UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

Case No.	SACV 12-627 AG (RNBx)	Date	August 10, 2012
Title	TRENCHES, INC, ET AL. v. HANOVER INSURANCE COMPANY		

Present: The Honorable	ANDREW J. GUILFORD	
Adrianna Gonzalez	Not Present	
Deputy Clerk	Court Reporter / Recorder	Tape No.

Attorneys Present for Plaintiffs: Attorneys Present for Defendants:

Proceedings: **[IN CHAMBERS] ORDER GRANTING MOTION TO DISMISS**

Plaintiffs Trenches, Inc., Trenches Holdings Inc., Richard Toschiaddi, Ginger Toschiaddi, Dimitri Maraletos, and Jeanette Maraletos (collectively, "Plaintiffs") filed a complaint ("Complaint") against Defendant Hanover Insurance Company ("Defendant"), claiming that their Insurance Policy ("Policy") required Defendant to defend Plaintiffs in an underlying lawsuit. Plaintiffs' complaint ("Complaint") stated claims for declaratory relief, breach of contract, and breach of the implied covenant of good faith and fair dealing.

Defendant now brings a Motion to Dismiss ("Motion"), claiming that the Complaint fails to allege a duty to defend because the underlying action falls outside the scope of the Policy. Alternatively, Defendant argues that various Policy exclusions bar coverage.

The Court finds that Plaintiffs sufficiently allege that the underlying action falls within the scope of the Policy. But the Court also finds that the Policy's "breach of contract" exclusion applies because the covered activity "arises out of" a breach of contract. Thus, Plaintiff has failed to allege a duty to defend in the underlying action.

UNITED STATES DISTRICT COURT
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The Court GRANTS Defendant's Motion.

BACKGROUND

The following facts are taken from the Complaint and from documents subject to judicial notice.

On September 26, 2011, Defendant issued a one-year commercial general liability insurance Policy, allegedly to Plaintiffs Trenches, Inc. and Trenches Holdings Inc. (collectively, "Trenches"). (Compl. ¶ 9.) Although ultimately not a factor in this Motion, Defendant contests whether Trenches, Inc. is covered under the Policy. (Mot. 1, n.1.)

On November 17, 2011, Hoodz International, LLC and Hoodz North America, LLC (collectively, "Hoodz") filed a complaint ("Hoodz Complaint") against all six Plaintiffs (the "Underlying Action"). (Compl. ¶ 10.)

On December 29, 2011, Hoodz filed a First Amended Complaint ("Hoodz FAC") in the Underlying Action, which was substantially similar to the original Hoodz Complaint. (Compl. ¶ 10.) The relevant allegations in the Hoodz FAC are summarized as follows. Hoodz alleged that in 2010 and 2011 it entered into franchise agreements ("Franchise Agreements") with Plaintiffs, giving Plaintiffs the right to operate a Hoodz franchise in the commercial kitchen exhaust cleaning business. (Compl. ¶ 11); (Defendant's Request for Judicial Notice ("DRJN"), Exs. A, C.) The Franchise Agreements gave Hoodz the immediate right to terminate if Plaintiffs had any felony convictions. (DRJN, Ex. C.) Under the Franchise Agreements, Plaintiffs had certain post-termination obligations, including the obligation to "immediately discontinu[e] use of the HOODZ Mark and any of HOODZ's other proprietary trademark[s, and] immediately refraining from holding themselves out as [] HOODZ franchisees . . . ." (DRJN, Ex. C, ¶ 34.)

Hoodz further alleged that, upon learning that certain of the individual Plaintiffs had felony convictions, it simultaneously terminated the Franchise Agreements and filed a lawsuit ("Prior Lawsuit") against Plaintiffs. (Compl. ¶ 11); (DJRN, Ex. C.)

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

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The parties reached a settlement agreement ("Settlement Agreement") a few days later, and the Prior Lawsuit was dismissed. (Compl. ¶ 11); (DJRN, Ex. C.) As part of the Settlement Agreement, Plaintiffs acknowledged that Hoodz validly terminated the franchises, and Hoodz agreed to conditionally reinstate the Franchise Agreements to allow Plaintiffs to sell the franchises. (Compl. ¶ 11); (DJRN, Ex. C.) Plaintiffs further acknowledged and agreed that Hoodz had "the right to . . . enforce the post-term obligations under the Franchise Agreements . . . ." (DJRN, Ex. C, ¶ 60.)

