IN THE SUPREME COURT OF THE STATE OF NEVADA

NAUTILUS INSURANCE COMPANY, Appellant, v. ACCESS MEDICAL, LLC; ROBERT CLARK WOOD, II; AND FLOURNOY MANAGEMENT LLC, Respondents.	**Supreme Court 79130** United States District Court, for the District of Nevada Case No. 2:15-cv-00321 United States Court of Appeals for the Ninth Circuit: Case Nos. 17-16265 17-16272 17-16273

NAUTILUS INSURANCE COMPANY'S OPENING BRIEF

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NRAP 26.1 CORPORATE DISCLOSURE STATEMENT

The undersigned counsel of record certifies that the following are persons and entities as described in NRAP 16.1(a), and must be disclosed.

1. Plaintiff/Appellant Nautilus Insurance Company ("Nautilus") is a wholly owned subsidiary of Admiral Insurance Company, which is a wholly owned subsidiary of Berkley Insurance Company, and both are subsidiaries of W.R. Berkley Corporation, which is a publicly traded corporation.

2. Linda Wendell Hsu, Peter W. Bloom, and Gil Glancz of Selman Breitman LLP have represented Nautilus Insurance Company in this litigation.

These representations are made in order that the judges of this court may evaluate possible disqualification or recusal.

DATED: November 20, 2019 Selman Breitman LLP

By: */s/ Gil Glancz*

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JURISDICTIONAL STATEMENT

This case presents a legal question certified to this Court under NRAP 5 by the United States Court of Appeals for the Ninth Circuit in *Nautilus Insurance Company v. Access Medical, LLC et al*. No. 17-16264, No. 17-16272, No. 17-16273, and D.C. No. 2:15-cv-00321-JAD-GWF (hereafter "*Nautilus Ins. Co. v. Access Medical*). Joint Appendix, Vol. VI, Page 01052 (hereafter "Jt. App'x, Vol. __, p. __"). Under NRAP 5(a), this Court "may answer questions of law certified to it by . . . a Court of Appeals of the United States . . . when requested by the certifying court, if there are involved in any proceeding before those courts questions of law of this state which may be determinative of the cause then pending in the certifying court and as to which it appears to the certifying court there is no controlling precedent in the decisions of the Supreme Court or Court of Appeals of this state." NRAP 5(a); *see Volvo Cars of N. Am., Inc. v. Ricci*, 122 Nev. 746, 749-51, 137 P.3d 1161, 1163-64 (2006). On September 20, 2019, this Court accepted the certified question. *See* Order Accepting Certified Question, Directing Briefing, and Directing Submission of Filing Fee.

ROUTING STATEMENT

This case presents a question of law certified by the United States Court of Appeals for the Ninth Circuit in *Nautilus Ins. Co. v. Access Medical*. Therefore,

jurisdiction is retained by the Supreme Court. NRAP 17(a)(6) ("The Supreme Court shall hear and decide . . . [q]uestions of law certified by a federal court.")

STATEMENT OF ISSUES

The Court has accepted certification of the following question:

> Is an insurer entitled to reimbursement of costs already expended in defense of its insureds where a determination has been made that the insurer owed no duty to defend and the insurer expressly reserved its right to seek reimbursement in writing after defense has been tendered but where the insurance policy contains no reservation of rights?

See Order Accepting Certified Question, Directing Briefing and Directing Submission of Filing Fee.

STATEMENT OF THE CASE

The following statement is taken primarily, and with only limited editing, from the Order Certifying Question to the Nevada Supreme Court. Citations are added only for the Court's convenience, not to contradict the facts as stated in that order.[1] The parties have included for the Court's convenience a Joint Appendix containing the full briefing before the Ninth Circuit relating to this issue. However, the information necessary to resolve this issue is included in this brief.

After a business partnership went sour, Ted Switzer filed a cross-complaint against Access Medical and Robert Clark Wood II (collectively "Insureds") in California state court. Jt. App'x, Vol. IV, p. 623-680. The cross-complaint included thirty-one causes of action against the Insureds, most of which the parties concede did not trigger a duty to defend. Included in those thirty-one claims was a purported claim for interference with prospective economic advantage, in which Switzer alleged that the Insureds interfered with relationships with hospitals with which Switzer "enjoyed a long-standing and mutually beneficial relationship."

Although never referenced in the cross-complaint, at some point an email written by Jacqueline Weide, a representative of Access Medical, was uncovered. Jt. App'x, Vol. II, p. 91. (In fact, the email was uncovered by Nautilus in the

[1] Citations to the joint appendix will include a page number, which refers to the "NV Sup Ct CQ – Joint Appendix00001" page numbering. This is to prevent any confusion, as many of the documents were previously numbered as exhibits in support of the briefing on this issue before the Ninth Circuit.

course of its coverage investigation). In the email, Weide advised one of the hospitals that Access Medical wanted to contract to sell spinal implants to them because the hospital's "Distributor in the California area is now banned from selling Alphatec implants." Switzer was the alleged Distributor.

Under the insurance policy, Nautilus was required to defend Insureds against "any suit seeking damages" because of a "personal and advertising injury," defined as "arising out of . . . [o]ral 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." Jt. App'x, Vol. II, p. 91.

Nautilus agreed to defend Insureds under an express reservation of rights. In a May 19, 2014 letter, Nautilus reserved its right to disclaim coverage, withdraw from the defense, and obtain a reimbursement of defense fees following a determination that no potential for coverage existed. Insureds did not object to the payment of defense counsel invoices. Jt. App'x, Vol. II, p. 91. On October 2, 2014, Nautilus issued a supplemental reservation of rights letter again reserving the right to reimbursement of all attorneys' fees, expert fees, defense costs, indemnification payments, and other litigation-related expenses paid in connection with its defense of Access Medical and Wood. Jt. App'x, Vol. II, p. 104-117.

