

CASE STUDY PREPARED FROM ORIGINAL PUBLISHED OPINION

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Alternative Dispute Resolution

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***Janopaul + Block Companies, LLC v Superior Court* 11/17/11**

Civil Code section 2860; “*Cumis* Counsel”; Timing of Bad Faith Claim vs. Fee Dispute

Janopaul owned the historic El Cortez Hotel in San Diego, which it planned to restore. In 1998, it contracted with St. Paul’s named insured, The Sundt Companies, to serve as general contractor for the project. Sundt agreed under an express indemnity provision to defend Janopaul for claims arising from Sundt’s work. In 2006, the El Cortez Owner’s Association sued Janopaul for construction defects at the El Cortez project. Janopaul timely requested that Sundt defend and indemnify it in the action. When Sundt failed to do so, Janopaul cross-complained for breach of express indemnity and other claims.

Janopaul retained Golub to represent it. In May 2006, Golub tendered Janopaul’s defense and indemnity to St. Paul. The tender identified a series of insurance policies issued by St. Paul for work on the El Cortez project, and requested a response within 20 days. When St. Paul responded, it stated that it was unable to “either decline or accept all or part of this tender.” It asked for numerous documents, most of which were likely available to Sundt, concerning the project. In response, Janopaul provided the information in July 2006, and followed up in December 2006, October 2007, and May 2008.

On July 8, 2008, more than 2 years after the original tender, Janopaul informed St. Paul that it intended to sue St. Paul for bad faith because of its failure to respond since the May 2006, tender. Janopaul included a draft complaint, asserting tort and contract causes of action, which it threatened to file if St. Paul did not respond conclusively within 30 days. Three days later, St. Paul agreed to defend Janopaul under a reservation of rights, and agreed to provide

Janopaul “*Cumis*” counsel.” St. Paul noted the provision for independent counsel at Civil Code section 2680, where the outcome of coverage issues might be controlled by counsel. It agreed to contribute to Janopaul’s defense at the rate of \$150 an hour for partners, \$135 an hour for associates, and \$75 an hour for paralegals. St. Paul stated in its reservation of rights letter that it was not obligated to pay for fees and costs incurred in prosecuting the claim against Sundt, and it only agreed to pay fees and costs that were “reasonable and necessary” to Janopaul’s defense.

In August 2009, St. Paul notified Golub it was reviewing invoices submitted for defending Janopaul. St. Paul and Golub had met in January 2009 regarding the carrier’s concerns over Golub’s alleged “objectionable billing practices” which did not appear reasonable or necessary. St. Paul stated that Golub had not changed its billing practices since the meeting, making it difficult to confirm whether the time it spent on various tasks was reasonable and necessary in the defense of Janopaul. It also disputed Golub’s hourly rates.

St. Paul invoked its alleged right to arbitrate under subdivision (c) of section 2860, claiming there was a “dispute concerning attorney fees” between the parties. It claimed the dispute “must be submitted to a single auditor for resolution.” It sought to determine the applicable hourly rate, whether the fees submitted by Golub were reasonable and necessary to the defense of Janopaul, and whether St. Paul had a reimbursement right against Janopaul for overpayment of defense fees. Janopaul and Golub refused to arbitrate, and St. Paul filed a petition to arbitrate. Golub filed a motion to dismiss the petition, arguing that St. Paul had breached the insurance contract and engaged in bad faith, and that it had forfeited and/or was stopped to assert its alleged right to compel arbitration and set rates for independent counsel.

The trial court denied the motion to dismiss and granted the petition to compel arbitration, noting that St. Paul had agreed to defend the entire action. Janopaul argued that under *Intergulf Development v Superior Court* (2010) 183 Cal.App.4th 16, St. Paul’s breach of the insurance contract had to be adjudicated first, but the trial court disagreed. The court ordered the parties to arbitrate the fee issues, but also asked for supplemental briefing regarding the fee questions and set a further hearing. Before the briefing was completed, Janopaul filed a

“bad faith” action against St. Paul alleging causes of action for breach of contract, tortious breach of the implied covenant of good faith and fair dealing and declaratory relief. The trial court affirmed its earlier “tentative” order granting St. Paul’s motion to petition to compel arbitration. Janopaul challenged the trial court’s ruling by filing a petition for writ of mandate, supersedeas or other relief and a request for stay. The Fourth District Court of Appeal issued a stay and an order to show cause.

