S211645

IN THE SUPREME COURT OF CALIFORNIA

J.R. MARKETING, L.L.C. et al.,
Cross-Defendants and Respondents,

v.

HARTFORD CASUALTY INSURANCE COMPANY,
Cross-Complainant and Appellant.

AFTER A DECISION BY THE COURT OF APPEAL,
FIRST APPELLATE DISTRICT, DIVISION THREE
CASE NO. A133750

REPLY BRIEF ON THE MERITS

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REPLY BRIEF ON THE MERITS

INTRODUCTION

No one disputes that Hartford has the right to seek the reimbursement of unreasonable and unnecessary attorney fees it paid *Cumis* counsel to defend its insureds. The only question raised by this appeal is whether Hartford may bring a reimbursement action directly against *Cumis* counsel, or whether it may only bring a reimbursement action against the insureds.

Hartford maintains that it has a right to seek restitution directly from Squire Sanders, the *Cumis* counsel that was unjustly enriched by its overpayments. Squire Sanders argues that its clients, not it, should bear sole responsibility for reimbursing Hartford for Squire Sanders's own egregious overbilling. Squire Sanders thus asks the Court to create a new immunity from a direct

reimbursement suit for *Cumis* counsel, putting the burden of its own overcharges solely on its clients, the insureds.

Squire Sanders offers two central public policy arguments to support the immunity it asks the Court to create.

First, it claims that asking *Cumis* counsel to defend the reasonableness of their fees would somehow undermine the attorney-client relationship. Precisely the opposite is true: the attorney-client relationship would be undermined if a law firm could saddle its clients with financial responsibility for its own excessive fees. A reimbursement action in this context focuses on whether *Cumis* counsel billed for *objectively* unreasonable work. It does not require the insurer to pry into attorney-client communications. Moreover, if the purported harms Squire Sanders identifies were real, they would exist in fee dispute arbitrations under Civil Code section 2860 (section 2860) and under Squire Sanders's cumbersome alternative process in which an insurer would sue its insured for reimbursement, who in turn would sue *Cumis* counsel for counsel's excesses.

Second, Squire Sanders argues that holding *Cumis* counsel directly responsible in restitution for its own excesses would cause insurers to breach the duty to defend. Yet any rational insurer would choose to arbitrate disputes contemporaneously under section 2860, rather than for years pay millions of dollars for unreasonable charges only to seek reimbursement when the underlying litigation ends.

In fact, the immunity that Squire Sanders asks this Court to create would undermine important public policies, put insureds in

untenable positions, punish insurers, prolong litigation, and allow *Cumis* counsel to keep ill-gotten profits from unreasonable bills. As shown in Hartford's opening brief and below, it would incentivize law firms to overbill, would leave their insureds-clients on the hook for the law firms' excesses, and could leave insurers with no effective remedy for the law firms' overbilling.

The proceedings in this case illustrate Hartford's point. After the court granted Squire Sanders's demurrer to Hartford's cross-complaint, Squire Sanders continued to represent the insureds. In a two-week trial in which its clients alone faced liability for the reimbursement, Squire Sanders introduced over $13 million in bills that it had sent to Hartford for payment and the testimony of its former partner who led the litigation team and had reviewed the bills for "reasonableness." (See Further Supp. MJN, Declaration of David M. Axelrad, exh. A, pp. 4, 7, 10.) After hearing the evidence, the court concluded that Squire Sanders's billing was not just excessive, but "appalling" (Further Supp. MJN, Declaration of David M. Axelrad, exh. A, p. 13, fn. 9), and determined that Hartford was entitled to almost $5 million in reimbursement before prejudgment interest (Further Supp. MJN, Declaration of David M. Axelrad, exh. A, p. 27)—a judgment that Squire Sanders has left its clients alone to face.

