MODEL DISCLOSURE LETTER
Firm Name
Attorneys at Law
&Date&

Policyholder InsCo Claim Adjuster

RE: Policyholder:
Claim Number:
Matter:

Dear Policyholder and Claim Adjuster:

I am &Blank&, a partner in the law firm of &Firm& (&Firm&). &Blank& Insurance Company (&InsCo&) has assigned &Firm& to defend &Policyholder& (&Policyholder&) against a lawsuit brought by &Injured Plaintiff& (&Injured Plaintiff&).

CONFIDENTIALITY

Although we do not yet represent &Policyholder& nor have an attorney-client relationship with it, in our opinion, we owe fiduciary duties to you both even at this very early stage of our relationship and this letter is protected from disclosure to others by our duty of confidentiality. "Between the attorney and the insurer who retained the attorney and paid for the defense, there exists a separate attorney-client relationship endowed with confidentiality." (*State Farm Mutual Automobile Ins. Co. v. Federal Ins. Co.* (1999) 72 Cal.App.4th 1422, 1429.)

PURPOSE OF THIS LETTER

I write to you both now for several reasons.

First, "[u]nlike the obligation to indemnify, which is only determined when the insured's underlying liability is established, the duty to defend must be assessed at the very outset of a case." (*Hartford Ins. Co. v. Swift Distribution, Inc.* (2014) 59 Cal.4th 277, 287.)

Second, our Canons of Ethics are prophylactic, intended to prevent harm from happening in the first place, rather than trying to unravel any damage done by ethical violations at a later time. "The primary purpose of this prophylactic rule [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.) "[T]he purpose of a disqualification order must be prophylactic, not punitive." (*Gregori v. Bank of America* (1989) 207 Cal. App. 3d 291, 308-309.)

Third, &InsCo& has asserted what is known as a reservation of rights, which alone triggers &Firm&'s obligation to make this disclosure to you. "[O]nce the insurer decides to assert a coverage defense, the same attorney may not represent both the insured and the insurer. . . . [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." (*San Diego Navy Fed. Credit Union v. Cumis Ins. Society, Inc.* (1984) 162 Cal.App.3d 358, 374-75.)

FACTS

&InsCo& issued a liability insurance policy to &Policyholder& for the policy period &Blank&. &Injured Plaintiff& filed a lawsuit against &Policyholder&. &Policyholder& notified &InsCo& of the suit. &InsCo& agreed to defend &Policyholder& on the complaint subject to a

broad reservation of rights to later deny coverage set forth in a letter dated &Blank&.

OUR INVESTIGATION

We have read the complaint, the policy, and &InsCo&'s reservation of rights letter. &Firm& believes that the reservation of rights letter accurately summarizes &Injured Plaintiff&'s allegations, recites pertinent policy language, and lists numerous bases upon which &InsCo& asserts that it may deny coverage to &Policyholder&. I will discuss each of these bases in detail below.

I have spoken by telephone with counsel for &Injured Plaintiff&, &Policyholder&, and &Claim Adjuster&. &Claim Adjuster& also advised that: 1) although &InsCo& has agreed to defend &Policyholder&, it does not do so unconditionally; and 2) &InsCo& does not unconditionally agree to pay for independent counsel selected and directed by &Policyholder&.

&Claim Adjuster& advised that &InsCo& will not pay compensatory damages if punitive damages are assessed against &Policyholder& because punitive damages require of finding of "malice" on the part of &Policyholder&.

Finally, &Claim Adjuster& advised that &InsCo& will not pay for &Policyholder&'s liability to &Injured Plaintiff& if &Policyholder& is found to be liable for breach of contract even if &Policyholder& is also has tort liability to &Injured Plaintiff& for the same conduct.

RULE 1.7

Canons of Ethics set forth in Rules of Professional Conduct, Rule 1.7 require &Firm& to investigate potential conflicts of interest created by &InsCo&'s reservation of rights, analyze those conflicts thoroughly, report our analysis to you, and if any disqualifying conflict of interest exists, obtain your informed written consent. Attachment #1 to this letter is a copy of Rules 1.7 and 1.8.6.

&Firm& interprets Rule 1.7 to say that we shall not accept or continue representation of &Policyholder& or &InsCo& without providing written disclosure to both of you the relevant circumstances and of the actual and reasonably foreseeable adverse consequences to you both where we have a legal, business, or financial relationship with &InsCo& that would be affected substantially by resolution of the complaint. Although &InsCo& has asserted a reservation of rights, our opinion is that &InsCo& remains a potential indemnitor that would be affected substantially by resolution of the complaint.

