

Insurers Forfeit Their Protections Under Civil Code Section 2860 (*Cumis* Statute) When They Fail to Meet Their Duty to Defend Obligations

If you want to read an important case on *Cumis* counsel and the consequences to insurers who fail to fulfill their obligations relating thereto, we have one for you. *J.R. Marketing LLC v. The Hartford Cas. Insurance Co.*, __ Cal.App.4th __ (May 17, 2013). This case has a lot to offer: *Cumis* counsel, attorneys' fees, *Buss* allocations, duty to defend, and insurance bad faith issues. In this case, the California Court of Appeal for the First District handed down a very important decision that is highly beneficial to insureds and their independent counsel (i.e., *Cumis* counsel). Significantly, the court expanded upon the limitations on the ability of insurers to impose upon their insureds' choice of defense counsel when they do not properly defend their insureds, most likely committing insurance bad faith. Specifically, the Court found that insurers who wrongfully refuse to defend their insureds are barred from maintaining suits against their insureds' independent counsel for reimbursement of fees and costs charged by such counsel and are barred from relying on the protections afforded insurers under Civil Code section 2860.

J. R. Marketing involved an insurer who issued two commercial general liability policies to two insureds under which the insurer promised to defend and indemnify the named insured for certain business-related damages alleged against them. When several claims were brought against the insureds in California, also in non-California Courts, the insureds and several non-insureds, tendered the defense of the lawsuit to the insurer also requesting that it indemnify them under the two policies. The insurer initially denied its duty to defend under the policies, but after the insureds filed a lawsuit against their insurer, the insurer agreed to defend under a reservation of rights, but declined to pay for attorneys' fees prior to its agreement to defend and refused to provide and pay for independent counsel pursuant to *San Diego Fed. Credit Union v. Cumis Ins. Society Inc.* 162 Cal.App.3d 358 (1984). However, the insurer then filed a cross-complaint seeking reimbursement of the fees and costs it had paid to *Cumis* counsel contending that they were unreasonable or unnecessary. The trial court later granted a motion for summary adjudication and ordered the insurer to pay all outstanding fee invoices sent by *Cumis* counsel within fifteen days. The insureds and non-insureds submitted bills for a whopping \$15 million (you read that correctly!). The insurer paid them.

In reviewing the trial court's order sustaining the insured's demurrer to the insurer's cross-complaint for reimbursement and other causes of action, the Court of Appeal focused on the issue of whether the insurer had a "quasi-contractual right rooted in common law to maintain a direct suit against" the insured's *Cumis* counsel. First, the Court stated that although Civil Code section 2860 provides an insurer with certain protections, such as setting a limit of the rate of fees an insurer is obligated to pay to *Cumis* counsel, an insurer forfeits such protection when it fails to meet its duty to defend. As such, the Court held, because the insurer in *J.R. Marketing* failed to defend and accept tender of defense of the insureds, it forfeited "its right to rely on the statutory protection of section 2860 and to otherwise control the defense."

Next, the Court addressed the key issue in this case; whether the insurer has also forfeited its right to seek reimbursement from the insured's *Cumis* counsel by failing to meet its duty to defend. The Court of Appeals concluded that the insurer had. Initially, the Court acknowledged that under *Buss v. Superior Court*, 16 Cal.435 (1997), the insurer may well have a right to reimbursement for unreasonable or unnecessary fees. But, crucially, the Court found that the insurer cannot seek reimbursement from an insured's *Cumis* counsel. The

Court based its conclusion on an examination of the policies behind the enactment of Civil Code section 2860. The Court found that under California law, by refusing to defend, the insurer lost all right to control the defense, including the right to manage the financial decisions “such as the rate paid to independent counselor or the cost effectiveness of any defense tactic. Finally, because established California law deprived the insurer of the right to manage the defense, the Court explained that it:

“[N]ow takes the law one slight step further by holding [the insurer] likewise barred from later maintaining a direct suit against independent counsel for reimbursement of fees and costs charged by such counsel for crafting and mounting the insureds’ defense where [the insurer] considers those fees unreasonable or unnecessary.”

Although the Court clarified that the holding is limited to the facts of the case and that an insurer may still be able to claim that independent counsel engaged in fraudulent billing practices, the “slight step further” taken by the Court actually substantially limits the power wielded by insurers who breach their duty to defend insured. More importantly, the case enhances the ability of independent counsel retained by insureds to vigorously prosecute their clients’ cases without fear of a possible action for reimbursement by insurers. This case sends a strong message: insurers who reserve their rights and refuse to fund the defense of *Cumis* counsel take a big chance that they will be stuck paying those fees without any real ability to challenge them.