LEGAL ARGUMENT

I. LONG-STANDING LEGAL PRINCIPLES SUPPORT HARTFORD'S RIGHT TO SEEK RESTITUTION DIRECTLY FROM SQUIRE SANDERS.

Restitution is not a "new" cause of action (see ABOM 1, 3, 4); it is one of the oldest. (See Rest., Restitution, Part I: The Right to Restitution, Introductory Note, pp. 5-10.) In *Buss v. Superior Court* (1997) 16 Cal.4th 35, 49-50 (*Buss*), this Court held that an insurer may rely on traditional principles of restitution to recoup payments made in excess of those required by an insurance policy or the law. *Buss* recognized that a party may receive a windfall at the insurer's expense, beyond the requirements of the insurance policy. (*Id.* at pp. 50-51.) To prevent such unjust enrichment, it concluded that "[t]he insurer therefore has a right of reimbursement that is implied in law as quasi-contractual." (*Id.* at p. 51; see OBOM 17-21.)

Like *Buss*, this case involves a windfall at the insurer's expense as a result of imposed-by-law obligations that went beyond the requirements of the insurance policy or law. *Buss* held that "a right [to restitution] runs against the person who benefits from 'unjust enrichment' and in favor of the person who suffers loss thereby." (*Buss*, *supra*, 16 Cal.4th at p. 51.) In *Buss*, that person was the insured, who received legal services not covered in the policy and not required by law. Here, that person was *Cumis* counsel, who received nearly $5 million for the unreasonable fees that it had charged. (See Further Supp. MJN, Axelrad Decl., exh.

A, p. 27.) Squire Sanders does not take direct issue with these principles nor does it challenge the obligation—assumed to be true on a demurrer and now found true by the Superior Court (*ibid.*)—that that it received millions of dollars in excessive fees. Instead, it ineffectively attempts to retain its ill-gotten gains by asking this Court to grant immunity to *Cumis* counsel from an insurer reimbursement action and leave the clients to pay back the money.

II. PERMITTING HARTFORD TO SUE SQUIRE SANDERS DIRECTLY IS CONSISTENT WITH THE PUBLIC POLICY OF THIS STATE.

A. Insurer reimbursement actions against overbilling *Cumis* counsel promote important public policies.

Hartford's post-litigation action for reimbursement directly reinforces professional conduct rules against unconscionable attorney fees. (See OBOM 32-33, discussing Rules Prof. Conduct, rule 4-200(A) [prohibiting attorneys from "charg[ing] or collect[ing] an illegal or unconscionable fee"].) Those rules embody an important public policy that transcends the attorney-client relationship. (See OBOM 32, citing *Bird, Marella, Boxer & Wolpert v. Superior Court* (2003) 106 Cal.App.4th 419, 431.) An insurer's action seeking reimbursement of unconscionable fees against *Cumis* counsel fortifies that public policy. By contrast, immunizing *Cumis* counsel from insurer reimbursement actions seeking to recover

unconscionable fees undermines that policy and is fundamentally unfair. (See OBOM 34-37.)

A client hires a law firm to protect it. Neither the client nor the firm should reasonably expect the client to defend counsel's work or bear liability for counsel's overbilling. Nonetheless, Squire Sanders proposes to do just that, leaving its clients holding the bag for its own misdeeds.

B. Insurer reimbursement actions against overbilling *Cumis* counsel do not undermine other public policies.

1. Reimbursement actions do not encourage insurers to breach the duty to defend.

Squire Sanders wrongly assumes that insurers would prefer reimbursement litigation to section 2860 arbitration and further, that insurers would deliberately breach their duty to defend in the hope that courts would deprive the insurer of the right to statutory arbitration and allow it to bring reimbursement litigation with the "benefit of hindsight." (See ABOM 4, 21, 27-29.)

Any reasonable insurer prefers to resolve billing disputes when they arise, through informal discussions with counsel where possible, and through section 2860 arbitration where necessary. That is far better than paying huge monthly legal bills that it cannot contest for years and only after paying its own lawyer and litigating against the insureds' *Cumis* counsel. (See OBOM 23-26.)

