Case No. 17-55125

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

OFFICE DEPOT, INC.,
Plaintiff-Appellant,

v.

AIG SPECIALTY INSURANCE COMPANY, F/K/A AMERICAN INTERNATIONAL SPECIALTY INSURANCE COMPANY,
Defendant-Appellee.

Appeal from a Judgment of the United States District Court
for the Central District of California, Case No. 2:15-cv-02416-SVW
Honorable Stephen V. Wilson

APPLICATION OF UNITED POLICYHOLDERS FOR LEAVE TO FILE BRIEF AMICUS CURIAE; [PROPOSED] BRIEF AMICUS CURIAE IN SUPPORT OF APPELLANT OFFICE DEPOT, INC.'S REQUEST FOR REVERSAL

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APPLICATION OF UNITED POLICYHOLDERS FOR LEAVE TO FILE BRIEF AMICUS CURIAE IN SUPPORT OF APPELLANT OFFICE DEPOT, INC.

Pursuant to Federal Rule of Appellate Procedure 29, proposed amicus, United Policyholders, respectfully applies to this Court for leave to file the accompanying Brief *Amicus Curiae* in Support of Appellant Office Depot, Inc. in the above-captioned case. United Policyholders understands and acknowledges that this proposed Brief *Amicus Curiae* is untimely under Fed. R. App. Proc. 29(a)(6) but, for the reasons set forth below in Section II of this Application, respectfully requests leave to be excused from those timing requirements.

United Policyholders is familiar with the briefs and legal issues in this case. United Policyholders believes its experience with these legal issues will assist this Court in deciding the important questions raised in this appeal, including issues on which the parties did not focus, but which are critical to the review of the district court's decision in this case.

Pursuant to Ninth Circuit Rule 29-3, United Policyholders states that the Office Depot consents to this filing and that AIG has objected to this filing.[1]

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[1] Pursuant to Federal Rule of Appellate Procedure 29(a)(4), United Policyholders states as follows: No party or counsel for any party authored any portion of the brief. No party or counsel for any party made a monetary contribution intended to fund the preparation or submission of the brief; instead, counsel for United Policyholders has prepared this brief on a *pro bono* basis. No

I. Interest of the *Amicus Curiae*

United Policyholders is a non-profit organization based in California that serves as a voice and information resource for insurance consumers in the 50 states. The organization is tax-exempt under Internal Revenue Code § 501(c)(3). United Policyholders is funded by donations, grants, and volunteer labor. United Policyholders does not sell insurance or accept money from insurance companies. While much of United Policyholders' work is aimed at helping individuals and businesses purchase appropriate insurance, United Policyholders engages with regulators, public officials, academics, and various stakeholders regarding legal and marketplace developments relevant to all policyholders and all lines of insurance.

United Policyholders' work is divided into three program areas: *Roadmap to Recovery*™ (disaster recovery and claim help for victims of wildfires, floods, and other disasters); *Roadmap to Preparedness* (insurance and financial literacy and disaster preparedness); and *Advocacy and Action* (advancing consumer laws and public policy). It hosts a library of tips and sample forms as well as articles on commercial and personal lines insurance products, coverage, and the claims process at www.uphelp.org.

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person or entity other than the *amicus curiae*, its members and its counsel made a monetary contribution intended to fund the preparation or submission of the brief.

United Policyholders monitors the insurance sales, claims, and law sectors; conducts surveys; and hears from a diverse range of individual and business policyholders throughout California on a regular basis. The organization interfaces with state regulators in its capacity as an official consumer representative in the National Association of Insurance Commissioners.

United Policyholders also provides topical information to courts via the submission of *amicus curiae* briefs in cases involving insurance principles that matter to people and businesses. To that end, it has been granted leave to file *amicus curiae* briefs in 400 cases throughout the United States, including at least six recent cases before this Court.[2] United Policyholders' consumer surveys recently assisted the California Supreme Court in *Association of California Insurance Companies v. Jones*, 2 Cal. 5th 376 (2017), and that Court adopted United Policyholders' arguments in *TRB Investments, Inc. v. Fireman's Fund Ins. Co.*, 40 Cal. 4th 19 (2006), and *Vandenberg v. Superior Court*, 21 Cal. 4th 815 (1999).

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[2] These include *Grayson v. Allstate Ins. Co.*, No. 14-55959 (9th Cir. 2014); *Vandana Upadhyay v. Aetna Life Ins. Co.*, No. 14-15420 (9th Cir. 2014); *Street Surfing, LLC v. Great Am. E&S Ins. Co.*, No. 12-5531 (9th Cir. 2014); *Chubb Custom Ins. Co. v. Space Sys./Loral, Inc.*, 710 F.3d 946 (9th Cir. 2013); *Hyundai Motor Am. v. National Union Fire Ins. Co. of Pittsburgh, Pa.*, 600 F.3d 1092 (9th Cir. 2010); and *Glanton v. Advancepcs Inc.*, 465 F.3d 1123 (9th Cir. 2006).

United Policyholders seeks to fulfill the "classic role of *amicus curiae* by assisting in a case of general public interest, supplementing the efforts of counsel, and drawing the court's attention to law that escaped consideration." *Miller-Wohl Co. v. Commissioner of Labor & Indus.*, 694 F.2d 203, 204 (9th Cir. 1982). This is an appropriate role for *amicus curiae*. As commentators have stressed, an *amicus curiae* is often in a superior position to "focus the court's attention on the broad implications of various possible rulings." Robert L. Stern et al., *Supreme Court Practice* 570-571 (6th ed. 1986) (citation omitted).

II. Usefulness, Relevance and Timeliness of this *Amicus* Brief

United Policyholders submits this proposed *amicus curiae* brief in support of Office Depot's appeal from district court's rulings that construe California Insurance Code § 533, which bars indemnification for "wilful" acts.[3] The district court effectively transformed section 533 into a vehicle to bar insurance coverage for claims arising out of negligent or reckless conduct. In so holding, the district court disregarded decades of contrary California authority, relying instead in large part on California Civil Code section 1668. But the court overlooked California Supreme Court precedent holding that section 1668 does not apply to insurance contracts. The district court also improperly applied

[3] The parties agree that California law governs in this diversity jurisdiction case.

section 533 to find no duty to defend, contrary to California Supreme Court precedent that section 533 does not relieve an insurer of that duty. United Policyholders respectfully requests that these errors of law be corrected and that this Court reverse the ruling below.

