

Dependent Counsel¹ Conflict of Interest Basics

The Cumis Rule

[Part 1] “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.”²

[Part 2] “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

Synthesis of Rules of Professional Conduct

Rule 1.0.1: Definitions

(e) “Informed consent” means a (policyholder)’s agreement to a proposed course of conduct after (dependent counsel) has communicated and explained (i) the relevant circumstances and (ii) the material risks, including any actual and reasonably foreseeable adverse consequences of the proposed course of conduct. (e-1) “Informed written consent” means that the disclosures and the consent required by paragraph (e) must be in writing.

Rule 1.4: Duty of Disclosure

(a) (Dependent counsel) shall: (1) promptly inform (the policyholder) of any decision or circumstance with respect to which disclosure or (the policyholder)’s informed consent is required . . . ; (2) reasonably consult with (the policyholder) about the means by which to accomplish (the policyholder)’s objectives in the representation; (3) keep (the policyholder) reasonably informed about significant developments . . . ; and (4) advise (the policyholder) about any relevant limitation on (dependent counsel)’s conduct. . . . (b) (dependent counsel) shall explain a matter to the extent reasonably necessary to permit (the policyholder) to make informed decisions regarding the representation.

¹ The phrase “dependent counsel” describes the counterpart to “independent counsel.”

² *San Diego Navy Fed. Credit Union v. Cumis Ins. Society, Inc.* (1984) 162 Cal.App.3d 358, 375 (*Cumis*). (LexisNexis rates the Cumis decision among the ten most significant liability coverage cases of all time. (<https://www.lexisnexis.com/legal newsroom/ insurance/b/insurance-coverage/archive/2015/02/19/the-10-most-significant-liability-coverage-cases-of-all-time.aspx#sthash.84WjDLV0.dpuf>).

³ *Ibid.*

⁴ *Golden Eagle Ins. Co. v. Foremost Ins. Co.* (1993) 20 Cal. App.4th 1372, 1394 (*Golden Eagle*); see also, “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*)). “Cumis is based on ethical standards, not on insurance concepts.” (*Mosier v. S. Cal. Physicians Ins. Exch.* (1998) 63 Cal. App.4th 1022, 1042.)

Rule 1.6: Duty of Confidentiality

(Dependent counsel) shall not reveal information protected from disclosure by Business and Professions Code section 6068, subdivision (e)(1) unless the (policyholder) gives informed consent. (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 (policyholder).”) Comment [1] (dependent counsel)’s duty to preserve the confidentiality of (policyholder) information involves public policies of paramount importance. (*In Re Jordan* (1974) 12 Cal.3d 575, 580.) Preserving the confidentiality of (policyholder) information contributes to the trust that is the hallmark of the lawyer-client relationship.

Rule 1.7: Duty of Undivided Loyalty

(Dependent counsel) shall not, without the informed written consent of (the policyholder and a reserving insurer) . . . represent a (policyholder) if the representation is directly adverse to (the reserving insurer). . . . **(or)** there is a significant risk (dependent counsel)’s representation of the policyholder will be materially limited by (dependent counsel)’s responsibilities to **or** relationships with (a reserving insurer) . . . **or** by (dependent counsel)’s own interests. . . . **(and)** the representation is not prohibited by law; **and** . . . (1) (dependent counsel) reasonably believes that (dependent counsel) will be able to provide competent **and** diligent representation to (the policyholder and the reserving insurer); (2) the representation is not prohibited by law; **and** (3) the representation does not involve the assertion of a claim by one reserving insurer against (the policyholder) represented by (dependent counsel).

Rule 1.8.6: Insurer Compensation Requires Informed Written Consent

(Dependent counsel) shall not . . . accept compensation for representing a (policyholder) from (a reserving insurer) unless: (a) there is no interference with the (dependent counsel)’s independent professional judgment or with the lawyer-client relationship; (b) information is protected . . .; and (c) (dependent counsel) obtains the (policyholder)’s informed written consent.

The Cumis Protocol

The Cumis Rule and the Rules of Professional Conduct apply whenever a liability insurer agrees to defend its policyholder under any reservation of rights and seeks to appoint dependent counsel to control the defense. Dependent counsel must follow this Cumis Protocol:

1. Dependent counsel must **Always** thoroughly investigate potential conflicts of interest raised by an insurer reservation of rights, or otherwise;
2. Dependent counsel must **Always** thoroughly analyze potential conflicts of interest raised by an insurer reservation of rights, or otherwise;
3. Dependent counsel must **Always** make written disclosure to the policyholder of its analysis of potential conflicts of interest raised by an insurer’s reservation of rights, or otherwise; and
4. Dependent counsel must **Sometimes** quit. Dependent counsel must refuse or withdraw from the representation unless: 1) its analysis correctly determines that no disqualifying conflict of interest exists because there are no issues of fact or law common to the liability dispute and the each coverage defense reserved; or 2) the policyholder gives informed written consent.

