Civil Code § 2860 Does Not Supersede the Cumis Case

**Introduction**

The landmark holdings of *San Diego Navy Fed. Credit Union v. Cumis Ins. Society, Inc.* (1984) 162 Cal.App.3d 358 (*Cumis*) states: “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.” (*San Diego Navy Fed. Credit Union v. Cumis Ins. Society, Inc.* (1984) 162 Cal.App.3d 358, 375.)

While three reported opinions have stated in dicta, without analysis of statutory construction, that the holdings of *San Diego Navy Fed. Credit Union v. Cumis Ins. Society, Inc.* (1984) 162 Cal.App.3d 358 (*Cumis*) have been “superseded” by Civil Code § 2860, those cases are clear wrong.

**Dozen Lessons of Cumis**

In Cumis, a policyholder sued her liability insurer to pay for independent counsel she retained to defend her in an underlying liability dispute where her insurer agreed to defend her under a broad reservation of rights to later deny coverage. The insurer had retained its chosen dependent counsel to represent the policyholder, which dependent counsel never offered any coverage opinion nor gave any coverage advice to either the insurer or the policyholder, but it did conclude that no conflict of interest existed for it to represent both the insurer and its policyholder. Without informing the policyholder, the insurer and dependent counsel attended a settlement conference of the liability dispute at which the case did not settle.

The Cumis case teaches a dozen valuable lessons.

**1: Dependent Counsel’s Conduct May Impact Coverage**

“What the defense attorney in the third party case does impacts the coverage case.” (*Id.* at 363.) “In such a case as this, the Insured is placed in an impossible position; on the one hand the Carrier says it will happily defend him and on the other it says it may dispute paying any judgment, but trust us.” (*Id.* at 364.) “A lawyer who does not look out for the Carrier’s best interest might soon find himself out of work.” (*Ibid.*)

This lesson is that dependent counsel is disqualified from representing the policyholder of a reserving insurer if there is any possibility that the lawyer’s work could impact coverage. It is not necessary that dependent counsel actually cause harm to the policyholder to be disqualified. The rationale for this lesson is that enforcement of the Rules of Professional Conduct (RPC) should be preventative, not remedial. “The primary purpose of this prophylactic rule [now 1.7] is to prevent situations in which an attorney might compromise his or her representation of the client in order to advance the attorney’s own financial or personal interests.” *Santa Clara County Counsel Attorneys Assn. v. Woodside* (1994) 7 Cal.4th 525, 546; see also, *Gregori v. Bank of America* (1989) 207 Cal. App. 3d 291, 308-309; *Aerojet-General Corp. v. Transport Indemnity Co.* (1997) 17 Cal.4th 38, 60.)

**2: Conflicts of Interest Bar Dependent Counsel From Advising Settlement**

“On the advisability of settlement, [dependent counsel] represented clients with conflicting interests (Citation). No matter how honest the intentions, counsel cannot discharge inconsistent duties.” (*Cumis, supra*, 162 Cal.App.3d at 366.) “[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.” (*Id.* at 375.)

The rationale for this lesson is that dependent counsel is “put in the position of representing clients with conflicting positions regarding settlement, one set of clients - the insurers - was seeking to settle the case with the other clients’ money. Under these circumstances, we hold the [policyholder] were entitled to independent counsel at the insurers’ expense to represent them in the settlement negotiations.” (*Golden Eagle Ins. Co. v. Foremost Ins. Co.* (1993) 20 Cal.App.4th 1372, 1396; see also, *Merritt v. Reserve Ins. Co.* (1973) 34 Cal.App.3d 858, 870 (“The assured may face the possibility of substantial loss which can be forestalled only by action of the carrier. Thus the assured may find himself and his goods in the position of a passenger on a voyage to an unknown destination on a vessel under the exclusive management of the crew.”); *Barney v. Aetna Casualty & Surety Co.* (1986) 185 Cal.App.3d 966, 976 (“[A] conflict of interest arises between insurer and insured when a third party claim is made in excess of the policy limits. In such a situation, it will *always* be to the insured’s advantage to have settlement effected within policy limits; the insurer, in deciding whether to compromise a claim, must consider the insured’s best interests as much as its own.” (emphasis added).)

