LOS ANGELES COUNTY BAR ASSOCIATION
update

What Rights Does an Insurer Have against *Cumis* Counsel?
February 2016

By Joel A. Osman and Melissa M. Kurata. Mr. Osman, senior counsel at Parker Mills LLP, concentrates his practice on litigation and trials. His current professional activities include membership in LACBA's Professional Responsibility and Ethics Committee, where he was the chairperson for the 2008-09 year. He is in the first year of a three-year term as a member of the State Bar's Committee on Professional Responsibility and Conduct. Ms. Kurata is an associate with Parker Mills LLP, where she focuses her practice on general business litigation. She is an active member of the Japanese American Bar Association and serves on the Programs Committee. The opinions expressed are their own.

Significant ethical issues arise whenever a lawyer undertakes the concurrent representation of more than one client in connection with a given matter. Some of these issues have the benefit of a well-developed body of law that makes them clear. For other questions, the law continues to develop. A recent California Supreme Court decision provides additional guidance to one of the murkier problems posed by this situation.

Rule of Professional Conduct 3-110 (F) generally sets forth the conditions under which a member of the bar may accept compensation for representing a client from someone other than the client. The most common circumstance in which this occurs is in the context of liability insurance. For many years, it has been well understood that a tripartite attorney-client relationship exists in which both the insurer and its insured are clients of the retained defense counsel.[1] In recognition of this, the comments to 3-110 state:

> Paragraph (F) is not intended to abrogate existing relationships between insurers and insureds whereby the insurer has the contractual right to unilaterally select counsel for the insured, where there is no conflict of interest.

Our understanding of the relationship between an insurer, its insured, and defense counsel was expanded in 1984 when the Fourth District Court of Appeal handed down its decision in *San Diego Naval Federal Credit Union v. Cumis Insurance Society* (1984) 162 Cal. App. 3d 358. The *Cumis* court held that when a conflict (i.e., over coverage) existed between the insurer and the insured, defense counsel retained by the insurer could not properly represent both "clients" in the tripartite relationship by virtue of the inherent conflict of interest between them. The *Cumis* court therefore held that in such a situation, the insurer must pay for independent counsel of the insured's choosing to represent it in the underlying dispute.[2] This ruling was subsequently codified in Civil Code Section 2860.[3]

Until recently, other than the provisions of Civil Code Section 2860, there was scant law clarifying what rights, if any, the insurer retained vis-à-vis the independent counsel for which it is on occasion required to pay.[4] The recent supreme court decision in *Hartford Casualty Insurance Company v. J.R. Marketing, L.L.C.* (2015) 61 Cal. 4th 988 provides some, but not a lot, much-needed insight. In that case, the supreme court held that even when an insurer is required to pay for "independent counsel" to represent its insured, the insurer may still bring a direct claim against the independent counsel to recover "unreasonable and unnecessary" fees charged by said independent counsel.

In *Hartford v. J.R. Marketing*, J.R. Marketing, L.L.C. had a commercial general liability (CGL) policy with Hartford Casualty Insurance Company (Hartford). When J.R. Marketing was sued, Hartford initially disclaimed coverage but agreed to defend under a reservation of rights. A coverage action was initiated. The court in the coverage case found that Hartford had a duty to defend and that J.R. Marketing was entitled to independent *Cumis* counsel. J.R. Marketing retained Squire Sanders as *Cumis* counsel.[5] The court in the coverage case then issued an enforcement order, directing Hartford to pay all defense invoices and future defense costs. The order was drafted by Squire Sanders and adopted by the court. The order stated Hartford breached its defense obligations by refusing to provide *Cumis* counsel until ordered to do so and by failing to pay counsel's submitted bills in a timely fashion. The order also declared that although Squire Sanders' bills "had to be reasonable and necessary," Hartford was precluded from invoking the rate provisions of Civil Code Section 2860 because of its breach. Furthermore, the order said the insurer could challenge any unreasonable and unnecessary fees in a reimbursement action after conclusion of the underlying suit.

