Will Nevada Adopt the Cumis Requirement?

History, Analysis, and Conflict Resolution

The Cumis requirement is now a reality in Nevada—at least according to one federal district court interpreting Nevada Supreme Court precedent. This article describes the development of case and statutory law in California and Nevada governing conflicts of interest on the part of insurance carrier-retained defense counsel when the defending carrier reserves its rights to deny coverage. In addition, this article identifies typical situations creating a disqualifying conflict of interest, as well as practice pointers regarding the method of analysis, negotiating attorney fee rates, and resolving Cumis conflicts.

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Introduction

The Tripartite Relationship

Liability carriers routinely are called upon to furnish a legal defense to their policyholders. If a third party claimant sues the policyholder, the liability insurance carrier will owe a contractual **duty to defend** the lawsuit if the claimant seeks damages that, if proven, are within the liability insurance policy's scope of coverage. In addition to a duty to defend, the liability insurance carrier possesses the **contractual right to defend**, including the right to select defense counsel and effectively control litigation decisions. Customarily, insurance carriers retain a law firm on their regular panel to provide the policyholder with a legal defense. Such law firms generally are known as "insurance defense firms". Thus, the insurance defense firm is rendering legal services to the policyholder, but is being paid by the carrier with whom the law firm has an ongoing economic relationship. This common arrangement is often referred to as a **tripartite relationship** because both the policyholder and the carrier are considered under the laws of some states, such as California and Nevada, to be clients of the insurance defense firm.

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Conflicts of Interest

An insurance carrier's contractual right to defend is not absolute. For example, a liability insurance carrier occasionally may furnish a legal defense while **reserving its right to deny coverage** for any judgments against the policyholder. Some states—such as California, Illinois, Texas, and New York—have recognized that in certain instances, a carrier's reservation of rights may create a conflict of interest on the part of the carrier retained defense counsel. In effect, these states have concluded that a policyholder's legal right to a conflict-free defense supersedes the carrier's contractual right to select its panel counsel and control the litigation decisions. When the carrier's panel counsel has a disqualifying conflict of interest, the remedy is to require the carrier to pay the policyholder's preferred counsel, who, significantly, is **independent of the carrier's control**.

Nevada Law

In the June 2007 edition of *Nevada Lawyer*, Jeffrey W. Stempel, Esq., a professor at the William S. Boyd School of Law, predicted that Nevada would "follow California's lead" with respect to a

policyholder's right to independent counsel.[1] Professor Stempel's article is largely based on the holding in *Nevada Yellow Cab Corp. v. Dist. Ct.,* 152 P.3d 737 (Nev. 2007), in which the Nevada Supreme Court found that under Nevada law, both the insurance carrier and insured are the clients of the insurance carrier-appointed defense counsel. In the *Yellow Cab* case, which did not involve Cumis issues, the Court noted that "joint representation is permissible as long as any conflict remains speculative."

In December 2012, the Unites States District Court found that "*Yellow Cab's* reasoning supports the concept that when a conflict of interest between the insurer and the insured arises, it is inappropriate for a single attorney to represent both." *Hansen v. State Farm Mut. Auto. Ins. Co.* (D. Nev., Dec. 12, 2012, 2:10-CV-01434-MMD) 2012 WL 6205722. Citing to the *Cumis* case, the district court specifically observed a tradition in Nevada courts of "looking to California law where Nevada law is silent." The district court concluded that "Nevada law requires that independent *Cumis* counsel must be appointed when a conflict of interest arises between the insured and insurer." It also **rejected a per se rule** that requires recognition of Cumis counsel whenever an insurance carrier reserves its rights, stating that "Nevada courts would determine the question on a case by case basis."

The Cumis Requirement

The term *Cumis* refers to the seminal opinion issued by the California Court of Appeals in 1984 entitled, *San Diego Navy Federal Credit Union v. Cumis Insurance Society* (1984) 162 Cal.App.3d 358.

In *Cumis*, the court recognized that, in some instances, an insurance company must **surrender its contractual right** to select defense counsel and control litigation decisions. The court was primarily concerned with the now frequent situation in which an insurance carrier retains panel counsel to defend its policyholder, while reserving its right to deny payment at a later date of the policy's indemnity benefit. The *Cumis* court reasoned that when a coverage dispute exists, the insurance carrier's defense counsel cannot effectively represent the interests of both the insurance carrier and the interests of the policyholder. The *Cumis* court ruled that, under such circumstances, the insurance carrier **must pay the reasonable legal fees charged by the policyholder's counsel**, that is, the attorney selected and controlled by the policyholder, commonly referred to as "Cumis counsel" or "independent counsel."

In reaching its conclusion, the *Cumis* court assumed that the insurance carrier's defense counsel would favor the interests of one client, most likely those of the insurance carrier, over the interests of the policyholder. This assumption rests upon the fact that panel counsel typically has an ongoing economic relationship with the insurance carrier, who is the party paying for legal services. More specifically, the rationale is that, since panel counsel wishes to continue receiving new assignments

[1] See Jeffrey W. Stempel, "The Relationship Between Defense Counsel, Policyholders, and Insurance Carriers: Nevada Rides Yellow Cab Toward 'Two-Client' Model of Tripartite Relationship. Are Cumis Counsel and Malpractice Claims by Insurance Carrier's Next?", *Nevada Lawyer*, June 2007, at p. 20.

from the insurance carrier, he or she will be naturally motivated to favor the interests of the insurance carrier over the interest of the policyholder.

Control of the Defense

Whenever a policyholder demands independent counsel, the real issue usually concerns who is going to control the defense. Controlling the defense via panel counsel enables claims handlers to efficiently adjust liability insurance claims. An insurance carrier's control of the defense is a cornerstone of the relationship between the insurance carrier and the policyholder. Where a policyholder is entitled to independent counsel, the insurance carrier will often prefer to **waive coverage defenses** in order to retain control of the defense. Consequently, claims for independent counsel often **evolve into negotiations** over what coverage defenses, if any, the insurance carrier is willing to waive in order to resolve the dispute concerning the policyholder's demand for independent counsel.

"Where a policyholder is entitled to independent counsel, the insurance carrier will often prefer to waive coverage defenses in order to retain control of the defense."

What's in this Book?

The first and second sections of this book discuss the development of the Cumis requirement under the laws of California and Nevada. The third section employs a question-and-answer format to explain some of the basic principles and terminology of the Cumis requirement under California law. The fourth and fifth sections address relations between Cumis counsel, the policyholder, and the insurance carrier, including negotiating attorney fees, processing invoices, and resolving conflicts. The sixth section sets forth nine hypotheticals illustrating when a policyholder may or may not be entitled to independent counsel. Addendum A sets forth the provisions of Section 2860 of the California Civil Code, which is California's codification of the basic principle in the *Cumis* decision. Addendum B sets forth selected provisions of the California Rules of Professional Responsibility. Addendum C sets forth selected provisions of the Nevada Rules of Professional Conduct. Addendum D discusses an example of a recently litigated Cumis dispute in the United States District Court, Central District of California. The four exhibits to Addendum D include a copy of the reservation-of-rights letter, the moving and opposing papers for an injunction motion, and the court's ruling. ✦

The *Cumis* Case and the California Legislature's Reaction

The Executive Aviation Case

The holding in the *Cumis* derives largely from a prior appellate court opinion in 1971 entitled, *Executive Aviation, Inc. v. National Insurance Underwriters* (1971) 16 Cal.App.3d 799.

There, the policyholder, who owned an aircraft sales business, faced liability for the loss of life resulting from an accident during a pre-sale demonstration flight. The aircraft's pilot had been licensed to fly private carriage operations, but not large aircraft in common carriage for compensation. The policyholder's liability policy excluded coverage to the extent the pilot was not licensed for the type of flight at issue. Insurance litigation ensued between the policyholder and its insurance carrier as to whether the flight would be considered under FAA rules as a bona fide sales demonstration (covered by insurance) or common carriage flight (not covered by insurance). *Executive Aviation, supra,* 16 Cal.App.3d at 805

Thereafter, survivors of the decedent passengers sued the policyholder. The liability insurance carrier agreed to defend but reserved its rights under the policy provisions limiting coverage to qualified pilots. To defend the policyholder, the carrier initially hired the same law firm that had represented the carrier in the insurance litigation with the policyholder. The carrier then sought to hire a different law firm as defense counsel, but the policyholder "had no say" in the selection of defense counsel. The carrier also refused to provide the second law firm with the claims file. *Executive Aviation, supra,* 16 Cal.App.3d at 806.

On appeal in the insurance litigation, the California Court of Appeal noted that the conflict-of-interest issue was a matter of first impression under California law. Looking to case precedent from the state courts of New York, the *Executive Aviation* court that found that:

> [W]here a conflict of interest has arisen between an insurer and its insured, the attorney to defend the insured in the tort suit should be selected by the insured and the reasonable value of the professional services rendered assumed by the insurer. If the insured and the insurer are represented by two different attorneys, each of whom is pledged to promote and protect the prime interests of his client, adequate representation is guaranteed and the deleterious effect of the conflict of interest imposed on an attorney who attempts the difficult task of representing both parties is averted. *Executive Aviation, supra,* 16 Cal.App.3d at 806.

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Accordingly, the appellate court in *Executive Aviation* held that that "in a conflict of interest situation, the insurer's desire to exclusively control the defense must yield to its obligation to defend its policy holder[,]" and that "the insurer's obligation to defend extends to paying the reasonable value of the legal services and costs performed by independent counsel, selected by the insured." *Executive Aviation, supra,* 16 Cal.App.3d at 807.

The Cumis Case

In *San Diego Navy Federal Credit Union v. Cumis Insurance Society* (1984) 162 Cal.App.3d 358, which has been superseded by statute, the court considered whether a reservation of the right to deny coverage at a later date created a conflict of interest requiring the provision of independent counsel.

In *Cumis*, the insured was faced with a wrongful termination lawsuit that sought, inter alia, punitive damages and damages for breach of contract. The insurer's position was that the punitive damages were not covered, and that if a breach of contract by the insured was found, that there could be no coverage for the claim at all. The insurer reserved its rights accordingly, and appointed counsel to defend the insured on all counts, including those seeking punitive damages. The insurer made its own conclusion that no conflict of interest existed under the circumstances, and it refused to pay for independent counsel. *Cumis, supra,* 162 Cal.App.3d at 361.

The *Cumis* court found that when some or all of the allegations of a complaint do not fall within the scope of coverage, the interests of the insured and the insurer may diverge, as embodied by a reservation of rights, leaving the single, insurer-appointed defense counsel to face decisions that could benefit one client at the expense of the other. The *Cumis* court further noted the difficulties and conflicts facing defense counsel when the insured desires settlement and the insurer does not, as well as confidentiality issues that could affect coverage. Given these conflicts, and the professional rules governing attorneys that prevent such representation, the court held that "[i]f the insurer must pay for the cost of defense and, when a conflict exists, the insured may have control of the defense if he wishes, it follows that the insurer must pay for such defense conducted by independent counsel." *Cumis, supra,* 162 Cal.App.3d at 370.

"The Cumis court further noted the difficulties and conflicts facing defense counsel when the insured desires settlement and the insurer does not, as well as confidentiality issues that could affect coverage. "

The *Cumis* case ruling was very broad. Some courts and many lawyers interpreted the *Cumis* case as requiring independent counsel whenever the insurance carrier reserves its rights. Consequently, policyholder attorneys began demanding that insurance carriers hire them as "*Cumis* counsel", even

in the absence of an actual, substantial conflict of interest. *Cumis, supra,* 162 Cal.App.3d at 373.

California Civil Code, § 2860

In 1987, the holding of the *Cumis* case was codified by the California Legislature at Section 2860 of the California Civil Code. It provides that if an insurance policy imposes a duty to defend, the insurance carrier "shall provide independent counsel" to the policyholder where a "conflict of interest arises." It further provides that "when an insurer reserves its rights on a given issue and the outcome of that coverage issue can be controlled by counsel first retained by the insurer for the defense of the claim, a conflict of interest may exist."

In addition to outlining a specific standard for determining disqualify conflicts of interest, Section 2860 governs other aspects of the relationship between insurance carriers and policyholders in potential Cumis situations by:

- Defining the standard for determining when a disqualifying conflict of interests arises;
- Permitting the insurance carrier to demand that independent counsel possess both sufficient experience and malpractice insurance;
- Limiting reimbursable legal fees to the hourly rates ordinarily paid by the insurance carrier to its counsel in similar cases in the local area;
- Mandating arbitration to resolve disputes regarding the amount of legal fees and the hourly rate paid by the insurance carrier;
- Allowing the insurance carrier to retain its own defense counsel to participate in every aspect of the lawsuit including settlement; and
- Requiring the policyholder and its own independent counsel to confer and cooperate with the insurance carrier and its counsel on all matters, as well as disclosing most information regarding the lawsuit.

The statute's other provisions expressly state that no disqualifying conflict of interests exists as to the following:

- Allegations of punitive damages;
- Allegations or facts for which the insurance carrier denies coverage; or
- Solely because an insured is sued for an amount in excess of the insurance policy limits. ✦

Yellow Cab and Its Progeny

"Under Nevada law, the attorney's client is the policyholder[,]" and "[a]lthough the insurer … under a duty to defend … ordinarily retains and compensates counsel on behalf of the policyholder, the policyholder has the rights of a client while the insurer has the subordinate rights of a third party payer…." Nevada Formal Ethics Opinion No. 28 (2002).

The Yellow Cab Case

In 2007, the Nevada Supreme Court established the legal precedent that would lead to the subsequent recognition of the Cumis requirement under Nevada law. See *Nevada Yellow Cab Corporation v. The Eighth Judicial District Court* (2007) 123 Nev. 44.

In *Yellow Cab*, attorneys who had formerly acted as insurer-appointed defense counsel were later hired by the insured, Yellow Cab, to pursue the insurer for bad faith. The insurer sought to disqualify these attorneys based upon conflict of interest. The issue hinged on whether or not the insurer was a former client, or in other words, if an attorney-client relationship existed between the insurer and the attorneys it hired to defend its insured. The court responded in the affirmative, and formally adopted the majority rule that counsel retained by the insurer to defend its insured represents both the insurer and the insured in the absence of a conflict. *Yellow Cab, supra,* 123 Nev. at 44.

The Hansen Case

In 2012, the United States District Court for the District of Nevada adopted the Cumis requirement. See, *Hansen v. State Farm Mutual Automobile Insurance Company*, 2012 WL 6205722 (D. Nev. 2012).

In *Hansen*, a gang member rear-ended a partygoer's car as its occupants were attempting to leave the party. After being rear-ended, and while driving away, the car was pelted with rocks and bottles by other partygoers. Stephen Hansen, one of the occupants, suffered serious injuries when a large rock crashed through the windshield. This gang-related incident formed the basis of a lawsuit against Brad Aguilar, the driver that rear-ended the car. Brad Aguilar submitted the claim under both his State Farm automobile policy, and his State Farm homeowner's policy. The automobile policy accepted Brad's claim under a reservation of rights, while the homeowner's policy declined. Later, Aguilar's father, Ernest, was added as a defendant and submitted a claim under the same State Farm homeowner's policy. Ernest's claim was accepted under a reservation of rights. The automobile policy provided $25,000 in coverage, while the homeowner's policy had limits of $100,000. *Hansen,*

supra, 2012 WL 6205722 at *1.

Brad and Ernest settled the claim against them by acknowledging an adverse judgment of $176,000 and assigning their rights against State Farm to plaintiff Hansen, who then sued State Farm for breach of contract and bad faith, alleging a failure by State Farm to adequately defend the Aguilars as required by the State Farm policies by failing to assign Cumis counsel. The *Hansen* court examined California law as well as the minority position on the issue, and in accord with *Yellow Cab*, formally adopted the requirement that an insurer appoint and pay for independent, or Cumis counsel, when a conflict of interest arises between the insured and insurer. The court ruled that the reservation of rights against coverage for intentional conduct created a real, not merely hypothetical conflict, and denied State Farm's motion for summary judgment.

Citing the *Yellow Cab* case, the district court in *Hansen* stated:

> Therefore, both *Yellow Cab's* holding and its reasoning support the conclusion that Nevada law requires the appointment of independent counsel when a conflict of interest arises. The Nevada Supreme Court's determination that an attorney cannot represent an insured against its former insurer in a later conflict means the Court would similarly prohibit a single attorney to represent both the insured and the insurer in a case when a conflict arises. Moreover, the [Nevada Supreme] Court (1) recognized that defense counsel represents both the insurer and the insured in the absence of conflict; (2) recognized that a conflict of interest can exist between an insured and insurer; and (3) held by negative implication that when such a conflict exists in more than hypothetical form, the parties must have separate and independent counsel ("dual-representation ... is permissible as long as any conflict remains speculative"). *Hansen, supra,* 2012 WL 6205722 at *6.

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The district court in *Hansen* went on to observe that "California's requirement for independent counsel … is the majority rule[,]" and that courts "often apply a *Cumis*-type requirement" as follows:

> The attorney retained by the insurer to defend the insured serves two clients, the insurer and insured. This premise is often referred to as the "dual client doctrine." When the insurer elects to defend subject to a reservation of rights, the interests of retained counsel's clients become adverse. The insured will work toward preserving indemnity whereas the insurer focuses on establishing non-coverage.
>
> The conflicting interests of retained counsel's two clients makes ethical representation of both difficult if not impossible. Courts identify the following potential problem areas: First, retained counsel may become

> aware of information damaging to a client through confidential communication with the other client. Second, retained counsel potentially could manipulate the trial strategy to benefit the interests of one client to the detriment of the other. For example, when seeking special verdicts, retained counsel will be responsible for framing jury questions, the answers to which, in many cases, will determine coverage/non-coverage.
>
> When faced with a decision that compromises the interests of one client over the other, courts in the majority presuppose that defense counsel will favor the insurer over the insured. Acknowledging that "no man can serve two masters," the ethical prohibition against representation of two clients with conflicting, inconsistent, diverse or otherwise discordant' interests, and the insurer's duty to defend, courts in the majority conclude that where a conflict of interest arises out of the insurer's reservation of rights to deny coverage, the insurer must pay for the reasonable costs of the insured's independent counsel. *Hansen*, *supra*, 2012 WL 6205722, *7, quoting Allison M. Mizuo, *Finley v. Home Insurance Co.: Hawai'i's Answer to the Troubling Tripartite Problem*, 22 U. Haw. L.Rev. 675, 680–82 (2000).

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The district court also went on to observe that, based upon language in the Yellow Cab case, "a reservation of rights letter can create a conflict of interest, but that Nevada courts would determine the question on a case by case basis." *Id*. at *10. Thus, the court concluded that "whether or not an insurer's reservation of rights creates a conflict of interest must be determined by looking to the particular facts of each case." *Id*. ✦

"The Hansen court examined California law as well as the minority position on the issue, and in accord with Yellow Cab, formally adopted the requirement that an insurer appoint and pay for independent, or Cumis counsel, when a conflict of interest arises between the insured and insurer."

Questions & Answers: The Basics of California's Cumis Law

This section sets forth some basic questions and answers concerning a policyholder's entitlement to independent counsel under California law when the liability insurance carrier has agreed to defend the policyholder under a reservation of rights. The questions, answers involve, and case citations involve issues that are governed by California law, including Section 2860 of the California Civil Code and its judicial interpretation.

1. What does it mean to say someone is "Cumis counsel" or "independent counsel"?

These phrases usually refer to an attorney or law firm who is independent of an insurance carrier, even though that carrier is paying that attorney or law firm to defend the firm's client. Generally, when a policyholder is sued by a third party, the insurance carrier—not the policyholder—has the contractual right to select and hire an attorney to defend the policyholder in the lawsuit. This contractual right includes the right of the carrier to control how the legal defense of the policyholder is handled.

Under certain circumstances, however, a policyholder may be entitled to select its own attorney and control the handling of the legal defense. Under such circumstances, the policyholder's attorney is "independent" in that the insurance carrier cannot control the defense. The term "Cumis" is often used to describe independent counsel, because one of the first cases to recognize the policyholder's right to independent counsel is entitled *San Diego Federal Credit Union v. Cumis Insurance Society, Inc.* (1984) 162 Cal. App. 3d 358.

2. What is a "Cumis" conflict or a disqualifying conflict of interest?

Generally speaking, a disqualifying conflict of interest (sometimes referred to as a Cumis conflict) may arise when the insurance company agrees to defend its policyholder under a reservation of rights. For example, suppose an insurance carrier agrees to defend the policyholder, but reserves its rights to deny any obligation to indemnify the policyholder if the lawsuit reveals that the policyholder intentionally caused injury to the plaintiff. In such a situation, the defense attorney may have the ability to shape the legal defense in such a way as to establish noncoverage. The original *Cumis* opinion suggested that an insurance carrier carrier's panel counsel, who routinely receives claims from the carrier, may be wrongfully motivated to manipulate the lawsuit to favor the carrier's interests over the policyholder's interests. It is important to note, however, that in California not every reservation-of-rights letter creates a *Cumis* conflict entitling the policyholder to independent counsel.

3. What do the terms "insurance defense firm" and "panel counsel" mean?

The term "insurance defense firm" is a general reference to a law firm whose clientele are primarily insurance carriers. The carriers retain the firm to serve as defense counsel for policyholders who are defendants in lawsuits where the damages sought may be within the scope of the policyholder's liability insurance policy. Such law firms, including lawyers at the firm, are often referred to as "panel counsel" because they are on the approved list, or panel, of insurance carriers who regularly retain them to defend policyholders.

4. Is the court's ruling in the Cumis case still followed?

In 1987, the California state legislature enacted a comprehensive statute, Section 2860 of the California Civil Code, to clarify and limit the requirements and standards set forth in the *Cumis* ruling. However, the courts in many other states commonly cite to the *Cumis* decision as a persuasive authority when determining issues of independent counsel. A broad interpretation of the *Cumis* decision is that the policyholder is entitled to independent counsel whenever the insurance carrier reserves its rights; however, the California Legislature has rejected such a per se rule. *Dynamic Concepts, Inc. v. Truck Ins. Exchange* (1998) 61 Cal.App.4th 999.

5. What is the significance of appointing independent counsel?

In California, the appointment of independent counsel shifts the control of the policyholder's defense in the liability action from the insurance carrier to the policyholder. Although the insurance carrier is still involved in the liability action and has certain legal rights, the insurance carrier can no longer insist on complete control of the defense of the litigation. In California, however, the carrier is entitled to retain control and fully participate in settlement negotiations. Nonetheless, many carriers believe that retaining independent counsel increases the costs of litigation and impacts a carrier's practical ability to effect settlements efficiently.

6. What rights does an insurance carrier possess after an independent counsel has been selected?

California law provides certain rights to an insurance carrier after independent counsel has been appointed. First, the insurance carrier has the right to be involved in the litigation and to obtain all information concerning the litigation except privileged materials relevant to coverage disputes. Second, the insurance carrier generally possesses the right under California law to maintain control of any settlement of the lawsuit against the policyholder, even though it cannot insist upon controlling the defense. Nonetheless, the insurance carrier must involve the policyholder, including its independent counsel, in the settlement

negotiations. This is because Section 2860, subd. (f) of the California Civil Code mandates that both attorneys—independent counsel selected by the policyholder and the insurance carrier's panel counsel—participate in all aspects of the litigation, especially the critical stage of settlement. *Novak v. Low, Ball & Lynch* (1999) 77 Cal.App.4th 278, 285.

7. Who has the right to decide which lawyer or law firm will serve as independent counsel for the policyholder?

If a disqualifying conflict of interest arises, the policyholder has the right to select independent counsel and that independent counsel represents only the interests of the policyholder. However, the policyholder's choice of independent counsel may be limited by applicable provisions within the insurance policy. Furthermore, the statutory law specifically sets forth the minimum requirements related to independent counsel. For example, California law states that the selected counsel may be required to have (1) at least five years of civil litigation practice which includes substantial defense experience in the subject at issue in the litigation, and (2) errors and omissions coverage. Cal. Civil Code, § 2860, subd. (c).

