial had not been set when the early 2007 district court jury trial occurred. App. 396a. On December 19, 2008, the district court enjoined Lee from seeking WCAB

adjudication of whether the insurer was entitled to rescission and restitution. App. 213a-216a. On August 5, 2009, the district court made findings of fact and conclusions of law on the court trial phase and then certified and entered a Judgment under FRCP Rule 54(b) based on the jury verdict and the court trial. App. 217a, 289a, 297a, 414a, 419a.

Lee appealed from the interlocutory permanent injunction, from all orders inextricably connected to it, from the Rule 54(b) Judgment, from the denial of Lee's Motion for Summary Judgment on USF&G's Complaint, and from the denial of Lee's FRCP Rules 59(e) and 60(a)(b) motions made regarding the March 1, 2007 Partial Judgment. App. 404a-408a, 409a-413a.

The Ninth Circuit rejected Lee's contention that if there was subject matter diversity jurisdiction, Lee was entitled to appellate review of the district court's denial of summary judgment. Relying on *Ortiz v. Jordan*, 131 S. Ct. 884 (2011), the Ninth Circuit stated a denial of a motion for summary judgment is not reviewable on appeal from a final judgment entered after trial on the merits. The Ninth Circuit did not address at all the legal issue whether California law bars an insurer's rescission of the policy based on the employer's misrepresentation in the application process of the type of work its employees would do when that restriction was not made part of the policy. The Ninth Circuit did not address the question left unresolved by *Ortiz* as to whether this purely legal issue here involved could be reviewed on appeal after trial.

The Ninth Circuit also did not address rulings in multiple other Circuits that subject matter diversity jurisdiction was lacking due to the courtroom "door closing" exclusive remedy provisions of State law and/or to the bar against removal in 28 USC § 1445(c).

REASONS FOR ALLOWANCE OF THE WRIT

A. The Ninth Circuit Court of Appeals Decided an Important Question of Federal Law That has Not Been, But Should be, Settled by this Court in that this Court Earlier this Year Specifically Declined to Address Whether Legal Error Permits Post-Trial Review of a Denial of Summary Judgment.

Assuming for the sake of argument only that there was original diversity jurisdiction, which there was not for the reasons discussed below, the Ninth Circuit improperly relied on *Ortiz v. Jordan*, 131 S. Ct. 884 (2011), to decline to review whether it was reversible error for the trial court to deny Lee's Motion for Summary Judgment in 2004. As a result, the Ninth Circuit did not address Lee's contention that California, as a matter of law, barred the insurer's reliance on the employer's misrepresentation in the application process of the type of work its employees would do when that restriction was not made part of the policy.

In *Ortiz*, this Court stated that the denial of summary judgment there involved was not reviewable post-trial. However, at page 892 this Court expressly declined to address whether a dispositive legal issue improperly resolved in a denial of summary judgment could be reviewed post-trial on appeal from the

judgment, noting that disputed factual issues were resolved at the trial there involved. In response to the *Ortiz* respondents' contention that their plea of qualified immunity raised pure legal issues that were preserved for appeal by their unsuccessful motion for summary judgment, this Court stated,

> We need not address this argument, for the officials' claims of qualified immunity hardly present 'purely legal' issues capable of resolution 'with reference to undisputed facts.' Cases fitting that bill typically involve contests not about what occurred or why an action was taken or omitted, but disputes about the substance and clarity of pre-existing law. At 892.
>
> In sum, the qualified immunity defenses asserted by Jordan and Bright do not present 'neat abstract issues of law.' *Id.* at 893.

Here, the dispute was about the substance and clarity of existing law on whether the insurer could rely on employer's misrepresentation of the type of work its employees would do without including this limitation in the policy in the manner required by California law. This dispositive issue was purely legal, yet the Ninth Circuit applied *Ortiz* to deny appellate review of the denial of summary judgment. Whether the legal issue here involved can be reviewed post-verdict is an important question that has not been, but should now be decided by this Court for the following reasons.

First, as a matter of law, California's statutory and regulatory scheme bars the insurer's rescission of the

policy, after the employee has already been injured, based on the employer's misrepresentation in the application process of the type of work the employee would do, where the restriction was not made part of the policy. In order to protect the injured employee, to protect the expectations of the employer, and to allow insurers a reasonable opportunity to limit their exposure to certain risks, California allows but closely regulates the limitations that an insurer can put in a workers' compensation insurance policy. Ins. Code section 11660 states that if the requirements of Ins. Code sections 11657 and 11659 are not observed, the policy is deemed to be unlimited. Section 11657 requires the Insurance Commissioner's advance approval of the form and substance of a limited policy. Section 11659 requires the use of an approved form of endorsement for further limitation of an approved policy form. Restrictive endorsements are governed by Cal. Code of Regs. tit. 10, §§ 2253-2268 (hereafter, 10 CCR §§ 2253-2268). 10 CCR § 2268 states:

> No collateral agreements modifying the obligation of either the insured or the insurer shall be made unless attached to and made part of the policy, provided, however, that if such agreements are attached and in any way restrict or limit the coverage of the policy, they shall conform in all respects with these rules.

Specifications and standards for endorsements are set forth in 10 CCR §§ 2257 and 2259. Pre-approved forms of limiting endorsements include Form Nos. 10 and 11. 10 CCR §§ 2260, 2264, 2265, 2266, 2269.10, 2269.11. App. 322a-327a. Endorsements not so specified as pre-approved forms must be drafted in accordance with 10 CCR § 2257 and submitted in

advance to the rating organization for approval. Ins. Code §§ 11658, 11659; 10 CCR §§ 2262, 2501, and 2502. App. 316a, 322a, 327a-328a.

USF&G could have used pre-approved regulatory Form 10 expressly to exclude employees engaged in specified operations by description and by the classification and code number applicable to such operations. *See* 10 CCR § 2264(e). Form No. 11 was available if Form 10 was not. 22 CCR § 2265. Section 2265 required Form 11 to "accurately and unambiguously state the limitations or restrictions and shall bear an appropriate side note descriptive of the limitations or restrictions." Section 2265(b) allowed Form 11 to be used "Where the employer's business is conducted in such a manner that it is impossible or impracticable to determine the nature, scope and extent of employment covered by the insurer without use of a limiting or restricting endorsement."

Here, the difficulty in determining whether a park maintenance worker doing such things as trenching to replace a water line or erecting a water slide would be excluded "construction" work, as opposed to covered activities within workers' compensation classifications for water park operations, could have been easily addressed through Form 11 with a simple statement that a specific activity, like slide erection, was excluded. Instead, USF&G chose to rely on an ambiguous request for a pre-policy representation and

the equally ambiguous pre-policy response it invoked.[3] This was not permissible under California law.

The policy itself did not restrict Lee's employees' activities. In fact, the policy stated,

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[3] The insurer's request stated in pertinent part: "Attached is a copy of The Island's workers' compensation loss runs. Bill, I think we have a problem. The loss runs seem to evidence an interchange of labor between the water park employees and the construction employees. Please review the type of losses that have occurred and help us understand how this fits with our understanding of the client/employee relationship. We would have anticipated training losses rather than construction losses.

After seeing the loss runs, we are concerned. The loss runs seem to support Industrial Indemnity auditor's position. Please help me to prove to our underwriter the following:

1. Island employees will not be performing tasks outside of their designated classification as water park employees;

2. Construction has ceased at The Island and all construction laborers working for Rexford Development Corporation have moved to a different jobsite. Therefore, workers' compensation claims arising from construction will not be reported under Lee Investments workers' compensation policy." App. 348a-350a.

The employer's response stated: "This is to confirm that the Island is operating as a water park. Our opening day was August 6, 1998. Our operation will no longer employ construction laborers. Any construction will be performed by independent contractors. We will obtain and forward certificates of insurance on any contractors hired.

The Island will provide appropriate training for water park employees. Their duties will be restricted to park operations." App. 351a-352a.

> Item 4 of the Information Page shows the rate and premium basis for certain business or work classifications. These classifications were assigned based on an estimate of the exposures you would have during the policy period. If your actual exposures are not properly described by those classifications, we will assign proper classifications, rates and premium by endorsement to this policy.
>
> The final premium will be determined after this policy ends by using the actual, not the estimated, premium basis and the proper classifications and rates that lawfully apply to the business and work covered by this policy. App. 367a-368a.

The policy further stated:

> It is further agreed that this policy, including all endorsements forming a part hereof, constitutes the entire contract of insurance. No condition, provision, agreement, or understanding not set forth in this policy or such endorsements shall affect such contract or any rights, duties, or privileges arising therefrom. App. 370a.

The policy thus did not restrict at all what activities Lee's employees were to do. On the contrary, the policy permitted any work activity and anticipated that different work classifications could be assigned later, depending on the actual work of the employees, along with payment of potentially higher rates.

The key word is "unlimited," which is what the policy was as a matter of law under Ins. Code § 11660, because of USF&G's failure to put the restriction not to do "construction" in the policy. *See also*, 10 CCR § 2268; *Fireman's Fund Ins. Co. v. Workers' Comp. Appeals Bd.*, 189 Cal. App. 4th 101, 115-116 (2010). As a matter of law, the more specific provisions of the Ins. Code relating to workers' compensation prevail over the general rules of Ins. Code §§ 331 and 359 that allow an insurer to rely on a misrepresentation in the application process. CAL. CONST. ART. XIV, § 4; Cal. Code Civ. Proc. § 1859; Cal. Civ. Code § 3534; *Denny's Inc. v. Workers' Comp. Appeals Bd.*, 104 Cal. App. 4th 1433, 1441 (2003) (specific statutory characterization of a workers' compensation insurer to include self-insured employer supersedes general Insurance Code definitions). "Unlimited" means "unlimited."

It is thus strictly a legal question whether the policy could be rescinded based on a representation in the application process as to the type of work the employees would do when that restriction was not made part of the policy. The district court's denial of summary judgment is therefore reviewable on this appeal from the Rule 54(b) Judgment and from the order granting the interlocutory permanent injunction. No further factual development was needed at trial and none occurred regarding this legal issue. This legal issue is also reviewable insofar as it was raised again in Lee's FRCP Rules 59(e) and 60(a)(b) motions to vacate or alter or amend the March 1, 2007 Partial Judgment. App. 171a. The order on Lee's Rules 59(e) and 60(a)(b) motions was not itself appealable when made because the Partial Judgment was not appealable. App. 166a-167a.

As a pure question of law, Lee was therefore entitled to summary judgment on USF&G's complaint because existing California law clearly here barred USF&G's reliance on the employer's misrepresentation in the application process of the type of work its employees would do. Here, the insurer's conduct was made even worse by the insurer's waiting until an employee had been severely injured before raising the issue. It is important that this Court decide whether this legal issue can be reviewed at this time because that question was expressly left open earlier this year in *Ortiz v. Jordan*, and because, in California and states with similar laws, the Ninth Circuit Opinion encourages insurers to use their economic power to bludgeon severely injured employees and their employers out of their rights in the state's workers' compensation system.

Second, this Court should also decide whether a dispositive legal issue improperly resolved on summary judgment can be reviewed post-verdict because there is a split in the Circuits on this issue, and even within the Ninth Circuit. The Seventh Circuit in *Rekhi v. Wildwood Indus. Inc.*, 61 F.3d 1313, 1318 (7th Cir. 1995), held that although post-verdict review of orders denying summary judgment is usually barred, review is proper of a potentially dispositive legal issue that the subsequent trial did not make moot. Here, the legal issue was never moot: it remains dispositive of USF&G 's complaint, and of the injunction, and was a proper subject of Lee's FRCP Rules 59(e) and 60(a)(b) motions. The Tenth Circuit stated in *Ruyle v. Cont'l Oil Co.*, 44 F.3d 837, 842 (10th Cir. 1994), that there is a "critical distinction between summary judgment motions raising the sufficiency of the evidence to create a fact question for the jury and

those raising a question of law the court may decide." *Contra*, *Ting Ji v. Bose Corp.*, 626 F.2d 116, 127-128 (1st Cir. 2010). The Ninth Circuit Panel's Opinion not only conflicts with two other Circuit Courts of Appeals on the same important matter, but also conflicts with other Ninth Circuit decisions. *F.B.T. Productions, LLC v. Aftermath Records*, 621 F.3d 958, 962-964 (9th Cir. 2010); *Banuelos v. Const. Laborers' Trust Funds for S. Cal.*, 382 F.3d 897, 902-903 (9th Cir. 2004).

It is crucial for the Circuits that this Court address whether the legal issue here involved can be reviewed in this appeal.

B. The Ninth Circuit Court of Appeals Has Entered a Decision in Conflict with the Decisions of Numerous Other United States Courts of Appeals on the Same Important Matter in that the Ninth Circuit Holds that Federal Subject Matter Jurisdiction Exists Where a State Workers' Compensation System Provides the Exclusive Remedy Whereas Five Other Circuits Hold that Federal Subject Matter Jurisdiction Does Not Exist.

California Labor Code section 5300(a)(b) states:

> All the following proceedings shall be instituted before the appeals board and not elsewhere, except as otherwise provided in Division 4:
>
> (a) For the recovery of compensation, or concerning any right or liability arising out of or incidental thereto.

> (b) For the enforcement against the employer or an insurer of any liability for compensation imposed upon the employer by this division in favor of the injured employee, his or her dependents, or any third person.

Labor Code section 5300(a) is not limited to an injured employee's claim for benefits, but broadly applies to any right or liability incidental to the recovery of compensation. *Marsh & McLennan, Inc. v. Superior Court*, 49 Cal. 3d 1, 8 (1989) ("the Workers' Compensation system encompasses all disputes over coverage and payment"); *Vacanti v. State Comp. Ins. Fund*, 24 Cal. 4th 800, 821 (2001); Cal. Lab. Code §§ 5301 and 5950 (the WCAB vested with full power and jurisdiction to try and finally determine all matters specified in Labor Code section 5300 subject only to writs of review to the California Court of Appeal and the California Supreme Court); Cal. Lab. Code § 5955 (no state court has jurisdiction to enjoin or interfere with the WCAB except as allowed by appellate court writ of mandate).

The insurer's payment of benefits unquestionably falls within the scope of Labor Code section 5300(a) no less than the employer's payment of benefits (or the California Uninsured Employers Fund's payment of benefits if the employer cannot pay). In line with this, Labor Code section 5275(a)(1) specifies that workers' compensation insurance coverage disputes are to be submitted to arbitration under the WCAB statutory and regulatory scheme. WCAB jurisdiction is exclusive to resolve whether an insurer can rescind a contract to provide workers' compensation benefits. The foregoing Labor Code sections and case law demonstrate that the jurisdiction of the WCAB is

exclusive to determine not only whether a workers' compensation insurance policy can be rescinded, but also to determine whether this question falls within its exclusive jurisdiction. *Compare Styne v. Stevens*, 26 Cal. 4th 42, 55, n. 6 (2001). Whether an insurer can rescind a workers' compensation policy and obtain restitution of workers' compensation benefits paid pending rescission is obviously a matter covered by Labor Code section 5300, but even if, *arguendo*, it were not, WCAB jurisdiction was exclusive to determine whether these issues were within the WCAB's exclusive jurisdiction. In short, California law "closed the door" here to both state and federal courts.

The Ninth Circuit determined, however, that the federal court had original diversity jurisdiction to determine whether WCAB jurisdiction was exclusive because, according to the Court, state law cannot control or limit the diversity jurisdiction of the federal courts. App. 11a. For the Ninth Circuit, the issue is not diversity jurisdiction, but whether USF&G's complaint states a claim upon which relief can be granted. The Ninth Circuit's analysis thus erroneously allows the Court to exercise jurisdiction to determine whether rescission of a workers' compensation policy is or is not within the exclusive jurisdiction of the WCAB. This holding improperly usurps the exclusive jurisdiction that California has vested in the WCAB to make this determination of its own jurisdiction.

Federal courts must respect that California has vested this jurisdiction exclusively in the WCAB. As this Court stated when addressing California's right to apply its workers' compensation laws to a Massachusetts employee injured while working in

California, "Few matters could be deemed more appropriately the concern of the State in which the injury occurs or more completely within its powers." *Pac. Emplrs. Ins. Co. v. Industrial Accident Comm'n*, 306 U.S. 493, 503 (1939).

The Ninth Circuit conflicts with holdings of the First, Fourth, Fifth, Tenth and Eleventh Circuits that federal subject matter jurisdiction does not exist where a state workers' compensation system provides the exclusive remedy. *Armistead v. C&M Transport*, 49 F.3d 43 (1st Cir. 1995), overruled on other grounds by *City of Chicago v. Int'l Coll. of Surgeons*, 522 U.S. 156 (1997); *Evans v. B.F. Perkins Co.*, 166 F.3d 642 (4th Cir. 1999): *Kay v. Home Indem. Co.,* 337 F.2d 898 (5th Cir. 1964) ; *Stuart v. Colo. Interstate Gas Co.*, 271 F.3d 1221 (10th Cir. 2001): and *Connolly v. MD Cas. Co.*, 849 F.2d 525 (11th Cir. 1988). The First, Fourth, Fifth, Tenth and Eleventh Circuits correctly hold that under *Erie R.R. Co. v. Tompkins*, 304 U.S. 64 (1938), the exclusive remedy of state workers' compensation closes the door to both state and federal courts and bars original diversity jurisdiction actions. The district court should have instantly granted Lee's and the injured employee's 1999 motion to dismiss.

Workers' compensation cases simply do not belong in federal court. This Court should resolve this conflict among the Circuits with a clear statement that where, as here, the state workers' compensation system provides the exclusive remedy, federal courts lack original diversity jurisdiction of not only a controversy that clearly falls within the state worker's compensation system's exclusive jurisdiction, but also of the question whether a controversy is of the type that is within the state workers' compensation

system's exclusive jurisdiction. These issues are, and should be, committed exclusively to the state workers' compensation systems.

Even if it were proper, which it was not, for the district court initially to exercise concurrent jurisdiction with the WCAB over the issue of rescission, in this case the California Supreme Court in April 2000 entered the first final judgment that the WCAB had jurisdiction. App. 384a. Under California law, where concurrent jurisdiction is properly exercised (which it was not here), the first final judgment on the issue of jurisdiction is conclusive on the question of which tribunal has jurisdiction. *Busick v. Workers' Comp. Appeals Bd.*, 7 Cal. 3d 967, 977 (1972). Again, under the authority of the First, Fourth, Fifth, Tenth and Eleventh Circuits, original diversity jurisdiction was lacking at that point if even if one assumes, *arguendo*, that the district court initially had concurrent original diversity jurisdiction. It is essential that this Court clarify for the Circuits that federal courts in diversity actions must abide by the state's exclusive jurisdiction rules in workers' compensation cases.

C. The Ninth Circuit Court of Appeals Has Entered a Decision in Conflict with the Decision of Another United States Court of Appeals on the Same Important Matter in that the Ninth Circuit Holds that 28 USC Section 1445(c) Does Not Bar a Subsequently Filed Diversity Action Whereas the Fifth Circuit Holds to the Contrary.

28 USC section 1445(c) bars removal of a "civil action in any State court arising under the workmen's

compensation laws of such State". In *Bryan v. Liberty Mutual Ins. Co.*, 415 F.2d 314 (5th Cir. 1969), the United States Court of Appeals for the Fifth Circuit held that where a party has initiated state proceedings under its workers' compensation laws, 28 USC section 1445(c) bars the opposing party from filing a subsequent diversity action on the same issues. *Bryan* reasoned that the subsequent diversity action was barred as "an actual removal of a workmen's compensation case from state court to the United States District Court." At page 316. See also, *Kay v. Home Indem. Co.*, *supra*. Here, the Ninth Circuit Opinion rejected Lee's contention that USF&G's complaint was a de facto removal. The Ninth Circuit narrowly read section 1445(c) only to bar a formal removal in accordance with the procedure set forth in 28 USC section 1446. However, *Bryan* correctly captures the purpose of section 1445(c) to prevent federal court nullification of a pending state workers' compensation proceeding. See S. Rep. No. 85-1830 (1958) on the adoption of section 1445(c), which also aptly observed:

> The removal of workmen's compensation cases from state courts to the federal courts adds to the already overburdened docket of the federal courts, the congestion in some of which is now most deplorable. App. 332a.

Preserving the injured employee's choice of the workers' compensation forum is crucial for the injured employee, who might otherwise have to travel a long distance to attend the federal court action, and who definitely will, unless the employee capitulates to the insurer, face the much greater expense and delay of the federal court action over the more summary

procedure of state workers' compensation. Employers likewise lose the benefit of a swift, inexpensive no-fault resolution of the claim through the state system. The protracted litigation here involved, for the courts and the parties, is a conspicuous example of Congress's concerns in adopting section 1445(c). The burden, expense and delay here involved no doubt drove the injured employee in 2001 to stipulate to be dismissed in return for the employee's agreement to be bound by the federal court outcome. App. 388a-391a. For these reasons, whether *Bryan* or the Ninth Circuit is correct is a matter of national importance that must be resolved, and resolved in favor of the former.

CONCLUSION

Assuming, *arguendo*, that the district court had subject matter jurisdiction, California law is and was clear that USF&G could not rely on the employer's misrepresentation in the application process of the type of work its employees would do. This purely legal ground should have resulted in the district court's granting Lee summary judgment on USF&G's complaint but the motion was erroneously denied. For all federal courts, this Court should determine that a denial of summary judgment is reviewable on appeal post-trial where, as here, a dispositive legal issue was erroneously decided and not made moot by the trial.

This Court should also resolve the conflicts in the Circuits over original diversity jurisdiction for cases arising under state workers' compensation laws. It is crucial to the swift, sure and proper administration of states' exclusive workers' compensation remedies that the door to federal court be closed so that insurers

seeking to rescind workers' compensation policies do not nullify those remedies.

Dated: August 23, 2011

Respectfully submitted,

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APPENDIX

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FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

[Filed April 18, 2011]

UNITED STATES FIDELITY AND GUARANTY COMPANY, *Plaintiff-Appellee,*	
v.	
LEE INVESTMENTS LLC, DBA The Island, *Defendant-Appellant,*	No. 08-17753
and	D.C. No. 1:99-cv-05583-OWW-SMS
AMERICAN SPECIALTY INSURANCE SERVICES; AMERICAN SPECIALTY RISK MANAGEMENT SERVICES LLC, *Counter-defendants-Appellees,*	
AON RISK SERVICES, INC., *Defendant-3rd-party-plaintiff-counter-defendant-Appellee.*	

UNITED STATES FIDELITY AND GUARANTY COMPANY, *Plaintiff-counter-defendant-Appellee,* v. LEE INVESTMENTS LLC, DBA The Island, *Defendant-counter-claimant-Appellant,* v. AMERICAN SPECIALTY INSURANCE SERVICES; AMERICAN SPECIALTY RISK MANAGEMENT SERVICES LLC, *Counter-defendants-Appellees,* and RICHARD K. EHRLICH; REXFORD PROPERTIES, LLC, a California limited liability company, *Defendants-counter-claimants,* v. AON RISK SERVICES, INC., *Third-party-defendant-Appellee.*	No. 09-16962 D.C. No. 1:99-cv-05583-OWW-SMS OPINION

Appeal from the United States District Court
for the Eastern District of California
Oliver W. Wanger, Senior District Judge, Presiding

Argued and Submitted
February 16, 2011—San Francisco, California

Filed April 18, 2011

Before: Mary M. Schroeder and
Sidney R. Thomas, Circuit Judges,
and Samuel Conti, Senior District Judge.[*]

Opinion by Judge Thomas

COUNSEL

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Jeffrey A. Charlston and Bruce T. Smith, Charlston, Revich & Wollitz, LLP, Los Angeles, California, for appellee/plaintiff United States Fidelity and Guaranty Company and for appellees/counter-defendants American Specialty Insurance Services, Inc., and American Specialty Risk Management Services, LLC.

Margaret L. Parker, Matthew S. Covington, and Stephen Chiari, DLA Piper LLP, San Francisco, California, for appellee/defendant, third-party plaintiff, counter-defendant Aon Risk Services, Inc.

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[*] The Honorable Samuel Conti, Senior District Judge for the U.S. District Court for Northern California, San Francisco, sitting by designation.

OPINION

THOMAS, Circuit Judge:

In this appeal, we consider whether a federal district court had subject matter jurisdiction over an insurance company's diversity action seeking rescission of a workers' compensation policy and, if so, whether it was required to dismiss the case because exclusive jurisdiction was vested by state law in a state workers' compensation agency. We conclude that the district court had subject matter jurisdiction and properly denied the motion to dismiss. We affirm.

I

This seemingly *ab aeterno* litigation originated in a simple event: an accident at "The Island," a California waterpark. The incident spawned parallel actions that proceeded in different venues over many years, ultimately resulting in a judgment in which The Island's insurer prevailed.

The mishap occurred when a maintenance worker ("the Employee") was helping to assemble a five-story water slide. A metal bar fell from a forklift and struck her head, causing serious injuries. Prior to the accident, The Island's owner, Lee Investments, LLC ("the Employer" or "Lee"), had purchased a workers' compensation policy ("the Policy") underwritten by United States Fidelity & Guaranty Co. ("the Insurer").[1]

[1] The Policy was marketed by American Specialty Insurance Services, Inc., the Insurer's managing general agent ("the

The Insurer contends that it agreed to issue the Policy contingent on the Employer's representations that Island employees would not be "performing construction operations, as opposed to performing duties in the day-to-day operation of a water park." Thus, the Insurer claimed that the Employer had not told the whole truth in its insurance application, and that the lie had wrongfully induced it to provide coverage.

The Employee filed a claim for benefits with California's Workers' Compensation Appeals Board ("the State Board") and the Insurer began paying benefits to the Employee pursuant to the Policy. Shortly thereafter, the Insurer filed this federal action against the Employer seeking Policy rescission and related relief on account of the Employer's alleged misrepresentations.

The Employee initially filed, but later abandoned, a request that the State Board arbitrate the claims asserted by the Insurer in the federal action. Years later, the Employer revived the Employee's request. The Insurer objected, and a state administrative law judge decided to hold a hearing on the objections. The hearing never occurred, and the issue was left adrift.

In federal court, the Employer joined a motion to dismiss raised by another party alleging that California law committed adjudication of the Insurer's action to the State Board. The district court denied the dismissal motion. Subsequently, the Employer, the

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Insurer's Agent"). The Employer purchased the policy through insurance broker Aon Risk Services, Inc. ("the Broker").

Insurer, the Insurer's Agent, and the Broker filed claims against one another and additional parties.[2]

The case was bifurcated, with some of the claims tried to a jury and others reserved for bench trial. The jury returned special verdicts in favor of the Insurer and against the Employer. The jury found that the Employer had made an intentional misrepresentation of material fact and concealed material facts during the policy application process. Based on that determination, the jury found that the Insurer was entitled to rescind the Policy and to recover restitution of payments it made under it. The jury found against the Employer on all of its affirmative defenses and counterclaims, and found in favor of the Insurer on all but one of its affirmative defenses to the Employer's counterclaims.

The district court entered partial judgment on the jury verdict. The Employer appealed, but its appeal was dismissed as premature. The Employer filed various post-trial motions seeking relief, which the district court denied. The district court then held a bench trial on some of the remaining issues, including the Insurer's claims to restitution of attorneys fees it paid to defend the Employer in the State Board proceedings and to prejudgment interest.

More than a year after the federal jury entered verdicts in favor of the Insurer on its claims against the Employer, and while the district court was

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[2] The additional parties include the Employer's alleged alter egos, Richard K. Ehrlich and Rexford Properties, LLC ("the Alter Egos"), who were part of the action but not this appeal.

deliberating on the issues presented in the bench trial, the Employer attempted an exodus from the federal action and again requested that the State Board arbitrate the Insurer's claims. The Insurer asked the federal court to enjoin the State Board proceedings. The court granted the Insurer's motion, observing that:

> The issues surrounding issuance of the insurance policy have been fully litigated and jury verdicts entered. Lee sought a jury trial, and only when the jury decided every issue against Lee, now seeks to avoid the effects of the trial following which the Partial Judgment was entered. It will be the height of judicial waste to permit Lee to yet again, a fourth time, seek to relitigate the issues, going backward to an administrative hearing.

The court also noted that "Lee's revisionist assertion that it was dragged kicking and screaming into the federal litigation is categorically belied by the record."

The court then granted the Insurer's motion for summary judgment on the Employer's counterclaims for breach of contract and the implied covenant of good faith and fair dealing. The court subsequently issued its decision on the issues presented in the bench trial and granted the Insurer's request for the entry of judgment pursuant to Rule 54(b). In addition to the amounts awarded by the jury, the court awarded the Insurer restitution of the amount it spent for the Employer's legal defense in the State Board proceedings and prejudgment interest.

In sum, after a jury trial, a bench trial, and post-trial motions, the Insurer won its claim for rescission, and was awarded restitution damages from the Employer in the amount of $841,708.13, to reimburse the Insurer for the benefits it paid under the Policy less premiums the Employer paid the Insurer. The Insurer was granted prejudgment interest against the Employer in the amount of $394,955.03 and was permitted to recover all costs of suit. Judgment was entered in favor of the Insurer on all claims the Employer brought against it. The Broker was granted judgment on all of the Employers's claims against it and, conversely, the Employer was granted judgment on all of the Broker's claims against it. No damages were awarded as between the Broker and the Employer and each side was ordered to bear its respective costs. The court also resolved certain claims involving the Alter Egos.[3]

Meanwhile, over in the state proceedings, the request that the State Board re-adjudicate the Insurer's claims for rescission and restitution remained enjoined. The Employer and the Employee reached a settlement of their separate disputes before the State Board, but the deal did not resolve any of the issues in the instant case.[4]

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[3] The district court found against the Alter Egos as to their claims against the Insurer. The district court severed claims filed by the Insurer against the Alter Egos for separate trial in the event that the Insurer prevailed on its rescission and restitution claims. Thus, those issues were left behind for later resolution and are not part of this appeal.

[4] The Insurer and The Broker have suggested that the settlement agreement between the Employer and the Employee has mooted

In the end, when the smoke cleared, the Insurer prevailed in the main action and the parallel proceeding remained in limbo. This appeal followed.

II

The Employer contends that the district court lacked subject matter jurisdiction over the Insurer's claims. We disagree. The Insurer is a corporation duly organized and existing under the laws of the State of Maryland, with its principal place of business located in that state. The Employer is a business entity organized and existing under the laws of the State of California with its principal place of business located in Fresno. Because the parties are diverse and because the amount in controversy exceeded $75,000, the district court had subject matter jurisdiction over the action. 28 U.S.C. § 1332.

The Employer's arguments to the contrary are not persuasive. First, the Employer argues that by filing the present action the Insurer improperly removed the Employee's state workers' compensation claim to federal court, thus running afoul of 28 U.S.C. § 1445(c). Section 1445(c) provides that "[a] civil action in any State court arising under the workmen's compensation laws of such State may not be removed to any district court of the United States." However, the federal action did not involve an adjudication of the Employee's workers' compensation benefits; it

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certain of the Employer's claims in this appeal. We disagree. Whatever the case may be as to resolution of the solitary issue regarding compensation due to the Employee, it is not relevant to the separate disputes among the Employer, the Insurer, the Insurer's Agent, and the Broker.

addressed whether the Employer's insurance policy had been wrongfully obtained through misrepresentation. Thus, this action did not "arise under" California's workers' compensation laws.

Furthermore, the Insurer did not "remove" a civil action from state court; it filed an original claim in federal court. The Employer urges us to construe the Insurer's complaint as a *de facto* removal and apply the relevant jurisdictional restrictions. However, removal jurisdiction differs from original jurisdiction and is subject to different constraints. *See Hurt v. Dow Chem. Co.*, 963 F.2d 1142, 1144-45 (8th Cir. 1992). There is nothing in the statutory scheme that would allow us to graft jurisdictional restrictions from one context onto another. Section 1445(c) "proscribes only the *removal* of claims arising under state workers' compensation statutes." *Vasquez v. North County Transit Dist.*, 292 F.3d 1049, 1061 (9th Cir. 2002) (emphasis in original) (citing *Horton v. Liberty Mut. Ins. Co.*, 367 U.S. 348, 352 (1961)). That statutory restriction on the federal courts' removal jurisdiction "does not prohibit plaintiffs from filing such actions directly in federal court." *Id.* Nor did the district court appear, *deus ex machina*, to wrest control over the litigation from the State Board. Rather, it addressed the issues put before it in an original federal proceeding. Section 1445(c) does not divest federal courts of jurisdiction over this diversity action.

