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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

SCOTTSDALE INSURANCE)	Case No. 15-436 DDP (FFM)
COMPANY,)	
)	ORDER RE: PLAINTIFF’S MOTION
Plaintiff,)	FOR SUMMARY JUDGMENT
)	
v.)	[Dkt. 78]
)	
NATIONWIDE MEDICAL, INC.,)	
HOWARD SIEGEL, DAVID SIEGEL,)	
AND DOES 1 through 10, inclusive,)	
)	
Defendants.)	
)	

Presently before the court is Plaintiff’s Motion for Summary Judgment. Having considered the parties’ submissions and heard oral argument, the court adopts the following Order.

I. BACKGROUND

This case arises from an insurance indemnification dispute between Plaintiff and Counter-Defendant Scottsdale Insurance Company (“Scottsdale”) and Defendants and

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1 Counter-Claimants Nationwide Medical, Inc., Howard Siegel, and David Siegel
2 (collectively, “Defendants”). Howard Siegel and David Siegel (“the Siegels”) are directors
3 and officers of Nationwide Medical, Inc., (“Nationwide”). (Decl. of Howard Siegel ¶ 4;
4 Messner Decl., Ex. 2.) David Siegel is the CEO of Nationwide and his father, Howard
5 Siegel, is the President. (*Id.*)

6 **a. The Policy**

7 Defendants were insured under a Business and Management Indemnity Policy
8 (“the Policy”) provided by Scottsdale. (Messner Decl., Ex. A). Under the terms of the
9 Policy, the Scottsdale agreed to indemnify certain losses arising from claims against
10 Defendants.¹ (App’x of Exhibits, Ex. Z, at 4.)

11 As relevant here, the Policy states that Scottsdale “shall pay the Loss” of the
12 Directors and Officers—or Nationwide—for which they have “become obligated to pay
13 by reason of a Claim . . . for any Wrongful Act taking place prior to the end of the Policy
14 Period.”² (Messner Decl., Ex. A, Part A.) A “Director and Officer” refers to anyone who
15 “was, now is, or shall become” an executive, director, officer, or employee. (*Id.*, Part B.4.)

16 With respect to Directors and Officers, the Policy contains a notable provision
17 called the “Insured v. Insured” Exclusion (the “Exclusion”). (*Id.*, Part C.1.e.) This
18 Exclusion states that Scottsdale “shall not be liable for Loss under this Coverage Section
19 on account of any Claim” that is “brought or maintained by . . . any Insured in any
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23 ¹ Loss includes “damages, judgments, settlements, pre-judgment or post-judgment
24 interest awarded by a court,” and (certain) Costs incurred by Directors and Officers or
25 Nationwide. Loss does not include, *inter alia*, “any amount for which the insured is not
26 financially liable or legally obligated to pay.” (Messner Decl., Part B.7., B.7.e.)

27 ² A Wrongful Act means “any actual or alleged error, omission, misleading statement,
28 misstatement, neglect, breach of duty, or act allegedly committed or attempted by”
Nationwide (subject to certain exclusions) or by a Director or Officer of Nationwide
“while acting in their capacity as such” or “solely by reason of his or her serving in such
capacity.” (*Id.*, Part B.9.a.-c.)

1 capacity.”³ (*Id.*) The Policy defines a Claim to include, *inter alia*, “a written demand
2 against any Insured for monetary damages or non-monetary or injunctive relief” or “a
3 civil proceeding against any Insured.” (*Id.*, Part B.1.a., B.1.c.) Therefore, claims by former
4 employees against Nationwide or its Directors and Officers are prohibited by the
5 Exclusion.

6 One exception to the “Insured v. Insured” Exclusion arises when a Claim is
7 brought by a “former director or officer of the Company solely in their capacity as a
8 securities holder of the Company and where such Claim is solely based upon and arising
9 out of Wrongful Acts committed subsequent to the date such director or officer ceased to
10 be a director or officer of the Company” (*Id.*, Part C.1.e.iv.) “All Claims arising out of
11 the same Wrongful Act and all Interrelated Wrongful Acts shall be deemed to constitute
12 a single Claim” (*Id.*, Part D.3.)

13 **b. The Underlying Action**

14 John Calligeros (“Calligeros”) is a former officer and director of Nationwide.
15 (Messner Decl., Ex. 1, Dep. Howard Siegel 21:12-22; 110-23-112:10.) Defendants in the
16 present lawsuit are also the defendants in a state lawsuit, *Calligeros v. Nationwide Medical,*
17 *Inc., et al.*, Los Angeles Superior Court Case No. BC512982 (the “Underlying Action”).
18 (*See App’x*, Ex. F.)

