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Coverage Advice: The Missing Piece of the Cumis Puzzle

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COVERAGE ADVICE: THE MISSING PIECE OF THE *CUMIS* PUZZLE

Leo P. Martinez

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I. INTRODUCTION

As observed recently by Professor James Fisher, the role of independent counsel has not received the attention it deserves.[1] The subject of "*Cumis* counsel," a concept that took its name from *San Diego Navy Federal Credit Union v. Cumis Insurance Society, Inc.*,[2] has received less and less attention as the years have passed.[3] In the last ten years, the scholarly commentary on *Cumis*, including related topics ranging from the tripartite relationship

1. James Fischer, *The Professional Obligations of Counsel Retained for the Policyholder but Not Subject to Insurer Control*, 43 TORT TRIAL & INS. PRAC. L.J. 173 (Winter 2008).
2. 162 Cal. App. 3d 358 (Cal. Ct. App. 1984).
3. Fischer, *supra* note 1, at 173–74.

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to independent counsel to the role of retained counsel subject to insurer control, has reduced to a trickle after an initial torrent of comment.[4] Court dicta has shadowed this development. Indeed, in the past five years, there is scarcely a judicial mention of *Cumis* beyond the obligatory reference to the tripartite relationship. *Cumis* has been relegated to the banal. Like James Fischer, however, I believe that lawyers who ignore *Cumis* risk a closer relationship with their malpractice insurers.

In this piece, I return to the basics. I focus not so much on the tripartite relationship among the insurer, the insured, and defense counsel that received attention initially. Rather, this discussion is devoted to the role of coverage counsel in cases involving conflicts of interest in the tripartite relationship.

II. BACKGROUND

Cumis[5] spawned such expressions as "*Cumis* counsel," "*Cumis* provision," and the like.[6] Like many eponymous cases, including *Mary Carter*,[7] *Miranda*,[8] and *Dred Scott*,[9] the familiarity of use breeds contempt; and we soon divorce the facts of the resulting case, substituting instead the easy and uncritical casualness of shorthand. Hence, it is useful to reread the *Cumis* case and recollect, or at least refresh, in our minds exactly what *Cumis* stands for.

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4. A number of excellent treatments on the ethical and malpractice considerations of insurance law practice are available. *See, e.g.*, ROBERT E. KEETON & ALAN I. WIDISS, INSURANCE LAW: A GUIDE TO FUNDAMENTAL PRINCIPLES, LEGAL DOCTRINES, AND COMMERCIAL PRACTICES § 7.6(c) (West 1988); RONALD E. MALLEN & JEFFREY M. SMITH, LEGAL MALPRACTICE § 23 (3d ed. 1989); Tom Baker, *Liability Insurance Conflicts and Defense Lawyers: From Triangles to Tetrahedrons*, 4 CONN. INS. L.J. 101 (1997–1998); John W. Dondanville, *Defense Counsel Beware: The Perils of Conflicts of Interest*, 18 FORUM 62 (Fall 1982); Robert E. Keeton, *Taking Professional Risks*, 4 CONN. INS. L.J. 405 (1997–1998); Robert E. O'Malley, *Ethics Principles for the Insurer, the Insured, and Defense Counsel: The Eternal Triangle Reformed*, 66 TUL. L. REV. 511 (Dec. 1991); Frank Revere & Arthur J. Chapman, *Insurer's Duty to Defend*, 13 PAC. L.J. 889 (1982); Douglas R. Richmond, *Lost in the Eternal Triangle of Insurance Defense Ethics*, 9 GEO. J. LEGAL ETHICS 475 (1996); Donald E. Sharpe & Jean K. Shaffer, *The Parameters of an Insurer's Duty to Defend*, 19 FORUM 555 (1984); Charles Silver & Kent Syverud, *The Professional Responsibilities of Insurance Defense Lawyers*, 45 DUKE L.J. 255 (Nov. 1995); J. Snowden Stanley Jr., *Can We Defend Both? A Defense Counsel's Dilemma*, 22 TORT & INS. L.J. 59 (Fall 1986); William C. Carpenter, Note, *Reservation of Rights in Insurance Contracts*, 32 ARIZ. L. REV. 387 (1990).

5. 162 Cal. App. 3d 358.

6. The case also prompted me to look up the dictionary meaning of the word *eponymous* when I was new to law practice a number of years ago. I discovered that an eponym is "one for whom or which something is or is believed to be named." MERRIAM-WEBSTER'S ONLINE DICTIONARY, www.merriam-webster.com/dictionary/eponym.

7. The term "*Mary Carter* agreement" is based on a 1967 Florida case, *Booth v. Mary Carter Paint Co.*, 202 So. 2d 8 (Fla. Dist. Ct. App. 1967), *overruled in part by Ward v. Ochoa*, 284 So. 2d 385, 388 (Fla. 1973), which upheld the validity and nondisclosure to nonsettling parties of a secret agreement that limited the maximum liability of two out of three defendants. The term "*Mary Carter* agreement" was actually coined in *Maule Industries, Inc. v. Rountree*, 264 So. 2d 445 (Fla. Dist. Ct. App. 1972), *modified*, 284 So. 2d 389, 390–91 (Fla. 1973).

