

1 Court, County of San Diego. The Complaint alleged two claims against Starr for
2 breach of contract and breach of the duty of good faith and fair dealing. The third
3 cause of action for negligence is asserted only against “DOE AGENTS/BROKERS.”¹

4 Plaintiffs are managing members of John DeWald and Associates, LLC (“JDA”),
5 a real estate development company. JDA has had only two members, Kelly and
6 DeWald, and has had only one employee for a short period of time in 2008 or 2009.
7 DeWald would largely manage the entitlements, permitting, construction and other
8 aspects of real estate development projects. While both Plaintiffs would work to obtain
9 financing for the development projects, Kelly would primarily prepare the prospectus,
10 or pro forma documents, regarding potential returns on investments. DeWald would
11 use his experience in construction to carry out his responsibilities with regard to design
12 and construction. Typically, for each project, Plaintiffs would form a limited liability
13 corporation (“LLC”), generally with the project’s name, with JDA serving as the
14 project manager. JDA was generally responsible for designing, constructing,
15 marketing, and obtaining financing through investors and banks. Private loans were
16 usually obtained in exchange for a promissory note with the development LLC, which
17 provided the lender with interest on the loans.

18 The 2010 Brehnan Demand

19 Brehnan was one of the investors in several JDA development projects. On
20 August 12, 2010, Brehnan emailed Plaintiffs and identified two delinquent promissory
21 notes and two notes coming due within several weeks (the “Promissory Notes”).²
22 Brehnan also informed Plaintiffs that “I would like to try not to proceed with legal
23 remedy . . . as being recommended by my legal team.” The loans were restructured in
24 August 2012, and ultimately resolved through settlement in a state court action between
25 Brehnan and Plaintiffs. The settlement consisted of Plaintiffs paying a discount on the
26

27 ¹ Doe defendants are not considered for federal pleading purposes. See Navarro
28 Sav. & Loan Ass’n v. Lee, 446 U.S. 458, 460-61 (1980).

² The balance owed on the Promissory Notes exceeded \$400,000.

1 outstanding balance of the Promissory Notes.

2 The Application and Policy for Insurance

3 In May 2011, Plaintiffs executed the Application for Insurance (“Application”)
4 for a directors and officers liability policy. The Application asked the insureds to
5 confirm that:

6 (a) No person or entities for whom this insurance is being applied have
7 any knowledge of any fact, circumstance, situation, or information of any
8 error, misstatement, act, omission, neglect, breach of duty or other matter
that may give rise to a Claim which may fall within the scope of coverage
of the proposed insurance.

9 (b) No person(s) or entity(ies) proposed for whom this insurance is being
10 applied for has knowledge of any inquiry, investigation or communication
that he/she/it has reason to believe might give rise to a Claim that might
11 fall within the scope of coverage of the proposed insurance.

12 (Starr Exh D, Barrett Decl., Exh. 14, ST01710). The insureds responded “no” to both
13 questions. The Application does not define the term “claim.” The Application also
14 provided:

15 IT IS AGREED THAT IF SUCH KNOWLEDGE OR INFORMATION
16 EXISTS WITH REGARD TO QUESTIONS 9 a), b), c), REGARDLESS
17 OF WHETHER IT IS DISCLOSED IN THIS APPLICATION, ANY
18 CLAIM BASED UPON, ARISING FROM, OR IN ANY WAY
19 RELATING TO SUCH ERROR, MISSTATEMENT, MISLEADING
20 STATEMENT, ACT, OMISSION, NEGLIGENCE, BREACH OF DUTY, OR
OTHER MATTER OF WHICH THERE IS KNOWLEDGE OR
INFORMATION SHALL BE EXCLUDED FROM COVERAGE
UNDER THE INSURANCE BEING APPLIED FOR AND THE
INSURER SHALL NOT BE LIABLE FOR SUCH LOSS AND, TO THE
EXTENT THIS POLICY PROVIDES DUTY TO DEFEND
COVERAGE, THE INSURER SHALL HAVE NO DUTY TO DEFEND.

