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BAD FAITH BLOG

Cumis Counsel's Sanctionable Conduct Precluded Bad Faith Award/Supported Insurer's Reimbursement Claim

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Veterinarians sued insurers for an allegedly improper defense under a professional liability insurance policy. The insurers filed a counterclaim seeking reimbursement. After the matter was sent to arbitration, the arbitration award did not include a finding that the insured's *Cumis* counsel charged fees which were "reasonable and necessary." In view of the failure to find that the insurer had improperly withheld the full amount of the fees and the further finding that the sanctions imposed for breach of a protective order, precluded a finding of coverage under California law and gave rise to a claim for reimbursement by the professional liability insurer.

Wallis v. Centennial Insurance Company, et al., 2013 WL 6000974 (E.D. Cal. 2013)

Dr. Dale Wallis was a research veterinarian licensed to practice veterinary medicine in California. She was insured under a professional liability insurance trust through Centennial Insurance Company, one of the Atlantic Mutual companies. Dr. Wallis filed suit against a former employer which in turn filed suit against her, the president of her veterinary practice, and the veterinary practice itself on multiple theories. Although Centennial agreed to provide a defense to the counterclaims under a reservation of rights, it was required to also retain independent *Cumis* counsel of her choosing. Wallis chose Attorney Mendoza as her *Cumis* counsel, in part because she had been prosecuting the action against her former employer. Dr. Wallis obtained a non-final Judgment of $2 million in compensatory damages and $500,000 in punitive damages when billing issues regarding Attorney Mendoza arose.

Attorney Mendoza was advised that the failure to do timely reporting and the submission of consistently high bills were issues with the billings to that point. The insurance company paid Attorney Mendoza and/or her firm more than $1.75 million and, although retained initially by Dr. Wallis and her practice, Dr. Wallis never paid her anything for prosecution of her claims.

A discovery referee was appointed and recommended the imposition of sanctions against Dr. Wallis and Attorney Mendoza for violation of a protective order and also awarded sanctions of more than $43,500. Eventually, a final Judgment was entered whereby the $1.945 million compensatory, $500,000 punitive, and $671,000 equitable damages awards to Dr. Wallis were set off against the $2 million settlement amount payable to her former employer.

While the underlying claim was being fully resolved, Dr. Wallis and her co-plaintiffs filed an action against Centennial for breach of the duty to defend and breach of the implied covenant of good faith and fair dealing. When the insurers responded, they filed counterclaims challenging the reasonableness of *Cumis* counsel's fees, as well as a duty to indemnify or defend plaintiffs for breach of the protective order. The insurers separately sued Mendoza seeking a reimbursement of all sums paid for Mendoza to defend against the motion for sanctions. The trial court granted insurers' motion to compel arbitration on the *Cumis* counsel attorney's fees issue.

Plaintiffs initially claimed that the insurers had breached their contract through their delay and reduction of plaintiffs' counsel's fees which arguably constituted a breach of the duty to defend. The court concluded that there was no such breach of the duty to defend and, alternatively, that even if there had been such a breach, no damages resulted.

Under California law, *Cumis* counsel is required to be paid "only those fees equivalent '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.'" Furthermore, California law requires the resolution of disputes about *Cumis* counsel reimbursement to be resolved by binding arbitration.

In some extreme examples of failing to pay or paying only a minuscule amount of the fees billed the courts have found that the insurer forfeited the right to arbitrate under the statute. However, the extreme examples where arbitration was deemed waived by the insurer's failure to appropriately pay to defend did not exist in the *Wallis* case. The court concluded that because Attorney Mendoza had received "a substantial amount of funding … the deficiencies in payments did not rise to the level of a breach of defendants' duty under the insurance contract, and defendants did not forfeit their right to arbitrate the fee dispute." Absent a finding by the arbitrator that the insurers, who had paid over $2.7 million of the fees billed and had not paid roughly $1.29 million (including interest on unpaid fees), that withholding "cannot serve as a basis for plaintiff's breach of contract and bad faith claims here."

