No. S211645

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

HARTFORD CASUALTY INSURANCE COMPANY,

Defendant, Cross-Complainant, and Appellant

v.

J.R. MARKETING, LLC, JANE A. RATTO, ROBERT E. RATTO, PENELOPE A. KANE, LENORE DEMARTINIS, GERMAIN DEMARTINIS, SCOTT HARRINGTON, SQUIRE SANDERS (US) LLP,

Plaintiffs, Cross-Defendants, and Respondents.

After A Decision By The Court Of Appeal, First Appellate District, Division Three, No. A133750
San Francisco County Superior Court, No. CGC-06449220, The Honorable Ronald E. Quidachay; The Honorable Loretta Giorgi; The Honorable Lynn O'Malley-Taylor

ANSWERING BRIEF ON THE MERITS

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I. ISSUE PRESENTED FOR REVIEW

When an insurer has breached its duty to defend its insureds in a lawsuit, and has been ordered to pay the insureds' defense costs, may the insurer directly sue the insureds' independent *Cumis*[1] counsel for quasi-contractual reimbursement, based on counsel's fees allegedly being unreasonable or excessive?

II. INTRODUCTION

Appellant Hartford Casualty Insurance Company ("Hartford") asks this Court to recognize a new cause of action that not only threatens the independence of *Cumis* counsel, but also rewards insurers that have breached their duty to defend their insureds. This proposed claim, which is unsupported by and contradicts California law and policy, is part of Hartford's ongoing efforts to avoid its duty to defend its Insureds[2] and undermine their choice of independent counsel.

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[1] *San Diego Navy Federal Credit Union v. Cumis Insurance Society, Inc.* (1984) 162 Cal.App.3d 358, 375.

[2] The "Insureds" are Respondents J.R. Marketing, LLC, Noble Locks Enterprises, Inc., Jane A. Ratto, Robert E. Ratto, Penelope A. Kane, and Lenore DeMartinis.

When the Insureds were sued in the underlying litigation, they asked Hartford to provide them with a defense. Hartford refused, and so the Insureds retained Respondent Squire Sanders (US) LLP ("Squire Sanders") as independent *Cumis* counsel. In the Insureds' coverage action, Hartford continued to deny its duty to defend and fought the Insureds' choice of *Cumis* counsel, but was ultimately ordered to pay the Insureds' defense costs in the underlying litigation. Hartford proceeded to violate that order by refusing to pay defense costs and refusing to acknowledge the Insureds' choice of *Cumis* counsel. Then, after the underlying litigation concluded, Hartford asserted "reimbursement" claims against its Insureds and their independent counsel, contending that the defense costs were allegedly excessive and unreasonable. The courts below roundly rejected Hartford's attempt to directly sue independent counsel, based on arguments substantially similar to those Hartford now raises once again.

Hartford contends that this Court should recognize a quasi-contractual right of breaching insurers to seek reimbursement directly from their insureds' independent *Cumis* counsel, in addition to seeking reimbursement from their insureds. This Court should reject

Hartford's invitation, as did the courts below, for at least two fundamental reasons. First, Hartford's novel right of action would critically (and needlessly) undermine the essential independence of counsel and the other core purposes that lie at the heart of Section 2860 of the Civil Code and the *Cumis* doctrine; it would, for example, fundamentally impair the attorney-client relationship between *Cumis* counsel and insureds when that relationship is most in need of protection from breaching insurers. Second, existing law already affords such insurers all the relief to which they are entitled, pursuant to the express contract of insurance they have with their insureds, and under "[l]ong-standing common law principles" of "restitution." (AOB at p. 4.)

Allowing breaching insurers such as Hartford to proceed directly against the insured-client's *Cumis* counsel would frustrate the basic goals of Section 2860, foremost of which is ensuring insureds' access to independent, non-conflicted counsel. Exposing *Cumis* counsel to after-the-fact challenges undermines this fundamental goal by casting a long shadow of doubt upon counsel, especially in circumstances such as these, where the insurer has abandoned its insureds and breached its obligation to defend them—circumstances

in which the insureds are in greatest need of truly independent, qualified counsel to protect their interests. Insureds will suffer, contrary to the basic goals and purpose of Section 2860, if whatever lawyers they are able to retain under Hartford's regime are forced to defend their clients with one eye over their shoulder, unduly influenced by the threat of being sued by insurers challenging counsel's every judgment call, litigation strategy, decision, or work product as "unreasonable" or "excessive," potentially years after the fact, even if they prevail in the underlying litigation.

Hartford's novel proposed right of direct reimbursement from *Cumis* counsel would also upend the carefully crafted set of incentives, benefits, and protections embodied in Section 2860. It would conflict with the Legislature's evident intent in Section 2860 to encourage insurers *not* to breach their duty to defend. It would also severely compromise the ability of insureds to find qualified, non-conflicted counsel willing and able to defend their interests in the face of insurers who have abandoned them and laid them bare, not only by threatening such counsel with insurer-initiated litigation challenging (with the benefit of hindsight) counsel's every judgment call and work product in the underlying litigation, but also by jeopardizing the

due process and other rights of independent counsel to defend themselves against charges of overbilling, if the requisite evidence is subject to an unwaived privilege. That is clearly not what the Legislature intended in enacting Section 2860. And there is no need to incur these highly troubling and problematic effects that would flow from adopting Hartford's novel cause of action, as more-than-sufficient safeguards already exist to guard against and remedy overbilling by *Cumis* counsel, including the Rules of Professional Conduct, as well as traditional remedies that clients have—and that clients alone may decide to seek—against their lawyers.

Not only does Hartford have no answer to these fundamental problems plaguing its proposed direct right of action against *Cumis* counsel, but it also offers no authority therefor, beyond inapt cases generally discussing the law of restitution. Contrary to Hartford's suggestion, this Court's decision in *Buss v. Superior Court* (1997) 16 Cal.4th 35 (*Buss*), lends no support to Hartford's position. Indeed, in *Buss*, this Court addressed and contemplated a far more limited right to restitution from the *insured*, and one closely tethered to the terms of the express contract of insurance between the insurer and insured.

More fundamentally, Hartford's proposed rule actually *conflicts* with well-established law limiting the reach of quasi-contract when express contracts are on point, as here. Under "traditional principles of restitution" and "long-standing common law principles" (AOB at pp. 4, 32), a party may not recover for "unjust enrichment" where the alleged benefit conferred on a third party (Squire Sanders) is simply *incidental* to the party's (Hartford's) performance of its contractual obligations under an express contract (the contract of insurance) between that party and another party with which it has contracted (the Insureds). Rather, to the extent Hartford believes it overpaid for the Insureds' defense costs, it already has contractual remedies against the party with which it bargained, and is in fact pursuing them.

Allowing breaching insurers to sue *Cumis* counsel directly for reimbursement would also run counter to well-established principles designed to safeguard the inviolability of the attorney-client relationship, particularly against third parties who lack standing to interfere with that vital relationship of trust, confidence, and undivided loyalty.

In sum, Hartford's proposed right of action has no support in law or policy and undermines the ability of insureds to retain truly

independent counsel to protect their interests after they have been abandoned by their insurers. This Court should therefore reject Hartford's arguments, affirm the judgment of the Court of Appeal, and hold that a breaching insurer may not seek restitution for allegedly unreasonable or excessive fees directly from *Cumis* counsel.

III. FACTUAL AND PROCEDURAL BACKGROUND

A. Hartford Enters Into A Bargained-For Contract With The Insureds But Breaches Its Duty To Defend.

In the summer of 2005, Hartford issued business insurance policies to J.R. Marketing, LLC and Noble Locks Enterprises, Inc. (1 Appellant's Appendix ("AA") 8-9.) In September 2005, a group of individuals led by Meir Avganim sued the Insureds for a variety of business torts in Marin County Superior Court (the "Avganim action"). (1 AA 9.)