OUR RELATIONSHIP WITH &InsCo&

&Firm& has a longstanding and valuable legal, business, or financial relationship with &InsCo&. &Firm& generates most of its income from assignments to it by &InsCo& and other liability insurers like &InsCo&. The Cumis case said this about the general relationship between liability insurers and dependent counsel. "The Carrier is required to hire independent counsel because an attorney in actual trial would be tempted to develop the facts to help his real client, the Carrier Company, as opposed to the Insured, for whom he will never likely work again. 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. The dictum in Gray flies in the face of the reality of insurance defense work. Insurance 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." Attachment #2 to this letter is a compilation of California case authority generally describing the relationship of dependent counsel to liability insurers that assign defense work to them.

&InsCo&'s policy is a contract of indemnity (Ins. Code § 22) by which it is now obligated, as it has agreed, to pay for a competent and ethical lawyer to do the actual work of defending

&Policyholder& against the complaint. At the same time &InsCo& may hire counsel to protect the interests of &InsCo& as a potential indemnitor if a judgment is entered against &Policyholder& and some or all of that judgment is covered by the policy.

Liability insurers like &InsCo&, dependent counsel like &Firm&, and policyholders like &Policyholder& may form what is know as a "tripartite relationship." This tripartite relationship may be harmonious or dissonant, depending on whether potential conflicts of interest exist. The tripartite relationship with &InsCo&, &Policyholder&, and &Firm& may be mutually beneficial with &InsCo& as financier, &Policyholder& as witness, and &Firm& as warrior for you both. However, the tripartite relationship may turn contentious when conflicts of interest develop between the policyholder and the insurer, such as &InsCo&'s reservation of rights. A leading case well describes "The Tripartite Insurer-Attorney -Insured Relationship. In California, it is settled that **absent a conflict of interest**, an attorney retained by an insurance company to defend its insured under the insurer's contractual obligation to do so represents and owes a fiduciary duty to both the insurer and insured. **So long as the interests of the insurer and the insured coincide**, they are both the clients of the defense attorney and the defense attorney's fiduciary duty runs to both the insurer and the insured." (*Gafcon, Inc. v. Ponsor & Associates* (2002) 98 Cal.App.4th 1388, 1406). In our opinion, &Firm& may not ethically enter into the tripartite relationship with &Policyholder& and &InsCo& if there is a conflict of interest between you by which your interests do no coincide. Your interests do no coincide because &InsCo& has asserted a reservation of rights to deny coverage to &Policyholder&.

&InsCo& is a client of &Firm&. If we accept &InsCo&'s assignment, &Firm& will have "two clients" (*American Mut. Liab. Ins. Co. v. Superior Court* (Nork) (1974) 38 Cal.App.3d 579, 592), &Policyholder& and &InsCo&. "The tranquility of this [tripartite relationship] coalition is disturbed however, where, as here, disagreement arises between the members. The situation has changed. Partners have become adversaries. The closely knit fabric of confidentiality is torn and shredded." (*Id*. at 592-93.)

We have concluded that &InsCo&'s reservation of rights and our Canons of Ethics require &Firm& to conduct a thorough investigation, analyze potential conflicts of interest between &InsCo& and &Policyholder&, write you this letter to make written disclosure of our analysis to you both. Because we conclude that &Firm& has a disqualifying conflict of interest, we seek your informed written consent to represent you.

INDEPENDENT COUNSEL

Independent counsel (sometimes called Cumis counsel) has a different relationship with &InsCo&. "[T]here is no attorney-client relationship between Cumis counsel and the insurer." (*Assurance Co. of America v. Haven* (1995) 32 Cal.App.4th 78, 90.)

THE CUMIS RULE

A landmark published court opinion known as the Cumis case says: "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. Moreover, in the absence of such consent, where there are divergent interests of the insured and the insurer brought about by the insurer's reservation of rights based on possible noncoverage under the insurance policy, 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 *(Tomerlin v. Canadian Indemnity Co., supra*., 61 Cal.2d 638, 648; and see *Nike, Inc. v. Atlantic Mut. Ins. Co.* (N.D.Cal.

1983) 578 F.Supp. 948, 949). Disregarding the common interests of both insured and insurer in finding total nonliability in the third party action, the remaining interests of the two diverge to such an extent as to create an actual, ethical, conflict of interest warranting payment for the insureds' independent counsel." (*San Diego Navy Fed. Credit Union v. Cumis Ins. Society, Inc.* (1984) 162 Cal.App.3d 358, 375.) Attachment #3 is additional authority generally describing the Cumis Rule.