21 (Starr Exh D, Barrett Decl., Exh. 14, ST01711).

22 Effective May 11, 2011, for the period from May 11, 2011 to May 11, 2012,
23 Starr issued its Resolute Portfolio For Private Companies, including a Directors &
24 Officers Liability Coverage section (the “Policy”). The Policy’s limit of liability was
25 \$1,000,000, and only provided directors and officers liability coverage. The Policy
26 expressly referred to and incorporated the Application and, among other terms and
27 conditions, provided: “The Insurer has the right and duty to defend any Claim against
28 any Insured covered under this policy, even if such Claim is false, fraudulent or

1 groundless”

2 The Tender

3 On November 17, 2011, Plaintiffs, through counsel, notified Starr of a November
4 2, 2011 demand letter received from Brehnan. The demand letter identified Plaintiffs’
5 default under the terms of the four Promissory Notes. The demand letter also identified
6 several misrepresentations made by Plaintiffs concerning anticipated payments on the
7 Promissory Notes and informed Plaintiffs, “Your clients’s actions give rise to several
8 civil causes of action that Dr. Brehnan may bring against [Plaintiffs], including breach
9 of contract, breach of fiduciary duties, fraud, and securities fraud.”³

10 On January 30, 2012, Starr agreed to provide a defense for the Brehnan claims
11 under a reservation of rights while it performed an investigation. On April 17, 2012,
12 Starr was provided with a copy of a draft complaint that Brehnan threatened to file. In
13 a free-flowing, exaggerated, conclusory style of pleading, the proposed complaint
14 alleged 30 causes of action including five breach of contract claims (four are related
15 to the unpaid Promissory Notes), five breach of the covenant of good faith claims,
16 breach of fiduciary duty, fraud, promissory fraud, securities fraud, conversion,
17 negligence, negligent misrepresentation, money due on default, constructive trust,
18 rescission, declaratory relief, two claims for quiet title, accounting, fraud by
19 concealment, unfair business practices, injunctive relief, money had and received, and
20 two counts for violations of RICO.

21 On May 3, 2012, Starr denied coverage in a lengthy analysis letter. Among other
22 things, coverage was denied on grounds that the failure to disclose the claim on the
23 Application defeats coverage, coverage is barred by the prior knowledge exclusion, the
24 claim was first made before the Policy incepted, and the claim is barred by the
25 professional services exclusion.

26 On August 9, 2012, in the Superior Court of California, County of San Diego,

27 _____
28 ³ Plaintiffs represent that JDA suffered from the general economic downturn in
2008 and 2009. One consequence of the economic downturn resulted in the reduced
ability of the real estate development industry to obtain financing. (PUF 32-34).

1 Brehnan filed a complaint against Plaintiffs, JDA, and several entities related to
2 Plaintiffs. The complaint alleged 18 claims for breach of contract, breach of fiduciary
3 duty, promissory fraud, negligent misrepresentation, intentional misrepresentation,
4 securities fraud, negligence, conversion, money due on default, constructive trust,
5 rescission, declaratory relief, money had and received, and accounting. Plaintiffs re-
6 tendered this complaint to Starr. On or about December 7, 2012, Starr provided an
7 additional analysis and again denied coverage. Ultimately, in December 2013,
8 Plaintiffs and Brehnan settled their dispute based upon a discount to the outstanding
9 balance on the Promissory Notes.

10 Procedural History

11 On November 20, 2015, Plaintiffs commenced this action in the Superior Court
12 of California, County of San Diego. On December 23, 2015, Starr removed the action
13 to this court, alleging diversity subject matter jurisdiction. The parties have completed
14 discovery and trial is scheduled to commence on October 16, 2017.