Hoodz then learned that Plaintiffs were violating the terms of the Settlement Agreement. (DRJN, Ex. C, ¶ 70.) Among other things, Plaintiffs allegedly violated the Settlement Agreement because, "[d]espite their obligation to do so under the Franchise Agreements, [Plaintiffs did] not cease[] using HOODZ's federally registered Mark and trade dress." DRJN, Ex. C, ¶ 70.) On November 17, 2011, Hoodz once again terminated the Franchise Agreements. (DRJN, Ex. C, ¶ 70.)

The Hoodz' FAC lists seven claims, including a claim for trademark infringement and unfair competition (violation of the Lanham Act, 15 U.S.C. §1114). This claim is based on Plaintiffs' continued use of the Hoodz trademark, "trade dress," and "proprietary business systems" "outside the scope of the" Settlement Agreement. (DRJN, Ex. C, ¶ 82.) Hoodz also states a claim for breach of contract relating to the Settlement Agreement and Franchise Agreements. (DJRN, Ex. C, ¶¶ 97-102.)

On December 19, 2011, Trenches tendered the Hoodz Complaint to Defendant, seeking defense and indemnity (although Plaintiffs do not appear to be seeking indemnity here). (Compl. ¶ 16.) On December 23, 2011, Hanover denied the claim. (Compl. ¶ 16.) On January 23, 2012, Trenches sent a letter asking Hanover to reconsider. (Compl. ¶ 16.) On March 19, 2012, Hanover responded, again rejected coverage. (Compl. ¶ 17.) On April 16, 2012, Plaintiffs sent a third letter, asking Hanover to reconsider. (Compl. ¶ 17.)

On April 23, 2012, Plaintiff filed this lawsuit.

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

Case No.	SACV 12-627 AG (RNBx)	Date	August 10, 2012
Title	TRENCHES, INC, ET AL. v. HANOVER INSURANCE COMPANY		

LEGAL STANDARD

A court should dismiss a complaint when its allegations fail to state a claim upon which relief can be granted. Fed. R. Civ. P. 12(b)(6). A complaint need only include "a short and plain statement of the claim showing that the pleader is entitled to relief." Fed. R. Civ. P. 8(a)(2). "'[D]etailed factual allegations' are not required." *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1940 (2009) (citing *Bell Atl. Corp. v. Twombly*, 550 U.S. 554, 555 (2007) (stating that "a complaint attacked by a Rule 12(b)(6) motion to dismiss does not need detailed factual allegations")). The Court must accept as true all factual allegations in the complaint and must draw all reasonable inferences from those allegations, construing the complaint in the light most favorable to the plaintiff. *Pollard v. Geo Group, Inc.*, 607 F.3d 583, 585 n.3 (9th Cir. 2010).

But the complaint must allege "sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Iqbal*, 129 S. Ct. at 1949 (quoting *Twombly*, 550 U.S. at 570). "A claim has facial plausibility when the pleaded factual content allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Iqbal*, 129 S. Ct at 1940 (citing *Twombly*, 550 U.S. at 556). A court should not accept "threadbare recitals of a cause of action's elements, supported by mere conclusory statements," *id.*, or "allegations that are merely conclusory, unwarranted deductions of fact, or unreasonable inferences." *Sprewell v. Golden State Warriors*, 266 F.3d 979, 988 (9th Cir. 2001). The Ninth Circuit addressed post-*Iqbal* pleading standards in *Starr v. Baca*, 652 F.3d 1202, 1204 (9th Cir. 2011). The *Starr* court held that allegations "must contain sufficient allegations of underlying facts to give fair notice and to enable the opposing party to defend itself effectively . . . [and] plausibly suggest an entitlement to relief, such that it is not unfair to require the opposing party to be subjected to the expense of discovery and continued litigation." *Id* at 1216*; see also Balderas v. Countrywide Bank, N.A.*, 664 F.3d 787, 790-91 (9th Cir. 2011) ("Complaints need only allege facts with sufficient specificity to notify defendants of plaintiffs' claims" and "support a theory that is not facially implausible[.]").

