"I FEEL SO CONFLICTED!"

HANDLING INSURANCE DEFENSE COUNSEL PROFESSIONAL RESPONSIBILITIES IN THE REAL WORLD

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THE CONFLICTS OF MODERN INSURANCE DEFENSE COUNSEL

Being an insurance defense attorney in today's world can make you feel so conflicted! Because of all the complicated rules, standards, and procedures, you may find yourself asking such seemingly elementary questions as: "Who are my clients? How am I supposed to represent them? What obligations do I owe them?" To compound the worries, you are inundated with demands from your firm, the insurance carriers, the insureds, and your profession. These recurrent uncertainties and pressures are enough to make modern defense counsel throw up his hands and cry for help.

Now, wait just one minute. Before you get too emotional, let's analyze the situation. The cause of your grief stems from two circumstances: (1) uncertainties about obligations to your clients; and (2) outside pressures. You can moderate your conflicted feelings if you:

- Know Your Legal Duties
- Recognize Common Conflict of Interest Fact Patterns
- Take Precautions
- Sometimes, Make Tough Decisions

The purpose of these materials and the accompanying presentation is to provide you with the information necessary to take these steps. By following them, your stress, as insurance defense counsel, will subside. We hope that by reading the pages ahead we will help you resolve "real world" ethical dilemmas and assist you in making as few tough decisions as possible.

THE BASICS

The starting point for avoiding conflicted feelings is to know the legal duties you owe your clients. However, you may ask, "Who is 'you'?" You may inquire, "Who is my client, or is it clients?" To alleviate the ambiguities, our discussion in this section begins with descriptions of the various types of lawyers who may be involved in an insurance defense attorney-client relationship. We continue with details on the "Tripartite Relationship." Next, we discuss California and Nevada law providing guidance on to whom legal obligations must be discharged. Finally, we conclude this section with specifics on the nature and extent of the legal duties owed in typical insurance defense cases. After review of this section, you will have completed the first step in the quest to avoid and, if necessary, resolve ethical dilemmas in your practice.

Insurance Defense Counsel Types

Private Defense Counsel

A fundamental part of a liability insurance agreement usually provides: "We will pay those sums that the insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' to which this insurance provides. We will have the right and duty to defend the insured against any 'suit' seeking those damages." ISO CG 00011207 (emphasis added). To discharge this duty, carriers often retain private sector attorneys who specialize in insurance defense work for the benefit of the insured. Christopher R. Wagner, *Making Reservations, Los Angeles Lawyer*, June 2003, at 37-38. *See also* James M. Fisher, *Insurer or Policyholder Control of the Defense and the Duty to Fund Settlements*, Nevada Law Journal, Spring / Summer 2002, at 1, 5 (noting that the insurer both "enjoys" and is burdened with the duty to retain insurance defense counsel). Subject to policy provisions, the insurer shoulders the responsibility of paying private counsel's attorney fees and costs. Generally, the insured pays nothing for its defense, unless a policy deductible is applicable. Fisher, *supra*, at 1. An insurer's appointment of private defense counsel is usually limited to defense of the insured in one action.

However, the scope of the representation may also include prosecution of transactionally-related cross-actions and collection actions.

Cumis Defense Counsel

As will be discussed in greater detail below, private insurance defense counsel owes the duty of competence to both the insured and insurer. *Unigard Ins. Group v. O'Flaherty & Belgum*, 38 Cal. App. 4th 1229, 1237-38 (Cal. Ct. App. 2d 1995). Cal. R. Prof. Conduct 3-110(A); Nev. R. of Prof. Conduct 1.1. He must also conduct the defense in good faith. *Tomerlin v. Canadian Indem. Co.*, 61 Cal. 2d 638, 647 (Cal. 1964). Occasionally, when an insurer reserves its right to deny coverage at a later date, it may lose interest in the once shared goal of minimizing or eliminating the insured's liability to a third party. *San Diego Navy Federal Credit Union v. Cumis Ins. Society, Inc.*, 162 Cal. App. 3d 358, 364 (Cal. Ct. App. 4th 1984). In these situations, defense counsel faces the prospect of concurrently representing two parties with materially divergent interests. *Id.* at 364-65. Under the strain of these interests, defense counsel cannot fully discharge his ethical obligations to either client. *Id.* at 366. Consequently, statutory and case law require the insurer to pay for insured-selected independent counsel, or more commonly *Cumis* counsel, to defend the insured in the litigation. *See* Cal. Civ. Code § 2860; *Cumis Ins. Society, Inc.*, 162 Cal. App. 3d at 369, 375. *See also Nevada Yellow Cab Corp. v. 8th Jud. Dist. Ct.*, 123 Nev. 44, 52 (Nev. 2007) (holding concurrent representation of the insurer and insured is permissible "as long as any conflict remains speculative").

Insurer In-House Defense Counsel

In 1987, a liability insurer, seeking ways to cut costs, submitted a question to the California State Bar Standing Committee on Professional Responsibility and Conduct: Can an insurer appoint in-house counsel to defend the interests of its insureds against claims brought by third parties pursuant its insurance policies? Cal. State Bar Form. Opn. 1987-91. Based on the rationales that the insurer had a legitimate financial interest in the relationship and its employee attorneys could not be presumed to sacrifice their professional obligations in their employer's favor, the Committee answered in the affirmative. *Id.* Thus, in California, liability insurers may create law divisions, name them after their lead attorneys, and conduct insureds' defenses. *Id.* This business may exist so long as the insurer does not compromise the independent professional judgment of their attorneys and the law departments strive to function as a separate

firm as much as possible. *Id. See Gafcon, Inc. v. Ponsor & Associates*, 98 Cal. App. 4th 1388, 1415 (Cal. Ct. App. 4th 2002) (holding that a liability insurer did not violate the law when it designated an in-house law firm to defend insured because the insurer did not influence or interfere with the salaried attorney's professional judgment or restrict his ability to represent the insured, and the attorney did not participate in any investigation or determination with regard to insurance coverage). Use of in-house defense counsel is not prohibited in Nevada, either. Stephen F. Smith, *Insurance Company Captive Law Firms Ethical or Not?*, Nevada Lawyer, September 2000, at 14. Because in-house counsel can often save liability insurers substantial sums, utilization of insurer law divisions is becoming increasingly popular. *Id.* at 12.

Insurance Defense "Attorney – Clients" Relationship

Tripartite Relationship

In both California and Nevada, "an attorney retained by an insurance company to defend its insured under the insurer's contractual obligation to do so represents and owes a fiduciary duty to both the insurer and insured." *Gafcon, Inc.*, 98 Cal. App. 4th at 1406; *Yellow Cab*, 123 Nev. at 50-51. "So long as the interests of the insurer and the insured coincide, they are both the clients of the defense attorney and the defense attorney's fiduciary duty runs to both the insurer and the insured." *National Union Fire Ins. Co. v. Stites Prof. Law Corp.*, 235 Cal. App. 3d 1718, 1727 (Cal. Ct. App. 2d 1991). Because the parties' positions in the representation can be envisioned as points of a triangle, the nature of insurance defense "attorney – clients" dealings has been described as the "Tripartite Relationship." *Purdy v. Pacific Automobile Ins. Co.*, 157 Cal. App. 3d 59, 76 (Cal. Ct. App. 2d 1984). At the center of the triangle is a "coalition for a common purpose, a favorable disposition of the claim – with the attorney owing fiduciary duties to both clients." *Id.*

It makes no difference that counsel appointed for the defense is employed by the liability carrier. Cal. State Bar Form. Opn. 1987-91. "A lawyer is required to follow ethical constraints whether employed directly or indirectly by an insurance company[.] In the house counsel situation, the lawyer owes the insured the same duty as any other client." Smith, *supra*, at 14.

