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An Updated Practical Guide To ICPIIC In Calif.

Law360, New York (May 12, 2009) -- California has been recognized as a leading authority (or at least one of the earliest authorities) on the right of a policyholder to select independent counsel paid by the insurance company (referred to herein as "ICPIC").

That is, when there is a conflict of interest between the policyholder and the insurer, the right of the policyholder to pick their own defense counsel, and to be reimbursed for that expense by the insurer, notwithstanding policy language indicating that the insurer has the right to select defense counsel.

Attorneys often use the nomenclature of "Cumis counsel," even in states other than California, to refer to ICPIIC in homage to the seminal California Court of Appeal decision in *San Diego Federal Credit Union v. Cumis Ins. Society Inc.*, 162 Cal.App.3d 358, 208 Cal. Rptr. 494 (1984).

Notwithstanding the popular use of that name, since 1988 the right to ICPIIC in California has actually been determined not by the decision in the Cumis case, but by a statute, Civil Code 2860. This article will address certain practical issues which still arise, virtually on a daily basis, under that statute.

When is There a Conflict Entitling the Insured to ICPIIC?

The statute purports to provide clear guidance as to when there is a conflict which triggers the right to ICPIIC. In our experience, the statute is regularly ignored and/or misunderstood by both insurers and policyholders, probably because it has such an odd definition of when there is, or is not, a qualifying conflict.

For example, assume that the insurer is suing the policyholder to rescind the policy, on the basis that a prior loss was not disclosed on the application, while simultaneously defending the insured in the underlying action. Is there a conflict between the insurer

and the policyholder? The answer would be “yes” using the ordinary meaning of the term “conflict” but the answer, as it relates to the right to ICPIIC in California, is “no.”

The basic test is whether defense counsel has the ability, in the underlying action, to control whether there is, or is not, coverage.

For example, if it is alleged that certain wrongful conduct was either intentional (excluded) or negligent (covered), you have a classic situation in which defense counsel can theoretically control whether damages are covered, and there would be a right to ICPIIC counsel.

However, the statute has a number of exceptions, some of which are important, and some of which are used in a “creative” manner in an effort, by some insurers, to avoid their obligation to provide ICPIIC.

One important exception relates to allegations of punitive damages, which are deemed uninsurable in California as a matter of public policy.

Since the insurer has no exposure to those damages, it would seem that there might be a conflict between the interests of the policyholder (“do anything you can to avoid uninsured punitive damages”) and the interests of the insurer (“be ethical, but don’t spend too much of our money defending those allegations”). But the statute states that an allegation of punitive damages does not create a conflict entitling the policyholder to ICPIIC.

Similarly, the statute indicates that just because the policyholder is being sued for an amount in excess of the policy limits does not necessarily create an ICPIIC qualifying conflict.

While it can be debated whether these two exceptions to the general rule are appropriate, at least they have the advantage of being relatively clear.

There is one other exception which seems to be the subject of conflict between certain insurers and sophisticated policyholders (or at least those with sophisticated insurance coverage counsel). The statute says that there is no ICPIIC conflict where the insurer has denied coverage, but there is such a conflict where the insurer reserves rights.

So, some insurers say “We hereby deny coverage to the extent your conduct is found to have been intentional” instead of saying “We hereby reserve our rights to deny coverage if your conduct is found to have been intentional rather than negligent.” We would argue that such a fine line of semantics is not sufficient to exclude the right to ICPIIC.

Does the ICPIC Statute Recognize the “Tri-Partite” Relationship?

Historically, the "tripartite relationship" between insurer, insured and insurer-retained defense counsel was recognized in California and the ABA Model Rules primarily to allow communications between defense counsel and the defendant's insurance company to remain privileged and confidential. The rule does not apply to ICPIC.

California does not follow the ABA Model Rules. The California Rules of Professional Conduct do not give rise to an ethical conflict of interest where the lawyer later represents another client adverse to the insurance company that previously paid defense counsel.

Comments adopted by the California State Bar to Rule 3-310 ("avoiding interests adverse to a client") recently clarified that "notwithstanding [State Farm Mut. Auto. Ins. Co. v. Federal Ins. Co., 72 Cal.App.4th 1422, 86 Cal.Rptr.2d 201 (1999) (and similar cases recognizing the tripartite relationship for insurer-retained defense counsel)], subparagraph (C)(3) [of Rule 3-310] is not intended to apply with respect to a relationship between an insurer and [an attorney] when, in each [prior] matter, the insurer's interest is only as an indemnity provider and not as a direct party to the action."

