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The *Cumis* Decision—What has it Done to Insurance Policies?

INTRODUCTION

In December 1984, the California Fourth District Court of Appeals issued a decision which has effectively changed the way California insurance companies conduct business. Prior to *San Diego Navy Federal Credit Union v. Cumis Insurance Society*,¹ an insurance company was obligated by the terms of its policy to provide a defense for its insured when a suit was filed against the insured alleging injuries covered under the policy. After *Cumis*, the insurance company not only must provide a defense, but also must offer and pay for independent counsel² when any potential conflict of interest between the insurer and its insured exists.³ Arguably, any time an insurer sends its insured a reservation of rights letter or obtains a nonwaiver agreement from its insured which allow the insurer to later dispute coverage under the policy, a conflict of interest exists.⁴ This is true because, in the court's view, an insurer will direct the defense of its insured to avoid lia-

1. 162 Cal. App. 3d 358, 208 Cal. Rptr. 494 (1984), *reh'g denied*.

2. An independent counsel is "pledged to promote and protect the prime interests of his client." *Executive Aviation, Inc. v. National Ins. Underwriters*, 16 Cal. App. 3d 799, 809, 94 Cal. Rptr. 347, 354 (1971).

3. A conflict of interest occurs when representation of one client is made less effective by representation of another. *Spindle v. Chubb Pac. Indem. Group*, 89 Cal. App. 3d 706, 713, 152 Cal. Rptr. 776, 780-81 (1979). Whether the court correctly discussed what constitutes a conflict of interest is a topic outside the scope of this article. For a brief discussion of the court's misapplication of the ABA Model Code and the applicable California rule regarding an attorney's conflict of interest, see Filice, *The "Cumis" Decision: Was it Correctly Decided?*, VERDICT, Nov. 1985, at 16.

4. The distinction between a nonwaiver agreement and a reservation of rights has been stated as follows:

"A nonwaiver agreement is a bilateral contract, normally in writing, entered into by the assured and the insurer after the accident, providing that the insurer will defend the tort suit while reserving its right to assert nonliability at a later date. . . . reservation of rights is very similar to a nonwaiver agreement, and it is subject to the same limitations and restrictions. It differs in being less formal than the nonwaiver and less tied to strict contract principles. The insurer need only notify, or attempt to notify, the assured that it is conducting the investigation and defense of the tort claim under a reservation of the right to assert policy defenses at a later time, and the assured's silence will usually be deemed acquiescence. Courts have in general been fairly liberal in implying reservations.

(Note, 68 HARV. L. REV. 1436, 1446; fns. omitted.)

Val's Painting & Drywall, Inc. v. Allstate, 53 Cal. App. 3d 576, 586, 126 Cal. Rptr. 267, 272-73 (1976)

bility on its part without considering the effect on the insured.⁵ Thus, whenever the insurer believes the insurance contract does not apply, it is in effect obligated to incur the expense of not one, but two, lawyers: one to protect both its interests and its insured's interests, and one to protect its insured's interests alone. Consequently, the *Cumis* decision will dramatically increase the cost of insurance.

While *Cumis* may be welcomed by those who are initially suspect of the insurance industry, the court's decision does violence to the foundation of insurance. An insurance policy is a contract, governed by settled contract principles. The district court, however, failed to address the application of these rules in *Cumis*. Rather, the court apparently relied on ethical considerations to the exclusion of all other rationales in reaching its decision. Setting aside the question of whether an insured needs representation by two lawyers, an issue remains in the court's decision: The court failed to justify imposing additional cost on the insurer in the apparent absence of any supporting language in the policy. Since *Cumis* is now the law in California, its potential effect on insurance policies should be seriously examined.

This Note first will discuss the *Cumis* decision itself.⁶ Next, this Note will address those contract rules historically used in insurance law.⁷ Third, it will trace the recent development of the duty to defend in the context of contract law by pointing out the major steps taken in *Gray v. Zurich Insurance Company*⁸ and *Executive Aviation, Inc. v. National Insurance Underwriters*.⁹ It then will contrast the contract principles used in these cases with the reasoning which influenced the court in *Cumis*.¹⁰ Finally, this Note will propose that the better solution to the problem of conflict of interest is the practice that was in force prior to *Cumis*.¹¹

I. THE *CUMIS* CASE

In the case underlying *Cumis*, a suit was filed against the San Diego Navy Federal Credit Union by one of its employees alleging tortious wrongful discharge, breach of the covenant of good faith and fair dealing, wrongful interference with contract, inducing

5. *Cumis*, 162 Cal. App. 3d at 364, 208 Cal. Rptr. at 498.

6. See *infra* text accompanying notes 12-28.

7. See *infra* text accompanying notes 29-63.

8. 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966). See *infra* text accompanying notes 64-85.

9. 16 Cal. App. 3d 799, 94 Cal. Rptr. 347 (1971). See *infra* text accompanying notes 86-99.

10. See *infra* text accompanying notes 100-42.

11. See *infra* text accompanying notes 143-55.

breach of contract, breach of contract and intentional infliction of emotional distress.¹² The credit union tendered defense of this action to Cumis, the credit union's insurance company.¹³ Cumis' associate counsel reviewed the allegations and believed that, under the credit union's insurance policy, Cumis was obligated to defend the action.¹⁴ Accordingly, Cumis hired counsel to defend the credit union, but informed it that Cumis was reserving the right to later deny coverage as the complaint alleged willful conduct and prayed for punitive damages, both of which were not covered by the policy.¹⁵ The credit union thereafter hired independent counsel to protect its interests as to those allegations not covered by the policy.¹⁶ While Cumis initially payed two bills submitted to it by the independent counsel,¹⁷ it subsequently refused to pay invoices believing that there was no existing conflict of interest which would have required such payment.¹⁸

At a settlement conference in the underlying action, Cumis, without informing the credit union of the conference, authorized its counsel to make an offer lower than the amount demanded.¹⁹ Later, but before trial, the credit union sent Cumis a letter expressing its desire that the underlying suit be settled.²⁰

The credit union and its employees involved in the underlying suit filed a declaratory relief action to determine whether the costs

12. In the underlying action, Magdaline S. Eisenmann brought suit when the credit union first suspended and later discharged her in 1980 after \$3,530 was found missing from a vault in a branch where she was manager. The credit union accused her of incompetence and neglect and contended that the missing money was a result of her failing to follow procedures included in a revised security manual. A jury found for Mrs. Eisenmann and awarded her \$230,000; \$200,000 in compensatory damages, \$5,000 for emotional distress and \$25,000 in punitive damages. The judgment was upheld by the California Court of Appeals for the Fourth District on March 19, 1986 in an unpublished opinion.

13. *Cumis*, 162 Cal. App. 3d at 361, 208 Cal. Rptr. at 496. The duty to defend clause in the credit union's policy with Cumis read as follows:

With respect to such insurance as is afforded by this policy the company shall: (a) defend any suit against the insured alleging such injury, sickness, disease or destruction and seeking damages on account thereof, even if such suit is groundless, false or fraudulent; but the company may make such an investigation, negotiation and settlement of any claims or suit as it deems expedient.

Opening Brief for Appellant at 11, n.2, *Cumis*, 162 Cal. App. 3d 358, 208 Cal. Rptr. 494 [hereinafter Opening Brief].

14. *Cumis*, 162 Cal. App. 3d at 362, 208 Cal. Rptr. at 496.

15. In fact, Cumis obtained opinions from other law firms which confirmed this opinion. Opening Brief at 8, *Cumis*, 162 Cal. App. 3d 358, 208 Cal. Rptr. 494.

16. *Cumis*, 162 Cal. App. 3d at 362, 208 Cal. Rptr. at 497. During the entire suit, Cumis had its own attorney defending the credit union.

17. These bills totaled only \$300. Opening Brief, *supra* note 13, at 7.

18. For an explanation of the circumstances in which an insurer would, under California law, have been obligated to pay for independent counsel prior to *Cumis*, see *infra* text accompanying notes 86-99.

19. *Cumis*, 162 Cal. App. 3d at 363, 208 Cal. Rptr. at 497.

20. *Id.* at 365, 208 Cal. Rptr. at 499.

of their independent counsel should be paid by Cumis. The trial court ruled that Cumis was obligated to pay for the independent counsel of the Credit Union and the court of appeals affirmed.²¹ Concentrating on the conflict of interest that the court believed existed between Cumis and the Credit Union, the appellate court held that one attorney could not ethically represent both parties.²² The court reasoned that the defense of one party might adversely affect the liability of the other. Specifically, Cumis would desire to prove that the Credit Union's acts were intentional which would preclude coverage while the Credit Union would want to prove the opposite to force Cumis to provide coverage.²³ While acknowledging that counsel representing both parties owed each a high duty of care,²⁴ the court in *Cumis* restated the general rule that "[i]n actions in which . . . the insurer and insured have conflicting interests, the insurer may not compel the insured to surrender control of the litigation."²⁵

The court then went one step further: It required the insurer to pay for the independent counsel of its insured whenever a potential conflict of interest exists, usually embodied in a reservation of rights letter as was sent by Cumis.²⁶ Whereas prior to this decision, the *Gray* ruling obligated an insurer to defend virtually all actions,²⁷ now the insurer is forced to pay for an additional lawyer in any case in which coverage of the insured may be at issue.²⁸ The court compounded the novelty of this decision by deviating from the usual reasoning in insurance cases. Therefore, some background is needed with regard to the historic role of courts vis-a-vis insurance contracts and how the courts' approach has changed in recent years.

II. HISTORICAL RULES OF INSURANCE POLICY INTERPRETATION

There can be little argument that insurance policies are contracts.²⁹ The contract is bargained for in that the insured has paid

21. *Id.* at 361, 208 Cal. Rptr. at 496.

22. *Id.* at 366, 208 Cal. Rptr. at 499.

23. *Id.* at 365-66, 208 Cal. Rptr. at 499.

24. *Lysick v. Walcom*, 258 Cal. App. 2d 136, 65 Cal. Rptr. 406 (1968).

25. *Cumis*, 162 Cal. App. 3d at 369, 208 Cal. Rptr. at 501 (quoting *Tomerlin v. Canadian Indemnity Company*, 61 Cal. 2d 638, 648, 394 P.2d 571, 577, 39 Cal. Rptr. 731, 737 (1964)).

