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The Right to Independent Counsel Protects Policyholders Against Conflicts of Interest

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When an insurance company owes a defense to a policyholder against a third-party claim, who gets to appoint defense counsel: the insurance company, or the policyholder?

In instances where a defense attorney is appointed by an insurance company to represent a policyholder, the insurance company often hires "panel" defense counsel which is retained scores or hundreds of times by the insurance company. The policyholder may find that their interests diverge from the insurance company's under various circumstances in which the insurance company reserves its rights or otherwise imposes conditions on the possibility or extent of coverage. In such cases, defense strategy may affect whether the insurance company limits the extent of coverage or acknowledges any coverage at all. That potential conflict leaves open the question of whether the insurance company panel counsel can provide proper representation when such a divergence arises.

The insurance company owes a duty to defend the policyholder, but when a conflict of interest exists between the parties, policyholders have a right to select independent defense counsel. The right to independent counsel protects the policyholder's interests against such conflicted representation.

What Is Independent Counsel?

Most defense counsel are appointed in insured matters with no input from the policyholder. That ordinary course changes in the case of a potential conflict. The right to independent counsel is based on attorneys' obligations, codified in both statutory and common law principles. Attorneys must abide by rules of professional conduct. New York's Rules of Professional Conduct are modeled after the ABA Model Code of Professional Responsibility. Under Rule 5.4 of the Rules of Professional Conduct, a lawyer is required to maintain professional independence and protect confidential information:

"(c) a lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal service for another to direct or regulate the lawyer's professional judgment in rendering such legal services or to cause the lawyer to compromise the lawyer's duty to maintain the confidential information of the client under Rule 1.6."

Furthermore, Rule 1.8 addresses specific conflict of interest rules with regard to a lawyer's clients:

"(f) A lawyer shall not accept compensation for representing a client, or anything of value related to the lawyer's representation of the client, from one other than the client unless: (1) the client gives informed consent; (2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and (3) information relating to representation of a client is protected as required by Rule 1.6."

In the context of the policyholder and insurance company relationship, these rules remind us that defense counsel has an obligation to represent the interests of the policyholder.

In addition to the Rules of Professional Conduct, the common law right to independent counsel long has been recognized by New York courts. See *Prashker v. U.S. Guarantee*, 136 N.E.2d 871 (N.Y. 1956). Recent New York case law maintains that where a conflict of interest arises between the policyholder and insurance company, policyholders are entitled to independent counsel at the insurance company's expense. In fact, an insurance company may be required to inform a policyholder that they are entitled to independent counsel.

Potential Duty To Inform of Independent Counsel. In New York, courts have held that insurance companies have a duty to inform a policyholder about their right to independent counsel in circumstances that may create a conflict of interest for panel defense. In *Elacqua v. Physicians' Reciprocal Insurers*, 52 A.D.3d 886 (3d Dep't 2008), the policyholders were physicians who were held liable for the conduct of a nurse practitioner whom they had hired. The defense counsel hired by the insurance company made motions to dismiss all the covered claims against the doctors themselves, while the insurance company reserved its right to disclaim defense for uncovered claims arising from the doctors' vicarious liability for the nurse practitioner's conduct.

The Appellate Division, Third Department, found that the insurance company had an "affirmative obligation to inform the insured of the right to select independent counsel at the insurer's expense," because otherwise, the failure to inform would "seriously erode the protection afforded." By failing to inform the policyholder-physicians of their right to independent defense counsel, the court held, the insurance company deceived the policyholder within the meaning of General Business Law §349. *Elacqua* illustrates that an insurance company's failure to inform a policyholder of their right to independent counsel may be a "deceptive act."

Reservation of Rights: A Conflict Giving Rise to Independent Counsel. When an insurance company has an obligation to defend a policyholder, sometimes it sends a letter to the policyholder providing notice that it reserves the right to limit coverage. The *Elacqua* court addressed that an insurance company's reservation of rights is a common conflict that gives rise to the need for independent counsel. A New York court more recently likewise held that a reservation of rights letter presents a conflict of interest between the policyholder and insurance company. In *Nat'l Hockey League v. TIG Ins. Co.*, No. 653421, 2022 WL 2733210 (N.Y. Sup. Ct. June 24, 2022), the insurance company attempted to deny coverage by pointing to its reservation of rights letter, despite its initial decision to defend and pay for independent counsel. *National Hockey League* involved various personal injury lawsuits brought by National Hockey League (NHL) players, who alleged that they had sustained concussion-related injuries throughout their careers. The NHL-policyholders provided notice of the underlying suits to the NHL's insurance company, seeking defense costs for the concussion lawsuits. The insurance company sent a reservation of rights letter. The NHL retained independent counsel after determining a conflict of interest. The insurance company made partial payments toward defense costs but eventually stopped making payments and asserted that it did not have a duty to reimburse for all costs because it did not have control over the defense.