Nautilus continued to pay for Insureds' counsel for the next two years. In an April 5, 2016 letter, Nautilus again reserved the right to demand reimbursement of

defense costs. Nautilus continued to pay defense costs after the letter was sent. Jt. App'x, Vol. IV, p. 545.

In the meantime, on February 24, 2015, Nautilus sought a declaratory judgment in Nevada federal district court that Nautilus never had a duty to defend or indemnify Insureds. Jt. App'x, Vol. IV, p. 612-621. Nautilus filed a motion for partial summary judgment. The Nevada district court found that Nautilus's duty to defend under the policy was never triggered under Nevada law because Switzer's cross-complaint did not allege, and the Weide email did not contain, a false statement that would support a claim for defamation, libel, or slander under California law. Jt. App'x, Vol. I, p. 72-78. Therefore, the district court construed Nautilus's motion as one for full summary judgment, entered judgment in favor of Nautilus, and closed the case. Nautilus subsequently brought a motion for further relief under 28 U.S.C. § 2202 seeking reimbursement of defense costs incurred defending Insureds in the Switzer cross-complaint. Insureds filed a motion for reconsideration arguing that Nautilus had a duty to defend Insureds. The district court denied both motions in the same order. Jt. App'x, Vol. I, p. 60-66. On the reimbursement issue, the district court concluded Nautilus was not entitled to further relief because (1) Nautilus did not include a claim for reimbursement or damages in its complaint; (2) Nautilus did not show it was entitled to relief as a matter of law under § 2202; and (3) Nautilus did not establish it was entitled to

reimbursement under Nevada law. Jt. App'x, Vol. I, p. 60-66.

In a memorandum disposition of July 2, 2019, the Ninth Circuit affirmed the district court's determination that Nautilus did not owe a duty to defend Insureds and reserved judgment on whether Nautilus could seek further relief under § 2202, depending on whether Nautilus is entitled to reimbursement under Nevada law. Jt. App'x, Vol. VI, p. 1046.

Nautilus defended the Insureds for over three years—from May 19, 2014 through August 1, 2017, and only withdrew after the District of Nevada granted summary judgment in Nautilus's favor.

STATEMENT OF FACTS

In its certification order, the Ninth Circuit Court of Appeals provided a factual background relevant to the certified question at issue. *See in re Fountainbleau Las Vegas Holdings, LLC*, 127 Nev. 941, 955, 267 P.3d 786, 794 (2011) ("The certifying court must include a statement of facts relevant to the question certified in its order certifying questions to this court.") (citation omitted). The Supreme Court of Nevada is "bound by the facts as stated in the certification order" and "cannot make findings of fact in responding to a certified question." *Id*. at 955-956. Thus, it is for this Court's ease of reference, not to contradict the Ninth Circuit, that Nautilus has provided the summary of the facts in the statement of the case.

SUMMARY OF NAUTILUS'S ARGUMENT

There is an implicit right to reimbursement of defense costs incurred in defending uncovered claims because insureds do not pay premiums for such a defense, and therefore are unjustly enriched. As discussed below, this position is consistent with Nevada's interpretation of insurance contracts in particular, and all contracts more generally. Nevada should also adopt this position because it incentivizes insurance companies to defend first and sort out coverage later, which both reduces the total cost to all parties and protects the insureds pending a coverage determination.

The majority of states to have ruled on this question, in particular California, allow for the recoupment of defense costs expended by the insurer in defending uncovered claims. *See Scottsdale Ins. Co. v. MV Transportation*, 115 P.3d 460, 468 (Cal. 2005), *Buss v. Superior Court*, 939 P.2d 766, 776–778 (Cal. 1997). This position is also endorsed by the Restatement (Third) of Restitution and Unjust Enrichment.

The District of Nevada and the Ninth Circuit have both made "*Erie* Predictions" that Nevada law would allow for the reimbursement of defense costs incurred in defending uncovered claims. *Forum Ins. Co. v. County of Nye, Nev.*, No. 91-16724, 1994 WL 241384, at *2-3 (9th Cir. 1994) (unpublished disposition), *Probuilders Specialty Ins. Co. v. Double M. Const.*, 116 F.Supp.3d 1173, 1182

(D.Nev. 2015), *Capitol Indem Corp. v. Blazer*, 51 F.Supp.2d 1080, 1090-1091 (D.Nev. 1999).

This Court should follow the majority of jurisdictions which have examined this question and reach the decision that under Nevada law, there is a quasi-contractual right for an insurer to recoup defense fees and costs expended in defending uncovered claims.

ARGUMENT

A. Nevada Already Upholds the Legitimacy of Unilateral Reservation of Rights Letters from the Insurer to the Insured

Liability insurance policies create a "cascading hierarchy of duties between the insurer and the insured." *Allstate Ins. Co. v. Miller*, 125 Nev. 300, 309, 212 P.3d 318, 324 (2009). At the top of this hierarchy are two duties owed by the insurer to the insured—the duty to indemnify and the duty to defend. *Miller*, 125 Nev. at 309, 212 P.3d at 324. The duty to defend arises whenever an insurer "ascertains facts which give rise to the potential of liability under the policy." *Century Surety Company v. Andrew*, 432 P.3d 180, 183, 134 Nev. Adv. Opp. 100, at *822 (2018) (not yet published in 134 Nev., therefore hereafter all citations to only the Pacific Reports).

The duty to defend, although broad, is not absolute. *United National Ins. Co. v. Frontier Ins. Co.,* 120 Nev. 678, 687, 99 P.3d 1153, 1158 (2004). There is no duty to defend when there is no theory where the facts fall within the coverage of

the insurance policy. *Andrew*, 432 P.3d at 184 n.4.