**3: Discovery May Create Conflicts of Interest**

“The potential problems may develop during pretrial discovery. . . . [Dependent counsel] was bound to investigate all conceivable bases on which liability might attach. These investigations and client communications may provide information relating directly to the coverage issue.” (*Cumis, supra*, 162 Cal.App.3d at 375.)

“Conflicts [of interest] come in all shapes and sizes.” (*Manfredi & Levine v. Superior Court (Barles)* (1998) 66 Cal.App.4th 1128, 1134). “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 . . . or whether an actual conflict of interest precludes insurer-appointed defense counsel from presenting a quality defense for the insured.’” (*Gulf Ins. Co. v. Berger, Kahn, Shafton, Moss, Figler, Simon & Gladstone* (2000) 79 Cal.App.4th 114, 131.)

**4: Dependent Counsel Must Fulfill the Duty of Disclosure**

“Counsel representing the insurer and the insured owes both a high duty of care (citation) and unswerving allegiance (citation.) 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.” (*Cumis, supra*, 162 Cal.App.3d at 374.)

PRC, Rule 1.4 provides in part that “A lawyer shall: . . . (2) reasonably\* consult with the client about the means by which to accomplish the client’s objectives in the representation; (3) keep the client reasonably\* informed about significant developments relating to the representation, including promptly complying with reasonable\* requests for information and copies of significant documents when necessary to keep the client so informed; and (4) advise the client about any relevant limitation on the lawyer’s conduct.”

**5: Dependent Counsel Must Fulfill the Duty of Confidentiality**

“[C]onfidentiality is essential where communication can affect coverage. Thus, the lawyer is forced to walk an ethical tightrope, and not communicate relevant information which is beneficial to one or the other of his clients.” (*Cumis, supra*, 162 Cal.App.3d at 374.)

Bus. & Prof. Code § 6068 “It is the duty of an attorney to do all of the following: (e) (1) To maintain inviolate the confidence, and at every peril to himself or herself to preserve the secrets, of his or her client.” See also, PRC, Rule 1.6.

**6: Dependent Counsel Must Fulfill the Duty of Undivided Loyalty**

“A lawyer should never represent in litigation multiple clients with differing interests. . . . If a lawyer accepted such employment and the interests did become actually differing, he would have to withdraw from employment with likelihood of resulting hardship on the clients; and for this reason it is preferable that he refuse the employment initially.” (*Id.* at 366-67.)

RPC, Rule 1.7 provides that a lawyer shall not represent a policyholder: (a) whose interests are directly adverse to the insurer; or (b) if there is a significant risk that the representation will be materially limited by (1) the lawyer’s responsibilities to or relationships with the insurer, or (2) by the lawyer’s own interests; and (c) the lawyer makes written disclosure of the relationship with the insurer; and (d) the lawyer reasonably believes subjectively that s/he can provide competent and diligent representation, and the representation is not unlawful, and the representation does not involve the assertion of a claim by the insurer against the policyholder. **7: The Tripartite Relationship Does Not Apply When the Insurer Issues a Reservation of Rights**

In the so-called tripartite relationship among insurer, policyholder and shared dependent counsel, “there is a single, common interest shared among them. . . . A different situation is presented, however, when [the insurer reserves its rights]. In this situation, there may be little commonality of interest. . . . Although issues of coverage under the policy are not actually litigated in the third party suit, this does not detract from the force of these opposing interests as they operate on the attorney selected by the insurer, who has a dual agency status.” (*Cumis, supra*, 162 Cal.App.3d at 364-65.)