8. Miranda v. Ariz., 396 U.S. 868 (1969).

9. Dred Scott v. Sanford, 60 U.S. 393 (1857).

The various ways that *Cumis* has been examined are reminiscent of the fabled blind men who encounter an elephant. Each perceives the elephant differently. None is wrong in his assessment, but each misses the sense of the whole.[10] Broadly, *Cumis* holds that whenever an insurer denies coverage, proceeds under a reservation of rights, or is faced with a conflict of interest (when the insured is sued for damages above the liability coverage), the insured has the right to independent counsel for which the insurer must pay.[11]

The underlying case in *Cumis* involved a wrongful termination action brought by Magdaline S. Eisenmann against the San Diego Navy Federal Credit Union (Credit Union).[12] The Eisenmann action alleged a number of intentional torts in addition to negligence.[13] The Credit Union tendered the defense to its insurer, Cumis Insurance Society, Inc. (Cumis), which retained the San Diego law firm of Goebel & Monaghan to represent the Credit Union.[14] Cumis also informed Goebel & Monaghan that Cumis was reserving its right to deny coverage at a later date and that the insurance policies did not cover punitive damages.[15] Goebel & Monaghan apparently did not at any time provide advice regarding coverage to the Credit Union.[16] Soon thereafter, Cumis informed the Credit Union that it was reserving its rights to disclaim coverage and that punitive damages would not be covered under the policy.[17]

After receiving the reservation of rights letter, the Credit Union retained the San Diego law firm of Saxon, Alt & Brewer to provide independent representation.[18] Although Cumis initially paid the invoices submitted, it soon stopped paying for the Saxon firm's costs on the basis that both Cumis and Goebel & Monaghan had arrived at the astounding conclusion that no conflict of interest existed.[19] This was followed by a settlement conference attended by Goebel & Monaghan, at which Eisenmann offered to settle the case within the policy limits.[20] Yet the parties did not reach a settlement

10. This is not to suggest that my own view is any less blind to the whole than others who have written on the topic.

11. The only significant case in California questioning *Cumis* is in a footnote of *Dynamic Concepts, Inc. v. Truck Insurance Exchange*, 61 Cal. App. 4th 999, 1002 (Cal. Ct. App. 1998), in which the court stated that California Civil Code § 2860, the text of which appears *infra* note 31, overruled dicta in *Cumis*, indicating that insurer-appointed defense would only offer token advocacy to claims outside the policy limits or serve to protect only the insurer's interests.

12. San Diego Navy Fed. Credit Union v. Cumis Ins. Soc'y, Inc., 162 Cal. App. 3d 358, 361 (Cal. Ct. App. 1984).

13. *Id.*

14. *Id.* at 361–62.

15. *Id.* at 362.

16. *Id.*

17. *Id.* The relevant text of the letter reserving rights is contained in the opinion. *Id.*

18. *Id.*

19. *Id.* at 363.

20. *Id.*

because Cumis only authorized Goebel & Monaghan to make an offer in an amount lower than the demand.[21] Although Goebel & Monaghan were in contact with Cumis before and during the settlement conference, the Credit Union was never contacted until after the conference ended.[22]

Thereafter, the Credit Union filed an action to require Cumis to pay all reasonable past and future expenses of Saxon, Alt & Brewer in the defense of the Eisenmann lawsuit.[23] In the litigation between Cumis and the Credit Union, the trial court held that Cumis was required to pay for the Saxon firm's fees as independent counsel.[24] In affirming the trial court's decision, the California Court of Appeal recognized that the interests of the insurer and the policyholder diverge where some of the allegations of a complaint do not fall within the scope of an insurance policy's coverage; in the court's words, "[i]n this situation, there may be little commonality of interest."[25] The court also recognized that although questions of coverage are not litigated in the underlying suit, counsel for the insured (here, Goebel & Monaghan) necessarily make decisions that will benefit either the insurer or the policyholder.[26] It did not help Cumis's position that Goebel & Monaghan communicated with it and not the insured in the course of the settlement conference.

The court noted that it was the insured who was entitled to select independent counsel and to have the "reasonable value of the professional services" paid by the insurer.[27]

Ultimately, the court adopted a broad prophylactic rule:

> 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 [citations omitted]. 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.[28]

21. *Id.*
22. *Id.* at 365.
23. *Id.* at 361.
24. *Id.* at 363.
25. *Id.* at 364.
26. *Id.* at 365. In addition, the court observed that this dilemma was also necessarily part of pretrial discovery. As such, confidentiality was an issue as well. *Id.* at 366.
27. *Id.* at 371.
28. *Id.* at 375.