When an insurer receives a tender of defense, the insurer has three options: (1) deny the tender, (2) agree to defend without a reservation of rights, or (3) agree to defend with a reservation of rights. When the facts as alleged may or may not fall within the coverage of the policy, "[t]he insurer can always agree to defend the insured with the limiting condition that it does not waive any right to later deny coverage based on the terms of the insurance policy under a reservation of rights." *Andrew*, at 184, n.4. This reservation of rights is effective because the duty to defend is not permanent once triggered. The duty to defend arises when the potential for indemnification arises, but is extinguished when it is determined that there was never a potential for indemnification. *Benchmark Ins. Co. v. Sparks*, 127 Nev. 407, 412, 254 P.3d 617, 620-621 (2011). In fact, this Court has encouraged an insurer, when that insurer has doubts about coverage, to defend a suit against its insured under a reservation of rights and "seek to terminate [the] duty to defend" in another action. *Andrew,* 432 P.3d at 184, n.4. This Court in *Andrew* favorably cited a Washington case that summarizes the position succinctly: "If the insurer is uncertain of its duty to defend, it may defend under a reservation of rights and seek a declaratory judgment that it has no duty to defend." *Woo v. Fireman's Fund Ins. Co.* 164 P.3d 454, 460 (Wash. 2007), cited with approval in *Andrew,* 432 P.3d at 184, n.4.

Nevada courts have found that unilateral reservations of rights letters are valid. *See e.g. Havas v. Atl. Ins. Co*., 96 Nev. 586, 586, 614 P.2d 1, 1 (1980); *see also Las Vegas Metropolitan Police Dept. v. Coregis Ins. Co*., 127 Nev. 548, 553, 256 P.3d 958, 962, n.3 (2011). If an insured does not object to the reservation of rights, this Court has found that "silence can raise an estoppel quite as effectively as can words." *NGA #2 Ltd. Liability Co. v. Rains*, 113 Nev. 1151, 1160, 946 P.2d 163, 169 (1997). The enforceability of a unilateral reservation of rights letter makes the insurer's three choices upon receiving a tender of defense meaningful: the insurer has a middle ground between denying coverage on the one hand, and on the other accepting defense of a claim for which the parties did not bargain. *See United National Ins. Co.*, 120 Nev. at 687, 99 P.3d at 1158.

B. Nevada Should Therefore Adopt the Majority Position—Expounded by the California Supreme Court in *Buss*—Which Allows for Reimbursement

California law allows insurers to seek reimbursement of defense fees and costs expended in defending insureds for uncovered claims. *Buss v. Superior Court*. 939 P.2d 766 (Cal. 1997). When deciding novel issues of insurance law, this Court has often looked to decisions by the California Supreme Court for guidance. *See e.g. Federal Ins. Co. v. American Hardware Mut. Ins. Co.*, 124 Nev. 319, 327, 184 P.3d 390, 395 (2008); *Jackson v. State Farm Fire and Cas. Co.*, 108 Nev. 504, 507-508, 835 P.2d 786, 789 (1992); *Commercial Standard Insurance*

Co. v. Tab Construction, Inc., 94. Nev. 536, 539, 583 P.2d 449, 451 (1978); *Eichacker v. Paul Reserve Life Ins. Co.*, 354 F.3d 1142, 1145 (9th Cir. 2004) ("[w]here Nevada law is lacking, its courts have looked to the law of other jurisdictions, particularly California, for guidance."). In particular, this Court has looked to California on the interpretation of the legal effect of a reservation of rights letter. *See State Farm Mut. Auto. Ins. Co. v. Hansen*, 131 Nev. 743, 750, 357 P.3d 338, 342 (2015) (holding that a reservation of rights does not *per se* create a conflict of interest).

The seminal case providing an insurer with the right to reimbursement of defense costs incurred in defending an uncovered claim is *Buss v. Superior Court*. 939 P.2d 766 (Cal. 1997).[2] The California Supreme Court held in *Buss* that the law "clearly allows insurers to be reimbursed for attorney's fees and other expenses paid in defending insureds against claims for which there was no obligation to defend." *Id.*, 776–778 (internal quotations omitted).

In *Buss*, a complaint was filed by a third party against an insured asserting

2 The California Supreme Court in *Buss* examined a so-called "mixed" case, that is, an "action containing some claims covered or potentially covered by a liability insurance policy and others that are not." 16 *Couch on Insurance*, § 226:124 (June 2019 Update). In a non-mixed case, like this one, the finding of no coverage means the "duty to defend [did] not arise in the first instance" and the insurer incurred costs without any legal obligation to do so. *Scottsdale Ins. Co. v. MV Transportation*, 115 P.3d 460 (Cal. 2005). "[J]urisdictions that have allowed recoupment in mixed cases, where the ground for recoupment is weaker, almost certainly would allow recoupment in non-mixed cases . . . . Conversely, jurisdictions that have disallowed recoupment in mixed cases might still allow recoupment in a non-mixed case, because in the latter action the insurer did not have the legal obligation to defend at all." Restatement of the Law of Liability Insurance, § 21, Reporter's Note A.

27 causes of action of which only defamation fell within the coverage of the insurance policy. *Buss*, 939 P.2d at 769. The insurer accepted the defense, but reserved its right to reimbursement. *Id*. at 770. Ultimately, the insured settled the claim, and the insurer had paid over $1 million in defense fees, of which only a portion was allocable to the defense of the defamation claim. *Id.* The California Supreme Court held that the insurer could not seek reimbursement for claims that were "at least potentially covered," but that an insurer could recover defense costs that were solely allocable to claims that were "not even potentially covered." *Id.* at 775-776.

