No. A170821

IN THE COURT OF APPEAL
OF THE STATE OF CALIFORNIA
FIRST APPELLATE DISTRICT, DIVISION ONE

CALIFORNIA DENTAL ASSOCIATION et al.,

Appellants,

v.

DELTA DENTAL OF CALIFORNIA et al.,

Respondents.

Appeal from San Francisco Superior Court,
Case No. CGC-22-603753
Hon. Ethan Schulman

APPELLANTS' REPLY BRIEF

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I. INTRODUCTION

As appellants California Dental Association and the Individual Plaintiffs[1] (collectively CDA) demonstrated in opening, the trial court erred in sustaining demurrers to CDA's Second Amended Complaint without leave to amend. The Second Amended Complaint more than adequately alleged claims for breach of the implied covenant of good faith and fair dealing, breach of fiduciary duty, and declaratory relief. There is no merit to the contrary arguments in the brief filed by respondents Delta Dental of California and the Individual Defendants[2] (collectively Delta Dental).

The trial court sustained the demurrer to the claim for breach of the implied covenant because it interpreted the applicable agreements to provide that Delta Dental has "unfettered discretion" to set fees for reimbursing Dentist Members. While conceding on appeal that the implied covenant applies (e.g., RB 50), Delta Dental doubles down on the notion that it has "unfettered discretion," effectively reading the implied covenant

[1] The Individual Plaintiffs are Meredith Newman, D.M.D; Tom Massarat, D.D.S.; Spencer Anderson,, D.D.S.; Steve Chen, D.D.S.; Ray Klein, D.D.S.; Garrett Russikoff, D.M.D.; and Shadie Azar, D.M.D.

[2] The Individual Defendants are members of Delta Dental's Board of Directors and of its "Dentist Compensation Committee," or "Compensation Committee," to which the Board delegated its authority regarding dentist reimbursement fees. More specifically, they are Roy A. Gonella; Glen F. Bergert; Stephen F. McCann; Heidi Yodowitz; Terry A. O'Toole; and Andrew J. Reid. (See also AOB 10–11, fn. 1.)

out of the Participating Provider Agreements (PPAs)[3] between Delta Dental and the Dentist Members, which incorporate Participating Dentist Rules (PDRs). Delta Dental's misreading of the contracts to grant itself "unfettered discretion" is refuted by the Settlement Agreement that resolved prior litigation between the parties and established the terms of the PDRs. Under the Settlement Agreement, Delta Dental's discretion is explicitly *not* "unfettered"; instead, it is expressly constrained by the covenant of good faith and fair dealing, which Delta Dental violated.

Delta Dental argues that under *Carma Developers (Cal.), Inc. v. Marathon Development California, Inc.* (1992) 2 Cal.4th 342, 374 (*Carma*), it is not prohibited "from doing that which is expressly permitted by [the] agreement." But CDA does not argue that Delta Dental is prohibited from doing what is expressly permitted. What is permitted is expressly *limited* by the Settlement Agreement's provision that nothing in the agreement would be construed as overriding the implied covenant of good faith and fair dealing. Delta Dental was granted discretion to determine reimbursement fees, but under *Carma*, the implied covenant "finds particular application in situations where one party is invested with a discretionary power affecting the rights of another. Such power must be exercised in good faith." (*Id.* at p. 372.) And the Settlement Agreement

[3] The PPAs were formerly called Participating Dentist Agreements (PDAs).

explicitly confirmed that this obligation applies to Delta Dental's fee setting.

Delta Dental also argues that it has the express right to set fees under the "Health Care Providers' Bill of Rights," part of the Knox-Keene Act. (See Cal. Health & Safety Code, § 1375.7.) According to Delta Dental, the Health Care Providers' Bill of Rights somehow abrogated the implied covenant of good faith and fair dealing for all health plans in California. That argument fails, as the very name of the statute makes clear. The Health Care *Providers'* Bill of Rights does not eliminate health care providers' rights under the implied covenant of good faith and fair dealing. The Bill of Rights, in fact, says nothing at all about the implied covenant and cannot be used to argue that those rights and duties no longer exist. CDA's cause of action for breach of the implied covenant is independent of, and not preempted by, the Health Care Providers' Bill of Rights.

Delta Dental also contends that the trial court correctly sustained the demurrer to CDA's claim for breach of fiduciary duty because the Individual Defendants, who are directors, purportedly owe no fiduciary duty to the Individual Plaintiffs as Dentist Members. But "the directors of a nonprofit mutual benefit corporation, like [Delta Dental] here, are fiduciaries who must act for the benefit of the corporation *and its members*." (*Coley v. Eskaton* (2020) 51 Cal.App.5th 943, 958 (*Coley*), emphasis added.) Delta Dental's efforts to evade that plain statement of the

law have no merit.

There is also no merit to Delta Dental's argument that establishing unfair reimbursement fees under the PPAs based on an improper process is not a violation of *membership* rights. In fact, the right to enter into a PPA is a "privilege of membership." (AA266.) The PPAs are at the heart of Delta Dental's corporate purpose, which is "to provide dental benefit coverage through" the PPAs. (AA327 ¶ 38.) Dentists become members of Delta Dental in order to obtain fair reimbursement for their services. Membership and reimbursement fees are inextricably intertwined.

Delta Dental's argument that the Individual Defendants are shielded by the business judgment rule—an issue not reached by the trial court—is meritless. Indeed, Delta Dental's willingness to abandon the reasoning offered by the trial court in favor of an "alternative" argument based on extraneous documents is telling. Delta Dental's argument is based on documents that are *not* part of the complaint, that were *not* judicially noticed by the trial court, and that Delta Dental expressly does *not* ask this Court to judicially notice. (See RB 24, fn. 6.) "A demurrer reaches only to the contents of the pleading and such matters as may be considered under the doctrine of judicial notice." (*Weil v. Barthel* (1955) 45 Cal.2d 835, 837 (*Weil*).) Delta Dental's reliance on documents not contained in the complaint and not judicially noticed is improper.

Moreover, Delta Dental relies on those documents for the purported

truth of statements within them, whereas judicial notice is only proper as to the *existence* of the documents. (See, e.g., *Fremont Indemnity Co. v. Fremont General Corp.* (2007) 148 Cal.App.4th 97, 113 (*Fremont*).) In any case, Delta Dental has at most raised factual questions about the adequacy of the Individual Defendants' inquiry into reimbursement fees. Discovery will show that the inferences Delta Dental tries to draw from these extraneous documents are false. But those factual disputes cannot be resolved on demurrer. "In short, a court cannot by means of judicial notice convert a demurrer into an incomplete evidentiary hearing in which the demurring party can present documentary evidence and the opposing party is bound by what that evidence appears to show." (*Id.* at p. 115.)

Because the trial court erred in sustaining the demurrer to CDA's claims for breach of the implied covenant and the duty of care, it also erred in sustaining the demurrer to CDA's claim for declaratory relief.

Finally, the trial court abused its discretion in denying CDA leave to amend. The complaint can be amended to more explicitly establish that Delta Dental knew and agreed that its discretion to set fees is not "unfettered." Because those allegations refute the trial court's ruling that Delta Dental has "unfettered discretion," the trial court should have granted CDA leave to add those allegations.

