
# How to break that dog of sucking eggs

## *Defeating insurance defense counsel's sneaky tactics*

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Invariably in our insurance coverage and bad-faith practice, we run across certain defendants and/or defense attorneys who frequently file frivolous motions and generally do what they can to waste time. We refer to these characters as egg-sucking dogs. The reason for the nickname is simple: Like an egg-sucking dog, these attorneys and insurers are seemingly addicted to doing what they know is wrong.

According to one court,

> It is a fact of common knowledge that when a dog has once acquired the habit of egg-sucking there is no available way by which he may be broken of it, and that there is no calculable limit to his appetite in the indulgence of the habitual propensity. And generally he has a sufficient degree of intelligence that he will commit the offense, and return to it upon every clear opportunity, in such a stealthy way that he can seldom be caught in the act itself.

*Hull v. Scruggs* (1941) 2 So.2d 543, 544.

With all due respect to the learned justices, we are here to tell you that you can break that dog of sucking eggs. The secret is to catch it in the act and slap a little turpentine on that dog's behind (according to *the great sage* Dick Sangster.) Presented below are three egg-sucking scenarios: a frivolous demurrer, discovery obstructionism, and the failure to suggest Cumis counsel, and our methods for applying the turpentine.

### Part 1: The junk demurrer

One common defense tactic in litigation is delay. This is particularly true in insurance coverage and bad-faith litigation. The longer an insurer holds on to the benefits, the more money it makes. The delay tactics start the moment the suit is filed. First, insurance defendants seek a lengthy extension of time to file a responsive pleading. Then, the insurer will demur to the Complaint.

Insurers like to demur to everything. After all, if they are paying the filing fee and aren't in a single-assignment county, why not see what sticks? The most common junk demurrer we see is brought against our breach of contract causes of action (every coverage complaint has to have one). The grounds for the demurrer are, without fail, that the actual insurance contract is neither attached to the Complaint nor pled *verbatim*. Although this all-too-common demurrer is a favorite of insurance carriers, it is one you may see in your practice even if you don't practice in the insurance coverage arena as it applies to all contract claims.

What makes the demurrer for failing to attach or plead contract terms *verbatim* a junk demurrer is that it is based on outdated and superseded case law that was bad to begin with. The case that the defense will cite is an employment case from 1985: *Otworth v. Southern Pac. Transp. Co.* (1985) 166 Cal.App.3d 452. In *Otworth*, our Second District Court of Appeal stated (incorrectly citing a case from 1963) that "If the action is based on an alleged breach of a written contract, the terms *must* be set forth verbatim in the body of the complaint or a copy of the written instrument must be attached and incorporated by reference." (*Otworth v. Southern Pac. Transp. Co.* (1985) 166 Cal.App.3d 452, 459 (citing *Wise v. Southern Pac. Co.* (1963) 223 Cal.App.2d 50, 59) (emphasis added).)

The citation to *Wise* was actually a bad one. The *Wise* decision actually said that a cause of action for breach of written contract "*may* be pleaded *in haec verba* by attaching a copy as an exhibit and incorporating it by proper reference." (*Wise* at 59 (emphasis added).) Obviously, "may" is not "must," but someone thought it was important enough to codify. (E.g., Cal. Rules of Court, rule 1.5(b) (defining "must" as mandatory and "may" as permissive).)

California plaintiffs' lawyers were stuck having to explain *Otworth's* misstatement of the law until 2002, when the California Supreme Court did away with it. (*Constr. Protective Svcs., Inc. v. TIG Specialty Ins. Co.* (2002) 29 Cal.4th 189, 198-99.) *CPS* involved a company (CPS) that provided security for


construction sites. TIG was its liability insurer. One of CPS's clients (a company called SHC) tried to stiff them on a $26,000 bill, and CPS sued. Rather than file a cross-complaint, SHC claimed it was entitled to a setoff. It alleged that CPS was responsible for fire damage at one of SHC's projects. CPS tendered the setoff claim to TIG, which refused to defend CPS or pay the claim. (*Id.* at 194.)

CPS sued TIG, alleging, among other things, a cause of action for breach of contract. TIG demurred, in part, on the grounds that CPS had not attached a copy of the insurance policy to its complaint. The trial court sustained the demurrer. The Court of Appeal (citing *Wise,* but not *Otworth*), reversed. (*Id.* at 194; *Constr. Protective Svcs., Inc. v. TIG Specialty Ins. Co.* (2001) 90 Cal.App.4th 149.)