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

Case No.	SACV 12-627 AG (RNBx)	Date	August 10, 2012
Title	TRENCHES, INC, ET AL. v. HANOVER INSURANCE COMPANY		

If the Court decides to dismiss a complaint, it must also decide whether to grant leave to amend. "A district court may deny a plaintiff leave to amend if it determines that allegation of other facts consistent with the challenged pleading could not possibly cure the deficiency . . . or if the plaintiff had several opportunities to amend its complaint and repeatedly failed to cure deficiencies." *Telesaurus VPC, LLC v. Power*, 623 F.3d 998, 1003 (9th Cir. 2010). A claim may be dismissed with prejudice if "amendment would be futile." *Swartz v. KPMG LLP*, 476 F.3d 756, 761 (9th Cir. 2007) (citing *Albrecht v. Lund*, 845 F.2d 193, 197 (9th Cir. 1988)).

PRELIMINARY MATTERS

Both Defendant and Plaintiffs filed Requests for Judicial Notice.

The Court may consider three kinds of documents when ruling on a motion to dismiss. First, the Court may consider documents attached to the Complaint. *See* Fed R. Civ. P. 10(c) ("A copy of a written instrument that is an exhibit to a pleading is a part of the pleading for all purposes."); *see also U.S. v. Ritchie*, 342 F.3d 903, 907–08 (9th Cir. 2003) (court may consider documents attached to the complaint).

Second, the Court may consider documents "whose contents are alleged in a complaint and whose authenticity no party questions, but which are not physically attached to the pleading." *Branch v. Tunnell*, 14 F.3d 449, 454 (9th Cir.1994) (overruled on other grounds by *Galbraith v. Cnty. of Santa Clara*, 307 F.3d 1119 (9th Cir.2002)); *see also Parrino v. FHP, Inc. et. al*, 146 F.3d 699, 705-706 (9th Cir. 1997) (holding that a court ruling on a motion to dismiss may consider "documents critical to plaintiff's claims, but not explicitly incorporated in his complaint" provided neither party questions its authenticity).

Third, the Court may consider documents that it has taken judicial notice of under Federal Rule of Evidence 201(b). "The court may judicially notice a fact that is not subject to reasonable dispute because it: (1) is generally known within the trial court's territorial

jurisdiction; or (2) can be accurately and readily determined from sources whose accuracy cannot reasonably be questioned." Fed. R. Evid. 201(b). Courts may take judicial notice of "*undisputed* matters of public record," but generally may not take judicial notice of "*disputed* facts stated in public records." *Lee v. City of Los Angeles*, 250 F.3d 668, 690 (9th Cir. 2001) (emphasis in original).

Here, Defendant asks this Court to take judicial notice of the following exhibits, identified as follows: (A) the Complaint in this action, (B) the Hoodz Complaint, (C) the First Amended Hoodz Complaint, (D) the complaint in the Prior Action, (E) the Opinion of the Court in *United States v. Toschiaddi*, and (F) the Judgment and Probation/Commitment Order in *United States v. Maraletos*. All of the exhibits are publicly-filed court documents.

The Court DENIES Defendant's request as to Exhibit A. The Court may consider the Complaint filed in this action without formal judicial notice, because it is part of this Court's docket. The Court GRANTS Defendant's request as to Exhibits B-F, although the Court did not rely on Exhibits E-F for its opinion here. Exhibits B-F are all publicly-filed court documents appropriate for judicial notice under Rule 201, although it seems that Exhibit E might simply be cited as legal, not factual, authority. Exhibits B-F are also appropriate for consideration because their contents are alleged in the Complaint.

Plaintiffs ask this Court to take judicial notice of, or otherwise consider the following exhibits, numbered as follows: (1) an April 16, 2012 letter from themselves to Defendant; (2) an April 27, 2012 letter sent from themselves to Defendant, and (3) a Joint Report of Early Meeting of Counsel in the Underlying Action.

Defendants oppose Plaintiffs' request because these materials are not appropriate for judicial notice, and are not referenced in the April 23, 2012 Complaint. The Court agrees. Communications between counsel generally do not fall under Federal Rule of Evidence 201. And because Plaintiffs' exhibits were not attached to or referenced in the Complaint, they are not are not appropriate for judicial consideration on those grounds.

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

Case No.	SACV 12-627 AG (RNBx)	Date	August 10, 2012
Title	TRENCHES, INC, ET AL. v. HANOVER INSURANCE COMPANY		

The Court DENIES Plaintiff's request for judicial notice.

