IN THE SUPREME COURT OF THE STATE OF NEVADA
CASE NO. 70504

JAMES NALDER, GUARDIAN AD LITEM ON BEHALF OF CHELSEA NALDER; AND GARY LEWIS, INDIVIDUALLY,
Appellants,

v.

UNITED AUTOMOBILE INSURANCE COMPANY,
Respondent.

RESPONDENT'S ANSWERING BRIEF

Ninth Circuit Case No. 13-17441
U.S.D.C. No. 2:09-cv-01348-RCJ-GWF

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NRAP 26.1 DISCLOSURE STATEMENT

The undersigned counsel of record certifies that the following are the persons and entities as described in NRAP 26.1(a)(1), and must be disclosed. These representations are made in order that the justices of this Court may evaluate possible disqualification or recusal:

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Dated this 6th day of January, 2017.

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page

Cases

Statutes

Other Authorities

STATEMENT OF THE ISSUE PRESENTED FOR REVIEW

The question of law presented for review by this Court, as certified by the United States Court of Appeals for the Ninth Circuit, is as follows:

> Whether, under Nevada law, the liability of an insurer that has breached its duty to defend, but has not acted in bad faith, is capped at the policy limit plus any costs incurred by the insured in mounting a defense, or is the insurer liable for all losses consequential to the insurer's breach?

STATEMENT OF THE CASE[1]

I. NATURE OF THE CASE

This appeal arises from an action by Appellants, Gary Lewis and James Nalder, guardian *ad litem* for his daughter Cheyanne Nalder, for claims of breach of contract, breach of the implied covenant of good faith and fair dealing, bad faith, fraud and breach of section 686A.310 of the Nevada Revised Statutes against Appellee, United Automobile Insurance Company ("UAIC"), following an incident

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[1] In providing the facts and procedural history in this matter, UAIC relies on the federal district court's articulation of that information in its certified question. *See In re Fontainebleau Las Vegas Holdings, L.L.C.*, 127 Nev. 941, 955, 267 P.3d 786, 795 (2011). For the limited purposes of providing context to the issues addressed in its brief on the certified question, however, UAIC also cites to the parties' briefs and appendix filed in the underlying action before the Ninth Circuit, which have been provided as part of the record transmitted to this Court. *See id.* (providing that an appendix that is submitted in a certified-question proceeding may help give context for the issues but should not be relied on "to contradict the certification order"). *See also Brady, Vorwerck, Ryder & Caspino v. New Albertson's, Inc.*, 333 P.3d 229, 230 n.4 (Nev. 2014). Citations to the parties' filings in the underlying Ninth Circuit case will be to the document number reflected in this Court's docket, and shall be designated "D.E. [document number], [page number]."

in which Mr. Lewis, UAIC's alleged insured, ran over Cheyanne Nalder. *In re Nalder*, 824 F. 3d 854, 855-56 (9th Cir. 2016). Mr. Lewis and Mr. Nalder have appealed to the Ninth Circuit the district court's determination that UAIC did not act in bad faith and that the only damages awardable for UAIC's breach of the duty to defend were the fees and costs incurred by Mr. Lewis in defending the underlying tort action, of which Mr. Lewis had none.

II. COURSE OF PROCEEDINGS

Mr. Nalder, on behalf of his daughter Cheyanne, initiated suit against Mr. Lewis in Nevada state court for injuries sustained by Cheyanne when she was run over by Mr. Lewis' truck in July of 2007. *In re Nalder*, 824 F. 3d at 855-56. On June 2, 2008, a default final judgment in the amount of $3.5 million was entered against Mr. Lewis. *Id. See also* D.E. 16-17698, 0075-79. Thereafter, Mr. Nalder and Mr. Lewis filed suit against UAIC in Nevada state court, alleging claims for breach of contract, breach of the implied covenant of good faith and fair dealing, bad faith, fraud and breach of section 686A.310 of the Nevada Revised Statutes. *In re Nalder*, 824 F. 3d at 855-56.

UAIC removed the action to federal court and moved for summary judgment, which was granted by the district court. *Id.* at 856. The Ninth Circuit Court of Appeals affirmed the district court's grant of summary judgment with respect to the Nevada statutory arguments, but reversed as to the remaining claims against UAIC.

Id. See also Nalder v. United Auto. Ins. Co., 500 F. App'x 701, 702 (9th Cir. 2012). On remand, the parties filed competing motions for summary judgment. *In re Nalder*, 824 F. 3d at 856.

III. DISPOSITION BELOW

The district court ultimately granted partial summary judgment to each party, finding in favor of Mr. Nalder and Mr. Lewis on the issue of coverage and finding that UAIC breached its duty to defend, but finding in favor of UAIC on the issue of bad faith. *Id.* The district court also awarded no damages to Mr. Lewis for UAIC's breach of its duty to defend, determining that the only damages awardable for UAIC's breach of the duty to defend were the fees and costs incurred by Mr. Lewis in defending the underlying tort action, of which Mr. Lewis had none. *Id.*

Mr. Nalder and Mr. Lewis appealed to the Ninth Circuit Court of Appeals the district court's grant of summary judgment in favor of UAIC on the issue of bad faith, as well as its finding of no damages for UAIC's breach of its duty to defend, and the Ninth Circuit thereafter certified to this Court the question of law presently at issue.

