

STATE OF MICHIGAN
IN THE 17th CIRCUIT COURT FOR KENT COUNTY

PHILADELPHIA INDEMNITY INSURANCE
COMPANIES, a foreign corporation,

Plaintiff,

vs.

VARNUM, RIDDERING, SCHMIDT &
HOWLETT LLP, a limited liability
partnership, a/k/a VARNUM LLP,

Defendant.

Case No. 12-03362-NMB

HON. CHRISTOPHER P. YATES

OPINION AND ORDER DENYING DEFENDANT VARNUM'S MOTION
FOR SUMMARY DISPOSITION REGARDING EQUITABLE SUBROGATION

This legal-malpractice action against a venerable Grand Rapids law firm requires the Court to address the ability of Philadelphia Indemnity Insurance Companies (“Philadelphia Insurance”) to step into the shoes of its insured under the doctrine of equitable subrogation. In an underlying civil case in the United States District Court for the Western District of Michigan, a couple from Virginia obtained a substantial settlement from Bethany Christian Services (“Bethany”) for a flawed adoption. After paying the full amount of the settlement on behalf of Bethany, Philadelphia Insurance launched this malpractice action against Defendant Varnum, Riddering, Schmidt & Howlett LLP (“Varnum”) for allegedly negligent representation of Bethany. Varnum has moved for summary disposition on the theory that Philadelphia Insurance may not invoke the doctrine of equitable subrogation to take up the cudgels in place of its insured. But because the Court concludes that Philadelphia Insurance has the right to go forward in Bethany’s stead against Bethany’s former counsel based upon equitable subrogation, the Court must deny Varnum’s request for summary disposition.

I. Factual Background

In moving for summary disposition, Defendant Varnum has cited MCR 2.116(C)(10), which requires the Court to “consider[] affidavits, pleadings, depositions, admissions, and other evidence submitted by the parties in the light most favorable to the party opposing the motion.” See Maiden v Rozwood, 461 Mich 109, 120 (1999). Accordingly, the Court shall set the factual background of this dispute by discussing the record in the light most favorable to Plaintiff Philadelphia Insurance, which has insisted upon its right to proceed on the basis of equitable subrogation.

In 2003, Virginia residents William and Julie Harshaw began the process of adopting a child through Bethany. See Harshaw v Bethany Christian Services, 714 F Supp 2d 771, 774 (WD Mich 2010). The Harshaws ruled out adoption of a child with “moderate to severe medical problems,” see id., but Bethany nonetheless placed a developmentally disabled Russian child with the Harshaws in 2004. See id. at 776. In 2006, the child was diagnosed “with an alcohol/drug-related birth defect, identified as a fetal alcohol spectrum disorder causing neurocognitive and psychiatric abnormalities.” See id. at 778. By 2008, the child’s difficulties were so persistent and acute that the Harshaws filed a lawsuit against Bethany seeking redress on behalf of themselves and the child. See id. at 789.

Shortly after the Harshaws filed suit against Bethany on January 31, 2008, Attorney Perrin Rynders – a partner at Defendant Varnum – sent information about the recently filed complaint to Bethany President William Blacquiere, who in turn forwarded the e-mail message to Jean Nolf, an employee of Bethany’s insurance broker, with the following comments:

Jean below is the complaint filed against Bethany. I have not authorized Perrin [Rynders] to [do] anything on Bethany’s behalf. I am okay with Perrin’s name being passed on to Philadelphia [Insurance] because he knows Bethany and is a quality attorney. However, I am open to working with whoever Philadelphia assigns to this case.

See Exhibit 2 to Varnum’s Brief in Support of Motion for Summary Disposition. On February 6, 2008, Bethany’s insurance broker – Buiten & Associates, LLC (“Buiten”) – sent a “General Liability Notice of Occurrence/Claim” to Plaintiff Philadelphia Insurance with a notation that “insured would like to use Varnum Law, Perrin Rynders” in connection with the pending lawsuit. See Exhibit 3 to Varnum’s Brief in Support of Motion for Summary Disposition.

