Reconstructing Cumis: What the California Legislature Got Wrong about California Civil Code Section 2860 and How to Fix It

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Notes

Reconstructing *Cumis*:
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INTRODUCTION

In 1984, California courts leapt to the forefront of protecting consumers of insurance with the decision in *San Diego Navy Federal Credit Union v. Cumis Insurance Society, Inc.* The opinion was one of the first in the country to deal extensively with the conflicts that can arise when insurance companies select defense attorneys for their insureds. Several years later, the California General Assembly enacted California Civil Code section 2860. The statute was presumably established in response to the expansive *Cumis* decision. However, the bill containing the language that ultimately became section 2860 received little to no public comment, nor does it appear to have received much scrutiny from the assembly. It amounted to a backroom deal among special interest groups that was revealed only a few days before it was submitted to the governor. The suspicious origins of the bill make it questionable whether strong consideration was given to the underlying thought in *Cumis*.

As a result, section 2860 distorts the problem and solution identified in *Cumis* and California courts are, accordingly, constrained from fixing the problem as originally envisioned in *Cumis*. This Note will proceed in

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[881]
five Parts, ultimately arriving at a suggestion for a legislative reformation of section 2860.

First, it will give a brief overview of the nature of the problem, culminating in a consideration of San Diego Federal Credit Union v. Cumis Insurance Society and its pre-section 2860 progeny. Next, the Note will examine section 2860 and its status as a partial codification of Cumis. The meager legislative history will be explored to demonstrate the questionable and muddled intent of the legislature. Next, the series of appellate decisions interpreting section 2860 will be examined to highlight the tension between the reasoning of Cumis and the judicial application of section 2860. The penultimate Part of the Note explores solutions to that tension, ranging from the extremely proinsurance carrier position of Washington, to the extremely proinsured position of Alaska. Finally, a revision of section 2860 will be proposed. The revision focuses on clearly defining “conflict of interest” within the statute. The definition draws primarily from the California Rules of Professional Conduct. It is the Author’s belief that placing a clearer and more robust definition of “conflict of interest” within the statute will better address the problem first presented in Cumis.

I. BRIEF OVERVIEW OF CUMIS AND ITS PROGENY

A. THE PROBLEM

Most insurance contracts contain an agreement to defend the insured from any suit brought against the insured. Generally, the insurance carrier selects the attorney to carry out this defense. However, because these attorneys tend to derive large amounts of their business from the insurance company, serious conflicts can arise. For instance, insured's are often sued for a mix of claims, some of which are covered by their policy, and others which are not. In this situation, the carrier-appointed attorney may, consciously or not, craft the defense to free the carrier from liability while leaving the insured solely responsible for the defense of the noncovered claims.

B. SAN DIEGO NAVY FEDERAL CREDIT UNION v. CUMIS INSURANCE SOCIETY, INC.

In the landmark case of San Diego Navy Federal Credit Union v. Cumis Insurance Society, Inc., the California Court of Appeal considered the issue: “whether an insurer is required to pay for independent counsel

3. Id. at 107.
5. Id.
for an insured when the insurer provides its own counsel but reserves its right to assert noncoverage at a later date." The court concluded that such circumstances amounted to a conflict of interest, and thus held that insurance carriers were required to provide independent counsel under those conditions. "This holding was based on a long line of attorney-client conflict of interest cases as well as the American Bar Association Code of Professional Responsibility."

In Cumis, San Diego Navy Federal Credit Union and several other defendants were sued seeking both compensatory and punitive damages. The defendants tendered the complaint to their liability insurer, Cumis. Cumis accepted the defense, but reserved the right to disclaim coverage if the defendants' conduct was found to be willful. It also disclaimed coverage of any punitive damages. When the credit union received notice that Cumis was reserving its rights, it retained independent counsel to protect its interests. Cumis, after initially agreeing to pay the cost of independent counsel, subsequently refused.