III. THE PROBLEM

Cumis made clear that an insurer's reservation of rights was a conflict that lawyers hired by that insurer had to address in a direct way. The lawyer was bound to advise the insured as to the conflict and if the insured did not consent to continued representation, the insurer was bound to retain independent counsel for the insured.[29] At the same time, *Cumis* raised more questions than it answered, among them whether or not the insurer in effect lost control of the defense in the underlying tort case. It did not address the proper standard of conduct for *Cumis* counsel, nor did it address the counselors' qualifications.[30] Further, the case did not address what fee or rate the *Cumis* lawyer was to be paid. Importantly, *Cumis* did not discuss the process or the mechanism by which an insured would be advised regarding whether a conflict triggering the appointment of independent counsel was present or not.

The California legislature responded to some of these concerns by enacting Civil Code § 2860.[31] Among other things, § 2860 purported to set

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29. *Id.*

30. To be fair, the court noted that it was the insured who was entitled to select independent counsel and to have the "reasonable value of the professional services" paid by the insurer. *Id.* at 371.

31. CAL. CIV. CODE § 2860 (2008) is set forth below:

§ 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.

fees for appointed counsel by using the rates in the community where the dispute is adjudicated.[32] One of the most significant departures from *Cumis* in the statute is the statement that a conflict does not arise upon the mere denial of coverage but may arise where the insurer reserves rights and where the coverage issue is under the control of the counsel first retained to defend the claim.[33] Effectively, the statute reset the default position articulated in *Cumis*. However, like *Cumis* itself, the civil code section is silent as to how the existence of conflict is to be determined and who is to advise the insured in the process.

For the most part, the scholarship dealing with this problem has focused on the difficulty of balancing the duties and relationships of insurance defense counsel.[34] By itself, this balancing is not a trivial task. As discussed below, some scholars, like Doug Richmond, have addressed the matter in conventional terms.[35] By contrast, Professor Tom Baker has resorted to geometry to assist in understanding this complex set of relationships.[36] What

(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.

32. The California Supreme Court has suggested that the limitations do not apply if the insurer has refused to provide a defense. In such cases, the fees paid by an insured for defense are presumptively reasonable. Aerojet-Gen. Corp. v. Transport Indem. Co., 70 Cal. Rptr. 2d 118 (Cal. 1997).

33. Cal. Civ. Code § 2860(b) (2008). It is not clear whether this part of the statute should be read conjunctively or disjunctively. Stated another way, the statute does not clarify whether the questions of reservation of rights and counsel's control state two separate and independent elements or whether both may be required to establish a conflict of interest.

34. *See, e.g.*, Baker, *supra* note 4; Ellen S. Pryor & Charles Silver, *Defense Lawyers' Professional Responsibilities: Part II—Contested Coverage Cases*, 15 Geo. J. Legal Ethics 29 (2001); Douglas R. Richmond, *Walking a Tightrope: The Tripartite Relationship Between Insurer, Insured, and Insurance Defense Counsel*, 73 Neb. L. Rev. 265 (1994).

35. Richmond, *supra* note 34 *passim*.

36. Baker, *supra* note 4 *passim*.

this piece serves to highlight is what has been forgotten in the fray, i.e., the role of coverage advice.

Traditionally, the problem addressed by *Cumis* has been described as the "tripartite relationship" among the insurer, the insured, and defense counsel.[37] The suggestion made by *Cumis* that the tripartite relationship posed a conflict of interest when an insurer reserved its rights was at the time a startling development.[38] Not surprisingly, this was the aspect of the *Cumis* case that garnered the most ink.

In order to examine the problems that arise out of this conflict, the relationships among the parties must be sharply defined. Fortunately, the basic relationships are simple. The obligations of parties to the typical liability insurance policy are defined by contract law. Parties that purchase liability insurance that they hope will protect them against liability to third parties want two things: (a) the insurer's promise to pay (within the policy limits) any amount adjudged against the insured and (b) the insurer's promise to defend the insured in an action to have such liability adjudged. Insurers are, of course, willing to sell such promises. The terms in which such promises are clothed are less than simple after decades of judicial interpretation.

An insured is generally entitled to compensation for covered losses during the policy period. Coverage under an insurance policy is determined by focusing on the terms of the policy itself, taking into account the scope and the limitations of the insurer's undertaking.[39] As one court has noted: "To establish coverage under an insurance policy, the insured must show that the occurrence on which the claim is based falls within the scope of basic coverage."[40]

To illustrate, a fairly ordinary set of clauses (slightly adapted from those currently in use) bearing on the insurer's obligation to pay and to defend in an automobile liability policy would read thus:

> (a) Insurer will pay on behalf of the insured all damages which the insured shall be legally obligated to pay because of bodily injury sustained by any person, and injury to or destruction of property arising out of the ownership or use of the owned automobile. The Insurer will defend any lawsuit, however groundless, false or fraudulent, against any insured for such damages as are payable under this policy but the Insurer may make such settlement of any claim or suit as it deems appropriate.