ANALYSIS

Defendant asserts that it has no duty to defend Plaintiffs because the Underlying Action falls outside of the scope of the Policy. Even if it falls within the scope of the Policy, Defendant claims it still has no duty to defend Plaintiffs because the Underlying Action falls under one of three exclusions: the intellectual property exclusion ("Intellectual Property Exclusion"), the prior publication exclusion ("Prior Publication Exclusion"), or the breach of contract exclusion ("Breach of Contract Exclusion").

The Court begins its analysis by reviewing the scope of an insurer's duty to defend. Applying this standard, the Court finds that the Complaint alleges that the Underlying Action falls within the scope of the Policy, but that the Breach of Contract Exclusion bars coverage.

1. DUTY TO DEFEND

An insurance company such as Defendant is obligated to "defend a suit where the evidence suggests, but does not conclusively establish, that the loss is not covered [until] undisputed facts conclusively show, as a matter of law, that there is no potential for liability." *Montrose Chem. Corp. v. Sup. Crt.*, 6 Cal. 4th 287, 299 (1993.) The insurance company must establish that the "complaint can by no conceivable theory raise a single issue which could bring it within the policy coverage." *Id.* at 299-300 (citations omitted) (emphasis in original). "[A]nything beyond a bare 'potential' or 'possibility' of coverage'" triggers the company's duty to defend. *Id.* Thus, the insured need only show that the underlying claim "may fall within policy coverage [but] the insurer must prove it cannot." *Id.*

To determine whether there is a duty to defend, courts usually begin by "comparing the allegations of the complaint with the terms of the policy." *Id.* at 295. But "facts extrinsic

to the complaint also give rise to a duty to defend when they reveal a possibility that the claim may be covered by the policy." *Id.* Conversely, "facts extrinsic to the third party complaint may obviate an insurer's defense duty" if those facts establish that "the underlying claim cannot come within the policy coverage by virtue of the scope of the insuring clause or the breadth of an exclusion." *Id*. at 300-301. Although extrinsic facts may give rise to a defense obligation, an insurer is not required to speculate about "extraneous 'facts' regarding potential liability or ways in which the third party claimant might amend its complaint at a future date." *Gunderson v. Fire Ins. Exch.*, 37 Cal. App. 4th 1106, 1114 (1995). Instead, an insurer's duty to defend is determined by "the allegations on the face of the third party complaint, and from extrinsic evidence available to it at the time." *Id.*

2. SCOPE OF COVERAGE

Applying this standard, the Court analyzes Defendant's duty to defend by comparing the Policy coverage with the allegations in the Underlying Action. This comparison reveals a possibility that the Underlying Action fell under the scope of the Policy.

First, the Court considers the relevant Policy provisions. The Policy requires Defendant to defend Plaintiffs in any action seeking damages for "personal and advertising injury." (DRJN, Ex. A, p. 25.) "Personal and advertising injury" is defined as including, among other things, "[t]he use of another's advertising idea in your 'advertisement . . . .'" (DRJN, Ex. A, p. 33.) "Advertisement" is defined as "a notice that is broadcast or published to the general public or specific market segments about your goods, products, or services for the purpose of attracting customers or supporters." (DRJN, Ex. A, p. 31.)

Thus, Defendant has a duty to defend Plaintiffs if the Underlying Action seeks damages for the use of Hoodz' advertising idea in any notice that Plaintiffs published about their services for the purpose of attracting customers.

Second, the Court considers the scope of the Underlying Action. The Hoodz' FAC

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

Case No.	SACV 12-627 AG (RNBx)	Date	August 10, 2012
Title	TRENCHES, INC, ET AL. v. HANOVER INSURANCE COMPANY		

challenges Plaintiffs' continued use of the Hoodz' trademark, trade dress, and proprietary business systems. (DRJN, Ex. C, ¶¶ 79, 80, 82, 83.) It alleges that the Hoodz' trademark "has been widely advertised and promoted by Hoodz." (DRJN, Ex. C, ¶ 17.) Thus, the Hoodz' FAC alleges that Plaintiffs used Hoodz' intellectual property, which is arguably an advertising idea. *See, e.g., Lebas Fasion Imports of the USA, Inc. v. ITT Hartford Ins. Group*, 50 Cal. App. 4th 548, 562 (1996) ("the misappropriation of an 'advertising idea' . . . appl[ies] to wrongful taking of the manner or means by which another advertises its goods or services.").