Second, the Employer argues that the district court was divested of jurisdiction by 28 U.S.C. § 1359, which provides that "[a] district court shall not have jurisdiction of a civil action in which a party, by assignment or otherwise, has been improperly or collusively made or joined to invoke the jurisdiction of

the court." The purpose of § 1359 is to prevent the perpetration of fraud on federal courts' jurisdiction. *See Hartog v. Memory*, 116 U.S. 588, 590-91 (1886) (citing *Williams v. Nottawa*, 104 U.S. 209, 211 (1881)). The Employer has presented no evidence of fraud or collusion. Its argument is without merit.

Finally, the Employer claims that the district court lacked subject matter jurisdiction because California law vests the State Board alone with jurisdiction to entertain the Insurer's claims.[5] However, in *Begay v. Kerr-McGee Corp.*, 682 F.2d 1311 (9th Cir. 1982), we rejected the argument that exclusivity provisions in state workers' compensation laws, like those in California's Workers' Compensation Act,[6] could divest federal courts of subject matter jurisdiction:

> [S]tate law may not control or limit the diversity jurisdiction of the federal courts. The district court's diversity jurisdiction is a creature of federal law under Article III and 28 U.S.C. § 1332(a). Pursuant to the supremacy clause, section 1332(a) preempts any contrary state law.

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[5] This jurisdictional allegation is distinct from the Employer's claim that exclusivity provisions in California law required the district court, in the proper exercise of diversity jurisdiction, to dismiss the action so that it could be decided by the State Board. We turn to this claim subsequently.

[6] *See* Cal. Labor Code § 5300 (proceedings "[f]or the recovery of [workers'] compensation, or concerning any right or liability arising out of or incidental thereto" "shall be instituted before the [State Board] and not elsewhere"); *see also id.* §§ 3600(a), 3602(a).

682 F.2d at 1315. Here, as in *Begay*, "[t]he question is whether the . . . complaint stated a claim for relief under [state] law pursuant to [*Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938)], rather than whether the district court lacked subject matter jurisdiction." *Id.* Thus, even if we were to hold that the exclusivity provisions applied, they would not operate to divest the federal court of subject matter jurisdiction.

The district court correctly concluded that it had subject matter jurisdiction over the action.

III

The State Board did not have exclusive jurisdiction to hear the Insurer's claims, as the Employer contends. Therefore, the district court properly denied the dismissal motion, a decision we review *de novo*. *Matter of McLinn*, 739 F.2d 1395, 1397 (9th Cir. 1984) (en banc).

[1] As a general proposition, federal courts sitting in diversity have authority to decide state law claims seeking rescission of an insurance policy. *See, e.g.*, *C.N.R. Atkin v. Smith*, 137 F.3d 1169, 1172 (9th Cir. 1998); *Gasaway v. Nw. Mut. Life Ins. Co.*, 26 F.3d 957, 958 (9th Cir. 1994). However, the California Workers' Compensation Act's exclusivity provisions "are 'substantive' provisions which, under *Erie*, a district court sitting in diversity is bound to follow." *Begay*, 682 F.2d at 1318. " '*Erie* requires that the federal court grant or withhold relief as the state courts would.' " *Id.* at 1316 (quoting *Markham v. City of Newport News*, 292 F.2d 711, 718 (4th Cir. 1961)); *see Angel v. Bullington*, 330 U.S. 183, 187 (1947) ("For purposes of diversity jurisdiction a federal court is 'in effect, only

another court of the State.' " (quoting *Guaranty Trust Co. v. York*, 326 U.S. 99, 108 (1945)).

Accordingly, we turn to California law and assess whether it would preclude California state courts from hearing the Insurer's claims in favor of the State Board's exclusive authority to do so. We are reminded that " '[t]he task of a federal court in a diversity action is to approximate state law as closely as possible in order to make sure that the vindication of the state right is without discrimination because of the federal forum.' " *Ticknor v. Choice Hotels Int'l., Inc.*, 265 F.3d 931, 939 (9th Cir. 2001) (quoting *Gee v. Tenneco, Inc.*, 615 F.2d 857, 861 (9th Cir. 1980)). Perhaps a better way of putting it is to say that one of the goals in deciding state law questions is to do no harm to state jurisprudence.

In analyzing state law in a diversity case, we are bound by the decisions of the state's highest court. If the California Supreme Court has not decided the question, " 'we are required to ascertain from all the available data what the state law is and apply it.' " *Soltani v. Western & Southern Life Ins. Co.*, 258 F.3d 1038, 1045 (9th Cir. 2001) (quoting *Insurance Co. of Pennsylvania v. Associated Int'l Ins. Co.*, 922 F.2d 516, 520 (9th Cir. 1990)). In assessing how the California Supreme Court would resolve the "question—absent controlling state authority—federal courts look to existing state law without predicting potential changes in that law." *Ticknor*, 265 F.3d at 939.

We are also mindful that "[o]nce a diversity case has been tried in federal court, with rules of decision supplied by state law under the regime of *Erie* . . . , considerations of finality, efficiency and economy

become overwhelming." *Caterpillar Inc. v. Lewis*, 519 U.S. 61, 75 (1996) (citation omitted). That advice is particularly apt in a case that has engaged the federal courts for more than a decade.

[2] California's Workers' Compensation Act grants the State Board exclusive authority to hear claims "[f]or the recovery of [workers'] compensation, or concerning any right or liability arising out of or incidental thereto." Cal. Labor Code § 5300(a). The Employer argues that the Insurer's claims arise out of or are incidental to the recovery of workers' compensation. Accordingly, the Employer argues that a California state court could not entertain the Insurer's complaint, and therefore that, pursuant to the *Erie* doctrine, neither can the federal courts. The district court disagreed, and on at least three occasions overruled objections to the exercise of its jurisdiction to hear the Insurer's claims in the face of the contention that the State Board had exclusive authority to do so.

While California case law is not conclusive on the matter,[7] we are not writing on a *tabula rasa*, either. The relevant California decisions establish that the State Board does not possess exclusive jurisdiction over the Insurer's claims.

[3] First, Cal. Labor Code § 5300 does not, by its terms, apply to the Insurer's action for rescission. The

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[7] *See Charles J. Vacanti, M.D., Inc. v. State Comp. Ins. Fund*, 24 Cal. 4th 800, 811 (2001) ("the unabated flow of published decisions *clarifying* the scope of workers' compensation exclusivity suggests considerable confusion as well as innovative lawyering" (emphasis in original)).

Insurer's complaint against the Employer sought a declaration that the Policy was void *ab initio* and that the Insurer was entitled to rescind it. The Insurer further sought restitution of all sums paid by it in connection with claims on the Policy. The relief the Insurer sought does not involve "the recovery of [workers'] compensation," nor does it "concern[ ] any right or liability arising out of or incidental thereto." Cal. Labor Code § 5300(a). The Insurer's claims here have no legal effect on the Employee's ability to recover workers' compensation; rather, they merely affect who pays those costs—the Insurer, the Employer, or California's Uninsured Employers Benefits Trust Fund. Indeed, the California Supreme Court has confirmed that "[c]auses of action seeking to recover '[e]conomic or contract damages incurred *independent* of any' workplace injury are . . . exempt from workers' compensation exclusivity." *Vacanti*, 24 Cal. 4th at 814 (emphasis and second alteration in original) (quoting *Pichon v. Pacific Gas & Electric Co.*, 212 Cal. App. 3d 488, 501 (1989)). Thus, while perhaps prompted by the Employee's workplace accident, the Insurer's contract claims are "independent of a compensable injury" under California workers' compensation law. *Id.* at 816 (quotation omitted).

[4] Second, the California Supreme Court has held that California state courts, and therefore federal courts sitting in diversity, can entertain such claims. *Scott v. Indus. Accident Comm'n*, 46 Cal. 2d 76, 89 (1956). Citing "the stricter rules governing court procedures and character of proof rather than the more liberal ones applicable" in administrative arbitrations, the court stated that, "where questions as to . . . insurance carrier liability within the terms of a contract[ ] are close," the carrier might "fil[e] a

declaratory relief action in [state] court rather than" before the State Board. *Id.*[8]

[5] Third, California law does not authorize the State Board to award the damages sought by the Employer in its counterclaims for breach of fiduciary duty, fraud, and negligent misrepresentation. " '[T]he [State Board] cannot award damages for injuries.' " *La Jolla Beach & Tennis Club, Inc. v. Indus. Indem. Co.*, 9 Cal. 4th 27, 35 (1994) (quoting *Scott*, 46 Cal. 2d at 83*; see id.* at 43 ("[A] civil suit for damages is no more a claim for workers' compensation benefits than a criminal or disciplinary action is a civil suit for damages."); *cf. United Nat. Ins. Co. v. R&D Latex Corp.*, 242 F.3d 1102, 1112 (9th Cir. 2001) (" 'when other claims are joined with an action for declaratory relief (e.g., bad faith, breach of contract, breach of fiduciary duty, rescission, or claims for other monetary relief), the district court should not, as a general rule, remand or decline to entertain the claim for declaratory relief' " (quoting *Gov't Emps. Ins. Co. v. Dizol*, 133 F.3d 1220, 1225 (9th Cir. 1998) (en banc)).

This limitation is consistent with the constant theme generally applicable to administrative agencies: that they are creatures of statute, bound to the confines of the statute that created them, and lack the inherent equitable powers that courts possess. *Int'l*

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[8] *See also U.S. Fidelity & Guaranty Co. v. Superior Court*, 214 Cal. 468, 471 (1931) (finding state court jurisdiction where a cause of action between an employer and its purported workers' compensation insurance provider did "not involve the construction of an insurance policy with respect to coverage thereunder, the recovery of compensation or incidental liability or the enforcement against an insurance carrier of compensation liability").

Union of Elec., Radio & Mach. Workers, AFL-CIO v. NLRB, 502 F.2d 349, 354 n.* (D.C. Cir. 1974). Further, the matters at hand involve state law questions of contract formation in which the State Board has no special expertise. The California Court of Appeals has summarized, stating that "jurisdiction rests with the courts" over claims "of bad faith and breach of contract" regarding workers' compensation insurance policies. *Salimi v. State Comp. Ins. Fund*, 54 Cal. App. 4th 216, 220 (1997) (collecting cases).

[6] Because it had jurisdiction, the district court did not abuse its discretion in enjoining the State Board proceedings after the Insurer's rescission and restitution claims had been resolved by the federal jury. *See Scott*, 46 Cal. 2d at 81 (where there is concurrent jurisdiction and one tribunal has already assumed jurisdiction, "another tribunal, although it might originally have taken jurisdiction, may be restrained by prohibition if it attempts to proceed"). Indeed, the court served the greater good of "finality, efficiency and economy," *Caterpillar*, 519 U.S. at 75, by declining to allow the Employer to litigate the primary issues anew a fourth time. The Employer's appeal to the Anti-Injunction Act, 28 U.S.C. § 2283, is misplaced: nothing in that act "prevent[s] federal courts from enjoining state administrative proceedings." *Bud Antle, Inc. v. Barbosa*, 45 F.3d 1261, 1271 (9th Cir. 1994).[9]

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[9] At oral argument, the Employer also challenged the district court's decision not to abstain from adjudicating the Insurer's claims. However, by not "specifically and distinctly" arguing this claim in its opening brief, the Employer has waived it. *United States v. Ullah*, 976 F.2d 509, 514 (9th Cir. 1992).

In sum, this case does not present a collision between federal and state interests. The district court properly wrote the final chapter in the case, with the parallel proceeding ultimately having no impact on the final reckoning.

IV

[7] The district court correctly concluded that, under California law, there can be no breach of a duty to defend under a rescinded insurance policy. Therefore, the Insurer was not obligated to defend the Employer before the State Board and in the federal action.[10] *See LA Sound USA, Inc. v. St. Paul Fire & Marine Ins. Co.*, 156 Cal. App. 4th 1259, 1266-71 (2007) (where an insurance policy is "void *ab initio*," the insureds "*never* had any coverage under [the policy], and [the insurer] *never* had a duty to defend or indemnify them" (emphasis in the original)); *Imperial Casualty & Indemnity Co. v. Sogomonian*, 198 Cal. App. 3d 169, 184 (1988) ("upon a rescission of a policy of insurance, based upon a material concealment or misrepresentation, all rights of the insured thereunder (except the right to recover any consideration paid in

[10] The district court also correctly concluded that under California law the Insurer adequately reserved its right to reimbursement for costs expended on the Employer's defense, *see Buss v. Superior Court*, 16 Cal. 4th 35, 61 n.27 (1997), and the court did not abuse its discretion in denying the Employer's request for further discovery on its claims, *see California ex rel. California Dep't of Toxic Substances Control v. Campbell*, 138 F.3d 772, 779 (9th Cir.1998) ("District courts have wide latitude in controlling discovery, and their rulings will not be overturned in the absence of a clear abuse of discretion." (internal quotation and citations omitted)).

the purchase of the policy) are extinguished"); *see also Cigna Property and Cas. Ins. Co. v. Polaris Pictures Corp.*, 159 F.3d 412, 419 (9th Cir. 1998) ("if [the insurer] prevailed on its rescission claim, [the insured's] counterclaims necessarily would be defeated"). Thus, the effect of the judicial rescission was to turn back time, voiding all actions taken under the Policy. With no effective policy in place, there was no duty to defend.

The Employer's appeal to *Buss v. Superior Court*, 16 Cal. 4th 35 (1997), is of no avail. There, the California Supreme Court affirmed that, where an action against an insured mixes claims that indubitably are covered by an insurance policy with those that may not be, the insurer has a duty to defend the entire action. *Id.* at 49. That such a duty is "an obligation imposed by law in support of the [insurance] policy," *id.* at 48-49, is irrelevant to the Employer's arguments, as *Buss* assumes the presence of a valid policy and never addresses rescission. Furthermore, with regard to restitution, the *Buss* court went on to hold that "[a]s to claims that are not even potentially covered" by the insurance policy, "the insurer may indeed seek reimbursement for defense costs" because " 'California law clearly allows insurers to be reimbursed for attorney's fees' and other expenses 'paid in defending insureds against claims for which there was no obligation to defend.' " 16 Cal. 4th at 50 (quoting *Omaha Indem. Ins. Co. v. Cardon Oil Co.*, 687 F. Supp. 502, 504 (N.D. Cal. 1988)).

[8] Applying this principle to these facts, under California law, the Insurer was entitled to summary judgment on the Employer's claims. Because the Policy was declared void *ab initio*, the Insurer had no

obligation to defend the Employer notwithstanding that the Policy, if valid, would have covered the Employee's injuries.

V

Reversal is not warranted on the basis of any of the district court's pre-trial rulings.

A

[9] The district court did not err in denying the Employer's motions in limine which sought to exclude two communications among the Employer, the Broker, and the Insurer's Agent that allegedly showed the Employer's material misrepresentations in the policy application process. In the first letter, the Insurer's Agent expressed concern to the Broker that the Employer's employees were performing construction duties, and asked for the Broker's help in proving to the Insurer that "[c]onstruction has ceased at The Island" and accordingly that "workers' compensation claims arising from construction will not be reported under [the Policy]." In the second letter, drafted by the Broker to assuage the Insurer's concerns and signed by the Employer's general manager, the Employer represented to the Insurer's Agent that The Island would "no longer employ construction laborers" and that "[a]ny construction work will be performed by independent contractors." It was six months later that the Employee suffered her injury while completing the assembly of a new water slide.

The Employer contends the letters were not relevant, arguing that the Insurer was required to issue a restrictive policy endorsement if it did not

intend to insure construction activities. However, the Insurer did not argue that the letters modified the Policy. Rather, the Insurer submitted those letters as evidence that the Employer misrepresented its operations to procure insurance, justifying the Insurer in rescinding the policy under California law. *See Mitchell v. United Nat. Ins. Co.*, 127 Cal. App. 4th 457, 468 (2005) ("any material misrepresentation or the failure, whether intentional or unintentional, to provide requested information permits rescission of the policy by the injured party" (citing Cal. Ins. Code §§ 351, 359; *Imperial Cas. & Indem. Co. v. Sogomonian,* 198 Cal. App. 3d 169, 179-80 (1988))). The letters were relevant, and the district court properly denied the Employer's motion in limine.

B

[10] The district court did not abuse its discretion in granting the Insurer's motions in limine that precluded the Employer from arguing at trial that the Broker was the Insurer's agent. The district court held that this theory was not fairly disclosed in discovery, that the defendants had not had an opportunity to conduct discovery on the theory or develop a defense, and that the defendants would be unfairly prejudiced if the court allowed the Employer to present the new theory at trial. The court did not abuse its discretion in declining to allow the belated assertion of an entirely new theory on the eve of trial, when discovery would have to be re-opened and the theory was of dubious merit. *See Archer Daniels Midland Co. v. Hartford Fire Ins. Co.,* 243 F.3d 369, 375 (7th Cir. 2001) (upholding the exercise of discretion and noting that "if the destination is fated, it is best to avoid the travail of the journey").

C

[11] The district court did not abuse its discretion in granting the Insurer's and the Broker's motions in limine precluding the Employer's experts from testifying as to matters beyond their expertise and the scope of their expert reports. The Employer complains that its hands were tied. However, its experts remained free to articulate the relevant standards of care and to opine as to whether the Insurer's and the Broker's conduct met their requirements. A district court does not abuse its discretion in limiting expert testimony to the expert's area of expertise and the subjects contained in the expert's disclosure. *United States v. W.R. Grace,* 526 F.3d 499, 503 (9th Cir. 2008).

D

The Employer's challenge to the district court's denial of the Employer's motion for summary judgment is not properly before the Court. The Employer has not appealed the district court order in question, nor could it: after a full trial on the merits, no appeal can be taken of an order denying summary judgment. *Ortiz v. Jordan*, ___ U.S. ___, 131 S.Ct. 884, 889 (2011); *accord. Locricchio v. Legal Services Corp.*, 833 F.2d 1352, 1358-59 (9th Cir. 1987) ("[T]he denial of a motion for summary judgment is not reviewable on an appeal from a final judgment entered after a full trial on the merits.").

E

Finally, the Employer's complaint about the "morass of documents" that the Insurer produced prior to the bench trial provides no cause for reversal.

VI

The district court did not err in its trial rulings. The district court did not impermissibly prevent the Employer from presenting its theories of the case. Rather, its decisions were in keeping with its "general 'gatekeeping' obligation . . . [as] to testimony based on 'technical' and 'other specialized' knowledge." *Kumho tire Co. v. Carmichael*, 526 U.S. 137, 141 (1999). A careful reading of the record demonstrates that the district court fully permitted the Employer to assert its theory.

[12] The further instructions given by the court on professional negligence claims conformed to the requirements that California law imposes on such claims. In California, negligence claims against insurance brokers are adjudicated according to the professional negligence standard,[11] and "proof of professional negligence requires testimony of experts as to the standard of care in the relevant community." *Huang v. Garner*, 157 Cal. App. 3d 404, 413 (1984), *disapproved on other grounds by Aas v. Superior Court*, 24 Cal. 4th 627 (2000). Therefore, the court properly instructed that expert testimony was required in order to sustain a professional liability claim. The Employer argues that its theories were not "complex," but California has yet to adopt a "simplicy of theory" exception to its professional negligence rule. Rather,

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[11] *See Hydro-Mill Co., Inc. v. Hayward, Tilton & Rolapp Ins. Assocs., Inc.*, 115 Cal. App. 4th 1145, 1154 (2004) (concluding that, where a negligence claim challenged the failure of an insurance broker to obtain appropriate insurance, "the negligence claim isone for professional negligence"); *Valentine v. Membrila Ins. Servs., Inc.*, 118 Cal. App. 4th 462, 474-75 (2004).

California requires expert testimony on the standard of care "unless the conduct required by the particular circumstances is within the common knowledge of the layman." *Flowers v. Torrance Memorial Hosp. Med. Ctr.*, 884 P.2d 142, 147 (Cal. 1994).

VII

Reversal is not warranted on the basis of the district court's findings of fact, conclusions of law, or post-trial rulings.

A

The district court's factual finding that the Insurer was the real party in interest for purposes of restitution is supported by the record. The Employer alleged that the Insurer was not the real party in interest, claiming that it had not actually paid benefits under the Policy. However, the record contains direct and uncontradicted evidence of payments by the Insurer for the Employee's medical and related expenses. The Employer did not tender any contrary evidence and did not sustain its burden of proof. The district court correctly held that the Insurer was the real party in interest.

B

The district court properly awarded prejudgment interest to the Insurer. " 'Prejudgment interest in a diversity action is . . . a substantive matter governed by state law.' " *In re Exxon Valdez*, 484 F.3d 1098, 1101 (9th Cir. 2007) (quoting *Webco Indus., Inc. v. Thermatool Corp.*, 278 F.3d 1120, 1134 (10th Cir. 2002)). California law provides that

> Every person who is entitled to recover damages *certain, or capable of being made certain by calculation*, and the right to recover which is vested in him upon a particular day, is entitled also to recover interest thereon from that day, except during such time as the debtor is prevented by law, or by the act of the creditor from paying the debt.

Cal. Civ. Code § 3287(a) (emphasis added).

In *Children's Hospital and Medical Center v. Bonta*, 97 Cal. App. 4th 740 (2002), the California Court of Appeal articulated the test for awarding prejudgment interest under § 3287(a) as entailing a determination of whether the "defendant actually knows the amount owed or from reasonably available information could the defendant have computed that amount." *Id.* at 774 (quotation omitted). In *Fireman's Fund Ins. Co. v. Allstate Ins. Co.*, 234 Cal. App. 3d 1154 (1991), quoted in *Bonta*, the court specified that

> [d]amages are deemed certain or capable of being made certain within the provisions of [§ 3287(a)] where there is essentially no dispute between the parties concerning the basis of computation of damages if any are recoverable but where their dispute centers on the issue of liability giving rise to damage. . . . The statute does not authorize prejudgment interest where the amount of damage, as opposed to the determination of liability, depends upon a judicial determination based upon conflicting evidence and is not ascertainable from truthful data supplied by the claimant to his debtor.

Id. at 1173.

The Employer argues that the district court erred in calculating the numbers because the Employer did not know, and could not have known, the amount of damages, placing it in a *Catch-22* situation. The Employer's contention, however, hinges on arguments it made in its counterclaims and third-party complaint—for example, that the Broker and the Insurer's Agent were responsible for the Insurer's loss—that the district court properly rejected. In contrast, the Insurer's claim for restitution, which simply sought reimbursement for payments it made pursuant to the Policy, was discrete, and once liability was determined, there could be "essentially no dispute between the parties concerning the basis of computation of damages." *Fireman's Fund*, 234 Cal. App. 3d at 1173.

"[A] defendant's denial of liability does not make damages uncertain for purposes of [Cal. Civ. Code § 3287(a)]." *Wisper Corp. v. California Commerce Bank*, 49 Cal. App. 4th 948, 958 (1996). And "where the amount of the plaintiff's claim can be determined by established market values or by computation," that provision "mandates an award of prejudgment interest." *Id.* (quotation omitted).

[13] *Chesapeake Industries, Inc. v. Togova Enterprises, Inc.*, 149 Cal. App. 3d 901 (1983), is distinguishable, as this *is* "a case where the debtor could keep complete records of the transaction from which it could calculate its indebtedness," and it is *not* a case where "much of the critical data was in the sole possession of" the Insurer. *Id.* at 911. Here, the amount of the payments the Insurer made to the

Employee and to the Employer's independent counsel were "reasonably available." *Bonta*, 97 Cal. App. 4th at 774. The Employee's workers' compensation payments were statutorily set based on her salary; her medical expenses were established as of May 24, 2002, and could be reasonably determined thereafter with simple inquiries; and the Employer admits that it "of course[ ] did know how much was being paid to its independent counsel." As the district court found, there was never any uncertainty as to the exact amount and date of each payment to the Employee and her counsel that is to be restored to the Insurer. The district court properly applied California law in awarding prejudgment interest. *See* Cal. Civ. Code § 3287.

C

The district court did not err in certifying its judgment pursuant to Federal Rules of Civil Procedure Rule 54(b). The pendency of the Insurer's claims against the Alter Egos did not preclude the court from doing so. Any similarities between the alter-ego claims and those already adjudicated by the district court are insufficient to negate the district court's conclusion, made on the record, that, "[d]ue to the prior delay in, complexity and contentiousness of this litigation, to avoid uncertainty and inconsistent verdicts, there is no just reason for delay and partial judgment should now therefore be entered." *See Gregorian v. Izvestia*, 871 F.2d 1515, 1519 (9th Cir. 1989) (noting approvingly that the court below, in granting Rule 54(b) certification, "expressly stated that it found 'no just reason for delaying the entry of judgment' "). "Both the Supreme Court and our court have upheld certification on one or more claims despite the presence of facts that overlap remaining claims when, for example, . . .

the case is complex and there is an important or controlling legal issue that cuts across (and cuts out or at least curtails) a number of claims." *Wood v. GCC Bend, LLC*, 422 F.3d 873, 881 (9th Cir. 2005).

The Employer contends that it was inequitable for the district court to enter judgment "piecemeal." Of course, that is precisely what a Rule 54(b) certification is intended to accomplish. The question is whether the preconditions for certification have been satisfied. Here, the record reflects that the district court carefully considered and applied the factors this circuit has stated are relevant in determining the propriety of Rule 54(b) certification. *See Wood*, 422 F.3d at 880-82; *General Acquisition, Inc. v. GenCorp, Inc.*, 23 F.3d 1022, 1030 (9th Cir. 1994).

[14] The order, although not final, certainly signaled the beginning of the end. Not all the questions have been answered, but most of the important issues have been resolved. Thus, although an epilogue will be required, this portion of the saga came to a proper end. The district court did not err in granting partial judgment and entering the certification order.

VIII

The district court properly exercised jurisdiction, correctly assessed the law, acted well within its discretion in making innumerable litigation decisions, and did not err in granting certification. We commit the remaining issues to the district court.

AFFIRMED.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

[Filed May 27, 2011]

UNITED STATES FIDELITY AND GUARANTY COMPANY,	No. 08-17753
Plaintiff - Appellee,	D.C. No. 1:99-cv-05583-OWW-SMS
v.	Eastern District of California, Fresno
LEE INVESTMENTS LLC, DBA The Island ,	
Defendant - Appellant,	ORDER
and	
AMERICAN SPECIALTY INSURANCE SERVICES; AMERICAN SPECIALTY RISK MANAGEMENT SERVICES LLC,	
Counter-defendants - Appellees,	
AON RISK SERVICES, INC.,	
Defendant-3rd-party-plaintiff-counter-defendant - Appellee,	

UNITED STATES FIDELITY AND GUARANTY COMPANY,	No. 09-16962
Plaintiff-counter-defendant Appellee,	D.C. No. 1:99-cv-05583-OWW-SMS Eastern District of California, Fresno
v.	
LEE INVESTMENTS LLC, DBA The Island ,	
Defendant-counter-claimant - Appellant,	
v.	
AMERICAN SPECIALTY INSURANCE SERVICES; AMERICAN SPECIALTY RISK MANAGEMENT SERVICES LLC,	
Counter-defendants - Appellees,	
and	
RICHARD K. EHRLICH; REXFORD PROPERTIES, LLC, a California limited liability company,	
Defendants-counter-claimants,	
v.	
AON RISK SERVICES, INC.,	

Third-party-defendant - Appellee.)

Before: SCHROEDER and THOMAS, Circuit Judges, and CONTI, Senior District Judge.*

The Workers' Injury Law and Advocacy Group's motion for leave to file a brief as *amicus curiae* in support of Lee Investment's Petition for Panel Rehearing and Rehearing En Banc is GRANTED.

Lee Investment's motion requesting that the panel withdraw its opinion and certify questions to the California Supreme Court is DENIED.

Lee Investment's motion for judicial notice is DENIED, and Lee Investment's motion to substitute the certified copy of the arbitrator's award in its motion for judicial notice is therefore DENIED as moot.

The panel has voted to deny Lee Investment's petition for panel rehearing. Judges Schroeder and Thomas have voted to deny the petition for rehearing en banc, and Judge Conti has so recommended.

The full court has been advised of the petition for rehearing en banc and no judge has requested a vote on whether to rehear the matter en banc. Fed. R. App. 35.

* The Honorable Samuel Conti, Senior District Judge for the U.S. District Court for Northern California, San Francisco, sitting by designation.

Lee Investment's petition for panel rehearing and petition for rehearing en banc are DENIED. Further petitions for rehearing and rehearing en banc shall not be entertained.

APPENDIX C

IN THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF CALIFORNIA

No. CV-F-99-5583 REC/SMS

[Filed October 28, 1999]

UNITED STATES FIDELITY & GUARANTY COMPANY,	)
Plaintiff,	)
vs.	)
LEE INVESTMENTS LLC dba THE ISLAND, et al.,	)
Defendant.	)

ORDER DENYING DEFENDANTS' MOTION TO DISMISS

On August 30, 1999, the court heard the Motion to Dismiss filed by defendant Diana Conley, which motion was joined by defendant Lee Investments LLC dba The Island.

Upon due consideration of the written and oral arguments of the parties and the record herein, the

court denies this motion for the reasons set forth herein.

United States Fidelity & Guaranty Company has filed a Complaint for Rescission and For Reimbursement of Sums Paid Under Policy Subject to Rescission. Defendants are Lee Investments LLC dba The Island (hereinafter referred to as Lee Investments) and Diana Conley. The Complaint seeks a judicial determination that it is entitled to rescind its Workers Compensation and Employers Liability Insurance Policy (hereinafter the Policy) it issued to Lee Investments and that the Policy is void ab initio and provides no coverage to any person or entity, including Diana Conley. The Complaint alleges that Fidelity is entitled to rescind the Policy because Lee Investments procured it based upon an application for insurance which was materially false. The Complaint alleges that Lee Investments represented to Fidelity in applying for the Policy that its business was a water park and that its operation no longer employed construction workers and that Fidelity relied on these representations in issuing the Policy. The Complaint further alleges that, on February 22, 1999, Conley and others employed by Lee Investments were engaged in the construction of a water slide and that an accident occurred that injured Conley. Conley thereafter filed a claim for workers compensation benefits under the Policy, and in the course of investigating her claim, Fidelity became aware of the misrepresentations made in connection with the issuance of the Policy. Fidelity has paid benefits to Conley under the Policy because her claims, but for the rescission of the Policy, would be covered by the Policy. The Complaint prays for recission of the Policy and for an order that Lee Investments is obligated to reimburse Fidelity for all

benefits paid to Conley under the Policy. The Complaint offers to restore all premiums paid by Lee Investments, subject to an offset in the amount of all benefits paid to date by Fidelity to Conley. The Complaint alleges that Conley is named as a "nominal defendant" because she has filed a claim for benefits under the Policy and so that "she may participate in the litigation, and so that she will be bound by the coverage determination made by the Court herein."

Conley has filed a Motion to Dismiss, which motion is joined by Lee Investments.

A. Exclusive Jurisdiction of Workers' Compensation Appeals Board.

In moving to dismiss the Complaint pursuant to Rule 12(b)(6), Federal Rules of Civil Procedure, for failure to state a claim upon which relief can be granted, defendants contend that the Workers' Compensation Appeals Board (WCAB) has exclusive jurisdiction over this controversy.

California Labor Code § 5300(a) provides that a proceeding for the "recovery of compensation, or concerning any right or liability arising out of or incidental thereto" "shall be instituted before the appeals board and not elsewhere".

In arguing that the allegations of Fidelity's Complaint are subject to the exclusive jurisdiction of the WCAB pursuant to Section 5300(a), defendants rely on a number of California cases.

Thus, defendants refer the court to General Acc. Etc. Corp. v. Indus. Acc. Com., 196 Cal. 179 (1925).

General Acc. Etc. Corp. involved a review by the California Supreme Court of an award made by the Industrial Accident Commission in favor of the dependents of a deceased employee, the sole presented to the Commission being whether the petitioner insurance company was, on the day of the fatal accident, the insurance carrier of the employer. The employer had applied for a workers' compensation insurance policy but had not paid the premium for it. On the day the employee was killed, the employer presented the premium check to his insurance agent, not advising the agent of the accident until two days later. The insurance company petitioned the Commission to rescind the policy because of fraud in the procurement of the policy. The California Supreme Court reversed the award of the Commission on the ground that the Commission's finding was not supported by any evidence. On appeal, the Supreme Court stated in pertinent part:

> It is the contention or suggestion of respondent Commission that the dependents of the employee have an enforceable right against petitioner under the alleged policy even though the employer be cut off from any remedy against petitioner. We are unable to understand what principle of law would give the dependents of the employee a cause of action against petitioner upon a contract which is void or voidable as to the employer . . . 'We may assume that any defense available to the Insurance 'company . . . against . . . the employer, would be equally available against the employee or his dependents.' Whether the foregoing quotation be regarded as doctrine or dicta, it would seem

> to express an unimpeachable principle of law . . . .
>
> There can be no doubt but that the Commission is vested by constitutional and legislative power to hear and determine every issue raised by the parties to this controversy, including the validity of the policy and the question of fraud alleged in its procurement and that the parties are not required to invoke either a court of law or equity in the determination of said question.