37. Richmond, *supra* note 34, at 272.

38. *Id.* at 273.

39. *See, e.g.*, Springdale Donuts, Inc. v. Aetna Cas. & Sur. Co., 74 A.2d 1117, 1119–21 (Conn. 1999); Chantel Assocs. v. Mount Vernon Fire Ins. Co., 656 A.2d 779, 784–85 (Md. 1995); Nw. Pump & Equip. Co. v. Am. States Ins. Co., 925 P.2d 1241, 1244 (Or. Ct. App. 1996).

40. Aydin Corp. v. First State Ins. Co., 18 Cal. 4th 1183, 1202 (Cal. 1998) (citing Weil v. Fed. Kemper Life Assurance Co., 7 Cal. 4th 125, 148 (Cal. 1994); Searle v. Allstate Life Ins. Co., 38 Cal. 3d 425, 438 (Cal. 1985)).

(b) No action shall lie against the Insurer until after full compliance with the terms of the policy and until the amount of the insured's obligation to pay shall have been finally determined by judgment against the insured or written agreement of settlement among the insured, the claimant and the Insurer.

(c) The insured shall cooperate with the Insurer by disclosing all pertinent facts known to him or her, and upon Insurer's request shall attend hearings and trials, shall assist in obtaining evidence and the attendance of witnesses and shall participate in effecting settlements and conducting suits.

Other policy terms will clearly be involved in determining when the insurer's promise to pay and the insurer's promise to defend are to be performed. These might include, for example, the terms of the policy concerning the extent and the amount of coverage, the meaning of *insured* under the policy, and clauses (or state statutes) prohibiting coverage of willful injuries inflicted by an insured.[41] The terms outlined above are complicated enough:

- Who has real control over a lawsuit against the insured?
- Can the insurer refuse to defend the lawsuit if the insurer believes that the policy does not cover the underlying liability?
- Does the insurer breach its duties when it refuses to make a settlement on behalf of the insured within the policy limits and the settlement offer was a reasonable one?
- When, if at all, do third parties have the right to sue the insurer directly?
- What is the responsibility of the insurer when it has breached either its duty to pay or its duty to defend?
- Is the insurer's duty to defend conditional on the insured complying with his duty to cooperate?
- In any case of breach of duty, what is the measure of damages?

In determining coverage, the starting point is the insuring clause—that portion of the policy under which an insurer promises to "pay on behalf of the insured all sums that the insured shall become legally obligated to pay as damages because of . . . property damage . . . caused by an occurrence."[42] The burden is on the insured to prove that a claim is covered under the policy.[43] In contrast, it is the insurer's duty to prove that a claim is within a policy exclusion. This is not always an easy task inasmuch as policy exclusions are read narrowly and against the insurer.[44]

41. *See generally*, Leo P. Martinez, Marc S. Mayerson & Doug R. Richmond, New Appleman Insurance Law and Practice Guide § 16.05 (LexisNexis 2007) (conflicts can be attributable to exclusions).

42. Old Republic Ins. Co. v. Superior Court, 77 Cal. Rptr. 2d 642 (Cal. Ct. App. 1998).

43. Royal Globe Ins. Co. v. Whitaker, 226 Cal. Rptr. 435 (Cal. Ct. App. 1986).

44. State Farm Mut. Auto. Ins. Co. v. Partridge, 10 Cal. 3d 94, 101–02 (Cal. 1973); *Whitaker*, 226 Cal. Rptr. 435.

With this background, a lawyer advising a client must first determine whether a claim falls within the terms of a policy. For example, courts have grappled with the threshold question of whether costs required to be expended by an administrative agency constitute damages. Many courts have found that such sums are not within the reach of the insurer's duty to indemnify.[45] The point is that even seemingly innocuous provisions in an insurance policy are potentially laden with ambiguity. Determining the scope of coverage is not always a straightforward task.

To further complicate matters, the duty to indemnify and the duty to defend are independent and are governed by different standards.[46] Accordingly, each is given separate treatment. Liability insurers may, and commonly do, seek to avoid paying the more esoteric varieties of personal injury and to limit coverage to "bodily" or "physical" injuries. For example, a standard homeowner's insurance policy covers bodily injury, which it cautiously defines as "bodily harm, sickness or disease." This language may be given literal effect to eliminate noneconomic damages, such as emotional suffering, from coverage.[47] At the other end of the spectrum, a court employing a liberal and expansive use of the canons of insurance policy interpretation may stretch *bodily injury* to embrace loss of consortium damages sustained by the spouse of a person injured in an auto accident.[48]

The more-often-litigated undertaking by the insurer is its duty to defend. As discussed above, this duty is broadly defined. Moreover, an insurer must act promptly in providing a defense. Insurer delay in declining a defense that results in prejudice to the insured may very well preclude the insurer from later declining coverage.[49] Moreover, an insurer's failure to meet its duty to defend may constitute breach of the covenant of good faith and fair dealing and expose the insurer to punitive damages.[50]

The problem faced by counsel in determining coverage is rooted in the obligation of the insurer to provide indemnity and defense of covered claims. Although the duty to indemnify poses no immediate difficulty from

45. *See, e.g.*, Certain Underwriters at Lloyd's of London v. Superior Court, 24 Cal. 4th 945, 951 (Cal. 2001).

