

The Antiquated Distinction Between Potential and Actual Conflicts of Interest

Introduction

When a liability insurer reserves its rights to later deny coverage, it must pay for independent counsel to conduct the policyholder's defense¹ if a disqualifying conflict of interest results.² Rules of Professional Conduct (Rule), old Rule 3-10 prohibited an attorney from representing dual clients who had "potential" or "actual" conflicts of interest without written disclosure to and inform written consent from both clients. However, new Rule 1.7 omits any distinction between "potential" and "actual" conflicts of interest. Still, reported cases occasionally draw the distinction, including a division of authority has developed in California regarding the appropriate trigger for an insurer's duty to pay for independent counsel.

Old Rule 3-310

"A [lawyer] shall not, without the informed written consent of each client: (1) Accept representation of more than one client in a matter in which the interests of the clients potentially conflict; or . . . actually conflict."³ Old Rule 3-10 did not define nor make a distinction between potential and actual conflicts.

Over the years, the distinction between "potential" and "actual" conflicts of interest has drawn fire from various courts. Rule 3-310(C) does not "attempt to draw the line demarking when 'potential' becomes 'actual.'"⁴ "[A] distinction between 'potential' and 'actual' conflicts of interest which is invalid and unworkable."⁵ "Rule 3-310 . . . applies when the interests of the clients are directly adverse or potentially adverse."⁶ The California Supreme Court observed that old Rule 3-310 "states that at the outset, an attorney may not accept representation if there is a potential conflict; it does not require an actual conflict."⁷ "There is no room . . . for labeling the conflict there described as merely a 'potential' one. 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 *Cumis*' 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

¹ See, *Cumis Test* at DutytoDefend.com.

² See, *Disqualifying Conflicts of Interest* at DutytoDefend.com.

³ Old Rule 3-310(C).

⁴ *In re Zamer G* (2007) 153 Cal. App. 4th 1253, 1267 (*Zamer*).

⁵ *San Diego Navy Fed. Credit Union v. Cumis Ins. Society, Inc.* (1984) 162 Cal.App.3d 358, 371, fn.7 (*Cumis*).

⁶ *Sharp v. Next Entertainment, Inc.* (2008) 163 Cal.App.4th 410, 426.

⁷ *In re Celine R.* (2003) 31 Cal.4th 45, 57 (*Celine*).

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.”⁸

Some Definitions

- “An actual conflict exists when an attorney’s professional judgment for one client necessarily will be affected adversely because of the interests of another client.”⁹
- The “terms ‘potential’ and ‘actual’ ‘must have reference to the degree of likelihood that the risk - the potentiality - will ripen into adverse effect - the actuality.’”¹⁰
- “[T]he Rule 3-310 concept of potential conflict to mean, at least in the dependency context, a reasonable likelihood an actual conflict will arise.”¹¹
- In another dependency context, a court stated: “We believe that a conflict becomes ‘actual’ when an attorney’s duties of loyalty, confidentiality, and zealous advocacy require the attorney to take or to refrain from taking some action to serve the ‘best interests’ of one minor client, but the attorney is unable to do so without violating a duty owed by the attorney to another client; or when the attorney is unable independently to evaluate the best interests of each minor client because of the minors’ conflicting interests.”¹²
- In a bankruptcy context: “A conflict of interest is potential if there is no present actual conflict of interest, but there is a possibility of an actual conflict arising in the future, resulting from developments that have not yet occurred or facts that have not yet become known.”¹³
- “One authority has opined that an ‘actual’ conflict is nothing more than a ‘potential’ conflict that has resulted in a breach of duty. This is not the meaning of those terms as used in the California ethics rules.”¹⁴

Enduring Mischief of Old Reported Cases

Although Rule 1.7 makes no distinction between “potential” and “actual” conflicts of interest, a perplexing and logically challenging division of authority has developed in California. The *Cumis* line of cases¹⁵ concludes that the “distinction between ‘potential’ and ‘actual’ conflicts of interest which is invalid and unworkable.” The *Dynamic Concepts* line of cases¹⁶

⁸ *Cumis, supra*, 162 Cal.App.3d at 371.

⁹ *Ibid.*, quoting 2 Mallen & Smith, *Legal Malpractice* (2007 ed.) § 16:2, p. 818.

¹⁰ *Ibid.*, quoting 1 Hazard & Hodes, *The Law of Lawyering* (3d ed. 2004 supp.) Conflicts of Interest, § 10.4, p. 10-13.

¹¹ *Celine, supra*, 31 Cal. 4th at 57 quoting *Carroll v. Superior Court* (2002) 101 Cal.App.4th 1423, 1429-1430.

¹² *Zamer, supra*, 153 Cal. App. 4th at 1267 (ellipsis omitted).

¹³ *In re Jaeger* 213 B.R. 578 (Bkrcty. C.D. Cal. 1997)

¹⁴ *Zamer, supra*, 153 Cal. App. 4th at 1267, quoting Freedman & Smith, *Understanding Lawyers’ Ethics* (2d ed. 2002) p. 266 (emphasis added).

¹⁵ See, *Cumis Line of Cases* at DutytoDefend.com.

¹⁶ See, *Dynamic Concepts Line of Cases* at DutytoDefend.com.

repeats that: “A mere possibility of an unspecified conflict does not require independent counsel. The conflict must be significant, not merely theoretical, actual, not merely potential.”¹⁷ Several reported opinions have cited this dictum in *Dynamic Concepts* with approval. (*Midiman v. Farmers Ins. Exchange* (1999) 76 Cal.App.4th 102; *Gulf Ins. Co. v. Berger, Kahn, Shafton, Moss, Figler, Simon & Gladstone* (2000) 79 Cal.App.4th 114; *James 3 Corp. v. Truck Ins. Exchange* (2001) 91 Cal.App.4th 1093; *Advanced Network, Inc. v. Peerless Ins. Co.* (2010) 190 Cal. App. 4th 1054; *Federal Ins. Co. v. MBL, Inc.* (2013) 219 Cal.App.4th 29; and *Centex Homes v. St. Paul Fire & Marine Ins. Co.* (2015) 237 Cal.App.4th 23.)

¹⁷ *Dynamic Concepts, Inc. v. Truck Ins. Exchange* (1998) 61 Cal.App.4th 999, 1007.