



Rights and Duties Where Insured Has Independent Counsel

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Rights and Duties Where Insured Has Independent Counsel

By

William T. Barker
Dentons U.S. LLP
233 S.Wacker Dr. #7800
Chicago IL 60606
312-876-8140

william.barker@dentons.com

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William T. Barker is a partner in the Chicago office of Dentons U.S. LLP, with a nationwide practice representing insurers in complex litigation, including matters relating to coverage, claims handling, sales practices, risk classification and selection, agent relationships, and regulatory matters. He sometimes serves as an expert witness on matters of insurance, professional responsibility and standard of care. He is a co-author (with Ronald D. Kent) of INSURANCE BAD FAITH LITIGATION and (with Charles Silver) of PROFESSIONAL RESPONSIBILITIES OF INSURANCE DEFENSE COUNSEL. He has been described as the leading lawyer-commentator on the connections between procedure and insurance. See Charles Silver & Kent Syverud, *The Professional Responsibilities of Insurance Defense Lawyers*, 45 DUKE L.J. 255, 257 n.4 (1995).

Mr. Barker is a member of the American Law Institute and an Adviser to its project on the Restatement (Fourth) of the Law of Liability Insurance.. He is Co-Chair of the Subcommittee on Ethics of the ABA Section of the Litigation Insurance Coverage Litigation Committee and a Vice Chair of the ABA Tort Trial & Insurance Practice Section ("TIPS") Committee on Insurance Coverage Litigation. He is the Liaison from TIPS to the ABA Standing Committee on Ethics & Professional Responsibility and to the ABA Standing Committee on Lawyers' Professional Liability.

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§ 14.03 What Rights Do Insurers Have When Dealing with Independent Counsel?

[1] Insurers Are Entitled to Advance Consultation About Defense Expenditures and Activities

Once counsel has been selected, “[t]he *Cumis* rule requires complete independence of counsel.”¹ (The *Cumis* rule is discussed in §§ 6.03 & 6.05, above.) “*Cumis* counsel represents solely the insured.”² Counsel may select defense strategies disadvantageous to the carrier.³ The insurance contract does not govern the relationship between the insurer and defense counsel. But counsel (especially counsel representing and answerable solely to the policyholder) could injure the policyholder’s coverage by failing to act in accordance with the policyholder’s duties under the policy (*e.g.*, by failing to communicate information the insurer is entitled to receive). At least as long as consulting with the insurer does not entail any substantial risk of harm to the policyholder, counsel’s duties to the policyholder require counsel to engage in such consultation (if requested by the insurer) to avoid any risk of injuring the policyholder’s coverage interests. Moreover, disclosure to the insurer of information relating to the representation is impliedly authorized to the extent necessary to avoid the risk of breaching the insurance policy, as long as disclosure does not endanger any policyholder interests and as long as the policyholder has not directed that such information be kept confidential. (See §§ 10.02 above, 14.04[3] below.)

Again, [California Civil Code § 2860](#) codifies some of these obligations and imposes them directly on defense counsel:

(d) When independent counsel has been selected by the insured, it shall be the duty of that counsel and the insured to disclose to the insurer all information concerning the action except privileged materials relevant to coverage disputes, and timely to inform and consult with the insurer on all matters relating to the action

In *Hartford Casualty Insurance Co. v. J.R. Marketing, L.L.C.*,^{3.1} a concurring opinion noted that that existence of a conflict on some issues

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CA—*State Farm Fire & Cas. Co. v. Superior Ct.*, 216 Cal. App. 3d 1222, 1226 (1989).
See also *Mosier v. Southern Cal. Physicians Ins. Exchange*, 63 Cal. App. 4th 1022, 1042 (1998).

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US/CA—*Emp’rs Ins. Co. of Wausau v. Albert D. Seeno Constr. Co.*, 692 F. Supp. 1150, 1157 (N.D. Cal. 1988);

CA—63 Cal. App. 4th at 1042; *Assurance Co. of America v. Haven*, 32 Cal. App. 4th 78, 87 (1995).

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NY—*Nelson Elec. Contr. Corp. v. Transcontinental Ins. Co.*, 231 A.D.2d 207 (1997) (subcontractor policyholder did not breach duty of cooperation by having independent counsel forego claim against general contractor which would have reduced carrier’s net liability, but required subcontractor to provide uninsured indemnity to general contractor, on the basis that the best defense strategy was to present a common defense against the injured workers).

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CA—*Hartford Cas. Ins. Co. v. J.R. Marketing, L.L.C.*, 61 Cal. 4th 988 (2015).

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does not mean the insurer and insured are entirely at odds. Their interests remain aligned as to third party claims unaffected by the coverage dispute. And even as to the claims implicating that dispute, “[b]oth the insured and the insurer, of course, share a common interest in defeating the claims.” The conflict exists only to the extent that “if liability is found, their interests diverge in establishing the basis for that liability.”^{3.2}

The independent counsel scheme created by § 2860, like its counterparts in other jurisdictions, contemplates that “an insurer can reasonably insist that independent counsel fully inform it of factual and legal developments related to the defense, consult with it on defense strategy and tactics, and consult with it before incurring major expenses in the course of the defense.” Indeed, “[t]he insurer’s advice, insight, or suggestions may prove valuable to the insured.”^{3.3}

These duties to disclose relevant information and to consult with the insurer seem especially well founded in the insurance contract. While a conflict of interest denies the insurer the right to direct counsel,⁴ to receive information prejudicial to the policyholder on the subject of the conflict, and to impede actions beneficial to the policyholder on that issue, it does not eliminate the insurer’s interest in the defense. The insurer still desires the most effective and efficient defense, as the insurer is still obliged to pay defense costs and may be required to pay any judgment or settlement. The policyholder is still bound by the contractual duty of cooperation except insofar as that duty is excused by the conflict. Moreover, the insurer retains the right to settle at its own expense and the right to deny payment of any settlement not approved by it. Exercise of these rights requires full and timely information, so the insurer can consider settlement opportunities and actions that may be necessary to fulfill any duty to the policyholder to accept reasonable settlement demands.

Moreover, the insurer should at least be entitled to make suggestions on defense options and decisions and to have the information necessary to do so. While the policyholder and defense counsel are not bound by any such suggestions, they cannot be harmed and may be helped by receiving them. As Dean Syverud observed with respect to common defense counsel guidelines, “[t]he advance consultation by defense counsel contemplated in the Guidelines is as minimal a form of cooperation as one can imagine.”⁵ “As long as the consultations do not reveal confidential information held by the insured that might be used to defeat coverage, allowing the insurer to consult on the defense cannot harm the

^{3.2} 61 Cal. 4th at 1012 (Liu, J., concurring).

^{3.3} 61 Cal. 4th at 1012 (Liu, J., concurring), quoting (Richmond, *Independent Counsel in Insurance*, 48 SAN DIEGO L. REV. 857, 890 (2011) (footnotes omitted by Justice Liu).

⁴ See:

US/RI—*Hartford Cas. Ins. Co. v. A & M Assocs., Ltd.*, 200 F. Supp. 2d 84, 90 (D.R.I. 2002) (explaining that the insurer cannot control the litigation);

WI—*Jacob v. W. Bend Mut. Ins. Co.*, 203 Wis. 2d 524, 536 (Ct. App. 1996) (explaining that unless the insurer is willing to accept coverage, it has no authority to affect independent counsel’s defense of the insured).

⁵ Kent D. Syverud, *The Ethics of Insurer Litigation Management Guidelines and Legal Audits*, 21 No. 7 INS. LITIG. REP. 180, 188 (1999).

