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UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF CALIFORNIA

CAROLINA CASUALTY INSURANCE CASE NO. 1:10-cv-916-LJO-MJS
COMPANY,

Plaintiff,

v.

JONES HELSLEY, PC, et al.,

Defendants.

ORDER RECOMMENDING THAT
DEFENDANTS' MOTION TO STAY BE
GRANTED

(ECF No. 44)

OBJECTIONS DUE WITHIN THIRTY DAYS

_____ /

Before the Court is Defendants' and Counterclaimants' Motion to Stay of All Proceedings. (ECF No. 44.) The Court considered all the papers filed in support of and in opposition to the Motion and heard argument on the Motion on December 10, 2010.

For the reasons stated at the hearing and modified and supplemented below, the Court recommends that Defendant and Counterclaimants' Motion for a Stay be GRANTED until the underlying action, *James A. Bratton and Bratton Investments, LLC v. Timothy Jones, et al.*, pending in California Superior Court, Fresno County, as action number 10CECG02212AM (the "Bratton Action" or the "Underlying Action") is resolved. However, it is further recommended that Plaintiff be given the right to seek relief from the stay if and

1 when it in good faith believes and represents that circumstances have changed so that the
2 reasons for the stay no longer exist, provided no such motion for relief from the stay be
3 initiated for at least six months..
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5 **I. LEGAL STANDARD**

6 Courts have the discretion to stay insurance coverage actions until after the
7 underlying actions have been decided. Courts may stay an insurance coverage action to
8 avoid inconsistent determinations that could prejudice an insured; a stay is appropriate
9 unless the facts to be litigated in the coverage case are unrelated to issues of
10 consequence in the underlying case . Montrose Chemical Corp. of Calif. v. Superior Court,
11 6 Cal. 4th 287, 24 Cal. Rptr. 2d 467 (1994) (“Montrose I”); Montrose Chemical Corp. of
12 Calif. v. Superior Court, 25 Cal. App.4th 902, 31 Cal. Rptr. 2d 38 (1994) (“Montrose II”);
13 California Ins. Guarantee Assoc. v. Superior Court, 231 Cal. App.3rd 1617, 283 Cal. Rptr.
14 104 (1991). Even where there are no issues overlapping between the coverage and the
15 underlying cases, the Court is to use its discretion and balance prejudice to the insured
16 (In having to wage a two-front war if the coverage action is not stayed) against the
17 prejudice to the insurer (in having to pay defense costs in a case where there may be no
18 duty to defend if the stay is granted), giving consideration to the anticipated length of the
19 underlying case, as to whether the insured has independent counsel in the underlying case
20 and as to whether the insured has other insurance. Great American Insurance Co. vs
21 Superior Court, 178 Cal. App. 4th 221, 100 Cal. Rptr. 3d 258 (2009).
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24 Courts also “possess discretion in determining whether and when to entertain an
25 action under the Declaratory Judgment Act, even when the suit otherwise satisfies the
26 subject matter jurisdictional prerequisites.” Wilton v. Seven Falls Co., 515 U.S. 277 (1995);
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1 Brillhart v. Excess Ins. Co., 316 U.S. 491 (1942). In explaining this authority, the Supreme
2 Court has stated: “Consistent with the nonobligatory nature of the remedy, a district court
3 is authorized, in the sound exercise of its discretion, to stay or to dismiss an action seeking
4 a declaratory judgment before trial or after all arguments have drawn to a close. In the
5 declaratory judgment context, the normal principle that federal courts should adjudicate
6 claims within their jurisdiction yields to considerations of practicality and wise judicial
7 administration.” Wilton, 515 U.S. at 288.

9 **II. FACTS**

10 The facts essential to this Motion are summarized briefly as follows:

11 At all times relevant to this motion Defendants and Counterclaimants Jones Helsley
12 PC, a California Professional Corporation, Timothy Jones, Esq., Jack Hindmarsh, Esq.,
13 and Jack Hindmarsh, PLC, a California Professional Law Corporation (collectively the
14 “Jones defendants”) have been attorneys at law insured against professional errors and
15 omissions under Lawyers Professional Liability Insurance Policy No. 9904986 (the “CCIC
16 Policy” or the “Policy”) issued by Carolina Casualty Insurance Company (“CCIC”).

