ASSOCIATION OF BUSINESS TRIAL LAWYERS SAN DIEGO

abtl REPORT

Volume XI No. 2 *August 2004*

Survival Guide For *Cumis* Counsel: How To Address Insurers' Challenges to Fees Owed to Independent Counsel

By Gary W. Osborne and Dominic S. Nesbitt, Osborne & Nesbitt LLP

The question of who gets to select defense counsel routinely arises when a liability insurer owes a duty to defend an insured against a third-party claim. Generally speaking, the insurer has this selection right. There are, however, several important exceptions to this general rule that allow the insured to select an attorney who is "independent" of the insurer, such as where defense counsel selected by the insurer could manipulate the litigation so as to result in a forfeiture of coverage for the insured by "defending" the case in a manner that results in a finding of intentional conduct against the insured. *San Diego Navy Federal Credit Union v. Cumis Ins. Soc.*, 162 Cal.App.3d 358 (1984); California Civil Code §2860.

Dominic S. Nesbitt

Gary W. Osborne

When an insured exercises its right to independent counsel, issues invariably

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VIEW FROM THE BENCH

The Southern District Welcomes Magistrate Judge Jan Adler To The Bench

By Yvonne M. Dutton, Esq.

On July 8, 2003, Jan M. Adler was sworn in as a Magistrate Judge for the Southern District of California. As many in this community know, prior to taking the bench, Judge Adler was a partner in the San Diego office of Milberg Weiss Bershad Hynes & Lerach LLP, where his practice focused on complex civil litigation. Many also know him from his participation in the San Diego legal community: he was a Lawyer Representative to the Ninth Circuit Judicial Conference between 2000 and 2003 and he has been, and still is, on the Board of Governors of the Association of Business Trial Lawyers.

Judge Adler was raised in upstate New York in a small town named Livingston Manor. After graduating from high school, he attended Cornell University, where he majored in American History and Government. His long-

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Inside

President's Column

By Frederick W. Kosmo, Jr. of Wilson Petty Kosmo & Turner LLP

I am pleased to report that the San Diego Chapter of ABTL is very healthy. For example, with final figures in, our ABTL membership has grown in 2004 by an amazing 35%. I believe this reflects broad-based support in the San Diego legal community for ABTL's goals of promoting civility, legal excellence, and ethics. In regard to our membership increase, I want to sincerely thank all of our very active board members, sponsoring firms and judicial members for all of their hard work and support.

Frederick W. Kosmo, Jr.

As you are aware, our ABTL Chapter represents a diverse cross-section of the legal community. We have members from large firms, medium firms, small firms, and solo practitioners. Our membership consists of both plaintiffs and defense lawyers. In addition, we have a large judicial membership. All this places ABTL in a unique position to promote and support the judicial process.

Over this year, I have participated in many conversations with state and local bar leaders regarding how California's budget crisis could affect access to the courts in San Diego. I have received troubling reports of layoffs of court personnel in Los Angeles County, and the temporary stoppage of civil trials in Orange and Riverside counties.

We have been fortunate to have ready access with few inconveniences to the civil courts in San Diego, primarily due to the excellent management of our local courts. However, at this point, the impact of the fiscal crisis has not been completely resolved. Accordingly, ABTL will continue to use its unique voice and efforts to appropriately support the courts and assist in assuring access to the courts for all litigants.

Lastly, please mark your calendar for our ABTL Annual Mini-Seminar on Saturday, September 18, 2004. The program features San Diego's top trial lawyers and judicial members. Because of the local venue, the cost is very reasonable. This is a tremendous opportunity for young lawyers to learn invaluable trial skills. Thus, I encourage all ABTL members to attend. ▲

Bowen: Business and Professions Code Section 17200 Not Applicable to Securities Transactions

By Jason M. Kirby, Esq. of Post Kirby Noonan & Sweat LLP

The Securities Exchange Act of 1934 expressly provides for state legislation of securities transactions. Section 78bb(a) of the Securities Exchange Act states that, "nothing in this chapter shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder." Congress did not intend that the Securities Exchange Act should displace, but rather would supplement, state securities laws. But should state legislation that was never expressly intended to regulate securities transactions nonetheless be applied to securities transactions?

This question was raised recently with regard to a cause of action brought under California's unfair competition law ("UCL"), Business and Professions Code section 17200 *et seq*. Judge Richard Haden of the San Diego Superior Court held that the UCL does not apply to securities transactions. The Fourth District Court of Appeal affirmed this holding in *Bowen v. Ziasun Technologies, Inc.* 116 Cal.App.4th 777, 790 (2004). This article summarizes the background, result and implication of *Bowen*.

