Dependent Counsel's Duty to Initiate an Adequate Conflict of Interest Analysis

Introduction

When a liability insurer reserves its rights to later deny coverage, both dependent counsel[1] and the insurer have duties to initiate analysis of potential conflicts of interest and to honestly disclose the analysis to the policyholder. Dependent counsel's duty originates in attorney ethics.[2] The insurer's duty is rooted in insurance laws and regulations, and the fiduciary-like nature of the insurer-policyholder relationship, and the covenant of good faith and fair dealing.[3] The policyholder has no duty to dependent counsel nor to the insurer to analyze or prove the existence of conflicts.[4]

"[T]raditional obligations of an attorney are in no way abridged by the fact that an insurer employs him to represent an insured. [W]hether in the insurer-insured context or otherwise, the attorney who undertakes to represent parties with divergent interests owes the 'highest duty' to each to make a full disclosure of all facts and circumstances which are necessary to enable the parties to make a fully informed decision regarding the subject matter of litigation, including the areas of potential conflict and the possibility and desirability of seeking independent legal

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[1] The succinct moniker "dependent counsel" describes and differentiates its counterpart, "**in**dependent counsel." This term acknowledges that "[a]s a practical matter . . . in reality, the insurer's attorneys may have closer ties with the insurer and a more compelling interest in protecting the insurer's position, whether or not it coincides with what is best for the insured" (*Purdy v. Pacific Automobile Ins. Co.*(1984) 157 Cal.App.3d 59, 76), "[i]nsurance companies hire relatively few lawyers and concentrate their business. A lawyer who does not look out for the Carrier's best interest might soon find himself out of work." (*San Diego Navy Fed. Credit Union v. Cumis Ins. Society, Inc.* (1984) 162 Cal.App.3d 358, 364 (*Cumis*)), and "defense counsel and the insurer frequently have a longstanding, if not collegial, relationship" (*Gulf Ins. Co. v. Berger, Kahn, Shafton, Moss, Figler, Simon & Gladstone* (2000) 79 Cal.App.4th 114, 131). "In California, an attorney may usually, under minimum standards of professional ethics, represent dual interests as long as full consent and full disclosure occur." (*Lysick v. Walcom* (1968) 258 Cal.App.2d 136, 147; See, also *Ishmael v. Millington* (1966) 241 Cal.App.2d 520, 528; *Industrial Indem. Co. v. Great American Ins. Co.* (1977) 73 Cal.App. 3d 529, 537.)

[2] See, *Dependent Counsel's Non-Delegable Duty to Comply With RPC Rules 1.7 and 1.8.6* at DutytoDefend.com.

[3] See, *Duty of Good Faith and Fair Dealing* at DutytoDefend.com.

[4] "Except as otherwise provided by law, a party has the burden of proof as to each fact the existence or nonexistence of which is essential to the claim for relief or defense that he is asserting." (Evid. Code § 500.) If the policyholder is forced to sue dependent counsel and/or a reserving insurer, the policyholder will have an evidentiary burden of proof to establish either that: 1) dependent counsel and/or a reserving insurer failed to comply with their respective obligations to initiate analysis of conflicts; or 2) that some potential or actual conflict of interest exists.

advice."[5]

Dependent Counsel Have a Duty to Adequately Analyze Potential Conflicts of Interest

Dependent counsel has an affirmative duty to the policyholder to analyze potential conflicts of interest. "[O]nce the insurer decides to assert a coverage defense, the same attorney may not represent both the insured and the insurer."[6] "Counsel representing the insurer and the insured owes both a high duty of care and unswerving allegiance. When two clients have diverging interests, counsel must disclose all facts and circumstances to both clients to enable them to make intelligent decisions regarding continuing representation. [B]efore a lawyer may represent multiple clients he should explain fully to each client the implications of the common representation and should accept or continue employment only if the clients consent."[7]

"[W]hen coverage is disputed, the interests of the insured and the insurer are always divergent. The attorney should not be placed in the position of divided loyalties. Such an arrangement would be adverse to the best interests of the insured, the insurer, the attorney, and the profession. [T]he Canons of Ethics impose upon lawyers hired by the insurer an obligation to explain to the insured and the insurer the full implications of joint representation in situations where the insurer has reserved its rights to deny coverage."[8]

"There is no talismanic rule that allows a facile determination of whether a disqualifying conflict of interest exists. Instead, '[t]he potential for conflict requires a careful analysis of the parties' respective interests to determine whether they can be reconciled.'"[9]

The following questions should inform a proper conflict of interest analysis: "(1) what is the exact nature of the claims asserted in the underlying action, (2) what defenses to coverage are asserted by the insurers, and to what extent, if at all, are they logically related to the liability issues raised in the underlying action, (3) what factual questions have to be resolved in order to sustain or defeat such defenses, (4) what is the likely nature of the available evidence."[10]

Business & Professions Code § 6068(m) provides: "It is the duty of an attorney to do all of the following: To respond promptly to reasonable status inquiries of clients and to keep clients reasonably informed of significant developments in matters with regard to which the attorney has agreed to provide legal services."

Dependent counsel must analyze potential as well as actual conflicts of interest.[11] Since a reservation of rights always creates at least a potential conflict of interest, dependent counsel cannot ethically accept of continue employment without first complying with Rules of

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[5] *Betts v. Allstate Ins. Co.* (1984) 154 Cal.App.3d 688, 716 (ellipses omitted).

[6] *Cumis, supra* 162 Cal.App.3d at 374.

[7] *Ibid.* (citations, quotation marks, and ellipses omitted.)

[8] *Id*. at 375 (ellipsis omitted).