For all of these reasons and more established below and in CDA's opening brief, the Court should reverse the judgment of dismissal.

II. BACKGROUND

It is worth briefly reiterating the facts because Delta Dental's account distorts them. Delta Dental is a nonprofit mutual benefit corporation and 501(c)(4) social welfare organization whose stated mission is "to provide dental benefit coverage through contracts with independent professional service providers." (AA316 ¶ 2.) Those providers are Dentist Members. (*Ibid.*) It is a "privilege of membership" to enter into a PPA with Delta Dental. (AA266, AA323, AA329 ¶¶ 20, 42.)

In 2018, the parties settled a prior case regarding reimbursement fees under the PPAs (then called PDAs). (AA151.) The Settlement Agreement gave Delta Dental discretion to determine reimbursement fees, but expressly provided that "nothing contained herein shall be construed to constitute an agreement that Delta Dental may violate any statutory or common law right by future conduct." (AA180.) "In this regard, the Settlement Agreement was intended to and did restrict Delta Dental's discretion and impose accountability for decisions regarding reimbursement rates. . . . Accordingly, while Delta Dental may have been accorded discretion, that discretion was expressly limited, affording Dentist Members crucial protection with respect to fee changes going forward." (AA330 ¶ 46.) Thus, "Delta Dental does not have unfettered discretion to alter the reimbursement fees and structure applicable to Dentist Members. Delta Dental cannot set fees in an arbitrary manner or in a manner that deprives

Dentist Members of the benefit of their bargain under their agreements with Delta Dental." (AA348 ¶ 86.) On the contrary, "in addition to the implied duty inherent in all agreements, the Settlement Agreement, which remains in effect and binding on Delta Dental, explicitly provides that Delta Dental may not violate any statutory or common law right by its future conduct, including with respect to the determination of provider fees." (*Ibid.*) Under that provision, which was the product of lengthy negotiations, Delta Dental is expressly bound by the covenant of good faith and fair dealing in setting fees. (*Ibid.*) "The purpose and intent of this provision, which refers to 'future conduct,' was to make it clear that going forward, Delta Dental could not write these protections out of existence," and that Delta Dental does not have "unfettered discretion." (*Ibid.*)

Despite the limitations on its discretion to alter reimbursement fees and the fee structure, Delta Dental adopted the 2023 Amendments, which substantially reduced reimbursement fees, in some cases by up to 40%. (AA342 ¶ 72.) The 2023 Amendments also changed the structure by which the fees of many Dentist Members are determined, including by eliminating their ability to submit their own fee schedules. (*Ibid.*) In some instances, the fee reduction is so significant that Dentist Members have no choice but to cease providing certain services—even when specifically requested by a patient, and even if the patient is willing to pay out of pocket amounts above the Delta Dental maximum fee, because Delta Dental punitively

prohibits such payments. (AA342–343 ¶ 73; see also AA331 ¶ 49.)

Some dentists have been forced to leave the network entirely, to the substantial detriment of their practices and availability to serve patients. (See, e.g., AA322 ¶ 19.) Most are "locked in," unable to "risk tremendous damage to their practices and disruption of their patient relationships if they leave Delta Dental's network." (AA331 ¶ 49.)

The Individual Defendants adopted the 2023 Amendments at a 75-minute Zoom meeting without any prior preparation and without the reasonable inquiry an ordinarily prudent director would have conducted. (AA336–339 ¶ 61.) There was no need for the Individual Defendants' haste and lack of inquiry—the existing fees had been in place for a decade without any significant increase, despite inflation. (AA330, AA338 ¶¶ 47, 61(d).) During that time, Delta Dental's profits and market dominance steadily increased. (AA331 ¶ 50.)

The changes made by the 2023 Amendments were monumental (AA336 ¶ 61), "representing a massive sea change in the relationship between Dentist Members and Delta Dental." (AA339 ¶ 62.) When Delta Dental was originally formed in 1955, its purpose was to "create conditions in which Dentist Members were more willing and able to serve California residents who needed dental service. Delta Dental's fee arrangements with its Dentist Members reflected these objectives and enabled Delta Dental to build the largest provider network in California and secure the market

dominance it enjoys today." (AA329 ¶ 44.) That all changed with the 2023 Amendments, which altered the fee structure that had been in place since 1955 and substantially reduced the reimbursement fees paid to Dentist Members, threatening their ability to continue to provide services to Delta Dental patients. (AA317 ¶ 4.) Instead of "provid[ing] dental benefit coverage through" the PPAs, which is Delta Dental's stated corporate purpose (AA322–323 ¶ 20), Delta Dental has *reduced* dental benefit coverage by reducing Dentist Members' ability to provide services to their patients. (See AA317 ¶ 4.)

The Individual Defendants, as directors, were required to carefully study these monumental changes, critically evaluating their impact on Dentist Members and their ability to serve patients. (AA336 ¶ 60.) Despite Delta Dental's general practice of providing appropriate materials to the Board so that they can be prepared ahead of meetings, however, Delta Dental provided nothing before the meeting at which the 2023 Amendments were approved. (AA337 ¶ 61(a).) The Individual Defendants were left to rely solely on the limited and selective information presented by management during the brief Zoom meeting. (*Ibid.*) That brief and superficial presentation was entirely inadequate to justify the massive changes the 2023 Amendments imposed. (AA337–338 ¶ 61(b); see also AA339–340 ¶ 64.) A reasonably prudent director would have required materials addressing the need for and impact of the 2023 Amendments,

especially because the Individual Defendants, who are not dentists, lacked sufficient information about the impact of the 2023 Amendments on Dentist Members and their patients. (AA338 ¶ 61(c).) Rather than conduct a reasonable inquiry, the Individual Defendants simply rubber-stamped the 2023 Amendments. (AA339 ¶ 62.)

III. ARGUMENT

A. The trial court erred in sustaining the demurrer to the claim for breach of the implied covenant of good faith and fair dealing.

1. The covenant finds particular application where, as here, one party has discretionary power.

The covenant of good faith and fair dealing is implied in every contract and "finds particular application in situations where one party is invested with a discretionary power affecting the rights of another. Such power must be exercised in good faith." (*Carma*, *supra*, 2 Cal.4th at p. 372.) Failure to set fees "in good faith at a reasonable level" is a breach of the implied covenant. (*Lazar v. Hertz Corp.* (1983) 143 Cal.App.3d 128, 141 (*Lazar*).) Delta Dental attempts to distinguish *Lazar* on the grounds that it "merely addressed class certification." (RB 34.) But in holding that the class should have been certified, the court relied on the allegation that the defendant violated the implied covenant by failing to set a charge "in good faith at a reasonable level." (*Lazar*, *supra*, 143 Cal.App.3d at p. 141.)

