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NOT TO BE PUBLISHED IN OFFICIAL REPORTS

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FOURTH APPELLATE DISTRICT

DIVISION THREE

SADDLEBACK INN, LLC, Plaintiff and Respondent, v. CERTAIN UNDERWRITERS AT LLOYD'S LONDON, et al., Defendants and Appellants.	G051121 (Super. Ct. No. 30-2012-00537179) O P I N I O N

Appeal from a judgment of the Superior Court of Orange County, Frederick P. Aguirre, Judge. Affirmed.

Soltman, Levitt, Flaherty & Wattles and John Steven Levitt; Law Office of Barry M. Wolf and Barry M. Wolf for Defendants and Appellants.

Shernoff Bidart Echeverria Bentley, Michael J. Bidart, Ricardo Echeverria, Danica Dougherty; The Ehrlich Law Firm and Jeffrey I. Ehrlich for Plaintiff and Respondent.

Saddleback Inn, LLC (Saddleback) sued its insurer, Certain Underwriters at Lloyd's London, Syndicate 570 and Certain Underwriters at Lloyd's London, Subscribing to Certificate No. ATR/C/119559 (collectively referred to as Underwriters), after Underwriters refused to pay a claim for fire loss. In a bifurcated proceeding, the trial court reformed the insurance policy to include Saddleback as a named insured. Underwriters paid Saddleback $2,884,583 after the ruling. In the second phase of trial, the jury found Underwriters liable for bad faith and awarded $50,000 in punitive damages. The trial court then awarded Saddleback its attorney fees and costs. Underwriters appeal the bad faith finding and the award of attorney fees, but do not dispute the reformation cause of action. We find no error and affirm the judgment in all aspects.

FACTS

In 2009, Saddleback was the lessee of a property in Santa Ana known as the "Saddleback Inn." Saddleback is a subsidiary of J.K. Properties, Inc. (J.K. Properties).

When it came time to seek a new policy in 2009, Saddleback used its broker, Gary Guenther, to apply for a new policy. The application form identified the company seeking insurance coverage as "Saddleback Inn." The form had boxes to indicate the type of entity seeking coverage, and a box on the form was checked for "'limited corporation.'" There was no box for a limited liability company (LLC). Testimony showed Underwriters understood the checkmark for "limited corporation" to indicate Saddleback was a LLC. The "owner" box on the application was also checked, indicating Saddleback Inn as the property owner.

Monika Jahnke, an agent for Underwriters, gave Saddleback a quote based on its application. Jahnke testified she did not investigate Saddleback's business structure because the policy concerned the property risk, not the business formation of the insured. Saddleback's broker, Guenther, sent Jahnke the signed insurance application to

obtain coverage and asked her to add an additional insured on the policy. Instead of adding J.K. Properties as an additional insured on the policy, Jahnke replaced Saddleback as the named insured with J.K. Properties. The new insured on the policy was listed as J.K. Properties dba Saddleback Inn. On previous insurance policies, the property was insured through the Lloyds of London market as Saddleback Inn, LLC and J.K. Properties, Inc. dba Saddleback Inn. Saddleback did not notice the error made on the policy.

In January 2011, the Saddleback property suffered a fire resulting in a $2,150,000 loss. Saddleback submitted a claim to Underwriters.

Underwriters hired attorney Steven Soltman to investigate the loss and advise them of their coverage obligations. During the investigation, internal communications from Underwriters indicated they were looking for reasons to deny the claim, and they would leave no stone unturned to defeat coverage. From a fictitious business name statement, Soltman determined "J.K. Properties, Inc, a corporation" operated under the name "Saddleback Inn." Later, a captain from the Orange County Fire Department told Soltman the correct owner of the subject property was Saddleback Inn, LLC. At trial, Underwriters claimed this conversation led Soltman to conclude they "needed to substantiate who the owner was . . . ." Soltman sent a letter to "'J.K. Properties, dba Saddleback Inn'" requesting "[a]ny and all documents evidencing your ownership interest in the subject property." Soltman received the application materials from Jahnke, including the original application showing a coverage request for Saddleback and Guenther's e-mail requesting an addition of J.K. Properties as an insured. Soltman called Jahnke only once and did not discuss the details of the application materials. Soltman did not interview Guenther.