19 The Underlying Action alleges that in 2007, the Siegels presented Calligeros with a
20 Restrictive Stock Agreement (“RSA”), which Calligeros signed and backdated to 2005.
21 (*Id.* at 6.) The RSA had a “Continuous Status” provision, which provided that if
22 Calligeros’s employment was terminated, then his restricted stock shares would revert to
23 Nationwide. (*Id.*) Calligeros claims that Howard Sigel and Nationwide fraudulently
24 induced him to sign the RSA by verbally assuring him that the Continuous Status
25 provision was only for tax purposes; that “under no circumstances would Calligeros be
26 required to return or forfeit any of his restricted shares”; and that he would continue to

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28 ³ Per the Policy, “‘Insured’ means the Company and the Directors and Officers.” (*Id.*, Part B.5.)

1 receive dividends, paid out as compensation, based on his 22% interest. (*Id.* at 7.) Prior to
2 leaving the company, Calligeros again “requested and received affirmation” that “his
3 compensation would continue to be based upon his 22% shareholder interest.” (*Id.* at 8.)
4 In reliance on these representations, Calligeros claims he left his position as Vice
5 President of Sales and Marketing at Nationwide around 2008. (*Id.*)

6 Several years later, around 2011, the Siegels attempted to sell Nationwide to a
7 third party, Watermark. (*Id.* at 10.) Watermark paid Nationwide \$2,500,000 for options to
8 purchase all of the shares in Nationwide, including those of Calligeros. Calligeros asserts
9 that Defendants “wrongfully received and retained Calligeros’s share of the option
10 price.” (*Id.*) Calligeros also asserts that the Siegels took improper distributions or
11 “disguised dividends,” including in the form of exorbitant salaries and expense
12 allowances, which reduced Calligeros’s distributions as a minority shareholder. (App’x
13 of Ex., Dkt. 78-5, Ex. F. at 12). Calligeros alleges that Defendants’ actions were designed
14 to “pressure him into selling his 21.9% shareholder interest in the Company at an
15 unreasonably low and below market price.”⁴ (*Id.*, Ex. D, at 12.) In addition, Defendants
16 sharply reduced Calligeros’s distributions and labelled the payments as “advances”
17 toward a “non-existent agreement to purchase” his shares. (*Id.*, Ex. F, at 10.) Eventually,
18 in 2012, all payments from Defendants ceased. (*Id.* at 10.)

19 Based on these allegations, Calligeros brought claims against Defendants in the
20 Underlying Action for, *inter alia*, breach of contract; breach of fiduciary duty; breach of
21 the implied covenant of good faith and fair dealing; fraud and deceit; promissory fraud;
22 promissory estoppel; and conversion. (*Id.* at 1.)

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25 ⁴ The documents in the Underlying Action alternately refer to Calligeros’s share in
26 Nationwide during various points in time as 21.9%, 22%, or 24%. (*See* App’x, Ex. I
27 (“Plaintiff’s percentage ownership of [Nationwide] increased from 10% to 22% in 2005
28 when he was granted 5,544 of the shares. . . . Plaintiff’s ownership percentage increased
to 24% in April 2013. . . .”) As the precise figure is not required for the purposes of this
motion, and for ease of reference, the court will assume that Calligeros’s share of
Nationwide was approximately 22%.

1 A jury found in favor of Calligeros on the core claims in the Underlying Action.
2 (App'x of Ex., Ex. H.) Specifically, the jury returned a special verdict that, at all relevant
3 times, Calligeros owned the "additional 5,544 shares" awarded under the RSA. (*Id.* at 5,
4 21). The jury rendered a verdict against Howard Siegel for (1) Breach of Fiduciary Duty,
5 awarding Calligeros \$2,538,340, and (2) Conversion, awarding him \$232,821. (*Id.* at 1, 16).
6 The jury also returned a verdict against both Howard Siegel and Nationwide for (1)
7 Breach of Contract; (2) Breach of the Implied Covenant of Good Faith and Fair Dealing;
8 and (3) Fraud (Concealment)—awarding Calligeros \$2,538,340 on these claims.⁵ (*Id.* at
9 19.) The jury did not find Defendant David Siegel liable under any cause of action.

10 The jury awarded \$2,771,161 in total damages. (*Id.*, Ex. I.) The court granted
11 Calligeros's motion for pre-judgment interest. (*Id.*, Ex. K, at 5.) In addition, the court
12 granted judgment notwithstanding the verdict on the Fraud (Concealment) cause of
13 action. (*Id.*, Ex. J at 1.) Defendants appealed, and Calligeros cross-appealed the judgment.
14 (*Id.*, Ex. L.)

15 c. The Coverage Dispute

16 Defendants notified Scottsdale of the Underlying Action and requested that
17 Scottsdale defend and indemnify it for losses. (*Id.*, Exs. N, P.) However, the parties
18 disagreed as to whether the Underlying Action was covered under the Policy. Scottsdale
19 denied coverage and cited, among other reasons, the Insured v. Insured Exclusion. (*Id.*,
20 Ex. O.) Moreover, the parties disagreed as to whether coverage was available under
21 "Exception iv" to the Insured v. Insured Exclusion. (*Id.*, Ex. S, at 6.) After receiving the
22 complaint in the Underlying Action, Scottsdale agreed to defend Defendants subject to a
23 reservation of rights. (*Id.* at 10.)