In *Scottsdale v. MV Transportation*, plaintiff-insurer Scottsdale filed a declaratory relief action against its insured, a transportation company, to determine its duty to defend its insured in a suit between its insured and competitor. 115 P.3d 460, 463 (Cal. 2005). Scottsdale had accepted the defense of its insured pursuant to a reservation of rights, including the right to seek reimbursement. *Id.* The California Supreme Court ruled that Scottsdale had never had a duty to defend MV Transportation in the underlying action, and that Scottsdale was therefore entitled to reimbursement of the costs and expenses of defense advanced to the insured. *Id.* at 465. Specifically, the California Supreme Court held that the duty to defend is contractual, and that the insurer "has not contracted to pay defense costs for claims that are not even potentially covered." *Id.* at 466 (internal quotations omitted).

The California Supreme Court further held that an insurer "may unilaterally condition its proffer of a defense upon its reservation of right later to seek reimbursement of costs" which "permits the insured to decide whether to accept the insurer's terms for providing a defense, or instead to assume and control its own defense." *Id.* at 467.

The California Supreme Court rejected the underlying Court of Appeals' argument that an extinguishment of the duty to defend only relieves the duty to defend prospectively, and held instead that an insurer that properly reserves its rights "may obtain reimbursement of defense costs which, in hindsight, it never owed." *Id.* The court in *MV Transportation* distinguished between two different situations: (1) where the insurer proves through facts developed after the tender that the potential for coverage cannot materialize or no longer exists, and (2) where the insurer has shown that the duty to defend never arose in the first place. *Id.* at 468. In the second instance, where there *never was* a duty to defend, the insurer may properly seek reimbursement. *Id.* The California Supreme Court held that:

> An insurer facing unsettled law concerning its policies' potential coverage of the third party's claims should not be forced either to deny a defense outright, and risk a bad faith suit by the insured, or to provide a defense where it owes none without any recourse against the insured for costs thus expended. The insurer should be free, in an abundance of caution, to afford the insured a defense under a reservation of rights, with the understanding that reimbursement is available if it is later established, as a matter of law, that no duty to defend ever arose.

Id. at 470. The *MV Transportation* Court noted as well that,

> by requiring an insurer to risk bad faith liability if it declines a defense because of its belief that the third party claims are not potentially covered, or to forgo reimbursement if it elects to provide one, we would place the insurer in a Catch–22 and force it to furnish a defense, at its own expense, where none was ever owed under the policy.

Id. at 470, n.5.

As discussed below, Nevada has already adopted the logical underpinnings of *Buss* and *MV Transportation* in other contexts. For that reason, Nevada should adopt the position taken by California in *Buss* and *MV Transportation* based on the same analysis relied on by the California Supreme Court: (1) an insured who is defended for non-covered claims is unjustly enriched by that defense, (2) the right to reimbursement is implied in the contract, (3) the insured acquiesces to reimbursement by accepting the defense pursuant to the reservation of rights letter, (4) allowing reimbursement incentivizes insurers to defend in marginal cases, which is consistent with both judicial efficiency and the state's stated desire to protect insureds.

(1) Nevada Should Follow the *Buss* Court's Logic that Without Reimbursement, an Insured is Unjustly Enriched by Receiving a Defense for Uncovered Claims

The first reason cited by the California Supreme Court in *Buss* why the insurer is entitled to reimbursement is that the insured is unjustly enriched by receiving a defense for which they have not bargained:

> With regard to defense costs for [uncovered] claims, the insurer has not been paid premiums by the insured. It did not bargain to bear these costs. To attempt to shift them would not upset the arrangement. The insurer therefore has a right of reimbursement that is implied in law as quasi-contractual, whether or not it has one that is implied in fact in the policy as contractual. As stated, under the law of restitution such a right runs against the person who benefits from "unjust enrichment" and in favor of the person who suffers loss thereby. The "enrichment" of the insured by the insurer through the insurer's bearing of unbargained-for defense costs is inconsistent with the insurer's freedom under the policy and therefore must be deemed "unjust." [3]

Buss v. Superior Court, 939 P.2d 766, 776–778 (Cal. 1997) (internal citations omitted). This Court should adopt the same logic, because Nevada law, likewise, recognizes the appropriateness of a cause of action for unjust enrichment:

> Unjust enrichment exists when the plaintiff confers a benefit on the defendant, the defendant appreciates such benefit, and there is acceptance and retention by the defendant of such benefit under circumstances such that it would be inequitable for him to retain the benefit without payment of the value thereof.

Certified Fire Prot. Inc. v. Precision Constr., 128 Nev. 371, 381, 283 P.3d 250, 257 (2012) (internal quotations omitted).

In this case, Nautilus conferred a benefit on the Insureds by providing a

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[3] The Court in *Buss* provided the following example:

> It is like the case of *A* and *B*. *A* has a contractual duty to pay *B* $50. He has only a $100 bill. He may be held to have a prophylactic duty to tender the note. But he surely has a right, implied in law if not in fact, to get back $50. Even if the policy's language were unclear, the hypothetical insured could not have an objectively reasonable expectation that it was entitled to what would in fact be a windfall[.]

Buss v. Superior Court, 939 P.2d 766, 776–778 (Cal. 1997) (some internal citations omitted).

defense in a case that did not ever trigger the duty to defend, and the Insureds accepted and retained that benefit. By receiving a defense for which it did not pay premiums, an insured receives a windfall, subsidized by the premiums paid by other policyholders. Robert H. Jerry II, *The Insurer's Right to Reimbursement to Defense Costs*, 42 Ariz L. Rev. 13, 24-25 (2000). This windfall belongs in equity and good conscience to the insurer, which has paid funds for a defense that was not owed under the policy. *See Unionamerica Mortg. And Equity Trust v. McDonald*, 97 Nev. 210, 212, 626 P.2d 1272, 1273 (1981).