Specifically, United Policyholders seeks leave to file an *amicus curiae* brief in order to provide context on appeal as to (1) the appropriate breadth of the intentional acts exclusion contained in California Insurance Code section 533; (2) the limitations on the application of section 533 when the insured lacks a specific intent to harm; (3) the relationship between section 533 and the duty to defend; (4) the inapplicability of California Civil Code section 1668 to insurance contracts; and (5) the dangers of expanding the scienter requirement of section 533.

United Policyholders recognizes that this motion for leave to file an *amicus* brief is untimely under Federal Rule of Appellate Procedure 29(a)(6) but respectfully asks the Court to exercise its discretion under that Rule to waive the timing requirement in this instance. Though Office Depot filed its opening brief on August 8, 2017, United Policyholders did not learn of this appeal until after AIG's Answering Brief was filed on October 11, 2017 when AIG's arguments were first reported in the legal press. Since learning of this appeal, United

Policyholders has worked diligently to prepare the *amicus curiae* brief in a timely manner.

To avoid prejudice to any of the parties, United Policyholders respectfully proposes that the parties be given an opportunity to respond to this *amicus curiae* brief. Office Depot has yet to file its Reply Brief and thus could respond to United Policyholders' *amicus curiae* brief in that reply. United Policyholders proposes that Appellee AIG's response to this *amicus curiae* brief be filed the same day as Office Depot's reply brief.

For these reasons, United Policyholders respectfully requests leave to file the accompanying *amicus curiae* brief presenting additional authorities and discussion in support of Appellant's arguments and request for reversal.

DATE: November 21, 2017 Respectfully submitted,

COVINGTON & BURLING LLP
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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

Cases

Statutes

I. INTRODUCTION AND SUMMARY OF ARGUMENT

Many calamities originate from benign intentions. A parent is late to pick up a child and speeds down a dark road. An employer wants to give a potential employee a chance to succeed and overlooks red flags in that person's employment history. A construction crew, working under a tight deadline, cuts corners to finish a project on time. In such cases, the conduct might be considered negligent, even reckless, but the actors did not intend to harm the people who may be injured as a result of their conduct.

Insurance policies rarely if ever exclude coverage for negligent or reckless conduct; in fact, consumers and businesses buy insurance to protect against liabilities arising out of precisely such activities.[4] Nor is there a California public policy against insuring negligent or reckless conduct. Instead, California courts have long used an "intentional act undertaken with intent to injure" standard to determine whether conduct is so reprehensible that, as a matter of public policy, California Insurance Code section 533 will prohibit insurance from covering any resulting liability.[5] This appeal asks this Court to decide whether the district court

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[4] *See Chevron USA Inc. v. Bragg Crane & Rigging Co.*, 180 Cal. App. 3d 639, 644 n.4 (1986) ("a fundamental purpose of insurance [is] to protect against liability for one's own negligence").

[5] As explained further below, the California Supreme Court has described this standard as acting with "a preconceived design to inflict injury." That Court

erred when it expanded the "intentional act undertaken with intent to injure" standard to bar insurance coverage for claims arising out of the insured's negligent or reckless speech or conduct merely because the speaker or actor, when acting recklessly, did so while intending to induce reliance on the insured's words or actions.

In particular, the district court held that section 533's statutory bar against insurance coverage for "wilful" acts precluded defense and indemnity for claims brought under the California False Claims Act (CFCA), Cal. Gov't Code § 12650(b)(3). The court acknowledged, and there is no dispute, that the CFCA does not require an intentional misrepresentation, but may be satisfied by showing a "reckless disregard" for the truth or falsity of the information on which the claim is based. *Id.*; ER20-21. The court held, however, that the fact that the representation must be made with the intent to induce reliance by the government agency—*i.e.*, saying something negligent or reckless in the hope of obtaining payment on the CFCA claim—is sufficient to satisfy the "wilful act" element of section 533. *Id.* Since the element of inducing reliance, *i.e.*, causing payment to the party lodging the claim, is inherent in every CFCA claim—and in many other kinds of speech

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subsequently recognized a "narrow" exception to its standard for determining whether conduct is "wilful" for truly heinous conduct, such as intentional child molestation, where the intent to injure is inherent in the conduct. *See* Section II.A *infra*.

made with the intent to induce action—the district court's reasoning expands section 533 to preclude insurance coverage for negligent or reckless misrepresentations. No California case has actually extended section 533 that far; and the court's reasoning, if adopted, could effectively render D&O and professional liability insurance a nullity in California, to the great detriment of California businesses and consumers.

But the district court's reasoning cannot stand. This is a diversity case in which California law governs, and the district court disregarded binding California Supreme Court precedent in at least four critical areas.

First, the district court attempted to justify its extraordinary holding by invoking California Civil Code section 1668. That statute precludes indemnification for fraud or negligent misrepresentation, and the district court cited to six federal court decisions, including one by this Court, rejecting coverage for misrepresentation claims based on section 1668. ER18-19. But the district court failed to notice that the California Supreme Court had held that section 1668 does not apply to insurance. *See Safeco Ins. Co. of Am. v. Robert S*, 26 Cal. 4th 758, 767 (2001) ("section 1668 simply does not apply"). Thus, the cases that the district court relied upon are not good law.

