Insurance Disputes Arising Out of Complex Litigation

FEATURE ARTICLE

It is a truism that complex business lawsuits invariably result in complex insurance disputes. In fact, general liability insurance policies provide coverage for a wide variety of business litigation lawsuits, including claims of misappropriation of trade secrets, unfair competition and copyright and trademark infringement. See *Sentex Systems, Inc. v. Hartford Acc. & Indem. Co.* (9th Cir. 1996) 93 F3d 578. Even business lawsuits that center on allegations typically not covered by general liability policies—such as wrongful termination or sexual harassment—nevertheless frequently involve secondary allegations of defamation, invasion of privacy or related torts which implicate insurance coverage See *Buss v. Transamerica* (1997) 16 Cal4th 35.

Although the insurance disputes engendered by these business litigation disputes are complex and fact specific, there are ten recurring insurance coverage issues that are typically raised by any business litigation claim. These ten issues constitute the paradigm I call the "Ten Phases of Insurance Coverage."

1. Duty to Defend

The duty to defend is the most important concept in insurance. Black letter California law requires an insurer to immediately defend its insured if the allegations in the complaint fall within, or may potentially fall within, the scope of coverage provided by the terms and definitions of the policy. *Gray v. Zurich Insurance Co.* (1966) 65 Cal.2d 263

The duty to defend frequently becomes the first battlefield between insurer and insured. Insurers file declaratory relief actions seeking judicial resolution of difficult coverage issues. Policyholders initiate bad faith complaints arising from the insurer's wrongful refusal to defend. Critically, many duty to defend issues can be promptly resolved through a motion for summary adjudication, allowing the insurer and policyholder to ascertain their rights and obligations early in the claims handling process.

2. Right to Independent Counsel

A derivative of the duty to defend is the right to independent counsel. California Civil Code section 2860 imposes a mandatory duty upon insurers to provide independent counsel when the resolution of a third party claim bears directly on the outcome of the coverage dispute between the insurer and its insured. *San Diego Navy Fed. Credit Union v Cumis Ins Society, Inc.* (1984) 162 Cal.App.3d 358, 364.

The right to independent counsel is one of the most heated disputes in insurance. Disputes arising over the right to independent counsel can take many months to resolve informally. To the extent that the insurer refuses to recognize the right to independent counsel, it may be necessary for the insured to initiate litigation and file a motion for summary adjudication on that issue. Furthermore, while the litigation is being prosecuted, the insured may need to involuntarily wrest control of the defense away from insurer-appointed counsel through a formal substitution of attorney Under such circumstances, the insurer may claim a breach of the duty to cooperate and purport to withdraw form the defense. Ultimately, obtaining the right to independent counsel is critical to the proper resolution of any insurance coverage dispute between the insured and its insurer.

3. Control of Litigation

Even in situations where independent counsel has been appointed, issues regarding control of the litigation frequently arise. Civil Code section 2860 provides that "both the counsel provided by the insurer and independent counsel selected by the insured shall be allowed to participate in all aspects of the litigation." Based on this provision, insurers frequently argue that their appointed counsel has the right to be directly involved in all discovery, law and motion, and strategy decisions

From the perspective of the insured, any efforts by the insurer to control the litigation directly contradict the purpose of Civil Code section 2860 and should be strenuously resisted While independent counsel and the insured have an obligation to fully cooperate and share information and documents with the insurer and its appointed "monitoring" counsel, at the end of the day there can only be one ultimate decision-maker in the litigation· independent counsel. Thus a bright line must be drawn between the legitimate monitoring activities of insurer's counsel and an improper attempt to become involved in substantive issues and decision making in the litigation.

4. Hourly Rate

Disputes involving the hourly rate to be paid arise in virtually every case involving independent counsel. Pursuant to Civil Code section 2860, the insurer must pay independent counsel "the same rates that

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actually paid by the insured to attorneys retained by it in the ordinary course of business in the defense of similar actions in the community." Based on this language, insurers typically will argue that independent counsel must accept the lowest "off the rack" rates paid by that insurer.

Independent counsel should resist such efforts. First, the hourly rate paid by insurers to their panel counsel does not truly reflect all the consideration that panel firms receive. For example, a law firm that has a commitment to a large volume of cases saves significantly on overhead and other costs, including marketing. In addition, the regular hourly rates do not include year-end bonuses or other incentives that may also be paid.

Second, an "apples to apples" comparison must be made. Many business litigation disputes are extremely complex and require sophisticated counsel. Likewise, such disputes frequently involve high damages and require specialized handling. Thus, what the insurer pays its lawyers to handle simple disputes is not relevant.

Ultimately, resolving hourly rate disputes is much easier when in a litigation mode. An insured can serve comprehensive discovery upon the insurer seeking information regarding what hourly rates the insurer pays to lawyers for similar claims. Independent counsel should be entitled to payment of the highest rate that the insurer pays in other cases. After completion of discovery, disputes regarding hourly rates must be resolved by binding arbitration.

5. Litigation Guidelines

Virtually all insurers have "Litigation Guidelines," which they require their regularly appointed panel defense counsel to follow as a condition of employment. Many of these insurers attempt to impose these same obligations upon independent counsel. Such efforts should be rejected by independent counsel

In *Dynamic Concepts, Inc. v. Truck Insurance Exchange* (1998) 61 Cal.App.4th 999, the court held that not only was it an improper interference in the attorney-client relationship for an insurer to attempt to impose any of its standard litigation guidelines upon independent counsel, but "questioned" their use even for insurer-appointed counsel. The Court stressed that, "Under

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no circumstances can such guidelines be permitted to impede the attorney's own professional judgment about how best to competently represent the insureds " *Dynamic Concepts* at 1004, fn 9.

