Now You See It; Now You Don’t: Recent Trends Among Cases Addressing Coverage for and Recoupment of Defense Costs¹

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I. INTRODUCTION

This article surveys recent trends among the cases addressing key recurring issues bearing on coverage for and recoupment of defense costs. These issues include: (1) whether an insurer is entitled to recoup

¹ The authors’ views are their own and not those of their firms or their clients. Further, each individual author does not necessarily agree with everything in this paper, which is a joint project and which contains portions that were authored by other panelists.
defense costs advanced to an insured if it is subsequently determined that the policy does not cover the claims asserted against the insured in the underlying litigation; (2) how, if at all, losses are to be allocated in instances in which the underlying case involves a mix of covered and potentially non-covered claims or parties; (3) the circumstances under which an insured may be entitled to its own independent counsel paid for by the insurance company; and (4) the extent to which an insurer that agrees to pay the insured’s defense costs may require the insured to comply with its “billing” or “litigation management guidelines.”

As discussed below, courts across the country continue to reach conflicting conclusions regarding these issues. Accordingly, and as is typically the case in insurance coverage disputes, how any given court will resolve a particular dispute may depend heavily on which body of law is determined to apply to the controversy.

II. RECOUPLMENT OF DEFENSE COSTS

A frequently litigated issue regarding the duty to advance defense costs relates to the circumstances under which an insurance company may obtain recoupment of defense costs that it has paid for claims ultimately determined not to be covered by the policy. Generally, the insurance company must advance defense costs for any claim potentially covered by a policy. Because an insurance company’s duty to advance defense costs extends to all potentially covered claims, a payment obligation may exist even though the insurance company ultimately has no duty to pay damages incurred in the suit.

Courts are split as to whether an insurance company may seek recoupment of defense costs when the policy does not specifically confer a right to recoupment. Their analysis of the issue typically is framed in terms of whether an insurance company may seek the extra-contractual recoupment of defense costs incurred in connection with a duty to defend claims under a CGL policy.

Courts that allow an insurance company to seek extra-contractual recoupment of defense costs typically do so under a theory of unjust enrichment. For example, in *Valley Forge Insurance Co. v. Health*  

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3 See, e.g., *id.*
CareManagement Partners, the U.S. Court of Appeals for the Tenth Circuit predicted that Colorado would allow an insurance company to seek extra-contractual recoupment of defense costs. The court reasoned that “Colorado recognizes a pair of interlocking legal entitlements.” Id. at 1092. One entitlement, designed “to protect policyholders,” obligates “insurers to advance funds towards the defense of claims that may ultimately turn out not to be covered . . . .” Id. The second entitlement, designed to provide “a corresponding legal remedy” to insurance companies, allows them “to obtain reimbursement when coverage is found not to exist, so long as they reserve (at least by letter) the right to do so.” Id. The court concluded that allowing reimbursement in such circumstances balances the interests of the policyholder and the insurance company by “ensuring that insureds will receive a defense and that insurers won’t be left holding the bag if it turns out they had no duty to provide one.” Id. at 1092–93.

Courts that prohibit an insurance company from seeking extra-contractual recoupment of defense costs typically reason that an insurance company’s rights can be no greater than the terms of its insurance policy provide; and, if the insurance policy does not provide for the recoupment of defense costs, the insurance company has no right of recoupment. Courts adopting this view also reason that the contractual duty to advance defense costs or to defend is broader than the duty to indemnify, and unless the policy provides otherwise, “it is the potential, rather than the certainty, of a claim falling within the insurance policy that triggers the insurer’s duty to defend.” “This duty,” these courts hold, “is not extinguished by a court’s later determination that the claims are not covered.”

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4 616 F.3d 1086, 1092 (10th Cir. 2010).


7 Id.; accord Nationwide Mut. Ins. Co. v. Mortenson, Case No. 3:00–CV–1180 (CFD), 2011 WL 2881314, at *1 (D. Conn. July 18, 2011) (“[B]ecause there was a potential that the defendants’ claims were covered, Nationwide is not entitled to recoup its defense costs for defending such claims.”).
These courts also find no unjust enrichment in permitting an insured to retain the benefit of defense costs incurred by the insurance company, reasoning that the insurance company as well as the insured benefits from incurring the costs because, in doing so, the insurance company hedges against incurring even greater costs in connection with breaching the insurance contract. Some courts further reason that placing the risk of overpayment on insurance companies is appropriate because insurance companies are in the business of and are responsible for determining the scope of coverage under their policies.

