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Cumis Counsel Made Easy: An Overview of a Policyholder's Right to Independent Counsel at the Expense of the Insurer

Saturday, August 11, 2007

ABA Tort Trial & Insurance Practice Section
2007 Annual Meeting

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Vicky Victim is injured while shopping at Pete Policyholder's grocery store when she slips on a grape. Victim thinks that she saw Policyholder throw the grape at her feet moments before she slipped. Policyholder denies throwing the grape.

Policyholder is insured by ABC Insurance Co. Under Policyholder's general liability insurance policy, coverage exists for damages caused by Policyholder's negligence, but not for damages resulting from intentional acts, which are subject to the standard intentional tort exclusion. Victim sues, alleging that her injuries were caused by Policyholder's intentional act of throwing the grape. In the alternative, Victim alleges that Policyholder was negligent in failing to clean and maintain the grocery store and allowing a grape on the floor which caused Victim to suffer injury.

Under the terms of the policy, ABC Insurance Co. has both the right and duty to provide a defense for Policyholder. ABC Insurance Co. therefore offers to appoint counsel to represent Policyholder while formally reserving the right to deny coverage if Victim can prove that Policyholder intended to cause the injury.

ABC Insurance Co. hires Anna Attorney to represent Policyholder. Attorney's practice consists almost exclusively of defending ABC Insurance Co. in coverage disputes. Policyholder wants Attorney to argue that, if any fault exists, Policyholder was merely negligent in failing to clean and maintain the grocery store. If this argument succeeds, damages would be covered by Policyholder's insurance policy.

But wait! Policyholder is a born skeptic, and is immediately concerned that ABC Insurance Co. may not really want him to win his lawsuit, because then ABC would have to pay for the damages. Is it not better for ABC Insurance Co. if Victim proves that her injuries were the result of an intentional tort? Is the lawyer hired by Policyholder's insurer and financially dependent on the insurer the best lawyer to represent him? Policy-

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holder wonders if he has any other options. Who can he turn to for assistance if not his insurance company or someone who claims to be his lawyer?

Introduction

The conflict of interest that is causing Pete Policyholder's concern is clear. Whose interest does Anna Attorney ***really*** represent in this tripartite relationship between the insured, the insurer, and the insurance defense counsel?[1] ABC Insurance Co. has reserved the right to challenge coverage, and the outcome of the coverage issue will be dramatically influenced by Attorney, the lawyer retained and paid by the insurer. It is in ABC Insurance Co.'s monetary best interests to limit liability to an excluded cause of loss, and Attorney is their regular outside insurance coverage lawyer. On the other hand, Attorney was retained to represent the best interest of Policyholder, not ABC Insurance Co. Can Policyholder depend on Attorney to present the most vigorous possible defense, despite her financial dependence on the insurer?

One method of addressing the conflict of interest that arises in this scenario is for Policyholder to retain his own independent counsel to litigate the case, with ABC Insurance Co. paying Policyholder's chosen counsel's fees. Policyholder's situation demonstrates one of the most frequent conflicts of interest that implicates an insured's right to retain independent counsel at the expense of the insurer - when the insurer reserves the right to challenge the existence of coverage, and the outcome of the coverage issue will be influenced by counsel retained and paid by the insurer. Such an independent counsel is frequently referred to as "*Cumis* counsel," so named after the seminal California case that recognized the policyholder's right to an independently retained attorney rather than counsel chosen by the insurer.[2]

The right to *Cumis* counsel derives from the contractual and fiduciary duties[3] that an insurer owes to its policyholder and the rules of professional responsibility governing lawyers. When Policyholder paid his premium, Policyholder purchased contractual rights from ABC Insurance Co. under his general liability insurance policy. These rights include the right to indemnity for insured losses and the right to a

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[1] *See* Douglas R. Richmond, *Walking a Tightrope: The Tripartite Relationship Between Insurer, Insured, and Insurance Defense Counsel*, 73 Neb. L. Rev. 265 (1994), for further discussion of the "tripartite relationship". Other commentators have referred to the situation as a "trilemma". Samuel F. Barnum and James Laflin, *Resolving the Trilemma with the Cumis Triangle: A Progressive Negotiation Strategy*, 10 Cal. Ins. L. Reg. Rep. 68, 68 (March and April, 1998) ("Barnum and Laflin").