[9] *Gulf Ins. Co. v. Berger, Kahn, Shafton, Moss, Figler, Simon & Gladstone* (2000) 79 Cal.App.4th 114, 131, quoting *Dynamic Concepts, Inc. v. Truck Ins. Exchange* (1998) 61 Cal.App.4th 999, 1007-1008.

[10] *Haskel, Inc. v. Superior Court* (1995) 33 Cal.App.4th 963, 980.

[11] See, *Distinction Between Potential and Actual Conflicts* at DutytoDefend.com.

Professional Conduct (Rule) Rule 1.7.[12]

Insurers Also Have a Duty to Analyze and Disclose Conflicts of Interest

When an insurer issues a reservation of rights to later deny coverage to the policyholder, some conflict of interest between the insurer and the policyholder always develops,[13] but not necessarily a disqualifying conflict of interest.[14] But the insurer has an affirmative duty to disclose to the policyholder conflicts of interest created by its reservation of rights. "[T]he insurer's fiduciary obligations were consistent with those of the attorney retained to represent the insured, and as a result the insurer should have informed the insured of the conflict of interest and of the opportunity to have independent counsel."[15] "Every insurer shall disclose to a [policyholder] all benefits, coverage, or other provisions of any insurance policy issued by that insurer that may apply to the claim presented by the [policyholder]. When additional benefits might reasonably be payable under an insured's policy, the insurer shall immediately communicate this fact to the insured and cooperate with and assist the insured in determining the extent of the insurer's additional liability."[16]

Burden of initiating Conflict of Interest Analysis

Dependent counsel has the burden of initiating analysis of conflicts of interest because Rule 1.7 prohibits a lawyer from starting work until conflicts are cleared by analysis, written disclosure, and informed written consent. The insurer has the burden of initiating analysis of conflicts of interest because of insurance regulations and the duty of good faith and fair dealing. As a lay person unfamiliar with the legal process and the intricacies of liability insurance, the policyholder has no obligation to analyze conflicts of interest. Both the insurer and dependent counsel are supposed to help the policyholder understand these processes. This is among the reasons why lawyers are regulated by the State Bar Act and insurers are regulated by the Insurance Code.

Practice Pointer

If it becomes necessary for the policyholder to sue the insurer and/or dependent counsel, at trial the policyholder may have an evidentiary burden of proof to establish that a conflict of interest exists. "[A] party has the burden of proof as to each fact the existence or nonexistence of which is essential to the claim for relief or defense that he is asserting."[17] Being prepared to meet this burden is among the reasons why it is important for the policyholder to develop admissible

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[12] "Cumis makes a distinction between 'potential' and 'actual' conflicts of interest which is invalid and unworkable." (*Cumis, supra*, 162 Cal.App.3d at 371, fn.7); Rule 1-7 omits any mention of potential or actual conflicts.

[13] See, *Conflicts of Interest* at DutytoDefend.com.

[14] See, *Disqualifying Conflicts of Interest* at DutytoDefend.com.

[15] *State Farm Fire & Casualty Co. v. Superior Court* (1989) 216 Cal.App.3d 1222, 1235-1236; see also, *Manzanita Park v. Insurance Co. of North America* (9th Cir. 1988) 857 F.2d 549, 555.

[16] Cal. Code Regs. § 2695.4 (ellipses omitted).

[17] Evid. Code § 500.

evidence.[18]

But just as importantly, if the insurer and/or dependent counsel feign ignorance of any conflict of interest created by a reservation of rights,[19] disclaim any obligation to analyze conflicts, assert that no conflict exists without revealing any analysis, or state the oxymoron that it would create a conflict of interest to analyze conflicts of interest, the policyholder may interpret such communications as grounds to distrust the insurer, dependent counsel, or both.

The client may fire an attorney[20] at any time, with or without cause. However, good cause to fire dependent counsel exists if the lawyer is: 1) required to obtain the policyholder's informed written consent to representation which the policyholder withholds;[21] or 2) the policyholder withholds authority for dependent counsel to appear in court.[22] Dependent counsel's refusal to comply with Rule 1.7 may constitute grounds for a policyholder to discharge a lawyer.[23] If so, then it may not be necessary to establish that a disqualifying conflict of interest exists. Absent analysis, disclosure and consent, Rule 1.7 clearly bars dependent counsel from doing any work. However, no reported California opinion reconciles whether Civil Code § 2860(f)[24] trumps Rule 1.7, as some insurers and dependent counsel contend.

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[18] See, *Develop Admissible Evidence of a Coverage Contest Promptly* at DutytoDefend.com.

[19] "[I]t was simply wishful thinking by [dependent counsel] when he [denied the existence of any conflicts of interest]. . . . That [dependent counsel] represented conflicting interests in the [liability] action is now plain." (*Industrial Indem. Co. v. Great American Ins. Co.* (1977) 73 Cal. App. 3d 529, 535, 537 (citation and ellipses omitted).)

[20] See, *Client May Fire Attorney* at DutytoDefend.com.

[21] Rule 1.7.

[22] "Corruptly or wilfully and without authority appearing as attorney for a party to an action or proceeding constitutes a cause for disbarment or suspension." (Bus. & Prof. Code § 6104.)

[23] See, *RPC Rule 1.7 and the Cumis Rule*, *Duty to Comply with Rule 1.7*, and *Dependent Counsel Is Not Exempt from Rule 1.7* at DutytoDefend.com.

[24] "[C]ounsel provided by the insurer . . . shall be allowed to participate in all aspects of the litigation. . . . consistent with each counsel's ethical and legal obligation to the insured."