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insured.”⁶

Consultation is valuable, in and of itself, in achieving an economical defense. Lawyers make money by delivering services. Their incentive is, therefore, to maximize service levels, which is antithetical to minimizing costs. “Even a lawyer who aims to provide only worthwhile defense efforts can subconsciously resolve doubts in favor of doing more, and so earning more.”⁷

Consultation, even without an approval requirement, tends to restrain inefficient efforts:

The lawyer’s evaluation is sharpened by responding to the adjuster’s comments and questions. Consultation also allows the claims staff to consider with counsel whether the effort proposed could safely be postponed, particularly when there is still a possibility of settlement.⁸

In short, consultation is valuable to the insurer and cannot be prejudicial to the policyholder (as long as any confidential information bearing on coverage is withheld from the insurer, as all agree it must be). Moreover, “[t]o the extent that such consultation avoids unnecessary discovery or motion practice, it also benefits the judicial system.”⁹

The Restatement of the Law of Liability Insurance provides such a right to consultation by stating that, when the insured has an independent defense, “[t]he insurer has the right to associate in the defense of the legal action,”¹⁰ just as an excess insurer or other nondefending insurer would have.¹¹

Even in a case which most severely restricted the insurer’s use of prior approval requirements, it was conceded that requirements of advance consultation are permissible. At oral argument, Justice Gray had the following exchange with one of Petitioners’ counsel, Robert James:

Mr. James: Rule 1.8 is fairly straight forward. A lawyer shall not accept compensation for representing a client from one other than the client unless there is no interference with the lawyers independence of professional judgment. Rule 5.4 is very similar. It essentially says the same thing. A lawyer shall not permit a person who recommends, employs or pays the lawyer to render legal services for another to direct or regulate the lawyer’s professional judgment. When the billing rules say that we need pre-approval to hire experts to conduct research to file a motion, to file pleadings, to engage in trial preparation or to decide how to staff a case we simply can’t agree to do so. Why? Our position is that the plain and ordinary meaning of these ethical rules prohibit us from allowing an insurance company from directing and regulating our judgment to do so. It’s just that simple.

⁶Douglas R. Richmond, *Independent Counsel in Insurance*, 48 *SAN DIEGO L. REV.* 857, 890–91 (2011).

⁷Opinion of Geoffrey C. Hazard, Jr., 15, *In re Ugrin, Alexander, Zadick & Higgins, P.C.*, 299 *Mont.* 321 (2000) (“Hazard Op.”).

⁸Hazard Op. 15; see Hazard Op. at 15–17 (expanding on the point).

⁹Hazard Op. at 4.

¹⁰RESTATEMENT OF THE LAW OF LIABILITY INSURANCE § 17(4) (Prop. Final Dr. No. 1 Mar. 28, 2017).

¹¹See RESTATEMENT § 23(1)(b) (right to associate includes “[a]reasonable opportunity to be consulted regarding major decisions in the defense of the action that is consistent with the insurer’s level of engagement with the defense of the action”).

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Justice Gray: Counsel, if the billing rules said “consult” instead of “approve,” would they still violate the rules?

Mr. James: No, I think that we consult with the insurance company all the time with insurance adjusters and tell them here’s what we think should be done so I think that one of the things that the insurance companies can expect defense counsel to do is to consult with them and find out what our thinking is, why we are thinking [that] and in many cases an adjuster may say let me question you about that. Maybe this isn’t a good thing at this particular time and maybe you will agree or maybe you will disagree.¹²

Advance consultation on substantial expenses may also lead the insurer to settle to avoid that cost or to withdraw its reservation of rights to regain control of the defense. Either of these results would be beneficial to the policyholder.

Were the insurer unaware that independent counsel was representing only the insured, the provision of legal advice to the insurer could result in creation of an attorney-client relationship not intended by the lawyer¹³ (and creating the very conflicts that the counsel’s independence was intended to avoid). But that could occur only if the insurer had a reasonable belief that the lawyer was acting on its behalf, and the process by which independent counsel was retained ordinarily should negate any such expectation.¹⁴ Any communication or consultation between independent counsel and the insurer is purely informational.¹⁵ If there is any doubt about the lawyer’s relationship with the insurer, the lawyer should clarify that the insurer is not a client. And, in some jurisdictions, the fact that the lawyer is independent counsel will automatically preclude existence of any attorney-client relationship with the insurer, without regard to the insurer’s belief.¹⁶

¹²Transcribed from tape of argument.

¹³RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 14 (2000).

¹⁴*See*

CA—*Mosier v. S. Cal. Physicians Ins. Exch.*, 63 Cal. App. 4th 1022, 1043 (1998) (quoting *First Pac. Networks, Inc. v. Atl. Mut. Ins. Co.*, 163 F.R.D. 574, 579 (N.D. Cal. 1995)).

¹⁵

CA—63 Cal. App. 4th at 1043 (quoting *First Pac. Networks, Inc. v. Atl. Mut. Ins. Co.*, 163 F.R.D. 574, 579 (N.D. Cal. 1995)).

See

US/WA—*Bell Lavalin, Inc. v. Simcoe & Erie Gen. Ins. Co.*, 61 F.3d 742, 748 (9th Cir. 1995) (status reports and confidential information about defense provided by independent counsel do not create any duty of loyalty to insurer).

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OH—*Swiss Reinsurance Am. Corp. v. Roetzel & Andress*, 163 Ohio App. 3d 336, at 1525 (2005) (concluding that conflict of interest precluded existence of attorney-client relationship between insurer and lawyer that it hired to defend insured).

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[2] Insurers Are Entitled To Challenge Defense Expenditures and Activities That They Regard as Inappropriate and To Withhold Payment for Costs and Services They Have Not Approved

Even where there is a conflict of interest, an insurance policy is not a blank check, requiring payment by the insurer for whatever work defense counsel chooses to do. An insurer is entitled not to pay for services that are overpriced or inappropriate to the case.¹⁷ The provider of services is not the sole judge of their necessity.¹⁸ Insurers must also be able to review all legal bills, including those submitted by independent counsel, to protect against fraud. For example, they must be able to determine that all services billed were actually performed, that lawyers are not turning expense items into profit centers by tacking surcharges onto them, etc.

So, sooner or later, a representative of the insurer must decide whether particular services are appropriate and should be paid for. A preapproval requirement simply requires that question to be addressed before the services are rendered instead of afterwards.

In other words, the insurer is entitled to challenge defense activities and expenditures it regards as excessive or inappropriate, and do so before they are executed, to the point of warning that it will not voluntarily pay for them. Accordingly, even where the policyholder is represented by independent counsel, insurers are still “entitled to apply billing Guidelines for purposes of obtaining the most effective, professional and efficient defense possible for their insureds.”¹⁹ But, while an insurer is entitled to some time to review and evaluate independent counsel bills that it is asked to pay, unreasonable delay in doing so can constitute a breach of the duty to defend.^{19.1}

Of course, the insurer’s refusal to pay does not end the matter. The policyholder can direct counsel to execute the disputed recommendations for expenses or activities, and counsel will be obliged to do so.

¹⁷ See, e.g.,

CA—*Center Found. v. Chicago Ins. Co.*, 227 Cal. App. 3d 547 (1991) (challenge to fees of Cumis counsel upheld in case where conflict of interest divests insurer of right to control defense); see also *Caiafa Prof’l Law Corp. v. State Farm Fire & Cas. Co.*, 15 Cal. App. 4th 800 (1993) (same);

cf. **OR**—*Village at North Pointe Condo. Ass’n v. Bloedel Constr. Co.*, 278 Or. App. 354, 372 (2016) (while plaintiff was contractually obliged to pay defendant’s fees for the underlying litigation, it was not obliged to pay for insurance coverage litigation).

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CA—*Sarchett v. Blue Shield*, 43 Cal. 3d 1, 8–10 (1987) (medical insurance, requiring payment for all “necessary” services; collecting cases from other jurisdictions).

¹⁹ Kent D. Syverud, *The Ethics of Insurer Litigation Management Guidelines and Legal Audits*, 21 No. 7 INS. LITIG. REP. 180, 187 (1999); accord Opinion of Geoffrey C. Hazard, Jr., 3–4, *In re Ugrin, Alexander, Zadick & Higgins, P.C.*, 299 Mont. 321 (2000);

CA—*Pepsi-Cola Metro. Bottling Co. v. Ins Co. of N. Am.*, 2010 U.S. Dist. LEXIS 144401, at *32–34 (C.D. Cal. Dec. 28, 2010) (reduction of payments in accordance with billing guidelines was a permissible method of disputing reasonableness of fees).

