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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

NORTHROP GRUMMAN CORPORATION, Plaintiff, vs. FACTORY MUTUAL INSURANCE COMPANY, and DOES 1 through 10, Defendants.	Case No. CV05-8444 DDP PLAx PLAINTIFF NORTHROP GRUMMAN CORPORATION'S OPPOSITION TO DEFENDANT FACTORY MUTUAL'S MOTION TO DISMISS, OR IN THE ALTERNATIVE, TO STAY Judge: Hon. Dean D. Pregerson Date: January 9, 2006 Time: 10:00 a.m. Courtroom: 3

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I. INTRODUCTION

Northrop Grumman Corporation filed this action in state court, seeking to determine rights under an insurance policy issued by Factory Mutual Insurance Company and seeking to recover for Factory's bad faith and fraud, and, if necessary, to reform the insurance policy to accurately reflect the parties' agreement.

On December 1, Factory removed the case to this Court pursuant to 28 U.S.C. section 1441, and thereby represented that this Court had "original jurisdiction" over this action. *See* 28 U.S.C. § 1441(a); *see also* Factory's Notice of Removal, ¶ 9 ("ask[ing] this Court to exercise jurisdiction over this matter"). Five days later, Factory filed the present motion. It now asserts that Northrop's action is not ripe and should be dismissed or stayed on the alleged basis that the Court lacks subject matter jurisdiction. In other words, Factory removed an indisputably proper state action to this Court only to claim that it cannot proceed in this Court.

Factory asserts two purported bases for its contention that Northrop's action should be dismissed or stayed. First, it argues that Northrop has not yet proven exhaustion of the primary coverage. Factory argues that this action therefore is not justiciable or ripe, and should be dismissed or stayed under Rule 12(b)(1) (for lack of subject matter jurisdiction) and under Rule 12 (b)(6) (for failure to state a claim upon which relief may be granted).[1] However, in making this argument, Factory relies upon outdated California law, ignoring more recent and controlling decisions that hold that an insured can pursue claims against its insurance carrier even when an underlying policy has not exhausted. *See, e.g., Lockheed Corp. v. Continental Ins. Co.*, 134 Cal. App. 4th 187, 35 Cal. Rptr. 3d 799 (2005). Factory also mistakenly relies upon a series of cases

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[1] Factory's Notice of Motion and proposed Order seek dismissal under Rule 12(b)(6) only but its supporting memorandum states that the Motion is filed "pursuant to Rules 12(b)(1) and 12(b)(6) . . . ." Factory Br. at 1. Therefore, Factory's notice is defective as to any request under Rule 12(b)(1).

(including many non-California cases) in which the excess policy involved expressly required that the underlying policy be exhausted before the excess insurer's duties arose. However, Factory's policy contains no such exhaustion requirement and, indeed, specifically contemplates that Factory's duties will be triggered before exhaustion of any underlying policy.

Second, Factory contends that Northrop has not complied with the Factory policy's proof of loss requirement. However, Factory goes beyond the pleadings and attempts to introduce extrinsic evidence to support its Rule 12(b)(6) motion—something that it cannot do. In any event, even if the evidence were to be considered, it demonstrates that Northrop has, in fact, filed a proof of loss, that Factory denied coverage for losses that it characterizes as being caused by "flood" even before Northrop could file a proof of loss, and that Factory cavalierly has waived any right to require a proof of loss.

As demonstrated below, this action is justiciable under both California and Federal law and should not be dismissed. Moreover, even if the Court were to rule to the contrary, 28 U.S.C. section 1447(c) requires that the case be remanded back to California state court–the court from which the case came and where the case clearly is justiciable under California law.

II. FACTS

A. The Factory Insurance Policies

Factory sold to Northrop two "all risk" insurance policies that were in effect when Hurricane Katrina struck. One policy, Policy No. UB270 (the "Factory Primary Policy"), obligates Factory to pay for "its proportional share of $100,000,000 per occurrence," with its proportional share being designated as 15% of $100,000,000. Complaint, ¶ 20. The Factory Primary Policy is a component of a $500,000,000 primary layer of coverage.

Factory also sold to Northrop an excess insurance policy, Policy No. UB276 (the "Factory Excess Policy"). *Id.*, ¶ 21. The Factory Excess Policy is an "all risk" policy,

meaning that it provides coverage for all losses from risks or perils not plainly, clearly, conspicuously, and expressly excluded. *Id.*, ¶ 23. Pursuant to the parties' mutual intent and understanding, the Factory Excess Policy does not exclude coverage for losses from hurricanes, "Named Windstorms," wind, storm surges, or wind-driven waves or water. *Id.*

B. Northrop's Losses Resulting from Hurricane Katrina and Factory's Denial of Coverage

Hurricane Katrina caused substantial damage to Northrop's three facilities in the Gulf Coast region. Complaint, ¶ 40. For example, Northrop's Pascagoula, Mississippi, Shipyard incurred substantial building damage due to the storm, with 1,750,000 square feet of buildings and structures that require repair or replacement. *Id.*, ¶ 41. Additionally, numerous vehicles, pieces of heavy equipment, trailers, computers, and other property were severely damaged or destroyed at that facility. *Id.* Northrop's Gulfport and New Orleans facilities incurred similar types of losses. *Id.*, ¶¶ 42-43. According to Northrop's initial estimates, Northrop's property losses alone amount to more than $1.2 billion. *Id.*, ¶ 45. Northrop has suffered substantial revenue losses as well, which, according to Northrop's present estimates, total approximately $500 million.

Northrop provided timely notice of its losses to its insurance carriers, including Factory, and provided them with extensive information concerning the nature and extent of its losses, including preliminary estimates of the extent of its property and "time element" losses. *Id.*, ¶¶ 45-49. Northrop's representatives also regularly have met with Factory's and the other carriers' adjusters, and have allowed them to visit the affected locations. *Id.*, ¶ 49. Northrop expects that its primary carriers, including Factory, will provide full coverage, up to their policy limits, for Northrop's losses. *Id.*, ¶ 50.