Ultimately, the court held that Cumis was responsible for providing independent counsel. In reaching its decision, the court first noted that carrier-selected defense counsel have a dual-agency status, owing duties to both the carrier and the insured. The court next recognized that when liability in an action turns on the conduct of the insured, some characterizations of that conduct could result in noncoverage. In that situation, the carrier-appointed counsel will often be faced with decisions that, regardless of his choice, will harm one of his clients and help the other.

The Cumis court recognized this as a conflict of interest. Where the interests of the carrier and the insured conflict, "the [carrier] cannot compel the insured to surrender control of the litigation." Therefore, "if the insurer must pay for the cost of defense and, when a conflict exists, the insured may have control of the defense if he wishes, it follows the insurer must pay for such defense conducted by independent

6. Cumis, 208 Cal. Rptr. at 496.
7. Id. at 508.
9. 208 Cal. Rptr. at 496.
10. Id.
11. Id.
12. Id.
13. Id.
14. Id. at 497.
15. Id. at 496.
16. Id. at 498.
17. Id.
18. Id.
19. Id.
20. Id. (quoting Tomerlin v. Canadian Indem. Co., 394 P.2d 571, 577 (Cal. 1964)).
counsel.” Interests, the court rejected Cumis’ argument that the right to independent counsel should exist only when “actual” conflicts arise (as opposed to “potential” conflicts). The court pragmatically observed that “[r]ecognition of a conflict cannot wait until the moment a tactical decision must be made during trial.”

Because the conduct of the credit union was at issue in the underlying liability case in a way that could determine coverage, the court held that Cumis was obligated to provide independent counsel for the credit union. After making this specific pronouncement, the court went on to make the general statement that, lacking consent of all parties, “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.”

While this broad language theoretically sanctioned use of independent counsel in almost any reservation of rights situation, decisions immediately following Cumpis would soon limit the scope of the holding while giving short shrift to the reasons underlying it.

C. POST-CUMIS CASES

The Cumis decision seemed to sanction the right to independent counsel whenever the right to refuse coverage was reserved by a carrier. The California Supreme Court implicitly approved of the Cumis decision when it refused to grant review. However, only a year after the Cumis decision, the court in McGee v. Superior Court refused to find a right to independent counsel for an insured whose carrier was defending an action under a reservation of rights.

In McGee, the owner of a car (McGee) brought a negligence action against its driver (Pedersen) for injuries she received as a passenger. McGee’s insurer agreed to defend Pedersen subject to a reservation of rights based on the resident-relative exclusion in plaintiff’s policy. McGee, citing Cumis, moved to have the counsel assigned to Pederson disqualified for a conflict of interest solely because the carrier had reserved its rights. The court affirmed the trial court’s ruling that no conflict existed that would entitle Pedersen to independent counsel.

21. Id. at 501–02.
22. Id. at 503 n.7.
23. Id. at 506.
24. Id.
27. Id. at 422.
28. Id.
29. Id. at 422–23.
In reaching its decision, the court first pointed out that Pedersen gave written, informed consent to the carrier-appointed representation, thus waiving any rights to independent counsel. The court then explained that the holding of the "rather wordy" *Cumis* opinion, while stated broadly, was limited to the facts of that case. That is, the reservation of rights in *Cumis* was based on "the nature of the insured's conduct, which as developed at trial would affect the determination as to coverage." Accordingly, because Pedersen's carrier reserved its rights based on the resident-relative exclusion of the insured's policy and not the insured's conduct, the holding of *Cumis* did not control the case. More succinctly, the coverage issue was "extrinsic to and independent of" Pedersen's liability or conduct. Pedersen and the carrier's interest were thus wholly aligned in finding nonliability in the tort action. Therefore, although the carrier did reserve its rights, because the grounds for that reservation were extrinsic to the issues in the third-party tort case, no conflict of interest arose between the carrier and the insured.

This general principle was further developed two years later, in *Native Sun Investment Group v. Ticor Title Insurance Co.* In that case, the court held that no conflict of interest exists when an insurer reserves rights on the grounds of a coverage issue that is not the subject of the underlying litigation.