^{19.1} **CA**—2010 U.S. Dist. LEXIS 144401, at *21–22.

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Either before or after that is done, the policyholder or counsel can seek to collect from the insurer for those expenses or services. If a court or arbitrator finds the expenses or services appropriate, the insurer will have to pay.²⁰ Otherwise, the policyholder will have to pay, unless the inappropriateness of the expenses or services prevents counsel from collecting from anyone.

In short, neither party may sit as judge in its own case. If disputes cannot be compromised, they must be submitted to an outside adjudicator. Both sides must take account of the likely rulings of such an adjudicator on the facts presented, and disputes are unlikely to be pressed unless the parties have very different predictions about such a ruling.

Outright refusal to pay has significant risks for the insurer. If held to be incorrect, it may be deemed a breach of the duty to defend, freeing the policyholder from policy restrictions on refusal to settle and, in some jurisdictions, even subjecting the insurer to an estoppel to assert coverage defenses.²¹ However, a California court has treated payment of independent counsel fees as a form of first-party benefit, meaning that an insurer is not subject to any extracontractual liability for withholding payment of amounts subject to a bona fide dispute.²² To avoid these risks, an insurer may wish to advance the disputed funds, while reserving the right to seek to recoup them.²³ But the ability to recoup may be problematic where the policyholder is impecunious, and counsel may have defenses to recoupment not available to the policyholder. If recoupment is to be sought, the insurer should either (1) obtain an agreement that the advances will be returned if the insurer prevails in later litigation or (2) seek prompt adjudication of the propriety of the expenses or services in question. Failure to do one or the other may prevent recoupment even if the expenses or services might be found beyond the insurer's obligations to pay.

The Restatement of the Law of Liability Insurance provides that:

In the event of a dispute during the course of the defense about the reasonableness of fees, either party should have the option of paying counsel under protest the difference between what the parties contend to be a reasonable fee, and counsel should have the option of receiving under protest what it regards as only a partial payment, and thereby defer the resolution of the reasonableness of the fees until after the duty to

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CA—A California statute provides for mandatory arbitration of fee disputes with independent counsel. [CAL. CIV. CODE § 2860\(c\)](#). If the policyholder contends that the insurer has breached the policy or acted in bad faith by prolonged delay in responding to the tender of defense, that dispute should be resolved by the court before compelling arbitration of the dispute about the amount of the fees. [Janopaul Block Cos. v. Super. Ct., 200 Cal. App. 4th 1239, 1249–51 \(2011\)](#).

²¹ See 3 Jeffrey E. Thomas & Francis J. Mootz, III, *NEW APPLEMAN ON INSURANCE LAW LIBRARY EDITION* §§ 16.03[3][g][iii], 17.02, 20.04[2][b].

²²

CA—[Behnke v. State Farm Gen. Ins. Co., 196 Cal. App. 4th 1443, 1470 \(2011\)](#).

²³

CA—[Buss v. Super. Ct., 16 Cal. 4th 35, 52 \(1997\)](#).

See also William T. Barker & Ronald D. Kent, *NEW APPLEMAN INSURANCE BAD FAITH LITIGATION, SECOND EDITION*, § 2.11.

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defend has ended and any coverage defenses have been adjudicated or settled, so as not to invade the attorney-client privilege or work-product immunity.²⁴

Nothing in this alternate procedure regarding payment is inconsistent with a right to advance review of proposed defensive actions and to give notice if the insurer intends to dispute fees incurred to take what it regards as unnecessary or inefficient defensive actions.

Apart from the possibility of freeing the policyholder to settle, an unreasonable refusal to pay could be the basis of a bad faith claim, as defense costs are a form of first-party benefit.²⁵

[3] The Montana Supreme Court's Rejection of Prior Approval Requirements Is Unlikely to Be Applied in an Independent Counsel Context

The Montana Supreme Court has held that any requirement of prior approval impermissibly interferes with a lawyer's obligation to exercise independent judgment on behalf of the policyholder.²⁶ The decision was rendered with respect to ordinary defense counsel, and the concern that motivated it does not justify an extension of the holding to representations in which independent counsel represent policyholders. This is so because independent counsel recommend options to policyholders and follow policyholders' instructions. They do not follow insurers' instructions and, therefore, are not subject to insurers' prior approval. They may learn that an insurer will not willingly pay for a defense-related service they believe should be employed, but they are nonetheless entirely free to recommend the service to the policyholder, to perform it at the policyholder's request, to bill for it, and to help the policyholder sue for reimbursement. Independent counsel thus stands in the same position as any other lawyer whose client has arguable contractual rights against another party which the latter disputes.

The propriety of this conclusion is reinforced by the similarity of the procedure to that approved by the ABA Standing Committee on Ethics for cases in which counsel is not independent.²⁷ Its Opinion 01-421 assumes that the insurer has directed the lawyer to proceed in a particular way, rather than merely declining to pay for services the lawyer has recommended. Because actual direction of the lawyer creates

²⁴ RESTATEMENT OF THE LAW OF LIABILITY INSURANCE § 17, cmt. *b* (Prop. Final Dr. No. 1 Mar. 28, 2017).

²⁵ *E.g.*,

US/CA—*Tibbs v. Great Am. Ins. Co.*, 755 F.2d 1370 (9th Cir. 1985);

CA—*Continental Casualty Co. v. Royal Ins. Co.*, 219 Cal. App. 3d 111 (1990);

ND—*Smith v. Am. Family Mut. Ins. Co.*, 294 N.W.2d 751 (N.D. 1980).

See also William T. Barker & Ronald D. Kent, NEW APPLEMAN INSURANCE BAD FAITH LITIGATION, SECOND EDITION, § 3.08[3].

²⁶

MT—*In re Ugrin, Alexander, Zadick & Higgins, P.C.*, 299 Mont. 321 (2000).

See also discussion in § 14.03[1], above.

²⁷ The procedures approved in ABA Opinion 01-421 for handling particular conflicts in insurance defense representations appear to have been first recommended in Ellen S. Pryor & Charles Silver, *Defense Lawyers' Professional Responsibilities: Part I-Excess Exposure Cases*, 78 TEX. L. REV. 599, 644 (2000). But those procedures are logically implied by the conflicts rules applicable to all representations involving duties to multiple persons.

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no insurmountable problem, a mere threat to withhold payment can hardly do so.

Much of the ABA Opinion addresses what the policyholder must be told about a representation in which the insurer expects to exercise a power to direct counsel. No such requirements apply to an independent counsel representation, so they need not be discussed here.

If counsel believes that some insurer decision poses a substantial risk to the policyholder, counsel should point that out to the insurer and request reconsideration. If the insurer will not reconsider, then counsel must inform the policyholder, fully describe the risks and benefits, and inquire whether the policyholder will consent to having counsel proceed on the basis the insurer requests. The Tennessee Bar describes such a consultation as follows:

Counsel should describe the decision and its risks and benefits from the standpoint of the insured. Of course, these will include whatever risks to the insured that counsel believes might result from the compliance. But objection to the insurer's directive would also have risks and therefore, where appropriate, counsel should point out that the insurer might take the position that any unjustified refusal to permit counsel to follow its direction would breach the insurance contract. If the insurer were correct in so contending[,] an objection would endanger the insured's coverage. On the other hand, if the insured permits counsel to follow the insurer's directive, the insured could also reserve the right to hold the insurer responsible for any resulting damage to the insured. (The insurer would be liable if the directive were found to breach its duties under the insurance policy.) The insured should be advised of the utility of obtaining independent counsel, at the insured's own expense, in considering whether to acquiesce in the insurer's directive (perhaps under protest). If the insured acquiesces, after being properly advised, counsel may comply with the insurer's directive.²⁸

If the policyholder gives informed consent (perhaps coupled with a declaration of intent to hold the insurer responsible for any resulting injury), then counsel may comply with the insurer's direction. If the policyholder refuses to consent, then counsel cannot proceed in the way the insurer requests. If the insurer will not rescind the disputed decision, counsel must then withdraw. (A request to withdraw will necessarily involve the court, which may resolve any dispute between insurer and policyholder.)