46. EDO Corp. v. Newark Ins. Co., 898 F. Supp. 952, 955 (D. Conn. 1995); Nw. Pump & Equip. Co. v. Am. States Ins. Co., 925 P.2d 1241, 1244 (Or. Ct. App. 1996).

47. *See* St. Paul Fire & Marine Ins. Co. v. Campbell County Sch. Dist. No. 1, 612 F. Supp. 285, 287 (D. Wyo. 1985).

48. Abellon v. Hartford Ins. Co., 212 Cal. Rptr. 852 (Cal. Ct. App. 1985).

49. *See, e.g.*, Bluestein & Sander v. Chi. Ins. Co., 276 F. 3d 119, 122 (2d Cir. 2002); Greenberg & Covitz v. Nat'l Union Fire Ins. Co., 711 A.2d 909, 915–16 (N.J. Super. Ct. App. Div. 1998).

50. *See* State Farm Mut. Auto. Ins. Co. v. Campbell, 538 U.S. 408 (2003); Ellen Smith Pryor, *The Tort Liability Regime and the Duty to Defend*, 58 MD. L. REV. 1, 20 (1999); Susan Randall, *Redefining the Insurer's Duty to Defend*, 3 CONN. INS. L.J. 221, 230–31 (1997).

a conflict standpoint, it is nonetheless related to the duty to defend. The duty to defend does not extend to claims that are not covered.[51] Thus, if an insurer can demonstrate a lack of coverage, the insurer will be able to escape, within bounds, the duty to defend. Of course, the demonstration of the lack of coverage coupled with the need to defend in the face of undeveloped facts causes the problem. An insurer-appointed independent defense counsel might, in the course of her investigation or in the course of litigation, discover facts that either establish coverage or demonstrate that the claim is not covered.

In arriving at this point, it is important to note that the insurance contract does not alter the primary attorney-client relationship. However, it does introduce potentially conflicting objectives between the insurer and the insured. A defense attorney may lose the ability to objectively manage settlement and litigation when a long-term relationship with an insurer is contrasted with a transitory claim file. There may be divergent interests when a claim rests on alternative theories or when a claim is partially covered. Finally, the effect on settlement and litigation strategy when defense expenses are included within the policy limits may also cause potential difficulties.[52]

Doug Richmond has compiled a neat summary of the conflicts that can arise in the tripartite relationship. He describes these costly and time-consuming conflicts, which he terms *distractions*, in a list that includes

- a lack of candor between insured and defense counsel where the insured believes there might be adverse consequences in being candid,
- a heightened awareness of the potential for conflicts,
- a need to disclose conflicts,
- obtainment of consent to proceed in the face of conflicts,
- identification of conflicts that cannot be waived,
- costs of the insured's coverage counsel in addition to independent counsel,
- control of the defense,
- confidentiality of information,
- malpractice liability concerns,[53] and
- the insured's concern for its reputation.[54]

Some of these conflicts come about because the responsibilities of counsel are implicit and not described in the insurance policy.[55] They also arise

51. Buss v. Superior Court, 16 Cal. 4th 35, 47 (Cal. 1997).

52. Dan D. Kohane & Audrey A. Seeley, *Managing the Relationship Between the Coverage Case and Underlying Litigation*, New Appleman Insurance Law and Practice Guide § 16.10 (LexisNexis 2007) (conflict can arise where the potential recovery exceeds the policy limits).

53. Richmond, *supra* note 34, at 271. Professors Pryor & Silver have a similar list. Pryor & Silver, *supra* note 34, at 39.

54. Baker, *supra* note 4, at 129–31. Tom Baker adds this to the list of possible conflicts.

55. Pryor & Silver, *supra* note 34, at 36.

because of the nature of the coverage contest, i.e., the assertion by an insurer "that its policy does not cover a claim asserted against an insured or reserves its right to make this assertion at a future point in time."[56]

The American Bar Association's response to the potential conflicts posed by the tripartite relationship is reflected in the Model Rules of Professional Conduct.[57] Rule 1.8(f) precludes a lawyer from receiving compensation for representing a client unless "(1) the client gives informed consent; (2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and (3) information relating to representation of a client is protected as required by rule 1.6 [relating to client confidential information]."[58] Although the model rule states an admirable goal, it provides little useful guidance as to exactly what set of circumstances might constitute a conflict, i.e., "the interference with the lawyer's professional judgment or with the client-lawyer relationship."[59] Thus, it is not surprising that courts and counsel alike have been unable to formulate a satisfactory bright-line test for determining when a conflict exists.