The Supreme Court affirmed. It held:

> In an action based on a written contract, a plaintiff may plead the legal effect of the contract rather than its precise language [citations omitted]. CPS has chosen to proceed in this manner, and . . . it satisfactorily alleged that (1) the insurance policy obligated TIG Insurance to defend and indemnify CPS against suits seeking damages, and (2) that under the terms of the policy, SHC's setoff claim fell within the scope of that contractual obligation.

(*CPS, supra,* 29 Cal.4th at 198-99.)

Regardless of whether *Otworth* ever contained an accurate statement of the law on this issue, the Supreme Court clearly superseded it. Unfortunately, they did not cite *Otworth*, so it still shows up as good law on both Westlaw and Lexis. Perhaps that explains why the dogs keep sucking that egg? The next time you face a demurrer for failing to attach a contract to your complaint (and if you ever sue for breach of contract, you will), keep your copy of *CPS* handy and turpentine that dog.

## Part 2: Discovery obstructionism

A favorite move for the insurance defense is to refuse to provide you with discoverable documents and then force you to make a motion to compel to get it. Insurance loss reserve information is commonly withheld. (A loss "reserve" is the amount the insurance carrier expects to pay on a claim.) The "reserves" can, and often do, change over the course of a claim to reflect additional information or changed circumstances. Defendants like to claim that loss "reserve" information is neither relevant nor reasonably calculated to lead to admissible evidence. They are wrong.

It has long been established that loss "reserve" information is discoverable in bad-faith cases against an insurer. (*Lipton v. Superior Court* (1996) 48 Cal.App.4th 1599, 1614-1615; *Bernstein v. Travelers Insurance Company* (2006) 447 F.Supp.2d 1100, 1107-08.) In *Lipton*, the court found that the loss "reserve" information could lead to admissible evidence regarding: the mental state of the claims personnel with regards to claims handling, whether the insurer had conducted a proper investigation, and/or whether the insurer had given reasonable consideration to all of the factors involved in a specific case. (*Id.* at 1614, 1616, and fn. 8.) In *Bernstein*, the court found that even under the more limited definition of relevance provided in the Federal Rules of Civil Procedure, loss "reserves" were discoverable. (*Id.* at 1107.)

Even in situations where the reserves were only changed once or were immediately set at the highest level, the plaintiff is entitled to discover that information. This is because the loss "reserves"can lead to admissible evidence regarding a variety of issues including: the knowledge or mental state of the claims handler(s) who set the reserve (i.e., how experienced they were, what factors they were considering, and are the reserves in mold claims all the same, a cookie cutter approach); whether, how, and why the valuation of the case changed over the course of time, and/or what or who caused the loss "reserves" to be changed.

For example, if a defendant immediately set the loss "reserves" at the policy limits but also refused to permit certain necessary tests, this would tend to show bad faith. Alternately, the reserve data could lead to a line of questioning in deposition regarding how the claim was analyzed at various times. Or, if the "reserves" were kept at zero even after it was shown there was coverage, that would tend to show bad faith. Conversely, the loss "reserves" could show that the insurer made reasonable valuations of the potential loss throughout the processing of the claim. Whatever amount of the loss "reserves," the information can and will lead to admissible evidence.

When an egg-sucking dog tells you that something may generally be the rule but that the rule doesn't apply in your particular case, do not believe him. Get out your motion to compel and your can of turpentine. Don't be afraid to ask for sanctions.

## Part 3: Protecting The right to a proper defense: Independent/Cumis Counsel

Imagine a situation where two next-door neighbors Joe and Bob, get into a heated argument. Bob goes inside, and Joe begins working on his side yard which is located next to Bob's driveway. Bob comes out, yells some profanity at Joe, gets in his car, and "clips" Joe while backing out of the driveway. If Bob intentionally hit Joe, there is no coverage. (See Ins. Code, § 533 (which bars coverage for willful acts).) If he drove negligently, there is coverage.

Joe files suit. He sues for battery and negligence. Bob tenders the defense to the carrier who agrees to provide a defense subject to a reservation of rights. The reservation of rights states that the carrier will not pay for any damages caused by intentional conduct. The carrier sends the defense of the case to one of its usual panel insurance defense counsel.

The insurance defense counsel is immediately placed in a conflict of interest situation because he has two clients, the insurer and Bob, with conflicting interests. It is in the best interests of Bob to


have defense counsel try to develop and present evidence in the case that Bob acted negligently. If liability is found, the carrier will have to pay the judgment. Conversely, it is in the best interests of the insurer to have insurance defense counsel develop and present the evidence in a way that, should liability be found, the insured is liable for battery, only. In such a situation, the carrier would not have to pay the resulting judgment. What should be done in this situation?