24 During the course of the litigation in the Underlying Action, Defendants requested
25 that Scottsdale appoint independent counsel to represent them, citing a conflict of
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27 ⁵ The \$2,538,340 corresponds to the amount that Calligeros's expert witness represented
28 to the jury as the amount of "disguised dividends" that Nationwide failed to pay
Calligeros between 2005 and 2013. (*Id.*, Ex. I.)

1 interest arising from the coverage dispute. (Shaneyfelt Decl., 2, Ex. 1.) Scottsdale
2 declined, reasoning that there was “nothing that the appointed counsel could do to take
3 this matter from being covered to uncovered.” (Kolari Dep. 64:4-19.) In addition,
4 Calligeros made two settlement offers to Defendants in the Underlying Action. In each
5 case, Defendants requested that Scottsdale pay the remaining policy limits to fund the
6 settlement. Scottsdale refused, reiterating its position that no coverage existed and
7 claiming the settlement terms were also unreasonable. (App’x, Exs. W, U.)

8 During the pendency of the litigation in the Underlying Action, Scottsdale brought
9 the present action against Defendants. The First Amended Complaint seeks a declaration
10 that Scottsdale does not owe Defendants a duty to defend or a duty to indemnify for
11 losses arising from the Underlying Action. (Dkt. 70.) Defendants filed counterclaims
12 against Scottsdale for breach of contract and breach of the implied duty of good faith and
13 fair dealing. (Dkt. 29.)

14 Scottsdale now moves for summary judgment on its declaratory relief cause of
15 action, and for summary judgment on Defendants’ counterclaims.

16 **II. LEGAL STANDARD**

17 Summary judgment is appropriate where the pleadings, depositions, answers to
18 interrogatories, and admissions on file, together with the affidavits, if any, show “that
19 there is no genuine dispute as to any material fact and the movant is entitled to judgment
20 as a matter of law.” Fed. R. Civ. P. 56(a). A party seeking summary judgment bears the
21 initial burden of informing the court of the basis for its motion and of identifying those
22 portions of the pleadings and discovery responses that demonstrate the absence of a
23 genuine issue of material fact. *See Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986). All
24 reasonable inferences from the evidence must be drawn in favor of the nonmoving party.
25 *See Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255 (1986). If the moving party does not
26 bear the burden of proof at trial, it is entitled to summary judgment if it can demonstrate
27 that “there is an absence of evidence to support the nonmoving party’s case.” *Celotex*, 477
28 U.S. at 325.

1 Once the moving party meets its burden, the burden shifts to the nonmoving party
2 opposing the motion, who must “set forth specific facts showing that there is a genuine
3 issue for trial.” *Anderson*, 477 U.S. at 256. Summary judgment is warranted if a party
4 “fails to make a showing sufficient to establish the existence of an element essential to
5 that party’s case, and on which that party will bear the burden of proof at trial.” *Celotex*,
6 477 U.S. at 322. A genuine issue exists if “the evidence is such that a reasonable jury
7 could return a verdict for the nonmoving party,” and material facts are those “that might
8 affect the outcome of the suit under the governing law.” *Anderson*, 477 U.S. at 248. There
9 is no genuine issue of fact “[w]here the record taken as a whole could not lead a rational
10 trier of fact to find for the nonmoving party.” *Matsushita Elec. Indus. Co. v. Zenith Radio*
11 *Corp.*, 475 U.S. 574, 587 (1986).

12 It is not the court’s task “to scour the record in search of a genuine issue of triable
13 fact.” *Keenan v. Allan*, 91 F.3d 1275, 1279 (9th Cir.1996). Counsel have an obligation to lay
14 out their support clearly. *Carmen v. San Francisco Sch. Dist.*, 237 F.3d 1026, 1031 (9th Cir.
15 2001). The court “need not examine the entire file for evidence establishing a genuine
16 issue of fact, where the evidence is not set forth in the opposition papers with adequate
17 references so that it could conveniently be found.” *Id.*

18 **III. DISCUSSION**

19 **A. Duty To Indemnify**

20 Scottsdale argues that it had no duty to indemnify Defendants under the Policy. It
21 invokes the Policy’s “Insured v. Insured” Exclusion as a bar to coverage, where claims
22 brought by one insured party against another insured party are not covered. (Messner
23 Decl., Ex. A, Part C.1.e.) There is no dispute that the parties in the Underlying Action are
24 “Insureds” under the Policy. The parties disagree, however, as to whether “Exception iv”
25 to the Exclusion nonetheless permits Defendants to recover. This Exception operates
26 when a Claim is brought by:

27 any former director or officer of the Company *solely* in their capacity as a
28 securities holder of the Company and where such Claim is *solely* based
upon and arising out of Wrongful Acts committed subsequent to the date

1 such director or officer ceased to be a director or officer of the Company . . .
2 . (Messner Decl., Ex. A, Part C.1.e.iv) (emphasis added).