[2] *San Diego Navy Fed. Credit Union v. Cumis Ins. Soc., Inc.*, 162 Cal. App.3d 358 (Cal. App. 1984) ("*Cumis*").

[3] Notably, some states that do not recognize a fiduciary relationship between insurer and insured still provide policyholders with the right to *Cumis* counsel.

liability defense at the insurer's expense.[4] As party to a contract for insurance, ABC Insurance Co. entered into a fiduciary relationship with Policyholder.[5] Courts across the country have recognized that the appointment of *Cumis* counsel is the best approach to reconciling the duties that an insurer owes its insureds with the ethical obligations that an attorney owes to his or her client to avoid representation that is rendered less effective by reason of the attorney's representation of others.[6]

There are actually three different "mini-cases" within a single *Cumis* scenario.[7] Using the fact scenario above to identify the actors, the first "mini-case" is the underlying tort liability litigation between Vicky Victim and Pete Policyholder. The second "mini-case" is the insurance coverage dispute between Policyholder and ABC Insurance Co. The final "mini-case" is the potential bad faith litigation between Policyholder and ABC Insurance Co. for breaches of the insurer's duties of good faith and fair dealing if the inherent conflict of interest is not recognized and mitigated by providing *Cumis* counsel to the insured.[8]

This paper will address the complexities of the tripartite relationship between insured, insurer, and insurance defense counsel. Parts II and III discuss the various positions taken by domestic jurisdictions, the types of conflicts of interest that implicate the right to *Cumis* counsel, and the criticisms and identified public policies influencing these determinations. Finally, Parts IV and V discuss two of the logistical issues that arise in the context of *Cumis* representations, namely whether the policyholder or the insurer is entitled to select *Cumis* counsel and who determines how much *Cumis* counsel is paid.

II. THE POSITIONS TAKEN BY THE COURTS

Recognition of the right to *Cumis* counsel emerged as a significant issue in California just over twenty years ago.[9] The issue in *San Diego Navy Federal Credit Union v. Cumis Insurance Society* was whether an insured was entitled to choose independent counsel at the insurer's expense to defend a third party action when the

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4 *See* Barnum and Laflin at 70 (discussing the insurer's "two basic promises").

5 *See supra* note 3 and accompanying text.

6 *See Cumis*, 162 Cal. App.3d at 364-365 and n.4 (citing *Spindle v. Chubb / Pacific Indem. Group*, 89 Cal.App.3d 706, 713 (Cal. App. 1979) and noting that the basis for requiring *Cumis* counsel is not the insurance contract, but rather the attorney's ethical obligations). *See also* Todd R. Smyth, *Duty of Insurer to Pay for Independent Counsel When Conflict of Interest Exists Between Insured and Insurer*, 50 A.L.R.4th 932 (2006) ("Smyth").

7 *See* Barnum and Laflin at 69.

8 A fourth "mini-case" is also possible – a legal malpractice action between Policyholder and Anna Attorney for an inadequate or unethically biased representation.

9 *Cumis.*

insurer reserved its right to subsequently deny coverage based upon facts that might arise during the underlying litigation. The plaintiff in the third party action sought general and punitive damages for tortious wrongful discharge, breach of the covenant of good faith and fair dealing, wrongful interference with contract, breach of contract and intentional infliction of emotional distress. The California Fourth Circuit Court of Appeal found that the attorney selected by the insurance company had dual agency status, representing both the insured and the insurer in the third party litigation.[10] During a trial, that attorney would have to make numerous decisions in which the attorney would be forced into the dilemma of helping one of his clients concerning insurance coverage and harming the other. "No matter how honest the intentions, counsel cannot discharge inconsistent duties."[11]

> 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 right to deny coverage. If the insured does not give an informed consent to continued representation, counsel must cease to represent both.[12]

The *Cumis* court concluded that if the insurer has a duty to defend, and if, in case of conflict, the insured has the right to independent counsel, then it follows that the insurer must pay the reasonable cost of the defense conducted by the independent counsel.