To begin with, the existence of this "potential" conflict needs to be identified at the outset of the litigation *before* insurance defense counsel takes any steps to favor one client over the other. This is because there is no distinction between a "potential" and "actual" conflict of interest with regard to the attorney's obligations to his two clients. California Rule of Professional Conduct 3-310 makes no distinction between actual and potential conflicts of interest. Rule 3-310(c)(1)-(2) states that potential conflicts are treated the same as actual conflicts. Under that rule, both types of conflict prohibit an attorney from jointly representing two clients without informed, written, consent. In *San Diego Navy Federal Credit Union v. Cumis Insurance Society* (1984) 162 Cal.App.3d 358, 371, n.7 the court explained that there can be no legitimate distinction between "potential" and "actual" conflicts of interest.

> Recognition of a conflict cannot wait until the moment a tactical decision must be made during trial. It would be unfair to the insured and generally unworkable to bring in counsel midstream during the course of trial expecting the new counsel to control the litigation. Contrary to *Cumis*' argument, the existence of conflicting interests should be identified early in the proceedings so that it can be treated effectively before prejudice has occurred to either party. (*Ibid.*)

Then, in order to deal with this situation, the *Cumis* court required that once the carrier reserved rights to deny coverage, the carrier had to pay for independent counsel whose only obligation was to represent the insured.

Three years after the *Cumis* decision, the California legislature enacted Civil Code section 2860 which requires a carrier to provide independent counsel to represent the insured when a conflict of interest arises. In subsection (b), it states that ". . . when an insurer reserves its rights on a given issue and the outcome of that coverage issue can be controlled by counsel first retained by the insurer for the defense of the claim, a conflict of interest may exist."

The factual scenario set forth above is clearly one that would require a carrier to advise the insured of the right to independent counsel to be paid for at the carrier's expense. The Rules of Professional Conduct, the reasoning of the *Cumis* decision, and Civil Code section 2860 all compel the carrier to do so.

## It started out well...

In the first few years after the *Cumis* decision was announced, and after Civil Code § 2860 was enacted (1987), carriers were fairly good about offering independent counsel to insureds when there were reservations of rights. Then, carriers began playing games with their coverage letters by saying that they were not "reserving rights" but were simply pointing out the types of claims that were not "covered" under the policy. They claimed that permitted them to refuse to provide independent counsel. Still, most carriers would offer to provide independent counsel at the beginning of the case, or would at least agree to provide such counsel when requested to do so. Over the last 20 years or so, the situation has changed. Carriers have begun to completely ignore their obligation to provide independent counsel and have increasingly refused to do so even when directly challenged on the point. They have been buoyed in this approach by three developments: bad case law, an inexperienced bar, and a lack of consequences for failing to abide by their obligations.

In cases such as *Dynamic Concepts, Inc. v. Truck Insurance Exchange* (1998) 61 Cal.App.4th 999, *James No. 3 Corp. v. Truck Insurance Exchange* (2001) 91 Cal.App.4th 1093, and *Federal Insurance Company v. MBL, Inc.* (2013) 219 Cal.App.4th 29, the courts have strayed from the reasoning of the *Cumis* decision, and ignored California Rule of Professional Conduct 3-310, by making a distinction between "actual" and "potential" conflicts of interest. The courts have said that where there is only a "potential" conflict of interest, and where the conflict is only "theoretical" rather than being "significant" (whatever that means), then the carrier does not have to offer to provide independent counsel. These decisions have no legal or conceptual support. The courts have made up these distinctions out of whole cloth. They have made no attempt to adequately address the language of Rule 3-310, or the *Cumis* decision which is directly contradictory. The policyholder bar has been attempting to reverse this trend. However, given the present makeup of the California Supreme Court and many of the Courts of Appeal, it may ultimately need to be addressed in the Legislature. (But that does not mean the courts should not be educated on this point).

Another factor which has given insurers solace in ignoring their obligations under Civil Code section 2860 is the lack of experience among plaintiff and defense counsel with these issues. During the late '70s, and early '80s, the question of whether carriers had to provide independent counsel where there was a reservation of rights was a hot topic among insurers, insurance defense counsel, coverage attorneys, and the plaintiff's bar. Then the *Cumis* decision came down and dramatically changed the way that carriers defended cases. "Cumis" attorneys appeared in every case where a reservation of rights letter was sent. When Civil Code section 2860 was enacted, there was some reduction in the number of independent counsel, but they were still appointed often. As time went by, however,


plaintiff and defense counsel were not exposed to these issues quite as often. Carriers began offering independent counsel less and less. In short, the next generation of lawyers had little experience with these issues. This has had two consequences. First, the lawyers are not as well trained to identify when independent counsel should be provided. Now, for example, insurance defense counsel alone are defending claims involving allegations of negligence and fraud, where there are reservations of rights with regard to the fraud claim, and both the carrier and defense counsel are ignoring their obligation to tell the insured that they cannot defend both sets of allegations without a conflict waiver. Likewise, plaintiff's attorneys are not pushing the issue, because they do not know to do so. Second, the consequence of this set of circumstance is that judges do not understand these independent counsel issues either, both because they have not been exposed to them in private practice, and because it is seldom presented to them in court. This leads to many judges adopting the erroneous approach espoused in *Dynamic Concept's, James No. 3 Corp.,* and *Federal Insurance, supra* that if insurance defense counsel has not *actually* done something to prejudice the insured, there cannot be a conflict of interest. Obviously, this is the wrong approach because when the actual conflict manifests, it is too late. The insured is already damaged.