California courts have adopted a variant of the view allowing extra-contractual recoupment in certain circumstances. Under this view, an insurance company that has honored its policy obligations to its insured and properly reserved its rights to do seek recoupment of defense costs paid may be entitled to recoupment as to that portion of a particular defense cost that is not related, even in the slightest, to a potentially covered claim. As the California Supreme Court held in *Buss v. Superior Court*,

An insurer may obtain reimbursement only for defense costs that can be allocated solely to the claims that are not even potentially covered. . . . And to do that, as we said in *Hogan v. Midland National Insurance Co.*, 3 Cal.3d 533, 564 (1970), it must accomplish a task that, “if ever feasible,” may be “extremely difficult.” . . . Hence, the insurer will probably pursue the matter only in apparently exceptional cases—for example, where the defense costs the insurer may obtain in reimbursement are clear and substantial and where the assets the insured has available for reimbursement are themselves of the same sort.

*Buss* applied a “preponderance of the evidence” standard for reimbursement of defense costs precisely because the insurer in that case did not breach its duty to defend its insured, making it clear that the right to allocate was being extended to insurers who paid for the entire defense because it would encourage

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8 See, e.g., *Immunex*, 256 P.3d at 447.


10 16 Cal. 4th 35 (1997).

11 Id. at 57-58 (emphases original).
insurers to fulfill their defense obligation. Indeed, the Buss court specifically noted that it was not addressing a case where the insurer had engaged in misconduct by breaching its duties to its insured.

Although under California law an insurer in some situations may recoup defense costs incurred in connection with claims that the policy does not potentially cover, one court recently has prohibited an insurer from recouping defense costs that it incurred after giving notice to its insured of rescinding the policy. The court, predicting California law, reasoned essentially that a rescinded policy is void ab initio and never gives rise to a duty to defend. In California, rescission is effective when a party gives notice of it; “any subsequent judicial proceedings are for the purpose of confirming and enforcing that rescission.” The court concluded that because rescission leaves the insurer without any duty to defend or advance defense costs, any payment of defense costs after giving notice of rescission is voluntary and at the insurance company’s own risk of the insured refusing to repay the defense costs. An insurance company’s entitlement to recoup defense costs incurred in connection with a claim neither actually nor potentially covered therefore is not absolute but instead depends on why the policy affords no potential coverage.

III. ALLOCATION BETWEEN COVERED AND NON-COVERED LOSSES

A. Allocation of Defense Costs Between Covered and Non-Covered Claims

In a situation where the insurer may not be obligated to defend the entire action, such as where some of the claims or parties are not covered, an insurer likely will argue that it is entitled to an allocation between

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13 Buss, 16 Cal. 4th at 60, n.25.


16 Id. (quoting Peterson v. Highland Music, Inc., 140 F.3d 1313 (9th Cir. 1998)).

17 Id.
covered and non-covered defense costs. Indeed, an insurer’s duty to advance defense costs in connection
with an action that includes claims that the policy actually or potentially covers and claims that the policy
does not actually or potentially cover is another frequently litigated issue. Unless the insurance policy
provides for a different allocation, courts typically hold that the insurance company is responsible for
defense costs “reasonably related” to any potentially covered claim, even if the defense costs were also
“useful” to the insured’s defense against a claim not potentially covered.18

Under the “reasonably-related rule,” insureds are entitled to payment of defense costs and fees incurred
not only in connection for covered claims but also for legal work that helps the insured parties defend
against non-covered claims and non-covered parties, provided that the legal work is “reasonably related”
to a covered claim.19 The “reasonably-related” rule, which originated under Maryland law, is now widely
followed.20

The proper allocation of covered and non-covered defense costs, however, depends heavily on an
insurance policy’s particular language. Indeed, one court, Endurance Am. Specialty Co. v. Lance-
Kashian & Co., has departed from the default “reasonably related” standard when the policy required
defense costs to be allocated in proportion to the relative financial and legal exposure that each claim
causes the insured.21 The policy at issue provided that “[t]he Insureds and the Company shall use their
best efforts to agree upon a fair and proper allocation between insured and uninsured Loss. However, the
Company shall not seek to allocate with respect to Claim Expenses and shall pay one hundred percent