8. Who pays for independent counsel?

The insurance carrier must pay for the independent counsel. However, the insurance carrier is required to pay only the amount of fees that it ordinarily would pay to other attorneys in similar actions in the community where the claim arose or is being defended. Cal. Civil Code, § 2860, subd. (c).

9. What are an independent counsel's duties?

Independent counsel's fiduciary duties are owed only to the policyholder. However, California law imposes upon independent counsel certain duties owed to the insurance carrier, such as the duty to cooperate and to share non-privileged information obtained throughout the course of litigation. Cal. Civil Code, § 2860, subd. (d).

10. How are disputes regarding independent counsel resolved?

The answer depends on the type of dispute. If the dispute relates to independent counsel's fees, California law requires resolution at binding arbitration. If the dispute is over any other matter, a declaratory relief action may be appropriate so long as the policy does not impose otherwise. Cal. Civil Code, § 2860, subd. (c).

11. Can independent counsel be held liable to the insurance carrier for malpractice in how the defense of the policyholder is handled?

No. Independent counsel cannot be held liable to the insurance carrier for malpractice related to how the defense of the policyholder is handled. Independent counsel is obligated only to consult and cooperate and to keep the insurance carrier reasonably informed. As one court explained, the compelling need for independent counsel "to remain free from the oftentimes subtle ethical dilemmas and temptations that arise along with conflict in joint representations prohibits [independent counsel] from having any duty to investigate, prepare, assert, establish, or perform similar functions regarding a defense or position in the insurance carrier's favor." *Assurance Co. of America v. Haven* (1995) 32 Cal.App.4th 78, 87.

12. What is the paradigm scenario in which a policyholder will likely be entitled to independent counsel?

When the insurance carrier reserves rights on a mental issue—such as the right to deny indemnification for intentionally-caused losses to a third party—a disqualifying conflict may arise thereby triggering the policyholder's entitlement to independent counsel. This is because a mental state is a factually malleable issue. One set of facts can be used to demonstrate either intent or mere accidental, negligent conduct. Also, unlike reserving rights on many issues, reserving rights on a mental issue typically involves a "coverage shifting" dynamic. For example, if the carrier reserves rights on an exclusion for intentionally-caused injuries, coverage will attach if the trier of fact merely finds accidental liability-producing conduct, but coverage will not attach if the jury finds the policyholder acted intentionally. *Golden Eagle Ins. Co. v. Foremost Ins. Co.* (1993) 20 Cal.App.4th 1372, 1395; *Long v. Century Indem. Co.* (2008) 163 Cal.App.4th 1460, 1471.

13. What are some examples of when insurance carrier may owe a duty to recognize and pay the policyholder's independent counsel?

Some of the circumstances that may create a conflict of interest requiring the insurer to provide independent counsel include: (1) where the insurer reserves its rights on a given issue and the outcome of that coverage issue can be controlled by the insurer's retained counsel; (2) where the insurer insures both the plaintiff and the defendant; (3) where the insurer has filed suit against the insured, whether or not the suit is related to the lawsuit the insurer is obligated to defend; (4) where the insurer pursues settlement in excess of policy limits without the insured's consent, leaving the insured exposed to claims by third parties; and (5) any other situation where an attorney who represents the interests of both the insurer and the insured finds that his or her representation of the one is rendered less effective by reason of his or her representation of the other. *James 3 Corp. v. Truck Ins. Exchange* (2001) 91 Cal.App.4th 1093.

14. *What are some examples of when an insurance carrier's reservation of rights does not trigger the policyholder's entitlement to independent counsel?*

- A disqualifying conflict generally does not arise where the coverage issue is wholly extrinsic and independent of the issues in dispute in the lawsuit against the policyholder. For example, where an auto insurance carrier reserved its rights to deny coverage based upon a resident relative exclusion, the court found no disqualifying conflict of interest. The outcome of the coverage issue was based upon the existence of a relationship, not an issue in dispute in the litigation. *McGee v. Superior Court* (1985) 176 Cal.App.3d 221, 226.

- If the insurance carrier's reservation is based upon the extent of damages, no disqualifying conflict of interest may arise where the carrier does not contest that some damages are within the scope of coverage. For example, where the carrier reserved its rights to deny coverage for damage to the policyholder's work, but acknowledged coverage for property damage resulting from the policyholder's work, the court found no disqualifying conflict of interest. The court reasoned that the primary interests of the carrier, policyholder, and panel counsel were aligned: they had a common interest to contest the existence of liability and the extent of proximately-caused damage. *Blanchard v. State Farm Fire & Cas. Co.* (1991) 2 Cal.App.4th 345, 350.

> *"In light of Nevada's case-by-case approach to the Cumis Requirement, California law—while not binding on Nevada courts—may constitute persuasive authority on some issues."*

- A claim for punitive damages alone is insufficient to trigger the policyholder's entitlement to independent counsel. Likewise, the mere fact that the third party claimant seeks amount in excess of the policy limits does not trigger entitlement to independent counsel. Section 2860, subd. (b) of the California Civil Code specifically states that such claims do not trigger entitlement to independent counsel. *Foremost Ins. Co. v. Wilks* (1988) 206 Cal.App.3d 251, 261.

- If the coverage issue is purely one of contract interpretation, the insurance carrier's reservation may not trigger entitlement to independent counsel. *Native Sun Invest. Group v. Ticor Title Ins. Co. of Calif.* (1987) 189 Cal.App.3d 1265, 1277.

- If the purported conflict is not specific, actual, and substantial, but merely hypothetical, speculative, or potential, a disqualifying conflict of interest may not arise. *Dynamic Concepts, Inc. v. Truck Ins. Exchange* (1998) 61 Cal.App.4th 999, 1007.✦

Analytical Checklist

Steerable Issues

A review of case law reveals that only certain types of issues—sometimes referred to as "steerable" issues—create a disqualifying conflict of interest on the part of the carrier retained defense counsel. As a general rule, steerable issues generally will be the malleable, fact-intensive issues. A common example of a steerable issue is when an insurance carrier reserves rights on a mental issue—such as an exclusion for intentionally caused losses. Proving a mental state typically is a function of circumstantial evidence. The same universe of facts can be used to demonstrate either intentional conduct or accidental conduct. Thus, the issue is relatively steerable, because a good lawyer could employ the same "bucket" of facts to show the policyholder's liability-producing conduct was intentional (not covered) or accidental (covered).

Analytical Approach

Insurance carriers reserve rights on many types of issues. It is often unclear, however, whether the carrier's reservations are based upon steerable issues. If a policyholder wishes to formulate arguments to persuade the carrier to furnish independent counsel, a careful analysis may be necessary to demonstrate that the carrier's reservations are "steerable" issues (or otherwise warrant recognition of the policyholder's entitlement to independent counsel). In order to analyze whether an insurance carrier's particular reservation triggers entitlement to independent counsel, the following checklist can assist in narrowing the analytical focus:

☐ ***Is the agreement to defend subject to any rights to deny the policy's indemnity benefit to the policyholder?***

- List the rights expressly and implicitly reserved
- Identify the nature of each right reserved
  - State of mind
  - Type of judicial relief
  - Type of injury or damage
  - Causation
  - Insured qualification
  - Legal status
  - Other

"Not every reservation of rights triggers a policyholder's entitlement to independent counsel."

> *"In identifying whether an issue is a 'steerable issue", it is often helpful to consider the nature of the evidence to prove or disprove the coverage issue. If the evidence is circumstantial, the issue is more likely to be steerable. If the evidence is direct and objective in nature, the issue is less likely to be steerable on the part of carrier-retained defense counsel. Also, one must consider the procedural stage of the litigation. Independent counsel may be warranted at later stages, such as settlement, even if not at the outset."*

(continued)

☐ ***Does the complaint allege more than one injury, and if so, does the complaining party seek recovery under multiple causes of action?***

- List each theory of liability seeking recovery for the same injury

☐ ***What are the disputed factual issues relating liability and damages?***

- List the elements of each theory of liability and affirmative defense
- Identify which elements are actually in dispute

☐ ***Could the resolution of any factual issues determine the outcome of any coverage issues raised by the reservation-of-rights letter?***

- List the corresponding factual and coverage issues
- Identify the type of evidence that will likely be needed to prove and disapproves each factual issue

☐ ***Identify and describe defense counsel's motive and ability, if any, to shape the case so that the resolution of the factual issue exposes the policyholder to uninsured liability instead of insured liability.***

- Do the facts indicate a coverage shifting dynamic?
- Are the primary interests of policyholder, carrier, and defense counsel aligned?
- Has the carrier voluntarily waived any coverage limitations? ✦

Negotiating Attorney Rates and Processing Invoices

Hourly Rates

When an insurance carrier agrees to recognize its policyholder's entitlement to independent counsel, disputes often arise over the hourly rates for the policyholder's selected independent counsel. Insurance carriers will typically assert their right to pay no more than what it pays to panel counsel in the same geographical area to defend similar types of lawsuits. The policyholder's attorney will often be unsatisfied with the highest hourly rate offered by the insurance carrier. They will often argue that the carrier must pay the market rates of independent counsel, or that the carrier should pay the hourly rate that it pays attorneys who represent and defend the carrier itself (e.g., bad faith defense counsel, coverage counsel).

Interim Arrangement

Ideally, a mutually agreeable hourly rate can be negotiated at the outset. As a practical matter, however, the carrier may refuse to pay the rates demanded by the policyholder's independent counsel. If the dispute cannot be resolved, the best option may be to "agree to disagree". In other words, the independent counsel agrees in the interim to accept an hourly rate as the case proceeds, while reserving the policyholder's right to subsequently seek reimbursement from insurance carrier. In such instances, the policyholder and the carrier may eventually file a lawsuit asking the court to determine the appropriate hourly rate—the rate offered by the carrier or the rate demanded by independent counsel—and order the carrier to pay the differential, if any.

Record Keeping

If this occurs, it will be in the interest of all involved—the insurance carrier, the policyholder, and independent counsel—to make a clear record of the invoices submitted. This includes all of the following: the hourly rates charged; the hourly rates actually paid; line item detail as to the amount and reasons for any other deductions; the date of invoice submission; the date of each partial or full payment of each invoice; and how the actual amounts paid were calculated. ✦

> *"The insurance carrier, policyholder, and independent counsel will benefit from a clear record showing which invoices were submitted, why the invoices were not paid in full, and the extent to which undisputed amounts were promptly paid to independent counsel."*

Dispute Resolution

Declaratory Relief

Cumis disputes occasionally require litigation. The critical issue in such litigation is whether the insurance carrier's agreement to defend is subject to any reserved rights that create a disqualifying conflict of interest on the part of the insurer-retained defense counsel. This issue typically is framed in the pleadings as a claim for declaratory relief. If it is unclear whether the insurance carrier owes a duty to defend in the first instance, the claim for declaratory relief may seek a judicial declaration on that issue as well. These issues are generally resolved via motion for summary judgment (or partial summary judgment), but sometimes policyholders will seek relief via a claim for injunctive relief. See Addendum C, Case Study: *Poshe USA, LLC vs. Nautilus Insurance Company*.

"A related issue that is often litigated or arbitrated is attorney fees, including disputes over hourly rates and deductions by insurance carriers."

A related issue that is often litigated or arbitrated is attorney fees, including disputes over hourly rates and deductions by insurance carriers. Under California law, these Cumis disputes generally are subject to binding arbitration under Section 2860, subd. (c) of the California Civil Code. Section 2860 also provides grounds for petitioning the state superior court for an order to share information, to allow participation of the carrier-selected defense counsel, and other similar grounds. While these statutory rules and procedures do not apply to Cumis disputes governed by Nevada law, they may ultimately prove to constitute persuasive precedent as to how analogous procedures and common law doctrines can be used to address similar issues.

Insurance Coverage Litigation

If litigation becomes necessary to resolve any of these disputes, the policyholder and the insurance carrier often will plead any other potential claims for relief to avoid any issue or claim preclusion (i.e., *collateral estoppel* and *res judicata*); therefore, litigation over independent counsel issues often escalates into an insurance coverage litigation including claims for breach of contract, breach of the implied covenant of good faith and fair dealing, and punitive damage.

To the extent such lawsuits prejudice the policyholder, grounds may exist to stay the insurance litigation until the third party claimant's lawsuit against the policyholder is resolved. *Montrose Chemical Corp. v. Superior Court* (1993) 6 Cal.4th 287, 301 ("To eliminate the risk of inconsistent factual determinations that could prejudice the insured, a stay of the declaratory relief action pending resolution of the third party suit is appropriate when the coverage question turns on facts to be litigated in the underlying action.").

Also, if the litigation is venued in federal court, policyholders occasionally file motions for an order dismissing the insurance litigation based upon the abstention doctrine. Such motions, which are rarely granted, seek to persuade the federal court to abstain from issuing declaratory relief in a state law matter where a state court action is pending involving related issues. *Wilton v. Seven Falls Co.* (1995) 515 US 277, 287–289, 115 S.Ct. 2137, 2142–2144; *Brillhart v. Excess Ins. Co. of America*, 316 U.S. 491, 62 S.Ct. 1173, 86 L.Ed. 1620 (1942); *Government Employees Ins. Co. v. Dizol* (9th Cir. 1998) 133 F3d 1220, 1225.

Choice of Law

If a lawsuit is venued in Nevada, but the insurance policy at issue was delivered to the policyholder in another state, a choice-of-law issue may arise if the laws of the state of delivery do not recognize entitlement to Cumis counsel.

Nationally, cases have split between whether the laws of the venue state (i.e., the state where the lawsuit against the insured person was filed) apply or the laws of the state of delivery apply (i.e., the state where the insurance policy was entered into and delivered). A slim majority of courts hold that the laws of the state of the policy's delivery apply. *Northern Insurance Co. v. Allied Mutual Ins. Co.* (9th Cir. 1992) 955 F.2d 1353; *American Family Life Assur. Co. of Columbus, Ga. v. U.S. Fire Co.* (11th Cir. 1989) 885 F.2d 826, 832; *C.B. Robinson Co. v. Zurich Am. Ins. Co.* (D. Minn. 2004) 2004 U.S.Dist.LEXIS 22797, *15-21; *Hartford Cas. Ins. Co. v. A&M Assocs*. (D. R.I. 2002) 200 F.Supp.2d 84, 87; *Britamco Underwriters v. Nishi, Papagiika & Assocs.* (D.D.C. 1998) 20 F.Supp.2d 73, 75; *Hawkins, Inc. v. Am. Int'l Specialty Lines Ins. Co.* (2008) 2008 Minn.App.Unpub.LEXIS 1218, *14*; United States Fidelity & Guaranty Co. v. Louis A. Roser Co.* (8th Cir. Minn. 1978) 585 F.2d 932, 935, n.2.

A minority of courts apply the laws of the state where the lawsuit is venued. *Hartford Underwriters Ins. Co. v. Found. Health Servs.* (5th Cir. Miss. 2008) 524 F.3d 588; *Lifestar Response of Ala., Inc. v. Admiral Ins. Co.* (2009) 2009 Ala. LEXIS 39, 34; *Bethlehem Constr., Inc. v. Transp. Ins. Co.* (E.D. Wash. 2006) 2006 U.S.Dist.LEXIS 70357; *Travelers Indem. Co. v. Royal Oak Enters.* (M.D. Fla. 2004) 429 F.Supp.2.d 1265, 1270. ✦

"It is possible that courts nationally will remain divided. Although a minority finds the forum state's laws apply, a strong argument exists that the forum state's laws are more appropriate, because defense counsel's duties are governed by the forum state's laws of professional conduct and responsibility."

Hypotheticals

This section contains nine hypothetical scenarios to illustrate situations that may or may not create entitlement to independent counsel. The critical issue in all but a few hypotheticals is whether the insurance carrier's position on coverage issues creates a disqualifying conflict of interest on the part of the defense counsel assigned and retained by the insurance carrier to defend the policyholder. Each scenario is loosely drawn from one or more published case opinions of the California Court of Appeal. An answer key is set forth immediately below for those attending a live or recorded presentation. The hypothetical scenarios are set forth on the following pages.

Hypo	Answer	Topic	Key Citation
1		Coverage Shifting Dynamic	*San Diego Navy Federal Credit Union v. Cumis Insurance Society* (1984) 162 Cal.App.3d 358
2		Independent Issue	*McGee v. Superior Court* (1985) 176 Cal.App.3d 221
3		Alignment of Interest	*Blanchard v. State Farm Fire & Cas. Co.* (1991) 2 Cal.App.4th 345
4		Fact Intensive Issues	*Schaefer v. Elder* (2013) 217 Cal.App.4th 1
5		Disputed Coverage Issues	*James 3 Corp. v. Truck Ins. Exchange* (2001) 91 Cal.App.4th 1093
6		Special Situations	*Golden Eagle Ins. Co. v. Foremost Ins. Co.* (1993) 20 Cal.App.4th 1372
7		Actual, Substantial Conflict	*Dynamic Concepts, Inc. v. Truck Ins. Exchange* (1998) 61 Cal.App.4th 999
8		No Reservations of Rights	*USF Ins. Co. vs. Smith's Food and Drug Center, Inc.*, 921 F.Supp.2d 1082 (D.Nev. 2013)
9		Policy Interpretation	*Federal Insurance Company v. MBL, Inc. (Cal. Ct. App. 2013) 160 Cal.Rptr.3d 910*

Hypo No. 1

Brittany confronted Paris outside a Hollywood dance club, demanding the return of a pearl handled fingernail file that she had lent to Paris. Paris, who resents Brittany's superior intelligence, threw the fingernail file at Brittany and quickly walked away. She filed a complaint for damages against Paris, alleging causes of action for negligence and assault and battery. Paris's liability insurance carrier, Airhead Insurance, agreed to defend but reserved its right to deny coverage if Paris is found liable for assault and battery. Thereafter, Paris objects to Airhead Insurance's retention of Miley as defense counsel, arguing that Miley has a disqualifying conflict of interest. Is Paris correct?

Hypo No. 2

While driving his car to the local fishing hole, Andy became distracted and drove off the road. Opie, his passenger, sustained a serious injury. Opie filed a lawsuit against Andy for personal injuries. Andy notified his auto insurance carrier, Small Town, who hired Barney as defense counsel. In agreeing to defend, Small Town reserved its rights based upon an "resident relative" exclusion in Andy's auto policy. The reservation-of-rights letter explained that Andy would not be entitled to liability coverage if the claimant, Opie, is a relative of Andy and a resident in his home. Andy claims that Barney has a disqualifying conflict of interest based upon the reservation of rights. Small Town disagrees. Is Andy correct?

Hypo No. 3

Frasier hired Sam to tear off the roof of his home and build a new roof. Shortly after completion, Frasier noticed that the new roof leaked during rainy weather. Eventually, water intrusion caused damage not only to the new roof itself, but also to interior portions of the home such as the furniture and carpeting. Frasier sued Sam to recover the costs of repair. Sam's liability insurance carrier, Old Boston, hired Diane as defense counsel. Old Boston also reserved its right to deny coverage for roof related repair costs. Sam refuses to accept the defense from Diane, insisting that she has a disqualifying conflict of interest. Is Sam correct?

Hypo No. 4

Luke hired Yoda to act as a general contractor for the construction of a new home on a planet far, far away. After completion, Luke filed a complaint against Yoda for construction defects. Luke specifically alleged that Yoda was responsible for all defects, including the work of his employees and/or subcontractors. Yoda tendered the lawsuit to his liability insurance carrier, Trade Federation, who hired Han Solo as defense counsel. In agreeing to defend, Trade Federation reserved its rights to deny coverage based upon a special contractor's condition in Yoda's insurance policy. It provides that the policy's liability insurance coverage does not apply unless Yoda procures an indemnity agreement and a certificate of insurance from each of his independent contractors. Yoda, who neglected to retain his subcontractor related documents, is adamant that his subcontractors were employees, not independent contractors. Does Han Solo have a disqualifying conflict of interest?

Hypo No. 5

Gilligan operates a beachside bar and grill called S.S. Minnow. Skipper filed a lawsuit against Gilligan alleging trademark infringement and breach of contract. The complaint seeks money damages and attorney fees. Gilligan's liability insurance carrier, Islands, hired Ginger as defense counsel. In agreeing to defend, Islands acknowledged that Gilligan's policy provided coverage for the trademark claim. But Islands reserved the right to seek reimbursement from Gilligan of any attorney fees paid to Ginger in defense of the breach of contract claim, as well as any settlement payments to resolve the breach of contract claim. Gilligan claims that the reservation of rights created a disqualifying conflict of interest on the part of Ginger, entitling Gilligan to hire Mary Ann as his independent counsel. Is Gilligan correct?

Hypo No. 6

Jerry and George own a dilapidated apartment building. Several tenants sued them alleging uninhabitable conditions. Jerry and George notified their insurance carrier, Big Apple, pursuant to a $1 million liability insurance policy. Big Apple hired Elaine as defense counsel who investigated and recommended settlement in the range of $1.2 million to $1.5 million. Acting pursuant to Big Apple's instructions, Elaine proposed a settlement in the amount of $1.2 million, and the tenants agreed on the settlement's proposed terms. Jerry and George, however, objected to the settlement going forward on several grounds. Big Apple hired a lawyer, Newman, to represent its interest and to petition the court for an order approving the settlement over the objections of Jerry and George. Elaine decided not to oppose the petition. Jerry and George hired their own attorney, Kramer, to oppose the petition and participate in settlement negotiations. If Jerry and George seek reimbursement for Kramer's fees, will they be able to successfully argue that they were entitled to independent counsel at Big Apple's expense?

Hypo No. 7

Magic, the owner of a professional sports team, hired Kobe as his lawyer to sue Shaq for breach of a contract to provide play-by-play commentary. Shaq filed a counterclaim, alleging that Magic himself had breached the contract by refusing to timely make an advance payment for services. Shaq also alleged causes of action for libel and slander. He claimed that Magic had defamed him by stating that he had only won NBA championships because he was tall and otherwise possessed no brains or talent. On behalf of Magic, Kobe notified Magic's insurance carrier, LA Insurance, who hired Wilt to defend the counterclaim against Magic. But Kobe refused to allow Wilt to participate in the defense, claiming that the reservations of rights by LA Insurance created a disqualifying conflict of interest. Kobe claimed that Wilt, who regularly performs legal work for LA Insurance, could potentially prejudice Magic by favoring the interests of LA Insurance over those of Magic. LA Insurance declines to recognize Kobe as independent counsel. Kobe claims that LA Insurance, in effect, breached its duty to defend by refusing to provide a conflict-free defense. Is Kobe correct?

Hypo No. 8

Kitty hired Matt as a janitor for her saloon. In his agreement with Kitty, Matt agreed to defend and hold Kitty harmless for any claims arising from his janitorial services. He also promised to obtain liability insurance and add Kitty as an additional insured. Festus sustained a serious injury when he slipped and fell on the floor near a spittoon. Festus sued Kitty and Matt, alleging that he would not have fallen had there been a "wet floor" warning sign in the area where he fell. Matt notified his liability carrier, Dodge Insurance, who hired Doc to defend both Matt and Kitty pursuant to Matt's $1 million policy. Festus demanded the full policy limits to settle his lawsuit, claiming that his demand would go up if not accepted within ten days. Dodge Insurance declined to settle. When Kitty learned about the lapsed offer, she demanded independent counsel even Dodge Insurance had not reserved its rights to deny coverage. Dodge Insurance refused because a special clause in Matt's policy provided that an insured person cannot select their own counsel. If Kitty decides to ask a court to resolve the issue, would it agree with Dodge Insurance?

Hypo No. 9

J.R. and Bobby own an oil refinery. The City of Dallas sued their neighbor, Sue Ellen, for groundwater contamination from leaking underground tanks. She sues J.R. and Bobby for contribution, alleging the contamination was caused in part by underground tanks on their property. J.R. and Bobby's carrier, Old Boys Insurance, agrees to defend but reserves rights on a pollution exclusion in their liability insurance policy. They disagree with Old Boys Insurance, claiming its interpretation of the pollution exclusion is erroneous. They claim the right to retain their own lawyer, Pamela, as independent counsel based upon the reservation of rights by Old Boys. Are they correct? ✦

Author's Profile

"Mr. Bolender advises insurance carriers and policyholders as to their rights and obligations based upon our research and prediction of how a civil court would rule if the disputed claim for insurance benefits is litigated."