In an independent counsel situation, there will be no possible need for withdrawal and no need to get the insurer's consent for proposed activities or expenses. The lawyer and the policyholder need only discuss whether to assume the risk of nonpayment and the burden of litigating for payment. If the policyholder is willing to advance the necessary funds or if the lawyer is willing to extend credit (possibly on a nonrecourse basis), they may proceed and pursue the insurer later. In the meantime, the insurer remains obligated to continue funding agreed expenses and activities.

While the Montana Supreme Court presumably would reject the ABA analysis, its opinion is both

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distinguishable when the problem is presented in an independent counsel context and should be rejected by other courts even where it is not distinguishable. (See § 11.04, above.)

[4] An Insurer Is Entitled to Pay No More Than Market Rates for the Type and Quality of Service Reasonably Necessary to the Defense of the Case

In a few states, statutes regulate the fees that insurers must pay independent counsel. Thus, in California,

[t]he insurer's obligation to pay fees to the independent counsel selected by the insured is limited to the rates which are actually paid by the insurer to attorneys retained by it in the ordinary course of business in the defense of similar actions in the community where the claim arose or is being defended²⁹

Oregon has a special statute requiring independent counsel for environmental claims when an insurer defends under reservation of rights, whether or not there is a conflict of interest. ¹ One of the provisions in the statute directs that "[t]he obligation of an insurer to pay fees to independent counsel ... is based on the regular and customary rates for the type and complexity of the environmental claim at issue arose or is being defended."²

Absent such a statute, lawyers are still limited to charging fees permissible under the applicable Rules of Professional Conduct. Most such rules are based on ABA Model Rule 1.5:

(a) A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses. The factors to be considered in determining the reasonableness of a fee include the following:

- (1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;
- (2) the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;
- (3) the fee customarily charged in the locality for similar legal services;
- (4) the amount involved and the results obtained;
- (5) the time limitations imposed by the client or by the circumstances;
- (6) the nature and length of the professional relationship with the client;
- (7) the experience, reputation, and ability of the lawyer or lawyers performing the services; and
- (8) whether the fee is fixed or contingent.³⁰

In addition to the limits imposed by the Rules of Professional Conduct, the insurer has a right to have the insured make the selection in accordance with the contractual duty of good faith and fair dealing.

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CA—CAL. CIV. CODE § 2860(c).

See also

AK—ALASKA STAT. § 21.96.100(d) (similar provision).

¹ OR. REV. STAT. § 465.843(1).

² OR. REV. STAT. § 465.843(3)(a).

³⁰ MODEL RULES OF PROF'L COND., Rule 1.5(a) (2011).

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As explained in *Center Foundation v. Chicago Insurance Co.*:³¹

the duty of good faith imposed upon an insured includes the obligation to act reasonably in selecting as independent counsel an attorney qualified to present a meaningful defense and willing to engage in ethical billing practices at a standard stricter than that of the marketplace. Conduct arguably acceptable in the ordinary attorney-client relationship where the latter pays the former from his own pocket is not necessarily appropriate in the tripartite context created when independent counsel undertakes to represent the insured at the expense of the insurer.

Insurers are likely to argue that a reasonable fee for defense services is established by the rates charged by lawyers from whom the insurers regularly purchase similar services. In their view, the cost of defending the insured ought not to be increased by the fortuitous existence of circumstances entitling the insured to independent counsel.

But lawyers not regularly retained by the insurer obliged to pay for independent counsel may resist accepting payment at the rates that the insurer normally pays for similar services. Insurers are able to provide their regular counsel with a volume of work warranting a significant discount in the rates charged for that work. Independent counsel do not receive a similar volume of work. If they have adequate business at rates not affected by such a discount, they have no incentive to accept the discounted rates charged by firms the insurer regularly retains.

If the insurer were obliged to pay no more than its customary discounted rates, a policyholder seeking independent counsel might find it necessary to supplement the insurer's payments to obtain comparable counsel or accept the services of less able (and therefore less expensive) counsel than would normally be retained for the particular case. Accordingly, policyholders would argue that the insurer's customary discounted rates are not adequate or reasonable for independent counsel.

One argument sometimes made in support of limiting the insurer's obligation to payment of its customary rates is that providing a defense by independent counsel is a form of substitute performance where a conflict of interest has rendered the performance contemplated by the contract partially impracticable.³² One commentator summarizes this argument as follows:

because the conflict does not excuse the insurer's duty to defend, the doctrine of substitute performance should be understood to effectuate the terms of the contract, i.e., the insurance policy, without conferring an advantage on either party. "Substitute performance" should therefore be a minimal variation from the performance originally contemplated. This approach is said to track courts' general recognition that a party injured by a contract breach should receive the benefit of its bargain but never a windfall.

Continuing, substitute performance advocates theorize that courts that allow an insured to select defense counsel and control the defense because of a conflict of interest rendering the insurer's duty to defend impractical are supplying a substitute for the carrier's performance so as to preserve the carrier's remaining contractual obligations. As a

³¹ *Center Foundation v. Chicago Insurance Co.*, 278 Cal. Rptr. 13, 21 (Cal. Ct. App. 1991).

³² See RESTATEMENT (SECOND) OF CONTRACTS § 270 (1981).

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substitute for the carrier's duty to defend, it follows that the alternative performance must conform to the original. The insured's defense should not be funded at a level substantially lower than the defense the carrier otherwise would have provided so that the insured receives the benefit of its bargain, but nor should the insured's defense costs substantially exceed those which the carrier would have paid were it in control lest the insured be unjustly enriched. Therefore, the carrier cannot be obligated to pay independent counsel hourly rates greater than those it would pay panel counsel.³³

This argument has a number of flaws. Most fundamentally, the doctrine of impracticability applies to excuse performance only where "a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made."³⁴ Nonoccurrence of a conflict of interest can hardly have been a basic assumption by the insurer: existence of conflicts in a significant number of cases and the need to provide a defense despite them is well known to insurers. Moreover, increased expense in performance generally is not considered to render performance even partially impracticable.³⁵ An insurer drafts the policy, and it could contractually specify limits on the rates payable to independent counsel. If the insurer has failed to include such language, it can hardly claim surprise when it is called upon to pay more than its customary rates to retain independent counsel appropriate to the case. And the insurer is still protected by the limitation of the fees payable to a reasonable amount.³⁶

Putting the matter succinctly, "while the substitute performance approach is superficially appealing, it quickly unravels when closely scrutinized."³⁷

³³ Douglas R. Richmond, *A Professional Responsibility Perspective on Independent Counsel in Insurance*, 33 No. 1 INSURANCE LITIGATION REPORTER 5, 9 (2011).

³⁴ RESTATEMENT (SECOND) OF CONTRACTS § 261.

³⁵ Allan Farnsworth, CONTRACTS § 9.6, at 646 (3d ed. 1999).

See, e.g.,

US—*Carabetta Enters., Inc. v. United States*, 482 F.3d 1360, 1366 (Fed. Cir. 2007) (finding that increased cost of performance did not make government agency's performance impracticable);

DC—*East Capitol View Cmty. Dev. Corp. v. Denean*, 941 A.2d 1036 (D.C. 2008) (noting the rule).

But see

CA—*Habitat Trust for Wildlife, Inc. v. City of Rancho Cucamonga*, 175 Cal. App. 4th 1306, 1341 (2009) (excessive and unreasonable expense may render performance impracticable).