The tripartite relationship among a liability insurer as financier, its policyholder as witness, and their shared lawyer may be harmonious, but only “absent a conflict of interest”. (*Gafcon, Inc. v. Ponsor & Associates* (2002) 98 Cal.App.4th 1388, 1406-07; see also, *State Farm Mutual Automobile Ins. Co. v. Federal Ins. Co.* (1999) 72 Cal.App.4th 1422, 1429 *National Union Fire Ins. Co. v. Stites Prof. Law Corp.* (1991) 235 Cal.App.3d 1718, 1727;*Kroll & Tract v. Paris & Paris* (1999) 72 Cal.App.4th 1537, 1543; *American Mut. Liab. Ins. Co. v. Superior Court* (1974) 38 Cal.App.3d 579, 592-93; and *James 3 Corp. v. Truck Ins. Exchange* (2001) 91 Cal.App.4th 1093, fn. 3.)

**8: Mere “Potential” Conflicts of Interest Require Ethical Compliance**

“[The insurer] makes a distinction between ‘potential’ and ‘actual’ conflicts of interest which is invalid and unworkable. Recognition of a conflict cannot wait until the moment a tactical decision must be made during trial. It would be unfair to the insured and generally unworkable to bring in counsel midstream during the course of trial expecting the new counsel to control the litigation. Contrary to [the insurer’s] argument, the existence of a conflict of interest should be identified early in the proceedings so it can be treated effectively before prejudice has occurred to either party. It may well be in a given case special verdicts will not be requested or given, and other indicators of the basis of liability such as punitive damages will not come into play. Nevertheless, this often cannot be known until shortly before the case is submitted to the jury. By that time, it is normally too late to prevent prejudice.” (*Id.* at 371, fn.7.)

“Rule (now 1.7) . . . applies when the interests of the clients are directly adverse or potentially adverse.” (*Sharp v. Next Entertainment, Inc.* (2008) 163 Cal.App.4th 410, 426.) Dependent counsel may not ethically represent a policyholder whose liability insurer has reserved its rights if “the basis for the reservation of rights is such as to cause assertion of factual or legal theories which undermine the positions to be asserted in the liability case” (*State Farm Fire & Cas. Co. v. Superior Court* (1989) 216 Cal.App.3d 1222, 1226, fn.3).

**9: The Cumis Rule - Part One: Dependent Counsel Must Comply With Canons of Ethics**

“We conclude the 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 to continued representation, counsel must cease to represent both.” (*Id.* at 375.)

The Cumis Rule has two parts: the first focuses on dependent counsel’s ethical conflicts of interest created by the insurer’s reservation of rights.

**10: The Cumis Rule - Part Two: A Reserving Insurer Must Pay For Independent Counsel**

“[I]n the absence of such consent, . . . the insurer must pay the reasonable cost for hiring independent counsel by the insured.” (*Ibid.*)

The second part of the Cumis Rule focuses on the insurer’s obligation to pay for independent counsel when dependent counsel is ethically disqualified from representing the policyholder under the first part of the Cumis Rule. There is a causal relationship between the two parts of the Cumis Rule. Dependent counsel unresolved ethical conflict of interest causes the reserving insurer to pay for independent counsel.

**11: A Reserving Insurer May Not Seize Control of the Policyholder’s Defense**

“In actions in which ... the insurer and insured have conflicting interests, the insurer may not compel the insured to surrender control of the litigation. [Citations.] . . . If the insurer must pay for the cost of defense and, when a conflict exists, the insured may have control of the defense if he wishes, it follows the insurer must pay for such defense conducted by independent counsel.” (*Id.* at 369.)

The defendant/policyholder always has the initial right and power to control one’s own defense. (See, Code Civ. Proc. § 284.) Typically, a liability insurance contract will give to the insurer the “right” to defend its policyholder. But because the insurer is not licensed to practice law, it may only discharge its right to defend by delegating the actual work of the defense to a qualified attorney. In turn, the attorney must comply with the lessons of the Cumis case.