196 Cal. at 190-191.

Defendants also rely on Bankers Indem. Ins. Co. v. Indus. Acc. Com., 4 Cal.2d 89, 94-98 (1935), wherein the Supreme Court held that Industrial Accidents Commission "has been invested with the power and authority to hear and determine equitable issues, including those arising in a controversy involving the reformation of a written instrument" and that the Supreme Court "was . . . in accord with the policy of the law which invests in one tribunal the power to dispose of the whole controversy involving the right of the injured employee to secure just compensation for the injury sustained by him." 4 Cal.2d at 98.

Conley argues that the critical fact that brings this case within the exclusive jurisdiction of WCAB is that the outcome of this controversy will determine her rights to recovery of workers' compensation benefits.

Conley refers the court to United States Fidelity and Guaranty Company v. Superior Court, 214 Cal. 468 (1931). In USF&G, in a proceeding before the Commission in which the employer and the insurance

company were defendants, the employee procured a compensation award against the defendants. In the proceeding before the Commission, the employer and the insurance company filed answers presenting the issue whether the insurance company was the compensation carrier for the employer at the time of the accident. The Commission found that the insurance company was not then the insurance carrier for the employer and ordered the insurance company released and discharged. No appeal was taken and the Commission's award became final. Some months later, the employer sued the insurance company for breach of the insurance contract, seeking damages for termination of the insurance policy without notice as required by the policy. The insurance company unsuccessfully demurred on the ground of lack of jurisdiction. The insurance company petitioned for a writ of prohibition. The California Supreme Court held that issues relating to the existence, at the time of the injury, of an insurance policy affording coverage and issues relating to the enforcement against the insurance company of any liability for compensation or for the payment of the workmans' compensation award had reached a final determination in the proceedings before the Commission. However, the Supreme Court held, to the extent the action is one for damages for breach of contract to issue and keep in effect the insurance, the complaint stated a cause of action within the jurisdiction of the Superior Court. In so holding, the Supreme Court explained:

> The cause of action for damages does not involve the construction of an insurance policy with respect to coverage thereunder, the recovery of compensation or incidental liability or the enforcement against an insurance carrier

> of compensation liability; it attempts to set forth purely a claim for damages based upon the breach of a contract to insure in a controversy affecting only the employer and the insurance carrier, no rights of the employee being involved. The mere circumstance that the damage claimed is the exact amount of the compensation award to the employee does not change the essential nature of the action and the court should not be prevented from proceeding with it.

214 Cal. at 471-472.

Defendants further refer the court to Hartford Acc. Etc. Co. v. Indus. Acc. Com., 216 Cal. 40 (1932). In Hartford Acc. Etc. Co., the Commission ordered the employer to obtain a surety bond as a prerequisite to the issuance to the employer of a certificate of self-insurance to secure the payment to its employees of workers' compensation benefits. The employer obtained a surety bond from Hartford. During the time the bond was in force, claims were made by the employees which awards were covered by the bond. Thereafter, in the district court, a receiver was appointed for all of the property and assets of the employer. The receiver stopped payment of the workers' compensation awards. At the time the receiver did so, the total amount of the awards exceeded the amount of the bond. The employees then petitioned the Commission for an order requiring Hartford, as surety on the bond, to pay or provide payment of the compensation remaining unpaid on account of the workers' compensation awards. Hartford appeared in the Commission proceedings. The Commission ordered Hartford to pay the amount

of the bond. On appeal, Hartford argued that the Commission had no jurisdiction to render an award against the surety on a self-insurer's bond. The Supreme Court rejected this argument, holding that the provisions of the workers' compensation act regulating a self-insurer employer and providing for the giving of a bond are one method of securing the payment of compensation and, therefore, within the grant of power to the Commission. Id. at 45-46. The Supreme Court further held that the employees' petition was a "proceeding for the recovery of compensation, or concerning any right or liability arising out of or incidental thereto" and that, therefore, "[t]here can be no question of the jurisdiction of the Commission to entertain such a proceeding and to determine all issues arising therein and to render an award in accordance with the facts presented to it." Id. at 46. The Supreme Court further stated in pertinent part:

> Petitioner complains that the granting of relief against it in the proceedings before the . . . Commission deprived it of legal and equitable rights to which it would otherwise be entitled. These rights petitioner claims are given it under sections 2845 and 2846 of the Civil Code and section 1050 of the Code of Civil Procedure. If petitioner is entitled to any rights under these sections of the code which it could not enforce before the Commission, it might be relegated to the courts for the purpose of enforcing them. This result would not affect the jurisdiction of the Commission if the Constitution and statutes have conferred jurisdiction upon the Commission to determine the matter involved. However, if the Commission is vested with

> jurisdiction over any given subject matter, it has the power to hear and determine every issue raised by the parties in the controversy . . . In such cases the parties are not required to resort to the courts.

Id. at 47.

Fidelity argues that Section 5300(a) does not cover a claim for recission of an insurance policy because a claim for recission does not involve "the recovery of compensation, or concerning any right or liability arising out of or incidental thereto."[1] Fidelity asserts that it does not contend that Conley cannot proceed before the WCAB for the recovery of workers' compensation benefits against Lee Investments but, rather, that the WCAB does not have jurisdiction of the claim for recission of the Policy. Fidelity argues that the Supreme Court's decision in General Acc. Etc.

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[1] Fidelity asserts that this court's subject matter jurisdiction is appropriately based on diversity and that none of the cases cited by Conley divest the court of subject matter jurisdiction based on diversity. The court does not find Fidelity's distinction relevant because, in an action based on diversity, the court is required to apply California law to substantive issues. See Eire R.R. Co. v. Thompkins, 304 U.S. 64, 78 (1938). As explained in Dunlap v.Association of Bay Area Governments, 996 F.Supp. 962, 967 (N.D.Cal. 1998), a claim brought in federal court that falls within the exclusive jurisdiction of the Workers' Compensation Appeals Board is preempted. Fidelity provides no persuasive authority that a claim brought in a federal action the subject matter jurisdiction of which is based on federal question is subject to the exclusive jurisdiction of the WCAB while the same claim brought in an action fortuitously involving diverse parties is not merely because of the fact that the court's subject matter jurisdiction is based on diversity.

Corp. is not controlling on this issue. In so arguing, Fidelity notes that no issue concerning the Commission's jurisdiction was raised by the insurance company in the appeal because the insurance company was the petitioner. In addition, Fidelity notes that the insurance company in General Acc. Etc. Corp. did not seek rescission of the policy in proceedings before the Commission but rather a determination that the insurance company was not liable.

Fidelity notes that the type of relief that can be granted by the court and by the WCAB differs. Thus, the trial court cannot award workers' compensation benefits, and the WCAB cannot award damages for injuries. La Jolla Beach & Tennis Club, Inc. v. Industrial Indemnity Co., 9 Cal.4th 27, 35 (1994); Scott v. Industrial Acc. Com., 46 Cal.2d 76, 82-83 (1956). In State Comp. Ins. Fund v. Ind. Acc. Com., 20 Cal.2d 264 (1942), the California Supreme Court held that the Commission was "without jurisdiction to adjudicate a supplemental controversy involving rights of contribution and reimbursement between two insurance carriers jointly and severally responsible for the payment of a compensation award." Id. at 266. In so holding, the Supreme Court distinguished General Acc. Etc. Corp. v. Indus. Acc. Com., and Bankers Indem. Ins. Co. v. Indus. Acc. Com., explaining in pertinent part:

> While petitioner concedes that the jurisdiction of the commission is limited to the settlement of disputes arising out of the relationship of the employer to his employee, it urges that once this status is established the commission has judicial power to determine any controversy whatsoever that may develop between parties in

interest respecting the compensation awarded. Upon this basis the petitioner contends that its application for an adjustment of its obligation to make compensation payments falls within the scope and intent of the . . . constitutional provision referable to the insurance features of the 'system of workman's compensation' and the legislative enactment adopted in pursuance thereof. In support of its argument the petitioner first cites several decisions of this court wherein it was held that in determining the liability of an insurance carrier for compensation to an injured employee, the commission had the power to determine all issues of law and fact upon which the liability of the insurance carrier depended . . . But in those cases the respective questions regarding the insurance aspect of the proceeding before the commission arose in connection with the rendition of an award in favor of an injured employee or his dependents and necessarily were involved in the enforcement of the compensation benefits contemplated under the basic liability of the employer to his employee. The present situation is readily distinguishable in that here the right of action in the employee to enforce his claim was finally determined by the joint and several award in his favor against the insurance carriers which had assumed the obligation of the respective employers in the premises. By such award the employee was assured of the scheduled payments, and the employers were discharged from all liability therefor. This adjudication concluded the authority of the commission to act in the matter. Any controversy between the insurance

> carriers relative to the burden of payment of the award for which both have been held responsible concerns neither the employee nor the joint employers in their essential relationship. Application for the adjustment of such dispute obviously is not a proceeding 'for the recovery of compensation' nor does it involve 'any right or liability arising out of or incidental thereto.' The fact that the petitioner has joined the employee as a nominal party in this proceeding cannot change the basic character of the litigation as an independent claim having no relation to the enforcement of benefits allowed the employee under the system of workman's compensation established in this state. The petitioner is seeking an award in its favor based on a claim wholly distinct from the right of an employee to recover compensation for an industrial injury. These considerations plainly indicate that the commission is not vested with constitutional or legislative power to determine the issues involved in a proceeding supplemental to the adjudication of the liability of the employer to his employee, and the petitioner must seek its relief in the ordinary courts . . . .

Id. at 267-268.

Here, as noted, the Complaint alleges that Fidelity has paid benefits to Conley under the Policy because her claims, but for the rescission of the Policy, would be covered by the Policy.

Fidelity further argues that, contrary to Conley's assertion, the outcome of this Complaint for rescission

will not determine Conley's right to recovery of compensation benefits. In so arguing, Fidelity notes that, pursuant to California Labor Code § 3715(a), an employee whose employer has failed to secure the payment of compensation under the workers' compensation laws may, in addition to proceeding to proceeding against the employer by civil action, "file his or her application with the appeals board for compensation and the appeals board shall hear and determine the application for compensation in like manner as in other claims and shall make the award to the claimant as he or she would be entitled to receive if the employer had secured the payment of compensation as required . . . ." Section 3715(a) further requires the employer to pay the award so ordered or furnish a bond to do so. If the employer fails to pay the award or post the bond as ordered pursuant to Section 3715(a), "the award, upon application by the person entitled thereto, shall be paid . . . from the Uninsured Employers Fund . . . ." California Labor Code § 3716(a). Therefore, Fidelity argues, if rescission is granted, Conley can recover benefits from her employer or from the Uninsured Employers Fund.[2]

The court concludes that this motion to dismiss is denied on this ground. The court is not persuaded that Fidelity's claim for rescission is within the exclusive jurisdiction of the WCAB because Fidelity has paid the benefits under the Policy. That Fidelity sues to recover the benefits paid (less premium) from the employer on

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[2] The court also notes that, because Fidelity has paid the benefits to Conley pursuant to the Policy, Conley has been paid workers' compensation. Fidelity seeks to recover the amount of benefits paid to Conley from Lee Investments, not from Conley.

a theory of rescission does not affect Conley's proceedings before the WCAB or her entitlement to benefits.

B. Dismissal under Abstention.

Alternatively, defendants argue that the dismissal or stay of this action pursuant to Burford v. Sun Oil, 319 U.S. 315 (1943) and Colorado River Water Conservation District v. United States, 424 U.S. 800 (1976) because of "the overriding interest of the State of California in adjudicating all workers' compensation disputes in a uniform and orderly manners, so as to further the 'social and public policy of this State'."

Federal courts have a strict duty to exercise the jurisdiction that is conferred upon them by Congress. However, this duty is not absolute. Quackenbush v. Allstate Ins. Co., 517 U.S. 706, 716 (1996).

1. Burford Abstention.

In Burford v. Sun Oil, the Supreme Court addressed the issue of the reasonableness of an order issued by the Texas Railroad Commission, which granted a permit to drill four oil wells on a small plot of land in the East Texas oil field. But to the potentially overlapping claims of the many parties who might have an interest in the common pool of oil, Texas endowed the Railroad Commission with exclusive regulatory authority in the area and placed the authority to review the Commission's orders in a single set of state courts to prevent the confusion of multiple reviews and to permit an experienced cadre of state judges to obtain specialized knowledge in the field. Id. at 326-327. Though Texas law had

demonstrated its interest in maintaining uniform review of the Commission's orders, the federal courts had become increasingly involved in reviewing the reasonableness of the Commission's orders under the federal Due Process clause and the Texas Due Process Clause. In Burford, the Supreme Court framed the question:

> Although a federal equity court does have jurisdiction of a particular proceeding, it may, in its sound discretion, whether its jurisdiction is invoked on the ground of diversity of citizenship or otherwise, "refuse to enforce or protect legal rights, the exercise of which may be prejudicial to the public interest," for it "is in the public interest that federal courts of equity should exercise their discretionary power with proper regard for the rightful independence of state governments in carrying out their domestic policy." While many other questions are argued, we find it necessary to decide only one: Assuming that the federal district court had jurisdiction, should it, as a matter of sound equitable discretion, have declined to exercise that jurisdiction here.

Id. at 317-318. In Burford, the Supreme Court approved the district court's dismissal of the complaint on a number of grounds that were unique to that case. As the Supreme Court has recently explained in Quackenbush v. Allstate Ins. Co., id. at 725-728:

> We noted . . the difficulty of the regulatory issues presented, stating that the 'order under consideration is part of the general regulatory system devised for the conservation of oil and

gas in Texas, an aspect of "as thorny a problem as has challenged the ingenuity and wisdom of legislatures.'" . . . We also stressed the demonstrated need for uniform regulation in the area . . . , citing the procedures Texas had established to 'prevent the confusion of multiple review,' . . . and the important state interests this uniform system of review was designed to serve . . . Most importantly, we also described the detrimental impact of ongoing federal court review of the Commission's orders, which review had already led to contradictory adjudications by the state and federal courts . . . .

We ultimately concluded in Burford that dismissal was appropriate because the availability of an alternative, federal forum threatened to frustrate the purpose of the complex administrative system that Texas had established . . . We have since provided more generalized descriptions of the Burford doctrine, see, e.g., County of Allegheny, 360 U.S., at 189 ('abstention on grounds of comity with the States where the exercise of jurisdiction by the federal court would disrupt a state administrative process'); Colorado River, 424 U.S. at 814-816 (abstention where 'exercise of federal review of the question in a case and in similar cases would be disruptive of state efforts to establish a coherent policy with respect to a matter of substantial public concern') . . . .

In NOPSI, our most recent exposition of the Burford doctrine, we again located the power to dismiss based on abstention principles in the

discretionary power of a federal court sitting in equity, and we again illustrated the narrow range of circumstances in which Burford can justify the dismissal of a federal action. The issue in NOPSI was pre-emption. A New Orleans utility that had been saddled by a decision of the Federal Energy Regulatory Commission (FERC) with part of the cost of building and operating a nuclear reactor sought approval of a rate increase from the Council of the City of New Orleans. The council denied the rate increase on the grounds that 'a public hearing was necessary to explore "the legality and prudency" [sic]' of the expenses allocated to the utility under the FERC decision . . . , and the utility brought suit in federal court, seeking an injunction against enforcement of the council's order and a declaration that the utility was entitled to a rate increase. The utility claimed that 'federal law required the Council to allow it to recover, through an increase in retail rates, its FERC-allocated share of the [cost of the reactor].' . . . The federal pre-emption question was the only issue raised in the case; there were no state law claims.

In reversing the District Court's dismissal under Burford, we recognized 'the federal courts' discretion in determining whether to grant certain types of relief,' . . . and we indicated . . . that Burford permits 'a federal court sitting in equity,' . . . to dismiss a case only in extraordinary circumstances. We thus indicated that Burford allows a federal court to dismiss a case only if it presents '"difficult questions of state law bearing on policy

problems of substantial public import whose importance transcends the result in the case then at bar,'" or if its adjudication in a federal forum '"would be disruptive of state efforts to establish a coherent policy with respect to a matter of substantial public concern.'" . . . .

We ultimately held that Burford did not provide proper grounds for an abstention-based dismissal in NOPSI because the 'case [did] not involve a state-law claim, nor even an assertion that the federal claims [were] "in any way entangled in a skein of state law that must be untangled before the federal case can proceed,'" . . . and because there was no serious threat of conflict between the adjudication of the federal claim presented in the case and the State's interest in ensuring uniformity in ratemaking decisions:

> 'While Burford is concerned with protecting complex state administrative processes from undue federal influence, it does not require abstention whenever there exists such a process, or even in all cases where there is a "potential for conflict" with state regulatory law or policy. Here, NOPSI's primary claim is that the Council is prohibited by federal law from refusing to provide reimbursement for FERC-allocated wholesale costs. Unlike a claim that a state agency has misapplied its lawful authority or has failed to take into consideration or properly weigh relevant state-law factors, federal adjudication of

> this sort of pre-emption claim would not disrupt the State's attempt to ensure uniformity in the treatment of an "essentially local problem.'" . . . .

These cases do not provide a formulaic test for determining when dismissal under Burford is appropriate, but they do demonstrate that the power to dismiss under the Burford doctrine, as with other abstention doctrines . . . , derives from the discretion historically enjoyed by courts of equity. They further demonstrate that exercise of this discretion must reflect 'principles of federalism and comity.' . . . Ultimately, what is at stake is a federal court's decision, based on a careful consideration of the federal interests in retaining jurisdiction over the dispute and the competing concern for the 'independence of state action,' . . . that the State's interests are paramount and that a dispute would best be adjudicated in a state forum . . . This equitable decision balances the strong federal interest in having certain classes of cases, and certain federal rights, adjudicated in federal court, against the State's interests in maintaining 'uniformity in the treatment of an "essentially local problem,'" . . . and retaining local control over 'difficult questions of state law bearing on policy problems of substantial public import,' . . . This balance only rarely favors abstention, and the power to dismiss recognized in Burford represents an '"extraordinary and narrow exception to the duty of the District Court to adjudicate a controversy properly before it.'" . . . .

In arguing that abstention under the Burford doctrine is appropriate in this case, defendants contend that the California workers' compensation system is similar to the Texas Railroad Commission. Defendants refer the court to Article XIV, § 4 of the California Constitution wherein the "Legislature is . . . vested with plenary power, unlimited by any provision of this Constitution, to create, and enforce a complete system of workers' compensation, by appropriate legislation . . . ." Section 4 further defines a "complete system of workers' compensation" as including:

> adequate provisions for the comfort, health and safety and general welfare of any and all workers . . . to the extent of relieving them from the consequences of any injury or death incurred or sustained by workers in the course of their employment, irrespective of the fault of any party; also full provision for securing safety in places of employment; full provision for surgical, hospital and other remedial treatment as is requisite to cure and relieve from the effects of such injury; full provision for adequate insurance coverage against liability to pay or furnish compensation; full provision for regulating such insurance coverage in all its aspects, including the establishment and management of a State compensation insurance fund; full provision for otherwise securing the payment of compensation; and full provision for vesting power, authority and jurisdiction in an administrative body with all the requisite governmental functions to determine any dispute or matter arising under such legislation, to the end that the administration of such

> legislation shall accomplish substantial justice in all cases expeditiously, inexpensively, and without incumbrance of any character; all of which matters are expressly declared to be the social public policy of this State, binding upon all departments of the State government.

Divisions 4 and 5 of the California Labor Code "are an expression of the police power and are intended to make effective and apply to a complete system of workers' compensation the provisions of Section 4 of Article XIV of the California Constitution." California Labor Code § 3201. Title 8 of the California Code of Regulations provides a body of regulations establishing the rules of practice and procedure before the WCAB, the administration of the system, and the treatment, evaluation and rating of industrial injuries. Defendants argue that, similar to the Texas Railroad Commission, California has enacted a wide-ranging and comprehensive system with its own judicial and regulatory bodies to determine issues relating to workmans' compensation. Defendants argue that the "dangers of conflicts, misunderstanding and confusion that may arise by federal interference with this system is very real and strongly suggests that abstention is necessary."

However, the court concurs with Fidelity that the showing necessary for Burford abstention as articulated by the Supreme Court has not been made. This Complaint does not present "'difficult questions of state law bearing on policy problems of substantial import whose importance transcends the result in the case at bar.'" Nor would the adjudication of Fidelity's Complaint in this court " . . . be disruptive of state efforts to establish a coherent policy with respect to a

matter of substantial public concern." The court notes Fidelity's claim for rescission of the Policy involves simple issues of California contract law, not any complicated administrative rulings or procedures of workers' compensation law. The court further notes that this action will not interfere with the state's efforts to establish a coherent policy with respect to a matter of substantial public concern because the WCAB does not have jurisdiction over a claim for rescission of a policy.

2. Colorado River Abstention.

In determining whether to abstain pursuant to Colorado River Water Conservation Dist. v. United States, 424 U.S. 800 (1976), the Supreme Court made clear that such abstention is applicable only in exceptional circumstances. Id. at 813. There are several factors to be considered in determining whether to abstain: (1) the desirability of avoiding piecemeal litigation; (2) the inconvenience of the federal forum; (4) the order in which jurisdiction was obtained by the concurrent forums; (5) whether the source of the governing law is state or federal; and (6) whether the state court proceedings can adequately protect the federal plaintiff's rights. Id. at 818-819; Moses H. Cone Memorial Hosp. v. Mercury Construction Corp., 460 U.S. 1, 23-27 (1983). "No one factor is determinative; a carefully considered judgment taking into account both the obligation to exercise jurisdiction and the combination of factors counseling against that exercise is required. Only the clearest of justifications will warrant dismissal." 424 U.S. at 818-819.

In arguing that abstention under Colorado River is appropriate, defendants note that Conley invoked the jurisdiction of the WCAB on March 9, 1999 before the filing of Fidelity's Complaint on April 26, 1999. Defendants further note that, on June 23, 1999, Conley filed a Declaration of Readiness to Proceed with the WCAB in which she advises the WCAB of the Complaint filed by Fidelity in this action, asserting the exclusive jurisdiction of the WCAB, and asserting that the principle issue before the WCAB is "coverage of policy of insurance". In addition, defendants argue, the federal forum is inconvenient from Conley's perspective because "litigating this dispute in federal court tramples all over the declared public policy of California" and that "nothing could be more inconvenient than having to participate in a federal court action between two businesses, where it is acknowledged that the worker did nothing wrong." Conley further contends that she has no choice but to participate because she may lose all of the benefits that the California workers' compensation system provides and for which Fidelity is obligated to pay. Finally, she contends that she will have to defend the Complaint in this action on an hourly basis while, in proceedings before the WCAB, attorneys are compensated on a contingent fee basis with limited reimbursement of litigation costs.[3]

Again, the court concurs with Fidelity that defendants have not shown that Colorado River

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[3] According to the declaration of Conley's counsel, Conley was rendered a paraplegic by the accident, is the sole support of two minor children and provides financial support to two adult children.

abstention is appropriate here under the governing factors. Litigating the issue of rescission in this court is not inconvenient because Conley, the witnesses to any construction activities, the water park, and the insurance agent for Lee Investments are located in the Eastern District of California, mostly in Fresno. The proceeding before the WCAB was filed in San Bernardino County. The assertion that this federal action will interfere with Conley's efforts to recover workers' compensation benefits expeditiously is without merit because her ability to obtain workers' compensation benefits against Lee Investments is unimpeded and the proceeding before the WCAB can proceed notwithstanding this litigation as argued above. Adjudication of the rescission claim before the WCAB will not be more expeditious because the WCAB lacks jurisdiction over the rescission claim. The avoidance of piecemeal litigation does not favor abstention because this court cannot adjudicate a claim for benefits and the WCAB cannot adjudicate a claim for rescission of an insurance policy. Furthermore, although Conley filed her application for adjudication of her claim for workers' compensation benefits with the WCAB on March 9, 1999, there is no dispute in this federal action that Conley is entitled to workers' compensation benefits. The issue of rescission was raised by Fidelity in the Complaint filed in this court before Conley raised the issue in the Declaration of Readiness filed in June. In addition, discovery has commenced in the federal action while the WCAB has not scheduled a hearing on Fidelity's objection to its jurisdiction.

ACCORDINGLY, IT IS ORDERED that defendants' Motion to Dismiss is denied.

Dated: Oct 28 , 1999

/s/ Robert E. Coyle
ROBERT E. COYLE
UNITED STATES DISTRICT JUDGE

[Certificate of Service omitted in printing of this Appendix]

APPENDIX D

IN THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF CALIFORNIA

No. CV-F-99-5583 REC/SMS

[Filed July 30, 2004]

UNITED STATES FIDELITY AND GUARANTY COMPANY,	)
Plaintiff,	)
vs.	)
LEE INVESTMENTS LLC,	)
Defendant.	)

ORDER DENYING LEE INVESTMENTS' MOTION TO AMEND ANSWER, DENYING LEE INVESTMENTS' MOTION FOR SUMMARY JUDGMENT, AND DENYING IN PART AND GRANTING IN PART USF&G'S MOTION FOR SUMMARY JUDGMENT

On August 5, 2002, the court heard defendant Lee Investments LLC's motion to amend answer and the cross-motions for summary judgment filed by United States Fidelity and Guaranty Company, American Specialty Insurance Services, Inc., and American

Specialty Risk Management Services, LLC (hereinafter sometimes referred to collectively as Fidelity) and by Lee Investments LLC (Lee).

Upon due consideration of the written and oral arguments of the parties and the record herein, the court denies the motion to amend answer. The court denies Lee Investments' motion for summary judgment. The court grants in part and denies in part the motion for summary judgment filed by Fidelity.

A. Motion to Amend Answer/Bar of California Insurance Code § 650.

Lee moves the court to amend its Answer to allege as an additional affirmative defense the bar of California Insurance Code § 650 to Fidelity's complaint for rescission.

Lee's Motion to Amend Answer was filed on July 2, 2002, more than a year after Lee initially filed its motion for summary judgment in which Lee contended that California Insurance Code § 650 barred Fidelity's Complaint for Rescission.[1] When the cross-motions for summary judgment were filed on May 24, 2002, Lee again asserted that California Insurance Code § 650 barred Fidelity's Complaint. Fidelity's opposition to Lee's motion for summary judgment, filed on June 21, 2002, argued that Lee's failure to allege the bar of Section 650 as an affirmative defense in Lee's Answer

[1] Lee filed a motion for summary judgment on July 2, 2001. Hearing on the motion was continued a number of times by stipulation and order. On March 26, 2002, the court issued an order denying Lee's motion without prejudice because it was listed on the CJRA list as unresolved motion.

precluded this ground for summary judgment in favor of Lee. On July 2, 2002, Lee filed an Ex Parte Application for Order Granting Permission to File Notice of Motion and Motion to Amend Answer. The Ex Parte Application was granted by Magistrate Judge Snyder and the Motion to Amend Answer is set for hearing on August 5, 2002

In moving for leave to amend the Answer to allege the affirmative defense, Lee relies of Rule 15, Federal Rules of Civil Procedure:

> (a) Amendments. ... [A] party may amend the party's pleading only by leave of court or by written consent of the adverse party; and leave shall be freely granted when justice so requires. ....
>
> (b) Amendments to Conform to the Evidence. When issues not raised by the pleadings are tried by the express or implied consent of the parties, they shall be treated in all respects as if they had been raised in the pleadings. Such amendment of the pleadings as may be necessary to cause them to conform to the evidence and to raise these issues may be made upon motion of any party at any time, even after judgment; but failure to so amend does not the result of the trial of these issues. If evidence is objected to at the trial on the ground that it is not within the issues made by the pleadings, the court may allow the pleadings to be amended and shall do so freely when the presentation of the merits of the action will be subserved thereby and the objecting party fails to satisfy the court that the admission of such evidence

> would prejudice the party in maintaining the party's action or defense upon the merits. ....

Lee argues that the court should grant this motion to amend, noting that its Answer alleges the affirmative defenses of laches and estoppel. Lee contends that it now wishes to amend to include this affirmative defense because Fidelity's opposition to Lee's motion for summary judgment argues that Lee's failure to plead this affirmative defense waives the right to assert it. In so arguing, Lee characterizes its failure to plead the affirmative defense as "inadvertent". Lee contends that Fidelity will not be prejudiced by the proposed amendment adding the affirmative defense because Fidelity has had notice of Lee's intent to invoke Insurance Code § 650 as an absolute bar to Fidelity's complaint for rescission since July 2, 2001. Lee further contends that it "granted" Fidelity nearly a year of extensions of time to conduct discovery to enable Fidelity to respond to Lee's summary judgment motion.[2]

The second amended scheduling order filed on December 13, 2001 set the non-dispositive motion deadline at February 15, 2002.[3] Because of this deadline in the scheduling order, Lee must first establish "good cause" for the modification of the

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[2] The court notes that Lee filed a new and more extensive motion for summary judgment when the cross-motions were filed, i.e., Lee did not merely re-notice its previously filed motion).

[3] There have been stipulated amendments to the scheduling order since the filing of the second amended scheduling order. However, these amendments have been to discovery deadlines, the filing of dispositive motions, and to expert designations and depositions.

scheduling order under Rule 16, Federal Rules of Civil Procedure, and, if good cause is shown, then show that amendment is appropriate under Rule 15. See Johnson v. Mammoth Recreations, Inc., 975 F.2d 604, 607-610 (9th Cir. 1992); United States v. Boyce, 148 F.Supp.2d 1069, 1077-1080 (S.D.Cal. 2001), aff'd, 2002 WL 1291978 (9th Cir. 2002); Jackson v. Laureate, Inc., 186 F.R.D. 605, 607-608 (E.D.Cal. 1999). As the Ninth Circuit explains:

> Unlike Rule 15(a)'s liberal amendment policy which focuses on the bad faith of the party seeking to interpose an amendment and the prejudice to the opposing party, Rule 16(b)'s 'good cause' standard primarily considers the diligence of the party seeking the amendment. The district court may modify the pretrial schedule 'if it cannot reasonably be met despite the diligence of the party seeking the extension.' ... Moreover, carelessness is not compatible with a finding of diligence and offers no reason for a grant of relief ... Although the existence or degree of prejudice to the party opposing the modification might supply additional reasons to deny a motion, the focus of the inquiry is upon the moving party's reasons for seeking modification ... If that party was not diligent, the inquiry should end.

Johnson, id., 975 F.2d at 609.

Lee has made no showing of "good cause" within the meaning of the cases cited above.

Furthermore, even if Lee had made a showing of "good cause", the court would deny the motion to amend on the ground of futility.

California Insurance Code § 650 provides:

> Whenever a right to rescind a contract of insurance is given to the insurer by any provision of this part such right may be exercised at any time previous to the commencement of an action on the contract. The rescission shall apply to all insureds under the contract, including additional insureds, unless the contract provides otherwise.

Lee contends that Conley's claim for workers' compensation benefits filed on March 15, 1999 with the Workers' Compensation Appeals Board (WCAB) is an "action on the contract" for purposes of Section 650. Because Conley filed her claim for workers' compensation benefits before Fidelity filed this action for rescission, Lee argues that Fidelity's Complaint is barred.

In so arguing, Lee refers the court to California Insurance Code § 11651, which provides that every workers' compensation contract or policy "shall contain a clause to the effect that the insurer will be directly and primarily liable to any proper claimant for payment of any compensation for which the employer is liable, subject to the provisions, conditions and limitations of the policy." Lee further refers the court to the provision in the Policy: "We are directly and primarily liable to any person entitled to the benefits payable by this insurance. Those persons may enforce our duties; so may any agency authorized by law."

Finally, Lee refers the court to the statement in Allstate Insurance Company v. McCurry, 224 Cal.App.2d 271, 273-274 (1964):

> For the right of an insurer to rescind a contract of insurance to be restricted under [Section 650] it is necessary that an action on the contract be brought by a party to the contract. An action by a third party against an insured for injuries received in an automobile accident with the car of the insured is not an action upon the contract of insurance.