Since the time of that landmark case, the right to independent *Cumis* counsel when the insurer's reservation of rights cause a conflict of interest has been recognized in many other jurisdictions.[13] Still other jurisdictions have expressly rejected the right.

A few state legislatures have codified the right to *Cumis* counsel to delineate the right and its mechanics. Shortly after the right was first recognized by its courts, the California Legislature codified the right to *Cumis* counsel and enacted Cal. Civ.

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[10] There are states such as Texas that recognize the right to *Cumis* counsel and while holding that an attorney hired by an insurance company to represent the insured does *not* also legally represent the insurance company. *See* TX Eth. Op. 532, 2000 WL 987293 (Tex. Prof. Eth. Comm. 2000); *Employer's Casualty Company v. Tilley*, 496 S.W. 2d 552 (Tex. 1973); and *State Farm Mutual Automobile Ins. Co. v. Traver*, 980 S.W. 2d 625, 628 (Tex. 1998). *But see American Home Assurance Co.*, 121 S.W.3d 831, 838 (Tex. App. 2004).

[11] *Cumis*, 162 Cal.App.3d at 366.

[12] *Id.* at 375.

[13] *See* citations to cases in Smyth.

Code § 2860.[14] The Florida Claims Administration Statute[15] is another example of a

[14] The statute reads as follows:

(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.

Cal. Civ. Code § 2860 (2007).

[15] The Florida Claims Administration Statute provides, in relevant part, as follows:

(2) A liability insurer shall not be permitted to deny coverage based on a particular coverage defense unless:

(a)Within 30 days after the liability insurer knew or should have known of the coverage defense, written notice of reservation of rights to assert a coverage defense is given to the named insured by registered or certified mail sent to the last known address of the insured or by hand delivery; and

(b) Within 60 days of compliance with paragraph (a) or receipt of a summons and complaint naming the insured as a defendant, whichever is later, but in no case later than 30 days before trial, the insurer:

1. Gives written notice to the named insured by registered or certified mail of its refusal to defend the insured;

2. Obtains from the insured a nonwaiver agreement following full disclosure of the specific facts and policy provisions upon which the coverage defense is asserted and the duties, obligations, and liabilities of the insurer during and following the pendency of the subject litigation; or

3. Retains independent counsel which is mutually agreeable to the parties. Reasonable fees for the counsel may be agreed upon between the parties or, if no agreement is reached, shall be set by the court.

a codified right to *Cumis* counsel.[16] For most jurisdictions, however, the right to independent counsel at the insurer's expense, if it exists, is jurisprudential.

A. There are three recognized conflicts of interest that can implicate the right to *Cumis* counsel.

The precise contours and mechanics of the right to *Cumis* counsel have evolved since its first appearance, and continue to change today as new issues are addressed by courts and legislatures. Generally speaking, there are now three basic conflicts of interest that entitle the policyholder to independent representation.[17]

1. A policyholder may be entitled to *Cumis* counsel if the allegations of a lawsuit include some causes of action of which are covered and some causes of action which are excluded by the policy. The insurer may offer to engage counsel to represent the policyholder after reserving the right to later deny coverage if it is proven that the loss is an excluded one.

This conflict of interest arising from the insurer's obligation to provide a defense and its desire to preserve its ability to subsequently deny coverage is the classic *Cumis* scenario, and the one demonstrated by Pete Policyholder, ABC Insurance Co., and Anna Attorney above. The right to *Cumis* counsel in such a situation has been widely recognized.[18] The basis for the independent counsel requirement is not the insurance contract itself, but rather the ethical obligations that the insurance defense counsel owes to his or her clients to avoid representing conflicting interests.[19]

The primary policy justification behind the appointment of *Cumis* counsel is readily apparent – avoiding divided loyalties. The California appellate court that decided *Cumis* quoted extensively from the American Bar Association Code of Professional Responsibility on this issue:

Fla. Stat. § 627.426(2) (2007).

