How Dependent Counsel Conflicts of Interest Arise

Prologue

"Conflicts [of interest] come in all shapes and sizes."[1]

Introduction

The Cumis Rule states that when a liability insurer agrees to defend its policyholder under a reservation of rights to later deny coverage, troubling conflicts of interest for dependent counsel usually arise because the lawyer represents both the insurer and the policyholder. However, several California cases illuminate dependent counsel may be ethically disqualified from representing the policyholder.

There Are Two Varieties of Conflicts of Interest

"[A] conflict between the interest of the insurer and the insured . . . in turn creates a conflict for counsel hired by the insurer to represent the insured."[2]

Liability insurer versus policyholder conflicts of interest arise whenever the one want the other to pay. Dependent counsel versus policyholder conflicts of interest arise whenever Rules of Professional Conduct preclude a lawyer from representing the interests of both a liability insurer and its policyholder.

The Cumis Rule

"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. If the insured does not give an informed consent . . . , counsel must cease to represent both. Moreover, . . . where there are divergent interests brought about by the insurer's reservation of rights, . . . the insurer must pay the reasonable cost for hiring independent counsel by the insured. The insurer may not compel the insured to surrender control of the litigation."[3] "[T]he Cumis rule is not based on insurance law but on the ethical duty of an attorney to avoid representing conflicting interests."[4]

The Cumis Test

In California, "not every conflict of interest triggers an obligation on the part of the insurer to provide the insured with independent counsel at the insurer's expense."[5] "[A] conflict of interest does not arise every time the insurer proposes to provide a defense under a reservation of

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[1] *Manfredi & Levine v. Sup. Ct.* (1998) 66 Cal.App.4th 1128, 1134 (*Manfredi*).

[2] *Id.* at 1135.

[3] *San Diego Navy Fed. Credit Union v. Cumis Ins. Society, Inc.* (1984) 162 Cal.App.3d 358, 375 (*Cumis*).

[4] *Golden Eagle Ins. Co. v. Foremost Ins. Co.* (1993) 20 Cal. App. 4th 1372, 1394.

[5] *James 3 Corp. v. Truck Ins. Exchange* (2001) 91 Cal.App.4th 1093, 1101 (*James 3*); see also, *Dynamic Concepts, Inc. v. Truck Ins. Exchange* (1998) 61 Cal.App.4th 999, 1006 ("not every reservation of rights entitles an insured to select Cumis counsel.')

rights."[6]

The legal test to determine whether a potential conflict of interest between a policyholder and a liability insurer that issues a reservation of rights or otherwise creates any potential conflict of interest is well established in California law. Dependent counsel has no disqualifying conflict of interest and the liability insurer its rights is not required to pay for independent counsel if each ground upon which the insurer may later deny coverage has "nothing to do with the issues being litigated in the underlying action"[7] For example, dependent counsel is not disqualified if the insurer denies coverage because the policyholder failed to pay the premium, since non-payment has "nothing to do with" disputed facts or law in a liability dispute.

Adequate Analysis of Conflicts of Interest

An adequate analysis of potential conflicts of interest should include the following: "(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, (5) to what extent, if at all, will [the policyholder] suffer prejudice by the enforced discovery of the evidence which tends to support or defeat its claim of coverage or the defenses raised by the insurers and (6) to what extent, if at all, will a confidentiality order realistically protect [the policyholder] from prejudicial disclosure."[8]

The California Supreme Court enunciated the analysis that should be applied to implement the Cumis Test. "[T]he question before us is whether the coverage questions are logically unrelated (that is, irrelevant) to the issues of consequence in the [liability] cases. To decide the trial court must determine: . . .

—(2) Of those that are still pending, what issues remain to be decided and when will that happen?

—(3) Which defenses to coverage (whether pleaded as affirmative defenses or raised by general denials) do each of the carriers intend to pursue as to each of the underlying actions?

—(4) What facts have to be determined to reach the merits of the carriers' defenses?

—(5) What other facts, if any, are relevant to the determination of prejudice [to the policyholder]?

—(6) Who has the burden of proof?

[T]he trial court needs declarations from the attorneys representing [the policyholder] in the [liability] cases, copies of dispositive orders, judgments and trial schedules, and a statement from each of the carriers listing the defenses to be pursued and the issues to be litigated as part of those defenses. Then and only then can the court determine whether the issues overlap and make the type of detailed findings needed for meaningful appellate review." (*Montrose Chemical Corp. v. Superior Court (Canadian Universal Ins. Co.)* (1994) 25 Cal.App.4th 902, 908-09 (ellipses omitted).)

Civil Code § 2860

"Civil Code, section 2860 codifies (with clarifications and limitations) the holding in

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[6] *Gafcon, Inc. v. Ponsor & Associates* (2002) 98 Cal.App.4th 1388, 1421 (*Gafcon*).

[7] *Long v. Century Indemnity Co.* (2008) 163 Cal.App.4th 1460, 1470 (*Long*).

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

(*Cumis*)"[9] "[W]hen an insurer reserves its rights on a given issue and the outcome of that coverage issue can be controlled by counsel first retained by the insurer for the defense of the claim, a conflict of interest may exist. No conflict of interest shall be deemed to exist as to allegations of punitive damages or be deemed to exist solely because an insured is sued for an amount in excess of the insurance policy limits."[10] No language of the statute purports to exempt any lawyer from any ethical obligations to the policyholder of the insurer.