Insurance Defense Counsel's Obligations to Clients

Duty of Competence

Every attorney owes her clients a duty to act competently during the course of the representation. Cal. R. Prof. Conduct 3-110(A); Nev. R. of Prof. Conduct 1.1. "Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation." Nev. R. of Prof. Conduct 1.1; Cal. R. Prof. Conduct 3-110(B). *See also* Nev. R. of Prof. Conduct 1.3 (providing "[a] lawyer shall act with reasonable diligence and promptness in representing a client").

Included within this broad definition of competence is an attorney's obligation to alert her clients to problems outside the scope of the representation. The Court, in *Nichols v. Keller*, 15 Cal. App. 4th 1672, 1683-84 (Cal. Ct. App. 5th 1993), succinctly described the responsibility:

> One of an attorney's basic functions is to advise. Liability can exist because the attorney failed to provide advice. Not only should an attorney furnish advice when requested, but he or she should also volunteer opinions when necessary to further the client's objectives. The attorney need not advise and caution of every possible alternative, but only of those that may result in adverse consequences if not considered.

See also Nev. R. of Prof. Conduct 2.1 (providing that "a lawyer shall exercise independent professional judgment and render candid advice").

Attorneys also have a duty to competently supervise subordinates and may be held liable for adverse consequences resulting from a failure in this regard. *Layton v. State Bar*, 50 Cal. 3d 889, 900 (Cal. 1990); Nev. R. of Prof. Conduct 5.1 - 5.3.

Duty of Loyalty

The most important aspect of the attorney-client, or "attorney-clients," relationship is the absolute and complete fidelity owed by the attorney to her clients. Cal. State Bar Form. Opn. 1984-83; *Flatt v. Sup. Ct.*, 9 Cal. 4th 275, 289 (Cal. 1994); Cal. R. Prof. Conduct 3-310; Nev. R. of Prof. Conduct 1.7; *Stalk v. Mushkin*, 199 P. 3d 838, 843 (Nev. 2009). An attorney's duty of loyalty serves the twin paramount purposes of ensuring that attorneys do not allow other relations to interfere with their devotion to client interests and encouraging public confidence essential to the effective administration of justice. *Santa Clara County Counsel Attys. Assn. v. Woodside*, 7 Cal. 4th 525, 548 (Cal. 1994), *overruled on other grounds*, *Coachella Valley Mosquito & Vector Control Dist. v. California Public Employment Relations Bd.*, 35 Cal. 4th 1072, 1077 (Cal. 2005); *Jeffry v. Pounds*, 67 Cal. App. 3d 6, 10-11 (Cal. Ct. App. 3d 1977); Cal. State Bar Form. Opn. 1984-83.

Conflict of interest situations will be discussed below. Avoiding breach of the duty of loyalty is the primary goal in seeking to resolve these ethical dilemmas. *Jeffry*, 67 Cal. App. 3d at 11 (stating "[a] lay client is likely to doubt the loyalty of a lawyer who undertakes to oppose him in an unrelated matter"). Because a lawyer's duty of loyalty survives completion of the subject of the representation, successive conflict of interests may arise when the lawyer seeks to represent the interests of a new client to the detriment of a former client. Cal. R. Prof. Conduct 3-310(C)(3); Nev. R. of Prof. Conduct 1.9.

Duty of Confidentiality

It is the solemn duty of every attorney to "[t]o maintain inviolate the confidence, and at every peril to himself or herself to preserve the secrets, of his or her client." Cal. Bus. & Prof. Code § 6068(e)(1); Cal. R. Prof. Conduct 3-300; Nev. R. of Prof. Conduct 1.6. However, like most ethical obligations, the duty of confidentiality is subject to two main exceptions: (1) client authorizes disclosure of confidential information after informed consent; (2) disclosure of confidential information is necessary to prevent bodily harm or the client from committing a crime or fraud. Cal. R. Prof. Conduct 3-300(B);

Nev. R. of Prof. Conduct 1.6(b). Also of note, the duty to maintain client confidences exists even after the attorney-client relationship is terminated. *Styles v. Mumbert*, 164 Cal. App. 4th 1163, 1167-68 (Cal. Ct. App. 6th 2008).

Duty of Communication

Rule 3-500 of the California Rules of Professional Conduct provides: "A member shall keep a client reasonably informed about significant developments relating to the employment or representation, including promptly complying with reasonable requests for information and copies of significant documents when necessary to keep the client so informed." *See also* Cal. Bus. & Prof. Code § 6068(m) (providing that an attorney must "respond promptly to reasonable status inquiries of clients and to keep clients reasonably informed of significant developments in matters with regard to which the attorney has agreed to provide legal services"). Nevada Rule of Professional Conduct 1.4 is even more specific and provides in relevant part:

> (a) A lawyer shall:
>
> (1) Promptly inform the client of any decision or circumstance with respect to which the client's informed consent is required by these Rules;
>
> (2) Reasonably consult with the client about the means by which the client's objectives are to be accomplished;
>
> (3) Keep the client reasonably informed about the status of the matter;
>
> (4) Promptly comply with reasonable requests for information; and
>
> (5) Consult with the client about any relevant limitation on the lawyer's conduct when the lawyer knows that the client expects assistance not permitted by the Rules of Professional Conduct or other law.
>
> (b) A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.

Communication Duty and Settlement Offers

In California, when an attorney is given a written settlement offer, she must promptly communicate to her client its amount, terms, and conditions. Cal. R. Prof. Conduct 3-510(A)(2);

Cal. Bus. & Prof. Code § 6103.5(a). The rule does not provide guidance for lawyers who receive oral settlement offers. However, the discussion section of 3-510 does. It states: "Any oral offers of settlement made to the client in a civil matter should also be communicated if they are 'significant' for the purposes of rule 3-500."

Nevada law is a little unclear on the subject. One could argue that a written or oral settlement offer constitutes a "decision or circumstance" requiring client consent under Nevada Rule of Professional Conduct 1.4(a)(1). However, settlement negotiations are often insignificant, such as a waiver of costs offer in a case with policy limits exposure. An offer like this one could be construed as being so meaningless that express rejection would be unnecessary. Additionally, the Nevada rule's definition of "client" is ambiguous. In the insurance defense context, insured consent to settlements within policy limits are unnecessary. As the party contractually bound to provide for the defense and indemnity of the insured, carrier consent is required. Rule 1.4(a) contains no language differentiating between various concurrently represented clients. Note, however, that California's Rule 3-510 does. Subsection (B) provides: "As used in this rule, 'client' includes a person who possesses the authority to accept an offer of settlement or plea, or, in a class action, all the named representatives of the class."

Tripartite Relationship's Modification of Defense Counsel's Duties

Greater Duty of Loyalty to the Insured

Case law recognizes the idea that insurance defense counsel owes a greater duty of loyalty to the insured. *See Purdy*, 157 Cal. App. 3d at 76 (noting that "[t]he attorney's primary duty has been said to be to further the best interests of the insured"); *Yellow Cab*, 123 Nev. at 51-52 (adopting majority view that in the Tripartite Relationship the insured remains the primary client). However, in reality, this principle is fairly difficult to apply. California courts go so far as to acknowledge that "as a practical matter, the attorney may have closer ties with the insurer than with the insured." *State Farm Mut. Auto. Ins. Co. v. Federal Ins. Co.*, 72 Cal. App. 4th 1422, 1429 (Cal. Ct. App. 5th 1999).

About the only way to give the insured greater loyalty in the day-to-day realities of insurance defense practice is to: (1) not allow insurer instructions or handling guidelines to interfere with defense counsels' professional judgment; and (2) not involve defense attorneys in the insurer's coverage investigation. *Gafcon*, 98 Cal. App. 4th at 1415; Nev. State Bar Form.