The Underlying Action further alleges that Plaintiffs' used Hoodz' intellectual property without permission, giving "consumers the improper indication that [Plaintiffs] are still operating as [a] licensed HOODZ franchise." (DRJN, Ex. C, ¶ 71.) This is sufficient to allege that Plaintiffs used Hoodz' advertising idea in their own "advertising," because they broadcast themselves as a Hoodz franchise to potential customers.

Based on this comparison, the Court concludes that Plaintiffs have alleged that the Underlying Action falls within the scope of the Policy.

Defendant's argument to the contrary is confused. Defendant erroneously conflates one independent sub-section of the "personal and advertising injury" definition with another independent sub-section of that definition. Namely, Defendant conflates the section providing coverage for actions alleging "the use of another's advertising idea in your advertisement" with the section that *also provides coverage* for actions that allege "[i]nfringing upon another's . . . trade dress . . . in your 'advertisement.'" (DRJN, Ex. A, p. 33.) Having conflated the two sub-sections, Defendant argues that the Underlying Action is barred because there are no allegations of *trade dress* in any advertisement, and because there are no allegations of damages arising from violations of *trade dress*.

Defendant ignores that fact that these two sub-sections each provide a separate basis for coverage. The "use of another's advertising idea in your advertisement" sub-section is *not* limited to trade dress. True, that sub-section might well be limited to trade-dress allegations under the Intellectual Property Exclusion (a hurdle which Plaintiff could likely

clear). But exclusions are the next step in this Court's analysis, not a threshold question. At this stage, Plaintiffs may establish coverage under "personal and advertising injury" sub-section, without any limitation.

Thus, the Court concludes that Plaintiffs have alleged a "potential for liability" that requires Defendant to defend Plaintiffs in the Underlying Action unless an exclusion applies. *Montrose*, 6 Cal. 4th at 299.

2. BREACH OF CONTRACT EXCLUSION

The Court now analyzes whether the Breach of Contract Exclusion applies. Defendant "bears the burden of bringing itself within a policy's exclusionary clauses" which are "strictly construed." *HS Services, Inc. v. Nationwide Mut. Ins. Co.*, 109 F.3d 642, 645 (9th Cir. 1997).

The Breach of Contract Exclusion bars coverage for any "[p]ersonal and advertising injury arising out of a breach of contract, except an implied contract to use another's advertising idea in your 'advertisement.'" (DRJN, Ex. A, p. 25.) Defendant and Plaintiffs debate whether the alleged personal and advertising injuries "arise out of" a breach of contract.

Plaintiffs cite an unpublished district court case, *Tower Ins. of New York v. Capurro Enter., Inc.*, No. 11-CV-03806 SI (N.D. Cal. Apr. 2, 2012) for the proposition that courts in California only apply the breach of contract exclusion to claims that would not have occurred "but for" the breach. The *Tower* court reasoned that this narrow reading was a logical extension of the general rule that insurance policy exclusions are construed narrowly. *See, e.g., Atlantic Mutual Ins. Co. v. J. Lamb, Inc.*, 100 Cal. App. 4th 1017, 1039 (2002) ("An insurer that wishes to rely on an exclusion has the burden of proving, through conclusive evidence, that the exclusion applies in all possible worlds.")

The *Tower* analysis is not applicable here because the phrase "arising out of" is not

ambiguous. Rather, "[c]ourts in California and elsewhere have consistently given a broad interpretation to terms such as 'arising out of' in various kinds of insurance provisions. It is settled that this 'arising out of' language does not import any particular standard of causation or theory of liability into an insurance policy. Rather, it broadly links a factual situation with the event creating liability, and connotes only a minimal causal connection or incidental relationship." *Acceptance Ins. Co. v. Syufy Enters*., 69 Cal. App. 4th 321, 328 (1999); *see also Continental Cas. Co. v. City of Richmond*, 763 F.2d 1076, 1080 (9th Cir.1985) (finding that "arising out of" means "an incidental relationship to the injury," even when the language falls within an exclusionary clause). Significantly, this analysis "is true even when the term is used in an exclusionary provision and a broad interpretation results in limiting coverage." *Nestle USA, Inc. v. Travelers Cas. & Sur. Co. of America*,10 Fed. Appx. 438, 439-40 (9th Cir. 2001) (citing *Continental Cas. Co.*, 763 F.2d at 1080).

