



Alerts

Supreme Court of California Authorizes Suit by Insurer Against Cumis Counsel

September 15, 2015

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Hartford Cas. Ins. Co. v. J.R. Marketing, L.L.C., 61 Cal.4th 988, 2015 WL 4716917 (2015)

Brief Summary

The Supreme Court of California held that an insurer may bring an action for the reimbursement of excessive or unreasonable legal fees directly against an insured's independently appointed *Cumis* ^[1] counsel.

Complete Summary

In 2005, Noble Locks Enterprises, Inc. (Noble Locks), a seller of cable locks for laptop and other computers, accused J.R. Marketing L.L.C. (JR Marketing) and its founders of conspiring to steal its customers and destroy its business. Civil suits between and among the companies and their employees were brought in several states, including the Marin County Superior Court in California (the "Marin County Action"), alleging breach of fiduciary duty, unfair competition, defamation and a variety of other intentional business torts. Shortly after the Marin County Action commenced, the defense of the action was tendered to The Hartford Insurance Company (The Hartford) under two comprehensive general liability policies issued to Noble Locks and JR Marketing.

The Hartford disclaimed coverage on the grounds that the acts alleged occurred prior to the policies' inception dates and that certain named defendants were not insureds. The Marin County Action defendants, represented by the law firm of Squire Sanders (now named Squire Patton Boggs (US) LLP) (Squire Sanders), commenced a coverage action against The Hartford seeking a declaration that it was obligated to defend and indemnify them. In January 2006, The Hartford agreed to defend Noble Locks, JR Marketing and certain defendants subject to a reservation of rights that preserved its coverage defenses. However, it refused to pay the Marin County Action defendants' accumulated defense costs, or pay for independent defense counsel going forward.

In the coverage action that followed, the court decided that The Hartford was obligated to defend the Marin County Action from the date the defense was tendered, and held that it was obligated to pay for independent *Cumis* counsel to defend the Marin County Action defendants. See *San Diego Federal Credit Union v. Cumis Ins. Society, Inc.*, 162 Cal.App.3d 358 (1984). Two months

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following that decision, The Hartford still had not paid Squire Sanders' accumulated invoices for work performed in defending the underlying actions. Upon motion by the Marin County Action defendants, an enforcement order was entered in the coverage action directing The Hartford to promptly pay all past and future defense costs. The enforcement order further held that The Hartford was in breach of its duty to defend, and precluded the insurer from invoking an hourly rate cap and fee arbitration statute applicable to payments made to *Cumis* counsel. Cal. Civ. Code § 2860 (limiting hourly rates to those which are "actually paid by the insurer" to attorneys retained "in the regular course of business in the defense of similar actions in the community where the claim arose or is being defended.") Although it stripped The Hartford of the benefits of the *Cumis* fee statute, the court preserved The Hartford's right to challenge the reasonableness of Squire Sanders' fees and seek reimbursement after the resolution of the Marin County Action in an action for reimbursement. The court's order, however, did not identify the party from whom The Hartford should seek reimbursement.

Represented by Squire Sanders, the Marin County Action defendants defended the underlying business tort claims through their conclusion. Thereafter, the coverage action resumed, with The Hartford filing cross-complaints against the insureds and Squire Sanders reiterating its coverage defenses and seeking to recoup some \$15 million in defense costs, including \$13.5 million paid to Squire Sanders pursuant to the enforcement order. Asserting theories of unjust enrichment, money had and received, and rescission against Squire Sanders, the cross-complaints alleged that The Hartford was entitled to reimbursement for the payment of defense costs paid on behalf of non-insureds that were "abusive, excessive, unreasonable or unnecessary." In defense of the claims, Squire Sanders demurred, arguing on its own behalf that The Hartford had no standing to assert legal or equitable claims because a right to reimbursement was limited by the existence of a contractual relationship between the alleged non-insureds and the insurer. Squire Sanders further argued that "recognizing a [direct] reimbursement cause of action against a law firm [acting in its role as *Cumis* counsel] would result in undesirable consequences."