Here, as CDA demonstrated in opening and alleged in the Second Amended Complaint, Delta Dental breached the implied covenant by

enacting the 2023 Amendments. Those amendments completely changed the method for determining fees for many Dentist Members. (AA317 ¶ 4.) They also imposed unreasonably low reimbursement fees that significantly penalize Dentist Members and hinder their ability to provide services to patients pursuant to the PPA, depriving them of the benefit of their bargain with Delta Dental. (AA341–342, AA352 ¶¶ 70, 102.) In imposing the 2023 Amendments, Delta Dental failed to act fairly and in good faith. Instead, it rubber-stamped the 2023 Amendments based on a deficient process and woefully inadequate information. (AA336–342, AA352 ¶¶ 60–70, 102.)

Delta Dental cites *Carma* for the principle that the covenant does not prohibit "that which is expressly permitted by an agreement." (RB 30, quoting *Carma*, *supra*, 2 Cal.4th at p. 374.) But CDA does not seek to prohibit what is expressly permitted. The Settlement Agreement expressly limits what is permitted. (See AA180, AA330, AA348 ¶¶ 46, 86.) Contrary to Delta Dental's misinterpretation of the PPAs as granting it unfettered discretion, its discretion is constrained by the implied covenant—as a matter of law and under the express terms of the Settlement Agreement. (See *ibid.*; *Locke v. Warner Bros., Inc.* (1997) 57 Cal.App.4th 354, 367 (*Locke*).) As the Second Amended Complaint alleges, the parties expressly agreed that common law principles such as the implied covenant would apply to Delta Dental's conduct under the PPA. (See AA180, AA330, AA348 ¶¶ 46, 86.)

Delta Dental notes that the PPAs provide that maximum fees are "determined by Delta Dental" and that participating dentists "will accept" them. (RB 21, 34, 36, quoting AA251, AA247.) But that simply means that Delta Dental has discretion to determine fees. It must exercise that discretion in good faith, as *Carma* makes clear. (See 2 Cal.4th at p. 372.) Moreover, as alleged in the Second Amended Complaint, the allegations of which must be accepted as true on demurrer, the Settlement Agreement precludes Delta Dental from writing the covenant of good faith and fair dealing out of the contracts. (See AA180, AA330, AA348 ¶¶ 46, 86.) The Settlement Agreement "explicitly provides that Delta Dental may not violate any statutory or common law right by its future conduct, including with respect to the determination of provider fees," and "including the obligation to abide by the covenant of good faith and fair dealing, when setting fees." (AA348 ¶ 86.) The "purpose and intent of this provision" was "to make it clear that going forward, Delta Dental could not write these protections out of existence." (*Ibid.*)

None of the cases on which Delta Dental relies support its effort to evade the requirement that discretion must be exercised in good faith. *Guz v. Bechtel Nat. Inc.* (2000) 24 Cal.4th 317, 350 (*Guz*) concerned at-will employment agreements, which may be terminated "for any or no reason." There is no corresponding provision of unfettered discretion in the agreements at issue here. On the contrary, the Settlement Agreement refutes

any contention that Delta Dental has unfettered discretion. (See AA180, AA330, AA348 ¶¶ 46, 86.)

Bevis v. Terrace View Partners, LP (2019) 33 Cal.App.5th 230, 256 held that the implied covenant cannot prohibit a particular action that the contract expressly allows. CDA does not seek to prohibit any action that is expressly allowed. Delta Dental is allowed to set fees. But its discretion is limited by the implied covenant of good faith and fair dealing, as a matter of law and under the Settlement Agreement. (See *Locke*, *supra*, 57 Cal.App.4th at p. 367; AA180, AA330, AA348 ¶¶ 46, 86.)

In *Hewlett-Packard Co. v. Oracle Corp.* (2021) 65 Cal.App.5th 506, the court upheld a jury verdict for the plaintiff on a claim for breach of the implied covenant. The defendant in *Hewlett-Packard*, like Delta Dental here, did not have "unfettered discretion." (*Id.* at p. 555.) The jury properly held the defendant liable for breach of the implied covenant. (*Id.* at pp. 555–556.)

And in *California Grocers Assn. Inc., v. Bank of America* (1994) 22 Cal.App.4th 205, the court held that imposing a $3 fee that was *explicitly provided for in the contract* did not violate the implied covenant. (See *id.* at p. 217.) There is no such provision at issue here.

Delta Dental also relies on *Third Story Music, Inc. v. Waits* (1995) 41 Cal.App.4th 798, but that reliance is "misplaced" for the reasons stated in *Locke*, *supra*, 57 Cal.App.4th at page 367. In *Third Story Music*, the

defendant was expressly granted the right, at its election, to refrain from marketing Tom Waits's music. The court in *Locke* distinguished the explicit right to refrain from marketing activities from the arrangement between Sondra Locke and Warner Brothers, whereby the latter agreed to either produce Ms. Locke's movies or pay her a fee. Although that either-or proposition would seem to encompass the right to not produce her movies, that right was not explicit. The "agreement did not give Warner the express right to refrain from working with Locke. Rather, the agreement gave Warner *discretion* with respect to developing Locke's projects. The implied covenant of good faith and fair dealing obligated Warner to exercise that discretion honestly and in good faith." (*Ibid.*)

Here, as in *Locke*, the Settlement Agreement and PPAs gave Delta Dental *discretion* to set fees, but the implied covenant and the Settlement Agreement obligated Delta Dental to exercise that discretion honestly and in good faith. (See *Locke*, *supra*, 57 Cal.App.4th at p. 367; AA180, AA330, AA348 ¶¶ 46, 86.) Delta Dental failed to do so, as CDA amply alleged. (See AA330, AA336–342, AA348, AA352 ¶¶ 46, 60–70, 86, 102.)

2. The trial court erred in reading the implied covenant out of the contracts based on its misinterpretation of the Settlement Agreement.

Delta Dental contends that the trial court did not hold that Delta Dental has no duty of good faith and fair dealing. (RB 26–27.) But the trial court held that "[i]mposing a covenant of good faith and fair dealing would

impermissibly contradict the express terms of the settlement agreement." (AA768.) According to the trial court, the Settlement Agreement and PPAs give Delta Dental "unfettered discretion." (*Ibid.*) That interpretation contradicts the Settlement Agreement and the Second Amended Complaint.

As already discussed, the Settlement Agreement "was intended to and did restrict Delta Dental's discretion and impose accountability for decisions regarding reimbursement rates. Per the terms of the Settlement Agreement, Delta Dental's obligation to comply with statutory and common law carried forward to all future conduct including (among other things) the setting of fees." (AA330 ¶ 46.) "The purpose and intent of this provision, which refers to 'future conduct,' was to make it clear that going forward, Delta Dental could not write these protections out of existence." (AA348 ¶ 86.) Delta Dental, therefore, "does not have unfettered discretion to alter the reimbursement fees and structure applicable to Dentist Members." (*Ibid.*)

These allegations regarding the underlying intent and interpretation of the Settlement Agreement must be accepted as true on demurrer. (See, e.g., *Moore v. Wells Fargo Bank, N.A.* (2019) 39 Cal.App.5th 280, 300 (*Moore*); *Rutherford Holdings, LLC v. Plaza Del Rey* (2014) 223 Cal.App.4th 221, 229 (*Rutherford*); *Fremont*, *supra*, 148 Cal.App.4th at pp. 114–115.)