The Required Quality of Conflict of Interest Analysis

Rules 1.0.1 and 1.4 require disclosure by dependent counsel to the policyholder of all information needed so that the policyholder can protect oneself from the reserving insurer and

dependent counsel. The law requires that dependent counsel take the initiative to conduct a thorough investigation and objective analysis of all potential conflicts of interest between its two clients, the insurer and the policyholder. The investigation and analysis must include reviewing the third party liability complaint, the policy, the insurer's reservation of rights letter(s), the logical commonality of coverage defenses and issues in the liability dispute, factual questions that might sustain or defeat coverage, the nature of the available evidence, the risk of policyholder prejudice from discovery of the evidence which tends to support or defeat coverage challenges, and the possible impact of a confidentiality order to protect the policyholder from prejudicial disclosure.⁵

The Cumis Test

Neither the Cumis opinion nor Civil Code § 2860 “clearly state when the right to an independent counsel vests.”⁶ However, in the 37 years since the case has been on the books, the substantive legal test in California has become clear. The Cumis Test has been expressed in a variety of ways, both negatively and positively. Some reported opinions collect cases that do and do not require an insurer to pay for independent counsel. “[T]he insurer may have more than one defense to coverage. In that event, the trial court will need to consider each defense separately.”⁷ “In the absence of dispute over some underlying fact, the existence of a conflict is a question of law for the trial judge to decide, not a jury question.”⁸

The recently published Restatement of Liability Insurance expresses the Cumis Test as follows: “When an insurer with the duty to defend provides the insured notice of a ground for contesting coverage under §15 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.”⁹ Fifty American jurisdictions have addressed the reservation of rights conundrum and the trend is to adopt the Cumis Rule.¹⁰

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.”¹¹

Expressed negatively, a liability insurer that reserves its rights *is not required* to pay for independent counsel if each ground upon which the insurer may later deny coverage: 1) has

⁵ *Haskel, Inc. v. Superior Court* (1995) 33 Cal.App.4th 963, 980.

⁶ *Dynamic Concepts, Inc. v. Truck Ins. Exchange* (1998) 61 Cal.App.4th 999, 1007 (*Dynamic Concepts*).

⁷ *Montrose Chemical Corp. v. Superior Court* (1993) 6 Cal.4th 287, 306 (conc. opn. of Kennard, J.) (*Montrose I*).

⁸ *Blanchard, supra* 2 Cal.App.4th at 350.

⁹ Rest. Liab. Ins. §16. The Obligation to Provide an Independent Defense.

¹⁰ See, 50 State Survey – Do Conflicts of Interest Arising from a Liability Insurer's Reservation of Rights Require Payment of Independent Counsel? at DutytoDefend.com.

¹¹ *State Farm Fire & Cas. Co. v. Superior Court* (1989) 216 Cal.App.3d 1222, 1226, fn.3 (*State Farm*).

“nothing to do with the issues being litigated in the underlying action;”¹² 2) “is logically unrelated to the issues of consequence in the underlying case;”¹³ 3) “is independent of the issues in the underlying case;”¹⁴ 4) “is extrinsic to the issues in the underlying action;”¹⁵ or “can be controlled by counsel first retained by the insurer for the defense of the claim.”¹⁶

Expressed positively, a liability insurer that reserves its rights *is required* to pay for independent counsel: 1) “whenever [the insurer’s and policyholder’s] common lawyer’s representation of the one is rendered less effective;”¹⁷ 2) if coverage issues “overlap” issues in the third party liability action;¹⁸ 3) if any coverage question depends “upon the insured’s own conduct;”¹⁹ 4) if “[i]nsurance counsel had [an] incentive to attach liability to [the insured];”²⁰ 5) “the ground of noncoverage was based on the nature of the insured’s conduct;”²¹ 6) “the outcome of the coverage issue can be controlled by the way counsel defends the case;”²² 7) “the way counsel retained by the insurance company defends the action will affect an underlying coverage dispute between the insurer and the insured;”²³ 8) “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;”²⁴ and 9) “where the issue creating the conflict is one which must be decided in the underlying action.”²⁵

¹² *Long v. Century Indemnity Co.* (2008) 163 Cal.App.4th 1460, 1470 (citation and ellipsis omitted).

¹³ *Montrose, supra* 6 Cal.4th at 302.

¹⁴ *Blanchard, supra*, 2 Cal.App.4th 345; see also, *Gafcon, Inc. v. Ponsor & Associates* (2002) 98 Cal.App.4th 1388, 1422 (*Gafcon*).

¹⁵ *Gafcon, supra*, 98 Cal.App.4th at 1422.

¹⁶ Civ. Code § 2860(b).

¹⁷ *Spindle v. Chubb/Pacific Indemnity Group* (1979) 89 Cal.App.3d 706, 713.

¹⁸ *United Enterprises, Inc. v. Superior Court* (2010) 183 Cal. App. 4th 1004, 1010.

¹⁹ *Foremost Ins. Co. v. Wilks* (1988) 206 Cal.App.3d 251, 261 (*Wilks*).

²⁰ *Berger, Kahn, supra*, 79 Cal.App.4th at 131.

²¹ *McGee v. Superior Court* (1985) 176 Cal.App.3d 221, 226 (*McGee*).

²² *Novak v. Low, Ball & Lynch* (1999) 77 Cal.App.4th 278, 282; Civ.Code § 2860(a).

²³ *James 3 Corp. v. Truck Ins. Exchange* (2001) 91 Cal.App.4th 1093, 1108.

²⁴ *State Farm, supra*, 216 Cal.App.3d at 1226, fn.3.

²⁵ *Truck Ins. Exchange v. Superior Court* (1996) 51 Cal.App.4th 985, 994; see also, *Golden Eagle, supra*, 20 Cal. App. 4th at 1395-1396.