CIVIL CODE § 2860

Three years after the Cumis case was published, the California Legislature enacted Civil Code § 2860. Attachment #4 to this letter is a copy of this statute. "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).

In the 33 years since this statute was enacted, courts have clarified its meaning. "(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). "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).)

In our opinion, Civil Code § 2860 does not apply to this case for two reasons. First, while &InsCo& has agreed to defend, it has not done so "unconditionally." "[I]n 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." (*Handy v. First Interstate Bank* (1993) 13 Cal.App.4th 917, 926.) In our opinion, each of the following cases support the holding of *Handy*: *Callahan & Guantlett v. Superior Court* (1992) 9 Cal.App.4th 1140, fn. 4; *Truck Ins. Exch. v. Dynamic Concepts* (1992) 9 Cal App 4th 1147, 1150; *Truck Ins. Exchange v. Superior Court* (1996) 51 Cal.App.4th 985, 992-98.

"Civil Code section 2860 does not clearly state when the right to an independent counsel vests. The Legislature declined to adopt the absolutist view that insurer-appointed defense counsel will only offer token resistance to claims that fall outside a policy's coverage terms or limits or will steer the defense in a direction favorable to the insurer." (*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.)" (*Gafcon, Inc. v. Ponsor & Associates* (2002) 98 Cal.App.4th 1388, 1421.)

THE CUMIS TEST

In our opinion, while Civil Code § 2860 does not articulate when &Policyholder&'s right to

independent counsel vests, California case law does. We have concluded that &Firm& may not represent &Policyholder& without making this disclosure to &Policyholder& and &InsCo& and obtaining the informed written consent of both of you unless all bases upon which &InsCo& has reserved its right to deny coverage to &Policyholder& have "nothing to do with the issues being litigated in" the &Injured Plaintiff& complaint. (*Long v. Century Indemnity Co.* (2008) 163 Cal.App.4th 1460, 1470.) Attachment #5 to this letter is a compilation of California case authority generally describing the Cumis Test in various ways.

"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. 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. (*Gafcon, Inc. v. Ponsor & Associates* (2002) 98 Cal.App.4th 1388, 1420-1421.)" (*Miller v. Zurich Ins. Co.* (2019) 41 Cal.App.5th 247, 251 fn.3 (citations and quotation marks omitted).)

CONFLICTS OF INTEREST AT SETTLEMENT

In our experience, most liability disputes in which &Firm& represents policyholders on behalf of liability insurers are resolved by settlement. In our opinion, conflicts of interest may arise which may require &InsCo& to pay for &Policyholder&'s independent counsel during settlement negotiations. These potential conflicts of interest are independent of our analysis of &InsCo&'s reservation of rights.

"Attorney control of the outcome of a coverage dispute . . . is not, however, the only circumstance in which Cumis counsel may be required. . . . [T]he governing principle underlying Cumis and section 2860 is the attorney's ethical duty to the clients. . . . We find a clear conflict of interest in the present case entitling the [insureds] to independent counsel. . . . Not only was [dependent] counsel 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 [the insureds] 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, 1395-96.)

OUR ANALYSIS OF &InsCo&'S RESERVATION OF RIGHTS

In light of the foregoing legal authority, I now proceed to analyze each of the &Blank& specific reservation of rights set forth in &InsCo&'s reservation of rights letter. Following is language quoted from the letter with our opinion in parentheses.

"The &InsCo&'s participation in the defense of Colorado Seasons in the complaints is subject to the following specific reservations:

"• Coverage is not provided for any person or entity that is not an 'insured', 'Named Insured', 'Person Insured' or 'Additional Insured' under the Policy (as those terms are defined in the Policy);" [This reservation does NOT create a disqualifying conflict of interest for us.]

"• The Policy does not provide coverage for 'personal and advertising injury' arising out of an offense committed by, at the direction of or with the consent or acquiescence of the insured with the expectation of inflicting 'personal and advertising injury';" [This reservation does create a disqualifying conflict of interest for us. This reservation deserves special consideration because it invoke a risk the &Policyholder& may be found to have acted intentionally. The Cumis case involved intentional conduct. Our Supreme Court described that "This is the classic situation" where independent counsel is required. (*Montrose Chemical Corp. v. Superior Court* (1993) 6 Cal.4th 287, 302.)]

&InsCo& HAS A DUTY TO OFFER INDEPENDENT COUNSEL TO &Policyholder&

Our foregoing analysis has resulted in our opinion that only &Blank& of the &Blank& grounds upon which &InsCo& has reserved its rights do not create a disqualifying conflict of interest for us, and some of those seven are qualified. Therefore, we conclude that during settlement negotiations and because of &InsCo&'s reservation of rights, &Firm& cannot ethically accept &InsCo&'s assignment without your informed written consent.