In May 2011, Soltman sent a letter to Saddleback on behalf of Underwriters denying coverage because Saddleback owned the property and J.K. Properties did not have an insurable interest in the damaged property. The letter also requested Saddleback

to provide additional information or documentation relevant to the coverage position. Soltman did not receive any communications from Saddleback requesting reconsideration of the coverage position.

In January 2012, J.K. Properties and Saddleback filed a complaint against multiple defendants, including Underwriters, for breach of contract, professional negligence, and breach of the implied covenant of good faith and fair dealing (bad faith). An amended complaint added a reformation cause of action to add Saddleback as an additional insured on the policy at issue.

At a bifurcated proceeding, Saddleback tried its reformation claim to the court in phase one of the trial. In July 2014, the court determined Saddleback and Underwriters had intended Saddleback be named as the insured under the policy. The court reformed the contract to list the named insured as "Saddleback Inn, LLC and J.K. Properties, Inc. dba Saddleback Inn." Underwriters paid Saddleback $2,884,583, representing $2,150,000 for the fire damage to the insured property and $734,583 in interest.

At the second phase of the trial, Saddleback tried its bad faith claim to a jury. The jury determined Underwriters unreasonably denied payments and awarded Saddleback $50,000 in punitive damages. After the trial, Saddleback moved for attorney fees and expenses and the court awarded $1,062,116.78 over Underwriters' objection.

DISCUSSION

Bad Faith

Underwriters argue there is no bad faith liability as a matter of law when an insurer properly denies coverage under a policy as issued, even if a court later reforms the policy to provide coverage. We review this issue de novo because it is a question of law and the relevant facts are undisputed. (*Ghirardo v. Antonioli* (1994) 8 Cal.4th 791, 799.)

Underwriters contend the decision in *R & B Auto Center, Inc. v. Farmers Group, Inc.* (2006) 140 Cal.App.4th 327, 354 (*R & B Auto*), binds this court because that

case determined a bad faith insurance claim was not viable as a matter of law where the insurer complied with the policy as issued, although not as reformed. *R & B Auto* is distinguishable from the facts at hand.

R & B Auto was a used car dealership. (*R & B Auto, supra,* 140 Cal.App.4th at p. 333.) When looking for an insurance policy for its business operations, R & B Auto sought bids including coverage for losses suffered under lemon laws. (*Ibid*.) Ultimately, the insurance policy purchased by R & B Auto provided coverage for lemon law claims for new vehicles, even though the dealership only sold used vehicles. (*Id.* at pp. 334-335.) Based upon this policy restriction, the insurer refused a lemon law claim arising out of the sale of a used car. (*Id.* at p. 335.) R & B Auto brought a reformation cause of action against its insurer, seeking to alter the policy to provide lemon law coverage for used vehicles. (*Id.* at p. 347.) The trial court granted nonsuit on the reformation claim and this court reversed. (*Id.* at pp. 348-349.) Additionally, this court further determined that even if the reformed policy provided coverage, it was reasonable at the time the insurer evaluated R & B Auto's claim to deny it. (*Id.* at p. 354.) Therefore, this court determined the trial court did not err in dismissing R & B Auto's bad faith claim. (*Ibid.*) This court limited its holding to the facts before it and determined the insurer's refusal to deny coverage in that particular situation was reasonable. (*Id.* at p. 354, fn. 12.)

The reformation in *R & B Auto* materially changed the nature of the policy's risk by extending lemon law coverage to used, not just new, cars. If the insurer had intended the coverage to include used cars, it would likely have either increased the policy premium or removed the new car limitation. Here, however, Underwriters do not argue the named insured on the policy made any material difference on the risk covered by the policy. Indeed, Jahnke testified her focus was on the insured property itself and not the corporate identity of the named insured. Underwriters' broad interpretation of *R & B Auto* would shield insurers who deny coverage for technical and inconsequential

defects in a policy. If an insurer knows the parties intended coverage and the insurer commits an error on the policy or mistakenly misstates the extent of coverage, it may be bad faith for the insurer to insulate itself from its own error as a basis for denying coverage. On these facts, the jury properly determined it was bad faith.