Fidelity argues that Conley's claim for workers' compensation benefits filed with the WCAB is not "an action on the contract" within the meaning of Section 650. In so arguing, Fidelity refers the court to California Labor Code § 5500, which sets forth the pleading requirements for an application to the WCAB:

> No pleadings other than the application and answer shall be required. Both shall be in writing and shall conform to forms prescribed by the appeals board in its rules of practice and procedure, simply but clearly and completely delineating all relevant matters of agreement and all issues of disagreement within the jurisdiction of the appeals board, and providing for the furnishing of any additional information as the appeals board may properly determine necessary to expedite its hearing and determination of the claim.

Fidelity notes that Conley's initial application for workers' compensation benefits filed with the WCAB was made on a preprinted form and states:

> This application is filed because of disagreement regarding liability for: 1) permanent disability indemnity; 2) reimbursement for medical expense; 3) medical treatment; 4) compensation at proper rate; 5) rehabilitation; and 6) Other (Specify) 'all benefits under the Labor Code'.

Fidelity argues that this application is not "an action on the contract" within the meaning of Section 650 because it does not name Fidelity as a party but rather, names "The Island and GAB Business Services, Inc. and GAB Robins North America, Inc.", identified in the application as "Employer's Insurance Carrier or, if Self-Insured, Adjusting Agency". Fidelity contends that GAB Robins was not Lee's insurance carrier and notes that nowhere in her initial application does Conley allege that the validity of the Policy is at issue. On June 23, 1999, after Fidelity filed the Complaint in this action, Conley filed a Declaration of Readiness to Proceed with the WCAB, indicating that she is presently receiving benefits and identifying as the only issue under "Other", the "Coverage of Policy of Insurance", averring that Fidelity filed the Complaint in this action seeking to void the Policy issued to Lee. Fidelity argues that it was only at this point, if then, that Conley's application before the WCAB may be deemed "an action on the contract" for purposes of Section 650.

In reply, Lee notes that Conley's application to the WCAB includes a request for all benefits under the

Labor Code. That Conley failed to name Fidelity in the application is argued by Lee to be irrelevant because there are no technical pleading requirements as pertain to filings in other courts. See DeMartini v. Industrial Accid. Comm., 90 Cal.App.2d 139, 148 (1949). In addition, Lee refers the court to the provision in the Policy that

> Jurisdiction over [the insured] is jurisdiction over [Fidelity] for purposes of the workers compensation law. We are bound by decisions against you under the law, subject to the provisions of this policy that are not in conflict with that law.

Lee argues that Conley, by naming The Island in the initial WCAB application, established jurisdiction over Fidelity as a party to that WCAB proceeding. In addition, Lee contends that, although GAB Robbins is not an insurance carrier, GAB Robbins was Fidelity's designated claims representative for purposes of resolving claims under the Policy. Finally, Lee argues that the validity of the Policy need not have been placed in issue in the WCAB application for that application to be "an action on the contract". Citing McCurry, supra, Lee contends that all that is required to establish an action on the contract for purposes of Section 650 is that the insurer be directly liable to the injured person for benefits provided under the insurance policy.

The court does not agree with Lee. The insured in the Policy at issue is Lee, not Conley. In McCurry, the case relied upon by Lee, the court stated "[f]or the right of an insurer to rescind a contract of insurance to be restricted under [Section 650] it is necessary that

an action on the contract be brought by a party to the contract." Conley is not a party to the contract at issue, only Lee and Fidelity are. Conley's application to the WCAB against Lee and Fidelity's claim representative cannot be viewed as an action on the policy brought by a party to that policy. Conley is in no different position than the third party who sued in McCurry.

Fidelity further contends that Conley was named in the Complaint for Rescission as a "nominal party", that Conley never asserted the bar of Section 650 in her motion to dismiss the Complaint, and that, when Lee joined in Conley's motion to dismiss, Lee did not assert the bar of Section 650.

Lee responds that Conley's failure to assert Section 650 in moving to dismiss the Complaint cannot be binding on Lee. Furthermore, Lee argues, Section 650 is not a jurisdictional statute but, rather, a substantive bar to the remedy of rescission properly raised on summary judgment (assuming it is pleaded as an affirmative defense).

Lee is missing Fidelity's point, i.e., that the bar of Section 650 has been waived by Lee because of Lee's joinder in Conley's motion to dismiss, which motion to dismiss did not assert the bar of Section 650.

Fidelity further opposes Lee's motion for summary judgment, contending that Section 650 does not support dismissal of an insurers' complaint for rescission based on fraud in the insured's application when the insurer is entitled to the same remedy in a counterclaim or affirmative defense based upon the underlying theory of fraud asserted in the Complaint.

In so arguing, Fidelity refers the court to Resure, Inc. v. Superior Court, 42 Cal.App.4th 156 (1996) and National Union Fire Ins. Co. of Pittsburgh v. Dixon, 663 F.Supp. 1121 (N.D.Cal. 1987).

In Resure, Palmer submitted an insurance application to Resure falsely stating that no claims giving rise to loss had occurred within the preceding five years. In one of the action against Palmer, the Newhall Action, judgment was entered for plaintiffs. Palmer then brought an action to determine coverage in the Newhall Action against various insurance companies, including Resure. Resure brought a motion for summary judgment, contending that their policy did not apply to the loss. When summary judgment was denied, Resure agreed to defend Palmer under a reservation of rights. In two other actions against Palmer, Resure agreed to defend under a reservation of rights. Resure then filed a complaint for rescission and declaratory judgment against Palmer based on the false insurance application. Palmer filed a counterclaim for breach of contract and breach of the implied covenant of good faith and fair dealing based on Resure's refusal to reimburse Palmer for attorneys' fees incurred in the legal actions, refusal to pay a settlement demand, and Resure's attempt to rescind the policy by filing the complaint. Resure moved for summary judgment on its claim for rescission. Palmer opposed the motion, arguing that Resure's action for rescission and the Newhall coverage action were actions "on the contract" within the meaning of Section 650. The trial court held that because Resure had not noticed or attempted to rescind the policy prior to the filing of the complaint, Resure's action for rescission was barred by Section 650. The Court of Appeal reversed, holding in pertinent part:

Established law clearly affords the insurer the right to avoid coverage by way of cross-claims and affirmative defenses when the insured files an action on the contract before the insurer can file its action for rescission. Respondent's reliance on Insurance Code section 650 to preclude an insurer's action for rescission where no action has been filed by the insured is neither logical nor promising.

...

When Insurance Code section 650 was enacted, the distinction between an action on the contract at law and an action for equitable rescission had great significance because of the artificial separation between law and equity. Equity would not assume jurisdiction when the plaintiff had a clear remedy at law . . . It followed that once an action to enforce a contract was commenced at law, the party holding a right to rescind was expected to raise that as a defense rather than bring a new action in equity ....

The rule that equitable rescission would not be permitted where there was an adequate remedy at law, taken together with the rule that an applicant's fraud could be raised as a defense to an action on the policy, clarifies what is meant by Insurance Code § 650's limitation on the right of an insurer to rescind the policy to the time 'previous to the commencement of an action on the contract.' The Legislature intended that the insurer be precluded from rescinding once the insured had proceeded with

> an action to enforce the insurance contract at law. (See 17 Couch on Insurance (2d ed. 1983) § 67:382, p. 792 ['In some jurisdictions, the fact that the insured or the beneficiary has commenced an action on the policy is held to bar a separate action for judicial rescission of the policy, the insurer in such circumstances being relegated to raising the ground for rescission as a defense in the action on the policy. So it has been held that if an action has been brought to enforce a contract of insurance such suit affords an adequate remedy which defeats jurisdiction in equity of a separate suit to cancel the policy; and where an action at law had been begun on the policy to which the insurer could set up fraud as a defense, equity should not entertain a suit to cancel the policy.']) The point was merely to guarantee that resort to equity was not needlessly made where the insurer had ample opportunity to raise the same issues in defense of the action on the policy. As we have indicated ..., California law affords that opportunity to insurers where the insured fires the first shot.

42 Cal.App.4th at 163, 166.

In Dixon, National Union Fire Insurance Company brought an action seeking rescission of two insurance policies on the basis of misrepresentations made by the insureds in applying for the policies. The insureds moved for summary judgment pursuant to Section 650, contending that "an action on the contract" was commenced in state court when the insureds sued National Union for breach of contract, bad faith, and other state insurance causes of action. In denying the

insureds' motion for summary judgment, the district court held:

> The fundamental flaw with the motion lies not in movants' construction of section 650, but in their implicit assumption that the unavailability of a particular remedy defeats the underlying cause of action. Section 650 pertains solely to the remedy of rescission. It does not bar National Union from obtaining other relief from defendants if the facts warrant.
>
> Movants may have been led astray when National Union labeled its complaint 'COMPLAINT FOR RESCISSION' and entitled the only cause of action therein 'FIRST CLAIM FOR RELIEF (RESCISSION)'. These labels confuse the concept of a remedy with that of the legal theory which provides a basis for a remedy. The complaint is based upon the legal theory of fraud. To obtain summary judgment, movants must show that National Union is unentitled to relief on that theory. It is not enough to assert the unavailability of one particular remedy, regardless of how prominently that remedy is mentioned in the complaint.
>
> Moreover, National Union does not limit its prayer for relief to rescission only. The complaint also prays for 'such other and further relief as this court may deem just and proper.' National Union may be able to prove that it is entitled to 'such other relief.' ....

> Finally, the pendency of movants' counterclaims renders the issue of rescission largely moot. Regardless of whether section 650 bars rescission at this stage, National Union is clearly entitled to proceed with proof of misrepresentation as a defense to movants' claims of wrongful insurance practices ... If there was no representation, then movants may be able to obtain damages and the other relief they seek in their counterclaim. If there has been misrepresentation, then National Union should be made whole for its losses; whether or not the Court then goes on to label the policies 'rescinded' is a formality with no further substantive effect on the rights of any of the parties here. (Formal rescission might affect the rights of absent parties who are suing movants for wrongful acts covered by the policies, but movants lack standing to object to rescission on this ground; in any event, it is unlikely that a judgment of rescission would be binding on absent parties.)

663 F.Supp. at 1122-1123.

Resure and Dixon, Fidelity argues, permit Fidelity to defend against Lee's counterclaims and to seek redress from the court from Lee for Fidelity's damages resulting from Lee's misrepresentations.

Lee asserts that Resure permits Fidelity to defend Conley's action before the WCAB based on the allegations alleged in the Complaint filed in this Court and, therefore, Fidelity "retains a forum for adequate redress."

Diana Conley, joined by Lee, moved the court to dismiss this action for lack of jurisdiction, contending that the WCAB has exclusive jurisdiction over Fidelity's claim for rescission pursuant to California Labor Code § 5300(a). Alternatively, Conley and Lee argued for dismissal or stay of this action pursuant to the abstention doctrines set forth in Burford v. Sun Oil and Colorado River Water Conservation District v. United States. The court denied the motion to dismiss. Thereafter, Conley moved for reconsideration, advising the court that the Workers' Compensation ALJ had ruled that the WCAB has subject matter jurisdiction over the issue of rescission of the policy. The court denied the motion for reconsideration. The point is that the WCAB has ruled that it has jurisdiction to resolve Fidelity's claim for rescission of the policy.

With this background, Fidelity argues that the WCAB's "acceptance of concurrent jurisdiction over the validity of the insurance policy" does not override the reasoning and rationale of Resure:

> This court denied Lee's motion to stay this action pending the WCAB proceeding, and accepted jurisdiction over the present dispute. Moreover, here in this action the parties have been actively litigating both sides of the 'fraud in the inducement issue', and conducting discovery relating to it, in connection with [Fidelity's] complaint for rescission, Lee's Counterclaims, and their respective third party complaints against Lee's broker, AN. That issue is alleged, directly or indirectly in all of those claims which are joined here for disposition.

> The practical rationale of Resure also relates to judicial economy and efficient management and disposition of related disputes in a single forum, to avoid the potential of conflicting dispositions. By its conduct, Lee and Conley have embraced this action as that forum.

Lee argues in reply that Resure and Dixon specifically acknowledge that Section 650 bars an action for rescission by the insured when "an action on the contract" has already been commenced, limiting relief to the insurer based on rescission to the insurer's defense of any counterclaims filed by the insured. Lee argues:

> [Fidelity] has not sued or sought affirmative relief for fraud in this action. The distinction between an action for rescission and an action for fraud is significant in this case. First, a direct action in fraud requires proof of intent to deceive. [Fidelity] does not attempt to prove science and knows that it will be unable to do so at trial. More importantly, however, rescission of the workers' compensation policy may subject Lee to significant penalties for being an uninsured employer. [Fidelity] has clearly elected the grounds and the remedy it desires. The time for [Fidelity] to amend its complaint to allege new causes of action which are otherwise time barred has passed.
>
> As [Fidelity] cites, Resure recognizes the established law that affords the insurer the right to proceed by cross-claim or affirmative defense in the direct action filed before commencement of the insurers rescission action

> ... [Fidelity] may, and indeed has, raised Lee's alleged misrepresentations as a defense in the WCAB action ... [Fidelity] is not without a forum or a remedy notwithstanding application of Insurance Code section 650 which bars [Fidelity's] rescission action.

Lee's position is not sustainable. Fidelity's Answer to Lee's amended counterclaims alleges as the Sixth Affirmative Defense that "Lee is barred from obtaining the relief alleged in the amended counterclaim by virtue of its material misrepresentation as alleged in the complaint of [Fidelity] herein." This situation is no different than that before the court in Dixon. As noted, this court has ruled that the WCAB does not have exclusive jurisdiction to decide Fidelity's claim for rescission and, as discussed supra, the court concludes that the application by Conley to the WCAB is not an "action on the contract" within the meaning of Section 650.[4]

Consequently, Lee's motion to amend answer is denied.

B. Cross-Motions for Summary Judgment.

1. Factual Background.

In late 1997 or early 1998, Lee Investments LLC (hereinafter referred to as Lee), entered into a contract

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[4] Fidelity further argues that the doctrines of waiver and estoppel preclude Lee from asserting the bar of Insurance Code § 650. It is not necessary for the court to address these assertions because its rulings set forth above

with Rexford Development Co. to construct a water park in Fresno, initially known as Splash Island and subsequently called The Island. Richard K. Ehrlich is a part owner of both Lee and Rexford. Lisa Ehrlich is a part owner of Lee and its general counsel.

In late 1997 or early 1998, Rexford subcontracted the water park construction to Whitewater West Industries. Whitewater agreed to furnish the labor and materials for the design, manufacturing, and supervision of erection of 9 water slides at the water park and to manufacture and deliver the steel members required to construct the slides.

In or about February, 1998, Lee contacted an insurance broker, AON Risk Services of Central California, Inc. Insurance Services (hereinafter referred to as AON), as Lee's agent to procure insurance for The Island.

American Specialty Insurance Services, Inc. (hereinafter referred to as American Specialty) was a managing general agent for Industrial Indemnity Insurance Company (hereinafter referred to as Industrial Indemnity) at the time AON submitted an application to Industrial on behalf of Lee for workers' compensation insurance.

On March 30, 1998, Lee sent a letter to American Specialty advising that Lee had appointed AON to act as Lee's insurance broker for the purpose of obtaining quotations for Lee's account.

On April 3, 1998, American Specialty prepared a "Proposal for Insurance Services for Splash Island". This proposal states in pertinent part:

ABOUT AMERICAN SPECIALTY

American Specialty is a risk management services company dedicated to providing a complete portfolio of services for the Sports * Entertainment industry worldwide.

Founded in 1989, we have grown to become the largest, private company devoted exclusively to this specialization. Our private status offers clients the benefits of superior service through our highly personalized, empowered team approach.

American Specialty's family of companies is solely dedicated to our mission of providing premier risk management services for the Sports * Entertainment industry worldwide.

SERVING THE SPORTS * ENTERTAINMENT INDUSTRY

The Sports * Entertainment industry is a dynamic international business. It is not a trend or fad, but an important industry which influences the lives of billions of people daily around the world. It crosses cultural and socio-economic boundaries, creating positive experiences that bring people together. The success of this industry is essential to the evolution of a peaceful and prosperous global community.

The product of this industry is ultimate human performance: being the best, winning, breaking records, building character. While achievement

> brings great rewards, its pursuit is always challenged by formidable risks. The proper management of risk is essential to success and can mean the difference between winning and losing on a grand scale. No other company offers the skill of managing risk like American Specialty.
>
> . . .
>
> BENEFITS
>
> Our portfolio of risk management services helps our clients achieve success. Benefits include increased profitability, equity value, and competitiveness as well as protection of reputation, assets, and human life. These benefits ultimately allow for the continued existence, growth, and stability of our clients and the Sports * Entertainment industry.

On April 3, 1998, AON, as agent for Lee, sent an application for workers' compensation insurance to American Specialty, as agent for Industrial Indemnity. The application set forth the following categories of employees who would be employed by Lee at The Island: 8017 - Stores-Retail; 8810 - Clerical; 9016 - Amusement; 9079 - Restaurant.

On April 14, 1998, Industrial Indemnity issued a workers' compensation insurance policy. The binder and policy listed the categories of employees set forth in Lee's application.

On May 12, 1998, Lee revoked its appointment of AON as its insurance broker, appointing Dibuduo &

DeFendis Insurance as Lee's exclusive insurance agent/broker for quotation purposes and advised American Speciality of this change.

On May 13, 1998 DiBuduo & DeFendis sent a fax to Cathy Hacker at American Specialty, forwarding "Workers Compensation information we had in file that does not appear to have been sent to you." Included in the fax is a "Workers' Compensation Application Supplement to Acord Application" which contains the following inquiry: "18. Is the construction and erection of new rides performed by employees? If yes, are construction hazards such as welding, heavy machinery operation and condition of tools supervised and controlled?" to which the answer "yes" was given to all inquiries.

Leon Hammonds, employed by Industrial Indemnity in 1998 as the national programs director, testified that another employee with Industrial Indemnity had developed the "Supplement to Acord Application" and that Question 18 encompassed activities that would normally be carried on by an amusement park business.

On May 22, 1998, Lee advised American Specialty that Lee had appointed AON as Lee's exclusive insurance broker with respect to the workers' compensation policy issued by Industrial Indemnity.

Between January and May, 1998, Lee hired six employees, in addition to its employee, Bruce Calomiris, to work in the construction of the water slides or the assembly of the water slides. Between May and July, 1998, Lee hired another ten employees

to assist Whitewater with the construction of the water slides.

On May 6, 1998, Hugh Awtrey of AON sent a fax to Lisa Ehrlich (hereinafter Ehrlich) of Lee, advising that a second injury to a construction worker at The Island was reported directly to Industrial Indemnity.

On May 7, 1998, Mr. Awtrey of AON sent a fax to Cathy Hacker of American Specialty regarding the Industrial Indemnity workers' compensation policy and stating in pertinent part:

> Please add class code 6218 - Excavation, NOC on an If Any Basis.

On May 29, 1998, Cathy Hacker sent a fax to Janine Lynn of Industrial Indemnity, stating:

> [T]he insured has requested that Class Code 6218 - Excavation - NOC be added to the above policy on an If Any basis.
>
> Please verify that the above had been added in writing.

This May 29, 1998 fax contains the handwritten notation: "Per telephone conversation w/Cathy Park is still under construction - will find out why 6218 is necessary."

A "File Memo" dated June 18, 1998 of a telephone call between Elaine Bartsh and Cathy Hacker states:

> Why did we add 6218 Excavation for the construction work?

> per Bill H. - Hugh advised Cathy Splash Island has hired basic laborers to do 'shovel work' - digging trenches to lay wiring, moving dirt, laying cement, etc. - getting the site ready for the subs to come in & do their work. Another code may be more appropriate. She will check with the Co. & advise.

In June and July, 1998, a dispute arose between Whitewater and Rexford/Lee over payment and the timely performance by Whitewater of the subcontract. Supervision of labor and work ceased on the construction of a water slide referred to as Group "C". In December, 1998, each side filed suit.

The parties dispute whether Lee employees began construction of the Group C slide in July, 1998 without Whitewater's supervision.

On July 13, 1998, Lee hired Diana Conley with the position of "construction".

In July, 1998, Jack Zygner of Industrial Indemnity conducted an on-site audit of The Island at the request of American Specialty and prepared a Safety and Health Survey Report. The report states in pertinent part:

> Presently, the insured has about 70 casual laborers doing construction work on the project to supplement the subcontractors. All the skilled work such as electrical, plumbing, assembly of towers and water slides is done by independent contractors. The insured employees are engaged in clean up, digging trenches, assembling picnic tables, lifting materials,

> sweeping down pool and deck areas, transporting concrete in wheelbarrows, using forklifts, and various other construction type tasks. Supervision is by a gen supt of construction overseeing the subs as well as all the casual labor, he is assisted by 2 lead foremen. These employees were hired 4/98 and will be laid off approx 8/98 ... There appears to be a misclassification as the work being performed by these employees does not fit into the amusement code. There is no safety training and minimum supervision.

On July 10, 1998, Fremont Corp., agents for Industrial Indemnity, sent the following memorandum to Cathy Hacker of American Specialty:

> This is to confirm our telephone conversation of this afternoon, advising our client to cancel coverage on Splash Island ....
>
> Our Loss Consultant recently completed an inspection of the operations and found that the Insured hired 70 casual laborers doing construction work to supplement the subcontractors. These laborers are cleaning up, digging trenches, assembling picnic tables, lifting materials, sweeping down pool and deck areas, transporting concrete in wheelbarrows, using forklifts and various other tasks. These laborers were hired in April and are due to be laid off sometime in August.
>
> As discussed, it was the intent of the Amusement Group to ensure water/amusement

> park operations only. Cancellation notification will be mailed ....

On July 13, 1998, Industrial Indemnity sent Lee a Notice of Cancellation of its workers' compensation policy, effective August 12, 1998, stating that the policy was being cancelled for the following reason:

> The occurrence of any change in your business or operations that materially increases the hazard of frequency of severity of loss. The occurrence of any change in your business or operation that requires additional or different classification for premium calculation.

Hugh Awtrey of AON testified that he understood the sentence in Industrial Indemnity's Notice of Cancellation, "The occurrence of any change in your business or operation that requires additional or different classification for premium calculation", to refer to the addition of class code 6218 to the Industrial Indemnity policy. [DT 90:3 - 94:16].

AON, acting as Lee's agent, then sought a replacement workers' compensation policy for Lee.

In July, 1998, American Specialty informed Industrial Indemnity that it was moving their amusement program to United States Fidelity & Guaranty Company (hereinafter referred to as Fidelity) . The record does not establish that American Specialty specifically advised either AON or Lee that it had become the managing agent for Fidelity.

On August 5, 1998, The Island opened to the public. Lee put completion of the Group C water slide on hold,

intending to complete construction during the off season when The Island would be closed and assuming that Lee received the components for the water slide.

After receiving the Notice of Cancellation from Industrial Indemnity, AON approached American Specialty, seeking a new workers' compensation policy from Fidelity. American Specialty at that point was the managing agent with respect to workers' compensation policies for Fidelity. Hugh Awtrey of AON testified:

> Q. Was there a reason you didn't discuss anybody else other than going back to American Specialty?
>
> A. Because basically we didn't have any other company that would quote on it or look - or write it, and American Specialty said that, 'Don't worry, go ahead, we will replace them, we've have got another park.' [sic]
>
> Q. Do you remember the substance of your conversation with Lisa Ehrlich about the cancellation or potential replacement?
>
> A. The same thing, we've got to replace it. We're going to replace if with American Specialty. They've got another market. They're going to take care of this. [DT 95:19 - 96:5]

Matt Sackett of American Specialty testified about the July 10, 1998 memo from Fremont Corp., agents for Industrial Indemnity, to Cathy Hacker of American Specialty:

Q. Do you recall being aware of the issue that was being raised relating to the laborers that 'were cleaning up, digging trenches, assembling picnic tables, lifting materials, sweeping down pool and deck areas, transporting concrete in wheelbarrows, using forklifts and various other tasks" as of July 10, 1998?

A. Yes.

Q. And where did you receive that information?

A. Most likely in discussions with underwriting.

Q. And is it your understanding that ... it was those laborers that Industrial Indemnity or Fremont Corp. had an issue with concerning The Island water park worker's [sic] compensation policy?

...

A. That would be my opinion, combined with the losses that --

...

Q. Okay, as of July 10, 1998, you were aware of the losses that The Island had to date?

A. I believe so, yes.

Q. And is it your recollection that the losses that were identified relating to The Island related to the activities as described in [the July 10, 1998

memo from Fremont Corp., agents for Industrial Indemnity, to Cathy Hacker]?

...

A. I believe so, yes.

Q. Is it your understanding at the time that it was the existence of the laborers identified in [the July 10, 1998 memo from Fremont Corp., agents for Industrial Indemnity, to Cathy Hacker] that caused the cancellation of the Industrial Indemnity policy?

...

A. Yes.

Q. Is it your understanding . . . that the laborers that are identified in [the July 10, 1998 memo from Fremont Corp., agents for Industrial Indemnity, to Cathy Hacker] were performing duties outside of their job classification, and that is why Industrial Indemnity was objecting to those laborers being on the policy?

...

A. Yes.

Q. And in connection with ... the ultimate issuance of the USF&G policy, it was these laborers identified in [the July 10, 1998 memo from Fremont Corp., agents for Industrial Indemnity, to Cathy Hacker] that you were

attempting to - or insuring were excluded from the policy, is that correct?

A. No, that is not correct. [DT 122:17 - 125:19].

Cathy Hacker of American Specialty testified:

Q. When you rated The Island for the issuance of the proposal through USF&G, did you review any of the information in The Island file relating to the Industrial Indemnity policy?

A. I might have.

Q. Would it be your custom and practice if an insured was changing carriers to review the information in the file relating to the prior carrier when you were rating a new policy through USF&G?

...

MS. HACKER: When you refer to carrier, are you referring to the difference between USF&G and Industrial Indemnity?

Mr. SHERWOOD: I am.

MS. HACKER: So are you saying that when I'm working on a renewal for USF&G and the prior policy was with Industrial Indemnity, would I review the Industrial Indemnity file?

MR. SHERWOOD: Let's start with that ...

A. I review the policy, the expiring policy.

> Q. And with regard to The Island, the Industrial Indemnity policy was actually cancelled. Is it your best recollection that you did review materials in the Industrial Indemnity policy when you were rating The Island for the issuance of a work comp policy through USF&G?
>
> ...
>
> A. I would have reviewed materials when I was issuing the USF&G quote. But I don't remember if they [sic] were new materials or from the Industrial Indemnity file. [DT 58:4 - 59:20]
>
> ...
>
> Q. Okay, do you recall also being the senior underwriter with regard to the issuance of a worker's compensation policy for a water park identified as Clovis Lakes through Industrial Indemnity?
>
> A. Yes.
>
> Q. ... were you an underwriter with regard to the issuance of a worker's compensation policy through USF&G to Clovis Lakes?
>
> A . Yes. [DT 79:13-21]

Stan Sheehan of American Specialty testified:

> Q. Does the supplement to Acord application prepared by American Specialty ask questions

of its potential insured of activities generally associated with the entertainment and leisure industry?

...

A. The workers' compensation supplement to the Acord application asks questions which are in regard to the operation of a leisure facility.

Q. And it's your understanding that it asks those questions because those questions may be relevant to the operations of their business?

...

A. Those questions are asked in order to secure an understanding of the operation of the prospective insured so as to allow the underwriter to determine both the acceptability and the pricing of the prospective insured.

...

Q. Is it your understanding that the questions contained in the supplement to the Acord application are being asked by American Specialty because they are questions that relate to the normal operation of amusement parks, family entertainment centers and water parks?

...

A. The questions on the supplement concern the operations of an amusement park, or a family

entertainment center, or a water park. [DT 83:14 - 85:21]

...

Q. Isn't it true, Mr. Sheehan, that [question 18 in the supplement to Acord application] is being asked by American Specialty of a potential insured, because it is part of the normal operations of water parks for construction and erection of new rides to be performed by employees?

...

A. No, that question is not asked by American Specialty, because we believe that is is part of the normal operations of a water park to erect new slides by employees.

Q. Why is that question being asked by American Specialty in the supplement to Acord application?

...

A. That question is asked to better understand the operation of an individual potential client.

...

Q. ... With regard to any client of American Specialty that you assist with workers' compensation insurance, are you aware of the construction and erection of any new rides being performed by any of their employees?

A. I am not aware of any client of American Specialty where erection of new rides is done by their employees. [DT 109:13 - 111:24]

...

Q. Looking at the last page of Exhibit 16, under the 'Class Code' section, this insurance proposal in comparison with the insurance proposal issued through Industrial Indemnity includes Class Code 9180. Do you know why that class code was added to this proposal in comparison with the proposal under the Industrial Indemnity policy?

A. Without reference to the documents, I do not know.

Q. What documents would you reference?

A. The correspondence, be in the intervening period between April and August, as to whether additional information had developed in regard to the operations of Lee Investments.

Q. Is there anything else you'd reference?

A. I might ask Matt Sackett or Cathy Hacker for their recollection.

Q. So if this was a new policy being issued under a new carrier, would it have been American Specialty's custom and procedure to obtain a new ... Acord and supplement to an Acord application?

...

A. This is very unusual - I'm not sure that there is a practice or procedure. It is quite unusual for a policy to be cancelled midterm, and then to be written by us. [DT 156:19-157:22]

...

Q. Let me show you what's been marked as Exhibit 22 to Mr. Sackett's deposition. It's a 'USF&G Facility Quote Request.' ....

...

Q. And what is the purpose of that document?

A. It allows the individual underwriter to jot down certain information about a proposed insured in preparation for a meeting with me.

...

Q. So on August 14, 1998, you reviewed and approved the USF&G Facility Quote Request?

A. Yes.

Q. The third line down on this form it says, 'Forms Approved,' and it's checkmarked 'yes.' What does that mean?

A. This facility quote request was used for a variety of coverages. Some of those coverages would have required that USF&G make a forms filing with the appropriate state to file forms

that were to be part of our program. That is not true on workers' compensation.

So the fact that USF&G ... is an approved workers' compensation plan would mean that the forms have indeed been approved.

Q. The information on the top of the form, that would have been filled out - is it your understanding that it was filled out by someone working for American Specialty?

A. Yes.

Q. And the procedure would have been to submit this USF&G Facility Quote Request to whom?

A. This quote request would have normally come to me.

Q. And then you would have initialed it at the bottom. What would have happened to it after you initialed it, reviewed and approved and initialed it?

A. It would become part of the file.

Q. Would it go to anyone at USF&G?

A. No.

Q. About three-quarters of the way down the page it says, 'Does the submission appear to meet all program guidelines,' and there's a

checkmark 'yes.' What are the program guidelines?

A. We operate a program which has been defined through to USF&G and reinsurers. And if the account fits within those guidelines, then it would be a 'yes.' If the account does not appear to fit within those guidelines, it would be a 'no.'

...

Q. ... My question is the program guidelines that you're referring to, are those the program guidelines that are ... an exhibit to the Producer Agreements which you produced today?

A. The program guidelines include a variety of documents, including the Producer Agreement. It would also include other documents, including things such as the state of California workers' compensation ... 'Rating Manual,' ... The effect of USF&G filing in which they adopted those rates which are part of the ... rate development program.

Q. Anything else other than those two documents and the Producer Agreement?

...

A. We would have an underwriting manual which we had written. We would have the underwriting mandate which is referred to in the Producer Agreement. I believe that's about it.

Q. Where would I get a copy of the underwriting mandate ... ?

A. Well, the underwriting mandate would be a business proprietary document.

Q. Is that a document relating to the relationship between American Specialty and USF&G?

...

A. That document would involve a relationship between USF&G and American Specialty.

Q. And what type of information would that underwriting mandate include?

A. It would include the limits of liability that American Specialty has agreed to be the maximum which would be allowed for various lines of insurance. It would have instructions as to how those limits might vary, depending upon a given circumstance.

Q. Would it include any other information?

...

A. No, not as ... I recall it. [DT 162:19 - 167:25]

...

Q. And is it your understanding, Mr. Sheehan, as the head of the Underwriting Department for American Specialty that the policy form

contains the terms of coverage between the named insured, Lee Investments, and the insured, United States Fidelity and Guaranty Company?

...

A. The insurance contract between United States Fidelity and Guaranty Company and Lee Investments would contain the terms, limitations, and conditions of the workers' compensation policy form as part of the insurance contract as the insurance contract stands in relationship to the law. [DT 177:21 - 178:10]

...