[16] *See* D. David Keller and Michael A. Krueger, *Update on Cumis Counsel: The Florida and Other Perspectives*, FDCC Quarterly Vol. 56, No. 3, p.315 (Spring 2006) ("Keller and Krueger") (available at http://www.thefederation.org/documents/Qt%20V56N3.pdf) (website last checked May 30, 2007) (discussing the Florida scheme).

[17] *See* Keller and Krueger at 315.

[18] *See* citations to cases from Alaska, Arkansas, California, Illinois, Indiana, Louisiana, Massachusetts, Maryland, Michigan, Minnesota, New Jersey, New Mexico, New York, Rhode Island, Texas, Washington, and Wisconsin in §5 of Smyth.

[19] *Cumis*, 162 Cal. App.3d at 364 (Cal. App. 1984).

> If a lawyer is requested to undertake or to continue representation of multiple clients having potentially differing interests, he must weigh carefully the possibility that his judgment may be impaired or his loyalty divided if he accepts or continues the employment. He should resolve all doubts against the propriety of the representation. A lawyer should never represent in litigation multiple clients with differing interests, and there are few situations in which he would be justified in representing in litigation multiple clients with potentially differing interests. If a lawyer accepted such employment and the interests did become actually differing, he would have to withdraw from employment with likelihood of resulting hardship on the clients; and for this reason it is preferable that he refuse the employment initially.[20]

The potential for even subconscious influence over counsel retained and paid by the insurance company has been recognized: "Common logic dictates that in such circumstances, counsel for [the insurer] would be inclined, albeit acting in good faith, to bend his efforts, however unconsciously, toward establishing that any recovery by [the third party] would be grounded on the theory of [the] claim which was not covered by the policy."[21] Even in the absence of obvious improper conduct, "[t]he most optimistic view of human nature requires [the court] to realize that an attorney employed by an insurance company will slant his efforts, perhaps unconsciously, in the interests of his real client, to one who is paying his fee and from whom he hopes to receive future business, the insurance company."[22]

2. A policyholder may be entitled to *Cumis* counsel if several defendants who have the same insurer have antagonistic interests.

The conflict of interest that implicates the right to independent counsel and most directly involves the insurance defense attorney's ethical obligations to avoid divided loyalties arises when several defendants to the same lawsuit have antagonistic interests but by coincidence or otherwise are insured by the same insurance company. The right to separate and independent counsel in this situation, rather

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[20] *Id.* at 366-67 (quoting ABA Code of Professional Responsibility, Ethical Consideration EC5-15).

[21] *Travelers Indemnity Co. v. Royal Oak Enterprises, Inc.*, 344 F. Supp. 1358, 1372 (M.D. Fla. 2004) (quoting *United States Fidelity & Guaranty Co. v. Louis A. Roser, Co.*, 585 F.2d 932, 938 (8th Cir. 1979)).

[22] *Id.* (quoting *Roser*, 585 F.2d at 938 n.5).

than joint representation by a single attorney, is a given.[23] In some, but not all such cases, courts have permitted the insured to select its own counsel, rather than accept counsel appointed by the insured.[24]

3. A policyholder may be entitled to *Cumis* counsel if misconduct by the insurer while providing the defense gives rise to a conflict of interest.

A few jurisdictions have granted the right to *Cumis* counsel when an insurer's alleged misconduct in defending the policyholder in the lawsuit leads to a conflict of interest.[25] In *Outboard Marine Corp. v. Liberty Mut. Ins. Co.*, 536 F.2d 730 (7th Cir. 1976), the Seventh Circuit, applying California law, held that allegations of insurer impropriety were too speculative to support the policyholder's claim for declaratory relief against the insurer, but that if misconduct of counsel hired by the insurer to defend the insured created a conflict of interest, the insured had the right to independent representation at the insurer's expense.[26]

B. Determining the existence of a conflict of interest that implicates the right to *Cumis* counsel is a fact-specific inquiry.