STATEMENT OF THE FACTS

On July 8, 2007, Mr. Lewis ran over Cheyanne Nalder. *In re Nalder*, 824 F. 3d at 855. Prior to the accident, Mr. Lewis purchased a month-long automobile liability policy term from UAIC for June 2007, which was renewable on a monthly basis. *Id. See also* D.E. 16-17697, 59. Mr. Lewis had previously received a statement instructing him that his renewal payment was due by June 30, 2007, and specifying that "[t]o avoid lapse in coverage, payment must be received prior to expiration of your policy." *Id.* The statement listed June 30, 2007, as the policy's effective date and July 31, 2007, as its expiration date. *Id.* Mr. Lewis did not pay to renew his policy until July 10, 2007, two days after the accident involving Cheyanne and approximately ten days after his renewal payment was due according to the renewal statement. *Id.*

UAIC denied coverage for the accident based on its determination that no policy was in effect at the time of the accident due to Mr. Lewis' failure to renew the policy by June 30th. *Id.* at 855-56. Mr. Nalder thereafter sued Mr. Lewis in Nevada state court and obtained a $3.5 million default judgment. *Id.* at 856. Mr. Nalder and Mr. Lewis then filed suit against UAIC, alleging claims of breach of contract, breach of the implied covenant of good faith and fair dealing, bad faith, fraud and breach of section 686A.310 of the Nevada Revised Statutes. *Id.* UAIC maintained its position that Mr. Lewis had no insurance coverage on the date of the

accident, and moved for summary judgment on Mr. Nalder and Mr. Lewis' claims. *Id.* Mr. Nalder and Mr. Lewis argued that Mr. Lewis was covered on the date of the accident because the renewal notice was ambiguous as to when payment had to be received to avoid a lapse in coverage, and that this ambiguity had to be construed in favor of the insured. *Id.*

The district court granted summary judgment in favor of UAIC, finding that the contract could not be reasonably interpreted in favor of Mr. Nalder and Mr. Lewis' argument. *Id.* The Ninth Circuit Court of Appeals reversed, however, holding that summary judgment "with respect to whether there was coverage" was improper because "[Mr. Nalder and Mr. Lewis] came forward with facts supporting their tenable legal position." *Id. See also Nalder v. United Auto. Ins. Co.*, 500 F. App'x at 702. The Court of Appeals affirmed the district court's grant of summary judgment "with respect to the [Nevada] statutory arguments," remanding the remainder of Mr. Nalder and Mr. Lewis' claims, including those for breach of contract and bad faith, back to the district court. *Id.*

On remand, the parties filed cross-motions for summary judgment on the remaining issues. Mr. Nalder and Mr. Lewis argued they were entitled to summary judgment on the issue of coverage because the renewal statements sent by UAIC were ambiguous and therefore were required to be construed in favor of Mr. Lewis, resulting in the policy being effective on the date of the accident D.E. 16-17698,

0005-0026. Mr. Nalder and Mr. Lewis further argued that UAIC breached the contract by failing to investigate for coverage and failing to provide coverage and other duties owed the insured. *Id.* Finally, Mr. Nalder and Mr. Lewis contended that, as a matter of law, the default judgment entered against Mr. Lewis was the proper measure of damages. *Id.*

UAIC filed a response in opposition to the motion for summary judgment on the issue of coverage, and it filed a counter-motion for summary judgment as to Mr. Nalder and Mr. Lewis' extra-contractual claims and remedies. *Id.* at 0264-0328. On the issue of coverage, UAIC argued that the renewal statements issued to Mr. Lewis were not ambiguous, as they clearly demanded remittance of the policy premiums for the subsequent term by the expiration date of the present policy period, and that at a minimum a material issue of fact remained as to whether the renewal statements were ambiguous. *Id.* at 0264-0293. As to its counter-motion for summary judgment, UAIC argued that, at best, Mr. Nalder and Mr. Lewis' arguments in favor of coverage based on an ambiguity in the renewal statements sought to create an implied or constructive insurance contract, but otherwise, no policy had been in force at the time of the accident pursuant to the terms of the policy itself, and UAIC's interpretation of the renewal statements had been recognized to be reasonable. *Id.* at 0294-0328. UAIC therefore argued that should the district court find, almost six years after the loss, that the renewal statements were ambiguous, creating an implied

insurance contract, it was nevertheless entitled to summary judgment as to Mr. Nalder and Mr. Lewis' extra-contractual claims and remedies, as a genuine dispute existed as to coverage for the loss and UAIC had a reasonable belief no coverage existed for the loss in question. *Id.*

On October 22, 2013, the district court held a hearing on the parties' cross-motions for summary judgment. *Id.* at 0708-0733. Following the district court's indication at the start of the hearing that it was inclined to grant summary judgment in favor of Mr. Lewis on the issue of coverage based on the ambiguities in the renewal statements and the Ninth Circuit's reversal, but otherwise found that UAIC did not act in bad faith, the parties' arguments at the hearing centered largely on the issue of whether Mr. Lewis was entitled to the full amount of the default judgment as damages for UAIC's breach of contract.