In *Moore*, the Court of Appeal reversed the trial court's grant of

nonsuit on a claim for breach of the implied covenant. The nonsuit was "based entirely on the trial court's interpretation of the contract documents. In essence, the trial court concluded Moore could not imply a covenant into the contract documents precluded by the express terms, as interpreted by the trial court." (*Moore*, *supra*, 39 Cal.App.5th at p. 300.) But the "breach of the implied covenant cause of action can be resolved only after a trier of fact resolves the contract interpretation issue." (*Ibid.*) Here, the trial court was not the trier of fact. It nonetheless adopted its contested interpretation of the Settlement Agreement and PPAs on demurrer. That was improper. (See *ibid.*)

The same conclusion follows from *Rutherford*, *supra*, 223 Cal.App.4th at page 229: "So long as the pleading does not place a clearly erroneous construction upon the provisions of the contract, in passing upon the sufficiency of the complaint, we must accept as correct plaintiff's allegations as to the meaning of the agreement." (Quoting *Aragon–Haas v. Family Security Ins. Services, Inc.* (1991) 231 Cal.App.3d 232, 239.)

Delta Dental tries to distinguish *Moore* and *Rutherford* by arguing that the agreements in those cases were ambiguous, whereas, according to Delta Dental, "there is no ambiguity" here. (RB 46.) But a contract is ambiguous "if the contract is susceptible of more than one reasonable interpretation." (*Fremont*, *supra*, 148 Cal.App.4th at p. 114.) The trial court adopted its interpretation whereby "[i]mposing a covenant of good faith and

fair dealing would impermissibly contradict the express terms of the settlement agreement." (AA768.) The Settlement Agreement is reasonably susceptible, instead, to the interpretation that Delta Dental's discretion to set fees is constrained by the implied covenant of good faith and fair dealing. That, indeed, is the meaning of the proviso that "nothing contained herein shall be construed to constitute an agreement that Delta Dental may violate any statutory or common law right by future conduct," as CDA has properly alleged. (AA180; see AA330, AA348 ¶¶ 46, 86.)

Furthermore, the court in *Fremont* held that "[f]or a court to take judicial notice of the meaning of a document submitted by a demurring party based on the document alone, without allowing the parties an opportunity to present extrinsic evidence of the meaning of the document, would be improper." (*Fremont*, *supra*, 148 Cal.App.4th at pp. 114–115.) Thus, a court ruling on a demurrer "cannot take judicial notice of the proper interpretation of a document submitted in support of the demurrer," particularly where, as here, that interpretation is disputed. (*Ibid.*)

Delta Dental tries to distinguish *Fremont* on the basis that the trial court here appropriately took judicial notice of the contracts at issue. (RB 46.) But the principles set forth in *Fremont* apply where judicial notice is proper; indeed, they apply even "with respect to a document attached to the complaint." (*Fremont*, *supra*, 148 Cal.App.4th at p. 115.) The point is that where, as here, the interpretation of a contract is subject to reasonable

dispute, the trial court cannot adopt a contested interpretation on demurrer because to do so improperly deprives the plaintiff of the "opportunity to present extrinsic evidence of the meaning of the document." (*Ibid.*)

Here, the parties intended the covenant of good faith and fair dealing to limit Delta Dental's discretion in setting fees. (See AA330, AA348 ¶¶ 46, 86.) As alleged in the Second Amended Complaint, the purpose and intent of the relevant provision of the Settlement Agreement was to make clear that the covenant of good faith and fair dealing, as well as other duties, applies to Delta Dental's conduct in setting fees. (*Ibid.*) The trial court erred by disregarding those allegations to adopt a contrary interpretation of the Settlement Agreement. (See AA768.)

3. The PPAs are governed by the Settlement Agreement, which refutes Delta Dental's contention that it has unfettered discretion to set reimbursement fees.

Delta Dental argues that the PPAs "are clear in providing DDC the right to unilateral [sic] set provider fees." (RB 34.) Delta Dental also argues that, under the Settlement Agreement, it "'has the right to determine unilaterally the provisions of the PDA (including the Rules). . . .'" (*Ibid.*, quoting AA180.)

But Delta Dental ignores the remainder of the sentence it quotes from the Settlement Agreement: "nothing contained herein shall be construed to constitute an agreement that Delta Dental may violate any statutory or common law right by future conduct." (AA180.) As already

discussed, that provision means that Delta Dental's right to set reimbursement fees "unilaterally" is constrained by the implied covenant. (See AA330, AA348 ¶¶ 46, 86.)

The PPAs and the incorporated PDRs are governed by the Settlement Agreement. The agreements "are interrelated and must be read together for purposes of interpretation." (*Heston v. Farmers Ins. Group* (1984) 160 Cal.App.3d 402, 417.) Although Delta Dental attempts to downplay the Settlement Agreement, it admits that the terms of the PDRs on which it relies "were attached as an appendix to the 2018 Settlement." (RB 21.)

Delta Dental contends that the Settlement Agreement "does not alter the covenant analysis" because it "neither expanded nor contracted the covenant." (RB 40.) But the point is that the Settlement Agreement explicitly makes the covenant applicable to the fee-setting process and thus defeats Delta Dental's argument, and the trial court's erroneous ruling, that Delta Dental has "unfettered discretion." (RB 35; AA768:12-13.) Delta Dental's discretion is limited by the covenant of good faith and fair dealing, as the Settlement Agreement provides. (See AA180, AA330, AA348 ¶¶ 46, 86.) Delta Dental was required to exercise its discretion fairly and in good faith. (See, e.g., *Locke*, *supra*, 57 Cal.App.4th at p. 367.) Instead, it acted unreasonably and set unfair fees. (See AA330, AA336–342, AA348, AA352 ¶¶ 46, 60–70, 86, 102.)

4. The Health Care Providers' Bill of Rights does not abrogate the implied covenant of good faith and fair dealing.

Delta Dental relies on the Health Care Providers' Bill of Rights, part of the Knox-Keene Act, but that is a red herring. The trial court merely held that the Health Care Providers' Bill of Rights does not limit Delta Dental's discretion to set fees. (AA764–766.) As CDA noted in opening, however, it does not rely on the Health Care Providers' Bill of Rights as a limitation on Delta Dental's discretion to set fees. CDA relies, instead, on the implied covenant of good faith and fair dealing. (See AOB 38, fn. 3.)

Delta Dental argues that the Health Care Providers' Bill of Rights supplants the implied covenant of good faith and fair dealing for all healthcare providers—a remarkable proposition. But nothing in that Bill of Rights purports to abrogate the covenant. That would be inconsistent with the fact that it is a Bill of Rights for *Health Care Providers*. (Cf. *Shell v. Schmidt* (1954) 126 Cal.App.2d 279, 286 [noting that "the very name of the statute disclose[d] its purpose"].)

Delta Dental relies on *Guz*, which held that the statutory "presumption that an employer may terminate its employees at will, for any or no reason" means that an employer may act "peremptorily, arbitrarily, or inconsistently." (*Guz*, *supra*, 24 Cal.4th at p. 350.) There is no corresponding statutory presumption in the Health Care Providers' Bill of Rights. Nothing in that Bill of Rights can be construed to allow dental plans

to act unfairly or in bad faith—that would be antithetical to the purpose of the Bill of Rights. (See Cal. Health & Safety Code, § 1375.7.)