Opn. 9. Also, if defense counsel learns of facts during her representation negating coverage or comes to believe that the insured has fraudulently created a situation in which coverage appears to exist when it actually does not, she owes a duty not to disclose this information to the insurer. Cal. State Bar Form. Opn. 1995-139, at 3; *Amer. Mut. Liab. Ins. Co. v. Sup. Ct.*, 38 Cal. App. 3d 579, 594 (Cal. Ct. App. 1974); *Yellow Cab*, 123 Nev. at 51; Nev. State Bar Form. Opn. 26.

Duty of Competence to the Insurer

Although counsel may conduct the defense with greater loyalties to the insured, she owes the insurer a duty of competence equal to that owed to the insured. *Unigard Ins. Group*, 38 Cal. App. 4th at 1235; *Yellow Cab*, 123 Nev. at 51. In fact, if defense counsel commits malfeasance in the representation of the insured, the insurer is entitled to sue the attorney for damages attendant thereto. *Id.* at 1236-37. *See* Professor Jeffrey W. Stempel, *The Relationship Between Defense Counsel, Policyholders, and Insurers: Nevada Rides Yellow Cab Toward "Two-Client" Model of Tripartite Relationship*, Nevada Lawyer, June 2007, at 25 (discussing whether or not an insurer may sue insurance defense attorneys for malpractice). These rules presume that the "insurer" is the carrier that retained defense counsel. Co-carriers who did not retain counsel defending the interests of the co-insured are not owed the duty of competence. *American Casualty Co. v. O'Flaherty*, 57 Cal. App. 4th 1070, 1077 (Cal. Ct. App. 2d 1997). They have no cause of action against non-retained defense counsel for malpractice. *Id.*

Duty of Confidentiality to the Insurer

Since, in California and Nevada, both the insured and insurer are insurance defense counsel's joint clients, the duty of confidentiality is owed equally to both. Consequently, a lawyer may not disclose confidential carrier communications to insureds. *Amer. Mut. Liab. Ins. Co.*, 38 Cal. App. 3d at 593-94; *Yellow Cab*, 123 Nev. at 51.

CONCURRENT CONFLICTS OF INTEREST IN INSURANCE DEFENSE

Now you know who you are in the insurance defense attorney-client relationship. You have, at least, a general understanding of who your clients are. You also are aware of the nature and extent of the legal obligations you are to perform. The next step on the path to avoiding and resolving ethical dilemmas is to recognize common conflict of interest fact patterns. This section

is designed to provide you with the information you need for "concurrent" conflicts of interest. These types conflicts of interest will be described in greater detail below. However, in sum, they may occur when an attorney represents more than one client simultaneously. As an insurance defense professional, it is vital that you be able to identify situations that may give rise to concurrent conflicts of interest. Facts leading to these types of conflicts present themselves more often than circumstances resulting in "successive" conflicts of interest, which will be discussed in the next section. Your ability to avoid the feeling of being "so conflicted," depends on your skill in recognizing the common concurrent conflict of interest fact patterns and taking prompt precautionary or remedial measures.

Concurrent Conflicts of Interest Categorized by Remedy

Before we discuss typical concurrent conflict of interest fact patterns, it is important to preview the available remedies so you will have them in mind when reviewing the following paragraphs. Concurrent conflicts of interest can be categorized by remedy:

Conflict Category	Remedy
Potential / Actual Concurrent Conflicts	**FULL WRITTEN DISCLOSURE** **+** **WRITTEN CLIENT CONSENT** **OR** **WITHDRAWAL** (Cal. R. Prof. Conduct 3-310; Nev. R. of Prof. Conduct 1.7)
Concurrent Conflicts Requiring *Cumis* Counsel	**APPOINTMENT OF *CUMIS* COUNSEL** (Cal. Civ. Code § 2860; *Yellow Cab*, 123 Nev. at 51)

Concurrent Conflict of Interest Defined

A concurrent conflict of interest exists when, in the absence of waiver, the interests of joint clients become irreconcilable during the representation. Cal. R. Prof. Conduct 3-310(C); Nev. R. of Prof. Conduct 1.7(a). When confronting the possibility of representing more than one client simultaneously, defense counsel must evaluate his potential clients' interests. *See id.* If he can envision that the interests may conflict in the future, he must disclose this to the potential clients in writing. *Id.* Thereafter, defense counsel may not jointly represent the clients unless they both consent to the representation in writing. *Id.* Additionally, if, during the representation, circumstances arise suggesting a possible concurrent conflict of interest,

defense counsel must reevaluate the interests of his joint client, provide new written disclosure, and obtain new written consent from them. *Id.*

Types of Concurrent Conflicts

Concurrent conflicts of interest come in two varieties.

Multiple Clients, Same Matter

The first type of concurrent conflict of interest may occur when an attorney represents more than one client simultaneously in a single action. Examples of this situation include: (1) the Tripartite Relationship; (2) forming a single business entity for multiple clients; (3) representing the purchaser and seller of a real estate transaction; and (4) litigating on behalf of co-defendants in a criminal case.

Multiple Clients, Different Matters

The second type of concurrent conflict of interest could arise when a lawyer represents multiple clients involved in different, but currently pending, matters. "Even though the simultaneous representations may have nothing in common, and there is no risk that confidences to which counsel is a party in the one case have any relation to the other matter, disqualification may nevertheless be required." *Flatt*, 9 Cal. 4th at 284.

Examples of circumstances leading to this type of conflict include: (1) representation of a subcontractor in a construction defect action and defense of a carrier sued by the subcontractor in an unrelated bad faith action; (2) representation of Contractor A in a breach of contract action and representation of Contractor B in an indemnity action against Contractor A; and (3) simultaneous representation of a husband in a personal injury case and his wife in an action against the husband for divorce. *See, e.g., Truck Ins. Exchange v. Fireman's Fund Ins. Co.*, 6 Cal. App. 4th 1050, 1055-56 (Cal. Ct. App. 1st 1992); *Jeffry*, 67 Cal. App. 3d at 9-10.

"Potential" / "Actual" Concurrent Conflicts in Insurance Defense

As can be seen above, concurrent conflicts of interest can arise in numerous attorney-client arenas. For purposes of these materials, however, concurrent conflict of interest situations stemming from an attorney's representation of both the insured and insurer, such as in

construction defect actions, are most relevant. The following paragraphs discuss circumstances implicating Tripartite Relationship "potential" and "actual" concurrent conflicts of interest. With various fact patterns, the differences between both types of concurrent conflicts of interest are explored.

Causes of "Potential" / "Actual" Concurrent Conflicts

Rifts in the Tripartite Relationship justifying legal remedies may be created by occurrence of the following instances:

- The insurer reserves its right to deny coverage on various grounds. *See Cumis Ins. Society, Inc.*, 162 Cal. App. 3d at 362-63 (carrier offered a defense and reserved its right to deny coverage of alleged willful acts); *Lysick v. Walcom*, 258 Cal. App. 2d 136, 146-47 (Cal. Ct. App. 1st 1968).

- The insured obtains a defense or coaxes a continued defense by alleging to the carrier false facts that implicate a potential for coverage. *See Betts v. Allstate Ins. Co.*, 154 Cal. App. 3d 688, 715-16 (Cal. Ct. App. 4th 1984) (insured appeared to have lied about circumstances giving rise to coverage); Cal. State Bar Form. Opn. 1995-139.