18 See, e.g., Safeway Stores, Inc. v. Nat’l Union Fire Ins. Co. of Pittsburgh, Pa., 64 F.3d 1282, 1289 (9th
Cir. 1995).

19 Id.


WL 5417103 (E.D. Cal. Nov. 8, 2011).
(100%) of Claim Expenses so long as a covered matter remains within the Claim.” In this case, a third party sued Lance-Kashian (the insured) and another entity who was not an insured under the policy. Lance-Kashian and the third party shared counsel under a joint defense agreement. The insurer reserved its rights with respect to defense costs and proffered an allocation of one-third of the claim’s defense costs to the policy, contending that the non-covered party was “the subject to the majority, if not all, of any potential liability” arising out of the underlying litigation, and that the majority of defense costs were incurred with respect to it. Lance-Kashian refused to offer any allocation of defense costs, contending under that the allocation provision the insurer had agreed “not . . . to allocate with respect to Claim Expenses”; and that, accordingly the insurance company was responsible for all defense costs reasonably related to a covered claim. The court rejected Lance-Kashian’s interpretation of the allocation provision, reasoning that the allocation provision prevented the insurance company from allocating only with respect to defense expenses “attributable to the insureds.” Finding that the insurer had put forward its best efforts to agree to a fair and proper allocation and that Lance-Kashian had offered “nothing meaningful” to challenge the insurance company’s allocation, the court approved the insurance company’s allocation as not “unreasonable or out of line with the insureds’ potential liability.”

B. Allocation Between Covered and Non-Covered Settlement Costs

Often when the underlying claim is settled, the insurance company will argue that it is entitled to pay less than all of the settlement if there were uncovered claims or parties involved that were resolved through settlement. Insureds, however, will argue that the insurance company is obligated to pay that portion of

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22 Id. at *2, *24.
23 See id. at *25.
24 See id.
26 See id. at *24.
27 Id.
28 Id. at *26.
the settlement that is reasonable in its entirety and that even if portions of the underlying action are not covered, the insurance company bears the burden of demonstrating that the settlement is larger than it otherwise would be because of the presence of the uncovered claims and, if so, by how much.

One of the leading cases addressing this issue is *Nordstrom, Inc. v. Chubb & Son*\textsuperscript{29}. In *Nordstrom*, the court addressed the question of allocation of settlements in the context of a directors and officers liability insurance policy. Both Nordstrom and its officers and directors were sued by Nordstrom’s shareholders based upon allegations of securities fraud. The insurer agreed to fund only a portion of the settlement, claiming that “both individual directors and officers of Nordstrom (insured entities) and the corporation (an uninsured entity) were named as defendants in the underlying suit.”\textsuperscript{30} Nordstrom disagreed, and brought suit, claiming an entitlement to additional payments by the insurer. In attempting to determine the insurer’s appropriate contribution to the settlement amount, the Ninth Circuit adopted the “larger settlement rule.” According to the court, “responsibility for any portion of the settlement should be allocated away from the insured party only if the acts of the uninsured party are determined to have increased the settlement.”\textsuperscript{31} In other words, the court recognized that the full amount of an insured’s settlement will be covered by its insurance policies unless the settlement was increased by the presence of uninsured parties or non-covered claims.

The Ninth Circuit reached a similar conclusion in *Safeway Stores v. National Union Fire Insurance Co.*\textsuperscript{32}. Specifically, the court recognized that allocation is appropriate “only if, and only to the extent that, the defense or settlement costs of the litigation were, by virtue of the wrongful acts of uninsured parties, higher than they would have been had only the insured parties . . . settled.”\textsuperscript{33}

\textsuperscript{29} 54 F.3d 1424 (9th Cir. 1995)

\textsuperscript{30} Id. at 1427.

\textsuperscript{31} Id. at 1432.

\textsuperscript{32} 64 F.3d 1282 (9th Cir. 1995).

