



California Insurance Law Alert

Richard Finn

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In a decision filed last month and reported today, the California Court of Appeal has held that an insurer's refusal to pay an insured's independent counsel's excessive fees does not constitute either a breach of contract or bad faith and that the fee dispute was properly submitted to mandatory arbitration under section 2860(c) of the California Civil Code, sometimes referred to as the *Cumis* statute. Here is a thumbnail sketch of the underlying facts in *Behnke v. State Farm General Insurance Company*, 2011 DJDAR 9751:

- the insured tendered a third-party property damage lawsuit to State Farm and hired his own independent counsel who billed at \$295 per hour;
- State Farm agreed to defend its insured subject to section 2860 which limits the fees an insurer is obligated to pay and mandates final and binding arbitration of any fee disputes;
- pursuant to section 2860, State Farm paid the insured's independent counsel at a rate of \$160 per hour;
- the fee dispute was ordered to arbitration in which State Farm was held liable for more than it had paid (\$140,000), but less than the amount claimed by the insured (\$199,000);
- the insured had signed a promissory note, secured by a deed of trust on his home, in favor of his independent counsel for the amount of the fees in excess of what State Farm had paid to the independent counsel;
- independent counsel foreclosed on the insured's home;
- after State Farm paid \$50,000 to settle the underlying lawsuit on behalf of its insured, the insured sued State Farm asserting contract and tort claims based on the insurer's supposed waiver of the hourly-rate protections afforded under section 2860 and on its alleged promise to pay independent counsel's uncapped rates.

This case is noteworthy because it was very early on in the litigation, in fact at the *pleading* stage, that certain of the insured's claims were dismissed while the remainder of the insured's causes of action was dismissed by summary judgment. In sum, the Court of Appeal held that the insured's breach of contract claim was without merit because 1) State Farm satisfied its contractual obligations by providing a defense under section 2860; 2) State Farm had a right to pay only reasonable rates to independent counsel; 3) the rate dispute was properly resolved through arbitration; and 4) the foreclosure instituted against the insured's property was not a form of damage that could be attributed to the insurance policy issued by State Farm.

Of equal note is the fact that the insured was not allowed to parlay the insurer's decision to pay reduced counsel rates pursuant to section 2860 into a breach of contract claim. Our recent experience in handling and litigating independent counsel rate disputes includes instances in which the insured has argued that the decision to pay less than the full rates billed by independent counsel—a decision which is supported by the authority of California Civil Code section 2860-- amounts to a breach of an insurer's duty to defend "fully" and "entirely." In other words, insureds have argued that we must first pay the full hourly rate upfront and, only afterwards, seek a reduction through the arbitration process, in essence turning the *Cumis* statute on its head. This case comes as a welcome response to those efforts. In the words of the *Behnke* Court: "...in light of the strong legislative policy favoring arbitration of *Cumis* counsel fee disputes expressed in the mandatory arbitration provision of section 2860(c), the fee dispute between [independent counsel] and State Farm cannot be a basis for a fraud or promissory fraud claim without a factually specific allegation that State Farm represented or promised that it would not dispute the amount of [independent counsel's] fees or that it waived its right to arbitrate the fee dispute under section 2860(c), a right that it had expressly reserved in writing."

Richard Finn has practiced law for over 25 years. His experience is informed by the range of cases handled throughout his career. These have included toxic torts, product liability, commercial litigation, catastrophic personal injury, construction defect and medical malpractice. He can be reached at 510.835.6821 or rfinn@burnhambrown.com.