Second, compounding its error, the district court failed to follow California Supreme Court precedent holding that a violation of section 533 must be

intentional. The district court cited to lower court cases saying that "intentional or fraudulent acts are deemed purposeful" and, hence, within section 533. ER18-19. But the court disregarded the admonition of the California Supreme Court that section 533 does not bar coverage for intentional acts that result in unintended injury, such as someone who intends to violate the law by driving over the speed limit and then hits another car. *J.C. Penney Cas. Ins. Co. v. MK*, 52 Cal. 3d 1009, 1020 (1991) ("'An ordinary consequence of … an intentional violation of a statute … is injury to the person or property of the driver or a third person. Certainly no one would contend that an injury occasioned by negligent or even reckless driving was not accidental within the meaning of a policy of accident insurance'") (citation omitted). In fact, the California Supreme Court has long held that an "accident" includes an "unexpected, unforeseen or undesigned happening *or consequence*" from an intentional act. *Delgado v. Interins. Exch. of Auto. Club of S. Cal.*, 47 Cal. 4th 302, 309 (2009) (italics added).

The district court then proceeded to disregard California Supreme Court precedent in a third respect: The court held, in reliance on lower court cases, that section 533 eliminated AIG's duty to defend (ER4-11), ignoring the California Supreme Court's ruling that section 533 applies only to an insurer's duty to indemnify for an adverse judgment or settlement and does not apply at all to the duty to defend. *See Horace Mann Ins. Co. v. Barbara B.*, 4 Cal. 4th 1076, 1087

(1993) ("the statutes [including section 533] 'establish a public policy to prevent insurance coverage from encouragement of wilful tort.' ... [A] contract to defend an assured upon mere accusation of a wilful tort does not encourage such wilful conduct.'") (quoting *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 277-78 (1966)).

Finally, the district court's ruling contravened longstanding California Supreme Court precedent holding that negligent or reckless conduct cannot trigger section 533. *See J.C. Penney*, 52 Cal. 3d at 1021 ("section 533 does not preclude coverage for acts that are negligent or reckless"). The district court also disregarded the plain language of section 533 itself, which states that the insurer is "not exonerated by the negligence of the insured, or of the insured's agents or others." The court's ruling raises public policy concerns by restricting the availability of insurance for types of claims widely understood to be insurable, and drawing a false dichotomy between negligent acts that directly injure and speech (or acts) that cause injury by inducing the reliance of others. Neither the district court nor the appellees offer justification for such a sea change in California law.

The Court should reverse the judgment in favor of AIG and hold that the district court erred in its attempt to expand section 533 in contravention of California Supreme Court precedent. Alternatively, the Court should certify the issues presented in this appeal to the California Supreme Court for resolution pursuant to Rule 8.548 of the California Rules of Court.

II. ARGUMENT

A. Section 533 Precludes Coverage Only for Acts Performed with an Intent to Inflict Harm or for Inherently Harmful Misconduct

Section 533 is a statute and therefore must be construed in accordance with the rules that govern statutory construction in California. *J.C. Penney*, 52 Cal. 3d at 1020. The Court must discern the intent of the Legislature, which is found, first, by looking at the plain language of the statute. *Id*. Section 533 provides that "[a]n insurer is not liable for a loss caused by the wilful act of the insured; but he is not exonerated by the negligence of the insured, or of the insured's agents or others." Any construction of section 533 thus requires a court to reconcile the statute's prohibition on insurance for "wilful" misconduct with its admonition that coverage must remain available for claims based on negligence. *Id.* This requires a court to balance the "public policy to deny insurance coverage for willful wrongs" with the goals of California's tort system, *e.g.*, to spread risk through the use of insurance and provide full compensation to tort victims. *Downey Venture v. LMI Ins. Co.*, 66 Cal. App. 4th 478, 499 (1998); *John R. v. Oakland Unified School Dist*., 48 Cal. 3d 438, 450 (1989) (where school district was found liable for molestation by its

employee, it would be against public policy to deny the victim access to the district's insurance to pay for his treatment and care).[6]

The California Supreme Court achieved this balance by construing section 533 to bar insurance coverage only when the insured either (1) *acted intentionally with the intent to injure* (a "preconceived design to inflict injury") or (2) engaged in misconduct that is so heinous that it is necessarily wilful because the act is always harmful and always wrongful. *J.C. Penney*, 52 Cal. 3d at 1028; *see also Marie Y v. General Star Indem. Co*., 110 Cal. App. 4th 928, 953 (2003).

As to the first type of prohibited conduct, an intentional act undertaken with intent to injure, the California Supreme Court has long recognized that this standard is narrower than the standard for proving "intent" in a tort action. *See Gray*, 65 Cal. 2d at 273, n.12 ("a number of cases have recognized that an act which under the traditional terminology of the law of torts is denominated 'intentional' or 'wilful' does not necessarily fall outside insurance coverage"). Thus, in *Clemmer v. Hartford Insurance Co.*, 22 Cal. 3d 865, 887 (1978), the

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[6] Indeed, one early decision discussing section 533's predecessor statute, Cal. Civ. Code section 2629, suggests that the statute was originally enacted not for the purpose of precluding insurance coverage for wilful misconduct but with the goal of ensuring that indemnity would be allowed for all degrees of negligence, settling a disagreement as to whether certain degrees of negligence were not insurable. *See Downey Venture*, 66 Cal. App. 4th at 499 n.30 (discussing *McKenzie v. Scottish Nat'l Ins. Co.*, 112 Cal. 548, 557-8 (1896)).

California Supreme Court held, based on a "clear line of authority in this state," that a wilful act must be the product of an intent to cause harm, and that

> even an act which is "intentional" or "willful" within the meaning of traditional tort principles will not exonerate an insurer from liability under Insurance Code section 533 unless it is done with a "preconceived design to inflict injury." (*Walters v. American Ins. Co.* (1960) 185 Cal.App.2d 776, 783 (8 Cal.Rptr. 665); see also *Meyer v. Pacific Employers Ins. Co.* (1965) 233 Cal.App.2d 321, 327 (43 Cal.Rptr. 542); see generally *Gray v. Zurich Insurance Co.*, (1966) 65 Cal.2d 263, 273-74, fn.12 (54 Cal.Rptr. 104), and cases there cited.)