In *Native Sun*, Ticor insured title to properties purchased by Native Sun. The policy excluded from coverage any claims not shown by public records. While Native Sun was planning development of the properties, the State of California claimed an interest. Ticor agreed to defend against any action by the State and indemnify Native Sun for any covered loss, but "advised Native Sun that it would not indemnify them for any loss occasioned by the State's enforcement of so-called *Gion-Dietz* rights," which would fall under the public record exception of its policy.

After unsuccessful settlement attempts between the State and Native Sun, Ticor agreed to prosecute a quiet-title action against the State and selected counsel to do so. Native Sun agreed, but also

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30. Id. at 423.
31. Id.
32. Id.
33. Id. at 424.
34. Id.
36. Id.
37. Id. at 35.
38. Id.
39. Id.
40. Id.
41. Id.
retained independent counsel at its own expense. After a satisfactory
settlement of the quiet-title claim, Native Sun sued Ticor for
reimbursement of the fees it paid to independent counsel, relying on
Cumis.\(^4\)

Upholding a lower court ruling that Ticor was not liable for
independent counsel fees, the Native Sun court held that “[c]ounsel
selected and paid by an insurer is not subject to a conflict which gives rise
to the right to independent counsel every time the insurer proposes to
provide a defense under a reservation of rights.”\(^4\) Analogizing to McGee,
the court explained that the coverage issue was unrelated to the
underlying quiet-title action.\(^4\) Specifically, whether the Gion-Dietz
claims were covered was a question of interpreting Ticor’s policy
language.\(^4\) No such interpretation would occur in the quiet-title action.
Accordingly, no conflict of interest existed that would trigger an
entitlement to independent counsel.\(^4\)

The court did acknowledge the potential for the carrier-appointed
counsel to steer liability towards the uncovered claims and away from the
covered claims, possibly triggering a right to Cumis counsel.\(^4\)
However, the court declined to extend Cumis so far, especially because there was
no evidence in the record that the carrier-appointed counsel was
anything less than diligent in his litigation of all the issues in the quiet-
title claim.\(^4\) This is significant, because it seems to imply that unless a
conflict of interest actually arises, an insured may not be entitled to
reimbursement for independent counsel even if there is a potential
conflict. As noted in Part I, section B, this distinction between a potential
and an actual conflict was specifically rejected by the court in Cumis.\(^4\)

In sum, while Cumis seemed to stand for the broad proposition that
any reservation of rights by an insurer creates a conflict that triggers an
entitlement to independent counsel, that holding was quickly restricted
by subsequent cases. The most important restriction being that
“[c]ounsel selected and paid by an insurer is not subject to a conflict
which gives rise to the right to independent counsel every time the
insurer proposes to provide a defense under a reservation of rights,”\(^4\)

\(^{42}\) Id. at 39.
\(^{43}\) Id. at 40.
\(^{44}\) Id.
\(^{45}\) Id.
\(^{46}\) Id.
\(^{47}\) Id.
\(^{48}\) Id.
\(^{49}\) See supra note 22 and accompanying text.
\(^{50}\) Native Sun, 235 Cal. Rptr. at 40.
especially when the issues determinative of coverage are "extrinsic to and independent of" the issues in the underlying liability action.\footnote{51}

Later courts continued to follow \textit{McGee} and \textit{Native Sun} in limiting the scope of \textit{Cumis}.\footnote{52} Four years after \textit{Cumis}, the California legislature entrenched many of the post-\textit{Cumis} restrictions with the enactment of California Civil Code section 2860.\footnote{53}

\section*{II. California Civil Code Section 2860}

Some commentators have opined that the California legislature was motivated by a desire to both codify the general principle of the \textit{Cumis} decision and increase the rights of carriers in a post-\textit{Cumis} legal landscape when it passed California Civil Code section 2860 in 1987.\footnote{54} However, the bill's history and the legislature's intent in its passage are opaque at best and suspicious at worst.

