BOLENDER & ASSOCIATES

A Professional Law Corporation

INSURANCE COVERAGE COUNSEL

Insurance Coverage Q&A

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Insurance Coverage Q&A

Independent Counsel

Generally, when a policyholder is sued by a third party, the insurance carrier — not the policyholder — has the contractual right to select and hire an attorney to defend the policyholder in the lawsuit.

1. What does it mean to say someone is "Cumis counsel" or "independent counsel"?

These phrases usually refer to an attorney or law firm who is independent of an insurance carrier, even though that carrier is paying that attorney or law firm to defend the firm's client. Generally, when a policyholder is sued by a third party, the insurance carrier—not the policyholder—has the contractual right to select and hire an attorney to defend the policyholder in the lawsuit. This contractual right includes the right of the carrier to control how the legal defense of the policyholder is handled. Under certain circumstances, however, a policyholder may be entitled to select its own attorney and control the handling of the legal defense. Under such circumstances, the policyholder's attorney is "independent" in that the insurer cannot control the defense. The term "Cumis" is often used because one of the first cases to recognize the policyholder's right to independent counsel is entitled *San Diego Federal Credit Union v. Cumis Insurance Society, Inc.* (1984) 162 Cal. App. 3d 358.

2. What is a "Cumis" conflict or a disqualifying conflict of interest?

Generally speaking, a disqualifying conflict of interest (sometimes referred to as Cumis conflict) may arise when the insurance company agrees to defend its policyholder under a reservation of rights. For example, suppose an insurance carrier agrees to defend the policyholder, but reserves its rights to deny any obligation to indemnify the policyholder if the lawsuit reveals the policyholder intentionally caused injury to the plaintiff. Under such a situation, the defense attorney may have the ability to shape the legal defense in a way to establish noncoverage. The original Cumis opinion suggested that an insurer carrier's panel counsel, who routinely receives claims from the carrier, may be wrongfully motivated to manipulate the lawsuit to favor the carrier's interests. It is important to note, however, that in California not every reservation-of-rights letter creates a Cumis conflict entitling the policyholder to independent counsel.

3. What is the legal standard in California for determining a policyholder's demand for independent counsel?

Some California courts have ruled that independent counsel may be required when: (1) the insurance carrier reserves its rights on a given issue and the outcome of that coverage issue can be controlled by the carrier's retained counsel; (2) where the carrier insures both the plaintiff and the defen-

dant; and (3) where the carrier pursues settlement in excess of policy limits without the policyholder's consent, leaving the policyholder exposed to claims by third parties.

4. Is the court's ruling in the Cumis case still followed?

In 1987, the California state legislature enacted a comprehensive statute, California Civil Code section 2860, to clarify and limit the requirements and standards set forth in the Cumis ruling. However, many other states commonly cite to the Cumis ruling as persuasive authority when determining issues of independent counsel.

5. What is the significance of appointing independent counsel?

In California, the appointment of independent counsel shifts the control of the policyholder's defense in the liability action from the insurance carrier to the policyholder. Although the insurance carrier is still involved in the liability action and has certain legal rights, the insurance carrier can no longer control the defense of the litigation. In California, however, the carrier is entitled to retain control and fully participate in settlement negotiations. Nonetheless, many carriers believe that retaining independent counsel increases the costs of litigation and limits a carrier's practical ability to efficiently effect settlement.

6. What rights does an insurance carrier have after an independent counsel has been selected?

California law provides certain rights to an insurance carrier after independent counsel has been appointed. For example, the insurance carrier has the right to be involved in the litigation and obtain non-privileged information regarding the litigation. Additionally, the insurance carrier maintains control of any settlement of the lawsuit against the policyholder.

7. Who gets to decide which lawyer or law firm will serve as Independent Counsel for the policyholder?

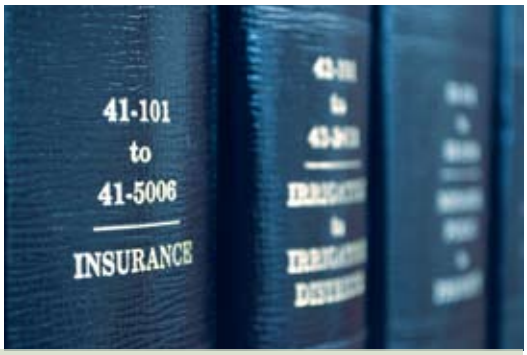
Independent counsel is selected by the policyholder and represents only the interests of the policyholder. However, the policyholder's choice of independent counsel is limited by certain minimum requirements set forth by law, in addition to any applicable provisions within the insurance policy. For example, California law states that the selected counsel may be required to 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.

