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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIFTH APPELLATE DISTRICT

NORTHERN CALIFORNIA COLLECTION
SERVICE, INC.,

Plaintiff and Respondent,

v.

JUAN RODRIGUEZ et al.,

Defendants, Cross-complainants and
Respondents;

STATE COMPENSATION INSURANCE
FUND,

Cross-defendant and Appellant.

F069313

(Super. Ct. No. 10CECG02633)

OPINION

APPEAL from a judgment of the Superior Court of Fresno County. Mark W. Snauffer, Judge.

Betty R. Quarles, Isabel C. Lallana for Cross-defendant and Appellant.

Magill Law Offices and Timothy V. Magill for Defendants, Cross-complainants and Respondents.

No appearance for Plaintiff and Respondent.

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This is an appeal by cross-defendant State Compensation Insurance Fund (State Fund), a workers' compensation insurance company, from the denial of a special motion to strike under Code of Civil Procedure section 425.16 (also known as an anti-SLAPP¹ motion). State Fund's former insureds, Juan Rodriguez dba Rodriguez Labor Service and Carlotta Rodriguez (together the insureds or cross-complainants), after being sued by a collection agency for unpaid workers' compensation insurance premiums, filed a cross-complaint against State Fund asserting various theories of recovery. Following a successful pleading challenge by State Fund, the insureds filed an amended cross-complaint adding new allegations of wrongdoing on the part of State Fund, including that State Fund had reported the insureds to law enforcement agencies for insurance fraud. In response to the new allegations, State Fund filed an anti-SLAPP motion, arguing that the newly asserted conduct was protected petitioning activity. The trial court disagreed with State Fund's assessment of the allegations, denying the motion on the ground that State Fund failed to meet its initial burden of showing that the causes of action in the amended cross-complaint arose out of conduct protected by section 425.16. Consequently, the trial court never reached the second step of the judicial analysis in the anti-SLAPP motion, which requires a determination of whether the insureds adequately "established that there is a probability that [they] will prevail on the claim[s]." (§ 425.16, subd. (b)(1).)

State Fund appeals from the denial of its section 425.16 motion, arguing that the statute applied to State Fund's petitioning activity (i.e., reporting suspected wrongdoing to the authorities), which activity was alleged in the amended cross-complaint to be a substantial part of State Fund's wrongful and injurious course of conduct. As explained more fully below, we agree with State Fund that it met its initial burden of showing that

¹ Unless otherwise indicated, all further statutory references are to the Code of Civil Procedure. The term "SLAPP" is "an acronym for 'strategic lawsuit against public participation.'" (*Jarrow Formulas, Inc. v. LaMarche* (2003) 31 Cal.4th 728, 732, fn. 1.) Section 425.16 is sometimes referred to herein as the anti-SLAPP statute.

one or more of the causes of action arose out of conduct protected under section 425.16. Accordingly, the burden shifted to the insureds to make the necessary showing under the second step of the statutory analysis as to those causes of action. Because the trial court failed to address or consider the second step in the anti-SLAPP analysis at all, we reverse and remand the matter with instructions that the trial court do so.

FACTS AND PROCEDURAL HISTORY

The Pleadings

On July 26, 2010, a collection action was filed by the assignee of State Fund (namely, Northern California Collection Service, Inc.) to collect monies allegedly due from the insureds as unpaid workers' compensation insurance premium. The amount allegedly owed by the insureds was \$278,837.68 in principal plus accrued interest.

In their answer to the complaint, the insureds (as defendants) included the affirmative defense of impossibility, stating as follows: "Defendants' performance of the contract was impossible to do because of the conduct of their employees and the misconduct by Plaintiffs. Defendants have an excuse for non-performance in that they were subjected to a significant loss of monies, documents, etc., by fraudulent conduct by their employees."

On November 19, 2010, the insureds filed a cross-complaint against State Fund, alleging a failure on State Fund's part to complete a final audit that was required to ascertain the actual amount of insurance premium due for the relevant time period. Additionally, the cross-complaint also named as cross-defendants the insureds' former employees, Tanya Fuentes and Dulce Fuentes (together the Fuentes sisters), who allegedly defrauded the insureds of substantial monetary amounts and failed to keep adequate or accurate financial or payroll records.² As a result of the Fuentes sisters' fraudulent actions, inadequate and insufficient information was provided to State Fund.

² In subsequent court filings, the insureds asserted the amount of monies lost due to the Fuentes sisters' theft was "in excess of approximately \$200,000 or more."

In particular, concerning the actions of the Fuentes sisters, the cross-complaint alleged as follows: “Starting on or about April 23, 2005, and terminating on or about November 24, 2007, Cross-complainants employed one Tan[y]a Fuentes to manage, and prepare all of the bookkeeping and all of the necessary fiscal documents necessary for the running of the business, Rodriguez Labor Service. In addition Tan[y]a Fuentes induced Cross-complainants to hire Dulce Fuentes on or about August 12, 2006, and she was employed with Rodriguez Labor Service up and through November 24, 2007. Cross-complainants relied upon the actions, information, work and conduct of said Fuentes sisters, especially in regard to the present actions involving [State Fund]. [¶]

... Unbeknownst to Cross-complainants, and until approximately December 4, 2007, [the Fuentes sisters] were stealing money, converting and writing checks to fictitious names, and others, cashing those checks themselves and keeping the proceeds, failing to keep the proper books and records, including the checking statement and all checks; reconciling said business checks, providing inadequate and insufficient information to Cross-complainant, Rodriguez Labor Service, which was provided to Cross-defendant, [State Fund], while maintaining and telling Cross-complainants that they were properly and appropriately performing all actions necessary for the handling, performing, and paying on the [State Fund] Worker[s’] Compensation Insurance policy No. 005-104974, and Cross-complainants’ business.”