Despite the district court's indication that it found no bad faith on the part of UAIC, Mr. Nalder and Mr. Lewis argued to the district court that recovery of the full amount of the default judgment was appropriate based on theories relating to bad faith. *Id.* at 0714-0721. The district court disagreed with this position, and instead questioned Mr. Nalder and Mr. Lewis regarding what damages, if any, were caused by UAIC's breach of the duty to defend. *Id.* at 0716 ("Assuming that I disagree with you and that bad faith cannot be attributed here even on summary judgment, but also assuming that I agree that breach of contract includes any damage for failure to

defend, what causally can you assert is the damage?"), 0718-0719 ("There's no coverage. So, how is there any causal connection between the damage of a default of three-and-a-half-million dollars? For all we know, he may have had a perfectly good defense -- and that's why you are saying you want the larger sum – but he said, 'It's just not worth defending. I don't have any way to answer any large judgment anyway, other than the insurance itself, and they are disclaiming. So I'll -- I agree with you. I'm not going to defend, and you agree with me that you won't chase me. You won't execute on the judgment. You will just simply take an assignment of the judgment for purposes of going against the insurance company.' If that's the factual scenario, then how is there any causal connection between the default of three-and-a-half million dollars? I mean, the default could have been any figure. It could have been $20,000, or it could have been $5 million. He just didn't care, because he can't answer any judgment[.]").

Ultimately, the district court granted partial summary judgment to each party, finding in favor of Mr. Nalder and Mr. Lewis on the issue of coverage and finding in favor of UAIC on the issues of bad faith and extra-contractual claims and remedies. *In re Nalder*, 824 F.3d at 856. Specifically, the district court found the renewal statements were ambiguous and construed the ambiguity against UAIC by finding that Mr. Lewis was covered on the date of the accident. *Id.* The district court further found UAIC did not act in bad faith because it had a reasonable basis

to dispute coverage. *Id.* Finally, the district court ruled UAIC breached its duty to defend Mr. Lewis, but awarded no damages because Mr. Lewis did not incur any fees or costs in defending the underlying action as he took a default judgment. The district court ordered UAIC "to pay Cheyanne Nalder the policy limits on Gary Lewis' implied insurance policy at the time of the accident."

Mr. Nalder and Mr. Lewis thereafter appealed to the Ninth Circuit once again, which certified the question of law at issue herein to this Court. These proceedings timely followed.

SUMMARY OF THE ARGUMENT

As a matter of law, an insurer that is determined to have breached its contractual duty to defend its insured, but has not acted in bad faith, is liable to the insured for damages limited to the insured's expenses in defending the underlying tort action. Where it has been determined that coverage for the underlying tort claim also exists, and where there has been a judgment entered in said tort action in excess of the policy limits, the insured is also entitled to be indemnified in an amount equal to the policy limits. However, where it is determined that the insurer has not acted in bad faith, extra-contractual damages in excess of the policy limits are not available for the mere breach of the duty to defend.

Even though the insurer's obligations under the insurance contract extended beyond the payment of the amounts stated and included the promise to conduct the

defense of the action, such a promise to defend cannot be held to enlarge the limitation as to the amount fixed as reimbursement for injuries to persons. Instead, the general rule is to award damages which will place the injured party in the position which he would have been in had the obligation in question been performed. Accordingly, had the duty to defend not been breached by the insurer, the insured would have been entitled under the policy to the cost of defense and indemnification in an amount up to the policy limits, and such are therefore the proper measure of damages for breach of the duty to defend.

ARGUMENT

I. STANDARD OF REVIEW

The issue of whether a party is entitled to a particular measure of damages is a question of law, which is reviewed de novo. *Dynalectric v. Clark & Sullivan*, 255 P.3d 286,288 (Nev. 2011). *See also In re Fontainebleau Las Vegas Holdings, L.L.C.*, 127 Nev. 941, 267 P.3d at 794-95 (2011) (providing that when responding to a certified question, state court only answer the legal questions and leaves the federal court to apply the clarified law to the facts before it); *Banegas v. State Indus. Ins. Sys.*, 117 Nev. 222, 224, 19 P.3d 245, 247 (2001) (providing that "[q]uestions of law are reviewed de novo").

II. WHERE IT IS DETERMINED THAT AN INSURER BREACHED ITS DUTY TO DEFEND AN INSURED, BUT DID NOT ACT IN BAD FAITH, THE INSURER IS LIABLE ONLY FOR REASONABLE AND NECESSARY ATTORNEY'S FEES AND COSTS INCURRED BY THE INSURED IN PROVIDING FOR HIS OWN DEFENSE.