Hartford then brought a cross-complaint against Squire Sanders seeking reimbursement of monies paid pursuant to the enforcement order, along with claims for unjust enrichment, accounting, and rescission. Squire Sanders demurred to the cross-complaint, which was sustained by the trial court and affirmed on appeal. The supreme court reversed the appellate court's ruling, holding that when an insurer pays *Cumis* counsel's fees under a court order expressly preserving the insurer's right to recover "unreasonable and unnecessary" fees, the insurer may proceed directly against *Cumis* counsel under principles of restitution and unjust enrichment. The supreme court emphasized its ruling was based on the trial court's order providing that Hartford could challenge Squire Sanders' bills in a subsequent reimbursement action. The supreme court noted that, because the trial court's order expressly allowed Hartford to seek reimbursement of excessive fees, it was not required to decide whether, absent such an order, an insurer that breached its duty to defend would be entitled to seek reimbursement of *Cumis* counsel's allegedly excessive fees.

Future implications. The *Hartford* decision is decidedly narrow. The majority opinion and the concurrence go out of their way to emphasize that the holding was limited to the unusual facts before it, especially the fact that a court order drafted by the law firm authorized the insurer to seek reimbursement directly from the law firm. In footnote 7, the court specifically emphasized that it was not addressing the following: (1) "whether, absent such an order, an insurer that breaches its defense obligations has *any* right to recover excessive fees it paid *Cumis* counsel" (emphasis in original); (2) "whether, in general, a dispute over allegedly excessive fees is more appropriately decided through a court action or an arbitration"; and (3) "*when* such fee disputes generally ought to be decided relative to the underlying litigation" (emphasis in original).

Obviously, given the narrowness of the holding, this new case does not resolve most of the questions left unanswered by the *Cumis* decision or Civil Code Section 2860. It does, however, provide at least one more brick along the road to ethical enlightenment. Even within the narrow facts of the holding in this case, it is evident that there are still significant hurdles for insurers seeking reimbursement of fees from *Cumis* counsel. The insurer has the burden of proving its right to reimbursement, and it must show not only that the fees it seeks to recover from *Cumis* counsel were not "*objectively reasonable at the time they were incurred,* under the circumstances then known to counsel" but also that "the fees were not incurred for [the insured's] benefit." This burden is further compounded by the fact that "absent evidence to the contrary, we should presume that the insured, as the client controlling *Cumis* counsel's defense of the third party action, was the entity that primarily benefited from any fees incurred."

[1] *State Farm Mutual Automobile Ins. Co. v. Federal Ins. Co.* (1999) 72 Cal. App. 4th 1422, 1428–29.

[2] *Id.*

[3] Although *Cumis* counsel does not owe any fiduciary duty to the insurer, *Cumis* counsel, as well as the insured, owes a statutory duty to the insurer "to disclose to the insurer all information concerning the action except privileged materials relevant to coverage disputes, and timely to inform and consult with the insurer on all matters relating to the action." (Long v. Century Indem. Co. (2008) 163 Cal. App. 4th 1460, 1470, citing Civil Code §2860(d); *see* Assurance Co. of America v. Haven (1995) 32 Cal. App. 4th 78 [liability insurer may sue insured's independent counsel under §2860 for negligence in failing to inform and consult with insurer in timely manner, disclose non-privileged information and cooperate in exchanging information].)

[4] Civil Code §2860(c) sets forth minimum standards of experience for independent counsel and states that the insurer cannot be required to pay rates higher than "the rates which are actually paid by the insurer to attorneys retained by it in the ordinary course of business in the defense of similar actions…."

[5] Squire Sanders is now known as Squire Patton Boggs LLP.

LACBA's Professional Responsibility and Ethics Committee welcomes new inquiries from LACBA members regarding ethical issues or concerns about professional responsibilities. The identity of the inquirer is kept confidential within the committee. The committee, however, does not publish formal opinions that are the subject of any pending litigation involving the inquirer. If you have an ethical question that you would like the committee to consider, you can mail your written inquiry to Los Angeles County Bar Association, Professional Responsibility and Ethics Committee, P.O. Box 55020, Los Angeles, CA 90055-2020, or e-mail your inquiry marked "Confidential" to Member Services at msd@lacba.org.