

ALERT

Insurer Only Required to Pay for Agreed-Upon Defense Counsel at Reasonable Rates

November 18, 2011

The United States District Court for the Eastern District of California, applying California law, held that an insurer was required to pay only defense costs incurred on behalf of its insured in an action brought against both insured and non-insured parties and the insurer was entitled to pay only reasonable defense costs for counsel chosen by the insured and for which the insurer consented. *Endurance American Specialty Co. v. Lance-Kashian & Co.*, 2011 WL 5417103 (E.D. Cal. Nov. 8, 2011).

A complaint was filed against several insureds and a non-insured entity, and they retained the same counsel to represent them in the action. The insureds tendered the action to their insurer under a duty to defend policy, and the insurer reserved its right to deny coverage and agreed to the retention of two firms to represent the insureds. The insurer's consent to the retention of the two firms was conditioned upon agreement that the insurer would only pay set rates for defense counsel and defense costs would be allocated between the insureds and the non-insured entity. The insured never responded to the insurer's positions concerning defense counsel rates and allocation of defense costs until the underlying action was settled, and the insurer filed litigation seeking a determination of the extent of its obligations to pay defense costs in the underlying action.

The court first held that the insurer obligated itself to pay for the defense costs incurred by two firms but not a third firm for which the insurer never gave its consent. The court explained that the policy provided that the insurer would pay for reasonable legal fees and expenses if the insurer consented to those costs. Because the insurer never consented to the retention of the third firm and the insureds never substantiated the need for a third firm in the underlying action,

Practice Areas

- D&O and Financial Institution Liability
- E&O for Lawyers, Accountants and Other Professionals
- Insurance
- Professional Liability Defense

the insurer was not obligated to pay any fees or expenses incurred by the third firm. The court, however, rejected the insurer's argument that the insureds waived or were estopped from seeking payment for defense costs above the rates to which the insurer consented. Although the insureds did not respond to the rates and allocation percentage outlined in the reservation of rights letter or other communications from the insurer, the court found there was no detrimental reliance on which to base waiver or estoppel because the insurer paid only those amounts to which it consented.

The court rejected the insureds' contention that they were entitled to independent counsel based on the insurer's reservation of rights. The court held that the insurer never retained defense counsel to represent the insureds in the underlying action as the insurer consented to the insureds' retained defense counsel, which controlled the defense. Under these circumstances, the court concluded that "the insureds were represented by independent counsel for conflict of interest purposes," and because no conflict of interest existed, the insurer was not required to inform the insureds of the right to select independent counsel.

In addition, the court held that the policy's allocation provision did not require the insurer to pay for defense costs incurred by the non-insured entity in the underlying action even though the insureds and the non-insured entity were represented by the same counsel. The court opined that the allocation provision was triggered because a claim was "made against both an Insured and others not insured under this Policy." The court further found that the policy's requirement that the insurer pay 100% of defense costs if an underlying action contained any covered matter only required the insurer to pay 100% of defense costs incurred by the insureds and not non-insured parties. Moreover, according to the court, the insurer's allocation of two-thirds of defense costs to the non-insured entity was not "unreasonable or out of line with the insureds' potential liability." The court also found that the policy provision allowing the insurer conclusively to determine the reasonableness of claims expenses was not unconscionable and the insurer's defense rates of \$350 per hour for partners, \$250 per hour for associates, and \$150 per hour for paralegals was not objectively unreasonable.