As this Court recognized in *Allstate Insurance Company v. Miller*, "[p]rimary liability insurance policies create a cascading hierarchy of duties between the insurer and the insured." 125 Nev. 300, 309, 212 P.3d 318, 324 (2009). The present matter centers on one of the two primary duties within this hierarchy—an insurer's duty to defend its insured. More specifically, the question of law certified by the Ninth Circuit concerns the measure of damages recoverable by an insured where an insurer has breached its contractual duty to defend, but has not acted in bad faith. For the reasons set forth below, the law and public policy support UAIC's position that this Court hold the proper measure of damages for an insurer's breach of its duty to defend are those reasonable and necessary attorney's fees and costs incurred by the insured in providing for his own defense.

A. The Duty to Defend is a Contractual Right that Entitles the Insured to Protection from the Expense of Defending Suits Brought Against Him and, As Such, Breach of this Duty Entitles the Insured to Receive Only What He is Owed Under the Contract—the Cost of Defense.

An insurer's duty to defend its insured from lawsuits within the policy's coverage arises from an insurer's contractual right to control litigation against its insured. *See Allstate Ins. Co.*, 125 Nev. at 309, 212 P.3d at 325 ("The right to control

litigation creates the duty to defend the insured from lawsuits within the insurance policy's coverage."). In this way, a primary liability insurance policy provides not only for indemnification of the insured, but also acts as a form of "litigation insurance," protecting the insured from the expense of defending suits brought against him. *Brohawn v. Transamerica Ins. Co.*, 276 Md. 396, 410, 347 A.2d 842, 851 (1975).

A liability insurer's mistaken refusal to provide a defense on the ground that there is no valid insurance contract gives rise to a breach of contract action against the insurer, for which the damages are limited to the insured's expenses, including attorney fees, in defending the underlying tort action, and the insured's expenses and attorney fees in a separate contract or declaratory judgment action if such action is filed to establish that there exists a duty to defend. *Mesmer v. Md. Auto. Ins. Fund*, 353 Md. 241, 252, 264, 725 A.2d 1053, 1058, 1064 (1999). This mistaken refusal to provide a defense, however, does not have the effect of exposing the insurer to a greater liability to the insured than the contracted for policy limits, but is instead controlled by the general rule that the measure of damages for the breach of a contract for the payment of money is the amount agreed to be paid, plus interest. *See Mannheimer Bros. v. Kan. Cas. & Sur. Co.*, 149 Minn. 482, 486, 184 N.W. 189, 191 (1921). *See also Willcox v. Am. Home Assurance Co.*, 900 F. Supp. 850, 856 (S.D. Tex. 1995) ("The damages recoverable on a contract claim for breach of the duty to

defend do not include damages in excess of the policy limits. *Employers Nat'l Ins. Corp. v. Zurich Am. Ins. Co.*, 792 F.2d 517, 520 (5th Cir. 1986); *United Servs. Auto. Ass'n v. Pennington*, 810 S.W.2d 777, 784 (Tex. App.--San Antonio 1991, writ denied). The insured's damages are generally limited to policy limits, expenses of the insured in defending the suit (including reasonable attorney's fees and court costs), and reasonable and necessary attorney's fees and costs incurred in the suit to enforce the judgment or settlement against the insurer.").

Even though the insurer's obligations under the insurance contract extended beyond the payment of the amounts stated and included the promise to conduct the defense of the action, such a promise to defend cannot be held to enlarge the limitation as to the amount fixed as reimbursement for injuries to persons. *Mannheimer Bros.*, 149 Minn. at 486, 184 N.W. at 191. *See also Servants of the Paraclete v. Great Am. Ins. Co.*, 866 F. Supp. 1560, 1577 (D.N.M. 1994) ("The insurer's breach of contract should not . . . be used as a method of obtaining coverage for the insured that the insured did not purchase."); *Colonial Oil Indus. v. Underwriters Subscribing to Policy Nos. To31504670 & To31504671*, 268 Ga. 561, 563, 491 S.E.2d 337, 339 (1997) ("[W]hen the insurer breaches the contract by wrongfully refusing to provide a defense, the insured is entitled to receive only what it is owed under the contract—the cost of defense. The breach of the duty to defend, however, should not enlarge indemnity coverage beyond the parties' contract. This

rule, which is the majority position, recognizes that the duty to defend and the duty to pay are independent obligations.").

Indeed, "[i]t is fundamental that contract damages are prospective in nature and are intended to place the nonbreaching party in as good a position as if the contract had been performed." *Colorado Env'ts v. Valley Grading Corp.*, 105 Nev. 464, 470, 779 P.2d 80, 84 (Nev. 1989) (citing *Lagrange Construction, Inc. v. Kent Corp.*, 88 Nev. 271, 496 P.2d 766 (1972)). *See also Gedeon v. State Farm Mut. Auto. Ins. Co.*, 410 Pa. 55, 59 n.5, 188 A.2d 320, 322 (1963) ("The general rule is to award damages which will place the injured party in the position which he would have been in had the obligation in question been performed."). The failure to defend an insured exposes the insured only to additional liability for the cost and expense of securing his or her own defense caused by the insurer's breach of the duty to defend. *Mannheimer Bros.*, 149 Minn. at 486, 184 N.W. at 191. *See also Colonial Oil Indus.*, 268 Ga. at 563, 491 S.E.2d at 339. Thus, by awarding damages in the form of such costs and expenses as the insured may have incurred in defending the underlying tort action, the courts place the insured in the position which he would have been in had the insurer properly performed its duty to defend. To award any other damages would be to place the insured in a better position than he or she would have been in had the breach of contract not occurred, resulting in a windfall to the insured, for had the insurer found a valid insurance contract existed and undertaken

to defend the insured without acting in bad faith, the insured would be spared the cost of defending the underlying tort action and would otherwise be entitled only to indemnification in an amount up to the policy limits.

