

Buss Defense Costs Reimbursement

Introduction

Under California law, a liability insurer may reserve its rights to later deny coverage to its policyholder, pay for the policyholder's defense, and recover reimbursement from its policyholder of defense costs allocable to claims that were never even potentially covered and recovery reimbursement from independent counsel of excessive defense fees that are fraudulent, useless, or wasteful.

"As to the claims that are not even potentially covered, the insurer may seek reimbursement for defense costs. [T]he insurer does not have a duty to defend the insured as to the claims that are not even potentially covered. With regard to defense costs for these claims, the insurer has not been paid premiums by the insured. It did not bargain to bear these costs. To attempt to shift them would not upset the arrangement. The insurer therefore has a right of reimbursement that is implied in law."¹

"We conclude that under the circumstances of this case, the insurer may seek reimbursement directly from *Cumis* counsel. If *Cumis* counsel, operating under a court order that expressly provided that the insurer would be able to recover payments of excessive fees, sought and received from the insurer payment for time and costs that were fraudulent, or were otherwise manifestly and objectively useless and wasteful when incurred, *Cumis* counsel have been unjustly enriched at the insurer's expense."²

The Duty to Defend

"The insurer's duty to indemnify runs to claims that are actually covered, in light of the facts proved. By contrast, the insurer's duty to defend runs to claims that are merely potentially covered, in light of facts alleged or otherwise disclosed. It follows that, in a 'mixed' action, in which some of the claims are at least potentially covered and the others are not, the insurer has a duty to defend as to the claims that are at least potentially covered, having been paid premiums by the insured therefor, but does not have a duty to defend as to those that are not, having not been paid therefor. Despite the foregoing, we have nevertheless held that, in a 'mixed' action, the insurer has a duty to defend the action in its entirety. We cannot justify the insurer's duty to defend the entire 'mixed' action contractually, as an obligation arising out of the policy, and have never even attempted to do so. That being said, we can, and do, justify the insurer's duty to defend the entire "mixed" action prophylactically, as an obligation imposed by law in support of the policy. To defend meaningfully, the insurer must defend immediately. To defend immediately, it must defend entirely. It cannot parse the claims, dividing those that are at least potentially covered from those that are not."³

Three Kinds of Claims

Because the duty to defend is broader than the duty to indemnify, liability insurers assume an

¹ *Buss v. Superior Court* (1997) 16 Cal.4th 35, 49-51 (*Buss*) (citations and ellipses omitted.)

² *Hartford Cas. Ins. Co. v. J.R. Marketing* (2015) 61 Cal.4th 988, 992-93 (*J.R. Marketing*).

³ *Buss, supra*, 16 Cal.4th at 45-49 (ellipses omitted).

obligation to defend claims that are not or may not be covered for indemnity by their policies.⁴ These claims fall into three categories: 1) claims that are clearly covered for indemnity; 2) claims that are potentially covered for indemnity; and 3) claims that are never even potentially covered for indemnity. A liability insurer may recover from its policyholder reimbursement of the costs of defend properly allocable to claims that are never even potentially covered for indemnity, but not the other two kinds of claims. This right is known as Buss reimbursement.⁵ The rationale for this rule is that the policyholder has not paid premiums for claims in the third category, while the policyholder has paid premiums for the first two kinds of claims.

Allocation Among the Claims

The *Buss* rule does not specify how one is to allocate the costs of defense among the three kinds of claims. However, the attorney is usually the best witness to testify as to proper allocation as the person who is actually performing the defense work. The policyholder may resist a Buss reimbursement claim by independent counsel using a favorable method of allocation and by withholding consent for dependent counsel to be paid by the insurer.

“As to the claims that are at least potentially covered, the insurer may not seek reimbursement for defense costs. . . . The reason is this. Under the policy, the insurer has a duty to defend the insured as to the claims that are at least potentially covered. With regard to defense costs for these claims, the insurer has been paid premiums by the insured. It bargained to bear these costs. To attempt to shift them would upset the arrangement. This would not be the case if the policy itself provided for reimbursement: such a policy would qualify itself. It would also not be the case if there were a separate contract supported by separate consideration: Such a contract would supersede the policy pro tanto. Otherwise, however, the insurer may not seek reimbursement. As to the claims that are not even potentially covered, however, the insurer may indeed seek reimbursement for defense costs. . . . The reason is this. Under the policy, the insurer does not have a duty to defend the insured as to the claims that are not even potentially covered. With regard to defense costs for these claims, the insurer has not been paid premiums by the insured. It did not bargain to bear these costs. To attempt to shift them would not upset the arrangement. The insurer therefore has a right of reimbursement that is implied in law as quasi-contractual, whether or not it has one that is implied in fact in the policy as contractual. Defense costs that can be allocated solely to the claims that are not even potentially covered. The reason is this. It is as to defense costs that can be allocated solely to the claims that are not even potentially covered that the insurer has not been paid premiums by the insured.”⁶

“It is the insurer that must carry the burden of proof. The reason is this. Evidence Code section 500 provides that, generally, a party desiring relief must carry the burden of proof thereon. The burden of proof is proof by a preponderance of the evidence.”⁷

The Policyholder May Protect Against the Insurer’s Reservation

“Through reservation, the insurer gives the insured notice of how [the insurer] will, or at least may, proceed and thereby provides [the insured] an opportunity to take any steps that it

⁴ See, *Duty to Defend* at DutytoDefend.com.