15 **DISCUSSION**

16 **Legal Standards**

17 A motion for summary judgment shall be granted where “there is no genuine
18 issue as to any material fact and . . . the moving party is entitled to judgment as a matter
19 of law.” FED. R. CIV. P. 56(c); Prison Legal News v. Lehman, 397 F.3d 692, 698 (9th
20 Cir. 2005). The moving party bears the initial burden of informing the court of the
21 basis for its motion and identifying those portions of the file which it believes
22 demonstrate the absence of a genuine issue of material fact. Celotex Corp. v. Catrett,
23 477 U.S. 317, 323 (1986). There is “no express or implied requirement in Rule 56 that
24 the moving party support its motion with affidavits or other similar materials negating
25 the opponent’s claim.” Id. (emphasis in original). The opposing party cannot rest on
26 the mere allegations or denials of a pleading, but must “go beyond the pleadings and
27 by [the party’s] own affidavits, or by the ‘depositions, answers to interrogatories, and
28 admissions on file’ designate ‘specific facts showing that there is a genuine issue for

1 trial.” Id. at 324 (citation omitted). The opposing party also may not rely solely on
2 conclusory allegations unsupported by factual data. Taylor v. List, 880 F.2d 1040,
3 1045 (9th Cir. 1989).

4 The court must examine the evidence in the light most favorable to the non-
5 moving party. United States v. Diebold, Inc., 369 U.S. 654, 655 (1962). Any doubt
6 as to the existence of any issue of material fact requires denial of the motion. Anderson
7 v. Liberty Lobby, Inc., 477 U.S. 242, 255 (1986). On a motion for summary judgment,
8 when “the moving party bears the burden of proof at trial, it must come forward with
9 evidence which would entitle it to a directed verdict if the evidence were
10 uncontroverted at trial.” Houghton v. South, 965 F.2d 1532, 1536 (9th Cir. 1992)
11 (emphasis in original) (quoting International Shortstop, Inc. v. Rally's, Inc., 939 F.2d
12 1257, 1264-65 (5th Cir. 1991), cert. denied, 502 U.S. 1059 (1992)).

13 **The Cross Motions**

14 The issues raised by the parties are fairly joined. Plaintiffs seek summary
15 adjudication on Starr’s duty to defend. Starr submits that the court does not reach
16 Plaintiffs’ summary adjudication issue because (1) Plaintiffs failed to disclose the
17 Brehnan demand for payment (\$418,000) in the Application; (2) the Brehnan demand
18 was a claim first made before the inception of the policy period; and (3) the
19 Professional Services Exclusion precludes coverage for Plaintiffs’ claims because the
20 Brehnan action sought recovery of a business debt, a business related and non-covered
21 claim under the policy.

22 Disclosure of the 2010 Brehnan Demand

23 Starr argues that it properly denied coverage because Plaintiffs failed to disclose
24 the 2010 Brehnan demand for payment in JDA’s May 2011 Application. The
25 Application asked Plaintiffs to confirm the following:

26 (a) No person or entities for whom this insurance is being applied have
27 any knowledge of any fact, circumstance, situation, or information of any
28 error, misstatement, act, mission, neglect, breach of duty or other matter
that may give rise to a Claim which may fall within the scope of coverage
of the proposed insurance.

1 (b) No person(s) or entity(ies) proposed for whom this insurance is being
2 applied for has knowledge of any inquiry, investigation or communication
3 that he/she/it has reason to believe might give rise to a Claim that might
4 fall within the scope of coverage of the proposed insurance.