The bill that eventually became section 2860 started its life as Senate Bill 241, a bill to eliminate a sunset date in attorney certification in medical malpractice cases.\footnote{55} It would remain in such a state until just a few days before its passage as the bill that ultimately became section 2860.\footnote{56} In fact, the only publicly available comment was the Senate Judiciary Committee's report on the bill in its earlier, medical malpractice form.\footnote{57}

While this bill made its usual rounds between the senate and the assembly, a war was brewing between California trial attorneys and insurance carriers. In 1986, a coalition of insurers and business owners successfully passed Proposition 51 (now codified as California Civil Code section 1431.2).\footnote{58} Encouraged by the large margin with which the proposition had passed, the same coalition readied another proposition to further protect businesses and insurers from large tort judgments.\footnote{59} In

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\item \footnote{52} See, e.g., Foremost Ins. Co. v. Wilks, 253 Cal. Rptr. 596, 602 (Cal. Ct. App. 1988) (holding that claims for punitive damages, without more, do not constitute a conflict of interest between the insured and the carrier); United Pacific Ins. Co. v. Hall, 245 Cal. Rptr. 99, 102 (Cal. Ct. App. 1988) (holding that \textit{Cumis} does not expand the obligation of a carrier to provide a defense where it would not otherwise exist under its policy language).
\item \footnote{53} CAL. CIV. CODE § 2860 (West 1993). The full text of the statute as currently in effect is provided in an appendix to this Note. See \textit{infra} Appendix I.
\item \footnote{54} Jon R. Mower & James P. Schratz, \textit{The Other Side of the Cumis Coin: The Insurer's Ability to Select Associate Defense Counsel Under Civil Code Section 2860(f)}, 20 W. St. U. L. Rev. 569, 573-74 (1993).
\item \footnote{55} CAL. DEP'T OF CONSUMER AFFAIRS, ENROLLED BILL REPORT: SB 241, at 3 (1987).
\item \footnote{56} Id.
\item \footnote{58} CAL. CIV. CODE § 1431.2 (West 2007); see Donald F. Miles, \textit{The Brown-Lockyer Civil Liability Reform Act of 1987}, 9 CEB CIV. LITIG. REP. 257, 257 (1987).
\item \footnote{59} Miles, supra note 58.
\end{itemize}
response, the California Trial Lawyers Association readied an opposing proposition that would demand extensive regulation of the insurance industry.60 Both sides, however, soon realized the enormous costs of waging such a “proposition war,” and agreed to meet and discuss their disagreements.61

After months of negotiation, and with the blessings of the legislative and executive branch (but no public comment or disclosure), the two groups put together and submitted a legislative package, “The Brown-Lockyer Civil Liability Reform Act of 1987.”62 The package addressed four substantive issues, one of which was “procedures governing so called Cumis counsel.”63 In a matter of days, Senate Bill 241 was gutted, and the language drafted by the insurance companies was inserted in its place. These “amendments” were passed by the assembly and senate, and quickly sent to the governor for signing.64 Only the Department of Consumer Affairs was able to offer any opposition to this backroom deal in the form of a short report attached to the governor’s report on the bill.65 The report pointed out that no consumer groups had been able to see the bill or debate its merits, and that no other interested parties had been allowed to offer comment.66 It questioned whether consumers were actually protected by the bill and whether it truly represented their interests.67 Senator Lockyer protested this characterization in a letter attached to the same report, but offered little in the way of substantive evidence to the contrary.68

Whatever the merits of that particular debate, this history of Senate Bill 241 shows that section 2860 is far from a careful, legislative consideration of what the court thought in Cumis. It muddies what was a fairly bright-line rule offered by the court in Cumis, and in so doing, it opens numerous ethical traps for California’s attorneys.

While the effects of section 2860 on subsequent court decisions will be discussed more fully in Part III of this Note, it is helpful to note the differences between section 2860 and the Cumis decision. Most significantly, this section seems to approve of the implication in Native Sun that a conflict must be actual to trigger Cumis obligations.69 It also codifies the Wilks holding that punitive damages or claims in excess of

60. Id.
61. Id.
62. Id.
63. Id.
64. 1987 CA\L. SENATE J. 3594; see also 1987 CA\L. SENATE J. 4068.
65. CAL. DEP’T OF CONSUMER AFFAIRS, supra note 55.
66. Id.
67. Id.
69. CAL. CIV. CODE § 2860(a) (West 1993).
the policy limit do not, in themselves, create a conflict of interest. 70 This is particularly odd, given how the possibility of punitive damages figured directly into the reasoning of the *Cumis* court. 71