\textsuperscript{33} Id. at 1287.
C. Burden of Proof on Allocation

There is a split of authority as to whether the burden of establishing a particular allocation of covered and non-covered defense costs rests with the insured or the insurance company. Courts applying Maryland law have held that the burden rests with the insured.34 Other courts have concluded that the burden of proof rests with the insurance company.35 This conclusion is supported by the view recognized by a number of courts that “[a]llocation is in effect a partial exclusion of the insurer’s liability.”36 The trend in recent cases is to hold that the burden of proving that the policy does not cover any portion of incurred defense costs rests with the insurer.37

IV. INSURED’S ENTITLEMENT TO INDEPENDENT COUNSEL

Another frequently litigated issue bearing on coverage for defense costs is the insured’s right to independent counsel. This issue typically arises when an insurer agrees to defend the insured under a reservation of rights. As the California Court of Appeal explained in the well-known Cumis case, although in “the usual tripartite relationship existing between insurer, insured and counsel, there is a single, common interest shared among them,” and “[d]ual representation by counsel is beneficial since the shared goal of minimizing or eliminating liability to a third party is the same,” a potential conflict of

35 See, e.g., Safeway, 64 F.3d at 1287-88 (the “settlement costs were fully recoverable under the policy, unless the insurer could show that the corporation’s liability had increased the amount of the settlement”).
37 See QBE Ins. Corp. v. ADJO Constr. Co., 33 Misc. 3d 1218(A) (N.Y. Sup. Ct. Oct. 26, 2011) (table) (“Practically speaking, determining when a particular tenant or claimant in the class action suffered damage or injury which first became apparent, is a difficult, if not impossible task. For the purpose of determining a duty to defend, it is sufficient that the Court can glean from the complaint that at least one of the members of the class suffered bodily injury or property damage throughout the entire span of the time when members of the class suffered injuries.”); PepsiCo, Inc. v. Cont’l Cas. Co., 640 F. Supp. 656, 661-62 (S.D.N.Y. 1986) (insurer bears burden of proving what should be allocated to an uncovered party or claim); Caterpillar, Inc. v. Great Am. Ins. Co., 62 F.3d 955 (7th Cir. 1995) (in dispute over allocation of settlement, court placed burden on insurer to prove that all or part of wrongful acts alleged against corporation or its directors and officers were wrongful acts of uninsured persons).
interest may arise between the insurer and the insured where the insurer reserves its right to later disclaim coverage for the third-party claim.\textsuperscript{38}

A typical situation in which such a potential conflict of interest may arise is where the third-party complaint alleges alternative theories of liability, and at least one theory is not covered by the insurance policy. As the Alaska Supreme Court explained:

\begin{quote}
If a plaintiff alleged both negligence and an intentional tort as alternative theories of recovery, an insurer operating under a reservation of rights might covertly frame its defense to achieve a verdict based upon commission of the intentional tort, so that it could later assert that the defendant was not covered, since the policy provided no coverage for intentional torts.\textsuperscript{39}
\end{quote}

The concern is that “the insurer may steer result to judgment under an uninsured theory of recovery,” which would be adverse to the interests of the insured.\textsuperscript{40}

Another example where such a potential conflict of interest may arise is where the third-party complaint seeks only a small amount in compensatory damages that is covered by insurance, along with a disproportionately large amount in punitive damages that is not covered by insurance. The concern is that the insurer may have “an interest in providing a less-than-vigorous defense,” which would also be adverse to the interests of the insured.\textsuperscript{41}

\begin{footnotes}
\item[40] CHI of Alaska, Inc. v. Emp’l’s Reinsurance Corp., 844 P.2d 1113, 1118 (Alaska 1993). See also U.S. Fid. & Guar. Co. v. Louis A. Roser, Co., 585 F.2d 932, 938 (8th Cir. 1978) (applying Utah law) (“Although it was to the common interest of both [the insured and the insurer] to prevent [the claimant] from making any recovery on its claim, a material difference existed with respect to the basis for recovery should [the insured] prevail in its lawsuit. It must be remembered that [the claimant] was relying on three separate grounds for relief, two covered by the policy and one outside the scope of coverage. Common logic dictates that in such circumstances, counsel for [the insurer] would be inclined, albeit acting in good faith, to bend his efforts, however unconsciously, toward establishing that any recovery by [the claimant] would be grounded on the theory of [Kemp]’s claim which was not covered by the policy. Therein lay the conflict.”).
\item[41] Nandorf, Inc. v. CNA Ins. Cos., 134 Ill. App. 3d 134, 138 (1985). Contra Ferguson v. Birmingham Fire Ins. Co., 460 P.2d 342, 349 (Or. 1969) (“It is feared that if the insurer knows that it can later assert non-coverage, it may offer only a token defense in the action brought against the insured, or be less prone
\end{footnotes}
Depending on the jurisdiction, the insurer’s reservation of its right to disclaim coverage for the third-party claim may entitle the insured to select and hire its own independent defense counsel, whose fees are to be paid by the insurer. Indeed, some courts have held that an insurer’s reservation of rights automatically entitles an insured to independent counsel. A variation of this rule adopted by some courts is that a conflict of interest is deemed to arise only under certain circumstances, such as when the third-party complaint alleges alternative theories of liability and one of which is covered by the insurance policy while the other is not.