The causes of action alleged against State Fund in the cross-complaint included the following: (1) breach of contract (1st cause of action); (2) fraud (4th cause of action); (3) negligent misrepresentation (5th cause of action); (4) unjust enrichment (6th cause of action); (5) intentional infliction of emotional distress (7th cause of action); (6) negligence (8th cause of action); (7) constructive fraud (9th cause of action); (8) fraud by concealment (10th cause of action); (9) unfair business practices (13th cause of action); (10) negligent hiring, training and supervision (14th cause of action); (11) bad

faith breach of contract (15th cause of action); (12) breach of implied covenant of good faith and fair dealing (16th cause of action).

On July 10, 2013, State Fund filed its motion for judgment on the pleadings, challenging the sufficiency of the allegations set forth in each of the 12 causes of action asserted against it by the insureds. On September 20, 2013, the trial court's tentative ruling became the order of the court, which was to grant the entire motion for judgment on the pleadings with 30 days leave to amend, except that as to the sixth cause of action the motion was granted without leave to amend.

Some of the salient reasons for the trial court's ruling to grant the motion for judgment on the pleadings, as expressed in its written order, were as follows: As to the first cause of action for breach of contract, the trial court granted the motion on the ground that the insureds needed to either attach a copy of the insurance contract or allege all of the essential terms of the insurance contract. As to the fourth cause of action for fraud and the fifth cause of action for negligent misrepresentation, the trial court granted the motion on the grounds that the insureds failed to adequately allege an affirmative misrepresentation of material fact, actual and reasonable reliance thereon and resulting harm, all with the degree of specificity required of a fraud cause of action. As to the seventh cause of action for intentional infliction of emotional distress, the trial court granted the motion because the insureds failed to allege conduct that was sufficiently "outrageous" or that State Fund committed such conduct either intending to cause emotional distress or with a reckless disregard of the probability that the insureds would suffer emotional distress. As to the eighth cause of action for negligence, the trial court granted the motion because the insureds failed to adequately allege a legal duty of care. As to the ninth and tenth causes of action for constructive fraud and fraud by concealment, the motion was granted based on failure to allege facts of nondisclosure or concealment, among other things. As to the 13th cause of action for unfair business practices, the trial court granted the motion based on failure to allege how the business

practices of State Fund caused the insureds to suffer economic injury for purposes of standing to sue. As to the 14th cause of action for negligent hiring, training and supervision, the trial court granted the motion because the insureds failed to sufficiently plead that State Fund's employees harmed the insureds or that the alleged negligence in hiring, supervision or training was a substantial factor in causing the insureds' harm. As to the 15th and 16th causes of action for bad faith breach of contract and breach of implied covenant of good faith and fair dealing, the trial court treated the two causes of action as identical. It granted the motion as to both the 15th and 16th causes of action because, under *Jonathan Neil & Assoc., Inc. v. Jones* (2004) 33 Cal.4th 917, 939, a dispute between an insurer and insured over the insurance premium amount due and/or an alleged refusal to conduct an audit necessary to determine final insurance premium amounts do not give rise to *tort* remedies.

On November 5, 2013, the insureds filed their first amended cross-complaint (the amended cross-complaint), attempting to cure the defects pointed out by the trial court in the order granting judgment on the pleadings. A copy of the insurance contract was attached to the amended cross-complaint. In addition to setting forth certain allegations with somewhat greater specificity, the amended cross-complaint added new substantive allegations. The most significant of the new allegations was the assertion that State Fund reported the insureds to the authorities for insurance fraud. Allegedly, State Fund "attempted to have Cross-complainants prosecuted criminally for the alleged non-payment of the full amount of the premium" by reporting them first to the Fresno County District Attorney and, second, as an act of "forum shopping," to the Tulare County District Attorney. "The Fresno County District Attorney's Office refused to file any criminal complaint, saying that it was a civil matter.... The Tulare County District Attorney's Office[] filed a four (4) count felony indictment, claiming insurance premium

fraud, which was ... dismissed ... on or about January 9, 2013.”³ State Fund’s actions led to the insureds having to incur substantial attorney fees and litigation costs to defend the criminal matters. In addition, the amended cross-complaint alleged that, notwithstanding the failure to conduct the final audit, State Fund represented that the insureds owed five or six differing amounts as premium, all of which were allegedly false representations because the total amount due could not be fairly determined until the final audit was completed. Further, on May 25, 2007, State Fund’s senior auditor, Robert Marchetti, allegedly began the workers’ compensation insurance premium audit to ascertain the final premium amount due with respect to 2006, but refused to complete the audit or review all of the available payroll documentation. All of the above described new allegations were incorporated into each and every cause of action against State Fund in the amended cross-complaint.

The Anti-SLAPP Motion

On March 7, 2014, State Fund responded to the amended cross-complaint by filing an anti-SLAPP motion pursuant to section 425.16. The motion was made on the ground that the amended cross-complaint asserted causes of action based upon State Fund’s activity of reporting suspected insurance fraud to the authorities, which reporting was not only required by law but constituted constitutionally protected petitioning activity that was absolutely privileged. According to State Fund, since the causes of action were premised on activity protected by section 425.16, the causes of action must be dismissed unless the insureds were able to show a probability of prevailing on the causes of action.

On March 21, 2014, the insureds filed their opposition to the anti-SLAPP motion. Among other things, the insureds’ opposition argued that the causes of action in this case have nothing to do with protected petitioning or free speech activity, but even if the

³ We grant the insureds’ request for judicial notice of the felony complaints filed by the Tulare County District Attorney against the insureds.

causes of action include such protected activity, the inclusion thereof is merely collateral or incidental to the causes of action. The insureds also submitted the declaration of Carlotta Rodriguez (Carlotta) and the declaration of their attorney, Timothy Magill. Magill's declaration included numerous exhibits. This evidence was presented by the insureds in an effort to meet their burden to substantiate the causes of action in the event that State Fund was found to have met its initial burden under section 425.16.