17 According to the Jones Defendants, in 2006, James A. Bratton and Bratton
18 Investments LLC (the “Brattons”) engaged the Jones defendants, or some of them, and/or
19 their predecessor firm, to provide legal services to the Brattons. Defendants provided legal
20 services to the Brattons in connection with the formation of various limited liability
21 companies organized to pursue real estate development ventures in specified locations in
22 Central California. (Decl. of Timothy Jones (“Jones Decl.”), ECF No. 31, ¶ 2.) Upon the
23 organization of two of these LLCs, defendant Timothy Jones received a membership
24 interest in each. Jones later transferred his interest in these two LLCs to Central Pacific
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1 Ventures, LLC, an LLC in which Mr. Jones individually holds a fifty percent membership
2 interest. (Id. at ¶¶ 6, 8-9.)

3 The Brattons claim that they suffered losses in connection with the above
4 transactions and in the real estate ventures associated therewith, and they have filed suit
5 against the Jones Defendants in California Superior Court, Fresno County, action number
6 10CECG02212AM, entitled *James A. Bratton and Bratton Investments, LLC v. Timothy*
7 *Jones, et al.*, (the “Bratton Action” or the “Underlying Action”). The Brattons allege, *inter*
8 *alia*, that the Jones Defendants performed negligently and breached professional duties
9 in their legal representation of the Brattons and/or in connection with the LLCs which were
10 formed. They also allege that the Jones Defendants (and others with interest in the LLCs)
11 breached fiduciary duties and committed fraud in connection with the operation and
12 ownership of the LLCs. The complaint attributes significant ownership and/or control of the
13 LLCs to Defendant Jones and/or companies owned by him. The Brattons seek
14 compensatory damages of at least nine million dollars, punitive damages, the
15 establishment of a constructive trust, and various other relief. (Decl. of Barry W. Lee (“Lee
16 Decl.”), ECF No. 32, Ex. 1.) The Bratton suit is in its infancy. At least one demurrer under
17 California law (motion to strike or dismiss under federal law) is pending.

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21 The Jones Defendants tendered the suit to CCIC and requested defense and
22 indemnity under the CCIC policy. (Jones Decl. ¶ 15.) CCIC agreed to defend the Bratton
23 action for the Jones Defendants but did so under a reservation of rights, and also filed this
24 action seeking a declaration that it has no duty to defend or indemnify the Jones
25 Defendants in the Bratton action. (Id., Ex. B.) CCIC contends that two exclusions in the
26 CCIC policy, Exclusions E and F, bar coverage.
27

1 Briefly summarized, Exclusion E precludes coverage for claims arising out of the
2 insured's acting as an officer, director, partner, trustee, or employee of any business other
3 than the insured law business. (Jones Decl. Ex. A.)
4

5 Exclusion F excludes coverage for a claim made "in connection with . . . [a business]
6 . . . in which the **Insured** owns more than a 10 percent interest, or in which any **Insured**
7 is an owner, partner, or employee, or which is directly or indirectly controlled, operated or
8 managed by any **Insured**, . . ." ¹ (Id.)

9 The Jones Defendants filed the instant motion asking the Court to stay this case in
10 its entirety until the underlying Bratton litigation is resolved. They claim that the issues
11 raised by CCIC here cannot be adjudicated without adjudicating facts at issue in the
12 Bratton action and that doing so exposes them to inconsistent, and potentially prejudicial,
13 determinations in the two cases. They note that findings made in this case could bind
14 them, but not the Brattons, in the Bratton case. They also claim that they will be prejudiced
15 by having to proceed with the coverage action while simultaneously having to defend the
16 Bratton action and by being represented in the Bratton case by counsel who are employed
17 by and owe professional duties to CCIC and who thus may share Jones Defendants'
18 confidences with CCIC.
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21 CCIC responds, in essence, that the facts necessary to resolve the Exclusion E and
22 F issues are a matter of record and not subject to legitimate factual dispute. CCIC also
23 contends that it would suffer more prejudice by having to provide a defense in the Bratton
24 action—which will be very expensive litigation—than Defendants would by having to
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26
27 ¹ The Jones Defendants assert, and the parties briefs devote a great deal of print to debating,
that this and other Exclusionary language is vague and ambiguous. The Court need not and will not
address those claims in connection with this motion.