8. Who pays for independent counsel?

The insurance carrier pays for the independent counsel. However, insurance carriers are required to pay only the fees that it would ordinary pay to other attorneys in similar actions in the community where the claim arose or is being defended.

9. What are an independent counsel's duties?

Independent counsel's fiduciary duties are owed only to the policyholder. However, California law imposes upon independent counsel certain duties owed to the insurance carrier, such as the duty to cooperate and share non-privileged information obtained throughout the course of litigation.



In California not every reservation-of-rights letter creates a Cumis conflict entitling the policyholder to independent counsel.

10. How are disputes regarding independent counsel resolved?

The answer depends on the type of dispute. If the dispute is over independent counsel's fees, California law requires that the issues be resolved at binding arbitration. If the dispute is over any other matter, a declaratory relief action may be appropriate so long as the policy does not impose otherwise.

11. Do states other than California recognize a policyholder's right to independent counsel?

Yes, however, every state is different and requires an analysis of the state's statutory authority and controlling case law.

1. Is it possible for a liability insurance carrier to obtain reimbursement from its policyholder for payments made by the carrier in defending a lawsuit and indemnifying the policyholder?

Under certain situations, a liability insurance carrier may be able to obtain reimbursement from the policyholder for policy benefits paid by the carrier under a liability insurance policy. These include payments made in defending the policyholder in a lawsuit, as well as payments made pursuant to either a judgment or pre-trial settlement. The legal standard for obtaining reimbursement of defense payments is different from the legal standard for obtaining reimbursement for indemnification payments. In order to receive reimbursement, an insurance carrier must first reserve its rights and later obtain a court order that entitles the carrier to recover the requested defense and/or settlement costs.

2. What types of defense costs can the insurance carrier recover from the policyholder?

California courts have ruled that an insurance carrier has the right to obtain reimbursement for all expenses incurred in defending claims that are not even potentially covered under the insurance policy. In order to obtain reimbursement for such defense costs, an insurance carrier must demonstrate by a preponderance of the evidence that each dollar requested went to defend a claim for which there was no potential for coverage.

An insurer cannot seek reimbursement for fees paid in defense of potentially covered claims.

3. What types of indemnification payments can the insurance carrier recover from the policyholder?

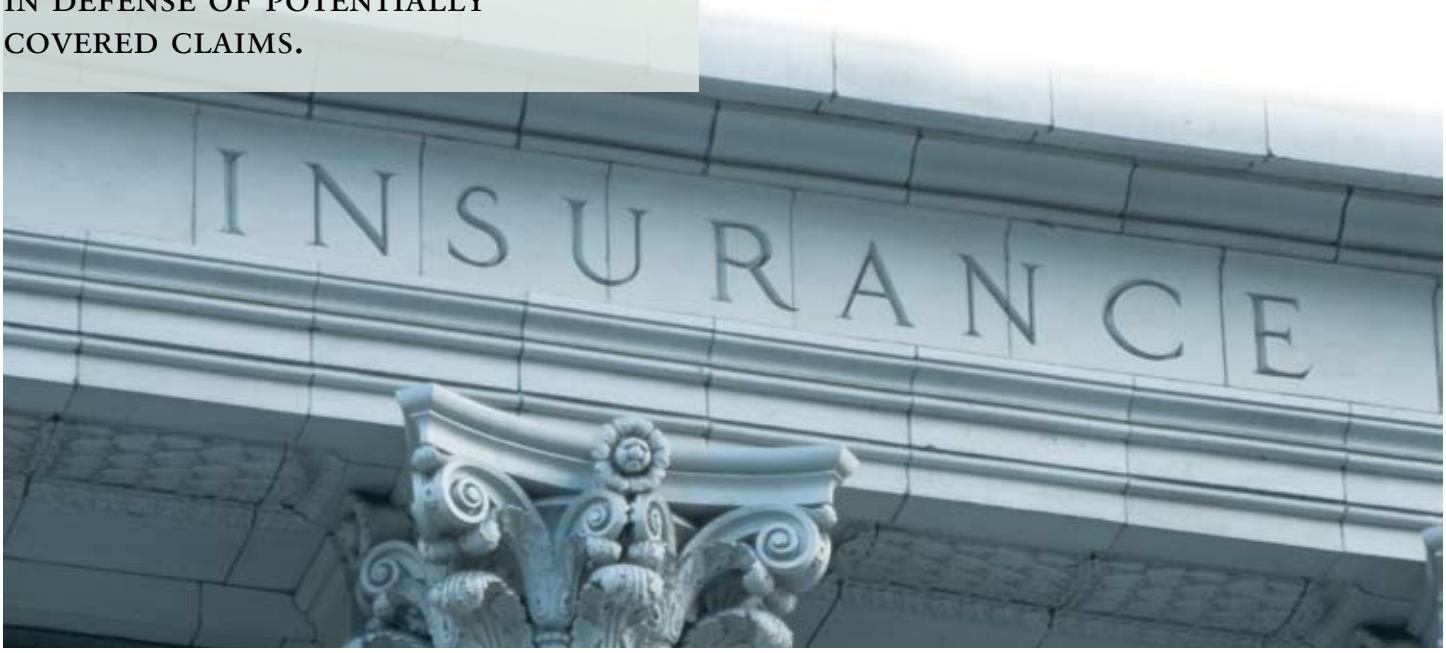
As a practical matter, insurance carriers often agree to settle for all claims alleged against a policyholder, including those that are not covered by an insurance policy. Since a carrier only has a contractual duty to indemnify a policyholder against those claims that are covered under an insurance policy, California courts have ruled that a carrier has a right to reimbursement for all settlement payments made for non-covered claims.