The Background and Analysis of *Bowen*

In *Bowen*, defendants solicited two foreign investors to purchase stock in a number of U.S.-based companies, including Ziasun. Defendants held themselves out as investment consultants with close ties to Ziasun and other companies, and told the two foreign investors that "no investor had ever lost money with these companies" due to defendants' intimate knowledge of the companies they recommended. *Id.* at 780. Based on these representations, plaintiffs purchased hundreds of thousands of dollars of stock in Ziasun and other companies.

After becoming the "first" unfortunate investors to lose their money, plaintiffs alleged defendants had failed to disclose that plaintiffs' investment proceeds would be used to front a Ponzi scheme and fund other criminal behavior. Plaintiffs sued under a variety of theories including the UCL, common law fraud, securities fraud and conversion. After discovery, Ziasun moved for summary judgment or, alternatively, summary adjudication of the issues, including plaintiffs' claims under the UCL. Ziasun argued that plaintiffs' UCL claims failed as a matter of law because the UCL does not apply to securities transactions, and the trial court agreed. *Id.* at 785.

Jason M. Kirby

On appeal, the Fourth District Court of Appeal began its analysis by noting that the UCL was mirrored after the Federal Trade Commission ("FTC") Act and that "the FTC has not viewed the FTC Act as reaching securities transactions." *Id.* at 787. The Fourth District also observed that Hawaii, like many states, had similar legislation mirroring the FTC Act, and the Ninth Circuit Court of Appeals had previously recognized in *Spinner Corp. v. Princeville Dev. Corp.* 845 F.2d 388, 391 (9th Cir. 1988), that "[a]ctions involving securities…[were] not typically on the agenda of consumer advocates." *Id*.

According to the Court of Appeal, at least 15 other jurisdictions had considered whether investment securities were within the scope of their consumer protection statutes and had reached the conclusion that securities violations were not actionable under those statutes. *Id.* at 787-788. The Court found nothing in the legislative history of either the UCL or its predecessor, Civil Code section 3369, to suggest that the intent of the California Legislature was any different from that of other state legislatures. Based on the legislative history of the UCL and federal and out-of-state authority, the Fourth

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time dream of becoming a lawyer was fulfilled when he graduated from Duke University School of Law in 1978. Immediately after law school, Judge Adler practiced civil litigation in Phoenix, Arizona at the law firm of Jennings, Strauss & Salmon. It was after his parents and brother moved to San Diego, and after frequent visits from Arizona, that Judge Adler decided to relocate. He joined Milberg Weiss in 1982 as an associate and remained there until he recently become one of our newest Magistrate Judges.

Of the changes between his prior job and his current job, Judge Adler noted that one of the greatest is the incredible diversity of the cases with which he deals on a day-to-day basis. From his prior practice he obtained a very good grasp of the many procedural aspects of civil litigation. His civil docket now, however, has required him to become familiar with many different areas of substantive law, including intellectual property, personal injury, social security, habeas corpus, and age and employment discrimination – areas of law with which he had not dealt extensively in private practice. He also commented on the fast and varied pace of his day. For example, in any one day he may handle case management conferences, discovery matters, an ENE, a mediation, and also preside over various criminal matters. This variety and pace, Judge Adler explained, is both a challenge and one of the greatest aspects of his new position.

With respect to civil matters, Judge Adler stated that one of the most important and rewarding aspects of his job is the role he plays in helping parties resolve their disputes through mediation or settlement conferences. Indeed, one thing that drew him to this position was the fact that it would allow him to play a role in achieving resolutions of cases. He has had much experience as a lawyer in mediation settings, which he believes has been very helpful in preparing him for his role in this setting as a Magistrate Judge.

In terms of tips for those appearing before him at settlement conferences, he finds it helpful if the parties present him with a brief that succinctly sets forth the strengths and weaknesses of their positions. This brief – which he noted could even be a letter brief as long as it gives a realistic appraisal of the party's case — helps him to formulate early an idea of how to assist in reaching a resolution. The parties should come to the mediation with a view as to how the case can be resolved efficiently and effectively. Presently, Judge Adler provides for confidential briefs, but he does not discourage the parties from exchanging their settlement statements.

