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Right to Independent Counsel: Effectively Implement An Insurer's Duty to Defend

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WHAT IS the "right to independent counsel" in insurance and how does it protect policyholders' rights? What are the practical ramifications of a defense provided by insurance company-appointed counsel, as opposed to "independent counsel" selected by the policyholder but paid for by the insurance company pursuant to an obligation to defend or to pay defense costs? How does a policyholder activate these protections?

What Is Independent Counsel?

In an ordinary matter where a defense attorney is provided by an insurance company to defend the policyholder, the attorney is often appointed with little or no input from the policyholder client. This is common in auto liability and homeowner liability cases. In such cases there often are: no reservations of rights to deny coverage; no above-policy-limits exposure to liability; and no difference of view regarding strategy and tactics to defend or resolve the matter. Such run-of-the-mill claims often do not give rise to a dispute regarding independent counsel because in such a context both the insurance company and policyholder often have virtually identical interests related to the defense of the matter.

A policyholder facing a potential dispute with the insurance company, however, may have concerns about conflicts facing the defense counsel. Thus, the rules are often different, in the context of a claim in which the insurance company has reserved its right potentially to deny coverage, or there is exposure beyond the policy limits, or there are differences regarding strategy and tactics in the conduct of the defense. In such cases, the right to independent counsel is often activated in many states.[1] This right to independent defense counsel selected by the policyholder is central to effective protection of the policyholder's rights, and has a number of practical impacts. Further, defense counsel cannot effectively both defend the policyholder and assist in determining disputed coverage issues.

Statutory and common law foundations. The right to independent counsel is founded on codified rules of ethics as well as upon longstanding common law principles. A fundamental premise is that defense counsel, hired by a liability insurance company to defend a policyholder, owe their total fidelity and allegiance to the policyholder client, not to the insurance company.[2]

Further, the pertinent Rules of Professional Conduct, promulgated in New York as joint rules of the Appellate Divisions of the Supreme Court, effective April 1, 2009, require that lawyers maintain independent professional judgment and protect confidential information with regard to defense of their clients whether the defense is insured or not. Rule 5.4, which addresses a lawyer's professional independence, and Rule 1.8, which addresses specific rules regarding accepting compensation


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from one other than the client, are illustrative:

> RULE 5.4: Professional Independence of a Lawyer…
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> (c) Unless authorized by law, 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.
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> RULE 1.8:
>
> Current Clients: Specific Conflict of Interest Rules…
>
> (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 independent professional judgment or with the client-lawyer relationship; and (3) the client's confidential information is protected as required by Rule 1.6.

The common law rule has been clearly a part of New York law for over half a century. Long ago, the court in *Prashker v. United States Guarantee*, 1 N.Y.2d 584, 136 N.E.2d 871, 154 N.Y.S.2d 910 (1956), held with regard to the defense of an action alleging negligence relating to an airplane accident that a potential conflict of interest existed between the policyholder and the liability insurance company. The *Prashker* court noted that defense attorneys employed by the insurance company would have a duty to the policyholder to defeat liability on any grounds, and that the defense counsel's duty to the insurance company would be to defeat only the covered causes of action. The *Prashker* court held that if such a conflict arose, the policyholders would be entitled to select their own independent defense counsel, and that the insurance company would be responsible for that reasonable fee of the attorney.

Following *Prashker*, many other New York courts have recognized that, under New York law, a policyholder has a right to independent counsel paid for by the insurance company, for the reasons stated above, where a conflict of interest arises because a complaint contains allegations possibly both within and outside the coverage of the insurance policy.[3] Another example of such a conflict giving rise to a right to independent counsel is conflicting trial strategies. *69th St. & 2nd Ave. Garage Assocs. v. Ticor Title Guar.*, 207 A.D.2d 225, 622 N.Y.S.2d 13 (1st Dept. 1995).

This right to independent defense counsel **selected by the policyholder** is central to **effective protection** of the policyholder's rights, and has a number of practical impacts.