4. What must an insurance carrier do to preserve its right to seek reimbursement from the policyholder for defense costs?

In California, an insurance carrier must timely and expressly reserve its right to obtain reimbursement for defense costs expended on defending claims that have no potential for coverage. This is typically accomplished through a "reservation of rights" letter sent by either the carrier or the carrier's attorney. Even though a policyholder may object to or disagree with a carrier's reservations, such responses have no affect if the policyholder ultimately accepts the carrier's defense.

5. What must an insurance carrier do to preserve its right to seek reimbursement for settlement costs?

In California, an insurance carrier must first timely and expressly reserve its right to reimbursement for settlements paid on behalf of non-covered claims. Once a settlement offer is made, the carrier must fulfill additional requirements in order to preserve its right to seek reimbursement. For example, the carrier must inform



the policyholder of the carrier's intent to accept the settlement and, if the policyholder objects to the proposed settlement, offer to allow the policyholder to take over its defense of the lawsuit from the carrier.

6. How does an insurance carrier prove that it is entitled to reimbursement for defense costs?

First, an insurance carrier must prove that certain claims had no potential for coverage under the policy. Such claims must be distinguished from claims that were potentially covered at the outset of the litigation, but ultimately proved to be outside the scope of coverage. An insurer cannot seek reimbursement for fees paid in defense of potentially-covered claims. Second, the carrier must show that each dollar requested as reimbursement was actually spent in defending the claims for which there was no potential for coverage. Generally, this is accomplished by filing a lawsuit, and requesting that the court issue an order finding that the carrier is entitled to reimbursement from the policyholder.

7. How does an insurance carrier prove that it is entitled to reimbursement for payment of a judgment or settlement?

First, an insurance carrier must prove that certain claims were in fact not covered under the policy. Second, the carrier must show that each dollar requested was actually spent in settling the non-covered claims. Generally, this is accomplished by filing a lawsuit, and requesting that the court issue an order finding that the carrier is entitled to reimbursement from the policyholder.

8. When should an insurance carrier consider seeking reimbursement from its policyholder?

Whether an insurance carrier should bring a reimbursement action against its insured depends upon the evaluation of practical, legal, and economic factors. These considerations should include the carrier's likelihood of success in showing that it is entitled to the requested reimbursement and whether the policyholder has the financial ability to reimburse the carrier.

Reimbursement of Policy Benefits

An insurer should consider reserving its reimbursement rights at the outset of the claim, as well as prior to settlement negotiations.

Insurance Coverage Q&A

Contribution and Methods of Allocation

When an insurer seeks contribution from another insurance carrier, it is attempting to force the other carrier to share the burden of defending and indemnifying a common policyholder.

1. When can an insurance carrier obtain contribution from other carriers who issued liability policies covering the same risk?

Generally, insurance carriers who issued insurance at the same level, which insure the same risk and policyholder, must share equitably in defense and indemnification payments. When multiple carriers insure the same policyholder for the same risk, yet only one carrier has paid for the costs associated with a loss, the paying insurer can seek contribution from the others. This principle, called "equitable contribution," also protects a carrier that has paid more than its fair share as compared to other participating carriers. The right to equitable contribution enables a carrier to sue other carriers for a court order requiring the other carriers to pay their fair allocation of the cost of defending and/or indemnifying the policyholder.

