

## The 'Cumis' Conundrum

Lawyers face ethical dilemmas when considering independent counsel

By Max H. Stern

**A** number of ethical issues arise for an attorney advising a client who has received a reservation of rights from a third party liability insurer. While these issues should be taken into consideration, they may not always be reviewed in practice.

The advice that clients usually receive from their attorneys in these situations is to reject the insurer's offer of insurer panel counsel and instead pursue all rights to have the policyholder's own attorneys appointed as independent counsel. But the policyholder client making this decision seldom fully understands that the insurer's obligation to pay for independent counsel is limited and that the policyholder often has to pick up a substantial part of the tab.

In many ways, an attorney's advice to seek independent counsel has the practical — though unintended — effect of depriving clients of an important part of the economic and "peace of mind" benefits they expected when purchasing liability insurance. This article discusses the potential negative side effects of the decision to choose independent counsel and explores how an attorney advising a policyholder client may not always be serving that client's best interests.

Under California law, the terms of a standard comprehensive general liability policy, which provide that the insurer has "the right and duty to defend any suit against the insured and make such investigation and settlement of any claim or suit as it deems expedient," generally give the insurer the right to appoint counsel for the insured and the right to control the defense and settlement of the claims against its insured. (*New Hampshire Ins. v. Ridout Roofing* (1998) 68 Cal.App.4th 495, citing *Robertson v. Chen* (1996) 44 Cal.App.4th 1290). This right includes the right to investigate claims, negotiate a settlement and otherwise conduct a defense of the action against its insured.

When an insurer first receives a lawsuit against a policyholder, among the first things it does is to compare the allegations of the complaint against the scope of coverage under the policy. If there are allegations of wrongdoing that fall outside of the scope of coverage, the usual practice is to send a letter reserving the right to deny coverage for liability that is not covered. The California Supreme Court, in *Blue Ridge Ins. v. Jacobsen*, (2001) 25 Cal.4th 489, has observed that such unilateral reservations of rights are valid and enforceable. It is the insurer's right to select defense counsel and control the defense of the case, combined

with the defense counsel's theoretical incentive to shade the outcome of the case in favor of the insurer in order to enhance the prospect of future assignments, that arguably creates a conflict of interest for defense counsel when such a reservation of rights is issued by the insurer.

The prospect of defense counsel shading the defense of the policyholder to the advantage of the insurer led California courts to establish a policyholder's right to so-called *Cumis* counsel — independent defense counsel paid for by the insurer but chosen and controlled by the policyholder. This approach was first spelled out by the court of appeal in *San Diego Federal Credit Union v. Cumis Ins. Soc'y*, (1984) 162 Cal.App.3d 358.

Since then, the original *Cumis* decision has been limited by Civil Code §2860, as outlined in *Buss v. Superior Court*, (1997) 16 Cal.4th 35. Under that statute, a conflict of interest may exist "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..." Importantly, not every reservation of rights creates a conflict of interest. Instead it depends on the nature of the coverage issue as it relates to the issues in the underlying case.

The policyholder client, however, may not realize that selecting *Cumis* counsel does not necessarily serve the client's best interests. The selection triggers a series of issues, which ultimately makes the defense a more costly, problematic endeavor for the policyholder. Explaining and advising a client on these issues can create an ethical dilemma for an attorney who represents a policyholder. The conflict is between the lawyer's interest in holding onto the case and the client's interest in minimizing the economic and opportunity costs of the litigation process. The attorney, of course, has an ethical duty to put the client's interests first. But practical experience suggests that few attorneys fully explain the real costs and benefits of electing to insist on the right to independent counsel.

The actual cost of the defense may be the most significant factor to consider. Under Civil Code §2860(c), the insurer's obligation to pay for *Cumis* counsel is limited to rates that 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." Even when several insurers are obligated to provide *Cumis* counsel, the same statute limits the attorney to a single fee based on billing rates paid by any one of the insurers in defense of similar actions in the community. The attorney is not entitled to add the contributions of each of the insurers to get a higher fee. In addition, the insurer's obligation is limited to services reasonably required to defend the insured. "While *Cumis* may prohibit an insurer

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from dictating the tactics of litigation, it does not delegate to *Cumis* counsel a meal ticket immunized from judicial review for reasonableness,” the court of appeal held in *United Pac. Ins. v. Hall*, (1988) 199 Cal.App.3d 551.