26. *Cumis*, 162 Cal. App. 3d at 375-76, 208 Cal. Rptr. at 505.

27. *See infra* text accompanying notes 48-63.

28. This is because the reservation of rights issued in such cases creates the conflict of interest entitling the insured to payment for additional counsel.

29. Courts both in and out of California have so held for decades. *See, e.g., Vyn v. Northwest Casualty Co.*, 47 Cal. 2d 89, 301 P.2d 869 (1956); *Sullivan v. Union Oil Co. of Ca.*, 16 Cal. 2d 229, 105 P.2d 922 (1940); *Whitney Estate Co. v. Northern Assurance Co.*,

a premium in return for the promise of the insurer to pay the benefits of the policy if certain conditions are met including the payment of future premiums. If a coverage dispute arises between the insurer and the insured, the construction of this contract becomes critical in determining whether the insurer must perform.

In making such decisions, courts generally have held that insurance contracts should be interpreted by applying the same rules of construction used in other construing other contracts.³⁰ In effect, this means that "[t]he question of construction of a contract of insurance, as of the contracts generally, can arise only when the language of the contract is in need of construction."³¹ Thus, if clear and unambiguous language is used by the drafter, there is nothing to be interpreted.³² The court "will indulge in no forced construction so as to cast a liability upon the insurance company which it has not assumed."³³ In interpreting a clear and unambiguous policy, the court looks to the intent of the parties which has been plainly expressed in the terms of the contract. The court can thus neither expand nor restrict the coverage in an insurance policy if the language is clear and unambiguous.³⁴ Therefore, the court's threshold inquiry is whether ambiguous language exists. If there are no ambiguities in the contract, the court's duty is to

155 Cal. 521, 101 P. 911 (1911); *Davis v. Phoenix Ins. Co.*, 111 Cal. 409, 43 P. 1115 (1896); *Gillies v. Michigan Millers Mutual Fire Ins. Co.*, 98 Cal. App. 2d 743, 221 P.2d 272 (1950); *McGlothlin v. U.S. National Life & Casualty Co.*, 36 Ga. App. 325, 136 S.E. 535 (1927); *Eicks v. Fidelity & Casualty Co. of New York*, 300 Mo. 279, 253 S.W. 1029 (1923); *Olendorff Watch Co. v. Pink*, 279 N.Y. 32, 17 N.E.2d 676 (1938); *State v. Standard Oil Co.*, 138 Ohio St. 376, 35 N.E.2d 437 (1941); *Ballou v. Fisher*, 154 Or. 548, 61 P.2d 423 (1936);

California has codified its courts' decisions: "Insurance is a contract whereby one undertakes to indemnify another against loss, damages, or liability arising from a contingent or unknown event." CAL. INS. CODE § 22 (West 1972).

30. *Liverpool and London and Globe Ins. Co. v. Kearney*, 180 U.S. 132, 135-36 (1901), where the United States Supreme Court stated that "the rules established for the construction of written instruments apply to contracts of insurance equally with other contracts." See also *Industrial Indem. Co. v. Aetna Casualty and Surety Co.*, 111 Cal. 503, 507-08, 44 P. 189, 190 (1896); *Financial Indem. Co. v. Murphy*, 223 Cal. App. 2d 621, 628, 35 Cal. Rptr. 913, 917 (1963).

31. See generally CAL. CIV. CODE § 1638 (West 1985); *Zito v. Fireman's Ins. Co.*, 36 Cal. App. 3d 277, 111 Cal. Rptr. 392 (1973); *Fyne v. Industrial Accident Comm'n*, 138 Cal. App. 2d 467, 292 P.2d 78 (1956); *Laventhal v. Fidelity and Casualty Co.*, 9 Cal. App. 275, 98 P. 1075 (1908).

32. In such cases, the court "simply read[s] the clear and controlling language and hold[s] accordingly." *McMillan v. State Farm Ins. Co.*, 211 Cal. App. 2d 58, 62, 27 Cal. Rptr. 125, 128 (1962) where the court applied clear and unambiguous exclusionary clauses to deny coverage after the plaintiff made a claim following an automobile accident.

33. *New York Life Ins. Co. v. Hollender*, 38 Cal. 2d 73, 81, 237 P.2d 510, 514 (1951).

34. See *American Casualty Co. v. Myrick*, 304 F.2d 179, 184 (5th Cir. 1962) where the court, relying on several prior decisions, specifically stated that "We cannot rewrite the policy."

apply the terms of the contract regardless of the potentially harsh results.³⁵

In determining whether an insurance policy contains ambiguous language, a court reads the policy as would a reasonably prudent person.³⁶ Stated differently, the policy is considered from the point of view of a layman who is trained in neither the law nor the insurance business.³⁷ This seemingly gives the court broad discretion in finding ambiguity as there are no concrete standards to guide it in its determination. However, the court is restrained by the broad rule that ambiguity exists in an insurance policy only if “there are two or more inconsistent interpretations [of the policy], both of which are fair and reasonable.”³⁸ Thus, the court will only indulge a layman’s interpretation of the policy if that interpretation is reasonable from an objective standard.³⁹

A court which finds ambiguities in a policy must strictly construe them against the insurer, as drafter of the policy, and liberally in favor of the insured.⁴⁰ However, even if ambiguous lan-

35. *Combined Communications Corp. v. Seaboard Surety Co.*, 641 F.2d 743, 745 (9th Cir. 1981). *See also* *Hatch v. Turner*, 145 Tex. 17, 21, 193 S.W.2d 668, 669-70 (1946), where the Texas Supreme Court stated “[t]hat the conditions may be harsh does not affect the rule [that the court must apply the plain words of the policy] as no one is compelled to deal with the insured on the basis of such conditions.”; 43 AM. JUR. 2D *Insurance* § 271 (1972).

36. *General Casualty Co. of America v. Azteca Films, Inc.*, 278 F.2d 161, 167 (9th Cir. 1960), *cert. denied*, 364 U.S. 863 (1960); *Crane v. State Farm Fire & Casualty Co.*, 5 Cal. 3d 112, 115, 485 P.2d 1129, 1130, 95 Cal. Rptr. 513, 514 (1971); *Hobson v. Mutual Benefit Health & Accident Assoc. Inc.*, 99 Cal. App. 2d 330, 333, 221 P.2d 761, 763 (1950).

37. *Trousdell v. Equitable Life Assurance Soc’y*, 55 Cal. App. 2d 74, 81, 130 P.2d 173, 177 (1942).

38. *Continental Savings Ass’n v. United States Fidelity and Guaranty Co.*, 762 F.2d 1239, 1245 (5th Cir. 1985), *modified*, 768 F.2d 89 (5th Cir. 1985) (quoting *Entzminger v. Provident Life and Accident Ins. Co.*, 652 S.W.2d 533, 535-36 (Tex. Civ. App. 1st Dist. 1983)).

39. R. KEETON, *INSURANCE LAW* § 6.3(a), at 351 (1971).

40. *Mutual Ins. Co. v. Hunri*, 263 U.S. 167, 174 (1923); *Russell v. Bankers Life Co.*, 46 Cal. App. 3d 405, 412, 120 Cal. Rptr. 627, 631 (1975); *see also* *Continental Casualty Co. v. Phoenix Constr. Co.*, 46 Cal. 2d 423, 437, 296 P.2d 801, 809 (1956), wherein the California Supreme Court stated that “[i]t is elementary that in insurance law any ambiguity or uncertainty in an insurance policy is to be resolved against the insurer.”

This approach to insurance contracts is logical because the insured rarely has the opportunity to contribute to the coverage he receives; rather, due to the bargaining relationship between an insurer and an insured, the conditions under which the insurer’s obligations will arise are predetermined by the insurer. In fact, insurance policies have been found to be contracts of adhesion.

Health insurance agreements . . . have been held to be adhesion contracts. . . . An adhesion contract is a standardized contract written entirely by a party with superior bargaining power. The weaker party to an adhesion must “take it or leave it,” and be without opportunity to bargain. . . . This particular standardized contract was prepared entirely by a major insurance company whose bargaining power is clearly superior to individual members of the general public.

Ponder v. Blue Cross of Southern California, 145 Cal. App. 3d 709, 718-19, 193 Cal. Rptr.

guage is found in an insurance contract, a court is not unrestrained in its interpretation and application of the policy. Despite the well-entrenched attitude that a policy should be interpreted against the insurance company,⁴¹ the court cannot create ambiguities where none existed, nor will it favor an insured's strained, and hence unreasonable, reading of the words of the policy over an insurer's use of the language in its logical sense.⁴² Furthermore, while courts will recognize ambiguity in an insurance policy, they will not then apply a forced construction of the insured's interpretation so as to fix liability on an insurer which it had not previously assumed.⁴³ The intent of both the insurer and the insured are thus important when an ambiguous provision is to be clarified.⁴⁴ If an insurance policy is indeed a contract of adhesion,⁴⁵ the provisions of the policy may not express the intent of one party, the insured. However, this problem regarding intent is solved in that the policy is to be interpreted "in the light of the reasonable and normal expectations of the parties as to the extent

632, 636-37 (1983). In addition, the California Supreme Court has indicated that a standardized life insurance contract sold from a vending machine could be considered one of adhesion. *Steven v. Fidelity and Casualty Co.*, 58 Cal. 2d 862, 882, 377 P.2d 284, 297-98, 27 Cal. Rptr. 172, 183 (1962).

Since the insured has so little choice in the drafting of the policy that is designed to protect him, the insurance company must be prevented from defeating the insured's interests by writing an uncertain policy. The role by which courts interpret ambiguities in the policy strictly against the insurer is the most efficient way of protecting the insured as that rule forces the insurer to use language that is clear and understandable to the insured so that he can decide if the coverage is adequate for his needs. The rule also prevents the insurer from using terms of art that may be foreign to the layman but which could affect the coverage provided to him.