In early October 2005, less than one month after Hurricane Katrina hit the Gulf Coast region, Factory denied coverage under its Excess Policy for any losses caused by Hurricane Katrina in the form of storm surges or wind-driven water. *Id.*, ¶ 51. Factory

informed Northrop that Factory deemed Northrop's Hurricane Katrina losses to involve two separate perils: loss caused by "wind peril," for which there is coverage, and loss caused by "flood peril," for which Factory claims there is no coverage. *Id.*, ¶¶ 52-53. Factory has since reiterated its position. *Id.*, ¶ 53. Factory's position contravenes the policy language, the substantial underwriting history concerning the Factory insurance coverage, the clear understanding of the parties that the Factory Excess Policy covers all damages caused by hurricanes, and common sense.

C. Northrop's Complaint

After Factory denied coverage for losses caused by Hurricane Katrina's storm surges and wind-driven water, Northrop filed this lawsuit. Northrop seeks declaratory, equitable, and legal relief for Factory's failure to adhere to its contractual obligations to provide insurance coverage for Northrop's losses from storm surges and hurricane-driven water that occurred during Hurricane Katrina. Northrop also asserts claims for fraud, negligent misrepresentation, and reformation. Northrop has alleged losses far in excess of the Factory Excess Policy's $500,000,000 attachment point, including property losses that exceed $1.2 billion and "time element" losses that exceed $500,000,000. *Id.*, ¶¶ 45 & 47.

III. THE RULES GOVERNING FACTORY'S MOTION

Under either Rule 12(b)(1) or Rule 12(b)(6), Factory must meet stringent requirements in order to prevail on a motion to dismiss. As the Ninth Circuit has recognized, dismissal of a complaint is disfavored and should only be granted in "extraordinary" cases. *United States v. City of Redwood City,* 640 F.2d 963, 966 (9th Cir.1981). *See Hall v. City of Santa Barbara*, 833 F.2d 1270, 1274 (9th Cir. 1986) ("It is axiomatic that the motion to dismiss for failure to state a claim is viewed with disfavor and is rarely granted.").

When a Rule 12(b)(1) motion to dismiss for lack of subject matter jurisdiction is based on the allegations in the complaint, "all allegations of material fact are taken as true and construed in the light most favorable to the nonmoving party." *Cahill v.*

Liberty Mut. Ins. Co., 80 F.3d 336, 337-38 (9th Cir. 1990). In addition, the Court must "presume that general allegations embrace those specific facts that are necessary to support the claim." *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 561 (1992).[2] Here, Factory has not disputed the material jurisdictional facts in Northrop's complaint, and those facts should be taken as true.[3]

Similarly, a complaint should not be dismissed under Rule 12(b)(6) for failure to state a claim "unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Redwood City*, 640 F. 2d at 966 (citing *Conley v. Gibson,* 355 U.S. 41, 45-46 (1957)). As is the case with respect to Rule 12(b)(1), this Court must accept Northrop's allegations as true, including Northrop's allegations of loss and coverage, and the complaint must be construed in the light most favorable to Northrop. *See id.*

Furthermore, unless Factory's motion is converted to a motion for summary judgment, the Court may not consider material outside the complaint. *See Arpin v. Santa Clara Valley Transp. Agency*, 261 F.3d 912, 925 (9th Cir. 2001). Factory has not submitted its motion as one for summary judgment and has made no effort to show that there is not a "genuine issue of material fact," as required under Federal Rule of Civil Procedure 56. In any event, conversion to summary judgment is disfavored here, where Factory's motion comes just a month after the complaint was filed, discovery has not begun, and the parties have not even participated in the Rule 26 meeting of counsel. *See*

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[2] *Lujan* involved questions of standing rather than ripeness, but whether Factory raises lack of exhaustion as an issue of standing or an issue of ripeness is immaterial because the constitutional analysis is similar.

[3] Although Factory has proffered affidavits concerning the amount of claims that have been submitted to and paid by the primary carriers, this evidence does not actually dispute the allegations in the Complaint concerning the amount of Northrop's losses. Moreover, the Ninth Circuit has held that when jurisdictional facts are challenged, and the plaintiff "can demonstrate the requisite jurisdictional facts if afforded that opportunity," the parties should at least be afforded discovery before the Court determines the jurisdictional question. *St. Clair v. Chico*, 880 F.2d 199, 201 (9th Cir. 1989).

Rubert-Tores v. Hosp. San Paplo, Inc., 205 F.3d 472, 475 (1st Cir. 2000). Thus, all evidence proffered by Factory outside of the complaint should be disregarded.[4]

IV. FACTORY HAS FAILED TO PROVE THAT THIS CASE IS NOT JUSTICIABLE

Northrop's complaint alleges (i) that it has suffered Hurricane Katrina-related losses that exceed the limits of its primary coverage and trigger the coverage of the Factory Excess Policy, and (ii) that Factory has denied coverage for those losses. Under California law, Northrop thereby has established a ripe and justiciable cause of action.

Factory has based its entire motion on its reading of California law, as previously interpreted by the Ninth Circuit. Unfortunately, Factory's argument is based on faulty assumptions and a misreading of the law.

A. Northrop's Claims Are Justiciable Under California State Law[5]

A request for declaratory relief against an excess insurance company is ripe under California law as long as the insured alleges "'an actual controversy relating to the legal rights and duties of the respective parties.'" *Lockheed*, 134 Cal. App. 4th at 220 (quoting *Ludgate Insurance Co. v. Lockheed Martin Corp.*, 82 Cal. App. 4th 592, 606, 98 Cal. Rptr. 2d 277, 287 (2000)). Furthermore, "[f]acts showing exhaustion of the underlying limits merely establish the insured's right to recover, not whether an actual controversy exists between the parties.'" *Id.* (quoting *Ludgate*, 82 Cal. App. 4th at 605-06). An insured's failure to plead or establish exhaustion of the primary coverage

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[4] Because Factory has submitted evidence outside the face of the complaint, Northrop refers to certain of that evidence herein. However, Northrop does so subject to its objection that the Court not consider any evidence outside the face of the complaint in deciding Factory's motion.