5 (Starr Exh D, Barrett Decl., Exh. 14, ST01710). JDA responded “no” to both
6 questions. The Application also provided:

7 IT IS AGREED THAT IF SUCH KNOWLEDGE OR INFORMATION
8 EXISTS WITH REGARD TO QUESTIONS 9 a), b), c), REGARDLESS
9 OF WHETHER IT IS DISCLOSED IN THIS APPLICATION, ANY
10 CLAIM BASED UPON, ARISING FROM, OR IN ANY WAY
11 RELATING TO SUCH ERROR, MISSTATEMENT, MISLEADING
12 STATEMENT, ACT, OMISSION, NEGLIGENCE, BREACH OF DUTY, OR
13 OTHER MATTER OF WHICH THERE IS KNOWLEDGE OR
14 INFORMATION SHALL BE EXCLUDED FROM COVERAGE
15 UNDER THE INSURANCE BEING APPLIED FOR AND THE
16 INSURER SHALL NOT BE LIABLE FOR SUCH LOSS AND, TO THE
17 EXTENT THIS POLICY PROVIDES DUTY TO DEFEND
18 COVERAGE, THE INSURER SHALL HAVE NO DUTY TO DEFEND.

19 (Starr Exh D, Barrett Decl., Exh. 14, ST01711).

20 The Application does not define the term “claim.” “In construing the language
21 of an insurance policy, a court should give the words used their plain and ordinary
22 meaning, unless the policy clearly indicates to the contrary When the language is
23 clear, a court should not give it a strained construction to impose on the insurer a
24 liability it has not assumed” Giddings v. Industrial Indemnity Co., 112 Cal.App.3d
25 213, 218 (1980). A claim need not be actual, only potential. While the definition of
26 “claim” varies with context, the ordinary definition of “claim” is “the assertion of a
27 liability of the party, demanding that the party perform some service or pay some
28 money.” Abifadel v. Cigna Ins. Co., 8 Cal.App. 4th 145, 160 (1992) (ordinary
definition of “claim” applied to a claims made insurance policy where that term was
not defined in the policy).

In Abifadel, the Court of Appeal addressed and defined the term “claim,” in
context of a claims made policy:

In defining “claims,” the law focuses on the claimant's formal demands
for service or payment and does not recognize a request for an
explanation, the expression of dissatisfaction or disappointment, mere
complaining, or the lodging of a grievance as a claim. In both its ordinary
meaning and in the interpretation given to it by other courts in similar
circumstances, a claim is a demand for something as a right or as due. A

1 formal lawsuit is not required before a claim is found to have been made.

2 Id. In short, “a claim is a demand for something as a right or as due.” Id.

3 Starr asserts that Brehnan made a claim against Plaintiffs when, on August 12,
4 2010, JDA received an email from him stating that two promissory notes were
5 delinquent, with an outstanding balance of \$107,250, and two notes were due in
6 September 2010, with a balance due of \$316,106. (Kelly Exh. 4). The email
7 concluded, “I expect all of these Notes to be paid off at beginning of September 2010.
8 I would like to try not to proceed with legal remedy . . . as being recommended by
9 my legal team.” Id. Kelly testified that at the time of the email Brehnan was
10 threatening legal action if the Promissory Notes were not paid, and that this was the
11 first time Brehnan had threatened legal action. (Kelly Depo. pp.180-187).

12 On this undisputed record, the court concludes that Plaintiffs had knowledge that
13 Brehnan had asserted JDA’s liability for the non-payment of the Promissory Notes.
14 Contrary to the representations in the Application that Plaintiffs were unaware of any
15 fact or circumstance that might lead to a claim, the Brehnan 2010 demand provided
16 Plaintiffs with notice of a claim, whether actual or potential, arising from the
17 Promissory Notes that could give rise to liability. Furthermore, had Starr known of the
18 risks associated with the Promissory Notes, it would not have issued the Policy.
19 (Barret Decl. ¶2). Accordingly, claims arising out of or related to the Promissory
20 Notes fall outside the policy’s coverage scope.