41. See generally CAL. CIV. CODE § 1654 (West 1985); *Steven*, 58 Cal. 2d 862, 377 P.2d 284, 27 Cal. Rptr. 172; *Continental Casualty Co.*, 46 Cal. 2d 423, 296 P.2d 801; *Victoria Steamship Co. v. Western Assurance Co.*, 167 Cal. 348, 139 P. 807 (1914); *Pacific Heating & Ventilating Co. v. Williamsburgh City Fire Ins. Co. of Brooklyn*, 158 Cal. 367, 111 P. 4 (1910); *Admiralty Fund v. Peerless Ins. Co.*, 143 Cal. App. 3d 379, 191 Cal. Rptr. 753 (1983); *Hays v. Pacific Independent Group*, 8 Cal. App. 3d 158, 86 Cal. Rptr. 815 (1970); *Everett v. Standard Accident Ins. Co.*, 45 Cal. App. 332, 187 P. 996 (1919).

42. See, e.g., *Guidici v. Pacific Auto. Ins. Co.*, 79 Cal. App. 2d 128, 179 P.2d 337 (1947), where the court refused to accept the insured's argument that the definition of "in charge of," as found in an exclusionary clause, meant possession plus active operation on item. Instead, the court upheld the insurer's contention that possession was sufficient.

43. *Jarrett v. Allstate Ins. Co.*, 209 Cal. App. 2d 804, 26 Cal. Rptr. 231 (1962). See also *Pacific Employers Ins. Co. v. Maryland Casualty Co.*, 65 Cal. 2d 318, 323, 419 P.2d 641, 643, 54 Cal. Rptr. 385, 387 (1966); *Stewart v. Estate of Bohnert*, 101 Cal. App. 3d 978, 985, 162 Cal. Rptr. 126, 129 (1980); *State Farm Mutual Automobile Ins. Co. v. Flynt*, 17 Cal. App. 3d 538, 546-47, 95 Cal. Rptr. 296, 301 (1971).

44. An ambiguity does not necessarily mean that the intent of the parties is not clear as, for example, despite unclear language, the court will look to the other clauses of the policy to determine the intent of the parties to resolve the uncertainty of the disputed clause. *Burr v. Western States Life Ins. Co.*, 211 Cal. 568, 575, 296 P. 273, 276 (1931) (quoting *Jones v. Van Nuys*, 161 Cal. 158, 165, 118 P. 541, 544 (1911) and *In re Estate of Winslow*, 121 Cal. 92, 94, 53 P. 362, 364 (1898)).

45. See *supra* note 40.

of coverage."⁴⁶ Again, this reinforces the proposition that despite the strong policy favoring an insured, a court cannot construe an insurance policy in a way which would confer unbargained for benefits on an insured at the expense of an insurer or which would violate the reasonable expectations of both parties.⁴⁷

III. THE PRE-GRAY DEVELOPMENT OF THE DUTY TO DEFEND

Courts traditionally have applied accepted contract principles in which the insurance company's duty to defend its insured has been at issue.⁴⁸ Originally, courts examined the duty to defend clause in the policy and applied it to the allegations contained in the complaint against the insured.⁴⁹ A typical duty to defend clause binds the insurance company to:

pay on behalf of the insured all sums which the INSURED shall become legally obligated to pay as DAMAGES because of C. BODILY INJURY or D. PROPERTY DAMAGE to which this insurance applies, caused by an OCCURRENCE . . . and the company shall have the right and duty to defend any suit against the INSURED seeking DAMAGES on account of such BODILY INJURY or PROPERTY DAMAGE, even if any of the allegations of the suit are groundless, false or fraudulent, and may make such investigation and settlement of any claim or suit as it deems expedient, but the company shall not be obligated to pay any claim or judgment or to defend any suit after the applicable limit of the company's liability has been exhausted by payment of judgments or settlements.⁵⁰

46. *Migliore v. Sheet Metal Workers' Welfare Plan*, 18 Cal. App. 3d 201, 204, 95 Cal. Rptr. 669, 671 (1971). The reasonable expectation doctrine dates as far back as *Bird v. St. Paul Fire & Marine Ins. Co.*, 224 N.Y. 47, 51, 120 N.E. 86, 87 (1918) where the court stated "[o]ur guide [to the resolution of a causation issue which determined the extent of the disputed insurance coverage] is the reasonable expectation and purpose of the ordinary business man when making an ordinary business contract."

47. However, it should be conceded that if the insured reasonably expects to receive certain benefits under a policy and the insurer reasonably expects not to provide such benefits, the insured will prevail.

48. *See, e.g., Osborne v. Security Ins. Co.*, 155 Cal. App. 2d 201, 318 P.2d 94 (1957) in which the court interpreted in favor of the insured the use of the ambiguous word "use" in an automobile insurance policy and found a duty to defend. *See also Ritchie v. Anchor Casualty Co.*, 135 Cal. App. 2d 245, 286 P.2d 1000 (1955).

49. For example, in *Greer-Robbins Co. v. Pacific Surety Co.*, 37 Cal. App. 540, 544, 174 P. 110, 111 (1918), the court stated

[t]here is a more certain basis [than independent investigation] for a determination of the liability of the appellant [insurance company] to defend, and that basis is to be found in the allegations of the complaint in each action for damages against the respondent [insured]. We construe the policy to mean that it is the duty of the appellant, under its terms, to defend every action in which the complaint shows "a claim for damages covered by this policy."

The court, therefore, merely applied the language of the policy as it would do in other contract situations.

50. R. KEETON, *supra* note 39, at 660.

If the suit alleged actions which fell into the class of risks against which the insurance contract promised to protect, the duty to defend was invoked.⁵¹ One of the last cases to follow this proposition to the letter was *Maxon v. Security Insurance Company*.⁵²

In *Maxon*, the insurance company issued to a store owner a policy which covered damages arising from both accidents and the ownership, maintenance, use or operation of a retail store.⁵³ The policy contained a corresponding duty to defend any suits alleging such injuries.⁵⁴ After it was given a bad check, the store had the customer arrested, but later dismissed the charges. The customer brought suit against the store charging malicious prosecution. The store informed its insurance company of the suit and requested a defense under its policy. The insurer, however, refused this tender, believing the policy did not cover the customer's allegations of an intentional tort.⁵⁵ The store prevailed in the suit against it brought by the customer and then sued the insurance company seeking to recover the money it expended in its defense.⁵⁶

Before reaching the duty to defend issue, the district court examined the liability of the insurance company under the policy. First, the court recognized that because the verdict reached in the underlying suit exonerated the store, there was no injury for which the store became legally obligated to pay.⁵⁷ The court then examined the allegations against the store, and found that the customer's suit was based solely on malicious prosecution,⁵⁸ an intentional tort.⁵⁹ Citing section 533 of the California Insurance Code⁶⁰ and section 1668 of the California Code of Civil Procedure,⁶¹ the

51. However, if there was no possibility of recovery under the policy, the insurance company was under no duty to defend its insured. For example, in *Weis v. State Farm Mutual Automobile Ins. Co.*, 242 Minn. 141, 145, 64 N.W.2d 366, 369 (1954), the Minnesota Supreme Court found no duty to defend because the insured admitted that his actions causing the claimant's injuries were deliberate thereby precluding indemnification.

52. 214 Cal. App. 2d 603, 29 Cal. Rptr. 586 (1963).

53. *Id.* at 607, 29 Cal. Rptr. at 587-88.

54. *Id.*

55. *Id.* at 608, 29 Cal. Rptr. at 588.

56. *Id.* at 613, 29 Cal. Rptr. at 591.

57. *Id.* at 614, 29 Cal. Rptr. at 592.

58. *Id.* at 615, 29 Cal. Rptr. at 592.

59. The elements of malicious prosecution are a judicial proceeding that is terminated in favor of the complainant, want of probable cause in bringing the original action, malice in the original prosecution, and resulting damages. *Oppenheimer v. Tambllyn*, 167 Cal. App. 2d 158, 160, 334 P.2d 152, 154 (1959).

60. An insurer is not liable for a loss caused by the willful act of the insured; but he is not exonerated by the negligence of the insured, or of the insured's agents. CAL. INS. CODE § 533 (West 1985).

61. All contracts which have for their object, directly or indirectly, exempting anyone from responsibility for his own fraud, or his willful injury to the person or property of another, or his violation of the law, whether willful or negligent, are against the policy of the law. CAL. CIV. PROC. CODE § 1668 (West 1985).

court held that even had the store been found liable, the insurance company would not have been obligated to indemnify against the loss.

Turning to the issue of the insurance company's duty to defend, the court noted the general rule at that time was that "the obligation to defend is measured by comparing the terms of the insurance policy with the pleadings of the claimants who sue the insured."⁶² Since the complaint against the store alleged only malicious prosecution and since the court had determined that the insurance company could not have become legally obligated to pay for such damages, there was no duty to defend this action.⁶³ The court implicitly recognized that there was no ambiguity in the insurance contract that would be resolved against the insurer. The court found the language in the policy clear and merely applied the precise words of the contract.

IV. THE FIRST CHANGE—*GRAY V. ZURICH INSURANCE COMPANY*

The practice of solely examining the face of the pleadings to determine whether a duty to defend existed was abandoned in *Gray v. Zurich Insurance Company*.⁶⁴ The underlying suit in *Gray* arose from a fight in which the insured was allegedly the aggressor. The victim brought suit alleging that the insured "willfully, maliciously, brutally and intentionally assaulted" him.⁶⁵ The insured tendered the defense to his insurance company stating that he acted in self-defense.⁶⁶ The insurer refused to defend, believing that the complaint alleged only an intentional tort which was not covered by the policy.⁶⁷

The California Supreme Court reiterated the rules that any doubts in an insurance policy must be resolved against the insurer and that any exceptions to an insurer's obligation under the policy must be clearly stated.⁶⁸ The court recognized that an insurance policy is, in effect, an adhesion contract. This in turn required that the insured's reasonable expectations of the benefits to be received under the policy control the court's interpretation.⁶⁹ The duty to

62. *Maxon*, 214 Cal. App. 2d at 616, 29 Cal. Rptr. at 593.

63. *Id.* at 617, 29 Cal. Rptr. at 594.

64. 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966).

65. *Id.* at 267, 419 P.2d at 170, 54 Cal. Rptr. at 106.

66. The incident occurred after the insured almost collided with another car and the driver of the car approached the insured in a threatening way at which time the insured felt that he must defend himself.

67. *Gray*, 65 Cal. 2d at 268, 419 P.2d at 170, 54 Cal. Rptr. at 106.

68. *Id.* at 269, 419 P.2d at 171, 54 Cal. Rptr. at 107.