Jeffrey S. Bolender

Admitted to practice law in 1994, Mr. Jeffrey S. Bolender is an established trial and appellate attorney with over eighteen years of experience representing policyholders, insurance carriers, underwriters, and other insurance professionals in complex legal disputes.

Mr. Bolender's practice focuses on commercial, business, and insurance law. He is licensed to practice law in the States of California, Hawaii, and Nevada, as well as the District of Columbia. Mr. Bolender regularly advises and advocates on behalf of policyholders and insurance professionals, providing guidance on legal principles for analyzing insurance policies and adjusting liability and property claims. He also designs and drafts insurance products, forms, and endorsements for regional and national underwriters. An approved MCLE provider and author of numerous legal articles on insurance law, Mr. Bolender speaks regularly before industry and attorney groups regarding his expertise in insurance law.

Mr. Bolender has litigated scores of complex civil lawsuits, including matters in the courts of Hawaii, California, Washington, Delaware, Florida, South Carolina, and Wyoming. He has successfully represented clients in lawsuits involving insurance coverage, trademark rights, trust administration, insurance broker malpractice, unfair competition, commercial leases, and products liability. In addition to trial experience, Mr. Bolender appears frequently before the California Court of Appeal and the Ninth Circuit Court of Appeals.

Born and raised in Kentucky, Mr. Bolender joined the Air Force Reserves after high school, receiving an honorable discharge in 1984. He earned a Bachelor's of Arts from California State University Northridge in 1991, and a law degree from Southwestern University School of Law in 1994. He has lived in the South Bay of Los Angeles County since 1989, and he presently lives in Torrance, California with his wife and two children. He enjoys traveling, as well as recreational tennis along with his wife on the public courts of the South Bay.

Professional Credentials

- California State Bar (1994)
- Hawaii State Bar (2006)
- Nevada State Bar (2008)
- District of Columbia Bar (2007)
- Ninth Circuit Court of Appeals (2004)
- United States District Courts
  - – Central District of California (1995)
  - – Eastern District of California (1995)
  - – Northern District of California (1999)
  - – District of Hawaii (2006)

Professional Associations

- Clark County Bar Association
- South Bay Bar Association
- Orange County Bar Association
- Inns of Court – Benjamin Aranda III
- Nevada State Bar Association
  - – Construction Law Section
  - – Insurance & Health Law Section
- Hawaii State Bar Association
  - – Insurance Coverage Litigation Section

Professional Services

Insurance Policy Coverage Analysis

Mr. Bolender's primary practice area centers on the legal analysis of various types of insurance policies. When a claim for insurance benefits is disputed, he performs legal research and analysis as to whether the insurance policy's language brings the claim within or outside the scope of the insurance policy's insurance protection. He advises insurance carriers and policyholders as to their rights and obligations based upon his research and prediction of how a civil court would rule if the disputed claim for insurance benefits is litigated. His coverage practice includes a wide variety of insurance products, including personal lines, excess and surplus lines, professional liability, errors and omissions, directors and officers, property and business interruption coverage.

Insurance Dispute Resolution

When disputed insurance claims cannot be resolved informally, Mr. Bolender advocates on behalf of insurance carriers and policyholders via litigation; arbitration before private judges; and non-binding mediation before a neutral mediator. He has broad experience in state and federal courts, both at the trial and appellate level. Mr. Bolender is licensed in California, Hawaii, Nevada, and the District of Columbia, and he has litigated in seven different states.

Claims Counseling and Litigation

Mr. Bolender's practice includes the education and counseling of claims professionals. He has presented numerous in-house seminars for our insurance carrier clients, including complex claims issues involving continuous losses involving multiple insurance carriers; claims for independent counsel; additional insured tenders and the interplay between additional insured coverage and insurance for indemnity agreements; preparing for mediation of large loss matters involving insurance disputes; and the nuts and bolts of analyzing liability insurance policies.

Insurance Policy Drafting

In addition to interpreting insurance policies as to particular claims for coverage, Mr. Bolender has assisted national and regional underwriters in drafting and revising various types of insurance products. Underwriters seek his assistance in crafting insurance policy language that will be interpreted, applied, and enforced consistent with the underwriter's intent. He has developed

techniques for identifying underwriting intent and formulating policy language that minimizes the likelihood that courts will find the language ambiguous or otherwise enforceable.

Insurance Agent Errors & Omissions

A natural complement to Mr. Bolender's expertise in insurance law is the defense of, and litigation against, negligent insurance agents. Occasionally, insurance agents will be sued when a policyholder's insurance carrier denies coverage or when the agent negligently binds an insurer to coverage not within the agent's binding power. Mr. Bolender has successfully defended insurance agents, as well as secured judgments against insurance agents exceeding $1.7 million.

Business Litigation & Intellectual Property

Mr. Bolender has prosecuted and defended various business disputes, including claims for infringement in state and federal courts and claims of unlawful business practices pursuant to California's Unfair Competition Law. He is experienced in filing trademark applications with the United State Patent and Trademark Office. He has assisted clients in formulating policies for use of intellectual asserts, including trademarks, policing their use, and actively monitoring the use of those assets. In addition to the business aspect of intellectual property, Mr. Bolender possesses substantial experience in evaluating whether liability insurance policies provide coverage for policyholders who face third-party liability claims for infringement of trademark, trade dress, copyright, and other intellectual property rights.

Presentations & Publications

- A Practical Guide to Reading & Understanding Liability Insurance Policies, Seminar at South Bay Bar Association, June 2013.
- Brown Bag Luncheon: Insurance Products, Policy Analysis, and the Duty to Defend, Nevada State Bar – Construction Law Section, April 2010.
- Social Media: Ethics In A Changing World, Panelist at Group Presentation for Inns of Court, April 2012.
- The ABC's of Analyzing a Liability Insurance Policy, Nevada State Bar Annual Meeting, June 2010.
- The Fun Never Ends - Key Insurance Coverage Developments from 2009 to 2010, Defense Research Institute, September 2010.Additional Insured Seminar, Seminar at Nautilus Insurance Group, February 2008.
- Insurance Coverage Q&A, Bolender & Associates Newsletter, July 2009. Meeting the Challenges of Raising Insurance Issues at Mediation, Defense Research Institute, In-House Defense Quarterly, Autumn 2011.

- A Practical Guide to Reading & Understanding Liability Insurance Policies, Seminar at AHTKY Insurance Agency, July 2013.
- Analyzing Liability Insurance: A Five Part Process, Seminar at Nautilus Insurance Group, June 2012.
- Coverage Analysis: Employee versus Independent Contractor, Seminar at Nautilus Insurance Group, June 2004.
- Coverage B: Defamatory and Injurious Falsehood Torts, Bolender & Associates Newsletter, February 2005.
- Demands for Independent Counsel: History, Analysis, and Strategies for Managing Disputes, Seminar at Markel Southwest Underwriters, October 2006.
- General Liability Coverage: Professional Services Exclusions, Bolender & Associates Newsletter, March 2005.
- Hot Topics in Construction Defect Litigation and Related Insurance Coverage Issues, Nevada State Bar Seminar, October 2011.
- Insurance Products, Policy Analysis and the Duty to Defend, Bolender & Associates Newsletter, April 2010.
- Multiple Insurer Disputes: Recovering Other Insurance, Bolender & Associates Newsletter, August 2003.
- Property Damage and the Work Exclusions, Seminar at Nautilus Insurance Group, November 2005.
- Property Damage Claims: Distinguishing Between Tangible & Intangible Property, Bolender & Associates Newsletter, April 2004.
- Seeking Reimbursement for Non-Covered Claims, Bolender & Associates Newsletter, August 2006. ✦

Addendum A—Cal. Civil Code, § 2860

§ 2860. Conflict of interest; duty to provide independent counsel; waiver; qualifications of independent counsel; fees; disclosure of information

(a) If the provisions of a policy of insurance impose a duty to defend upon an insurer and a conflict of interest arises which creates a duty on the part of the insurer to provide independent counsel to the insured, the insurer shall provide independent counsel to represent the insured unless, at the time the insured is informed that a possible conflict may arise or does exist, the insured expressly waives, in writing, the right to independent counsel. An insurance contract may contain a provision which sets forth the method of selecting that counsel consistent with this section.

(b) For purposes of this section, a conflict of interest does not exist as to allegations or facts in the litigation for which the insurer denies coverage; however, when an insurer reserves its rights on a given issue and the outcome of that coverage issue can be controlled by counsel first retained by the insurer for the defense of the claim, a conflict of interest may exist. No conflict of interest shall be deemed to exist as to allegations of punitive damages or be deemed to exist solely because an insured is sued for an amount in excess of the insurance policy limits.

(c) When the insured has selected independent counsel to represent him or her, the insurer may exercise its right to require that the counsel selected by the insured possess certain minimum qualifications which may include that the selected counsel have (1) at least five years of civil litigation practice which includes substantial defense experience in the subject at issue in the litigation, and (2) errors and omissions coverage. The insurer's obligation to pay fees to the independent counsel selected by the insured is limited to the rates which are actually paid by the insurer to attorneys retained by it in the ordinary course of business in the defense of similar actions in the community where the claim arose or is being defended. This subdivision does not invalidate other different or additional policy provisions pertaining to attorney's fees or providing for methods of settlement of disputes concerning those fees. Any dispute concerning attorney's fees not resolved by these methods shall be resolved by final and binding arbitration by a single neutral arbitrator selected by the parties to the dispute.

(d) When independent counsel has been selected by the insured, it shall be the duty of that counsel and the insured to disclose to the insurer all information concerning the action except privileged materials relevant to coverage disputes, and timely to inform and consult with the insurer on all matters relating to the action. Any claim of privilege asserted is subject to in camera review in the appropriate law and motion department

of the superior court. Any information disclosed by the insured or by independent counsel is not a waiver of the privilege as to any other party.

(e) The insured may waive its right to select independent counsel by signing the following statement: "I have been advised and informed of my right to select independent counsel to represent me in this lawsuit. I have considered this matter fully and freely waive my right to select independent counsel at this time. I authorize my insurer to select a defense attorney to represent me in this lawsuit."

(f) Where the insured selects independent counsel pursuant to the provisions of this section, both the counsel provided by the insurer and independent counsel selected by the insured shall be allowed to participate in all aspects of the litigation. Counsel shall cooperate fully in the exchange of information that is consistent with each counsel's ethical and legal obligation to the insured. Nothing in this section shall relieve the insured of his or her duty to cooperate with the insurer under the terms of the insurance contract. ✦

Addendum B—California Rules of Professional Conduct

California Rules of Prof. Conduct, Rule 3-110

Rule 3-110 Failing to Act Competently.

(A) A member shall not intentionally, recklessly, or repeatedly fail to perform legal services with competence.

(B) For purposes of this rule, "competence" in any legal service shall mean to apply the 1) diligence, 2) learning and skill, and 3) mental, emotional, and physical ability reasonably necessary for the performance of such service.

(C) If a member does not have sufficient learning and skill when the legal service is undertaken, the member may nonetheless perform such services competently by 1) associating with or, where appropriate, professionally consulting another lawyer reasonably believed to be competent, or 2) by acquiring sufficient learning and skill before performance is required.

California Rules of Prof. Conduct, Rule 3-310

Rule 3-310 Avoiding the Representation of Adverse Interest

(A) For purposes of this rule:

(1) "Disclosure" means informing the client or former client of the relevant circumstances and of the actual and reasonably foreseeable adverse consequences to the client or former client;

(2) "Informed written consent" means the client's or former client's written agreement to the representation following written disclosure;

(3) "Written" means any writing as defined in Evidence Code section 250.

(B) A member shall not accept or continue representation of a client without providing written disclosure to the client where:

(1) The member has a legal, business, financial, professional, or personal relationship with a party or witness in the same matter; or

(2) The member knows or reasonably should know that:

(a) the member previously had a legal, business, financial, professional, or personal relationship with a party or witness in the same matter; and

(b) the previous relationship would substantially affect the member's representation; or

(3) The member has or had a legal, business, financial, professional, or personal relationship with another person or entity the member knows or reasonably should know would be affected substantially by resolution of the matter; or

(4) The member has or had a legal, business, financial, or professional interest in the subject matter of the representation.

(C) A member shall not, without the informed written consent of each client:

(1) Accept representation of more than one client in a matter in which the interests of the clients potentially conflict; or

(2) Accept or continue representation of more than one client in a matter in which the interests of the clients actually conflict; or

(3) Represent a client in a matter and at the same time in a separate matter accept as a client a person or entity whose interest in the first matter is adverse to the client in the first matter.

(D) A member who represents two or more clients shall not enter into an aggregate settlement of the claims of or against the clients without the informed written consent of each client.

(E) A member shall not, without the informed written consent of the client or former client, accept employment adverse to the client or former client where, by reason of the representation of the client or former client, the member has obtained confidential information material to the employment.

(F) A member shall not accept compensation for representing a client from one other than the client unless:

(1) There is no interference with the member's independence of professional judgment or with the client-lawyer relationship; and

(2) Information relating to representation of the client is protected as required by Business and Professions Code section 6068, subdivision (e); and

(3) The member obtains the client's informed written consent, provided that no disclosure or consent is required if:

(a) such nondisclosure is otherwise authorized by law; or

(b) the member is rendering legal services on behalf of any public agency which provides legal services to other public agencies or the public.

California Rules of Prof. Conduct, Rule 3-300

Rule 3-300 Avoiding Interests Adverse to a Client

A member shall not enter into a business transaction with a client; or knowingly acquire an ownership, possessory, security, or other pecuniary interest adverse to a client, unless each of the following requirements has been satisfied:

(A) The transaction or acquisition and its terms are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner which should reasonably have been understood by the client; and

(B) The client is advised in writing that the client may seek the advice of an independent lawyer of the client's choice and is given a reasonable opportunity to seek that advice; and

(C) The client thereafter consents in writing to the terms of the transaction or the terms of the acquisition.

California Rules of Prof. Conduct, Rule 3-500

Rule 3-500 Communication

A member shall keep a client reasonably informed about significant developments relating to the employment or representation, including promptly complying with reasonable requests for information and copies of significant documents when necessary to keep the client so informed.

California Rules of Prof. Conduct, Rule 3-510

Rule 3-510 Communication of Settlement Offer

(A) A member shall promptly communicate to the member's client:

(1) All terms and conditions of any offer made to the client in a criminal matter; and

(2) All amounts, terms, and conditions of any written offer of settlement made to the client in all other matters.

(B) As used in this rule, "client" includes a person who possesses the authority to accept an offer of settlement or plea, or, in a class action, all the named representatives of the class. ✦

Addendum C—Nevada Rules of Professional Conduct

Nevada Rules of Prof. Conduct, Rule 1.0

Rule 1.0. Terminology.

As used in these Rules, the following terms shall have the meanings ascribed:

(a) "Belief" or "believes" denotes that the person involved actually supposed the fact in question to be true. A person's belief may be inferred from circumstances.

(b) "Confirmed in writing," when used in reference to the informed consent of a person, denotes informed consent that is given in writing by the person or a writing that a lawyer promptly transmits to the person confirming an oral informed consent. See paragraph (e) for the definition of "informed consent." If it is not feasible to obtain or transmit the writing at the time the person gives informed consent, then the lawyer must obtain or transmit it within a reasonable time thereafter.

(c) "Firm" or "law firm" denotes a lawyer or lawyers in a law partnership, professional corporation, sole proprietorship or other association authorized to practice law; or lawyers employed in a legal services organization or the legal department of a corporation or other organization.

(d) "Fraud" or "fraudulent" denotes conduct that is fraudulent under the substantive or procedural law of the applicable jurisdiction and has a purpose to deceive.

(e) "Informed consent" denotes the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct.

(f) "Knowingly," "known," or "knows" denotes actual knowledge of the fact in question. A person's knowledge may be inferred from circumstances.

(g) "Partner" denotes a member of a partnership, a shareholder in a law firm organized as a professional corporation, or a member of an association authorized to practice law.

(h) "Reasonable" or "reasonably" when used in relation to conduct by a lawyer denotes the conduct of a reasonably prudent and competent lawyer.

(i) "Reasonable belief" or "reasonably believes" when used in reference to a lawyer denotes that the lawyer believes the matter in question and that the circumstances are such that the belief is reasonable.

(j) "Reasonably should know" when used in reference to a lawyer denotes that a lawyer of reasonable prudence and competence would ascertain the matter in question.

(k) "Screened" denotes the isolation of a lawyer from any participation in a matter through the timely imposition of procedures within a firm that are reasonably adequate under the circumstances to protect information that the isolated lawyer is obligated to protect under these Rules or other law.

(l) "Substantial" when used in reference to degree or extent denotes a material matter of clear and weighty importance.

(m) "Tribunal" denotes a court, an arbitrator in a binding arbitration proceeding or a legislative body, administrative agency or other body acting in an adjudicative capacity. A legislative body, administrative agency or other body acts in an adjudicative capacity when a neutral official, after the presentation of evidence or legal argument by a party or parties, will render a binding legal judgment directly affecting a party's interests in a particular matter.

(n) "Writing" or "written" denotes a tangible or electronic record of a communication or representation, including handwriting, typewriting, printing, photostating, photography, audio or video recording and e-mail. A "signed" writing includes an electronic sound, symbol or process attached to or logically associated with a writing and executed or adopted by a person with the intent to sign the writing.

(o) "Organization" when used in reference to "organization as client" denotes any constituent of the organization, whether inside or outside counsel, who supervises, directs, or regularly consults with the lawyer concerning the organization's legal matters unless otherwise defined in the Rule.

Nevada Rules of Prof. Conduct, Rule 1.1

Rule 1.1. Competence.

A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation

Nevada Rules of Prof. Conduct, Rule 1.3

Rule 1.3. Diligence.

A lawyer shall act with reasonable diligence and promptness in representing a client.

Nevada Rules of Prof. Conduct, Rule 1.4

Rule 1.4. Communication.

(a) A lawyer shall:

(1) Promptly inform the client of any decision or circumstance with respect to which the client's informed consent is required by these Rules;

(2) Reasonably consult with the client about the means by which the client's objectives are to be accomplished;

(3) Keep the client reasonably informed about the status of the matter;

(4) Promptly comply with reasonable requests for information; and

(5) Consult with the client about any relevant limitation on the lawyer's conduct when the lawyer knows that the client expects assistance not permitted by the Rules of Professional Conduct or other law.

(b) A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.

(c) Lawyer's Biographical Data Form. Each lawyer or law firm shall have available in written form to be provided upon request of the State Bar or a client or prospective client a factual statement detailing the background, training and experience of each lawyer or law firm.

(1) The form shall be known as the "Lawyer's Biographical Data Form" and shall contain the following fields of information:

(i) Full name and business address of the lawyer.

(ii) Date and jurisdiction of initial admission to practice.

(iii) Date and jurisdiction of each subsequent admission to practice.

(iv) Name of law school and year of graduation.

(v) The areas of specialization in which the lawyer is entitled to hold himself or herself out as a specialist under the provisions of Rule 7.4.

(vi) Any and all disciplinary sanctions imposed by any jurisdiction and/or court, whether or not the lawyer is licensed to practice law in that jurisdiction and/or court. For purposes of this Rule, disciplinary sanctions include all private reprimands imposed after March 1, 2007, and any and all public discipline imposed, regardless of the date of the imposition.

(vii) If the lawyer is engaged in the private practice of law, whether the lawyer maintains professional liability insurance, and if the lawyer maintains a policy, the name and address of the carrier.

(2) Upon request, each lawyer or law firm shall provide the following additional information detailing the background, training and experience of each lawyer or law firm, including but not limited to:

(i) Names and dates of any legal articles or treatises published by the lawyer, and the name of the publication in which they were published.

(ii) A good faith estimate of the number of jury trials tried to a verdict by the lawyer to the present date, identifying the court or courts.

(iii) A good faith estimate of the number of court (bench) trials tried to a judgment by the lawyer to the present date, identifying the court or courts.

(iv) A good faith estimate of the number of administrative hearings tried to a conclusion by the lawyer, identifying the administrative agency or agencies.

(v) A good faith estimate of the number of appellate cases argued to a court of appeals or a supreme court, in which the lawyer was responsible for writing the brief or orally arguing the case, identifying the court or courts.

(vi) The professional activities of the lawyer consisting of teaching or lecturing.

(vii) The names of any volunteer or charitable organizations to which the lawyer belongs, which the lawyer desires to publish.

(viii) A description of bar activities such as elective or assigned committee positions in a recognized bar organization.

(3) A lawyer or law firm that advertises or promotes services by written communication not involving solicitation as prohibited by Rule 7.3 shall enclose

with each such written communication the information described in paragraph (c)(1)(i) through (v) of this Rule.

(4) A copy of all information provided pursuant to this Rule shall be retained by the lawyer or law firm for a period of 3 years after last regular use of the information.

Nevada Rules of Prof. Conduct, Rule 1.6

Rule 1.6. Confidentiality of Information.

(a) A lawyer shall not reveal information relating to representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation, or the disclosure is permitted by paragraphs (b) and (c).

(b) A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:

(1) To prevent reasonably certain death or substantial bodily harm;

(2) To prevent the client from committing a criminal or fraudulent act in furtherance of which the client has used or is using the lawyer's services, but the lawyer shall, where practicable, first make reasonable effort to persuade the client to take suitable action;

(3) To prevent, mitigate, or rectify the consequences of a client's criminal or fraudulent act in the commission of which the lawyer's services have been or are being used, but the lawyer shall, where practicable, first make reasonable effort to persuade the client to take corrective action;

(4) To secure legal advice about the lawyer's compliance with these Rules;

(5) To establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client; or

(6) To comply with other law or a court order.

(c) A lawyer shall reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary to prevent a criminal act that the lawyer believes is likely to result in reasonably certain death or substantial bodily harm.

Nevada Rules of Prof. Conduct, Rule 1.7

Rule 1.7. Conflict of Interest: Current Clients.

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

(1) The representation of one client will be directly adverse to another client; or

(2) There is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) The lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) The representation is not prohibited by law;

(3) The representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

(4) Each affected client gives informed consent, confirmed in writing.

Nevada Rules of Prof. Conduct, Rule 1.9

Rule 1.9. Duties to Former Clients.

(a) A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent, confirmed in writing.

(b) A lawyer shall not knowingly represent a person in the same or a substantially related matter in which a firm with which the lawyer formerly was associated had previously represented a client:

(1) Whose interests are materially adverse to that person; and

(2) About whom the lawyer had acquired information protected by Rules 1.6 and 1.9(c) that is material to the matter;

(3) Unless the former client gives informed consent, confirmed in writing.

(c) A lawyer who has formerly represented a client in a matter or whose present or former firm has formerly represented a client in a matter shall not thereafter:

(1) Use information relating to the representation to the disadvantage of the former client except as these Rules would permit or require with respect to a client, or when the information has become generally known; or

(2) Reveal information relating to the representation except as these Rules would permit or require with respect to a client.

Nevada Rules of Prof. Conduct, Rule 2.1

Rule 2.1. Advisor.

In representing a client, a lawyer shall exercise independent professional judgment and render candid advice. In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social and political factors, that may be relevant to the client's situation.

Nevada Rules of Prof. Conduct, Rule 8.4

Rule 8.4. Misconduct.

It is professional misconduct for a lawyer to:

(a) Violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another;

(b) Commit a criminal act that reflects adversely on the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects;

(c) Engage in conduct involving dishonesty, fraud, deceit or misrepresentation;

(d) Engage in conduct that is prejudicial to the administration of justice;

(e) State or imply an ability to influence improperly a government agency or official or to achieve results by means that violate the Rules of Professional Conduct or other law; or

(f) Knowingly assist a judge or judicial officer in conduct that is a violation of applicable rules of judicial conduct or other law. ✦

Addendum D—Case Study: Poshe USA, LLC vs. Nautilus Insurance Company

A good example of a Cumis dispute, including its judicial resolution, is the recent lawsuit entitled *Poshe USA, LLC vs. Nautilus Insurance Company*, Case No. LA CV11-06795 JAK (Ex) filed in the United States District Court, Central District of California. The paragraphs below describe how the conflict arose and how the insurance carrier and policyholder resolved the dispute by seeking declaratory and other relief.