According to Plaintiff Philadelphia Insurance’s electronic records, the claim against Bethany was “added by Heather Leibring on 02/06/2008” and then “assigned to examiner Tami McLarty” on February 7, 2008. See Exhibit 4 to Varnum’s Brief in Support of Motion for Summary Disposition (Claim Summary/Notes Report at 25). McLarty, who worked as a claims examiner for Philadelphia Insurance, noted at the outset “that the insured is requesting the defense be assigned to Varnum Law (Perrin Rynders)” Id. Approximately two weeks later, on February 22, 2008, McLarty made the written observation that Philadelphia Insurance “would owe a defense” and asked “what defense firm would we want to assign”? Id. (Claim Summary/Notes Report at 24). After two more weeks passed, McLarty noted on March 5, 2008, that “[t]he insured is pushing very hard for us to use this Varnum Firm,” but she “made NO promises.” Id. McLarty closed on that date by asking: “Please advise as to defense counsel” Id. That message elicited a response from Cynthia Lasprogata, the vice-president of claims for Philadelphia Insurance, to the effect that “[i]f you cannot secure [an] extension to answer the complaint,” it would be “ok to send to insured’s counsel for this one time contingent upon acceptable rates and level of experience.” Id. (Claim Summary/Notes Report at 23).

Despite all of the notations and communications, the question of representation for Bethany remained unresolved. Consequently, Defendant Varnum apparently stepped into the breach, much to the displeasure of Plaintiff Philadelphia Insurance. On March 20, 2008, Tami McLarty noted that

Bethany had “arbitrarily and unbenounced [sic] to us, signed a waiver of service of summons through their personal counsel Perrin Rynders @ Varnum. We NEVER gave them permission or authority to accept service.” See Exhibit 4 to Varnum’s Brief in Support of Motion for Summary Disposition (Claim Summary/Notes Report at 23). Finally, on March 24, 2008, McLarty spoke with Attorney Rynders, who “explained that he does a lot of work for Bethany and knows this plaintiff atty pretty well.” Id. Attorney Rynders informed McLarty that “[t]here is an answer due 4/18/08” and promised to send billing-rate information to Philadelphia Insurance. Id.

On April 15, 2008, Attorney Rynders sent a letter to Tami McLarty “via e-mail and first class mail” laying out his relationship with Bethany, his experience with the types of issues presented in the pending lawsuit against Bethany, and the hourly rates customarily charged by Defendant Varnum. See Exhibit 6 to Varnum’s Brief in Support of Motion for Summary Disposition. McLarty failed to respond promptly to Attorney Rynders. On April 16, 2008, William Blacquiere sent an e-mail to Attorney Rynders expressing frustration that he had “not heard from Ms McLarty regarding who is assigned to the case” and that Bethany was “losing a lot of time that could have been used to prepare our response.” See Exhibit 7 Varnum’s Brief in Support of Motion for Summary Disposition. On April 17, 2008, Attorney Rynders sent another e-mail to Tami McLarty explaining that, “given our deadline to file the answer by tomorrow, I’m going to get that document ready to go.” See Exhibit 8 to Varnum’s Brief in Support of Motion for Summary Disposition. But that electronic missive drew no response from anyone at Philadelphia Insurance.

Defendant Varnum apparently obtained an additional extension of the deadline for Bethany to answer because, on April 22, 2008, Attorney Rynders sent yet another e-mail to Tami McLarty advising her that “I need to finalize the answer tomorrow.” See Exhibit 9 to Varnum’s Brief in

Support of Motion for Summary Disposition. Attorney Rynders suggested a conference call later that week. McLarty did not dignify that request with an answer. Two days later, Attorney Rynders sent McLarty an e-mail including “a copy of the answer that was filed yesterday on behalf of the various Bethany entities[.]” See Exhibit 10 to Varnum’s Brief in Support of Motion for Summary Disposition. That e-mail, which Attorney Rynders also furnished to William Blacquiere of Bethany, prompted Blacquiere to write an urgent e-mail to McLarty on April 25, 2008, stating:

Hello Tammy, it has been awhile since we have talked. Given the actions Perrin [Rynders] has taken at your direction I am assuming you have selected him for the attorney on this case. I would like to begin intensive strategy planning for this case with Perrin. Several staff involved in this case are being assigned to different duties and one has left our agency. It is very important to us to start this work now. Also, we would like to explore with the other party a possible settlement which would save everyone time and money. This was initiated by the other party. Please confirm that we can continue our work with Perrin.

See Exhibit 10 to Varnum’s Brief in Support of Motion for Summary Disposition. Remarkably, this e-mail drew no response from McLarty.¹

According to the electronic records of Plaintiff Philadelphia Insurance, on October 27, 2008, the “Defense [was] Assigned.” See Exhibit 4 to Varnum’s Brief in Support of Motion for Summary Disposition (Claim Summary/Notes Report at 22). Curiously, though, no firm is identified in that notation. Instead, a separate notation entered on the following day, October 28, 2008, reflects that “[s]ince case is in Michigan,” Tami McLarty “talked with Mark Zausmer” – an attorney with a firm other than Defendant Varnum – about independent adjusting firms. See id. (Claim Summary/Notes Report at 22).