We briefly summarize the insured's evidentiary showing in opposition to the motion. The declaration of Carlotta included her assertion that when Marchetti conducted the incomplete workers' compensation insurance premium audit on May 25, 2007 (for calculation of the final premium amount for the 2006 workers' compensation policy), he was supplied with a computer payroll record for the entire 2006 year, but allegedly Marchetti did not use or refer to those particular records. Further, according to Carlotta, even though the audit could have been completed based on the entirety of the payroll records provided, Marchetti would not do so. Said payroll records were believed by Carlotta to have been provided by Tanya or Dulce Fuentes to Marchetti at the time of the audit. Carlotta also pointed out that no one at State Fund interviewed her or her husband prior to referring the matter to the district attorneys' offices. If that had happened, she could have informed State Fund of the theft of \$200,000 or more due to employee fraud by the Fuentes sisters. Carlotta's declaration also made a conclusory statement that, in view of the varying calculations by State Fund of the amount of premium due from the insureds, there must have been intentional misrepresentation on the part of State Fund. She also expressed her subjective belief that State Fund, although repeatedly asked to complete the audit and having been furnished with additional records when requested, chose not to complete the audit "because they were trying to increase their efforts to have us prosecuted."

The insureds also submitted several numbered exhibits that were attached to the declaration of attorney Timothy Magill. Exhibit No. 1 to the Magill declaration is the

transcript of the statement given by Marchetti on February 10, 2010, to an investigator for the Tulare County District Attorney's Office. In that statement, Marchetti answered the investigator's questions concerning the audit he performed on May 25, 2007, of the insureds' workers' compensation insurance premium for 2006. Marchetti told the investigator that the insureds failed to report a total of \$3.3 million in payroll for 2006. Payroll figures are used in computing the insurance premium due. He noted that in one particular month alone, the insureds had underreported payroll amounts by approximately \$600,000. Marchetti believed he had "reviewed enough documentation" to complete the audit.

Exhibits Nos. 2 and 3 to the Magill declaration are records and communications between State Fund and the Fresno County District Attorney and Tulare County District Attorney. Exhibit No. 4 is described as a payroll report allegedly provided to Marchetti at the time of his May 25, 2007, audit. Exhibit No. 5 is a discovery order. Exhibit No. 6 is a copy of the workers' compensation insurance contract. Exhibits Nos. 7, 8 and 9 are exhibits to the deposition of the person most knowledgeable (PMK) for State Fund. Exhibit No. 7 includes several settlement discussion letters between Northern California Collection Service, Inc., the plaintiff in the collection action, and the insureds. Exhibit No. 8 includes a written calculation of the unpaid insurance premium amount of \$271,238. Exhibit No. 9 includes the insureds' audit revision request. Exhibit No. 10 is a copy of the criminal pleadings, including the dismissal of the four-count felony complaint by Tulare County Superior Court on January 9, 2013, along with the insureds' motion(s) to dismiss said criminal counts based on lack of venue or jurisdiction.

Exhibit No. 11 to Magill's declaration is a copy of portions of the deposition transcript of Marchetti taken by the insureds in this case on October 5, 2011. In his deposition, Marchetti admitted that if the entirety of the documents furnished by the insureds at the time of the audit had been reviewed, he could have determined the total payroll and the total insurance premium due, notwithstanding the insureds'

underreporting of payroll in certain of the records. Nevertheless, Marchetti stated that once his audit showed substantial discrepancies and underreporting of payroll, he felt that such circumstances were a “red flag,” or enough of an indication of “suspicious activity,” that he should refer the matter to the fraud unit, which he did.

The Trial Court’s Ruling

The hearing of State Fund’s special motion to strike under section 425.16 was set for April 3, 2014. On that date, the trial court’s tentative ruling became the written order of the court. In that written order, the trial court denied the motion, explaining that the case concerned bad faith *conduct* in setting workers’ compensation insurance premiums, *not* any constitutionally protected or privileged communication. Further, the trial court concluded, based on a footnote 5 in *Gruenberg v. Aetna Ins. Co.* (1973) 9 Cal.3d 566 at pages 575–576 (*Gruenberg*) that State Fund’s reports to law enforcement of suspected insurance fraud would not come within the protection of the Civil Code section 47 privilege as a matter of law. In similar fashion, the trial court indicated that State Fund’s reports of insurance fraud were not the injury-causing wrongdoing, but merely one part of the evidence of wrongdoing. Finally, the trial court noted that State Fund’s conduct as alleged was an “attempt to *extort* more premium than allegedly due by reporting them to various District Attorneys,” apparently alluding to the unlawful conduct exception to section 425.16. (Italics added.) The trial court did not expressly state in its order whether it was denying the motion at the first or second step of the motion. However, since the trial court concluded the causes of action were not based upon any petitioning conduct protected by section 425.16, and since the court also did not engage in any consideration of the evidence presented or of the elements of any of the causes of action, it is clear that the court denied the motion at the first step of the anti-SLAPP motion, as more fully explained below.

On the same date that the trial court denied the anti-SLAPP motion, it granted the insureds’ motion for leave to file a second amended cross-complaint, which added a new

18th cause of action for abuse of process and a 19th cause of action for malicious prosecution. The second amended complaint, and the new causes of action therein, are not part of the present appeal.

State Fund timely appealed from the trial court's order denying the anti-SLAPP motion.