Thus, in this case the Breach of Contract exclusion is unambiguous. *See, e.g*,. *Continental Cas. Co.*, 763 F.2d at 1080 (finding the phrase "arising from" unambigious"). It excludes from coverage any personal and advertising injury that bears a "minimal causal connection or incidental relationship" to the breach of contract." *Id.* Because it is unambiguous, the *Tower* analysis does not apply.

Having determined the broad scope of the Breach of Contract Exclusion, the Court must still determine whether it applies here. As long as Hoodz' infringement claim bears a "minimal causal connection or incidental relationship" to its breach of contract claim, the Court must find that the exclusion bars Plaintiff's claims.

The Ninth Circuit opinion in *Nestle USA* is instructive. In *Nestle USA*, Nestle contracted with Stoner, a company engaged in the sale of distressed food products, to sell its defective tomato paste product. The contract provided, among other things, that Stoner would not use Nestle's trademarks and would remove the labels from the tomato paste cans before resale. Nestle sued Stoner for allegedly violating the contract in various ways, including reselling the product without removing the labels. The complaint alleged claims for breach of contract, trademark infringement, violations of Lanham Act, and

various tort claims. Travelers declined to defend Stoner. Stoner and Nestle eventually settled the Underlying Action with Stoner agreeing to assign its claims against Travelers to Nestle.

On appeal, the Ninth Circuit considered whether the breach of contract exclusion in the Traveler's insurance policy applied. This exclusion barred trademark infringement claims arising out of breach of contract claims. *Id.,* at 439. The Court concluded that it did apply. *Id.* The Court reasoned that Nestle's Lanham Act allegations "all arise out of the *factual* situation that constituted a breach of contract . . . ." *Id.*, at 440 (emphasis added). Thus, the breach of contract exclusion applied even though the Lanham Act claims had a separate and independent *legal* basis. *Id.; see also Century Transit Sys., Inc. v. Am. Empire Surplus Lines Ins. Co.*, 42 Cal. App. 4th 121, 127 n.4 (1996) (to determine whether one claim arises out of another, the court must "examine the conduct underlying the . . . lawsuit, instead of the legal theories attached to the conduct.") (citations and quotations omitted).

The *Nestle USA* holding makes logical sense. If Stoner was allowed to re-characterize its breach of contract as an advertising injury, it could pass the costs off to Traveler, and breach the contract with impunity.

The *Nestle USA* analysis squarely fits the facts of this case. As in *Nestle USA,* Hoodz' trademark infringement and unfair competition claim arises out of the same *factual* situation as its breach of contract claim. In fact, the factual basis for the former entirely subsumes the latter. Under the Franchise Agreements and the Settlement Agreement, Plaintiffs had a right to use Hoodz' intellectual property. As part of both Agreements, Plaintiffs agreed that once Hoodz' terminated the Franchise Agreement, Plaintiff no longer had a right to use that intellectual property. Plaintiffs' continued use of that intellectual property constituted a breach of contract. Indeed, Hoodz specifically alleged that Plaintiffs violated the Settlement Agreement because, "[d]espite their obligation to do so under the Franchise Agreements, [Plaintiffs] have not ceased using HOODZ's federally registered Mark and trade dress." (DRJN, Ex. C, ¶ 70.)

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

Case No.	SACV 12-627 AG (RNBx)	Date	August 10, 2012
Title	TRENCHES, INC, ET AL. v. HANOVER INSURANCE COMPANY		

Because Hoodz'infringement claim arises out of the same factual situation as its breach of contract claim, the Breach of Contract Exclusion applies, even though the former has an independent legal basis. As in *Nestle USA*, this holding makes logical sense. If Plaintiffs were allowed to re-characterize their breach of the Settlement and Franchise Agreements as advertising injuries, they could pass the costs off to Defendant, and breach those contracts with impunity.

Because the Breach of Contract Exclusion unambiguously applies, Plaintiff's Complaint fails to allege any facts that could conceivably give rise to a duty to defend given the facts of this case.

DISPOSITION

The Court GRANTS Defendants' Motion.

The Court concludes that "allegation of other facts consistent with the challenged pleading could not possibly cure the deficiency . . . ." *Telesaurus*, 623 F.3d at 998. Thus, "amendment would be futile." *Swartz*, 476 F.3d 756 at 761 (citing *Albrecht*, 845 F.2d at 197. The Court DENIES leave to amend.

Defendant may submit a proposed judgment within 14 days of this Order becoming final.

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