69. *Id.* at 269-70, 419 P.2d at 171-72, 54 Cal. Rptr. at 107-08.

defend clause in *Gray* was ambiguously drafted such that an insured could “reasonably” expect the insurance company to provide a defense in this case.⁷⁰ Since the obligation to indemnify could not be determined until the tort suit was resolved, the question of whether a duty to defend existed could not be answered until that time.⁷¹ Thus, the court found that the insurer’s promise to defend was ambiguous because it depended on a court’s finding in the very suit in which the duty to defend could apply.⁷²

In addition, the court also found uncertainty in the words of the duty to defend clause. The language of the provision stated that “the company shall defend any suit against the insured alleging such bodily injury” even if the suit were groundless, false or fraudulent.⁷³ The court found this to be sweeping language that could be interpreted by the insured to promise a defense for any and all suits.⁷⁴ Further, the exclusionary clause relied on by the insurer, which provided that no coverage would lie for intentional acts, was uncertain because “intentionally” could connote a different meaning to a layman than to an insurance company.⁷⁵ Since there was no one clear meaning to the word “intentionally,” there was uncertainty in the contract. Rules of construction of insurance policies in favor of the insured thus came into play.⁷⁶ Due to the reasonable expectation of the insured and the uncertainty of the language of the policy, the court construed the contract against the insurer and found a duty to defend even in a case alleging only an intentional tort.⁷⁷

The court in *Gray* went further than merely requiring the insurance company to defend the suit in this case. It also laid down the policy that the insurer “bears a duty to defend its insured whenever it ascertains facts which give rise to a potential of liability under the policy.”⁷⁸ The language in the allegations against the insured would not be determinative of the insurer’s duty to de-

70. *Id.* at 271-72, 419 P.2d at 173-74, 54 Cal. Rptr. at 109.

71. *Id.* at 272, 419 P.2d at 173, 54 Cal. Rptr. at 109.

72. *Id.*

73. *Id.* at 267, 419 P.2d at 170, 54 Cal. Rptr. at 106.

74. *Id.* at 273, 419 P.2d at 174, 54 Cal. Rptr. at 110.

75. The layman might, for instance, believe that intentional acts might mean “collusive, willful or planned action beyond the classical notion of intentional tort.” *Id.* at 273, 419 P.2d at 174, 54 Cal. Rptr. at 110.

76. See *supra* text accompanying notes 40-41.

77. *Gray*, 65 Cal. 2d at 273-74, 419 P.2d at 176, 54 Cal. Rptr. at 112.

78. *Id.* at 276-77, 419 P.2d at 177, 54 Cal. Rptr. at 113. This in itself places a burden on the insurance company as it may not deny coverage without instituting an investigation of the incident if it has reason to believe the potential for coverage might exist. See, e.g., *Mullen v. Glen Falls Ins. Co.*, 73 Cal. App. 3d 163, 173, 140 Cal. Rptr. 605, 611 (1977).

defend.⁷⁹ In perhaps the most novel proposition put forward to that date in insurance law, the court intimated that the duty to defend is much broader than the duty to indemnify.⁸⁰ The burden was now placed on the insurer to justify its refusal to defend its insured. If any potential theory existed on which the claimant could recover that would be covered by the policy, the insurer had the duty to defend the suit.⁸¹

In *Gray*, the court placed a heavy burden on the insurance company by requiring that it provide a defense in virtually every suit against one of its insureds.⁸² The court did so, however, by applying well-recognized principles of contract interpretation. Case law had firmly established the rule that any and all ambiguities in an insurance contract must be construed against the insurer.⁸³ While the court introduced the idea that the reasonable expectations of the insured should control in such controversies, this arguably is merely an assertion that the intent of the insured should be preferred over that of the insurer since, to the court, an insurance policy may be in its purest form a contract of adhesion.⁸⁴ Since the intent of the parties is critical in interpreting an ambiguous instrument,⁸⁵ the court in *Gray* did no more than follow contract law in expanding the duty to defend.

V. THE NEXT STEP—THE *EXECUTIVE AVIATION* CASE

The next major case to impact insurance companies and their duty to defend was *Executive Aviation, Inc. v. National Insurance Underwriters*.⁸⁶ This case involved a claim after an airplane acci-

79. For example, the court recognized the possibility that an amended complaint could be filed which could allege damages which would be covered. *Gray*, 65 Cal. 2d at 276, 419 P.2d at 176, 54 Cal. Rptr. at 112.

80. While the court did not use this precise language in *Gray*, subsequent courts have interpreted the holding of *Gray* in this way. See, e.g., *Val's Painting & Drywall, Inc. v. Allstate*, 53 Cal. App. 3d 576, 584, 126 Cal. Rptr. 267, 271 (1976), where the court stated "[u]nder *Gray*, the duty to defend is broader than the duty to indemnify."

81. This is not to say that the insurance company had no recourse when it found itself in such situations. The court recognized the procedure whereby the insurer defended under a reservation of rights. *Gray*, 65 Cal. 2d at 279, 419 P.2d at 178, 54 Cal. Rptr. at 114. By so doing, the insurer has the opportunity to later assert its noncoverage defense and still provide its insured with the required defense. See *supra* note 4.

82. As the court noted, the victim is not concerned with what theory he will recover on; his only purpose is to obtain the largest judgment a court will award. *Gray*, 65 Cal. 2d at 279, 419 P.2d at 178, 54 Cal. Rptr. at 114. Hence, suits against an insured will contain all possible allegations of both negligence and intentional acts. Thus, the duty to defend will be invoked in almost all suits since claims of negligence will be included in complaints whenever possible.

83. See *supra* notes 40-41.

84. See *supra* note 40.

85. A. CORBIN, *CONTRACTS* § 95 (1952).

86. 16 Cal. App. 3d 799, 94 Cal. Rptr. 347 (1971).

dent. The insurance policy protecting the company that owned the plane provided coverage for injuries arising out of the proper use of an aircraft.⁸⁷ The policy contained an exclusion clause which disclaimed coverage for accidents occurring when the plane was piloted by someone who did not have the qualifications specified in an endorsement to the policy.⁸⁸ After the plane disappeared and was apparently lost or destroyed, the insurer notified its insured that the policy did not apply to any claims arising from the accident because the pilot did not meet the specified requirements.⁸⁹ Therefore, the defense of any claims were subject to a reservation of rights to determine if the policy should apply to the accident. The insured brought a declaratory relief action against its insurer to determine if the insurer's position was correct. Soon after, the heirs of one of the passengers filed a wrongful death suit against both the insurer and the insured.⁹⁰ The insurer hired the same attorneys to defend both its own interests in the declaratory relief action and its interests and those of its insured in the wrongful death suit.⁹¹

The court of appeals first restated the rule of *Gray* that an insurer must "defend its insured pursuant to the provisions of its contract and do nothing that would injure the interests of its insured."⁹² However, the court also recognized that there was an unsolvable conflict of interest in these cases. In the declaratory relief action, the insurer would want to prove that the plane was being used in common carriage and thus the pilot was not qualified under the terms of the policy, which would preclude coverage.⁹³ Conversely, in the wrongful death suit, the insured would try to prove the plane was being flown in a private carriage operation and hence the pilot was qualified.⁹⁴ Since the same attorneys were used in both cases to defend both the insurer and the in-

87. *Id.* at 803, 94 Cal. Rptr. at 349.

88. *Id.* The policy was effective "only while being piloted by any Pilot while holding a valid Private or Commercial Pilot Certificate with Appropriate F.A.A. Ratings for the operation being performed" and only when the plane was being flown by "Any Commercial Pilot Properly Rated in Type and Qualified for the aircraft and flight and having a minimum of 2,000 flying hours experience as a Pilot." It was alleged, however, that the pilot at the time of the accident was prevented as a result of disciplinary proceedings from flying passengers in common carriage, but could fly private carriage operations such as demonstration flights. Thus, the applicability of the exclusionary clauses, and hence the policy itself, turned on a finding of whether or not the plane was being flown in public transportation.

89. *Id.* at 804, 94 Cal. Rptr. at 350.

90. *Id.*

91. *Id.* at 809-10, 94 Cal. Rptr. at 354.

92. *Id.* at 809, 94 Cal. Rptr. at 353.

93. *Id.* at 804, 94 Cal. Rptr. at 350.

94. *Id.*

sured, and since the decision in each turned on an opposite finding of common carriage or private carriage, an actual conflict of interest had arisen and the lawyers could not successfully appear in both suits.⁹⁵ Therefore, the court concluded that "the insurer's obligation to defend extends to paying the reasonable value of the legal services and costs performed by independent counsel, selected by the insured."⁹⁶ The court of appeal, like the supreme court in *Gray*, stated that it was merely applying standard principles of contract interpretation and found that the insurance policy failed "to provide with any degree of clarity for this conflict of interest contingency in drafting the terms of its contract."⁹⁷ This explanation may be unsatisfactory since the court did not expound on the uncertainty in the policy nor apply the "reasonable expectation" doctrine developed in *Gray*. At the very least, however, the court acknowledged that it was attempting to invoke contract principles, albeit in a liberal fashion.⁹⁸

While *Executive Aviation* represented a notable departure from the manner in which insurance companies previously had handled their clients' defense, it did not have a tremendous impact because the decision was applied only to those cases in which an actual conflict of interest was present.⁹⁹ *Cumis*, however, extends the obligation of the insurer to pay for independent counsel in all cases in which a coverage issue might be present.

VI. THE COURT'S ANALYSIS IN *CUMIS*

In its *Cumis* decision, the court of appeals first stated that when an insurer issues a reservation of rights, there is no longer a commonality of interest among insurer, insured and attorney.¹⁰⁰ By definition, a reservation of rights embodies an insurer's belief that a claim might not fall under the protection of the policy.¹⁰¹ The court therefore believed that an insurer might direct the litigation towards showing that the policy does not cover the allegations

95. *Id.* at 809-10, 94 Cal. Rptr. at 354.

96. *Id.* at 810, 94 Cal. Rptr. at 354.

97. *Id.*

98. The unsatisfying aspect of this case is thus not that the insured is entitled to independent counsel when a conflict of interest arises, but rather the court's seeming reliance on *Prashker v. United States Guarantee Co.*, 1 N.Y.2d 584, 154 N.Y.S.2d 910, 136 N.E.2d 871 (1956), when it stated that a "reasonable solution" was adopted by the New York Court of Appeals that the insurer should be responsible for the cost of independent counsel in conflict of interest situations; however, the New York court provided no authority for its decision.