The Insureds did not pay premiums for the defense of uncovered claims, and neither the Insureds nor Nautilus bargained for the defense of uncovered claims. Nevada provides equitable remedies specifically to avoid such situations where a party would receive a windfall. *See Houston v. Bank of America Federal Savings Bank*, 119 Nev. 485, 490, 78 P.3d 71, 74 (2003). The purpose of unjust enrichment is to do justice to the parties. *Unionamerica Mortg. And Equity Trust, supra*, 97 Nev. at 212, 626 P.2d at 1273.

Moreover, an insured that accepts a defense pursuant to a reservation of rights and later is ordered to reimburse the insurer is in a better position than one that tendered but did not receive a defense because it received a defense for which it has been able to defer payment. "Benefit in the unjust enrichment context can include services beneficial to or at the request of the other, [and] denotes any form

of advantage." *Certified Fire Prot. Inc. v. Precision Constr.*, 126 Nev. 371, 382, 283 P.3d 250, 257 (2012) (internal quotations omitted). This is similar to the unjust enrichment found by this Court in *Topaz Mut. Co. Inc. v. Marsh*, where the benefit received by the respondent property owner was not just the cash received, but the "additional time to negotiate" by postponing the foreclosure of their property. 108 Nev. 845, 856, 839 P.2d 606, 613 (1992). The insured benefits from the postponement of the payment that it was required to make.

The availability of unjust enrichment relief for an insurer under Nevada law is evident from considering its inverse: the "voluntary payment" affirmative defense. *See e.g. JPMorgan Chase Bank, N.A. v. Saticoy Bay LLC Series 7517 Apple Cider*, 2019 WL 4677013, at *3 (D.Nev. 2019); *Deutsche Bank National Trust Company as Trustee for Ameriquest Mortgage Securities Inc. v. SFR Investments Pool 1, LLC* 2019 WL 1445956, at *3-4 (D.Nev. 2019). The voluntary payment doctrine states that "money voluntarily paid, with full knowledge of all the facts, although no obligation to make such payment existed, cannot be recovered back." *Nevada Ass'n Servs., Inc. v. Eighth Jud. Dist. Ct.*, 130 Nev. 949, 954, 338 P.3d 1250, 1254 (2014). A reservation of rights letter makes clear that the insurer's payment of defense costs is not "voluntarily paid." Rather, it is paid with the express statement that coverage may be challenged in a separate action, and that the insurer will seek to recoup those costs if there is a finding of no

coverage.

Thus, Nevada should follow its own unjust enrichment law and apply it in the insurance context. An insured that received the benefit of a defense to which it was not entitled must reimburse the insurer.

(2) The Right to Reimbursement is Necessarily Implied in the Policy

The right of reimbursement is necessarily implied in law even though it does not exist expressly in the policy. "As a general matter at least, one may infer that a party to a contract has an implied-in-fact right to bring an action for damages in case of breach. Apparently he could similarly infer that the insurer has a right of reimbursement of the same kind." *Buss*, 939 P.2d at 776, n.13.

The right to sue for damages exists in all contracts. *U.S. v. Winstar Corp.* 518 U.S. 829 (1996) (citing Restatement (Second) of Contracts § 346, Comment *a* (1981) ("Every breach of contract gives the injured party a right to damages against the party in breach.")). As the California Supreme Court pointed out, the lack of a reimbursement provision in the policy does not mean that the right does not exist, but rather, the implied right renders the inclusion of an express provision unnecessary. *Buss*, 939 P.2d at 776, n.13.

As the Court in *Buss* stated, a related implied term in a liability policy is the insurer's duty to defend an entire action prophylactically even when only a single cause of action is potentially covered. *Id.*, 939 P.2d at 775. This duty does not

arise out of the policy, but rather is "an obligation imposed by law in support of the policy." *Id.* This Court has previously cited this line of California cases favorably for the related holding that the duty to defend is broader than the duty to indemnify, and that the duty to defend arises whenever the insurer ascertains facts that give rise to the potential for liability under the policy. *United National Ins. Co. v. Frontier Ins. Co., Inc*., 120 Nev. 678, 686, 99 P.3d 1153, 1158, n.21, 23 (2004) (citing *Horace Mann Ins. Co v. Barbara B.*, 846 P.2d 792, 795 (Cal. 1993); *Gray v. Zurich Ins. Co.*, 419 P.2d 168, 177 (Cal. 1966)). "The insurer's reimbursement right merely *balances out* the insured's right to a defense of the entirety of a mixed action." *Prichard v. Liberty Mut. Ins. Co.*, 84 Cal.App.4th 890, 907 (Cal. App. 2000) (emphasis in original).

In Nevada, the existence of implied terms in a contract does not exceed the reasonable expectations of an insured—Nevada recognizes the existence of implied terms in all contracts, including insurance contracts. Where possible, a court "must supply those things which it is bound under the law to imply in order to carry out the intent of the parties so as to make the agreement lawful, effective and reasonable." *Mohr Park Manor, Inc. v. Mohr*, 83 Nev. 107, 113, 424 P.2d 101, 106 (1967). For instance, the covenant of good faith and fair dealing itself does not appear in the express terms of the insurance contract. *See e.g. Allstate v. Miller*, 125 Nev. at 319, 212 P.3d at 330. Nevada also recognizes the existence of

implied terms of residential leases—the covenant of quiet enjoyment and the warranty of habitability. *Radaker v. Scott*, 109 Nev. 653, 661, 855 P.2d 1037, 1042 (1993), *Ripps v. Kline*, 70 Nev. 510, 513-514, 275 P.2d 381, 382-383 (1954). As another example, Nevada recognizes that a construction lender has an implied-in-law duty to inspect the construction work if the borrower requests that the lender halt payment because of self-evidently faulty work, even when there is an explicit term in the contract that states the lender has no duty of inspection. *Davis v. Nevada Nat. Bank*, 103 Nev. 220, 223, 737 P.2d 503, 505-506 (1987).