The strategic conflict at issue in *Ansonia Associates v. Public Service Mutual Insurance*, 180 Misc.2d 638, 693 N.Y.S.2d 386 (Sup. Ct. 1998), aff'd 257 A.D.2d 84, 692 N.Y.S.2d 5 (1st Dept. 1999) illustrates the necessity of independent counsel. In *Ansonia*, the policyholder asserted that its insurance company acted in bad faith by refusing to engage in settlement negotiations regarding the underlying litigation and thereby exposing the policyholder to a judgment at trial that included a substantial punitive damages award, which the insurance company argued were not covered under the insurance policy. The policyholder retained separate counsel on its own and settled the underlying case, and then sought to recover from the insurance company not only cost of the settlement, but also the attorney fees incurred. In ruling for the policyholder, the court noted:

> [In] New York, "When a conflict of interest exists between an insured and the insurer which is obligated to defend, the remedy is to permit the insured to select defense counsel, with the reasonable cost of the defense to be borne by the insurer." *Ladner v. American Home Assur.*, 201 A.D.2d 302, 304, 607 N.Y.S.2d 296 (1st Dept. 1994).

Another example upholding the policyholder's right to independent counsel is *Parker v. Agricultural Insurance*, 109 Misc. 678, 683-84, 440 N.Y.S.2d 964, 968-69 (Sup. Ct. 1981). In this case involving "multiplicity of suits and large sums of money sought," which exceeded the policy limits, the court found that "the insured is entitled to choose counsel and control all litigation, the reasonable expense of which shall be borne by the primary insurer and, should it become necessary, by the excess carriers. *Parker* involved a policyholder with both primary and excess insurance policies facing multiple claims that exceeded the limits of its primary insurance policy. The *Parker* court concluded that the primary insurance company had a conflict of interest because the claims exceeded the policy limits and included punitive damages, and held that the policyholder would be entitled to appoint its own counsel, and the reasonable fees of counsel would be paid by the insurance companies.

Practical Ramifications

Independent counsel is often a reflection of a need to protect all of a policyholder's interests and to defend the entirety of a lawsuit rather than conducting a defense being directed by the confines of a liability insurance policy. Defense counsel almost always aim simply to defend their clients; however, insurance companies, not infrequently, attempt to avoid coverage.

Such coverage issues put defense counsel in the unenviable position of a conflict between their client-policyholder and payor-insurance company.

Insurance companies have argued that the so-called "cooperation clause" or "right to associate" or similar clauses require coordination and involvement in defense of an action. Policyholders should exercise caution to avoid the impact of such potentially overreaching arguments.

Travelers Property v. Centex Homes, C-10-02757 CRB, 2011 WL 1225982 (N.D. Cal. April 1, 2011), illustrates one such potential pitfall in the interaction of the right to independent counsel with so-called cooperation clause arguments made by an insurance company. In *Centex*, the policyholder was a general contractor sued in two construction defect cases. The insurance company sent a reservation of rights letter, and eventually agreed to the policyholder's choice of defense counsel. The insurance company appointed separate defense counsel of its own choosing. According to the opinion, the policyholder apparently refused to permit such counsel to associate in the defense to defend, and the court also found that independent counsel was not required under California law pursuant to Civil Code §2860. The *Centex* court determined that the policyholder had breached the duty to cooperate, and thus denied the policyholder defense and indemnity. *Centex* shows the potentially serious ramifications of a finding of a breach of the cooperation clause in the defense context.

A case somewhat analogous to *Centex* was evaluated by the U.S. Court of Appeals for the Second Circuit. *N.Y. Marine & Gen. Ins. v. Lafarge N. Am.*, 599 F.3d 102 (2d Cir. 2010). In *Lafarge*, the liability insurance policy contained a so-called "naming clause," which stated that the insurance company had the option to name mutually acceptable attorneys to represent the policyholder in any underlying litigation that related to significant alleged liability on account of the levee breaches in New Orleans. The *Lafarge* court held that while the policyholder did have a right to independent counsel, it could not reject without even considering the list of potential firms offered by the insurancet company, as they were qualified firms. The court found that the policyholder breached a duty by not even considering the list of firms, and the court determined that the policyholder would not be entitled to reimbursement of legal fees after the date of the policyholder's conduct in refusing to consider the list of firms. These cases suggest that policyholders must take care in addressing a potential dispute with an insurance company over appointment of defense counsel.

Insurance companies also have a duty to inform regarding the right to independent defense counsel. In the event of a conflict of interest, the insurance company has a duty to inform an insured about their right to independent counsel. *Elacqua v. Physicians' Reciprocal Insurers*, 52 A.D.3d 886, 860 N.Y.S.2d 229 (3d Dept. 2008) (finding a duty); *Jones v. Nat'l Emblem Ins.*, 436 F. Supp. 1119 (E.D. Mich. 1977) (finding a duty). But see *Sumo Container Station v. Evans, Orr, Pacelli, Norton & Laffan*, 278 A.D.2d 169, 719 N.Y.S.2d 223 (1st Dept. 2000). Thus, in New York a failure of an insurance company to advise of the right to independent counsel may itself be a breach of duty by the insurance company.