99. *See, e.g., Previews, Inc. v. California Union Ins. Co.*, 640 F.2d 1026 (9th Cir. 1981).

100. *Cumis*, 162 Cal. App. 3d at 364, 208 Cal. Rptr. at 498.

101. *See supra* note 4.

against the insured which, of course, would be contrary to the insured's interests.¹⁰² The attorney finds himself in an ethical dilemma as, in the court's view, he is now representing clients with conflicting interests.¹⁰³ In fact, the attorney might be tempted to favor the insurer because of the continuing relationship between these two parties and the lack of any future connection between attorney and insured.¹⁰⁴ Although no actual conflict of interest has yet appeared, if an insurer reserves its right to later disclaim coverage, it immediately is liable for the cost of independent counsel because such a conflict might appear at some later date.¹⁰⁵

While the court's belief that such a potential conflict of interest entitles an insured to independent counsel is disputable,¹⁰⁶ a more important question remains: Where in the policy did the court find language obliging the insurer to pay for this independent attorney? The court relied on *Tomerlin v. Canadian Indemnity Company*¹⁰⁷ in which the California Supreme Court held that the insurer cannot require the insured to surrender control of the litigation when a conflict of interest arises.¹⁰⁸ From this rule, the court in *Cumis* held that

[a]lthough *Tomerlin* did not expressly state the insurer had to pay for the insured's independent counsel under such circumstances [as arise when there exists the potential for a conflict of interest], this is necessarily implicit in the decision. If the insurer must pay for the cost of defense and, when a conflict exists, the insured may have control of the defense if he wishes, it follows the insurer must pay for such defenses conducted by independent counsel.¹⁰⁹

102. *Cumis*, 162 Cal. App. 3d at 364, 208 Cal. Rptr. at 498.

103. *Id.* at 364-65, 208 Cal. Rptr. at 498.

104. Brief for Respondent at 26, *Cumis*, 162 Cal. App. 3d 358, 208 Cal. Rptr. 494 [hereinafter Brief for Respondent].

105. For a discussion of the issue of conflict of interest as it relates to the *Cumis* decision, see Comment, *Reexamining Conflicts of Interest: When is Private Counsel Necessary?*, 17 PAC. L.J. 1421 (1986).

106. For example, as explained *infra* text accompanying notes 137-42, the insurer and its attorney must always give priority to the insured's interests.

107. 61 Cal. 2d 638, 394 P.2d 571, 39 Cal. Rptr. 731 (1964). In *Tomerlin*, the insurer provided its insured an attorney after an incident resulted in a complaint alleging assault and battery against the insured. Consequently, the insurer reserved its rights to later dispute coverage. The insured hired an independent attorney but dismissed him after the insurer stated that the reservation of rights was no longer in effect. After the insured was found liable for assault and battery, the insurer refused to indemnify him. While ruling that the insurer could not manipulate the insured such that he gives up his independent attorney and surrenders the litigation to the insurer, the court nowhere stated in its opinion that the independent attorney should be paid for by the insurer. That is, *Tomerlin* simply states that an insured is entitled to independent counsel if the insured so desires.

108. *Id.* at 648, 394 P.2d at 577, 39 Cal. Rptr. at 737. However, it should be noted that in the absence of such a conflict, the insurer retains control of the defense. *Spindle v. Chubb Pac. Indem. Group*, 89 Cal. App. 3d 706, 713, 152 Cal. Rptr. 776, 780-81 (1979).

109. *Cumis*, 162 Cal. App. 3d at 369, 208 Cal. Rptr. at 501-02.

The court failed, however, to cite an ambiguous provision in the policy enabling it to make this ruling. Additionally, it failed to identify the reasonable expectation of the insured entitling him to this payment. Rather, the court rewrote an unambiguous policy to provide an additional benefit to the insured at the expense of the insurer.

The court of appeal, in effect, gave no rationale for its holding. By not doing so, the court failed to recognize that it was deciding a contract dispute.¹¹⁰ The court could have tried to liberally apply the rules of construing an insurance contract. By not applying contract principles at all, however, the court ignored the fact that an agreement had been reached between insurer and insured that should have been honored. Even if a contract of adhesion, the policy at least represented the reasonable expectations of the two parties which should have guided the court in its application of the contract's terms. Both parties had bargained for the policy, the insurer providing coverage in exchange for the insured's premium.¹¹¹ A contract had been signed, necessitating the application of contract principles in its interpretation, albeit weighted heavily in favor of the insured.¹¹² The court was on solid ground in its analysis leading up to its ultimate decision that an insurer must defend any action that might be covered under the policy by relying on *Gray* and its application of contract rules. However, the court went beyond *Gray* (and even beyond *Executive Aviation*) and imposed a tremendous burden on the insurer by requiring the insurer to provide independent counsel if it simply reserves its right to later dispute coverage. Had the court applied the principles of *Gray*, it would have had a more difficult time ruling that independent counsel should be provided in such cases paid for by the insurance company. This might explain the route taken by the

110. In a footnote, the court cited those decisions which supported its decision. *Id.* at 373 n.9, 208 Cal. Rptr 504 n.9. However, only two decisions, *Magoun v. Liberty Mutual Ins. Co.*, 346 Mass. 677, 195 N.E.2d 514 (1964), and *Employers' Fire Ins. Co. v. Beals*, 103 R.I. 623, 240 A.2d 397 (1968), included the court's rationale that the insurance contract was too uncertain in that the insurer could have "included in the covenant to defend explicit provisions concerning the cost of defense in various situations," *Magoun*, 346 Mass. at 685, 195 N.E.2d at 519, or could have "set forth its provisions in such clear and distinct language as would have avoided any doubt relative to the extent of its duty to defend." *Employers' Fire Ins. Co.*, 103 R.I. at 635, 240 A.2d at 404. One other court cited in *Cumis* touched briefly on the contractual basis for its holding. In *Maryland Casualty Co. v. Peppers*, 64 Ill. 2d 187, 199, 355 N.E.2d 24, 30 (1976), the Illinois Supreme Court merely stated that "[b]y reason of [the insurer's] contractual obligation to furnish [the insured] a defense it must reimburse him for the reasonable cost of defending the action." 64 Ill. 2d at 199, 355 N.E.2d at 30.

111. See *supra* note 29 for examples of cases holding an insurance policy is a contract.

112. See *supra* text accompanying note 40 for a description of this policy.

Cumis court.

The "reasonable expectation" aspect of *Gray* is probably the most difficult principle to harmonize with the decision in *Cumis*.¹¹³ As stated in *Gray*,

[a]n examination of the policy discloses that the broadly stated promise to defend is not conspicuously or clearly conditioned solely on [a particular event, in this case on] a nonintentional bodily injury; instead, the insured could reasonably expect such protection [in cases that might be found to involve such an injury].¹¹⁴

An insured undoubtedly can expect a defense from his insurance company when a suit is filed against him. Expecting two defenses each of which is to be paid for by the insurer when there is a mere possibility of a conflict of interest is, however, unreasonable.¹¹⁵

In fact, in its letter to *Cumis* before trial of the underlying suit, the Credit Union stated that it desired *Cumis* to settle the underlying action. The letter read: "You [*Cumis*] should know that the Credit Union desires the lawsuit to be settled without trial. Our insurance coverages, duly paid and contracted for, are precisely for such cases and any settlement liability that may arise therefrom."¹¹⁶ The Credit Union itself explained what it expected from *Cumis*: Representation in its best interests,¹¹⁷ not independent counsel to be paid by *Cumis*.¹¹⁸ The court in *Cumis* thus has silently abandoned the previous position that the reasonable expectation of the insured will govern the extent of the coverage supposedly agreed upon by both parties.¹¹⁹

Additionally, the court seemingly has violated the rule that a

113. Ironically, the credit union argued that the policy itself was ambiguous and that it could reasonably expect an independent attorney to be paid for by *Cumis*. The credit union argued further that since the policy was silent on the issue of a defense in conflict of interest situation, the policy not only should be strictly construed against *Cumis* but also *Cumis* should pay for an independent attorney. Brief for Respondent, *supra* note 104, at 23-24. Unfortunately, the court failed to address these contentions in its opinion.

114. *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 272, 419 P.2d 168, 173, 54 Cal. Rptr. 104, 109 (1966).

115. As argued by *Cumis*, this situation is different from that in which there is an actual conflict of interest as in *Executive Aviation*. In the latter case, an insured reasonably may expect payment for an independent attorney because the company will act in its own interests which are contrary to those of its insured. Yet, the insurer is obligated always to act in the insured's best interests. See *infra* text accompanying notes 137-42. The only way that the insurer can do both is to hire independent counsel for its insured.

116. *Cumis*, 162 Cal. App. 3d at 365, 208 Cal. Rptr. at 499.

117. See *infra* text accompanying notes 137-42 for a discussion regarding *Cumis*' obligation to favor the credit union's interests at all times during the suit.

118. The credit union's letter indicated that it was satisfied with the attorney provided by *Cumis* although it did express its wish that the suit be settled.

119. For application of the "reasonable expectation" doctrine, see discussion of *Gray*, *supra*, text accompanying notes 64-85.

court should not strain to find an ambiguity where none exists.¹²⁰ Again, this relates to the reasonableness of the interpretation of the language of the policy. That is, there must be two fair and reasonable meanings of the words used in the policy before the court can intercede.¹²¹ Yet, the problem with the court's decision in *Cumis* is whether a duty to defend can be interpreted to require payment for an independent lawyer. The insurer in *Cumis* contended that it had satisfied the requirement of *Gray* when it provided a defense for its insured. The court, however, dispensed with this argument by distinguishing the facts of *Gray*.¹²² Rather than relying on the express law in *Gray* that an insurer must defend any action on behalf of its insured which potentially is covered by the policy, the court turned to the implications it found in *Tomerlin*. The question remains, however, whether there is any ambiguity in a duty to defend clause after *Gray*. Specifically, if no reasonable interpretation of, and hence reasonable expectation concerning, the duty to defend included payment for an independent lawyer, the court completed its analysis of this duty with its ruling in *Gray*.