[5] If Factory asserts that California and Mississippi substantive insurance law is in agreement on this issue (although Factory's reading of both states' law is wrong) Factory ultimately has made no attempt to show that Mississippi law should apply. Therefore, as forum state, California law should apply. *See Rivera v. S. Pac. Transp. Co.*, 217 Cal. App. 3d 294, 298, 266 Cal. Rptr. 11, 13 (1990) ("Accordingly, there is no true conflict of law and California, as the forum state, is entitled to apply its own law.").

therefore is immaterial to whether it has stated a ripe cause of action for declaratory relief. *Id.*

In *Ludgate*, the California Court of Appeal had explained that, under California law, in order to be entitled to declaratory relief concerning an excess insurance policy, "a party need not establish that it is also entitled to a favorable judgment." 82 Cal. App. 4th at 605-06. In that case, the insurance company had sought declaratory relief against Lockheed, which then filed its own cross-complaint for declaratory relief and for breach of contract. *Id.* at 597-98. The insurance company argued that Lockheed had failed to state a claim for relief because it had not alleged actual exhaustion of its primary insurance. *Id.* at 601. In reversing the trial court's judgment on the pleadings in favor of the insurance company, the appellate court explained that under California substantive insurance law, "[e]xhaustion is merely an issue of proof and entitlement to recovery, not of pleading." *Id.* at 606.

In *Lockheed* , the California Court of Appeal reemphasized its earlier decision in *Ludgate*, holding that excess insurance carriers' demurrers were "a procedurally inappropriate method for disposing of a complaint for declaratory relief." 134 Cal. App. 4th at 221. The trial court had sustained the demurrers on its finding that Lockheed "did not adequately allege actual exhaustion of the primary policies or that it was reasonably likely Lockheed would exhaust its primary coverage, which it would have to do in order to reach the excess policies." *Id.* at 219. In reversing the trial court ruling, the appellate court held that the California declaratory relief statute does "not require an insured to show a reasonable probability of exhaustion of its primary coverage before it may state a cause of action for declaratory relief against an excess insurer." *Id.* at 220. The court explained that, even if an actual breach had not yet taken place, a "fundamental" purpose of declaratory relief would be "defeat[ed]" if the court failed to determine the rights of parties having an "actual controversy:"

> [L]eav[ing] the parties where they [are], with no binding determination of their rights, to await an actual breach and ensuing litigation . . . would

> defeat a fundamental purpose of declaratory relief, to remove uncertainties as to legal rights and duties before breach and without the risks and delays that it involves. In brief, the object of declaratory 'relief' is not necessarily a beneficial judgment; rather, it is a determination, favorable or unfavorable, that enables the plaintiff to act with safety. This theory has prevailed, and the rule is now established that the defendant cannot, on demurrer, attack the merits of the plaintiff's claim. The complaint is sufficient if it shows an actual controversy; it need not show that plaintiff is in the right.

Id. at 221 (quoting 5 Witkin, Cal. Procedure, (4th ed. 1997) Pleading § 831, pp. 288-289.).

Here, for the same reasons, Northrop has stated a ripe claim for declaratory relief against Factory under the Factory Excess Policy regardless of whether Northrop's Complaint alleges that the primary coverage actually has been exhausted.[6] Northrop has alleged that its losses exceed $1,200,000,000, and thus will tap into Factory's excess layer of coverage. Factory repeatedly and unequivocally has taken the position that any of Northrop's losses that were caused by Hurricane Katrina's storm surges or by wind-driven waves or water are not covered under the Factory Excess Policy. Complaint, ¶¶ 52 & 53. Under these circumstances, Northrop has demonstrated "an actual controversy relating to the legal rights and duties of the parties under a written instrument," and therefore presently is entitled to obtain declaratory relief. *See Lockheed*, 134 Cal. App. 4th at 221.

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[6] Despite its holding on this issue, the *Lockheed* court actually affirmed judgment against Lockheed on the excess insurance policies. *Id.* at 221. The court did this, however, because it reached the merits of the coverage issues and affirmed the trial court's ruling for Lockheed's primary insurance companies on all of the coverage issues. In contrast, Northrop's primary insurance companies (including Factory) have admitted liability for Northrop's losses, and Northrop expects those companies to pay their limits. Complaint, ¶ 50. Thus, the court's actual disposition is irrelevant to the *Lockheed's* authority as California law on this issue.

Factory's brief does not discuss, or even acknowledge, *Lockheed* and *Ludgate*, two authorities that are directly on point. Rather, Factory relies on outdated and otherwise inapplicable federal cases that purport to apply outdated California law and a more restrictive standard concerning ripeness. However, as shown below, Northrop's claims are ripe under the federal standard as well.

B. Northrop's Claims Also Are Justiciable Under California Federal Law

Even if the Court were to rely solely upon the California federal precedent cited by Factory,[7] and to ignore the clear precedent from the California Court of Appeal, those federal cases no longer are precedential and are otherwise distinguishable.

First, all of Factory's cases were decided prior to the California Court of Appeal's opinions in *Ludgate* and *Lockheed*. In *Iolab Corp. v. Seaboard Surety Co.*, 15 F.3d 1500 (9th Cir. 1994), the court stated that it was applying "California law" and looked to principles and policies enunciated by California courts. *Id.* at 1502, 1504-05. Inasmuch as California state law informs California federal procedural law, a federal court assessing the ripeness of a claim for declaratory relief should look to the California Court of Appeal's analysis and holdings in *Ludgate* and *Lockheed*, and should apply the principles espoused in those cases.