³⁶ *See*

IL—*Mobil Oil Corp. v. Md. Cas. Co.*, 288 Ill. App. 3d 743, 759 (1997) (approving rate of \$150/hour for independent counsel, even though insurer only paid its own, very experienced attorneys \$94/hour).

³⁷ Douglas R. Richmond, *A Professional Responsibility Perspective on Independent Counsel in Insurance*, 33 No. 1 INS. LITIG. REP. 5, 10 (2011).

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The policy promises the policyholder an adequate and appropriate defense to any suit seeking any relief that, if established, would be covered.³⁸ This is promised at no cost to the policyholder. To fulfill this promise, the insurer must be obliged to pay independent counsel fees equal to “the prevailing market rates in the relevant community” for the type and quality of services reasonably necessary for the defense of the particular lawsuit.³⁹ The market rate will typically reflect the factors enumerated in Model Rule 1.5. However, the rate the insurer will be obliged to pay should not exceed the rate which counsel had agreed to accept from the policyholder.³

The market rate may or may not be the customary rate charged by the lawyer(s) the insured has chosen to retain, depending on whether it is appropriate to the case:

not all cases are alike. The “novelty and difficulty” of a matter may be either factual or legal. A catastrophic injury, wrongful death, or professional liability case, for instance, is much different from a slip-and-fall or automobile case involving minor injuries. Insurers obligated to engage independent counsel chosen by an insured must acknowledge that the defense of difficult matters generally requires experienced and skilled lawyers and that such lawyers can command greater rates than lawyers who handle relatively minor or simple cases. Fortunately for all concerned, liability insurers, as professional litigants, understand this quite well. Most insurers factor the nature of a case into their defense assignments and they typically have strata of law firms on their panels. Thus, and by way of example, although Firms A and B on an insurer’s

³⁸3 JEFFREY E. THOMAS & FRANCIS J. MOOTZ, III, NEW APPLEMAN ON INSURANCE LAW LIBRARY EDITION § 17.01; WILLIAM T. BARKER & RONALD D. KENT, NEW APPLEMAN INSURANCE BAD FAITH LITIGATION, SECOND EDITION, § 3.02[1]–[4].

³⁹

US—*Blum v. Stenson*, 465 U.S. 886, 900 (1984) (statutory fees under 42 U.S.C. § 1988).
See

NJ—*Aquino v. State Farm Ins. Co.*, 349 N.J. Super. 402, 415–16 (App. Div. 2002) (trial court must determine reasonable hourly rate and consider necessity of the work done);

NY—*Prashker v. U.S. Guar. Co.*, 1 N.Y.2d 584, 593 (1956) (independent counsel entitled to a reasonable fee);

OH—*Socony-Vacuum Oil Co. v. Cont’l Cas. Co.*, 144 Ohio St. 382, 397 (1945) (same);

WA—*Nat’l Sur. Corp/ v. Immunex Corp.*, 297 P.3d 688, 695 (Wash. 2013) (same).

See also RESTATEMENT OF THE LAW OF LIABILITY INSURANCE § 17, cmt. *b* (Prop. Final Dr. No. 1 Mar. 28, 2017) (“The reasonableness of defense fees in relation to the complexity of the claim and the risks at stake is a fact question. What the insurer usually pays lawyers to defend similar claims is relevant but not dispositive. Law firms regularly retained by an insurer commonly accept reduced rates in return for a good supply of business. A lawyer providing an independent defense should not be required to accept the rates paid to the insurer’s regular defense lawyers, unless the lawyer so regularly accepts other business at those rates that they represent the reasonable value of his or her services. On the other hand, the lawyer’s regular rates or amount of time spend on a matter may be excessive in relation to the complexity of the claim or the amount at stake in the matter.”).

³ *Northern Sec. Ins. Co. v. R.H. Realty Trust*, 941 N.E.2d 688, 697-98 (Mass. App. Ct. 2010).

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panel may receive simple cases to defend at very low hourly rates, Firms C and D are assigned complex matters or large losses, and are compensated at higher hourly rates.⁴⁰

If a policyholder chooses to use more capable attorneys than the case requires, the policyholder may have to pay the extra cost beyond what would be required for less capable, but adequate attorneys. And disputes regarding the required level of capability (and the corresponding reasonable rate) may need to be adjudicated. Pending adjudication, insurer, policyholder, and lawyers need to have some agreement on payment of fees as the litigation proceeds.

Even if the carrier has breached the duty to defend, the policyholder has the burden of proving that the rate demanded is reasonable.⁴

[5] An Insurer's Cost-Minimization Rights May Be Affected if It Breaches the Duty To Defend

[a] *Hartford Casualty Insurance Co. v. J.R. Marketing, L.L.C.*

[i] The Court of Appeal Decision

In *Hartford Casualty Insurance Co. v. J.R. Marketing, L.L.C.*,⁴¹ a California court held that an insurer that had breached the duty to defend and had been required to pay its insured's independent counsel could not seek to recover from defense counsel the amount by which those fees were allegedly excessive. The California Supreme Court granted review and reversed,^{41.1} depriving the court of appeal opinion of precedential weight. The description of that opinion is retained to identify and illuminate issues not addressed by the supreme court and as background for the supreme court's decision.

Hartford issued policies to J.R. Marketing, L.L.C. and Noble Locks Enterprises, Inc. Certain suits were tendered to Hartford for defense. Hartford initially refused a defense, but (after the policyholders filed suit) ultimately provided a defense under reservation; it refused to provide independent counsel. The trial court held that Hartford was obliged to provide independent counsel. It ordered Hartford to pay bills within 30 days of receipt, subject to a right to seek recovery of allegedly excessive or unnecessary amounts after resolution of the underlying action. However, it also held that, because of its prior breaches of the duty to defend, Hartford could not invoke the limits on hourly rates imposed by § 2860 of the [California Civil Code](#).⁴² Squire Sanders was retained as independent counsel.

After the underlying matter was resolved, the policyholders submitted legal bills totalling over \$15 million, which Hartford paid and then filed a new action seeking recovery of allegedly excessive charges and charges for allegedly unnecessary services. Squire Sanders demurred to the complaint,

⁴⁰Douglas R. Richmond, *Independent Counsel in Insurance*, 48 [SAN DIEGO L. REV.](#) 857, 885 (2011) (footnotes omitted).

⁴ *Liberty Mut. Ins. Co. v. Cont'l Cas. Co.*, 771 F.2d 579, 582 (1st Cir. 1985) (MA law).

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CA—*Hartford Cas. Ins. Co. v. J.R. Marketing, L.L.C.*, 216 Cal. App. 4th 1444 (2013), *rev'd in part*, 61 Cal. 4th 988 (2015).

^{41.1} CA—*Hartford Cas. Ins. Co. v. J.R. Marketing, L.L.C.*, 61 Cal. 4th 988 (2015).

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CA—216 Cal. App. 4th at 1448–51.

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challenging Hartford’s claimed right to recover allegedly unjust enrichment resulting from payment of the disputed charges, and the superior court sustained the demurrer. (It denied demurrers filed by the policyholders.)⁴³ The court of appeal affirmed.