By failing to identify the provision or provisions in the policy that could be interpreted as requiring payment for another lawyer, the court in *Cumis* created ambiguity in the policy where none existed which arguably makes meaningless the express terms of the contract. This creates uncertainty in contractual obligations since the court could, and arguably did in *Cumis*, violate the intentions of the parties through its own interpretations. By simply reaching its decision in *Cumis*, the court has created a new role for itself: Drafter, rather than interpreter, of an insurance contract. The court never addressed its assumption of this expanded role, preferring to hold that the duty to pay for other counsel is implicit in prior decisions.¹²³

Finally, the court failed to explain its holding with regard to the

120. See *New York Life Ins. Co. v. Hollender*, 38 Cal. 2d 73,81,237 P.2d 510,514 (1951).

121. *Continental Savings Ass'n v. United States Fidelity and Guaranty Co.*, 762 F.2d 1239,1245 (5th Cir. 1985), modified 768 F.2d 89 (5th Cir. 1985) (quoting *Entzinger v. Provident Life and Accident Ins. Co.*, 652 S.W.2d 533, 535-36 (Tex. Civ. App. 1st Dist. 1983)).

122. The court stated that "*Gray* is not controlling here because it does not address whether the scope of the duty to defend includes payment for the insured's independent counsel where a conflict of interest exists." *Cumis*, 162 Cal. App. 3d at 368, 208 Cal Rptr. at 501. However, *Gray* in fact ruled that the insurer was legally and ethically responsible for the defense of its insured, even in cases involving conflicts of interest, which was language seemingly broad enough to include the present situation. *Gray*, 65 Cal. 2d at 279 n.18, 419 P.2d at 178 n.18, 54 Cal. Rptr. at 114 n.18.

123. *Cumis*, 162 Cal. App. 3d at 369, 208 Cal. Rptr. at 501-02.

decision in *Jarrett v. Allstate Insurance Company*¹²⁴ in which the court held that it would not construe an insurance policy so as to create a liability where none had existed. In order to decide *Cumis*, the court necessarily had to find a preexisting duty to provide and pay for independent counsel. However, no reference was made to any such obligation; rather, the court appeared to create the duty in its decision. Had an insurance company promised to pay for independent counsel in its policy, this commitment should have been found in *Gray* as that case involved similar allegations against the insured.¹²⁵ There, the court instead restricted its holding to providing a defense, not paying for two counsels. The *Cumis* court deviated from the holding in *Gray* that the insurer's contractual commitment extended only to providing a defense, not paying for a defense conducted by an independent lawyer. There is no indication in either *Cumis* or *Gray* that the insurer had explicitly or implicitly assumed the duty to make such payments in its policy. Yet, the court in *Cumis* failed to identify from where in the insurance contract the duty to pay for independent counsel arose.

The court also failed to note that prior to *Cumis*, an aggrieved insured did have an adequate remedy. If an insured believed that he had been treated improperly by his insurer or inadequately represented by counsel, he could bring an action against the insurer. Such suits alleged a breach of the covenant of good faith and fair dealing,¹²⁶ a clause which is "in every contract, including policies of insurance, . . . that neither party will do anything which will injure the right of the other to receive the benefits of the agreement."¹²⁷ The California Supreme Court has specifically recognized that "[o]ne of the most important benefits of a maximum limit policy is the assurance that the company will provide the insured with defense and indemnification for the purpose of pro-

124. 209 Cal. App. 2d 804, 26 Cal. Rptr. 231 (1962).

125. Both cases involved conflicts of interest in terms of demands in excess of policy limits and allegations that the insured's actions were intentional and hence not covered by the policy.

126. "Although the covenant [of good faith and fair dealing] is couched in contractual terms, it is largely a creation of tort law." *San Jose Production Credit Ass'n v. Old Republic Life Ins. Co.*, 723 F.2d 700, 703 (9th Cir. 1984).

127. *Crisci v. Security Ins. Co. of New Haven*, 66 Cal. 2d 425, 429, 426 P.2d 173, 176, 58 Cal. Rptr. 13, 16 (1967) (citing *Comunale v. Traders and Gen. Ins. Co.*, 50 Cal. 2d 654, 328 P.2d 198 (1958)). There is a reciprocal duty imposed on the insured by his policy to act in good faith toward the insurance company. However, the insurance company's duty to act in good faith is unconditional. Therefore, a breach of the covenant of good faith and fair dealing by the insured does not justify a similar breach by the insurer. *Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 566, 577-78, 510 P.2d 1032, 1040, 108 Cal. Rptr. 480, 488 (1973).

protecting him from liability."¹²⁸ This duty is not merely found in case law. There are also statutory provisions prescribing the conduct of both the insurance company¹²⁹ and the attorney¹³⁰ in deal-

128. *Commercial Union Assurance Companies v. Safeway Stores, Inc.*, 26 Cal. 3d 912, 918, 610 P.2d 1038, 1041, 164 Cal. Rptr. 709, 712 (1980).

129. CAL. INS. CODE § 790.03 (West Supp. 1986), also known as the Unfair Practices Act, provides in pertinent part:

The following are hereby defined as unfair methods of competition and unfair and deceptive acts or practices in the business of insurance . . . (h) Knowingly committing or performing with such frequency as to indicate a general business practice any of the following unfair claims settlement practices:

(1) Misrepresenting to claimants pertinent facts or insurance policy provisions relating to any coverages at issue.

(2) Failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies.

(3) Failing to adopt and implement reasonable standards for the prompt investigation and processing of claims arising under insurance policies.

(4) Failing to affirm or deny coverage of claims within a reasonable time after proof of loss requirements have been completed and submitted by the insured.

(5) Not attempting in good faith to effectuate prompt, fair, and equitable settlements of claims in which liability has become reasonably clear.

(6) Compelling insureds to institute litigation to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in actions brought by such insureds, when such insureds have made claims for amounts reasonably similar to the amounts ultimately recovered.

(7) Attempting to settle a claim by an insured for less than the amount to which a reasonable man would have believed he was entitled by reference to written or printed advertising material accompanying or made part of an application.

(8) Attempting to settle claims on the basis of an application which was altered without notice to, or knowledge or consent of, the insured, his representative, agent, or broker.

(9) Failing, after payment of a claim, to inform insureds or beneficiaries, upon request by them, of the coverage under which payment has been made.

(10) Making known to insureds or claimants a practice of the insurer of appealing from arbitration awards in favor of insureds or claimants for the purpose of compelling them to accept settlements or compromises less than the amount awarded in arbitration.

(11) Delaying the investigation or payment of claims by requiring an insured, claimant, or the physician of either, to submit a preliminary claim report, and then requiring the subsequent submission of formal proof of loss forms, both of which submissions contain substantially the same information.

(12) Failing to settle claims promptly, where liability has become apparent, under one portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy coverage.

(13) Failing to provide promptly a reasonable explanation of the basis relied on in the insurance policy, in relation to the facts or applicable law, for the denial of a claim or for the offer of a compromise settlement.

(14) Directly advising a claimant not to obtain the services of an attorney.

(15) Misleading a claimant as to the applicable statute of limitations.

This statute has been the basis for recovery by an insured even if the insurer was accused of one instance of misconduct provided that the action was knowingly done or was part of a regular business practice. *Colonial Life & Accident Ins. Co. v. Superior Court*, 31 Cal. 3d 785, 647 P.2d 86, 183 Cal. Rptr. 810 (1982).

130. CAL. BUS. & PROF. CODE § 6068 (West Supp. 1986) provides that

It is the duty of an attorney to do all of the following:

(a) To support the Constitution and law of the United States and of this state.

(b) To maintain the respect due to the courts of justice and judicial officers.

ing with an insured when a suit is brought against the insured.

If an insured prevailed in such a suit, he could be awarded general damages,¹³¹ damages for emotional distress,¹³² attorney's fees in the underlying suit brought against him by the injured party¹³³ and punitive damages if he could prove that the insurer acted "maliciously, with an intent to oppress, [or] in conscious disregard of the rights of its insured."¹³⁴ Punitive damages could be awarded on a showing of an established course of action by the insurer.¹³⁵ The possibility of recovery by an insured seems to adequately protect him from any tortious behavior on the part of the insurer or its attorney. Conversely, this possibility of recovery, especially of punitive damages,¹³⁶ seemingly would also cause the insurer to treat its insured with the utmost degree of care.

An issue then arose as to when an insured could successfully bring a bad faith action against his insurer or his attorney. Once an insurer accepts the tender of a defense from its insured, it is obligated to act in the best interests of its insured at all times.¹³⁷

(c) To counsel or maintain such actions, proceedings or defenses only as appear to him or her legal or just, except the defense of a person charged with a public offense.

(d) To employ, for the purpose of maintaining the causes confided to him or her such means only as are consistent with truth, and never to seek to mislead the judge or any judicial officer by an artifice or false statement of fact or law.

(e) To maintain inviolate the confidence, and at every peril to himself or herself to preserve the secrets, of his or her client.

(f) To abstain from all offensive personality, and to advance no fact prejudicial to the honor or reputation of a party or witness, unless required by the justice of the cause with which he or she is charged.

(g) Not to encourage either the commencement or the continuance of an action or proceeding from any corrupt motive of passion or interest.

(h) Never to reject, for any consideration personal to himself or herself, the cause of the defenseless or the oppressed.

(i) To cooperate and participate in any State Bar proceeding pending against the attorney. However, this subdivision shall not be construed to deprive an attorney of any constitutional or statutory privileges.

131. *Silberg v. California Life Ins. Co.*, 11 Cal. 3d 452, 521 P.2d 1103, 113 Cal. Rptr. 711 (1974).

132. *Crisci*, 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13.

133. *Brandt v. Superior Court*, 37 Cal. 3d 813, 693 P.2d 796, 210 Cal. Rptr. 211 (1985).

134. *Neal v. Farmers Ins. Exchange*, 21 Cal. 3d 910, 923, 582 P.2d 980, 986-87, 148 Cal. Rptr. 389, 395-96 (1978).

135. *Id.*

136. *See, e.g., Moore v. American United Life Ins. Co.*, 150 Cal. App. 3d 610, 197 Cal. Rptr. 878 (1984).