B. A Distinction Exists Between a Contract Cause of Action, Alleging An Insurer's Complete Failure to Initiate Performance of a Purely Contractual Duty, Which Would Not Entitle an Insured to Damages in Excess of the Policy Limits, and Tort Cause of Action, Alleging An Insurer's Undertaking of a Contractual Duty in Bad Faith and in Breach of its Duty of Good Faith and Fair Dealing, Which Would Entitle an Insured to Damages in Excess of the Policy Limits.

There is a distinction between a situation in which a liability insurer mistakenly, but reasonably, refuses to provide any defense whatsoever on the ground that there is no valid insurance contract, which gives rise to a breach of contract action against the insurer, and a situation in which a liability insurer exercises control over the litigation, undertaking to defend same, and wrongfully refuses an offer to settle, breaching the duty of good faith and fair dealing and giving rise to a tort action.

An insurer has the contractual right to control settlement discussions, which creates the duty of good faith and fair dealing during negotiations. *Allstate Ins. Co.*, 125 Nev. at 309, 212 P.3d at 325. A tort action based on bad faith failure to settle a liability claim within the policy limits arises when the liability insurer acknowledges coverage, or proceeds as if there were coverage, and undertakes to provide a defense to the insured. *See Mesmer*, 353 Md. at 262-63, 266, 725 A.2d at 1063, 1065 ("Since

the insurer makes no promise that it will settle a claim within policy limits, no breach of contract damages are available for violation of any duty to settle a claim within policy limits. Instead, any duty to settle within policy limits is strictly a tort duty which only arises when the insurer undertakes to provide a defense. The damages for breach of that duty may be recovered only in a tort action.") (internal citation and quotation marks omitted).

It is when the insurer undertakes to provide a defense that it has the exclusive control of settlement and defense of any claim or suit against the insured, and it is at this stage that a fiduciary duty comes into being through the duty of good faith and fair dealing. *Id.* "If an insurer violates its duty of good faith and fair dealing by failing to adequately inform the insured of a reasonable settlement opportunity, the insurer's actions can be a proximate cause of the insured's damages arising from a foreseeable settlement or excess judgment." *Allstate Ins. Co.*, 125 Nev. at 313-14, 212 P.3d at 327.

However, where the insurer does not purport to act on behalf of the insured by refusing to defend based on the mistaken belief there is no valid insurance contract, a tort action does not arise because the insurer has not undertaken to provide a defense or undertaken the fiduciary duty arising from sole control of the settlement. *See Mesmer*, 353 Md. at 262-64, 725 A.2d at 1063-64; *Tibbs v. Great Am. Ins. Co.*, 755 F. 2d 1370, 1375 (9th Cir. 1985) ("Refusal to defend, without more, does not

constitute a breach of the implied covenant [of good faith and fair dealing]."). *Cf. Lunsford v. Am. Guar. & Liab. Ins. Co.*, 18 F. 3d 653, 656 (9th Cir. 1994) ("[A] court can conclude as a matter of law that an insurer's denial of a claim is not unreasonable, so long as there existed a genuine issue as to the insurer's liability."). And it is the bad faith failure to settle, which courts have generally found entitles an insured to recover for a judgment in excess of the policy limits, not a mere breach of the duty to defend. *See, e.g., Willcox*, 900 F. Supp. at 856 ("The damages recoverable on a contract claim for breach of the duty to defend do not include damages in excess of the policy limits. *Employers Nat'l Ins. Corp.*, 792 F.2d at 520; *United Servs. Auto. Ass'n*, 810 S.W.2d at 784. The insured's damages are generally limited to policy limits, expenses of the insured in defending the suit (including reasonable attorney's fees and court costs), and reasonable and necessary attorney's fees and costs incurred in the suit to enforce the judgment or settlement against the insurer."); *Am. Fid. Fire Ins. Co. v. Johnson*, 177 So. 2d 679, 683 (Fla. 1st DCA 1965) ("The decisive factor in fixing the extent of Traders' liability is not the refusal to defend; it is the refusal to accept an offer of settlement within the policy limits. Where there is no opportunity to compromise the claim and the only wrongful act of the insurer is the refusal to defend, the liability of the insurer is ordinarily limited to the amount of the policy plus attorneys' fees and costs.").