42 See, e.g., Herbert A. Sullivan, Inc. v. Utica Mut. Ins. Co., 439 Mass. 387, 406-07 (2003) (“When an insurer seeks to defend its insured under a reservation of rights, and the insured is unwilling that the insurer do so, the insured may require the insurer either to relinquish its reservation of rights or relinquish its defense of the insured and reimburse the insured for its defense costs”; but holding that because the insurer neither insisted on having the reservation of rights removed nor insisted on assuming its own defense, the insured “acquiesced in the legal representation provided by [the insurer]”); Moeller v. Am. Guarantee & Liab. Ins. Co., 707 So. 2d 1062, 1071 (Miss. 1996) (“Because [the insured] was being defended under the [covered] defamation claim with a reservation of rights, [the insurer] was obligated to let them select their own attorney at [the insurer’s] cost to represent them. Also, [the insurer] was under no obligation whatever to attempt any legal defense of the remaining [uncovered] claims. . . [The insurer], having chosen to defend all claims, was obligated to permit [the insured] to select its own counsel for those claims outside the coverage of the policy.”); Howard v. Russell Stover Candies, Inc., 649 F.2d 620, 625 (8th Cir. 1981) (applying Missouri law) (“To avoid the potential conflict of interest, [the insurer] must either provide an independent attorney to represent the insured or pay the costs incurred by the insured in hiring counsel of its own choice”) (internal quotes and citation omitted).

43 See, e.g., Pub. Serv. Mut. Ins. Co. v. Goldfarb, 53 N.Y.2d 392, 401 & n.* (1981) (finding in that case that “inasmuch as the insurer’s interest in defending the lawsuit is in conflict with the defendant’s interest – the insurer being liable only upon some of the grounds for recovery asserted and not upon others – [the insured] is entitled to defense by an attorney of his own choosing, whose reasonable fee is to be paid by the insurer,” but also noting that “[t]hat is not to say that a conflict of interest requiring retention of separate counsel will arise in every case multiple claims are made. Independent counsel is only necessary in cases where the defense attorney’s duty to the insured would require that he defeat liability on any ground and his duty to the insurer would require that he defeat liability only upon grounds which would render the insurer liable. When such a conflict is apparent, the insured must be free to choose his own counsel whose reasonable fee is to be paid by the insurer.”); N. Cnty. Mut. Ins. Co. v. Davalos, 140 S.W.3d 685, 689 (Tex. 2004) (noting that “[e]very disagreement about how the defense should be conducted cannot amount to a conflict of interest,” and opining that “when the facts to be adjudicated in the liability lawsuit are the same facts upon which coverage depends, the conflict of interest will prevent
Other courts have reached the opposite conclusion, holding either that the rules of professional conduct governing attorney-client relationships sufficiently protect the insured’s interest even where the insurer has issued a reservation of rights,44 or that no conflict of interest arises because the insurer and the insured are not estopped in a coverage action from litigating or relitigating facts that were determined in the third-party action.45 Some jurisdictions have established rules that at least certain circumstances per se do not constitute a conflict of interest.46

44 See, e.g., Finley v. Home Ins. Co., 975 P.2d 1145, 1151-53, 1155 (Haw. 1998) (“Upon balancing the respective pros and cons of suggested solutions to the issues, we are convinced that the best result is to refrain from interfering with the insurer’s contractual right to select counsel and leave the resolution of the conflict to the integrity of retained defense counsel. Adequate safeguards are in place already to protect the insured in the case of misconduct.”; also holding that “the sole client of the attorney is the insured,” and that the insured is entitled to reject the insurer’s tender of defense, but “[i]f the insured chooses to conduct its own defense, the insured is responsible for all attorneys’ fees related thereto”); Twin City Fire Ins. Co. v. Ben Arnold-Sunbelt Beverage Co. of S.C., 433 F.3d 365, 373 (4th Cir. 2005) (applying South Carolina law) (“We are [ ] unable to conclude that the Supreme Court of South Carolina would profess so little confidence in the integrity of the members of the South Carolina Bar . . . . [S]anctions such as suspension, public reprimand, or disbarment . . . coupled with the threat of bad faith actions or malpractice actions if a lawyer violates these rules, provide strong incentives for attorneys to comply with their ethical obligations”; also noting that “[i]f the insured does not consent to counsel selected by the insurance company, the insured may refuse the defense and pay for its own defense”).