Reiterating conclusions it had reached in a prior, unpublished decision, it first stated that the billing rate limitations and arbitration right provided by § 2860

come with an important caveat. “ ‘[T]o take advantage of the provisions of [section] 2860, an insurer must meet its duty to defend and accept tender of the insured’s defense, subject to a reservation of rights.’ ”

When, to the contrary, the insurer fails to meet its duty to defend and accept tender, the insurer forfeits the protections of section 2860, including its statutory limitations on independent counsel’s fee rates and resolution of fee disputes. More generally, “[w]hen an insurer wrongfully refuses to defend, the insured is relieved of his or her obligation to allow the insurer to manage the litigation and may proceed in whatever manner is deemed appropriate.”⁴⁴

Because Hartford had refused the tender of defense, the court held that it was not entitled to the protections of § 2860.⁴⁵

The court also recognized that Hartford had a right, after the underlying case was concluded to seek reimbursement of any defense expenditures solely allocable to noncovered claims.⁴⁶ However, that right is based on the law of unjust enrichment—a right that runs only against a party who has been unjustly enriched. In the court’s view, the right to independent counsel

“envisions an attorney pursuing an insured’s defense independently of the insurer rather than intertwined with it.” Thus, under this scheme, where, as here, the insurer breaches its duty to defend the insured, the insurer loses all right to control the defense, including, necessarily, the right to control financial decisions such as the rate paid to independent counsel or the cost-effectiveness of any particular defense tactic or approach. Retroactively imposing the insurer’s choice of fee arrangement for the defense of the insured by means of a post-resolution quasi-contractual suit for reimbursement against the insured’s separate counsel, such as Hartford seeks to pursue here against Squire, runs counter to

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CA—216 Cal. App. 4th at 1452.

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CA—216 Cal. App. 4th at 1454–55 (citations omitted).

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CA—216 Cal. App. 4th at 1455.

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CA—216 Cal. App. 4th at 1455, *following* *Buss v. Superior Court*, 16 Cal. 4th 35, 50 (1997).

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these *Cumis*-scheme principles ...⁴⁷

In addition to undercutting the policyholder's right to control the defense, allowing an independent suit against defense counsel would expand the insurer's dispute resolution rights as a result of its breach of its duty to defend. Had the breach not rendered § 2860 inapplicable, the insurer would be limited to proceeding in arbitration, and ought not to obtain the right to litigate as one fruit of its breach.⁴⁸ Moreover, Squire Sanders had not conferred a benefit primarily on Hartford, but rather on its (insured) clients. If they agreed to the payment of excessive or noncovered amounts, it is to them (rather than the law firm) that Hartford should look for reimbursement.⁴⁹

[ii] The Supreme Court Decision

The California Supreme Court narrowly defined the issue it had agreed to review: from whom may a CGL insurer seek reimbursement when (1) the insurer initially refused to defend its insured against a third party lawsuit; (2) compelled by a court order, the insurer subsequently provided independent counsel under a reservation of rights—so-called *Cumis* counsel—to defend its insured in the third party suit; (3) the court order required the insurer to pay all “reasonable and necessary defense costs,” but expressly preserved the insurer's right to later challenge and recover payments for “unreasonable and unnecessary” charges by counsel; and (4) the insurer now alleges that independent counsel “padded” their bills by charging fees that were, in part, excessive, unreasonable, and unnecessary?^{49.1}

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CA—216 Cal. App. 4th at 1457–58 (citations and footnote omitted).

⁴⁸On this point, the opinion is a little schizophrenic: it had just correctly held the right to arbitrate to be a benefit to the carrier, which benefit was forfeited by breach of the duty to defend. Now it treats the right to litigate as a benefit which ought not to be acquired by breaching the duty to defend. More realistically, litigation is the inferior option remaining if the right to arbitrate has been lost.

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CA—216 Cal. App. 4th at 1458–60.

^{49.1}CA—61 Cal. 4th at 992 (citations omitted). The court identified three questions that it did not decide:

the trial court's 2006 enforcement order, requiring Hartford to promptly pay *Cumis* counsel's bills, specified that Hartford “is ... not permitted to take advantage of Section 2860.” Nevertheless, the order stated that counsel's bills “still must be necessary and reasonable” and that, “[t]o the extent Hartford seeks to challenge fees and costs as unreasonable or unnecessary, *it may do so* by way of reimbursement after resolution of the [Marin County action].” (Italics added.) In light of the 2006 enforcement order's express provision authorizing Hartford to seek reimbursement for excessive fees, we need not and do not decide here whether, absent such an order, an insurer that breaches its defense obligations has *any* right to recover excessive fees it paid *Cumis* counsel.

Next, section 2860 specifies that disputes concerning the fees charged by *Cumis* counsel are to be resolved by final and binding arbitration. In

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It summarized its conclusion as follows:

We conclude that under the circumstances of this case, the insurer may seek reimbursement directly from *Cumis* counsel. If *Cumis* counsel, operating under a court order that expressly provided that the insurer would be able to recover payments of excessive fees, sought and received from the insurer payment for time and costs that were fraudulent, or were otherwise manifestly and objectively useless and wasteful when incurred, *Cumis* counsel have been unjustly enriched at the insurer's expense. *Cumis* counsel provide no convincing reason why they should be absolutely immune from liability for enriching themselves in this fashion. Alternatively, *Cumis* counsel fail to persuade that any financial responsibility for their excessive billing should fall first on their own clients—insureds who paid to receive a defense of potentially covered claims, not to face additional rounds of litigation and possible monetary exposure for the acts of their lawyers.^{49.2}

The court reasoned that if

Squire Sanders's bills were objectively unreasonable and unnecessary to the insured's defense in the underlying litigation and that they were not incurred for the benefit of the insured, principles of restitution and unjust enrichment dictate that Squire Sanders should be directly responsible for reimbursing Hartford for counsel's excessive legal bills.^{49.3}

Squire Sanders argued that it was only an incidental beneficiary of Hartford's performance of a preexisting contractual obligation. But Hartford did not simply perform its contractual obligation. That obligation was limited both by the 2006 enforcement order and by the rules of professional conduct to payment of reasonable costs. Nor did Hartford voluntarily pay the amounts billed, but did so under compulsion of court order. These facts negated any claim that any benefit to Squire Sanders was incidental.^{49.4}

contrast, the 2006 enforcement order provided that any dispute over allegedly excessive fees would be addressed in a court action. Because the 2006 enforcement order is final and not subject to our review, and because Squire Sanders has raised no issue about the effect of section 2860's arbitration provision on the current litigation, we do not decide whether, in general, a dispute over allegedly excessive fees is more appropriately decided through a court action or an arbitration.

Finally, because the 2006 enforcement order expressly stated that resolution of any fee dispute would take place *after* the underlying litigation concluded, we do not decide *when* such fee disputes generally ought to be decided relative to the underlying litigation. [61 Cal. 4th at 997 n.7]

^{49.2} CA—61 Cal. 4th at 992–93.

^{49.3} CA—61 Cal. 4th at 999.

^{49.4} CA—61 Cal. 4th at 1000–01.

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Squire Sanders also urged that allowing a claim for restitution against defense counsel would frustrate public policy by unduly interfering with the insured’s attorney-client privilege and its absolute right to direct independent counsel’s defense. The court again disagreed: “Although *Cumis* counsel must indeed retain the necessary independence to make reasonable choices when representing their clients, such independence is not inconsistent with an obligation of counsel to justify their fees.”^{49.5} Moreover, the governing statute specifically requires *Cumis* counsel to justify their fees, albeit in arbitration, rather than litigation.^{49.6} Squire Sanders argued that the arbitration process was “more collaborative,” but the court noted there is an inherent degree of tension in any dispute resolution process and concluded that it “fail[ed] to see how the degree of tension in the relationship between Hartford and the insureds in this case—even if purportedly higher than in cases where section 2860 is triggered—meaningfully heightens any threat to *Cumis* counsel’s independence.”^{49.7}

Squire Sanders also contended that section 2860 arbitration was less disruptive because it provides for contemporaneous resolution of fee disputes as they arise during the course of the underlying lawsuit against the insureds. Squire Sanders asserts that contemporaneous proceedings intrude less on counsel’s independence than after-the-fact litigation, because a contemporaneous proceeding provides “real-time guidance to counsel about which activities [they] may undertake,” without raising the concern that counsel will “hav[e] the rug pulled out from under [them] years after the fact by the insurer.”^{49.8}

The court found this point “speculative at best.”^{49.9} The statute does not dictate timing, and defense counsel might prefer to delay addressing billing issues, “insofar as this would allow counsel to devote their full attention to the insureds’ defense while the third party suit is in progress, rather than becoming embroiled in side arguments with the insurer over fees.”^{49.10} But there was no need to resolve timing issues, because those were dictated here by the enforcement order, drafted by Squire Sanders and upheld on a prior appeal.^{49.11}

Squire Sanders argued that the insured had exclusive authority to monitor and control counsel’s expenditures and that it should bear the responsibility for any failure to do so, subject to a right of indemnity from counsel. The court rejected this argument because it all but ignores the realities of cases like the one before us. Squire Sanders acknowledges that the insureds in this case were not sophisticated, frequent litigators accustomed to monitoring their counsel’s day-to-day litigation decisions. Having contracted with Hartford, and having paid premiums, to be spared the fees and expenses of their defense, there is no indication that the insureds had reasonable cause to expect that they would nonetheless face exposure if Squire Sanders submitted

^{49.5} CA—61 Cal. 4th at 1002.