21 Plaintiffs contend that the August 10, 2010 Brehnan demand letter is not a claim.
22 Rather, the Brehnan demand letter should be analogized to the simple receipt of a bill.
23 The mere receipt of a bill is insufficient, Plaintiffs contend, because “there must be a
24 demand for money on account of some wrongful act.” (Oppo. at p.13:22-23). The
25 court rejects this and similar arguments. While the mere receipt of a bill is not a claim,
26 the failure to pay a bill, like a promissory note, ripens into a claim when the bill
27 remains unpaid and, like here, collection efforts are threatened or commenced. The
28 August 10, 2010 Brehnan demand identified delinquent payments on two of the

1 Promissory Notes, noted that two of the Promissory Notes came due in two weeks, and
2 threatened legal action because of non-payment. Moreover, Plaintiffs knew that all
3 four Promissory went unpaid until Brehnan and JDA determined to restructure the
4 Promissory Notes two years later in August 2012, after the Policy period. The court
5 also rejects Plaintiffs' argument that a claim is valid only if "a demand [is] made on the
6 officer or director for money owed on account of a wrongful act." (Oppo. at p.13:27-
7 28). This proposed definition of "claim," requiring service of a demand on an officer
8 or director, is inconsistent with Abifadel, 8 Cal.App. 4th at 160.

9 The court also rejects Plaintiffs' contention that the language in the Application
10 is ambiguous. In the Policy, Plaintiffs represented that they were unaware of "any fact,
11 circumstance, situation, or information of any error, misstatement, act, mission, neglect,
12 breach of duty or other matter that may give rise to a Claim which may fall within the
13 scope of coverage of the proposed insurance." (ST01710). This language is
14 sufficiently clear and concise. See Phoenix Ins. Co. v. Sukut Construction Co., 136
15 Cal.App.3d 673 (1982) (finding phrase, "might be expected to be the basis of a claim
16 or suit" "perfectly clear" and unambiguous). Also unavailing is Plaintiffs' argument
17 that the non-rescindability clause in the Policy somehow results in the waiver of the
18 provisions in the Application. It is well established that rescission is not an exclusive
19 remedy. See Williamson & Vollmer Engineering, Inc. v. Sequoia Ins. Co., 64
20 Cal.App.3d 261, 276 (1976).

21 The court turns to examine whether the November 2011 tender encompasses the
22 claims related to or arising from the Promissory Notes.

23 The Tender

24 On November 2, 2011, Brehnan's counsel memorialized previous discussions
25 regarding the four delinquent Promissory Notes, identified potential causes of action
26 related to the non-payment of the Promissory Notes, and once again offered to settle
27 all claims against JDA for \$750,000, instead of the previous demand for \$400,000. The
28 letter stated:

1 On July 12, 2011, Dr. Brehnan notified your clients that all four of
2 the outstanding promissory notes totaling more than \$400,000, were in
3 default, and he offered to compromise his claims on them for \$378,000.
That offer was not accepted and has expired.

4 (JDA Exh. 4). In addition to identifying the unpaid Promissory Notes, the letter set
5 forth several instances where Plaintiffs allegedly misrepresented that payments on the
6 Promissory Notes would be forthcoming as other properties of JDA were sold, and
7 funds received would be applied to the outstanding balance of the Promissory Notes.
8 The letter also identified an alleged February 2011 scheme to defraud Brehnan and
9 other investors in the Oceanside Bluffs project. Id. These latter events predate the
10 Policy period.

11 On November 17, 2011, JDA notified Starr of Brehnan's demand. On January
12 30, 2012, Starr agreed to provide a defense under a reservation of rights. (JDA Exh.
13 5). Plaintiffs received a draft complaint from Brehnan and, on April 13, 2012,
14 forwarded the complaint to Starr. In shotgun fashion, the conclusory draft complaint
15 alleged 30 causes of action arising from the failure to comply with the terms of the
16 Promissory Notes and misrepresentations made in connection with payment on the
17 Promissory Notes. The draft complaint alleged that the Promissory Notes and interest
18 remained unpaid. (JDA Exh.7).