&InsCo&'S DUTY TO PAY TIMELY

"[T]he insurer's duty to defend . . . entails the rendering of a service, viz., the mounting and funding of a defense in order to avoid or at least minimize liability. (*Buss v. Superior Court* (1997) 16 Cal.4th 35, 46 (citations omitted).) In our opinion, if &Policyholder& elects to be represented by independent counsel, &InsCo& will be required to pay independent counsel promptly. "The trial court properly treated [the insurer]'s payment of defense fees at the end of the litigation "as the equivalent of a defense denial." (*The Housing Group v. PMA Captial Insurance Co.* (2011) 193 Cal.App.4th 1150, 1157.) A failure to pay independent counsel promptly may constitute a breach of the duty to defend. "Breach of duty to defend also results in the insurer's forfeiture of the right to control defense of the action or settlement, including the ability to take advantage of the protections and limitations set forth in section 2860. (*Fuller-Austin Insulation Co. v. Highlands Ins. Co.* (2006) 135 Cal.App.4th 958, 984 [38 Cal.Rptr.3d 716] (*Fuller-Austin*); *Atmel Corp. v. St. Paul Fire & Marine Ins. Co.* (N.D.Cal. 2005) 426 F.Supp.2d 1039, 1047 (Atmel).)" (*Intergulf Development LLC v. Superior Court* (2010)183 Cal.App.4th 16, 20.) &InsCo& may also invite bad faith liability. If the insurer "failed to accept [the policyholder's] selection of independent counsel and pay its share of defense costs in a timely manner - [is] a factual question at the heart of [the policyholder's] breach of contract and bad faith claims." (*Intergulf Development LLC v. Superior Court* (2010)183 Cal.App.4th 16, 22.) If &InsCo& fails to pay independent counsel promptly, a court may conclude that it "cannot avail itself of the protections and limitations set forth in § 2860." (*Atmel Corp. v. St. Paul Fire & Marine Ins. Co.* (N.D.Cal. 2005) 426 F.Supp.2d 1039, 1047; see also, *The Housing Group v. PMA Captial Insurance Co.* (2011) 193 Cal.App.4th 1150, 1157.)

&Firm&'S FUTURE PARTICIPATION IN &Policyholder&'S DEFENSE?

Civil Code § 2860 describes that insurer appointed dependent counsel may "participate" in the policyholder's defense. However, as noted above, in our opinion, Civil Code § 2860 is not applicable to this case. (*Handy v. First Interstate Bank* (1993) 13 Cal.App.4th 917, 926.) Therefore, in our opinion, &InsCo& may not require &Policyholder& to allow &Firm& to participate in &Policyholder&'s defense in the matter described in the statute. Even if &Policyholder& does not give us informed written consent to represent it as its lawyers, we request that &Policyholder& consent to our participation in the defense in a supporting role with &Policyholder&'s independent counsel.

OFFENSE AND DEFENSE

&Injured Plaintiff& has sued &Policyholder& and &Policyholder& has sued &Injured Plaintiff&. In our opinion, &InsCo& is not required to pay &Firm& nor &Policyholder&'s independent counsel to prosecute &Policyholder&'s lawsuit against &Injured Plaintiff&. However, if you allow &Firm& to be you attorneys, we will have an ethical obligation to represent all of your interests in the litigation, both offense and defense. The client must give informed written consent to limit our representation (ABA Model Rule 1.2(c); *Janik v. Rudy, Exelrod & Zieff* (2004) 119 Cal.App.4th 930, 940). Attorneys "still have a duty to alert the client to legal problems which are reasonably apparent, even though they fall outside the scope of the

retention." (*Nichols v. Keller* (1993) 15 Cal.App.4th 1672, 1684.)

In order to honor &InsCo&'s limited obligation to pay for &Policyholder&'s defense only, &Firm& will be required to allocate its time and expenses between offense and defense. The time that we allocate to offense will be &Policyholder&'s obligation to pay. However, there are many ways that we might go about the task of allocating between offense and defense. In our opinion, the proper method of allocation is a "but for" analysis. We will bill all of time and expense to &InsCo& unless we do in good faith believe that we would not have spent any time or incurred any expense "but for" the complaint against &Injured Plaintiff&. For example, if we attend a deposition and half of the time is spent on offense while half of the time is spent on defense, &Firm& will bill &InsCo& for the entire time and cost of the deposition because we would have to attend as you counsel on defense, spent all of our time and incur all of the expense on defense. No addition time or expense is properly allocable to offense because we would not spend any additional time nor incur any additional expense simple because we also represent you on offense.