On the discovery front, Judge Adler requires a genuine, full-fledged, and, if possible, in-person meeting before a party is permitted to bring a motion to compel or motion for protective order. He found as a litigator that sitting down with the other side often obviated the need to bring discovery matters before the judge. In addition, before a party may file a discovery motion, all parties in the case must participate in a discovery conference with one of Judge Adler's law clerks. During that conference – which takes place by telephone – the parties must explain their efforts to meet and confer. They must also talk through any remaining issues with the law clerk in an effort to narrow or resolve the dispute. After the parties complete this process, he finds that many discovery disputes are eliminated or substantially narrowed. Judge Adler places a very high value on civility and professionalism, and strongly believes that the resolution of any matter that comes before him is promoted by such conduct.

In most respects, Judge Adler finds his new job as he had expected. Judge Adler is gratified to find that as in private practice, as a Magistrate Judge he is constantly learning. It is this process of constantly learning that he says keeps judges and lawyers vital and challenged. We are excited to welcome Magistrate Judge Adler to the Southern District bench.

We gratefully acknowledge and thank the Federal Bar Association for giving permission to re-print this article, first published in the Federal Bar Association's Spring 2004 Newsletter. ▲

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arise concerning the amount of fees and costs the insurer has to pay. This article discusses the propriety of three techniques used by insurers to control or challenge the fees and costs billed by an insured's independent counsel.

A. Hourly Rates

1. The Statutory Limitation

California Civil Code Section 2860(c) governs the financial relationship between an insurer and its insured's independent counsel:

> The insurer's obligation to pay fees to the independent counsel selected by the insured is limited to the rates which are actually paid by the insurer to attorneys retained by it in the ordinary course of business in the defense of similar actions in the community where the claim arose or is being defended. This subdivision does not invalidate other different or additional policy provisions pertaining to attorney's fees.

While insurers need only pay independent counsel the same rates they pay other lawyers to defend similar actions in the same locale, there are nonetheless several important issues for independent counsel to consider when negotiating such fee agreements.

First, insurers typically impose a "panel rate" on independent counsel without discussing, or even contemplating, that the rate may be increased at some future point in time. Independent counsel should request, in writing, that the rate be increased in line with any increases paid to the insurer's panel counsel.

Second, both insureds and their independent counsel should ask the insurer to verify, in writing, that the rate offered equates to the highest rate currently being paid to panel counsel to defend similar actions in the same geographic area. Insurers arguably have an implied-in-law duty to disclose the rates they pay to panel counsel — otherwise, how is an insured to verify that the rate offered by the insurer is correct? Moreover, the statutory reference only to "rates" indicates there is no limitation on the insurer's duty to pay "costs" incurred by independent counsel. See, *Gray Cary Ware & Freidenrich v. Vigilant Ins. Co.*, 114 Cal.App.4th 1185 (2004).

2. Section 2860 Only Applies To Insurers With A "Duty To Defend."

Section 2860 by its own terms applies only where "the provisions of a policy of insurance impose a *duty to defend*" on the insurer. See, Cal. Civ. Code §2860(a) (italics added). Consequently, section 2860 – and its rate limitation provision – has no application to a policy of insurance (*e.g.*, a typical Directors and Officers policy) that only obligates the insurer to "indemnify" the insured against defense expenses. See, *e.g.*, *National Union Fire Ins. Co. of Pittsburgh, PA v. Stiles Professional Law Corporation*, 235 Cal.App.3d 1718, 1727 (1991). Arguably, an insurer with a duty to "indemnify" defense expenses has no legal basis for reducing the hourly rates of its insured's defense counsel.

3. The Statutory Language Permits Reference To The Attorney Rates Insurers Pay To Defend Themselves.

Insurers typically argue that they pay independent counsel no higher rates than they pay to their panel counsel to defend *other insureds* against similar actions. Since such rates are usually deeply discounted, independent counsel is thus forced to either accept these lower panel rates or look to the insured to make up the rate differential. However, the language of Section 2860 – limiting rates to those paid by the insurer "*in the ordinary course of business*" to defend "*similar actions*" – arguably permits reference to the higher rates insurers typically pay lawyers when defending *themselves* in business litigation.

B. Audits and "Billing Guidelines"

Despite the absence of any mention in Section 2860 of any "billing guidelines", it is common practice for insurers to insist upon independent counsel's chapter-and-verse compliance with such guidelines. Oftentimes, legal auditors are brought in to scrutinize the bills and adjust down any fee or cost entries they determine are not in compliance, despite (except on rare occasions) the fact there is no policy provision requiring such compliance.

1. Insurer Billing Guidelines Should Not Apply To Independent Counsel.

While no California case has yet addressed this issue, billing guidelines arguably should not

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apply to independent counsel, since there exists no statutory or contractual basis for requiring such compliance. They are not mentioned in either section 2860 or in standard insurance policies. Billing guidelines are also only intended to apply to an insurer's panel counsel; this is often reflected in the language of the guidelines themselves. Panel counsel agree to comply with the billing guidelines as a condition of their employment. Such a condition does not exist for independent counsel who are hired by the insured, not the insurer.