Extent of Concurrent Conflicts

Later, we will discuss concurrent conflicts of interest that warrant appointment of *Cumis* counsel. However, in this section, we will describe the two types of concurrent conflicts of interest that justify disclosure and consent remedies, viz. "potential" and "actual" concurrent conflicts of interest. Both these terms appear in California Rule of Professional Conduct 3-310 (C), which provides in relevant part:

A member shall not, without the informed written consent of each client:

> (1) Accept representation of more than one client in a matter in which the interests of the clients *potentially conflict*; or
>
> (2) Accept or continue representation of more than one client in a matter in which the interests of the clients *actually conflict*[.]

(emphasis added).

The relevant portion of Nevada Rule of Professional Conduct 1.7 employs broader wording, but appears to have substantially the same impact on counsels' obligations:

> (a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:
>
> (1) The representation of one client will be *directly adverse* to another client; or
>
> (2) There is a *significant risk* that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

(emphasis added).

"Potential" Concurrent Conflicts

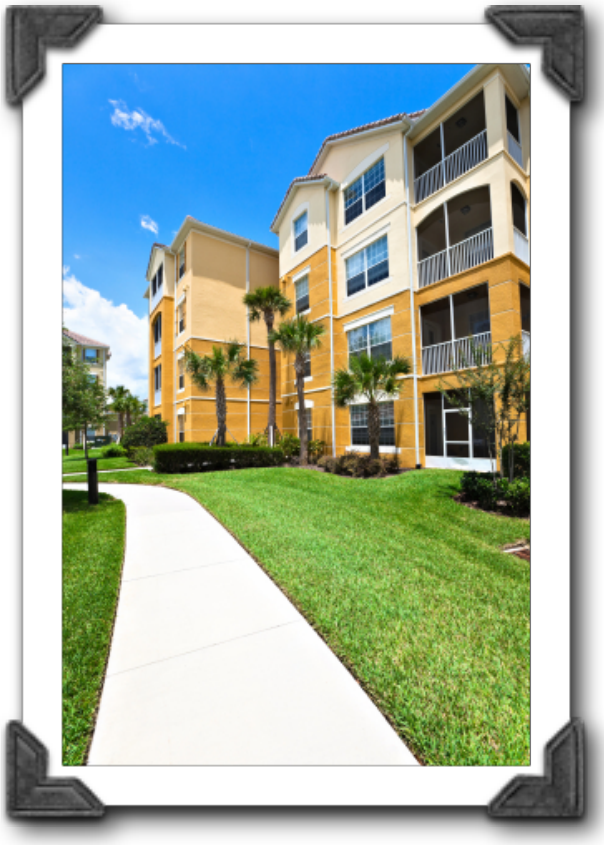
California law defines a "potential" conflict as a set of reasonably foreseeable consequences that could impair the attorney's ability to fulfill his professional obligations to each client of the proposed representation. *See In re Jaeger*, 213 B.R. 578, 584 (Bkrtcy. C.D. Cal. 1997) (holding "[a] conflict of interest is potential if there is no present actual conflict of interest, but there is a possibility of an actual conflict arising in the future, resulting from developments that have not yet occurred or facts that have not yet become known").

Regardless of whether California or Nevada law is applicable, the key questions when confronting a "potential" conflict or a "significant risk" of a conflict are "the likelihood that a difference in interests will eventuate and, if it does, whether it will materially interfere with the lawyer's independent professional judgment in considering alternatives or foreclose courses of action that reasonably should be pursued on behalf of the client." ABA Model Rule of Professional Conduct 1.7 Comment.

The following are examples of potential concurrent conflicts of interest in insurance defense cases:

- **Multiple Contractors - Damage Causation**: A liability insurer assigns a defense attorney to represent multiple subcontractors in a construction defect action involving a single project. One subcontractor is the framer. The other installed the concrete slab. The defense attorney should be able to envision that at some point either of the insureds may blame the other for resultant stucco cracking.

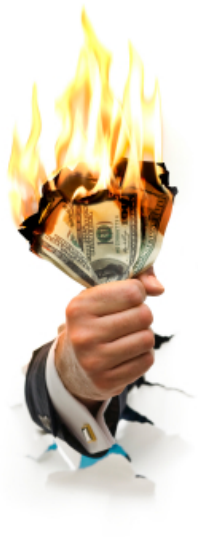
- **Multiple Contractors - Unreasonable Repair**: Defense counsel is appointed to represent a painter and window installer in a construction defect action pertaining to a single residence. The homeowner alleged he replaced the windows because of water intrusion caused by the painter's defective work. During discovery, it becomes clear that the owner replaced the windows on the recommendation of the installer. Additionally, through retained cost of repair experts, defense counsel learns that the alleged window damage could have been more easily repaired with cost-effective window buffing procedures. In this situation, defense counsel should anticipate the conflict between his clients concerning the



reasonableness of the owner's damages.

- **Employer / Employee - Failure to Train**: An insured driver injures another with a tractor during the course and scope of his employment. After a personal injury action is filed and tendered, the liability carrier of the driver's employer retains defense counsel to defend the interests of the employer and the driver. During the investigation phase of the personal injury case, defense counsel cannot determine whether the insured was licensed or trained in the operation of the vehicle. In this circumstance, defense counsel should foresee that it may be in the best interest of the driver to argue non-liability due to the employer's alleged failure to properly train him.

- **Employer / Employee - Failure to Maintain**: A carrier assigns a defense attorney to represent an employer and driver in a personal injury action. The driver was alleged to have injured plaintiff while driving a company vehicle in the course and scope of employment. Investigation of the accident reveals that the brakes of the company vehicle were inoperative at the time of the collision. The defense attorney should anticipate that his driver client may argue that the employer's alleged failure to maintain the company vehicle was a substantial factor in causing the accident.



- **"Burning Limits"**: A liability insurer assigns defense counsel to represent an insured in a potentially high exposure personal injury case. Shortly after appearing for the insured in the action, defense counsel receives a copy of its "burning limits" policy, viz. an insurance policy in which defense costs deplete the policy limits. *See Powerine Oil Co., Inc. v. Sup. Ct.*, 37 Cal. 4th 377, 401 (Cal. 2005). He should perceive a potential conflict of interest between the insured and the insurer. The insured's interest will be to avoid expenditure of defense costs to preserve indemnity limits for potential settlement. The insurer may desire to incur substantial defense costs to defeat the action, and possibly avoid future litigation with other claimants.

In addition to providing the insured and carrier full written disclosure of the above facts and obtaining written consent from each, defense counsel, in a situation with exposure above policy limits, should request that the insurer allow the insured to take over control of the defense and conduct it how she chooses. If the exposure is below policy limits, defense counsel should at least ask the carrier to provide the insured with options concerning how policy limits are consumed. Regardless of the insurer's decision, defense counsel should be cognizant of heightened legal duties to do his utmost to settle early and to provide both clients with regular status updates and summaries of defense costs incurred.

Readers of these materials may suggest that every time an insurer reserves its right to deny coverage, at least a "potential" concurrent conflict of interest exists. The California State Bar Standing Committee on Professional Responsibility and Conduct is of the opinion that mere reservations of rights do not rise to the level of "overt" potential conflicts, which must be remedied. This is because: (1) the "contract of insurance itself, drafted by the insurer for its own benefit, provides more than adequate disclosure under rule 3-310(B)(3) to the insurer"; and (2) case law provides for all clear potential conflicts to be resolved in favor of the insured. The Committee appears to assume that if California ethical conflict law is properly applied, the insured will never experience less than adequate insurance defense representation. Cal. State Bar Form. Opn. 1995-139 at 2.

"Actual" Concurrent Conflicts

An actual concurrent conflict of interest is a set of circumstances that impairs the attorney's ability to fulfill his professional obligations to each client in the proposed representation. *See Spindle v. Chubb/Pacific Indem. Group*, 89 Cal. App. 3d 706, 713 (Cal. Ct. App. 2d 1979) (holding "[a] conflict of interest is actual between jointly represented clients whenever their common lawyer's representation of one may be rendered less effective by reason of the representation of the other").