Further, the statute envisions both the independent counsel and a carrier-appointed counsel cooperating on each case. 72 While the permissible extent of the carrier-appointed counsel’s involvement is unclear, prior to the enactment of section 2860 the carrier-appointed counsel typically had no interaction with independent counsel. 73 Finally, section 2860 allows the carrier to demand certain qualifications from the independent counsel as well as capping the rates that counsel may charge at “rates which are actually paid [by the carrier] in the ordinary course of business.” 74

### III. DUTIES OF INSURER AND INSURED AFTER SECTION 2860

As explained above, section 2860 asserts the right of insureds to demand independent counsel from their insurance carriers when a conflict of interest arises, while also outlining the scope of some qualifying conflicts. 75 The code also grants certain rights to carriers, allowing them to demand a minimum amount of experience from the counsel their insureds select and governing the rate independent counsel may charge. 76 Further, it requires independent counsel to disclose to the insurer all nonprivileged information about the action in a timely fashion. 77 Finally, without abrogating any existing contractual duties to cooperate, the statute gives the carrier a right to have carrier-selected counsel “participate in all aspects of the litigation.” 78 How California courts have applied and enforced these rights and duties is the subject of this Part.

#### A. APPOINTMENT OF INDEPENDENT COUNSEL

Since the enactment of section 2860, courts have been fond of stating that the section “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

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75. *Id.* §§ 2860(a)–(b).
76. *Id.* § 2860(c).
77. *Id.* § 2860(d).
78. *Id.* § 2860(f).
Despite this acknowledgement, courts, with a few exceptions, construed the *Cumis* doctrine narrowly and failed to find a right to *Cumis* counsel in most cases that have reached the appellate level.

1. **Triggering Conditions**

Generally, any time an attorney who represents both the carrier and its insured finds "his or her representation of the one is rendered less effective by reason of his [or her] representation of the other," a conflict of interest sufficient to require independent counsel may be present. The "paradigm case" requiring independent counsel is where the defense strategy of counsel retained by the insurance carrier can affect an underlying coverage dispute between the carrier and its insured. *Scottsdale Insurance Co. v. The Housing Group*, provides an example.

In *Scottsdale*, a developer's insurance policies provided for significantly less coverage when earth movement caused property damage on the developer's property. When the developer tendered a construction defect suit against it to its insurance carrier, the carrier accepted the defense but reserved its right to reduce coverage for damage caused by earth movement. The developer then retained independent counsel, and the carrier sued for a declaration that it was not liable to provide such counsel.

In granting summary judgment to the insured, the court reasoned that:

>[The factual position favorable to [the carrier] is the precise opposite of the one favorable to [the insured, and] ... the coverage issues "turn on" facts which will be developed in [the construction defect] action. For this reason, requiring [the insured] to rely ... on the pretrial fact gathering and case preparation of attorneys whose clients' interests are served by the establishment of facts detrimental to [the insured's] coverage case clearly runs counter to the principle set out in *Cumis* and *Golden Eagle*.](74)

Courts have recognized several other situations that trigger a right to independent counsel. Some imply such obvious violations of an
attorney’s ethical duty that they are rarely litigated. Other cases, more recently litigated, involve conflicts that may not be as apparent.

One such instance is where the insurance carrier pursues a settlement in excess of policy limits, leaving the insured exposed to further liability. In *Golden Eagle*, an insurance carrier negotiated the settlement of a claim far in excess of the policy limits of its insureds. The insureds retained independent counsel to protect their interests in the settlement agreement. The carrier refused to pay for independent counsel and, when the insureds objected to the settlement because it exposed them to further liability, the carrier petitioned the court to approve the settlement over the insured’s objections. The carrier-appointed attorney initially recommended the settlement and then failed to oppose it, despite his knowledge that the insureds did not approve.

