

Duty To Defend Does Not Include Uninsured Co-Defendants, and Right To Independent Counsel Subject To Payment of Reasonable Rates

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The United States District Court for the Eastern District of California has held that an insurer's declaratory judgment complaint properly alleged that (i) the insurer was entitled to condition consent to counsel on payment of reasonable rates, (ii) it was entitled to allocate defense expenses because the duty to defend did not include a defense for uninsured co-defendants and (iii) the insured had waived, or was estopped from asserting, its alleged right to payment of its chosen counsel's normal rates by accepting a defense without objecting to the insurer's conditions. *Endurance Am. Spec. Ins. Co. v. Lance-Kashian & Co.*, 2010 WL 3619467 (E.D. Cal. Sept. 13, 2010)

A minority partner in a business enterprise sued the insured and an uninsured partnership for tortious interference with the minority partner's sale of an interest in the business. The insured asked the insurer to consent to its choice of defense counsel for himself and the uninsured entity defendant. The insurer issued a reservation of rights letter noting that the chosen defense counsel's rates were much higher than the insurer generally paid and that it would consent to the insured's choice of counsel only if they agreed to reduced rates. The insurer also stated that if it consented to the insured's choice of counsel, it would pay only the portion of defense costs allocated to the defense of the insured. The insured did not object to the conditions in the reservation of rights letter for several months, but then sent a letter demanding that the insurer cover all defense fees for all defendants at defense counsel's usual rates. The insurer filed suit seeking a determination as to its obligations under the policy, and the insured filed a motion to dismiss.

The court first rejected the insured's argument that the insurer's reservation of rights letter created an actual conflict of interest that allowed the insured to select independent counsel. The court noted that an actual conflict exists under California law only where the insurer reserves rights on a given issue and the outcome of that coverage issue can be controlled by defense counsel. Here, the insurer reserved rights based on an intentional acts exclusion over which defense counsel had no control. As the court noted, "a court or jury, not defense counsel, will determine if the insured engaged in intentional acts not subject to coverage." The court further found that, even if an actual conflict existed, a factual dispute existed as to whether the insured was

provided with independent counsel. In that regard, the court opined that "the insureds' gripe is not about their counsel; it is about payment of defense counsel's entire fees at rates above those generally accepted by [the insurer]."

The court also determined that Cal. Stat. 2860(c), which states that "the insurer's obligation to pay fees to the independent counsel selected by the insured is limited to the rates which are actually paid by the insurer to attorneys retained by it in the ordinary course of business in the defense of similar actions in the community where the claim arose or is being defended," did not obligate the insurer to pay defense counsel's full market rates, but rather to pay "actual" rates of counsel that the insurer ordinarily retained. The court further noted that the policy expressly entitled the insurer to determine the reasonableness of defense expenses, which it had done in the reservation of rights letter. The insured was free to pay amounts in excess of acceptable rates at its own expense.

Additionally, the court held that the insured's effort to dismiss the insurer's "allocation" claim failed because the insured "twisted the allocation provision" of the policy. Rejecting the insured's reliance on California case law regarding the duty to defend both covered and non-covered claims, the court opined that the duty to defend is not so broad as to encompass the duty to defend parties that are not insured under the policy. According to the court, interpreting the policy to provide coverage for an uninsured defendant's defense costs "adds a term not found in the policy."

The court also declined to dismiss the insurer's claim that the insured waived or was estopped from seeking attorney's fees that the insurer did not consent to pay because "the complaint's reasonable inferences are that the insureds accepted [the insurer]'s proposed defense arrangement for [three and a half] months and later sought to undo the arrangement." The court also pointed out that the insurer properly had alleged estoppel by pleading that the insurer detrimentally relied on the insured's acquiescence to the reduced rates by foregoing its right to appoint defense counsel of its own choosing.