Accordingly, where there is a determination that the insurer has not acted in bad faith, an insured is only entitled to contract damages for the insurer's breach of its duty to defend, which are intended to protect the insured's expectation interest—that is, the insured's interest in having the benefit of his bargain by being put in as good a position as he would have been in had the contract been performed. *See* Restatement 2d of Contracts, § 344 (2nd 1981). Because the insured's bargain in the case of an insurance contract is limited to indemnification and protection from the expense of defending suits brought against him, such is the measure of damages available to him or her upon breach of said contract—indemnification in an amount up to the policy limits and damages limited to the insured's expenses, including attorney fees, in defending the underlying tort action, as well as the insured's expenses and attorney fees in a separate contract or declaratory judgment action if such action is filed to establish that there exists a duty to defend. *See Mesmer*, 353 Md. at 252, 264, 725 A.2d at 1058, 1064; *Miller v. Secura Ins. & Mut. Co.*, 53 S.W.3d 152, 155 (Mo. Ct. App. 2001) ("By breaching a contract by refusing to provide a defense to an insured under the policy, an insurance company is liable to its insured for 'any judgment recovered against [the insured] up to the limits of the policy plus attorney fees, costs, interest and any other expenses incurred by the insured in conducting the defense of the suit which it was the obligation of the

company to perform under its contract.' *Landie v. Century Indemnity Company*, 390 S.W.2d 558, 562 (Mo. App. 1965).").

C. The Bad Faith Standard of Tort Liability Strikes a More Acceptable Balance Between the Interests of the Insured and the Insurer.

Where the existence of a valid insurance contract is deemed to be fairly debatable, and an insurer is found to have breached the duty to defend but not to have acted in bad faith, to hold the insurer liable for an excess judgment rendered against its insured would create an absolute duty to defend on the part of the insurer without regard for whether a valid insurance contract exists. Such a holding by this Court would not only serve to extend the rights and duties of an insurance contract beyond those which were agreed to by the contracting parties, but it would also contradict this Court's own case law, which recognizes that "the duty to defend is not absolute." *United Nat'l Ins. Co. v. Frontier Ins. Co.*, 120 Nev. 678, 687, 99 P.3d 1153, 1158 (2004). Additionally, such a holding has the potential to result in extortionate lawsuits against the insurer, forcing insurers to clog the courts with declaratory actions in every case where there exists a reasonable basis for denying an insured the benefits of the insurance policy. *Cf. Mowry v. Badger State Mut. Cas. Co.*, 129 Wis. 2d 496, 522, 385 N.W.2d 171, 183 (1986) ("[T]o require an insurer to settle any claim within policy limits where the insured's liability and the victim's

damages in excess of policy limits are relatively certain, without consideration as to whether coverage exists, may result in extortionate lawsuits against the insurer.").

Instead, the preferred course of action—and one that is followed by a number of other jurisdictions—would be to hold that an insurer may be liable for a default judgment in excess of the policy limits only when it is shown that the insurer acted in bad faith and breached the covenant of good faith and fair dealing imposed on insurers by Nevada law. *See, e.g., Conway v. Country Cas. Ins. Co.*, 92 Ill. 2d 388, 397, 65 Ill. Dec. 934, 938, 442 N.E.2d 245, 249 (1982) ("The mere failure to defend does not, in the absence of bad faith, render the insurer liable for that amount of the judgment in excess of the policy limits."). The Nevada Supreme Court has defined "bad faith as 'an actual or implied awareness of the absence of a reasonable basis for denying benefits of the [insurance] policy.'" *Allstate Ins. Co.*, 125 Nev. at 308, 212 P.3d at 324. Thus, requiring a finding of bad faith before holding an insurer liable for extra-contractual damages where the duty to defend has been breached serves to balance the insurer's interest in raising issues of coverage where there exists a reasonable basis for denying an insured the benefits of the insurance policy, with the insured's interest in its contracted for right to be protected from the expense of defending suits brought against him.

III. EVEN IF, AS MR. NALDER AND MR. LEWIS ARGUE, AN INSURER THAT BREACHES ITS DUTY TO DEFEND IS LIABLE FOR ALL LOSSES CONSEQUENTIAL TO ITS BREACH, A DEFAULT JUDGMENT IN EXCESS OF THE POLICY LIMITS ENTERED AGAINST THE INSURED FOLLOWING THE INSURED'S FAILURE TO APPEAR AND DEFEND AGAINST THE UNDERLYING TORT ACTION IS NOT, AS A MATTER OF LAW, A CONSEQUENTIAL LOSS CAUSED BY THE BREACH.

While it is true that an insurer has a duty to defend its insured and to indemnify him for damages within policy limits, it does not necessarily follow that an insurer promises to settle a claim with the policy limits, rather it merely reserves the right to settle a claim if it deems it appropriate. *See Mesmer*, 353 Md. at 266, 725 A.2d at 1065 (citing *Allstate Ins. Co. v. Campbell*, 334 Md. 381, 394, 639 A.2d 652, 658 (1994)). Thus, where the insurer has not undertaken to provide a defense or undertaken the fiduciary duty arising from sole control of the settlement, it cannot be said with the degree of certainty necessary to award consequential damages that a default judgment in excess of the policy limits entered against the insured is a foreseeable consequential loss proximately caused by the breach of the duty to defend.