2. What are the differences between equitable contribution and equitable indemnification?

When an insurer seeks contribution from another insurance carrier, it is attempting to force the other carrier to share the burden of defending and/or indemnifying a common policyholder. When an insurer seeks indemnification from another insurance carrier, it is attempting to shift the entire burden of defending and indemnifying a common policyholder to the other carrier.

3. What must a carrier do to preserve its right to seek contribution from other carriers?

In California, case law exists indicating that a carrier who intends to seek contribution should immediately notify other carriers that they may be liable for contribution. Failure to provide notice to other carriers could extinguish a carrier's right to contribution. Although there is no set deadline for notification, by immediately notifying the other carriers, the other carriers can investigate the matter and decide whether to join in the defense. Waiting until after the underlying lawsuit is over will likely result in the other carriers refusing to contribute any money. Moreover, if the carrier delays in notifying the other carriers, there is a chance that the Court will deny a claim for contribution. The form that this notice takes may be a simple letter: formal tender is unnecessary.

4. If a carrier has already settled a claim on behalf of the policyholder, what must that carrier do in order to obtain contribution from the nonparticipating carriers?

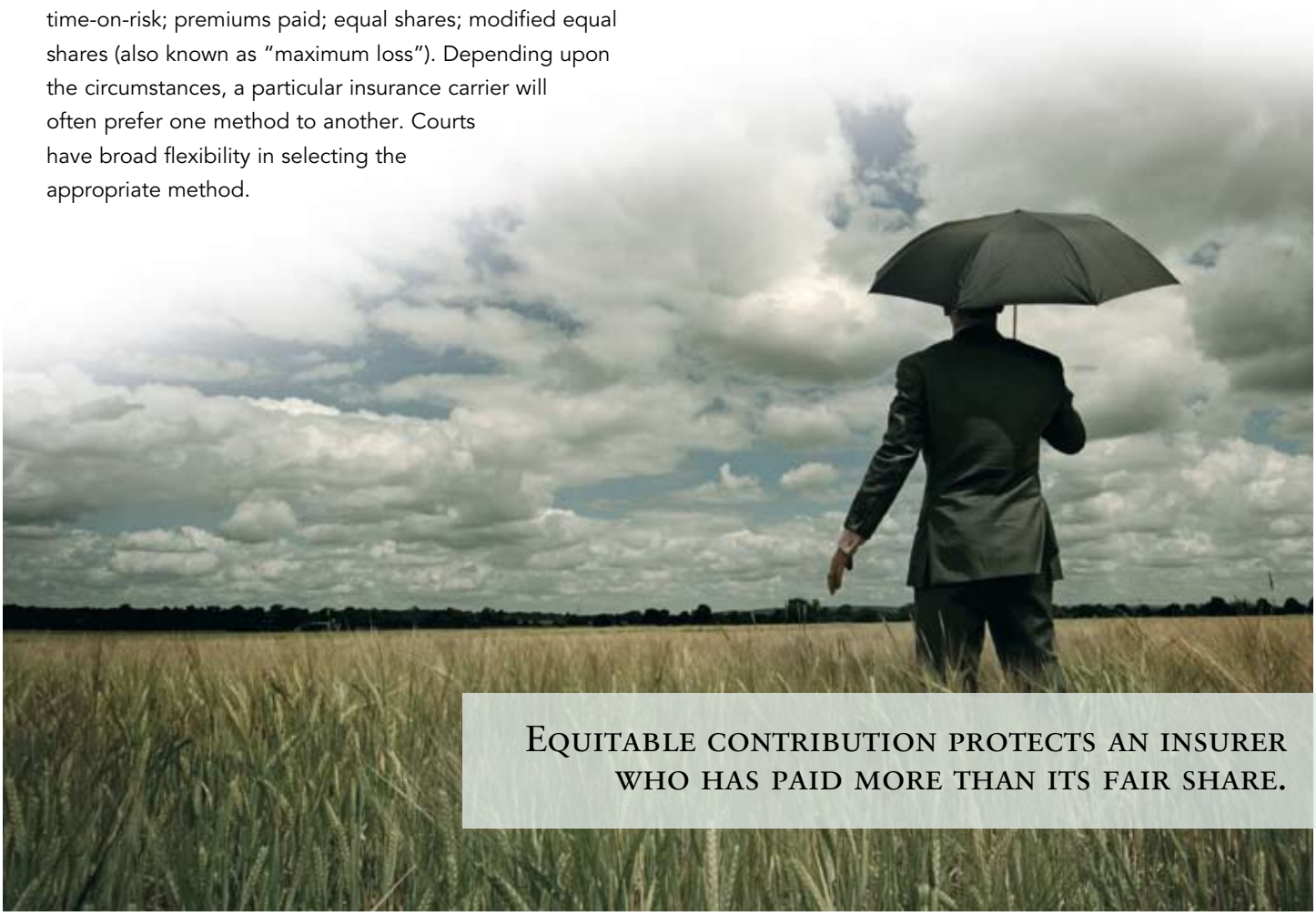
For the participating carrier to sue other carriers for contribution, it must show that the non-defending carriers owed a defense to the policyholder. Once the carrier has satisfied this burden, responsibility shifts to the other carriers to show that the settlement is not within the scope of coverage under the non-defending carrier's policy. If the other carriers cannot meet this burden, then the settling carrier can obtain contribution from the other carriers.