Other cases have similarly described a "wilful act" under section 533 as an act done with malevolence (*Transport Indem. Co. v. Aerojet-Gen. Corp*., 202 Cal. App. 3d 1184, 1188 (1988)), with a subjective intent to harm another (*Republic Indem. Co. v. Superior Court*, 224 Cal. App. 3d 492, 502 (1990)), with "malice in fact" or with a wish to vex, annoy or injure another (*California Shoppers, Inc. v. Royal Globe Ins. Co.*, 175 Cal. App. 3d 1, 32 (1985)), or when an insured acts "deliberately for the express purpose of causing damage … with knowledge that damage is highly probable or substantially certain to result" (*Downey*, 66 Cal. App. 4th at 500).[7]

Numerous California cases have held that, to satisfy this element, the insurer typically must prove that the insured acted intentionally with the *intent to cause*

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[7] The district court followed the latter test (ER15-16) even though no California Supreme Court decision has endorsed it.

harm. Where the insured's conduct is not *necessarily* done with intent to cause harm—*e.g.*, where the underlying claim could be proven without a showing of such specific intent—section 533 does not preclude coverage. *See, e.g.*, *Republic Indem.*, 224 Cal. App. 3d at 500-03 (section 533 did not necessarily preclude coverage for an employer's failing to reasonably accommodate and terminating an employee, because liability could be based on "unreasonable" conduct rather than an intent to harm); *Allstate Ins. Co. v. Overton*, 160 Cal. App. 3d 843 (1984) (same; where the insured was convicted of misdemeanor battery, because the Penal Code requires proof of wilful commission of an act but not a specific intent to cause bodily injury); *Zurich Ins. Co. v. Killer Music, Inc.*, 998 F.2d 674, 677-78 (9th Cir. 1993) (same; copyright infringement, because infringement need not be intentional for liability and it is not inherently injurious).

The second type of conduct, acts that are "inherently harmful," encompasses a narrow range of conduct deemed so morally heinous that harm is inherent in the act, *i.e.*, the act cannot be committed without "wilful" intent. The California Supreme Court set forth this category in *J.C. Penney* in response to an insured's argument that twenty-five acts of child molestation of a five year old girl should be covered by insurance because the molester, who admitted to intentional misconduct, claimed that he never intended to harm the child. *J.C. Penney*, 52 Cal. 3d at 1014. The Court held that "some acts are so inherently harmful that the

intent to commit the act and the intent to harm are one and the same. The act is the harm." *Id.* at 1026-27 (discussing, as an example, a case in which a father claimed he had molested his daughter with the benevolent intent of educating her about boys and dating; the "court rejected this distorted view of parental education").

Subsequent to *J.C. Penney*, California state courts applied the "inherently harmful" appellation to a narrow class of morally reprehensible claims including assault and battery where no self-defense is claimed (*Fire Insurance Exchange v. Altieri*, 235 Cal. App. 3d 1352 (1991) (teenage boys hit another boy in the face, knocking him unconscious, on a bet)),[8] intentional sexual harassment of an employee (*Coit Drapery Cleaners, Inc. v. Sequoia Ins. Co.*, 14 Cal. App. 4th 1595 (1993) (CEO of corporate insured engaged in a long pattern of intentional sexual harassment and discrimination which the company's board condoned)), enslaving a domestic employee (*State Farm Gen. Ins. Co. v. Mintarsih*, 175 Cal. App. 4th 274, 288 (2009)), intentionally exposing a sex partner to AIDS virus (*Aetna Cas. and Sur. Co. v. Sheft*, 989 F.2d 1105, 1108 (9th Cir. 1993)), and malicious prosecution (*Downey Venture*, 66 Cal. App. 4th at 500 (proof of malice and wrongful intent to injure another is always required for malicious prosecution)). These claims reflect

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[8] Because not *every* assault and battery is necessarily wilful in the sense of intending harm, assault and battery cannot be deemed "inherently harmful" in every case. For example, some battery occurs in self-defense. *See, e.g., Allstate Ins. Co.*, 160 Cal. App. 3d 843; *J.C. Penney*, 52 Cal. 3d at 1026.

situations in which the courts have concluded, as a matter of public policy, that intent to act cannot be separated from intent to injure.

However, the claims that implicate the "inherently harmful" exception are very limited in scope. As the California Supreme Court instructed, "[w]e cannot emphasize too strongly to the bench and bar the narrowness of the question before us." *J.C. Penney*, 52 Cal. 4th at 1028; *see also Horace Mann*, 4 Cal. 4th at 1082 (in *J.C. Penney*, "[w]e emphasized the narrowness of our holding, stressing we were addressing only child molestation and no other type of wrongdoing."). Thus, after an initial flurry of decisions in the early-to-mid 1990s finding acts to be "inherently harmful," California courts began to take the California Supreme Court's admonition to heart. As a result, no published California state court decision in the past 15 years has invoked the "inherently harmful" exception to eliminate liability insurance coverage, with the sole exception of *Mintarsih*, which involved truly egregious misconduct on the part of the insureds.

It also bears noting, when evaluating intent to injure for purposes of section 533, that the critical test is the intent or actions of the insured and not necessarily those of the person committing the act. For example, when the insured's liability is based on a theory of vicarious liability or respondeat superior (*e.g.*, for the acts of an employee), section 533 simply does not apply. *See, e.g.*, *Lisa M. v. Henry Mayo Newhall Mem. Hosp.*, 12 Cal. 4th 291, 305 n.9 (1995) ("[N]either Insurance

Code section 533 nor related policy exclusions for intentionally caused injury or damage preclude a California insurer from indemnifying an employer held vicariously liable for an employee's willful acts.").

B. Section 533 Does Not Preclude Coverage for Negligent or Reckless Conduct

Because section 533 requires proof of either a specific intent to injure or inherently harmful conduct, claims based on negligence or reckless conduct are *not* sufficient to trigger the exclusionary bar of section 533. This rule is codified in section 533 itself, which provides that "an insurer. . . *is not exonerated by the negligence of the insured*, or of the insured's agents or others." Ins. Code § 533 (emphasis added).