Typically, lawyers who are part of an insurers’ panel of counsel charge lower rates than attorneys who advise policyholders. This is not unusual given the economics of their respective practices. Panel counsel are assured of a steady supply of defense work from the insurer. They have assembled their practice with a business model designed to prosper at insurer panel rates, for example, by controlling overhead and marketing costs. On the other hand, business advisor counsel generally charge rates based on a business model of marketing to and serving a greater number of sources of work, with more peaks and valleys in their workload. It is neither surprising nor suspicious that business counsel rates are higher than those of insurer panel counsel.

The effect on the policyholder, though, is significant. Agreeing to go forward with an insurer-retained defense counsel protects the policyholder from incurring any up-front cost from the defense of the case. On the other hand, the decision to use *Cumis* counsel often forces the policyholder to bear a significant cost for each hour spent on the defense of the case, based on the differential between panel counsel rates and business counsel rates. Unless the client’s chosen independent counsel is willing to work at the insurer’s panel rate, there is a very real cost in electing to proceed with *Cumis* counsel.

A decision to refuse an insurer’s offer of panel counsel often adds other less obvious costs to the defense, which nevertheless can be substantial. For example, panel counsel are usually chosen from the ranks of attorneys with a great deal of experience in the particular subject area and are exposed to a steady flow of work in the area. Practical experience indicates that panel counsel are also more attuned to issues of efficiency and cost control in their work than are business counsel. This is because most clients do not have the litigation experience that has led insurers to be so efficient in managing litigation. After all, managing litigation is the business of a liability insurer. As a result, a policyholder who is represented by panel counsel is better able to avoid disputes that may arise over the dollar and time costs of such disputes.

Cost issues may also arise in the course of disputes over whether a case actually triggers an entitlement to *Cumis* counsel and, if so, what the proper rate for reimbursement of the policyholder’s chosen counsel will be. As discussed above, the policyholder is only entitled to *Cumis* counsel when there is an actual conflict on a coverage issue, with defense counsel having an opportunity to affect the outcome of the coverage issue adversely and the incentive to do so. A merely hypothetical conflict does not create a right to independent counsel at the insurer’s expense. Getting the insurer to agree on *Cumis* counsel in a close case can involve a costly letter-writing war. This could also lead to coverage-related litigation, with all of its hard costs

(fees and expenses) and soft costs (time spent and opportunities lost).

Finally, there is a potential cost to be considered in terms of damaging the relationship between a policyholder and an insurer. While insurers reserve rights as to non-covered claims on a routine basis, the involvement of independent counsel can increase the number and scope of actual disputes between an insurer and a policyholder. Lawyers tend to disagree about the best way to proceed in any case. Undermining a harmonious relationship between an insurer and a policyholder may very well lead to additional hard and soft costs to the policyholder.

Notwithstanding these potential costs — whether or not they are meaningfully disclosed and discussed with a client — *Cumis* counsel is often perceived as necessary because of the presence of a conflict that purportedly prevents panel defense counsel from providing effective representation. This perception, however, may not be truly grounded in the practical realities facing the policyholder. The question to ask is whether the benefits of the perceived need for *Cumis* counsel outweighs the costs.

Panel defense counsel are usually well respected and experienced attorneys who have their own ethical duties to the policyholder. That duty comes first, before any duty to the insurer. When there are conflicts between an insurer and a policyholder, ethical panel attorneys can avoid the conflict by keeping the scope of their representation to diligent efforts to minimize liability and damages, without any consideration of coverage. In most cases, it will not be in a policyholder’s economic interest to presume that panel counsel will not honor those duties.

If those duties are breached and panel counsel acts against a policyholder’s interests, remedies are available. California law provides for both a malpractice action against an attorney who has put the interest of an insurer ahead of a policyholder client and a bad faith claim against an insurer who improperly uses panel counsel to the detriment of a policyholder. Although there is some cost to enforce these remedies, it is a contingent cost that is only incurred if things go wrong. If things work out — as they usually do — a policyholder is far better off for not having incurred all of the hard and soft costs previously discussed.

An attorney who advises an insured client has an obligation to educate that client regarding these and other potential consequence of demanding *Cumis* counsel. This obligation may conflict with the attorney’s interest in retaining the case as *Cumis* counsel for the policyholder client, posing an ethical dilemma that should always be resolved in favor of the client’s best interests. A recommendation to choose *Cumis* counsel should only be made if it is economically advantageous for the client. That decision should take into consideration all of the limitations on the insurer’s duty to provide independent counsel and should not be based on the attorney’s own interest in holding onto the file. ♦