Delta Dental relies on the statement in the Health Care Providers' Bill of Rights that "[n]othing in this section shall be construed or applied as setting the rate of payment to be included in contracts between plans and health care providers." (RB 38, quoting Cal. Health & Safety Code, § 1375.7(g).) But CDA does not argue that the Health Care Providers' Bill of Rights sets or governs the rate of payment. Delta Dental apparently interprets this anodyne provision to mean that the Health Care Providers' Bill of Rights supplants the implied covenant of good faith and fair dealing, but that is obviously not what it means. (See Cal. Health & Safety Code, § 1375.7(g).)

Delta Dental contends that under the Health Care Providers' Bill of Rights, it has the right to make "material changes" to its contracts with providers. (RB 38.) But nothing in the Health Care Providers' Bill of Rights allows Delta Dental to make material changes that violate the implied covenant of good faith and fair dealing; that is an independent covenant that is not addressed—and certainly is not abrogated—in the Health Care Providers' Bill of Rights. (See Cal. Health & Safety Code, § 1375.7.)

Delta Dental relies on *California Emergency Physicians Medical Group v. PacifiCare of California* (2003) 111 Cal.App.4th 1127 (*California Emergency Physicians*), disapproved by *Centinela Freeman Emergency*

Medical Associates v. Health Net of California, Inc. (2016) 1 Cal.5th 994, 1014, fn. 10 (*Centinela*). But *California Emergency Physicians* did not hold that the Health Care Providers' Bill of Rights, or the Knox–Keene Act more generally, bars claims for breach of the implied covenant of good faith and fair dealing. On the contrary, the court recognized that plaintiffs "may bring common law causes of action," and that "'[t]he Knox–Keene Act itself contemplates that a health care plan may be held liable under theories based on other law.'" (*California Emergency Physicians*, *supra*, 111 Cal.App.4th at p. 1134, quoting *Coast Plaza Doctors Hospital v. UHP Healthcare* (2002) 105 Cal.App.4th 693, 706, 129 (*Coast Plaza*).) Although "a common law cause of action that is contrary to a specific provision of the Knox–Keene Act" might not be expressly preserved by that Act (*ibid.*), Delta Dental does not point to any "specific provision of the Knox–Keene Act" that is contrary to the implied covenant of good faith and fair dealing.

Delta Dental's reliance on *Desert Healthcare Dist. v. PacifiCare FHP, Inc.* (2001) 94 Cal.App.4th 781 (*Desert Healthcare*), disapproved by *Centinela*, *supra*, 1 Cal.5th at p. 1014, fn. 10, is also misplaced. Nothing in *Desert Healthcare* suggests that the Knox–Keene Act supplants the implied covenant of good faith and fair dealing. The court merely rejected a statutory interpretation of one provision of that Act that would conflict with other provisions. (See *Desert Healthcare*, *supra*, 94 Cal.App.4th at p. 789.) *Desert Healthcare* had nothing to do with the implied covenant of good

faith and fair dealing or common law claims more generally. (See *ibid.*)

Far from supporting Delta Dental, *Cel-Tech Communications, Inc. v. Los Angeles Cellular Telephone Co.* (1999) 20 Cal.4th 163 refutes Delta Dental's argument. In *Cel-Tech*, the California Supreme Court held that if the Legislature has created a "safe harbor," plaintiffs cannot use the unfair competition law to assault that harbor. (*Id.* at p. 182.) But the court drew an important distinction between a statute that specifically creates a safe harbor versus one that simply does not prohibit the conduct at issue:

> To forestall an action under the unfair competition law, another provision must actually "bar" the action or clearly permit the conduct. There is a difference between (1) not making an activity unlawful, and (2) making that activity lawful. For example, Penal Code section 211, which defines robbery, does not make murder unlawful. Most assuredly, however, that section does not also make murder lawful. Acts that the Legislature has determined to be lawful may not form the basis for an action under the unfair competition law, but acts may, if otherwise unfair, be challenged under the unfair competition law even if the Legislature failed to proscribe them in some other provision.

(*Id.* at p. 183.)

Here, the Health Care Providers' Bill of Rights does not specifically allow Delta Dental to set reimbursement fees in a manner that violates the implied covenant of good faith and fair dealing. CDA's claim for breach of the implied covenant is independent of, and not preempted by, the Health Care Providers' Bill of Rights. Indeed, the trial court did not hold otherwise. It merely held that the Health Care Providers' Bill of Rights

does not limit Delta Dental's discretion to set fees. (AA764–766.) Again, CDA does not rely on the Health Care Providers' Bill of Rights, so the trial court's discussion of this issue is simply beside the point. (See *ibid.*)

5. Delta Dental's argument regarding "evergreen" contracts has no merit.

Delta Dental argues that "this is not a discretionary power case" because the PPAs are purportedly "evergreen" contracts. The point of this argument is not entirely clear—Delta Dental admits that the implied covenant applies to "evergreen" contracts and characterizes its own argument as "moot." (RB 50–51.) In any event, Delta Dental's argument is meritless.

Delta Dental relies exclusively on *Richards v. Direct Energy Services, LLC* (2d Cir. 2019) 915 F.3d 88, a federal summary-judgment case applying Connecticut law. *Richards* is inapposite, as CDA explained in opening. (See AOB 36–37.) Delta Dental contends that it makes no difference that *Richards* was decided on summary judgment and applied Connecticut law. (RB 50) But the procedural posture and governing law of the case make a dispositive difference. Connecticut law, unlike California law, imposes a "high bar" on implied-covenant claims, which are limited to "a narrow range of cases." (*Richards*, 915 F.3d at p. 97, citation omitted.) The Second Circuit judged the evidence against Connecticut's high bar and concluded that the plaintiff's claim had no merit. The case turned on the

plaintiff's failure to carry its burden on summary judgment, not on some purported difference between "evergreen" contracts and other contracts. (See *id.* at pp. 97–100.) Delta Dental is unable to cite a single case applying California law where a demurrer to a claim for breach of the implied covenant was sustained because the contract was "evergreen."

Furthermore, Delta Dental's argument that Dentist Members may simply "terminate the agreement" (RB 50) ignores reality and the allegations of the Second Amended Complaint. In fact, "Delta Dental has effectively locked in many of its Dentist Members, who risk tremendous damage to their practices and disruption of their patient relationships if they leave Delta Dental's network." (AA331 ¶ 49.) Delta Dental points to Dr. Shadie Azar as an example of a dentist who left the network (RB 48), but Delta Dental ignores the fact that Dr. Azar suffered significant damage to his practice. (AA322 ¶ 19.) As alleged in the Second Amended Complaint, "it is not practicable for Dentist Members to simply leave Delta Dental's network if they do not like the contract amendments unilaterally imposed by Delta Dental." (AA330 ¶ 48.) Indeed, "Delta Dental has specifically designed its PPAs and plans to maximize disruption to those dentists who leave the Delta Dental network." (AA330–331 ¶ 48.) As a result, Dentist Members are "locked in." (AA331 ¶ 49.)