While insurers have no duty to pay unreasonable fees and costs, the proper measure of reasonableness is not insurer billing guidelines. In fact, such guidelines are designed to minimize litigation costs for insurers, often at the expense of providing the insured a full and complete defense.

The proper measure of "reasonableness" has been developed in a wide body of decisional law. *See*, ABA Disciplinary Rule No. 2-106; see also, California Rule of Professional Conduct No. Rule 4-200; *Glendora Community Redevelopment Agency v. Demeter*, 155 Cal. App. 3d 465, 474-481 (1984); *People ex rel. Dept. of Transportation v. Yuki*, 31 Cal. App. 4th 1754, 1767 (1995). Such common law requires the examination of numerous factors in determining reasonableness, such as: (1) the novelty and difficulty of the questions involved and the requisite skill to perform the legal service properly; (2) the fee customarily charged in the locality for similar legal services; (3) the amount of the fee in proportion to the value of the legal services performed; (4) the amount involved and the results obtained; and (5) the experience, reputation, and ability of the lawyer or lawyers performing the services. Insurer billing guidelines do not supplant this body of law in measuring the reasonableness of independent counsel's fees and costs.

2. The Ethical Implications Of Insurer Billing Guidelines.

Complying with insurer "billing guidelines" can impact upon counsels' ethical obligations to their clients. For this reason, one California appellate court has questioned "the wisdom and propriety" of using billing guidelines to limit counsel compensation:

> [W]e question the wisdom and propriety of so-called "outside counsel guidelines" by which insurers seek to limit or restrict certain types of discovery, legal research, or computerized legal research by outside attorneys they retain to represent their insureds where there is a potential for an uncovered claim. Some guidelines go so far as to call for the use of paralegals, rather than attorneys, to respond to "routine" discovery requests or prohibit the retention of experts or the filing of certain pretrial motions until shortly before trial. Under no circumstances can such guidelines be permitted to impede the attorney's own professional judgment about how best to competently represent the insureds. If the attorney's representation is to be limited in any way that unreasonably interferes with the defense, it is the insured, not the insurer, who should make that decision.

Dynamic Concepts, Inc. v. Truck Insurance Exchange, 61 Cal.App.4th 999, fn. 9 (1998).

Furthermore, ethical considerations may prohibit independent counsel, who has no attorney-client relationship with the insurer, from complying with billing guidelines to the extent such compliance would interfere with his or her exercise of professional judgment. ABA's Canon No. 5 ("A lawyer should exercise independent professional judgment on behalf of a client."); see also, ABA's Ethical Consideration No. 5-1 ("The professional judgment of a lawyer should be exercised, within the bounds of the law, solely for the benefit of his client and free of compromising influences and loyalties. Neither his personal interests, the interests of other clients, nor the desires of third persons should be permitted to dilute his loyalty to his client."); ABA's Disciplinary Rule No. 5-107 (B) ("A lawyer shall not permit a person who recommends, employs, or pays him to render legal services for another to direct or regulate his professional judgment in rendering such legal services.")

C. Allocation

"Allocation" is another common technique uti-

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lized by insurers to reduce the fees and costs billed by independent counsel. For example, where an insured is both a defendant and plaintiff in the same lawsuit, the insurer will often argue that the independent counsel's fees should be allocated one-half to defense (payable by the insurer) and one-half to prosecution (payable by the insured). Alternatively, where independent counsel defends both an insured defendant and a non-insured defendant in the same lawsuit, the insurer may try to allocate one-half of the fees to the defense of the insured and one-half to the defense of the non-insured.

Such arbitrary allocations are likely inappropriate for two reasons. First, fees and costs that are "inextricably linked" to both prosecuting an insured's action and defending a covered cross-action must be paid by the insurer. See, *California v. Pacific Indemnity*, 63 Cal.App.4th 1535, 1548-1549 (1998). This rule parallels the common law rule of apportionment that is applied in non-insurance cases. See, *e.g.*, *Reynolds Metals Company v. Alperson*, 25 Cal.3d 124, 129-130 (1979).