Likewise, no reasonable insurer would adopt a policy of deliberately breaching the duty to defend in order to obtain an (nonexistent) advantage in litigation years later. (See ABOM 16-17.) An insurer adopting such a policy would open itself up to bad faith claims with their significantly greater exposure. Notably, the jury here found that Hartford had not acted in bad faith toward Squire Sanders's clients. (Further Supp. MJN, Axelrad Decl., exh. A, p. 4.)[1]

Squire Sanders's main response is that the insurer would have the "benefit of hindsight" in a post-litigation reimbursement action against an overbilling *Cumis* counsel because it could more easily establish unreasonableness after the fact, when the course of litigation is known. (ABOM 28.) But "reasonableness" is assessed

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[1] Squire Sanders's contention that allowing insurers to bring post-litigation reimbursement actions where section 2860 arbitration is unavailable would frustrate the Legislature's intent to discourage insurers from breaching the duty to defend lacks any support in the text or history of section 2860. Section 2860 is not directed at the duty to defend; it is directed at the duty to provide independent counsel in a conflict-of-interest situation. Indeed, section 2860 was a piece of compromise legislation enacted not only to protect insureds, but also to protect insurers. (See, e.g., Delia M. Chilgren, Assn. of Cal. Ins. Cos., letter to Governor Deukmejian re Sen. Bill No. 241 (1987-1988 Reg. Sess.) Sept. 15, 1987; Cal. Chamber of Commerce, letter to Cal. Assembly re Sen. Bill No. 241 (1987-1988 Reg. Sess.) Sept. 11, 1987.) Cases holding that section 2860 arbitration is unavailable to a breaching insurer do not rely upon the language of the statute or legislative intent of section 2860. (See, e.g., *The Housing Group v. PMA Capital Ins. Co.* (2011) 193 Cal.App.4th 1150, 1155-1158 (*The Housing Group*); *Intergulf Development LLC v. Superior Court* (2010) 183 Cal.App.4th 16, 20.)

objectively: the question is whether bills were reasonable *when incurred.* (See *Aerojet-General Corp. v. Transport Indemnity Co.* (1997) 17 Cal.4th 38, 62 (*Aerojet*) [whether insured's investigation and defense costs were reasonable and therefore within insurer's duty to defend is determined by an objective standard]; *People v. Jones* (2010) 186 Cal.App.4th 216, 235 [objective reasonableness of counsel's conduct judged by counsel's perspective at the time, not hindsight].) The inquiry is the same whether conducted shortly after counsel bills (as with most section 2860 arbitration) or long after (as with a post-litigation reimbursement action).

Indeed, Squire Sanders's argument is belied by its own actions. It sought (and drafted) the Immediate Payment Order to prevent Hartford from challenging its fees until after the underlying litigation had ended. (1 AA 2.) The notion that Squire Sanders worked hard to give its litigation opponent an advantage is self-evidently spurious.

2. Post-litigation reimbursement actions do not threaten *Cumis* counsel's independence.

Squire Sanders argues that "the looming threat of after-the-fact insurer-initiated litigation" will interfere with the independence of *Cumis* counsel that section 2860 was designed to protect. (ABOM 21.) Of course, by taking the position that the insureds should be primarily financially responsible for counsel's overbilling, Squire Sanders is not protecting the insured clients—it is putting its interests ahead of theirs. And Squire Sanders is wrong.