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[7] *See* Factory Brief at 8-9 (citing *Iolab Corp. v. Seaboard Surety Co.*, 15 F. 3d 1500 (9th Cir. 1994); *Cont'l Cas. Co. v. U.S. Fid. & Guar.*, 516 F. Supp. 384, 393 (N.D. Cal. 1981); *Valentine v. Royal Globe Ins. Co.*, 564 F. 2d 292, 296 (9th Cir. 1977); *County of Santa Clara v. U.S. Fid. & Guar.*, No. C-93-20160, 1994 WL 715657 (N.D. Cal. 1994)).

Factory also cites several California state cases, all of which were decided prior to *Ludgate* and *Lockheed*, and thus are superseded to the extent they are in conflict. Moreover, in *Olympic Insurance Co. v. Employers Surplus Lines Ins. Co.* and *Hellman v. Great American Insurance Co.*, the dispute revolved around the attachment point of the excess policy due to interaction of the "other insurance clause," rather than the amount of the insured's damages. 126 Cal. App. 3d 593, 178 Cal. Rptr. 908 (1981); 66 Cal. App. 3d 298, 136 Cal. Rptr. 24 (1977). The parties did not dispute that the amount of the insureds' damages in those cases did not exceed the attachment point of the excess policies as determined by the court. *Olympic*, 126 Cal. App. 3d at 600; *Hellman*, 66 Cal. App 3d at 305.

Iolab and Factory's other cases also are distinguishable on their facts. In *Iolab*, the insured's losses were not alleged to reach above the aggregate limit of primary coverage. *Id.* at 1504. Additionally, the excess policies specifically stated that their coverage did not attach until the underlying insurance had been paid, or had been held liable to pay, and the trial court held that they primary coverage in fact did not cover the losses at issue. *Id.* at 1503, 1504. Accordingly, there was no chance that the insured ever would be able to prove exhaustion of the primary coverage or that it would tap into the excess coverage. Here, Northrop's losses greatly exceed the primary coverage $500,000,000 limit, and Northrop has alleged that the Factory Excess Policy's attachment point will be exceeded. Moreover, the Factory Excess Policy attaches upon Northrop's incurring covered "losses" in excess of $500,000,000. Complaint, ¶ 21. Nothing in the Factory Excess Policy unambiguously requires such loss or damages actually to be paid by Northrop's primary insurance companies before liability under the Excess Policy attaches.

In *Santa Clara,* the court expressed "doubts about the soundness of" the rule expressed in *Iolab* and explained that "a single comprehensive declaratory action is a far better way to go from the standpoint of judicial economy and fairness to the insured." 1994 WL 715657 at *1. As noted above, *Iolab* no longer is controlling because the California state law principles on which it was based soundly were rejected in *Ludgate* and *Lockheed.*[8]

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[8] Two other cases upon which Factory relies, *Continental* and *Valentine*, address the doctrine of equitable subrogation and therefore are inapplicable. 516 F. Supp. at 393; 564 F.2d at 296.

Although the Court need not consider Mississippi law based on Factory's position that there is no conflict between California law and Mississippi law, Factory's Mississippi cases likewise are unavailing. *Garriga v. Nationwide Mut. Ins. Co.*, 813 F. Supp. 457, 463 (S.D. Miss. 1993), concerned a claim that an excess, rather than a primary, carrier had first dollar liability for the insured's loss. Similarly, *Geiselbreth v. Allstate Ins. Co.*, 8 F. 3d 281 (5th Cir. 1993) addressed whether, at an evidentiary hearing, the insured had proven that an excess policy in fact was triggered. Finally, *Nationwide Gen. Ins. Co. v. Perry*, 2 F. Supp. 2d 857 (S.D. Miss. 1997) actually confirms the ripeness of Northrop's declaratory judgment claim. There, the court

(Continued...)

Moreover, *Santa Clara* also is factually distinguishable. In that case, which involved excess *liability*, rather than *casualty*, insurance, the insured's "loss" had not been established because the insured had not been held liable for an amount that exceeded the limits of its primary coverage. Thus, the contemplated loss had not yet taken place. Here, by contrast, Hurricane Katrina already has hit, Northrop's property damage and business interruption loss already has taken place and is continuing to take place, and Northrop already has suffered and is continuing to suffer overwhelmingly large losses that will greatly exceed its primary coverage. Indeed, Northrop's primary carriers, including Factory, have acknowledged liability for Northrop's claims and are continuing to adjust the claims and cover Northrop's losses.[9]

In any event, none of Factory's cases address a circumstance where an insured has asserted claims for fraud, negligent misrepresentation, and reformation. Factory does not even attempt to argue that those claims are not "ripe" or that this Court cannot now adjudicate those claims.

C. Moreover, the Factory Excess Policy Does Not Unambiguously Require That the Primary Policies Be Exhausted

Factory contends that no excess policy must respond until the primary coverage has been exhausted. Factory cites a multitude of cases for this proposition, without ever discussing the specific language of the policies involved in those cases. The Factory policy involved here does *not* unambiguously require exhaustion of any primary policy

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granted, on summary judgment, an excess insurance carrier's request for a declaration that the underlying primary insurance was not exhausted or even "substantially exhausted." *Id.* at 859.

[9] Factory overstates the significance that, to date, Northrop has submitted only $252,320,840 worth of invoices for reimbursement. In fact, and as alleged, Northrop's covered losses will exceed $1,000,000,000. It simply takes time to adjust, and then to make the repairs and/or replacements that result in the actual losses being paid by the primary carriers, time that Factory was not willing to wait before telling Northrop that it would not pay.

before Factory's duties are triggered under its Excess Policy. Significantly, for the purposes of Factory's motion, the Factory Excess Policy attaches upon Northrop's incurring covered "losses" in excess of the primary coverage $500,000,000 limit of liability, up to the Factory Excess Policy's limits of liability. Complaint, ¶ 21.

