Debunking the *Cumis* counsel myths

Civil Code section 2860 and the conflict with Cumis

By E. Gerard Mannion and Wesley Lowe

In *San Diego Navy Federal Credit Union v. Cumis Insurance Society* (1984) 162 Cal.App.3d 358, 364, the Court of Appeal announced a rule that would have far-reaching implications for how insurers are supposed to comply with their obligation to provide a defense in cases where there is any actual or potential dispute concerning whether the policy covers the claims in a lawsuit.

> We conclude that 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 upon 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. (Citations omitted.)
>
> Disregarding the common interests of both insured and insurer in finding total non-liability 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.

(*Id. at 375.*)

Although these principles were well known in California law prior to the *Cumis* decision, (see *Previews, Inc. v. California Union Insurance Co.* (9th Cir. 1981) 640 F2d. 1026, 1028), most insurance companies refused to acknowledge their obligation to provide independent counsel until *Cumis* was decided. The meaning of this decision was litigated extensively over the course of the next few years with some of the courts getting the analysis right, (*McGee v. Superior Court* (1985) 176 Cal.App.3d 221), and others getting it wrong (*Native Son Investment v. Tycor Title Insurance* (1987) 189 Cal.App.3d 1265). Then the California legislature stepped in and really made a mess of things with the enactment of Civil Code section 2860.[1]

The primary impetus behind enactment of Civil Code section 2860 was the outrageous bills that were being submitted by *Cumis* counsel who were hired to "monitor" litigation where there was a reservation of rights, of any sort. Some of these *Cumis* counsel were charging three, five, or seven times the hourly rate of the insurance defense counsel who was also working on the case. Some of the *Cumis* attorneys had little or no experience. Defense costs increased astronomically. The insurance industry sought to remedy these problems by including requirements that *Cumis* counsel only bill as much as a standard defense counsel, that *Cumis* counsel have five years experience in the handling of cases like the one they were hired to provide assistance in, and that they have malpractice insurance. (Civ. Code, § 2860(c).) The insurers also tried to limit their *Cumis* obligations by providing that " . . . a conflict of interest does not exist as to allegations or facts in the litigation for which the insurer denies coverage;" . . . (*Id.* subsection (b)). They then added: "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." (*Ibid.*) These latter provisions were ostensibly added because before the statute was enacted, insureds were demanding that *Cumis* counsel be provided even where the sole coverage "dispute" between the insured and the insurer was that the plaintiff's demand was in excess of the policy limits, or because punitive damage claims had been "tacked on" a negligence claim.[2]

Insurers continued to identify the existence of conflicts, and offer Cumis counsel, for a number of years after the enactment of Civil Code 2860. Then, approximately 10 years ago or so, carriers began sending out reservation of rights letters *without* telling insureds that they were entitled to independent counsel. Apparently, taking their cue from subsequent Court of Appeals decisions which ignored the conceptual underpinning of the *Cumis* decision (which is that the Canons of Ethics determine whether there is a conflict of interest, *and what an attorney has to do when confronted with that conflict of interest)*, and emboldened by the general trend among some courts to protect insurers at the expense of consumers, the insurers began spreading

myths about how section 2860 and the *Cumis* decision are to be applied. The claims personnel and insurance defense counsel have continued to restate these myths in an attempt to make them a reality. This article is an attempt to debunk three of the more prevalent myths.

The trigger to Section 2860 and *Cumis* counsel

A *potential* conflict of interest is sufficient to trigger the application of section 2860 and the *Cumis* principles. Carriers and their counsel have taken to arguing that *Cumis* counsel does not have to be provided unless there is an "actual" conflict between the insured and the carrier. Although they are seldom so brazen as to admit that this means that the insured has to show that insurance defense counsel has actually damaged him or her before *Cumis* counsel is warranted, from a practical standpoint, that is exactly what they mean. In support of this position, insurers typically point to sloppy language from cases such as *Lehto v. Allstate Insurance Co.* (1994) 31 Cal.App.4th 60, 71 and *Dynamic Concepts v. Truck Insurance Insurance* (1998) 61 Cal.App.4th 999, 1007-1008, where the courts talk how the conflict must be "significant" and that an actual conflict is needed because the "mere possibility of an unspecified conflict does not require independent counsel". (*Ibid.*)

The *Cumis* decision recognized the fallacy of making the distinction between "actual" and "potential" conflicts of interest:

> Cumis makes the 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 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 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.

(*Cumis, supra* at 162 Cal.App.3d 371, fn. 7.)

This analysis is also consistent with the obligation an attorney has to withdraw *as soon as possible* from representation where a conflict exists. (*Cumis, supra* at 374-375.) It's exactly the wrong approach to wait until insurance defense counsel has acted in a way to prejudice the insured before determining that *Cumis* counsel is warranted.