Nevada should extend this logic to the insurance context, and hold that the right of reimbursement is implied in the insurance policy, as a necessary corollary to the obligation to defend all claims prophylactically.

(3) The Insured Acquiesced to the Right of Reimbursement by Accepting the Defense Pursuant to the Reservation of Rights

Interpreting *Buss*, the California Supreme Court found that an "insurer may unilaterally condition its proffer of a defense upon its reservation of a right later to seek reimbursement of costs . . . [and s]uch an announcement [] permits the insured to decide whether to accept the insurer's terms for providing a defense, or instead to assume and control its own defense." *Scottsdale Ins. Co. v. MV Transportation*, 115 P.3d 460, 467 (Cal. 2005). Nevada law similarly recognizes that one party can acquiesce to proffered terms through silence. The Nevada Supreme Court "has

noted that silence can raise an estoppel quite as effectively as can words." *Cheqer, Inc. v. Painters and Decorators Joint Committee, Inc.* 98 Nev. 609, 614, 655 P.3d 996, 999 (1982); *see Goldstein v. Hanna*, 97 Nev. 559, 562, 635 P.2d 290, 292 (1981); *Gardner v. Pierce*, 22 Nev. 146, 36 P. 782 (1894).

Reservation of rights letters are valid under Nevada law. *Havas v. Atl. Ins. Co.*, 96 Nev. 586, 588, 614 P.2d 1, 2 (1980) (per curium) (insurer "agreed to investigate validity of the claim while specifically reserving all defenses available to it."). The validity of reservation of rights letters is also supported by Nevada's adoption of the Uniform Commercial Code, including the provision that "[a] party that with explicit reservation of rights performs . . . in a manner demanded [] by the other party does not thereby prejudice the rights reserved." N.R.S. 104.1308. Comment 2 to the analogous provision of the U.C.C. notes that the provision exists to reserve rights "where one party is claiming as of right something which the other believes to be unwarranted." Nevada law does not require that an agreement be manifested by language, but can be "inferred from other circumstances, including course of performance." N.R.S. 104.1201. This course of performance can include silence. Restatement (Second) of Contracts § 4, comment a (interpreting Uniform Commercial Code § 1-201(3), favorably cited in *Hilton Hotels Corp. v. Butch Lewis Productions, Inc.*, 107 Nev. 226, 231, 808 P.2d 919, 922, n.3 (1991).

An insured's silent acceptance of performance following a reservation of

rights demonstrates assent to the terms of the reservation of rights, and the insured cannot later alter the terms under which that performance was offered. *See* Restatement (Second) of Contracts § 69 (1981). It is commonly accepted that the insured acquiesces to the terms of the reservation of rights by silence:

> The insurer need only notify, or attempt to notify, the assured that it is conducting the investigation and defense of the tort claim under a reservation of the right to assert policy defenses at a later time, and the assured's silence will usually be deemed acquiescence. Courts have in general been fairly liberal in implying reservations. In fact, where an assured refused to consent to a nonwaiver agreement and then said nothing when the insurer undertook to defend the suit, it was held that he had impliedly assented to the appearance of the insurer on a basis of rights reserved. In another case a minor who had signed a nonwaiver agreement disaffirmed it upon reaching his majority. The court held the disaffirmance ineffective since the assured had notice of the insurer's reservation and that was all that was necessary.

Liability Insurance Policy Defenses and the Duty to Defend., Note, 68 Harv. L. Rev. 1436, 1447 (1955).

"An insured's acceptance of a defense the insurer proffers with a reservation of rights implies the insured's consent to the reservation." *Excess Underwriters at Lloyd's, London v. Frank's Casing Crew & Rental Tools, Inc*., 246 S.W.3d 42, 47 (Tex. 2008). In fact, numerous state courts have found that a reservation of rights letter is effective so long as no objection is made to it after receipt. Magarick, et. al., *Casualty Insurance Claims*, § 14:10 Unilateral Instrument (May 2019 Update) (citing *State Farm Mut. Auto. Ins. Co. v. Lucas*, 365 N.E.2d 1329 (Ill. 1977),

Johnson v. Universal Underwriters, Inc., 283 F.2d 316 (7th Cir. 1960) (applying Ind. law), *Allstate Ins. Co. v. Manger*, 213 N.Y.S.2d 901 (Sup 1961), *Western Cas. & Sur. Co. v. Newell Mfg. Co*., 566 S.W.2d 74 (Tex. Civ. App. San Antonio 1978), writ refused n.r.e., (Sept. 20, 1978)).

The District of Nevada, in *Capitol Indem. Corp. v. Blazer*, found that reimbursement is available when the insured has "unambiguous notice that it may later be held responsible for costs incurred." 51 F.Supp.2d 1080, 1090 (D.Nev. 1999). A clear reservation of rights letter provides such unambiguous notice, and an insured may acquiesce through silence. *Id.* The same court later held that "acceptance of monies constitutes an implied agreement to the reservation of the insurer's right to seek reimbursement." *Probuilders Specialty Ins. Co. v. Double M. Const.*, 116 F.Supp.3d 1173, 1182 (D.Nev. 2015). The California Supreme Court described this as follows: "The insurer may unilaterally condition its proffer of a defense upon its reservation of a right later to seek reimbursement of costs advanced to defend claims that are not, and never were, potentially covered by the relevant policy." *Scottsdale Ins. Co. v. MV Transportation*, 115 P.3d 460, 467 (Cal. 2005).