In January 2006, Hartford disclaimed coverage of the Avganim action and refused to pay for the Insureds' defense costs, despite its self-described "duty to defend its insureds and to provide them with *Cumis* counsel." (AOB at p. 18; 1 AA 9.) The Insureds accordingly retained Squire Sanders as their independent *Cumis* counsel. Shortly thereafter, Squire Sanders filed a coverage suit (the "Coverage action") on the Insureds' behalf against Hartford, claiming breach of

contract and breach of the covenant of good faith and fair dealing, due to Hartford's refusal to defend the Insureds in the Avganim action. (2 AA 271-278.)

B. The Trial Court Orders Hartford To Pay The Insureds' Defense Costs.

After briefing on summary adjudication, the trial court found in July 2006 that Hartford had a duty to defend the Insureds in the Avganim action, and ordered Hartford to honor its obligation to pay for the Insureds' *Cumis* counsel. (1 AA 10.) Hartford nonetheless continued to flout its duty to timely pay the Insureds' defense costs, either paying invoices several months after they were received, or paying significantly less than what Hartford owed. (1 AA 4.) Indeed, rather than complying with this order, in August 2006 Hartford moved to disqualify Squire Sanders as counsel for the Insureds in this action. (1 AA 148-166.) That late scorched-earth tactic by Hartford was roundly rejected, however, by both the trial court and the Court of Appeal, which specifically noted that Hartford waited to seek disqualification "for tactical reasons" until after the trial court found that it had a duty to defend the Insureds. (1 AA 168-183.)

Hartford's intransigence forced the Insureds to seek further relief from the trial court. They moved to enforce the trial court's

summary adjudication order, and asked the court to compel Hartford to pay past invoices within fifteen days of the court's order, and to pay future fees and costs within thirty days of receipt of future invoices. (1 AA 4, 60.)

In response, the trial court granted the Insureds' motion, and ordered Hartford to pay past and future fees and costs (the "Enforcement Order"). (1 AA 10-11.) The court found that Hartford "has breached and continues to breach its defense obligations by (1) failing to pay all reasonable and necessary defense costs incurred by the insured and by (2) failing to provide *Cumis* counsel." (1 AA 3.) As a result of Hartford's breach, the court concluded that Hartford could not:

> unilaterally take advantage of the rate limitation provision of Section 2860. Indeed, such an outcome would encourage insurers to reject their *Cumis* obligations for as long as they chose, safe in the notion that they could, at any point, invoke the protection of the statute, effectively forcing the policyholder to transfer the file to yet another law firm whose rates are lower. The Court finds that, particularly in this case, such a result would work an injustice, since Hartford has already forced its policyholders to transfer the defense of the *Avganim* matter from Squire Sanders to Hartford's panel counsel, only to have it come back again.

(1 AA 4.)

Hartford appealed from the Enforcement Order, as well as the trial court's summary adjudication order finding that Hartford had a duty to defend the Insureds in the Avganim action. (1 AA 61.) In November 2007, the Court of Appeal affirmed both orders, agreeing that Hartford had a duty to defend the Insureds, and holding that the Enforcement Order was fully justified; it also held that "Hartford was not entitled to the protections of section 2860 . . . [g]iven th[e] evidence of Hartford's ongoing failure to meet its duty to defend . . . ." (1 AA 76-77.) Further, the Court of Appeal concluded that Hartford was "at odds with [the Insureds] in developing defenses in the *Avganim* matter, triggering the right to *Cumis* counsel under section 2860." (1 AA 72.)

C. After The Underlying Litigation Concludes, Hartford Sues The Insureds *And* Squire Sanders In Quasi-Contract For Reimbursement.

Despite Hartford's efforts to undermine the Insureds' defense, the Insureds ultimately prevailed in the underlying litigation and in October 2009, the Avganim action and other related cases were resolved. (1 AA 11; 2 AA 308-309.) After again unsuccessfully challenging the Enforcement Order (1 AA 228-249), in July 2011, Hartford filed its First Amended Cross-Complaint, raising claims

against both the Insureds *and* Squire Sanders. (1 AA 6-17.) Hartford asserted four claims against these parties: (1) "reimbursement of all or part" of the funds paid to cover the Insureds' defense costs; (2) unjust enrichment; (3) accounting/money had and received; and (4) rescission. (1 AA 6.)

Squire Sanders and the Insureds (together, the "Cross-Defendants") collectively demurred to Hartford's cross-complaint, and the trial court sustained the demurrer. (1 AA 21-47; 2 AA 430.) The court reasoned that "legal analysis and policy considerations, [including] protecting the integrity of the attorney-client relationship between the insured and their counsel," counseled against permitting an insurer to seek reimbursement directly from *Cumis* counsel. (*Ibid.*) The trial court permitted Hartford to proceed with its reimbursement claim against the Insureds. (*Ibid.*)

D. The Court Of Appeal Affirms And Holds That Hartford May Not Seek Quasi-Contractual Reimbursement Directly From Squire Sanders.

Hartford appealed from the trial court's demurrer ruling, and the Court of Appeal unanimously affirmed. (*J.R. Marketing, LLC v. Hartford Casualty Insurance Co.* (2013) 158 Cal.Rptr.3d 41, 44 (*Hartford*).) The Court of Appeal agreed with the trial court that

"important policies—to wit, those underlying the enactment of section 2860—would indeed be frustrated by allowing Hartford to directly sue Squire [Sanders] for reimbursement." (*Id.* at p. 51.) The Court of Appeal noted that "[t]o hold otherwise would effectively afford the insurer that has waived the protections of section 2860 through its own wrongdoing more rights in a fee dispute with independent counsel than the insurer that has not waived such protections," and rejected Hartford's proposed direct right of restitution from *Cumis* counsel to avoid "this inequitable result." (*Id.* at p. 52.)

The Court of Appeal also rejected Hartford's argument that a direct right of restitution derived from this Court's decision in *Buss*. (*Id.* at p. 51.) Finally, the Court of Appeal criticized Hartford for breaching its duty to defend, noting that "had Hartford met its duty to defend . . . the issue of its right to directly sue Squire for reimbursement would not have arisen." (*Id.* at p. 52, fn. 11.)

E. A Jury Finds Hartford Breached Its Contract With The Insureds, And The Trial Court Permits Hartford To Seek Reimbursement From The Insureds.

In the meantime, the Insureds' remaining claims proceeded to a jury trial. In December 2012, a jury found that Hartford had breached

its contract with the Insureds, though it declined to find that Hartford's breach was in bad faith. (Appellant's Supp. MJN, ex. A, p. 3.)

Afterwards, the court held a bench trial on Hartford's claim for reimbursement from the Insureds. (*Ibid.*) The latest judge to preside over this case in the trial court (there have been at least three to date) issued two tentative statements of decision, at first granting Hartford reimbursement of $5,206,730 from the Insureds, and then decreasing that award to $4,997,395. (*Id.* at p. 2; Appellant's MJN, ex. A, p. 2.) The Insureds filed objections challenging the trial court's tentative decision, and the trial court issued a final statement of decision, which remains deeply flawed, further decreasing its reimbursement award to $4,857,832. (Appellant's Further Supp. MJN, ex. A, p. 2.) That decision, of course, does not impact the appeal before this Court, and will likely be subject to its own appeal in due course.[3]

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[3] Squire Sanders will not attempt to prematurely litigate in this Court the various tentative and final reimbursement decisions from the trial court of which Hartford has requested judicial notice. Squire Sanders respectfully submits that this Court should not be distracted by these unreviewed findings and conclusions in resolving the issues of law presented here.

IV. ARGUMENT

A. Hartford's Proposed Right of Action Would Needlessly And Seriously Impair Section 2860, The *Cumis* Doctrine, And The Attorney-Client Relationship Between *Cumis* Counsel And The Insured.

Hartford's proposed quasi-contractual claim for reimbursement from *Cumis* counsel would undermine the vital policies animating the entire *Cumis* doctrine codified in Section 2860.[4] And, as Hartford recognizes, a party cannot recover in quasi-contract where such a recovery would undermine established public policy. (E.g., *California Emergency Physicians Medical Group v. Pacificare of California* (2003) 111 Cal.App.4th 1127, 1136; see also AOB at p. 26.)

