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PERSPECTIVE

Despite what you've read, this was good for insureds

By Kirk A. Pasich

Last week, the California Supreme Court rendered its long-awaited decision in *Hartford Casualty Insurance Co. v. J.R. Marketing LLC*, 2015 DJDAR 9111 (Aug. 10, 2015). Insurers and insureds alike have been waiting to see how the court would address the question of an insurer's right to seek reimbursement of fees from independent counsel representing an insured in litigation.

Many were hoping, or fearing, the decision would be an expansive one allowing broad reimbursement rights. Much of the early commentary suggests the decision is horrible for insureds, or rather their independent defense counsel, because it permits an insurer to seek repayment *from counsel* when the insurer believes it overpaid.

But this decision is not a giant shift in the law, an overwhelming defeat for the rights of insureds or their independent counsel, or a momentous victory for insurers that somehow limits their defense duty. The court's holding actually is very narrow. It did not address reimbursement or allocation of fees for uncovered claims, or say that an insurer could recover from *Cumis* counsel the fees incurred in the defense of uncovered claims.

The court was remarkably careful to repeatedly state how narrow its holding was, and to link its holding to the very peculiar facts before it. As it phrased the issue and its holding: "May an insurer seek reimbursement directly from counsel when, in satisfaction of its duty to fund its insureds' defense in a third party action against them, the insurer paid bills submitted by the insureds' independent counsel for the fees and costs of mounting this defense, and has done so in compliance with a court order expressly preserving the insurer's post-litigation right to recover 'unreasonable and unnecessary' amounts billed by counsel? We conclude that, given the facts of this case and within the limits discussed below, such a right of reimbursement should run directly against *Cumis* counsel."

It then noted, "We emphasize that our conclusion hinges on the particular facts and procedural history of this litigation," which it said was a "rather unusual one."

Additionally, the court emphasized the issues it was not deciding: (1) "whether, absent such an order that an insurer could seek reimbursement for excessive fees], an insurer that breaches its defense obligations has *any* right to recover excessive fees it paid *Cumis* counsel"; (2) "whether, in general, a dispute over allegedly excessive fees is more appropriately decided through a court action or an arbitration"; and (3) "*when* such fee disputes generally ought to be decided relative to the underlying litigation."

Having assessed the narrow issue that the court actually did decide, and what the court did not decide, the question then becomes: What else did the court have to say? The answer to that question is, a lot beneficial to insureds.

The court addressed an insurer's duty to defend: "When an insured under a standard CGL policy is sued by a third party, the insurer's contractual duty to defend the insured extends to all claims that are even potentially subject to the policy's indemnity coverage." This reaffirmed the principles first enunciated almost 50 years ago in *Gray v. Zurich Insurance Co.*, 65 Cal. 2d 263, 275-77 (1966).

The court emphasized that "when the third party suit includes some claims that are potentially covered, and some that are clearly outside the policy's coverage, the law nonetheless implies the insurer's duty to defend the entire action." This, too, is a reaffirmation of principles previously stated by the court. See, e.g., *Horace Mann Ins. Co. v. Barbara B.*, 4 Cal. 4th 1076, 1084 (1993) ("We look not to whether non-covered acts predominate in the third party's action, but rather to whether there is *any* potential for liability under the policy.").

The court also reaffirmed the insurer's duty when there is a conflict of interest: "[U]nless the insured agrees otherwise, in a case where — because of the insurer's reservation of rights based on possible noncoverage under the policy — the interests of the insurer and the insured diverge, the insurer must pay reasonable costs for retaining independent counsel by the insured."

The court then addressed an insurer's challenges to the reasonableness of defense fees and costs. It noted that "under the ethical rules that govern attorney conduct generally," an insurer's "obligation to finance its insureds' defense" does not "ultimately extend beyond the duty to pay the reasonable costs of defense." The court said the "proper test" for resolving an insurer's "claims of excessive billing" is "whether the charges were *objectively reasonable at the time they were incurred* under the circumstances then known to counsel." It then held that the burden to prove that defense fees "were in fact unreasonable and unnecessary falls entirely on the insurer."

While this holding is perhaps the most definitive statement of the principle, it is consistent with prior appellate decisions. See, e.g., *Buss v. Superior Court*, 16 Cal. 4th 35, 53 (1997) (insurer "must carry the burden of proof" in showing what defense costs "can be allocated solely to the claims that are not even potentially covered"); *Am. Motorists Ins. Co. v. Superior Court*, 68 Cal. App. 4th 864, 875 (1998) (insurer bears burden of proving that fees were unreasonable because "party desiring relief must carry the burden of proof thereon").

The court also cautioned that because there was an order permitting the insurer before it to pursue recovery of alleged overpayments, it was not addressing whether a "breaching" insurer "that was arguably caught shirking its defense duties, ought to be able to pursue *anyone* for alleged overpayments." That issue remains to be decided on another day.

However, there is some appellate guidance on the issue. "When it does not appear that the attorneys' fees and other expenses are obviously excessive, testimony of the amounts paid will constitute a *prima facie* case; and it will be assumed in such case that the attorneys' fees so paid were reasonable, unless the contrary appears." *Kershaw v. Maryland Cas. Co.*, 172 Cal. App. 2d 248, 258 (1959). The insurer's burden will not be an easy one because the question, as the court intimated, is whether the insurer can establish fees that "were unreasonable and unnecessary for the insured's defense against any claim."

As Justice Goodwin Liu stated in a concurring opinion, "it will be [the insurer's] burden to show not only that the fees it seeks to recover ... were not *'objectively reasonable at the time they were incurred*, under the circumstances then known to counsel,' but also that the fees were not incurred for [the insured's] benefit" (citation omitted). Justice Liu emphasized, "It may be difficult to determine whether or how much the insured benefited simply by looking at the services provided ... [A]bsent evidence to the contrary, we should presume that the insured, as the client controlling *Cumis* counsel's defense of the third party action, was the entity that primarily benefited from any fees incurred."

Finally, the court addressed one issue now frequently disputed between insurers and insureds — whether an insured must produce unredacted copies of its defense bills to an insurer in order to obtain payment of those bills. The court held: "[A]n objective assessment of the litigation as a whole to determine whether counsel's bills appear fundamentally reasonable is unlikely to involve an examination of individual attorney-client communications or the minute details of every litigation decision. If privileged information on these subjects is included in counsel's billing records, it can be redacted for purposes of assessing whether counsel's bills are reasonable." See also Cal. Civ. Code Section 2860(d) (specifying that while independent counsel has a duty to disclose to an insurer information concerning an action, that duty does not extend to "privileged materials relevant to coverage disputes").

Thus, the portions of *Hartford* that are theoretically unfavorable to an insured or its independent defense counsel are narrowly crafted to deal with a unique situation. The rest of the decision provides guidance and clarity on issues that have been the subject of considerable disagreement between insureds and insurers, with clear determinations and reaffirmations of the rights of the insureds.

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