When attorneys provide services for a fee, they know they may be asked to account for the reasonableness of their fees. The fact that a lawyer's bills may be questioned does not create an "intractable conflict," threaten lawyer independence, nor compromise the ability of insureds to find qualified counsel. (See ABOM 1, 14-15, 21, 23.) And just as lawyers in private practice must justify bills to questioning clients, *Cumis* counsel must defend their bills in section 2860 arbitration. The statute provides as much. If the Legislature has determined that *Cumis* counsel can be required to defend the reasonableness of their bills in arbitration under section 2860 without threatening *Cumis* counsel's independence, there is no reason to prohibit a reimbursement action, which is no different.[2] The need to justify the objective reasonableness of their fees is thus not a "looming threat" that leads lawyers to do "less than they should" when representing their clients, as Squire Sanders contends. (ABOM 21, 23.)

Further, under section 2860, insurers challenge bills only after the work has already been performed and bills have already been sent. Indeed, section 2860 says nothing about timing: it does

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[2] Squire Sanders asserts, without authority, that section 2860 arbitrations are "usually brought by the *insured*" and are limited to rates. (ABOM 25, fn 8.) The cases do not support its assertion. (E.g., *Janopaul + Block Companies, LLC v. Superior Court* (2011) 200 Cal.App.4th 1239, 1252 [insurer's motion to compel arbitration under section 2860]; *The Housing Group, supra*, 193 Cal.App.4th at pp. 1152-1153 [same]; *Compulink Management Center, Inc. v. St. Paul Fire & Marine Ins. Co.* (2008) 169 Cal.App.4th 289, 301 [granting insurer's motion to compel arbitration over, inter alia, number of hours billed].)

not require contemporaneous resolution of fee disputes with *Cumis* counsel, and it does not preclude resolution of fee disputes with *Cumis* counsel after the underlying litigation has concluded. Squire Sanders does not explain why a post-litigation reimbursement action undermines *Cumis* counsel's independence any more than the "after-the-fact" challenge endorsed by the Legislature in section 2860.[3]

For the same reason, Squire Sanders's argument that insurers would file reimbursement actions willy-nilly (see ABOM 27-30) cannot survive analysis. An insurer must perform a cost-benefit analysis about whether it makes economic sense to bring a reimbursement action, and that analysis depends on whether *Cumis* counsel's billings were substantially and *objectively* unreasonable—not merely whether some other course would have been preferable.[4] In any event, here too the same argument could be made about section 2860 arbitrations, but the Legislature has already resolved it against Squire Sanders's position.

Again, this case illustrates Hartford's point. The trial court had entered an order that Hartford could seek reimbursement for

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[3] Similarly, Squire Sanders calls for a rule of law in which the insurer could seek reimbursement only from the insured, who would then sue *Cumis* counsel. (ABOM 26, 34; typed opn. 15-16.) Yet that, too, would require *Cumis* counsel to defend its fees in "after-the-fact" litigation. The only difference is that Squire Sanders wants its clients to bear the primary burden of litigating the issue and paying any resulting judgment.

[4] As this Court recognized in *Buss*, an insurer is likely to seek reimbursement only where it would be worthwhile, which is not going to be often. (See *Buss*, *supra*, 16 Cal.4th at p. 58.)

excessive fees after the litigation concluded. (1 AA 2 [Immediate Payment Order].) And the Court of Appeal had not yet erected its blanket immunity for *Cumis* counsel from insurer reimbursement actions when Squire Sanders was defending the insureds. Thus, Squire Sanders knew that it would have to defend the reasonableness of its fees (at least) in an action between Hartford and its clients. Yet Squire Sanders billed more than $13 million in the underlying litigation (Further Supp. MJN, Axelrad Decl., exh. A, p. 10)—hardly chilled by the supposed "looming threat" of accountability. If anything, Squire Sanders's behavior in the face of the Immediate Payment Order shows that it felt itself unconstrained by any legal or ethical limit whatsoever, let alone the possibility of after-the-fact review.

III. THE HYPOTHETICAL POSSIBILITY OF A DUE PROCESS DEFENSE TO *SOME* REIMBURSEMENT ACTIONS PROVIDES NO REASON TO CREATE BLANKET IMMUNITY IN *ALL* REIMBURSEMENT ACTIONS.