Cumis and Section 2860 are designed to safeguard insureds' right to independent counsel free of conflicts of interest and uncompromised by the possibility of divided loyalties, and to incentivize insurers to honor their duty to defend their insureds, rather than laying them bare to fend for themselves, as Hartford did here.

Adopting Hartford's proposed rule would defeat these vital policy goals. It would subject independent counsel to an intractable

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[4] All statutory references, unless otherwise stated, are to the Civil Code.

conflict between their duty to defend insureds and their own interest in avoiding personal liability in insurer-initiated, after-the-fact litigation second-guessing that defense. In at least one important respect, it would also put breaching insurers in a potentially *better* position than their competitors who complied with Section 2860's requirements, by permitting them to challenge (with the benefit of hindsight) defense costs and fees as "excessive" or "unreasonable," potentially years after the underlying litigation has concluded. Independent counsel facing a restitution action may also find themselves unable to defend themselves by relying on evidence subject to the attorney-client privilege. And there is no need for the rule Hartford proposes: the ethics rules already prohibit any lawyer from charging unconscionable fees, and insureds can choose to sue or seek appropriate relief from their counsel if an insurer seeks to recover legal fees from the insured.

Hartford's proposed rule would therefore seriously compromise and undermine the basic purpose of Section 2860—to protect the interests of insureds by making sure they have access to qualified, conflict-free counsel—and should be rejected by this Court.

1. Section 2860 Guarantees Insureds Access To Qualified And Truly Independent Counsel And Disincentivizes Insurers From Breaching Their Duty To Defend.

Section 2860 of the Civil Code was enacted in 1987 to codify the core holding in *San Diego Navy Federal Credit Union v. Cumis Insurance Society, Inc.* (1984) 162 Cal.App.3d 358, 375 (*Cumis*): that "where there are divergent interests of the insured and the insurer brought about by the insurer's reservation of rights based upon possible noncoverage under the insurance policy, the insurer must pay the reasonable cost for hiring independent counsel by the insured." Section 2860 was thus enacted to protect insureds by ensuring access to qualified and entirely independent counsel that would vigorously represent the insureds' interests.

In *Cumis*, the Court of Appeal explained the nature of the predicament facing an insured where "the insurer promises to defend but states it may not indemnify the insured if liability is found." (*Id.* at p. 364.) Under those circumstances, the interests of the insured and the insurer no longer align: the insurer has an interest in avoiding coverage through a liability finding in the underlying litigation based on a ground *not* covered by its policy, while the insured has the

conflicting interest in obtaining coverage through a liability finding that *would* trigger the insurer's duty to indemnify. (*Ibid.*)

When such an "actual, ethical conflict of interest" arises, a lawyer may not represent both the insurer and the insured. (*Id.* at p. 375.) Were a lawyer to attempt to do so, he or she would be "forced to walk an ethical tightrope, and not communicate relevant information which is beneficial to one or the other of his clients"; "[n]o matter how honest the intentions, counsel [could not] discharge [these] inconsistent duties." (*Id.* at p. 366.)

The *Cumis* doctrine therefore came into existence in order "to protect an *insured's* interest." (*J.C. Penney Casualty Insurance Co. v. M. K.* (1991) 52 Cal.3d 1009, 1018.) *Cumis* "intended to eliminate the ethical dilemmas and temptations that arise along with conflict in joint representations" by "mandating the insured's right to *Cumis* counsel that represent *only* the insured." (*Employers Insurance of Wausau v. Albert D. Seeno Construction Co.* (N.D.Cal. 1988) 692 F.Supp. 1150, 1157-1158, italics added.) Section 2860 realizes this goal by codifying insureds' right to qualified and truly independent counsel. (See *Musser v. Provencher* (2002) 28 Cal.4th 274, 282-283

(*Musser*), quoting *Kroll & Tract v. Paris & Paris* (1999) 72 Cal.App.4th 1537, 1542.)[5]

Courts applying Section 2860 have recognized this fundamental purpose underlying the statute, and have consistently interpreted the statute to protect the independence of the insureds' counsel. For example, in *Dynamic Concepts, Inc. v. Truck Insurance Exchange* (1998) 61 Cal.App.4th 999 (*Dynamic Concepts*), the court questioned the "wisdom and propriety of so-called 'outside counsel guidelines'" that might "violate the insurer's duty to defend *as well as* the attorneys' ethical responsibilities to exercise their independent professional judgment." (61 Cal.App.4th at p. 1009 & fn. 9, italics added.) Such guidelines must not "be permitted to impede the

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[5] Specifically, Subdivision (a) requires an insurer to provide "independent counsel" where a conflict of interest arises between the insurer and the insured. (Civ. Code, § 2860, subd. (a).) Subdivision (c) establishes minimum qualifications for independent counsel selected by the insured, limits the insurer's obligation to pay fees to those "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," and provides for mandatory arbitration of "[a]ny dispute concerning attorney's fees" not resolved by contractual dispute-resolution mechanisms. (*Id.*, subd. (c).) And Subdivision (d) requires independent counsel and the insured to disclose "all information concerning the action" to the insurer, *except* for "privileged materials relevant to coverage disputes." (*Id.*, subd. (d).)

attorney's own professional judgment about how best to competently represent the insureds." (*Ibid.*) Instead, "[i]f the attorney's representation is to be limited in any way that unreasonably interferes with the defense, it is the *insured*, not the insurer, who should make that decision." (*Ibid.*, italics added.)

Similarly, in *Assurance Co. of America v. Haven* (1995) 32 Cal.App.4th 78, 81 (*Assurance Co.*), the court concluded that "*Cumis* counsel cannot be held negligently or statutorily liable *to the insurer*" for failing to develop a complete defense to liability.[6] Recognizing a general duty of care owed by independent counsel to an insurer where there is a conflict of interest between the insurer and insured would subject independent counsel to "the oftentimes subtle ethical dilemmas and temptations that arise along with conflict in joint representations." (*Id.* at p. 87.) Permitting an insurer to sue independent counsel would thus jeopardize the essential and "*complete independence of counsel*" that lies at the heart of the *Cumis* doctrine. (*Ibid.*)

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[6] The court held, however, that the non-breaching insurer could sue for a breach of specific duties owed by independent counsel to the insurer under Section 2860. (*Id.* at p. 87.)

Section 2860 also attempts to protect the interests of *insureds* by creating strong incentives for insurers to honor their duty to defend, and not to leave their insureds in the lurch without the resources to hire qualified counsel. In particular, as the Court of Appeal concluded, a breaching insurer "forfeits the protections of section 2860, including its statutory limitations on independent counsel's fee rates and resolution of fee disputes." (*Hartford, supra*, 158 Cal.Rptr.3d at p. 49; *Atmel Corp. v. St. Paul Fire & Marine* (N.D.Cal. 2005) 426 F.Supp.2d 1039, 1047.) And more generally, "'[w]hen an insurer wrongfully refuses to defend, the insured is relieved of his or her obligation to allow the insurer to manage the litigation and may proceed in whatever manner is deemed appropriate.'" (*Hartford, supra*, 158 Cal.Rptr.3d at p. 49; see also *Safeco Insurance Co. v. Superior Court* (1999) 71 Cal.App.4th 782, 787.) By making these benefits contingent on compliance with the duty to defend, the Legislature offered insurers a "carrot" to incentivize them to defend their insureds' interests.

Section 2860 thus makes the right to independent counsel established in *Cumis* meaningful by protecting the effective independence of counsel, and it offers several benefits to insurers who

honor their fundamental obligation to provide their insureds with independent counsel when a conflict of interest arises with their insureds. But it does nothing to protect insurers who, like Hartford, violate their contractual (and statutory) obligations to their insureds.

2. Permitting Insurers To Second-Guess *Cumis* Counsel Would Undermine The Essential Independence Of Counsel.

Allowing breaching insurers to directly sue their insureds' *Cumis* counsel for allegedly excessive or unnecessary legal work would eviscerate the very independence *Cumis* and Section 2860 were designed to protect, and create a conflict of interest that "would prevent [independent counsel] from devoting his entire energies to his client's interests." (*Flatt v. Superior Court* (1994) 9 Cal.4th 275, 289.)