137. *Ivy v. Pacific Automobile Ins. Co.*, 156 Cal. App. 2d 652, 659, 320, P.2d 140, 146 (1958), where the court stated:

The insurance company has the legal right to try and protect its own financial interests, but when those interests conflict with those of the insured, the company must, in good faith, give consideration to the interests of the insured. It has no right to sacrifice the interests of the insured in order to protect its own interests. Therefore, arguably there are no conflicts of interests in insurance defense cases. Any time

Additionally, "[i]nsofar as the insured is concerned the attorney owes him the same obligations of good faith and fidelity as if he had retained the attorney personally."¹³⁸ There are three major types of cases in which a bad faith suit can be maintained successfully: (1) those in which the insurer wrongfully refuses to accept the defense of its insured;¹³⁹ (2) those in which the insurer, once it agrees to defend the action, refuses to accept a settlement offer within the policy limits;¹⁴⁰ and (3) those in which the lawyer retained by the insurer acts to the detriment of the interests of the insured.¹⁴¹ In all of these situations, the insurer has promoted its own interests to the detriment of the insured entitling the insured to damages. The court in *Cumis*, however, failed to explain its reason for not having the credit union pursue this remedy.¹⁴² Ap-

the desires of the insured and the insurer collide, the interest of the former must take precedence over that of the latter. As recognized by the Oregon Supreme Court,

[i]f the judgment in the original action is not binding upon the insurer or insured in a subsequent action on the issue of coverage, there would be no conflict of interests between the insurer and the insured in the sense that the insurer could gain any advantage in the original action which would accrue to it in a subsequent action in which coverage is in issue.

Therefore, the Oregon Supreme Court held, the rule of estoppel by judgment should not be applied in actions involving insurance coverage. *Ferguson v. Birmingham Fire Ins. Co.*, 254 Or. 496, 511, 460 P.2d 342, 348-49 (1969).

138. *Lysick v. Walcom*, 258 Cal. App. 2d 136, 146, 65 Cal. Rptr. 406, 413 (1968). See also *Egan v. Mutual of Omaha Ins. Co.*, 24 Cal. 3d 809, 818-19, 598 P.2d 452, 456, 157 Cal. Rptr. 482, 486 (1979), where the California Supreme Court stated that "[f]or the insurer to fulfill its obligation not to impair the right of the insured to receive the benefits of the agreement, it must again give at least as much consideration to the latter's interest as it does to its own."

139. See e.g., *Samson v. Transamerica Ins. Co.*, 30 Cal. 3d 220, 636 P.2d 32, 178 Cal. Rptr. 343 (1981).

140. See *Crisci*, 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13, in which the California Supreme Court stated that *Comunale*, 50 Cal. 2d 654, 328 P.2d 198, makes clear that "liability based on an implied covenant exists whenever the insurer refuses to settle in an appropriate case and that liability may exist when the insurer unwarrantedly refuses an offered settlement where the most reasonable manner of disposing of the claim is by accepting the settlement." 66 Cal. 2d at 430, 426 P.2d at 176-77, 58 Cal. Rptr. at 16-17. See also *Samson*, 30 Cal. 3d 220, 636 P.2d 32, 178 Cal. Rptr. 343; *Johansen v. California State Automobile Association Inter-Insurance Bureau*, 15 Cal. 3d 9, 538 P.2d 744, 123 Cal. Rptr. 288 (1975).

141. *Ivy*, 156 Cal. App. 2d 652, 320 P.2d 140, in which the insurer's attorney committed the insured to a judgment in excess of his policy limits without disclosing this action with the insured. The court had little difficulty finding this to be a breach of the covenant of good faith and fair dealing.

142. The credit union possibly could have prevailed in a bad faith suit against *Cumis*. The credit union could have argued two theories: First, *Cumis* never discussed the proposed settlement in the Eisenmann action with the credit union. Thus, as in *Ivy*, the insurer acted without informing the insured, in effect exposing the latter to liability because of the punitive damages award. This implies that *Cumis* did not properly promote the credit union's interests. Second, *Cumis* did not settle the underlying litigation despite a demand within the policy limits. *Cumis* might have been found to have violated its statutory duty to settle under California Insurance Code § 790.03(h)(5) as well as the implied covenant of good faith and fair dealing because the credit union became obligated to pay

parently the court has tacitly disapproved of the existing solution of a bad faith suit brought by an insured without commenting as to any deficiencies in such relief.

The opinion in *Cumis* appears incomplete because it failed to include any discussion of accepted contract principles and any explanation of the inadequacy of the existing course of remedial action. If the court had acknowledged that the insurance policy is a contract and had attempted to apply the corresponding rules of interpretation, the decision, while perhaps not popular with certain parties and industries, at least would have avoided some of the uncertainties which it has created.

VII. THE PRESENT AND POTENTIAL RAMIFICATIONS OF *CUMIS*

Thus far, only a handful of cases have begun the long process of refining the *Cumis* ruling.¹⁴³ However, the courts have yet to issue definitive answers to such questions as: 1) What are reasonable attorney's fees; 2) how, or whether, an insurer can effectively reserve its rights to later assert a coverage defense without subjecting itself to the requirement of paying for independent counsel; 3) how much, if any, information must be shared between the attorneys; 4) what is the liability, if any, of the insurer when it fails to meet its statutory duty to settle under California Insurance Code sec. 790.03(h)(12) because the independent attorney refuses to authorize a settlement; and 5) what is the liability, if any, of the insurer's attorney for the bad faith actions of the independent counsel? Many other issues likely will arise in the future.

The *Cumis* decision initially has caused confusion and consternation in the insurance industry with regard to the proper action to be taken when faced with a situation in which a reservation of rights letter had previously sufficed. The potential ramifications of *Cumis*, however, extend much further. By avoiding established contract principles,¹⁴⁴ the court has left uncertain the viability and enforceability of the express provisions of the insurance contract. While a court will almost certainly never dispense with an insur-

punitive damages it could have avoided had the case settled. Thus, *Cumis* would have been liable for all resulting damages from the judgment against the credit union in the underlying suit. See *Samson*, 30 Cal. 3d 220, 636 P.2d 32, 178 Cal. Rptr. 343; *Johansen*, 15 Cal. 3d 9, 538 P.2d 744, 123 Cal. Rptr. 288.

143. See, e.g., *McGee v. Superior Court*, 176 Cal. App. 3d 221, 221 Cal. Rptr. 421 (1985); *Bogard v. Employers Casualty Co.*, 164 Cal. App. 3d 602, 210 Cal. Rptr. 578 (1985) in which the courts pointed out that an independent attorney must be paid for by the insurer only in cases in which a coverage dispute exists.

144. These principles include those that have been identified *supra* text accompanying notes 29-47, including the definition of ambiguity, the role of the court in resolving such uncertainties and the restraint exercised by the court when no ambiguities are found.

ance policy in its entirety, the holding in *Cumis* nevertheless represents a significant departure from the usual role of the court in deciding insurance cases. The court in effect rewrote the insurance contract to impose an obligation on the insurer where none had previously existed.¹⁴⁵ The problem with this action is twofold. First, the cost of insurance necessarily will increase. Rather than hiring one lawyer to represent its interests and those of its insured, the insurance company now must pay for an additional attorney for the insured, if he so requests, if there is a possibility of a conflict of interest.¹⁴⁶ This increase in costs will have to be accounted for in some way.¹⁴⁷ The increased costs most likely will be passed on to the consumer in the form of even higher rates or perhaps in the form of elimination of certain types of coverage if the costs become astronomical.

This detrimental aspect of *Cumis*, however, is relatively minor compared to the holding's second potential effect. Assuming first that a bad faith suit does not adequately protect an insured in potential conflict of interest situations and second that an insured does need independent representation, the question still remains in the *Cumis* ruling: Where in the insurance contract did the insurer agree to pay for such counsel when it merely reserves its right to later dispute coverage? The court failed to view the policy as a contract, apparently preferring to base its decision on ethical principles.¹⁴⁸ The *Cumis* holding would be more palatable had the court recognized the settled principle that an insurance policy is a contract subject to certain rules of interpretation. While any alter-

145. That the court did the same thing in *Executive Aviation*, is arguable; however, the holding in that case was not as far-reaching since it was applied only to actual controversies whereas *Cumis* seemingly applies to any and all possible conflicts of interest. Further, as noted above, the court attempted to use some rules of contract interpretation in *Executive Aviation*. See *supra* text accompanying notes 97-98.

146. While the number of insureds requesting additional counsel cannot be predicted, the potential for such demands is tremendous because of the general practice of pleading numerous alternative theories of recovery. Many of these causes of action include prayers for punitive damages which are not covered by insurance policies, immediately creating a conflict of interest.

147. Although the exact increase in costs is unknown, see, e.g., Berg, *After Cumis: Regaining Control of the Defense*, FOR THE DEFENSE, Aug. 1985, at 13, 14, wherein the author estimates that a suit "which might have been defended quite adequately for \$50,000 to \$100,000 may ultimately cost the insurer ten to twenty times that amount."

148. The court arguably has the inherent power to create rights and duties as it sees fit: This is what it has done with the implied covenant of good faith and fair dealing which is not expressly found in an insurance policy. There are three difficulties with such an assertion, however: First, if the court was creating a new duty, it should have stated it was doing so; second, the implied covenant of good faith and fair dealing is found in every contract, not just insurance policies; and third, a duty such as good faith and fair dealing obligates both parties to conduct themselves in certain ways. The increased duty found in *Cumis*, however, falls squarely on the insurer. If the court is to imply a new provision in a policy, the provision should be one that has reciprocal rights and duties.

native rationale admittedly would be subject to its own criticisms,¹⁴⁹ at least the court could have preserved the integrity of the insurance policy as a binding agreement.

While the outcome of *Cumis* may not be liked, the way in which the court reached its decision is far more disturbing. The implication of the court's reasoning is unclear with respect to the strength of the policy as an instrument which describes the rights and obligations of the parties. If the court disregards the words of the policy and the reasonable expectations of the parties involved, there is no longer any use for the policy itself. Instead, the liability of the insurer will depend on a court's ruling. Neither insurer nor insured will be able to foresee their respective obligations or rights which were previously enumerated in the policy. The court may have unnecessarily cast itself in a new, and perhaps unwanted, role in which it will have to redefine and apply the seemingly clear and unambiguous provisions of a policy which had been agreed upon by both insurer and insured.