In awarding the costs of independent counsel to the insureds, the court stated that: “Not only was [carrier-appointed] 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 [insureds] were entitled to independent counsel . . . .”

One of the more recent cases to deal extensively with other circumstances that trigger a right to independent counsel is *Gafcon, Inc. v. Ponsor & Associates.* While *Gafcon* concerned motions for summary disposition and thus did not directly reach the issue of independent counsel, the court’s comments are helpful in understanding the current state of the law.

In *Gafcon*, the insured’s (Gafcon) insurance carrier accepted defense of a negligent construction suit under a reservation of rights. Gafcon sought declaratory relief that a conflict of interest existed sufficient to trigger a right to independent counsel. The trial court granted summary judgment in Gafcon’s favor. In reversing that holding and declaring that its carrier-appointed counsel was not operating under a conflict of interest, the Court of Appeal outlined what a carrier must show to win a summary judgment.

88. See, e.g., O’Morrow v. Borad, 167 P.2d 483, 486 (Cal. 1946) (explaining that an insurance carrier could not represent both plaintiff and defendant in a single action because a full and fair examination of the merits of the case could not occur).  
90. Id.  
91. Id.  
92. 120 Cal. Rptr. 2d 392, 397 (Cal. Ct. App. 2002).  
93. Id.  
94. Id.  
95. Id. at 398–99.  
96. Id. at 399.  
97. Id. at 419.
First, it must be able to prove both that the carrier-appointed counsel could not control coverage issues and that the carrier-appointed counsel's representation of the insured would not be rendered less effective because of its relationship with the carrier. The court suggested that some showing of how "the issues presented by [the carrier's] reservation of rights differed from or were extrinsic to" the issues in the third-party litigation, would at least help to meet this burden.

In its explanation, the court succinctly presented the two most likely signs that a Cumis triggering conflict has arisen. First, that the carrier-appointed counsel could control coverage issues by his actions in the underlying suit, and second, that his representation of one client was rendered less effective by his representation of the other. Finally, the court reiterated the holding of several post-Cumis, pre-section 2860 cases that when the carrier's reservation of rights is based on an issue extrinsic to the subject of the underlying litigation, no conflict exists.

2. Grounds for Appointment Lacking

While these post-section 2860 cases allow for appointment of Cumis counsel, they are not the majority. As at least one commentator has pointed out, courts have been reluctant to find grounds for Cumis counsel in the post-section 2860 landscape.

One of the first post-section 2860 cases to find a lack of a Cumis conflict was Blanchard v. State Farm Fire & Casualty Co. In Blanchard, a general contractor tendered defense of a construction defect suit to his insurance carrier. The carrier accepted the defense, but reserved its rights with respect to coverage for certain damages. In a suit by the insured, alleging bad faith on the part of the carrier for failing to provide independent counsel, the court refused to acknowledge that this sort of reservation created a conflict of interest sufficient to trigger the duty to provide independent counsel.

Reiterating the holding of McGee, the court stated "[a] conflict of interest does not arise unless the outcome of the coverage issue can be controlled by [carrier-appointed] counsel." Because the coverage issue

98. Id.
99. Id.
100. Id.
101. Id.
104. Id. at 885.
105. Id.
106. Id. at 886.
107. Id. at 887.
involved only damages and *not* the conduct of the insured, the carrier-appointed counsel had no motivation to attach liability to the insured; both the carrier and the insured were aligned in their goal to minimize liability.\(^\text{108}\) Further, the insured produced no evidence showing any specific manner in which the carrier-appointed counsel could have influenced the case to the insured’s detriment.\(^\text{109}\) The court characterized the insured’s position as urging that “an unspecified possibility of a conflict” was sufficient to trigger the duty to provide independent counsel.\(^\text{110}\) The court rejected this position because the insured offered no facts that indicated any conflict.\(^\text{111}\) Because no facts were in dispute, and the existence of a conflict is a question of law, the insurance carrier was entitled to judgment as a matter of law.\(^\text{112}\)