**12: Other Jurisdictions Support the Cumis Holdings**

“Among the cases from other jurisdictions which are generally supportive of the view we take are” Alaska, Arizona, Illinois, Maryland, Massachusetts, New York, Rhode Island, and Texas. (*Id.* at 375, fn.9.) Since Cumis was published, fifty American jurisdictions have adopted one of three versions of the Cumis holdings: 1) the “Restatement” rule; 2) the “per se” rule; and 3) the “enhanced duties” rule. (50 State Survey: Does RPC Rule 1.7 Disqualify Insurance Defense Counsel and Require Liability Insurers to Pay Independent Counsel When Reserving Rights to Deny Coverage? DutytoDefend.com).

With the foregoing lessons of the Cumis case in mind, we now proceed to analyze whether application of well established rules of statutory interpretation justify the dictate noted above that Civil Code § 2860 superseced Cumis. It does not.

**Rules of Statutory Interpretation**

“We begin with the fundamental rule that our primary task is to determine the lawmakers’ intent. To determine intent, [t]he court turns first to the words themselves for the answer. If the language is clear and unambiguous there is no need for construction, nor is it necessary to resort to indicia of the intent of the Legislature.” (*Delaney v. Superior Court* (1990) 50 Cal.3d 785, 798 (citations, ellipses, and quotation marks omitted).) “In determining legislative intent, ‘[w]e first examine the words themselves because the statutory language is generally the most reliable indicator of legislative intent. [Citation.] The words of the statute should be given their ordinary and usual meaning and should be construed in their statutory context. [Citations.] These canons generally preclude judicial construction that renders part of the statute `meaningless or inoperative.’ (*Hassan v. Mercy American River Hospital* (2003) 31 Cal.4th 709, 715-716.)” (*Goehring v. Chapman University* (2004) 121 Cal.App.4th 353, 370.) Rules of statutory interpretation are clear.

**The Substance of Civil Code § 2860**

Civil Code § 2860, subsection (a) limits the applicability of the statute. It provides that if a liability insurer; 1) has a duty to defend; and 2) a disqualifying conflict of interest arises, the insurer shall pay for independent counsel unless the insured waives that right, with proposed language set forth in subsection (e). Subsection (b) provides that no conflict of interest exists because punitive damages, exposure in excess of policy limits or the insurer denies coverage, but that a conflict of interest may exist if the insurer reserves its right on a coverage issue can be controlled by dependent counsel. Subsection (c) provides that the insurer may require that independent counsel selected by the insured possess certain qualifications, limits independent counsel hourly rates paid to those paid to dependent counsel, and requires arbitration of attorney’s fees disputes. Subsection (d) provides that the independent counsel has a duty to disclose information concerning the action to the reserving insurer except privileged materials relevant to coverage disputes. Subsection (f) provides that both independent counsel and dependent counsel may participate fully in the defense and shall cooperate with each other consistent with each “counsel’s ethical and legal obligation to the insured.”

**Civil Code § 2860 Does Not Negate Any of the Lessons of the Cumis Case**

No language in the statute speaks to the many ways that dependent counsel’s conduct may impact coverage through discovery, settlement, confidentiality, undivided loyalty, disclosure, nor full compliance with Canons of Ethics. Instead, the statute emphasizes that dependent counsel has “ethical and legal obligation to the insured” and that “a conflict of interest may exist” “when an insurer reserves its rights on a given issue and the outcome of that coverage issue can be controlled by” dependent counsel. No language suggests that the tripartite relationship remains harmonious despite conflicts of interest created by a liability insurer’s reservation of rights, nor does any language contradict or overrule the Rules of Professional Conduct adopted by the California Supreme Court. The statute does state that dependent counsel “may fully participate” in the policyholder’s defense.