Conclusion

Independent counsel in insurance is borne of the realization that defense counsel, whose only job is to defend the policyholder, should not carry the burden of conflicting loyalties as between the policyholder and the insurance company. New York has been among the jurisdictions most clearly articulating this principle, with decades-old precedent further supported by codification of ethical rules supporting the appointment of independent counsel in insurance in appropriate cases. Recent cases both outside and within New York show, however, that policyholders and insurance companies should exercise care regarding the right to independent defense counsel.

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1. See Douglas R. Richmond, "Independent Counsel in Insurance," San Diego L. Rev, Vol. 48, No. 3 (Summer 2011); Wood, Bender & Shaneyfelt, "Corporate Policyholders' 50-State Guide: The Right to Independent Counsel" (Anderson Kill 2009).

*2. Schneider v. Canal Ins., No. 98-CV-5368 (JG), 1999 WL 689476 at *14 (E.D.N.Y. Sept. 1, 1999); Feliberty v. Damon, 72 N.Y.2d 112, 120, 527 N.E.2d 261, 531 N.Y.S.2d 778 (1988) ("[T]he paramount interest independent counsel represents is that of the insured, not the insurer"); Hartford Fire Ins. v. Masternak, 55 A.D.2d 472, 390 N.Y.S.2d 949, 953 (4th Dept. 1977) (when an insurance company retained counsel on behalf of its policyholders, "[t]he insureds thus became the clients of those attorneys and deserv[ed]…total fidelity, despite the fact that [the insurance company] pays the attorneys' fees"). New York does not recognize the insurance company as a co-client. E.g., N.Y. State Bar Ass'n Comm. Prof. Ethics, Op. 716 (March 1999) ("When a lawyer defends a policyholder in civil litigation, the client is the policyholder, not the insurance company. This is true even though the insurance company has retained the lawyer pursuant to its contractual duty to defend the policyholder").*

3. Hartford Acc. & Indem. v. Hempstead, 48 N.Y.2d 218, 397 N.E.2d 737, 422 N.Y.S.2d 47(1979); Pub. Serv. Mut. Ins. v. Goldfarb, 53 N.Y.2d 392, 425 N.E.2d 810, 442 N.Y.S.2d 422 (1981); Utica Mut. Ins. v. Cherry, 45 A.D.2d 350, 358 N.Y.S.2d 519 (2d Dept. 1974), aff'd 38 N.Y.2d 735, 343 N.E.2d 758, 381 N.Y.S.2d 40 (1975); Rimar v. Continental Cas., 50 A.D.2d 169, 376 N.Y.S.2d 309 (4th Dept. 1975); Jaeger v. Travelers Ins., 53 A.D.2d 637, 384 N.Y.S.2d 848 (2d Dept. 1976); Penn Aluminum v. Aetna Cas. & Sur., 61 A.D.2d 1119, 402 N.Y.S.2d 877 (4th Dept. 1978); Allstate Ins. v. Long, 85 A.D.2d 880, 446 N.Y.S.2d 742 (4th Dept. 1981); Baron v. Home Ins., 112 A.D.2d 391, 492 N.Y.S.2d 50 (2d Dept. 1985); Parker v. Agric. Ins., 109 Misc.2d 678, 440 N.Y.S.2d 964 (Sup. Ct. 1981); State Farm Ins. v. Trezza, 121 Misc.2d 997, 469 N.Y.S.2d 1008 (Sup. Ct. 1983); Emons Indus. v. Liberty Mut. Ins., 749 F. Supp. 1289, 1297 (S.D.N.Y. 1990); see also NL Indus. v. Certain Underwriters at Lloyd's, 926 F. Supp. 446, 456 (D.N.J. 1996) (under New York law, Policyholder did not breach policy by hiring outside counsel because "insured is entitled to select its counsel") (quoting Emons, 749 F. Supp. at 1297)); Lowenstein Dyes & Cosmetics v. Aetna Life & Casualty, 524 F. Supp. 574 (E.D.N.Y. 1981,), affd without opp., 742 F.2d 1437 (2d Cir. 1983) (applying New York law); New York State Urban Dev. v. VSL, 738 F.2d 61 (2d Cir. 1984) (applying New York law).

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