Additionally, the Factory Excess Policy does not unambiguously require that the losses actually be paid by Northrop's primary insurance carriers before liability under the Excess Policy attaches. The Factory Excess Policy states only that Northrop must sustain losses in excess of the attachment point. For example, the deductible provision of the Factory Excess Policy provides:

> In each case of loss covered by this Policy, the Company will be liable only if the Insured sustains a loss in a single occurrence greater than the applicable deductible amounts on the primary policies, subject to the EXCESS OF LOSS PROVISIONS of the Policy.

Id., ¶ 25.

The Excess of Loss Provisions, however, are at best for Factory ambiguous as to whether exhaustion of the underlying policies is required. The first paragraph of that provision states that "this Policy shall apply excess of the amount(s) shown under the LIMITS of LIABILITY after application of the deductibles applying in the underlying (primary) policy(ies) . . . ," which "amount" is stated only as "$500,000,000." *Id.*, ¶¶ 18 & 37; Factory Excess Policy, §§ A.6 & E.9 (Ex. A to Vandall Dec., at 11 & 40).[10] The Excess of Loss Provisions further state that "[a]ll losses, damages or expenses arising out of any one occurrence shall be adjusted as one loss." Complaint, ¶ 37; Factory Excess Policy, § E.9 (Ex. A to Vandall Dec., at 40). Thus, these provisions require only that there be a loss in excess of $500,000,000, not that the underlying insurers first pay $500,000,000.

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[10] The Excess Policy is Exhibit A to the Declaration of William R. Vandall ("Vandall Dec.") submitted by Factory in support of its motion. However, Factory has failed to properly authenticate this document.

Factory relies heavily on language contained in the second paragraph of the Excess of Loss Provisions,[11] which arguably calls for exhaustion under certain circumstances and provides:

> In the event loss or damage involves more than one coverage or peril, the coverage provided under any underlying policies shall apply first to the coverage(s) or peril(s) not insured by this Policy. Upon exhaustion of the limits of liability of the underlying policies, this Policy shall then be liable for the loss uncollected from the coverage(s) or peril(s) insured hereunder, subject to the limit of liability.

See Factory Excess Policy, § E.9 (Ex. A to Vandall Dec., at 40). This provision arguably is inconsistent with the other provisions that do not mention, let alone require, exhaustion. This renders the policy ambiguous with respect to any purported exhaustion requirement. Under well-established principles of insurance policy interpretation, such ambiguities must be construed against the insurance company that drafted the language and in favor of the insured. *See, e.g., AIU Ins. Co. v. Superior Court*, 51 Cal. 3d 807, 872, 277 Cal. Rptr. 820 (1990) ("In the insurance context, we generally resolve ambiguities in favor of coverage. . . . Because the insurer writes the policy, it is held 'responsible' for ambiguous policy language, which is therefore construed in favor of coverage."). Furthermore, this provision clearly is intended to maximize Northrop's coverage by having the underlying insurers pay for loss not covered under the Excess Policy. It does not address the situation here where Factory is not challenging whether the underlying policies are paying for losses that they should not be paying. Nothing in this provision requires exhaustion outside of the very narrow circumstances addressed by this provision. Factory is simply mixing applies and oranges. Hence, Factory's coverage-defeating interpretation must be rejected.

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[11] Factory's quotation from the Excess of Loss Provisions erroneously consolidates the two paragraphs into one.

D. In Any Event, If the Court Were to Conclude That It Lacks Subject Matter Jurisdiction Over Northrop's Claims, the Only Appropriate Remedy Is Remand

Even if the Court were to determine that Northrop's action is not ripe under federal law, the case should be remanded to California state court, not dismissed or stayed. Specifically, 28 U.S.C. section 1447(c) governs the disposition of this action and requires that the case be remanded if there is no subject matter jurisdiction: "If at any time before final judgment it appears that the district court lacks subject matter jurisdiction, the case *shall* be remanded." *Id.* (emphasis added); *see also Martin v. Franklin Capital Corp.*, 2005 U.S. LEXIS 9234, *9 (2005) (contrasting Congress's use of word "may" elsewhere in statute with its specific intentional use of word "shall"); *Lee v. Am. Nat'l Ins. Co.*, 260 F.3d 997, 1006 (9th Cir. 2001) (holding that remand is required where federal court lacks subject matter jurisdiction over removed action); *Mortera v. N. Am. Mortgage Co.*, 172 F. Supp. 2d 1240 (N.D. Cal. 2001) (remanding action where federal court lacked subject matter jurisdiction).

Public policy and pure logic require this result as well. Northrop pled and filed a justiciable and ripe case in California state court under California law. Factory sought Federal jurisdiction through the removal process, and then immediately sought to have this Court dismiss the case for lack of justiciability and ripeness. Factory's effort is nothing more than gamesmanship—removing a perfectly valid lawsuit that could proceed in state court to this Court, only to argue that it cannot proceed here and, therefore, that it cannot proceed at all, notwithstanding the presence of a readily available state forum. Were the Court to do Factory's bidding and dismiss, the case simply would be refiled in California state court and, unless Factory chose to continue its "revolving door" litigation strategy by removing again, the case would go forward in the California court system. In the end, there would have been much expense and burden to the federal court system for no ostensible purpose. If, however, Factory actually is seeking dismissal for some other purpose, for example, to initiate litigation of

this dispute in another state jurisdiction, such forum shopping and procedural gamesmanship certainly should not be countenanced and abetted by the rulings of this Court.[12]

V. NORTHROP HAS SATISFIED, AND FACTORY HAS WAIVED, ANY ARGUABLY APPLICABLE POLICY CONDITIONS

Equally unavailing are Factory's erroneous contentions that Northrop has not met its purported obligation to comply with the Factory Excess Policy's proof of loss provision, and that this action accordingly is premature. On the contrary, (1) Northrop has satisfied, or at a minimum substantially complied with, the proof of loss requirement by submitting proofs of loss and other substantial information; (2) Factory has waived the proof of loss requirement with respect to any losses caused by Hurricane Katrina's storm surges or wind-driven waves or water; and (3) Northrop's allegation that it has satisfied or is excused from performing policy conditions cannot be challenged on a motion to dismiss.