“Civil Code section 2860 does not clearly state when the right to an independent counsel vests.” (*Dynamic Concepts, Inc. v. Truck Ins. Exchange* (1998) 61 Cal.App.4th 999, 1007 fn5.) “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.” (James 3 Corp. v. Truck Ins. Exchange, supra, 91 Cal.App.4th at p. 1101.) Civil Code section 2860, subdivision (b) is “an example of a conflict of interest which may require appointment of independent counsel. It is not, however, the only circumstance in which Cumis counsel may be required. The language of Civil Code section 2860 ‘does not preclude judicial determination of conflict of interest and duty to provide independent counsel such as was accomplished in Cumis so long as that determination is consistent with the section.’ [Citation.]” (Golden Eagle Ins. Co. v. Foremost Ins. Co. (1993) 20 Cal.App.4th 1372, 1395-1396 [25 Cal.Rptr.2d 242].)” (*Gafcon, Inc. v. Ponsor & Associates* (2002) 98 Cal.App.4th 1388, 1421.)

Civil Code § 2860 does not disturb the lessons of Cumis that a reserving insurer may not seize control of the policyholder’s defense, but must instead pay for independent counsel selected and directed by the policyholder. a) If the provisions of a policy of insurance impose a duty to defend upon an insurer and a conflict of interest arises which creates a duty on the part of the insurer to provide independent counsel to the insured, “[T]he insurer shall provide independent counsel to represent the insured” if it is established that a reserving insurer: 1) has a duty to defend; and 2) its reservation of rights creates a disqualifying conflict of interest for dependent counsel.

While the Cumis case identified eleven other American jurisdictions that support its holdings, now fifty jurisdictions support the lessons of Cumis.

However, Civil Code § 2860 does impact reserving insurers, perhaps most importantly that conflicts of interest are not deemed to exist merely because of allegations of punitive damages or liability in excess of policy limits and in the rate limitation provision of subsection (b).

**Civil Code § 2860 Embraces, But Does Not Supersede Cumis**

“Civil Code, section 2860 codifies (with clarifications and limitations) the holding in (*Cumis*), which concluded that an insurer is responsible to pay the reasonable cost for hiring independent counsel for the insured when the insured and insurer have divergent interests due to the insurer’s reservation of its right to deny coverage.” (*Seltzer v. Barnes* (2010) 182 Cal.App.4th 953, 966 (ellipsis omitted).) “(Cumis) articulates the responsibility of an insurer to pay the reasonable cost for hiring independent counsel by the insured when the insured and insurer have divergent interests brought about by the insurer’s reservation of its right to deny coverage. Section 2860 codifies this holding.” (*Novak v. Low, Ball & Lynch* (1999) 77 Cal.App.4th 278, 282). “In 1987, the Legislature enacted Civil Code section 2860, which codified the right to independent or Cumis counsel but “clarifi[ed]”and “limit[ed]” Cumis’s stated rights and responsibilities of insurer and insured.” (*Gafcon, Inc. v. Ponsor & Associates* (2002) 98 Cal.App.4th 1388, 1420).

Since Cumis was published, the California Supreme Court has thoroughly rewritten the Rules of Professional Conduct. No exception to ethical compliance is carved out of the Rules for dependent counsel nor for the tripartite relationship. Dependent counsel’s duties to the policyholder of competent representation, confidentiality, disclosure, and undivided loyalty are all preserved in the new Rules.

**Bad Case Law**

Against this backdrop, three reported opinions state in dicta that Civil Code § 2860 “superseces” the Cumis opinion. *Derivi Construction & Architecture, Inc. vs. Wong* (2004) 14 Cal.Rptr.3d 329 held that defense counsel who is married to an attorney in a law firm that was previously disqualified need not be disqualified because of the marriage relationship. In passing, the court stated in dicta, in a footnote, without any analysis that “Cumis has been superseded by Civil Code section 2860.” (*Id.* at 335, fn.1.) *United Enterprises, Inc. v. Superior Court* (2010) 183 Cal.App.4th 1004 held that a declaratory relief action should be stayed pending resolution of underlying liability actions “because factual issues to be resolved in the declaratory relief action overlap factual issues to be resolved in the underlying actions, the court was required to issue the stay.” (*Id.* at 1010.) Also in passing the court stated in dicta and without any analysis that “(Cumis), superseded by Civ. Code, § 2860.” (*Ibid.*)

In *Carmelo v. Harson* (2010 E.D.Cal.) CIV S-09-2272 WBS KJM, a federal magistrate ruled that certain documents sent by Cumis counsel to an insurance carrier were protected from disclosure under the common interest doctrine. Again in passing, in dicta, and without any analysis stated that Cumis was “superseded by statute, Cal. Civil Code Section 2860.” (*Id.* at, fn.1.)

