DAMAGES FOR BREACHING THE DUTY TO DEFEND

Twenty years ago in *Buss v. Superior Court*, 16 Cal. 4th 35, 58-59 (1997), the California Supreme Court held that in a "mixed action" – where some claims against the insured are potentially covered and others are not – the insurer has to defend the action in its entirety. The *Buss* decision laid to rest any argument that an insurer may allocate defense expenses when conducting an insured's defense.

Nevertheless, some insurers will argue that the *Buss* rule, requiring a complete defense, does not dictate the scope of contractual damages they must pay for breaching the duty to defend. Instead, they contend that a breaching insurer is obligated to pay as damages only those fees and costs associated with the defense of covered claims. If confronted with a breaching insurer making an argument along these lines, insureds should consider the following points and authorities when fashioning their response.

1. *Buss* Dictates The Scope of Damages Owed

The theory behind damages in contract law is that the injured party should receive, as nearly as possible, the equivalent of the benefits of the contract he or she would have received had performance been rendered as promised. *See Archdale v. American Int'l Specialty Lines Ins. Co.*, 154 Cal. App. 4th 449, 469 (2007). It necessarily follows that a breaching insurer must pay as damages the equivalent of what it would have paid had it discharged its duty to defend, *i.e.*, the entire cost of defending the underlying "mixed action." Simply put: if *Buss* requires a defending insurer to pay to defend both covered and non-covered claims, then a breaching insurer must do the same.

2. A Breaching Insurer Has No Right Of Reimbursement

The California Supreme Court held in *Buss* that at the conclusion of the underlying lawsuit, a defending insurer may seek reimbursement from its insured of any costs related solely to the defense of claims not even potentially covered by its policy. However, the Court made clear that to exercise such a right of reimbursement, an insurer must have reserved that right. A breaching insurer, of course, will not have reserved any rights, let alone a right of reimbursement. It follows, therefore, that a breaching insurer is precluded as a matter of law from pursuing any reimbursement claim or otherwise allocating between covered and non-covered fees and costs.

3. An Insurer Should Not Benefit From Its Breach

It would be utterly nonsensical if a defending insurer – *which has failed to reserve reimbursement rights* – would have to bear the entire cost of its insured's defense, while a breaching insurer – *which has also failed to reserve reimbursement rights* – was permitted to allocate between the costs of defending covered and non-covered claims. This makes no sense from either a legal or public policy standpoint. On the contrary, such an outcome would give insurers an economic incentive to breach their duty to defend. *See Comunale v. Traders and General Ins. Co.*, 50 Cal. 2d 654, 660 (1958) (an insurer "should not be permitted to profit by its own wrong.").

4. Post-Buss Authorities

Numerous authorities since *Buss* have held that a breaching insurer must pay as damages what it failed to provide, *i.e.*, the cost of a complete defense. *See State v. Pacific Indem. Co.*, 63 Cal. App. 4th 1535, 1549 (1998) ("*Buss* does not support Pacific Indemnity's theory that the State should contribute to attorney's fees. To the contrary, it unequivocally holds that the insurer's duty is to defend the action in its entirety."); *Cassady v. Morgan, Lewis & Bockius LLP*, 145 Cal. App. 4th 220, 236 (2006) ("When an insurer *refuses* to defend an action in which a potential for coverage exists, the insured may recover defense costs, including attorney's fees allocable to the defense of noncovered claims, unless the insurer can prove they were unreasonable or unnecessary."); *Electronics For Imaging, Inc. v. Atlantic Mut. Ins. Co.*, 06 3947 (N.D. Cal. May 14, 2007) ("As defendant did not provide plaintiff with a defense, defendant is liable for plaintiff's costs and fees incurred in defending the underlying action, including those fees and costs incurred in defending claims that are not even potentially covered."); *Thane International, Inc. v. Hartford Fire Ins. Co.*, 06 1244 (C.D. Cal. February 19, 2009) ("'[The insurer's] argument that its duty to defend should be apportioned with its insured . . . is contrary to California law.'"); *KM Strategic Management LLC v. American Cas. Co. of Reading PA*, 15 1869 (C.D. Cal. July 25, 2016) (breaching insurer required to pay as damages all fees and costs incurred by the insureds including "any fees and costs related to the defense of claims for which there was not even a potential for coverage.").

Leading commentators on insurance law are in full agreement that a breaching insurer owes as damages the entirety of the reasonable defense costs incurred by the insured without any right of allocation. *See* Hon. H. Walter

Croskey, *et al.*, California Practice Guide: Insurance Litigation § 12:652 (The Rutter Group 2016) ("By refusing to provide a defense, the insurer becomes liable for defense costs incurred by the insured allocable to claims *not even potentially covered* under the policy.") (italics in original); 1_7 New Appleman on Insurance Law Library Edition § 7.06, n. 365 ("Based on [the *Buss*] rationale, in California, at least, the policyholder's recovery where the insurer does not defend should include reasonable and necessary fees and expenses to defend against claims within the underlying suit that are not potentially covered.").

Twenty years *post-Buss*, there are some breaching insurers still arguing they do not owe as damages the fees and costs their insureds incurred to defend non-covered claims. This argument is both anachronistic and legally unsound in light of *Buss*, as well as being directly contradicted by the myriad legal authorities cited above.