PAYNE & FEARS

California Insurance Law Alert

August 2015

California Supreme Court Allows Insurer to Sue Independent Counsel Directly for Reimbursement of Defense Costs in "Unusual" Procedural Setting

In a highly-anticipated decision regarding an insurer's rights against an insured's independent counsel, the California Supreme Court has ruled that an insurer may sue independent counsel for reimbursement of excessive defense costs if those costs were paid involuntarily pursuant to a trial-court order that expressly permitted the insurer to "recover payments of excessive fees." *Hartford Cas. Ins. Co. v. J.R. Marketing, LLC*, ___ Cal. 4th ___ (Aug. 10, 2015).

The Supreme Court reached this holding based on what the court described as "unusual" facts. J.R. Marketing tendered a third-party lawsuit to its liability insurer, Hartford, which denied coverage. Hartford subsequently agreed to defend, but refused to pay J.R. Marketing's previously-incurred defense costs or any of the fees generated by its independent counsel, Squire Sanders. The trial court found that Hartford had breached its duty to defend, and based on Hartford's intransigence, the trial court issued an "enforcement order" requiring Hartford to pay all past and future defense costs. This order noted that Squire's bills must still be "reasonable and necessary," and that Hartford could challenge any "unreasonable and unnecessary" defense fees "by way of reimbursement after resolution" of the third-party lawsuit. Once the third-party lawsuit resolved, Hartford sought reimbursement directly from Squire for the approximately $13.5 million in defense costs that Hartford had paid Squire to defend J.R. Marketing against the third-party lawsuit. Squire demurred to Hartford's reimbursement claim, which the trial court sustained and the Court of Appeal affirmed.

The Supreme Court granted review to answer what it called a "narrow question:" "May an insurer seek reimbursement directly from counsel when . . . the insurer paid bills submitted by the insured's independent counsel for the fees and costs of mounting [a] defense, and has done so in compliance with a court expressly preserving the insurer's post-litigation right to recover 'unreasonable and unnecessary' amounts billed by counsel?" The Supreme Court concluded that Hartford may seek reimbursement directly from Squire under these unique facts. However, the Court cautioned that its "conclusion is a limited one" based on the "history of this litigation."

The Supreme Court's decision may be most interesting for its repeated articulation of the questions that it was not answering. For instance, throughout the Opinion, the Court explained that it was not deciding whether an insurer who breaches the duty to defend "ought to be able to pursue *anyone* for alleged overpayments," including the insured or independent counsel. Likewise, the Court emphasized that it was not deciding whether a breaching insurer can take advantage of the protections of Civil Code § 2860, such as the mandatory arbitration provision. The Court may be inviting future appellate litigation on these issues.

The Opinion also addressed multiple concerns raised by amicus curiae (including Payne & Fears LLP, who prepared an amicus brief on behalf of a firm client) that siding with Hartford, an insurer who spent years trying to avoid its defense obligation, would send the wrong message and reward a bad actor. The Court explained that "to the extent . . . amici curiae perceive unfairness in the conclusion that a breaching insurer . . . should nevertheless retain the right to recoup allegedly excessive legal charges in a later court proceeding, any such unfairness stems from the . . . enforcement order and not from our holding here."

Moving ahead, the Supreme Court's Opinion in *J.R. Marketing* raises as many questions as it answers. However, by emphasizing that there is an open issue about whether a breaching insurer loses its right to challenge the reasonableness of defense costs, the Opinion does give policyholders a leg up in demonstrating to other courts that such an argument is worth considering.