Q. Does anyone in your department review, as a matter of course and practice, contracts of insurance that are issued through American Specialty Insurance Services on behalf of insurers through . . . United States Fidelity and Guaranty Company?

A. It would be customary for members of my Underwriting Department to review a workers' compensation insurance policy before it would be issued from the American Specialty office. [DT 181:1-10]

...

A. The underwriter would review the policy to see if the policy as issued matches the

expectations they had in preparing the earlier quotation. [DT 182:1-4]

...

Q. ... My question for you, Mr. Sheehan, as the head of the Underwriting Department for American Specialty, who prepared this Contract of Insurance on behalf of United States Fidelity and Guaranty Company, is it your understanding that if the actual exposures are not properly described by the classifications set forth in the policy, that United States Fidelity Group will assign proper classifications?

...

A. The policy states that 'If your actual exposures are not properly described by those classifications, we will assign proper classifications, rates and premiums basis by endorsement to this policy.' The 'we' in that case would refer to United States Fidelity and Guaranty Company. They might do that themselves, or they might do that through their representatives.

Q. Their representatives, in this case, being American Specialty ...?

A. It might be American Specialty or American Specialty may employ another firm. [DT 200:15 - 201:17].

...

> Q. My question ... is prior to the issuance of the Contract of Insurance ... was the August 12, 1998 letter ... provided to anyone at United States Fidelity and Guaranty Company?
>
> A. To my knowledge, [the August 12, 1998 letter] would not have been presented to an employee of United States Fidelity and Guaranty Company prior to September 2nd. [DT 221:20 - 222:4]
>
> ...
>
> Q. If, based upon information you receive from an insured, you felt that some of its employees should be classified under a different classification code section, would you undertake to modify the premiums and rates and change the classification of those employees?
>
> ...
>
> A. We would try of put the actual job duties within the classification code which best fits those actual job duties. [DT 229:20 - 230:6]

On August 11, 1998, Matt Sackett of American Specialty, acting on behalf of Fidelity, faxed Bill Hildebrand of AON as follows:

> Attached is a copy of The Island's worker's compensation loss runs. Bill, I think that we have a problem. The loss runs seem to evidence an interchange of labor between the water park employees and the construction employees. Please review the type of losses that have

> occurred and help us understand how this fits with our understanding of the client/employee relationship. We would have anticipated training losses rather than construction losses.
>
> After seeing the loss runs, we are concerned. The loss runs seem to support Industrial Indemnity auditors' position. Please help me to prove to our underwriter the following:
>
> 1. Island employees will not be performing tasks outside of their designated classifications as water park employees.
>
> 2. Construction has ceased at The Island and all construction laborers working for Rexford Development Corporation have moved to a different job site. Therefore, workers' compensation claims arising from construction will not be reported under Lee Investments' workers' compensation policy.

Matt Sackett testified about the August 11, 1998 memo to AON as follows:

> Q. [R]eferring ... to ... your August 11, 1998 letter to Bill Hildebrand ... , it says, 'After seeing the loss runs, we are concerned. The loss runs seem to support Industrial Indemnity's auditor's position.' When you made that statement ... , what was your understanding of what the position was?
>
> A. My understanding was ... that Island employees were performing construction functions.

Q. And their position was actually identified in [the memorandum dated July 10, 1998 from agents of Industrial Indemnity to Ms. Hacker of American Specialty advising that the Industrial Indemnity policy was being cancelled], is that correct ... ?

...

A. I believe so, yes.

Q. Okay, and when you were referring to Industrial Indemnity's auditor's position [in the August 11, 1998 letter to Mr. Hildebrand] , you were referring to their position in [the July 10, 1998 memorandum]?

...

A. I believe so. [DT 133:20 - 134 :20]

...

Q. What were you referring to?

A. I was referring to ... that people were trying to convince us to place coverage with USF&G as construction had ceased at the job site.

Q. Right. But as far as making this statement 'construction has ceased and all construction laborers working for Rexford Development Corporation have moved to a different job site ... [¶] ... is it correct that you were referring to the construction laborers that were also identified

[in the July 10, 1998 memorandum] by Industrial Indemnity?

...

A. As ... I understand the question, when ... this is referring to construction laborers, I'm referring to construction laborers working for Rexford Development. Not The Island employees working as construction laborers. [DT 136:2-25]

...

Q. Do you have something to add, Mr. Sackett?

A. Yes, upon reviewing again the first paragraph [of the August 11, 1998 memorandum from Sackett to Hildebrand of AON] , it discusses an interchange of labor, and that was our concern. The interchange of labor between the Rexford Development employees and the Lee Investment employees. And the intent of paragraph number two was to make sure that Rexford Development employees were also away from the job site because there could not be an interchange if they no longer existed at the job site. [DT 142:22 - 143:8]

Q. ... Prior to August 11, 1998, did you ever notify anyone at Aon [sic] that there might be a problem with regard to issuing a replacement policy for The Island?

...

A. I believe I spoke with both Hugh Awtrey and Bill Hildebrand.

Q. Do you have any documentation that reflects or memorializes in any way those communications prior to August 11, 1998?

A. Just going back to the e-mail, July 21, 1998.

Q. Now that e-mail, that is an internal communication, correct, with Mr. Sheehan and Ms. Hacker, and that's not -

A. Uh-huh (affirmative).

Q. - a communication with Aon [sic]?

A. That is not. But it does provide some information here that I would not have been able to obtain other than through conversation with Aon [sic]. [DT 143:9 - 144:4]

Stan Sheehan of American Specialty testified concerning the August 11, 1998 memo:

A. My recollection is that there were discussions regarding the cancellation of Splash Island by Industrial Indemnity due to the conduct of construction activities by Splash Island employees as reported to us by Industrial Indemnity in the notice of cancellation.

We talked about whether or not it would be possible for USF&G to write a workers' compensation policy for The Island. We would not write a workers' compensation policy on a

> contractor. So in order for us to consider writing such a policy, we would need to have clarification as to the actual exposure at The Island.
>
> ...
>
> Q. [P]aragraph one says, 'Island employees will not be performing tasks outside their designated classification as water park employees.' Did you discuss with Mr. Sackett what that sentence in his letter meant?
>
> ...
>
> A. The Industrial Indemnity indication was that there was construction activities. We do not want to insure construction activities. [DT 147-148]

Cathy Hacker of American Specialty testified that Mr. Sheehan "was willing to issue a quotation for USF&G as long as we were assured that there was no construction of any kind by any employee." DT 94-95.

AON did not forward a copy of the August 11, 1998 communication to Lee. Hugh Awtrey of AON advised Lisa Ehrlich of the need for a reply letter from Lee that would address Fidelity's need to know that Lee employees would not be doing construction work.[5] Mr.

---

[5] Lee disputes that Mr. Awtrey told Lisa Ehrlich that Fidelity needed to know that Lee would not be doing construction work and asserts that AON confirmed that Lee's 70 casual construction laborers which were covered by class code 6128 had been laid off.

Awtrey testified that he understood the term "construction employees" in the statement in the fax, "The loss runs seem to evidence an interchange of labor between the water park employees and the construction employees" to refer to "the laborers." [DT 107:8-19] Mr. Awtrey further testified as follows:

> Q. ... After your discussion with Bill Hildebrand [about the August 11, 1998 fax from Mr. Sackett], what did you then do in order to provide information to American Specialty?
>
> A. I spoke with The Island about getting some sort of documentation or letter that they - that the laborers - they weren't going to have laborers anymore.
>
> Q. Who did you talk to?
>
> A. I spoke with Lisa first.
>
> Q. ... Did you tell her that you needed to provide certain information before American Specialty would issue a policy on The Island?
>
> A. Yes.
>
> Q. And did you tell her that you needed some kind of a letter from The Island before American Specialty would issue the policy?
>
> A. Yes.

However, the deposition testimony of Awtrey upon which Lee relies does not support Lee's assertion.

Q. Do you recall, did you tell her that American Specialty would not issue the policy if employees of The Island were performing construction work?

A. No.

...

Q. What did you tell her about what kind of information American Specialty needed before issuing the policy?

A. I told her that American Specialty had a problem because the laborers and the losses they were having aren't characteristic with a water park. They don't want to have those losses and that's not what they're looking to write, so you need to tell them there were not going to be any laborers anymore.

Q. There would not be any construction laborers anymore?

A. Correct.

Q. And there could not be anymore construction work performed by employees of The Island?

...

THE WITNESS: Yes.

...

Q. Do you recall what Lisa Ehrlich said in response?

A. They were getting ready to open and they were done with the laborers.

...

Q. Did she say that they would, that The Island would no longer do construction work with its own employees?

A. No. [DT 110:20 - 112:23]

...

MS. FALK: [Mr. Awtrey] needs to clarify that it related to his discussion with Lisa Ehrlich about future construction work, if any, and whether he discussed future construction work with her or not.

THE WITNESS: What I discussed with Lisa Ehrlich was that the park was in a completion stage, construction was completed before that. We did not have any discussion, though, . . . with regards to construction, but the fact that the laborers were no longer there and they had no other construction lined up.

...

Q. Well, did you understand that American Specialty was not interested in issuing a workers' compensation policy if The Island was

> going to perform construction work that would be covered under that policy?
>
> ...
>
> THE WITNESS: I don't know. [DT 120:21 - 121:8]

Mr. Awtrey insisted that Lee's response be provided by an authorized employee of The Island on The Island's letterhead. Awtrey first contacted Lisa Ehrlich to discuss the requested information and also spoke with Christy Platt, the administrative manager of The Island. Awtrey and Joanne Moore of AON drafted a letter at Ms. Ehrlich's request on The Island's letterhead which was then sent to Christy Platt at The Island. Ms. Platt, who had spoken with Ms. Ehrlich before the draft arrived, reviewed the draft to make sure that it complied with Ms. Ehrlich's instructions and signed it. The letter, dated August 12, 1998, sent by The Island to Matt Sackett of American Specialty, states:

> This is to confirm that The Island is operating as a water park. Our opening date was August 6, 1998. Our operation will no longer employ construction laborers. Any construction work will be performed by independent contractors. We will obtain and forward certificates of insurance on any contractors hired.
>
> The Island will provide appropriate training for the water park employees. Their duties will be restricted to park operations.

Mr. Awtrey testified about the meaning of the August 12, 1998 letter as follows:

> Q. The next line says, 'The Island will provide appropriate training for the water park employees. Their duties will be restricted to park operations.' Why was that put in there?
>
> A. Because part of the loss control concern was lack of training.
>
> Q. And the restriction of the employees to park operations was also put in there to assure American Specialty that the water park employees would not be performing construction work?
>
> A. They wouldn't be doing labor and construction.
>
> Q. Wouldn't be performing any construction work; is that right?
>
> A. Within reason, yes.
>
> Q. What would be -
>
> A. Well, sometimes you've got regular maintenance stuff, which I don't think you could say are construction maintenance.
>
> Q. Okay. But this would assure -
>
> A. That they were doing park operations.

> Q. This would assure American Specialty that, for example, they wouldn't be - employees of The Island wouldn't be assembling slides; is that right?
>
> A. I can't tell you that because I don't know what the normal - what the definition of maintenance of the park is. So they wouldn't be doing outside park operation and construction.
>
> Q. You don't understand that assembling of slides constitutes maintenance, do you?
>
> A. I don't know. It could be. [DT 118:18 - 119:22].

On August 12, 1998, the same day that The Island sent the above-quoted letter to American Specialty, Ms. Ehrlich wrote to Whitewater that Lee would rent the appropriate equipment and provide the labor to complete the assembly of the Group C slide when the components arrive at the site.

After receipt of The Island's August 12, 1998 letter, American Specialty, acting on behalf of Fidelity, issued a workers' compensation binder and policy to Lee. On August 14, 1998, American Specialty sent to Lee a "Proposal for Insurance & Risk Management Services for Lee Investments, LLC dba The Island". This proposal states in pertinent part:

> ABOUT AMERICAN SPECIALTY
>
> American Specialty is a risk management services company dedicated to providing a

complete portfolio of services for the Sports * Entertainment industry worldwide.

Founded in 1989, we have grown to become the largest, private company devoted exclusively to this specialization. Our private status offers clients the benefits of superior service through our highly personalized, empowered team approach.

American Specialty's family of companies is solely dedicated to our mission of providing premier risk management services for the Sports * Entertainment industry worldwide.

SERVING THE SPORTS * ENTERTAINMENT INDUSTRY

The Sports * Entertainment industry is a dynamic international business. It is not a trend or fad, but an important industry which influences the lives of billions of people daily around the world. It crosses cultural and socio-economic boundaries, creating positive experiences that bring people together. The success of this industry is essential to the evolution of a peaceful and prosperous global community.

The product of this industry is ultimate human performance: being the best, winning, breaking records, building character. While achievement brings great rewards, its pursuit is always challenged by formidable risks. The proper management of risk is essential to success and can mean the difference between winning and

> losing on a grand scale. No other company offers the skill of managing risk like American Specialty.
>
> ...
>
> BENEFITS
>
> Our portfolio of risk management services helps our clients achieve success. Benefits include increased profitability, equity value, and competitiveness as well as protection of reputation, assets, and human life. These benefits ultimately allow for the continued existence, growth, and stability of our clients and the Sports * Entertainment industry.

The August 14, 1998 Proposal from American Specialty states that American Specialty's program insurer is Fidelity and that "American Specialty is empowered on behalf of USF&G as a program manager to handle underwriting, policy service, and claims for American Specialty's sport/entertainment business."

Mr. Awtrey of AON did not discuss with Ms. Ehrlich that American Specialty's requirements or concerns had been met, but he did discuss this with Christy Platt when American Specialty issued the binder for workers' compensation coverage:

> Q. You may not recall the specific words, but do you recall expressing to her in substance that the letter had satisfied American Specialty's concerns and that's why the policy was being issued?

A. Not in that way.

Q. What do you recall?

A. If I would remember, I probably said something to that effect, that the policy has issued coverage and we satisfied the requirements. [DT 123:21 - 126:9]

On August 25, 1998 AON sent a fax to American Specialty, acknowledging receipt of the binder for workers' compensation insurance and asking "what are the guidelines for employees that fall under code 9180, Amusement Device Operations?" On August 26, 1998, American Specialty replied to this inquiry by forwarding copies of guidelines for class codes 9016 and 9180 to AON. Class code 9016 is captioned "amusement part or exhibition operation & drivers" and "applies to the operation" but states that "[o]peration or maintenance of amusement devices to be separately rated as 9180 - Amusement Device Operation NOC". Class code 9016

> includes the care, custody and maintenance of the premises; operation of elevators or heating, lighting or power apparatus as well as security people, musicians, box office employees and gate attendants. It does not include the operation of amusement devices, amusements or ... other operations separately classified in the manual ....

Class code 9180 "applies to the operation and maintenance of ... amusement devices not otherwise classified ...."

Mr. Sackett of American Specialty visited The Island on August 20, 1998 and stated in a letter to The Island on August 31, 1998 that the facility "looks great".

On August 31, 1998, Hugh Awtrey and Joanne Moore of AON sent a letter to Christy Platt at The Island enclosing the binder of insurance with Fidelity and further stating:

> ... You will note the inclusion of Class 9180, Amusement Device Operations. Employees who service the rides will fall under this classification.
>
> ...
>
> Your previous coverage with Industrial Indemnity was cancelled ... due to the increased exposure of construction laborers. The coverage with United States Fidelity and Guaranty Company has been issued on the premise that there will be no construction laborers employed by Lee Investments, LLC.

This letter is shown as copied to Lisa Ehrlich and Richard Miler, then accountant for Lee. Mr. Miler testified at his deposition that he recalls seeing this letter. Ms. Ehrlich testified that she never saw this letter.

Christy Platt testified that, when she was employed at Wild Water Adventures, park services put in new slides. Bruce Calomiris testified that, when he was employed as a supervisor for Wild Water Adventures from 1992 to 1998, the duties of he and his crew

included repair work and assembly and disassembly of the rides and water slides.

Diana Conley testified that she performed the following tasks between her hire date of July 1998 and the date of her injury in February 1999: digging up and replacing drains encased in concrete, and repacking with concrete; chiseling concrete in pool reservoirs and repaving with concrete; knocking out concrete; digging to access city sewer; using concrete saw to cut out concrete tiles; cutting and replacing pipes in deep trenches; shoveling underneath concrete for two days to access sewers; working under Lee's payroll for Rexford Properties housing development project; cleaning up construction debris for Rexford; operating heavy equipment such as grade-alls, tractors, forklifts, and scissor lifts; grading parking lots; drilling bolt holes in fiberglass sections of slides; preparing slide sections to be hoisted by hooking a crossbar and running straps around sections.

Fidelity's expert witness Greg Briggs opines that, pursuant to the custom and practice of the water park industry, "the activities of persons involved in the construction and assembly of the components of a permanent water slide prior to its being ready for use by the public are treated as 'construction' activities, while activities of persons engaged in the operation and maintenance of water slides thereafter are not." Lee's expert witness Kent LeMasters opines:

> the activity engaged in by the injured worker is one performed by a water park maintenance/ park services employee. In my experience, the repair, maintenance and installation of water slides is performed by the water park's

> maintenance staff. It is not uncommon for such activities to include, but are not limited to, repairs and patching of the fiberglass, grinding of joints and more particularly, the addition of fiberglass sections and/or extensions to water slides. To perform these tasks, a water park will own or rent a forklift to move slide sections from one location within the park to the site where the slide and/or section will be erected. The water park's maintenance staff will then use the forklift to lift the section into place and then will attach the section using the appropriate method. Moreover, the maintenance staffs' activities are not limited to work on existing water slides. It is not uncommon for maintenance staff to either perform the erection of new slides if they have the knowledge to do so, or erect the slide under the supervision of a technician provided by the water slide supplier.
>
> To my knowledge, during my 28 years of involvement in the water park industry, the employees performing the above described tasks were classified and covered within the park's worker's compensation policies as water park maintenance employees. To my knowledge, any injuries sustained by such employees during the performance of these tasks were covered by our worker's compensation insurance carriers under the designated water park classifications.

Any work described by Ms. Conley after The Island was closed for the season to maintain or repair completed facilities would not be considered construction. Ms. Conley testified that the activities performed by her at Rexford Properties development

involved the moving of stored water park furniture from a garage to the water park.

Claims were made under Fidelity's workers' compensation policy in September, 1998 for "puncture wound, left heel" sustained while walking; for "laceration, left forearm" while "removing piece of carpet" with a cutter; and for "laceration, right lower leg" "while walking past metal debris. Two of the claimants are listed as being employed by the maintenance department and the third is listed as employed by park services.

In January 1999, Lee undertook to complete the construction or erection of the Red Wave water slide in Group C, utilizing its own employees, without Whitewater supervision. The construction was supervised by Lee's employee, Bruce Calomiris.

For this construction or erection, Lee hired two employees who had previously performed construction work for Lee and also used current employee, Diana Conley.

On February 22, 1999, an accident occurred in the course of the construction or erection of the Red Wave water slide and Diana Conley was injured. At the time of her injury, Ms. Conley and Mr. Calomiris were preparing to hoist a section of the Red Wave waterslide into the air. Ms. Conley's job was to guide the slide sections into place as they were lifted by slingstraps, and to disconnect the slingstraps when the section was in place. A forklift holding a slide section in the air moved accidentally as Mr. Calomiris released the brake while Ms. Conley walked under the load. A bar fell from the load and hit Ms. Conley.

Diana Conley filed a claim for workers' compensation benefits under the Fidelity policy. As of May 23, 2002, Fidelity has paid the sum of $623,320.26 in costs and benefits for Ms. Conley under the policy.

The California Worker's Compensation Uniform Statistical Reporting Plan (USRP) requires all insurers to report to the WCIRB all individual claims and the classification code assigned by the insurer to the claim. Fidelity reported Diana Conley's injury to the WCIRB under the class code 9016.[6]

2. Cross-Motions for Summary Judgment - Fidelity's Claim for Rescission.

a. Integration of Policy.

In moving for summary judgment and in opposing Fidelity's motion for summary judgment, Lee argues that the Policy is an integrated, unrestricted policy which defeats Fidelity's cause of action for rescission as a matter of law.

There is no dispute by Fidelity that the Policy is an integrated, unrestricted policy. Where the parties part company is in connection with the relevance of that fact to the resolution of this lawsuit.

Lee argues that the fact that the Policy is an integrated, unrestricted Policy precludes Fidelity's

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[6] This fact is noted disputed by Fidelity. Although Fidelity objects to the exhibit setting this forth as lacking in foundation, the fact that Fidelity does not dispute the ultimate fact renders the objection irrelevant.

claim for rescission based on Fidelity's allegations and evidence of intentions to limit coverage.

Fidelity responds that California law does not permit restriction of workers' compensation policies for the classifications of workers or descriptions of activity pertinent to this case. For this reason, Fidelity argues, Industrial Indemnity canceled its unrestricted policy and Fidelity sought assurances from Lee that Lee would no longer employee construction workers before Fidelity issued its unrestricted workers' compensation policy. Fidelity asserts that it is not claiming a restriction that is not included in the Policy but, rather, is basing its claim for rescission on fraud in the inducement.

It is agreed by the parties that California Insurance Code §§ 11657, 11659 and 11660 permit a workers' compensation insurer to restrict or limit coverage only by endorsement approved by the Insurance Commissioner in accordance with rules adopted by the Insurance Commissioner. Fidelity argues that these rules do not permit restriction or limitation as to classification of workers or description of work activity.

The Insurance Commissioner's rules are set forth in 10 C.C.R. § 2259, "Grounds for the Use of Limiting and Restricting Endorsements", and in 10 C.C.R. § 2265, "Use of Form No. 11 Restricted". 10 C.C.R. § 2259 provides that "a limiting and restricting endorsement other than California Approved Form Endorsement No. 11 may be used only under one or more of the following circumstances":

> (a) Where the purpose of the endorsement is to limit insurance coverage to the liability for

> compensation to employees of the specific entity named as the insured in the policy. (b) Where the insured seeks to exclude an individual whose relationship by blood or marriage to the insured suggests family rather than employment ties, particularly if the insured denies the existence of employment. (c) Where the insured seeks by endorsement to negate an 'election' under Labor Code Section 4151 to bring under the compensation provisions of the Labor Code persons in his employment who are excluded from the definition of 'employee' by Section 3352 and other provisions of Article 2 of Chapter 2 of Part 1 of Division 4 of the Labor Code. (d) Where the endorsement serves as a notice to the employer that any liability for additional compensation payable to his employee by reason of the illegal employment of a minor under 16 years of age, is uninsurable (Insurance Code Sections 11661 and 11661.5). (e) Where the endorsement seeks to exclude only such liability of the employer for compensation as the latter affirms to the insurer in writing is otherwise secured or is lawfully uninsured (e.g., liability of the State and its political subdivisions and institutions). (f) Where the endorsement seeks to exclude an employee who is covered for workers compensation benefits on a policy also affording comprehensive personal liability insurance.

10 C.C.R. § 2265, "Use of Form No. 11 Restricted", states:

> California Approved Form Endorsement No. 11 may be used only in those cases where other

> California Approved Form Endorsements are applicable or may not be used ... It may be used only under one or more of the following circumstances:
>
> (a) Where use of the Form No. 11 Endorsement is in accordance with one or more of the guiding standards set forth in Section 2259 of these rules. (b) Where the employer's business is conducted in such a manner that it is impossible or impracticable to determine the nature, scope and extent of employment covered by the insurer without the use of a limiting and restricting endorsement. (c) Where the use of the Form No. 11 Endorsement is for the intended purpose of preventing performance of work in such an extremely hazardous manner or under such hazardous conditions as would reflect a reckless disregard by the employer for the welfare of his employees. (d) Where the issuance of an unrestricted policy would serve to encourage an operation which is illegal clearly contrary to public interest or contrary to the rules and practices of a public regulatory.

Fidelity argues that none of the delineated circumstances described for the use of a limiting endorsement other than Form No. 11 and none of the delineated circumstances for the use of Form No. 11 are applicable to this action.

Lee responds that Fidelity presents no evidence and fails to satisfy its burden of proof establishing that none of the delineated circumstances for use of Form No. 11 are applicable to this case. Lee contends the use of Form No. 11 set forth in Section 2265(b) ("Where the

employer's business is conducted in such a manner that it is impossible or impracticable to determine the nature, scope and extent of employment covered by the insurer without the use of a limiting and restricting endorsement") is applicable to exactly the case here. Lee argues:

> By use of such an endorsement, the insurer can unambiguously restrict the activities which the insurer agrees to insure. USF&G could have and should have utilized this endorsement to document the 'representations' or 'assurances' restricting the covered risks which USF&G intended to insure under the workers compensation policy. Without justification, USF&G failed to do so.

Lee further refers the court to 10 C.C.R. § 2268:

> No collateral agreements modifying the obligation of either the insured or the insurer shall be made unless attached to and made a part of the policy, provided, however, that if such agreements are attached and in any way restrict or limit the coverage of the policy, they shall conform in all respects with these rules.

Lee argues that, because the Insurance Code permits an insurer to tailor workers' compensation policies to cover only those risks which an insurer desires to assume by proper endorsement, and because Fidelity had the power to do so, summary judgment for Lee on Fidelity's complaint is proper.

Lee's contention that Fidelity could have limited or restricted the policy by use of Form No. 11 pursuant to

Section 2265(b) is not relevant. Even if Fidelity could have done so, that fact is irrelevant to Fidelity's claim for rescission against Lee. The basis of Fidelity's claim against Lee is that Lee represented to Fidelity in applying for the Policy that its business was a water park and that its operation no longer employed construction workers and that Fidelity relied on those representations in issuing the Policy. Assuming the truth and accuracy of these allegations, there would be no basis or reason for Fidelity to issue the Form No. 11 endorsement pursuant to Section 2265(b) because Fidelity would not have expected construction workers to be employed by Lee. Therefore, Lee's argument that the failure to issue the Form No. 11 endorsement entitles Lee to summary judgment as a matter of law with respect to Fidelity's claim for rescission is without merit.

Therefore, the court denies summary judgment for Lee's on this ground.

Lee further moves for summary judgment with respect to Fidelity's claim for rescission on the ground that Lee's letter of August 12, 1998 is inadmissible as a matter of law to prove any fact contradicting the express terms of the integrated Policy.

In arguing that this August 12, 1998 letter is inadmissible, Lee cites Bank of America v. Pendergrass, 4 Cal.2d 258, 263-264 (1935).

At issue in Pendergrass was the admission of evidence of a promise that if the appellant executed a note and mortgage, the appellant would not be required to make any payments of interest or principal

for a year. In holding that this evidence was inadmissible, the Supreme Court stated:

> [I]t is manifest that the promise which it is claimed they relied upon was ... that the respondent would 'extend' or 'postpone' all payments for the period of one year. This promise is in direct contravention of the unconditional promise contained in the note to pay the money on demand. The question then is: Is such a promise the subject of parol proof for the purpose of establishing fraud as a defense to the action or by way of cancelling the note, assuming, of course, that it can be properly coupled with proof that it was made without any intention of performing it? Our conception of the rule which permits parol evidence of fraud to establish the invalidity of the instrument is that it must tend to establish some independent fact or representation, some fraud in the procurement of the instrument, or some breach of confidence concerning its use, and not a promise directly at variance with the promise of the writing ... Lindemann v. Goryell ... confirms the opinion we entertain, for while it is said no question of fraud was raised, yet the effort was made to prove that the note was executed upon the understanding that the payee would not enforce payment until the payor had sold sufficient real estate to enable him to pay. It was there said ... that fraud may not be established by parol evidence to contradict the terms of the writing 'when the statements relate to rights depending upon contracts yet to be made, to which the person complaining is a party, as under such circumstances he has it in

> his power to guard in advance against any and all consequences of a subsequent change of conduct by the person with whom he is dealing, and to admit evidence of extrinsic agreements would be to open the door to all evils that the parol evidence rule was designed to prevent.' ....

See also Bank of America v. Lamb Finance Co., 179 Cal.App.2d 498, 502 (1960):

> A distinction has been made by our courts in cases in which the fraud sought to be proved consists of a false promise. They have held that if, to induce one to enter into an agreement, a party makes an independent promise without intention of performing it, this separate false promise constitutes fraud which may be proven to nullify the main agreement; but if the false promise relates to the matter covered by the main agreement and contradicts or varies the terms thereof, any evidence of the false promise directly violates the parol evidence rule and is inadmissible.

See also Continental Airlines, Inc. v. McDonnell Douglas Corp., 216 Cal.App.3d 388, 419 (1989):

> But the fraud exception is not applicable where 'promissory fraud' is alleged, unless the false promise is independent of or consistent with the written instrument ... It does not apply where ... parol evidence is offered to show a fraudulent promise directly at variance with the terms of the written agreement.

Relying on these legal principals, Lee argues in pertinent part as follows:

> USF&G contends that it issued the workers' compensation policy at issue in this case on USF&G's understanding and agreement that the policy would not cover or insure any employees performing 'construction' at the water park. According to USF&G, this was an indispensable part and integral condition of issuing the USF&G policy. However, this contention is directly at odds with and contradicts the unrestricted, integrated and auditable policy, written, assembled, reviewed and approved by American Specialty for USF&G. This very policy contains not one, but two, integration provisions and purports to fully describe the entire relationship and all obligations of the parties. The policy, which by its very terms is unlimited and unrestricted as to employees and occupations covered, directly contradicts USF&G's contention that it issued the policy premised upon the condition that construction workers would not be covered under the policy. Consequently, the August 11 and 12th letters are inadmissible and cannot provide grounds for rescission of the USF&G policy.

Fidelity takes issue with Lee's assertion that Fidelity "issued the policy premised upon the condition that construction workers would not be covered under the policy". Fidelity's position is that it issued the unrestricted policy based on Lee's representation that Lee would not be employing any construction workers. Furthermore, Fidelity argues that parol evidence is

admissible to prove fraud in the inducement of a contract notwithstanding an integration clause. See Ron Greenspan Volkswagen, Inc. v. Ford Motor Land Development Corp., 32 Cal.App.4th 985, 995 (1995); Airs, Inc. v. Perfect Scents, Ltd., 902 F.Supp. 1141, 1145-1147 (N.D.Cal. 1993).

Lee responds that Fidelity's reliance on these cases is misplaced because this exception to the parol evidence rule does not apply where the evidence in question concerns a matter covered by the main agreement which contradicts the terms of the agreement.

The court does not agree with Lee. Fidelity's position is that Lee's misrepresentations that it would not employ construction workers caused Fidelity to issue an unrestricted policy and that Fidelity would not have done so (or would not have issued any policy at all to Lee) in the absence of that misrepresentation. This misrepresentation is a separate "false promise" that is not directly at variance with the terms of the contract. In other words, Lee "promised" that it would not employ construction workers and based on that promise Fidelity issued a policy covering all of Lee's employees. That Conley was employed as a construction worker is not at variance with the policy because the policy terms apply to Lee's employees but it is at variance with Lee's "promise" that it would not employ construction workers. Therefore, the court rules that August 11, 1998 memorandum from Mr. Sackett of American Specialty to Mr. Hildebrand of AON and the August 12, 1998 letter from Ms. Platt to American Specialty are admissible.

Therefore, the court denies summary judgment for Lee on this ground.

b. Waiver of Right to Rescind.

Lee moves for summary judgment in connection with Fidelity's claim for rescission on the grounds that Fidelity waived its right to seek rescission by failing to investigate pursuant to California Insurance Code § 336 and by accepting policy premiums.

i. Failure to Investigate.

Lee moves for summary judgment with respect to Fidelity's claim for rescission on the ground that Fidelity waived its right to rescind pursuant to California Insurance Code § 336:

> The right to information of material facts may be waived, either (a) by the terms of insurance or (b) by neglect to make inquiries as to such facts, where they are distinctly implied in other facts of which information is communicated.

Lee argues that Fidelity waived its right to rescind by issuing an unrestricted, integrated policy will full knowledge of the purported restrictions which it deemed material.

However, for the reasons discussed supra, Fidelity seeks rescission on the ground that Lee's misrepresentations caused it to issue that policy. Therefore, the fact that the policy is unrestricted and integrated cannot itself constitute a waiver of Fidelity's right to rescind.

Lee further argues that Fidelity waived its right to rescind the policy because of Fidelity's failure to investigate.

"The insurer's right to disclosure of material facts may be waived by its own failure to follow up obvious leads. Waiver 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.' (Ins. Code, § 336)." Old Line Life Ins. Co v. Superior Court, 229 Cal.App.3d 1600, 1606 (1991).