Thus, California courts have consistently held that insurance coverage for a wide variety of claims based on negligent or reckless conduct is not barred by section 533. *See, e.g.*, *J.C. Penney*, 52 Cal. 3d at 1021 ("section 533 does not preclude coverage for acts that are negligent or reckless"); *Melugin v. Zurich Canada*, 50 Cal. App. 4th 658, 665 (1997) (section 533 did not bar all coverage for sex discrimination by an employer, because liability could be based on unintentional or negligent conduct); *Escobedo v. Travelers Ins. Co.*, 227 Cal. App. 2d 353 (1964) (section 533 did not preclude coverage for violation of Vehicle Code Section 482—failure to stop and render aid to an accident victim—even though such conduct was wanton, reckless and grossly negligent, because there

was no finding that the insured intended to injure the victim); *Unified Western Grocers, Inc. v. Twin Cities Fire Ins. Co*., 457 F.3d 1106, 1113-14 (9th Cir. 2006) (section 533 did not bar breach of fiduciary duty claim based on negligence); *Reshamwalla v. State Farm Fire & Cas. Co*., 112 F. Supp. 2d 1010, 1020-21 (E.D. Cal. 2000) (refusing to apply section 533 on summary judgment where the insured's son threw chunks of concrete into freeway traffic because liability could exist for "reckless disregard").

Moreover, and critically for this appeal, the California Supreme Court has applied the same reasoning to questions of insurance coverage for claims involving negligent or reckless misrepresentation. As the California Supreme Court explained in a case that the district court failed to cite, "standard business liability insurance is available to cover instances of negligent misrepresentation or nondisclosure." *Randi W. v. Muroc Joint Unified School Dist.*, 14 Cal. 4th 1066, 1078 (1997) (italics deleted). Thus, for example, *Transport Indemnity v. Aerojet-General Corp*., 202 Cal. App. 3d 1184, 1186-89 (1988), held that section 533 did not preclude indemnity or defense after an employer had fraudulently concealed harmful working conditions. The court indicated that "the employer's deliberate concealment of the existence of the employee's industrial injury and its connection with the employment with the intent to induce plaintiff to continue to work in a dangerous environment" did not necessary establish an intent to injure within the

meaning of section 533; the conduct could have been motivated by the desire to increase profits by avoiding the cost of eliminating the danger, adverse media attention, or employee resignations rather than by an intent to inflict injury. *Id*.

Likewise, *Raychem Corp. v. Federal Ins. Co.*, 853 F. Supp. 1170, 1179-80 (N.D. Cal. 1994), held that section 533 did not prohibit coverage for securities law claims alleging that Raychem's management had made numerous misrepresentations intended to inflate the price of Raychem's stock. A violation of Section 10(b) of the Securities Exchange Act or Rule 10b-5 may be based on reckless conduct, defined as

> a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.

Id. at 1179, quoting *Hollinger v. Titan Capital Corp*., 914 F.2d 1564, 1569 (9th Cir. 1990). The court found that even this heightened standard for recklessness did not satisfy section 533's requirement of intent to cause harm. *Id*. at 1180.

Other decisions, while not expressly addressing section 533, have found coverage for claims based on negligent or reckless misrepresentations, including violations of the CFCA. *See. e.g*., *Watts Indus., Inc. v. Zurich Am. Ins. Co*., 121 Cal. App. 4th 1029, 1034 (2004) (insurer had a duty to defend against claim that insured "knowingly defrauded" municipal water systems in violation of the CFCA

by selling merchandise that resulted in increased lead exposure); *Church Mut. Ins. Co. v. United States Liab. Ins. Co.*, 347 F. Supp. 2d 880 (S.D. Cal. 2004) (coverage for allegations that insured committed fraud by falsely claiming vendor's work was unsatisfactory, thereby inducing vendor to reduce its billing statements, was not barred by policy exclusion); *Hardin v. Greenwich Ins. Co.*, 2012 WL 3217704 at *7-*8 (C.D. Cal. Aug. 3, 2012) (allegations that corporate officer facilitated, and failed to disclose, a fraudulent billing scheme and fraudulent financial reports raised a potential for coverage sufficient to support a duty to defend).

The critical thread running through all these decisions is the specific intent to cause harm of such a nature and severity that it triggers the public policy that intentional wrongdoers should not be able to insure themselves against wilful misconduct. A mere intent to act, whether carefully or carelessly, does not equate an intent to harm, any more than a driver who intentionally speeds necessarily intends to injure a pedestrian in the process.

C. The District Court Decision Improperly Extended Section 533 to Reckless or Negligent Acts Performed with an Intent to Induce Reliance

Notwithstanding the statutory language and substantial precedent discussed above, the district court, in two separate orders, held that section 533 bars insurance coverage for claims alleging reckless misconduct. In the first order,

issued on July 21, 2016, the court granted AIG's motion to dismiss Office Depot's duty to indemnify claim on the ground that section 533 barred indemnification of the underlying claims for violation of the CFCA as a matter of law. ER12-22. In the second order, dated January 4, 2017, the district court granted AIG's motion for summary judgment on the duty to defend, finding that because indemnity was barred by section 533, there was no potential for coverage sufficient to support a duty to defend. ER4-11.

In so ruling, the district court acknowledged that the CFCA only requires an allegation of "recklessness with regard to the truth or the falsity of the statement" being made in support of the claim for payment. ER17. In order to prove a violation of the CFCA, the plaintiff must show that the defendant "knowingly present[ed] or caus[ed] to be presented a false or fraudulent claim for payment or approval" or that defendant "knowingly ma[de], use[d], or cause[d] to be made or used a false record or statement" to get a false claim paid or approved by the state or by any political subdivision. Cal. Gov. Code §§ 12651(a)(1), (a)(2). As the district court explained, "[t]he requirement under the CFCA that claims be 'knowingly' presented includes claims submitted with '[r]eckless disregard for the truth or falsity of the information' where 'specific intent to defraud is not required.'" ER16 (citing Cal. Gov't Code § 12650(B)(3)). Thus, defendants who bury their heads in the sand and fail to make reasonable inquiries may still be liable

under CFCA. *Id.*, citing *San Francisco Unified School Dist. v. First Student, Inc.*, 224 Cal. App. 4th 627, 631, 646, 649 (2014).