45 See, e.g., Ferguson v. Birmingham Fire Ins. Co., 460 P.2d 342, 349 (Or. 1969) (“The judgment should operate as an estoppel only where the interests of the insurer and insured in defending the original action are identical — not where there is a conflict of interests. If the judgment in the original action is not binding upon the insurer or insured in a subsequent action on the issue of coverage, there would be no conflict of interests between the insurer and the insured in the sense that the insurer could gain any advantage in the original action which would accrue to it in a subsequent action in which coverage is in issue.”); St. Paul Fire & Marine Ins. Co. v. Engelman, 639 N.W.2d 192, 199-200 (S.D. 2002) (“Under South Dakota law, if an insurer has a duty to defend its insured, it is bound — absent a reservation of rights — under the doctrine of collateral estoppel by those facts decided in the action against the insurer that are essential to the judgment of liability, whether the insurer elects or refuses to defend. On the other hand, if the insurer’s interest in defending the claim while restricting its obligation to the terms of the policy creates a conflict of interest between the insured and the insurer, there can be no estoppel from litigating in a later proceeding those issues on which there was a conflict of interest. . . . By reserving the noncoverage issue, a conflict of interest will be avoided and the interests of the insured and the insurer in defending against the injured claimant will be identical.”) (internal citations omitted).

46 See, e.g., Alaska Stat. § 21.89.100(b) (“a claim of punitive damages,” “a claim of damages in excess of the policy limits,” and “claims or facts in a civil action for which the insurer denies coverage” “do not constitute a conflict of interest” for purposes of determining whether the insurer is required to provide the
Not surprisingly, a majority of jurisdictions have not adopted a bright-line rule one way or the other, but rather require a case-by-case analysis. The test in California, for example, is set forth in a statutory pronouncement that “when an insurer reserves its rights on a given issue and the outcome of that coverage issue can be controlled by counsel first retained by the insurer for the defense of the claim, a conflict of interest may exist.” In Illinois and Louisiana, among other jurisdictions, the test is whether “the interest of the insurer would be furthered by providing a less-than-vigorous defense.” In Ohio, the standard is whether “an insurer’s interests and those of its insured are mutually exclusive.” Other courts simply require an actual, as opposed to a perceived or potential, conflict of interest before an insured will be entitled to independent counsel.

Other courts have held that where the insurer has issued a reservation of rights, the insurer and the defense counsel hired by the insurer must fulfill an “enhanced obligation of good faith” to the insured, or they may be held liable to the insured. The Supreme Court of Washington, for example, has set forth

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48 Nandorf, Inc. v. CNA Ins. Cos., 134 Ill. App. 3d 134, 138 (1985) (“In determining whether a conflict exists, Illinois courts have considered whether, in comparing the allegations of the complaint to the policy terms, the interest of the insurer would be furthered by providing a less-than-vigorous defense to those allegations.”); Belanger v. Gabrial Chems., Inc., 787 So. 2d 559, 566 (La. Ct. App. 2001) (on this issue of first impression, looking to Corpus Juris Secundum for guidance, which states: “The significant question in determining if a conflict of interest is created is whether, in comparing the allegations of the complaint to the terms of the policy, the interests of insurance company or codefendant would be furthered by providing a less than vigorous defense to those allegations.”).