DISCUSSION

I. Standard of Review

We review de novo the trial court's ruling to grant or deny an anti-SLAPP motion. (*Flatley v. Mauro* (2006) 39 Cal.4th 299, 325 (*Flatley*)). “Resolving the merits of a section 425.16 motion involves a two-part analysis, concentrating initially on whether the challenged cause of action arises from protected activity within the meaning of the statute and, if it does, proceeding secondly to whether the plaintiff can establish a probability of prevailing on the merits. [Citation.]” (*Overstock.com, Inc. v. Gradient Analytics, Inc.* (2007) 151 Cal.App.4th 688, 699.) In our de novo review, “[w]e consider “the pleadings, and supporting and opposing affidavits ... upon which the liability or defense is based.” (§ 425.16, subd. (b)(2).) However, we neither “weigh credibility [nor] compare the weight of the evidence. Rather, [we] accept as true the evidence favorable to the plaintiff and evaluate the defendant's evidence only to determine if it has defeated that submitted by the plaintiff as a matter of law.” [Citation.]” (*Flatley, supra*, at p. 326.)

II. Overview of the Anti-SLAPP Statute

Section 425.16, subdivision (b)(1), provides: “A cause of action against a person arising from any act of that person in furtherance of the person's right of petition or free speech under the United States Constitution or the California Constitution in connection with a public issue shall be subject to a special motion to strike, unless the court determines that the plaintiff has established that there is a probability that the plaintiff will prevail on the claim.” An act in furtherance of a person's right of petition or free

speech is broadly defined by section 425.16, subdivision (e), to include the following:

“(1) any written or oral statement or writing made before a legislative, executive, or judicial proceeding, or any other official proceeding authorized by law, (2) any written or oral statement or writing made in connection with an issue under consideration or review by a legislative, executive, or judicial body, or any other official proceeding authorized by law, ... or (4) any other conduct in furtherance of the exercise of the constitutional right of petition or the constitutional right of free speech in connection with a public issue or an issue of public interest.”

“[T]he Legislature enacted section 425.16, the anti-SLAPP statute, to provide for the early dismissal of unmeritorious claims filed to interfere with the valid exercise of the constitutional rights of freedom of speech and petition for the redress of grievances. [Citation.]” (*Club Members for an Honest Election v. Sierra Club* (2008) 45 Cal.4th 309, 315.) “The Legislature authorized the filing of a special motion to strike such claims (§ 425.16, subs. (b)(1), (f)), and expressly provided that section 425.16 should ‘be construed broadly.’ [Citations.]” (*Ibid.*; see § 425.16, subd. (a).) As noted, the resolution of an anti-SLAPP motion follows a two-step process: “First, the court decides whether the defendant has made a threshold showing that the challenged cause of action is one arising from protected activity.... [Second], [i]f the court finds such a showing has been made, it then determines whether the plaintiff has demonstrated a probability of prevailing on the claim.” (*Equilon Enterprises v. Consumer Cause, Inc.* (2002) 29 Cal.4th 53, 67.) “Only a cause of action that satisfies *both* prongs of the anti-SLAPP statute—i.e., that arises from protected speech or petitioning *and* lacks even minimal merit—is a SLAPP, subject to being stricken under the statute.” (*Navellier v. Sletten* (2002) 29 Cal.4th 82, 89.) The defendant has the burden on the first issue; the plaintiff has the burden on the second issue. (*Kajima Engineering & Construction, Inc. v. City of Los Angeles* (2002) 95 Cal.App.4th 921, 928.)

To satisfy the first step or prong, the moving defendant must show the cause of action arises from or is based on acts that come within one of the categories of section 425.16, subdivision (e). (*City of Cotati v. Cashman* (2002) 29 Cal.4th 69, 78 (*City of Cotati*)). If the defendant does not meet this threshold burden at the first step, the court denies the motion without addressing the second step. If the defendant makes the required showing, the burden shifts to the plaintiff to satisfy the second step of the anti-SLAPP analysis. (*Tuszynska v. Cunningham* (2011) 199 Cal.App.4th 257, 266–267.) To satisfy the second step or prong, a plaintiff must state and substantiate a legally sufficient claim. (*Rusheen v. Cohen* (2006) 37 Cal.4th 1048, 1056.) “Put another way, the plaintiff “must demonstrate that the complaint is both legally sufficient and supported by a sufficient prima facie showing of facts to sustain a favorable judgment if the evidence submitted by the plaintiff is credited.” [Citations.]” (*Ibid.*) “In deciding the question of potential merit, the trial court considers the pleadings and evidentiary submissions of both the plaintiff and the defendant (§ 425.16, subd. (b)(2)); though the court does not weigh the credibility or comparative probative strength of competing evidence, it should grant the motion if, as a matter of law, the defendant’s evidence supporting the motion defeats the plaintiff’s attempt to establish evidentiary support for the claim.” (*Wilson v. Parker, Covert & Chidester* (2002) 28 Cal.4th 811, 821.)

III. State Fund Met Its Burden Under the First Prong of Section 425.16

A. Protected Conduct Was Alleged in the Pleading

The amended cross-complaint includes allegations that State Fund wrongfully reported the insureds for suspected insurance fraud to the Fresno County and Tulare County District Attorneys. Preliminarily, before addressing whether the causes of action *arose out of* this particular conduct for purposes of the first prong of the statutory analysis, we observe that making reports to law enforcement or to other public agencies to prompt or facilitate an investigation is considered to be protected petitioning activity for purposes of the anti-SLAPP statute. (See, e.g., *Dickens v. Provident Life & Accident*

Ins. Co. (2004) 117 Cal.App.4th 705, 709, 714–717 [in anti-SLAPP motion relating to malicious prosecution cause of action, insurer’s role in contacting United States Attorney regarding potential insurance fraud on the part of its insured was petitioning conduct protected by § 425.16]; *ComputerXpress, Inc. v. Jackson* (2001) 93 Cal.App.4th 993, 1009–1010 [report filed with Security and Exchange Commission seeking to prompt an investigation was protected by § 425.16]; *Dove Audio, Inc. v. Rosenfeld, Meyer & Susman* (1996) 47 Cal.App.4th 777, 784 [preliminary letter seeking endorsement of others for filing a complaint with Attorney General in regard to alleged underpayment of royalties to designated charities held protected by litigation privilege and § 425.16].) Following this line of cases, we conclude that the allegations in the amended cross-complaint that State Fund reported to two district attorneys’ offices that the insureds may have committed insurance fraud and that State Fund also assisted in the investigation thereof came within the protection of section 425.16.⁴