Underwriters also contend that even if bad faith liability could be based upon a reformed policy, there was insufficient evidence to hold Underwriters liable.[1] We review this contention under the substantial evidence standard of review. (*Wilson v. County of Orange* (2009) 169 Cal.App.4th 1185, 1188.)

Ultimately, a claim for bad faith liability hinges on whether the insurer's refusal to pay policy benefits was reasonable at the time. (*R & B Auto, supra,* 140 Cal.App.4th at p. 354.) The insurer must fully investigate the claim and then evaluate the investigation's outcome objectively. (*Egan v. Mutual of Omaha Ins. Co.* (1979) 24 Cal.3d 809, 817-819.) The jury's finding Underwriters failed to act reasonably by denying Saddleback's claim was supported by substantial evidence. Such evidence included the following: Soltman did not include the insurance application and related documents that showed an intent of the parties to insure Saddleback in his denial letter; Jahnke placed the risk based on the application listing the named insured as Saddleback; Soltman failed to investigate Jahnke's intent in underwriting the policy or interview her regarding the application process; and Soltman failed to interview Guenther. The record supports the jury's determination Underwriters' investigation was not complete or objective. Underwriters' contention the evidence was "contradictory" does nothing to change the fact there was still substantial evidence supporting the jury's finding. Because we determine there was substantial evidence Underwriters failed to conduct a reasonable

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[1] Underwriters also argue there was confusion as to whether exhibits from the reformation phase of trial were introduced into evidence at the bad faith phase. Because testimony and other evidence admitted at the bad faith stage of trial serve to support the jury's finding, we need not address whether the exhibits were deemed admitted in the later proceeding.

investigation, we need not decide Underwriters' claim there was no substantial evidence negating the existence of a genuine dispute as to whether Saddleback was an intended insured.

Underwriters also argue bad faith liability is precluded by Saddleback's failure to establish economic damages other than attorney fees. While the jury did not hear evidence of Saddleback's economic damages, this was because Underwriters paid the policy proceeds after they lost the reformation issue in phase one of the trial and the parties stipulated any award of fees would be made by the trial court after the trial. Underwriters' payment to Saddleback did not negate their bad faith liability. (*Hulett v. Farmers Ins. Exchange* (1992) 10 Cal.App.4th 1051, 1060-1061.)

Punitive Damages

Underwriters contend the jury's punitive damage award cannot stand because the fraud finding was not supported by substantial evidence. The jury imposed a punitive damage award of $50,000 after determining Underwriters' conduct satisfied the fraud standard under Civil Code section 3294, subdivision (c)(3). They claim this was error because Saddleback did not respond to the false statements in Underwriters' denial letter, showing the statements were not material.[2] Underwriters cite no authority for their position that failing to respond to a letter can demonstrate a lack of materiality. The materiality of the letter was a factual issue for the jury, and the jury heard ample evidence about the parties' intent to insure Saddleback's interest in the property, Underwriters' investigation, and the ultimate impact of the letter and denial of Saddleback's claim. Substantial evidence supported the jury's determination of materiality.

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[2] Underwriters also advance an argument that even if they made misrepresentations to Saddleback, those were irrelevant because they owed no duty to Saddleback until after the policy was reformed. Because this argument is identical to the contention Underwriters could not be held liable for bad faith under the policy was reformed, we need not consider this argument again.

Brandt Fee Award

Underwriters argue the *Brandt* fee award must be reduced to $143,882.61 because the court abused its discretion by awarding attorney fees and expenses unsupported by substantial evidence. (*Brandt v. Superior Court* (1985) 37 Cal.3d 813 (*Brandt*).) Under this standard, our "inquiry is limited to determining whether the trial court's decision exceeds the bounds of reason. [Citation.]" (*American Federation of State, County & Municipal Employees v. Metropolitan Water Dist.* (2005) 126 Cal.App.4th 247, 269.)