The district court held, however, that the applicability of section 533 turned not on Office Depot's intent (or lack of intent) to make a false statement but on Office Depot's intent to induce reliance on its actions—specifically, its intent to induce the payment of claims by the government entities. ER17. The court characterized the intent to induce payment as a "second scienter requirement" that precluded coverage as a matter of law. ER17, 20. In so holding, the district court effectively read the "intent to injure" requirement out of section 533. Such a reading flies in the face of the overwhelming jurisprudence interpreting section 533.

As discussed above, section 533 codifies the public policy that certain types of conduct will be deemed so wrongful as to be uninsurable. These fall into two categories: conduct undertaken with a specific intent to harm and conduct so heinous as to be deemed inherently wrongful like intentional child molestation. *See J.C. Penney*, 52 Cal. 3d at 1025-6. With the possible exception of an unusually overzealous insurance claims adjuster, no one would argue that recklessness in preparing a claim for government reimbursement constitutes the moral equivalent of child molestation. Yet the district court's decision arguably reaches such a result because every claim under CFCA, by definition, is always

prepared with the intent to seek reimbursement. So under the district court's reasoning, any government claim becomes *de jure* uninsurable even if the claim documents were prepared negligently or recklessly.

The district court identified no California precedent so holding. Instead, the court and AIG cited three categories of cases, none of which support such an extraordinarily extension of existing law.

The first category of cases consists of half a dozen federal court decisions holding that California Civil Code section 1668 could preclude insurance coverage for claims involving fraud or misrepresentation, whether intentional or negligent. However, AIG never told the district court—and the district court apparently failed to find out for itself—that the California Supreme Court held that section 1668 does *not* apply to contracts of indemnity, including insurance policies. *See Safeco Ins. Co.*, 26 Cal. 4th at 766-67 (because "[a]n insurance policy is an indemnity contract … section 1668 simply does not apply"). AIG's other cases do not address the construction of section 533.

The second group of cases, including *California Amplifier, Inc. v. RLI Ins. Co.*, 94 Cal. App. 4th 102, 106 (2001), and *B&E Convalescent Center v. State Compensation Ins. Fund*, 8 Cal. App. 4th 78 (1992), involved situations in which the underlying claim expressly required a knowing falsehood or was deemed inherently wrongful. In *California Amplifier*, the insured sought indemnity under a

policy of director and officer insurance for a class action involving alleged violations of California Corporations Code sections 25400 and 25500. Section 24500 prohibits false or misleading statements made for the purpose of inducing the purchase or sale of securities, and is enforceable only by the Department of Corporations; section 25500, which creates the private right of action for violation of section 24500, and adds an element of "willful" participation, meaning that the defendant needed to have made a "knowingly false statement," for liability to exist. *California Amplifier*, 94 Cal. App. 4th at 112, 117. Because the claim asserted in the class action required a "knowingly false statement," the Court of Appeal distinguished *Raychem* and other cases allowing coverage for reckless misrepresentations, and found that section 533 barred coverage. *Id*. at 117.[9]

B&E Convalescent Center involved a claim for coverage of an employment discrimination action in which the employee alleged that she had been terminated

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[9] AIG focuses on language from *California Amplifier* discussing the elements of section 25400, and noting that liability for a violation of section 25400 may be based on recklessness as to the truth or falsity of the statement as long as the statement is made with deliberate intent to influence the price of a security. That discussion was not a part of *California Amplifier's* holding; the only claim at issue in *California Amplifier* was a private cause of action under section 25500, and thus the court specifically analyzed only whether the higher scienter requirement of section 25500 was sufficient to trigger Insurance Code section 533. 94 Cal. App. 4th at 116. *California Amplifier* never once stated that either the "recklessness as to truth or falsity" or the "intent to influence the price of a security" element of section 24500 would be sufficient to trigger section 533.

for refusing to interfere with union activities and on the basis of gender, age, and ethnic origin. *B&E*, 8 Cal. App. 4th at 94-98. The Court held that termination in violation of antidiscrimination statutes or other fundamental public policies was "inherently harmful," and that the employee's claim thus "necessarily involve[d] willful and intentional conduct," again distinguishing cases that permitted coverage for conduct based on recklessness. *Id*.; *see also Downey Venture*, 66 Cal. App. 4th at 506 (malicious prosecution is inherently harmful).[10]

The final group of cases interpreted the language of specific insurance policies, most notably the requirement in some liability insurance policies that the underlying injury be the result of an "occurrence." For example, *Chatton v. National Union Fire Ins. Co. of Pittsburgh*, 10 Cal. App. 4th 846 (1992), construed a CGL, or commercial general liability, policy, which defined "occurrence" as "an accident" and held, in the course of interpreting that term, that "fraudulent acts are deemed purposeful rather than accidental …." *Id*. at 860-61. *Chatton* relied on a decision of this Court, *Safeco Ins. Co. of America v. Andrews*, 915 F.2d 500 (9th Cir. 1990), which does not support *Chatton*'s reasoning.[11] It also relied on a

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[10] Whether the California courts would go as far as *B&E* today is far from certain.

[11] *Safeco* held that a misrepresentation was not an "occurrence." But the Court so held not because a misrepresentation can never be accidental but because the "occurrence" definition in that case required the accident to cause "property

definition of "accident" that focused on whether the *act* that caused the loss was intentional, ignoring the California Supreme Court authority holding that an intentional act can result in an "accident" if the *consequences* of the act are "unexpected, unforeseen or undesigned." *Delgado*, 47 Cal. 4th at 309.[12] But even if the reasoning in *Chatton* had been correct, that court never addressed whether coverage for such a claim would be barred by section 533, and *Chatton's contractual* interpretation of a particular insurance policy provision does not govern the construction of the *statute*. *See Allstate Ins. Co. v. Kim W.*, 160 Cal. App. 3d 326, 334 (1984) (section 533 and policy exclusions are not necessarily identical in scope).

D. The District Court Erred Further in Concluding that Section 533 Relieved AIG of Its Duty to Defend

The district court's January 4, 2017 order granted AIG's motion for summary judgment, holding that AIG had no duty to *defend* Office Depot against the underlying *Sherwin* action. ER11. In so ruling, the district court failed to

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damage," and the only loss at issue in *Safeco* was purely economic and, hence, not one involving property damage. 915 F.2d at 502.