Not every reservation of rights creates a conflict of interest that would entitle the insured to engage independent counsel at the insurer's expense. The inquiry is extremely fact-specific, and requires analysis of the nature of the coverage issue as it relates to the issues in the underlying case. If the underlying case does not implicate the issue upon which the existence of coverage turns, there is no potential conflict of interest or need for *Cumis* counsel. An attorney retained by the insurer would not be influenced by contradictory allegiances to the policyholder and the insurer. Courts may look at the reservation of rights letter itself as evidence of the existence of a conflict of interest between the insurer and the policyholder.[27]

The distinction between an actual conflict of interest and a potential conflict of interest may determine whether the policyholder is entitled to *Cumis* counsel. Many states require an ***actual*** conflict of interest. In order for the policyholder to be entitled to *Cumis* counsel, the insurer must reserve the right to deny coverage, and it

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23 *See* citations to cases from Arizona, California, Hawaii, Illinois, Maryland, Mississippi, New Jersey, New York, and Pennsylvania in §3 of Smyth.

24 *See, e.g., Moeller v. American Guar. and Liability Ins. Co*., 707 So.2d 1062 (Miss. 1996); *Joseph v. Markovitz*, 551 P.2d 571 (Ariz.App. 1976).

25 536 F.2d at 737.

26 *Id.*

27 *See* citations to cases discussing the reservation of rights from jurisdictions such as California, Idaho, Illinois, Louisiana, Massachusetts, Michigan, Minnesota, Mississippi, New Mexico, New York, Ohio, and Utah in §4 of Smyth.

must appear that the attorney retained by the insurer can influence the outcome of the coverage issue in the underlying dispute.[28] Some courts require that the policyholder refuse the insurer's offer to defend under a reservation of rights before the insured is entitled to independent counsel.[29]

C. There are consequences if the insurer fails to provide *Cumis* counsel.

The complexity and fact-specificity of determining the right to independent counsel raises another question: does the policyholder have to identify the conflict of interest himself? Does Pete Policyholder have to raise his concerns regarding Ann Attorney to ABC Insurance Co. himself? Is ABC Insurance Co. required itself to disclose the conflict and offer to let Policyholder select his own counsel? If ABC Insurance Company fails to do so, is it liable for bad faith penalties? Does Anna Attorney have to inform ABC Insurance Co. and Policyholder of the conflict?

A closer analysis of the reasoning applied to *Cumis* counsel cases reveals that the ethical duties that every attorney owes his clients require counsel to identify when he finds himself representing two clients with antagonistic interests and withdraw from the representation.[30] In *Great Divide Ins. Co. v. Carpenter ex. rel. Reed*[31] the Supreme Court of Alaska held that an insurance company is obligated to inform its policyholder that he is entitled to independent representation at the insurer's expense when a conflict of interest arises. The court determined that failure to inform the policyholder was a material breach of the insurance policy.[32] Failure to identify and remedy the conflict is an ethical violation that may even be attributable to the insurer.

The extent to which an insurer's failure to identify a conflict of interest that entitles the policyholder to *Cumis* counsel is bad faith or a breach of the insurer's duty of good faith and fair dealing remains legally undeveloped. Certainly the

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[28] *See Dynamic Concepts, Inc. v. Truck Ins. Exchange*, 71 Cal. Rptr.2d 882 (4th Dist. 1998), as modified, (Mar. 27, 1998); *Truck Ins. Exchange v. Superior Ct.*, 59 Cal. Rptr.2d 529 (2d Dist. 1996); *Blanchard v. State Farm Fire & Casualty Co.*, 2 Cal. Rptr.2d 884 (2d Dist. 1991).

[29] *See Travelers Ins. Co. of Ill. v. Royal Oak Enterprises, Inc.*, 344 F. Supp.2d 1358 (M.D. Fla. 2004) (holding that the possibility of conflict, by itself and absent evidence that the representation provided by the insurance defense counsel was prejudiced, did not justify interfering with the insurer's right to control the defense).

