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# Minding the Cap

**By Philip Hunter Thompson and Timothy M. Thornton**

Civil Code Section 2860, the codification and clarification of the rule set forth in *San Diego Navy Federal Credit Union v. Cumis Insurance Society, Inc.*, 162 Cal. App. 3d 358 (1984), requires an insurer to offer independent counsel to represent an insured if "the provisions of a policy of insurance impose a duty to defend" and the 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*" (emphasis added), such that a conflict of interest would exist for that attorney. The insurer's obligation to pay *Cumis* fees 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," and disputes concerning *Cumis* fees "shall be resolved by final and binding arbitration."

The specific fact pattern necessary to trigger an insured's right to *Cumis* counsel and 2860's rate cap and arbitration provision has bedeviled insurers. For example, insureds often argue that any reservation of rights by an insurer triggers the right to *Cumis* counsel, but that the rate cap and arbitration provision do not apply unless the insurer and insured hire separate defense counsel, with the insurer paying for both. This argument, however, is inconsistent with the language of 2860 and the underlying purpose of its enactment. Two recent reported decisions, *Sovereign Gen. Ins. Servs. v. Nat'l Cas. Co.*, 2008 U.S. Dist. LEXIS 11601 and *Long v. Century Indemnity Co.*, 2008 Cal. App. LEXIS 919, help resolve this troublesome issue.

**Sovereign**

Sovereign General Insurance Services is a licensed California insurance broker, and is allowed to transact business with foreign insurers that are not admitted by the California Department of Insurance. Pursuant to this license, Sovereign acted as a broker for Lloyd's of London. National Casualty Company insured Sovereign for damages it incurred for its errors and omissions. Lloyd's instituted an arbitration proceeding against Sovereign in England, for Sovereign's alleged violations of its agreements with Lloyd's. Sovereign tendered its defense to National, which agreed to defend, reserving its right to later contest coverage based on a territorial limits' restriction and an exclusion. Sovereign hired the California-based Aguilar Law Offices to help secure London counsel to represent Sovereign in England. Sovereign chose Charles Russell, a London-based law firm. During the course of the arbitration, Aguilar provided legal support and advice to Charles Russell on California law. Sovereign argued that Charles Russell qualified as National's panel counsel, and asked National to pay Aguilar's legal fees as California *Cumis* counsel. National refused. As a result, Sovereign sued National asking the Court to declare,



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among other things, that Sovereign was entitled to *Cumis* counsel.

National moved for summary adjudication, arguing that its reservation of rights did not create a *Cumis* conflict, and accordingly Sovereign was not entitled to independent counsel under *Cumis* or 2860. Sovereign opposed the motion by first arguing that Charles Russell had a conflict of interest because it was not capable of providing a full defense, and that Aguilar was required to, and did, assist Charles Russell in the litigation. The court rejected this argument, finding that although a second set of attorneys may have been beneficial to Sovereign, that fact did not in and of itself create a conflict of interest entitling Sovereign to *Cumis* counsel. The court noted that the "pertinent issue is not competence, but instead whether a conflict of interest was created by any ability, on the part of Charles Russell as Sovereign's defense counsel, to also affect the outcome of Sovereign's coverage dispute with National. The utility of any advice Aguilar was able to provide is simply not germane to whether that very narrowly defined conflict existed."

Not to be deterred, Sovereign also asserted that a conflict of interest existed because Charles Russell refused to assert a viable defense in the arbitration. The court responded, finding "Sovereign, however, does not allege, and has provided no evidence to support, that Charles Russell, even if it did refuse to assert the above described defense, was doing so to control the determination of the coverage issue. . . .There similarly is no evidence that Charles Russell, in its handling of Sovereign's defense, had even the ability to color the facts upon which coverage turned."

The Court noted that from the facts presented, Charles Russell was hired to resolve the claims of Lloyd's against Sovereign, and not be involved directly in the coverage dispute. Likewise, Sovereign offered no evidence that Charles Russell could control the outcome of the coverage issues. The court found "there is no evidence of a conflict of interest regarding the representation provided by Charles Russell as to whether National would provide coverage to Sovereign, and thus no triggering of the statutory requirement of *Cumis* counsel," and granted National's motion. Thus, the simple act by a liability insurer of reserving its rights does not trigger an insured's right to *Cumis* counsel. The insured bears the burden to provide sufficient evidence of panel counsel's direct involvement in the coverage dispute and panel counsel's control of the outcome of a coverage issue, before an insurer's reservation of rights triggers *Cumis* and 2860.

**Long**

INA issued liability insurance to a recycling company, which became one of many defendants in a large hazardous waste cleanup action. The recycling company tendered its defense to INA, which agreed to defend but reserved all of its rights. INA asked attorney Jay Long, who had defended the recycling company as *Cumis* counsel in a prior matter, to defend the company. INA, however, was unwilling to pay Long his normal hourly rate, contending he would be *Cumis* counsel in the new matter and subject to the rate cap of 2860. Long disputed the application of the rate cap, but agreed to undertake the company's defense at a reduced rate with the company paying the difference, while reserving the company's right to later seek the overage.

The company settled its part of the litigation. Three years later, Long demanded that Century Indemnity, INA's successor in interest, pay the attorney fee overage, and, without conceding that the 2860 arbitration provision applied, demanded that the hourly rate dispute be submitted to arbitration. Century refused both the payment request (claiming INA did not owe it) and the arbitration demand (asserting it was untimely).



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The company assigned all of its attorney fee rights to Long, who, as the company's assignee, sued Century to recover the overage. Century demurred, asserting that the suit was improper because the fee dispute was subject to mandatory 2860 arbitration. The trial court agreed with Century and sustained the demurrer without leave to amend. Long appealed, and argued that under 2860's express terms the fee cap and arbitration provisions remained inoperative unless both the insured and insurer retained defense counsel, with the insurer paying for both. Consequently, as Long's argument went, 2860's fee cap and arbitration provisions simply did not apply to the pending fee dispute because INA had not retained its panel counsel to defend the company, and, accordingly the demurrer must be overruled.

From the insurer's perspective, Long's 2860 analysis would have defeated the purpose of 2860, which was to curb the independent counsel abuses that arose following the *Cumis* decision. Under Long's approach, an insurer could only obtain the cost saving benefits of 2860's rate cap and arbitration requirements if it added the cost of an additional defense firm, hardly an attractive prospect. As a practical matter insurers rarely retain panel counsel to defend an insured being defended by *Cumis* counsel. Accordingly, if the court adopted Long's analysis, 2860's most important protections would have been eviscerated, and its underlying policy purposes defeated. The court, however, rejected Long's analysis and affirmed the judgment. It held that, placed in context, Section 2860's phrase "*counsel first retained by the insurer for the defense of the claim*" references the initial determination of the existence of a 2860 conflict of interest, not whether the rate cap and arbitration requirement apply. Accordingly, the rate cap and arbitration provisions apply "whether or not the insurer has—or will—retain its own counsel."

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