50 See, e.g., Mut. Serv. Cas. Ins. Co. v. Luetmer, 474 N.W.2d 365, 368 (Minn. Ct. App. 1991) (“We believe the more reasoned approach to be that before an insured will be entitled to counsel of its own choice, an actual conflict of interest, rather than an appearance of a conflict of interest, must be established.”).
specific criteria that both the insurer and the defense counsel hired by the insurer must meet in order to satisfy their “enhanced obligation of good faith” to the insured.\(^\text{51}\)

The independent counsel issue has also spawned and/or been addressed in the context of other related issues, such as:

- Whether an insurer can be estopped from raising, or be deemed as having waived, certain coverage defenses by not timely issuing a reservation of rights;\(^\text{52}\)
- Whether the insurer can be held liable for the misconduct or malpractice of the defense attorney hired by the insurer;\(^\text{53}\)
- Whether the insurer can sue the independent counsel selected by the insured for malpractice;\(^\text{54}\)


\(^{52}\) See, e.g., City of Carter Lake v. Aetna Cas. & Sur. Co., 604 F.2d 1052, 1060-61 (8th Cir. 1979) (applying Iowa law) (holding that the insurer was estopped to disclaim coverage because it did not inform the insured of the disclaimer until six months after the third-party complaint had been filed; also noting that “[t]here is authority for the proposition that prejudice is presumed from undertaking the defense of an action without a reservation of rights or, alternatively stated, that the loss of control of one's own case is itself prejudice’); Emery v. Progressive Cas. Ins. Co., 49 So .3d 17, 21-22 (La. Ct. App. 2010) (holding that the insurer had waived its right to disclaim coverage by appointing a single attorney to represent itself and the insured after disclaiming coverage); First United Bank of Bellevue v. First Am. Title Ins. Co., 496 N.W.2d 474, 480-81 (Neb. 1993) (holding that the insurer was estopped to deny coverage because the insurer had sufficient knowledge of facts or circumstances indicating non-coverage, the insurer assumed defense of the insured without obtaining an effective reservation of rights agreement, and the insured per se suffered prejudice because the insurer had complete control over the defense for 12 months); Hartford Fire Ins. Co. v. Gilbane Building Co., C.A. No. 11-019-ML, Mem. & Order at 8 (D.R.I. June 16, 2011) (holding that the insurer’s reservation of rights throughout the process of negotiating with the insured how to provide defense to the insured – e.g., by independent counsel – was sufficient to prevent waiver of coverage defenses).

• The insurer’s rights and obligations in the third-party action when the insurer is represented by its own counsel separate from the insured’s independent counsel;\(^{55}\)

• Whether the insurer is required to pay the independent counsel’s fees incurred in defense of the insured with respect to only the covered portions of the third-party claim or both the covered and non-covered portions;\(^{56}\) and

• The rates at which the insurer must pay the insured’s selected independent counsel.

On this last issue, it should be noted that while some jurisdictions, like Alaska and California, have enacted statutes specifying that the insurer is permitted to pay independent counsel the same rates as it would pay its “panel counsel” (who are typically paid at discounted rates that have been negotiated by the insurance company in exchange giving panel counsel greater volumes of work), most courts engage in a fact-intensive, case-by-case analysis of the reasonableness of the rates charged by the insured’s selected independent counsel.\(^{57}\)

\(^{54}\) See, e.g., Hartford Ins. Co. of Midwest v. Koeppel, 629 F. Supp. 2d 1293, 1298-1301 (M.D. Fla. 2009) (predicting that Florida would follow majority rule recognizing attorney-client relationship between insurer and attorney retained to represent insured or finding that insurer is intended third-party beneficiary of relationship between defense counsel and insured, as opposed to minority rule in Michigan, Texas, and New York precluding direct legal malpractice action by insurer against attorney retained to represent an insured).

\(^{55}\) See, e.g., Pharmacists Mut. Ins. Co. v. Myer, 993 A.2d 413, 419-20 (Vt. 2010) (holding that burden is on insurer to prove how damages are to be allocated between covered and non-covered issues, and insurer cannot meet such burden where insurer monitored underlying action through “litigation specialists” separate from insured’s independent counsel, but failed to intervene to seek special interrogatories or verdict to establish proper allocation).

\(^{56}\) See, e.g., SL Indus., Inc. v. Am. Motorists Ins. Co., 128 N.J. 188, 215-16 (1992) (holding that insurer is obligated to pay only those defense costs reasonably associated with claims covered under the policy; also recognizing that “insurers, insureds, and courts will rarely be able to determine the allocation of defense costs with scientific certainty. However, the lack of scientific certainty does not justify imposing all of the costs on the insurer by default. The legal system frequently resolves issues involving considerable uncertainty. We presume that the insurer and insured can negotiate a satisfactory settlement that fairly apportions the defense costs. When they are unable to agree, we likewise presume that our courts will be able to analyze the allegations in the complaint in light of the coverage of the policy to arrive at a fair division of costs.”).