Brandt established an insured's right to recover attorney fees in a bad faith action against the insurer. (*Brandt, supra*, 37 Cal.3d at p. 819.) The fees recovered "may not exceed the amount attributable to the attorney's efforts to obtain the rejected payment due on the insurance contract. Fees attributable to obtaining any portion of the plaintiff's award which exceeds the amount due under the policy are not recoverable." (*Ibid*.) The policy behind *Brandt* is to compensate the insured for the cost of hiring an attorney to recover policy benefits, and cannot include the cost of obtaining a compensatory damages award that exceeds the amount due under the policy. (*Ibid*.) The amount of fees incurred to obtain an award of compensatory damages for bad faith or punitive damages cannot be included in a *Brandt* fee award. (*Ibid*.) The determination of the reasonableness of the fees is made by the trier of fact. (*Ibid*.)

The trial court awarded Saddleback $1,062,116.78 in attorney fees and costs, representing 30 percent of the policy benefits paid by Underwriters after the reformation phase of trial, plus actual costs. The 30 percent represented Saddleback's counsel's contingency percentage. The award also reflected a deduction made by the trial court for two experts necessary only to prove bad faith. Underwriters contend this was error because Saddleback failed to provide a specific accounting of the hours counsel spent on the case and allocate those hours between the reformation cause and the bad faith action. While *Brandt* is silent on the issue of calculating fees in a contingent fee

case, Underwriters rely on *Cassim v. Allstate Ins. Co.*, (2004) 33 Cal.4th 780 (*Cassim*), for *Brandt* fee calculation requirements.

In *Cassim*, the contract benefits were approximately $40,000, but the jury's compensatory damage award was approximately $3.6 million. (*Cassim*, *supra*, 33 Cal.4th at p. 805.) The jury decided both the contract and tort actions after a lengthy trial, and the award included an undifferentiated amount of compensatory damages for bad faith, as well as the amount of policy benefits withheld. (*Id*. at p. 794.) The trial court, without explanation, awarded *Brandt* fees of more than $1 million and the Supreme Court reversed because the award was not calculated properly. (*Id*. at p. 805.) There, faced with an undifferentiated fee award, the Supreme Court held the contingency fee on the total recovery for compensatory damages had to be apportioned between work performed to obtain the contract benefit and work performed to obtain tort damages. (*Id*. at pp. 810-811.) Such an apportionment required a breakdown by hours and/or tasks. (*Id*. at pp.811-812.)

Unlike in *Cassim* where the breakdown was necessary to enable an award that exceeded the contingency percentage of the contract benefits obtained, Saddleback recovered a *Brandt* fee award that fully compensated the policy holder for the amount of fees actually paid to obtain the contract benefits. Furthermore, the way the trial was bifurcated, there was no dispute about the amount of fees Saddleback incurred in the first phase of trial was to recover policy proceeds. In light of this, the trial court correctly determined *Cassim* had "no application to this case." The *Brandt* fee award was not undifferentiated, and indeed was a contingency percentage of the insurance proceeds. While some work may necessarily have overlapped between obtaining contract benefits and the bad faith action, "[i]f plaintiffs can prove that some portion of that fee was for legal work solely or partially attributable to the contract, failure to reimburse plaintiffs for that out-of-pocket expense would necessarily result in a diminution of their policy benefits." (*Cassim*, *supra*, 33 Cal.4th at p. 808.)

The trial court properly awarded Saddleback the full amount of fees incurred for Underwriters' failure to pay the policy benefits. This amount was based upon Underwriters' payment after the policy was reformed in phase one of the trial. The fees were not based on the punitive damages award, and no other compensatory damages were awarded. Indeed, the trial court made sure to deduct expert expenses solely attributable to the bad faith cause of action. The trial court did not abuse its discretion and the award of *Brandt* fees was proper.

DISPOSITION

The judgment is affirmed. Saddleback is awarded its costs on appeal.

O'LEARY, P. J.

WE CONCUR:

BEDSWORTH, J.

THOMPSON, J.