¹ The electronic records of Plaintiff Philadelphia Insurance reflect no activity whatsoever on the file between March 24, 2008, and August 22, 2008. See Exhibit 4 to Varnum’s Brief in Support of Motion for Summary Disposition (Claim Summary/Notes Report at 22-23).

In December 2008, an administrative assistant at Defendant Varnum sent Tami McLarty an e-mail requesting information about “the billing guidelines for Philadelphia” Insurance. See Exhibit 11 to Varnum’s Brief in Support of Motion for Summary Disposition. McLarty responded that the “billing should be done quarterly” and “costs should be supported with receipts.” Id. As a result of that exchange, on January 5, 2009, Bethany sent McLarty invoices from Varnum that Bethany had paid on its own initiative throughout 2008. See Exhibit 12 to Varnum’s Brief in Support of Motion for Summary Disposition. Although the record does not conclusively establish whether Philadelphia Insurance ever compensated Bethany for the \$48,144.45 that Bethany paid to Varnum for attorney fees in 2008,² the record leaves no doubt that Varnum began billing Philadelphia Insurance directly in November of 2008 and, by December 1, 2009, Varnum had an unpaid balance of \$638,407.64. See Exhibit 13 to Varnum’s Brief in Support of Motion for Summary Disposition. McLarty assured Varnum on February 26, 2009, that she was “auditing the bills” and would “be requesting authority next week,” see Exhibit 14 to Varnum’s Brief in Support of Motion for Summary Disposition, but months passed without any action.

In May 2009, Dolores Blubaugh of Plaintiff Philadelphia Insurance began looking into the attorney-fee issues. See Exhibit 4 to Varnum’s Brief in Support of Motion for Summary Disposition (Claim Summary/Notes Report at 22). As the attorney-fee dispute blossomed into a major conflict between Varnum and Philadelphia Insurance, Varnum continued to serve as counsel for Bethany in the Harshaw federal-court litigation. On November 30, 2009, Philadelphia Insurance vice-president Cynthia Lasprogata discussed the “matter with Mark Zausmer” and started to “secure authority to

² E-mail correspondence from June 2011 strongly suggests that Bethany had not yet received any reimbursement for the attorney fees it had paid to Defendant Varnum in 2008. See Exhibit 18 to Varnum’s Brief in Support of Motion for Summary Disposition.

engage atty to protect interests of [Philadelphia Insurance] against bad faith” See id. (Claims Summary/Notes Report at 19).

By February 2010, Plaintiff Philadelphia Insurance was not only contesting the attorney-fee requests of Defendant Varnum, but also paying Attorney Zausmer tens of thousands of dollars for work on the matter. See Exhibit 4 to Varnum’s Brief in Support of Motion for Summary Disposition (Claim Summary/Notes Report at 14).³ Ultimately, on March 18, 2010, Varnum withdrew from its role as counsel for Bethany in the Harshaw case, and Attorney Zausmer’s firm formally assumed the role as lead counsel for Bethany in that litigation.⁴ By all accounts, Attorney Zausmer and his firm ultimately settled the case on behalf of Bethany for approximately \$3.7 million, which Philadelphia Insurance paid as Bethany’s insurer. After satisfying its obligation arising from that settlement in the Harshaw case, Philadelphia Insurance filed this action on April 12, 2012, alleging malpractice on the part of Varnum in its capacity as counsel for Bethany. The Court need not address the merits of that claim at this juncture, however, because the parties have chosen to present a threshold issue as to Philadelphia Insurance’s right to step into the shoes of its insured, Bethany, under the doctrine of equitable subrogation. Specifically, Varnum has moved for summary disposition under MCR 2.116(C)(10), asserting that the Court must bring this case to a close because Philadelphia Insurance

³ A note entered by Terri Courtney on February 15, 2010, states: “Rev Zausmer 2-4-10 inv 29150 for \$40,405.56, req authority to pay.” See Exhibit 4 to Varnum’s Brief in Support of Motion for Summary Disposition (Claim Summary/Notes Report at 18).

⁴ The evolution of Bethany’s representation in the Harshaw case is reflected in the decisions of Chief Judge Paul L. Maloney in that litigation. In a ruling rendered on July 22, 2009, Chief Judge Maloney identified Varnum as the exclusive representative of Bethany. But on December 15, 2009, Chief Judge Maloney listed counsel for Bethany as Varnum and Attorney Mark. K. Zausmer from the firm of Zausmer Kaufman August Caldwell & Tayler, PC. Finally, in an opinion issued May 28, 2010, Chief Judge Maloney simply identified counsel for Bethany as “Cameron R. Getto, Mark J. Zausmer, Zausmer Kaufman August Caldwell & Tayler PC.” See Harshaw, 714 F Supp 2d at 773.

cannot rely upon equitable subrogation. In response, Philadelphia Insurance has asked for summary disposition on the equitable-subrogation issue and the related defense of unclean hands.