Squire Sanders contends that because *Cumis* counsel "may" be unable to defend itself in some reimbursement actions due to the attorney-client privilege, due process requires that *Cumis* counsel have blanket immunity from all reimbursement suits against insurers. (ABOM 30-31.) The argument boils down to this: the insurer should sue the insured client for the lawyer's overbilling,

because the client can waive the privilege but the lawyer cannot. (ABOM 32-33.) The argument fails.

First, section 2860 arbitrations take place routinely without any need to immunize *Cumis* counsel from responsibility for overbilling. And courts regularly resolve fee disputes in other contexts as well—again without harming the attorney-client privilege. (See, e.g., *Chavez v. City of Los Angeles* (2010) 47 Cal.4th 970, 990-991 [upholding denial of lawyer's excessive fee request in context of plaintiff's request that defense pay plaintiff's attorney fees].) Nothing in section 2860 jurisprudence or any other area of law involving the payment of attorney fees suggests that due process requires a blanket immunity to protect lawyers from challenges to their billings.

That should not be surprising. In reimbursement actions, as in section 2860 arbitrations, a claim of unreasonable and excessive billing is tested objectively. (See *Aerojet, supra*, 17 Cal.4th at p. 62.) It is thus unlikely to involve attorney-client communications. The bills themselves—not emails or conversations between the lawyers and their clients—are the principal relevant evidence. Bills are generally not privileged. (See *Concepcion v. Amscan Holdings, Inc.* (Feb. 18, 2014, B247832) __ Cal.App.4th __ [2014 WL 595822, at p. *11 ["we seriously doubt that all—or even most—of the information on each of the billing records proffered to the court [to obtain a reasonable fee award] was privileged"]; see also Vapnek et al., Cal. Practice Guide: Professional Responsibility (The Rutter Group 2013) ¶ 7:216.5, pp. 7-70.9 to 7-70.10 ["[C]ommunications regarding . . . the amount of the fee . . . and the general purpose of the work

performed are usually not protected from disclosure by the attorney-client privilege. Thus, attorney fee statements or billings containing such information generally are not privileged."].) "[B]illing records revealing 'the motive of the client in seeking representation, litigation strategy, or the specific nature of the services provided, such as researching particular areas of law' are protected by the attorney-client privilege" (Vapnek et al., Cal. Practice Guide: Professional Responsibility, *supra*, ¶ 7:216.5, pp. 7-70.9 to 7-70.10), but such privileged information can be redacted (see *Banning v. Newdow* (2004) 119 Cal.App.4th 438, 454 [defendant was able to challenge reasonableness of attorney fees using bills redacted to protect attorney-client privilege]; see also *Concepcion*, at p. *11).

Indeed, as already seen, after Squire Sanders was dismissed from Hartford's reimbursement cross-complaint, Hartford proceeded against the insured clients. Squire Sanders defended the clients by defending its billings. At trial, Squire Sanders introduced all $13 million of its bills into evidence that it sent to Hartford for payment, and its former partner that led the litigation team was able to testify about them. (See Further Supp. MJN, Axelrad Decl., exh. A, p. 10.)[5] Notably, Squire Sanders offers no argument that it would

[5] By effectively controlling the client's defense in the cross-complaint for restitution, Squire Sanders was in privity with the insureds. On the facts of this case, then, there may be no occasion for a trial on remand at all. (See generally *Coscia v. McKenna & Cuneo* (2001) 25 Cal.4th 1194, 1201, fn. 1 [elements of collateral estoppel].)

actually be constrained by the attorney-client privilege in any way in this case.

