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Timing may not be everything after all: A clarification from the California Court of Appeal concerning conflicts of interest and Cumis counsel

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The California Court of Appeal recently clarified that insurers have no obligation to appoint independent counsel pursuant to California Civil Code § 2860 (so-called Cumis counsel, after the Court of Appeal’s decision in San Diego Federal Credit Union v. Cumis Ins. Society, Inc. (1984) 162 Cal.App.3d 358), where the issue relates to the timing of property damage or issues that will not be litigated in the underlying action because defense counsel cannot control the resolution of such facts. The court of appeal also reaffirmed that Cumis counsel is required only where a conflict of interest is “significant, not merely theoretical, and actual, not merely potential,” and addressed the methods by which an insurer defending multiple insureds can avoid such a conflict.

The coverage actions in Federal Insurance Company, et al. v. MBL, Inc., 219 Cal. App. 4th 29; 2013 Cal. App. LEXIS 679 (2013), arose out of a Comprehensive Environmental Response, Compensation and Liability (CERCLA) action brought by the federal government against a dry-cleaning facility in Modesto, California, for soil and groundwater contamination. The defendants in the CERCLA action brought a third-party action against other entities, including a supplier of dry-cleaning products, seeking contribution, indemnity and declaratory relief. The product supplier, in turn, tendered the claim to its insurers, which had separately insured the supplier over several years.

The insurers accepted the tender under separate reservations of rights and retained defense counsel. Generally, the insurers reserved their rights to disclaim coverage for property damage occurring outside of their policy periods and to the extent the amounts the policyholder was required to pay were not “damages” under the policies (such as fines and penalties or punitive damages). Another insurer reserved its right to disclaim to the extent that coverage was barred by its policies’ pollution exclusions.

The policyholder argued these reservations created a conflict of interest that entitled the policyholder to independent Cumis counsel. All but one of the insurers categorically disagreed that independent
counsel was required and sought declaratory relief concerning their obligations to the policyholder. (The other insurer, while disagreeing that there was a conflict requiring independent counsel, appointed such counsel pursuant to a reservation of rights and filed a separate action.)

The court of appeal affirmed the superior court’s determination that neither the insurers’ specific nor general reservations of rights created a conflict requiring independent counsel. The court of appeal also concluded that because the insurer providing independent counsel pursuant to a reservation of rights was not obligated to do so, it could only recover the amounts that it spent defending the policyholder from the policyholder itself—not from the other insurers.

Of particular interest, the court of appeal concluded that it “is clear where the coverage issue in question relates only to the timing of damages, there is no conflict under section 2860.” In reaching its conclusion, the court assumed that the insurers and policyholder had the same interest in defeating liability and that defense counsel could not control when the policyholder supplied chemicals or the timing of the releases. The court of appeals also concluded, as a practical matter, that the fact that defense counsel was retained by multiple insurers issuing coverage over a lengthy period of time also would reduce any incentive for defense to attempt to steer the damage to a particular time period.

The court further concluded that a conflict of interest should be analyzed based on the specific defenses on which an insurer reserves its rights to disclaim coverage. Put another way, an insurer’s general reservation of the right to rely on any other potentially applicable policy provision is too remote to give rise to a conflict of interest requiring the independent counsel.

The court of appeal also determined that an insurer’s defense of another party in the third-party action does not automatically create an actionable conflict of interest. While certain of the insurers also were defending other third-parties in the underlying litigation, the court of appeal concluded that there was no conflict of interest because the insurer had taken steps such as retaining different law firms for the defense and assigning different claims adjusters to the files. The court of appeal also reasoned that there was no actual conflict because the insurers could only avoid liability if it established that one of its insureds had no liability for the pollution, not merely that each of its insureds was partially responsible for the loss—which the court concluded avoided the insurer’s incentive to shift liability among them.

While this opinion ultimately tilts more toward an attorney’s ethical duty to avoid conflicts of interest, it is instructive for insurers on several points. First, insurers should remain mindful that reservations of rights trigger a need for independent counsel only when they pose actual conflicts, and actual conflicts may be created when an attorney is in the position to control the outcome of a coverage issue. Second, an insurer defending multiple defendants can reduce exposure for conflict claims by hiring different firms to represent the respective third-parties, assigning different claims adjusters to the cases and creating a “wall” between adjusters so that proprietary information is not shared among different adjusters.
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