II. Legal Analysis

By requesting summary disposition under MCR 2.116(C)(10), Defendant Varnum is testing the factual sufficiency of the complaint. See Maiden, 461 Mich at 120. “Summary disposition is appropriate under MCR 2.116(C)(10) if there is no genuine issue regarding any material fact and the moving party is entitled to judgment as a matter of law.” West v General Motors Corp, 469 Mich 177, 183 (2003). Such a “genuine issue of material fact exists when the record, giving the benefit of reasonable doubt to the opposing party, leaves open an issue upon which reasonable minds might differ.” Id. Here, the parties agree on all of the significant facts, but they disagree about how those facts affect the ability of Plaintiff Philadelphia Insurance to invoke equitable subrogation.

In a plurality opinion, our Supreme Court has explained that defense counsel retained by an insurance company to defend its insured can be held answerable to the insurer for legal malpractice under the doctrine of equitable subrogation. See Atlanta Int’l Ins Co v Bell, 438 Mich 512, 515-516 (1991) (Brickley, J). This approach marks a departure from the traditional view “that only a person in special privity of the attorney-client relationship may sue an attorney for malpractice[.]” id. at 518, so our Supreme Court has prescribed three conditions that must be met before equitable subrogation can be invoked: “(1) a special relationship must exist between the client and the third party in which the potential for conflicts of interest is eliminated because the interests of the two are merged with regard to the particular issue where negligence of counsel is alleged, (2) the third party must lack any other available legal remedy, and (3) the third party must not be a ‘mere volunteer,’ i.e., the damage

must have been incurred as a consequence of the third party's fulfillment of a legal or equitable duty the third party owed to the client." Beaty v Hertzberg & Golden, PC, 456 Mich 247, 254-255 (1997).

The Court shall address each of these three requirements in turn.

With respect to the first requirement, a "special relationship" existed between the client, *i.e.*, Bethany, and the third party, *i.e.*, Plaintiff Philadelphia Insurance as its insurer, in which the interests of the two were "merged with regard to the particular issue where negligence of counsel is alleged."⁵ See Beaty, 456 Mich at 254-255. Here, Bethany and its insurer, Philadelphia Insurance, shared the goal of defeating the Harshaws' suit. As Justice Brickley reasoned, "the interests of the insurer and the insured generally merge" because the "client and the insurer both have an interest in" winning the case. Atlanta Int'l Ins, 438 Mich at 523. And more precisely, with respect to the principal issue upon which the malpractice claim against Defendant Varnum rests – the failure to assert a statute-of-limitations defense, the interests of Bethany and Philadelphia Insurance merged because successful assertion of such a defense would have absolved Bethany and Philadelphia Insurance of all financial responsibility for the Harshaws' adoption. See Beaty, 456 Mich at 255. Consequently, Philadelphia Insurance has satisfied the first requirement for equitable subrogation.

As to the second requirement, Plaintiff Philadelphia Insurance has no available legal remedy against Defendant Varnum other than a malpractice suit under the doctrine of equitable subrogation. Refusal to apply the doctrine of equitable subrogation in the situation presented would "completely absolve a negligent defense counsel from malpractice liability" and "place the loss for the attorney's

⁵ Defendant Varnum has focused on its relationship with Defendant Philadelphia Insurance, rather than Bethany's relationship with Philadelphia Insurance. Our Supreme Court has made clear, however, that the focus must be upon the relationship between the client and the third party, *i.e.*, the client's insurer. See Beaty, 456 Mich at 254 ("a special relationship must exist between the client and the third party").

misconduct on the insurer” because the insurer has no avenue of relief other than a malpractice suit against the attorney. Atlanta Int’l Ins, 438 Mich at 522. Moreover, “because the insurance company, not the client, is required to satisfy a judgment arriving from a defense counsel’s malpractice, the client has no real incentive to sue defense counsel.” Id. at 519. Therefore, Philadelphia Insurance has established that equitable subrogation provides the sole basis for imposing the cost of the alleged malpractice upon the party that should bear that expense. See id. at 523.