The Justices stated that the scope of section 2860 and its arbitration provision, presented a question of law, subject to independent review. (*Compulink Management Center, Inc. v St. Paul Fire & Marine Ins. Co.* (2008) 169 Cal.App.4th 289) Section 2860(c) provides in part: “Any dispute concerning attorney’s fees not resolved by [an alternative procedure set forth in the policy] shall be resolved by a final and binding arbitration by a single neutral arbitrator selected by the parties to the dispute.” Here, Janopaul contends that the complaint is about the bad faith and breach of duty/contract by the carrier. St. Paul contends the suit involves a dispute concerning attorney fees between an insurer and *Cumis* counsel.

The 4th DCA noted the complaint filed by Janopaul does allege breach of contract and bad faith by St. Paul when it waited over two years to accept the tender of defense and nearly three years to begin paying for that defense. It claims St. Paul forfeited, waived, and/or is estopped from asserting all rights under the policies of insurance, including section 2860 rights. Janopaul cited *Intergulf Development*, for the proposition that an unreasonable delay in paying policy benefits is an actionable withholding of benefits which may constitute a breach of contract as well as bad faith giving rise to damages in tort. The general measure of damages for breach of duty to defend consists of the insured’s cost of defense in the underlying action, including attorney fees. Breach of duty to defend also results in the insurer’s forfeiture of the right to control defense of the action or settlement, including the ability to take advantage of the protections and limitations set forth in section 2860. (*Intergulf*, at p. 20)

The Justices observed that when Janopaul filed its bad faith action for breach of contract, tortious breach of the implied covenant of good faith and fair dealing and declaratory relief, it put St. Paul on notice that it was treating St.

Paul's delay in accepting Janopaul's tender as a "total breach of the duty to defend." Because issues regarding the duty to defend, breach and bad faith in connection with Janopaul's tender must be decided in the trial court (See Intergulf, at p. 22; Buss v Superior Court (1997) 16 Cal.4th 35) and because these issues had not been resolved before the trial court granted St. Paul's motion under section 2860(c), the 4th DCA concluded the trial court erred when it prematurely stayed the bad faith case and ordered the parties to arbitrate their "fee dispute." As numerous courts have recognized, "to take advantage of the provisions of section 2860, an insurer must meet its duty to defend and accept tender of the insured's defense, subject to a reservation of rights." (See Atmel Corp. v St. Paul Fire & Marine (N.D. Cal. 2005) 426 F. Supp.2d 1039)

The Appellate Court rejected St. Paul's argument that Janopaul filed a "retaliatory bad faith complaint to avoid section 2860 arbitration and insulate Golub's excessive fees from judicial scrutiny." Instead, the Court's decision merely requires a preliminary determination whether St. Paul had a duty to defend Janopaul, and if so, whether St. Paul breached that duty and engaged in bad faith conduct. If the dispute is found in St. Paul's favor, the claim ultimately boils down to the amount of attorney fees St. Paul owes for Janopaul's defense. At that point Golub's fees would be subject to judicial scrutiny, which is only postponed by determination of the threshold questions of duty to defend, breach and bad faith.

St. Paul also argued the Justices would be unnecessarily expanding Intergulf. That case involved an insurer waiting 8 months to accept a tender of defense and refusing to appoint Cumis counsel in the underlying construction defect case. The insured filed a bad faith action, and shortly before trial, the insurer moved to compel arbitration under subdivision (c) of section 2860. As in this case, the insurer argued the insured's counsel had charged excessive legal fees. Relying on Compulink Management Center, Inc. v St. Paul Fire & Marine Ins. Co. (2008) 169 Cal.App.4th 289, the trial court granted the petition to arbitrate fees. Thereafter, the California Supreme Court issued an order following the insured's writ of mandate, to show cause why the relief sought should not be granted. The writ was returned to the intermediate Appellate level which found that unlike Compulink which involved only a fee dispute, Intergulf involved preliminary questions of the duty to defend and the right to independent counsel. Compulink

was merely a dispute over the amount to be paid independent counsel, as the insurer had allowed the insured to select independent counsel.

Here, the Justices agree that under both Compulink and Intergulf, where the dispute is over the amount of Cumis counsel fees owed in the defense of the insured in a third party suit, that dispute must be resolved by arbitration under section 2860. However, when, as here and in Intergulf, an insured raises in a bad faith action the duty to defend, breach and bad faith by the insurer, those issues must be resolved first, before an arbitration, because a determination of one or more of those issues in favor of the insured may eliminate altogether the need for a fee arbitration under section 2860. The focus here, as in Intergulf, is the timing of the arbitration in the context of a bad faith action, which was not the issue in Compulink.

A writ shall issue directing the trial court to vacate its order granting St. Paul's motion to compel arbitration in connection with its arbitration petition and enter a new order denying that motion to compel. Janopaul, as petitioner, is entitled to its costs in this writ proceeding.

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