Our conclusion is further supported by the applicability of the absolute privilege under Civil Code section 47, subdivision (b) (hereafter Civil Code section 47(b)), to such communications. (See *Flatley, supra*, 39 Cal.4th at pp. 322–323 [although the two statutes are not identical in purpose or scope, courts may look to litigation privilege of Civ. Code, § 47(b) as an aid in determining whether a given communication falls within the ambit of Code Civ. Proc., § 425.16, subd. (e)(1) or (e)(2)].) Generally speaking, communications within the protection of the privilege of Civil Code section 47(b) are equally entitled to the benefits of protection under Code of Civil Procedure section 425.16. (*Briggs v. Eden Council for Hope & Opportunity* (1999) 19 Cal.4th 1106, 1115; *Johnson v. Ralphs Grocery Co.* (2012) 204 Cal.App.4th 1097, 1104.) It is well established that reports to law enforcement of suspected criminal activity are within

⁴ Furthermore, we note that insurance companies are *required* by law to report suspected insurance fraud to the public authorities. (Ins. Code, §§ 1871, 1875.20, 1877.3.)

the absolute privilege of Civil Code section 47(b). For example, in *Hagberg v. California Federal Bank* (2004) 32 Cal.4th 350 (*Hagberg*), the Supreme Court held that the absolute privilege of Civil Code section 47(b) applied to a citizen's report of suspected criminal activity to a police officer, explaining that to permit tort liability (other than claims of malicious prosecution) for such communications would threaten the need for utmost freedom of communication between citizens and the public authorities whose responsibility it is to investigate and redress wrongdoing. (*Hagberg, supra*, at pp. 360–361; & see pp. 361–375.) In *Fremont Comp. Ins. Co. v. Superior Court* (1996) 44 Cal.App.4th 867, 875–877, the Court of Appeal held that the absolute privilege of Civil Code section 47(b) applied to reports made by a workers' compensation insurance carrier to the district attorney and to the Department of Insurance fraud bureau that a physician was committing insurance fraud. Following these cases, it is clear that the privilege of Civil Code section 47(b) applies to State Fund's communications to the district attorneys in this case. In light of the general correlation between the Civil Code section 47(b) privilege and the protection to petitioning activity afforded under Code of Civil Procedure section 425.16, the above authorities applying said privilege to the reporting of suspected wrongdoing to law enforcement agencies solidifies our conclusion herein that State Fund's communications to the district attorneys' offices relating to potential insurance fraud on the part of the insureds were within the protection of the anti-SLAPP statute.

In so concluding, we disagree with the trial court's assumption, based on its understanding of footnote 5 in *Gruenberg, supra*, 9 Cal.3d at pages 575–576 that the absolute privilege of Civil Code section 47(b) would not apply in the present case where a bad faith or tortious breach of implied covenant was asserted.⁵ The trial court was

⁵ In *Gruenberg*, it was alleged that the insurer unreasonably and in bad faith withheld the payment of the insured's claim of fire insurance policy benefits by a conspiracy that included prompting a criminal investigation into possible arson in order to cause the insured to

apparently persuaded by that footnote to conclude that none of the petitioning conduct alleged in the amended cross-complaint would be protected by the Civil Code section 47(b) privilege or, by parity of reasoning, the anti-SLAPP statute. We disagree with the trial court's reasoning and decision on both points because, in our opinion, *Gruenberg* is clearly distinguishable. First, *Gruenberg* is distinguishable because it involved an insurer's scheme to wrongfully deny payment of its insured's claim for fire insurance policy benefits, whereas the instant case is not about claims practices or nonpayment of policy benefits, but principally involves a dispute about the amount of insurance premium due and alleged failures to abide by the contractual process for determining said insurance premium. (See *Jonathan Neil & Assoc., Inc. v. Jones, supra*, 33 Cal.4th at pp. 938–939 [tort of bad faith breach of insurance contract does not apply to disputes over insurance premium].) Second, *Gruenberg* is further distinguishable in that the protected conduct in that case was more or less collateral to the principal thrust of the cause of action. The actionable and injurious wrongdoing in *Gruenberg* was a denial of benefits under the policy, and the protected activity of prompting the arson investigation was not *itself* the basis for potential liability but was simply a circumstance used to set the stage for that wrongful denial of benefits. (See *Old Republic Ins. Co. v. FSR Brokerage,*

temporarily refuse to submit to an examination under oath by the insurer, which refusal was then used as a pretext for denial of the payment of benefits. (*Gruenberg, supra*, 9 Cal.3d at pp. 570–572, 575.) In the course of holding that the allegations were sufficient to state a cause of action for bad faith or tortious breach of the implied covenant (for purposes of surviving a demurrer), the Supreme Court stated as follows: “We reject [the] defendants’ argument that a cause of action is not stated because the separate acts of the non–insurer defendants may be privileged in various respects. For example, they contend that ... testimony at [the] plaintiff’s preliminary hearing, as part of a judicial proceeding, is absolutely privileged (see Civ. Code, § 47, subd. 2; Rest., Torts, § 587), and that the conduct of [the] defendant law firm and its employee ... is given the cloak of immunity under Civil Code section 47. However, even if these privileges apply to the separate acts of the insurers’ alleged agents, the defendant insurers may not benefit from them, because *their alleged scheme to avoid liability under the policies*, in breach of an implied duty of good faith and fair dealing, transcends the individual acts of their agents. Consequently, [the] defendant insurers cannot be heard to say that they are privileged to act in bad faith and deal unfairly with their insured.” (*Id.* at pp. 575–576, fn. 5, italics added.)

