



# Insurance Coverage **ALERT**

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## California Appellate Court Holds That Insurer Must Provide Independent Counsel Even Where Conflict Would Not Affect Outcome of Liability

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*Schaefer v. Elder*, --- Cal. Rptr. 3d ---- (2013), 2013 WL 2588675

The insured general contractor was hired to design and build a home. After problems with the home's design and construction arose, the homeowner sued the insured for negligence and breach of contract. The general contractor's insurer agreed to defend its insured under a reservation of rights and appointed counsel of its choice to represent the insured (appointed counsel). The insurer also filed a declaratory relief action against the insured to determine whether the insurance policy provided coverage for the lawsuit.

The insured hired a different law firm to move to disqualify appointed counsel and to determine the insured's right to independent counsel. The insurer opposed the motion. The trial court granted the insured's motion, disqualifying appointed counsel based on its determination that the insured had a right to independent counsel.

The California Court of Appeal for the Third District affirmed, holding that the insured was entitled to independent counsel under *San Diego Federal Credit Union v. Cumis Ins. Society, Inc.*, 162 Cal. App. 3d 358, 374 (1984) and Cal. Civ. Code § 2860 based on the insurer's reservation of rights to disclaim coverage under the policy's "contractor's special condition" provision. The provision stated that coverage would not apply to work performed by independent contractors unless the insured first obtained an indemnity agreement and a certificate of insurance from those independent contractors. The underlying complaint alleged that the insured's work was defective by virtue of the work performed by its employees or its independent contractors. Thus, if liability was established because the work was performed by employees, the policy provision would not apply. But, if liability was established because the work was performed by independent contractors, coverage would be precluded under the provision.

The insurer argued that there was no actual conflict because the insured would be liable (assuming liability was established) regardless of whether it is established that the work was done by an employee or an independent contractor. The trial and appellate courts rejected this argument because it "avoid[ed] rather than resolve[ed] the question of whether there [was] a conflict." The appellate court reasoned: "To establish liability, [the owner] will have to establish that someone did something at [the insured's] bidding. Whether it was an employee or an independent contractor, which implicates two different paths . . . to establish liability, one or the other must be proven. . . . Put simply, [appointed



counsel] had an ethical duty to [the insured] to try to establish that the workers were employees and, at the same time, had an ethical duty to [the insurer] to try to establish that the workers were independent contractors. That conflict supported the trial court's determination that [the insured] has the right to independent counsel."

### **Practice Note**

This decision highlights that the conflict question is not necessarily determined by examining whether the outcome of the liability case will be affected. Rather, the question turns on whether the outcome of the coverage dispute can be controlled by appointed defense counsel in the process of litigating the relevant issues in the case.

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