Adopting Hartford's proposed rule would force every "independent" counsel to balance the interests of his or her client, whether consciously or not, against the looming threat of after-the-fact insurer-initiated litigation and personal liability. Where a conflict of interest gives rise to an insurer's duty to provide its insured with independent counsel, the insurer's interests and preferences will often diverge markedly from those of the insured. For example, the insurer

may not want to have additional depositions taken that would demonstrate that the insured's conduct was merely negligent, rather than intentional; it may prefer not to spend additional money researching issues related to punitive damages for which the insurer would not be liable; and it may not open its wallet to support the insured's demurrer to intentional tort or contract claims not covered under the policy. The insured, on the other hand, would benefit from its lawyer vigorously carrying out each and every one of these steps in the underlying litigation.

Hartford's proposed rule would leave independent counsel subject to *both* of these conflicting sets of interests, and would threaten counsel, as a practical matter, with a heavy and unfair price to pay for championing their client-insured's cause and exercising their independent "professional judgment about how best to competently represent the insureds." (*Dynamic Concepts, supra*, 61 Cal.App.4th at p. 1009, fn. 9.) This tension between the lawyer's *duty* to the client and his or her own *interest* in avoiding personal liability to a third party (the insurer) whose interests diverge from his or her client's would exacerbate the "subtle ethical dilemmas and temptations" that Section 2860 and *Cumis* were designed to overcome, and place the

insured in a materially worse situation than under Section 2860. (*Assurance Co., supra*, 32 Cal.App.4th at p. 87.) Even the most scrupulous and dutiful lawyers may be tempted to hedge, to the client's detriment, on strategic or tactical steps in the litigation that might increase the overall cost of the representation.

Thus, even the best of lawyers may end up doing less than they should to vigorously and zealously defend the interests of their client-insureds. That is why the law governing lawyers has always disapproved of placing lawyers in a position of having to choose between their pecuniary or other personal interests (here, in avoiding liability for restitution to insurers) and their zealous, competent and single-minded representation of clients. (See Rules of Professional Conduct, rule 3-310 ["A member shall not accept or continue representation of a client . . . where . . . [t]he member has or had a legal, business, financial or professional interest in the subject matter of the representation."].)[7] Even if, as Hartford suggests, lawyers

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[7] (See also ABA Model Rules of Professional Conduct, rule 1.7(a) ["[A] lawyer shall not represent a client if . . . there is a significant risk that the representation . . . will be materially limited by . . . a personal interest of the lawyer"]; Rest.3d, Law Governing Lawyers, § 125 ["[A] lawyer may not represent a client if there is a

[Footnote continued on next page]

could ignore their personal interest in avoiding after-the-fact, insurer-initiated litigation (AOB at p. 28), the mere acceptance of the conflicted representation would still be prohibited by the rules of ethics. (See *People v. SpeeDee Oil Change Systems, Inc.* (1999) 20 Cal.4th 1135, 1147 ["'The rule [against conflicting representations] is designed not alone to prevent the dishonest practitioner from fraudulent conduct,' *but also to keep honest attorneys from having to choose between conflicting duties, or being tempted to reconcile conflicting interests*," italics added.].) Regardless of how a lawyer "reconcile[s] conflicting interests," it is the *choice* between the interests of the client and those of a third party, and not the outcome, that the ethics rules prohibit.

Equally unpersuasive is Hartford's argument that a right to after-the-fact reimbursement from *Cumis* counsel "poses no risk to counsel's independence" because the Legislature already allows parties to arbitrate disputes over insureds' defense costs under Subdivision (c) of Section 2860. (AOB at p. 29.) As even Hartford

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substantial risk that the lawyer's representation of the client would be materially and adversely affected by the lawyer's financial or other personal interests"].)

notes elsewhere in its brief, there is a key distinction between these two rights of action: unlike Hartford's claim for restitution, Section 2860 arbitration, according to Hartford, "take[s] place *contemporaneously*, generally while the underlying litigation is still underway." (AOB at p. 29, italics added.)

Contemporaneous resolution of billing disputes actually *mitigates* the aforementioned conflict of interest and threat to counsel's ability to provide zealous representation to his or her client-insured. It does so by providing clear, real-time guidance to counsel about which litigation activities counsel may undertake without having the rug pulled out from under him or her years after the fact by the insurer. Counsel could thus focus single-mindedly, as he or she should, on providing the best possible representation to the client without worrying about being second-guessed by an insurer with interests that conflict with the client-insured's.[8] Hartford therefore

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[8] There are other relevant differences as well. As a practical matter, most arbitrations under Section 2860 concern independent counsel's billing rates and do not call into question strategy or judgment calls in the way that Hartford's proposed rule would. Moreover, arbitrations under Section 2860 are usually brought by the *insured*, rather than the insurer, thereby undermining Hartford's suggestion that in Section 2860(c) fee arbitrations non-breaching

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has it backwards in suggesting that after-the-fact litigation somehow alleviates the conflict its proposed rule would create. (AOB at p. 29.)

Hartford is also wrong that requiring "an insurer [to] sue its insured . . . [who] must then sue *Cumis* counsel" would create the same problems that plague Hartford's proposed rule. (See AOB at pp. 31-32.) In actuality, existing law, as applied by the Court of Appeal (*id.* at p. 31), would best protect the interests of the insured, its *Cumis* counsel, and even the insurer. Because insureds are potentially liable for purportedly unreasonable fees charged by their independent counsel, client-insureds have a real incentive to monitor the fees charged by their counsel.

Insureds thus have many of the same interests in weighing the costs and benefits of their defense as other clients do outside of the insurance context—interests that promote ongoing consultation with counsel and an optimal level of expenditure on litigation. Relying on the client-insureds to serve as an added check against excessive activity or billing by their lawyers also avoids many of the divided-

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insurers routinely proceed directly against *Cumis* counsel without the involvement or assent of insureds. (See AOB at pp. 29-30.)

loyalties and incentive problems discussed earlier (see *ante*, at pp. 20-26), as the law has long recognized with respect to clients in other, non-insurance contexts. (See *post*, at pp. 51-54.)

By limiting breaching insurers to proceeding against their insureds for any allegedly excessive or unreasonable fees charged by the insureds' independent counsel, this Court would properly encourage client-insureds to weigh the benefits of independent counsel's representation against the economic costs of that representation, which would in turn promote efficient and effective advocacy. Most importantly, by rejecting Hartford's proposed claim, this Court would protect the essential independence and undivided loyalty of *Cumis* counsel and thereby protect the fundamental purpose of the *Cumis*/Section 2860 regime: to guarantee zealous, single-minded representation to the client-insured.

3. Hartford's Proposed After-The-Fact Restitutionary Right Of Action Would Create Perverse Incentives For Both Insurers And Prospective *Cumis* Counsel.

Permitting a breaching insurer to sue *Cumis* counsel directly for reimbursement would also undermine insurers' incentives to comply with Section 2860. An after-the-fact suit for reimbursement from *Cumis* counsel would represent too easy and ready of an alternative

for insurers to arbitration under Subdivision (c) of Section 2860—the "carrot" offered by the statute to encourage insurers *not* to breach their duty to defend.[9]

Hartford's proposed rule would not only render the "carrot" offered by the Legislature far less attractive, it would also perversely place insurers in a *better* position, in at least one important respect, than if they had not breached and were limited to contemporaneously challenging defense fees and costs through Section 2860(c) arbitration. With the benefit of hindsight, a breaching insurer would be in a better position to challenge legal fees, costs, judgment calls, or decisions that may have seemed reasonable and warranted during the course of the underlying litigation. Hartford's proposed rule would thus pull insurers in the opposite direction from that intended by the Legislature, offering a unique benefit to those who breached their duty

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[9] Hartford also argues that this Court should recognize a direct right of reimbursement against *Cumis* counsel because such an after-the-fact right "could not possibly have interfered with" Squire Sanders' representation of the Insureds *in this case*. (AOB at p. 30.) But of course this Court's resolution of this appeal will bind all future *Cumis* counsel (and insurers and insureds) going forward, and thus the problematic effects of Hartford's proposed rule would (if adopted by this Court) have a very real (and deleterious) impact on the defense available to all insureds.

to defend. This special status for *breaching* insurers would turn on its head the principle that a party seeking equity must "come into court with 'clean hands.'" (*Allen v. Los Angeles County District Council of Carpenters* (1959) 51 Cal.2d 805, 813.)