6. Delta Dental's "prudential considerations" are meritless.

Delta Dental contends that "prudential considerations" compel

affirmance. According to Delta Dental, if the trial court's ruling is overturned "even a very small absolute or percentage decrease in fees would support a lawsuit." (RB 52.) This is a strawman. CDA alleged far more than a small decrease. CDA alleged a substantial decrease of up to 40% as part of a "sea change" in fee determination. (AA339, AA342 ¶¶ 62, 72.) CDA alleged an unreasonable process that resulted in unfair fees that deprive the Dentist Members of the benefit of their bargain in entering into the PPAs. (AA336–342, AA352 ¶¶ 60–70, 102.)

Delta Dental contends that its unfair process is irrelevant to the claim for breach of the implied covenant of good faith and fair dealing. (RB 51–53.) But Delta Dental offers no support for that proposition. It only cites *Carma* for the principle that the implied covenant prohibits "objectively unreasonable conduct." (*Id.* at 51–52, quoting *Carma*, *supra*, 2 Cal.4th at p. 373.) Delta Dental's process for setting the reimbursement fees was objectively unreasonable, as CDA alleged. (See AA330, AA336–342, AA348, AA352 ¶¶ 46, 60–70, 86, 102.)

Delta Dental also argues that courts are ill-situated to act as "price regulators." (RB 53.) But CDA does not ask the court to regulate prices. CDA asks that Delta Dental be required to comply with its duty of good faith and fair dealing. To hold Delta Dental to that duty does not require the court to set prices, and CDA does not ask it to do so.

In sum, the trial court erred in sustaining the demurrer to CDA's

claim for breach of the implied covenant. This Court should reverse.

B. The trial court erred in sustaining the demurrer to the claim for breach of the duty of care.

The trial court also erred in sustaining the demurrer to the claim for breach of the duty of care. Delta Dental's arguments to the contrary have no merit.

1. The Individual Defendants, as directors, owe fiduciary duties to the Dentist Members.

Delta Dental argues that the Individual Defendants, who are directors of Delta Dental, do not owe fiduciary duties to the Dentist Members. But "the directors of a nonprofit mutual benefit corporation, like [Delta Dental] here, are fiduciaries who must act for the benefit of the corporation *and its members*." (*Coley*, *supra*, 51 Cal.App.5th at p. 958, emphasis added.)

In arguing otherwise, Delta Dental improperly relies on the *dissent* in *Frances T. v. Village Green Owners Assn.* (1986) 42 Cal.3d 490, 525, which is not the law.[4] In the *majority opinion*, the court acknowledged that the directors of the nonprofit mutual benefit corporation owed a fiduciary duty to the plaintiff, who was a member. (See 42 Cal.3d at pp. 496, 513–

[4] Although Delta Dental purports to rely on Justice Mosk's concurrence (RB 54–55), the portion of the opinion on which it relies is, in fact, the dissent. (See *Frances T.*, *supra*, 42 Cal.3d at p. 525.)

514.)[5] That is why the court in *Coley* cited *Frances T.* for the proposition that "the directors of a nonprofit mutual benefit corporation . . . are fiduciaries who must act for the benefit of the corporation *and its members*." (*Coley*, *supra*, 51 Cal.App.5th at p. 958, emphasis added.)

Delta Dental also tries to evade the rule set forth in *Coley* by arguing that it only applies to homeowners' associations. (RB 57.) But the rule is not so narrow. It applies to "the directors of a nonprofit mutual benefit corporation," not merely to the directors of a homeowners' association. (*Coley*, *supra*, 51 Cal.App.5th at p. 958.)

Delta Dental relies on the fact that Corporations Code section 309(a) refers to the fiduciary duties of directors of for-profit corporations to "the corporation and its shareholders," whereas section 7231(a) refers to the fiduciary duties of directors of nonprofit mutual benefit corporations to "the corporation." (RB 54–55.) According to Delta Dental, the absence of the words "and its members" means that directors of nonprofit mutual benefit corporations do not owe fiduciary duties to their members. (*Ibid.*) But Delta Dental's argument proves too much. Under Delta Dental's statutory interpretation, the directors of a nonprofit mutual benefit corporation could

[5] The fiduciary relationship was not implicated, however, because the "plaintiff alleged that the Association, as a landlord, breached its duty to her as a tenant rather than as a shareholder." (*Frances T.*, 42 Cal.3d at p. 514.) Here, as discussed below, the Individual Plaintiffs sue as *members*.

never owe fiduciary duties to its members. But not even Delta Dental goes that far; instead, it admits that at least homeowners' association directors owe fiduciary duties to members. (See RB 57–58.) And there is no basis in the statutory language for distinguishing between members of homeowners' associations and members of other nonprofit mutual benefit corporations. The statutory language does not have the meaning that Delta Dental seeks to ascribe to it.[6]

Delta Dental contends that homeowners' associations are different because they have "power over the members." (RB 57.) But Delta Dental holds great power over its members, as well. As already discussed, "Delta Dental has specifically designed its PPAs and plans to maximize disruption to those dentists who leave the Delta Dental network," and "has effectively locked in many of its Dentist Members, who risk tremendous damage to their practices and disruption of their patient relationships if they leave Delta Dental's network." (AA330–331 ¶¶ 48–49.)

Thus, Delta Dental is wrong to contend that its Dentist Members have less of a "stake" in the corporation than the shareholders of a for-profit

[6] Delta Dental argues that CDA only "weakly" suggested that "members" are not specified in section 7231 because nonprofit mutual benefit corporations need not have members. (RB 56.) According to Delta Dental, this is a "wholly unsupported inference." (*Ibid.*) But there is no support for Delta Dental's competing inference that "members" are not specified because the Legislature intended to excuse directors of nonprofit mutual benefit corporations from fiduciary duties to the corporation's members.

company, "who have often substantial financial stakes in the enterprise." (RB 55.) Dentist Members also have enormous financial stakes in the enterprise. (See AA330–331 ¶¶ 47–49.) Indeed, Dentist Members have a greater stake in Delta Dental than shareholders in for-profit corporations because Dentist Members depend on payment for their services for their livelihood and are "locked in." (AA331 ¶ 49.)

Delta Dental also tries to draw a sharp distinction between rights relating to membership and reimbursement fees under a PPA. (RB 59–63.) But the right to enter into a PPA is "a privilege of membership." (AA266.) Indeed, it is the reason for becoming a Delta Dental member. The PPAs are also central to Delta Dental's corporate purpose, which is "to provide dental benefit coverage through" the PPAs. (AA327 ¶ 38.) There is nothing more basic to Delta Dental's business than the services provided by Dentist Members, for which they are entitled to fair reimbursement fees. Membership and reimbursement fees under PPAs are inextricably intertwined. The Individual Plaintiffs sue as Dentist Members, in which capacity they are owed fiduciary duties by the Individual Defendants. (See AA348–350 ¶¶ 88–91.)

Thus, the trial court erred in concluding that the Individual Defendants do not owe a fiduciary duty to the Individual Plaintiffs. The demurrer was wrongly sustained. This Court should reverse.