The *Dynamic Concepts* case is only the most recent articulation of the fundamental principle that an insurance company cannot engage in the practice of law nor impede the professional judgment of the attorneys defending its insureds. California Business & Professions Code section 16125. See *In the Matter of the Rules of Professional Conduct and Insurer Imposed Billing Rules and Procedures (2000)* 2000 MT 110, 2 P.3d. 806.

6. Recovery of Pre-Tender Fees

The *sine qua non* of any insurance claim is tender to the insurer. If the insurer has no notice of the claim, no coverage can exist. On some occasions, tender is made weeks or months after the claim is filed. Late tender can result from various factors, including inability to locate the policy, a lack of understanding that the claim may potentially trigger insurance coverage or simple inadvertence. Whatever the reason for the late tender, insurers uniformly take the position that they are not responsible for reimbursement of attorneys' fees and costs incurred prior to tender.

Although recovery of pre-tender fees is not possible in every case, insureds should attempt to obtain pre-tender fees whenever possible. Recovery of pre-tender fees will depend upon the circumstances of each case. For example, if a case is filed with a flurry of ex-parte applications, requests for temporary restraining orders, injunctions, and other early litigation activity, the insured should be entitled to reimbursement of its attorneys' fees for these activities even before tender. Likewise, if the insurer has suffered no prejudice as a result of the defense activities—and in fact benefits from such defense expenditures—and if independent counsel would have been warranted in any event, then the insurer should reimburse pre-tender fees as a matter of equity and fairness Further, an insured may also be excused from late tender because of a lost policy of other mitigating factors. See *Shell Oil Co. v. National Union Fire Ins. Co.* (1996) 44 Cal.App.4th 1633; Fiorito v. Sup.Ct. (1990) 226 Cal App.3d. 433.

7. Recovery of Post-Tender and Pre-Acknowledgment Fees

A derivative of issues regarding pre-tender fees are attempts by insurers to avoid payment in full of an insured's attorney's fees incurred post-tender but before acknowledgment of the defense by the insurer. Once an insurer refuses to defend its insured, such insurer must pay all attorney's fees incurred after its refusal to defend, in full, and without any reduction in the hourly rate. *Stalberg v. Western Title Ins. Co.* (1991) 230 Cal.App.3d 1223. This same rule applies equally when the insured incurs attorney's fees post-tender but before acknowledgment of the duty to defend. The insurer must pay all of the attorney's fees and the regular hourly rate charged by that counsel.

8. Reasonableness of Fees

The litigation audit is an offshoot of Litigation Guidelines and the bane of appointed panel defense lawyers everywhere. Insurers will typically scrutinize bills of independent counsel even more carefully than the bills of regular panel lawyers. While appointed panel lawyers usually have no choice in the matter, independent counsel have no obligation to endure unreasonable attempts to reduce their bills. Rather, the insurer is obligated as matter of law to pay all reasonable fees and expenses.

Pursuant to Civil Code section 2860, all billing disputes must be submitted to binding arbitration. It may be wise for independent counsel to immediately petition for arbitration, so that billing issues are resolved early in the case and a protocol is established. Furthermore, the insurers' refusal to pay all outstanding bills may be a breach of the duty to defend or even an interference with the contract between the insured and its independent counsel.

9. Settlement

The settlement context is rife with disputes and conflicts between insurers and their insureds. For example, insurers frequently attempt to obtain contribution from their insureds for settlement because some portion of the settlement deals with uncovered claims. Insureds just as strenuously demand that insurers pay the entire amount of such settlements

Similarly, many disputes arise regarding timing of settlements. For example, insureds may demand that the insurers immediately settle outstanding claims, even up to policy limits. Insurers, on the other hand, may evaluate the case much differently and view it as economically more feasible to litigate the case. Interestingly, professional liability claims frequently involve the converse situation, as insureds demand that the insurer fight the claim all the way through trial while insurers seek the predictability of a settlement

Finally, high deductible or self-insured retention policies also create interesting settlement dynamics, as insurers may wrongfully attempt to settle cases within the deductible or retention amounts (which the insured then has to pay).

10. Post-Judgment

Ironically, resolution of the underlying claim does not mean that the litigation process is over. Rather, it frequently signals the beginning of a lengthy, second lawsuit with the policyholders own insurer. Typically, the insurer's conduct throughout the ten phases of insurance coverage becomes the principal issue in the insurance lawsuit.

For the insured, most post-judgment disputes concern litigation for breach of contract or bad faith. For example, if the insurer had an opportunity to settle within policy limits but chose not to do so, any judgment in excess of policy limits may be the responsibility of the insurer. Further, the insured may sue for reimbursement of defense fees and costs not paid or the complete failure by the insurer to defend and indemnify.

From the insurer's perspective, two principal issues arise post-judgment. First, an insurer who has issued a reservation of rights letter may seek reimbursement of attorneys' fees and costs which were incurred in the

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defense of clearly uncovered claims pursuant to *Buss v. Transamerica* (1977) 16 Cal.4th 35. Second, an insurer that pays a settlement to a claimant may later seek reimbursement of that settlement through a declaratory relief action finding that there was no coverage for the claim at issue. *Maryland Cas. Co. v. Imperial Contracting Co.* (1989) 212 Cal.App.3d 712 Both of these mechanisms are rarely utilized by insurers, however, as they involve significant litigation costs in enforcing the rights at issue and typically concern insureds without the resources to pay any significant judgment.

Understanding the ten phases of insurance coverage is critical to properly representing one's client in complex business litigation. This is especially true in circumstances where an insurer acts improperly in discharging its obligations and prejudices the defense of the insured in the litigation