Consequently, if a carrier and its counsel state that an actual conflict is required, they should be reminded of footnote 7 in the *Cumis* decision, and the Canons of Ethics underpinning that analysis.

Section 2860 did not "occupy the field"

Civil Code section 2860 did not "occupy the field" with regard to all circumstances which would require independent counsel. Insurers will sometimes argue that a particular circumstance does not fall under the scope of Civil Code section 2860 and so independent or *Cumis* counsel need not be provided.[3] In response to such claims, insureds should point out that section 2860 does not "occupy the field", or identify every circumstance when an insured is entitled to independent counsel.

> Moreover, 'Civil Code §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." [Citation] Civil Code §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 §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 this section.'

(Citations omitted.) (*Long v. Century Indemnity Co.,* (2008) 163 Cal.App.4th 1460, 1472-73.)

As explained in *Golden Eagle Insurance Co. v. Foremost Insurance Co.* (1993) 20 Cal.App.4th 1372, 1396:

> Thus, an attorney representing the interest of the insurer and the insured is subject to the rule a "[c]onflict of interest between jointly represented clients occurs whenever their common lawyer's representation of the one is rendered less effective by reason of his representation of the other." (Citations omitted.)[4]

It is therefore important to focus on the reasons for the requirement of independent counsel: the Rules of Ethics. Some formulaic approach which focuses solely on whether certain "magic words" ("we reserve rights" as opposed to "do not cover") are stated in a letter or communication from the carrier cannot control. It is the potential conflict which determines this obligation, not clever phrasing in a letter.[5]

Punitive damages may trigger independent counsel

A claim for punitive damages can require independent counsel be provided. Civil Code section 2860 states that no conflict of interest shall be deemed to exist as to allegations of punitive damages. See subsection (b). While it is true that punitive damages claims *by themselves*, do not automatically require *Cumis* counsel, the underlying basis for the claim for punitive damages may require independent counsel.

Punitive damages are only allowed for conduct which is malicious, fraudulent, or oppressive. Civil Code §3294. Malicious conduct is defined as conduct which is *intended* by the defendant *to cause injury* or

"despicable conduct which is carried on by the defendant with a wilful and conscious disregard of the rights or safety of others". (*Ibid.*) Oppression is similar. (*Ibid.*)

> The 'paradigm case' requiring independent counsel exists where the insured's conduct at issue in the underlying litigation could be found to have been intentional, and the coverage depends on a finding that such conduct was *not* intentional. While the insured and the insurer share a common interest in defeating the claim, *their interests diverge* in establishing the basis for that defeat [Citations omitted] Croskey *Insurance Litigation*, Rutter (2012 revision) §7:775, p. 7b-101.

The prime example of this would be working to prove that the defendant acted intentionally to cause harm (as opposed to acting with a conscious disregard of a person's rights or safety) so as to bring the claim within the definition of malice. If the insurance defense lawyer presented evidence in a way which would result in a finding of intentional conduct on the part of the insured, that would not be covered by the policy. Such a finding would benefit the carrier because there would be no coverage for any portion of the claim. In contrast, it would be in the insured's best interest to show that all conduct was done with conscious disregard, at most, because that would be covered. In such a situation independent *Cumis* counsel is absolutely required.

Punitive damage cases are therefore often the "paradigm case" requiring independent counsel. Insureds should always challenge the refusal to provide *Cumis* counsel in these situations.

Conclusion

Carriers, and courts, need to be reminded of the conceptual underpinnings of the *Cumis* decision. The rules of ethics require independent counsel be provided in situations far beyond those set forth in Civil Code §2860. Even the supposed limitation on having to provide independent counsel where punitive damages are alleged should not be an impediment to demanding and obtaining such independent counsel in most situations.


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Endnotes

[1] Civil Code §2860 was one of the progeny of the infamous "napkin deal" which was an agreement that was struck (and memorialized on a napkin) between CAOC and the business interests in order to head off an initiative fight. The deal also brought changes to the punitive damages statute, provided immunity to the tobacco companies, etc.

[2] These "limitations" have done nothing but create confusion and problems for insureds ever since.

[3] For example, carriers like to play the game of saying they are not "reserving their rights" with regard to certain claims, they are simply denying coverage for those claims. From a practical standpoint, that is a distinction without a difference, although the language of subsection b of §2860 does seem to support that view.

[4] The Canons of Ethics were *not* amended to change an attorney's obligation with regard to advising an insured of a conflict, and then withdraw from the conflicted representation. Consequently, every situation must still be evaluated in accordance with those Canons. If there is a conflict between the Canons and Civil Code section 2860, as far as the attorney is concerned, the former must prevail.

[5] Civil Code §2860 provides in subpart (a) that if the carrier has a duty to defend " . . . 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 . . . . The statute does not require that there be a "reservation of rights" or a "statement of conflict". The obligation exists when a "conflict of interest arises". This is a practical analysis which is dependent upon the *actual* circumstances and relationship between the parties.