In arguing waiver because of failure to investigate, Lee asserts that the Supplement to Acord Application clearly states that Lee's employees would be erecting water slides as part of their job duties. Fidelity's position that the August 11, 1998 memo from Mr. Sackett to AON and The Island's letter to American Specialty on August 12, 1998 represent that The Island's employees would not engage in the erection or construction of water slides cannot be sustained, Lee argues, because that task is not described or referred to. Lee refers to evidence that it understood Mr. Sackett's request for clarification that "Island employees will not be performing tasks outside of their designated classification as water park employees" not to include the erection of water slides because of the Supplement to Acord Application. However, as discussed supra, these contentions are factually disputed. Nonetheless, Lee argues, Fidelity's underwriting file contained conflicting information giving rise to a duty to investigate. Lee contends that Fidelity's interpretation of The Island's August 12, 1998 letter means that it contains facts directly in conflict with the more specific information provided by

Lee in the Supplement to Acord Application contained in American Specialty's underwriting file for The Island. Therefore, an investigation should have occurred at that time to determine whether the construction or erection of the water slides was construction work or was included in the category of water park operations. Lee further argues that the claims made in September, 1998 should have suggested to Fidelity that Lee's employees were engaged in construction work and caused Fidelity to investigate. Lee also refers to the onsite investigation conducted by American Specialty on September 17, 1998 "to determine whether [the facility] met the underwriting requirements of American Specialty's general liability insurance program" and the Underwriting Evaluation prepared by American Specialty in connection with that investigation. Lee notes that this Underwriting Evaluation contains a picture of the uncompleted slide and notes that it will be completed within a year. The Underwriting Evaluation also mandates the following corrective work as a condition of general liability coverage, i.e., the construction of fences around the water slides, repairs on concrete walls and the wave pool, replacement or installation of grates in the wave pool, repairs to two of the slide structures, replacement of gel coat on slide structures, installation of handrails. Lee argues that the Underwriting Evaluation describes work similar to that being performed by Diana Conley at the time of her injury.

Fidelity contends that Lee is not entitled to summary judgment that Fidelity waived its right to rescind the workers' compensation policy by failing to investigate. Fidelity argues that it could not have been on notice that Lee was misrepresenting itself based on

the Supplement to Acord because the Supplement to Acord was sent to American Specialty before it became the managing general agent for Fidelity in July, 1998. Fidelity further argues that, in the August 11, 1998 fax, American Specialty asked Lee to clarify that Lee would no longer employ construction workers, thereby adequately investigating Lee. Fidelity argues that the injury claims made in September 1998 do not necessarily equate with construction work to put American Specialty on notice that it should conduct an investigation to determine whether The Island's employees were involved in construction. Fidelity further argues that the repair work mandated by the Underwriting Evaluation does not describe the activities which Ms. Conley testified as having performed as part of her work duties from the date of her hire in July 1998 to the date of her injury in February 1999: digging up and replacing drains encased in concrete, and repacking with concrete; chiseling concrete in pool reservoirs and repaving with concrete; knocking out concrete; digging to access city sewer; using concrete saw to cut out concrete tiles; cutting and replacing pipes in deep trenches; shoveling underneath concrete for two days to access sewers; working under Lee's payroll for Rexford Properties housing development project; cleaning up construction debris for Rexford; operating heavy equipment such as grade-alls, tractors, forklifts, and scissor lifts; grading parking lots; drilling bolt holes in fiberglass sections of slides; preparing slide sections to be hoisted by hooking a crossbar and running straps around sections.

The court concludes that Lee is not entitled to summary judgment that Fidelity waived its right to rescind by failing to investigate. The record before the

court is disputed and raises genuine issues of material fact concerning the notice received by Fidelity that would have triggered a duty to conduct further investigation before issuing the workers' compensation policy or would have triggered a basis for Fidelity to terminate the policy prior to Conley's injury.

ii. Acceptance of Premiums.

As explained in Waller v. Truck Ins. Exchange, Inc., 11 Cal.4th 1, 31 (1995):

> Case law is clear that "'[w]aiver is the intentional relinquishment of a known right after knowledge of the facts.' ... The burden ... is on the party claiming a waiver of a right to prove it by clear and convincing evidence that does not leave the matter to speculation, and "doubtful cases will be decided against a waiver" ...' ... The waiver may be ... implied, based on conduct indicating an intent to relinquish the right.

Lee contends that Fidelity waived its right to rescind the policy by billing for and accepting premiums for that policy after giving notice of rescission and instituting this action.

The record establishes that Fidelity filed the complaint in this action seeking rescission on April 26, 1999. American Specialty received a check dated April 23, 1999 for the policy premium from AON. That check and all of the premiums received to date from AON on the policy, totaling $32,188.00, were tendered to Lee by a check dated May 4, 1999. Lee rejected the tender on May 28, 1999. American Speciality received and

deposited two checks in July 1999, totaling $6,047.70, from AON for the policy premiums. These two checks were returned to AON by American Speciality on November 10, 1999 because of the rescission action. AON returned the check to American Speciality on January 18, 2000.

In arguing that Fidelity waived its right to rescind, Lee relies on Neet v. Holmes, 24 Cal.2d 447, 457 (1944):

> The general rule, with certain exceptions not applicable to the facts involved in this case, is that the offer to restore what has been received under the contract is a condition precedent to maintaining an action founded on the assumption that rescission has been accomplished by the act of the party ... It is waived by recognition of the existence of the contract after the right to rescind was created ... Waiver of a right to rescind will be presumed against a party who, having full knowledge of the circumstances which would warrant him in rescinding, nevertheless accepts and retains benefits accruing to him under the contract ... It has been said that citation of authorities is unnecessary in support of the doctrine well established in this state that an affirmance of the contract at a time subsequent to the discovery of the falsity of the representations inducing its execution forecloses the exercise of the right of rescission ... In Bancroft v. Woodward, 183 Cal. 99 ..., it appeared that the party suing to enforce rescission of a lease collected rents thereunder after he was fully aware of his rights and was affirmatively

> seeking rescission. It was held that his action was unequivocal affirmance of the lease and destroyed whatever right of rescission he might theretofore have had.
>
> But, say the plaintiffs, a notice of rescission was promptly given after knowledge of the facts, and the acceptance of further royalties under the lease was expressly 'without prejudice.' ... [P]rompt notice does not complete the act of rescission. Restoration or offer to restore is also required. The plaintiffs neither restored nor offered to restore the benefits received under the lease ... By the acceptance of royalty payments subsequent to the notice of rescission, the plaintiffs treated the lease as in existence and thereby waived their attempted rescission.

Lee's motion focuses solely on the facts that Fidelity billed and accepted checks for premiums after issuing the notice of rescission. However, as Fidelity notes, the record establishes that Fidelity has either restored or offered to restore all of the premium payments. The record establishes, therefore, that resolution of this issue is not controlled by the conclusion in Neet v. Holmes. The court concludes further that the record before it does not permit an inference that Fidelity waived its right to rescission by retaining the benefits of the policy. As noted, Fidelity did not retain those benefits. Lee's position is that a waiver of rescission occurs as a matter of law if any contract benefit is received after notice of rescission, even if that benefit is subsequently and expeditiously restored. Lee refers the court to no case in which a waiver of rescission was found under similar circumstances. That there was a delay of several

months before the actual attempt to restore two of the premium checks is not germane given that Fidelity was actually prosecuting its claim for rescission during that time and may not have been aware of the purpose of the two checks. There is no evidence before the court from which it may reasonably be inferred that Fidelity intentionally waived its right to rescind the policy as argued by Lee.

Therefore, the court denies summary judgment for Lee on the ground that Fidelity waived its right to rescind because of the acceptance of premiums.

c. Merits of Claim for Rescission.

Fidelity and Lee respectively move for summary judgment with respect to Fidelity's claim for rescission.

An insurer is entitled to rescind an insurance policy if the insured misrepresents or conceals a material fact upon which the insurer relied in issuing the insurance policy. See Thompson v. Occidental Life Ins. Co., 9 Cal.3d 904, 914-916 (1973); Imperial Casualty & Indemnity Co. v. Sogomonian, 198 Cal.App.3d 169, 177-182 (1988). No intent to deceive is required to be shown on the part of the insured is required to be shown. Freeman v. Allstate Life Ins. Co., 253 F.3d 533, 536 (9th Cir. 2001)

i. Misrepresentation.

Fidelity contends that it is entitled to summary judgment with respect to its rescission claim because Lee misrepresented to Fidelity that it would no longer employ construction laborers, that any construction work would be performed by independent contractors,

and that the duties of the employees of The Island would be limited to water park operations. In so contending, Fidelity relies on the August 12, 1998 letter from The Island to American Speciality.

Lee moves for summary judgment on the ground that it made no misrepresentation because Fidelity admits that the erection of prefabricated water slides is a normal water park activity covered by the code classifications contained in Fidelity's policy.

Lee opposes summary judgment for Fidelity and contends that Lee is entitled to summary judgment on the ground that it did not misrepresent any facts to Fidelity.

Lee argues that the August 12, 1998 letter asked two questions: (1) whether The Island employees will be performing tasks within their designated classification as water park employees; and (2) whether construction has ceased at The Island and all construction laborers employed by Rexford Development Corporation have moved to a different job site so that claims associated therewith would not be reported on Lee's workers' compensation policy. With regard to the second question described by Lee, Lee refers to Mr. Sackett's deposition testimony:

> Q. Right. But as far as making this statement 'construction has ceased and all construction laborers working for Rexford Development Corporation have moved to a different job site ... [¶] ... is it correct that you were referring to the construction laborers that were also identified [in the July 10, 1998 memorandum] by Industrial Indemnity?

...

> A. As ... I understand the question, when ... this is referring to construction laborers, I'm referring to construction laborers working for Rexford Development. Not The Island employees working as construction laborers. [DT 136:2-25]

Lee argues that nowhere in the August 12, 1998 letter from The Island to American Specialty does Lee state that construction at The Island has ceased or that there were be no construction at The Island in the future but, rather, states that construction is ongoing, and that that ongoing construction will be performed by subcontractors for whom certificates will be obtained. Lee contends that the term "construction laborer" in Lee's August 12, 1998 letter corresponds to Mr. Sackett's testimony that he was referring to "construction laborers working for Rexford Development Corporation". Lee argues that the only reasonable understanding that Fidelity could place on the August 12, 1998 letter is that Lee is confirming that employees of Rexford Development Corporation have left the job site. Because Rexford had no employees on water park site on August 12, 1998, Lee's statement to Fidelity is true and cannot be the basis for rescission of the policy.

Fidelity responds that Mr. Sackett's August 11, 1998 letter referred to problems with The Island's employees being involved in construction under the Industrial Indemnity workers' compensation policy and sought assurances that "construction has ceased at the Island ...." Fidelity argues that the only reasonable understanding that Fidelity could place on

Lee's letter is exactly what it says, "[o]ur operation will no longer employ construction laborers" and "[w]e will obtain certificates of insurance on any contractors hired", and that the "duties of [water park employees] will be restricted to park operations." Fidelity contends that Lee's attempt to equate "construction laborers working for Rexford" with "construction laborers" referred to in the August 12, 1998 letter is not only inconsistent with the plain language of the letter, but also ignores the concern expressed by Mr. Sackett in his August 11 memo to AON that construction injuries had been claimed under the Industrial Indemnity policy and that Fidelity wanted no such exposure.

Fidelity also argues that the falsity of Lee's representation that it would not employ construction laborers is established by the fact that, on August 12, 1998, Lisa Ehrlich wrote to Whitewater West Industries, to whom the waterpark construction had been subcontracted, stating that Lee would rent the appropriate equipment and provide the labor to complete the assembly of the Group C slide when the components arrived at water park. In addition, Fidelity notes that Lee admits that "construction laborers" refers to Lee's employees who were performing the tasks described in the Safety and Health Survey Report prepared by Jack Zygner of Industrial Indemnity. Because Diana Conley remained employed by The Island and performed "construction type" activities from July 1998 to the date of her injury in February 1999, Lee's representation that "[o]ur operation will no longer employ construction laborers" was false.

The court concludes that the falsity of Lee's representation in the August 12, 1998 letter is not

established as a matter of law by the continued performance by Diana Conley of "construction type" activities prior to the injury on February 22, 1999. The activities described by Ms. Conley in her deposition occurring prior to construction or erection of the Group C slide in February, 1999 involved repairs and maintenance to existing structures at The Island. Fidelity's expert witness opines that, pursuant to the custom and practice of the water park industry, activities of persons engaged in the operation and maintenance of water slides after their construction are not treated as construction activities.

Lee further argues that it did not make any misrepresentations in the August 12, 1998 letter because of the statement therein that the duties of The Island's employees "will be restricted to park operations." Lee contends that the erection of pre-fabricated water slides is an activity conducted during the normal operations of water parks and is covered by the designated code classifications contained in the "Workers Compensation Application Supplement to Acord Application" and in Fidelity's workers' compensation policy. The Supplement to Acord Application was completed on Lee's behalf by its then broker, DiBuduo & DeFendis for submission with Lee's application for workers' compensation insurance to Industrial Indemnity. The Supplement to Acord contains the following inquiry: "18. Is the construction and erection of new rides performed by employees? If yes, are construction hazards such as welding, heavy machinery operation and condition of tools supervised and controlled?", to which the answer "yes" was given to all inquiries. Lee refers to the deposition testimony of Stan Sheehan of American Specialty that the questions on the Supplement to Acord relate to the

operations of a water park. Cathy Hacker, an underwriter with American Specialty who rated the Island for the issuance of Fidelity's policy, testified that she would have reviewed materials in the Industrial Indemnity file and that she was the senior underwriter with regard to the issuance of an Industrial Indemnity workers' compensation policy to a water park known as Clovis Lakes. Christy Platt of The Island and Bruce Calomiris testified that the duties of park services employees while they were employed at Wild Water Adventures included the assembling of the water slides.

Although it is inferrable from this evidence that the erection or construction of water slides is considered to be part of the normal operations of a water park, the court notes the testimony of Stan Sheehan and Cathy Hacker that Fidelity did not want to insure construction activities, relying on the reason for cancellation stated by Industrial Indemnity, which can be construed to include the construction of water slides. In addition, the court notes that the Safety and Health Survey Report prepared by Jack Zygner of Industrial Indemnity stated that the "skilled work such as ... assembly of towers and water slides is done by independent contractors."

Therefore, the court concludes that neither Fidelity nor Lee are entitled to summary judgment on the issue of whether or not Lee made a misrepresentation to Fidelity.

Lee further argues that any ambiguity or confusion created by Lee's August 12, 1998 letter was created by the ambiguities in Sackett's August 11, 1998 letter and therefore is chargeable to Fidelity. See Thompson,

supra, 9 Cal.3d at 912 ("[A]n insurance company is not precluded from imposing conditions precedent to the effectivenesss of insurance coverage ... However, ... any such condition must be stated in conspicuous, unambiguous and unequivocal language which an ordinary layman can understand. As the insurer is responsible for drafting the application, it is appropriate that he be required to choose plain and unequivocal terms."). As the parties concede, the duty to properly determine the proper classifications to include in a workers' compensation policy lies with the insurer. Lee refers to the expert opinion evidence of Arthur Levine that the phrase in Mr. Sackett's August 11, 1998 letter to AON "performing tasks outside of their designated classification as water park employees" is inherently ambiguous because the letter does not delineate what activities are covered by water park classifications and fails to specifically address or reference the erection or construction of the water slides.[7] Lee contends that the ambiguity in Mr. Sackett's letter caused Hugh Awtrey of AON to misconstrue the issues raised by Mr. Sackett. In so arguing, Lee refers to Mr. Awtrey's deposition testimony that the language in The Island's August 12, 1998 letter to American Specialty was included to assure American Specialty that The Island's employees

[7] Lee asserts that the reason for the ambiguity is that Mr. Sackett "does not know what activities are included within the classifications." However, the deposition testimony of Mr. Sackett upon which Lee relies does not support the assertion. Mr. Sackett only testified that he did not have any expertise in identifying on behalf of an insured which of their employees would fall under any class codes for workers' compensation insurance and that he was not involved in determining which workers' compensation class codes The Island's employees should fall under.

would not be doing labor and construction, that the employees would be doing park operations, and that Mr. Awtrey did not know if assembling water slides constituted maintenance but that "it could be". [DT 118:18 - 119:22]. Lee asserts that Mr. Awtrey relayed this information to Lisa Ehrlich. However, Mr. Awtrey did not testify that he told Lisa Ehrlich that assembling water slides could be maintenance as opposed to construction. Lee refers to the evidence that Industrial Indemnity cancelled the workers' compensation policy because of Lee's hiring of laborers which caused the request to include Class Code 6128 to the Industrial Indemnity policy. Lee argues that Lee understood that Mr. Sackett's August 11, 1998 letter pertained to the Class Code 6128 construction laborers only, which The Island truthfully responded had been terminated.

The court concludes that Lee is not entitled to summary judgment that ambiguities in Mr. Sackett's August 11, 1998 letter caused Lee to make an ambiguous response. Mr. Sackett specifically sought a representation from Lee that construction has ceased at The Island, that workers' compensation claims arising from construction will not be reported under Lee's workers' compensation policy and that The Island's employees will not be performing tasks outside their designated classification as water park employees. As noted, the assembly of the towers and water slides was being performed by independent contractors.

ii. Materiality.

Fidelity and Lee respectively move for summary judgment on the issue of the materiality of Lee's alleged misrepresentation.

"Materiality is determined solely by the probable and reasonable effect which truthful answers would have had upon the insurer . . . 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." Thompson, supra, 9 Cal.3d at 916.

In arguing that it is entitled to summary judgment on this issue, Fidelity refers to the deposition testimony of Kathy Hacker and Stan Sheehan, Fidelity's underwriters, that Fidelity would not have issued the workers' compensation policy to Lee if Fidelity had been informed that Lee's employees were or would be engaged in construction work. Fidelity also refers to the April 11, 1998 fax from Mr. Sackett of American Specialty to Lee's broker, AON, and contends that this fax makes explicit the need for Lee to establish to American Specialty that no construction work will be performed by Lee's employees, that all of Lee's employees' duties will be restricted to water park operations, and that no injuries resulting from construction work will be reported under the workers' compensation policy. In addition, Fidelity refers to evidence that Lee knew that Industrial Indemnity had cancelled the workers' compensation policy because Lee had employed laborers to perform construction work, thereby requiring the addition of a code classification to the Industrial Indemnity policy. Fidelity notes the evidence that Mr. Awtrey of AON

required that The Island provide the response to Mr. Sackett's August 11, 1998 fax on The Island letterhead after Mr. Awtrey drafted the letter following consultation with Christy Platt and Lisa Ehrlich. Fidelity argues that the materiality of Lee's alleged misrepresentation is further confirmed by the August 27, 1998 transmittal letter to Lee from AON stating that the Fidelity workers' compensation policy was "issued on the premise that there will be no construction laborers employed by Lee, LLC".

Lee argues that it is entitled to summary judgment that its alleged misrepresentation was not material because the evidence does not support Fidelity's assertions that it did not wish to assume the risk of covering construction activities performed by Lee's employees.

In so arguing, Lee contends that Fidelity could have issued a workers' compensation policy that excluded construction workers but instead issued an unrestricted and integrated policy, thereby disclosing an intent to provide complete coverage for all activities at The Island as long as Lee paid the applicable class code rates. However, as discussed infra, Fidelity could not have endorsed a workers' compensation policy to exclude construction workers employed by Lee.

Lee further refers to evidence that Fidelity received notice of injuries in August and September of 1998 that were similar to those sustained while the Industrial Indemnity policy was in effect, but did not investigate or question Lee about the type of work being performed or take action to rescind the workers' compensation policy. Therefore, Lee argues, its alleged misrepresentation could not have been material.

The evidence to which Lee refers are claims under Fidelity's workers' compensation policy on September 23, 1998 for "puncture wound, left heel" sustained while walking; on September 18, 1998 for "laceration, left forearm" while "removing piece of carpet" with a cutter; and on September 18, 1998 for "laceration, right lower leg" "while walking past metal debris". Two of the claimants are listed as being employed by the maintenance department and the third is listed as employed by park services. This evidence does not allow the inference that Fidelity knew or was on notice that The Island's employees were engaged in construction work. What triggered the eventual cancellation of the Industrial Indemnity policy was the request to add the class code to the policy because The Island's employees were engaged in construction type activities followed by Mr. Zygner's on-site audit. No such trigger can be inferred from these claims.

Lee further argues that the alleged misrepresentation was not material because Mr. Sackett of American Specialty visited The Island on August 20, 1998 and stated in a letter to The Island on August 31, 1998 that the facility "looks great".

Lee further argues that evidence of past underwriting practices of American Specialty and Fidelity establish that the alleged misrepresentation was not material. Lee notes that Cathy Hacker of American Specialty, the underwriter for the Fidelity workers' compensation policy, was the underwriter who approved the issuance of a workers' compensation policy for the Clovis Lakes water park, a water park which routinely erected water slides utilizing its park services employees. Lee also refers to the deposition testimony of Stan Sheehan where Mr. Sheehan

reviewed Fidelity's underwriting criteria, contending that nothing therein indicates a limitation on the activities that can be performed by water park employees.

This evidence does not suffice to entitle Lee to summary judgment on the issue of materiality or to raise a genuine issue of material fact concerning the issue of materiality given the specific evidence that Fidelity would not issue a workers' compensation policy to Lee if The Island's employees engaged in construction activities.[8]

Finally, Lee reiterates its arguments set forth above concerning Lee's interpretation of Mr. Sackett's August 11, 1998 fax, contending that Fidelity did not ask Lee to confirm that The Island's employees would not be engaged in construction work but, rather, addressed the construction employees of Rexford Development. Lee refers to Mr. Sackett's deposition testimony:

> Q. Right. But as far as making this statement 'construction has ceased and all construction laborers working for Rexford Development Corporation have moved to a different job site ... [¶] ... is it correct that you were referring to the construction laborers that were also identified

[8] Because The Island's August 12, 1998 letter was never provided to Fidelity, Lee contends that the alleged misrepresentation could not have affected Fidelity's decision to issue to workers' compensation policy. This argument is without merit because the August 12, 1998 letter was provided to Fidelity's managing agent, American Specialty.

> [in the July 10, 1998 memorandum] by Industrial Indemnity?
>
> ...
>
> A. As ... I understand the question, when this is referring to construction laborers, I'm referring to construction laborers working for Rexford Development. Not The Island employees working as construction laborers. [DT 136:2-25]
>
> ...
>
> Q. Do you have something to add, Mr. Sackett?
>
> A. Yes, upon reviewing again the first paragraph [of the August 11, 1998 memorandum from Sackett to Hildebrand of AON], it discusses an interchange of labor, and that was our concern. The interchange of labor between the Rexford Development employees and the Lee Investment employees. And the intent of paragraph number two was to make sure that Rexford Development employees were also away from the job site because there could not be an interchange if they no longer existed at the job site. [DT 142:22 - 143:8]

The court concludes that Mr. Sackett's testimony does not entitled Lee to summary judgment on the issue of materiality nor raise a genuine issue of material fact with regard to that issue. It is clear that Mr. Sackett's concern that there no longer be any interchange of labor between employees of Rexford Development and The Island was so that there would

not be any construction work by The Island's employees.

Lee further argues that Fidelity never intended to restrict the activities of The Island's employees because Fidelity issued an unrestricted workers' compensation policy, thereby entitling Lee to summary judgment on the issue of materiality.

However, as noted supra, the August 27, 1998 transmittal letter to Lee from AON stated that the Fidelity workers' compensation policy was "issued on the premise that there will be no construction laborers employed by Lee, LLC".

Therefore, the court grants summary judgment for Fidelity on the issue of materiality.

iii. Entitlement to Restitution.

Fidelity seeks "an order that Lee Investments is obligated to reimburse USF&G for all benefits paid to Diana Conley under the USF&G Policy, which USF&G would not have been required to pay but for the misrepresentations by Lee Investments in applying for issuance of the USF&G Policy."

The undisputed facts establish that Fidelity has advanced $623,320.26 in medical costs, expenses and workers' compensation benefits to Diana Conley pursuant to California Workers' Compensation law.

As a general rule, upon rescission of a contract, the successful party is entitled to restitution, i.e., to recovery of the consideration he gave and any other

compensation to make him whole. Witkin, 1 Summary of California Law, Contracts, § 884 (1987).

Here, however, Fidelity has paid nothing to Lee. Rather, Fidelity paid the monies directly to Diana Conley on Ms. Conley's direct action against Fidelity.

Lee argues that, because Fidelity has paid Ms. Conley on a direct obligation owed to Ms. Conley, Fidelity is not entitled to restitution from Lee of these amounts.

Fidelity responds that the workers' compensation policy issued to Lee makes clear that the benefits paid to Conley are on behalf of Lee:

> GENERAL SECTION, ITEM B
>
> You are insured if you are an employer named in Item 1 of the Information Page (naming 'Lee Investments LLC d.b.a. The Island').
>
> PART ONE, ITEM B
>
> We will pay promptly when due the benefits required by you by the workers compensation law.

Fidelity argues that, because it paid benefits to Conley to indemnify Lee from its obligations under the California Workers' Compensation law, Fidelity is entitled to reimbursement from Lee upon rescission of the policy.

As explained in Dunkin v. Boskey, 82 Cal.App.4th 171, 198 (2000):

> Restitution is defined "as restoration of the status quo by the awarding of an 'amount which would put plaintiff in as good a position as he would have been if no contract had been made and restores to plaintiff value of what he parted with in performing the contract' ..." ... '"In modern legal usage, its meaning has frequently been extended to include not only the restoration or giving back of something to its rightful owner, but also compensation, reimbursement, indemnification, or reparation for benefits derived from, or for loss or injury caused to, another.'" ....

Consequently, the court concludes that, if Fidelity prevails on its claim for rescission, Fidelity will be entitled to the amount sought by its complaint.

3. Fidelity's Motion for Summary Judgment on Lee's Counterclaims.

Fidelity moves for summary judgment in its favor with respect to the counterclaims alleged against American Specialty and Fidelity.

a. First Counterclaim for Negligence.

Fidelity and American Specialty move for summary judgment with respect to this counterclaim on the ground that neither American Specialty or American Specialty Risk Management (ASRM) were Lee's agents or dual agents for the procurement of the workers' compensation policy from Fidelity.

In opposing this motion, Lee contends that Fidelity misconstrues the law and that the issue in this

counterclaim is not whether American Specialty was Lee's insurance agent but whether American Specialty assumed by its conduct additional legal duties the breach of which is actionable. Lee relies on Fitzpatrick v. Hayes, 57 Cal.App.4th 916, 927 (1997), wherein the Court of Appeal held in pertinent part:

> [A]s a general proposition, an insurance agent does not have a duty to volunteer to an insured that the latter should procure additional or different coverage ... The rule changes, however, when - but only when - one of the following three things happens: (a) the agent misrepresents the nature, extent or scope of the coverage being offered or provided ..., (b) there is a request or inquiry by the insured for a particular type or extent of coverage ..., or (c) the agent assumes an additional duty by either express agreement or by 'holding himself out' as having expertise in a given field of insurance being sought by the insured.

Lee contends that American Specialty held itself out to Lee as an expert in providing for the insurance and risk management needs of the amusement/leisure facility. Lee refers to the "Proposal for Insurance Services for Splash Island" prepared by American Specialty on April 3, 1998, and to the "Proposal for Insurance & Risk Management Services for Lee Investments, LLC dba The Island" prepared by American Specialty on August 14, 1998. Both proposals state in pertinent part:

ABOUT AMERICAN SPECIALTY

American Specialty is a risk management services company dedicated to providing a complete portfolio of services for the Sports * Entertainment industry worldwide.

Founded in 1989, we have grown to become the largest, private company devoted exclusively to this specialization. Our private status offers clients the benefits of superior service through our highly personalized, empowered team approach.

American Specialty's family of companies is solely dedicated to our mission of providing premier risk management services for the Sports * Entertainment industry worldwide.

SERVING THE SPORTS * ENTERTAINMENT INDUSTRY

The Sports * Entertainment industry is a dynamic international business. It is not a trend or fad, but an important industry which influences the lives of billions of people daily around the world. It crosses cultural and socio-economic boundaries, creating positive experiences that bring people together. The success of this industry is essential to the evolution of a peaceful and prosperous global community.

The product of this industry is ultimate human performance: being the best, winning, breaking records, building character. While achievement

> brings great rewards, its pursuit is always challenged by formidable risks. The proper management of risk is essential to success and can mean the difference between winning and losing on a grand scale. No other company offers the skill of managing risk like American Specialty.
>
> ...
>
> BENEFITS
>
> Our portfolio of risk management services helps our clients achieve success. Benefits include increased profitability, equity value, and competitiveness as well as protection of reputation, assets, and human life. These benefits ultimately allow for the continued existence, growth, and stability of our clients and the Sports * Entertainment industry.

In these proposals, Lee contends, American Specialty represents itself to be a recognized leader in providing risk management services for the leisure market segments, which includes water parks. Both proposals contain a description of the specialized risk management, insurance, claims management and information services which would be provided if Lee agreed to allow American Specialty to obtain its insurance needs, including workers' compensation insurance. Lee asserts that, because it was a neophyte in the amusement park business, the statement in the proposals that American Specialty's benefits "include ... protection of reputation, assets, and human life" was particularly important to Lee. As detailed in the proposals, American Specialty would provide these

services either directly to Lee or to Lee's appointed agents. By making such proclamations of expertise, Lee argues that American Specialty

> assumed a fiduciary duty to accurately represent and disclose policy terms, conditions of coverage, and to evaluate and inform LEE of circumstances creating the risk of potential financial loss.

Lee further relies on the deposition testimony of Mr. Awtrey of AON as support for Lee's assertion that, after receiving the notice of cancellation from Industrial Indemnity, American Specialty assured Lee that American Specialty would identify and obtain replacement coverage on behalf of Lee:

> Q. Was there a reason you didn't discuss anybody else other than going back to American Specialty?
>
> A. Because basically we didn't have any other company that would quote on it or look - or write it, and American Specialty said that, 'Don't worry, go ahead, we will replace them, we've have got another park.' [sic]
>
> Q. Do you remember the substance of your conversation with Lisa Ehrlich about the cancellation or potential replacement?
>
> A. The same thing, we've got to replace it. We're going to replace if with American Specialty. They've got another market. They're going to take care of this. [DT 95:19 - 96:5]

Lee argues that American Specialty misrepresented the nature, extent or scope of the coverage being offered because American Specialty did not tell Lee that it had only one market for the replacement coverage when its prior proposal had indicated that it had a number of markets and did not tell Lee that its relationship with Industrial Indemnity had been terminated because of misclassification of employees. In addition, Lee refers to evidence that American Specialty, with knowledge of the cancellation of the Industrial Indemnity policy, said nothing about any problems in underwriting the replacement coverage until the eve of the cancellation of the Industrial Indemnity policy. Lee argues that, based upon the representations made by Mr. Sackett to Mr. Awtrey, American Specialty assumed a duty to properly market and provide Lee with replacement coverage for all of Lee's activities or to inform Lee in a timely manner that American Specialty was unable to do so in order that Lee could obtain the workers' compensation insurance from the State Fund.

Mr. Awtrey's testimony does not permit the inference that American Specialty failed to advise him that it only had one market for the replacement workers' compensation coverage. Mr. Awtrey testified that American Specialty had told him that it had "another market". The August 14, 1998 Proposal from American Specialty states that American Specialty's program insurer is Fidelity and that "American Specialty is empowered on behalf of USF&G as a program manager to handle underwriting, policy service, and claims for American Specialty's sport/entertainment business." Furthermore, there is evidence in the record that Mr. Awtrey of AON and Mr. Sackett and others with American Specialty were

discussing and reviewing whether or not to issue a replacement workers' compensation policy well prior to the eve of the effective date of Industrial Indemnity's cancellation.

Fidelity responds that Lee retained AON and AON/Albert G. Ruben as its broker of record to obtain workers' compensation insurance and another agent, DiBuduo & DeFendis, to obtain other coverages. Lee notes that the letter appointing AON as Lee's exclusive insurance broker was with respect to the workers' compensation policy issued by Industrial Indemnity and that there is such appointment of AON by Lee with respect to the workers' compensation issued by Fidelity. However, the evidence establishes that AON approached American Specialty about obtaining replacement workers' compensation coverage after Industrial Indemnity cancelled its policy, that Mr. Sackett of American Specialty faxed the August 11, 1998 memo to AON, not Lee, that Mr. Awtrey of AON contacted Lee about American Specialty's concerns, drafted the letter for The Island to respond to American Specialty, and forwarded the signed letter to American Specialty on behalf of Lee, and that AON made direct premium payments to American Specialty. Fidelity further notes that American Specialty was not an independent broker with respect to the Fidelity workers' compensation policy but had an exclusive relationship with Fidelity as its managing general underwriter with respect to workers' compensation policies. Fidelity argues that it was the responsibility of AON and not American Specialty to shop for competing workers' compensation bids as the agent for Lee.