For example, assume A is driving B in A's car. B distracts A who collides with another car injuring those occupants. They sue B for negligence in distracting A. B tenders defense of the suit to his automobile insurance company claiming that he was "using" the automobile as defined in his liability policy because, even though he was not driving, he was being transported in the car which is its normal purpose. In light of *Cumis*, B's insurer would probably be reluctant to refuse the defense despite this strained application of the word "use" by B. Arguably, if *Cumis* indeed reduces the applicability of contract principles, the insurer can no longer claim that this is not the sort of protection that B could reasonably expect from it, nor that the defense would create an obligation of the insured where none had previously existed. In fact, the insurer could not issue a reservation of rights without facing the potential of being financially responsible for another lawyer. Instead, the insurance company unhappily might have to defend B even though it had no intention of protecting against this sort of risk when it issued the policy.¹⁵⁰

149. Although it would have been more difficult to reach, the same ruling could have been reached by, perhaps, finding that the insured had a reasonable expectation of payment for independent counsel or that there was some ambiguity in the policy justifying the decision.

150. This situation actually was brought before a court in *Potomac Ins. Co. v. Ohio Casualty Ins. Co.*, 188 F. Supp. 218 (N.D. Cal. 1960). The court held that B's insurance company was not obligated to defend him, stating:

It is the opinion of his court that no reasonable person could thusly construe the language of the policy; to do so would, in effect, extend its coverage to any situation wherein the insured is the occupant of the automobile. Clearly, this is neither the intended nor apparent meaning of the policy.

Further, that the court restricted its holding in *Cumis* to the duty to defend is not clear. That is, by not recognizing an insurance policy as a contract, the normal rules of determining liability may also have been correspondingly expanded. Although this issue has not been addressed, if the court continues in this active role, there are in reality few, if any, limitations on the imposition of liability where an insurance policy is not recognized as a contract. Thus, in the above example, B's insurer may be responsible not only for B's defense, but also for the damage to the injured persons if the court stretches the terms in the policy to include this situation.

VIII. POSSIBLE SOLUTIONS TO *CUMIS*

A number of solutions have been proposed to eliminate or at least deal with the requirements of *Cumis*.¹⁵¹ The most drastic suggestion is that an insurer simply delete the duty to defend clause from its policy. This would be an unsatisfactory step, however, for two primary reasons. First, an insurer would not want to surrender its interest in reaching a settlement or in defending a suit. If it did so, the insurer would be bound by the actions of the insured, the reverse of what the *Cumis* decision purported to eliminate. Second, due to the view of some courts that insurance policies are contracts of adhesion, a court might not allow an insurer to eliminate this clause which would place the entire responsibility for a defense on the insured.¹⁵²

A second solution is that an insurer limit the cost of defense it would be willing to assume. Here again, however, the same problems as described above would be encountered, although on a lesser scale, as the insurer would participate to a predetermined point. After this point, the insurer would withdraw from the litigation, shifting the remaining burden to the insured.

Another solution is that an insurer participate in the selection of independent counsel as allowed by *New York State Urban Development Corp. v. VSL Corp.*¹⁵³ This would allow an insurer at least

However, as discussed *supra* text accompanying notes 113-19, courts may no longer be applying the "reasonable expectations" standard. Therefore, a court today might not follow this precedent. The argument could be made that the insurer should expressly disclaim liability in situations such as this in its policy. This example, however, also demonstrates the immense difficulty that would be encountered in trying to provide for any and all possible circumstances.

151. For a more detailed discussion of each of the following, see Berg, *supra* note 147, at 14-19.

152. Kornblum and Olson, *The Cumis Decision: When Does it Control in Conflict Situations?*, VERDICT, Nov. 1985, at 12.

153. 738 F.2d 61, 65 (2d Cir. 1984) where the Court of Appeals admitted that "it is not inherently objectionable to permit an insurer to participate in the selection of indepen-

to choose competent counsel and perhaps control the cost of litigation to a limited degree.

None of these solutions, nor any others proposed to date, address the issue that the policy nowhere requires the insurer to assume the cost of the additional representation. Perhaps the best solution is simply to return to the pre-*Cumis* situation: If an insured feels he has not received competent representation, he can bring a bad faith suit against his insurer. The court has seemingly assumed that insurance companies and their lawyers will work to the detriment of the insured in all cases. However, the spectre of a bad faith suit against the insurer and the attorney in reality forces both to act in the best interests of the insured at all times. Further, the cost of this additional lawyer would be avoided which would benefit all insureds. Litigation would also progress in a much smoother fashion as only one attorney would be involved on behalf of the insured and insurer.¹⁵⁴ Finally, the principle that an insurance policy is a contract would remain in force, relieving the court of its new duty of resolving potentially all disputes between insurer and insured. All of these results would be accomplished without eroding an insured's rights to a defense for he would have the bad faith suit available as a remedy for any wrongs committed by the insurer or its attorney.¹⁵⁵

CONCLUSION

Admittedly, the insurance industry is a business which seeks profits. Therefore, insurance companies draft their policies to enable them to profit while satisfying consumer needs. A conflict exists between insurer and insured because of the necessity of insurance in today's world.¹⁵⁶ The costs faced by the consumer who fails to secure insurance are such that adequate coverage is of the utmost importance. An insured is placed in an inferior bargaining position to his insurer because of this pressing need. Due to the very real lack of bargaining power in negotiating insurance policies, an insured does require protection from arbitrary or even

dent counsel for the insured as long as the insurer discharges its obligation in good faith and the attorney chosen is truly independent and otherwise capable of defending the insured." See also *Suffolk County Patrolmen's Benevolent Ass'n, Inc. v. County of Suffolk*, 751 F.2d 550, 551 (2d Cir. 1985).

154. In contrast, in the underlying suit in *Cumis*, there were three defendants (the Credit Union and two of its employees), meaning at a minimum, four attorneys could be involved, one to represent *Cumis'* interests, and one for each of the defendants.

155. Of course, in future cases, a court could simply apply the contract principles which the *Cumis* court failed to address. By its silence, however, the *Cumis* court may have tacitly admitted that it could not invoke these rules and come to the same ruling.

156. The insurer wants to operate at a profit and thus reduce expenses while the insured desires the greatest benefits at the lowest cost.

wrongful actions by its insurer. However, an insurance policy is in reality a contract between the insurer and insured. Thus, while the insured's needs may weigh more heavily in policy interpretation questions because of the insurer's superior bargaining strength, a balance between the interests of the two parties must nevertheless be reached. While the insurer may not disregard its insured in its actions, neither may the insured's wishes be promoted without respect for the insurer's wishes, since this is not what the insurer had bargained for. The standard rules of contract interpretation, modified to compensate for the insured's weaker voice, strike the necessary balance between the competing interests of the two.¹⁵⁷

A critical aspect of any insurance policy to both parties is the right and duty of an insurer to defend actions brought against the insured under his policy. The prospect of liability compels the insurer to accept the defense of such suits to protect its interests. With the inclusion of a duty to defend clause in the contract comes the assumption and expectation by the insured that part of the premium he pays entitles him to such a defense.¹⁵⁸ The problem that courts must then resolve is the extent of the insurer's obligation and the insured's expectations.

The court in *Cumis*, however, both failed to act in its traditional role as interpreter of a vague instrument and failed to determine and apply the credit union's reasonable expectations of a defense under its policy with *Cumis*. Instead, the court itself decided that *Cumis*' policy tacitly contained the obligation that *Cumis* would pay for an independent attorney when it issued a reservation of rights. The court failed to note any ambiguity in the policy with respect to the duty to defend to justify its rewriting the express provisions as it did. Nor did it indicate that the credit union reasonably expected to be represented by an independent attorney to be paid for by *Cumis*.¹⁵⁹

In summation, this Note has explained those contract rules that should apply to the interpretation of insurance policies and their application prior to *Cumis* with regard to the insurer's duty to defend.¹⁶⁰ Then it examined the changes that *Cumis* has made in

157. The primary compensatory device employed by the courts is to resolve any and all ambiguities in the policy in favor of the insured. *See supra* text accompanying note 40.

158. Prior to *Cumis*, this expectation was limited initially by the requirement that the actions alleged against the insured be covered by the policy although after *Gray*, the scope of covered actions, at least for defense purposes, was extremely broad.

159. *Cumis* did pay the first two bills in nominal amounts before it had ascertained that there was no existing conflict of interest. But, once the conclusion had been reached that there was no conflict, *Cumis* immediately indicated to the credit union that it would not pay any further costs of the independent attorney. *Cumis*, 162 App. 3d at 363, 208 Cal. Rptr. at 497.

160. *See supra* text accompanying notes 29-99.

this duty to defend, identifying the failure of the court to apply general contract principles.¹⁶¹ This Note then analyzed the dangers of the court's embarking on this course of active interference in contractual relations.¹⁶² Finally, it argued that the remedy in effect prior to *Cumis* was more than adequate to protect the interests of the insured.¹⁶³

Initially, of course, the focus of insurance companies' dismay is their increased costs. The argument that a bad faith suit was an adequate remedy for an insured injured by the acts of an insurer has a great deal of merit. A bad faith suit allowed recovery not only for the judgment rendered against the insured, but also emotional distress and even punitive damages. Contrary to the court's implications, an insured was protected from wrongful conduct by both the insurer and its attorney. Now, however, the insurer must incur the expense of two attorneys, dramatically increasing its costs.

While the decision may be disliked for this reason, a potentially more damaging result may emerge from *Cumis*. On its face, *Cumis* makes serious inroads into the viability of insurance policies. Unless the courts restrict the holding in *Cumis*, an insurance policy may become worthless. Every claim submitted by an insured to his insurer may have to be litigated in a court to determine whether a duty to defend exists. Neither the insured nor the insurer will be able to determine the scope of that duty by looking to the terms of the policy, as by its holding, the court in *Cumis* has implied that such terms no longer are binding. Instead, arbitrary decisions from a court will decide the rights and obligations of the parties. Neither party will be certain of their duties or of their standing with respect to whether the insured is protected from a certain risk. The conclusion reached in *Cumis* thus may not only have been unwarranted, but also unwise, with respect to its potentially devastating intrusion into the contractual relations between insurer and insured.

*Peter B. Lightstone**

161. See *supra* text accompanying notes 100-42.

162. See *supra* text accompanying notes 143-50.

163. See *supra* text accompanying notes 154-55.

* This Note is dedicated to my family, and especially my parents, without whose love and support I would not have come this far.