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Curb your *Cumis* counsel

By Stephen L. Raucher

In a decision that may strike fear into the hearts of lawyers representing policyholder clients as independent counsel, the California Supreme Court recently ruled in *Hartford Casualty Insurance Company v. J.R. Marketing LLC*, 2015 DJDAR 9111 (Aug. 10, 2015), that an insurance company can sue independent counsel directly for reimbursement of "unreasonable and unnecessary charges."

At first blush, *J.R. Marketing* seems to raise a new specter of litigation between insurers and independent (or *Cumis*) counsel over fees incurred for the benefit of counsel's insured clients. Upon closer review, it is perhaps best viewed as being limited to its unique history. Nonetheless, the case has important implications in the area of fee disputes arising between carriers and independent counsel — including potentially helpful language for lawyers in the concurring opinion.

The term "*Cumis* counsel" refers to a situation where an insurance company has a duty to defend its policyholder, but the carrier has reserved the right to contest coverage on a given issue and the outcome of that issue can be controlled by counsel's strategic choices in the underlying litigation. This leaves "panel counsel" normally appointed by the carrier with conflicting duties to its insurer and insured clients.

In such a situation, the policyholder has a right to select its own independent — *Cumis* — counsel to defend the action at the insurance company's expense, albeit at the typically lower rates paid by the insurer in the defense of similar actions. See *San Diego Federal Credit Union v. Cumis Ins. Society Inc.*, 162 Cal. App. 3d 358 (1984). The California Legislature codified and clarified the right to *Cumis* counsel by enacting Civil Code Section 2860, which, among other things, provides for arbitration of fee disputes.

J.R. Marketing differed from the typical *Cumis* situation in several ways — indeed, the fact pattern might be characterized as *sui generis*.

J.R. Marketing was sued for various business torts, including defamation, and tendered the complaint to its commercial general liability carrier, Hartford. When Hartford refused to defend, J.R. Marketing, through its defense counsel in the underlying case, Squire Sanders & Dempsey LLP (now Squire Patton Boggs after merging with Patton Boggs LLP), filed a coverage action.

Although Hartford agreed to defend its insured subject to a reservation of rights, it refused to provide independent counsel. J.R. Marketing then obtained a summary adjudication order in the coverage litigation finding that Hartford had a duty to defend through *Cumis* counsel.

The trial court also entered an "enforcement order" (drafted — as the California Supreme Court notes several times in its subsequent opinion — by Squire Sanders) requiring Hartford to pay all defense invoices within 30 days of receipt. The order also found that, as a result of its breaches of the duty to defend, Hartford was precluded from invoking the provisions of Section 2860, and therefore had to pay Squire Sanders' normal rates. Finally, the order provided that "to the extent Hartford seeks to challenge fees and costs as unreasonable or unnecessary, it may do so by way of reimbursement after resolution of the [underlying action]." Squire Sanders incurred $13.5 million in defense costs in the underlying matter, which were paid for by Hartford pursuant to the enforcement order.

Following the conclusion of the underlying case, Hartford sued not only J.R. Marketing, but also Squire Sanders, for reimbursement on a theory of unjust enrichment. Hartford sought reimbursement for fees, which were "abusive, excessive, unreasonable or unnecessary." The trial court sustained Squire Sanders' demurrer to the reimbursement cause of action on the ground that Hartford had right to reimbursement from its insureds, not directly from *Cumis* counsel.

The Court of Appeal affirmed in a published decision, concluding that allowing a direct action against Cumis counsel for reimbursement would frustrate the policies underlying Section 2860.

In reversing, the California Supreme Court noted that the question it was addressing was narrow and unique: "May an insurer seek reimbursement directly from counsel when, in satisfaction of its duty to fund its insureds' defense in a third party action against them, the insurer paid the bills submitted by the insureds' independent counsel for the fees and costs of mounting this defense, and has done so in compliance with a court order expressly preserving the insurer's post-litigation right to recover 'unreasonable and unnecessary' amounts billed by counsel?"

The state high court said it was not deciding whether (1) absent such an order, an insurer has any direct right against *Cumis* counsel; (2) a dispute over allegedly excessive fees is more appropriately decided in a court action or arbitration; or (3) such fee disputes generally should be decided during or after the underlying litigation. Nonetheless, it did decide that, under the unique procedural posture of this case, Hartford could proceed against Squire Sanders for restitution.

The starting point was *Buss v. Superior Court*, 16 Cal. 4th 35 (1997), in which the Supreme Court had held that where an insurer defends a "mixed" action encompassing both covered and uncovered claims, the insurer can maintain an action against its insured for reimbursement of fees incurred defending uncovered claims after the conclusion of the underlying action. The court employed the equitable principles of restitution and unjust enrichment from Buss against Squire Sanders, finding that the firm would be unjustly enriched if it were able to "retain payments that were unreasonable and unnecessary for the insureds' defense."

The court rejected Squire Sanders' argument that allowing such a restitution claim would undermine the attorney-client privilege and the insured's right to control its own defense through independent counsel in the *Cumis* context. Squire Sanders asserted that the threat of a direct action by an insurer to recover allegedly "unreasonable" fees would chill *Cumis* counsel's zeal and independence.

But the Supreme Court was not convinced, noting that lawyers are often called upon to justify their fees, such as in cases brought under fee-shifting statutes, class actions, probate and bankruptcy. Moreover, it commented that Section 2860 already seems to contemplate that an insurer can institute a direct fee arbitration with independent counsel — an observation which previously had not been the subject of a published decision and which will have broader implications for *Cumis* fee disputes. In any event, Squire Sanders' public policy arguments failed.

The *J.R. Marketing* opinion unrealistically minimizes the chilling effect that the threat of litigation over fees can have on attorneys, particularly where the adversary is an insurer that may have unrealistic expectations regarding the "reasonableness" of bills. However, the concurring opinion by Justice Goodwin Liu offers some solace to *Cumis* counsel. Liu wrote that "it will be Hartford's burden to show not only that the fees it seeks to recover from Squire Sanders were not '*objectively reasonable at the time they were incurred*, under the circumstances then known to counsel'... but also that the fees were not incurred for J.R. Marketing's benefit. If Squire Sanders' fees were unreasonable but incurred primarily for J.R. Marketing's benefit, Hartford's reimbursement action should lie against J.R. Marketing, not Squire Sanders."

Moreover, according to Liu, Hartford should have to overcome a *presumption* that any fees billed — even unreasonable ones — were incurred primarily for the client's benefit. He reasoned that without such a presumption, "counsel will face a conflict between its duty of loyalty to the insured and its understandable desire to avoid liability in a subsequent reimbursement action." Thus, while the *J.R. Marketing* case potentially opens up a new front in the battle over *Cumis* fees, Justice Liu's concurrence at least provides counsel with some weapons to fight back.

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