The court cannot conclude as a matter of law that American Specialty owed no duty to Lee and, consequently, denies summary judgment for American Specialty and Fidelity with respect to this counterclaim.[9]

However, the court grants summary judgment for ASRMS. The evidence before the court establishes that ASRMS agreed to provide risk management review in connection with Lee's general liability policy. ASRMS was not involved in the provision of workers' compensation insurance.[10]

b. Second Counterclaim for Fraud and Fourth Counterclaim for Negligent Misrepresentation.

Fidelity and American Specialty move for summary judgment with respect to the Second Counterclaim for Fraud and the Fourth Counterclaim for Negligent Misrepresentation on the grounds that Lee has not established that any misrepresentations were made by American Specialty and/or Fidelity, Lee has not established justifiable reliance on any alleged misrepresentations, and Lee has not established damage resulting from the alleged misrepresentations.

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[9] Fidelity contends that the court dismissed the First Counterclaim against it by the Order filed on March 14, 2001. The court dismissed the First Counterclaim against Fidelity only to the extent that the First Counterclaim alleged that Fidelity was negligent in connection with the Industrial Indemnity workers' compensation policy.

[10] Consequently, the court grants summary judgment for ASRMS on all of the counterclaims alleged against by Lee.

The court denies this motion for summary judgment. For the reasons discussed supra, the facts underlying these counterclaims are disputed.[11]

c. Third Counterclaim for Conspiracy to Defraud.

Fidelity moves for summary judgment with respect to the Third Counterclaim for Conspiracy to Defraud, contending that this claim for relief does not exist under California law.

The court does not agree. The case upon which Fidelity relies, Thompson v. California Fair Plan Assn., 221 Cal.App.3d 760, 767 (1990), does not so hold. Thompson explains:

> A civil conspiracy does not give rise to a cause of action unless a civil wrong has been committed resulting in damage. The elements of an action for civil conspiracy are (1) formation and operation of the conspiracy and (2) damage resulting to plaintiff (3) from an act done in furtherance of the common design ....
>
> To maintain such an action, 'there must be alleged an act in furtherance of the conspiracy which is itself a tort.' ... Civil conspiracy is not a tort but rather a theory of joint liability whereby all who cooperate in another's wrong may be held liable ... In a civil case, liability

[11] Because of this conclusion, the court denies summary judgment for Fidelity on Lee's prayer for punitive damages.

attaches only for action taken pursuant to the conspiracy.

Consequently, the court denies summary judgment for Fidelity on this ground.

d. Fifth Counterclaim for Equitable Indemnity.

The Fifth Counterclaim for Equitable Indemnity alleges:

> 40. As a direct and proximate result of counter-defendants' acts or omissions, defendant LEE has been required to act in the protection of its own interests by defending against the Complaint filed in this action and bringing these counterclaims. LEE is without fault with respect to the matters alleged in the Complaint, and any other claim or action arising directly or indirectly from obtaining the USF&G policy. If and to the extent LEE has any liability for any relief sought in any judicial or administrative proceedings brought against it by any persons or entities with regard to rescission of the USF&G policy or any consequence thereof, including without limitation, the pending Complaint in this action, such liability is purely secondary, imputed, vicarious or technical, and primary liability attached to counter-defendants, and is attributable to their acts and omissions.
>
> 41. Counter-defendants are liable to LEE for indemnity for all costs, including but not limited to costs, expenses, penalties, and damages

> awarded in any legal or administrative actions and attorneys' fees and costs of litigation arising out of the defense of said claims.

Fidelity moves for summary judgment with respect to this counterclaim on the ground that it is a non-sequitur as a matter of law. If Fidelity prevails on the claim for rescission of the workers' compensation policy based on Lee's misrepresentations that caused the issuance of the policy, Fidelity cannot have been at fault and a judgment of rescission will eliminate any such claim.

The court agrees with Fidelity. However, because the court has denied summary judgment for Fidelity on its claim for rescission, the court does not grant summary judgment with respect to this counterclaim.

e. Seventh Counterclaim for Breach of Oral Contract.

The Seventh Counterclaim for Breach of Oral Contract alleges that, after Industrial Indemnity cancelled its workers' compensation policy, "American Specialty acting as the managing general agent of USF&G, contacted AON and assured AON that American Specialty would obtain a replacement worker's compensation insurance policy with equal or better coverage for LEE's operations at The Island" and that counter-defendants breached this oral contract "by failing to obtain coverage for all of The Island's employees and by misrepresenting the terms and coverage provided ...."

The evidence before the court does sustain this allegation. In opposing summary judgment, Lee relies

on the above-quoted statements in the Proposals that American Specialty will use its expertise to insure that Lee's operations are protected against loss and to comply with all legal requirements in order to insure growth and protection of assets as well as Mr. Sackett's statement to Mr. Awtrey that he would obtain replacement coverage. While this evidence is not compelling, the questions of fact that preclude summary judgment on the other counterclaims also preclude summary judgment on this counterclaim.

ACCORDINGLY, IT IS ORDERED that Lee Investments' motion to amend answer is denied.

IT IS FURTHER ORDERED that motion for summary judgment filed by Lee Investments is denied.

IT IS FURTHER ORDERED that the motion for summary judgment filed by United States Fidelity and Guaranty Company, American Specialty Insurance Services, Inc., and American Risk Management Services, LLC is granted in part and denied in part. Specifically, the court grants summary judgment in favor of American Risk Management Services, LLC, and grants summary judgment for Fidelity with respect to the issue of materiality in Fidelity's claim for rescission of the workers' compensation policy.

Dated: July 20, 2004

/s/ Robert E. Coyle

ROBERT E. COYLE
UNITED STATES DISTRICT JUDGE

[Certificate of Service omitted
in printing of this Appendix]

APPENDIX E

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF CALIFORNIA

No. 1:99-cv-5583 OWW SMS

[Filed March 1, 2007]

UNITED STATES FIDELITY & GUARANTY COMPANY, a Maryland corporation,

Plaintiff,

v.

LEE INVESTMENTS LLC dba THE ISLAND, a California Limited Liability Company, RICHARD K. EHRLICH, an individual, REXFORD PROPERTIES, LLC, a California Limited Liability Company, REXFORD DEVELOPMENT CORPORATION, a California corporation, and DIANA CONLEY, an individual,

Defendants.

AND RELATED COUNTERCLAIMS.

PARTIAL JUDGMENT ON JURY'S VERDICTS UPON MULTIPLE CLAIMS INVOLVING MULTIPLE PARTIES (FED.R.CIV.P. 55(b))

This case was tried before a jury commencing January 29, 2007, and concluded upon the return, by the jury, of its verdicts on February 26, 2007. The case involves more than one claim for relief, including counter-claims and third-party claims and involved multiple parties. The parties have reserved, by written stipulation and order: USF&G's alter ego claims against Richard K. Ehrlich, an individual, et al., the determination of the amount of any attorneys' fees and interest claimed by USF&G; and the claim of Aon Risk Services Inc. of Central California Insurance Services ("Aon") for relief based on the tort of another. All other claims of the parties were adjudicated by the jury, including USF&G's claim for rescission based on fraud; all claims of Lee Investments LLC, dba The Island, a California limited liability company. Any claims as to Diana Conley have been determined by the parties' stipulation.

Due to the prior delay in, complexity and contentiousness of this litigation, to avoid uncertainty and inconsistent verdicts, there is no just reason for delay and partial judgment should now therefore be entered.

Based on the jury's written verdicts returned in open court February 26, 2007, the following verdicts were rendered:

A. The jury's verdicts finding in favor of USF&G on its claim for rescission finding fraud and intentional

concealment; finding against Lee on all Lee's defenses of statutory waiver, common law waiver, estoppel, unreasonable delay, wrongful conduct, and awarding USF&G restitution damages in the amount of $875,034.99.

B. On Lee's claims against USF&G, American Specialty and Aon, finding in favor of USF&G, American Specialty, and Aon and against Lee on all Lee's claims for fraud/intentional misrepresentation; concealment; conspiracy; negligent misrepresentation; and negligence. Finding against Lee and in favor of Aon on Lee's claim for breach of an oral contract against Aon. Finding in favor of USF&G, American Specialty and Aon and against Lee on all their defenses to Lee's claims based on fraud of Lee; negligent misrepresentation by Lee; estoppel against Lee; wrongful conduct by Lee; common law waiver against Lee; as to Aon against Lee due to Lee's intentional tort as superseding cause; as to Aon, no unreasonable delay by Lee; and in favor of Aon and against Lee on Aon's defense of assumption of risk.

C. On all Aon's claims against Lee, finding in favor of Aon and against Lee on Aon's claims for intentional misrepresentation, negligent misrepresentation and that Lee was 100% comparatively at fault; in favor of Aon's claim of negligence against Lee; that Aon was not negligent. Finding in favor of Aon and against Lee on all Lee's affirmative defenses to Aon's claims, including fraud, negligent misrepresentation, estoppel, no wrongful conduct by Aon; no common law waiver by Aon, no unreasonable delay by Aon.

Accordingly, on each of these claims and defenses, JUDGMENT IS ENTERED AS FOLLOWS:

1. In favor of USF&G and against Lee for rescission and USF&G shall recover from Lee restitutionary damages of $875,034.99;

2. Against Lee on all Lee's defenses to USF&G's claims for rescission;

3. Against Lee on all its claims and in favor of USF&G, American Specialty and Aon against Lee and in favor of USF&G, American Specialty and Aon on all their affirmative defenses to Lee's claims;

4. In favor of Aon on all its claims and against Lee; and against Lee in favor of Aon on all on Lee's affirmative defenses to Aon's claims; and

5. USF&G, American Specialty and Aon shall recover their costs of suit.

SO ORDERED.

DATED: February 28, 2007.

/s/ Oliver W. Wanger

Oliver W. Wanger
UNITED STATES DISTRICT JUDGE

APPENDIX F

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

NO. 07-15665

D.C. NO. CV-99-05583-OWW/SMS
Eastern District of California, Fresno

[Filed in Court of Appeals August 27, 2007]
[Filed in District Court September 20, 2007]

UNITED STATES FIDELITY AND GUARANTY COMPANY,	)
Plaintiff - Appellee,	)
v.	)
LEE INVESTMENTS LLC, dba The Island	)
Defendant - Appellant,	)
AMERICAN SPECIALTY INSURANCE SERVICES; et al.,	)
Counter-defendants - Appellees,	)

AON RISK SERVICES, INC.,	)
	)
Defendant-third-party-plaintiff-counter-defendant - Appellee.	)
	)

ORDER

Before: SCHROEDER, Chief Judge, KLEINFELD and M. SMITH, Circuit Judges.

The court has received the responses to its May 17, 2007 order to show cause.

This appeal is dismissed for lack of jurisdiction without prejudice to refiling following the entry of final judgment in the district court as to all claims and all parties. *See* Fed. R. Civ. P. 54(b); *Chacon v. Babcock,* 640 F.2d 221 (9th Cir. 1981).

DISMISSED.

A TRUE COPY
CATHY A. CATTERSON
Clerk of Court
ATTEST

SEP 17, 2007
by: /s/ M
Deputy Clerk

MOATT

APPENDIX G

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UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF CALIFORNIA

CASE NO. CIV F-99 5583 OWW-SMS

[Filed November 21, 2008]

UNITED STATES FIDELITY & GUARANTY COMPANY, a Maryland corporation,	)
Plaintiff,	)
v.	)
LEE INVESTMENTS LLC dba THE ISLAND, et al.,	)
Defendants.	)
AND RELATED THIRD PARTY COMPLAINTS AND COUNTERCLAIMS	)

ORDER GRANTING IN PART AND DENYING IN PART MOTION OF LEE INVESTMENTS LLC TO VACATE PARTIAL JUDGMENT ON JURY VERDICT UPON MULTIPLE CLAIMS INVOLVING MULTIPLE PARTIES OR TO ALTER OR AMEND PARTIAL JUDGMENT PURSUANT TO FEDERAL RULES OF CIVIL PROCEDURE 59(e), 60(a) and 60(b) (Document 704)

The Court having considered the motion of Lee Investments LLC (hereinafter "Lee") for an order vacating the "Partial Judgment on Jury's Verdicts Upon Multiple Claims Involving Multiple Parties" (hereinafter "Patrial Judgment") entered herein or, in the alternative to alter or amend the Partial

Judgment, which motion is made pursuant to Federal Rules of Civil Procedure 59(e), 60(a) and 60(b); and

The Court having considered the arguments and authorities of Lee in support of said motion, and the arguments and authorities of United States Fidelity & Guaranty Company (hereinafter "USF&G") and Aon Risk Services, Inc. of Central California Insurance Services (hereinafter "Aon") in opposition to said motion; and

The Court having filed on March 18, 2008, it's "Memorandum Decision Granting In Part and Denying In Part Lee Investments LLC's Motion To Vacate Partial Judgment On Jury Verdict Upon Multiple Claims Involving Multiple Parties Or To Alter Or Amend Partial Judgment Pursuant To Rules 59(e) and 60(a) & (b), Federal Rules of Civil Procedure (Doc. 704)" (hereinafter "Memorandum Decision") which sets forth the rulings of the Court on said motion in detail, the substance and content of which Memorandum Decision are incorporated herein by this reference,

IT IS ORDERED as follows:

1. Lee's motion based on the contention that the Partial Judgment is void and should be vacated on the ground that exclusive jurisdiction over the subject matter of this action lies with the California Workers' Compensation Appeals Board is DENIED;

2. Lee's motion based on the contention that Lee is entitled to judgment as a matter of law on the ground that exclusive jurisdiction over the subject matter of this action lies with the California Workers' Compensation Appeals Board is DENIED;

3. Lee's motion based on the ground that USF&G failed to comply with California law requiring any limitation on coverage afforded under a workers' compensation to be by an approved form of endorsement, and Lee's argument that the Partial Judgment should be vacated, altered or amended on that ground, is DENIED;

4. Lee's motion based on the contention that a workers' compensation policy cannot be rescinded, but can only be cancelled in accordance with California Insurance Code §676.8, is DENIED;

5. Lee's motion based on the ground that Matt Sackett's August 11, 1988 letter (Exhibit 833) was allegedly a condition or exception limiting insurance coverage, and was not, as required by law, clear, plain and conspicuous, is DENIED;

6. Lee's motion based on the contention that Christy Platt's August 12, 1998 letter to Matt Sackett and related communications should have been excluded from evidence under the parol evidence rule is DENIED;

7. Lee's motion based on the contention that USF&G failed to require Lee to provide a signed and completed application for the workers' compensation insurance policy issued by USF&G, and Lee's argument that the Partial Judgment should be vacated, altered or amended on that ground, is DENIED;

8. Lee's motion based on the ground that USF&G and Aon were allegedly required to show, but failed to show, that Lee's employees were engaged in activities

outside of the workers' compensation classification codes contained in the workers' compensation policy issued to Lee by USF&G is DENIED;

9. Lee's motion based on the ground that there was no legally sufficient evidence for a reasonable jury to find that Lee made misrepresentations to Aon, that Lee intended Aon to rely on them, and that Aon relied on them, causing it damages, and that Lee is liable to Aon under the "tort of another" doctrine is DENIED, subject to allocation of recoverable attorneys' fees and costs under the "tort of another" doctrine;

10. Lee's motion to amend the Partial Judgment to require USF&G to return all premiums paid by Lee is DENIED as premature;

11. Lees motion to amend the Partial Judgment by changing references therein from Rule 55(b) of the Federal Rules of Civil Procedure to Rule 54(b) of the Federal Rules of Civil Procedure is GRANTED *nunc pro tunc*;

12. Lee's motion to amend the Partial Judgment to reflect that Lee did not stipulate to the inclusion of an alter ego claim against Richard Ehrlich, et al., but to instead reflect that USF&G was allowed to amend its Complaint to add alter ego allegations against Richard Ehrlich, which claims were severed for trial by Order filed on July 18, 2006 (Document 256, pp. 12-16), is GRANTED *nunc pro tunc*;

13. Lee's motion to amend the Partial Judgment to reflect that Lee did not stipulate to any determination of claims as to Diana Conley is GRANTED *nunc pro tunc*;

14. Lee's motion based on the ground that entry of partial judgment against it for restitution is premature is DENIED; and

15. Lee's motion to clarify that the issue of whether USF&G breached a duty to defend in the WCAB proceedings and in this action is not among the issues disposed of by the Partial Judgment and is reserved for resolution in a future proceeding is GRANTED.

IT IS SO ORDERED.

Dated: November 20, 2008

/s/ Oliver W. Wanger
UNITED STATES DISTRICT JUDGE

APPENDIX H

IN THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF CALIFORNIA

No. CV-F-99-5583 OWW/SMS

[Filed December 2, 2008]

UNITED STATES FIDELITY & GUARANTY COMPANY,	)
Plaintiff,	)
vs.	)
LEE INVESTMENTS LLC dba THE ISLAND, et al.,	)
Defendants.	)

MEMORANDUM DECISION GRANTING MOTION FOR INJUNCTION AGAINST DEFENDANT AND COUNTERCLAIMANT LEE INVESTMENTS LLC FROM PROCEEDING WITH REQUEST FOR ARBITRATION OR OTHER ADJUDICATION OF THE COMPLAINT FOR RESCISSION OF USF&G BEFORE THE WORKERS' COMPENSATION APPEALS BOARD (Doc. 826)

Plaintiff and Counter-Defendant United States Fidelity & Guaranty Company (USF&G) and Counter-

Defendant American Specialty Insurance Services (American Specialty) move for the issuance of an injunction barring Defendant and Counter-Claimant Lee Investments LLC dba The Island (Lee) from pursuing arbitration or other adjudication of USF&G's complaint for rescission before the California Workers' Compensation Appeals Board. USF&G and American Specialty move pursuant to 28 U.S.C. § 1651 and 28 U.S.C. § 2283, on the ground that the injunction is necessary to protect or effectuate the judgment issued in this action by the District Court. This motion is joined by Aon Risk Services, Inc. of Central California (Aon). The motion is opposed by Lee on the merits.

On March 1, 2007, following an extended jury trial, a "Partial Judgment on Jury's Verdicts Upon Multiple Claims Involving Multiple Parties (Fed.R.Civ.P. 55(b))", (Doc. 681), was entered:

> This case was tried before a jury commencing January 29, 2007, and concluded upon the return, by the jury, of its verdicts on February 26, 2007. The case involves more than one claim for relief, including counterclaims and third-party claims and involved multiple parties. The parties have reserved, by written stipulation and order: USF&G's alter ego claims against Richard K. Ehrlich, an individual, et al., the determination of the amount of attorneys' fees and interest claimed by USF&G; and the claim of Aon Risk Services Inc. of Central California Insurance Services ('Aon') for relief based on the tort of another. All other claims of the parties were adjudicated by the jury, including USF&G's claim for rescission based on fraud; all claims of Lee Investments LLC, dba The Island,

a California limited liability company. Any claims as to Diane Conley have been determined by the parties' stipulation.

Due to the prior delay in, complexity and contentiousness of this litigation, to avoid uncertainty and inconsistent verdicts, there is no just reason for delay and partial judgment should now therefore be entered.

Based on the jury's written verdicts returned in open court February 26, 2007, the following verdicts were rendered:

A. The jury's verdicts finding in favor of USF&G on its claim for rescission finding fraud and intentional concealment; finding against Lee on all Lee's defenses of statutory waiver, common law waiver, estoppel, unreasonable delay, wrongful conduct, and awarding USF&G restitution damages in the amount of $875,034.99.

B. On Lee's claims against USF&G, American Specialty and Aon, finding in favor of USF&G, American Specialty, and Aon and against Lee on all Lee's claims for fraud/intentional misrepresentation; concealment; conspiracy; negligent misrepresentation; and negligence. Finding against Lee and in favor of Aon on Lee's claim for breach of an oral contract against Aon. Finding in favor of USF&G, American Specialty and Aon and against Lee on all their defenses to Lee's claims based on fraud of Lee; negligent misrepresentation by Lee; estoppel against Lee; wrongful conduct by Lee; common law waiver

against Lee; as to Aon against Lee due to Lee's intentional tort as superseding cause; as to Aon, no unreasonable delay by Lee; and in favor of Aon and against Lee on Aon's defense of assumption of risk.

C. On all Aon's claims against Lee, finding in favor of Aon and against Lee on Aon's claims for intentional misrepresentation, negligent misrepresentation and that Lee was 100% comparatively at fault; in favor of Aon's claim of negligence against Lee; that Aon was not negligent. Finding in favor of Aon and against Lee on all Lee's affirmative defenses to Aon's claims, including fraud, negligent misrepresentation, estoppel, no wrongful conduct by Aon; no common law waiver by Aon, no unreasonable delay by Aon.

Accordingly, on each of these claims and defenses, JUDGMENT IS ENTERED AS FOLLOWS:

1. In favor of USF&G and against Lee for rescission and USF&G shall recover from Lee restitutionary damages of $875,034.99;

2. Against Lee on all Lee's defenses to USF&G'S claims for rescission;

3. Against Lee on all its claims and in favor of USF&G, American Specialty and Aon against Lee and in favor of USF&G, American Specialty and Aon on all their affirmative defenses to Lee's claims;

> 4. In favor of Aon on all its claims and against Lee; and against Lee in favor of Aon on all on [sic] Lee's affirmative defenses to Aon's claims; and
>
> 5. USF&G, American Specialty and Aon shall recover costs of suit.

Also on March 1, 2007, a "Stipulation and Order Regarding Issues To Be Determined By The Court" was filed, (Doc.682):

> The parties hereto, by and through the undersigned, hereby stipulate and agree that the Court, acting without a jury, will hear and decide the following issues:
>
> > 1. Whether any of Aon's claims against Lee are barred by applicable statutes of limitations;
> >
> > 2. Whether any party is entitled to, and the extent of the reduction in damages, if any, arising from the affirmative defense of failure to mitigate;
> >
> > 3. Whether USF&G is entitled to restitution of any amount in light of Aon and Lee's contention that USF&G did not actually incur the costs or expenses associated with Ms. Conley's injury (i.e. whether USF&G is the real party in interest);
> >
> > 4. The amount, if any, of restitution that USF&G is entitled to recover from Lee

> for fees, costs and expenses paid allegedly to defend Lee in the Worker's Compensation proceeding (and whether USF&G is the real party in interest in relation to this restitution);
>
> 5. The amount, if any, of punitive damages to which Lee is entitled if the jury makes the necessary factual determinations;
>
> 6. If applicable, the amount of damages, if any, Lee suffered and is entitled to recover against any liable party under their fraud, negligent misrepresentation, and negligence claims.
>
> 7. If applicable, the amount of damages, if any, Aon suffered and is entitled to recover against Lee under their fraud, negligent misrepresentation, and negligence claims;
>
> 8. If applicable, the amount of damages Lee suffered and is entitled to recover from Aon for breach of oral contract.
>
> The parties understand and agree to waive their Seventh Amendment right to a jury trial on these issues.

Lee filed three post-trial motions: (1) a motion for new trial; (2) a motion for judgment pursuant to Rule 50(b), Federal Rules of Civil Procedure; and (3) a motion to vacate partial judgment or jury verdicts upon multiple claims involving multiple parties or to

alter or amend the partial judgment pursuant to Rules 59(e) and 60(a) & (b), Federal Rules of Civil Procedure. All of these post-trial motions were denied by memorandum decisions filed on March 18, 2008.[1]

On March 30, 2007, Lee filed a Notice of Appeal from the Partial Judgment. (Doc. 728). On April 18, 2007, an "Order on Request of Parties for Temporary Stay of Appeal Pending Entry of Final Judgment of District Court," (Doc. 770), was filed:

> A bench trial to determine additional issues and damages to complete trial of the action was scheduled for April 4, 2007. That trial was held April 4 through April 7, 2007, and the parties are submitting supplemental authorities and the matter will be finally submitted for decision as of April 30, 2007.
>
> Lee has timely filed and served three post-trial motions in the District Court: 1) a Motion to Vacate or, in the Alternative, to Alter, Amend [sic] the Judgment; 2) a Motion for Judgment as a Matter of Law; and 3) a Motion for New Trial, following the entry of the Partial Judgment on Jury Verdicts. These motions are scheduled to be heard April 30, 2007.
>
> The parties have stipulated and the Court believes that it would be most prudent and

---

[1] Certain technical and nonsubstantive changes were made to the Partial Judgment in the Memorandum Decision issued in connection with Lee's motion to vacate the Partial Judgment or to alter or amend the Partial Judgment.

> would conserve the time, resources and serve judicial economy, for a partial stay of the appeal to be entered pending entry of final judgment following the jury and bench trial on the first and second phase issues.
>
> Respectful request is made that the Court of Appeal enter an interim stay of the appeal in this case of the Jury Verdicts and Partial Judgment pending entry of the Judgment on the issues to be tried to the Court without a jury.

On May 17, 2007, the Ninth Circuit issued an Order stating that "[t]he district court's order challenged in this appeal did not dispose of the action as to all claims and all parties" and that "appellant shall move for voluntary dismissal of this appeal or show cause why it should not be dismissed for lack of jurisdiction." On September 17, 2007, Lee's appeal of the Partial Judgment was dismissed by the Ninth Circuit for lack of jurisdiction. (Doc. 814).

The Court trial conducted on April 4-6, 2007 was fully briefed and proposed findings of fact and conclusions of law and objections thereto submitted by May 2, 2007.

A. Governing Standards.

28 U.S.C. § 1651(a) provides that "[t]he Supreme Court and all courts established by Act of Congress may issue all writs necessary or appropriate in aid of their respective jurisdictions and agreeable to the usages and principles of law."

28 U.S.C. § 2283 provides that "[a] court of the United States may not grant an injunction to stay any proceedings in a State court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments." Here, the injunction is sought "to protect or effectuate" the Partial Judgment entered by this Court on March 1, 2007.

This exception in the Anti-Injunction Act is known as the relitigation exception. *Merle Norman Cosmetics, Inc. v. Victa*, 936 F.2d 466, 468 (9th Cir.1991). As explained in *Brother Records, Inc. v. Jardine*, 432 F.3d 939, 942-943 (9th Cir.2005):

> This exception is grounded in 'the well-recognized concepts of res judicata and collateral estoppel,' . . . and is intended to 'prevent the harassment of successful federal litigants through repetitious state litigation[.]' . . . Thus, the exception permits a district court to enjoin state court litigation if that litigation is barred by the res judicata effect of the district court's earlier judgment.

"[A] decision whether to enjoin a state court proceeding pursuant to the narrow exceptions to the Anti-Injunction Act is committed to the discretion of the district court." *Bechtel Petroleum, Inc. v. Webster*, 796 F.2d 252, 253 (9th Cir.1986). "Doubts as to the appropriateness of an injunction should be 'resolved in favor of permitting the state courts to proceed in an orderly fashion to finally determine the controversy." *Id.* "'We take the view that a complainant must make a strong and unequivocal showing of relitigation of the same issue in order to overcome the federal courts'

proper disinclination to intermeddle in state court proceedings. If we err, all is not lost. A state court is as well qualified as a federal court to protect a litigant by the doctrines of res judicata and collateral estoppel.'" *Id.* As explained in *Blalock Eddy Ranch v. MCI Telecommunications Corp.*, 982 F.2d 371, 375 (9th Cir.1992):

> In determining whether the injunction . . . falls within the scope of the relitigation exception, we first examine whether there could be an actual conflict between the subsequent state court judgment and the prior federal judgment. If such a conflict is possible, then the district court could properly enjoin the state court proceedings . . . However, even if no actual conflict is possible, the injunction could still be proper if res judicata would bar the state court proceedings.

See also G.C. and K.B. Investments, Inc. v. Wilson, 326 F.3d 1096, 1107 (9th Cir.2003).

The essential issue in resolving this motion is the effect of the Partial Judgment entered pursuant to Rule 54(b), Federal Rules of Civil Procedure.[2]

---

[2] Rule 54(b), Federal Rules of Civil Procedure, provides:

> When an action presents more than one claim for relief - whether as a claim, counterclaim, crossclaim, or third-party claim - or when multiple parties are involved, the court may direct entry of a final judgment as to one or more, but fewer than all, claims or parties only if the court expressly determines that there is no just reason for delay. Otherwise, any order or other decision, however

Movants argue that an injunction under the relitigation exception applies to a partial judgment under Rule 54(b).

Movants cite *Rutledge v. Scott Chotin, Inc.*, 972 F.2d 820 (7th Cir.1992). Rutledge brought a suit for personal injuries under the Jones Act, 46 U.S.C. App. § 688, and general maritime law after his claims had been dismissed by the Illinois state court on grounds of forum non conveniens. The District Court granted summary judgment in favor of defendants and enjoined Rutledge from seeking reinstatement of the state court action. The Seventh Circuit held:

> In this case, Chotin's motion for summary judgment had previously been granted on COUNTS I and II, but COUNTS III and IV remained outstanding. Judge Mihm had not yet entered a final judgment on COUNTS I and II under Fed.R.Civ.P. 54(b) at the time Rutledge filed his motion to reinstate in the state court. Judge Mihm did, however, enter a final judgment on COUNTS I and II under Rule 54(b) simultaneously with his order of injunctive relief.
>
> A federal court may employ the relitigation exception to § 2283 in order to protect a final judgment entered under Rule 54(b). *Donelon v.*

---

designated, that adjudicates fewer than all the claims or the rights and liabilities of fewer than all the parties does not end the action as to any of the claims or parties and may be revised at any time before the entry of a judgment adjudicating all the claims and all the parties' rights and liabilities.

> *New Orleans Terminal Co.*, 474 F.2d 1108, 1113 (5th Cir.1973). In *Donelon*, the Fifth Circuit stated that the injunctive order was granted after the court made the partial summary judgment order final under Rule 54(b), but both orders appear to have been entered on the same day. We see no reason for requiring that the district court direct entry of final judgment under Rule 54(b) by a separate order. Since the order directing entry of final judgment on COUNTS I and II was included within the injunction order, Judge Mihm's injunctive order was appropriate . . . as an order to protect or effectuate a final judgment.

972 F.2d at 824-825. *See also* Wright, Miller & Cooper, Federal Practice and Procedure: Jurisdiction 2d § 4226, p.550.

Movants argue that the Partial Judgment bars Lee's attempt at relitigation because the Partial Judgment is res judicata. Movants cite *Continental Airlines, Inc. v. Goodyear Tire & Rubber Company*, 819 F.2d 1519 (9th Cir.1987), and *Acuna v. Regents of University of California*, 56 Cal.App.4th 639 (1997).

In *Continental Airlines*, after a serious accident involving a Continental DC-10 aircraft, Continental filed two suits, one state and one federal. In state court, Continental sued McDonnell Douglas Corporation (MDC) and Sargent Industries, supplier of escape slides. In federal court, Continental sued Goodyear and B.F. Goodrich, each of which had supplied one of the two blown-tires. MDC unsuccessfully attempted to remove the state court action to federal court. When removal was denied for

lack of subject matter jurisdiction, MDC filed a federal declaratory judgment action in which it named Continental, Sargent, Goodyear and Goodrich as defendants, basing jurisdiction on diversity. All federal actions were consolidated. Proceedings in Continental's remanded case continued independently in state court. In early 1985, MDC sought summary judgment in its federal action. At the same time, Continental moved to dismiss or stay MDC's federal action in favor of the state litigation. The District Court denied Continental's motion to dismiss and granted partial summary judgment in favor of MDC, ruling that MDC's exculpatory clause was enforceable under California law and effective against Continental's negligence and strict liability claims as to loss of the aircraft. The partial summary judgment did not reach Continental's fraud or breach of warranty theories of recovery or its passenger indemnification claims. Later in 1985, the District Court also granted partial summary judgment to the parts manufacturers on the basis of its holding that MDC's exculpatory clause barred any action against them for damage to the airplane. On motion by MDC and the parts manufacturers shortly before the state trial was to begin, the District Court certified these partial summary judgments as final for appeal under Rule 54(b). The state court correctly held that these judgments, because certified as final, were res judicata for purposes of the state jury trial. Nevertheless, Continental pursued and prevailed on its fraud/breach of warranty claims for damage to the aircraft, which state court judgment was on appeal in the higher California courts. During the trial, the parties settled passenger indemnity claims. Only the loss of the aircraft remained at issue. 810 F.2d at 1521-1522. On appeal to the Ninth Circuit, Continental challenged

appellate jurisdiction, on the ground that the Rule 54(b) certification of the judgments was an abuse of discretion because the requirements of Rule 54(b) were not met and the purpose of the certifications was to generate a res judicata effect. *Id.* at 1524. After concluding that the Rule 54(b) certification was proper, the Ninth Circuit held:

> This case raises the question, which we believe is novel in this circuit, of whether a 54(b) certification may be awarded for the purpose of procuring res judicata effects elsewhere. At least two circuits have suggested it may . . . Continental would have us hold that a judgment's res judicata effect is an improper consideration in determining whether to certify it for appeal under Rule 54(b). This we decline to do. Because a Rule 54(b) ruling in fact has res judicata ramifications, which are potentially very important, it would be unsound and ineffectual to hold that the district courts may not consider this factor in deciding for or against certification.
>
> We do not wish to encourage the district courts to use their 54(b) powers to promote a race to judgment or to 'snatch from the state courts' a dispute properly litigated there . . . But we would be reluctant to adopt a rule that, in the circumstances of complex parallel state and federal litigation, the district court must either become inactive or incur the risk of wasting its efforts. We hold that an otherwise permissible 54(b) certification designed to produce res judicata effects in another forum was proper under the circumstances.