Because Nevada already acknowledges the validity of reservation of rights letters, this Court should follow the decisions of the District of Nevada and require reimbursement when that right is reserved by the insurer.

(4) Allowing Reimbursement Will Incentive Insurers to Defend in Cases Where Coverage is Questionable

The California Supreme Court, in *Buss*, emphasized that reimbursement properly incentivizes insurers to defend in marginal cases.

> Without a right of reimbursement, an insurer might be tempted to refuse to defend an action in any part—especially an action with many claims that are not even potentially covered and only a few that are—lest the insurer give, and the insured get, more than they agreed.

Buss v. Superior Court, 939 P.2d 766, 776–778 (Cal. 1997). The case at issue in this certified question is a perfect example. The underlying cross-complaint that was the subject of this declaratory relief action was fifty-nine pages, one hundred ninety-six paragraphs and thirty-one causes of action, arising out of allegations of business malfeasance. Jt. App'x, Vol. IV, p. 623. Coverage turned on one email communication that was not mentioned in any underlying pleading, Jt. App'x, Vol. IV, p. 623, was located by the insurer's counsel while investigating the tender, Jt. App'x, Vol. II, p. 91, and ultimately did not create coverage. Jt. App'x, Vol. I, p. 62-64, 72-78. Nautilus defended for over three years on the basis of that email.

The California position is endorsed by the Restatement (Third) of Restitution and Unjust Enrichment.

> Faced with the impossibility, in many circumstances, of obtaining a determination of the parties' rights and obligations before the claimed performance is due, and failing a compromise, a contracting party may be compelled by circumstances to render a performance to which the other is not entitled. Compulsion frequently lies in the fact that the alternative course of action—rejecting the other party's demand before

> the requirements of the contract can be judicially determined—would expose the claimant to a risk of loss or liability whose expected value exceeds the amount in controversy . . . .
>
> The common-sense solution to this dilemma—allowing performance with reservation of rights—promotes justice and efficiency. Because it offers recourse to a party who might otherwise be effectively compelled to render an extracontractual performance, it serves both to reinforce the parties' agreement and to prevent the unjust enrichment that would otherwise result. Equally important, the mechanism of contingent or provisional performance (that is, performance subject to an eventual claim in restitution) will serve in many cases to reduce the overall cost of resolving the parties' dispute.

Restatement (Third) of Restitution and Unjust Enrichment § 35 (2011).

Other provisions of this restatement have been adopted by this Court. *See e.g., Certified Fire Prot. Inc. v. Precision Constr.*, 128 Nev. 371, 381, 283 P.3d 250, 257 (2012); *see also Topaz Mut. Co., Inc. v. Marsh*, 108 Nev. 845, 856, 839 P.2d 606, 613 (1992), *Tarrant v. Monson*, 96 Nev. 844, 845, 619 P.2d 1210, 1211 (1980), *Leibowitz v. Eighth Judicial Dist. Court in & for County of Clark*, No. 77377, 432 P.3d 188 (Table), 2018 WL 6617710 (Nev. 2018) (unpublished disposition).

Specifically in the insurance context, the Restatement (Third) recommends allowing performance with a reservation of rights and a subsequent suit for reimbursement:

> Public policy strongly favors the prompt discharge of an insurer's obligations to its policyholder. If the insurer intends to dispute coverage, protection of the policyholder requires prompt notice of the

> insurer's legal position. Statutes in many jurisdictions[4] penalize an insurer that fails either to disclaim coverage (if it intends to do so), or to settle a claim, within a reasonable time or within specified time limits. Such laws acknowledge the policyholder's special interest in obtaining either a prompt settlement or a prompt test of its rights under the policy . . . .
>
> In the absence of compromise, however, the risk of enhanced liability in coverage disputes may compel a performance by the insurer that is outside the scope of the insurance contract. If the insurer, by denying coverage, risks a potential liability greater than the amount initially in controversy—and if the insurer is obliged to take action before the coverage issue can be adjudicated—the effect of the applicable legal rules may be to subject the insurer to an extracontractual liability. **Such a result distorts the parties' allocation of risks and creates the sort of unjust enrichment with which the present section is concerned**.

Restatement (Third) of Restitution and Unjust Enrichment § 35 (2011) (emphasis added).

The Restatement (Third) of Restitution and Unjust Enrichment urges insurers in receipt of a tender of defense to defend under a reservation of rights, unilaterally if necessary, file a declaratory relief action, and seek restitution. § 35 (2011). The same course of action has been endorsed by the state courts that have adopted the majority position as a matter of their own state law. *See e.g. Hecla Min. Co. v. New Hampshire Ins. Co.* 811 P.2d 1083, 1089 (Colo. 1991) ("The appropriate course of action for an insurer who believes that it is under no

4 See, e.g., N.R.S. 686A.310(1)(b) (failure to acknowledge and act reasonably promptly upon communications with respect to claims arising under an insurance policy), 686A.310(1)(d) (failure to affirm or deny coverage of claims within a reasonable time after proof of loss requirements have been completed and submitted by the insured).

obligation to defend, is to provide a defense to the insured under a reservation of rights to seek reimbursement should the facts at trial prove that the incident resulting in liability was not covered by the policy, or to file a declaratory judgment action after the underlying case has been adjudicated.") (cited favorably in *United National Ins. Co. v. Frontier Ins. Co.,* 120 Nev. 678, 687, 99 P.3d 1153, 1158 n.26 (2004)); *Sec. Ins. Co. of Hartford v. Lumbermens Mut. Cas. Co*., 826 A.2d 107, 125 (Conn. 2003) ("A cause of action for reimbursement is cognizable to the extent required to ensure that the insured not reap a benefit for which it has not paid and thus be unjustly enriched. Where the insurer defends the insured against an action that includes claims not even potentially covered by the insurance policy, a court will order reimbursement for the cost of defending the uncovered claims in order to prevent the insured from receiving a windfall."); *Travelers Cas. and Sur. Co. v. Ribi Immunochem Research Inc.*, 108 P.3d 469, 480 (Mont. 2005); *see also Nationwide Mut. Ins. Co. v. Flagg*, 789 A.2d 586, 597 (Del. Super. Ct. 2001).