[30] *See supra* note 20 and accompanying text (discussing the ABA Code of Professional Responsibility identification and withdrawal requirements); *see also infra* Part III (discussing the policy justifications behind the right to *Cumis* counsel).

[31] 79 F.3d 599 (Alaska 2003).

[32] *Id.*

the prospect of bad faith damages in such situations should cause both insurers and attorneys to take notice. Insureds may also argue that the insurer's failure to identify the right to independent counsel constitutes a waiver of the insurer's right to subsequently challenge the cost of an independent defense.

III. CRITICISMS OF CUMIS COUNSEL

There are jurisdictions that have determined that appointing independent counsel at the expense of the insurer is unwarranted, and have rejected the argument that the right to *Cumis* counsel arises out of the contractual and fiduciary obligations that an insurer owes its policyholder and the ethical rules governing lawyers.

A. Do policyholders need to be protected from lawyers?

The primary rationale for rejecting the right to *Cumis* counsel is that the dangers of subconscious influences and divided loyalties are adequately addressed by self-policing and the ethical codes governing the legal profession.[33] The lawyer may represent the insured in the underlying liability litigation and also have strong allegiances to the insurer. However, under the law, it is clear that the primary duty of loyalty owed by insurance defense counsel is to the insured, not the insurer, and "[t]o suggest that human nature prevents the harnessing of actions motivated by self-interest is to contend that fiduciary relationships are unworkable."[34] The rules governing attorney conduct and the threat of professional malpractice liability serve as sufficient deterrents to ensure that insurance defense counsel's loyalties are properly extended towards the insured rather than towards the insurer who pays his fees.

Critics of the right to *Cumis* counsel also argue that the right to manage the defense of the insured is a significant contractual benefit that the insurer bargained for and acquired.[35] It allows the insurer to monitor its financial interest in litigation and protect itself from unwarranted liability claims. They say a court should not interfere with the express terms of a contractual agreement between insurer and policyholder. As a Michigan federal court stated:

> To hold that the insurer who, under a reservation of rights, participates in the selection of counsel, automatically breaches its duty of good faith is to indulge in the conclusive presumption that counsel is unable to fully represent its client, the insured, without consciously or unconsciously compromising the insured's interests. The Court is unable to

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[33] *See Cumis*, 162 Cal. App.3d at 364.

[34] *Cent. Mich. Bd.. of Trustees v. Employers Reinsurance Corp.*, 117 F. Supp.2d 627, 636 (E.D. Mich. 2000).

[35] *Id.*

> conclude that Michigan law professes so little confidence in the integrity of the bar of this state.[36]

Finally, there are billing concerns, and insurers claim that a "cottage industry" has developed consisting of *Cumis* counsel who inflate their rates and force insurers to overspend on the defense of their policyholders.[37]

B. The right to *Cumis* counsel avoids unnecessary conflicts of interest and best protects the interests of policyholders.

In response, proponents of the right to *Cumis* counsel counter that the strong subconscious influences on an attorney who is retained by and financially beholden to an insurance company cannot be mitigated by the rules of professional responsibility and the threat of malpractice, precisely because the influences are ***subconscious***. Recognition of real-world influences on lawyers, which may be subtle, does not detract from the import of the attorney's fiduciary duties and professional codes of responsibility, but rather systematically ensures that policyholders are not prejudiced by their insurer's selection of counsel. Courts have recognized that insurance contracts are frequently contracts of adhesion, and policyholders must enter into them with little bargaining power. Granting the right to *Cumis* counsel also mitigates the distrust that the public frequently expresses towards both the legal profession and the insurance industry. As for the billing rates charged by *Cumis* counsel, any concerns regarding the reasonableness of rates can be cured with judicial oversight.[38] Weighing the policy arguments for and against the right to *Cumis* counsel, the majority trend favoring the right to independent counsel at the insurer's expense is likely to continue spreading across domestic jurisdictions.