1 proceed with this declaratory relief action.

2 **III. ANALYSIS**

3 _____ The parties agree that the primary issue in determining whether a stay is appropriate
4 is whether factual issues central to the resolution of the instant action substantially overlap
5 with factual issues at the heart of the underlying action. If resolution of disputed factual
6 issues in the coverage action might prejudice the insured in the underlying action, a stay
7 is appropriate. See Great Am. Ins. Co. v. Superior Court, 178 Cal App 4th 221, 235 (Cal.
8 Ct. App. 2009). “However, if the declaratory relief action can be resolved without prejudice
9 to the insured in the underlying action—by means of undisputed facts, issues of law, or
10 factual issues unrelated to the issues in the underlying action—the declaratory relief action
11 need not be stayed.” Id.; “To eliminate the risk of inconsistent factual determinations that
12 could prejudice the insured, a stay of the declaratory relief action pending resolution of the
13 third party suit is appropriate when the coverage question turns on facts to be litigated in
14 the underlying action.” Montrose I, 6 Cal. 4th at 301).

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17 In determining whether to grant a stay, the Court must also consider the possible
18 prejudice to the insured. This prejudice goes beyond having to defend against two actions
19 simultaneously. The Court must consider whether allowing the coverage action to proceed
20 would put the insured in the untenable position of having to prove facts in the coverage
21 case which could be adverse to him in the underlying case and/or having findings entered
22 against him in the coverage case which he may be collaterally estopped to deny in the
23 underlying case (while the plaintiff in the underlying case would not be so bound.) See
24 Montrose Chem. Corp. v. Superior Court, 25 Cal. App. 4th 902, 910 (Cal. Ct. App. 1994)
25 (“If the declaratory relief action is tried before the underlying litigation is concluded, the
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1 insured may be collaterally estopped from relitigating any adverse factual findings in the
2 third party action, notwithstanding the fact that any fact found in the insured's favor could
3 not be used to its advantage."'). However, the relative prejudice to the insurer in having to
4 proceed with and perhaps pay hundreds of thousands of dollars in defense costs on an
5 underlying claim which may not be covered must be balanced against the prejudice to the
6 insureds in proceeding with the Coverage action.
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8 The Court will address each of these factors in turn below.

9 **A. Overlapping Facts.**

10 1. Exclusion E

11 As the Jones Defendants assert and CCIC does not vigorously dispute (at least
12 insofar as the two cases are presently postured), the issues raised by Exclusion E clearly
13 overlap with the issues raised in the Bratton action. The Brattons allege that the Jones
14 Defendants, or some of them, were officers and/or directors and/or trustees of the LLCs,
15 and that they breached their duties and used their positions as such to defraud the
16 Brattons. (Lee Decl. Ex. A.) In determining whether Exclusion E barred coverage, the
17 Court would have to evaluate whether any of the Jones Defendants was an officer,
18 director, partner, trustee, or employee of any of the LLCs. The Jones Defendants argue
19 that they were not and CCIC must establish otherwise to prevail on Exclusion E. Findings
20 on this issue adverse to the Jones Defendants could bind them in the Bratton action, but
21 findings favorable to the Jones Defendants would not so bind the Brattons. It is a lose-lose
22 situation for the Jones Defendants.
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25 The Court therefore recommends that the coverage action be stayed as to Exclusion
26 E. The Court recommends that this stay remain in effect until the underlying action is
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1 resolved or until there is a showing in this Court that circumstances have changed such
2 that the elements of Exclusion E are no longer in dispute in the underlying action or no
3 longer can be legitimately disputed.