The Claim Against the Policyholder

The *Poshe* case involved litigation between the policyholder (Poshe USA, LLC) and its liability insurance carrier (Nautilus Insurance Company). A third-party claimant had sued the policyholder for infringement of trademark and trade dress, seeking various species of relief such as damages, injunctions, and attorney fees.

The Reservation of Rights

The insurance carrier agreed to defend under a limited reservation of rights. *See Exhibit 1*. The carrier agreed that coverage attached to claims of infringement of trade dress within the policyholder's advertising, but reserved the right to decline coverage for infringement of trademark or other intellectual property rights. The carrier took the position that coverage did not attach to claims of attorney fees or injunctive relief. It also reserved the right to seek reimbursement to the extent that it paid any settlement or judgment outside the insurance policy's scope of coverage. Notably, in offering a defense via panel counsel, the carrier indicated it would waive the policy's intent- and knowledge-based exclusions.

The Demand for Independent Counsel

The policyholder claimed entitlement to independent counsel, demanding the insurance carrier transfer defense of the claim against the policyholder to its preferred counsel. The carrier declined to recognize or pay independent counsel. The carrier noted that it had waived the intent- and knowledge-based exclusions. And it offered to consider waiving any other reservation if the policyholder could demonstrate that any of its reservations created an actual, substantial conflict of interest on the part of assigned panel counsel.

Insurance Litigation

In reaction to the insurance carrier's rejection of the demand for independent counsel, the policyholder filed suit in federal court. Shortly thereafter, it filed a motion for preliminary injunction. *See Exhibit 2*. The motion sought an order requiring the transfer of the

policyholder's legal defense from the carrier-retained panel counsel to the policyholder's preferred counsel. The insurance carrier opposed the motion, raising the various positions it had taken in response to the policyholder's demand for independent counsel. *See Exhibit 3*. The carrier argued, among other things, that it had not raised its rights on the type of issues that arise in the paradigm Cumis scenario. It further argued that it was only reserving rights as to the extent of damages. It argued that because it had agreed that coverage attached for trade dress infringement, the primary interests of the policyholder, panel counsel, and carrier were aligned: to aggressively defend all liability and damage claims.

The Court's Ruling

The Court (Honorable John A. Kronstadt) supported the carrier's position and issued an Order Denying Plaintiff's Motion for Preliminary Injunction. *See Exhibit 4*. The Court reasoned that the policyholder had failed to meet the criteria for a preliminary injunction: that is, the likelihood of success on the merits, irreparable harm, balance of equities in plaintiff's favor, and public interest in plaintiff's favor.

Significantly, the Court held that the policyholder failed to establish likelihood of success on the merits because the policyholder had failed to identify any disqualifying Cumis conflict. The Court listed the conflicts alleged by the policyholder to be Cumis conflicts: exclusions for trademark infringement, infringement of a domain name, and manipulation of a website. The Court rejected the speculation that the carrier's panel counsel would purposely violate—by not mounting a proper defense of the underlying case—its duties of professional responsibility. With respect to the policyholder's claim that a Cumis conflict arose from alleged events that occurred outside the policy period, the Court restated the carrier's offer to waive its related reservation of rights.

In like manner, the Court held that the policyholder failed to show irreparable harm. The irreparable harm alleged by the policyholder took the form of a conjecture that the carrier's counsel would fail to protect the policyholder's interests. The Court pointed out, however, that the policyholder's argument assumed that the carrier's attorney would breach his duty of professional responsibility. The Court further reasoned that even if such an unlikely scenario occurred, the policyholder could be compensated adequately by money damages. This makes it clear that the potential harm alleged by the plaintiff would not be irreparable, and thus a preliminary injunction would not be the only way to protect the plaintiff from harm.

The Court further ruled that the balance of equities did not favor the policyholder. In this instance, the Court pointed out that the policyholder first rushed into a lawsuit against the carrier and then into a request for preliminary injunction. The Court contended that the carrier had no obligation to provide independent counsel until after a careful analysis of the Cumis issue. The Court stated that the carrier had offered to negotiate, but that a mere eight days

after the offer, the policyholder filed the action for preliminary injunction, thereby eliminating any possibility of negotiation.

Finally, the Court affirmed that the public interest went against the policyholder in this case. Analysis of the facts shows that the parties could have worked together to resolve their differences, but that the policyholder instead added a "short-fuse deadline" in its demand for independent. ✦

EXHIBIT 1

EXHIBIT 1

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BOLENDER & ASSOCIATES
A PROFESSIONAL LAW CORPORATION

2601 AIRPORT DRIVE, SUITE 360
TORRANCE, CALIFORNIA 90505

JEFFERY S. BOLENDER†

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†ADMITTED IN CALIFORNIA, HAWAII, NEVADA AND DISTRICT OF COLUMBIA

August 3, 2011

FOX ROTHSCHILD LLP
1800 Century Park East, Suite 300
Los Angeles, CA 90065

Via Facsimile:
310-556-9828

Attn: Mr. James E. Doroshow

Re: ***American International Industries vs. Poshe Products, et al.***
Case No. : CV-11-5600-JAK
Claim No. : 10056022
Policyholder : Poshe USA, LLC; Poshe Products, LLC
Policy No. : NC 993184 (02/13/2010 – 02/13/2011)
Our File No. : 11-70927

Dear Mr. Doroshow:

On behalf of Nautilus Insurance Company, I again thank you and acknowledge your tender with respect to the above-captioned lawsuit on behalf of your clients, Poshe USA, LLC, Poshe Products, LLC, and Ms. Lynn Beaurline. Please let us know if there is anyone else to whom we should direct this letter.

This will serve as Nautilus's formal agreement to defend Poshe USA, LLC, Poshe Products, LLC, and Ms. Lynn Beaurline under Policy No. NC 993184 from the date of tender and subject to the limited reservation of rights as set forth herein. We have hired the law firm Wolfe & Wyman (2301 Dupont Drive, Suite 300, Irvine, CA 92612-7531 (Tel: 949-475-9200) to provide Poshe USA, LLC, Poshe Products, LLC, and Ms. Lynn Beaurline with a legal defense in the subject lawsuit.

Kindly cooperate fully with the Wolfe Wyman firm and provide them with any information, documents, witnesses, or other matter that will assist legal defense. It is my understanding that assigned defense counsel is prepared to contact you concerning the immediate assumption of the defense.

Please be advised that while the Wolfe Wyman firm will be defending all claims for relief in the Complaint, there are certain causes of action and items of damage that are not covered by the Nautilus policy. Nautilus will be unable to make any payment or pay any judgment based upon such cause of action or items of damages.

In order to explain the coverage issues, we must discuss the allegations in the Complaint. Nautilus understands that those allegations are unproven and may be untrue, incomplete, or embellished. In discussing the allegations, Nautilus has not and does not conclude that any such allegations are true, and no statement in this letter should be construed otherwise.

On July 7, 2011, Plaintiff American International Industries filed a Complaint in the United States District Court, Central District of California, Western Division, Case No. CV-11-5600-JAK against Poshe USA, LLC, Poshe Products, LLC, and Ms. Lynn Beaurline. The Complaint's allegations are framed under four claims for relief:

1. Federal Unfair Competition (15 U.S.C. §1125, subd. (a))
2. Trademark Infringement (15 U.S.C. § 1114)
3. Common Law Unfair Competition
4. Statutory Unfair Competition and False Advertising (Cal. Business & Professions Code §§ 17200 and 17500)

Plaintiff alleges that on January 12, 2011, it acquired from Almell, Ltd. all rights, title, and interest in Poshe' ® brand manicure and pedicure products, including patent and trademark rights. Plaintiff further alleges that its intellectual property rights include a Poshe' word mark, a design mark, and certain utility patents.

Allegedly, Almell had previously entered into a restricted license with Poshe USA, LLC, but had purportedly terminated that license around the time that Plaintiff acquired its interest in the Poshe' ® brand. Plaintiff alleges that after January 12, 2011, Defendants have continued to hold themselves out to the public as authorized Poshe' product distributors. Plaintiff alleges that Ms. Beaurline registered the domain name <www.discountposhe.com> and commenced the sale of Poshe' ® brand products at a discount. Additionally, the Defendants allegedly manipulated the website <www.poshe.com> to automatically forward all accessing internet uses to <www.discountposhe.com> until May 2011.

Plaintiff further alleges that Poshe USA, LLC controls the website <www.poshnails.com>. Defendants allegedly continue to use the Poshe' word mark, such as in the name Poshe USA, LLC, in their advertising, invoices, and instructions for nail polish application. Plaintiff alleges that Defendants have misappropriated its word mark, design mark, and trade dress rights. Plaintiff seeks actual damages; treble damages; injunctive relief; restitution; punitive damages; and attorneys' fees.

Nautilus issued a liability insurance policy, No. NC 993184, effective February 13, 2010 to February 13, 2011, to the following named insureds: Poshe USA, LLC and Poshe Products, LLC. The Common Policy Declarations describe the named insureds' operations as: DISTRIBUTOR AND MFG OF BASE AND TOPCOAT NAIL POLISH. Liability coverage is afforded via a Commercial General Liability Coverage Form, designated form CG 00 01 12 04, hereinafter "CGL form." The Commercial General Liability Coverage Part Declarations schedule the following limits of insurance:

General Aggregate Limit	$2,000,000
Products/Completed Operations Aggregate Limit	$2,000,000
Personal and Advertising Injury Limit	$1,000,000
Each Occurrence Limit	$1,000,000

Please refer to the CGL form, specifically the Insuring Agreement under Section I – Coverages, Coverage A – Bodily Injury and Property Damage Liability, which provides in pertinent part as follows:

SECTION I – COVERAGES

COVERAGE A. BODILY INJURY AND PROPERTY DAMAGE LIABILITY

1. Insuring Agreement

a. We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. We will have the right and duty to defend the insured against any "suit" seeking those damages. However, we will have no duty to defend the insured against any "suit" seeking damages for "bodily injury" or "property damage" to which this insurance

does not apply. We may, at our discretion, investigate any "occurrence" and settle any claim or "suit" that may result. …

b. This insurance applies to "bodily injury" and "property damage" only if:

(1) The "bodily injury" or "property damage" is caused by an "occurrence" that takes place in the "coverage territory";

(2) The "bodily injury" or "property damage" occurs during the policy period; and

(3) Prior to the policy period, no insured listed under Paragraph 1. of Section II - Who Is An Insured and no "employee" authorized by you to give or receive notice of an "occurrence" or claim, knew that the "bodily injury" or "property damage" had occurred, in whole or in part. If such a listed insured or authorized "employee" knew, prior to the policy period, that the "bodily injury" or "property damage" occurred, then any continuation, change or resumption of such "bodily injury" or "property damage" during or after the policy period will be deemed to have been known prior to the policy period.

* * * * *

Please refer to the CGL form, specifically Section V – Definitions, which defines the following policy terms:

SECTION V – DEFINITIONS

…

3. "Bodily injury" means bodily injury, sickness or disease sustained by a person, including death resulting from any of these at any time.

…

13. "Occurrence" means an accident, including continuous or repeated exposure to substantially the same general harmful conditions.

…

17. "Property damage" means:

a. Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it; or

b. Loss of use of tangible property that is not physically injured. All such loss of use shall be deemed to occur at the time of the "occurrence" that caused it.

* * * * *

As you will note, the liability insurance under Coverage A applies only to "bodily injury" and "property damage" sustained during the policy period as a result of an "occurrence." The allegations in the Complaint cannot be reasonably construed as alleging "bodily injury," "property damage," or an "occurrence." Accordingly, Nautilus must respectfully decline to defend any tendering party under Coverage A, and hereby formally disclaims coverage for the subject lawsuit under Coverage A.

Please refer again to the CGL form, specifically the Insuring Agreement under Section I – Coverages, Coverage B – Personal and Advertising Injury Liability, which provides in pertinent part as follows:

SECTION I – COVERAGES

COVERAGE B. PERSONAL AND ADVERTISING INJURY LIABILITY

1. Insuring Agreement

a. We will pay those sums that the insured becomes legally obligated to pay as damages because of "personal and advertising injury" to which this insurance applies. We will have the right and duty to defend the insured against any "suit" seeking those damages. However, we will have no duty to defend the insured against any "suit" seeking damages for "personal and advertising injury" to which this insurance does not apply. We may, at our discretion, investigate any offense and settle any claim or "suit" that may result. …

b. This insurance applies to "personal and advertising injury" caused by an offense arising out of your business but only if the offense was committed in the "coverage territory" during the policy period.

* * * * *

Please refer to the CGL form, specifically Section V – Definitions, which defines the following policy terms:

SECTION V - DEFINITIONS

1. "Advertisement" means a notice that is broadcast or published to the general public or specific market segments about your goods, products or services for the purpose of attracting customers or supporters. For the purposes of this definition:

a. Notices that are published include material placed on the Internet or on similar electronic means of communication; and

b. Regarding web-sites, only that part of a web-site that is about your goods, products or services for the purposes of attracting customers or supporters is considered an advertisement.

...

14. "Personal and advertising injury" means injury, including consequential "bodily injury", arising out of one or more of the following offenses:

a. False arrest, detention or imprisonment;

b. Malicious prosecution;

c. The wrongful eviction from, wrongful entry into, or invasion of the right of private occupancy of a room, dwelling or premises that a person occupies, committed by or on behalf of its owner, landlord or lessor;

d. Oral or written publication, in any manner, of material that slanders or libels a person or organization or disparages a person's or organization's goods, products or services;

e. Oral or written publication, in any manner, of material that violates a person's right of privacy;

f. The use of another's advertising idea in your "advertisement"; or

g. Infringing upon another's copyright, trade dress or slogan in your "advertisement".

* * * * *

Coverage B applies to "personal and advertising injury" caused by an offense arising from the named insured's business during the policy period. The Complaint cannot be reasonably construed as alleging any of the "personal and advertising injury" offenses defined in items **a., b., c., d.** and **e.**

Please refer again to the CGL form – specifically Section I.B.2., Exclusions, which state in pertinent part as follows:

> **2. Exclusions**
>
> This insurance does not apply to:
>
> **a. Knowing Violation Of Rights Of Another**
>
> "Personal and advertising injury" caused by or at the direction of the insured with the knowledge that the act would violate the rights of another and would inflict "personal and advertising injury".
>
> **b. Material Published With Knowledge Of Falsity**
>
> "Personal and advertising injury" arising out of oral or written publication of material, if done by or at the direction of the insured with knowledge of its falsity.
>
> **c. Material Published Prior To Policy Period**
>
> "Personal and advertising injury" arising out of oral or written publication of material whose first publication took place before the beginning of the policy period.
>
> ...
>
> **f. Breach Of Contract**
>
> "Personal and advertising injury" arising out of a breach of contract, except an implied contract to use another's advertising idea in your "advertisement".
>
> **i. Infringement Of Copyright, Patent, Trademark Or Trade Secret**
>
> "Personal and advertising injury" arising out of the infringement of copyright, patent, trademark, trade secret or other intellectual property rights.
>
> However, this exclusion does not apply to infringement, in your "advertisement", of copyright, trade dress or slogan.
>
> ...

l. Unauthorized Use Of Another's Name Or Product

"Personal and advertising injury" arising out of the unauthorized use of another's name or product in your e-mail address, domain name or metatag, or any other similar tactics to mislead another's potential customers.

* * * * *

As you will note in the exclusionary provisions quoted above, the insurance afforded under the Nautilus policy does not apply to "personal and advertising injury" arising out of the infringement of copyright, patent, trademark, trade secret or other intellectual property rights; however, the exclusion does not apply to infringement, in your "advertisement," of copyright, trade dress or slogan.

The Complaint does not allege that any named insured's "advertisement" contains material that infringes upon another's copyright or slogan, but the first claim for relief alleges Defendants have misappropriated Plaintiff's intellectual property rights, including infringing upon word marks and trade dress rights. Additionally, it appears from the Complaint that the alleged infringement of trade dress may have occurred within a named insured's "advertisement" between the acquisition date, January 12, 2011, and the policy's termination date, February 13, 2011.

The Nautilus policy contains supplementary provisions. Please refer again the CGL form, specifically the Supplementary Payments set forth in Section I, which provides in pertinent part as follows:

SUPPLEMENTARY PAYMENTS COVERAGES A AND B

1. We will pay, with respect to any claim we investigate or settle, or any "suit" against an insured we defend:

e. All costs taxed against the insured in the "suit".

* * * * *

Under California law, the phrase "costs taxed against the insured" has been interpreted to include an award of attorney fees; however, these provisions do not apply to attorneys' fees awarded pursuant to a claim that is not potentially covered. State Farm Gen. Ins. Co. v. Mintarsih (2009) 175 Cal.App.4th 274.

The Nautilus policy is also subject to certain conditions. Please refer again the CGL form, specifically Section IV, Commercial General Liability Conditions, which states in pertinent part as follows:

SECTION IV COMMERCIAL GENERAL LIABILITY CONDITIONS

2. Duties In The Event Of Occurrence, Offense, Claim Or Suit

...

c. You and any other involved insured must:

...

(3) Cooperate with us in the investigation or settlement of the claim or defense against the "suit"; and

* * * * *

In light of the foregoing provisions of the Nautilus policy, the position of Nautilus concerning coverage and other matters is set forth below:

1. Nautilus owes no duty to indemnify the tendering parties for judicial relief that does not constitute damages, such as injunctive relief. AIU Ins. Co. v. Sup.Ct. (FMC Corp.) (1990) 51 Cal.3d 807.

2. Nautilus owes no duty to indemnify the tendering parties for statutory unfair competition under Sections 17200 and 17500 of the California Business & Professions Code, because those statutory provisions do not authorize judicial relief that constitutes damages under a liability policy. Bank of the West v. Superior Court (1992) 2 Cal.4th 1254.

3. Nautilus owes no duty indemnify any tendering party under Coverage A, Bodily Injury and Property Damage, because the Complaint does not allege "bodily injury," "property damage," or an "occurrence."

4. Nautilus owes no duty to indemnify any tendering party for a "personal and advertising injury" offense committed before or after the policy period.

5. Nautilus owes no duty to indemnify any tendering party under items **a., b., c., d.,** and **e**. of the definition of "personal and advertising injury," because the Complaint does not allege the torts defined therein.

6. Nautilus owes no duty to indemnify the tendering parties, or any of them, for an amount greater than the applicable limits of insurance, which are $1,000,000.

7. Nautilus owes no duty under the Supplementary Payments provisions to indemnify any tendering party for attorneys' fees awarded pursuant to claims that are not potentially covered.

8. Nautilus owes no duty to indemnify any tendering party for infringement of patent, trademark, trade secrets, or other intellectual property rights except for infringement within a named insured's "advertisement" of copyright, trade dress, or slogan, and therefore reserves its rights with respect to the exclusionary provisions set forth in the CGL form at Section **I.B.2.e.,** under the heading: Infringement of Copyright, Patent, Trademark or Trade Secret.

9. If Nautilus's offer of defense, as set forth herein, is accepted by the tendering parties, Nautilus will agree to waive the statutory exclusion set forth at Section 533 of the California Insurance Code and the following policy's exclusions set forth in the CGL form at Section **I.B.2.a., b., c.,** and **f.**: Knowing Violation of Rights of Another; Material Published with Knowledge of Falsity; Material Published Prior to Policy Period; and Breach of Contract.

10. Nautilus owes no duty to indemnify any tendering party for a "personal and advertising injury" arising out of the unauthorized use of another's name or product in an e-mail address, domain name, metatag, or similar tactic to mislead another's potential customers, and therefore reserves its rights with respect to the exclusionary provisions set forth in the CGL form at Section **I.B.2.l**., under the heading: Unauthorized Use of Another's Name Or Product.

11. Nautilus reserves its right to seek judicial declarations regarding the respective rights and obligations of all interested parties under the policy.

12. Nautilus reserves the right to recover from any qualifying insured payments made in the defense of the Poshe USA, LLC, Poshe Products, LLC, and Ms. Lynn Beaurline for claims that are not potentially covered.

13. Nautilus reserves the right to recover from any qualifying insured payments made in the indemnification of Poshe USA, LLC, Poshe Products, LLC, and Ms. Lynn Beaurline for claims that are not within the Insuring Agreements of

Coverage A or Coverage B or form claims that are within the exclusionary provisions to which Nautilus has specifically reserved its rights herein.

14. Nautilus reserves the right to withdraw from the defense should facts show there is no potential coverage under the insurance afforded by Nautilus, or if a court determines there is no duty to defend.

In summary, Nautilus agrees to participate in the defense of Poshe USA, LLC, Poshe Products, LLC, and Ms. Lynn Beaurline subject to the limited reservation of rights in this letter. It is the position of Nautilus that the limited reservation of rights does not constitute grounds for independent counsel under Section 2860 of the California Civil Code. Subdivision (b) provides that "a conflict of interest does not exist as to allegations or facts in the litigation for which the insurer denies coverage[.]" Subdivision (b) further provides that "No conflict of interest shall be ... be deemed to exist solely because an insured is sued for an amount in excess of the insurance policy limits." Similarly, the reservation of the right to seek reimbursement of defense costs allocable to noncovered claims does not does trigger the insurer's duty to appoint independent counsel. See CALIFORNIA PRACTICE GUIDE: INSURANCE LITIGATION, Chapt. 7B-K, § 7:773 (Rutter 2011); *James 3 Corp. v. Truck Ins. Exch.* (2001) 91 Cal.App.4th 1093.

As noted in prior correspondence, Nautilus possesses the right to waive its rights with respect to policy provisions that create an actual or potential, or perceived conflict of interest. As noted above, if the offer of defense is accepted, Nautilus will waive its rights as to various exclusions, including the policy's knowledge- and intent-based exclusions, as well as others. If you believe that other specific reservations trigger you clients' entitlement to independent counsel, kindly identify the specific reservation along with any legal authorities or other matter in support of your position." As explained in prior correspondence, a disqualifying conflict of interest under Section 2860 "must be significant, not merely theoretical, actual, not merely potential."[1] And the party seeking to establish entitlement to independent counsel must produce "evidence to show in what specific way the defense attorney could have controlled the outcome of the damages issue to [the policyholder's] detriment, or had incentive to do so."[2]

If you identify any such reservation, I will carefully evaluate whether the stated grounds trigger the statutory standard set forth at Section 2860, including an evaluation as to whether Nautilus will consider waiving the purported reservation.

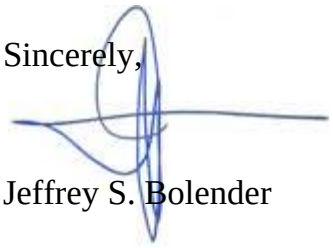
[1] Dynamic Concepts, Inc. v. Truck Ins. Exchange (1998) 61 Cal.App.4th 999.

[2] Blanchard v. State Farm Fire & Casualty Co. (1991) 2 Cal. App. 4th 345, 350.

Bureau, 11th Floor, 300 South Spring Street, Los Angeles, CA 90013; or you may call 800-927-4357 or 213-897-8921.

You are not required to contact the California Department of Insurance, and you are welcomed to contact the undersigned should you have any comments or questions about this letter. Thank you.

Sincerely,



Jeffrey S. Bolender

JSB:kb

Copies to: Mr. Richard Conrad
NAUTILUS INSURANCE COMPANY
7233 E. Butherus Drive
Scottsdale, AZ 85260

EXHIBIT 2

EXHIBIT 2

EXHIBIT 2

EXHIBIT 2

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Attorneys for Plaintiff,
POSHE USA LLC

UNITED STATES DISTRICT COURT

FOR THE CENTRAL DISTRICT OF CALIFORNIA

LOS ANGELES DIVISION

POSHE USA, LLC,

Plaintiff,

vs.

NAUTILUS INSURANCE COMPANY,

Defendant.