In contrast, a non-breaching insurer that complies with Section 2860 and is concerned that *Cumis* counsel is spending too much time preparing for a series of depositions, for example, would be similarly situated to the insured at the time: neither party would know the role the deposition will end up playing in resolving the litigation, and the insurer would be hard-pressed to argue that independent counsel should not be as thorough and comprehensive as counsel would like. But with the benefit of hindsight, an insurer's critique could be informed (implicitly or explicitly) by the *outcome* of the deposition and the entire litigation. Insurers should not gain any advantage by virtue of breaching their duty to defend.

Moreover, by casting a long shadow of doubt on lawyers concerned about being sued after the fact by an insurer with interests in conflict with the client-insured, Hartford's proposed rule would discourage lawyers from serving as *Cumis* counsel. This threat of future satellite litigation over every strategy, judgment call, or

decision made in the underlying litigation would make it far more difficult for insureds to secure the qualified and committed legal representation to which they are entitled—representation free of even the "subtle ethical dilemmas" and "temptations" that could affect the best and most dutiful of lawyers. (*Assurance Co., supra*, 32 Cal.App.4th at p. 87.) In addition to the clear conflicts of interest Hartford's proposed rule would engender, its pernicious effect on the incentives created by the *Cumis*/2860 regime is yet another reason for this Court to affirm the judgment of the Court of Appeal.

4. Hartford's Proposed Rule May Unfairly Deprive *Cumis* Counsel Of Their Due Process And Other Rights To Defend Themselves.

Beyond creating an unavoidable conflict of interest, Hartford's proposed rule would expose independent counsel to restitution suits in which the attorney-client privilege may unfairly hamstring *Cumis* counsel from exercising their due process and other rights to mount an effective defense against charges of excessive or unreasonable billing. The attorney-client privilege, after all, "belongs to the client," and only the client may decide whether to waive the privilege or not. (*De Los Santos v. Superior Court* (1980) 27 Cal.3d 677, 685.)

There is, of course, a self-defense exception that enables the lawyer to introduce otherwise-privileged evidence to defend against a client's charges of overbilling or malpractice. (See Evid. Code, § 958 ["There is no privilege . . . as to a communication relevant to an issue of breach, by the lawyer or client, of a duty arising out of the lawyer-client relationship."].) However, it is far from clear whether this limited exception would apply in an action brought by a *third party* (e.g., a breaching insurer) challenging a lawyer's billing practices, and there is good reason to hold that such a stranger to the attorney-client relationship should not be able to force a waiver of the privilege belonging to the client-insured.

Indeed, courts have rejected attempts to assign legal malpractice claims to non-client third parties (see *post*, at pp. 51-54) in part *because* attorney-defendants in those cases may not waive the privilege. (See, e.g., *McDermott, Will & Emery v. Superior Court* (2000) 83 Cal.App.4th 378, 381 [holding shareholders could not bring derivative malpractice action against corporation's attorneys where corporation had not waived privilege and attorney would therefore be "effectively foreclosed from mounting any meaningful defense"];

Kracht v. Perrin, Gartland & Doyle (1990) 219 Cal.App.3d 1019, 1024 (*Kracht*).)

Recognizing a direct restitutionary right of action by the insurer against *Cumis* counsel could thus put counsel in an untenable position: the client-insured having done nothing to waive the privilege, independent counsel may be precluded from disclosing privileged information in defending against any such direct suit for reimbursement. But while "[d]ue process requires that there be an opportunity to present every available defense" (*Lindsey v. Normet* (1972) 405 U.S. 56, 66), Hartford's proposed rule could very well frustrate counsel's ability to raise *any* defense based on its privileged communications with an insured.

Hartford's assertion to the contrary—that "there should be nothing relevant to the reimbursement issue that remains confidential where, as here, the insurer has already received and paid the attorney's fee bills" (AOB at p. 31)—is simply wrong. The privilege does not disappear after the litigation concludes, and the client retains the decision on whether to waive it. If, for instance, the client insisted on a particular course of action in the litigation (e.g., third-party subpoenas, taking particular depositions, etc.) that the insurer

subsequently attacked as excessive, the lawyer could not effectively mount a defense without explaining the client-driven rationale for the actions. (See Civ. Code, § 2860, subd. (d).)

5. There Is No Need For Hartford's Proposed Right Of Action.

Given the problematic impact that Hartford's proposed quasi-contractual right of reimbursement from *Cumis* counsel would have on Section 2860 and the *Cumis* regime, this Court need not and should not permit Hartford to seek reimbursement here. Furthermore, such a right is simply not necessary: Rule of Professional Conduct 4-200(A) already prohibits attorneys from "enter[ing] into an agreement for, charg[ing], or collect[ing] an illegal or unconscionable fee."

Ironically, Hartford relies on the Rules of Professional Conduct elsewhere in its brief to argue that its proposed rule would not compromise the effective and vigorous representation of client-insureds, because those Rules require attorneys to "exercise independent judgment and represent their clients competently." (AOB at p. 28.) Yet Hartford inexplicably argues that other provisions of those same Rules—namely, Rule 4-200(A)—somehow do not suffice to guard against excessive or improper activity or billing by attorneys. Under Hartford's logic, if the Rules

are sufficient to guarantee something far more amorphous and difficult to gauge like the former, then surely they suffice to safeguard against the latter.

While some unscrupulous lawyers may try to exploit their ability to recover fees from breaching insurers as "a meal ticket immunized from judicial review for reasonableness," the vast majority take their ethical responsibilities and the threat of attorney discipline seriously. (See *United Pacific Insurance Co. v. Hall* (1988) 199 Cal.App.3d 551, 557; AOB at p. 16.) And even if some do not, mechanisms already exist to remedy overbilling by lawyers, including the disapproval of, or legal action by, their clients (in addition to bar and governmental authorities). Those mechanisms are more than adequate to contain the limited risk of true attorney overbilling. (*Buss, supra*, 16 Cal.4th at p. 58.)

Hartford protests that concerns of "judicial economy" require its proposed restitutionary right of action (AOB at pp. 34-36), without once explaining why the "double litigation burden" and judicial inefficiency of which it warns (AOB at p. 35) could not be dispensed with through the simple expedient of the client-insured filing a cross-complaint against *Cumis* counsel, in the "exceptional cases" in which

a negotiated or other resolution could not be worked out.[10] (*Buss, supra*, 16 Cal.4th at p. 58; see, e.g., Code Civ. Proc., § 428.10, subd. (b).) But as demonstrated in Sections IV.B.4-5, *post*, whether the attorney should be sued for overbilling or professional misconduct is a decision for the *client*, and the client alone, to make (with full appreciation for the privileged communications that occurred during the relationship), and not for third-party interlopers with interests adverse to the client-insured.

B. Existing Law And Important Public Policy Concerns Militate Against Hartford's Proposed Right Of Action.

Hartford's attempts to ground its novel proposed right to restitution in this Court's decision in *Buss* fails. Neither *Buss* nor any other authority supports the broad-reaching and problematic right of action that Hartford asks this Court to create. Perhaps recognizing that *Buss* simply does not address a breaching insurer's right to obtain reimbursement directly from *Cumis* counsel, Hartford additionally seeks to ground its request in "basic principles of restitution." (AOB at p. 14.) But Hartford's effort falls flat because existing law and

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[10] Of course a *client*'s claim against its counsel is different in nature than an *insurer*'s reimbursement claim against its insureds, and both claims are not necessarily evaluated under the same standards.

important public policy concerns impose equally basic *limitations* on the availability of quasi-contract in circumstances such as these.