Inc. (2000) 80 Cal.App.4th 666, 687 [describing *Gruenberg* as an instance where “the insurer engaged in unreasonable conduct *beyond* instituting litigation”].) Here, in contrast, the wrongful and injurious conduct is (in part) the petitioning activity itself.⁶

Finally, we reject the insureds’ argument that the present case fits within the exception to the applicability of section 425.16 where there is illegal or criminal conduct (i.e., extortion). That exception is articulated by the Supreme Court in *Flatley* as follows: “[W]here a defendant brings a motion to strike under section 425.16 based on a claim that the plaintiff’s action arises from activity by the defendant in furtherance of the defendant’s exercise of protected speech or petition rights, but either the defendant concedes, or the evidence conclusively establishes, that the assertedly protected speech or petition activity was illegal as a matter of law, the defendant is precluded from using the anti-SLAPP statute to strike the plaintiff’s action.” (*Flatley, supra*, 39 Cal.4th at p. 320.)⁷ The rationale for the rule is that “the statute does not protect activity that, because it is illegal, is not in furtherance of constitutionally protected speech or petition rights.” (*Flatley, supra*, at p. 324.) In *Flatley*, an attorney’s settlement letter making certain threats if the settlement terms were not accepted was held to constitute illegal extortion as a matter of law (*id.* at pp. 329–333) and, therefore, it was not a communication in the furtherance of a right of constitutionally protected speech or petition. Accordingly, it was not protected by the anti-SLAPP statute and the moving party did not meet its initial burden regardless of whether that party’s liability might

⁶ To the extent the trial court was convinced by the *Gruenberg* footnote that certain torts are exempt from the privilege, we note that subsequent Supreme Court cases have made clear that the Civil Code section 47(b) privilege applies to all causes of action other than malicious prosecution. (*Hagberg, supra*, 32 Cal.4th at pp. 360–361; *Silberg v. Anderson* (1990) 50 Cal.3d 205, 216.)

⁷ The Supreme Court noted that the illegal conduct exception is resolved at the initial or first prong, where the court addresses the issue of whether the conduct is protected by section 425.16; the exception is not related to the second prong of the anti-SLAPP statutory analysis. (*Flatley, supra*, 39 Cal.4th at p. 320.)

ultimately be defeated or limited under the Civil Code section 47(b) privilege at trial. (*Flatley, supra*, at pp. 320–324.)⁸

Here, the exception to applicability of section 425.16 based upon illegality is plainly unavailable because there was no factual basis for concluding, as a matter of law, that State Fund was guilty of extortion as defined under the Penal Code⁹ or any other crime. (See *Finton Construction, Inc. v. Bidna & Keys, APLC* (2015) 238 Cal.App.4th 200, 210 [the use of the phrase ““illegal”” in *Flatley* was intended to mean criminal, and not merely violative of a statute].) To the contrary, Marchetti, as auditor for State Fund, stated that he had found discrepancies that raised red flags or caused him to suspect the possibility of fraud, and the insureds themselves admitted that their own employees had not only failed to prepare proper payroll or other records, but had defrauded them of substantial sums of money. Under the circumstances, and given State Fund’s statutory obligation to report suspected insurance fraud, there was clearly no basis in this case to determine, as a matter of law, that State Fund committed extortion. In short, the illegality exception to applicability of section 425.16 does not apply.

B. Certain Causes of Action Were Based on the Protected Conduct

In our discussion above, we have found that there *is* protected conduct alleged within the amended cross-complaint—namely, the communications made by State Fund to the district attorneys’ offices relating to suspected insurance fraud by the insureds. However, the mere existence of protected conduct within the allegations is not enough to satisfy the first prong of section 425.16. The statute applies only to a cause of action

⁸ *Flatley* highlighted the differences in the purpose of Code of Civil Procedure section 425.16, which protects constitutional rights of speech and petition from abusive lawsuits, and Civil Code section 47(b), which grants a privilege or immunity against liability in order to secure the freedom of access to judicial and other official proceedings. (*Flatley, supra*, 39 Cal.4th at pp. 320–324.) Thus, although the two statutes are related, they are not identical, and in some unusual instances a communication might be covered by one and not the other.

⁹ See Penal Code sections 518 and 519.

“*arising from*” protected conduct. (§ 425.16, subd. (b)(1), italics added; *City of Cotati, supra*, 29 Cal.4th at p. 78.) This requirement is met only if “the plaintiff’s cause of action itself was *based on* an act in furtherance of the defendant’s right of petition or free speech.” (*City of Cotati, supra*, at p. 78). Courts have made various efforts to elaborate on or clarify this basic test, including statements to the effect that a cause of action will be considered to be *based on* protected activity whenever the protected activity was “core injury-causing conduct” (*Trilogy at Glen Ivy Maintenance Assn. v. Shea Homes, Inc.* (2015) 235 Cal.App.4th 361, 368–369), a wrongful and injurious act (*Old Republic Construction Program Group v. The Boccarrdo Law Firm, Inc.* (2014) 230 Cal.App.4th 859, 869), an act on which liability was based (*Wallace v. McCubbin* (2011) 196 Cal.App.4th 1169, 1190–1191), or part of the “*principal thrust or gravamen*” of the claim as opposed to being merely incidental or collateral thereto (*Renewable Resources Coalition, Inc. v. Pebble Mines Corp.* (2013) 218 Cal.App.4th 384, 395; *Martinez v. Metabolife Internat., Inc.* (2003) 113 Cal.App.4th 181, 188). Consistent with these decisions, we have stated that “[o]ur focus is on the principal thrust or gravamen of the causes of action, i.e., the allegedly wrongful and injury-producing conduct that provides the foundation for the claims.” (*Castleman v. Sagaser* (2013) 216 Cal.App.4th 481, 490–491.)