IV. WHO GETS TO SELECT CUMIS COUNSEL?

Practically speaking, the conflict of interest that triggers the right to *Cumis* counsel can typically be identified at the onset of the underlying liability litigation. Most *Cumis* cases begin when the insurer sends the policyholder a reservation of rights letter, agreeing to provide a defense but reserving the right to deny coverage.[39] In such simple scenarios, *Cumis* counsel must be retained for the underlying liability litigation to proceed. However, a conflict of interest between the insurer

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36 *Id.*

37 *See infra* Section V.

38 *See infra* Section V.

39 *See* Barnum and Laflin at 73.

and policyholder can arise at a later stage of the litigation.[40]

A. The policyholder may be entitled to select counsel independently.

Many courts grant the right to the policyholder to select his *Cumis* counsel completely independently from the insurer. In *Cunniff v. Westfield*, 829 F. Supp. 55 (E.D.N.Y. 1993), the court noted the absence of policy language governing the issue, and held that the insurer had no right to participate in the selection of independent counsel.[41] The court held that the insured could not be forced to select a lawyer from a list of firms provided by the insurer because all of the firms on the list regularly did work for the insurer. On the far other extreme, a few courts have held that the insurer could select independent counsel for the insured.[42] More frequently, however, courts attempt to balance the insured's right to independently select counsel with the insurer's right to control the litigation through a compromise solution.

B. The insurer may be entitled to approve the selection of *Cumis* counsel or to set minimum standards for such a selection.

The insurer's contractual right to control the defense militates in favor of allowing the insurer to approve the insured's selection of *Cumis* counsel. Alternatively, the insurer may be entitled to set minimum standards to ensure the adequacy of the representation. When the California Legislature codified the right to *Cumis* counsel, it provided that the insurer could set minimum standards for counsel.[43]

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[40] *See, e.g., Cumis*, 162 Cal. App.3d at 499 (discussing how the conflict can arise before litigation begins or at other stages of trial); *Golden Eagle Ins. Co. v. Foremost Ins. Co.*, 25 Cal. Rptr.2d 242 (Cal. App. 1993) (conflict arising during settlement negotiations); *Bogard v. Employers Cas. Co.*, 210 Cal. Rptr. 578 (Cal. App. 1985) (same). *See generally* Barnum and Laflin (discussing complications that arise in settlement negotiations within the context of a *Cumis* tripartite relationship).

[41] *See* citations to cases from Arizona, Arkansas, California, Illinois, Louisiana, Maryland, Massachusetts, Minnesota, Missouri, Montana, New Jersey, New York, Puerto Rico, Texas, Utah, and Wisconsin in §9 of Smyth.

[42] *See Red Head Brass, Inc. v. Buckeye Union Ins. Co.*, 735 N.E.2d 48 (Ohio App. 1999) (holding that counsel retained by the insurer for the insured had no obligation to disclose the volume of work it performed for the insurer).

[43] *See supra* note 14 and accompanying text (discussing the California legislation). The California statute provides in pertinent part that

> [w]hen 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

C. The policyholder may be able to pursue an action for declaratory judgment to determine the insurer's obligation to provide *Cumis* counsel.

From the perspective of a policyholder, the insurer's duty of reasonable care requires the insurer to independently identify conflicts of interest that may arise in the context of the tripartite relationship between insurer, insured, and insurance defense counsel.[44] The insurer could also file a declaratory judgment action for a judicial determination of its obligations under the insurance policy, including whether or not it must pay for the insured's independent representation.

What can a policyholder do if the insurer does not come forward on its own initiative to identify conflicts of interest that would implicate the right to independent counsel? Unfortunately, there simply are not many palatable options for an insured. Jurisdictions such as California and Florida that have codified the right to *Cumis* counsel are better equipped to resolve the dilemma posed to policyholders. To a lesser extent, jurisdictions that have well developed bodies of *Cumis* law offer greater predictability regarding the availability of independent counsel to insureds. But in many jurisdictions, when faced with a situation that may or may not implicate the right to *Cumis* counsel, the policyholder may find himself between a rock and a hard place. The insured may be entitled to file a declaratory judgment action seeking a judicial declaration that the insurer must pay for independent counsel. However, this separate litigation could be a significant expense, and one not covered by insurance.