In order to award consequential damages, the damages for breach of contract must be foreseeable. *Clark County Sch. Dist. v. Rolling Plains Constr.*, 117 Nev. 101, 106, 16 P.3d 1079, 1082 (2001). Foreseeability requires that: (1) damages for the loss must fairly and reasonably be considered as arising naturally from the breach

of contract itself, and (2) the loss must be such as may reasonably be in the contemplation of both parties, at the time they make the contract as the probable result of the breach of it. *Id.* In this respect, Mr. Nalder and Mr. Lewis' reliance on the United States District Court for the District of Nevada's ruling in *Andrew v. Century Sur. Co.*, 134 F. Supp. 3d 1249 (D. Nev. 2015) ("*Andrew II*"), is misplaced, as the district court's conclusion in that instance that the default judgment was foreseeable and proximately caused by the insurer's breach of its duty to defend is distinguishable from the facts herein.

As the Ninth Circuit noted in its certification order to this Court, the Nevada District Court recently issued two orders addressing the "proper measure of damages" under Nevada law for an insurer's breach of the duty to defend. *In re Nalder*, 824 F.3d at 857. In its first order, the district court relied on the Supreme Court of California's decision in *Comunale v. Traders & General Insurance Company*, 50 Cal. 2d 654, 328 P.2d 198 (1958), which held that "[w]here there is no opportunity to compromise the claim and the only wrongful act of the insurer is the refusal to defend, the liability of the insurer is ordinarily limited to the amount of the policy plus attorneys' fees and costs[,]" to conclude "that the Nevada Supreme Court would not allow for extra-contractual damages if the insurer did not act in bad faith." *Andrew v. Century Surety Co.*, No. 2:12-cv-00978, 2014 U.S. Dist. LEXIS 60972, at *9 (D. Nev. Apr. 29, 2014) ("*Andrew I*"). Upon reconsideration, however, the

Andrew court thereafter modified its ruling, relying on contract law to conclude that an insured is entitled to consequential damages for an insurer's breach of the duty to defend and finding that the default judgment at issue therein "represent[ed] consequential damages to [the insured] that may be recoverable as a result of [the insurer's] breach of the duty to defend." *Andrew II*, 134 F. Supp. 3d at 1259, 2015 U.S. Dist. LEXIS 131745, *17.

The facts that led the *Andrew II* court to conclude that the default judgment entered in that matter was foreseeable and proximately caused by the insurer's breach of the duty to defend, however, are wholly distinguishable from the facts of this case. Specifically, the *Andrew II* court found as follows:

> Century has not argued it was unforeseeable that its insured, a mobile auto detailing business, could cause a car accident resulting in catastrophic injuries. It also was foreseeable that a plaintiff's attorney would allege that the business's vehicle was being used in the course and scope of employment at the time of the accident. It therefore was foreseeable at the time of contracting that if Century refused to provide a defense in the face of such allegations, a substantial default judgment against its insured could result. As for proximate cause, Century has consistently asserted that Vasquez was not in the course and scope of employment at the time of the accident. Thus, by Century's own position, had it defended Blue Streak, Blue Streak would have obtained a judgment in its favor instead of an $18 million judgment against it. Consequently, Century's breach of its duty to defend proximately caused the default judgment.

Id. at 1258. Here, in contrast, there is no allegation of a viable defense that, if pled, would have entitled Mr. Lewis to a judgment in his favor, or even a judgment in an amount less than the default judgment. Thus, even if UAIC had undertaken to defend Mr. Lewis in the underlying tort action under a reservation of rights, there is no indication that Mr. Lewis' liability would not be the same as it is now. As such, it cannot be said that the default judgment arose from the breach of contract itself, raising issues of proximate cause not found in *Andrew II.*

The district court identified these causation issues during its hearing on the parties' cross-motions for summary judgment, stating

> There's no coverage. So, how is there any causal connection between the damage of a default of three-and-a-half-million dollars? For all we know, he may have had a perfectly good defense -- and that's why you are saying you want the larger sum – but he said, 'It's just not worth defending. I don't have any way to answer any large judgment anyway, other than the insurance itself, and they are disclaiming. So I'll -- I agree with you. I'm not going to defend, and you agree with me that you won't chase me. You won't execute on the judgment. You will just simply take an assignment of the judgment for purposes of going against the insurance company.' If that's the factual scenario, then how is there any causal connection between the default of three-and-a-half million dollars? I mean, the default could have been any figure. It could have been $20,000, or it could have been $5 million. He just didn't care, because he can't answer any judgment[.]

D.E. 16-17698, 0718-0719.