The case of *Dynamic Concepts, Inc. v. Truck Insurance Exchange* also spoke about conditions that would not be sufficient to trigger a duty to provide independent counsel.\(^\text{113}\) In *Dynamic Concepts*, the insured tendered a lengthy complaint to its carrier. The complaint listed numerous causes of action,\(^\text{114}\) only one of which was even potentially covered by the insured’s policy with its carrier. When the carrier accepted the defense under a reservation of rights, the insured insisted that the reservation necessarily triggered a *Cumis* duty and demanded that the carrier withdraw its reservation of rights.\(^\text{115}\) One of the rights being reserved was the right to be reimbursed for defense costs for any claims that were not covered by the policy.\(^\text{116}\) Even though the carrier allowed the insured’s independent counsel to control the defense, it did not withdraw its reservation and attempted to have carrier-appointed counsel associate in the action.\(^\text{117}\) The carrier also appointed an attorney to investigate any *Cumis* issues that might be involved in the case.\(^\text{118}\) However, the insured refused to acknowledge or communicate with carrier-appointed counsel, and proceeded to settle all the claims without informing the carrier.\(^\text{119}\) The insured subsequently sued the carrier, alleging bad faith in that it had failed to acknowledge its duty to provide

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\(^\text{108}\) *Id.*
\(^\text{109}\) *Id.*
\(^\text{110}\) *Id.*
\(^\text{111}\) *Id.*
\(^\text{112}\) *Id.*
\(^\text{114}\) *Id.* at 884.
\(^\text{115}\) *Id.*
\(^\text{116}\) *Id.*
\(^\text{117}\) *Id.*
\(^\text{118}\) *Id.*
\(^\text{119}\) *Id.* at 885.
Cumis counsel. The insured demanded reimbursement for the entire settlement amount.

In refusing to award the insured the damages it requested, the court made several observations about what factors trigger a duty to provide independent counsel. First, "not every reservation of rights entitles an insured to select Cumis counsel." Furthermore, "[a] mere possibility of an unspecified conflict does not require independent counsel. The conflict must be significant, not merely theoretical, actual, not merely potential." The court noted that the language of section 2860 "specifically provides that 'a conflict of interest does not exist as to allegations or facts in the litigation for which the insurer denies coverage.'" It further uses the permissive "conflict of interest may exist," rather than the mandatory "shall."

Because of this, the court rejected the insured's contention that either a "global reservation of rights" or a reservation of the right to reimbursement for uncovered claims always triggers a duty to provide independent counsel. The court offered the following guidelines for determining when such a duty arises: "the potential for conflict requires a careful analysis of the parties respective interest to determine whether they can be reconciled (such as by a defense based on total nonliability) or whether an actual conflict of interest precludes insurer-appointed defense counsel from presenting a quality defense for the insured." The court also noted that any potential conflict of interest could be obviated so long as carrier-appointed counsel actually litigated diligently on the insured's behalf. The court also rejected the assumption that simply because an attorney is appointed by an insurance carrier he will attempt to manipulate any litigation against the insured. While these comments, which seem to heighten the requirements for appointment of Cumis counsel, have been disputed, they continue to be cited with approval in later decisions.
Generally then, courts have been hesitant to find a duty to provide independent counsel without an actual conflict concerning a coverage issue that could be determined in the underlying third-party litigation. A key to determining whether such a conflict exists is establishing whether "the retained attorney in fact was . . . subject to the conflicting forces which gave rise to Cumis." Stated differently: "the test is whether the conflict 'precludes the insurer-appointed defense counsel from presenting a quality defense for the insured.' If the conflict does not prevent counsel from providing a diligent and complete defense, then there is no need for Cumis counsel. While this may be a fair reading of section 2860, it turns a blind eye to the issues addressed in Cumis as well as the California Rules of Professional Conduct.