Second, if attorney-client communications ever *were* relevant in a reimbursement action—and Squire Sanders points to no case under section 2860 or elsewhere in which that has ever occurred—California courts are well equipped to deal with a due process defense on a case-by-case basis. Claims that due process issues will hamper the defense almost never require dismissal at the outset of a case. When confronted with such a claim, "a court must determine whether (1) the evidence at issue is the client's confidential information, and the client insists that it remain confidential; (2) given the nature of plaintiff's claim the confidential information is highly material to the defendant's defenses; (3) there are 'ad hoc' measures available to avoid dismissal such as ' "sealing and protective orders, limited admissibility of evidence, orders restricting the use of testimony in successive proceedings, and, where appropriate, in camera proceedings" '; and (4) it would be fundamentally unfair to proceed." (*Reilly v. Greenwald & Hoffman, LLP* (2011) 196 Cal.App.4th 891, 904.) The trial court considered none of those factors below; nor did the Court of Appeal.

Moreover, those factors vary from case to case. (See *Dietz v. Meisenheimer & Herron* (2009) 177 Cal.App.4th 771, 792 ["If dismissal were required whenever a lawyer's ethical duties prevented the lawyer from presenting evidence having *any* relevance to the action, without respect to the materiality of the evidence, the 'drastic action' of dismissal would become commonplace" despite the principle that dismissal should only be

used in "the rarest of cases," emphasis omitted].) It is extremely unlikely that a due-process defense would ever succeed, because a rational client would presumably prefer to waive the privilege than to be left solely responsible for his lawyer's overbilling.

In short, *Cumis* counsel has the right to raise a due process *defense* in a reimbursement action, claiming that privilege concerns make defense impossible *in that particular case*, and the courts can test such claims. But the availability of such claims in isolated (and hypothetical) cases provides no reason to create blanket immunity across the board, shielding all *Cumis* counsel from the responsibility to defend the reasonableness of their fees in an insurer's direct action for reimbursement. (Cf. *General Dynamics Corp. v. Superior Court* (1994) 7 Cal.4th 1164, 1170, 1190 [holding former in-house counsel's wrongful termination suit against former client can be maintained if counsel can prove case without disclosing privileged information; noting that such cases should rarely be decided at pleading stage].)

IV. SQUIRE SANDERS'S PROPOSED ALTERNATIVES TO AN INSURER REIMBURSEMENT ACTION ARE INADEQUATE AND FUNDAMENTALLY UNFAIR.

Ignoring the established law of restitution, Squire Sanders contends that Hartford's direct reimbursement action against it is unnecessary because three other safeguards already protect against attorney overbilling. (See ABOM 33.)

First, Squire Sanders mistakenly justifies the new immunity it seeks by arguing that ethical rules already prohibit overbilling. But ethical rules did not stop Squire Sanders; according to the trial court, it engaged in "appalling" overbilling—nearly $5 million worth. (Further Supp. MJN, Axelrad Decl., exh. A, pp. 13, fn. 9, 27.) And those wronged by errant lawyers should have a remedy. Ethical rules do not provide remedies to the wronged; the law of restitution does that.

Second, Squire Sanders attempts to justify the new immunity it seeks by arguing that clients are in a better position than lawyers to ensure that its lawyers do not overbill. (ABOM 26-27, 34.) However, client-insureds are often unsophisticated in the ways of litigation, as the trial court found here. (Further Supp. MJN, Axelrad Decl., exh. A, p. 26.) Few clients will have the knowledge (or gumption) to criticize their lawyers for the litigation choices the lawyers make, especially when the clients are not paying the bills and have no economic incentive to do so. (See Further Supp. MJN, Axelrad Decl., exh. A, pp. 26-27 ["The Court is not sure that the insured had the ability or understood how to review the attorney fee bills they were receiving to determine if the fees and costs were reasonable or necessary. The Court doubts that the bills were ever reviewed by the insured with the thought in mind that they actually might have to pay the bills. . . . They undoubtedly were totally focused on being well defended in the Marin case."].)

Third, Squire Sanders tries to justify the new immunity it seeks by arguing that there is no need for insurers to seek reimbursement from overbilling *Cumis* counsel directly, because