Second, an insurer is required to pay fees and costs that are "reasonably related" to the defense of its insured. See, *Safeway Stores v. National Union Fire Ins. Co.*, 64 F.3d 1282, 1289 (9th Cir. 1995). Thus, where independent counsel also represents non- insured defendants, it is only appropriate to allocate fees to the extent this joint representation results in an *increase* in the fees and costs billed. *Id.*, at 1287, citing *Raychem Corp. v. Federal Ins. Co.*, 853 F. Supp. 1170, 1180 (N.D. Cal. 1994).

D. Conclusion

Insureds and their independent counsel can use the above authority to resist their insurer's unilateral attempts to inappropriately limit rates and/or to discount fees and costs via billing guidelines, audits and allocation. ▲

Bowen

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District thus affirmed the trial court's order that the UCL does not apply to securities transactions.

Is There a Conflict Between *Bowen* and *Roskind*

There appears to be no actual conflict between the holdings of *Bowen* and *Roskind v. Morgan Stanley Dean Witter & Co.* 80 Cal.App.4th 345 (2000). In *Roskind*, plaintiffs sued under the UCL alleging that the brokerage firm's practice of "trading ahead" was an unfair and unlawful business practice. The First District Court of Appeal held that there was no provision of federal law that preempted a UCL claim under the circumstances before it. *Id*. at 347, 354.

The First District in *Roskind* focused on the "sweeping" coverage of the UCL as applying to "anything that can properly be called a business practice" (*Id.* at 350), and emphasized that the remedies provided by the UCL are expressly cumulative to the remedies "available under all others laws of this state." *Id.*, (quoting Bus. & Prof. Code § 17205). The First District also recognized that "case authority clearly provides that violation of a federal law may serve as a predicate for a section 17200 action" and, as a result, "[u]nder these broad and sweeping precedents, it is clear that the UCL could potentially provide a remedy" for the brokerage firm's trading ahead of its customers. *Id.* at 352.

While it might be natural to doubt if the First District would have reached the same conclusion in *Bowen* even if provided with the legislative history of the UCL and the apparent lack of legislative intent that it be made applicable to securities transactions as discussed in

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Bowen, the First District's decision in *Roskind* was limited solely to the issue of whether a claim under the UCL was preempted by federal law. *Id.* at 352. Thus, while the *Roskind* court stated that the UCL could potentially provide a remedy for securities transactions, the First District's analysis started and ended with the issue of preemption — not whether the UCL should provide a remedy for securities transactions. This separate issue was considered and resolved by *Bowen*.

Reading the cases together, *Bowen* confirms the holding of *Roskind*. After *Bowen*, it is all the more clear that federal securities laws should not have preempted state law. However, that the UCL did not impair or conflict with any provision of federal law under the circumstances in *Roskind* does not change the fact that the UCL was apparently never intended to apply to securities transactions in the first place.

Conclusion

Section 17200's intentionally vague language and all-encompassing applicability make it a frequent rider in civil complaints. While the UCL provides consumers with a powerful remedy against unfair business practices, UCL claims are very often included in civil complaints, including securities complaints, as a matter of course. While there undoubtedly have been, and will be, cases that support the argument that the UCL should apply equally to securities transactions, nothing changes the fact that the California Legislature never intended its application to these transactions. The fundamental objective of statutory interpretation is to "ascertain and effectuate legislative intent." *Redevelopment Agency of City of San Diego v. San Diego Gas & Elec. Co.* 111 Cal.App.4th 912, 916 (2003). After ascertaining the California Legislature's lack of intent to make the UCL applicable to securities transactions, according to *Bowen*, courts are left without an intent to effectuate. ▲

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See included flyer for more details.

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ABTL Seminar Slated for Oct. 20-24 in Hawaii

"Corporate America on Trial" is the title of this year's annual ABTL seminar. While it may seem like only yesterday that "irrational exuberance" filled the air, today the airways are filled instead with restated earnings reports and prominent executives being lead away in handcuffs. How will the constant drumbeat of corporate scandals impact your next business case?

ABTL is bringing together an all-star cast of judges and lawyers at the Mauna Lani Hotel on the Big Island of Hawaii to answer the questions on the mind of every inquisitive business trial lawyer, including:

- How to manage executive testimony in the new environment
- How to address document retention policies and the discarded document
- How to protect your civil litigation client who is subject to a parallel government investigation
- How to deal with whistleblowers and retaliation claims
- How to balance trade secret presentation and the public's right to know; and
- How are fiduciary duty and business judgment rules evolving in response to current events.

The issues are timely and compelling, the faculty is unsurpassed, the setting is beautiful (and surprisingly affordable), and the mai tais promise to be refreshing.

ABTL's 31st Annual Seminar is scheduled for October 20 through 24, 2004. For a detailed brochure, log onto:

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