However, the biggest problem with getting carriers to abide by their obligations under the *Cumis* decision, and Civil Code section 2860 is that there are no clear adverse consequences if they fail to do so. Carriers figured out that section 2860 has no penalties or enforcement mechanism built into it if they do not abide by it. Returning to our factual scenario above, assume the carrier failed to offer to pay for independent counsel or refused a demand that such counsel be provided. The case then goes to trial and a large verdict is rendered against Bob on the battery theory alone. In addition, punitive damages are awarded against Bob. Bob turns to the carrier demanding it pay the judgment, including punitive damages. The carrier says no because the battery claim is not covered under Insurance Code section 533 (as a willful act), and it is improper to pay for punitive damages under California law. Bob responds that that may be true generally, but here the judgment happened because no independent counsel was provided. Bob says, "Your failure to provide independent counsel was the reason this case was tried in a way that I got hit with an allegedly uncovered judgment, and so you should pay for the full judgment."

There is no case law or statutory law which answers the question of whether the carrier would be liable for the judgment in this situation. Right now, all we have are questions. Can the carrier be held liable for an allegedly uncovered claim? Who has the burden of proving what would have happened if independent counsel had been involved in the case? Carriers will say the insured must prove that the failure to provide independent counsel was the cause of a judgment being entered against the insured on these (uncovered) causes of action, and for these amounts. Insureds will say the burden should be on the carrier to prove that its violation of the law did not cause the insured to suffer this loss. Furthermore, the insured will argue the carrier should be liable for all the damages, including the punitive damages, because it is responsible for all damage proximately caused by its failure to abide by its contractual and statutory obligations. (*Amato v. Mercury Casualty* (1997) 53 Cal.App.4th 825.) (Carrier is liable for all damages proximately caused by tortious breach of the contract).

As noted, there is no case law which decides these issues. The only case that touches on the issues is *Dynamic Concepts, supra* which dealt with the question of whether the carrier would be liable for a settlement reached without its consent. The insured claimed the settlement was proper because the insurer refused to pay for an attorney hired by the insured after the insurer reserved its rights to deny coverage. However, in that case the court found that there was competent insurance defense counsel already in place, only a "theoretical conflict," and that there was an attempt to "set up" the insurer. Where the insurer controls the defense completely, and does not abide by its legal obligation to provide independent counsel, the *Dynamic Concepts, supra* analysis should have no application.

## Hold the insurer responsible

We suggest that the only way to reinvigorate Civil Code section 2860, and the *Cumis* decision, and to force carriers to honestly and fairly provide independent counsel when needed, is to hold the carrier responsible for any judgment which is rendered in the case where independent counsel should have been provided but was not. This would include all damages awarded, even punitive damages.

Such a rule would definitely increase the number of independent counsel that would be hired. That, in turn, would undoubtedly increase the number of settlements, and as to those judgments which were rendered, it would increase the likelihood they would be structured in such a way as to require the carrier to pay it. (In our example, the judgment would have been a general verdict, or only on the negligent cause of action).

Of course, such a rule would produce the usual wailing and gnashing of teeth by the carriers about how their resources were being squandered to pay for claims which were not covered by the policy. The rejoinder is that this is because the carrier and its insurance defense counsel did not do a job of properly protecting the insured. But, let us acknowledge that these complaints could receive a receptive ear among certain members of the Judiciary. An alternative to an absolute rule of strict liability for the full amount of the judgment could be to create a rebuttable presumption that where independent

counsel should have been provided, and was not, the judgment came about as a result of the failure to provide independent counsel. The defendant would then have the burden of proving that independent counsel would not have made a difference. The beauty of this approach is that it places the burden on the party who created the problem, the insurer which violated the law by not providing independent counsel when required to do so, but avoids requiring a carrier to pay for truly nefarious conduct.

In the end, it is going to be up to the plaintiffs and policyholder bars to push these issues with carriers, opposing counsel, and the courts. Otherwise, carriers will continue to suck the life (egg) out of the defense obligation.

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