2. Delta Dental's reliance on documents outside the complaint that were not judicially noticed is improper.

Delta Dental argues, in the alternative, that the Individual Defendants are shielded by the business judgment rule. As an initial matter, however, that argument fails because it is based on documents that are *not* in the complaint; were *not* judicially noticed by the trial court; and which Delta Dental explicitly does *not* ask this Court to judicially notice. (See RB 24, fn. 6.) "A demurrer reaches only to the contents of the pleading and such matters as may be considered under the doctrine of judicial notice." (*Weil*, *supra*, 45 Cal.2d at p. 837.) Delta Dental's reliance on documents that are neither part of the complaint nor judicially noticed is improper.

In any case, "[a]lthough the existence of a document may be judicially noticeable, the truth of statements contained in the document and its proper interpretation are not subject to judicial notice if those matters are reasonably disputable." (*Fremont*, *supra*, 148 Cal.App.4th at p. 113.) Delta Dental asks this Court to assume the *truth* of statements in the documents on which it improperly relies. Delta Dental's arguments are improper for this additional and independent reason. (See *ibid.*)

Delta Dental's improper reliance on these extraneous documents underscores the weakness of its business-judgment-rule argument.

3. Delta Dental's business-judgment-rule argument fails.

Delta Dental argues that this Court should affirm based on the

business judgment rule, even though the trial court did not reach it in the order sustaining the demurrer to the Second Amended Complaint, because the trial court relied on the business judgment rule in sustaining the demurrer to the *First* Amended Complaint. (RB 63.) But that is irrelevant. The *Second* Amended Complaint is the operative pleading. The earlier ruling, based on a different complaint, is beside the point.

In any case, "[t]he business judgment rule does not shield actions taken without reasonable inquiry, with improper motives, or as a result of a conflict of interest." (*Everest Investors 8 v. McNeil Partners* (2003) 114 Cal.App.4th 411, 430 (*Everest*).) "When courts say that they will not interfere in matters of business judgment, it is presupposed that judgment—reasonable diligence—has in fact been exercised. A director cannot close his eyes to what is going on about him in the conduct of the business of the corporation and have it said that he is exercising business judgment." (*Burt v. Irvine Co.* (1965) 237 Cal.App.2d 828, 852–853, citation omitted.)

The business judgment rule "raises various issues of fact," including whether the defendant directors "made a reasonable inquiry as indicated by the circumstances. *Such questions generally should be left to a trier of fact*." (*Gaillard v. Natomas Co.* (1989) 208 Cal.App.3d 1250, 1267–1268 (*Gaillard*), emphasis added.) For example, in *Gaillard*, there were triable issues of fact about whether a compensation committee conducted a reasonable inquiry. (See *id.* at pp. 1269–1271.) Likewise, in *Everest*, there

were triable issues of fact about whether the defendant conducted "a good faith and reasonable investigation." (*Everest*, *supra*, 114 Cal.App.4th at p. 432.) And in *Palm Springs Villas II Homeowners Assn., Inc. v. Parth* (2016) 248 Cal.App.4th 268, 286, there were "triable issues of material fact as to whether [the director] acted on an informed basis and with reasonable diligence."

The question of whether directors' actions are shielded by the business judgment rule must be left for the trier of fact where, as here, there are factual allegations that the directors did not conduct a good faith and reasonable investigation, which must be accepted as true on demurrer. (See, e.g., *Gaillard*, *supra*, 208 Cal.App.3d at pp. 1267–1268.) CDA alleged that reasonable inquiry was called for and would have resulted in the discovery of facts material to the decision to adopt the 2023 Amendments, yet the Individual Defendants conducted no such inquiry. (AA336–342 ¶¶ 60–70.) Instead, they held a superficial 75-minute Zoom call with no materials or preparation in advance, failing to conduct a reasonable inquiry into numerous relevant factors, including but not limited to the effect of the 2023 Amendments on Dentist Members and their patients. (*Ibid.*) Those factual allegations, set forth at much greater length in the Second Amended Complaint, are more than sufficient to withstand demurrer. (See *ibid.*)

Delta Dental contends that 75 minutes was "entirely adequate to address a reasonably routine supplier pricing decision." (RB 67.) But that

factual allegation cannot be credited on demurrer, especially because it contradicts the allegations of the Second Amended Complaint. In fact, the decision was "monumental and the issues implicated complex." (AA336 ¶ 61.) Given the monumental nature of the changes in the 2023 Amendments, which represented a sea change in the relationship between Delta Dental and its Dentist Members, the Individual Defendants, as directors, were required to do far more than simply rubber-stamp the amendments, which is all they did. (AA336–342 ¶¶ 60–70.)

Delta Dental relies on *Kops v. Hassell* (Del. Ch., Nov. 30, 2016, No. CV 11982-VCG) 2016 WL 7011569, at *5, for the proposition that a 30-minute meeting was sufficient. But that is misleading. The court held that a mere 30-minute meeting *would be cause for concern*, but the committee there had been constituted for over a year and was already familiar with the investigation at issue. (*Ibid.*) Here, by contrast, there was a "single 75-minute meeting," with no materials provided to the Compensation Committee in advance and no preparation. (AA337 ¶¶ 61–61(a).)

Delta Dental also relies on *Boyer v. Wilmington* (Del. Ch., June 27, 1997) 23 Del. J. Corp. L. 692, 1997 WL 382979, but there the court held that it was "unable to grant plaintiffs motion for summary judgment on a breach of due care claim." (*Id.* at *5.) Its holding that the length of time of a meeting was not dispositive as to support summary judgment for the plaintiff does not mean that the brevity of the meeting at issue here does not

support CDA's claim—it does. For example, directors "did not reach an informed business judgment" where they approved a merger "upon two hours' consideration, . . . without the exigency of a crisis or emergency," and without sufficient information. (*Smith v. Van Gorkom* (Del. 1985) 488 A.2d 858, 874 (*Smith*), overruled on other grounds in *Gantler v. Stephens* (Del. 2009) 965 A.2d 695, 713, fn. 54.)[7]

Delta Dental contends that the fact that the Committee did not receive materials in advance of the meeting is "of no consequence." (RB 68.) Delta Dental cites no support for that contention, which is belied by the allegation that Delta Dental's normal practice was to provide materials in advance. (AA337 ¶ 61(a).) Delta Dental's deviation from its usual practice is telling.

Delta Dental argues that it is "irrelevant" that the presentation to the Committee was made by an executive focused on sales, product strategy, and business development, rather than on the impact of the 2023 Amendments on Dentist Members and their patients. (RB 69.) But it is certainly relevant that the Committee Members, none of whom were dentists, did not hear from anyone knowledgeable about the practice of

[7] Delta Dental attempts to distinguish *Smith* on the basis that it was a "change-in-control case" whereas this, according to Delta Dental, "is a run-of-the-mill contractor pricing case." (RB 74.) Far from being "run-of-the-mill," this case is about fee reductions that threaten the livelihoods of Dentist Members to whom the Individual Defendants owe fiduciary duties.

dentistry at the meeting. Without information about the impact of the 2023 Amendments on Dentist Members and their practices, the Individual Defendants lacked the ability to make an informed decision. (See AA338 ¶ 61(c).)