3 Scottsdale maintains that the Underlying Action is not subject to the Exception
4 because it is not “solely based upon and arising out of” alleged Wrongful Acts
5 committed after Calligeros left Nationwide.⁶ (Pl.’s MSJ at 13.)

6 When interpreting insurance contracts, a court applies the ordinary rules of
7 contract interpretation. *La Jolla Beach & Tennis Club, Inc. v. Industrial Indemnity Co.*,
8 9 Cal.4th 27, 37 (1995). Contracts are construed to effectuate the mutual intent of
9 the parties at the time of drafting. Cal. Civ. Code § 1636. “The language of a
10 contract is to govern its interpretation, if the language is clear and explicit, and
11 does not involve an absurdity.” *Id.* § 1638. A contract will be interpreted as a
12 whole and “so as to give effect to every part, if reasonably practicable, each clause
13 helping to interpret the other.” *Id.* § 1641. Typically, the words in a contract “are to
14 be understood in their ordinary and popular sense” unless they are used or
15 defined in a technical or specialized manner. *Id.* § 1644.

16 Applying these principles, the court concludes that Exception iv to the
17 “Insured v. Insured Exclusion” does not allow for coverage in this case. The “clear
18 and explicit” language of the Exception provides that Scottsdale does not have a
19 duty to indemnify Defendants for the Underlying Action unless it is brought by
20 Calligeros “solely in [his] capacity as a securities holder of the Company and
21 where such Claim is solely based upon and arising out of Wrongful Acts
22 committed subsequent to the date that [Calligeros]” left Nationwide. *Id.* § 1638.

23 Upon reviewing the complaint (and amendments thereto) in the
24 Underlying Action, the court finds that the Underlying Action does not arise out

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26 ⁶ Wrongful Acts means “any actual or alleged error, omission, misleading statement,
27 misstatement, neglect, breach of duty, or act allegedly committed or attempted by”
28 Nationwide (subject to certain exclusions) or by a Director or Officer of Nationwide
“while acting in their capacity as such” or “solely by reason of his or her serving in such
capacity.” (Messner Decl., Ex. A, Parts B.9.a.-c.)

1 of “actual or alleged” events occurring solely after Calligeros left Nationwide.
2 (Messner Decl., Ex. A, Parts B.9.a.-c.) Instead, the court concludes that Wrongful
3 Acts occurring before Calligeros’s departure form the basis of the Underlying
4 Action.

5 Assuming that Calligeros’s departure date was, as Defendants maintain, on
6 or around March 2008, then the court concludes that the Wrongful Acts occurred
7 at some point before this date. Specifically, the Wrongful Acts are “based upon
8 and arising out of” alleged statements, representations, or promises made to
9 Calligeros, all of which occurred before Calligeros left Nationwide in 2008. (App’x,
10 Ex. F, at 5.) The breach of fiduciary duty cause of action, for example, states that
11 Defendants “fraudulently induc[ed] Calligeros to sign the RSA” and “fraudulently
12 induc[ed] Calligeros to withdraw as an active employee by affirming that his
13 economic position was secure, that under no circumstance would he be required
14 to return or forfeit any part of his shareholder interest, and that his compensation
15 would continue to be based upon his then-22% shareholder interest.”⁷ (*Id.* at 14.)
16 Calligeros’s breach of contract claims rely upon the same representations. In
17 particular, Calligeros sued Defendants for breach of the “2007 Agreement,” which
18 they defined as the RSA and oral promises to Calligeros that the RSA was for tax
19 purposes only and “that under no circumstances would Calligeros be required to
20 return or forfeit any of his shares . . . and that his compensation would continue to
21 be based upon his then 22% shareholder interest.” (App’x, Ex. F, ¶ 17.)

22 At the same time, the court acknowledges that some of Calligeros’s shares
23 pre-dated the RSA Agreement. The Underlying Complaint alleges that Calligeros
24 owned 4,620 shares, an approximately 10% interest, in the company since its
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26 ⁷ Additionally, the court notes that a key predicate for Calligeros’s claims is that the 5,544
27 shares, received via the RSA, were not forfeited upon his departure and that overdue
28 distributions and option payments were owed to him arising from his possession of
those shares.