CASE NO.: LACV11-06795-MMM (JCGx)

NOTICE OF MOTION AND MOTION FOR PRELIMINARY INJUNCTION; MEMORANDUM OF POINTS AND AUTHORITIES; AND DECLARATIONS OF LYNN BEAURLINE AND JAMES E. DOROSHOW; AND [PROPOSED] ORDER SUBMITTED UNDER SEPARATE COVER

Hon. Margaret M. Morrow

Date: November 14, 2011
Time: 10:00 a.m.
Courtroom: 780

TO ALL PARTIES AND THEIR COUNSEL OF RECORD:

PLEASE TAKE NOTICE that on November 14, 2011, at 10:00 a.m., in Courtroom No. 780 of the above entitled Court before the Honorable United States District Court Judge Morrow, Plaintiff Poshe USA, LLC ("Poshe") will and hereby does move for the entry of a preliminary injunction enjoining Defendant Nautilus Insurance Company ("Nautilus') from controlling the defense of the action brought against Poshe and others in the United States District Court, Central District of

California, Western Division, Case No. CV-11-5600-JAK (entitled American Industries International v. Poshe USA, LLC, et al. (the "AII Lawsuit"), and for the appointment of independent counsel to defend this action.

This Motion is brought on the grounds that Nautilus' agreement to defend Poshe in the AII Lawsuit under a reservation of rights entitles Poshe to be defended by independent counsel under California law because of a conflict which has arisen with Nautilus' selected counsel (Wolfe & Wyman LLP); but notwithstanding such conflict Nautilus has demanded the right to control the defense of the litigation through its longstanding insurance counsel, and refused to appoint or pay independent Cumis counsel to defend the litigation.

This Motion is and will be based upon this Notice of Motion, the attached Memorandum of Points and Authorities, the accompanying Declarations of Lynn Beaurline and James E. Doroshow, the [Proposed] Order submitted herewith under separate cover, and such further pleadings, papers or arguments as the Court may consider before or during the hearing of this Motion.

Dated: August 31, 2011

FOX ROTHSCHILD LLP

BY: James E. Doroshow

James E. Doroshow
Alan C. Chen
Attorneys for Plaintiff, POSHE USA, LLC

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I. INTRODUCTION.

Plaintiff Poshe USA, LLC ("Poshe") is the named insured under a commercial general liability insurance policy No. NC993184 (the "Policy") issued by Defendant Nautilus Insurance Company ("Nautilus"). On July 7, 2011, within the Policy period, Poshe was sued in this Court for trademark infringement, unfair competition and false advertising by a business competitor, Plaintiff American International Industries ("AII"). *See*, United States District Court, Central District of California, Western Division, Case No. CV-11-5600-JAK (the "AII Lawsuit"). After being served with the Complaint in the AII Lawsuit, Poshe promptly tendered defense of the AII Lawsuit to its insurer, Nautilus.

Although Nautilus responded to Poshe's tender by agreeing to defend Poshe in the AII Lawsuit under a *reservation of rights*, at the same time Nautilus insisted that Poshe agree to be defended by Nautilus' longstanding insurance counsel (Wolfe & Wyman LP); rather than independent counsel (Fox Rothschild LLP) selected by Poshe. At the same time, Nautilus advised Poshe that if it did not agree to allow the Wolfe firm to defend the AII Lawsuit, *Nautilus would consider this to be a material breach of the Policy and would refuse to pay independent counsel to defend the Lawsuit*. With a "gun to its head," and despite an obvious conflict of interest, Poshe has therefore been forced to rely on Nautilus' selected counsel in order to have Nautilus fund the defense of the AII Lawsuit. This lawsuit has been filed by Poshe to remedy Nautilus' refusal to comply with its legal obligations.

Nautilus knows that Poshe is entitled to select independent counsel based upon the multiple reservation of rights Nautilus has raised in agreeing to defend the AII Lawsuit. For example, among other reservations, as explained more fully below, Nautilus has stated that it owes *no duty to defend Poshe for infringement of trademark or other intellectual property rights except for infringement within Poshe's "advertisement" of trade dress or slogan*. Yet, even thought the Complaint in the AII

Lawsuit alleges both trademark infringement (which Nautilus claims to be *excluded*) and trade dress infringement (which Nautilus acknowledges to be *covered*), Nautilus has taken the position that the insurance counsel it has selected purportedly has no conflict in representing Poshe in the AII Lawsuit.

Similarly, although injunctive relief and damages are both sought in the AII Lawsuit, *Nautilus has stated it has no duty to defend any claim for injunctive relief*. In addition, *Nautilus claims it owes no duty to defend Poshe for a "personal and advertising injury" offense committed before or after the Policy period*. As if this was not enough to establish grounds for the appointment of independent counsel, *Nautilus also has stated it owes no duty to defend Poshe for a "personal and advertising injury" arising out of the unauthorized use of another's name or product in an e-mail address, domain name, metatag or similar tactic to mislead another's potential customer*, even though such an offense is clearly alleged as part of the grounds for asserted liability against Poshe in the AII Lawsuit.

California law is perfectly clear on an insurer's obligations in a case like this. Nautilus' reservation of rights on multiple coverage issues clearly creates a conflict of interest between Nautilus and Poshe that obligates Nautilus to provide independent counsel for Poshe in the AII Lawsuit. *See* Civil Code §2860(b), and *San Diego Navy Fed. Credit Union v. Cumis Ins. Society, Inc.* (1984) 162 Cal. App. 3d 358, 364 ("*Cumis*"). Where, as here, the insurer reserves its rights on multiple issues and the outcome of the coverage issue can be controlled by counsel retained by Nautilus to defend the claims, Nautilus must appoint independent counsel. Civil Code §2860(b). Simply put, the question is whether the manner in which the liability action is defended can predetermine the outcome of any subsequent coverage determination. *See Gafcon, Inc. v. Ponser & Assocs.* (2002) 98 Cal. App. 4th 1388, 1423 (insurer seeking summary judgment must show appointed counsel "could not impact coverage by the manner in which they defended the case").

Here, Nautilus' selected counsel (Wolfe & Wyman LLP) can clearly influence coverage by the manner in which it defends the AII Lawsuit. Thus, Nautilus' insurance counsel could of course influence potential liability for excluded claims (*e.g.*, trademark infringement, injunctive relief, claims that fall outside the Policy period, or "advertising" claims arising from the use of another's name in an email address, domain name, metatag or similar tactic). Conversely, Nautilus' insurance counsel could influence coverage so as to exclude liability for potentially covered claims (*e.g.*, trade dress infringement of slogan, damages, etc.). In short, while Nautilus and Poshe may share a common interest in defeating AII's claims, *their interests clearly diverge in establishing the basis for that defeat*. *See Golden Eagle Ins. Co. v. Foremost Ins. Co.* (1993) 20 Cal. App. 4th 1372, 1395. The appointment of independent counsel (Fox Rothschild LLP) to defend the AII Lawsuit is therefore mandated.

The predicament presented here - - and the reason why expedited relief is necessary - - is because Nautilus has insisted that its longstanding insurance counsel defend the AII Lawsuit, while Nautilus has refused to recognize (much less pay) independent counsel to defend the Lawsuit. Under these circumstances, rather than allow insurance counsel to control the AII Lawsuit and continue to have the ability to impact coverage, it is imperative that this Court intervene early in the AII Lawsuit - - otherwise there will be no possible way to reverse the damage that can be done. Therefore, by this Motion, Poshe respectfully asks the Court prohibit Nautilus and its selected insurance counsel from controlling the AII Lawsuit, and appoint Fox Rothschild LLP as independent *Cumis* counsel to defend the AII Lawsuit.

II. FACTUAL BACKGROUND.

A. The American International Industries Lawsuit.

On July 7, 2011, Plaintiff American International Industries ("AII") filed a Complaint in the United States District Court, Central District of California, Western Division, Case No. CV-11-5600-JAK against Poshe USA, LLC, Poshe Products,

LLC, and Lynn Beaurline (the "AII Lawsuit"). The Complaint alleges four claims for relief:

1. Federal Unfair Competition (15 U.S.C. §1125, subd. (a));
2. Trademark Infringement (15 U.S.C. § 1114);
3. Common Law Unfair Competition; and
4. Statutory Unfair Competition and False Advertising (Cal. Business & Professions Code §§ 17200 and 17500).

See, Doroshow Decl., Ex. A.

Plaintiff AII alleges that on January 12, 2011, it acquired from Almell, Ltd. ("Allmell") all rights, title, and interest in Poshe' ® brand manicure and pedicure products, *including patent and trademark rights*. Plaintiff further alleges that its *intellectual property rights include a Poshe' word mark, a design mark, and certain utility patents*. *Id.*

Allegedly, Almell had previously entered into a restricted license with Poshe USA, LLC, but had purportedly terminated that license around the time that Plaintiff acquired its interest in the Poshe' ® brand. Plaintiff AII alleges that after January 12, 2011, Defendants continued to hold themselves out to the public as authorized Poshe' product distributors. Plaintiff AII alleges that Ms. Beaurline registered the domain *name* <www.discountposhe.com> and commenced the sale of Poshe' ® brand products at a discount. Additionally, the Defendants allegedly *manipulated the website* <www.poshe.com> to automatically forward all accessing internet uses to <www.discountposhe.com> until May 2011. *Id.*

Plaintiff, AII further alleges that Poshe USA, LLC controls *the website* <www.poshnails.com>. Defendants allegedly continue to use the Poshe' *word mark*, such as in the name Poshe USA, LLC, in their advertising, invoices, and instructions for nail polish application. Plaintiff alleges that Defendants have *misappropriated its word mark, design mark, and trade dress rights*. Plaintiff seeks *actual damages;*

treble damages; injunctive relief; restitution; punitive damages; and attorneys' fees. *Id.*

B. The Nautilus Insurance Policy.

Nautilus issued a liability insurance policy, No. NC 993184, effective February 13, 2010 to February 13, 2011, to the following named insureds: Poshe USA, LLC and Poshe Products, LLC. *See*, Beaurline Decl., Ex. A. The Common Policy Declarations describe the named insureds' operations as: DISTRIBUTOR AND MFG OF BASE AND TOPCOAT NAIL POLISH. Liability coverage is afforded via a Commercial General Liability Coverage Form, designated form CG 00 01 12 04, hereinafter "CGL form." The Commercial General Liability Coverage Part Declarations schedule the following limits of insurance:

General Aggregate Limit	$2,000,00
Products/Completed Operations Aggregate Limit	$2,000,00
Personal and Advertising Injury Limit	$1,000,00
Each Occurrence Limit	$1,000,00

Id.

Under the Policy, specifically the Insuring Agreement under Section I — Coverages, Coverage B — *Personal and Advertising Injury Liability*, Nautilus agreed to the following:

> **"SECTION I — COVERAGES**
> **COVERAGE B. PERSONAL AND ADVERTISING INJURY LIABILITY**
>
> 1. Insuring Agreement
>
> We will pay those sums that the insured becomes legally obligated to pay as damages because of "personal and advertising injury" to which this insurance applies. We will have the right and duty to defend the insured against any "suit" seeking those damages. However, we will have no duty to defend the insured against any "suit" seeking damages for "personal and advertising injury" to which this insurance does not apply. We may, at our discretion, investigate any offense and settle any claim or "suit" that may result. ...

> This insurance applies to "personal and advertising injury" caused by an offense arising out of your business but only if the offense was committed in the "coverage territory" during the policy period."

Id.

In Section V — Definitions, which defines the following Policy terms, the following definitions appear:

> **SECTION V – DEFINITIONS**
>
> 1. "Advertisement" means a notice that is broadcast or published to the general public or specific market segments about your goods, products or services for the purpose of attracting customers or supporters. For the purposes of this definition:
>
> a. Notices that are published include material placed on the Internet or on similar electronic means of communication; and
>
> b. Regarding web-sites, only that part of a web-site that is about your goods, products or services for the purposes of attracting customers or supporters is considered an advertisement.
>
> . . .
>
> 14. "Personal and advertising injury" means injury, including consequential "bodily injury", arising out of one or more of the following offenses:
>
> a. False arrest, detention or imprisonment;
>
> b. Malicious prosecution;
>
> c. The wrongful eviction from, wrongful entry into, or invasion of the right of private occupancy of a room, dwelling or premises that a person occupies, committed by or on behalf of its owner, landlord or lessor;
>
> d. Oral or written publication, in any manner, of material that slanders or libels a person or organization or disparages a person's or organization's goods, products or services;
>
> e. Oral or written publication, in any manner, of material that violates a person's right of privacy;
>
> f. The use of another's advertising idea in your "advertisement"; or

g. Infringing upon another's copyright, trade dress or slogan in your "advertisement".”

Id.

C. Nautilus' Reservation of Rights.

Despite the fact that Coverage B applies to "personal and advertising injury" caused by an offense arising from the named insured's business during the Policy period, Nautilus (through its insurance counsel) issued a Reservation of Rights letter to Poshe on August 3, 2011 stating that:

> “the Complaint cannot be reasonably construed as alleging any of the "personal and advertising injury" offenses defined in items a., b., c., d. and e.”

Doroshow Decl., Ex. B.

In the same correspondence, Nautilus referenced Poshe to the CGL form — specifically Section I.B.2., Exclusions, which state in pertinent part as follows:

> **2. Exclusions**
>
> This insurance does not apply to:
>
> **a. Knowing Violation Of Rights Of Another**
>
> "Personal and advertising injury" caused by or at the direction of the insured with the knowledge that the act would violate the rights of another and would inflict "personal and advertising injury".
>
> **b. Material Published With Knowledge Of Falsity**
> "Personal and advertising injury" arising out of oral or written publication of material, if done by or at the direction of the insured with knowledge of its falsity.
>
> **c. Material Published Prior To Policy Period**
> "Personal and advertising injury" arising out of oral or written publication of material whose first publication took place before the beginning of the policy period.
>
> . . .
>
> **f. Breach Of Contract**
>
> "Personal and advertising injury" arising out of a breach of contract, except an implied contract to use another's advertising idea in your "advertisement".

i. Infringement Of Copyright, Patent, Trademark Or Trade Secret

"Personal and advertising injury" arising out of the infringement of copyright, patent, trademark, trade secret or other intellectual property rights.
However, this exclusion does not apply to infringement, in your "advertisement", of copyright, trade dress or slogan.

1. Unauthorized Use Of Another's Name Or Product

"Personal and advertising injury" arising out of the unauthorized use of another's name or product in your e-mail address, domain name or metatag, or any other similar tactics to mislead another's potential customers."

Id. (emphasis supplied).

In its August 3, 2011 reservation of rights letter, Nautilus also stated that:

"in the exclusionary provisions quoted above, the insurance afforded under the Nautilus policy does not apply to "personal and advertising injury" arising out of the infringement of copyright, patent, trademark, trade secret or other intellectual property rights; however, the exclusion does not apply to infringement, in your "advertisement," of copyright, trade dress or slogan."

Id. (emphasis supplied).

Nautilus then concluded:

"The Complaint does not allege that any named insured's "advertisement" contains material that infringes upon another's copyright or slogan, *but the first claim for relief alleges Defendants have misappropriated Plaintiffs intellectual property rights, including infringing upon word marks and trade dress rights. Additionally, it appears from the Complaint that the alleged infringement of trade dress may have occurred within a named insured's "advertisement" between the acquisition date, January 12, 2011, and the policy's termination date, February 13, 2011."*

Id. (emphasis supplied).

In light of the foregoing provisions of the Nautilus Policy, the position of Nautilus concerning coverage and other matters was set forth as follows:

"1. Nautilus owes no duty to indemnify the tendering parties for judicial relief that *does not constitute damages, such as injunctive relief*. AIU Ins. Co. v. Sup.Ct. (FMC Corp.) (1990) 51 Ca1.3d 807.

2. Nautilus owes no duty to indemnify the tendering parties *for statutory unfair competition under Sections 17200 and 17500 of the California Business & Professions Code, because those statutory provisions do not authorize judicial relief that constitutes damages under a liability policy*. Bank of the West v. Superior Court (1992) 2 Ca1.4th 1254.

3. Nautilus owes no duty indemnify any tendering party under Coverage A, Bodily Injury and Property Damage, because the Complaint does not allege "bodily injury," "property damage," or an "occurrence."

4. *Nautilus owes no duty to indemnify any tendering party for a "personal and advertising injury" offense committed before or after the policy period.*

5. Nautilus owes no duty to indemnify any tendering party under items **a., b., c., d.,** and **e.** of the definition of "personal and advertising injury," because the Complaint does not allege the torts defined therein.

6. Nautilus owes no duty to indemnify the tendering parties, or any of them, for an amount greater than the applicable limits of insurance, which are $1,000,000.

7. *Nautilus owes no duty under the Supplementary Payments provisions to indemnify any tendering party for attorneys' fees awarded pursuant to claims that are not potentially covered.*

8. *Nautilus owes no duty to indemnify any tendering party for infringement of patent, trademark, trade secrets, or other intellectual property rights except for infringement within a named insured's "advertisement" of copyright, trade dress, or slogan, and therefore reserves its rights with respect to the exclusionary provisions set forth in the CGL form at Section I.B.2.e., under the heading: Infringement of Copyright, Patent, Trademark or Trade Secret.*

9. If Nautilus's offer of defense, as set forth herein, is accepted by the tendering parties, Nautilus will agree to waive the statutory exclusion set forth at Section 533 of the California Insurance Code and the following policy's exclusions set forth in the CGL form at Section I.B.2.**a.**, **b.,** c.**,** and **f.**: Knowing Violation of Rights of Another; Material Published with Knowledge of Falsity; Material Published Prior to Policy Period; and Breach of Contract.

10. *Nautilus owes no duty to indemnify any tendering party for a "personal and advertising injury" arising out of the unauthorized use of another's name or product in an e-mail address, domain name, metatag, or similar tactic to mislead another's potential customers, and therefore reserves its rights with respect to the exclusionary provisions set forth in the CGL*

> *form at Section I.B.2.1., under the heading: Unauthorized Use of Another's Name Or Product.*
>
> 11. Nautilus reserves its right to seek judicial declarations regarding the respective rights and obligations of all interested parties under the policy.
>
> 12. Nautilus reserves the right to recover from any qualifying insured payments made in the defense of the Poshe USA, LLC, Poshe Products, LLC, and Ms. Lynn Beaurline for claims that are not potentially covered.
>
> 13. Nautilus reserves the right to recover from any qualifying insured payments made in the indemnification of Poshe USA, LLC, Poshe Products, LLC, and Ms. Lynn Beaurline for claims that are not within the Insuring Agreements of Coverage A or Coverage B or form claims that are within the exclusionary provisions to which Nautilus has specifically reserved its rights herein.
>
> 14. Nautilus reserves the right to withdraw from the defense should facts show there is no potential coverage under the insurance afforded by Nautilus, or if a court determines there is no duty to defend."

Id. (emphasis supplied).

In summary, Nautilus agreed to participate in the defense of Poshe USA, LLC, Poshe Products, LLC, and Ms. Lynn Beaurline subject to a reservation of rights in its August 3, 2011 letter. At the same time, however, Nautilus took the following position:

> "It is the position of Nautilus that the limited reservation of rights *does not constitute grounds for independent counsel under Section 2860 of the California Civil Code.* Subdivision (b) provides that "a conflict of interest does not exist as to allegations or facts in the litigation for which the insurer denies coverage[.]" Subdivision (b) further provides that "No conflict of interest shall be ... be deemed to exist solely because an insured is sued for an amount in excess of the insurance policy limits." Similarly, the reservation of the right to seek reimbursement of defense costs allocable to noncovered claims does not does trigger the insurer's duty to appoint independent counsel See CALIFORNIA PRACTICE GUIDE: INSURANCE LITIGATION, Chapt. 7B-K, § 7:773 (Rutter 2011); *James 3 Corp. v. Truck Ins. Exch.* (2001) 91 Cal.App.4th 1093."
>
> "*Nautilus will not agree to retain you or your law firm [Fox Rothschild LLP] while it evaluates your clients' demand for independent counsel. "* An insurer need not appoint independent counsel for an insured while conducting a good faith investigation to determine whether a sufficient conflict exists to require such appointment[.] '3 As explained by one court, "Given the

> complexities of any Cumis analysis, [the insurance carrier] did not breach any legal obligation to defend [the insured] when it offered to fully defend at its own expense through appointed counsel pending further coverage analysis of the Cumis issue."

Id. (emphasis supplied).

Although Poshe repeatedly requested that Nautilus agree to the retention of independent counsel (Fox Rothschild LLP) given Nautilus' reservation of rights on multiple issues as set forth above, Nautilus has refused, stating:

> *"Please be advised that Nautilus has the right to select counsel and control the defense absent a disqualifying conflict of interest as noted herein and in prior correspondence. If your clients wish to retain [independent counsel], please advise your clients that any and all attorneys' fees and expenses will be the responsibility of your clients, not Nautilus. If you or the clients refuse to cede control of the defense or accept Nautilus's offer of defense or cooperate with appointed defense counsel, Nautilus reserves the right to assert that any such refusal is a material breach of policy conditions, and that such breach excuses any obligation on the part of Nautilus to defend or indemnify the tendering parties."*

Id. (emphasis supplied).

With a "gun to its head," Poshe has therefore been required to cede control of the defense of the AII Lawsuit to Nautilus' longstanding insurance counsel, Wolfe & Wyman, LP. Doroshow Decl., ¶17.[1]

III. ARGUMENT.

A. General Legal Standards for a Preliminary Injunction.

An injunction is an equitable remedy. "The basis for injunctive relief (preliminary or permanent) in the federal courts has always been irreparable injury and the inadequacy of legal remedies." *Weinberger v. Romero-Barcelo* (1982) 456 US 305, 312. *Stanley v. University of So. Calif.* (9th Cir. 1994) 13 F.3d 1313, 1320.

[1] Although Wolfe & Wyman, LP has confirmed that it has a longstanding relationship with and handled many matters for Nautilus, the firm has refused to tell Poshe or its counsel which matters it has handled for Nautilus; whether its lawyers have experience handling claims similar to those brought against Poshe in the AII Lawsuit; or what the Wolfe firm is charging Nautilus to defend the AII Lawsuit. Therefore, in addition to being forced to be defended by a law firm with longstanding ties to Nautilus, it is not clear that insurance counsel is qualified to defend the AII Lawsuit. *See* Doroshow Decl., ¶17; Beaurline Decl., ¶4. In fact, from the firm biographies of the two lawyers Nautilus appointed to defend this case, neither appears to have any experience defending claims like those brought in the AII Lawsuit. *See* Doroshow Decl., Ex. E.

In addition to the requirements for equitable relief generally, a plaintiff seeking a preliminary injunction has the burden of showing that he is likely to succeed on the merits, that he is likely to suffer irreparable harm in the absence of preliminary relief, that the balance of equities tips in his favor and that an injunction is in the public interest. *Winter v. Natural Resources Defendant Council, Inc.* (2008) 555 U.S. 7, 11; *Stormans, Inc. v. Selecky* (9th Cir. 2009) 586 F.3d 1109, 1127.

Here, Poshe has clearly shown grounds warranting the issuance of a preliminary injunction prohibiting Nautilus from controlling the defense of the AII Lawsuit through its conflicted insurance counsel.

B. Poshe Meets All of the Grounds for Issuance of a Preliminary Injunction.

1. Poshe Has a Strong Likelihood of Success on the Merits.

There is clearly a strong probability that Poshe will prevail on the merits in this action. As shown, where, as here, an insurer reserves rights on multiple coverage issues, a conflict of interest arises between the insurer and insured that obligates Nautilus to provide independent counsel for Poshe to defend the AII Lawsuit. *See* Civil Code §2860(1)(b); *San Diego Navy Fed. Credit Union v. Cumis Ins. Society, Inc.* (1984) 162 Cal. App. 3d 358, 364.

Having reserved rights on multiple coverage issues, Nautilus cannot seriously maintain that its longstanding insurance firm (Wolfe & Wyman) cannot predetermine the outcome of a subsequent coverage determination depending upon the manner in which insurance counsel defends the AII Lawsuit. A few examples make this perfectly clear:

1. As shown, the Complaint in the AII Lawsuit alleges liability based both upon *trademark infringement and trade dress infringement*. Doroshow Decl., Ex. A. At the same time, Nautilus has stated it has no duty to defend AII's trademark claims (which are *excluded* under the Policy), but acknowledges its duty to defend AII's trade dress claim (which is *covered* under the Policy). As such, insurance counsel can

clearly impact a subsequent coverage determination by building a record that could defeat trade dress liability, while presenting a less rigorous defense for trademark infringement. In short, while insurer and insured may share a common interest in defeating AII's claims, their interests clearly diverge in establishing the basis for that defeat. *See Golden Eagle Ins. Co. v. Foremost Ins. Co.* (1993) 20 Cal. App. 4th 1372, 1395.