In arriving at that finding, the district court relied on *Behnke v. State Farm* which held that a "breach of contract claim for unpaid fees depended on arbitrator's determination of what fees were reasonable and, after payment of that reasonable amount, granted summary judgment to the insurance carrier." Even though Dr. Wallis and the other insureds contended they owed Attorney Mendoza the sums billed, absent an arbitration award for the reasonable amount due, there was no such obligation by anyone. The court noted that other attorneys had worked as co-counsel alongside Attorney Mendoza and all of their fee bills had been fully paid.

Similarly the district court found the insurance companies had not "engaged in bad faith" because there was no finding that they unreasonably withheld any benefits under the policy. Furthermore, even if the plaintiffs could show some bad faith, they failed to show that they sustained any damages as a result of bad faith.

Similar to other states, in order to show a breach of the implied covenant of good faith and fair dealing under California law, the plaintiff has to show that benefits due under the policy were withheld and the withholding was "unreasonable or without proper cause." As an initial matter, the district court concluded the plaintiffs had not proven a breach of contract and for that reason alone they had not shown they were due any benefits under the policy which had been improperly withheld. Alternatively, the district court concluded that if there was some denial of benefits under the policy there was no showing by a preponderance of the evidence that "the reason for withholding benefits was unreasonable or without proper cause." The benefits arguably due were the withheld *Cumis* counsel fees previously addressed by the district court on the breach of contract claim. Because the reasonableness of the amounts billed was solely within the province of the arbitrator and that arbitrator had not issued his decision, the district court judge could not make a determination without engaging in improper speculation. Accordingly, the refusal to pay the additional "balance of $1,288,039.46 owed" above the more than $2 million paid, could not "serve as a basis for plaintiff's claim of bad faith."

The plaintiffs had argued that the insurers had "acted unreasonably by forcing plaintiffs to accept a settlement" on the cross-claim despite Dr. Wallis' preference to "seek vindication" which could happen only by continuing the litigation. The district court initially noted that most likely that issue was not even properly before the court. If it was, multiple attorneys had testified that resolving the cross-claim as they did potentially saved Dr. Wallis and her co-plaintiffs from an adverse judgment of between $15 and $20 million. Faced with such a consequence, a settlement was the superior and proper course of action.

Importantly, "Dr. Wallis testified at trial that she made her own educated decision to settle the cross complaint, in an effort to protect herself against the prospect of significant liability." The district court further noted Dr. Wallis was a strong willed individual and the court did not believe she "could be coerced into any decision." In light of the insurers' nearly two year period of insolvency and other factors mentioned above, as well as ongoing differences between Attorney Mendoza and other counsel for plaintiffs, the record did not show the reductions in payments in any way affected the way Dr. Wallis and her co-plaintiffs/counter defendants were defended. The district court further concluded the plaintiffs "have completely failed to prove any damages as a result of defendants' alleged bad faith." There had been no damages in view of the fact that it was the insurers who ultimately paid the full amount of the settlement on the counterclaim. The district court further noted it was entirely speculative to contend that "had Mendoza received full funding from the insurers, she would have maintained the lead in litigating the defense of the cross complaint and would have heeded Dr. Wallis' wishes not to settle, resulting in a successful defense verdict on the cross complaint and no offset." The district court doubted a full funding of Attorney Mendoza would have led to a different result. The failure to show by a preponderance of the evidence plaintiffs had suffered any actionable harm much less that the insurers had "actually committed bad faith by unreasonably withholding policy benefits" caused the district court to enter judgment in favor of the insurers on the bad faith claim.

The district court denied the insurers' counterclaim seeking a declaration the attorney fees in question were unreasonable because the issue was squarely within the province of the arbitrator. However, the counterclaim to require Attorney Mendoza to reimburse the insurers for the $43,678 paid to satisfy the sanctions award was a different matter. The district court found the insurers had no duty to defend against the sanctions motion because all California state courts had ruled against plaintiff and Attorney Mendoza on that sanctions award. Accordingly, the district court ruled plaintiffs were required to reimburse the carriers nearly $116,000.

By Anthony Martin

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