Indeed, as Hartford itself admits, a quasi-contract claim is "an equitable claim developed by courts specifically to address situations where a contract does not determine the rights of the parties." (AOB at p. 16.) Courts have repeatedly rejected claims for restitution where, as here, there is an express, bargained-for contract on point.

Additionally, courts have long prohibited the assignment of legal malpractice and related claims, recognizing that such assignment would fundamentally impair the attorney-client relationship. Allowing an insurer to seek reimbursement directly from *Cumis* counsel, without any input from the client, would result in the same troubling effects—if not worse. It would do so in a particularly pernicious way in circumstances, such as the one presented here, where the client-insureds are most vulnerable following the insurer's breach and in need of zealous, effective, conflict-free legal representation.

1. Recognizing A Quasi-Contractual Right Of Reimbursement From *Cumis* Counsel Is Not Supported By *Buss* Or Any Other Case Or Authority.

Hartford's proposed quasi-contractual right of reimbursement from *Cumis* counsel finds no support in this Court's decision in *Buss* or in any other reported case or authority. (AOB at pp. 17-21.) This Court in *Buss* never considered, or had any occasion to consider, whether an insurer could recover defense costs from *Cumis* counsel or, for that matter, anyone other than the insured. (*Buss, supra*, 16 Cal.4th at pp. 39-40.)

The only question this Court considered in *Buss* was whether to allow an insurer to obtain reimbursement from its *insured* for claims that were not even potentially covered under the insurance policy. (*Id.* at p. 52 ["[F]or what specific defense costs may the insurer obtain reimbursement from the insured? The answer is: Defense costs that can be allocated solely to the claims that are not even potentially covered."].) And *Buss* held only that, given the contractual limits on coverage negotiated between the insurer and the insured, the insurer had a narrow quasi-contractual right to recover defense fees and costs entirely attributable to claims that were not even potentially covered

(i.e., claims that the insurer negotiated to exclude from the scope of the policy). (*Id.* at pp. 49-50.)

In so holding, *Buss* recognized that this reimbursement claim would only arise "*in apparently exceptional cases*—for example, where the defense costs the insurer may obtain in reimbursement are clear and substantial and where the assets the insured has available for reimbursement are themselves of the same sort." (*Id.* at p. 58, italics added.) In short, *Buss* provides no support for the extraordinary and unprecedented remedy Hartford seeks here; much to the contrary, *Buss* understood that the right it was describing was narrow and would rarely be pursued.

In *Buss*, after a conflict of interest arose between an insurer and an insured, the insured retained *Cumis* counsel to defend itself in the underlying lawsuit. (*Buss, supra*, 16 Cal.4th at pp. 40-41.) The plaintiff insurer complied with its duty to pay for *Cumis* counsel, even for work that was arguably not covered. (*Ibid.*) After the underlying litigation ended, the insurer sued the insured, asserting a right of reimbursement for fees attributable only to work for claims that were not even potentially covered. (*Id.* at pp. 50-51.)

In recognizing the very different quasi-contractual right of reimbursement sought in *Buss*, this Court noted that such a right *must* exist "under the policy" bargained for by the parties. (*Id.* at p. 51.) The Court recognized that the insurer "bargained to bear the[ ] costs" associated with *covered* claims, but bargained to *avoid* the costs associated with claims that were not even potentially covered. (*Id.* at p. 49.) The broad duty to defend additionally obligated the insurer to pay defense costs attributable to "claims that are merely potentially covered, in light of facts alleged or otherwise disclosed," even if those claims were ultimately found to *not* be covered. (*Id.* at p. 46.) Given the parties negotiated express limitations on coverage, the "insured could not have an objectively reasonable expectation that it was entitled to what would in fact be a windfall"—i.e., the payment of defense costs attributable entirely to claims that were not even potentially covered, and thus did not fall within the insurer's duty to defend. (*Id.* at p. 51.)

This Court thus concluded that "[t]he 'enrichment' of the insured by the insurer through the insurer's bearing of unbargained-for defense costs is inconsistent with the insurer's freedom *under the policy* and therefore must be deemed 'unjust.'" (*Ibid.*, italics added.)

In other words, forcing an insurer to defend an insured against claims that were not even potentially covered was inconsistent with the bargained-for express contract, and a limited quasi-contractual right to reimbursement from the insured of "defense costs that can be allocated solely to the claims that are not even potentially covered" was a necessary corollary to the express contract of insurance. (*Id.* at p. 53.)

Since *Buss*, other cases have also grounded an insurer's right to quasi-contractual reimbursement from the insured in the terms of the express contract of insurance. In *Aerojet-General Corp. v. Transport Indem. Co.* (1997) 17 Cal.4th 38, 69, for example, this Court explained, quoting *Buss*, that when an insurer seeks reimbursement of fees and costs attributable to claims that are not even potentially covered, "'the insurer has not been paid premiums by the insured. It did not bargain to bear these costs. To attempt to shift them would not upset the [contractual] arrangement.'" (*Ibid.*)

Similarly, in *Scottsdale Insurance Co. v. MV Transportation* (2005) 36 Cal.4th 643 (*Scottsdale*), this Court tied the quasi-contractual right of reimbursement recognized in *Buss* to the terms of the express contract of insurance and to what was necessary

to effectuate that bargained-for agreement between insurer and insured. In recognizing that an insurer had a right to seek reimbursement from the insured for claims that the insurer never actually had a duty to defend, this Court focused on the contractual bargain negotiated between the insurer and insured:

> As *Buss* explained, the duty to defend, and the extent of that duty, are *rooted in basic contract principles. The insured pays for, and can reasonably expect, a defense against third party claims that are potentially covered by its policy, but no more.* Conversely, the insurer does not bargain to assume the cost of defense of claims that are not even potentially covered. To shift these costs to the insured does not upset the contractual arrangement between the parties. Thus, where the insurer, acting under a reservation of rights, has prophylactically financed the defense of claims as to which it owed no duty of defense, it is entitled to restitution. *Otherwise, the insured, who did not bargain for a defense of noncovered claims, would receive a windfall and would be unjustly enriched.*

(*Id.* at p. 659, italics added.)

Indeed, this Court recognized that *without* a right to reimbursement against the insured, "the insurer [will] give, and the insured get, more than they agreed." (*Id.* at p. 660.) As such, an insurer's limited right to quasi-contractual reimbursement from the

insured was necessary to effectuate the express agreement reached by the parties.[11]

The foregoing differs markedly from, and provides no authority for, a much broader, more nebulous quasi-contractual right of restitution directly from *Cumis* counsel. *Buss* is simply inapt, and speaks only to a limited right of restitution against an insured arising out of, and as a necessary corollary to, the express contract (and the limitations on coverage therein) between the insurer and insured. *Buss* provides no support for Hartford's claimed right to restitution from *Cumis* counsel.[12]

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[11] Other courts have also discussed *Buss*'s right to reimbursement as a "counterbalance" to effectuate the bargained-for agreement between the parties. (See, e.g., *Prichard v. Liberty Mutual Insurance Co.* (2000) 84 Cal.App.4th 890, 904-906 ["*Buss* held that an insurer's right to seek reimbursement is implied in law, as a counterbalance to an insured's right, also implied in law, to have a defense of the whole of an action. . . . [A] reader can gather from the main text [of *Buss*] that the court was referring to an insurer's providing a defense of claims for which the policyholder never bargained, which is the main theme of *Buss*'s rationale."].)

[12] Hartford also cites a tentative draft statement issued by the American Law Institute. (See AOB at p. 20.) But this tentative draft provides no authority or explanation for the novel proposition Hartford cites it for, and has not been adopted as final.

2. Quasi-Contractual Restitution Is Inappropriate Where The Alleged "Benefits" Conferred By The Insurer Are *Incidental* To The Insurer's Performance Of Its Pre-Existing Contractual Obligations.