\(^{57}\) See, e.g., Santa’s Best Craft, L.L.C. v. Zurich Am. Ins. Co., 941 N.E.2d 291, 300 (Ill. App. Ct. 2010) (declining to hold that defense expenses submitted on behalf of insured’s independent counsel are per se reasonable, noting that court had “held a three-day hearing, considered several witnesses’ testimony, and examined volumes of documents” to conduct “a line-by-line review of the defense expenses” to determine whether fees reasonable); N. Sec. Ins. Co. v. RH Realty Trust, 78 Mass. App. Ct. 691, 695-98 (2011) (affirming trial court’s holding that independent counsel’s $225/hour rate, as opposed to panel counsel’s
V. ININSURER BILLING GUIDELINES

When insurance companies assume their duty to defend an insured, they often impose various restrictions and requirements on the insured with respect to the fees and costs incurred in the insured’s defense. These include so-called billing or litigation “guidelines” and detailed requirements as to how time is to be entered, how many lawyers are to bill on a particular matter, what tasks will or will not be paid for, and what costs are appropriate. Indeed, insurance companies often will attempt to argue that they need not pay for certain tasks, such as inter-office conferences, costs without receipts, block billed time entries, and various costs, such as messenger and courier services that it deems as “overhead” because these items are included as non-reimbursable in its billing guidelines.

Some courts have found, however, that these so-called “billing guidelines,” by which insurers seek to limit or restrict certain types of services, “may well violate the insurer’s duty to defend, as well as the attorneys’ ethical responsibilities to exercise their independent professional judgment in rendering legal services.”58 In Dynamic Concepts, Inc. v. Truck Ins. Exch., for example, the court held that, “[u]nder no circumstances can such guidelines be permitted to impede the attorney’s own professional judgment about how best to competently represent the insureds. If the attorney’s representation is to be limited in any way that unreasonably interferes with the defense, it is the insured, not the insurer, who should make that decision.”59

$150/hour rate, was reasonable in light of expert testimony and independent counsel’s usual charge of $385/hour; also finding that insurer’s 14-month delay in paying independent counsel’s fees – not even a portion thereof calculated at $150/hour rate – constituted unfair practice in violation of Massachusetts’ G.L. c. 93A; but capping rate at which independent counsel may recover against insurer at $225/hour instead of $385/hour).

58 Dynamic Concepts, Inc. v. Truck Ins. Exch., 61 Cal. App. 4th 999, 1009 (1998); see also ABA Standing Comm. on Ethics & Prof’l Responsibility, Formal Op. 01-421 (Feb. 16, 2001) (attorney must not permit compliance with guidelines and other directives to impair materially the attorney’s independent professional judgment in representing an insured); In re Rules of Prof’l Conduct, 2 P.3d 806 (Mont. 2000) (insurer-imposed restrictions in litigation costs may violate insurer’s duty to defend and attorneys’ ethical responsibilities to exercise independent professional judgment).

59 61 Cal. App. 4th at 1009 n.9; see also Frederick v. UNUM Life Ins. Co. of Am., 180 F.R.D. 384, 385 (D. Mont. 1998) (“The problem as I see it is that UNUM’s bottom line GUIDE is in conflict, not only
VI. CONCLUSION

Courts throughout the country have reached differing opinions on several key recurring issues bearing on coverage for and recoupment of defense costs. For example, courts are split as to whether an insurer may seek recoupment of defense costs advanced to an insured if it is subsequently determined that the policy does not cover the claims asserted against the insured in the underlying litigation. While several courts follow the “reasonably related rule” to determine whether and how defense or settlement losses are to be allocated between covered and non-covered claims or parties, the particular language of the policy at issue may dictate otherwise. Different jurisdictions also have different rules about whether and when an insured may be entitled to its own independent counsel paid for by the insurance company. Finally, some courts have opined that an insurer’s billing or litigation “guidelines” may violate the insurer’s duty to defend, or at least may not operate to impede the defense counsel’s professional responsibilities to the insured.

with the local rules of practice, but also with the Federal Rules of Civil Procedure. The GUIDE hamstrings the lawyer charged with defending the claim.”