5. What methods of allocation can a carrier propose when seeking contribution?

Several methods of allocation exist, depending on the particular circumstances. Courts weigh competing considerations on a case-by-case basis, including the applicable insurance policies, the nature of the claim made, and the relationship between the carriers and the policyholder. In keeping with this fluid standard, courts have adopted several distinct methods of apportioning costs among insurers, including the following: policy limits; time-on-risk; modified time-on-risk; premiums paid; equal shares; modified equal shares (also known as "maximum loss"). Depending upon the circumstances, a particular insurance carrier will often prefer one method to another. Courts have broad flexibility in selecting the appropriate method.

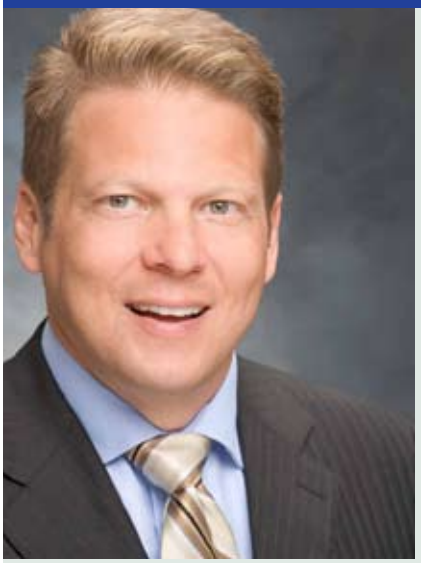
6. Is there a deadline by which a carrier must sue nonparticipating carriers for contribution?

Yes, but courts are not in agreement as to how much time a carrier has to bring a claim for contribution. Some courts will apply the statute of limitation that applies to breach of written contracts. Other courts conclude a different statute of limitations applies – specifically, the statute of limitations that applies to causes of action sounding in equity. This is an important difference. For example, in California the statute for written contracts is four years, whereas the statute for equitable actions is two years.



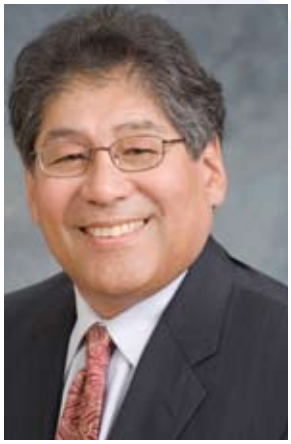
EQUITABLE CONTRIBUTION PROTECTS AN INSURER WHO HAS PAID MORE THAN ITS FAIR SHARE.

Bolender & Associates Increases National Presence



Jeffrey S. Bolender is licensed in California (1995), Hawaii (2006), Washington D.C. (2007), and Nevada (2008). He is a founding member of Health and Insurance Section, as well as the Construction Law Section, of the Nevada State Bar.

Daniel F. Sanchez has extensive experience in insurance coverage and litigation. In addition, he has expertise in third-party general liability coverage, first-party property coverage, cargo liability insurance, insurance defense, complex products liability, real estate transactions, bad faith litigation, and appellate law.



Elisabeth M. D'Agostino received her J.D. from Southwestern University School of Law. Her practice focuses on litigating matters in the state and federal courts with a focus on general business and various insurance coverage matters. Prior to joining Bolender & Associates, she was an associate attorney with Wilkes & McHugh, P.A.

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The law practice of Bolender & Associates is exclusively devoted to matters concerning insurance coverage and business litigation, including contract interpretation, policy drafting, dispute resolution, and litigation.

Bolender & Associates recently opened offices in Hawaii and Nevada to better serve its national clientele.