

Insurance Company's Right to Reimbursement

JR Marketing, LLC v. Hartford Casualty Insurance Company (A133750 decided by the First Appellate District; certified for publication on June 11, 2013) is ostensibly a dispute over attorney's fees but is in fact an analysis of what happens when an insurer denies coverage for a claim that is later determined to be covered.

Hartford issued commercial general liability policies to Noble Locks Enterprises, Inc. and JR Marketing. While the policies were in effect several individuals brought suit in the Superior Court of Marin County against the insureds for intentional misrepresentation, breach of fiduciary duty, unfair competition, restraint of trade, defamation, interference with business relationships, conversion, accounting, mismanagement and conspiracy. The suit was tendered to Hartford for defense by JR Marketing and Noble Locks. Two other actions were brought against JR Marketing and Noble Locks in courts outside California and were also tendered to Hartford for defense and indemnity.

In the Marin matter, Hartford refused to defend or indemnify on the grounds that the acts complained of appeared to have occurred before coverage inception. JR Marketing, Noble Locks and others filed a coverage lawsuit against Hartford. As a result of that action Hartford agreed to defend the underlying claims under reservation of rights; but Hartford refused to pay defense costs incurred before the coverage action was filed or to provide *Cumis* counsel. The insureds then brought a motion for summary adjudication as to whether Hartford owed them a duty to defend including a duty to provide *Cumis* counsel dating back to the initial tender of the claim to Hartford.

The trial court found that there was a duty to defend and that the insureds were entitled to independent *Cumis* counsel. Subsequent motions directed Hartford to pay outstanding invoices and "all future, reasonable and necessary defense costs within 30 days of receipt." The trial court held that because Hartford had breached its defense obligations and the duty to provide *Cumis* counsel, it was barred from relying on Civil Code §2860 that limits the amounts an

insurer has to pay for independent *Cumis* counsel because that section “is limited to 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 in the community where the claim arose or is being defended.” See CC §2860 (c). The trial court reasoned that allowing an insurer to initially refuse to defend or provide *Cumis* counsel and then allow the insurer to unilaterally take advantage of the rate limitation of CC §2860 would encourage insurers to reject their *Cumis* obligations as long as they felt safe in the notion that they could invoke the benefit of the statute at any time.

Hartford received bills for defense costs totaling over \$50 million which were subsequently paid. Hartford complained in a cross action (which is the subject of the instant opinion) that the insured's counsel's charges not only covered the Marin County matter but other matters as well. Hartford sought reimbursement of "overpayments" made pursuant to the order based on a theory of unjust enrichment and sought an accounting and rescission. The response of the insureds and its law firm, Squire Sanders, was to demur. The trial court sustained the demurrer in favor of Squire Sanders but allowed the reimbursement and rescission causes of action as to the insureds to go forward. As a result, Squire Sanders was dismissed from the lawsuit and that dismissal was the subject of the appeal.

The question on appeal was whether Hartford had a quasi-contractual right rooted in common law to maintain a direct action against Squire Sanders as independent counsel for certain cross defendants for reimbursement of excessive or otherwise improperly invoiced defense fees and costs. The court determined that it did not. Normally the court stated an insurer has an established right to control litigation that it is defending. When, however, a conflict of interest exists between the insurer and insured that right disappears. The independent counsel (hereinafter “*Cumis* counsel”) has limited duties to the insurer to provide non privileged information but the *Cumis* counsel represents the insured alone. There is therefore no attorney client relationship between the *Cumis* counsel and the insurer. The balance that is provided in these situations is CC §2860 which protects the insurer from excessive charges. To take advantage of §2860 the insurer must meet its duty to defend and accept tender of the insured’s defense subject to reservation of rights. This case holds that an insurer who refuses to accept the defense under reservation loses its protection under CC §2860. An insurer’s right to seek reimbursement of overpayment was recognized by the California Supreme Court in Buss v.

Superior Court (1997) 16 Cal.4th 35. Hartford argued that under Buss and similar cases, it had a right to seek reimbursement against the attorneys under both contractual and quasi-contractual theories. Because the insurer does not have a duty to defend the insured for claims that were not even potentially covered, the insurer therefore has a right of reimbursement that is implied in law as quasi-contractual whether or not it was one that was implied in fact or in the policy itself. In essence Hartford was arguing that this was an unjust enrichment claim and the right exists against the person who was unjustly enriched, i.e., the *Cumis* counsel, in favor of the person who suffered a loss thereby, i.e., Hartford. The Court of Appeal concluded Hartford's argument was incomplete because it ignored the fact that a benefit received by one person does not by itself constitute a sufficient basis to require restitution. There must also be a showing that by allowing the person who has benefitted to retain the benefit would be "unjust". Here the Court concluded that important public policies such as the one exemplified by CC §2860 would be frustrated by allowing Hartford to sue Squire Sanders directly for reimbursement.

By failing to accept the defense under reservation and agreeing to the appointment of *Cumis* counsel, Hartford was penalized by the Court. Hartford lost the protection of CC §2860 for fees and costs which in this case were significant. This is a very severe penalty for an insurer who failed to defend for a relatively limited period of time (approximately 6 months). However the insurer is not without remedies – it can pursue claims against its insured if it can establish that its fees were not covered by the insurance policy or if the insured agreed to pay the law firm more than was reasonable for the services performed. Whether this turns out to be an alternative for Hartford to pursue is another story.