⁵ *Buss, supra*, 16 Cal.4th 35 (citation omitted.)

⁶ *Id.* at 49-52 (citations and ellipses omitted).

⁷ *Id.* at 53 (ellipses omitted).

may deem reasonable or necessary in response”⁸

Multiple Policyholders

When there are more than one policyholder from whom the insurer seeks Buss reimbursement, the insurer will likely have the burden to establish how much of the costs of defense are allocable to each. “It would be inequitable to require a party insured to reimburse the insurer the policy benefits it received and also all policy benefits that every other insured party received. The right to reimbursement may run against the person who benefits from unjust enrichment, but it should do so only to the extent the person actually benefits.”⁹

Possible Estoppel

One reported opinion suggests, but does not decide “whether an insurer may be estopped from seeking reimbursement from its insured for the defense costs of uncovered claims when it insists upon appointed counsel rather than allowing the insured to control the defense, with its accompanying control and oversight over defense fees and costs.”¹⁰

Reimbursement from Independent Counsel

The *J.R. Marketing* case holds that independent counsel may be required to reimburse an insurer for certain excessive defense fees on ground of unjust enrichment. However, the Supreme Court opinion is extremely narrow and may be limited to “*Cumis* counsel, operating under a court order that expressly provided that the insurer would be able to recover payments of excessive fees.”¹¹

Practice Pointers

1. Incentive to Yield to Potentially Coverage Claims

The existence of a Buss reservation creates an ironic incentive for the policyholder to welcome covered and potentially covered claims by the plaintiff. A policyholder who is exposed to its own insurer to reimburse defense costs allocable to claims that were never even potentially covered, but immune to reimbursement claims for other claims will benefit by maximizing claims that are potentially and actually covered. This incentive may impact the duties of independent counsel and dependent counsel to protect the interests of the policyholder by supporting, rather than resisting, covered and potentially covered claims. Since the vast majority of liability lawsuits are settled, and a Buss reimbursement claim survives resolution of the plaintiff’s lawsuit, it may be important to the policyholder that substantial evidence exist supporting the viability and value of covered and potentially covered claims. Accordingly, it may work against the policyholder’s interests for defense counsel to eliminate covered and potentially covered claims by demurrer, motions for judgment on the pleadings, motions for summary adjudication, or motions for summary judgment. Similarly, it may work against the policyholder’s interests to give testimony that undermines the viability or value of covered and potentially covered claims. Instead, it may work in the policyholder’s favor to give evidence supporting covered and potentially covered claims. This ironic reality is among the reasons why

⁸ *Blue Ridge Ins. Co. v. Jacobsen* (2001) 25 Cal.4th 489, 501.

⁹ *LA Sound USA, Inc. v. St. Paul Fire & Marine Ins. Co.* (2007) 156 Cal.App.4th 1259, 1273 (citations, quotation marks, and ellipses omitted.)

¹⁰ *Dynamic Concepts, Inc. v. Truck Ins. Exch.* (1998) 61 Cal.App.4th 999, 1007, fn. 6.

¹¹ *J.R. Marketing, supra*, 61 Cal.4th at 992-93.

the policyholder and plaintiff may choose to properly cooperate with one another.¹²

2. Allocation by Independent Counsel

Trustworthy and convincing evidence of how the costs of defense should be allocated is likely to come from defense counsel who has performed the defense work and is familiar with the various claims asserted by a plaintiff. Civil Code § 2860(c) does not require arbitration of Buss allocation, so that the policyholder is entitled to a jury trial on this issue.

Independent counsel may use a “but for” analysis to allocate among the three kinds of claims and combinations of them. In this fashion, only time and costs that are properly allocable exclusively to claims that were never even potentially covered will be reimbursed. The policyholder and independent counsel should consider trying to find some time and costs that fall into the reimbursement column so that the trier of fact may have confidence that independent counsel has diligently and fairly done a proper allocation.

3. Allocation by Dependent Counsel

Because dependent counsel is beholden to the insurer, the policyholder may not have confidence that dependent counsel will give favorable testimony. “The single, best source of evidence for proving that allegation is Appointed [dependent] Counsel’s bills.”¹³

The policyholder may expressly withhold consent for dependent counsel to accept payment from the insurer.¹⁴ If the insurer sues the policyholder seeking Buss reimbursement, the policyholder may cross complaint against the insurer alleging that it unlawfully paid dependent counsel in violation of Rule 1.8.6 and sue dependent counsel for breach of fiduciary duty and disgorgement of defense costs accepted by dependent counsel and paid by the insurer in violation of Rule 1.8.6.

Alaska prohibits reimbursement of defense costs. “We conclude that Alaska law prohibits reimbursement of fees and costs incurred by the insurer defending claims under a reservation of rights, even in circumstances where it is later discovered that there was ‘no possibility of coverage’ under the policy.”¹⁵

¹² See, *Line Dividing Cooperation from Collusion and Buss Defense Cost Reimbursement - Response Options* at DutytoDefend.com.

¹³ *James 3 Corp. v. Truck Ins. Exchange* (2001) 91 Cal.App.4th 1093, 1109.

¹⁴ “A lawyer shall not accept compensation for representing a client from one other than the client unless . . . the lawyer obtains the client’s informed written consent.” (Rule 1.8.6 (ellipses omitted).)

¹⁵ *Attorneys Liab. Pro. Soc. v. Ingaldson Fitzgerald, PC* Supreme Court No. S-15683 (Ala. 2016).