The *National Hockey League* court held that the insurance company could not backtrack on defense costs because "NHL was entitled to independent counsel by virtue of defendants' reservation of rights." Moreover, the insurance company had made partial payments toward defense over the course of several years, and thus failed to timely demand that NHL cede control of the defense. The impact of untimely disclaimer under liability insurance policies is another common conflict that gives rise to the policyholder's right to independent counsel. Pursuant to New York Insurance Law §3420(d), insurance companies must provide prompt notice when disclaiming defense under liability policies.

Notice Issues Give Rise to Possible Conflicts. Insurance companies have argued that "reasonable circumstances" excuse delays of timely notice. As a result, courts routinely interpret what constitutes "reasonable" timely notice. Policyholders should exercise caution when asserting an untimely notice argument.

Peleus Ins. Co. v. Atl. State Dev. Corp., No. 20 CIV. 2971 (JPC), 2022 WL 562357 (S.D.N.Y. Feb. 24, 2022) demonstrates how policyholders and insurance companies differ on the interpretation of "timely notice." In *Peleus*, an injured worker sued their employer, a construction company, which sought coverage from its insurance company. Five months later, the insurance company reserved its right to disclaim coverage under the terms of the policy. The policyholder argued that the insurance company gave untimely notice of its decision to deny coverage after waiting five months and failed to advise the policyholder of their right to independent counsel, but the court disagreed.

The court contended that the insurance company needed five months to determine sufficient facts to issue a disclaimer. As a result, the court held that the insurance company did provide untimely notice, and in turn, no conflict gave rise to the need for independent counsel.

A table of relevant case law is available on the Anderson Kill website.

Punitive Damages Claim May Cause Conflicts. Another example of a common conflict between policyholders and insurance companies is the possibility of punitive damages. *Med-Plus v. Am. Cas. Co. of Reading, PA*, No. 16-CV-2985, 2017 WL 3393824 (E.D.N.Y. Aug. 4, 2017); *Ansonia Assocs. v. Pub. Serv. Mut. Ins.*, 693 N.Y.S.2d 386 (N.Y. Sup. Ct. 1998). When the policyholder faces liability for punitive damages, and the insurance company purports to exclude coverage for such damages, the policyholder may be forced to choose between exposure to potentially ruinous judgments by proceeding to trial, or the loss of coverage for compensatory damages by entering into a compromise without the insurance company's consent. The court in *Med-Plus* upheld the policyholder's right to independent counsel after finding that the possibility of punitive damages necessitates the policyholder's right to independent counsel. The court stated: "It would be illogical to delay appointing independent counsel until *after* the risk underlying a conflict of interest has fully materialized and harmed the client. A conflict of interest can insidiously infect professional decision making in myriad ways over the course of a lawyer's representation." *Med-Plus* reinforces the notion in favor of the policyholder that the *possibility* of something occurring that gives right to a conflict of interest allows for the policyholder to select their own independent counsel.

Steps for Policyholders To Protect the Right to Independent Counsel

New York is among the jurisdictions that clearly articulates the need for independent counsel when a policyholder and insurance company hold conflicting interests. While New York courts have held that insurance companies have a duty to inform policyholders of conflicts, there are ways for a policyholder to proactively protect their right to independent counsel:

(1) A policyholder should review a *reservation of rights* letter for conflicts and to determine if the insurance company *provided timely notice of disclaimer.*

(2) If the policyholder faces possible liability for *punitive damages*, they should consider independent counsel.

Manifold conflicts can occur between the policyholder and insurance company giving rise to the need for independent counsel. The right to independent counsel—the right to select un-conflicted counsel—protects the policyholder's interests in litigation. If the right is yours, insist on it.

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