A. Northrop Has Satisfied the Factory Excess Policy's Proof of Loss Provision

Factory Excess Policy contains a proof of loss provision stating that a proof of loss is to provide the following information:

a) the time and origin of the loss.

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[12] Moreover, in the event of a remand, Northrop is entitled to recover its "just costs and any actual expenses, including attorney fees, incurred as a result of the removal." 28 U.S.C. § 1447(c); *Martin*, 2005 U.S. LEXIS 9234 at *17. In *Martin*, the Supreme Court held that costs are appropriate when the removing party "lacked an objectively reasonable basis for seeking removal." *Id.* Here, Factory removed this action, thereby representing that this Court had "original jurisdiction" over this action. *See* 28 U.S.C. § 1441(a); *see also* Factory's Notice of Removal notice, ¶ 9 ("ask[ing] this Court to exercise jurisdiction over this matter"). Just days later, Factory filed this motion asserting that this Court lacks subject matter jurisdiction over the action. Moreover, there is no doubt that the action was ripe in state court based on the California Court of Appeal's clear and unequivocal rulings in *Ludgate* and *Lockheed*. Under these circumstances, if the action is remanded, Factory, at a minimum, should be required to reimburse Northrop for the costs and fees it was forced to expend as a result of Factory's gamesmanship.

b) the Insured's interest and that of all others in the property.

c) the Actual Cash Value and replacement value of each item and the amount of loss to each item; all encumbrances; and all other contracts of insurance, whether valid or not, covering any of the property.

d) any changes in the title, use, occupation, location, possession or exposures of the property since the effective date of this Policy.

e) by whom and for what purpose any location insured by this Policy was occupied on the date of loss, and whether or not it then stood on leased ground.

Factory Excess Policy, § D.4.A.4 (Ex. A to Vandall Dec., at 42).

Northrop already has submitted partial proofs of loss that set forth all of the information requested other than the actual cash value or the replacement value of the damaged or destroyed property. Moreover, one of the very exhibits attached to Factory's motion–a November 23, 2005, letter from Dean Reynolds, Northrop's Corporate Director of Risk Management, itself is a "proof of loss" and confirms that Northrop in fact has provided Factory with substantially more information than that provided in the earlier proofs of loss and all of the information sought by the proof of loss provision. *See* Exhibit 1 to Declaration of Thomas M. Cook, Jr. ("Cook Dec."), at 7-10. Mr. Reynolds' November 23 letter incorporated by reference all of the previously submitted proofs of loss and all of the "facts regarding the origin and nature of loss alleged" in Northrop's Complaint in this action. *Id.* at 7. In addition, Northrop's Complaint includes, among other things, detailed descriptions of Northrop's property losses as well as Northrop's estimates of the rough order of magnitude of those, and Northrop's revenue, losses. Although Northrop has requested and received an extension of time, until at least February 28, 2006, to submit an even more precise proof of loss, the information provided to date more than satisfies the Factory Excess Policy's requirement. Thus, Factory itself has submitted evidence that Northrop already has satisfied any requirement for a proof of loss. That alone defeats Factory's argument.

Moreover, even if all of the information submitted to date somehow could be deemed technically incomplete, any arguable deficiencies are minor and do not provide a basis for dismissing this action for two reasons. First, Factory has waived any alleged defects in the proofs of loss submitted to date because it failed specifically to advise Northrop of, or to give Northrop an opportunity to correct, such alleged defects. *Elliano v. Assurance Co. of Am.*, 3 Cal. App. 3d 446, 448, n.2, 83 Cal. Rptr. 509, 511 n.2 (1970); *see also* Cal. Ins. Code § 553 ("All defects in a notice of loss, or in preliminary proof thereof, which the insured might remedy, and which the insurer omits to specify to him, without unnecessary delay, as grounds of objection, are waived.").

Second, because Northrop, at a minimum, substantially has complied with the proof of loss provision, this lawsuit should be permitted to go forward. *Cf. McCormick v. Sentinel Life Ins. Co.*, 153 Cal. App. 3d 1030, 1046, 200 Cal. Rptr. 732, 741 (1984). In reversing a grant of summary judgment in favor of an insurance carrier, the *McCormick* court held that a triable issue existed as to whether the insured had substantially complied with a policy's proof of loss requirement. *Id.* at 1046. In so ruling, the court explained that "[a]n insurance company has a duty to pay a claim when it has acquired, through one means or another, sufficient evidence to establish the validity of that claim," and that a denial is not made in good faith "merely because an insured failed to dot the i's or cross the t's on a claim form or other submission." *Id.* It further explained:

> The issue is not whether the insurance company has received every item of information it requested from an insured. The question is not even whether the insurance company appears to have in its hands the exact type of information it prefers when deciding on a claim. Rather the real question is whether there was enough evidence of whatever form and however

acquired that it would be unreasonable for the insurance company to refuse to pay the claim.

Id.[13]

Here, Northrop already has provided Factory with more than enough information for it to assess and to investigate the sufficiency of Northrop's claim. Indeed, Factory has made payments to Northrop with respect to its Primary Policy based upon proof of Hurricane Katrina losses. Any arguable and minor deficiencies in the proof of loss information Northrop has provided to date do not provide a basis for dismissing the Complaint.