The cases have further explained that a cause of action is not based on protected conduct where the protected conduct is merely incidental, collateral, or background to the cause of action. “[W]hen the allegations referring to arguably protected activity are only incidental to a cause of action based essentially on nonprotected activity, collateral allusions to protected activity should not subject the cause of action to the anti-SLAPP statute.” (*Martinez v. Metabolife Internat., Inc., supra*, 113 Cal.App.4th at p. 188, approved by *Episcopal Church Cases* (2009) 45 Cal.4th 467, 477.) Conversely, “where a cause of action alleges both protected and unprotected activity, the cause of action will be subject to section 425.16 unless the protected conduct is “merely incidental” to the

unprotected conduct.”” (*Peregrine Funding, Inc. v. Sheppard Mullin Richter & Hampton LLP* (2005) 133 Cal.App.4th 658, 672.) Reasonably implied by the above quoted statements is the principle that, in mixed cases involving both protected and unprotected conduct, if the protected conduct is more than incidental because it is *a substantial part* of the cause of action, section 425.16 applies. (See *Mann v. Quality Old Time Service, Inc.* (2004) 120 Cal.App.4th 90, 100 (*Mann*) [“where a defendant has shown that a substantial part of a cause of action constitutes speech or petitioning activity protected” by § 425.16, the defendant’s initial burden is met].)

An example of protected conduct being found to be incidental or collateral is the case of *Castleman v. Sagaser, supra*, 216 Cal.App.4th 481 at page 493, where we held that the gravamen of the claim of attorney malpractice was not the litigation-related petitioning activity that was alluded to within the framework of the allegations, but the defendant/attorney’s conduct of choosing to align himself with his client’s adversaries, thereby breaching professional duties of loyalty and confidentiality owed to the plaintiff by virtue of a prior attorney-client relationship. (*Id.* at pp. 492–493; accord, *Freeman v. Schack* (2007) 154 Cal.App.4th 719, 729–732.) Another outworking of this principle is seen in *Episcopal Church Cases, supra*, 45 Cal.4th 467, where the parties’ religious motivations and protected expression thereof were held to be essentially background to the actual dispute at issue—one of neutral property law. (*Id.* at pp. 477–478.) The Supreme Court held: “This [property] dispute, and not any protected activity, is ‘the gravamen or principal thrust’ of the action.” (*Id.* at p. 477.)

Similarly, in deciding whether a cause of action is based on protected conduct, sometimes a distinction is drawn between the wrongful conduct or ultimate facts upon which a cause of action is based and the *evidence* that shows the actionable wrongdoing. In *Gallimore v. State Farm Fire & Casualty Ins. Co.* (2002) 102 Cal.App.4th 1388 (*Gallimore*), where the plaintiff brought an action on behalf of himself and the general public for improper business practices against the defendant insurance company, the

complaint referred to a Department of Insurance investigation, which was a source of information containing numerous instances of the defendant's improper insurance practices. No recovery was being sought based on the fact that the defendant had communicated to the Department of Insurance in connection with the investigation. Such communications were not themselves the actionable, wrongful or injurious acts. Instead, the Department of Insurance investigative report was merely *evidence* of the defendant's wrongful insurance practices. In denying the anti-SLAPP motion brought by the defendant, the Court of Appeal held the cause of action did not arise from the Department of Insurance investigation or any communication pursuant thereto. (*Gallimore, supra*, at pp. 1399–1400.) Rather, the cause of action was based solely on the defendant's allegedly improper insurance claims-handling practices. The Court of Appeal emphasized that the defendant's motion had mistakenly “confuse[d]” the “allegedly *wrongful acts*[, i.e., improper practices,] with the *evidence*” that the plaintiff would utilize to prove such misconduct. (*Id.* at p. 1399.) In *Castleman v. Sagaser*, we drew a similar distinction between the principal thrust of the cause of action and the evidentiary support for the same, explaining as follows: “Sagaser’s communications with Attorney Georgeson and testimony in the *Bratton v. Jones* matter may have been the impetus for this lawsuit, but those activities are collateral to the principal thrust of [the] respondents’ causes of action. The behavior is more appropriately characterized as evidence of Sagaser’s alleged breach of fiduciary duties or evidence in support of an affirmative defense. [Citation.] Although protected speech and petitioning are part of the ‘evidentiary landscape’ within which the action arose, the claims are ultimately based on the allegation that Sagaser engaged in conduct inconsistent with the fiduciary obligations he owed to the respondents. [Citation.]” (*Castleman v. Sagaser, supra*, 216 Cal.App.4th at p. 494.)

Having summarized the relevant legal framework, we now seek to apply the above principles to the causes of action alleged by the insureds in the amended cross-complaint

to ascertain whether one or more of the causes of action were *based on* the protected conduct of reporting suspected criminal conduct (i.e., insurance fraud) to the district attorneys' offices.

The first cause of action is for simple breach of contract. A copy of the written policy agreement is attached to the amended cross-complaint. The alleged basis for the breach of the parties' contract is State Fund's failure to complete the audit of workers' compensation insurance in order to accurately determine the final amount of insurance premium due for the prior year's coverage. Although the amended cross-complaint added the new allegations referring to State Fund's report of insurance fraud to the district attorneys' offices, those allegations have no bearing whatsoever on whether or not State Fund breached the terms of the written insurance contract. The inclusion of the protected activity is, as to the first cause of action, merely incidental because the cause of action clearly did not arise out of that protected conduct. Accordingly, State Fund did not meet its threshold burden as to the first cause of action, and the trial court correctly denied the anti-SLAPP motion as to that first cause of action.