4
5 2. "Part 2" of Exclusion F

6 Exclusion F has two separate provisions that could bar coverage in this case. What
7 the Court will refer to as "Part 2" excludes coverage where a claim is made in connection
8 with any business in which the insured is an owner, partner or employee or which is directly
9 or indirectly controlled, operated or managed by any insured. For the reasons stated in
10 connection with the Court's discussion of Exclusion E, the Court finds that these issues
11 overlap with facts disputed in the underlying action. The Court therefore recommends that
12 the action be stayed with respect to "Part 2" of Exception F until the underlying action is
13 resolved or until there is a showing in this Court that circumstances have changed such
14 that these elements of the Exclusion are no longer in dispute in the underlying action or no
15 longer can legitimately be disputed.

16
17 3. "Part 1" of Exclusion F

18 What the Court will refer to as "Part 1" of Exclusion F excludes coverage for a claim
19 made in connection with a business in which the Insured owns more than a ten percent
20 interest.

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22 As expressed at the hearing on this Motion, the Court initially believed that the
23 issues raised by CCIC with respect to Part 1 of Exclusion F did not overlap with the issues
24 in the Bratton case. Thus, the Court's tentative ruling was that the case could proceed as
25 to this discrete issue alone. This is because it is not clear that the Bratton parties would
26 find it necessary to litigate the percentage of ownership issue in the underlying case; their
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1 case does not appear to rest on proving ownership. Also the Court tends to agree with
2 CCIC's argument that the facts of ownership are unlikely to be legitimately disputed; they
3 should be simple matters of record.

4
5 However, on further consideration of the parties' argument at the hearing as well as
6 further reflection on the record before the Court at this juncture, the Court finds that this
7 case is so postured that discovery into the ownership issue could not reasonably be
8 conducted without potentially forcing the Jones Defendants to take positions adverse to
9 their interests in the Bratton action. If this action were allowed to proceed on whether
10 coverage was barred by Part 1 of Exclusion F, there would be dispute as to what
11 "ownership" means in the context of this case. The parties have made it clear that they
12 disagree as to whether Jones's acknowledged fifty percent "membership" in Central Pacific
13 Ventures (which is, in turn, a "member" of the LLCs at the core of this dispute) is an
14 "ownership" interest within the meaning of the insurance policy.

15
16 The Court is concerned that the Brattons's claims, or at least the potential appeal
17 of those claims to the trier of fact, could be strengthened by a finding in the coverage case
18 that the Jones Defendants either directly or indirectly "owned" a significant portion of the
19 entities in which the Brattons suffered losses. The Court is also concerned with the likely
20 scope of inquiry into those and potentially related issues (e.g., which LLCs and companies
21 did what, out of what businesses "the claims arose", with which businesses the claims were
22 "connected", which entities had "ownership" in which others, whether "membership" carried
23 with it the rights, privileges, and obligations and, perhaps, control inherent in other forms
24 of "ownership", etc.). Such issues could not likely be addressed without significant
25 discovery into how the businesses operated and how they were interrelated. Any findings
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1 on these issues could prejudice the Jones Defendants defense of the claims in the Bratton
2 action. Thus, the Court finds that allowing this action to proceed with respect to Part 1 of
3 Exclusion F could prejudice the Jones Defendants in the underlying action.

4
5 Moreover, allowing this case to proceed on the single issue of whether the Jones
6 Defendants owned more than a ten percent interest in a particular entity would make
7 discovery difficult for both parties. The Court believes that trying to carve out this narrow
8 issue from such a complex case in which there are multiple, intertwined business entities
9 would almost certainly generate otherwise unnecessary discovery disputes. The Court
10 finds that allowing this litigation to proceed in a piece-meal fashion does not conform “to
11 considerations of practicality and wise judicial administration.” Wilton, 515 U.S. at 288.