1 inception, and that an additional 12% (corresponding to the 5,544 shares) was
2 subsequently awarded to Calligeros in 2005. (App'x, Ex. F, at 2.) Had Calligeros
3 brought a separate action for breach of fiduciary duty based upon Defendants'
4 failure to pay appropriate dividends on the 10% interest after he left Nationwide,
5 then the Wrongful Acts at issue might be said to have occurred solely after his
6 departure. Yet the court concludes that Defendants' failure to pay appropriate
7 dividends cannot be so parsed into Defendants' treatment of the 5,544 shares and
8 their treatment of the remaining shares. First, Defendants repeatedly engaged in
9 oral representations to Calligeros prior to his departure that he would be paid
10 compensation, in lieu of dividends, commensurate with his overall 22% interest.
11 (App'x, Ex. F, ¶¶ 17, 25 (representing in 2007, and reaffirming in 2008, that "his
12 compensation would continue to be based upon his 22% shareholder interest").)
13 This representation did not distinguish between the 5,544 shares and the
14 remaining shares. In addition, to avoid claim preclusion, Calligeros was required
15 to bring claims arising from Defendants' failure to pay dividends on his shares in
16 the same action, as they arise from the same "transactional nucleus of facts."
17 *Howard v. City of Coos Bay*, 871 F.3d 1032, 1039 (9th Cir. 2017). Therefore,
18 Calligeros's breach of fiduciary duty claim is not "based upon and arising out of"
19 Wrongful Acts occurring only after Calligeros's departure.

20 Upon contemplating the plain language of the contract, the allegations in
21 the complaint, and the facts presented by Calligeros at trial, the court concludes as
22 a matter of law that the Underlying Action does not satisfy the criteria for
23 Exception iv. Because the Wrongful Acts did not arise solely from actions taken
24 after Calligeros's departure, the Policy's "Insured v. Insured" Exclusion operates
25 to bar coverage.

26 Defendants do not appear to contest these facts, but insist that the Policy
27 language is susceptible to another interpretation. They claim the Policy could be
28 reasonably read to mean that "[E]xception iv permits those portions of the Loss (or

1 damages) which arise subsequent to the date” that Calligeros left the company.
2 (Opp. at 19.) Yet a plain reading of the Policy reveals that coverage for a Claim is
3 not severable in the manner Defendants describe, *i.e.* according to whether the
4 damages arose before or after Calligeros’s departure. Thus, Defendants’ singular
5 focus on coverage for damages, as opposed to the Wrongful Acts alleged in the
6 Underlying Action, finds no support in the language of the Policy.

7 Defendants also raise the affirmative defense of equitable estoppel, arguing
8 that Scottsdale should be estopped from raising Exception iv because it refused to
9 provide independent counsel and because this refusal led to a judgment in the
10 Underlying Action that barred the application of Exception iv. This argument
11 overlooks the critical fact that it is not the final judgment in the Underlying Action
12 that bars the application of Exception iv, but the allegations in the Underlying
13 Complaint giving rise to Calligeros’s action.

14 Even so, the elements of equitable estoppel are not satisfied. “An insurer
15 can be estopped from raising coverage defenses if, knowing of the grounds of
16 noncoverage, it provides a defense under the policy without a reservation of
17 rights, and the insured reasonably relies on this apparently unconditional defense
18 to his detriment.” *State Farm Fire & Cas. Co. v. Jioras*, 24 Cal. App. 4th 1619, 1626
19 (Ct. App. 1994). Such conditions were not present here as Scottsdale expressly
20 denied coverage under the Policy, yet elected to defend Defendants in the
21 Underlying Action subject to a reservation of rights. “Through reservation, the
22 insurer gives the insured notice of how [the insurer] will, or at least may, proceed
23 and thereby provides [the insured] an opportunity to take any steps that it may
24 deem reasonable or necessary in response-including whether to accept defense at
25 the insurer's hands and under the insurer's control or, instead, to defend itself as it
26 chooses.” *Blue Ridge Ins. Co. v. Jacobsen*, 25 Cal. 4th 489, 501 (2001). Because
27 Scottsdale gave Defendants notice of its reservation of rights, the court concludes
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1 that it is not estopped from now exercising those rights and asserting that no
2 coverage existed.

3 Finally, the court observes that, even if Scottsdale's coverage did extend to
4 Defendants' failure to pay appropriate dividends on Calligeros's 10% interest,
5 other policy provisions would operate to bar coverage.⁸ Notably, the Policy
6 excludes coverage for loss arising from "matters uninsurable under the laws."
7 (Messner Decl., Ex. A, Part B.7.b.) Here, coverage for the payment of restitution is
8 barred under California public policy. *Bank of the West v. Superior Court*, 2 Cal.4th
9 1254, 1266 (1992) ("It is well established that one may not insure against the risk of
10 being ordered to return money or property that has been wrongfully acquired.").

11 In the Underlying Action, the jury awarded "disguised dividend" damages
12 of \$2,538,340 and conversion damages arising from the Watermark option sale of
13 \$232,821. (See App'x, Ex. H.) As to the conversion claim, the jury found that
14 Defendants had "intentionally and substantially interfere[d]' with [Calligeros's]
15 right to possession" of a portion of the Watermark option payment, which was
16 commensurate with his ownership interest in Nationwide. (App'x, Ex. J, at 3.) The
17 return of this unlawfully withheld sum thus constitutes restitution.