B. Factory's Denial of Liability As to Losses Caused by Storm Surges or Wind-Driven Waves or Water Excuses Northrop From Any Obligation to Comply With the Factory Excess Policy's Terms and Conditions With Respect to Those Losses

Even if Northrop did not comply, or substantially comply, with the Factory Excess Policy's proof of loss provision, Factory has waived that condition with respect to all losses for which Factory flatly has denied coverage – *i.e.*, storm surges and wind-driven waves or water. In early October 2005, Factory denied liability for Northrop's losses caused by Hurricane Katrina's storm surges or by wind-driven water, claiming that such losses are barred by the Factory Excess Policy's flood exclusion, a position that Factory has since reiterated. Complaint, ¶¶ 51-53. Factory's denial excuses Northrop from complying with any of the Factory Excess Policy's terms or conditions,

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[13] Factory's reliance on *Flick v. Liberty Mutual Fire Insurance Co.*, 205 F.3d 386 (9th Cir. 2000), is misplaced. *Flick* concerned a standard flood insurance policy underwritten as part of the National Flood Insurance Program. "Because flood losses, whether insured by FEMA or by a participating WYO insurer, are paid out of the National Flood Insurance Fund, a claimant under a standard flood insurance policy must comply strictly with the terms and conditions that Congress has established for payment. That is the simple, but powerful, command of the Appropriations Clause." *Id.* at 394. Courts thus do not "power to award a money remedy to a flood insurance claimant" who submits an untimely proof of loss requirement. " *Id.*

including the proof of loss condition, which Factory admits otherwise would not be due until, at the earliest, February 28, 2006.[14] *See, e.g., Dietlin v. Gen. Am. Life Ins. Co.*, 4 Cal. 2d 336, 350, 49 P.2d 590, 597-98 (1935); *Lee v. United States Fire Ins.*, 55 Cal. App. 391, 203 P. 774 (1921); *Buxton v. Int'l Indem. Co.*, 47 Cal. App. 583, 591, 191 P. 84, 88 (1920); *Bank of Anderson v. Home Ins. Co. of New York*, 14 Cal. App. 208, 219-20, 111 P. 507, 511 (1910). *See Select Ins. Co. v. Superior Court*, 226 Cal. App. 3d 631, 637, 276 Cal. Rptr. 598, 601 (1990) ("[A]n insurer is not allowed to rely on an insured's failure to perform a condition of a policy when the insurer has denied coverage because the insurer has, by denying coverage, demonstrated performance of the condition would not have altered its response to the claim."); *Downey Sav. & Loan Ass'n v. Ohio Cas. Ins. Co.*, 189 Cal. App. 3d 1072, 1088-89, 234 Cal. Rptr. 835, 843-44 (1987) (when carrier denies coverage under policy, it waives any claim that insured has not complied with notice requirements). In *Lee*, for example, the court held that an insurance carrier's "denial of . . . liability prior to the expiration of the time to make proof of loss is a waiver of the condition of the policy requiring such proof." 55 Cal. App. at 396 (citations omitted). For the same reasons, by denying liability, Factory likewise waived its right to require Northrop to comply with any of the Factory Excess Policy conditions, such as the proof of loss provision. Factory's motion therefore should be denied.

C. Northrop's Allegation That it Has Met the Terms and Conditions of the Factory Excess Policy Cannot Be Challenged on a Motion to Dismiss

Finally, Factory's argument improperly challenges the allegations set forth in Northrop's Complaint, which is inappropriate on a motion to dismiss. Although

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[14] *See* Ex. 1 to Cook Dec., at 4 (reflecting Factory's agreement to extend "Northrop Grumman's time to file its Proof of Loss under [the Factory Excess Policy]" and its agreement to "timely consider" any requests for further extensions).

Factory obviously disagrees with Northrop's position, such disputes are more appropriate for consideration on summary judgment *after* the parties have had an opportunity to take discovery that would bear on these issues. Converting Factory's motion to dismiss to a motion for summary judgment would be premature at this time, when the parties have not yet begun, let alone completed, discovery. Northrop sufficiently has pled satisfaction of or excusal from any conditions set forth in the Factory Excess Policy. Specifically, Northrop alleged: "Northrop has complied with all terms and conditions contained in the insurance policies, including in Factory's excess policy, except to the extent its performance has been or is excused or waived by the insurers, including Factory." Complaint, ¶ 55. This allegations more than satisfies Northrop's pleading obligations under Federal Rule of Civil Procedure 9(c), which states: "In pleading the performance or occurrence of conditions precedent, it is sufficient to aver generally that all conditions precedent have been performed or have occurred. A denial of performance or occurrence shall be made specifically and with particularity." Northrop thus has sufficiently pled its claims.

Moreover, because a court reviewing a Rule 12(b)(6) motion to dismiss must accept all material allegations as true and must draw all inferences in favor of the non-moving party, the Court should reject Factory's attempt to challenge the accuracy of Northrop's allegations concerning purported policy conditions. Even if a required proof was not submitted, the remedy of dismissal would be available only if Factory satisfied its burden of proving actual and substantial prejudice, which is a question of fact not even alleged by Factory, is denied by Northrop, and, in any event, is not appropriate for disposition on a motion to dismiss. *See Fidelity Sav. & Loan Ass'n v. Aetna Life & Cas. Co.*, 647 F.2d 933, 938 (9th Cir. 1981) (breach of proof of loss requirement and notice clause); *Downey*, 189 Cal. App. 3d at 1089 ("[T]hough an insurer may assert a defense based upon an alleged breach of the notice requirements of the policy, the breach cannot be a valid defense unless the insurer was substantially prejudiced thereby.")

VI. FACTORY ALSO HAS FAILED TO SATISFY ITS BURDEN OF PROVING THAT THIS ACTION SHOULD BE STAYED

Factory's alternative request for a stay should be rejected for two reasons. First, as mentioned above, if the Court determines that it does not have subject matter jurisdiction over this action, then the only appropriate remedy is to remand it to state court. *See* 28 U.S.C. § 1447(c) ("If at any time before final judgment it appears that the district court lacks subject matter jurisdiction, the case *shall* be remanded." (emphasis added)).