Examine the following fact patterns giving rise to actual concurrent conflicts of interest:

- **Employer / Employee - Off Duty**: Pursuant to an insurance carrier's referral, a defense attorney was set to represent a driver and his employer in a personal injury action. During investigation of the claim, the driver told counsel that he was working at the time of the accident. When the defense attorney interviewed the employer, he stated that the driver was

off-duty when the collision occurred. The defense attorney should know immediately that an actual concurrent conflict of interest exists.

- **Joint Representation of Primary Insured and Additional Insured**: Defense counsel was tasked with representing a sub-subcontractor primary insured and a subcontractor additional insured by a liability carrier as a result of a construction defect action. The policy's coverages for the primary insured and additional insured were different. The additional insured was covered only with respect to liability arising out of the primary insured's ongoing operations. In this situation, defense counsel should perceive an actual conflict of interest created by the fact that to preserve policy limits the primary insured sub-subcontractor must argue that the additional insured subcontractor was actively negligent, and therefore uncovered, in connection with work at the project.

- **Settling for an Amount Above Policy Limits**: An instant actual concurrent conflict of interest exists if the carrier directs the defense attorney to settle the case for an amount above policy limits, leaving the insured exposed to personal liability. In such a situation, the insured would rather have the case tried, and hopefully, a sub-policy limits verdict obtained than pay money out of his pocket.

- **SIRs**: The tender of an insured subcontractor in construction defect litigation often triggers coverage of multiple carriers with multiple policy periods. Sometimes, in one or more policy periods, a self-insured retention ("SIR") is applicable. Defense counsel appointed to represent the insured may be directed by the retaining carrier to seek contribution from the SIR carrier for settlement. The insured will oppose this direction to avoid applicability of the SIR. Usually, this situation cannot not be remedied, and an actual concurrent conflict of interest exists.

Remedying Potential / Actual Concurrent Conflicts

Certainly, a goal of Tripartite Representation is to avoid conflicts of interest. By being familiar with the above concepts, defense attorneys will go a long way to achieving this goal. However, seasoned litigators know that potential and actual concurrent conflicts of interest cannot be entirely avoided throughout their career. In addition to understanding their legal obligations and being aware of common conflict of interest fact patterns, defense counsel must

know how to resolve conflict of interest situations that arise. The following section details remedies per conflict type.

Remedying Potential Concurrent Conflicts

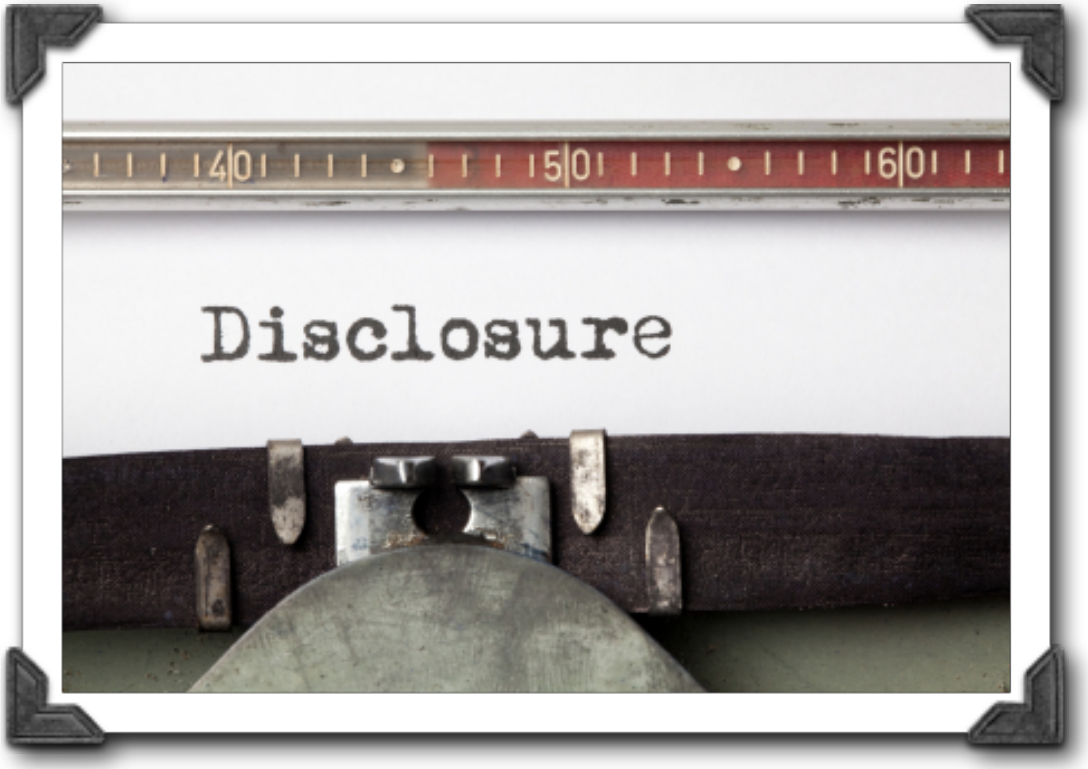
Under both California and Nevada rules, resolving a potential concurrent conflict of interest has the following two steps:

- Written Disclosure
- Each Clients' Consent

Written Disclosure

"Written disclosure" has different meanings depending on whether defense counsel represents his clients in California or Nevada.

California Rule of Professional Conduct 3-310(A)(2) defines "informed written consent" as "the client's or former client's written agreement to the representation following written disclosure[.]" (emphasis added). Therefore, when a potential concurrent conflict of interest arises in California, defense counsel must explain to his clients in writing "the implications of the



common representation, including possible effects on loyalty, confidentiality and the attorney-client privilege and the advantages and risks involved." Cal. R. Prof. Conduct 3-310(A)(2); ABA Model Rule of Professional Conduct 1.7 Comment.

Nevada has adopted the language of ABA Model Rules 1.0 and 1.7 with respect to written disclosure. Under this framework, client disclosure can be oral. However, it must be followed by service of a written summary of the oral disclosure within a reasonable time. Nev. R. of Prof. Conduct 1.0(b), 1.0(e), and 1.7(b)(4); ABA Model Rules 1.0, 1.7, and Comments.

Each Clients' Consent

In California, client consent to a potential concurrent conflict of interest must be in writing. Cal. R. Prof. Conduct 3-310(A)(2). In Nevada, clients may orally consent to potential conflicts of interest so long as defense counsel promptly transmits to them a writing confirming their consent. Nev. R. of Prof. Conduct 1.0(b). "[T]he writing is required in order to impress upon clients the seriousness of the decision the client is being asked to make and to avoid disputes or ambiguities that might later occur in the absence of a writing." ABA Model Rules 1.7 Comment.

Prospective Consent

In California and Nevada, allowing lawyers to have their new clients sign agreements waiving future potential conflicts is not per se invalid. *Zador Corp. v. Kwan*, 31 Cal. App. 4th 1285, 1301 (Cal. Ct. App. 6th 1995); Cal. State Bar Form. Opn. 1989-115 at 4; Nev. R. of Prof. Conduct 1.7; ABA Model Rules 1.7 Comment. A prospective waiver fails, however, if the clients, taking into account their relative sophistication, were not fully informed concerning the particular conflict that arose. *Kwan*, 31 Cal. App. 4th at 1301; ABA Model Rules 1.7 Comment.