The trial court sustained the defense of the alleged non-insureds and Squire Sanders, concluding that The Hartford's "right of reimbursement, if any, was from its insureds, not directly from *Cumis* counsel." On appeal to the appellate court, The Hartford urged that it was entitled to recover directly from *Cumis* counsel for allegedly "unreasonable" and "excessive" fees and costs on the theory that counsel, not the insureds, had been unjustly enriched by allegedly overcharging The Hartford for the insureds' defense. The appellate court disagreed, holding that to allow The Hartford to sue Squire Sanders directly for reimbursement of defense costs would frustrate the public policies underlying the independence and payment of *Cumis* counsel. The appellate court reasoned that where an insurer is found to be in breach of its duty to defend and is precluded from invoking the benefits of California's statutory rate cap provisions, it should not be permitted to seek restitution in court. To do so would put a breaching insurer in a better position than it might have been had it complied with its obligations.

The Supreme Court of California reversed and held that based on the "rather unusual" facts of the case, The Hartford possessed standing to bring suit directly against Squire Sanders for reimbursement of unreasonable and unnecessary defense fees. In qualifying its holding, the majority observed that the language of the trial court's enforcement order — which was final and not subject to further appellate review — was a key distinguishing factor. It explained that "[i]n light of the 2006 enforcement order's express provision authorizing the Hartford to seek reimbursement for excessive fees, we need not and do not decide here whether, absent such an order, an insurer that breaches its defense obligations has any right to recover excessive fees it paid *Cumis* counsel."

Despite the narrow parameters of its ruling, the court provided guidance for future reimbursement claims that may arise. Notably, it rejected Squire Sanders' argument that the fees it received were merely an incidental benefit of the obligation running from The Hartford to its insureds. The court reasoned that under the trial court's enforcement order, as well as California's rules of professional conduct governing legal fees, The Hartford's obligation to pay Squire Sanders was limited to only the reasonable costs of its insureds' defense. California Rule of Professional Conduct 4-200(A). The court concluded that any amounts paid by The Hartford exceeding that standard were not voluntary payments by The Hartford, nor were they an incidental benefit that was immune from an equitable obligation to repay.

The court also rejected Squire Sanders' defense that an unjust enrichment theory is not available in such situations. Although the firm urged that the terms of the policies between The Hartford and its insureds expressly governed the obligation to pay defense costs, the court found that the Hartford did not accept a bargain binding it "to absorb whatever defense fees and expenses the insureds' independent counsel might choose to bill, no matter how excessive." The court



also stated it was "not convinced" that direct liability to an insurer based on a theory of unjust enrichment posed a threat to settled public policy supporting the right to appoint *Cumis* counsel paid by an insurer. It noted that although the hallmark of *Cumis* counsel is its ability to advise its client independently, that independence "is not inconsistent with an obligation of counsel to justify their fees." Pointing to other examples where attorneys are called upon to justify their fees to third parties, the court concluded that there was no basis for distinguishing fee claims in those circumstances from those arising where *Cumis* counsel is appointed.

Significance of Opinion

In certain circumstances, under California law, an insured is entitled to the appointment of independent counsel to defend its interests where the insurer takes a position adverse to its insured's coverage interests. Because that counsel, known as "*Cumis* counsel," is engaged by the insured, but is paid by the insurer at rates subject to statutory limits under California law, public policy questions have arisen concerning whether an insurer may object to, and seek reimbursement of, fees charged by *Cumis* counsel in a fee action brought directly against *Cumis* counsel. This decision is significant because although limited to the "unusual" circumstances presented, the court authorized a direct suit by the insurer on the basis that *Cumis* counsel, like others, are accountable to third-party payors to demonstrate the reasonableness of the fees charged for the services performed.

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[1] The *Cumis* decision held that where the insurer provides a defense, but reserves the right to contest indemnity liability under circumstances suggesting that the insurer's interest may diverge from that of its insured, a conflict arises between insured and insurer. In such circumstances, a single counsel cannot represent both the insurer and the insured unless the insured gives informed consent. Absent the insured's consent to joint representation, the insurer must pay the insured's "reasonable cost" for hiring independent counsel to represent the insured's litigation interests under the insured's control. (*Cumis, supra*, 162 Cal.App.3d at p. 375.)