One obstacle to formulating a useful approach is that professional responsibility principles may be inadequate to the task of policing conduct in insurance cases.[60] Unfortunately, substantive insurance law also may not be up to the task.[61]

IV. IMPRECISION OF CONFLICTS OF INTEREST

All of this brings us to the central question: How is it determined whether an insured is entitled to coverage under a policy? This is the threshold inquiry that puts into motion the tripartite relationship, that informs an insurer's decision to consider a reservation of rights, and that is a key to the invocation of the insurer's duty to provide independent counsel under California Civil Code § 2860. As noted above, § 2860 makes clear that not every reservation of rights will entitle a policyholder or insured the right to independent *Cumis* counsel. This pronouncement does not make the task of determining the existence of a conflict any easier. In *James 3 Corp. v. Truck Insurance Exchange*,[62] for example, an insurance company retained separate counsel to advise it as to whether there existed a conflict under

56. *Id.* at 38.
57. Model Rules of Prof'l Conduct Annotated (6th ed. 2007).
58. *Id.* R. 1.8(f).
59. *Id.*
60. Pryor & Silver, *supra* note 34, at 35.
61. *Id.*
62. 91 Cal. App. 4th 1093 (2001).

Civil Code § 2860.[63] The court held that an insured is not entitled to independent counsel "where the coverage issue is independent of, or extrinsic to, the issues in the underlying action [citation omitted]."[64] It goes without saying that a determination of whether the coverage issue was independent of, or extrinsic to, the issues in the underlying action required the consultation and advice of an expert by the insurer.[65] This only begs the question of what a policyholder or insured can do when faced with the same questions.

The courts that have dealt with *Cumis* situations have not treated the issue in a focused way. In California, the suggestion is that a lawyer's coverage advice is distinctly separate from a lawyer's defense of an insured.[66] According to the California formulation,

> [s]ince 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).[67]

As a practical matter, this separation of defense duties and coverage advice makes sense. Commentators have noted that an insurer is neither inclined nor able to provide coverage advice to its policyholder[68] and have concluded that because an insurance policy does not contain any explicit or implicit obligation to provide coverage advice, the insurer's primary obligation is to provide what the insurance policy explicitly requires, i.e., a defense.[69] That being the case, the duties of appointed counsel may be construed narrowly: appointed counsel have a specialized role limited to providing a defense.[70] Indeed, appointed counsel may very well not be

63. *Id.* at 1099.

64. *Id.* at 1101.

65. *See* Kohane & Seeley, *supra* note 52, §§ 16.10[1], 16.11 (a reservation of rights letter can preserve an insurer's coverage defenses, and a nonwaiver agreement can resolve initial conflicts).

66. *See* Employers Ins. of Wausau v. Albert D. Seeno Constr. Co., 692 F. Supp. 1150 (N.D. Cal. 1988); Assurance Co. of Am. v. Haven, 32 Cal. App. 4th 78, 38 Cal. Rptr. 2d 25 (Cal. Ct. App. 1995).

67. *Haven*, 32 Cal. App. 4th at 87 (citing San Diego Navy Fed. Credit Union v. Cumis Ins. Soc'y, 162 Cal. App. 3d 358, 364–67; Bogard v. Employers Cas. Co., 164 Cal. App. 3d 602, 613 (Cal. Ct. App. 1985)).

68. Pryor & Silver, *supra* note 34, at 57.

69. *Id.*; Marc S. Mayerson, *Fettering the Insurer's Privilege to Control the Defense It Is Duty Bound to Provide*, 5:4 Ins. Coverage L. Bull. 1 (May 2006) (insurance policies rarely address this problem); *see also* Susan Randall, *Managed Litigation and the Professional Obligations of Insurance Defense Lawyers*, 51 Syracuse L. Rev. 1, 11 (2001) (noting that policies do not define the extent of the defense obligation).

70. Pryor & Silver, *supra* note 34, at 93.

competent to render coverage advice.[71] This presents a persuasive case that independent counsel's task may be difficult in cases where coverage-related responsibilities are excluded from their duties.[72] This does not even take into account the crass observation by one court that "appointed counsel may tend to favor the interests of the insurer primarily because of the prospect of future employment."[73] All of this leaves aside the issue of the mechanism by which a policyholder or insured receives the coverage advice. Policyholders more often than not simply tender claims to their insurers without any thought about independent counsel.[74]

The hint in the cases that address the tripartite relationship is that appointment of independent counsel was intended to cure the problem, even if coverage is a separate and distinct duty of counsel.[75] Commentators discussing the Fourth Circuit's *Twin City Fire Insurance Co. v. Ben Arnold-Sunbelt Beverage Co.*[76] expand on this point.[77] The Fourth Circuit's expectation is that professional responsibility rules combined with the potential for a malpractice action will adequately protect an insured's interests.[78] However, as outlined above, the problem faced by insureds is more subtle.