**Proper Statutory Interpretation of Civil Code § 2860**

A proper analysis of statutory construction of Civil Code § 2860 reveals that the clear and unambiguous of the statute itself determine the legislature’s intent so that it is not necessary to resort to judicial construction. (See, *Delaney v. Superior Court* (1990) 50 Cal.3d 785, 798; *Hassan v. Mercy American River Hospital* (2003) 31 Cal.4th 709, 715-716; *Goehring v. Chapman University* (2004) 121 Cal.App.4th 353, 370.) No language of Civil Code § 2860 diminishes any of the dozen lessons of Cumis. Dependent counsel’s ethical obligations to the policyholder are nowhere lessened, but are in fact reinforced by the language of the statute. The language of the code nowhere addresses when a disqualifying conflict of interest for dependent counsel vests nor when a reserving insurer must pay for independent counsel. Instead, the statute allegations of punitive damages and exposure in excess of policy limits may, but does not necessarily create a disqualifying conflict of interest. The code also permits a qualifying reserving insurer to pay reduced rates to independent counsel.

As courts that have analyzed the case and the code have consistently found that, far from superseding the holdings of Cumis, “Civil Code, section 2860 codifies (with clarifications and limitations) the holding in (Cumis)” (*Seltzer v. Barnes* (2010) 182 Cal.App.4th 953, 966; see also, *Novak v. Low, Ball & Lynch* (1999) 77 Cal.App.4th 278, 282; *Gafcon, Inc. v. Ponsor & Associates* (2002) 98 Cal.App.4th 1388, 1420.)

**Cumis Remains Vital**

The continuing vitality of Cumis is rooted in the fact that “the Cumis rule is not based on insurance law but on the ethical duty of an attorney to avoid representing conflicting interests.” (*Golden Eagle Ins. Co. v. Foremost Ins. Co.* (1993) 20 Cal. App. 4th 1372, 1394; *Spindle v. Chubb/Pacific Indemnity Group* (1979) 89 Cal.App.3d 706, 713 (“the governing principle underlying Cumis and section 2860 [which] is the attorney’s ethical duty to the clients”); see also, *Golden Eagle, supra*, 20 Cal.App.4th at 1396; *James 3 Corp. v. Truck Ins. Exchange* (2001) 91 Cal.App.4th 1093, 1102.)

Thus, the holdings of Cumis remain vital because the Canons of Ethics remain vital. “[W]hen coverage is disputed, the interests of the insured and the insurer are always divergent.” (*Cumis, supra*, 162 Cal.App.3d at 375.) Rule 1.7 requires all lawyers who wish to represent dual clients with conflicting interests to analyze potential conflicts and make written disclosure. If the analysis discloses a disqualifying conflict of interest, counsel must obtain informed written consent before starting or continuing representation. Rules of Professional Conduct impose on dependent counsel a duty of disclosure (Rule 1.4), a duty of confidentiality (Rule 1.6), and that “the disclosures and the consent required by paragraph (e) must be in writing.” (Rule 1.0.1(e-1).)

The California Supreme Court has exclusive jurisdiction over lawyer ethics. “The judiciary’s authority to regulate and control the practice of law is universally accepted and dates back to the year 1292.” (*In re Attorney Discipline System* (1998) 19 Cal.4th 582, 585.) “[T]he inherent judicial power of . . . attorney disciplinary actions . . . is exclusively held by the Supreme Court and the State Bar, acting as its administrative arm.” (*Sheller v. Superior Court* (2008) 158 Cal.App.4th 1697, 1710.) However, diligent research has disclosed no reported opinion addressing whether the Supreme Court will yield its exclusive jurisdiction to the legislature through Section 2860.