However, as to the remaining causes of action, consisting of the fourth cause of action (for fraud), the fifth cause of action (for negligent misrepresentation), the seventh cause of action (for intentional infliction of emotional distress), the eighth cause of action (for negligence), the ninth cause of action (for constructive fraud), the 10th cause of action (for fraud by concealment), the 13th cause of action (for unfair business practices), the 14th cause of action (for negligent hiring, training and supervision), the 15th cause of action (for bad faith breach of contract), and the 16th cause of action (for breach of implied covenant of good faith and fair dealing), we reach a different conclusion. In each of these causes of action, the protected conduct is more than incidental; it is a substantial and integral part of the injury-producing wrongdoing upon which such causes of action are founded. In each, it is alleged State Fund made false representations to the district attorneys' offices, which resulted in a criminal prosecution that, in conjunction with other

acts (i.e., unsubstantiated claims of workers' compensation insurance premium due), financially damaged or destroyed the insureds' business and forced them to incur substantial attorneys' fees and costs to defend themselves, as well as causing great emotional distress and upset. Accordingly, as to the causes of action identified above, we conclude that State Fund met its initial burden of showing that such claims (or a substantial part thereof) arose out of protected conduct.

IV. Remand to Address Second Prong of Anti-SLAPP Motion

Since, as we have concluded, State Fund met its burden of showing that all of the causes of action asserted against it (other than the first cause of action) were based on conduct protected under section 425.16, the burden shifted to the insureds to show a probability of prevailing on those causes of action pursuant to the second prong of the anti-SLAPP motion. Here, the trial court never reached the second prong of the motion, as it should have done in this case. Because the parties' briefing failed to adequately discuss the second step of the anti-SLAPP motion analysis, and the trial court failed to consider it all, we shall reverse and remand the matter with instructions that the trial court undertake the second step of the statutory analysis in the first instance.¹⁰

We do so with the following guidance. As noted, to satisfy the second step or prong, a plaintiff must ““demonstrate that the complaint is both legally sufficient and supported by a sufficient prima facie showing of facts to sustain a favorable judgment if the evidence submitted by the plaintiff is credited.” [Citations.]” (*Rusheen v. Cohen, supra*, 37 Cal.4th at p. 1056.) That is, a plaintiff must (1) *state* and (2) *substantiate* a

¹⁰ Where a trial court has erroneously failed to address the second prong of the analysis under section 425.16, we have discretion to either reach the second prong ourselves, or remand the matter to the trial court to address the second prong in the first instance. (*Birkner v. Lam* (2007) 156 Cal.App.4th 275, 286; *Tuszynska v. Cunningham, supra*, 199 Cal.App.4th at p. 271; *Schwarzburd v. Kensington Police Protection & Community Services Dist. Bd.* (2014) 225 Cal.App.4th 1345, 1355.) We choose the latter course here. Of course, in undertaking the second step of the analysis in this case, the trial court may order any further proceedings or briefing as it may deem necessary.

legally sufficient claim. (*Ibid.*) To make the required evidentiary showing, “the plaintiff must produce *admissible evidence*, from which a trier of fact could find in the plaintiff’s favor, as to every element the plaintiff needs to prove at trial” (*Wallace v. McCubbin, supra*, 196 Cal.App.4th at p. 1206.) Moreover, and of particular importance to this case, the privilege of Civil Code section 47(b) is “relevant to the second step in the anti-SLAPP analysis in that it may present a substantive defense a plaintiff must overcome to demonstrate a probability of prevailing.” (*Flatley, supra*, 39 Cal.4th at p. 323, citing *Kashian v. Harriman* (2002) 98 Cal.App.4th 892, 926–927 [where the plaintiff’s defamation action was barred by Civ. Code, § 47(b), the plaintiff cannot demonstrate a probability of prevailing under the anti-SLAPP statute].) As we have found herein, State Fund’s communications to the district attorneys’ offices to report suspected insurance fraud were privileged under Civil Code section 47(b).

Finally, any consideration of the second prong of the anti-SLAPP analysis should bear in mind the rule applicable where a cause of action is mixed (i.e., where it is based on both protected and unprotected activity) and the unprotected activity is legally sufficient to support the cause of action: “Where a cause of action refers to both protected and unprotected activity and a plaintiff can show a probability of prevailing on *any part of its claim*, the cause of action is not meritless” and it survives under the second prong of the anti-SLAPP procedure. (*Mann, supra*, 120 Cal.App.4th at p. 106.) Or, as was expressed elsewhere in the same opinion: “[W]here a defendant has shown that a substantial part of a cause of action constitutes speech or petitioning activity protected by the anti-SLAPP ... statute (Code Civ. Proc., § 425.16), thereby requiring the plaintiff to show a probability of prevailing on the cause of action to avoid dismissal, the plaintiff need only show a probability of prevailing on *any part of its claim*. Once the plaintiff makes this showing, the court need not determine whether the plaintiff can substantiate *all theories* presented within the single cause of action.” (*Id.* at p. 100.) This approach has been quoted with approval by our Supreme Court in *Oasis West Realty, LLC v.*

Goldman (2011) 51 Cal.4th 811, 820 (*Oasis*); see *Wallace v. McCubbin*, *supra*, 196 Cal.App.4th at pp. 1211–1212 [noting that *Oasis* embraced the view in *Mann* that “where a cause of action arises from both protected and unprotected activity, the plaintiff may satisfy its obligation in the second prong by simply showing a probability of prevailing on any part of the cause of action”].)

DISPOSITION

The trial court’s denial of the anti-SLAPP motion is affirmed as to the first cause of action only of the amended cross-complaint. The trial court’s threshold denial of the motion as to the balance of the causes of action against State Fund is reversed and the matter is remanded to the trial court with instructions that the trial court undertake the second step, or prong, of the anti-SLAPP analysis to determine if the insureds have established that there is a probability they will prevail. (§ 425.16, subd. (b)(1).) Costs on appeal are awarded to State Fund.

KANE, Acting P.J.

WE CONCUR:

POOCHIGIAN, J.

FRANSON, J.