18 The remaining monetary relief awarded to Calligeros was in the form of
19 "disguised dividends" that Defendants failed to pay Calligeros from 2005 to 2013,
20 and which arose from his 22% share in Nationwide. This relief, too, is
21 restitutionary, as it restores to Calligeros money that was wrongfully acquired
22 from him and is based upon his ownership of shares in the company. See *Pan Pac.*
23 *Retail Properties, Inc. v. Gulf Ins. Co.*, 471 F.3d 961, 968 n.5 (9th Cir. 2006). Therefore,
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26 ⁸ Although not addressed here, the Policy also prohibits coverage for loss corresponding
27 to "any amounts owed or paid to one or more securities holders of the Company under
28 any written or express contract of agreement." (Messner Decl., Ex. A., Part B.7.g.)
Scottsdale argues that this bars coverage for breach of contract and related breaches of
the implied covenant of good faith and fair dealing.

1 the court concludes that coverage that returns the value of these unlawfully
2 obtained “disguised dividends” to Defendants is barred under public policy.

3 **B. Duty To Defend**

4 “[T]he insurer's duty to defend is broader than its duty to indemnify. . . . It
5 extends beyond claims that are actually covered to those that are merely potentially so—
6 but no further.” *Buss v. Superior Court*, 16 Cal. 4th 35, 46 (1997). The determinative
7 question is whether the Underlying Action was potentially covered under the Policy “in
8 light of facts alleged or otherwise disclosed” to Scottsdale. *Id.*

9 To determine whether the Underlying Action was potentially covered, the court
10 turns first to the complaint. *See Horace Mann Ins. Co. v. Barbara B.*, 4 Cal. 4th 1076, 1081
11 (1993). As discussed above, the Underlying Complaint details Defendants’ conduct *before*
12 Calligeros’s departure, and which gives rise to the causes of action. Coverage exists
13 under the Policy if the Claim is “solely based upon and arising out of Wrongful Acts
14 committed subsequent to” Calligeros’s departure. (Messner Decl., Part C.1.e.iv.)
15 Wrongful Acts include “actual or alleged” acts and omissions, including “misleading
16 statement[s]” or “misstatements.” (*Id.*, Part B.9.a.-c.) The allegations in Calligeros’s
17 complaint reveal that the Wrongful Acts—namely false or misleading representations
18 and oral promises—did not occur solely after Calligeros’s departure. Instead, the claims
19 in Calligeros’s complaint recite, and depend upon, breaches of the oral promises and
20 representations made by Defendants prior to Calligeros’s departure. Therefore, the court
21 finds that the allegations in the Underlying Complaint were sufficient for Scottsdale to
22 conclude that no potential coverage existed under the Policy. Nor have Defendants
23 pointed to material facts extrinsic to the complaint that might set forth a basis for
24 coverage. Because there was no potential for coverage, the court concludes that there was
25 likewise no duty to defend.

26 Defendants counter that Scottsdale elected to defend the Underlying Action
27 action, subject to a reservation of rights, because it could not conclusively negate
28 coverage. Yet Scottsdale is not barred from defending Scottsdale out of an abundance of

1 caution. The court cannot conclude that, because Scottsdale “gave its policyholder the
2 benefit of the doubt (or more precisely, the benefit of the doubt as to whether there was
3 even a doubt),” that an actual potential for coverage existed under the Policy. *Prichard v.*
4 *Liberty Mut. Ins. Co.*, 84 Cal. App. 4th 890, 903 (Ct. App. 2000). Therefore, Scottsdale’s
5 actual decision to defend does not alter the court’s analysis as to whether a duty to
6 defend in fact existed.

7 **C. Counterclaims**

8 **i. Breach of Contract**

9 Defendants’ breach of contract counterclaim alleges that Scottsdale “is in breach of
10 the Policy, because it refuses to indemnify Nationwide and Howard Siegel against the
11 Judgment.” (Dkt. 29, ¶ 61.) Because the court has concluded that Scottsdale had no duty
12 to indemnify, then Defendants’ breach of contract claim cannot survive.

13 **ii. Breach of the Implied Covenant of Good Faith and Fair Dealing**

14 Defendants further allege that Scottsdale violated an “implied covenant of good
15 faith and fair dealing” because it “unreasonably or without proper cause refused to
16 honor its duty to defend the insured or its duty to indemnify the insured under the
17 insurance policy.” (*Id.* ¶ 65.)

18 The court acknowledges that the covenant of good faith and fair dealing is related
19 to the contractual duties of the insured under the Policy. “[T]he covenant is implied as a
20 supplement to the express contractual covenants, to prevent a contracting party from
21 engaging in conduct that frustrates the other party’s rights to the benefits of the
22 agreement. . . . Absent that contractual right, however, the implied covenant has nothing
23 upon which to act as a supplement, and should not be endowed with an existence
24 independent of its contractual underpinnings.” *Waller v. Truck Ins. Exch., Inc.*, 11 Cal. 4th
25 1, 36 (1995) (quotation omitted).