Since &Injured Plaintiff& and &Policyholder& have sued each other, it is possible that each may recover damages from the other. A rule of "set-off" sometimes requires that when parties are entitled to collect money from each other, the recovery by one simply reduced the recovery of the other so as to result in a judgment only for the net amount in favor of the party with the larger recovery. In our opinion, the set-off rule does not apply with both parties have liability insurance. "[W]e conclude that the current setoff statutes cannot properly be interpreted to require setoff in cases in which such a setoff will defeat the principal purpose of California's financial responsibility law and will provide an inequitable windfall to an insurance carrier at the expense of the carrier's insured." (*Jess v. Herrmann* (1979) 26 Cal.3d 131, 143.)

REQUEST FOR INFORMED WRITTEN CONSENT

&Firm& respectfully requests that &Policyholder& and &InsCo& give &Firm& your informed written consent to accept &InsCo&'s assignment. You should both consult with independent counsel of your choice to determine whether this disclosure letter is sufficient and whether you choose to give us your informed written consent to represent you both. If you decide to give us informed written consent, please sign and return this letter to us.

If you have any questions, please let me know.

Very truly yours,

&Firm&

&Blank& Insurance Company	&Policyholder&
_____	_____
By: &Blank&	By: &Policyholder&
Approved as to content and form	
_____	_____
Independent Counsel for &InsCo&	Independent Counsel for &Policyholder&

Rule 1.7 Conflict of Interest: Current Clients

(a) A lawyer shall not, without informed written consent* from each client and compliance with paragraph (d), represent a client if the representation is directly adverse to another client in the same or a separate matter.

(b) A lawyer shall not, without informed written consent* from each affected client and compliance with paragraph (d), represent a client if there is a significant risk the lawyer's representation of the client will be materially limited by the lawyer's responsibilities to or relationships with another client, a former client or a third person,* or by the lawyer's own interests.

(c) Even when a significant risk requiring a lawyer to comply with paragraph (b) is not present, a lawyer shall not represent a client without written* disclosure of the relationship to the client and compliance with paragraph (d) where:

(1) the lawyer has, or knows* that another lawyer in the lawyer's firm* has, a legal, business, financial, professional, or personal relationship with or responsibility to a party or witness in the same matter; or

(2) the lawyer knows* or reasonably should know* that another party's lawyer is a spouse, parent, child, or sibling of the lawyer, lives with the lawyer, is a client of the lawyer or another lawyer in the lawyer's firm,* or has an intimate personal relationship with the lawyer.

(d) Representation is permitted under this rule only if the lawyer complies with paragraphs (a), (b), and (c), and:

(1) the lawyer reasonably believes* that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law; and

(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal.

(e) For purposes of this rule, "matter" includes any judicial or other proceeding, application, request for a ruling or other determination, contract, transaction, claim, controversy, investigation, charge, accusation, arrest, or other deliberation, decision, or action that is focused on the interests of specific persons,* or a discrete and identifiable class of persons.*

Rule 1.8.6 Compensation from One Other Than Client

A lawyer shall not enter into an agreement for, charge, or accept compensation for representing a client from one other than the client unless:

(a) there is no interference with the lawyer's independent professional judgment or with the lawyer-client relationship;

(b) information is protected as required by Business and Professions Code section 6068, subdivision (e)(1) and rule 1.6; and

(c) the lawyer obtains the client's informed written consent* at or before the time the lawyer has entered into the agreement for, charged, or accepted the compensation, or as soon thereafter as reasonably* practicable, provided that no disclosure or consent is required if:

(1) nondisclosure or the compensation is otherwise authorized by law or a court order; or

(2) the lawyer is rendering legal services on behalf of any public agency or nonprofit organization that provides legal services to other public agencies or the public.

ATTACHMENT #2

The succinct moniker "**de**pendent 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), 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.)

