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POLICYHOLDER RIGHTS TO INDEPENDENT COUNSEL:

ISSUES REMAIN REGARDING COMPENSATION, SUPERVISION OF COUNSEL

BY JEFFREY W. STEMPEL, ESQ.

More than 30 years ago, a California appellate court decision (*San Diego Navy Federal Credit Union v. Cumis Insurance Society*, 162 Cal. App. 3d 358 (4th Dist. 1984)) worked a revolution of sorts by ruling that, in cases of conflict between an insurer and a policyholder defending against a plaintiff's claim, the insurer was obligated to permit the policyholder to select its own defense counsel rather than having the case defended by an attorney selected by the insurer.

The California legislature essentially codified *Cumis* in California Civil Code § 2860. Cases or legislation from other jurisdictions followed suit enough to make *Cumis* the majority rule, and to make the term “*Cumis* counsel” common insurance parlance. See Randy Maniloff & Jeffrey Stempel, *General Liability Insurance coverage: Key Issues in Every State*, Ch. 6 (3d ed., 2015) (state-by-state survey).

The classic case presenting a *Cumis*-style conflict involves a claim in which the plaintiff sues the policyholder alleging multiple claims, some of which may fall within the liability insurance coverage and some of which may not. For example, a

patron roughed up by a bouncer at a club may allege both assault and battery by the bouncer, as well as inadequate training by the club and negligent injurious conduct by the bouncer. Thus, because the outcome of the case can affect coverage, policyholder defendants often seek to choose their own defense counsel, reasoning that a lawyer selected by the insurer (and most defense counsel chosen by insurers is approved “panel” counsel that obtains a significant amount of business from insurers), may have an incentive (perhaps even subconscious) to defend the case in a manner that makes a finding of uncovered battery more likely than might be the case if the policyholder's chosen counsel defended the litigation.



The *Cumis* movement was more evolutionary than revolutionary in Nevada. Until *State Farm Mutual Automobile Ins. Co. v. Hansen*, 131 Nev. Adv. Op. 74 (Sept. 24, 2015), Nevada law was not clear on the point, although most observers expected that Nevada would eventually follow California's lead on this topic, particularly after *Nevada Yellow Cab Corp. v. Eighth Judicial Dist. Court*, 152 P.3d 737, 742 (Nev. 2007). *Yellow Cab* ruled that both the policyholder/defendant and the insurer were clients of the attorney defending the case but



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that, in cases of conflict, the attorney’s greater duty was to the insured defendant. Having embraced the two-client model of the insurer-attorney-policyholder relationship but favoring policyholder interests in the event of conflict, the next logical step was to require independent counsel rather than placing insurer-selected counsel in the difficult position of attempting to adequately represent two client with divergent interests. See Jeffrey Stempel, “The Relationship Between Defense Counsel, Policyholders, and Insurers: Nevada Rides Yellow Cab Toward “Two-Client” Model of Tripartite Relationship. Are *Cumis* Counsel and Malpractice Claims by Insurers Next?,” *Nevada Lawyer* (June 2007) p. 20.

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Arguably, the two-client model is not a prerequisite to requiring independent counsel in cases of conflict. If the defense attorney's only client is the policyholder, this presumably heightens the judicial system's interest in ensuring that counsel's loyalty is undivided and not colored by concern for the insurer, who even if not a client is a third-party payer with substantial contract rights (under the policy) to control defense and settlement of the case. Relatedly, insurers expect regular updates from defense counsel on the status of a case, which can place counsel in a quandary about whether or not to report developments that may support a coverage defense. The insurer is also a client, presumably entitled to full disclosure by counsel of all matters relevant to the representation — but perhaps not when this is contrary to the interests of the policyholder client.

Perhaps the most important question remaining open after *Hansen* is independent defense counsel's selection and compensation. California has a statutory provision stating that counsel must have at least five years of litigation practice, including "substantial defense experience in the subject at issue in the litigation," as well as professional liability insurance. Further: [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. *See* Cal. Civ. Code § 2860(c); *see also* *Wallis v. Centennial Ins. Co.*, 982 F. Supp. 2d 1114 (E.D. Cal. 2013) (insurer not required to pay entire bill submitted by independent counsel where counsel offered no evidence of reasonableness and necessity of unpaid fees); *J.R. Mktg., L.L.C. v. Hartford Cas. Ins. Co.*, 158 Cal. Rptr. 3d 41 (Cal. Ct. App. 2013) *rev. granted*, 308 P.3d 860 (Sept. 18, 2013) (where insurer breaches duty to defend, it loses protection of the statute regarding rate to be paid to reimburse policyholder for funding its own defense).

In the most recent issue of his newsletter *Coverage Opinions*, Randy Maniloff finds a silver lining of *Hansen* that insurers are overlooking. Maniloff's prediction is that the Nevada Supreme Court, having so fully embraced *Cumis*, is likely to embrace the California *Cumis* statute regarding the rate of pay for independent counsel as well. *See A Win for Insurers: Nevada Supreme Court Adopts "Cumis" Rule*, available at <http://coverageopinions.info/Vol4Issue9> at p. 15 (Sept. 30, 2015). Perhaps this prediction will prove accurate. California has operated under its approach for many years, with apparent success.

But although the California approach makes good sense as a tool or starting point for determining independent counsel's compensation, it should perhaps not be an absolute rule. Insurers have a good argument in contending that a policyholder should not be able to select a \$1,000/hour Wall Street law firm as independent counsel on the liability insurer's tab when the insurer ordinarily pays \$200/hour (or less) to panel counsel. But converse unfairness can result if the insurer is able to cap independent counsel fees below the rate at which the policyholder can obtain adequate counsel of its choice.

Insurers are able to obtain counsel at lower rates (unduly low rates, according to most any defense lawyer) because of the insurer's purchasing power and leverage. But policyholders, particularly individuals and small businesses, lack such leverage and often also lack the expertise necessary for finding the most low-cost defense attorneys for a given case. In order to make a truly independent selection of counsel (e.g., an attorney not recommended by the insurer), policyholders may have to pay something more than the going rate for panel counsel.

Policyholders should also note that it is the insurer's conduct in disputing coverage that created the need for independent counsel. Although a reservation of rights does not create a per se conflict under *Hansen*, an insurer's defense without reservation would eliminate possible conflicts and permit the insurer to defend through panel counsel. **NL**

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