Relying on minutes not found in the complaint and not judicially noticed, Delta Dental contends that impacts on dentists were discussed. (RB 69–70.) This Court should ignore that assertion because it is based on material that is inappropriate to consider on demurrer. (See *Weil*, *supra*, 45 Cal.2d at p. 837.) Likewise, the Court should disregard Delta Dental's reliance on assertions about a consultant (CBIZ) that are not found in the complaint and not judicially noticed. (See *ibid.*; RB70–71.) Delta Dental also claims that CDA is "wrong" about the Individual Defendants' failure to make a reasonable inquiry into whether there was a need for the 2023 Amendments. (RB 71–72.) That assertion, too, is based on a document not found in the complaint and not judicially noticed. The Court should disregard it.

In any event, the assertion that CDA is "wrong," like the rest of Delta Dental's assertions based on documents that were not judicially noticed, at most indicates that there are factual disputes regarding the reasonableness of the Individual Defendants' inquiry. Those disputes cannot be decided on demurrer. "We do not resolve factual disputes at this stage of the proceeding." (*Roe v. Hesperia Unified School District* (2022)

85 Cal.App.5th 13, 30.)

Furthermore, as already discussed, judicial notice is only proper insofar as it establishes the *existence* of a document, not the *truth* of statements within it. (See, e.g., *Fremont*, *supra*, 148 Cal.App.4th at p. 113.) Delta Dental relies on the purported truth of statements in the documents it cites, not the mere existence of those documents. (See RB 69–74.) Delta Dental's arguments are improper and should be disregarded.

Indeed, Delta Dental not only improperly relies on documents that are not judicially noticed, it relies on documents that *could not have been considered by the Individual Defendants in reaching their decision*. The CBIZ report on which Delta Dental relies *was not prepared until three months after the meeting at which the 2023 Amendments were adopted.* (See AA571 [CBIZ report is dated Nov. 16, 2022]; AA337 ¶ 61(a) [meeting was on Aug. 10, 2022].) The CBIZ report also relies on a faulty comparison of discounts as opposed to fees. (See AA576.) Analyzing discounts, as opposed to fees, paints an inaccurate picture. As discovery would show, Delta Dental's fees are low by comparison to other plans and the post-hoc analysis in the CBIZ report is pretextual. The picture that DDC attempts to paint by referring to the belated CBIZ study is false and illustrates why it is improper for Delta Dental to rely on these extraneous documents on demurrer. (See, e.g., *Fremont*, *supra*, 148 Cal.App.4th at p. 115 ["a court cannot by means of judicial notice convert a demurrer into an incomplete

evidentiary hearing"].)

There is also no merit to Delta Dental's argument that CDA did not allege "specific facts about specific alternative courses of action." (RB 75–78.) The specific alternative course of action was to not enact the 2023 Amendments. If the Individual Defendants had conducted a reasonable inquiry, "it would have been apparent that there was no legitimate need or justification for the 2023 Amendments and Defendants would not have enacted them." (AA341 ¶ 69.)

C. The trial court erred in sustaining the demurrer to the cause of action for declaratory relief.

Delta Dental does not dispute that if the Court reverses as to either the claim for breach of the implied covenant or the claim for breach of the duty of due care, the Court should also reverse as to the claim for declaratory relief. Because CDA stated valid claims for breach of the implied covenant and breach of the duty of care, it likewise stated a valid claim for declaratory relief and the Court should reverse the judgment of dismissal as to this claim, as well.

D. The trial court abused its discretion in denying leave to amend.

Finally, it is an abuse of discretion to sustain a demurrer without leave to amend "if there is any reasonable possibility that the defect can be cured by amendment." (*Skov v. U.S. Bank National Assn.* (2012) 207 Cal.App.4th 690, 695, citation omitted.) As CDA demonstrated in opening,

there is more than a reasonable possibility that the purported defect in CDA's allegations can be cured by amendment. The trial court, therefore, abused its discretion in denying leave to amend.

The trial court found that Delta Dental has "unfettered discretion" to set fees (AA768), but CDA can amend the complaint to allege that Delta Dental knew that the Settlement Agreement refutes any argument that Delta Dental's discretion is "unfettered." (See RT 373:17–375:19, 378:2-15.) Delta Dental suggests that the Settlement Agreement is irrelevant, but then asserts again the very contention that the Settlement Agreement refutes: that it has "the unfettered right to set fees." (RB 79–80.) Delta Dental's discretion to set fees is *not* "unfettered." It is constrained by the implied covenant of good faith and fair dealing, and CDA can amend the complaint to make that fact clear, if it is not clear enough already.

Delta Dental argues that Delta Dental's "subjective beliefs" about the Settlement Agreement are "irrelevant." (RB 80.) But Delta Dental ignores the principle that "[i]f the terms of a promise are in any respect ambiguous or uncertain, it must be interpreted in the sense in which the promisor believed, at the time of making it, that the promisee understood it." (Civ. Code, § 1649.) CDA can amend the complaint to allege that Delta Dental knew, at the time of making its promises, that CDA understood the Settlement Agreement to preclude Delta Dental's current argument that its right to set fees is "unfettered." (See RT 373:17–375:19, 378:2-15.)

Thus, the trial court abused its discretion in denying leave to amend.

IV. CONCLUSION

For all of the reasons above and in CDA's opening brief, the Court should reverse the judgment of dismissal and remand this case for further proceedings.

Respectfully submitted,

Dated: February 14, 2025

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CERTIFICATE OF WORD COUNT

PURSUANT TO CALIFORNIA RULES OF COURT

Pursuant to California Rules of Court, rule 8.204(c)(1), I certify that this brief is proportionately spaced, has a typeface of 13 points, and contains 9,526 words (as counted by the computer program used to prepare this brief).

Keker, Van Nest & Peters LLP

Dated: February 14, 2025

By: _____
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CERTIFICATE OF SERVICE

I am employed in the City and County of San Francisco, State of California in the office of a member of the bar of this court at whose direction the following service was made. I am over the age of eighteen years and not a party to the within action. My business address is Keker, Van Nest & Peters LLP, 633 Battery Street, San Francisco, CA 94111-1809.

On February 14, 2025, I served the following:

APPELLANTS' REPLY BRIEF

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☑ by regular **UNITED STATES MAIL** by placing Copy in a sealed envelope addressed as shown below. I am readily familiar with the practice of Keker, Van Nest & Peters LLP for collection and processing of correspondence for mailing. According to that practice, items are deposited with the United States Postal Service at San Francisco, California on that same day with postage thereon fully prepaid. I am aware that, on motion of the party served, service is presumed invalid if the postal cancellation date or the postage meter date is more than one day after the date of deposit for mailing stated in this affidavit.

Hon. Ethan P. Schulman
Complex Litigation
San Francisco County Superior Court
400 McAllister Street, Dept. 304
San Francisco, CA 94102-4514

Executed on February 14, 2025, at San Francisco, California. I declare under penalty of perjury under the laws of the State of California that the above is true and correct.

Sandy Giminez