19 On May 3, 2012, Starr disclaimed coverage, largely based upon the failure to
20 disclose the August 2010 Brehnan demand and, with respect to allegations of
21 mismanagement of Brehnan's investments, based upon the professional services
22 exclusion. (JDA Exh. 8). On August 9, 2012, Brehnan filed a slimmed-down version
23 of the draft complaint in the Superior Court, County of San Diego. (JDA Exh. 12). As
24 with the earlier draft complaint, Brehnan's claims arose from the nonpayment of the
25 Promissory Notes and misrepresentations related to, or arising from, promises for
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1 payment or payment terms related to the Promissory Notes.⁴ Plaintiffs re-tendered
2 Brehnan's claim to Starr and, on September 17, 2012, Starr analyzed each claim in the
3 complaint and again denied coverage for essentially the same reasons as earlier stated.
4 (JDA Exh. 13).⁵

5 Based upon the undisputed factual record submitted by the parties, the court
6 concludes that Plaintiffs' failure to disclose the Brehnan 2010 demand was a claim first
7 made before the inception date of the Policy. As outlined in the November 2, 2011
8 Brehnan demand letter, the non-payment of the delinquent Promissory Notes led to
9 representations related to payment terms on the Promissory Notes by Plaintiffs and
10 form the basis for Brehnan's alleged claims for "breach of contract, breach of fiduciary
11 duties, fraud, and securities fraud." (Starr Exh. E at p.3). As the claim was one that
12 had to be disclosed per the express terms of the Application, the Brehnan claims
13 tendered for defense to Star predated the inception of the Policy period and are not,
14 therefore, a covered claim. Moreover, by its very nature, "a claims made policy limits
15 coverage to claims made against the insured during the policy period." Homestead Ins.
16 Co. v. American Empire Surplus Lines Ins. Co., 44 Cal.App.4th 1297, 1304 (1996).
17 "To extend coverage to claims made against the insured [before or] after the policy
18 period would contradict the purpose of claims made policies, impair the well
19 documented 'social utility' of these policies, and would add a term to the [claims made]

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23 ⁴ The court notes, for example, that the securities claim is based upon Plaintiffs'
24 misrepresentation that "they would pay Mr. Brehnan for his investments and loans
25 associated with said real estate projects." (JDA Exh.13 ¶142). In other words, the
26 securities claim is based upon the nonpayment of the Promissory Notes, claims arising
27 before the inception of the Policy period, not disclosed in the Application, and
excluded as a claim arising before the inception date of the Policy or by the
professional services exclusion, to the extent Brehnan alleged mismanagement of his
investments.

28 ⁵ Ultimately, Plaintiffs and Brehnan settled their dispute for \$350,000. (Compl.
¶32). DeWald stated that this amount represented a discount to the outstanding balance
on the Promissory Notes. (Starr Exh. D, DeWald Depo at pp.185:17-186:24).

1 policy for which the parties had not bargained.” Id. at 1305-06.⁶

2 In sum, the court grants Starr’s motion for summary judgment on all claims
3 alleged in the complaint because the Brehnan claims arose prior to the policy period.⁷

4 Plaintiffs’ Motion for Summary Judgment

5 In light of the court’s determination that coverage does not extend to the
6 Brehnan claims, there was no duty to defend. Accordingly, the court denies Plaintiffs’
7 motion for partial summary judgment.

8 In sum, the court grants summary judgment in favor of Starr and against
9 Plaintiffs on all claims asserted in the Complaint. The Clerk of Court is instructed to
10 enter judgment accordingly and to close the file.

11 **IT IS SO ORDERED.**

12 DATED: August 10, 2017

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14 _____
15 Hon. Jeffrey T. Miller
16 United States District Judge

17 cc: All parties
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25 _____
26 ⁶ Plaintiffs acknowledge that the provision of professional services exclusion
27 does not provide coverage for business debts or the provision of activities that
28 constitute “professional services.”

⁷ Where there is no coverage, and no benefits are due, there can be no breach of
the implied covenant of good faith and fair dealing. American Medical Int’l, Inc. v.
National Union Fire Ins. Co. Of Pittsburgh, 244 F.3d 715, 723 (9th Cir. 2001).