Two problems faced by independent counsel illustrate the problem, as observed by the Alaska Supreme Court in *CHI of Alaska, Inc. v. Employers Reinsurance Corp.*[79] These problems are not novel[80] and include (1) an insurer's reservation of rights and (2) an insurer-appointed independent counsel's discovery of information that might lead to a coverage defense.

71. *Id.*

72. *Id.* at 56–57.

73. CHI of Alaska, Inc. v. Employers Reins. Corp., 844 P.2d 1113, 1116–17 (Alaska 1993).

74. Pryor & Silver, *supra* note 34, at 55.

75. *See* Employers Ins. of Wausau v. Albert D. Seeno Constr. Co., 692 F. Supp. 1150, 1158 (N.D. Cal. 1988); *CHI of Alaska*, 844 P.2d at 1118.

76. 433 F.3d 365 (4th Cir. 2005).

77. Mayerson, *supra* note 69.

78. *Ben Arnold*, 433 F.3d at 373; Mayerson, *supra* note 69.

79. 844 P.2d at 1116. The *CHI* case actually mentions three situations. First, the court suggests that a reservation of rights might prompt only a token defense where the insurer thinks it will succeed in asserting noncoverage. Second, it suggests that the defense will be motivated to shade the facts toward a showing of noncoverage. Third, it suggests that the insurer might discover confidential information in the course of conducting an investigation. *Id.* I conflate the first two scenarios in arriving at my analysis.

80. *See* Mayerson, *supra* note 69; Richmond, *supra* note 34, at 272–84. Richmond discusses seven different situations that give rise to conflicts. These include where an insurer reserves its rights, where claimed damages exceed coverage, where defense costs reduce available coverage, where multiple parties are represented, where counsel's defense activities generate information suggesting a possible coverage defense, where punitive damages are claimed, and where the insurer attempts to limit discovery to reduce expenses. *Id.*

A. *Insurer's Reservation of Rights*

A reservation of rights is essentially an insurer's unilateral decision under which it "agrees to defend the policyholder but reserves its right to assert coverage defenses."[81] Certainly, a reservation of rights is not benign from an insured's perspective. Many jurisdictions recognize this and, as a consequence, have adopted a per se rule regarding reservations of rights.[82] In these jurisdictions, an insurer's reservation of rights is a per se conflict of interest that allows an insured to reject the reservation. In jurisdictions adopting the per se approach, by rejecting the reservation an insured forces the insurer either to defend unconditionally or to surrender control of the defense to an insured-chosen independent counsel.[83] Although this approach is not a perfect solution, it does have the advantage of seeing that the insured's interests are protected.[84] Either the insured is provided an unconditional defense, or the insured is allowed to choose his or her own lawyer.

In such cases, competence on coverage matters might still be an issue. Within law practices, it is not uncommon for defense lawyers to defer to colleagues on coverage matters. Defense expertise and coverage expertise are each sufficiently broad and arcane so as to preclude the ordinary lawyer from mastering both areas of the law. Although the insured still faces the problem of lawyer competence in coverage matters, at least it is a matter within the insured's control, and the risk of expertise is correctly placed on the insured.

Other jurisdictions have rejected the notion that the reservation of rights is a per se conflict of interest.[85] California Civil Code § 2860 adopts this approach. It specifies that a conflict *may* arise in the case of a reservation of rights.[86]

The problems that arise in a reservation of rights in this scenario are several and each is dependent on the context in which it occurs. First, an insured is not free to reject the insurer-appointed defense counsel. In the case of rejection, it is the insured who then must pay for independent counsel.[87] Surely this is an unpalatable alternative to an insured who expected to be represented at the insurer's expense. Second, an insured who accepts the insurer-appointed defense counsel may be represented by a lawyer whose

81. Martinez, Mayerson & Richmond, *supra* note 41, § 11.11[2][a].

82. *See* Twin City Fire Ins. Co. v. Ben Arnold-Sunbelt Beverage Co., 433 F.3d 365, 370–71 (4th Cir. 2005) (listing jurisdictions that adopt the per se approach).

83. *See* CHI of Alaska, Inc. v. Employers Reins. Corp., 844 P.2d 1113, 1118 (Alaska 1993).

84. *Id.* (the loyalties of insurer-appointed independent counsel are very much in doubt).

85. *Ben Arnold*, 433 F.3d at 372. The *Ben Arnold* case provides a list of other jurisdictions that reject the per se approach. *Id.* at 371.