Furthermore, Mr. Lewis had the opportunity to secure counsel of his own to defend against the action, having been made aware by UAIC as early as a few days after the accident that there was no coverage, or enter into a consent judgment with Mr. Nalder in exchange for an agreement that said judgment would not be executed against him, but instead he chose to take no action, resulting in entry of the default judgment.[2] *Cf. Thomas v. W. World Ins. Co.*, 343 So. 2d 1298, 1303 (Fla. Dist. Ct. App. 1977) ("[A] party suffering a breach is obligated to take all reasonable means to protect himself and mitigate his damages. Here, for example, depending upon all relevant facts, circumstances and wherewithal on the part of the insureds, reasonable diligence in this regard may have made it incumbent on them to employ independent counsel (even though they became aware of the carrier's breach at a very late date) either immediately to jump into the fray to preserve remaining rights or to attempt timely to have the default and final judgment set aside."). To hold in such a circumstance that *any* default judgment entered against an insured who fails to

[2] In its cross-motion for summary judgment, UAIC sought leave to amend its pleadings to add a counter-claim against Mr. Nalder and Mr. Lewis for collusion, breach of the cooperation clause of the insurance policy, and champerty, regarding issues that arose during the course of discovery concerning the relationship between Mr. Nalder, Mr. Lewis, and plaintiffs' counsel. D.E. 16-17698, 0289-0291. Specifically, Mr. Lewis testified in interrogatory responses and deposition that he and James Nalder are friends, and plaintiffs' counsel admitted to being in contact with Mr. Lewis shortly after the loss occurred. *Id.* The request was ultimately mooted, however, based on the district court's ruling on the cross-motions, and the district court did not therefore address the issue.

appear and defend themselves is a consequential loss proximately caused by the insurer's breach of its duty to defend, without a requirement that the insured show they have taken all reasonable means to protect themselves and mitigate damages, would be to remove all responsibility from the insured, allowing them to walk away from any action brought against them without regard for their obligation to mitigate damages and then further allowing them to seek to hold the insurer responsible for the full amount of any default judgment entered against them, including judgments in excess of the policy limits.

Finally, unlike the insurer in *Andrew II* that refused to defend based on its conclusion that the insured's employee was not acting within the course and scope of his employment at the time of the accident, UAIC's refusal to defend herein was not based on a policy exclusion, but rather on UAIC's reasonable belief that a valid insurance policy did not exist on the date of the accident because the policy had lapsed due to non-payment of the renewal premium. It could not have been reasonably foreseeable to the parties at the time they entered into the insurance contract, which provided coverage for one month, that the insurer would owe any duty to the insured after the expiration without renewal of the one-month period, much less that the breach of any such duty would result in damages to the insured. It was therefore not reasonably foreseeable at the time of contracting that if UAIC refused to provide a defense in the face of allegations relating to an accident that

occurred after the expiration of the policy, a $3.5 Million default judgment against Mr. Lewis could result. Indeed, Mr. Lewis did not raise the ambiguity of the renewal statements to UAIC when it declined to provide a defense and advised him that there was no coverage, instead raising the issue for the first time in discovery propounded as part of the present litigation, well after the default judgment had been entered against him. *See* D.E. 16-17697, 62-65.

Accordingly, should this Court agree that an insurer in breach of its duty to defend is liable for all losses consequential to its breach, UAIC nevertheless urges this Court to hold that a default judgment in excess of the policy limits that is entered against an insured following the insured's failure to appear and defend against the underlying tort action is not, as a matter of law, a consequential loss caused by said breach. Instead, an insured should be required to establish with reasonable certainty that the insurer caused the default judgment in excess of the policy limits, that said loss flowed naturally from the insurer's failure to defend and that the insurer could have foreseen said loss at the time of contracting. *See Servants of the Paraclete v. Great Am. Ins. Co.*, 866 F. Supp. 1560, 1578 (D.N.M. 1994).

CONCLUSION

For the reasons set forth above, UAIC respectfully requests that this Honorable Court hold that where an insurer has breached its duty to defend, but has not acted in bad faith, it is liable for damages limited to the insured's expenses,

including attorney fees, in defending the underlying tort action. Additionally, UAIC respectfully suggests that the decisional process will be aided through oral argument, and hereby requests that this Honorable Court grant oral argument in this cause.

CERTIFICATE OF COMPLIANCE

1. I hereby certify that this brief complies with the formatting requirements of NRAP 32(a)(4), the typeface requirements of NRAP 32(a)(5) and the type style requirements of NRAP 32(a)(6). This brief has been prepared in a proportionally spaced typeface using Microsoft Word 2016 in 14 point, double-spaced Times New Roman font.
2. I further certify that this brief complies with the type-volume limitations of NRAP 32(a)(7) because, excluding the parts of the brief exempted by NRAP 32(a)(7)(C), it is proportionately spaced, has a typeface of 14 points, and contains 6,975 words.
3. Finally, I hereby certify that I have read this appellate brief, and to the best of my knowledge, information, and belief, it is not frivolous or interposed for any improper purpose. I further certify that this brief complies with all applicable Nevada Rules of Appellate Procedure, in particular NRAP 28(e)(1), which requires every assertion in the brief regarding matters in the record to be supported by a reference to the page and volume number, if any, of the transcript or appendix where the matter relied on is to be found. I understand that I may be subjected to sanctions in the event that the accompanying brief is not in conformity with the requirements of Nevada Rules of Appellate Procedure.

Dated this 6th day of January, 2017.

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on the 6th day of January, 2017, I served the foregoing **Respondent's Answering Brief** by electronically filing and serving the document listed above with the Nevada Supreme Court.

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