Second, if the Court were to determine that it has subject matter jurisdiction over this action, Factory nevertheless has failed to satisfy its burden of proving that it is entitled to a stay. *See Clinton v. Jones*, 520 U.S. 681, 708 (1997) (proponent of a stay bears burden of establishing its need). In determining whether to stay an action, courts consider the following factors: (1) the plaintiff's interest in proceeding expeditiously with the civil action and prejudice to plaintiffs resulting from any delay; (2) the public interest; (3) the interest of non-parties to the civil litigation; (4) the burden on the defendant; and (5) convenience to the courts. *Federal Sav. & Loan Ins. Corp. v. Molinaro*, 889 F.2d 899, 903 (9th Cir. 1989). None of these factors justify the imposition of a stay.

Northrop already has demonstrated that its losses greatly exceed the limits of the primary coverage. Additionally, the primary carriers have acknowledged their liability for the losses, and have been working with Northrop to adjust those claims.

Thus, as is shown below, Northrop and the public at large have a compelling interest in an expeditious resolution of this dispute, and would suffer prejudice from any undue delays. And, because there is a "fair [if not certain] possibility that the stay [Factory seeks] . . . will work damage to some one else," Factory must "must make out a clear case of hardship or inequity in being required to go forward." *Landis v. N. Am. Co.*, 299 U.S. 248, 255 (1936). Here, Factory has failed to demonstrate any, let alone a clear case of, hardship or inequity in being required to go forward and be held

accountable for its actions at this time, particularly because disputes between the parties have already materialized and are substantial.

A. Northrop and the Public at Large Have a Compelling Interest in an Expeditious Resolution of this Dispute and Would be Prejudiced by the Imposition of a Stay

Northrop has a compelling interest in proceeding expeditiously with this action and would suffer prejudice from undue and unnecessary delays. There is no dispute that Hurricane Katrina caused Northrop and others in the Gulf Coast region to suffer devastating property and revenue losses. Many of Northrop's Gulf Coast facilities, which comprise a significant sector of Northrop's operations, have suffered substantial property damage and destruction, thereby hampering Northrop's business operations. Northrop alleged that its property losses exceed $1,200,000,000, and its revenue losses approximating $500,000,000. Complaint, ¶¶ 46 & 47.

With losses of this magnitude, Northrop has been forced to expend substantial financial and other resources to planning and implementing its rebuilding and restoration efforts, which are of national import given that Northrop's operations largely involve contracts for work on behalf of the United States Navy. Requiring Northrop to continue to make and implement these significant plans and decisions, which require substantial outlays of financial and other resources, without a determination of the scope of coverage available to it under the Factory Excess Policy would be prejudicial, particularly in light of Factory's unequivocal and improper disclaimer of liability for any losses caused by storm surges or wind-driven water. Factory has failed to demonstrate why Northrop should be deprived of its right to, among other things, a declaratory judgment, which is designed to "remove uncertainties as to legal rights and duties before breach and without the risks and delays that it involves" and which "enables the plaintiff to act with safety." *Lockheed*, 134 Cal. App. 4th at 221.

Additionally, the public interest would be served by allowing this dispute to be resolved expeditiously. This is not, as Factory contends, a garden variety contract

dispute. Northrop provides a diverse range of technologically advanced, innovative products, services and solutions in systems integration, defense electronics, information technology, advanced aircraft, shipbuilding, and space technology, and serves domestic and international military, government, and commercial customers, including the United States Navy. Complaint, ¶ 2. Ensuring that Northrop is in a position to resume and restore interrupted operations quickly and with as minimal disruption as possible furthers national security interests, especially given that our nation currently is at war.

Northrop's operations also contribute significantly to the Gulf Coast economy. For example, Northrop's Ingalls Operation, which is located in Pascagoula, Mississippi is the largest private employer in the state with more than 10,000 employees, and Northrop's Avondale Operations, located near New Orleans, is the largest manufacturing employer in Louisiana. Complaint, ¶¶ 4-5. The public therefore has a compelling interest in ensuring a quick resolution of this dispute, which will impact Northrop's financial ability to rebuild and repair its facilities and equipment and restore its operations to pre-loss levels.

Additionally, other insureds and insurance carriers have an interest in allowing lawsuits such as this to go forward. Indeed, as noted above, parties have a right to obtain declaratory judgments in order to "remove uncertainties as to legal rights and duties before breach and without the risks and delays that it involves" and to "enable the plaintiff to act with safety." *Lockheed*, 134 Cal. App. 4th at 221. Insureds and insurance carriers both are better served by obtaining determinations of their respective rights and obligations as soon as a dispute materializes, regardless of whether either party actually has yet breached its contractual obligations. In fact, by obtaining such relief, parties are able to prevent inadvertent breaches.

B. Allowing this Action to Proceed at this Time Would Not Impose any Added Burdens on Factory or the Court

Factory fails to show how allowing a ripe action to go forward would impose any added burdens on it or on the Court. As demonstrated above, Factory's ripeness

arguments are meritless, and therefore provide no basis for imposing a stay. Moreover, because Northrop has demonstrated that its losses already greatly exceed the limits of the primary coverage, there is no reason to allow Factory to avoid accountability for its wrongful actions (or inaction, as the case may be).

Nor would denying a stay inconvenience the Court. Northrop already has demonstrated that this is a ripe, justiciable dispute. Because Northrop's losses have greatly exceeded the limits of the primary coverage and Factory has disclaimed liability for losses caused by storm surge and wind-driven water, there is no possibility that an opinion would be advisory only.

VII. CONCLUSION

For all of the foregoing reasons, Northrop respectfully requests that this Court deny Factory's Motion in its entirety.

Dated: December 23, 2005 DICKSTEIN SHAPIRO MORIN & OSHINSKY, LLP

By: _____
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