2. Similarly, as shown above, the AII Complaint also predicates liability based upon Poshe's registration and use of an *allegedly infringing domain name*, and by Poshe's *alleged manipulation of a website*. Doroshow Decl., Ex. A. At the same time, Nautilus denies any duty to defend or indemnify Poshe for a "personal and advertising injury" arising out of the *unauthorized use of another name in a domain name or similar tactic to mislead another's potential customers*. *Id*., Ex. B. Thus, insurance counsel can also influence any subsequent coverage decision by building a record in the AII Lawsuit that liability, if any, is predicated on the use of an infringing domain name or manipulation of website (both of which would be *excluded* under the Policy).

3. The Nautilus Policy is effective from February 13, 2010 to February 12, 2011. Beaurline Decl., Ex. A. As shown, in reserving its rights, Nautilus has stated it has no duty to defend or indemnify Poshe for a "personal and advertising injury" offense *committed before or after the Policy period*. Here, the AII Complaint alleges a number of events that *occurred during the Policy period*. *See* Doroshow Decl., Ex. A, para. 11 ("*[o]n or about January 12, 2011*, AII acquired all rights, title, and interest to Poshe' products, including but not limited to patent and trademark rights . . . "); (*[o]n January 27, 2011*, Defendant . . . registered the domain name *www.discountposhe.com* . . ."") (emphasis supplied). However, other events that may ultimately determine coverage are alleged to have occurred *outside the Policy period*. *Id*., para. 12 (POSHE was registered as a word mark on *June 11, 1996*, and a design mark featuring a stylized portrait of a woman was registered on *May 20, 2008*); para.

14 (AII's patents issued on *September 2, 1997* and *February 14, 2008* in the Poshe products); para. 21 (Defendants were sent a cease and desist letter "no later than" *April 14, 2011*, and met with Almell on *April 19, 2011*, where Defendants were reminded they had no right to continue using the Poshe' brand or marks); para. 22 (referencing an "example" of an allegedly infringing advertisement published in *July 2011*); and para. 28 (AII alleges it sent Defendants a cease and desist letter on *June 10, 2011*). Still other potentially relevant events *are not assigned any particular date, including when AII allegedly acquired trade dress rights, when AII first learned that Defendants were allegedly involved in unauthorized activity or when Poshe's license to use the allegedly infringing marks was terminated*. All of these activities (and others) can obviously be used to predetermine coverage, including whether coverage is excluded because liability is based on activity before, after or during the Policy period.

4. Although the AII Lawsuit includes a claim for statutory unfair competition under Cal. Business & Professions Code §§ 17200 and 17500, Nautilus has also stated it owes no duty to defend or indemnify Poshe for this claim since "those statutory provisions do not authorize judicial relief that constitutes damages under a liability policy." Doroshow Decl., Ex. B. As such, once again, Nautilus' longstanding insurance counsel (Wolfe & Wyman LLP) can predetermine a subsequent coverage determination by *defeating claims for damages, while Poshe remains vulnerable to excluded claims like injunctive relief.*

5. Nautilus has also disavowed any obligation to indemnify Poshe for attorney's fees awarded pursuant to claims that are not potentially covered. *Id.* Yet, there are a number of claims in the AII Lawsuit - - including claims for trademark infringement and statutory unfair competition under California law - - which Nautilus claims are excluded, and which could support a claim for attorney fees. *Id.*, Ex. A. Once again, Nautilus' selected counsel can obviously predetermine coverage by the manner in which it defends covered and uncovered claims in the AII Lawsuit.

These are not merely theoretical conflicts, as Nautilus maintains - Nautilus has reserved the right to seek judicial declarations regarding the respective rights and obligations of all interested parties under the Policy, and to recover from its insured all payments made in defending them for claims that are not potentially covered. *Id*., Ex. B. Thus, it is clear the Poshe has shown a strong likelihood of success on the merits that warrants the issuance of a preliminary injunction at this time.

2. Poshe Will Suffer Irreparable Harm Absent An Injunction.

The AII Lawsuit, filed July 7, 2011, is now being actively litigated.[2] Poshe has been told by its insurer in no uncertain terms that it will not defend the AII Lawsuit *unless Poshe agrees to be defended by Nautilus' selected insurance counsel and allows the insurer to control the defense of the litigation*. Poshe has therefore been forced to select between two equally damaging choices - - *i.e.,* default in the AII Lawsuit or allow Nautilus to control the defense of the AII Lawsuit, and run the risk of having insurance counsel predetermine any subsequent coverage decision. Poshe cannot afford to fund the defense of the AII Lawsuit; nor should it be forced to do so. Beaurline Decl., ¶5. Therefore, money damages will not protect Poshe absent immediate injunctive relief. Moreover, if Nautilus is allowed to continue to control the defense of the AII Lawsuit while this action is pending, the damages will be irreversible.

Thus, Poshe has also clearly satisfied its burden of proving irreparable harm absent a preliminary injunction during the pendency of this action. *See Ross-Simons of Warwick, Inc. v. Baccarat, Inc.* (1st Cir. 1996) 102 F.3d 12, 18 (when plaintiff suffers "substantial injury that is not accurately measurable or adequately compensable by money damages, irreparable harm is a natural sequel"); *Food Comm. Int'l. v. Barry* (7th Cir. 2003) 328 F.3d 300, 304 (the legal remedy, damages, need not

[2] The Court has scheduled the initial Rule 26 conference on November 7, 2011, one week before this Motion is presently scheduled to be heard. [D.I. 11].

be wholly ineffectual; rather, it must be "seriously deficient as compared to the harm suffered").

3. The Balance of Equities Clearly Weigh In Poshe's Favor.

Poshe cannot afford to fund the defense of the AII Lawsuit. Beaurline Decl., ¶5. Thus, absent injunctive relief, it must either default in the AII Lawsuit or turn the defense of the Lawsuit over to Nautilus' longstanding (and inexperienced) insurance counsel, who can predetermine a subsequent coverage decision. The harm Poshe will suffer is therefore very strong (if not irreversible) if an injunction does not issue at this time.

By contrast, Nautilus, who was paid sizeable premiums to defend exactly this kind of risk, is a highly solvent insurance company who can clearly fund the defense of the AII Lawsuit.[3] The only question is who will defend the Lawsuit - - *i.e.,* Nautilus' longstanding insurance counsel (who has multiple conflicts in defending Poshe and no apparent experience in defending the claims brought in the AII Lawsuit); or Poshe's selected counsel (who is highly experienced in defending these types of cases and who has no conflict in representing Poshe). *See* Doroshow Decl., Ex. C. At the same time, Nautilus has also reserved the right to seek a judicial declaration of non-coverage, and the right to be repaid for defending any non-covered claims. Therefore, Nautilus can point to no injury (actual or potential) should an injunction issue.

Thus, the equities clearly weigh in Poshe's favor, and in favor of injunctive relief at this time. *See Sardis' Restaurant Corp. v. Sardie* (9th Cir. 1985) 755 F.2d 719, 726 (in assessing the relative hardships to each party, the court should consider the impact the injunction may have on the respective parties, and, the relative size and strength of the parties is pertinent to this inquiry); *Ayres v. City of Chicago* (7th Cir. 1997) (even in a case, unlike this, where the plaintiff does *not* have a high probability

[3] In 2010, Nautilus reported over a billion and half dollars in assets. Doroshow Decl., Ex. F.

of success, the plaintiff is still entitled to preliminary relief if he faces great irreparable harm and the defendant very little).

4. The Public Interest Also Favors Preliminary Relief.

Here, there are no third parties who would be adversely impacted by the issuance of a preliminary injunction. Thus, where, as here, an injunction is narrow and affects only the parties with no impact on nonparties, "the public interest will be at most a neutral factor in the analysis rather than one that favors granting or denying the preliminary injunction." *Stormans, Inc. v. Selecky* (9th Cir. 2009) 586 F.3d 1009, 1139 (internal quotes and brackets omitted).

However, if in fact the Court considers the impact its decision would have on the public interest, this too clearly favors issuing an injunction. If Nautilus is allowed to continue controlling the defense of the AII Lawsuit and disobey California law, insurance companies will be emboldened to flaunt their legal obligations by forcing consumers who have paid them valuable premiums to either default in defending insured risks, or to cede control to conflicted counsel who has a clear interest in receiving additional work from the insurer depending upon the manner in which it defends the insured's interest. This is exactly why the California courts and legislature recognized the right of an insured to select independent counsel in cases like this. This Court too should protect the interest of all insureds who are presented with an insurer who chooses to disobey the law by selecting counsel it can control, and who is clearly interested in factoring the interests of the insurer and its chance of obtaining additional work into the defense of the insured. Again, as the California Court of Appeals has stated, while Nautilus and Poshe may share a common interest in defeating AII's claims, *their interests clearly diverge in establishing the basis for defeat*. *Golden Eagle Ins. Co. v. Foremost Ins. Co.* (1993) 20 Cal.

Thus, the public interest also clearly favors issuing a preliminary injunction.

IV. CONCLUSION.

For these reasons, the Court should issue an order preliminarily enjoining Nautilus and its longstanding insurance counsel (Wolfe & Wyman LLP) from controlling the defense of the AII Lawsuit, and permitting Poshe to select independent counsel consistent with California law.

Dated: August 31, 2011

FOX ROTHSCHILD LLP

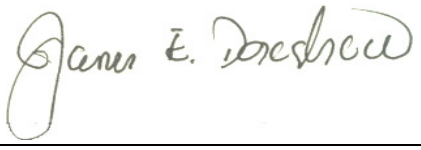
BY: 

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EXHIBIT 3

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UNITED STATES DISTRICT COURT

FOR THE CENTRAL DISTRICT OF CALIFORNIA

WESTERN DIVISION

POSHE USA, LLC,

Plaintiff,

v.

NAUTILUS INSURANCE COMPANY,

Defendant.

Case No. LA CV11-06795 JAK (Ex)

OPPOSITION OF NAUTILUS INSURANCE COMPANY TO PLAINTIFF'S MOTION FOR PRELIMINARY INJUNCTION; MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF

Hearing Date : 11/07/2011
Hearing Time : 8:30 a.m.
Judge : Hon. John A. Kronstadt
Courtroom : 750

Compl. Filed : 08/18/2011
Trial Date : None set

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I. INTRODUCTION

In filing this lawsuit and its Motion for Preliminary Injunction, Plaintiff argues that Nautilus Insurance Company's agreement to defend Plaintiff in the Underlying Action is subject to reservations that create a disqualifying conflict of interest on the part of insurer-appointed defense counsel; that Nautilus is asserting its right to control the defense while refusing to provide a conflict-free defense; and that Plaintiff is therefore entitled to extraordinary relief in the form of an order requiring Nautilus to transfer the primary handling and control of the defense to Plaintiff's counsel.

Nautilus disputes Plaintiff's position. Moreover, Nautilus contends that this lawsuit and Motion raises a broader, more fundamental issue: whether a liability insurance carrier can lawfully furnish a legal defense under a limited reservation of rights without triggering the policyholder's entitlement to independent counsel? As explained below, California courts have repeatedly held that even a "global reservation of rights" does not automatically obligate an insurance carrier to provide independent counsel.

Thus, California law expressly and specifically permits an insurance carrier to select defense counsel and control the defense notwithstanding a reservation of rights—at least under certain circumstances. Here, as part of its offer of a legal

defense, Nautilus stated that it would waive five broad exclusionary clauses. Those clauses include, but are not limited to, exclusions relating to the nature of the policyholder's conduct. By doing so, Nautilus eliminated any possibility of a conflict resembling the paradigm Cumis scenario in which the nature of the policyholder's conduct as developed at trial—intentional versus accidental—will determine the outcome of a coverage dispute.

Moreover, Nautilus repeatedly stated that it would consider waiving additional reservations if Plaintiff or its counsel would explain why the limited reservations created a disqualifying conflict of interest. Nautilus (through counsel) explained its position in detail; offered to clarify its position in writing if requested; identified the pertinent legal standards; invited Plaintiff's counsel to comment on the legal standards and Nautilus's legal analysis of the issues; and repeatedly expressed its intent to continue a dialogue regarding the disputed issues.

Plaintiff chose to file this lawsuit. It now seeks extraordinary relief in the form of a mandatory injunction that would, if granted, disturb the status quo. Specifically, the relief sought would require that Nautilus affirmatively transfer the defense of the Underlying Action to another law firm. As such, the injunction is "disfavored" and therefore subject to heightened judicial scrutiny.

As explained below, Plaintiff has not demonstrated a likelihood of

succeeding on the merits. Plaintiff's arguments are limited to a few sentences stating that defense counsel could "create a record" that would somehow be detrimental to Plaintiff. Plaintiff seems to be arguing that insurer-appointed defense counsel will strive to create a record of liability for excluded claims, such as trademark infringement, while trying to establish non-liability on the part of Plaintiff for covered claims, such as trade dress infringement.

Plaintiff's arguments are conclusory and unpersuasive. Moreover, those arguments rely primarily upon an unstated presumption: that insurer-appointed defense counsel will breach their professional responsibility. California courts, however, have specifically ruled that such presumptions are not permitted. California courts have also ruled on multiple occasions that a demand for independent counsel must be supported by evidence showing the specific way that counsel could have controlled the outcome of coverage issues or had the incentive to do so. Plaintiff's Motion contains no such evidence.

Finally, Plaintiff has not demonstrated irreparable harm. Notably, Plaintiff requested and obtained proof of insurance from insurer-appointed defense, showing professional liability coverage with $5 million limits. Plaintiff has not shown or explained why monetary damages cannot provide adequate relief. Consequently, Plaintiff's Motion should be denied because the grounds stated for injunctive relief do not satisfy the heightened scrutiny required for mandatory

injunction.

II. FACTUAL BACKGROUND

A. The Underlying Action

On August 18, 2011, Plaintiff Poshe USA, LLC, hereinafter "Plaintiff" or "Poshe," initiated this lawsuit (Case No. CV 11-06795-JAK (Ex)) by filing a Complaint for Declaratory Relief, Breach of Contract, and Tortious Breach of Contract. Plaintiff, Poshe Products, LLC, and their mutual principal, Lynn Beaurline, are defendants in a related lawsuit (Case No. CV-11-5600-JAK) filed on July 7, 2011, hereinafter "Underlying Action." See Plaintiff's Complaint for Declaratory Relief, Breach of Contract, Tortious Breach of Contract, hereinafter "Complaint," at p. 3, lines 6-15, and Exhibit A thereto.

The gravamen of the Complaint is that Nautilus declined to retain the law firm, Fox Rothschild LLP, as independent counsel under Section 2860 of the California Code of Civil Procedure. Compl. at p. 10, lines 1-9. Plaintiff alleges that Nautilus agreed to participate in the defense of Plaintiff and the other defendants in the Underlying Action, subject to a reservation of rights as set forth in correspondence dated August 3, 2011, hereinafter "Reservations Letter." Compl. at p. 6, lines 8-13, and p. 20, lines 12-14. The Reservation Letter is attached as Exhibit B to the Declaration of James E. Doroshow in Support of Motion for Preliminary Injunction . References herein to the 99-page Doroshow

Declaration employ the CM/ECF numbers on the upper margin.

B. The Initial Claim for Independent Counsel

On August 1, 2011, Nautilus corresponded (via its coverage counsel) with Plaintiff's attorney. Doroshow Decl. at pp. 65-70. The letter addressed Mr. Doroshow's demand that Nautilus retain him as independent counsel. Id. at 66, last full paragraph. Nautilus indicated that it had "not yet issued a reservations letter," and that it did "not intend to reserve rights on any issue that would create a disqualifying conflict of interest." Id. at 67, first full paragraph. Specifically, Nautilus advised of its intent to "offer to waive the policy's intent- and knowledge-based exclusions[,]" as well as other exclusionary provisions. Id. at 68, last full paragraph.

Nautilus indicated it would issue a reservation-of-rights letter within a few days. It also stated: "If, after reviewing that reservations letter, you contend that one or more specific reservations trigger Section 2860's statutory standard, Nautilus will then determine if those reservations trigger the statutory standard, and if so, whether Nautilus will elect to waive such reservations as part of its offer of defense." Doroshow Decl. at p. 69, second full paragraph.

C. The Reservations Letter

On August 3, 2011, Nautilus transmitted (via its coverage counsel) the Reservations Letter to Plaintiff's attorney, setting forth its agreement to defend

under a limited reservation of rights. Doroshow Decl., Exh. 2 thereto, at pp. 71-84. Nautilus advised that it had retained the law firm Wolfe & Wyman LLP as defense counsel to defend Plaintiff, Poshe Products, LLC, and Lynn Beaurline. Doroshow Decl. at p. 9, ¶ 17, and at p. 37, last full paragraph.

In agreeing to defend, Nautilus specifically notified Plaintiff that its defense would be subject only to the "limited reservations of rights in this letter." Doroshow Decl. at p. 47, second full paragraph. Nautilus further advised that, "If Nautilus's offer of defense … is accepted by the tendering parties, Nautilus will agree to waive the statutory exclusion set forth at Section 533 of the California Insurance Code and the following policy's exclusions set forth in the CGL form at Section I.B.2.a., b., c., and f.: Knowing Violation of Rights of Another; Material Published with Knowledge of Falsity; Material Published Prior to Policy Period; and Breach of Contract." Doroshow Decl. at p. 46; Compl. at p. 8, lines 19-23.

Nautilus offered to consider waiving additional policy provisions. Doroshow Decl. at p. 47, last full paragraph. Nautilus further stated that it would "carefully evaluate whether the stated grounds trigger the statutory standard set forth at Section 2860, including an evaluation as to whether Nautilus will consider waiving the purported reservation." Id., last partial paragraph. Nautilus invited any requests for clarification concerning the Reservations Letter, promising to "immediately evaluate ... and provide a detailed written response."

Doroshow Decl. at p. 48 , last full paragraph.[1]

Shortly after Nautilus's counsel transmitted the Reservations Letter on August 3, 2011, Plaintiff's counsel repeated his client's threat to sue Nautilus, claiming "There are clearly multiple conflicts created by the matters you have reserved rights on." Bolender Decl. at p. 11. Nautilus responded that same day, indicating that a "lawsuit is premature because you have not identified any specific reservation that triggers a disqualifying conflict of interest." Id. at p.9, second full paragraph. Nautilus again reiterated that "it is the intent and desire of Nautilus Insurance to provide a conflict-free defense." Id. at 7.

Nautilus cited case law holding that carriers have the right to evaluate claims for independent counsel to determine "whether [the various interests] can be reconciled … such as a defense based upon total nonliability…" Id. at p. 11. Nautilus "urge[d] [Plaintiff's counsel] to consider [his] decision to file suit without providing Nautilus the benefit of evaluating the specific basis of [Plaintiff's] demand for independent counsel." Id. On August 4 and 5, 2011, Plaintiff's counsel transmitted three electronic mail messages, setting forth the grounds for his clients' demand for independent counsel. Bolender Decl. at p. 3, ¶4 ; Doroshow Decl. at pp. 86-89.

[1] The Reservations Letter contains a typographical error. See Doroshow Decl. at p. 81, ¶8. The reference to "Section **I.B.2.e.**" should have read "Section **I.B.2.i.**" Nautilus's counsel corrected and clarified that error in an electronic mail message later the same day. See Bolender Decl. at p. 11.

D. Response to Demand for Independent Counsel

On August 10, 2011, Nautilus responded to Plaintiff's demand for independent counsel. Doroshow Decl. at pp. 51-64 . Nautilus cited to Section 2860 of the California Civil Code, including several appellate opinions interpreting Section 2860. Id. at pp.53-55 . Nautilus advised Plaintiff's counsel that, "If you believe the legal principles stated above are incorrect, kindly advise me in writing at your earliest convenience so that we can evaluate your basis for reaching a different conclusion. " Id. at p. 55, third full paragraph. He offered no rebuttal in this respect. Bolender Decl. at pp. 3-4, ¶5.

Nautilus set forth in detail its evaluation of each ground cited by Plaintiff in support of its demand for independent counsel. Id. at pp. 56-62. Nautilus repeatedly offered to continue evaluating Plaintiff's claim. For example, Nautilus stated that, "If you are able to demonstrate that the trademark exclusion reservation creates a disqualifying conflict of interest, Nautilus will consider offering to waive the trademark reservation." Doroshow Decl. at p. 59, second full paragraph; see other examples at Doroshow Decl. at p. 61, third full paragraph, and p. 62, last full paragraph,

Additionally, with respect to one of the few issues on which Nautilus reserved it rights, i.e., offenses committed outside the policy period, Nautilus expressly agreed to amend the Reservations Letter by offering to waive that

reservation, even though it did not create a disqualifying conflict of interest. Doroshow Decl. at p. 62, second full paragraph. In the closing paragraphs of its August 10, 2011 response, Nautilus again invited any request for clarification, stating it would "immediately evaluate ... and provide a detailed written response." Doroshow Decl. at p. 64, first full paragraph. Mr. Doroshow did not submit any written request for clarification. Bolender Decl. at pp. 3-4, ¶5.

III. ARGUMENT

A. Plaintiff's Stated Grounds for Preliminary Injunctive Relief Are Subject to Heightened Judicial Scrutiny Because Plaintiff Seeks A Mandatory Injunction that Disturbs the Status Quo

"A plaintiff seeking a preliminary injunction must establish that he is likely to succeed on the merits, that he is likely to suffer irreparable harm in the absence of preliminary relief, that the balance of equities tips in his favor, and that an injunction is in the public interest." Winter v. Natural Resources Defense Council, Inc. (2008) 555 U.S. 7, 20, 129 S.Ct. 365, 374, 172 L.Ed.2d 249.

In certain cases, preliminary injunctive relief is "disfavored," thereby invoking a heightened scrutiny standard of the above-quoted requirements for injunctive relief. Schrier v. University of Colorado (10th Cir. 2005) 427 F.3d 1253, 1259 ("Such disfavored injunctions 'must be more closely scrutinized to assure that the exigencies of the case support the granting of a remedy that is extraordinary even in the normal course.'"); Marlyn Nutraceuticals, Inc. v. Mucos

Pharma GmbH & Co. (9th Cir. 2009) 571 F.3d 873, 879 (holding that mandatory injunctive relief is "particularly disfavored" and will not be "granted unless extreme or very serious harm will result" that are not capable of compensation in damages).

These "disfavored injunctions" are those that would (1) disturb the status quo; (2) are mandatory as opposed to prohibitory; or (3) provide substantially all the relief the movant would obtain after a full trial on the merits. Schrier, 427 F.3d at 1260–1261; Chalk v. United States Dist. Ct. Cent. Dist. of Calif. (9th Cir. 1988) 840 F.2d 701, 704 (primary purpose of a preliminary injunction is to preserve the status quo pending a determination of the action on its merits); GoTo.com, Inc. v. Walt Disney Co. (9th Cir. 2000) 202 F.3d 1199, 1210 ("status quo" means the last uncontested status that preceded the pending controversy); Meghrig v. KFC Western, Inc. (1996) 516 US 479, 485, 116 S.Ct. 1251, 1254 (injunction is "mandatory" if its functions to command performance of an act, contrasted to an injunction to prohibit an act).

Here, Plaintiff seeks a mandatory injunction that disturbs the status quo. Presently, the law firm Wolfe & Wyman is functioning as lead attorney of record in the Underlying Action pursuant to Nautilus's contractual right to control the defense. Plaintiff's Motion seeks a court order that, in effect, would require Nautilus to affirmatively transfer the handling of the defense of the Underlying

Action away from existing counsel to the law firm, Fox Rothschild LLP. Accordingly, the injunctive relief sought by Plaintiff is subject to the heightened scrutiny standard of the 4-part rule in Winter, 555 U.S. at 20.