The Cumis Rule

The general application of rules of lawyer ethics has long been applied to the specific situation where a liability insurer reserves its rights to later deny coverage to its policyholder in fifty American jurisdictions. In California, development of this rule started with *Gray v. Zurich Insurance Co.* (1966) 65 Cal.2d 263, 268 (a liability insurer is not excused from its duty to defend because its reservation of rights "would embroil it in a hopeless conflict of interest"). The rule was extended by *Executive Aviation, Inc. v. National Ins. Underwriters* (1971) 16 Cal.App.3d 799, 810 ("We hold, therefore, that in a conflict of interest situation, the insurer's desire to exclusively control the defense must yield to its obligation to defend its policy holder. Accordingly, the insurer's obligation to defend extends to paying the reasonable value of the legal services and costs performed by independent counsel, selected by the insured"). The rule matured with *Previews, Inc. v. California Union Ins. Co.* (9th Cir. 1981) 640 F.2d 1026, ("California law provides that in a conflict of interest situation, the insurer's desire to control exclusively the defense must yield to its obligation to defend the policyholder. Accordingly, the insurer's obligation to defend extends to paying the reasonable value of the legal services and costs performed by independent counsel selected by the insured.") But the rule was popularized in the landmark Cumis case, which coined such phrases as "Cumis counsel" and the "Cumis Rule".

A. The Cumis Rule Has Two Parts

As enunciated in the opinion, the Cumis Rule has two parts. Part one of the Cumis Rule 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 to continued representation, counsel must cease to represent both." (*Cumis, supra*, 162 Cal.App.3d at 375.) Part two of the Cumis Rule states: "Moreover, in the absence of such consent, where there are divergent interests of the insured and the insurer brought about by the insurer's reservation of rights based on possible noncoverage under the insurance policy, 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." (*Ibid*.)

B. The Cumis Rule Is Rooted in Lawyer Ethics

"We begin by briefly reviewing the reason for Cumis counsel. . . . An insurer usually provides a defense to its insured by hiring competent defense counsel, who represents the interests of both the insurer and the insured. . . . Usually, these conflicts involve the insured trying to obtain coverage and the insurer trying to avoid it. When this happens, defense counsel may not be permitted to represent both the insurer and the insured." (*Haven, supra*, 32 Cal.App.4th at 83-84 (citations omitted).)

"The obligation of an insurer to provide independent Cumis counsel for an insured is premised on the ethical inability of an attorney to represent conflicting interests." (*United Pac. Ins. Co. v. Hall* (1988) 199 Cal. App.3d 551, 556.) "The Cumis opinion was based heavily on the canons of ethics and the possibly conflicting choices confronting an attorney" (*Blanchard v. State Farm Fire & Casualty Co.* (1991) 2 Cal.App.4th 345, 350 (*Blanchard*).) "[T]he 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 (*Golden Eagle*).) "Cumis is based on ethical standards, not on insurance concepts." (*Mosier v. S. Cal. Physicians Ins. Exch.* (1998) 63 Cal. App.4th 1022, 1042.

C. Unavoidable Impact on Coverage

"The basic premise for this view (the Cumis Rule) is well established. Since it is almost unavoidable that, in the course of investigating and preparing the insured's defense to the third party's action, the insured's attorney will come across information relevant to a coverage or similar issue, it is quite difficult for an attorney beholden to the insurer to represent the insured where the insurer is reserving its rights regarding coverage (unless, of course, the insured consents). . . . [T]he Cumis doctrine intended to eliminate the ethical dilemmas and temptations that arise along with conflict in joint representations ... through mandating the insured's right to Cumis counsel that represent[s] only the insured. ¶ An important corollary of the Cumis doctrine is that if the insured is entitled to Cumis counsel, the insured is entitled to control the defense of the case." (*Haven, supra*, 32 Cal.App.4th at 87 (citations and quotation marks omitted).)

"[W]here the carrier questions the availability of coverage and provides a defense in the third party action subject to a reservation of rights, a conflict exists - because the insured's goal is coverage, which flies in the face of the insurer's desire to avoid its duty to indemnify. (Citation.) Since it is unavoidable that, in the course of investigating and preparing the insured's defense in the third party action, the insured's attorney will come upon information relevant to a coverage issue, it is impossible for the carrier's attorney to represent the insured." (*Rockwell Internat. Corp. v. Superior Court* (1994) 26 Cal.App.4th 1255, 1263-64.)

One court reviewed self-serving excuses proffered by dependent counsel as red herrings and wishful thinking. "We first dispose of an obvious red herring: [that dismissal of the city cured the conflict]. . . . Along the same line it was simply wishful thinking by [dependent counsel] when he further declared: 'My involvement in this litigation is not, nor has it ever been, adverse to the [policyholder/client] . . . While [dependent counsel] may be literally correct in stating that no confidential information 'with respect to the questions of insurance coverage' was revealed to him by the [policyholder], it is inconceivable that if he prepared the case at all, he failed to learn facts which are relevant to the issue of coverage." (*Industrial Indem. Co. v. Great American Ins. Co.* (1977) 73 Cal. App. 3d 529, 534-36.)