This Court has already endorsed the first two steps in the strategy suggested by the Restatement of Restitution—(1) defending pursuant to a reservation of rights, and (2) filing a declaratory relief action. "[T]he insurer can always agree to defend the insured with the limiting condition that it does not waive any right to later deny coverage based on the terms of the insurance policy under a reservation

of rights." *Century Sur. Co. v. Andrew*, 432 P.3d 180, 184, n.4 (2018). This Court in *Andrew* encouraged insurers to raise facts from outside the complaint in a declaratory-judgment action while defending the insureds in the underlying action. *Id.* at 184 n.4 (citing *Woo v. Fireman's Fund Ins. Co.*, 164 P.3d 454, 460 (Wash. 2007). This Court has previously upheld summary judgment granted in declaratory relief actions brought by insurers to determine coverage while providing a defense in an underlying action. *See e.g. Mallin v. Farmers Ins. Exchange*, 108 Nev. 788, 796, 839 P.2d 105, 110 (1992).

Holding that there is an implicit right to reimbursement under a theory of unjust enrichment will further incentivize insurers to defend in marginal cases, knowing that there is the possibility of mitigating the costs of that extracontractual performance later. This Court should therefore adopt the majority position.

C. Nevada Should Reject the Minority Position Because an Insured is Still Unjustly Enriched, Even When the Insurer Benefitted from Providing a Defense to the Insured

Those Courts that have held that there is no right to reimbursement inappropriately disregard the application of the principle of unjust enrichment. These courts presume that the offer of defense is made at least as much for the benefit of the insurer as for the benefit of the insured. *See Terra Nova Ins. Co., Ltd v. 900 Bar, Inc.*, 887 F.2d 1213, 1219-1220 (3d Cir. 1989); *General Agents Ins. Co. of America, Inc. v. Midwest Sporting Goods Co.*, 828 N.E.2d 1092, 1102-1103

(Ill. 2005). However, such a holding is not supported by the tenets of Nevada law.

No Nevada case supports the principle that there can be no unjust enrichment in a circumstance where the party seeking recovery for unjust enrichment also benefitted from conferring extracontractual performance. The Court in *Buss* found that such a principle was inappropriate, because it presumes the "motive" of an insurance company. *Buss*, 939 P.2d at 776, n.13 ("the mind and heart of [an insurer] is purely fictive. The analysis in the text does not attempt to fathom why the insurer acts as it does subjectively, but merely looks to what results from its action objectively."). This Court should follow the California Court's reasoning.

In addition to this defect, the logic of the *Terra Nova* and *Midwest Sporting Goods* courts is, respectfully, not coherent: the insurer's provision of a defense to protect itself from future bad faith litigation is not "incidental to the performance of [its] own duty or to the protection of [its] own things." *Buss*, 939 P.2d at 776, n.13 (describing prior California case law on the same question). It cannot be incidental to the performance of its own duty, as the question only arises when there *was no duty to defend*. When there was no potential for coverage, there was no duty owed. *Andrew*, 432 P.3d at 184 n.4. Although in a mixed case it is arguable that the defense of non-covered claims is incidental to the performance of the insurer's duty to defend covered claims, in a case where there was no duty to defend at all,

defense of the case could not have been incidental to performance of a duty.

CONCLUSION

This Court should adopt the majority position as articulated by the California Supreme Court in *MV Transportation* and in *Buss*, and answer the Ninth Circuit's Certified Question in the affirmative. This is consistent with Nevada's principles of unjust enrichment and will encourage insurers to protect their insureds in cases of dubious coverage by defending while awaiting a judicial determination of coverage.

By defending an insured in a case where there is no coverage, an insurer provides an extracontractual benefit to the insured, beyond the scope of their bargaining, and not paid for by the insured's premiums. Because an insurance policy is interpreted like any other contract under Nevada law, this should give rise to a right to be reimbursed for the costs of that extracontractual performance. Like the right to sue for damages for breach of contract, the right to seek reimbursement for performance beyond the terms of a contract is implied in the contract.

Such a rule is fair and logical. The insured will not be surprised by the insurer seeking reimbursement where, as here, the insurer defended pursuant to a complete reservation of rights including an explicit reservation of the right to seek reimbursement of these costs.

Importantly, such a rule will encourage insurers to defend the insured in

cases where the duty to defend is not clear, and litigate that defense in a separate action, rather than leave the insured to defend itself. This promotes Nevada's interest in having competent counsel representing litigants in its courts. To hold otherwise would encourage insurers to take the risk of withholding defense in a marginal case.

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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) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word in 14-point Time New Roman font.

2. I further certify that this brief complies with the page or type-volume limitations of NRAP 32(a)(7)(A) because, excluding the parts of the brief exempted by NRAP 32(a)(7)(c), it: contains fewer than 10,000 words (9,609).

3. I hereby certify that I have read this 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.

4. I understand I may be subject to sanctions in the event the accompanying brief is not in conformity with the requirements of the NRAP.

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CERTIFICATE OF SERVICE

I hereby certify that I am an employee of SELMAN BREITMAN LLP and on the 22nd day of November, 2019, a true and correct copy of the above and foregoing document was e-filed and e-served on all registered parties to the Supreme Court's electronic filing system and by United States First-Class mail to all unregistered parties as listed below:

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