Hartford's invocation of "basic principles of restitution" (AOB at p. 14) fails, because it simply disregards longstanding limitations on restitution in circumstances such as these. The Restatement (First) of Restitution, cited approvingly by this Court on numerous occasions (see, e.g., *AIU Insurance Company v. Superior Court* (1990) 51 Cal.3d 807, 835), makes clear that "[a] person who, *incidentally* to the performance of his own duty or to the protection or improvement of his own things, has conferred a benefit upon another, is not thereby entitled to contribution." (Rest., Restitution, § 106, italics added.) Because Hartford was obligated, both contractually and as a matter of insurance law, to pay for the Insureds' defense costs, any benefits resulting from the payment of those funds was simply *incidental to* Hartford's "performance of [its] own duty" and pre-existing obligations. Therefore, Hartford cannot now properly seek restitution of those funds in quasi-contract from a third party such as *Cumis* counsel.

The principle set out in Section 106—that a plaintiff cannot recover in quasi-contract for conferring a benefit that is merely

incidental to the performance of plaintiff's preexisting obligations—is a well-established principle of California law. (See, e.g., 1 Witkin Summary of Cal. Law, § 1020 ["It is even more obvious that, where the plaintiff acts in performance of his or her own duty or in protection or improvement of the plaintiff's own property, any incidental benefit conferred on the defendant is not unjust enrichment."].) The commentary to Section 106 is highly instructive:

> A and B are adjoining mine owners whose mines have been flooded by seepage from a near-by swamp. . . . C had contracted to keep water out of A's mine, and he drains the swamp in the performance of his duty to A. C is not entitled to contribution from B.

(Rest., Restitution, § 106 cmt.) Just like party C in this illustration, Hartford had contracted to pay the Insureds' defense costs. (1 AA 8-9.) Under Section 106, any incidental benefit to Squire Sanders from this contractual arrangement cannot serve as the basis for a valid claim in quasi-contract, as the Court of Appeal recognized in *California Medical Association, Inc. v. Aetna U.S. Healthcare of California* (2001) 94 Cal.App.4th 151 (*CMA*).

In *CMA*, the plaintiffs, a group of physicians, sought restitution from defendant health-plan operators, who had bargained with certain plan administrator intermediaries to pay participating physicians for

their services. (*Id.* at pp. 156-158.) The plaintiffs did not, however, enter into contracts with the defendant health-plan operators themselves—rather, the plaintiffs entered into express contracts only with the intermediaries who would actually make payments to them. (*Ibid.*)

Even though no contract existed directly between the plaintiffs and the defendants in *CMA*, the Court of Appeal properly rejected the plaintiffs' claim for restitution because "any benefit conferred upon defendants by [plaintiffs] was simply an *incident to* [plaintiffs'] performance of their own obligations to Intermediaries under the Intermediary-Physician Agreements." (*Id.* at p. 174, italics added, citing Rest., Restitution, § 106; see also *Dinosaur Development, Inc. v. White* (1989) 216 Cal.App.3d 1310, 1313-1314; *Major-Blakeney Corp. v. Jenkins* (1953) 121 Cal.App.2d 325, 340-341.) Because the plaintiffs entered into contracts with the intermediaries in which the plaintiff physicians agreed to provide medical services to the health plan defendants' members, the fact the health plans may have incidentally benefitted "[wa]s not unjust enrichment." (*CMA, supra*, 94 Cal.App.4th at p. 174.)

Federal courts have also applied this limitation on the otherwise amorphous reach of quasi-contract. In *Oregon Laborers-Employers Health & Welfare Trust Fund v. Philip Morris, Inc.* (9th Cir. 1999) 185 F.3d 957 (*Oregon Laborers*), for example, the Ninth Circuit relied on similar logic, invoking Section 106 to reject an analogous quasi-contractual claim. There, the plaintiffs were health care providers obligated to pay the health care costs incurred by individual plan members. Some plan members suffered from cancer, possibly resulting from years of smoking. (*Id.* at p. 961.) The plaintiff health care providers sued defendant cigarette manufacturers seeking restitution for the costs of cancer treatment for these individuals. (*Ibid.*)

The Ninth Circuit rejected the plaintiffs' claim for restitution, concluding that any benefits defendant cigarette manufacturers received from plaintiff health care providers (by virtue of not having to pay for smoking-related injuries for which they may otherwise have had to pay) was simply incidental to the plaintiffs' performance of their contractual obligations to their plan members. (*Id.* at pp. 968-969 ["Moreover, because plaintiffs had an independent obligation to pay the smokers' medical expenses, they cannot maintain an action

for unjust enrichment against defendants just because defendants were incidentally benefitted."].)[13]

Both *CMA* and *Oregon Laborers* thus recognized an important limitation on the "traditional principles of restitution" that Hartford invokes. (AOB at p. 40.) Where a plaintiff is contractually obligated to perform a duty, and in so doing incidentally benefits a third party, the plaintiff is not entitled to recover in quasi-contract for conferring that incidental benefit. This limitation on quasi-contract applies in full force here. Hartford argues that it conferred a benefit on *Cumis* counsel in the form of defense fees and costs. But just like the physicians in *CMA* and the health plans in *Oregon Laborers*, any benefit to *Cumis* counsel was simply *incidental to* Hartford's performance of its independent contractual obligations to the Insureds. Hartford cannot now seek restitution from Squire Sanders based on the amount of the benefits that Hartford previously agreed to pay for. To the extent that an insurer contests its obligation to pay defense

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[13] (See also *Santa Clara Valley Water Dist. v. Olin Corp.* (N.D.Cal. 2009) 655 F.Supp.2d 1048, 1065 [holding that a water district could not seek restitution of costs of recharging groundwater, as any benefits were incidental to the district's statutory obligation to ensure adequate water supply].)

costs and fees, its dispute lies with its own insureds—the parties with whom Hartford negotiated the obligation in the first place—and not the insureds' counsel.

3. Hartford Cannot Recover In Quasi-Contract For Conduct Covered By An On-Point Express Contract.

In declining to allow claims of restitution or quasi-contract to proceed where the claim is premised on conduct covered by an express contract, courts have long concluded that it would be inappropriate to revise the bargain struck by the parties under the court's after-the-fact assessment of what is "fair" and "just." Here, Hartford and the Insureds bargained for their contract, which defines the parameters of Hartford's duty to defend, and the Insureds and *Cumis* counsel bargained for their contract, which sets out the billing rates and other financial terms of Squire Sanders' engagement as *Cumis* counsel. Hartford should not be permitted to disrupt and revise the terms of these express contracts after the fact.

It is well-established that where two parties enter into a contract that governs a particular issue, those parties cannot recover in quasi-contract for conduct falling within the scope of that bargained-for issue. (See generally 55 Cal.Jur.3d, Restitution, § 5 ["A plaintiff may

not . . . pursue or recover on a quasi-contract claim if the parties have an enforceable agreement regarding a particular subject matter."].)[14]

"The reason for the rule is simply that where the parties have freely, fairly and voluntarily bargained for certain benefits in exchange for undertaking certain obligations, it would be inequitable to imply a different liability . . . ." (*Wal-Noon Corp. v. Hill* (1975) 45 Cal.App.3d 605, 613.) Further, as the court explained in *Hedging*, this limitation is necessary because quasi-contract "is an equitable theory which supplies . . . implicitly missing contractual terms. Contractual terms are not implicitly missing when the parties have agreed on express terms regarding that subject." (*Hedging, supra*, 41 Cal.App.4th at p. 1419.) As a result, "[w]hen parties have an actual contract covering a subject, a court cannot—not even under the guise of equity jurisprudence—substitute the court's own concepts of

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[14] (See also *Lance Camper Mfg. Corp. v. Republic Indem. Co.* (1996) 44 Cal.App.4th 194, 203 ["[A]n action based on an implied-in-fact or quasi-contract cannot lie where there exists between the parties a valid express contract covering the same subject matter."]); *Hedging Concepts, Inc. v. First Alliance Mortgage Co.* (1996) 41 Cal.App.4th 1410, 1419 (*Hedging*) ["[T]here is no equitable basis for an implied-in-law promise to pay reasonable value when the parties have an actual agreement covering compensation."].)

fairness regarding that subject in place of the parties' own contract." (*Id.* at p. 1420.)