B. Plaintiff Has Not Shown That It Is Likely to Succeed on the Merits Because Nautilus Did Not Reserve Rights on an Issue that Creates a Disqualifying Conflict of Interest

1. Cal. Civil Code, §2860

Unless a contract of insurance contains special provisions permitting the policyholder to retain its own counsel, a liability insurance carrier possesses the right to control the defense, including the selection of counsel. If the carrier agrees to defend while reserving its rights to deny indemnification, the policyholder *may* be entitled to independent counsel but only for a disqualifying conflict of interest under the statutory standard set forth at Section 2860 of the California Civil Code.

Although independent counsel is often referred to as "Cumis counsel," the California Supreme Court has held that the Legislature's enactment of Section 2860 "clarifies and limits" the original Cumis opinion. Buss v. Superior Court (1997) 16 Cal.4th 35, 59, 65 Cal.Rptr.2d 366, 383, 939 P.2d 766, 783. The statutory standard for evaluating claims for independent counsel provides:

> "[A] conflict of interest does not exist as to allegations or facts in the litigation for which the insurer denies coverage;

> however, when an insurer reserves its rights on a given issue and the outcome of that coverage issue can be controlled by counsel first retained by the insurer for the defense of the claim, a conflict of interest ***may*** exist. No conflict of interest shall be deemed to exist as to allegations of punitive damages or be deemed to exist solely because an insured is sued for an amount in excess of the insurance policy limits." Cal. Civ. Code § 2860, subd. (b) (emphasis added).
>
> * * * * * *

Thus, California courts have expressly rejected a "per se rule requiring the appointment of an independent counsel whenever a carrier issues a so-called 'global reservation of rights' or ... reserves its right to seek reimbursement for defense costs for uncovered claims." Dynamic Concepts, Inc. v. Truck Ins. Exchange (1998) 61 Cal.App.4th 999, 1007, 71 Cal.Rptr.2d 882; Gafcon, Inc. v. Ponsor & Associates, et al. (2002) 98 Cal.App.4th 1388, 1421, 120 Cal.Rptr.2d 392 (observing that California courts have "repeatedly recognize[d] a conflict of interest does not arise every time the insurer proposes to provide a defense under a reservation of rights.").

Notably, the above-quoted statutory language "uses the permissive 'conflict of interest *may* exists, rather than the mandatory 'shall.'" Dynamic Concepts,

supra, 61 Cal.App.4th at 1007, original italics. Thus, under California law, "A mere possibility of an unspecified conflict does not require independent counsel." Id. at 1007. "The conflict must be significant, not merely theoretical, actual, not merely potential." Id. at 1007.

Case law also shows no disqualifying conflict of interest arises where the insurance carrier recognizes its liability for certain damages but reserves rights as to other excluded damages. Cal. Prac. Guide Ins. Lit. Ch. 7B-K, § 7:775 (Rutter 2011); Blanchard v. State Farm Fire & Casualty Co. (1991) 2 Cal.App.4th 345, 350, 2 Cal.Rptr.2d 884; James 3 Corp. v. Truck Ins. Exch. (2001) 91 Cal.App.4th 1093, 1099, 111 Cal.Rptr.2d 181. No disqualifying conflict of interest arises where the insurer-appointed counsel is given carte blanche to defend and litigate all issues, covered and uncovered, and proceeds to diligently litigate all matters on behalf of the policyholder without regard to coverage issues. Native Sun Investment Group v. Ticor Title Insurance Company (1987) 189 Cal.App.3d 1265, 1277-1278, 235 Cal.Rptr. 34.

A party seeking to establish entitlement to independent counsel must produce "evidence to show in what specific way the defense attorney could have controlled the outcome of the damages issue to [the policyholder's] detriment, or had incentive to do so." Blanchard, supra, 2 Cal.App.4th 345, 350; James 3 Corp., supra, 91 Cal.App.4th at 1099.

2. No Conduct-Related Reservations

By waiving rights on coverage issues related to the nature of the policyholder's conduct, Nautilus eliminated any potential for the paradigm Cumis scenario in which the reservation depends upon the nature of the policyholder's conduct. McGee v. Superior Court (1985) 176 Cal.App.3d 221, 226, 221 Cal.Rptr. 421 ("The crucial fact in Cumis, as the court took pains to point out and explain several times, was that the insurer's reservation of rights on the ground of non-coverage was based on the nature of the insured's conduct, which has developed at trial would affect the determination as to coverage."); Native Sun Investment Group, supra, 189 Cal.App.3d at 1277-1278 ("Under these circumstances, where the retained attorney in fact was not subject to the conflicting forces which gave rise to Cumis, an extension of Cumis is not warranted.").

Case law consistently shows that "coverage issues" within Section 2860 generally arise only where the conduct of the insured person is at issue. James 3, supra, 91 Cal.App.4th at 1008. A "coverage issue" under Section 2860 is limited to situations where the insurer-appointed counsel controls "the outcome of a coverage dispute ... involv[ing] whether a certain risk or peril is covered under the policy[;]" and "the coverage dispute must be one that will be litigated in the underlying action." Id.

For example, in one case, the policyholder claimed entitlement to independent counsel because the insurance carrier reserved the right to seek reimbursement of noncovered defense fees. James 3 Corp., 91 Cal.App.4th at 1107-1108. The Court of Appeal declined to find a justiciable "coverage issue" under Section 2860, reasoning that the carrier's reservation "does not involve the possibility that policy coverage will be determined or affected by the nature of [the policyholder's] conduct as developed at trial." Id.

3. Infringement of Trademark

Plaintiff claims that Nautilus's reservation of rights on the exclusion for infringement of trademark constitutes grounds for independent counsel. It notes that while Nautilus has conceded coverage for trade dress infringement, it has reserved rights on trademark claims, thereby creating a disqualifying conflict of interest on the part of the Wolfe & Wyman law firm.

Plaintiff identifies no case law showing a disqualifying conflict of interest under the same or similar circumstances. Nor has Plaintiff drawn any analytical or factual analogies showing a disqualifying conflict under similar circumstances. Instead, Plaintiff simply concludes that "insurance counsel could clearly impact a subsequent coverage determination by building a record that could defeat trade dress liability, while presenting a less rigorous defense for trademark infringement." Plaintiff's Memo. of Points and Authorities, at p. 13, lines 1-3.

As noted above, a "coverage issue" under Section 2860 is limited to situations in where the insurer-appointed counsel controls "the outcome of a coverage dispute ... involv[ing] whether a certain risk or peril is covered under the policy[;]" and "the coverage dispute [is] one that will be litigated in the underlying action." James 3 Corp., 91 Cal.App.4th at 1099. Thus, where the nature of the policyholder's conduct is the critical liability issue, such as in the paradigm Cumis scenario, a finding of liability for intentional conduct results in no coverage, whereas a finding of merely negligent (accidental) conduct results in coverage.

Here, unlike the paradigm Cumis scenario, a finding of trademark liability does not shift coverage away from a covered claim to a non-covered claim. Nautilus has acknowledged that the insurance affords liability coverage for trade dress liability while reserving its rights as to trademark liability. No rationale motive would exist for Nautilus or defense counsel to defend only the trade dress claim and somehow try to expose the policyholder to liability for trademark infringement. Nautilus has not placed any restrictions on defense counsel in this respect, and no evidence has been presented suggesting otherwise. Nautilus has every incentive to vigorously defend the liability and damages issues as to all claims for relief, including trademark claims.

A similar situation arose in Blanchard, supra, 2 Cal.App.4th 345. There,

homeowners sued a general contractor alleging various construction defects and resulting property damage. In agreeing to defend, the insurance carrier acknowledged coverage for property damage resulting from the insured's work, but not for damage to the insured's work product. The carrier declined a demand for independent counsel. In subsequent coverage litigation, the Court of Appeal found that the insurer-appointed counsel "faced no conflict concerning the conduct of [the policyholder]." Id. at 350. The court reasoned as follows:

> "Insurance counsel had no incentive to attach liability to [the policyholder]. [The carrier] recognized its liability for certain damages flowing from [the policyholder's] liability; thus it was to the advantage of both [the policyholder] and [the carrier] to minimize [policyholder's] underlying liability. [The policyholder] produced no evidence to show in what specific way the defense attorney could have controlled the outcome of the damage issue to appellant's detriment, or had incentive to do so. [The policyholder] merely urged that there was an unspecified possibility of a conflict." Id. at 350.

* * * * * *

Id. at 350; see also, James 3 Corp., supra, 91 Cal.App.4th at 1003 ("In this case, the interests of the insureds and [the insurance carrier] do not conflict vis-à-vis

defense of the trademark infringement, unfair competition and related causes of action in ... [the] complaint. It is in the interest of both to be found not liable or, if found liable, to minimize damages.").

Here, as in Blanchard and James 3, a common interest is shared by Nautilus, appointed defense counsel, and the policyholders to vigorously defend all claims for relief, including each item of judicial relief sought. Plaintiff offers no persuasive argument, legal authority, or evidence suggesting Nautilus's appointed defense counsel would somehow be motivated and capable of "creating a record" to establish liability for noncovered claims.

4. Unauthorized Use of Name or Product

Plaintiff claims the exclusion for infringing domain names, etc. constitutes grounds for invoking its right to independent counsel. It cites no case law in support of its argument. Nor does it offer any clear argument, such as analogies to the paradigm Cumis scenario. Rather, it concludes that "insurance counsel can also influence any subsequent coverage decision by building a record in the [Underlying Action] that liability, if any, is predicated on the use of an infringing domain name or manipulation of website (both of which would be *excluded* under the Policy." Plaintiff's Memo. of Points and Authorities, at p. 13, lines 13-16, original italics.

Plaintiff's argument, likes many of the arguments set forth in its Motion, is

predicated upon an unstated assumption that the attorneys of Wolfe & Wyman will breach their professional obligations to their client, Plaintiff. Nautilus contends that under California law, Plaintiff is not entitled to reply upon such a presumption. Both the California Legislature and Court of Appeal have specifically rejected such a presumption:

> "The Legislature declined to adopt the absolutist view that insurer-appointed defense counsel will only offer token resistance to claims that fall outside a policy's coverage terms or limits or will steer the defense in a direction favorable to the insurer." Dynamic Concepts, supra, 61 Cal.App.4th at 1007

* * * * * *

Thus, in Dynamic Concepts, the Court of Appeal declined to permit such a presumption, finding that "as insurer-appointed defense counsel, [they] owed their primary obligations to [the policyholder] ... to provide the same level of competent and ethical representation 'as if [the policyholder] had retained [defense counsel] personally.'" Id. at 1008.

Like the argument regarding the trademark exclusion, Plaintiff's argument regarding the exclusion for domain names appears to rely upon an assumption of unlawful conduct—namely, that the attorneys of Wolfe & Wyman would breach

their professional responsibilities by "building a record" to ultimately establish Plaintiff's liability for noncovered claims, while vigorously defending potentially-covered claims. Plaintiff has offered no persuasive argument or evidence suggesting such a professional breach has already occurred, and as a matter of settled law, it is not entitled to rely upon a presumption that a breach has or will occur at some future time.

5. Offenses Outside Policy Period

Plaintiff mistakenly contends that Nautilus has reserved its rights to deny coverage based on offenses committed before or after the policy period. In fact, the August 10, 2011 letter specifically and expressly amends the Reservations Letter by waiving that coverage defense as an accommodation to Plaintiff: "Nonetheless, in order to address the concerns of your client in this respect, Nautilus has considered its right to waive reservations that create a perceived conflict of interest, and therefore hereby amends the Agreement to Defend ... by offering to waive its reservation of rights with respect [to] offenses falling outside the policy period." Doroshow Decl. at p. 62, second full paragraph.

6. Injunctive Relief

Reserving rights on the ground the Nautilus policy provides no coverage for injunctive relief does not constitute a coverage issue. No case law or other evidence is identified in support of this issue. Nautilus's legal research reveals no

legal authority holding, or even suggesting, that reserving rights not to indemnify an insured for an injunction triggers Section 2860's standard.

7. Attorney Fee Award

Plaintiff's Motion appears to be the first time that it has cited this reservation as grounds for its entitlement to independent counsel. Like its other arguments, Plaintiff's arguments on this reservation is unsupported by any analogous case law. Nor are any analogies drawn to the paradigm Cumis scenario, or other cases that have found a disqualifying conflict of interest.

C. Plaintiff Has Not Shown That It Will Sustain Irreparable Harm Unless Preliminary Injunctive Relief is Granted

Plaintiff claims this Court should "intervene early in the [Underlying Action]—otherwise there will be no possible way to reverse the damage that can be done." Plaintiff's Memo. of Points and Authorities, at p. 3, lines 19-20. It claims that it must either allow a default in the Underlying Action or "run the risk of having insurance counsel predetermine any subsequent coverage decision." Id. at p. 15, lines 13-20. Observing that it cannot afford to fund the defense of the Underlying Action, Plaintiff concludes that "money damages will not protect [it] absent immediate injunctive relief[,]" and that the "damages will be irreversible" if Nautilus is "allowed to control the defense of the [Underlying Action] while this action is pending." Id.

A preliminary injunction may not be granted based on a "possibility" of irreparable harm, even if Plaintiff demonstrates a strong likelihood of prevailing on the merits. This is because injunctive relief is "an extraordinary remedy that may only be awarded upon a clear showing that the plaintiff is entitled to such relief." Winter, supra, 555 US at 21.

Plaintiff must also demonstrate "immediate threatened harm." Caribbean Marine Services Co., Inc. v. Baldrige (9th Cir. 1988) 844 F.2d 668, 674. Establishing a risk of irreparable harm in the indefinite future is not enough. Church v. City of Huntsville (11th Cir. 1994) 30 F.3d 1332, 1337. Further, speculative losses that are unsupported by evidence of actual injury do not support a finding of "irreparable" injury. Goldie's Bookstore, Inc. v. Sup.Ct. (9th Cir. 1984) 739 F.2d 466, 472.

The fact that adequate compensatory damages will ultimately be available in the ordinary course of litigation weighs heavily against a claim of "irreparable" harm. Sampson v. Murray (1974) 415 US 61, 90, 94 S.Ct. 937, 953. "[P]laintiff must demonstrate potential harm which cannot be redressed by a legal or an equitable remedy following a trial. The preliminary injunction must be the *only* way of protecting the plaintiff from harm." Campbell Soup Co. v. ConAgra, Inc. (3rd Cir. 1992) 977 F.2d 86, 91 (original italics); Los Angeles Memorial Coliseum Comm'n v. NFL (9th Cir. 1980) 634 F.2d 1197, 1202 (monetary harm

alone does not constitute irreparable harm).

Here, Plaintiff has not made a clear showing of irreparable, immediately-threatened harm for which it cannot be compensated in money damages. As quoted above, its arguments are mere conclusions that are unsupported by any persuasive evidence or argument. Moreover, Plaintiff neglects to explain clearly why monetary damages are insufficient. For example, Plaintiff's Motion fails to explain why a malpractice claim against Wolfe & Wyman would not compensate it via monetary damages. In fact, Plaintiff's attorney sought and obtained evidence from Wolfe & Wyman that it possesses a $5 million liability policy for professional liability claims. Bolender Decl. at p. 4, ¶6, and Exh. 2 thereto.

D. The Balance of Equities Does Not Clearly Weigh in Plaintiff's Favor

Plaintiff argues that it cannot "afford to fund the defense" of the Underlying Action, whereas Nautilus "is a highly solvent insurance company" who can do so. Plaintiff's Memo. of Points and Authorities, at p. 16, lines 4-12. It further argues that, because Nautilus has reserved the right to seek reimbursement and declaratory relief, it "can point to no injury (actual or potential) should an injunction issue." Id.

As noted earlier, Plaintiff has not explained why it could not be fully compensated by a malpractice claim against Wolfe & Wyman. Nor has Plaintiff

addressed the basic fact that it did not purchase insurance that permits selection of independent counsel. Such insurance is obtainable, albeit more expensively, but Plaintiff or its insurance broker apparently elected to purchase basic commercial liability insurance that permits insurers to control the defense.

Additionally, Plaintiff ignores the fact that it filed this lawsuit prematurely in an apparent attempt to intimidate Nautilus. As reflected in the various letters from its counsel, Nautilus repeatedly offered to consider any argument by Plaintiff's counsel so that it could, first, consider the stated grounds for independent counsel, and second, consider waiving those grounds. Instead of engaging in a meaningful exchange of positions, which would have avoided this litigation, Plaintiff initiated these proceedings and then filed this Motion before Nautilus had the chance to answer the Complaint. Consequently, the equities do not weigh in favor of Plaintiff.

E. <u>The Public Interest Does Not Favor Injunctive Relief</u>

Plaintiff claims the public interest favors its Motion because "insurance companies will be emboldened to flaunt their legal obligations by forcing consumers who have paid them valuable premiums to either default … or cede control to conflicted counsel who has a clear interest in receiving additional work from the insurer depending upon the manner in which it defends the insured's interest." Plaintiff's Memo. of Points and Authorities, at p. 17, lines 11-17.

Plaintiff purchased basic liability coverage, not the more expensive kind that permits the insured to retain its own counsel. It is common knowledge that insurance premiums are calculated based upon a variety of factors, including claims related expenses. Those insurers, like Nautilus, have the right to provide a conflict-free defense, including the right to select defense counsel and control the defense.

Here, Nautilus waived multiple exclusions; invited Plaintiff's counsel to identify any other conflict-creating reservations; and promised to evaluate those grounds and consider waiving those if they met the statutory standard. It does not support the public interest to permit Plaintiff to ignore the good faith attempts by Nautilus to discuss the issues, choosing instead to file litigation and seek injunctive relief.

IV. CONCLUSION

For the foregoing reasons, Nautilus respectfully request that this Court deny the Motion for Preliminary Injunction.

A Professional Law Corporation

Dated: October 17, 2011

By: */s/ Jeffrey S. Bolender*
Jeffrey S. Bolender
Attorneys for Defendant,
NAUTILUS INSURANCE COMPANY

EXHIBIT 4

EXHIBIT 4

EXHIBIT 4

EXHIBIT 4

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES – GENERAL

Case No.	LA CV11-06795 JAK (Ex)	Date	November 30, 2011
Title	Poshe USA, LLC v. Nautilus Insurance Company		

Present: The Honorable	JOHN A. KRONSTADT, UNITED STATES DISTRICT JUDGE
Andrea Keifer	Not Reported
Deputy Clerk	Court Reporter / Recorder
Attorneys Present for Plaintiff:	Attorneys Present for Defendant:
Not Present	Not Present

Proceedings: **(IN CHAMBERS) ORDER DENYING PLAINTIFF'S MOTION FOR PRELIMINARY INJUNCTION (Dkt. 5)**

I. INTRODUCTION

Plaintiff Poshe USA, LLC ("Poshe") seeks a preliminary injunction that would: (i) preclude its general liability insurer, Defendant Nautilus Insurance Company ("Nautilus"), from controlling Poshe's defense of a trademark infringement and unfair competition action brought against Poshe by a competitor; and (ii) require Nautilus to permit the appointment of independent counsel to represent Poshe in that matter, with Nautilus to advance payment for such counsel. Poshe claims that Nautilus has a duty to defend by providing independent counsel pursuant to section 2860 of the California Civil Code. Nautilus disputes this contention. Following oral argument on November 7, 2011, the Court took the matter under submission. Civil Minutes – General, Dkt. 28. For the reasons discussed in this Order, Poshe's motion for a preliminary injunction is DENIED.

II. BACKGROUND

A. Allegations in the Complaint

Poshe's first cause of action seeks a declaration that, with respect to each claim brought against Poshe in the underlying action, Nautilus "had both a duty to promptly and thoroughly investigate the claims against POSHE and an immediate duty to defend them through independent counsel." Compl. ¶ 29, Dkt. 1, Aug. 18, 2011. Poshe's second cause of action alleges that Nautilus "materially breached its contract with POSHE by failing and refusing to investigate, defend or indemnify" the claims in the underlying action, and by refusing "to appoint independent counsel to defend them." Compl. ¶ 33. Poshe claims contract damages in the form of "defense costs" paid to its own counsel. Compl. ¶ 35. Poshe's third cause of action asserts that Nautilus's alleged breach of contract constitutes "tort[i]ous

denials of the existence of, and tort[i]ous refusals to perform, NAUTILUS's known contractual obligations." Compl. ¶ 37. Poshe further alleges that Nautilus failed timely to "communicate with POSHE in response to its tenders of defense" and misrepresented "the meaning and import of the material terms" of the insurance policy. Compl. ¶ 40. Poshe seeks punitive damages, claiming that Nautilus has "undertaken its wrongful course of conduct fraudulently, maliciously, and oppressively…" Compl. ¶ 43.

B. The Reservation of Rights and Negotiations Regarding Independent Counsel

In support of its motion for a preliminary injunction, Poshe submitted the declaration of James E. Doroshow, the independent counsel proposed by Poshe to serve as its counsel in the underlying trademark action; Doroshow is also counsel to Poshe in this action. Declaration of James E. Doroshow in Support of Motion… ("Doroshow Decl."), Dkt. 5-2, Aug. 31, 2011. Doroshow provided as exhibits to his declaration: (1) the August 3, 2011 Reservation of Rights Letter ("Reservations Letter") from Nautilus's counsel to Doroshow in connection with the underlying action, *id.*, Exh. B; and (2) the August 10, 2011 Follow-Up Letter ("August 10th Letter") from Nautilus's counsel, with respect to that matter. *Id.*, Exh. C. The Complaint in the present action contains the following excerpt from the Reservations Letter:

> It is the position of Nautilus that the limited reservation of rights does not constitute grounds for independent counsel under Section 2860 of the California Civil Code. Subdivision (b) provides that "a conflict of interest does not exist as to allegations or facts in the litigation for which the insurer denies coverage[.]" Subdivision (b) further provides that "No conflict of interest shall be … be [sic] deemed to exist solely because an insured is sued for an amount in excess of the insurance policy limits." Similarly, the reservation of the right to seek reimbursement of defense costs allocable to noncovered claims does not does [sic] trigger the insurer's duty to appoint independent counsel. See CALIFORNIA PRACTICE GUIDE: INSURANCE LITIGATION, Chapt. 7B-K, § 7:773 (Rutter 2011); James 3 Corp. v. Truck Ins. Exch. (2001) 91 Cal.App.4th 1093.

Compl. ¶ 20; Doroshow Decl., Exh. B at Page ID # 150. The Reservations Letter also states:

> [I]f the offer of defense is accepted, Nautilus will waive its rights as to various exclusions, including the policy's knowledge- and intent-based exclusions, as well as others. If you believe that other specific reservations trigger you [sic] clients' entitlement to independent counsel, kindly identify the specific reservation along with any legal authorities or other matter in support of your position…. If you identify any such reservation, I will carefully evaluate whether the stated grounds trigger the statutory standard set forth at Section 2860, including an evaluation as to whether Nautilus will
>
> consider waiving the purported reservation.

Id.

The August 10th Letter was sent as "a formal response to the Claim for Independent Counsel pursuant to Section 2860 of the California Civil Code." Doroshow Decl., Exh. C at Page ID # 154. It states that:

> [Nautilus has] considered the demand for independent counsel under the applicable legal standards and ha[s] concluded that Nautilus's agreement to defend does not trigger entitlement to independent counsel. [¶] Nautilus has hired a reputable law firm to provide a complete defense without regard to coverage issues. As noted below, Nautilus is willing to consider waiving additional coverage defenses if you are able to demonstrate that the limited reservations [sic] of rights creates a disqualifying conflict of interest. The grounds you have stated thus far, however, do not demonstrate such a conflict.

Id. The Letter then addresses each of the potential conflicts identified by Poshe, and explains Nautilus's reasons for determining that such conflicts do not rise to the level of qualifying conflicts. *See id.* at 156-165. In response to one of the alleged conflicts identified by Poshe -- potential non-coverage of offenses that occurred outside the policy period -- Nautilus offered "to waive its reservation of rights with respect to offenses falling outside the policy period." *Id.* at 165. Finally, the Letter states that "[i]f your [Doroshow's] firm refuses to transfer the defense and control of the lawsuit to the Wolfe Wyman firm by Friday, August 12, 2011, Nautilus will consider that as a specific rejection of the offer of defense set forth in the Agreement to Defend, as well as a material breach of the Nautilus policy's Cooperation Clause." *Id.* at 167.