IV. OTHER STATES' SOLUTIONS

California is not the only state to have dealt with the pitfalls that insurer-appointed attorneys face. While there are almost as many approaches as there are states, they generally fall between two extremes, best represented by Alaska on the one end and Washington on the other. Alaska, by judicial decision that was later codified, allows for insureds to select their own attorney whenever the carrier reserves its rights, regardless of the reasons for the carrier's reservation. While certainly reassuring to insureds, this approach has at least one problem of its own. An insurance carrier may reserve its rights for perfectly legitimate reasons that can not possibly give rise to a conflict of interest for the carrier-appointed attorney. Making a carrier pay for a second attorney in every one of these situations will likely increase the cost of doing business, resulting in higher premiums and removing liability insurance from some consumers' reach.

Washington, on the other hand, entrusts all conflict problems to the integrity of the attorney, giving the insured no right to select independent counsel. If the carrier-appointed attorney sees a conflict, he is obligated to withdraw; if he sees no conflict, he may proceed. Furthermore, states

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133. Id. (quoting WALTER CROSKEY ET AL., CALIFORNIA PRACTICE GUIDE: INSURANCE LITIGATION § 7:772 (1999)).
135. For instance, if there is some question about whether or not the insured is up to date on his or her premium payments.
137. Id. at 1138.
adoptiong this position note that if the carrier-appointed attorney wrongs an insured, the insured may always sue the attorney.138

This approach is flawed for two reasons. First, when an attorney derives a large portion of his income from insurance carriers it is a dubious proposition that he can always put that fact aside while representing an insured.139 Second, leaving pursuit of the remedy to the insured, and even then only after injury has occurred, amounts to little deterrence. Many insureds are unsophisticated, and if they have just lost a serious tort suit due to the malpractice of the carrier-appointed attorney they may not have the resources (or indeed the patience or nerve) to return to court in pursuit of the attorney.140

V. RECONSTRUCTING CUMIS

Both of the above approaches seem to give either too little or to much to the insured. The Washington approach leaves the insured at the mercy of an attorney who may or may not be ethical in his choices. The Alaska approach forces insurance carriers to bear increased costs in order to prevent a harm that may have little to no chance of occurring. California appellate courts have slowly crept more towards the direction of Washington, in a fairly consistent move to limit the scope of what qualifies an insured to select independent counsel. A careful reading of the opinions reveals that California courts have not settled on one definition of “conflict,” and this lack of consistency is largely responsible for the judicial narrowing of the protections first established in Cumis and to some extent codified in section 2860. To remedy this situation, the legislature should add language to the beginning of section 2860, clearly defining the type of conflict necessary for triggering the right to independent counsel.

The ABA Model Rules of Professional Conduct prohibit representing a client when a conflict of interest exists and define a conflict as a situation where:

(1) the representation of one client will be directly adverse to another client; or

(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer’s responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.141

138. See, e.g., id.
139. CHI of Alaska, 844 P.2d at 1117.
141. MODEL RULES OF PROF'L CONDUCT R. 1.7(a) (2008).
The California Rules similarly provide:

A member 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

(2) Accept or continue representation of more than one client in a matter in which the interests of the clients actually conflict.  

This language, including both potential and actual conflicts, could be integrated into the new definitions for section 2860 either outright or with some slight editing. While some commentators see this move as conflating ethics and substantive insurance law, others recognize that the statute inherently pits insurance law and legal ethics against each other. More importantly, the California courts themselves have recognized that this issue is inherently an ethical one that happens to arise in the area of insurance law. Accordingly, this modest definitional amendment will give insureds maximum protection from the myriad of conflicts that arise in the context of insurance defense, while keeping the expenditure of the insurance carriers limited to those situations where there is an actual risk of harm to the insureds. Furthermore, it will further the always admirable goal of increasing public confidence in the bar.

CONCLUSION

Because of the meager and suspicious history of California Civil Code section 2860, the difficulty courts have had in applying it in the very situations it was allegedly intended to remedy, and the deficiencies of the approaches of other states, the California legislature needs to spend time seriously considering the intersection of the rules of professional conduct and substantive insurance laws. By clearly defining “conflict” in a revised section 2860 the legislature can streamline application in the courts and do more to protect unsophisticated insureds from conflicted attorneys and adversarial insurance providers.

144. Schmalz, supra note 130, at 87.
APPENDIX I: CALIFORNIA CIVIL CODE SECTION 2860

(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.