Id. at 1525.

In *Acuna*, Acuna applied for a tenured position at UCSB. After his application was denied, Acuna filed suit against the Regents and individual University employees in state court alleging violations of the FEHA based on race, ethnicity, and age, employment discrimination based on Acuna's political views and speech, and age discrimination under the ADEA. The action was removed to federal court. The Regents moved to dismiss the state causes of action as barred by the Eleventh Amendment. Acuna filed a cross-motion to remand the FEHA causes of action to state court. The District Court remanded the FEHA causes of action and retained jurisdiction over the ADEA claim. Acuna amended the federal complaint to include causes of action for race and ethnic discrimination under Title VII. The District Court granted summary judgment for the Regents on the Title VII causes of action. Acuna proceeded to trial on the ADEA claim and was awarded damages and attorney's fees against the Regents. Because the ADEA claim did not permit general or punitive damages, the District Court entered judgment for the individual employees under the ADEA claim because they had no personal liability under the ADEA. In the state court action, the Regents and employees were granted summary adjudication on the cause of action for speech discrimination as barred by the statute of limitations. Acuna then filed an amended complaint alleging causes of action for race, ethnic and age discrimination in violation of the FEHA which were identical to the Title VII claims but sought damages under the FEHA. The Regents/individual employees were granted summary adjudication on the FEHA claims as barred by the federal summary judgment. The state trial court stayed the action on

the age discrimination claim until the federal ADEA action was tried. Thereafter, the Regents were granted summary judgment on the FEHA age discrimination claim on the ground that it was barred by the federal judgment against the Regents. The Court of Appeal affirmed the trial court's rulings that the federal judgments barred Acuna's state law claims because they arose from the same primary right. *Id.* at 648-649. The Court of Appeal further ruled:

> Appellant asserts that the federal summary judgment was an interlocutory order and not final. We disagree. "'[A] judgment or order, once rendered, is final for purposes of res judicata until reversed on appeal or modified or set aside in the court of rendition." . . . .' . . . .

Id. at 649-650.

Movants argue that the Ninth Circuit's dismissal of Lee's Rule 54(b) appeal of the Partial Judgment for lack of jurisdiction does not invalidate the Partial Judgment, citing *Tripati v. Henman*, 857 F.2d 1366, 1367 n.1 (9th Cir.1988):

> We note that a pending Rule 59 motion deprives a case of finality for appellate jurisdiction purposes - indeed, this was the reason we remanded action #1 for consideration of the motion . . . This observation does not suggest, however, that a pending Rule 59 motion deprives the judgment of finality for preclusion purposes. *See* 18 C. Wright, A. Miller, & E. Cooper, *supra*, at 4432, p.299 ('it is clear that definitions of finality cannot automatically be carried over from appeals cases to preclusion

> problems'). The policies served by the finality requirement are very different in the two instances. In the case of appellate jurisdiction, the requirement ensures that appellate courts do not waste time reviewing cases whose outcome might change. By setting the point of 'finality' after the disposition of the Rule 59 motion, we save trial courts and appellate courts from duplicating each other's work. In the case of preclusion, the finality requirement ensures that parties have a full opportunity to litigate a claim before they are barred from asserting it again. The claim has already been fully litigated by the time a Rule 59 motion is pending; the considerations of economy underlying preclusion militate in favor of setting the point of 'finality' sooner rather than later.

Lee argues that the Partial Judgment entered under Rule 54(b) is not final and cannot be res judicata. Lee cites *Coopers & Lybrand v. Livesay*, 437 U.S. 463, 467 (1978): "Federal appellate jurisdiction generally depends on the existence of a decision by the District Court that 'ends the litigation on the merits and leaves nothing for the court to do but execute the judgment.'" Lee acknowledges that a final judgment may be entered pursuant to Rule 54(b) that disposes of less than all claims in a pending action or against less than all of the parties if the District Court makes "an express determination that there is no just reason for delay." Lee then sets forth the standards governing Rule 54(b) certification and argues that the Court should not certify the Partial Judgment under Rule 54(b) at this juncture.

Lee's position is baffling. The Partial Judgment was entered and certified by the Court under Rule 54(b). Lee's arguments that certification now would be improper are simply wrong. The Partial Judgment's purpose was to conclude this seemingly endless litigation over insurance coverage. However, as explained in Moore's Federal Practice 3rd, § 54.28[1]:

> A district court has the power to enter a Rule 54(b) judgment with respect to an order that: (1) finally disposes of one or more but fewer than all of the claims for relief; or (2) finally disposes of all of the claims asserted by or against one or more but fewer than all of the parties . . . Rule 54(b) does not and cannot relax in any way the statutory requirement of finality, and by its own terms establishes the minimum unit of disposition. Both requirements are jurisdictional prerequisites to the exercise of the district court's power. If the court enters judgment under Rule 54(b) on an order that is either nor final or does not dispose of at least one claim for relief or all of the claims by or against at least one party, the judgment is beyond the power of the district court, and the court of appeals must dismiss any appeal from the judgment, unless there is some independent basis for appeal of the order.

Lee contends that a Partial Judgment that is not reviewable cannot be the basis for claim preclusion. Lee cites Moore's Federal Practice 3rd § 131.30(2)(c)(i):

> Generally, a ruling that is not appealable cannot be the basis for claim preclusion. Thus, such interim rulings as a finding of liability

> without determination of the appropriate relief, or denial of a summary judgment motion, cannot be the basis for application of the claim preclusion doctrine. Although the concept of a final judgment for purposes of claim preclusion parallels in many respects the requirement under 28 U.S.C. § 1291 for appeals only from 'final decisions' of district courts, the analogy with appealable orders and judgments cannot be carried too far. The Supreme Court has construed the term 'final decision' to embrace some collateral orders the effect of which cannot be rectified on appeal from final judgment. Furthermore, 28 U.S.C. § 1292 provides for appeals of certain interlocutory orders. Even though such matters are 'appealable,' they could not be the basis for claim preclusion.

The Ninth Circuit dismissal of Lee's appeal from the Partial Judgment for lack of jurisdiction simply means that the Court of Appeal found that the existence of undecided claims prevented entry of judgment.

Lee argues that, because subject matter jurisdiction in this action is based on diversity, the Court must apply the preclusion law to the Partial Judgment that the California courts would apply. *See Giles v. General Motors Acceptance Corp*. 494 F.3d 865, 884 (9th Cir.2007), citing *Semtek Int'l Inc. v. Lockheed Martin Corp.*, 531 U.S. 497, 508-509 (2001).

In *Semtek*, a plaintiff, whose claims under California law had been dismissed by the District Court in California as barred by the California statute of limitations, brought an action in Maryland state

court asserting similar claims under Maryland law. The Maryland state court dismissed plaintiff's action on res judicata grounds. The Supreme Court held that the claim preclusive effect of the federal diversity court's dismissal was governed by the federal rule that in turn incorporated the forum state's law of claim preclusion. In so ruling, the Supreme Court cautioned:

> This federal reference to state law will not obtain, of course, in situations in which the state law is incompatible with federal interests. If, for example, state law did not accord claim-preclusive effect to dismissals for wilful violation of discovery orders, federal courts' interest in the integrity of their own processes might justify a contrary federal rule. No such conflict with potential federal interests exists in the present case. Dismissal of this state cause of action was decreed by the California federal court only because the California statute of limitations so required; and there is no conceivable federal interest in giving that time bar more effect in other courts that the California courts themselves would impose.

531 U.S. at 1028-1029.

"The doctrine of res judicata applies only to judgments and orders that are final in the sense that no further judicial act remains to be done to end the litigation. Intermediate determinations, such as rulings on motions and interlocutory orders, are not conclusive." 7 Witkin, California Procedure, Judgment, § 363, p.985. "A judgment or order may be final in nature, but it does not become res judicata until it is final in the other sense of being free from direct attack.

Hence, while an appeal is pending or, though no appeal has yet been taken, the time for appeal has not expired, the judgment is not conclusive." *Id*., § 364. ""California and federal law differ in their definition of finality for purposes of res judicata. The pendency of an appeal precludes finality under California law, but, under federal law and the law of many other states, the pendency of an appeal does not alter the res judicata effect of an otherwise final judgment." . . . ' . . . ." *Nathanson v. Hecker*, 99 Cal.App.4th 1158, 1163 n.1 (2002), quoting *In re Bellucci*, 119 B.R. 763, 768-769 (E.D.Cal.Bkrptcy 1990).

Relying on this authority, Lee contends that the Partial Judgment is not res judicata to the WCAB proceeding and, therefore, "the parallel state action by definition does not seek to relitigate issues that were already finally adjudicated in the federal system and the relitigation exception of the AIA does not apply." This assertion is incomprehensible. The issues surrounding issuance of the insurance policy have been fully litigated and jury verdicts entered. Lee sought a jury trial, and only when the jury decided every issue against Lee, now seeks to avoid the effects of the trial following which the Partial Judgment was entered. It will be the height of judicial waste to permit Lee to yet again, a fourth time, seek to relitigate the issues, going backward to an administrative hearing.

Movants respond that the finality of the Partial Judgment is not determined by state law. They cite *Sosa v. DIRECTV, Inc.*, 437 F.3d 923 (9th Cir.2006). In *Sosa*, DIRECTV sent thousands of demand letters alleging that the recipients had accessed DIRECTV's satellite television signal illegally and would be sued

if they did not quickly settle DIRECTV's claims against them under the Federal Communications Act. Plaintiffs, including Sosa, filed an action in the California Superior Court, referred to as the *Blanchard* case, alleging that the letters constituted extortion and violated California's unfair business practices statute. DIRECTV filed a motion to strike under California's anti-SLAPP statute, which was granted by the state court. Sosa appealed. Thereafter, Sosa filed an action in the District Court against DIRECTV, alleging claims for violation of RICO based on extortion and mail fraud. DIRECTV filed a motion to dismiss, alleging that Sosa failed to state a claim under RICO and that Sosa's claims were barred by various abstention doctrines and the *Noerr-Pennington* doctrine. The District Court granted DIRECTV's motion to dismiss solely on the *Noerr-Pennington* doctrine. Sosa appealed the dismissal to the Ninth Circuit. After the federal action was dismissed but before the hearing on Sosa's appeal, the California Court of Appeal affirmed the anti-SLAPP ruling and the California Supreme Court denied review. DIRECTV argued to the Ninth Circuit that it need not address the merits of the District Court's dismissal because, under the doctrine of res judicata, the state court decision in the *Blanchard case* precludes the District Court case. The Ninth Circuit held:

> Like the federal courts, California courts recognize the rule that where parallel litigation is pending in different tribunals, the first case to reach final judgment is accorded preclusive effect, regardless of the order in which the cases were filed . . . . California and federal law differ, however, with respect to when a judgment rendered by a trial court becomes a 'final

> judgment' for res judicata purposes. 'Under California law, . . . a judgment is not final for purposes of res judicata during the pendency of and until resolution of an appeal.' . . . The judgment in the *Blanchard* litigation is now final, because there has been a decision on appeal as well as the denial of review by the California Supreme Court.
>
> In contrast, '[i]n federal courts, a district court judgment is "final" for purposes of res judicata.' . . . This is so even during the pendency of an appeal . . . Moreover, '[a] federal [district court] judgment is as final in California courts as it would be in federal courts.' . . . .

437 F.3d at 928. Because the District Court reached the merits and entered judgment before the *Blanchard* plaintiffs had exhausted their appeals and because of the differing rules governing the finality of state and federal judgments, the *Blanchard* state case could not be given preclusive effect. *Id.*

Movants also cite *Lumpkin v. Jordan*, 49 Cal.App.4th 1223 (1996). Lumpkin filed suit in state court against the Mayor of San Francisco, alleging employment discrimination on the basis of religion in violation of the FEHA. The state court action was removed to the District Court, the City was added as a defendant, and a claim for deprivation of the right to exercise constitutionally protected religious beliefs in violation of 42 U.S.C. § 1983 was alleged. The District Court granted summary judgment for the Mayor and the City on all claims, except for claims based on the FEHA over which the District Court declined to exercise supplemental jurisdiction. The state FEHA

claims were dismissed without prejudice to refiling in the state court. Lumpkin appealed the summary judgment ruling to the Ninth Circuit. While that appeal was pending, Lumpkin filed his FEHA claims against the Mayor and the City in state court. The Mayor and the City successfully demurred on the ground that the summary judgment ruling was final under federal law and operated as collateral estoppel on the issue of Lumpkin's removal for religious belief. The Court of Appeal affirmed, ruling that all of prerequisites for the application of collateral estoppel were satisfied, i.e., the parties were in privity; the federal summary judgment was a judgment on the merits, and the federal court's ruling on summary judgment, even though appealed, is final under the federal rule. *Id.* at 1230-1231.

Movants argue that *Semtek* is not controlling because *Semtek* had nothing to do with the finality of the federal decision.

The fact that the Ninth Circuit dismissed Lee's appeal from the Partial Judgment for lack of jurisdiction does not preclude application of the relitigation exception. The Partial Judgment is now final on all issues related to the insurance contract. The jury rendered its verdicts and all post-trial motions directed to the jury trial and the jury's verdicts have been decided.

Movants argue that the injunction should issue because a determination by the WCAB of the claim preclusive effect of the Partial Judgment entered on the jury's verdicts does not provide an adequate remedy. Movants point to this Court's extensive familiarity with this case, having litigated it for over

nine years, presided over a five-week jury trial and entered the judgment on the jury's verdicts, and having considered all of the issues in numerous pre-trial and post-trial motions. Movants contend that the claim preclusive effect of the Partial Judgment is determined under federal law. Finally, Movants note that the issue of claim preclusion in the WCAB proceedings, if allowed to go forward, is determined initially by an Administrative Law Judge or, potentially, an attorney arbitrator, whose experience may be limited to workers' compensation matters. Movants contend:

> A determination of res judicata by a workers' compensation arbitrator, whose experience may be solely as an applicant's attorney in workers' compensation matters, is extremely unlikely to involve practitioners with extensive knowledge or experience in the application of federal res judicata law. Although the WCAB arbitration process does provide judicial review through a writ process, such determinations are made based upon extremely relaxed standards, such as whether the decision was not based on substantial evidence . . . Further, the WCAB arbitration process, which involves privately paid arbitrators, is not designed to provide the level of trial testimony and consideration of legal issues of a federal jury trial. Indeed, the arbitrator's fee is subject to a review process if the time spent is believed to be excessive . . . Determination of res judicata by the WCAB does not provide an adequate remedy to protect this Court's judgment.

Lee responds that the WCAB is competent to address all issues related to workers' compensation insurance, including the validity of policies, interpretation of their provisions, and fraud in their procurement. Lee contends that the WCAB is a constitutional court authorized by the California Constitution. It is not a court. It is an administrative tribunal where the right to jury trial is not afforded. Although WCAB proceedings are not overseen by judges with life tenure, their proceedings are subject to oversight by the California Courts of Appeal and the California Supreme Court.

Lee argues that, even if authorized under the AIA, the permanent injunction sought by Movants should not be granted. Lee contends that the injunction should not issue because California has a substantial interest in its workers' compensation scheme. This rings hollow, after nine years and Lee's voluntary election not to actively pursue the state administrative proceeding, but rather to seek huge tort damages remedies in the federal litigation. Lee cites *Daewoo Electronics Corp. of America, Inc. v. Western Auto Supply Co.*, 975 F.2d 474, 478-479 (8th Cir.1992):

> The fact that an injunction may issue under the Anti-Injunction Act does not mean that it must issue. The injunction must be an otherwise proper exercise of the district court's equitable power. Accordingly the district court below found that Western Auto would suffer irreparable harm if injunctive relief were not issued because it would face relitigation of claims already adjudicated in its favor. Daewoo, however, argues for a higher standard. Daewoo argues that before the district court exercised

its equitable power to enjoin a state proceeding, it should have found that Western Auto was 'threatened with great and immediate irreparable injury that cannot be eliminated by his defense to the state court proceeding." *Goodrich v. Supreme Court of South Dakota*, 511 F.2d 316, 317 (8th Cir.1975)(citing *Younger v. Harris*, 401 U.S. 37, 46 . . . (1971).

In *Goodrich*, an attorney admitted to practice in South Dakota brought an action under 42 U.S.C. § 1983 alleging that the state's disbarment procedure violated his constitutional right to due process. We found that the principles of federal-state comity required that this higher standard be meet before the district court could enjoin the state disbarment proceeding. We noted that as a general rule courts of equity, in the exercise of their discretionary powers, should refuse to interfere with or embarrass state court proceedings except in extraordinary cases where the threat of harm is severe and imminent. *Goodrich*, 511 F.2d at 318. Inherent in our reasoning was the understanding that the state has a strong interest in protecting the standards of its bar and in adhering to its disbarment procedure.

In contrast to *Goodrich*, no similarly important state interest is at stake here. The injunction in this case does not threaten the authority of the New Jersey judiciary or state law. Neither does the injunction challenge the processes by which New Jersey compels compliance with the judgments of its courts. New Jersey has no

> interest in the action enjoined by the district court beyond that of adjudicating a wholly private dispute. Accordingly, considerations of comity do not require the district court to apply the *Goodrich* standard here . . . Rather than interfere with New Jersey's interests, the injunction will promote judicial economy and protection of parties from harassing, duplicative litigation, interests which the federal and state courts share.

Lee cites *Tucci v. Club Mediterranee, S.A.,* 89 Cal.App.4th 180, 189-190 (2001), a choice of law case, for the proposition that California has a substantial interest in the welfare and subsistence of disabled workers. In *S.G. Borello & Sons, Inc. v. Department of Industrial Relations,* 48 Cal.3d 341, 354 (1989), the California Supreme Court held that the purposes of the workers' compensation act are several:

> It seeks (1) to ensure that the cost of industrial injuries will be part of the cost of goods rather than a burden on society, (2) to guarantee prompt, limited compensation for an employee's work injuries, regardless of fault, as an inevitable cost of production, (3) to spur increased industrial safety, and (4) in return, to insulate the employer from tort liability for his employees injuries.

Lee, reiterating its position that the WCAB has exclusive jurisdiction over the rescission issue and noting that USF&G agreed to comply with California statutory scheme by issuing workers' compensation insurance in California, argues:

> California's interest in its workers' compensation scheme raises the standard that the Insurers must meet before being entitled to an injunction. This is a hurdle the Insurers cannot meet as it is within the interests of comity and federalism to permit the state courts to continue to refine and control their policies in this area free from the interference of the federal courts.

Lee's argument is based on abstention principles. Lee's motion to dismiss on abstention grounds was denied by Judge Coyle in 1999.

Lee argues that the injunction should be denied because Movants have an adequate remedy at law. Lee cites *Aristud-Gonzalez v. Government Dev. Bank for Puerto Rico,* 501 F.3d 24 (1st Cir.2007). In *Aristud-Gonzalez*, an employee of the Government Development Bank for Puerto Rico brought a Section 1983 suit against the Bank, charging that he had been deprived of his payroll manager position based on his political views in violation of the First Amendment. After the District Court dismissed the Section 1983 action, Aristud brought a new lawsuit in the Puerto Rico Superior Court, again alleging political discrimination in violation of the First Amendment. The Bank moved the District Court for an injunction on the ground that the Superior Court action was an attempt to relitigate matters foreclosed by the federal judgment. The District Court denied the injunction because res judicata and collateral estoppel defenses could be asserted in the Superior Court proceedings and, therefore, there was no irreparable injury and an adequate alternative remedy existed. The First Circuit affirmed:

Some overlap exists between Aristud's two lawsuits but we have no intention of pursuing the issue - and for the same reason as the district judge. True, a federal court can issue an injunction to protect its judgment; this is a conventional ground for equitable relief and an explicit exception to the Anti-Injunction Act . . . , which otherwise limits the ability of federal courts to derail state litigation.

However, the 'protect the judgment' category covers more than one type of case. For example, ancillary injunctive relief is common where a defendant has failed to comply with a prior injunction . . . Injunctive relief incident to an interpleader action is also common - the whole purpose being to avoid inconsistent results in separate lawsuits . . . .

By contrast, the need for an injunction barring a new lawsuit, where relief is sought solely on the ground that the claim has already been litigated in a prior action, takes more justification . . . , and injunctive relief based on issue preclusion would be even rarer. Yes, the judge in the prior case knows the scope of his own litigation, but the judge in the new case has the advantage in assessing its scope. And res judicata in both its forms turns on the relationship between the two lawsuits.

Accordingly, many judges would take the view that, absent unusual circumstances, res judicata is just another defense that ought to be asserted in the new lawsuit; and judges are even more likely to take this view where, as

here, the res judicata question is itself subject to debate and might not yield an all or nothing answer. We ourselves have said that substantial justification should be provided for such intervention . . . .

No doubt some cases will call out for preemption: considerations might be the number and frequency of new suits, whether they are obviously barred by res judicata, the burden imposed by re-litigation in a far away or unfriendly venue, improper motivations for the new suit or suits and the extent to which the res judicata issue turns on judgments that are clearly better able to be made by the first judge. Courts have adverted to such concerns to inform their discretion.

This case has nothing that leaps out as a reason for taking the res judicata issues away from the local court - let alone reasons so compelling that we would think that the district court had abused its discretion. The bank criticizes the district judge for failing to spell out his calculations; but the considerations so plainly supported a decision to leave the matter to the local court that no one needed further explanation and the appeal, although not technically frivolous, is hopeless.

The district judge spoke both of a lack of irreparable injury and of an available remedy of urging res judicata defensively in the new lawsuit. The bank says that the defense against the new lawsuit will cost time and money and that this counts as irreparable injury; it does

> not address the adequate remedy issue but conceivably could argue that it would cost more to litigate in the new case.
>
> Courts sometimes treat the cost of further litigation as an important equitable consideration, sometimes say it is not irreparable injury, and sometimes disregard irreparable injury as a requirement where someone seeks to re-litigate a previously decided issue. Possibly there is some pattern to this contrariety of statements; not all litigation expenses are the same in magnitude or certainty or symmetry as between alternative forums.
>
> In all events, Puerto Rico courts are an alternative forum and any assumption that it would cost less to decide the res judicata issue in the district court is unsupported. If the res judicata issue can be easily resolved, the local court can do that. And, to the extent that res judicata has some application but does not end the local litigation, only one court need tackle the problem rather than two.

501 F.3d at 27-28.

Lee argues that nearly every factor listed in *Aristud-Gonzalez* favors denying Movants' injunction. Lee contends that there is only one prior lawsuit, which was not initiated by Lee; the WCAB proceeding is not barred by res judicata or collateral estoppel because the Partial Judgment is not final; and there is little burden on Movants defending the action before the WCAB because they consented to WCAB

jurisdiction when they sold workers' compensation insurance in California. Lee contends:

> [I]t was the insurers, not Lee who initiated the second action. If anyone has a complaint, it should be Lee. It was, and is, entitled to a prompt and efficient resolution of the issues before the WCAB and it has instead been dragged, kicking and screaming, for years in this federal proceeding. Accordingly, there are no improper motivations for the WCAB action. Any additional cost in continuing dual federal/state litigation is minimal in light of the costs the parties have incurred to date. The cost of complying with state law in finishing the WCAB action cannot serve as the basis of irreparable harm to a workers' compensation insurer and broker.

Lee's revisionist assertion that it was dragged kicking and screaming into the federal litigation is categorically belied by the record. Although Lee did join Diana Conley's initial motion to dismiss, Lee did not join in her subsequent motion for reconsideration and filed counterclaims in this action and moved for summary judgment in 2001. Lee did not even seek arbitration before the WCAB until 2006.

Lee further opposes the requested injunction on the ground that Movants have unclean hands. Lee asserts:

> USF&G, by machinations in the WCAB, led Lee to believe that attorney Giesler was hired by USF&G to serve as primary counsel for Lee in the WCAB proceedings. As the primary counsel, Giesler should have protected Lee in those

> proceeding [sic] and kept Lee and its independent counsel appropriately informed regarding conflicts of interest between Lee and USF&G which would have required an intervention of independent counsel in the WCAB proceedings. Because Lee did not receive a single correspondence from Giesler or his firm and because Giesler told Lee's counsel, James Sherwood, that the WCAB proceedings were stayed, Lee was under the reasonable impression that the WCAB stayed its proceedings. Otherwise Sherwood would have taken every opportunity to advance Lee's interest in those proceedings. Due to Giesler's apparent loyalty to only one of its clients, USF&G, he took no action to protect Lee and prosecute the action before the WCAB.
>
> Moreover, USF&G intentionally subjected Lee to economic duress by compelling Lee to remain in federal court, and for several years, even paid Lee's defense costs in federal court, only to stop paying fees near the time of expert discovery. USF&G's action were performed for the purpose of it advancing its own interests above that of its insured Lee. USF&G's actions were taken in bad faith and USF&G should be denied equitable relief it seeks due to its unclean hands.

Lee asserts that the Court should deny the injunction on purely legal grounds but that, if the Court reaches the issue of USF&G's actions, Lee requests "a full evidentiary hearing before a permanent injunction is issued." Lee does not identify any unresolved evidentiary issues that require such a hearing.

With regard to the disqualification of Mr. Giesler, Lee filed a motion for disqualification on September 22, 2007 (Doc. 271). The motion was opposed and argued and denied on the record by the Court from the bench on November 14, 2006 (Doc. 363).

Movants argue that the injunction should issue because allowing the arbitration to go forward will violate Movants' Seventh Amendment rights by relitigating a jury's determinations of fact.

Movants cite *Lytle v. Household Mfg., Inc.* 494 U.S. 545 (1990). In *Lytle*, the plaintiff filed an action under Title VII and 42 U.S.C. § 1981, alleging that defendant had terminated his employment because of his race and had retaliated against him for filing a charge with the EEOC by subsequently providing inadequate references to prospective employers. Plaintiff requested a jury trial on all issues triable by a jury. The District Court dismissed the Section 1981 claims on the ground that Title VII provided the exclusive remedy and conducted a bench trial on the Title VII claims. It granted defendant's motion to dismiss the discriminatory discharge claim pursuant to Rule 41(b) at the close of plaintiff's case in chief and entered a judgment for defendant on the retaliation claim after both parties had presented all their evidence. The Court of Appeals affirmed but noted that the dismissal of the Section 1981 claims was apparently erroneous because Title VII and Section 1981 remedies were separate, independent and distinct. Nonetheless, the Court of Appeals ruled that the District Court's findings with respect to the Title VII claims collaterally estopped plaintiff from litigating his Section 1981 claims because the elements of a cause of action under the two statutes are identical. The Court

of Appeals rejected plaintiff's claim that the Seventh Amendment precluded affording collateral estoppel effect to the District Court's findings, reasoning that the judicial interest in economy of resources overrode plaintiff's interest in relitigating the issues before a jury. The Supreme Court reversed:

> We decline to extend *Parkline Hosiery Co.* . . . and to accord collateral-estoppel effect to a district court's determinations of issues common to equitable and legal claims where the court resolved the equitable claims first solely because it erroneously dismissed the legal claims. To hold otherwise would seriously undermine a plaintiff's right to a jury trial under the Seventh Amendment.

494 U.S. at 555. Relying on *Lytle*, Movants argue:

> This Court should similarly preserve this plaintiff's right to trial by jury by not allowing those same issues to be relitigated by an arbitrator and administrative law judge. Further, allowing Lee to proceed in the WCAB may be futile because any determination by the WCAB cannot have res judicata effect because previously determined by a jury. A [sic] noted by the *Lytle* Court, collateral estoppel cannot be used to deny a plaintiff his right to a jury trial.

Movants also cite *Hughes v. Atlantic Pacific Construction Co.*, 194 Cal.App.3d 987, 1003 (1987), holding, *inter alia*:

> [S]ince a workers' compensation proceeding gives an employer no right to a jury trial, were

> it applied in the case at bench, the res judicata doctrine would deny the defendant its constitutional right concerning a key issue upon which liability turns.

See also Kelly v. Trans Globe Travel Bureau, Inc., 60 Cal.App.3d 195, 202 (1976):

> A jury trial is not available to the employer in the workers' compensation case. If a determination of scope of employment in that proceeding is deemed collaterally to estop the employer from denying the scope of employment when a third person asserts it as a basis for vicarious liability of the employer, the employer is denied his California constitutional right . . . to a jury trial on a key issue on which his liability turns.

Movants assert that "[t]hose courts undoubtedly would be more likely to deny collateral estoppel or res judicata effect where the party already had a jury trial."

Lee apparently misunderstands Movants' Seventh Amendment argument because Lee refers to cases upholding workers' compensation statutes against challenges based on the contention that the statutory scheme does not provide a right to jury trial. Movants contend that "[u]nder controlling precedent, once the jury has reached a decision, a party cannot undercut that determination through subsequent relitigation by

a judge, let alone by an arbitrator or administrative judge."[3]

It is undeniable that the change of emphasis from the federal action to the WCAB proceedings did not occur until Mr. Jamison and other attorneys associated with Dowling, Aaron & Keeler, Inc., entered the case on April 7, 2005 before the transfer of the action from Judge Coyle's docket to Judge Wanger's docket on December 19, 2005. Yet, Lee asserted numerous tort claims in the federal action for which it sought substantial monetary recovery. Richard Ehrlich is reported to have said he will never pay a penny of the judgment in his lifetime. Lee's strategy is delay and

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[3] On October 20, 2008, Lee filed a "Notice of Claim of Unconstitutionality of State Law," (Doc. 848), contending that Movants claim that the Workers' Compensation Act unconstitutionally denies them a right to a jury trial, and giving notice as required by Rule 24-132(b), Local Rules of Practice:

> If, at any time in an action to which neither a State nor any of its officers, agencies, or employees are a party, any party draws in issue the constitutionality of any state administrative regulation of general applicability, that party shall immediately file a notice with the Clerk identifying the regulation in issue and setting forth in what respects its constitutionality is questioned. Thereupon, or sua sponte, the Court shall serve a copy of that notice on the Attorney General of the State and on all other parties. If the party required to file such a notice fails to do so, every other party shall file and serve such notice, provided that as soon as a notice is filed and served, all other parties are relieved of this obligation.

Lee's notice is meritless; Movants do not challenge the constitutionality of the Workers' Compensation Act.

convolution to keep the federal judgment from having effect and being enforced.

The sole purpose of the WCAB arbitration is to decide the *exact* issue that has been fully litigated after an extended jury trial to final Partial Judgment in the federal court. There is no constitutional right to have such an administrative decision made by an arbitrator of what has already been fully tried to verdict and final judgment before a federal jury. There has to be a way to stop this and enter a final appealable judgment in this case.

CONCLUSION

For the reasons stated:

1. Movants' motion for injunction against Defendant and Counterclaim Lee Investments LLC from proceeding with its request for arbitration or other adjudication of USF&G's complaint for rescission before the Workers' Compensation Appeals Board is GRANTED;

2. Counsel for Movants shall prepare and lodge a form of order that reflects the rulings made in this Memorandum Decision within five (5) days following the date of service of this decision by the Court's Clerk.

IT IS SO ORDERED.

Dated: December 1, 2008

/s/ Oliver W. Wanger
UNITED STATES DISTRICT JUDGE