12
13 **B. Prejudice**

14 Beyond the potential prejudice resulting from the overlapping factual issues, the
15 Court must also consider the prejudice to both parties if the stay is not granted. As stated
16 at the hearing on this Motion, the Court agrees with CCIC’s argument that if having to fight
17 a two-front war constituted sufficient prejudice to justify a stay of a declaratory relief action,
18 an insurer could never avail itself of this judicial remedy while an underlying case
19 proceeded. The Court acknowledges that in such a case, because the duty to defend is
20 so much broader than the duty to indemnify, the insurer would have to pay defense costs
21 throughout the underlying case even where it might be clear coverage did not exist. That
22 would be unjust. However, in this case, the prejudice to the Jones Defendants goes
23 beyond that associated with simply having to defend against two actions simultaneously.
24 Even though CCIC has provided counsel for the Jones Defendants in the underlying action
25 under a reservation of rights, the Jones Defendants have hired independent counsel to
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1 represent them at their own expense because CCIC has reportedly declined to provide
2 independent counsel (also known as Cumis counsel). (Jones. Decl. ¶ 29.) Most
3 significantly, the Jones Defendants have no other insurance coverage for the Bratton
4 action. (Id. ¶ 20.) Accordingly, the Court finds that even if there were no overlapping
5 issues and the Court were simply balancing prejudice, the prejudice to the Jones
6 Defendants in allowing this case to proceed would substantially outweigh the prejudice to
7 CCIC in having to provide a defense under reservation of rights. See Great Am. Ins. Co.,
8 178 Cal. App. 4th at 271.
9

10 **IV. FINDINGS**

11 For all the reasons announced on the record at the time of oral argument on this
12 motion, and elaborated on above, the Court finds:
13

- 14 1. The parties' evidentiary Objections (ECF Nos. 55 & 58) need not and will not
15 be ruled on by the Court. The objected-to evidence was not considered by
16 the Court in making these Findings and Recommendations.
- 17 2. Disputed issues raised by Plaintiff's claims under Exclusion E overlap with
18 the issues in the Bratton action such that it would be prejudicial to
19 Defendants to have to litigate those issues here while the Bratton action is
20 still pending.
- 21 3. The disputed issues raised by Plaintiff's claims under Exclusion F overlap
22 with the issues in the Bratton action such that it would be prejudicial to
23 Defendants to have to litigate those issues here while the Bratton action was
24 still pending. Discovery into ownership issues could not reasonably be
25 conducted without potentially forcing Defendants to take positions adverse
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1 to their interests in the Bratton action and create unduly expensive and
2 time-consuming discovery disputes and motions.

3 4. The prejudice to CCIC in having to expend funds to represent the Jones
4 Defendants in the Bratton action is substantially less than the prejudice to
5 the Jones Defendants in having to proceed with the litigation of this case
6 while also litigating the Bratton case.

7
8 5. Because of the possibility of overlapping factual issues and the impact these
9 factual issues would likely have on the discovery process in the instant action
10 plus consideration of relative prejudice to the parties, the Court finds that a
11 stay is appropriate. See Montrose Chemical Corp. v. Superior Court, 25 Cal.
12 App. 4th 902, 907-08 (1994) (“It is only where there is no potential conflict
13 between the trial of the coverage dispute and the underlying action that an
14 insurer can obtain an early trial date and resolution of its claim that coverage
15 does not exist.”) (emphasis added).

16
17 **V. CONCLUSION**

18 For the reasons stated on the record at the December 10, 2010 hearing,
19 supplemental by the findings made herein, the Court RECOMMENDS that Defendants’
20 Motion to Stay be GRANTED until the underlying action, *James A. Bratton and Bratton*
21 *Investments, LLC v. Timothy Jones, et al.*, pending in Fresno County Superior Court as
22 action number 10CECG02212AM, is resolved but WITHOUT PREJUDICE to Plaintiff
23 seeking relief from the stay if and when it in good faith believes and represents that
24 circumstances have changed so that the reason for the stay no longer exists (provided no
25 such motion for relief from the stay be initiated within six months of the date of the Court’s
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