"But Civil Code section 2860 does not purport to address any and all conflicts that might arise: 'It does not clearly state when the right to independent counsel vests.'"[11] Also, "in the absence of a stipulation or unconditional agreement between the insurer and insured, unless and until there has been a judicial determination of an insurer's duty to defend and the existence of a conflict of interest, the provisions of Civil Code section 2860 are inapplicable."[12]

No Conflict Where All Coverage Is Denied

"[A] conflict of interest does not exist as to allegations or facts in the litigation for which the insurer denies coverage."[13] Indeed, when the insurer denies all coverage and refuses to defend its policyholder, dependent counsel is not engaged to conduct the policyholder's defense and the insurer does not participate in the third party liability action.

Recognized Disqualifying Conflict of Interest

Several reported cases have tried to collect precedence of recognized conflicts of interest that may ethically disqualify an attorney.

"Some of the circumstances that may create a conflict of interest requiring the insurer to provide independent counsel include: (1) where the insurer reserves its rights on a given issue and the outcome of that coverage issue can be controlled by the insurer's retained counsel; (2) where the insurer insures both the plaintiff and the defendant; (3) where the insurer has filed suit against the insured, whether or not the suit is related to the lawsuit the insurer is obligated to defend; (4) where the insurer pursues settlement in excess of policy limits without the insured's consent and leaving the insured exposed to claims by third parties; and (5) any other situation where an attorney who represents the interests of both the insurer and the insured finds that his or her 'representation of the one is rendered less effective by reason of his [or her] representation of the other.'"[14]

"The following list, by no means exhaustive, illustrates circumstances giving rise to a

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[9] *Seltzer v. Barnes* (2010) 182 Cal.App.4th 953, 966 (ellipsis omitted); see also, *Novak v. Low, Ball & Lynch* (1999) 77 Cal.App.4th 278, 282 ("Section 2860 codifies this holding" in *Cumis*); *Gafcon, supra*, 98 Cal.App.4th at 1420 (Civ. Code § 2860 "codified the right to independent or Cumis counsel").)

[10] Civ. Code § 2860(b).

[11] *Gafcon, supra*, 98 Cal.App.4th at 1421 (quoting *James 3, supra* 91 Cal.App.4th at 1101; see also, *Dynamic Concepts, Inc. v. Truck Ins. Exchange* (1998) 61 Cal.App.4th 999, 1007 fn5.

[12] *Handy v. First Interstate Bank* (1993) 13 Cal.App.4th 917, 926.

[13] Civ. Code § 2860(b).

[14] *James 3, supra* 91 Cal.App.4th at 1101 (citations omitted.)

conflict: ¶ (1) counsel has divided loyalty between current client and former clients; ¶ (2) counsel has acquired a pecuniary interest which is adverse to the interests of the client; ¶ (3) unpaid fees to counsel may result in the sacrifice of important client rights; . . . ¶ (5) there is a conflict between the interest of the insurer and the insured which in turn creates a conflict for counsel hired by the insurer to represent the insured; . . . ¶ (7) there has been an irreparable breakdown of the working relationship between counsel and client; ¶ (8) counsel plans to take on the role as a witness."[15]

"Some of the circumstances that may create a conflict of interest requiring the insurer to provide independent counsel include: (1) where the insurer reserves its rights on a given issue and the outcome of that coverage issue can be controlled by the insurer's retained counsel; (2) where the insurer insures both the plaintiff and the defendant; (3) where the insurer has filed suit against the insured, whether or not the suit is related to the lawsuit the insurer is obligated to defend; (4) where the insurer pursues settlement in excess of policy limits without the insured's consent and leaving the insured exposed to claims by third parties; and (5) any other situation where an attorney who represents the interests of both the insurer and the insured finds that his or her representation of the one is rendered less effective by reason of his [or her] representation of the other.'"[16]

"A disqualifying conflict exists if [i]nsurance counsel had [an] . . . incentive to attach liability to [the insured]."[17]

Various Recognized Issues That Do Not Require Independent Counsel

Several reported California opinions have found the no disqualifying conflict of interest was proved at trial because the policyholder failed to carry its burden of proof. This cases include: *Dynamic Concepts, Inc. v. Truck Ins. Exch.* (1998) 61 Cal.App.4th 999, 1008 ("There is no basis on the record"); *Midiman v. Farmers Ins. Exchange* (1999) 76 Cal.App.4th 102, 120 ("We are not prepared to assume appointed defense counsel's misfeasance in the absence of any evidence"); *James 3 Corp. v. Truck Ins. Exchange* (2001) 91 Cal.App.4th 1093, 1099 (The policyholders "fail to demonstrate the existence of a triable issue of fact"); *Federal Ins. Co. v. MBL, Inc.* (2013) 219 Cal.App.4th 29, 48 (The policyholder "failed to present evidence demonstrating a triable issue of material fact on the question of whether there exists a conflict of interest under section 2860."); *Centex Homes v. St. Paul Fire & Marine Ins. Co.* (2015) 237 Cal.App.4th 23, 31-32 ([The policyholder] is alleging conclusions without substance, not facts. As Gertrude Stein famously said about Oakland, there is no there there."); and *Centex Homes v. St. Paul Fire & Marine Ins. Co.* (2018) 19 Cal.App.5th 789, 802 (The policyholder "has failed to establish a triable issue of material fact.")

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[15] *Manfredi, supra*, 66 Cal.App.4th at 1134-35 (citations, quotation marks, and ellipses omitted).

[16] *James 3, supra* 91 Cal.App.4th at 1101 (citations omitted.)

[17] *Gulf Ins. Co. v. Berger, Kahn, Shafton, Moss, Figler, Simon & Gladstone* (2000) 79 Cal.App.4th 114, 131.