Attached as exhibits to the August 10th Letter are: (i) an August 1, 2011 letter from Nautilus's counsel to Doroshow expressing Nautilus's intent to defend pursuant to a reservation of rights and stating that, prior to August 1, 2011, Doroshow asserted that Poshe was entitled to independent counsel, rejected Nautilus's offer of a defense and demanded Nautilus retain Doroshow, *id.* at 169; and (ii) a series of e-mails from Doroshow to Nautilus's counsel demanding independent counsel, *id.* at 189-192. In these emails Doroshow asserts that Poshe is entitled to independent counsel[1] and identifies the conflicts that he asserts as the basis for such entitlement. *See id.*

[1] Some of the statements made in these e-mails include: "[Y]ou leave us no alternative other than to proceed with a lawsuit against your client should we not hear from you by the end of this week," Doroshow Decl., Exh. C at Page ID # 189, Dkt. 5-2; "You know there is a conflict on the trademark issue, as do I. This is a summary judgment matter," *id.* at 190; "The multiple conflicts created by your client's reservation of rights are plainly evident from even the most cursory examination of the Complaint and your correspondence and other communications with me," *id.* at 192.

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES – GENERAL

Case No.	LA CV11-06795 JAK (Ex)	Date	November 30, 2011
Title	Poshe USA, LLC v. Nautilus Insurance Company		

III. ANALYSIS

A. Preliminary Injunction Standard

"A plaintiff seeking a preliminary injunction must establish that he is likely to succeed on the merits, that he is likely to suffer irreparable harm in the absence of preliminary relief, that the balance of equities tips in his favor, and that an injunction is in the public interest." *Winter v. Natural Resources Defense Council, Inc.*, 555 U.S. 7, 20 (2008).

A preliminary injunction can be either prohibitory, which means it "preserves the status quo pending a determination of the action on the merits," or mandatory, which means it "orders a responsible party to take action." *Marlyn Nutraceuticals, Inc. v. Mucos Pharma GmbH & Co.*, 571 F.3d 873, 878-79 (9th Cir. 2009) (internal quotations omitted). "A mandatory injunction goes well beyond simply maintaining the status quo pendente lite and is particularly disfavored. In general, mandatory injunctions are not granted unless extreme or very serious damage will result and are not issued in doubtful cases or where the injury complained of is capable of compensation in damages." *Id.* at 879 (internal quotations and citations omitted).

B. Application of the Standards for Preliminary Injunctive Relief

Poshe is seeking a mandatory injunction, not one that would preserve the status quo. Thus, it seeks an order from this Court that compels Nautilus to relinquish control of the defense of Poshe in the underlying action and retain independent counsel at its expense to represent Poshe there. Counsel appointed by Nautilus is currently taking the lead in defending Poshe in the underlying action; thus, disqualifying lead counsel and ordering Nautilus to provide independent counsel, as Poshe requests, would change, not preserve, the current state of affairs. Because Poshe seeks such affirmative relief, its motion is subject to heightened scrutiny and should only be granted if "extreme or very serious damage will result…."

1. Likelihood of Success on the Merits

Poshe has not demonstrated adequately a likelihood of success on the merits for its declaratory relief, breach of contract, or tortious breach of contract claims. The success of Poshe's claims turns on one major issue: Whether Poshe has sufficiently alleged a disqualifying conflict of interest between Poshe and its insurer-appointed counsel such that Poshe is entitled to independent counsel pursuant to *Cumis*[2] and California Civil Code section 2860.

[2] *San Diego Navy Fed. Credit Union v. Cumis Ins. Society, Inc.*, 162 Cal. App. 3d 358 (1984).

UNITED STATES DISTRICT COURT
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CIVIL MINUTES – GENERAL

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a) Overview of Entitlement to Independent Counsel—Cumis and California Civil Code Section 2860

Cumis holds that, if there is a qualifying conflict of interest between an insurer and its insured, the insured is entitled to retain independent counsel at the insurer's expense. *San Diego Navy Fed. Credit Union v. Cumis Ins. Society, Inc.*, 162 Cal. App. 3d 358 (1984). Thus, the right to independent counsel turns on whether a qualifying conflict exists between insurer and insured. Qualifying conflicts arise when "an insurer reserves its rights on a given issue and the outcome of that coverage issue can be controlled by counsel first retained by the insurer…." Cal. Civ. Code § 1860. For example, in the paradigmatic *Cumis* scenario, the third party complainant asserted conduct-based claims in the underlying action against the insured that would be covered if the insured were found to have acted negligently, but would not be covered if the insured had acted intentionally. *See id.* Because the presence or absence of intent would, therefore, be litigated in the underlying action, the coverage dispute would also necessarily be adjudicated because it turned on this issue. These circumstances created a qualifying conflict of interest. *See id.* This was the result because the insurer-appointed counsel could be tempted to litigate the underlying action in such a manner as to shift the insured's liability toward liability premised on intentional acts, rather than liability premised on negligence, for the benefit of the insurer but at the expense of the insured's best interests. *See id.*[3]

The *Cumis* opinion was codified in 1987 through the enactment of California Civil Code section 2860, which "clarifies and limits" the rights and responsibilities of insurer and insured as set forth in *Cumis*. *Buss v. Superior Court*, 16 Cal. 4th 35, 59 (1997); *San Gabriel Valley Water Co. v. Hartford Accident & Indemnity Co.*, 82 Cal. App. 4th 1230, 1234 (2000). Section 2860 provides, in pertinent part:

> (a) If the provisions of a policy of insurance impose a duty to defend upon an insurer and a conflict of interest arises which creates a duty on the part of the insurer to provide independent counsel to the insured, the insurer shall provide independent counsel to represent the insured.... [¶] (b) For purposes of this section, a conflict of interest does not exist as to allegations or facts in the litigation for which the insurer denies coverage;

[3] Another case that is illustrative of this paradigmatic scenario is *Executive Aviation, Inc. v. National Insurance Underwriters*, 16 Cal. App. 3d 799 (1971). There, a pilot who did not hold a license to fly passengers in common carriage was employed by Executive Aviation to fly potential buyers of an airplane on a demonstration flight. The plane crashed, killing all on board. That crash formed the basis for the underlying action brought by the family of those who died on the crash. Executive Aviation's insurer agreed to defend that action subject to a reservation of rights. A conflict was present, however, because the claims were not covered by the policy if the flight were one for commercial carriage; thus it benefitted the insurer to characterize the flight as a commercial carriage. On the other hand, such a characterization was adverse to the interests of the insured: if the plane were being used in commercial carriage, Executive Aviation would be held to a higher standard of care and thus the plaintiff in the underlying action would have to meet a lesser burden to demonstrate liability. Under these circumstances, the reservation of rights created a conflict of interest for the insurer-appointed counsel. Accordingly, independent counsel was necessary.

> however, when an insurer reserves its rights on a given issue and the outcome of that coverage issue can be controlled by counsel first retained by the insurer for the defense of the claim, a conflict of interest may exist. No conflict of interest shall be deemed to exist as to allegations of punitive damages or be deemed to exist solely because an insured is sued for an amount in excess of the insurance policy limits.

Cal. Civil Code § 2860(a)-(b).

b) Parties' Arguments

Nautilus contends that, in agreeing to defend Poshe in the underlying action, it was entitled to appoint counsel pending a complete analysis of the *Cumis* issue. Nautilus asserts that it sought to eliminate any possibility of an actual or potential conflict, and thus had no obligation to provide *Cumis* counsel until after further discussions in which Poshe identified its concerns and Nautilus attempted to address them. Nautilus contends that it might have been able to do so by, for example, waiving additional policy exclusions. Nautilus also contends that, because the conflicts Poshe identifies are not qualifying conflicts, they are insufficient to entitle Poshe to independent counsel funded by Nautilus.

Poshe responds that Nautilus's reservation of rights on multiple coverage issues clearly creates a conflict of interest between Nautilus and Poshe that obligates Nautilus to provide independent counsel for Poshe in the underlying action. Poshe then outlines five conflicts that allegedly entitle it to independent counsel. Poshe relies on *Golden Eagle Insurance Co. v. Foremost Insurance Co.*, 20 Cal. App. 4th 1372, 1395 (1993). However, *Golden Eagle* does not support Poshe's position. The *Golden Eagle* court recognized that, "[a]s statutory and case law make clear, not every conflict of interest triggers an obligation on the part of the insurer to provide the insured with independent counsel at the insurer's expense." *Id.* at 1394. Further, "the mere fact the insurer disputes coverage does not entitle the insured to *Cumis* counsel; nor does the fact the complaint seeks punitive damages or damages in excess of policy limits." *Id.* Nonetheless, the court went on to hold that the insured persons "were entitled to independent counsel at the insurers' expense to represent them in the settlement negotiations," because the insurer sought to finalize a settlement in excess of policy limits without the consent of the insured. *Id.* at 1396. There is no factually analogous situation here.

In a significantly more analogous case cited by Nautilus, *Blanchard v. State Farm Fire & Casualty Co.*, 2 Cal. App. 4th 345 (1991), the court held that a contractor did not have a right to independent counsel in a lawsuit by a homeowners association alleging various construction defects. Although the contractor's insurer tendered a defense reserving the right to deny coverage for damages excluded by the policy, the court found that appointed counsel had no incentive to attach liability to the contractor. *Id.* at 349-50. Instead, it was to the advantage of both the contractor and insurer to minimize the contractor's liability, especially because the contractor failed to produce any evidence showing how appointed counsel could have controlled the outcome of the coverage issue. *See id.* at 350. Thus,

because the coverage dispute related only to damages, the court held that there was no qualifying conflict. *See id.*

Here, Nautilus has admitted it is liable for certain damages flowing from Poshe's liability, such as those attributable to trade dress infringement, so, like in *Blanchard*, it is in the interest of both parties to limit Poshe's overall liability. Further, Nautilus offered to waive additional reservations in both its August 3, 2011 and August 10, 2011 letters, and followed through on that promise in the August 10th Letter, in which it stated that it would waive its reservation of rights with respect to offenses falling outside the policy period to address Poshe's concerns. Doroshow Decl., Exh. C at Page ID # 165. Thus, despite the perceived urgency of obtaining its desired counsel for the underlying action, Poshe has failed to make a sufficient showing of a likelihood of success on the merits.

c) Poshe Has Not Identified a Qualifying Conflict

Not every conflict of interest entitles an insured to insurer-paid independent counsel. *See Golden Eagle*, 20 Cal. App. 4th at 1394. For independent counsel to be required, the conflict of interest must be "significant, not merely theoretical, actual, not merely potential." *Dynamic Concepts, Inc. v. Truck Ins. Exchange*, 61 Cal. App. 4th 999, 1007 (1998). Nor does "every reservation of rights entitle[] an insured to select *Cumis* counsel. There is no such entitlement, for example, where the coverage issue is independent of, or extrinsic to, the issues in the underlying action or where the damages are only partially covered by the policy." *Id.* at 1006 (internal citations omitted). However, independent counsel is required when there is a reservation of rights and "the outcome of that coverage issue can be controlled by counsel first retained by the insurer for the defense of the claim." Cal. Civil Code § 2860(b). Thus, the key issue is whether the manner in which the underlying action is defended can predetermine the outcome of any subsequent coverage evaluation. *See Gafcon, Inc. v. Ponsor & Associates*, 98 Cal. App. 4th 1388, 1423 (2002).

Here, Poshe generally asserts that because Nautilus has reserved its rights with respect to coverage, there is a qualifying conflict. This argument is unpersuasive; it is premised on an incorrect statement of the relevant law. The issue is whether the outcome of the coverage dispute can be controlled by the defense counsel retained by the insurer in such a manner that said counsel is placed in an improper conflict of interest in which ethical obligations will be compromised. Poshe has failed to identify any such conflict.

(1) The Alleged Trademark/Trade Dress Conflict

The primary conflict Poshe asserts as a qualifying conflict is the following: Nautilus has stated it is reserving its rights as to its responsibility for damages arising from Poshe's alleged trademark infringement, but has acknowledged that damages flowing from any trade dress claim are covered by

the policy. Doroshow Decl., Exh. B at Page ID # 147, # 149. Poshe contends that this creates a qualifying conflict because insurance counsel can impact a subsequent coverage determination by building a record that could defeat trade dress liability while presenting a less rigorous defense for trademark infringement.

This fails to state a qualifying conflict. There is no contention that appointed counsel will have conflicting duties and a motivation to shift coverage away from trade dress liability and toward trademark liability. Instead Poshe contends that such counsel will violate duties of professional responsibility by purposefully failing to develop and present a thorough defense of the non-covered trademark claims. Such a presumption cannot support a demand for *Cumis* counsel based on a qualifying conflict. *Dynamic Concepts*, 61 Cal. App. 4th at 1007 n.5 ("The Legislature declined to adopt the absolutist view that insurer-appointed defense counsel will only offer token resistance to claims that fall outside a policy's coverage terms or limits or will steer the defense in a direction favorable to the insurer."); *id.* at 1008 ("There is no basis on the record to presume [appointed counsel] would have violated their stringent ethical responsibilities to completely defend [insured] for *all* allegations of the entire complaint, covered or uncovered.") (italics in original). Moreover, Poshe can be liable for both trade dress and trademark infringement; they are separate claims and there is no one element, like state of mind or intent, that will be litigated at trial and will simultaneously control the coverage issue.

(2) Poshe's Other Identified Conflicts

The second, claimed conflict Poshe identifies is the following: Poshe may be liable in the underlying action for the registration and use of an allegedly infringing domain name and alleged manipulation of a website. Doroshow Decl., Exh. A. Nautilus denies a duty to indemnify Poshe for a "personal or advertising injury" arising out of the unauthorized use of another name in a domain name or similar tactic to mislead another's potential customers. *Id.*, Exh. B. Poshe alleges that appointed counsel can influence any subsequent coverage decision by building a record in the underlying action that liability, if any, is predicated on the use of an infringing domain name or manipulation of website, both of which would be excluded under the Policy. Similarly, the fourth claimed conflict identified by Poshe allegedly arises from Nautilus's position that it is not responsible for indemnifying Poshe for any award arising from a successful unfair competition claim pursuant to California Business and Professions Code sections 17200 and 17500. Doroshow Decl., Exh. B at Page ID # 148. Neither of these claimed conflicts is sufficient to create a right to independent counsel. Each is analogous to the alleged trademark conflict above. Both reduce to assertions that Nautilus will not cover certain claims or will not pay certain damages, such as damages arising from a successful unfair competition claim, and consequently, that Nautilus's designated counsel will violate its ethical obligation to advance a vigorous defense to these claims.

The third claimed conflict Poshe identifies is based on the assertion that certain alleged events

that may give rise to liability in the underlying action occurred outside the Policy period. However, Nautilus agreed to waive its reservation of rights on this issue in the August 10th Letter. Doroshow Decl., Exh. C at Page ID # 165. Thus, there is no conflict between insurer and insured on this issue.

The fifth conflict that allegedly entitles Poshe to independent counsel is that Nautilus has stated it will not indemnify Poshe for attorney's fees awarded pursuant to claims that are not covered. *Id.*, Exh. B at Page ID # 149. However, awards of attorney's fees arising from uncovered claims are analogous to damages arising from uncovered claims. Poshe has made no showing as to how appointed counsel could predetermine coverage on this issue, and cites no cases in which a similar conflict was found to qualify. Thus, this alleged conflict is also insufficient to entitle Poshe to independent counsel.

Accordingly, because it has failed to identify a qualifying conflict, and because its claims are premised on Nautilus's alleged breach of contract for failure to provide independent counsel, Poshe cannot show a likelihood of success on the merits for its breach of contract claims. It similarly cannot show a likelihood of success on its declaratory relief claim, which seeks a declaration that Nautilus is required to provide independent counsel.

d) Nautilus Had No Duty to Provide Independent Counsel Pending a Careful Analysis of the Cumis Issue

Even if Poshe could identify a qualifying conflict, it has failed to demonstrate that the *Cumis* analysis was complete at the time it filed this action. Thus, Poshe's demand that Nautilus supply independent counsel was premature.

"[I]nsurers are entitled to a reasonable period of time to analyze a situation requiring a coverage decision." *Dynamic Concepts*, 61 Cal. App. 4th at 1010. In *Dynamic Concepts*, the court held that, given the "complexities of any *Cumis* analysis, [the insurer] did not breach any legal obligation to defend [the insured] when it offered to fully defend at its own expense through appointed counsel pending further coverage analysis of the *Cumis* issue." *Id.*

"The potential for conflict requires a careful analysis of the parties' respective interests to determine whether they can be reconciled (such as by a defense based on total nonliability) or whether an actual conflict of interest precludes insurer-appointed defense counsel from presenting a quality defense for the insured." *Id.* at 1007-08. "No reason exists to allow insureds who face the prospect of no defense or indemnity for uncovered claims to 'set up' insurers by making *Cumis* demands with unreasonably short deadlines, especially where the issues listed in the underlying litigation do not coincide with the issues raised in the reservation of rights and where the insurer agrees to provide a full and complete defense without regard to coverage." *Id.* at 1006.

Under these standards, Nautilus was within its rights to refuse to appoint independent counsel pending a complete analysis of whether such counsel was necessary. When Poshe filed this action on August 18, 2011, two weeks had elapsed since Nautilus sent the Reservations Letter. Moreover, the parties had continued to negotiate over whether disqualifying conflicts existed up until at least August 10, 2011, when Nautilus's counsel sent a follow-up letter offering to waive an additional reserved right. Accordingly, Poshe cannot demonstrate that Nautilus breached its legal obligations by offering to defend without regard to coverage issues through appointed counsel pending further discussions regarding whether independent counsel would be necessary.

2. Irreparable Harm

a) Parties' Arguments

Poshe claims that, unless this Court intervenes early in the underlying action, the resulting damage will be irreversible. Poshe contends that it must either allow a default judgment to be entered in the underlying action or run the risk of having appointed counsel predetermine any subsequent coverage decision. However, as discussed above, Poshe has not established how appointed counsel could predetermine subsequent coverage issues based on counsel's approach to defending the action consistent with its ethical obligations.

Poshe also asserts that it cannot afford to fund its defense of the underlying action through independent counsel, and concludes that money damages will not protect it absent immediate injunctive relief. Nautilus responds that Poshe must demonstrate immediate threatened harm, not a risk of irreparable harm in the indefinite future to warrant preliminary injunctive relief. Further, Nautilus contends that, if appointed counsel's representation is unethical and causes Poshe harm, Poshe will have a remedy at law for money damages through, *inter alia,* a malpractice suit against its insurer-appointed counsel.

b) Poshe Has Failed to Identify Irreparable Harm

"Speculative injury does not constitute irreparable injury sufficient to warrant granting a preliminary injunction." *Carribbean Marine Svcs. Co., Inc. v. Baldridge*, 844 F.2d 668, 674 (9th Cir. 1988). Further, "[i]n order to demonstrate irreparable harm the plaintiff must demonstrate potential harm which cannot be redressed by a legal or an equitable remedy following a trial. The preliminary injunction must be the *only* way of protecting the plaintiff from harm." *Campbell Soup Co. v. ConAgra, Inc.*, 977 F.2d 86, 91 (3d Cir. 1992) (italics in original); *Los Angeles Memorial Coliseum Comm'n v. Nat'l Football League*, 634 F.2d 1197, 1202 (9th Cir. 1980) (holding that monetary harm alone does not constitute irreparable harm).

Here, the potential harm Poshe describes is premised on the assumption that appointed

counsel will not adequately protect its interests because such counsel may dispose of any covered claim while leaving Poshe exposed to liability for uncovered claims. This argument fails for several reasons: (i) it relies on the improper assumption that counsel will breach applicable professional responsibilities; (ii) the claimed harm is not immediate -- the parties in the underlying action are currently in mediation and thus far, Poshe cannot point to any injury resulting from its defense being coordinated by appointed counsel; and (iii) it assumes that money damages will not be adequate in the event there is a breach of ethical obligations or another standard of care by appointed counsel.

3. The Balance of Equities

Poshe argues that it cannot afford to fund the defense, whereas Nautilus is a highly solvent insurance company. Poshe also asserts that appointed counsel lacks experience in defending the types of claims brought against it in the underlying action, and that Nautilus will suffer no injury should an injunction issue.[4] Nautilus contends that Poshe has not explained why it could not be fully compensated by a malpractice claim against appointed counsel, should such malpractice occur and cause Poshe harm. Nautilus also points out that Poshe did not purchase an insurance policy that permits selection of independent counsel, despite the availability of such insurance, albeit at a higher rate. Moreover, Nautilus contends that Poshe filed this suit prematurely in an apparent attempt to intimidate Nautilus.

The application of this factor also supports the denial of the present motion. As explained above, Nautilus had no legal obligation to provide independent counsel while analyzing the merits of Poshe's demand for such counsel. Indeed, given the "complexities of any *Cumis* analysis, [the insurer] did not breach any legal obligation to defend [the insured] when it offered to fully defend at its own expense through appointed counsel pending further coverage analysis of the *Cumis* issue." *Dynamic Concepts*, 61 Cal. App. 4th at 1010. Here, Poshe filed the present action only eight days after the August 10, 2011 letter from Nautilus's counsel, in which Nautilus sought to continue negotiations regarding providing *Cumis* counsel and offered to waive an additional reservation. Thus, because Poshe refused to negotiate or accept appointed counsel pending a complete analysis of the *Cumis* issue, the balance of equities calls for a denial of preliminary injunctive relief.

[4] In support of these arguments, Poshe cites *Ayres v. City of Chicago*, 125 F.3d 1010 (7th Cir. 1997), for the proposition that even in a case where the plaintiff does not have a high probability of success, the plaintiff is still entitled to preliminary relief if he faces great irreparable harm and the defendant very little. However, *Ayres* is factually distinct. The *Ayres* court granted a preliminary injunction to maintain the status quo by permitting five persons to sell the peddler's t-shirts pending the resolution of her case, which alleged that the Peddlers' Ordinance violated her First Amendment right to free speech. The court found that the harm to the City in permitting this activity was minimal, while the harm to the peddler in losing the opportunity to advertise her message was substantial. The court stated that the granting of a preliminary injunction was not a decision on the merits of plaintiff's suit, but merely a decision that the suit had enough merit to justify temporary relief by maintaining the status quo. Here, Poshe does not seek such a status quo order, but a mandatory injunction.

4. The Public Interest

Poshe contends that, where an injunction is narrow and affects only the parties, with no impact on nonparties, "the public interest will be at most a neutral factor in the analysis rather than one that favors granting or denying the preliminary injunction." *Stormans, Inc. v. Selecky*, 586 F.3d 1109, 1139 (9th Cir. 2009) (internal quotations and brackets omitted). Poshe also notes that the public interest favors issuing an injunction because otherwise insurers will be emboldened to ignore their legal obligations.

The application of this factor also supports a denial of the instant motion. "The tripartite relationship between insurer, insured and insurance defense counsel is complicated enough without adding an additional element of a short-fuse deadline for decisions with respect to *Cumis* counsel." *Dynamic Concepts*, 61 Cal. App. 4th at 1011. "Wherever possible, the tripartite relationship requires all participants to work in harmony as a loose partnership, coalition or alliance directed toward a common goal, sharing a common purpose to avoid or at least minimize liability." *Id.* (internal quotations and citations omitted). Here, the parties could have worked together toward the common purpose of avoiding liability, as Nautilus suggested on multiple occasions, in furtherance of serving the public interest of encouraging harmonious "tripartite relationships" and avoiding unnecessary litigation. Instead, Poshe repeatedly demanded independent counsel, refused to negotiate and filed the present action before *Cumis* discussions were complete.

IV. CONCLUSION

For the foregoing reasons, Poshe has failed to establish a basis for the issuance of the requested preliminary injunction. Poshe has failed to demonstrate a likelihood of success on the merits or irreparable harm. Moreover, Poshe seeks a "disfavored" mandatory injunction. Accordingly, Plaintiff's motion for preliminary injunction is DENIED.

IT IS SO ORDERED.

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