Implied Consent

Nevada clients' consent to potential concurrent conflicts of interest must be oral with confirming correspondence or in writing. Nev. R. of Prof. Conduct 1.0(b), 1.0(e), and 1.7(b)(4). Perhaps counter-intuitively, in California, clients may impliedly consent to potential concurrent conflicts of interest. *In re Marriage of Friedman*, 100 Cal. App. 4th 65, 71 (Cal. Ct. App. 2d 2002). Implied consent may be found if: (1) the clients were advised of the potential conflict

orally and in writing; (2) they did not object to the representation; and (3) they continued to participate in the representation. *Id.*

Remedying Actual Concurrent Conflicts

Under both California and Nevada law, resolution of an actual concurrent conflict of interest has the following two steps:

- New Written Disclosure
- Each Clients' New Consent

On occasion, potential concurrent conflicts ripen into actual concurrent conflicts. Defense counsel may not rely on a previously issued written disclosure and consent of his clients to remedy a pending actual concurrent conflict of interest. Cal. R. Prof. Conduct 3-310(C)(2) and Comment; Nev. R. of Prof. Conduct 1.7(b)(4) and Comment. If a potential conflict becomes an actual conflict, or a different potential or actual conflict arises, defense counsel must obtain new informed consent of his clients. *Id.*

The following should be included in the new disclosure, if applicable:

- Relevant facts and circumstances of the actual conflict;
- Description of the relationship(s) that could cause defense counsel to favor one interest over the other;
- Defense counsel may not be able to present appropriate claims or defenses in the action;
- Defense counsel's obligations to one client may be impaired because of his obligations to the other client;
- Defense counsel may be required to limit his representation and be unable to give each client complete legal advice as a result of his obligations to the other client;
- The client should consult with independent counsel to provide an opinion on whether the client should continue the representation with present defense counsel; and
- Defense counsel may be required to withdraw from representing either of the clients.

See In re Marriage of Egedi, 88 Cal. App. 4th 17, 23 (Cal. Ct. App. 2d 2001) (holding "counsel 'who undertake to represent parties with divergent interests owe the highest duty to each to make a full disclosure of all facts and circumstances which are necessary to enable the parties to make a fully informed decision regarding the subject matter of the litigation, including the areas of potential conflict and the possibility and desirability of seeking independent legal advice'"); Nev. R. of Prof. Conduct 1.7 Comment.

Ineffective Attempts to Remedy Potential / Actual Concurrent Conflicts

In seeking to avoid potential or actual conflicts of interest, lawyers have been quite creative. The following examines their methods and shows that courts mostly reject them.

Vicarious Disqualification

Defense counsel, faced with a potential or actual conflict of interest, may think: "Well, if I can't represent this client, maybe my partner in the San Diego office can? We won't even ever talk about the case . . ." Following this course would implicate vicarious disqualification law. In Nevada, vicarious disqualification, in the context of concurrent conflicts, is discussed in Rule of Professional Conduct 1.10(1), which provides:

> While lawyers are associated in a firm, none of them shall knowingly represent a client when any one of them practicing alone would be prohibited from doing so by Rules 1.7, 1.9, or 2.2, unless the prohibition is based on a personal interest of the prohibited lawyer and does not present a significant risk of materially limiting the representation of the client by the remaining lawyers in the firm.

See also Nev. R. of Prof. Conduct 1.8(m) (stating "[w]hile lawyers are associated in a firm, a prohibition in the foregoing paragraphs, with the exception of paragraph (j), that applies to any one of them shall apply to all of them.")

The California Rules of Professional Conduct do not discuss vicarious disqualification. *Henriksen v. Great American Savings & Loan*, 11 Cal. App. 4th 109, 114 (Cal. Ct. App. 1st 1992). Application of the concept is left to case law. *Id.* The general rule is that when a defense attorney is disqualified from multi-client representation, his entire law firm is vicariously disqualified. *Id.* at 114-15; *William H. Raley Co. v. Sup. Ct.*, 149 Cal. App. 3d 1042, 1049-50 (Cal. Ct. App. 4th 1983). However, California courts caution that "[a]utomatic or mechanical application of the

vicarious disqualification rule can be harsh and unfair to both a law firm and its client. . . . The better approach is to examine the circumstances of each case in light of the competing interests noted above." *Id.* at 1049 (citations omitted).

"Ethical Wall"

Both California and Nevada law disallow defense lawyers from creating an "ethical wall" to avoid vicarious firm disqualification based on potential or actual concurrent conflicts of interest. *Henriksen*, 11 Cal. App. 4th at 115-16; Nev. R. of Prof. Conduct 1.7 and 1.10. An "ethical" wall generally includes a law firm directive that any individual involved in the representation of one client may not communicate with any other person at the firm not involved in the representation of this client about the subject of the representation. *Henriksen*, 11 Cal. App. 4th at 115-16. *See* David Stein, *Law Firm Disqualified Despite Advance Conflict Waiver And Ethical Wall*, Orange County Lawyer, April 2009 (discussing "ethical" walls). "The typical elements of an ethical wall are: physical, geographic, and departmental separation of attorneys; prohibitions against and sanctions for discussing confidential matters; established rules and procedures preventing access to confidential information and files; procedures preventing a disqualified attorney from sharing in the profits from the representation; and continuing

education in professional responsibility." *Henriksen*, 11 Cal. App. 4th at 116 n.6. Ethical walls are outlawed to avoid a continual threat to the duties of loyalty and confidentiality owed to jointly represented clients. *See Concat LP v. Unilever, PLC*, 350 F. Supp. 2d 796, 821 (N.D. Cal. 2004) (stating that "[a]lthough an ethical wall may, in certain limited circumstances, prevent a breach of confidentiality, it cannot, in the absence of an informed waiver, cure a law firm's breach of its duty of loyalty to its client").

"Hot Potato" Rule

Under this rule, defense counsel, facing a potential or actual concurrent conflict of interest, cannot avoid disqualification by dropping one client like a "hot potato" in favor of the other. *Truck Ins. Exchange*, 6 Cal. App. 4th at 1059. Withdrawing from the representation of one of joint clients likely breaches a defense attorney's duty of loyalty to the client. *American Airlines, Inc. v. Sheppard, Mullin, Richter*, 96 Cal. App. 4th 1017, 1037 (Cal. Ct. App. 2d 2002).

Neither Nevada case law nor professional responsibility rules address the "Hot Potato" Rule specifically. Depending on interpretation of the term of art, "former client," one could argue Nevada Rules of Professional Conduct 1.9 and 1.16 allow Nevada attorneys to withdraw from the representation of one client in concurrent conflict of interest situations.

Consequences of Failing to Remedy Potential / Actual Concurrent Conflicts

Failure to abide the above ethical rules could result in: (1) malpractice liability; (2) forfeiture of right to attorney fees from client(s); (3) reversal of a civil judgment; and (4) state bar discipline. *Klemm v. Sup. Ct.*, 75 Cal. App. 3d 893, 901 (Cal. Ct. App. 5th 1977); *Image Technical Service, Inc. v. Eastman Kodak Co.*, 136 F. 3d 1354, 1359 (9th Cir. 1998); *Hammett v. McIntyre*, 114 Cal. App. 2d 148, 158-59 (Cal. Ct. App. 2d 1952); Cal. R. Prof. Conduct 1-100; Nev. R. of Prof. Conduct 8.4.

Concurrent Conflicts Requiring Appointment of Independent Counsel

In previous sections, our dialogue centered on potential or actual concurrent conflicts of interest that counsel often confronts in day-to-day insurance defense litigation. Most of the examples discussed above involved conflict situations among the insureds themselves. In this section, our sights are trained solely on actual concurrent conflicts of interest between the insured and the insured. Absent effective waiver, these situations require the carrier to pay for independent counsel, chosen by the insured, to conduct the defense in the litigation. Cal. Civ. Code § 2860; *Yellow Cab*, 123 Nev. at 51. *See also Cumis Ins. Society, Inc.*, 162 Cal. App. 3d at 369 (discussing California case law requiring the insurer to pay for independent counsel in insured - insurer actual concurrent conflict circumstances).

