

Amounts Awarded Against Former Trustee Termed "Restitution" and Not Covered by Professional Liability Policy

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In an unpublished decision, a California intermediate appellate court has held that: (1) all but one of several monetary judgments against an attorney for misappropriating trust assets were for "restitution," and therefore not covered by the attorney's professional liability policy, and (2) the claimants were only entitled to \$6,000 under the policy because all of the claims against the attorney were "related" and subject to one policy limit, and the remainder of that policy limit had been exhausted by the payment of defense expenses. *McWethy v. California Ins. Guarantee Assoc.*, 2006 WL 1793640 (Cal. Ct. App. Jun. 30, 2006).

From 1974 to 1992, an attorney acted as the personal attorney for an individual who had created a trust. During this period of time, the attorney prepared various testamentary instruments and amendments to the trust and made himself a beneficiary. When the individual died, the attorney distributed \$3.5 million in stock to himself and his daughter. In 1992, the other beneficiaries of the trust filed a petition to void the provision designating the attorney as a beneficiary and to impose a constructive trust on the assets he received from the trust. This action resulted in judgments against the attorney and his daughter totaling more than \$4 million. In 1993, the beneficiaries filed a second petition to recoup amounts paid out of the trust for attorneys' fees and tax losses caused by the distribution of assets.

Starting in the late 1980s, an insurer issued a series of professional liability policies to the attorney. The policies provided that the insurer would pay "all sums...which the insured shall become legally obligated to pay as damages." The policies also provided that "damages" did not "include fines or statutory penalties, or sanctions whether imposed by law or otherwise, nor the return of or restitution of legal fees, costs, and expenses."

In the instant action, the trust beneficiaries filed suit against the California Insurance Guarantee Association to recover \$500,000 in policy limits for each of two "claims": the 1992 and 1993 petitions. The intermediate appellate court first rejected the beneficiaries' contention that the amounts for legal fees that were refunded to the trust were covered damages because "[t]he policy's definition of 'damages' expressly excludes 'the return of or restitution of legal fees.'"

The court then rejected the beneficiaries' assertion that the \$4 million judgment on the 1992 petition constituted "damages" because it "awarded money to repay the other trust beneficiaries for the detriment suffered from [the attorney's] acts." Instead, the court concluded that the amount awarded was "restitution" because the award recognized that the attorney obtained the stock through fraudulent means and it "in essence seeks disgorgement of the benefits the [attorneys] wrongfully obtained."

Relying on *Bank of the West v. Superior Court*, 2 Cal. 4th 1254 (1992), the court noted California's public policy against insuring amounts paid as restitution because "[a]llowing attorneys to shift responsibility for a judgment requiring disgorgement of ill-gotten gains to a malpractice insurer would only encourage defalcations and reward wrongdoing."

Next, the court rejected the beneficiaries' contention that the two petitions alleged multiple distinct claims under two different policies because both policies provided that "[r]elated acts, errors or omissions shall be treated as a single claim." Relying on *Bay Cities Paving & Grading, Inc. v. Lawyers' Mutual Insurance Co.*, 5 Cal. 4th 854 (1993), the court held that the claims asserted in the two petitions "were both logically and causally related" because they were each "part of a single plan to obtain for himself and his daughter a large share of the...estate."

Finally, the court held that the trial court did not err in concluding that only \$6,000 in policy limits remained available for the beneficiaries, as opposed to an additional \$134,000 that the beneficiaries sought, because: (1) one portion of the amounts paid for defense costs that the beneficiaries sought to discount were legitimate defense expenses incurred by the attorney's counsel in defending the actions and (2) the record was insufficient to determine whether the remaining amounts, which were paid to a different law firm, were amounts expended for "co-counsel" or "supervisory counsel."