“Section 2860 does not create an attorney-client relationship between Cumis counsel and the carrier.” (Assurance Co. of America v. Haven, 32 Cal.App.4th 78 at pp. 89-90, 38 Cal.Rptr.2d 25 (1995).) The ICPIC’s “sole obligation” is to vigorously represent the interests of the insured, not the insurer. (Ibid.; see also Employers Ins. of Wausau v. Albert D. Seeno Constr. Co., 945 F.2d 284, 287 (9th Cir. 1991) [“independent counsel [is] charged with zealously representing solely the insured's interests” — adverse to the interests of the carrier, if necessary].)

The insurer's interest in the defense of covered claim is as a payor of the legal services provided by the lawyer on behalf of its policyholder. The "primary duty" of all defense counsel (even defense counsel engaged by the insurer) is and remains to vigorously defend the claims asserted by the plaintiff in the liability action — regardless of who pays the bills, insurer or insured, defense counsel's primary "ethical and legal obligation [is] to the insured." (See Cal. Civ. Code section 2860(f).)

What Legal and Ethical Duties Apply to ICPIC?

Because ICPIC does not have a tripartite relationship with the carrier under California law, the obligations arise from the statute and, in some cases, from the insurance policy.

The statute actually has a relatively stringent affirmative requirement, which is that counsel has a duty to “disclose to the insurer all information concerning the [liability] action except privileged materials relevant to the coverage dispute, and timely to inform and consult with the insurer on all matters related to the action.”

Significantly, the statute states that provision of this information, to the insurer, is not a waiver of the attorney-client privilege.

In other words, counsel is clearly obligated to provide information to the insurer which is privileged, as long as it doesn't relate to the coverage matters in dispute between the insurer and the insured. This would include, for example, an otherwise "privileged" evaluation of the likely verdict.

The more common issues occurs when, for example, the insured makes damaging admissions in deposition, which admissions could destroy coverage.

Under the statute ICPIIC counsel is obligated to make that deposition testimony available to the insurer, because information developed during discovery, consistent with the statutory reporting duties of counsel under Civil Code section 2860, is not privileged from the insurer.

Of course, referring to or emphasizing the harmful testimony could be a breach of ethical duties to the client. So sending of the entire transcript, without comment, would appear to be the best way for counsel to comply with both obligations.

There is relatively little litigation under any aspect of this statute. However, we are aware of one trial court case in which an insurer actually obtained a Preliminary Injunction requiring ICPIIC to comply with the statutory obligations.

When Must ICPIIC Fees Be Arbitrated?

Under the statute, any dispute relating to attorney's fees for ICPIIC must be sent to final and binding arbitration before a single arbitrator. There have been some recent court decisions which provide further clarification.

First, the fact that other causes of action (such as bad faith) may be entwined does not alter the statutory requirement. A California state court must refer the attorney fee portion to arbitration. (See *Compulink Mgt. Ctr. v. St. Paul Fire & Marine*, 169 Cal.App.4th 289, 81 Cal. Rptr. 2d 456 (Dec. 17, 2008).)

Second, if the case is brought in Federal Court, under a federal statute such as RICO, the federal court is not bound by the California statute. (See *Caiafa Prof. Law Corp. v. State Farm Fire & Cas. Ins.*, 15 Cal.App.4th 800, 19 Cal. Rptr. 2d 138 (1993).)

But, if the case is before the Federal Court based on diversity, then the court must apply California law and the fee dispute must be sent to arbitration. (See *Karsant Family Ltd. Pshp. v. Allstate Ins. Co.*, 2009 U.S. Dist. LEXIS 7558, (Jan. 27, 2009, N.D. Cal.).)

Summary

Every day there are hundreds of suits filed in the state of California. Insurance coverage applies to many of those suits so it is likely that these issues, and others, arise many times every day.

Although there has been a statute for 22 years we find that mistakes are made, particularly by policyholders, on a frequent basis. With routine claims (minor personal injury or property damage) it probably makes very little difference whether the policyholder is defended by “regular” defense counsel or by ICPIC.

It is distressing to see the number of significant claims (D&O, E&O, CGL with potential liability over \$100,000, etc.) where policyholders fail to properly analyze their rights to ICPIC — whose sole obligation is to protect the legal rights of the insured — or otherwise fail to retain coverage counsel to assist them in high stakes lawsuits.

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