Concurrent conflict situations requiring appointment of independent, or *Cumis*, counsel include the following:

- **Reservation of Rights Coupled with Defense Counsel Control of the Outcome of the Coverage Dispute**: Most of the time, when insurers offer a defense of a claim, they simultaneously issue the insured a writing reserving their right to deny coverage on various grounds. Rich Marotti, *Reconstructing Cumis: What the California Legislature Got Wrong About California Civil Code Section 2860 and How to Fix It*, Hastings L.J. 881, 882 (2009). Usually, carriers also retain counsel to defend the case on behalf of the insured. *Id.* For the uninitiated, at least a potential concurrent conflict, per California and Nevada Professional Conduct Rules, may be thought to exist. After all, the insurer hired defense counsel to represent it and the insured. The insurer has made it plain that no coverage exists, and the insured, by tendering, contends coverage of the claim does exist. One may think, "How much clearer do the facts have to be for informed written consent to be required?"

  Under California and Nevada law, the circumstances need to be much clearer. As discussed in preceding sections, legal authorities are of the opinion that a mere reservation of rights does not trigger informed consent or independent counsel remedies because of the "unusual, perhaps unique, interrelationship of insurer, insured and counsel [.]" Cal. State Bar Form. Opn. 1995-139 at 2. Essentially, in typical situations, the concurrent conflict happenstance has not risen to the level of an actual conflict and the insurance policy puts the parties on notice of the risks attendant to the Tripartite Relationship. *Id.* In other words, by the very existence of the insurance defense

relationship, counsel has substantially complied with professional responsibility requirements. *Id.*

Nonetheless, an actual, coverage-related concurrent conflict may come between the insured and insurer. *See* Cal. Civ. Code § 2860(a) (providing that a right to independent counsel exists when "a conflict of interest arises"); *Native Sun Investment Group v. Ticor Title Ins. Co.*, 189 Cal. App. 3d 1265, 1277 (Cal. Ct. App. 4th 1987) (holding only "actual" concurrent coverage-related conflict provides basis for *Cumis* counsel).

In these materials, we refer to the basis on which potential *Cumis* issues are analyzed as the "Real Quandary" standard. Defense counsel must be placed in a "Real Quandary" in order for *Cumis* counsel to be warranted.

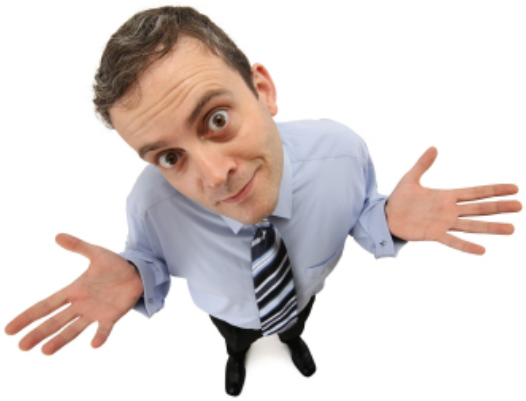
Thus, such a conflict of interest may arise when:

- liability in the action turns on:
    - the conduct of the insured or
    - the cause of the alleged harm; and
- the litigation is such that defense counsel has the ability to develop different characterizations of the insured's conduct or the cause of the alleged harm that could result in non-coverage.

See Cal. Civ. Code § 2860(b) (providing that "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, a conflict of interest may exist"); *Gafcon, Inc.*, 98 Cal. App. 4th at 1423; *Dynamic Concepts, Inc. v. Truck Ins. Exchange*, 61 Cal. App. 4th 999, 1007-08 (Cal. Ct. App. 4th 1998) (holding "[t]he potential for conflict requires a careful analysis of the parties' respective interests to determine whether they can be reconciled (such as by a defense based on total non-liability) or whether an actual conflict of interest precludes insurer-appointed defense counsel from presenting a quality defense for the insured"); *Cumis Ins. Society, Inc.*, 162 Cal. App. 3d at 364; Marotti, *supra*, at 890-92; Christopher R. Wagner, *Making Reservations, Los Angeles Lawyer*, June 2003, at 39.

Compare Scottsdale Ins. Co. v. The Housing Group, 1995 U.S. Dist. LEXIS 8791, 13 (N.D. Cal. 1995) (determining facts plus carrier's earth movement exclusion created *Cumis* conflict), *with Blanchard v. State Farm Fire and Cas. Co.*, 2 Cal. App. 4th 345, 350 (Cal. Ct. App. 2d 1991) (finding facts plus "work product" exclusion failed to implicate *Cumis*).

An observation about the "Real Quandary" standard should be noted. The word "may" is emphasized because an insured may not be entitled to *Cumis* counsel even if the two components of the standard are applicable. *Cumis* counsel is not required in every circumstance in which a defense attorney can control the outcome of the coverage dispute. *Blanchard*, 2 Cal. App. 4th at 350. "There is no such entitlement, for example, where the coverage issue is independent of, or extrinsic to, the issues in the underlying action . . . or where the damages are only partially covered by the policy." *Dynamic Concepts, Inc.*, 61 Cal. App. 4th at 1006 (citations omitted).



The purpose of setting forth a permissive definition for the "Real Quandary" standard is to communicate the time when notice of a circumstance implicating *Cumis* counsel should be given to the insured and insurer. To properly discharge your duties of loyalty to the insured and insurer, you must know when you should give the insured and insurer notice of a possible need for independent counsel so that they will have sufficient time to investigate the circumstances. *See Cumis Ins. Society, Inc.*, 162 Cal. App. 3d at 371 n. 7 (holding "the existence of a conflict of interest should be identified early in the proceedings so it can be treated effectively before prejudice has occurred to either party"); *Dynamic Concepts, Inc.*, 61 Cal. App. 4th 999, 1010 (holding insurers are entitled to a reasonable period of time to investigate a potential *Cumis* conflict).

Synthesis of case law reveals that the "may" in the above standard changes to "does" when an additional component is added to the above definition: "the purported

conflict of interest between the policyholder and insurance defense counsel is not dependent upon a presumption that counsel will act in a manner that favors the insurer and harms the policyholder." *See* Wagner, *supra*, at 39 (describing the case law synthesis); *Gafcon, Inc.*, 98 Cal. App. 4th at 1422 (noting that evidence on "what specific way the defense attorney could have controlled the outcome of the damage issue to [insured's] detriment, or had incentive to do so" must be offered for a decision in favor of *Cumis* counsel). More succinctly, offering independent counsel is mandated where defense counsel's representation of the insured is rendered less effective by virtue of the applicable facts and the carrier's coverage position. *Gafcon, Inc.*, 98 Cal. App. 4th at 1423. *See Long v. Century Indem. Co.*, 163 Cal. App. 4th 1460, 1473 (Cal. Ct. App. 2d 2008) (stating the duty to appoint *Cumis* counsel exists when the conflict actually arises). "A mere possibility of an unspecified conflict does not require independent counsel. The conflict must be significant, not merely theoretical, actual, not merely potential." *Dynamic Concepts, Inc.*, 61 Cal. App. 4th at 1007.

- **Insurer Seeks to Settle for an Amount in Excess of Policy Limits**: Appointment of *Cumis* counsel is required when the carrier requests defense counsel settle a claim for an amount higher than the insurance policy limits. *Golden Eagle Ins. Co. v. Foremost Ins. Co.*, 20 Cal. App. 4th 1372, 1396 (Cal. Ct. App. 2d 1994). *See* Marotti, *supra*, at 891 (stating *Cumis* counsel required where insurance carrier pursues settlement in excess of policy limits). In this situation, the insured is exposed to personal liability, and therefore, the interests of the insured and insurer actually conflict. *Golden Eagle Ins. Co.*, 20 Cal. App. 4th at 1396.