26 **a. Scottsdale’s Refusal To Settle**

27 Defendants claim that Scottsdale violated this covenant by refusing reasonable
28 settlement demands made by Calligeros in the Underlying Action. However, Scottsdale

1 was not “under a duty to settle since its policy did not provide coverage.” *Johansen v.*
2 *California State Auto. Assn. Inter-Ins. Bureau*, 15 Cal. 3d 9, 18 (1975). Scottsdale stated as
3 much when it refused Defendants’ requests to fund the settlement offers. (*Id.*, Exs. W, U.)
4 By refusing to accept a reasonable settlement demand, Scottsdale risked paying the full
5 costs of the Underlying Action without regard to policy limits. See *Archdale v. Am. Int’l*
6 *Specialty Lines Ins. Co.*, 154 Cal. App. 4th 449, 466 (Ct. App. 2007). “Clearly, if defendant's
7 belief that the policy did not provide coverage in the instant case had been vindicated, it
8 would not be liable for damages flowing from its refusal to settle.” *Johansen*, 15 Cal. 3d at
9 19. Because the Policy did not cover the Underlying Action, then Scottsdale was under no
10 duty to settle.

11 **b. Scottsdale’s Refusal to Provide Independent Counsel**

12 Defendants assert that Scottsdale also violated the covenant by unreasonably
13 refusing to provide independent counsel. Defendants claim Scottsdale was obliged to
14 provide independent counsel under California Civil Code § 2860, which states that “[i]f
15 the provisions of a policy of insurance impose a duty to defend upon an insurer and a
16 conflict of interest arises which creates a duty on the part of the insurer to provide
17 independent counsel to the insured,” then the insurer may be required to provide
18 independent counsel. This claim presumes that Scottsdale had a duty to defend in the
19 first instance. The court earlier concluded that it did not.

20 Similarly, the California Supreme Court has held, in the context of a bad faith
21 claim challenging the insurer’s handling of the claims process, that “[i]t is clear that if
22 there is no potential for coverage and, hence, no duty to defend under the terms of the
23 policy, there can be no action for breach of the implied covenant of good faith and fair
24 dealing because the covenant is based on the contractual relationship between the
25 insured and the insurer.” *Waller*, 11 Cal.4th at 36. Therefore, the absence of a duty to
26 defend would appear fatal to Defendants’ counterclaims.

27 Defendants do not rebut Scottsdale’s argument that, when there is no duty to
28 defend or indemnify under the Policy, then there is no attendant violation of the implied

1 covenant of good faith and fair dealing. Instead, they rely upon the assumption that an
2 underlying duty to defend did exist—an assumption that the court has rejected.

3 Through its own inquiry into this issue, however, the court notes that some
4 appellate-level state cases, have held that that “a breach of the implied covenant may be
5 found without the existence of coverage.” *Judah v. State Farm Fire & Cas. Co.*, 266 Cal.
6 Rptr. 455, 465 (Ct. App. 1990); *see also Local Initiative Health Auth. for Los Angeles Cty. v.*
7 *OneBeacon Prof'l Ins., Inc.*, No. EDCV164810VAPAGR, 2017 WL 3579491, at *14 (C.D.
8 Cal. July 7, 2017) (“When a bad faith claim is brought based on an insurer's handling of a
9 claim, however, California law is unclear on whether the claim can prevail in the absence
10 of a breach of contract.”). The court, therefore, does not foreclose the possibility that
11 “there may be unusual circumstances in which an insurance company could be liable to
12 its insured for tortious bad faith despite the fact that the insurance contract did not
13 provide for coverage.” *McMillin Scripps N. P'ship v. Royal Ins. Co.*, 19 Cal. App. 4th 1215,
14 1222 (Ct. App. 1993), *as modified on denial of reh'g* (Nov. 1, 1993).

15 However, the court is not convinced that this case presents such an unusual
16 circumstance. The alleged violation appears to arise purely from Scottsdale's refusal to
17 appoint independent counsel (“*Cumis* counsel”) pursuant to California Civil Code § 2860.
18 “[T]he *Cumis* rule is not based on insurance law but on the ethical duty of an attorney to
19 avoid representing conflicting interests.” *Swanson v. State Farm Gen. Ins. Co.*, 219 Cal.
20 App. 4th 1153, 1164 (Ct. App. 2013). As the court determined earlier, § 2860 does not
21 apply here. Furthermore, apart from the issue of independence, Defendants do not claim
22 that the performance of appointed counsel was otherwise lacking. They do not, for
23 example, raise negligence or malpractice claims.

24 Thus, the court is uncertain whether an action for breach of the implied covenant
25 is the appropriate vehicle for challenging an insurer's refusal to appoint independent
26 *Cumis* counsel here, when there exists *no* duty to defend, and hence no potential for
27 coverage, in the first place. The court further notes that an insured would not be without
28 a remedy, as the insured may bring counterclaims for negligence arising from the

1 insurer's failure to meet a duty of care that it had assumed when it elected to defend the
2 action. Here, Defendants have raised no negligence counterclaims. The counterclaims
3 exclusively pertain to Scottsdale's contract obligations, and implied covenants, arising
4 under the insurance policy. The court earlier found that no such obligations exist under
5 the Policy, thereby extinguishing the counterclaims for breach of contract and breach of
6 the implied covenant.