[12] The California Supreme Court granted review in *Liberty Surplus Ins. Corp. v. Ledesma & Meyer Constr. Co.*, 834 F.3d 998 (9th Cir. 2016), in which this Court certified questions to the California Supreme Court concerning the scope of what is "accidental" under California insurance law. According to a letter that the California Supreme Court recently posted on its website, a hearing will take place in the first quarter of 2018, which means that a decision on the certified question will be issued during the second quarter of 2018.

acknowledge that the California Supreme Court has repeatedly held that section 533 does not apply to the duty to defend. *See, e.g.*, *Horace Mann*, 4 Cal. 4th at 1087 ("no public policy forbids the *defense* of claims alleging intentional acts") (italics in original); *Gray*, 65 Cal. 2d at 277-78 (same). Even setting that authority aside, the two grounds that the court invoked to attempt to justify its rejection of a defense duty do not stand up to scrutiny.

The district court's first ground was that the scienter requirement of CFCA triggered section 533 and thereby eliminated the potential for coverage as a matter of law. *See Montrose Chem. Corp. of Cal. v. Superior Court*, 6 Cal. 4th 287, 300-01 (1993) (under California law, a liability insurer must defend if the underlying claim against the insured raises a potential for, or even a mere possibility of, coverage). That was error because, as discussed above, a claim under CFCA may be based on reckless or negligent misrepresentations that do not trigger the scienter requirement of section 533. *See, e.g., Randi W.*, 14 Cal. 4th at 1078 (a liability insurer can cover claims based on negligent or reckless misrepresentations); *Watts*, 121 Cal. App. 4th 1029 (same; duty to defend).

The district court's second ground was that that the insured had no reasonable expectation of a defense based on the language of the insurance policy. *See La Jolla Beach & Tennis Club v. Industrial Indem. Co.*, 9 Cal. 4th 27, 38 (1994) (insured also can be entitled to a defense based on the insured's reasonable

expectations of coverage) (citing *Gray*, 65 Cal. 2d at 278). This latter ground likewise does not stand up to scrutiny.

Most fundamentally, because the duty to defend is broader than the duty to indemnify, the existence of a duty to defend does not turn on actual coverage. *Montrose*, 6 Cal. 4th at 299. It thus is well-established under California law that an insured may contract for the defense of claims for which indemnity would be prohibited as a matter of law. *See Downey Venture*, 66 Cal. App. 4th at 507-08 ("if the reasonable expectations of an insured are that a defense will be provided for a claim, then the insurer cannot escape that obligation merely because public policy precludes it from indemnifying that claim").

The California Supreme Court explained the rationale for this rule in its landmark decision in *Gray*, 65 Cal. at 277-78, where the Court addressed a liability insurance policy in which the insurer promised to "defend any suit against the insured alleging bodily injury or property damage." The California Supreme Court held that the insurer owed a duty to defend its insured against a lawsuit in which the sole theory of liability alleged in the complaint was that the insured had committed an intentional assault. The Supreme Court explained that "a contract to defend an assured upon mere accusation of a willful tort does not encourage such wilful conduct," and that "[i]f [the insured] is to be required to finance his own defense and then, only if successful, hold the insurer to its promise by means of a

second suit for reimbursement, we defeat the basic reason for purchase of the insurance." *Id*. at 278; *see also Horace Mann*, 4 Cal. 4th at 1087.

In applying the "reasonable expectations" test, courts look to whether the insured had a reasonable expectation of a defense "in light of the nature and kind of risks covered by the policy." *B&E*, 8 Cal. App. 4th at 99 (citing *Gray*, 65 Cal. 2d at 74). If the claim is consistent with the type of risk covered by the policy, and is not clearly excluded from coverage, the insured has a reasonable expectation of a defense. *Id*. at 99-100 ("For example, an automobile liability insurance policy holder could 'reasonably expect' his insurer to defend any suit arising out of his driving a car, but could not 'reasonably expect' defense of an action for injuries occurring from a defect in a stairway."). To eliminate a defense duty, the risk must be clearly excluded; an ambiguous exclusion does not serve to defeat the insured's reasonable expectations. *Id*.; *see also St. Paul Fire & Marine Ins. Co. v. v. Weiner*, 606 F.2d 864, 867-68 (9th Cir. 1979) (insurance policy that both expressly afforded and appeared to exclude coverage for dishonesty, misrepresentation or fraud was sufficiently ambiguous to give rise to a reasonable expectation of a defense).

The district court erred when it considered section 533, combined with the insurance policy language, in assessing the insured's reasonable expectations. ER10 (citing *B&E*, 8 Cal. App. 4th at 100). The court based its decision on *B&E*,

but the insurance policy in that case contained a provision stating that the insurer may "optionally" provide a defense for "serious and willful" claims, including claims as to which indemnity was statutorily prohibited. *B&E*, 8 Cal. App. 4th at 102. *B&E* held that this language was clear enough to defeat any reasonable expectation that the insured would be guaranteed a defense for the asserted claims. *Id*. No such language is in Office Depot's insurance policy. Moreover, California cases both prior and subsequent to *B&E* have analyzed the insurance policy language separately from any analysis of whether section 533 bars a defense. *See, e.g.*, *Gray*, 65 Cal. 2d at 278-79; *Downey Venture*, 66 Cal. App. 4th at 507-510; *St. Paul*, 606 F.2d at 870. To do otherwise would undermine the rule that parties may contract for the defense of matters as to which indemnity is unavailable.