D. Shutting Out Independent Counsel Deprives the Policyholder of Procedural Due Process

"The Cumis rule requires complete independence of counsel when an insurance company interposes a reservation of rights, the basis of which creates a conflict of interest." (*State Farm Fire & Casualty Co. v. Superior Court* (1989) 216 Cal.App.3d 1222, 1226 (*State Farm*); *Haven, supra*, 32 Cal.App.4th at 87.) "Cumis counsel represents solely the insured." (*Employers Ins. of Wausau v. Albert D. Seeno Const.* (N.D.Cal. 1988) 692 F.Supp. 1150, 1155; *Haven, supra*, 32 Cal.App.4th at 87.)

"The section 2860 equilibrium is shattered when counsel provided by the insurer shuts the independent counsel out of the process." (*Novak v. Low, Ball & Lynch* (1999) 77 Cal.App.4th 278, 284 (*Novak*)

When a reserving insurer and its dependent counsel wrongfully control the policyholder's defense and the insurer does not pay for independent counsel, they deprive the policyholder of procedural due process of law.

The Fifth and Fourteenth Amendments to the U.S. Constitution say to the federal and state governments that no one shall be "deprived of . . . property without due process of law." The California Constitution, section 1 also guarantees due process of law. Dependent counsel functioning at the direction of a reserving insurer has the power to guide policyholder through a sham judicial procedure which may result in a non-covered judgment against the policyholder. While such a judgment may have the outward appearance of satisfying procedural due process of law, upon examination, it may not. Without independent counsel controlling the policyholders

defense, the outcome is suspect at least to the extent that the outcome impacts coverage. This is so because no lawyer was present to protect the policyholder from possible abuse by the reserving insurer and its unethical dependent counsel. Maybe the outcome correctly decided coverage issues, but maybe it did not. The policyholder is necessarily unrepresented regarding the impact of the third party liability dispute on coverage. A remedy for this deprivation of procedural due process is a do-over. The policyholder should be is entitled to a new trial. (See, *Mosier v. S. Cal. Physicians Ins. Exch.* (1998) 63 Cal. App. 4th 1022

E. The Definition of Disqualifying Conflict of Interest

"The mandatory rule of disqualification in cases of dual representations . . . - analogous to the biblical injunction against 'serving two masters' (Matthew 6:24) - is such a self-evident one that there are few published appellate decisions elaborating on it." (*Flatt v. Superior Court* (1994) 9 Cal.4th 275, 286.) "The issue of disqualification ultimately involves a conflict between a client's right to chosen counsel and the need to maintain ethical standards of professional responsibility. (*Comden v. Superior Court* (1978) 20 Cal.3d 906, 915.)" (*State Farm Mutual Automobile Ins. Co. v. Federal Ins. Co.* (1999) 72 Cal.App.4th 1422, 1428; see also, *Gregori, supra*, 207 Cal. App. 3d at 308; *Dynamic Concepts, supra*, 61 Cal.App.4th at 1008.)

However, not all reservations of rights by a liability insurer necessarily disqualify insurer appointed counsel from simultaneously representing both the policyholder and representing the interests of the insurer as a potential indemnitor in the tripartite relationship under California law. The bright line denoting that a disqualifying conflict of interest exists are described by the Cumis Test.

ATTACHMENT #4

Civil Code § 2860. Conflict of interest; duty to provide independent counsel; waiver; qualifications of independent counsel; fees; disclosure of information

(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, the insurer shall provide independent counsel to represent the insured unless, at the time the insured is informed that a possible conflict may arise or does exist, the insured expressly waives, in writing, the right to independent counsel. An insurance contract may contain a provision which sets forth the method of selecting that counsel consistent with this section.

(b) For purposes of this section, a conflict of interest does not exist as to allegations or facts in the litigation for which the insurer denies coverage; however, when 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.

(c) When the insured has selected independent counsel to represent him or her, the insurer may exercise its right to require that the counsel selected by the insured possess certain minimum qualifications which may include that the selected counsel have (1) at least five years of civil litigation practice which includes substantial defense experience in the subject at issue in the litigation, and (2) errors and omissions coverage. 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 or providing for methods of settlement of disputes concerning those fees. Any dispute concerning attorney's fees not resolved by these methods shall be resolved by final and binding arbitration by a single neutral arbitrator selected by the parties to the dispute.

(d) When independent counsel has been selected by the insured, it shall be the duty of that counsel and the insured to disclose to the insurer all information concerning the action except privileged materials relevant to coverage disputes, and timely to inform and consult with the insurer on all matters relating to the action. Any claim of privilege asserted is subject to in camera review in the appropriate law and motion department of the superior court. Any information disclosed by the insured or by independent counsel is not a waiver of the privilege as to any other party.