The same principle applies even when the parties to the lawsuit did not negotiate a contract between *themselves*. Rather, as the Court of Appeal explained in *CMA*, a plaintiff may not raise a quasi-contractual claim where "the *subject matter* of such claim . . . was governed by express contracts." (*CMA, supra*, 94 Cal.App.4th at pp. 172-173, italics added.) Where, as here, a plaintiff has entered into a contract governing a particular subject, and negotiates for certain rights and obligations as part of that contract, it has no valid claim in equity that the results of that contract are so unjust as to require restitution.

4. Hartford's Proposed Right of Action Would Run Counter To The Well-Established Prohibition Of The Assignment Of Legal Malpractice And Related Claims.

Moreover, affording breaching insurers an unprecedented right to seek reimbursement directly from *Cumis* counsel would effectively assign the *client-insureds*' claims against their counsel (claims that are necessarily different than an insurer's reimbursement claim against its insured, see *ante*, at p. 35, fn. 11) to a third party outside of the attorney-client relationship (i.e., the insurer), and would thus run afoul

of the longstanding prohibition on assigning a client's legal malpractice or related claims to third parties. (See generally *Musser, supra*, 28 Cal.4th at p. 286 [reaffirming the general rule that "legal malpractice claims are not assignable or subject to subrogation absent express statutory authorization"]; *Fireman's Fund Insurance Co. v. McDonald, Hecht & Solberg* (1994) 30 Cal.App.4th 1373, 1383-1384 [same].)

In *Kracht, supra*, 219 Cal.App.3d at p. 1021, the Court of Appeal explicated the reasons for the rule against the assignment of legal malpractice and related claims when a client attempted to assign his claims against his attorneys to a judgment creditor:

> the attorney owes a duty of undivided loyalty and diligence in representing the client. Such duty is personally owed by the attorney and may not be delegated to others, and is owed solely to the client, his one intended beneficiary. Assignability would encourage commercialization of claims, and would force attorneys to defend themselves against persons to whom no duty was ever owed. Moreover, the legal profession is debased by such commercialization, because it could (1) encourage unjustified lawsuits; (2) generate increased malpractice lawsuits, burdening the profession, the court system and (to the extent malpractice premiums would inevitably rise and be passed to the consumers) the public; and (3) promote champerty. [citation] Assignability could conceivably reduce the public's access to legal services, since the ever present threat of assignment by irresponsible clients (seeking quick financial gain) could cause lawyers to evaluate more

> selectively the desirability of representing a particular client.

(*Id.* at pp. 1023-1024.)

Allowing a third-party insurer to bring a claim for reimbursement against an insured's independent *Cumis* counsel would similarly encourage the proliferation of lawsuits against counsel and degrade the attorney-client relationship between insureds and their *Cumis* counsel. (*Ibid.*, see also *Musser, supra*, 28 Cal.4th at p. 287 ["'California courts have consistently held legal malpractice claims are nonassignable to protect the integrity of the uniquely personal and confidential attorney-client relationship'"].) The insurer's interest in minimizing its own financial exposure, even at the expense of the effectiveness of the insureds' representation, may induce insurers to file reimbursement suits against *Cumis* counsel in an attempt to nickel-and-dime independent counsel after the underlying litigation has concluded.

Insurers would obviously have incentives to challenge counsel's conduct even where the insureds may not take issue with their attorneys' performance. In every case, regardless of result, an insurer that is allowed to sue *Cumis* counsel directly for reimbursement may be able to recover some already-spent defense

costs by claiming that *some* decision made or tactic used by counsel in retrospect could be argued not to have been strictly necessary. As a result, Hartford's proposed rule would result in the proliferation of lawsuits against counsel, creating the sort of "satellite litigation" that this Court has disapproved of in the past. (*Haynie v. Superior Court* (2001) 26 Cal.4th 1061, 1075.)

This Court should accordingly reaffirm the longstanding prohibition on the assignment of claims like Hartford's, and prevent insurers from usurping the client's role in deciding whether to challenge their attorneys' conduct.

5. A Breaching Insurer Lacks Standing To Invade The Relationship Between The Client-Insured And *Cumis* Counsel.

Finally, allowing insurers to sue *Cumis* counsel directly for reimbursement of fees associated with defending the client-insureds would also wrest control and decision-making authority out of the hands of the only parties properly entitled to call into question the performance of their attorneys—the client-insureds—and place it in the hands of an interloper (i.e., the insurer). But breaching insurers lack *standing* to raise quasi-contractual claims arising out of *Cumis*

counsel's representation of the client—only the *client* has standing to raise such claims.

This follows from cases such as *Goodley v. Wank & Wank, Inc.* (1976) 62 Cal.App.3d 389, 392, where the Court of Appeal recognized that a third-party not part of the attorney-client relationship lacked "standing to bring [an] action for legal malpractice." The plaintiff there, like Hartford here, lacked standing under well-established principles of contract law: only the contracting parties (the attorney and the client) or an intentional beneficiary of that contract had standing to challenge the attorney-client relationship. "An attorney has but one intended beneficiary, his client [citation], and no one other than plaintiff's assignor was intended to be benefitted by defendants' performance." (*Id.* at pp. 396-397.)[15]

Here, the Insureds contracted with Squire Sanders to represent the Insureds as *Cumis* counsel. Because Hartford breached its duty to

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[15] *CMA* applied this same reasoning in rejecting a quasi-contract claim by a third party seeking to insert itself into a contractual relationship far less fundamental to our legal system than the attorney-client relationship. (*CMA, supra*, 94 Cal.App.4th at p. 173 ["[S]ince [plaintiffs] were strangers to the [contracts], CMA . . . lacks *standing* to the extent it now attempts through its quasi-contract claim either to affirm or to void any portion of those contracts."] [italics added].)

defend the Insureds, it lost the right to negotiate *Cumis* counsel's rates during the course of the Avganim action. (See *ante*, at p. 20.) Under these circumstances, the only party from whom Hartford can properly seek reimbursement of allegedly excessive or unreasonable fees is the party with whom it contracted: the Insureds.

V. CONCLUSION

Despite cloaking its request in the trappings of "traditional principles of restitution," Hartford's proposed direct right of reimbursement from *Cumis* counsel finds no support in such principles and would significantly undermine the Section 2860 and *Cumis* regimes, as well as the incentives and benefits that the Legislature crafted to protect the interests of insureds when they diverge with those of their insurers.

Such a right of reimbursement runs counter to well-settled law precluding recovery in quasi-contract where there is an express contract on point, as well as longstanding limitations on the ability of non-client third parties to sue an attorney for the attorney's work on

behalf of the client. This Court should reject the novel right of quasi-contractual reimbursement that Hartford proposes and affirm the judgment below.

DATED: January 17, 2014

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE PURSUANT TO RULE 8.520(c), CALIFORNIA RULES OF COURT

In accordance with rule 8.520(c), California Rules of Court, the undersigned hereby certifies that this Answering Brief on the Merits contains 10,918 words, as determined by the word processing system used to prepare this brief, excluding the tables, the cover information, the signature block, and the certificates.

Respectfully submitted,

DATED: January 17, 2014

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CERTIFICATE OF SERVICE

I, Christopher C. Ginnaven, hereby certify as follows:

I am employed in the County of Los Angeles, State of California; I am over the age of eighteen years and am not a party to this action; my business address is 333 South Grand Ave., Los Angeles, CA 90071, in said County and State; I am employed in the office of Julian W. Poon of Gibson, Dunn & Crutcher LLP a member of the bar of this Court, and at his direction I caused the **ANSWERING BRIEF ON THE MERITS** to be served on the interested parties in this action (listed below) by:

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I certify under penalty of perjury that the foregoing is true and correct, that the foregoing document(s), and all copies made from same, were printed on recycled paper.

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