V. WHO CONTROLS HOW MUCH INSURERS WILL PAY FOR CUMIS COUNSEL?

One of the basic tensions arising from the tripartite relationship between policyholder, insurer, and insurance defense counsel is the insurer's interest in keeping defense costs to a minimum versus the policyholder's interest in presenting a full and vigorous defense. Unfortunately, this tension is not relieved by the appointment of *Cumis* counsel, and may in fact be exacerbated. The insurer cannot be expected to hand over a blank check to the independent counsel, but likewise, the insurer cannot be allowed to vitiate the intent of *Cumis* counsel by refusing to open its pocketbook.

Insurance companies typically hire insurance defense counsel who work on a volume basis at lower billable rates. The policyholder may wish to hire a private attorney who bills at a much higher rate. If the insurer has to pay whatever rate

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experience in the subject at issue in the litigation, and (2) errors and omissions coverage.

Cal. Civ. Code § 2860 (2007).

[44] *Yaquinto v. Segerstrom*, 247 F.3d 218, 227-28 (5th Cir. 2001).

Cumis counsel sets for his services, the insurer does not get the benefit of the negotiated rate it pays to its usual counsel who gives the insurer a volume discount. Critics of the right to *Cumis* counsel claim to have identified a "cottage industry" of private lawyers who represent policyholders as *Cumis* counsel and charge extravagant rates because the insurers cannot challenge the price. On the other hand, if the insurer unilaterally sets the price it is willing pay for *Cumis* counsel, the policyholder may be just as effectively prevented from presenting an independent, vigorous defense as if he were forced to accept a lawyer appointed by and loyal to the insurer alone.

Additionally, a dispute over the bill for legal services may come ***after*** the underlying litigation is complete, and the policyholder may unexpectedly find himself on the hook for a large portion of extensive defense costs. Arguably, this violates the insurer's obligations of good faith and fair dealing towards its insureds. For this reason, it is important to bring the issue of rates to the forefront as soon as the need for *Cumis* counsel is identified.

California and Florida have codified the right to *Cumis* counsel and directly address the extent of the insurer's liability for independent defense costs. California's statute limits litigation costs and the independent attorney's fees to the rate the insurer normally pays its usual counsel for similar cases,[45] which are essentially the typical insurance defense lawyer's lower rates. Florida's statute provides that the insurer and insured can agree upon the rate in advance, or it can be set by the court.[46] As a practical matter, when billing issues are identified at the outset of a lawsuit, policyholders, insurers and *Cumis* counsel frequently negotiate a solution on rates. Absent a negotiated agreement, the rate problem can result in "satellite litigation" which itself can be expensive.

VI. CONCLUSION

The codified right to *Cumis* counsel that has appeared in California and Florida is emblematic of the trend towards granting the right to independent representation of an insured at the expense of his insurer. As this trend continues, as the law continues to evolve, and as the contours of the right to *Cumis* counsel are further defined, it is critical that the focus remains on providing adequate protection to the policyholder from biased or subliminally prejudiced representation. The requirement that insurers pay for independent counsel when a conflict of interest arises offers policyholders some systematic protection. Hopefully, this protection will be

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[45] *See supra* note 14 and accompanying text (discussing the California legislation). The California statute provides that "[t]he 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." Cal. Civ. Code § 2860 (2007).

[46] *See supra* note 15 and accompanying text (discussing the Florida legislation). The Florida statute provides that "[r]easonable fees for the counsel may be agreed upon between the parties or, if no agreement is reached, shall be set by the court." Fla. Stat. § 627.426(2) (2007).

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strengthened as undeveloped legal issues such as who gets to select *Cumis* counsel and who determines how much *Cumis* counsel will be paid are addressed by the courts.