The district court erred further when it held that the insurance policy must contain express language that provides for a defense against claims as to which section 533 bars indemnity. ER10 (citing *Mez Industries, Inc. v. Pac. Nat'l Ins. Co.*, 76 Cal. App. 4th 856, 878 n.21 (1999)). This holding inverts the established California rule that wherever the insurance policy language affords the insured a reasonable expectation of a defense, *even if that language is unclear or ambiguous*, the insurer is required to defend. *La Jolla Beach & Tennis Club*, 9 Cal. 4th at 38. *Mez* never held that such a statement was required to find a reasonable expectation of a defense; that court merely noted, in a footnote, that no such provision had been

identified in the insurance policy at issue in that case. *Mez*, 76 Cal. App. 4th at 878 n.21. In fact, under California law, a defense duty is *presumed* in any liability insurance policy "unless the policy clearly provide[s] otherwise." *Maryland Cas. Co. v. Nationwide Ins. Co.*, 65 Cal. App. 4th 21, 31 (1998) (citing *Gray*, 65 Cal. 2d at 273 (language necessary to disclaim a defense duty must be "conspicuous, plain and clear"), and Cal. Civ. Code § 2778(4)). The district court failed to identify any language in the AIG insurance policy satisfying that exacting standard.

E. It Would Be Error to Expand Section 533 to Preclude Defense or Indemnity Coverage for Reckless or Negligent Conduct

An affirmance of the district court's ruling—including its analysis of section 533—would have a far-reaching adverse impact on existing law and on California policyholders (at least until the ruling is clarified or disapproved by the California Supreme Court). The district court interpreted section 533 to prohibit indemnity for claims arising out of *any* statement that is made with the intent to induce reliance. As explained above, this interpretation, by barring coverage for claims arising out negligent or reckless speech (or conduct intended to induce reliance), contravenes not only the plain language of section 533 (the insurer "is not exonerated by the negligence of the insured") but also longstanding California precedent holding that section 533's prohibition on insuring settlements or judgments for "wilful" misconduct does not apply to negligence or recklessness.

Neither the district court nor AIG offers any basis for disregarding California law on this score.

Indeed, the district court's interpretation of section 533, if more widely adopted, could significantly restrict the availability of insurance for claims long understood to be insurable under countless numbers of insurance policies that insurers have been selling to California consumers and businesses for many decades. It would affect not only claims for government reimbursement (since inherent in the submission of a claim is an intent that the claim be paid), but also claims arising out of many other kinds of speech, such as statements on employment applications (necessarily submitted with the intent to procure employment), advertisements (made with the intent to induce the purchase of goods or services), medical disclosures by doctors (made with the intent to convince the patient to pursue or decline a specific course of treatment), securities-related disclosures by corporations or investment brokers (made to encourage or discourage trading or investment), postings about safety or hazardous conditions (intended to influence the users of beaches, parks, or private recreational facilities), product manuals and instructions (instructing the user regarding installation and use of a product), and advice given by lawyers, accountants, or other professionals (intended to influence financial or business decisions), among many examples. Insurance coverage for claims of medical or professional malpractice, employment

practices liabilities, false advertising, product liability, securities law violations, personal injuries, and many other categories of torts and statutory violations could be rendered uninsurable as a matter of misguided public policy.

Furthermore, the district court's reasoning, if applied consistently across all categories of cases, would lead to an odd dichotomy under California public policy whereby claims arising out of reckless actions that do not require reliance to cause harm (*e.g.*, a claim for personal injuries caused by a speeding driver) would still be covered, but claims arising out of reckless speech (*e.g.*, a product liability claim arising out of an omission in an instruction manual) may not be. This dichotomy could further create problems in analyzing insurance coverage for particular claims. For example, in a claim for medical malpractice arising out of the death of a cancer patient, is the cause of the patient's injury the failure to read the scans properly (an action), the failure to mark the scans with the proper notations indicating cancer (speech), the failure to identify the proper treatment (an action), or the failure to adequately explain the disease and treatment options to the patient (speech)? We can think of no public policy that would support such a distinction, which would also undermine the public policy goal that insurance contracts be clear and understandable, and that any ambiguity be construed in favor of policyholders. *See, e.g., Minkler v. Safeco Ins. Co. of Am.*, 49 Cal. 4th 315, 319, 325 (2010).

The district court's rulings relating to the duty to defend are also problematic from a public policy perspective. As explained above, the district court's ruling improperly limits the insurer's duty to defend in two ways: by reading section 533 into the policy as a policy term, and by requiring an express statement in the policy that the insurer will provide a defense for specific types of wilful conduct. Both limitations would restrict the duty to defend without justification; as explained by the California Supreme Court in *Gray*, a contract to defend against an accusation of a willful tort does not encourage willful conduct, and requiring the insured to fund his own defense against such claims "defeat[s] the basic reason for the purchase of the insurance." 65 Cal. 2d at 278.

F. If the Court Is in Doubt, It Should Certify the Issue Presented to the California Supreme Court

United Policyholders respectfully submits that if this Court has doubt as to the outcome of this appeal, the Court should certify the questions presented here to the California Supreme Court pursuant to Rule 8.548 of the California Rules of Court.

III. CONCLUSION

For all of the foregoing reasons and the reasons discussed in Appellant's Opening and Reply Briefs, the Court should reverse the judgment of the district court. In so holding, this court should expressly clarify that section 533 does not apply to negligent or reckless misstatements (or any conduct) undertaken with the

intent to reduce reliance, and that section 533 does not preclude a duty to defend even for intentional or willful misconduct. Alternatively, the Court should certify the issues in this case to the California Supreme Court.

DATE: November 21, 2017 Respectfully submitted,

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CERTIFICATION OF COMPLIANCE

Pursuant to Fed. R. App. P. Rule 28.1(e)(2)(A) and Ninth Circuit Rule 32-1, I certify that this brief is proportionately spaced and has a typeface of 14 points or more, and further certify that the body of this brief contains 6674 words, as calculated by the word processing system used to prepare the brief.

DATE: November 21, 2017

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CERTIFICATE OF SERVICE

Pursuant to Ninth Circuit Rule 25-5(f), I hereby certify that I electronically filed APPLICATION OF UNITED POLICYHOLDERS FOR LEAVE TO FILE BRIEF AMICUS CURIAE; [PROPOSED] BRIEF AMICUS CURIAE IN SUPPORT OF APPELLANT OFFICE DEPOT, INC.'S REQUEST FOR REVERSAL with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system on November 21, 2017.

I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

/s/ David B. Goodwin
DAVID B. GOODWIN