7 However, because the law is not entirely settled on this issue, and out of an
8 abundance of caution, the court analyzes whether Defendants were harmed in the
9 Underlying Action because of appointed counsel's alleged conflict of interest.

10 Assuming *arguendo* that a duty to defend were to exist, Defendants still cannot
11 meet the requirements of Civil Code § 2860, which provides that "when an insurer
12 reserves its rights on a given issue and the outcome of that issue can be controlled by
13 counsel first retained by the insurer for the defense of the claim, a conflict of interest may
14 exist." As the court concluded above, because coverage depended not on the jury verdict
15 but on the allegations of wrongdoing in the Underlying Complaint, then the performance
16 of appointed counsel could not have controlled the outcome of the coverage issue. *See*
17 *Gafcon, Inc. v. Ponsor & Assocs.*, 98 Cal. App. 4th 1388, 1422 (Ct. App. 2002) ("[T]here is no
18 entitlement to independent counsel where the coverage issue is independent of, or
19 extrinsic to, the issues in the underlying action.") (quotations omitted).

20 Nonetheless, Defendants argue that Scottsdale's appointed counsel could "steer[]
21 proof of the case away from coverage" in order to preserve its ability to invoke the
22 "Insured v. Insured" Exception. (Shaneyfelt Decl., Ex. 1.) Specifically, Defendants claim
23 that a conflict of interest emerged with respect to the statute of limitations defenses.
24 Defendants demanded that appointed counsel request, in a motion for summary
25 adjudication, that all damages that occurred prior to the applicable limitations period be
26 stricken. (Messner Decl., Ex. 7, Little Dep., Ex. 33.) Appointed counsel instead claimed in
27 its motion for summary adjudication that certain causes of action were completely barred
28 under the statute of limitations. The trial court denied the motion. (Defs.' MJN, Ex. 2.)

1 Appointed counsel also raised the statute of limitations as a complete affirmative defense
 2 at trial. (Defs.' MJN, Jury Instruction 4120 at NW12852.) The jury ultimately rejected this
 3 defense. (App'x, Ex. H.)

4 "The potential for conflict requires a careful analysis of the parties' respective
 5 interests to determine whether they can be reconciled (such as by a defense based on
 6 total nonliability) or whether an actual conflict of interest precludes insurer-appointed
 7 defense counsel from presenting a quality defense for the insured." *Dynamic Concepts,*
 8 *Inc. v. Truck Ins. Exch.*, 61 Cal. App. 4th 999, 1007–1008 (Ct. App. 1998), *as modified* (Feb.
 9 26, 1998). "The conflict must be significant, not merely theoretical, actual, not merely
 10 potential." *Id.* at 1007. Here, appointed counsel twice presented a statute of limitations
 11 defense "based on total nonliability." *Id.* at 1008. Here, there is no basis in the record to
 12 presume that counsel violated their duty to defend Defendants on all matters, whether
 13 covered or uncovered. *Id.* at 1009. Defendants allude to no more than a "vague,
 14 ephemeral, and highly theoretical" conflict, one which ultimately does not impact the
 15 coverage determination. *Id.* at 1009–1010.⁹

16 In view of these facts and the evidence set forth by the parties, the court concludes
 17 that, even assuming Scottsdale had a duty to defend, there is no triable issue of fact as to
 18 whether a conflict of interest existed, thereby necessitating the appointment of
 19 independent counsel.¹⁰

21 ⁹ In addition, the court is dubious that appointed counsel's inclusion of a request in the
 22 motion for summary adjudication to exclude damages arising before the limitations
 23 period, as Defendants had requested, would have led to an improved result. As
 24 Scottsdale observes, "Code of Civil Procedure section 437c, subdivision (f)(1), does not
 25 permit summary adjudication of a single item of compensatory damage which does not
 dispose of an entire cause of action." *DeCastro W. Chodorow & Burns, Inc. v. Superior Court*,
 47 Cal. App. 4th 410, 421 (Ct. App. 1996).

26 ¹⁰ As the court grants Scottsdale summary judgment on Defendants' counterclaims in
 27 their entirety, it need not reach Scottsdale's challenge to Defendants' request for punitive
 28 damages. The court also declines to reach Scottsdale's motion, in the alternative, to stay
 the proceedings, which was raised in the event that the court denied the present motion
 for summary judgment.

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IV. CONCLUSION

For the reasons stated above, Scottsdale’s Motion for Summary Judgment on the First Amended Complaint, Dkt. 70, and Defendants’ Counterclaims, Dkt. 29, is GRANTED.

IT IS SO ORDERED.

Dated: December 13, 2017



DEAN D. PREGERSON
UNITED STATES DISTRICT JUDGE