(e) The insured may waive its right to select independent counsel by signing the following statement: "I have been advised and informed of my right to select independent counsel to represent me in this lawsuit. I have considered this matter fully and freely waive my right to select independent counsel at this time. I authorize my insurer to select a defense attorney to represent me in this lawsuit."

(f) Where the insured selects independent counsel pursuant to the provisions of this section, both the counsel provided by the insurer and independent counsel selected by the insured shall be allowed to participate in all aspects of the litigation. Counsel shall cooperate fully in the exchange of information that is consistent with each counsel's ethical and legal obligation to the insured. Nothing in this section shall relieve the insured of his or her duty to cooperate with the insurer under the terms of the insurance contract.

The Cumis Test

Perhaps the best statement of the Cumis Test is this: "It is only when the basis for the reservation of rights is such as to cause assertion of factual or legal theories which undermine or are contrary to the positions to be asserted in the liability case that a conflict of interest sufficient to require independent counsel, to be chosen by the insured, will arise."[1]

The Restatement of Liability Insurance also expresses this test. "When an insurer with the duty to defend provides the insured notice of a ground for contesting coverage under § 15 (Reserving the Right to Contest Coverage) and there are facts at issue that are common to the legal action for which the defense is due and to the coverage dispute, such that the action could be defended in a manner that would benefit the insurer at the expense of the insured, the insurer must provide an independent defense of the action." (§ 16. The Obligation to Provide an Independent Defense)

The substantive legal test to determine whether a liability insurer's reservation of rights creates a disqualifying conflict of interest has been expressed by California courts in a variety of ways, both negatively and positively, but always expressing the same concept.

Expressed negatively, no disqualifying conflict of interest for dependent counsel exists and a reserving liability insurer has no duty to pay for independent counsel if each ground upon which the insurer may later deny coverage: has "nothing to do with";[2] "is logically unrelated to";[3] "is independent of";[4] or "is extrinsic to"[5] disputed issues of fact or law in the liability dispute.

Expressed positively, a disqualifying conflict of interest does exist and the reserving liability insurer is required to pay for independent counsel: "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";[6] "whenever [the insurer's and policyholder's] common lawyer's representation of the one is rendered less effective";[7] coverage issues "overlap"[8] issues in the third party liability action; "the ground of noncoverage was based on the nature of the insured's conduct";[9] or "upon the insured's own conduct";[10] dependent counsel has an "incentive to attach liability to"[11] the policyholder; "the outcome of the coverage issue can be controlled by the way counsel defends the case";[12] "can be controlled by counsel first retained by the insurer for the defense of the claim";[13] "the way counsel retained by the insurance company defends the action will affect an

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[1] *State Farm Fire & Cas. Co. v. Superior Court* (1989) 216 Cal.App.3d 1222, 1226, fn.3 (*State Farm*).

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

[3] *Montrose Chemical Corp. v. Superior Court* (1993) 6 Cal.4th 287, 302.

[4] *Blanchard v. State Farm Fire & Casualty Co.* (1991) 2 Cal.App.4th 345, 350.

[5] *Gafcon, Inc. v. Ponsor & Associates* (2002) 98 Cal.App.4th 1388, 1422.

[6] *State Farm, supra* 216 Cal.App.3d at 1226, fn.3.

[7] *Spindle v. Chubb/Pacific Indemnity Group* (1979) 89 Cal.App.3d 706, 713.

[8] *United Enterprises, Inc. v. Superior Court* (2010) 183 Cal. App. 4th 1004, 1010.

[9] *McGee v. Superior Court* (1985) 176 Cal.App.3d 221, 226.

[10] *Foremost Ins. Co. v. Wilks* (1988) 206 Cal.App.3d 251, 261.

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

[12] *Novak v. Low, Ball & Lynch* (1999) 77 Cal.App.4th 278, 282.

[13] Civ. Code § 2860(a).

underlying coverage dispute between the insurer and the insured";[14] or "where the issue creating the conflict is one which must be decided in the underlying action."[15]

[14] *James 3 Corp. v. Truck Ins. Exchange* (2001) 91 Cal.App.4th 1093, 1108.

[15] *Truck Ins. Exchange v. Superior Court* (1996) 51 Cal.App.4th 985, 994; see also, *Golden Eagle Ins. Co. v. Foremost Ins. Co.* (1993) 20 Cal. App. 4th 1372, 1395-1396.