Cumis Procedure

In Nevada, neither statutory nor case law provide rules for the process of appointing independent counsel. However, in California, *Cumis* procedural requirements are detailed in California Civil Code § 2860(c). It provides in relevant part:

> When the insured has selected independent counsel to represent him or her, the insurer may exercise its right to require that the counsel selected by the insured possess certain minimum qualifications which may include that the selected counsel 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. The 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.

Cumis counsel represents solely the interests of the insured. He does not owe a duty of loyalty to the insurer. *Employers Ins. of Wausau v. Albert D. Seeno Const. Co.*, 692 F. Supp. 1150, 1157 (N.D. Cal. 1988). However, he must cooperate with insurer defense counsel and discharge duties of competence and communication to insurer. Cal. Civ. Code § 2860(d) and (f).

Resolution of Cumis Conflicts

Once defense counsel has identified a "Real Quandary" circumstance, three courses of action will remedy the conflict issue:

- Disclosure to the insured and insurer of facts and circumstances giving rise to the potential *Cumis* conflict, insured's written waiver of its right to independent counsel, and insurer's written consent;
- Disclosure to the insured and insurer of facts giving rise to the potential *Cumis* conflict, insurer's written waiver of its coverage defenses, and insured's written consent; or
- Disclosure to the insured and insurer of facts and circumstances giving rise to the potential *Cumis* conflict and appointment of *Cumis* counsel.

Cal. R. Prof. Conduct 3-110(C); Nev. R. of Prof. Conduct 1.7; Cal. Civ. Code § 2860(e).

SUCCESSIVE CONFLICTS OF INTEREST IN INSURANCE DEFENSE LITIGATION

Many conflicts of interest involve former clients or former representations. For example, a lawyer is asked by a new client to pursue a claim against someone the lawyer represented in the past. Or, an attorney who was formerly a member of a law firm representing one party to litigation transfers to a firm that represents the adverse party in the same matter.

Disqualification in such cases is based on the lawyer's inability to discharge duties of loyalty and confidentiality to her former clients. Simply stated, a lawyer may not do anything that will injuriously affect a former client in any matter in which the lawyer formerly represented the client; nor may the lawyer use knowledge or information acquired by virtue of representing a former client against that client. *People ex rel. Deukmejian v. Brown*, 29 Cal. 3d 150, 155-56 (Cal. 1981); Cal. R. Prof. Conduct 3-110(E); Nev. R. of Prof. Conduct 1.9.

Elements of Successive Conflicts of Interest

Successive representation conflicts require attorney disqualification where the following elements are satisfied:

- the lawyer's current representation must be adverse to a current or former client;
- the lawyer must have obtained confidential information while representing the former client; and
- the confidential information must be material to the current representation.

Cal. R. Prof. Conduct 3-110(E); Nev. R. of Prof. Conduct 1.9(a).

Remedying Successive Conflicts of Interest

Informed Written Consent of Former Client

Representation of a client whose interests are adverse to a former client is permitted with the former client's informed written consent. Cal. R. Prof. Conduct 3-310(E); Nev. R. of Prof. Conduct 1.9(a); *City & County of San Francisco v. Cobra Solutions, Inc.*, 38 Cal. 4th 839, 847 (Cal. 2006).

Informed Written Consent of New Client?

As a practical matter, the new client should also consent (although it need not be in writing) after having been given written disclosure where the proposed representation is adverse to the attorney's former client. This is because, without such consent, counsel may be prohibited by the attorney-client confidentiality duty from disclosing the proposed representation to the former client or anyone else, thus precluding the former client's informed consent. *See* Cal. Bus. & Prof. Code § 6068(e) (providing that an attorney has a duty "[t]o maintain inviolate the confidence, and at every peril to himself or herself to preserve the secrets, of his or her client").

Consequences of Successive Conflicts of Interest

Vicarious Law Firm Disqualification

As in concurrent representation conflict cases, when an attorney is disqualified by a conflict of interest based on an earlier representation in another matter, the attorney's entire law firm may be vicariously disqualified as well. Nev. R. of Prof. Conduct 1.10(a). In California, vicarious disqualification rules derive from case law and are based on the assumption "that attorneys, working together and practicing law in a professional association, share each other's, and their clients' confidential information." *Cobra Solutions, Inc.*, 38 Cal. 4th at 847-48. However, an entire law firm is not automatically disqualified where the attorney who did the work for the former client is no longer with the firm. Nev. R. of Prof. Conduct 1.10(b); *Goldberg v. Warner/Chappell Music, Inc.*, 125 Cal. App. 4th 752, 762 (Cal. Ct. App. 2d 2005).

"Ethical Walls" Do Not Cure Successive Conflicts

Ethical walls do not remedy successive conflicts of interest not involving an attorney moving from the public to the private sector. *Sharp v. Next Entertainment, Inc.*, 163 Cal. App. 4th 410, 438 n.11 (Cal. Ct. App. 2d 2008); Nev. R. of Prof. Conduct 1.11(b).

Prohibit Recovery of Attorney Fees for Current Representation

Defense counsel's failure to obtain her clients' informed written consent to a successive conflict may defeat her right to recover fees for the current representation. *Goldstein v. Lees*, 46 Cal. App. 3d 614, 618 (Cal. Ct. App. 2d 1975).

Disgorgement of Attorney Fees Paid for Prior Representation

Similarly, counsel who violates conflict of interest rules may be forced to disgorge fees already paid by the affected client. *In re Fountain*, 74 Cal. App. 3d 715, 719 (Cal. Ct. App. 4th 1977).

CONCLUSION

Now, let's review. The conflicted feelings of insurance defense counsel can be drastically reduced if you:

- Know Your Legal Duties
- Recognize Common Conflict of Interest Fact Patterns
- Take Precautions
- Sometimes, Make Tough Decisions

Unless you are *Cumis* counsel, you owe four main legal duties to the insured and the insurer: (1) Loyalty; (2) Confidentiality; (3) Communication; and (4) Competence. Because of the unique Tripartite Relationship, you must remember that a heightened duty of loyalty is owed to the insured, but you owe both clients a duty not to disclose their secrets.

An alarm should go off in your head if you are tasked with representing: (1) co-insureds; (2) multiple clients in one action; (3) an insured with a "burning limits" policy; (4) a carrier who seeks to settle above policy limits; (5) an insured with a self-insured retention; (6) an insured whose liability turns on facts relating to a carrier's reservation of rights; and (7) an insured whose defense is linked to facts applicable in causation and coverage analyses. You do not need to reject the assignment or withdraw automatically. The presence of the above factual scenarios should give you pause. If you are a California lawyer, you should review California Rule of Professional Conduct 3-310. If you practice in Nevada, you should read Nevada Rule of Professional Conduct 1.7 - 1.11. If you determine that a potential conflict of interest exists, you need to take precautions.

The most important precaution is disclosure. You should disclose the facts and circumstances giving rise to the potential conflict to both the insured and the carrier. Oftentimes, this mere disclosure is enough to resolve the potential conflict. Maybe the carrier will withdraw its coverage defenses or offer independent counsel.

Finally, you may have to make a "tough decision." If the carrier does not take action to alleviate the potential conflict, you must provide your clients full written disclosure. You must request written consent. If none is forthcoming from either client, you must take action to withdraw. At the time of this decision, you may feel like you are leaving someone who needs help, but in the long run, not only are your clients' interests better served, but yours are as well.

Hopefully, review of these materials will leave you feeling less "conflicted" and help you to avoid as many tough decisions as possible.