86. Cal. Civ. Code § 2860(b) (2008).

87. Mayerson, *supra* note 69.

engagement may be limited by the insurer to providing a defense, presumably to the exclusion of providing coverage advice.[88] There is nothing sinister in this limitation: the insurance policy only requires the insurer to provide a defense and does not require the insurer to provide a lawyer for the purpose of providing coverage advice. Third, as noted above, the defense lawyer may not be competent to provide coverage advice. Lastly, an insured is denied the peace of mind and security that a truly independent counsel might provide.[89]

B. *Problem of Confidential Information*

The second problem that comes with the use of insurer-appointed independent counsel is the possibility of discovering confidential information that would defeat coverage. In this respect, the first question that requires an answer is a seemingly innocent inquiry: Who exactly does the insurer-appointed independent counsel represent—the insured, the insurer, or both? Unfortunately, the ultimate solution depends on geography because the answer varies from jurisdiction to jurisdiction.[90]

The more defensible position, in my opinion, is that the insured is the client of the insurer-appointed defense counsel.[91] If this is the case, there is little theoretical difficulty with the possibility of divided loyalties. Of course, this sets aside the very real problem of the lawyer who is motivated by repeat business from the insurer.[92]

The more difficult question arises in jurisdictions in which the insurer-appointed independent counsel's client is either the insurer or the combined insurer/insured. In such cases, the crucial question is what the appropriate result is if the independent counsel comes across confidential information that may defeat coverage. If the insurer-appointed independent counsel's client is the insurer, practically speaking, both the insured and insurer are ill-served by that counsel's defense. The insured is likely to be less candid if he appreciates the import of the counsel's representation. If the insured does not appreciate the effect of the counsel's representation, it is fun-

88. Pryor & Silver, *supra* note 34, at 56.

89. Mayerson, *supra* note 69.

90. Professor Charles Silver has an excellent article that discusses this problem. Charles Silver, *Does Insurance Defense Counsel Represent the Company or the Insured?* 72 TEX. L. REV. 1583 (May 1994).

91. *See, e.g.*, *In re* Rules of Professional Conduct & Insurer Imposed Billing Rules & Procedures, 2 P.3d 806, 814 (Mont. 2000); Barefield v. DPIC Cos., 600 S.E.2d 256, 269–70 (W. Va. 2004).

92. *See* CHI of Alaska, Inc. v. Employers Reins. Corp., 844 P.2d 1113, 1116–17 (Alaska 1993); Aviva Abramovsky, *The Enterprise Model of Managing Conflicts of Interest in the Tripartite Insurance Defense Relationship*, 27 CARDOZO L. REV. 193, 195 (Oct. 2005) (discussing the pecuniary motivation of insurer-appointed counsel).

damentally unfair to allow such counsel to potentially gain access to any information that might defeat coverage.

Additionally, the problem outlined above is not mitigated by the idea that insurer-appointed independent counsel represents two clients, the insurer and the insured. This idea, better known as the dual-client doctrine, provides that "[s]o 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."[93] The unstated assumption is that dual representation is inappropriate where the interests of the insurer and the insured do not coincide.[94]

Although it is easy to state that dual representation is not appropriate if the interests of the insurer and the insured do not coincide, it is not always apparent that this is the case. Discovery may disclose the presence of a coverage defense, or an insured might, advertently or inadvertently, disclose to his independent counsel information that might defeat coverage. Does the lawyer's duty of loyalty to the insured preclude disclosure to the insurer, or does the lawyer's duty of loyalty to the insurer require disclosure to the insured? In the latter case, even if the lawyer at that point advises the insured on the need to retain truly independent counsel, the existence of a coverage defense is now known by the insurer if the independent counsel shares the information with it. I agree with the suggestion that resorting to rules of professional responsibility or requiring an insured to pursue a malpractice action falls far short of an adequate solution.[95]

V. CONCLUSION

The use of independent counsel is fraught with peril for the insured. Whether faced with a reservation of rights or the possibility of disclosing information that might defeat coverage, *Cumis* and its progeny leave an insured practically unprotected and in need of essential coverage advice. The insidious aspect of this oversight is that it is seldom given much thought either by the parties involved or by the courts that are called on, often too late, to fix the harm. Coverage advice really is the missing piece of the *Cumis* puzzle.

93. Kroll & Tract v. Paris & Paris, 72 Cal. App. 4th 1537, 1542 (Cal. Ct. App. 1999) (citing Nat'l Union Fire Ins. Co. v. Stites Prof'l Law Corp., 235 Cal. App. 3d 1718, 1727 (Cal Ct. App. 1991)). The MODEL RULES OF PROFESSIONAL CONDUCT R. 1.8(f) (6th ed. 2007) contains a list of citations in various jurisdictions that follow the dual-client doctrine.

94. *See* Employers Cas. Co. v. Tilley, 496 S.W.2d 552, 560 (Tex. 1973) (actions of "independent" counsel who actively worked with the insurer to develop information that defeated coverage held against public policy).

95. Mayerson, *supra* note 69.