Finally, Plaintiff Philadelphia Insurance has satisfied the third requirement by demonstrating that it cannot be characterized as a “mere volunteer” because it paid the full amount of the settlement to the Harshaws for its insured, Bethany. Indeed, as Justice Brickley explained, the insurer bears the financial obligation when liability is imposed upon its insured. See Atlanta Int’l Ins, 438 Mich at 519. That observation applies with special force here because, despite Philadelphia Insurance’s lack of involvement in strategy during the early days of the Harshaw litigation, Philadelphia Insurance had to make the Harshaws whole when their claims resulted in a financial obligation imposed upon Bethany to the tune of \$3.7 million. Therefore, the Court concludes that Philadelphia Insurance has met all three of the requirements for equitable subrogation.

Defendant Varnum makes much of Plaintiff Philadelphia Insurance’s cavalier attitude about legal representation for Bethany at the outset of the Harshaw litigation. To be sure, the actions – or, more accurately, inaction – of Tami McLarty and, to a lesser degree, Cynthia Lasprogata strike the Court as breathtakingly irresponsible. For months, Attorney Perrin Rynders and Bethany President William Blacchiere sent increasingly urgent messages to Philadelphia Insurance that were met with deafening silence. But that lack of response cannot be treated as “unclean hands” sufficient to defeat Philadelphia Insurance’s invocation of equitable subrogation. “The clean-hands doctrine closes the

doors of equity to one tainted with inequity or bad faith relative to the matter in which he or she seeks relief,” Richards v Tibaldi, 272 Mich App 522, 537 (2006), and it has even been applied to defeat the equitable-subrogation theory. E.g., Hocker v New Hampshire Ins Co, 922 F2d 1476, 1488 (10th Cir 1991). But our Supreme Court and Court of Appeals have “observed that a party who has ‘acted in violation of the law’ is not ‘before a court of equity with clean hands,’ and is therefore ‘not in position to ask for any remedy in a court of equity.’” Attorney General v PowerPick Player’s Club of Michigan, LLC, 287 Mich App 13, 52 (2010), quoting Farrar v Lonsby Lumber & Coal Co, 149 Mich 118, 121 (1907). Here, the employees of Philadelphia Insurance may well have acted in a manner that could be characterized as indifferent or negligent, but nothing in the record rises to the level of “unclean hands” under Michigan law.⁶ Accordingly, the Court must reject Varnum’s effort to foreclose, through assertion of the unclean-hands doctrine, Philadelphia Insurance’s reliance upon equitable subrogation.⁷

⁶ The Court’s ruling in this regard does not prevent Defendant Varnum from arguing that the actions or inaction of Plaintiff Philadelphia Insurance may be considered as comparative negligence. Because the parties have not yet developed that issue, however, the Court must reserve ruling on the propriety of such an argument at trial.

⁷ Defendant Varnum not only accuses Plaintiff Philadelphia Insurance of unclean hands, but also asserts that Philadelphia Insurance never even retained Varnum as counsel in the Harshaw case, so Philadelphia Insurance lacks any basis for proceeding with a malpractice claim against a firm that it neither hired nor paid. The record belies this assertion. To be sure, Philadelphia Insurance at first made no long-term commitment to Varnum. See Exhibit 1 to Varnum’s Brief in Support of Motion for Summary Disposition (Tami McLarty Deposition at 96); Exhibit 4 to Varnum’s Brief in Support of Motion for Summary Disposition (Claim Summary/Notes Report at 24). But as the Harshaw case progressed in federal court, Philadelphia Insurance “assigned” the “defense” in October of 2009, see id. (Claim Summary/Notes Report at 22), and engaged in a whole host of activities in the second half of 2009 that reflected Philadelphia Insurance’s acceptance of Varnum as the firm assigned to serve as counsel for Bethany. See id. (Claim Summary/Notes Report at 20). Indeed, a letter from Dolores Blubaugh on behalf of Philadelphia Insurance to Varnum on November 12, 2009, dispels any notion that Varnum had been representing Bethany without the authorization or approval of Philadelphia Insurance. See Binder of Documents Submitted in Conjunction With Oral Argument at 69-70.

III. Conclusion

Although the Court sympathizes with Defendant Varnum and its client, Bethany, because of Plaintiff Philadelphia Insurance's utter failure to communicate about Varnum's role in the Harshaw case at the inception of that litigation, the Court must deny Varnum's summary-disposition motion under MCR 2.116(C)(10) and permit Philadelphia Insurance to proceed with its malpractice claim under the doctrine of equitable subrogation.

IT IS SO ORDERED.

Dated: April 17, 2014



HON. CHRISTOPHER P. YATES (P41017)
Kent County Circuit Court Judge