^{49.6} CA—61 Cal. 4th at 1002–03.

^{49.7} CA—61 Cal. 4th at 1004.

^{49.8} CA—61 Cal. 4th at 1004.

^{49.9} CA—61 Cal. 4th at 1004.

^{49.10} CA—61 Cal. 4th at 1004.

^{49.11} CA—61 Cal. 4th at 1004.

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unreasonable and excessive bills to Hartford. Nor is there any indication the insureds expected that they would have to mount and finance a separate litigation against their own counsel in order to have any hope of recovering the funds they were ordered to pay to the insurer as a result of counsel's unreasonable billing. Such a circuitous, complex, and expensive procedure serves neither fairness nor any other policy interest. We see no persuasive ground to hold that any direct liability to Hartford for bill padding by Squire Sanders must fall solely on the insureds.^{49.12}

Squire Sanders also expressed the fear that if its client refused to waive attorney-client privilege, it might be unable to defend against Hartford's claim for fees. But there was no concrete indication that this would be necessary and, in any event,

an objective assessment of the litigation as a whole to determine whether counsel's bills appear fundamentally reasonable is unlikely to involve an examination of individual attorney-client communications or the minute details of every litigation decision. If privileged information on these subjects is included in counsel's billing records, it can be redacted for purposes of assessing whether counsel's bills are reasonable. Trial courts are accustomed to dealing with claims of attorney-client privilege in a manner that balances the competing interests of the parties, and can thus presumably address any privilege issues that arise on a case-by-case basis.^{49.13}

Justice Liu, in a concurring opinion, pointed out that there remained a significant issue as to the division of any liability to Hartford between Squire Sanders and J.R. Marketing. While the court assumed (in accordance with Hartford's allegations) that any unreasonable fees or unnecessary services conferred no benefit on J.R. Marketing, Squire Sanders was free to contest this assumption on remand. To the extent that any such fees or services were incurred for the benefit of J.R. Marketing,

such fees necessarily fall outside the scope of today's holding. For that holding is premised on the dual assumptions "that Squire Sanders's bills *were* objectively unreasonable and unnecessary to the insured's defense in the underlying litigation *and* that they were not incurred for the benefit of the insured." On remand, it will be Hartford's burden to show not only that the fees it seeks to recover from Squire Sanders were not "*objectively reasonable at the time they were incurred*, under the circumstances then known to counsel" but also that the fees were not incurred for J.R. Marketing's benefit. If Squire Sanders's fees were unreasonable but incurred primarily for J.R. Marketing's benefit, Hartford's reimbursement action should lie against J.R. Marketing, not Squire Sanders.^{49.14}

[iii] Analysis

Looking at the case solely in terms of the issue defined by the supreme court, the decision seems correct. If the fees were really so unreasonable that charging them would have been a violation of the California Rules of Professional Conduct, then Squire Sanders was unjustly enriched to the extent that the

^{49.12} CA—61 Cal. 4th at 1005.

^{49.13} CA—61 Cal. 4th at 1005–06 (citations omitted).

^{49.14} CA—61 Cal. 4th at 1010 (concurring op.).

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fees exceeded the largest permissible charge. That would be equally true if the charges were “fraudulent” or the bills “padded” with clearly unnecessary work.

But an insurer’s right to pay only reasonable charges is not merely a right not to pay amounts that counsel could not lawfully charge. It is a right to pay no more than the market rate for services reasonably necessary to the proper defense of the case. (See § 14.03[4], above.)

Insofar as the fees at stake were potentially lawful charges for services requested by or beneficial to J.R. Marketing, the court of appeal’s result seems largely correct, though some of the court’s reasoning is questionable. The policyholders presumably agreed to pay the rates charged by the law firm. By doing so, they incurred a valid debt to the law firm when it rendered service to them, even if adequate service could have been obtained from a less expensive firm, unless the rates were so exorbitant that it was unethical to charge them. Thus, at least with respect to the rates charged, the law firm was not unjustly enriched by Hartford’s payment.

The Restatement (Third) of Restitution and Unjust Enrichment provides that “[e]ven if the claimant has conferred a benefit that results in the unjust enrichment of the recipient when viewed in isolation, the recipient may defend by showing that some or all of the benefit conferred did not unjustly enrich the recipient when the challenged transaction is viewed in the context of the parties’ further obligations to each other.”⁵⁰ An illustration of that rule is that

A owes B \$ 5,000. Intending to pay C, another creditor, A sends \$ 5,000 to B who accepts the payment despite notice of A’s mistake. (B’s notice of A’s mistake means that B is not entitled to defend as a bona fide payee by the rule of § 67.) A has a prima facie claim to restitution of the mistaken payment (§ 6), but B is not unjustly enriched by A’s unintended payment of a valid debt. B is not liable to A in restitution.⁵¹

While the payment to the law firm in this case was compelled (by the order to pay), the law firm was still not, as to the rates charged, unjustly enriched. Even as to possibly unnecessary work, if the policyholders approved it, it also might have created a valid debt of the policyholder, precluding unjust enrichment of the law firm. While a more refined analysis would have been desirable, the result seems at least approximately correct.

Insofar as the court of appeal’s reasoning suggests that the policyholders had unfettered freedom to approve law firm rates or the cost-effectiveness of particular work, that is inconsistent with the policyholders’ own duty of good faith, as discussed in § 14.03[4] above. The duty of good faith is not dependent on the other party’s performance of its own contractual obligations.⁵² Even if the carrier has breached the duty to defend, the policyholder is obliged to reasonably manage defense costs. The policyholder alone is liable for any excessive amounts it agreed to pay and it would be unjustly enriched if the carrier instead had been required to pay such amounts without reimbursement.

⁵⁰ RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 62 (2011).

⁵¹ RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 62, Illus. 2.

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[b] *National Union Fire Insurance Co. v. Seagate Technology, Inc.*

*National Union Fire Insurance Co. v. Seagate Technology, Inc.*⁵³ was a high stakes dispute over application of the principle that an insurer that wrongfully denies coverage cannot rely on the limitation of independent counsel rates provided by [Section 2860 of the California Civil Code](#). Seagate was sued in 2000 by Convolve, Inc. and the Massachusetts Institute of Technology for patent infringement. National Union and certain of its affiliates (collectively, AIG) insured Seagate. AIG initially refused the tender of defense, but began paying for independent counsel (at § 2860 rates) in 2003. In 2004, AIG sought a declaration that it had no duty to defend. In 2007, the district court ruled that a duty to defend had arisen on November 1, 2001, but terminated on July 18, 2007. Seagate appealed, but AIG withdrew the defense. In 2012, the Ninth Circuit held that the duty to defend had not terminated. As a result, the question arose whether AIG was required to pay the full rates charged by Seagate’s counsel after it withdrew the defense, or only § 2860 rates. This was said to be a \$20 million question.⁵⁴

As the court saw it, everything turned on whether, after the ruling that the duty to defend had terminated, AIG had “wrongfully” withdrawn its defense.⁵⁵ The court relied on general principles regarding the finality of judgments:

In the ordinary case, the duty to defend terminates upon a judicial determination that the insured does not have a potentially-covered claim. The decision granting summary judgment became such a judicial determination when judgment was entered under Rule 54(b). The entry of judgment created a final order with res judicata effect. It is a “basic proposition that all orders and judgments of courts must be complied with promptly. If a [defendant] believes that order is incorrect the remedy is to appeal, but, absent a stay, he must comply promptly with the order pending appeal.”⁵⁶

Seagate had appealed but had not sought a stay. “As a result, NIU was entitled to the benefit of the (erroneous) ruling that there was no longer a duty to defend.”⁵⁷ The court also found persuasive an unpublished Fourth Circuit opinion concluding that withdrawal of a defense in a similar situation was not unjustified under North Carolina law:

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US/CA—[Nat’l Union Fire Ins. Co. v. Seagate Tech., Inc.](#), 2013 U.S. Dist. LEXIS 10502 (N.D. Cal. Jan. 25, 2013).
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US/CA—2013 U.S. Dist. LEXIS 10502, at *2–4; [Nat’l Union Fire Ins. Co. v. Seagate Tech., Inc.](#), 2013 U.S. Dist. LEXIS 89242, at *3–5. Some of the issues in the case turned on the distinctions among the companies, but those can be disregarded for purposes of the point discussed here.
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US/CA—2013 U.S. Dist. LEXIS 10502, at *13–14.
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US/CA—2013 U.S. Dist. LEXIS 10502, at *5 (citations omitted).
57

US/CA—2013 U.S. Dist. LEXIS 10502, at *5–6.

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“it would tip the balance too far in favor of the insured to hold that an insurer must wait for all appeals of a declaratory judgment (relieving it of a duty to defend) to be exhausted before removing its defense of the insured. The fact that the insurer provided a defense for the insured until the time the insurer received a declaratory judgment Order demonstrates to this Court that the insurer adhered to the spirit of the public policy requiring defense of insured persons.”⁵⁸

Following reversal, AIG’s contractual responsibilities were “reinstated retroactively.”⁵⁹ In the court’s view, “During the pendency of the appeals, Seagate should have been aware that it was retaining expensive counsel at a risk to itself. If Seagate had wanted to change this calculus, it should have made a motion for stay pending appeal.”⁶⁰

Putting aside the issue of what effect should be given to the judgment, prior to its reversal, there is some equitable appeal to Seagate’s position on the particular facts in that case. Had AIG continued to fund the defense, California law would have permitted it to reserve the right to recover amounts expended on a defense it was not obligated to provide.⁶¹ Seagate was the rare insured who could be relied upon to reimburse a multimillion defense bill, should it be found that no defense was due. In that situation, the issue was only who should have to advance costs during the pendency of the appeal. But one cannot base a rule of law on the exceptional ability of one insured to provide reimbursement for benefits not due.

This decision will surely be appealed, unless the parties settle. How it will fare on appeal is hard to predict.

§ 14.04 Ethical Obligations of Independent Counsel

[1] Overview

There is a vast amount of literature on the ethical obligations and problems of lawyers defending policyholders on behalf of insurers. There is a smaller, but still substantial amount of literature dealing with whether and when a policyholder is entitled to independent counsel. There is very little published writing addressing the ethical obligations and problems of lawyers serving as independent counsel for policyholders.¹ Of course, those duties include all of the usual duties of a lawyer retained by the

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US/CA—2013 U.S. Dist. LEXIS 10502, at *7, quoting *Auto-Owners Insurance Co. v. Potter*, 242 F. App’x 94, 101 (4th Cir. 2007),

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US/CA—2013 U.S. Dist. LEXIS 10502, at *7.

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US/CA—2013 U.S. Dist. LEXIS 10502, at *14.

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US/CA—*Buss v. Super. Ct.*, 16 Cal. 4th 35, 46–53 (1997).

¹The only substantial treatments known to us are James M. Fischer, *The Professional Obligations of Cumis Counsel Retained for the Policyholder but not Subject to Insurer Control*, 43 TORT TRIAL & INS. PRAC. L.J. 173 (2008), and Douglas R. Richmond, *A Professional Responsibility Perspective on Independent Counsel in Insurance*, 33 No. 1 INS. LITIG. REP. 5 (2011). Our own thinking on these issues has benefited from those articles.

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policyholder to defend a suit. But independent counsel do have their own special ethical issues, which deserve our attention. Some of these issues, notably regarding fees and consultation with the insurer are addressed in § 14.03 above, with particular attention to the interaction of the lawyer's duties and the insurance law duties of the policyholder. Insurance law has a primary role in those issues, with lawyer duties a secondary consideration. This section addresses issues where lawyer duties come to the fore and insurance law plays a secondary role.

[2] Obtaining Informed Consent to the Representation

A key feature of independent counsel is that the lawyer is paid by the insurer, even though the policyholder is the lawyer's sole client. Such third-party payment implicates Model Rule 1.8(f):

A lawyer shall not accept compensation for representing a 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 1.6.²

Looking first to the requirement of "informed consent," the Model Rules define that as "the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct."³ (See also § 9.03, above.) It is not necessary to "inform a client ... of facts or implications already known to the client ... ; nevertheless, a lawyer who does not personally inform the client ... assumes the risk that the client ... is inadequately informed and the consent is invalid."

Thus, while the process by which independent counsel was provided and selected will often have informed the policyholder about some aspects of independent counsel's representation, it is wise for independent counsel to discuss the terms of that representation and some of the problems it can present at the outset and to have that consent and the underlying advice confirmed in writing. Of particular importance are any facts which might raise questions as to counsel's independence of the insurer, such as representations of the insurer or its affiliates in other matters. (See § 6.05[15] above.) Such facts might cause the policyholder to look elsewhere for counsel, if the policyholder makes the selection, or to object to the insurer's selection, if the insurer makes the selection.

The policyholder should understand any significant limitations on the scope of the representation and some important aspects of the way in which the representation will be conducted. The policyholder should be informed of the extent to which the insurer will be consulted in defense planning and the general nature of the problems that can arise if the insurer disagrees with the defensive activities proposed by counsel. (See § 14.03[1]–[2] above.) This information could affect the ways in which the policyholder chooses to be involved in defense planning, even where no dispute has yet arisen. The policyholder should be informed of the arrangements with the insurer regarding payment of fees or the need to negotiate such arrangements, and of any possibility that the policyholder might have to pay or advance some portion of the fees. (See § 14.03[2]&[4] above.) The policyholder should be informed of the extent to which confidential information will be shared with or withheld from the insurer and of the problems

²MODEL RULES OF PROF'L COND. Rule 1.8(f) (2011). *See also* Rule 5.4(c) ("A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services.").

³Model Rule 1.0(e).

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that can arise from such sharing or withholding. (See §§ 14.03[1] above and 14.04[3] below.)

In an independent counsel situation, the insurer will have no right to control the defense, so counsel's independence of judgment would seem assured. But the fee arrangement (or any collateral relationship with the insurer) may provide incentives that could affect counsel's judgment. If so, these must be explained.

[3] Handling Confidential Information and Cooperation with Insurer

[a] Providing and Withholding Information

As in all representations, information relating to the representation must be kept confidential, as provided in Model Rule 1.6.⁴ However, disclosure of such information may be impliedly authorized if useful to the representation, not injurious to the interests of the policyholder, and not forbidden by the policyholder. (See § 10.01, above (discussing confidentiality in representations by assigned counsel).)

Disclosure is useful to the representation if necessary to comply with the policyholder's duty of cooperation, thereby preserving the policyholder's coverage. (See § 14.03[1] above.) Even if disclosure may not be necessary to comply with the policyholder's duty of cooperation, it may be useful if it avoids a risk that the duty might be breached. Disclosure may also be useful if it will help persuade the insurer to take or authorize some action favored by the policyholder (such as settling the case).

Disclosure would be injurious to the policyholder's interests if it would assist the insurer in disputing coverage, so coverage sensitive information must be kept from the insurer unless the policyholder gives informed consent to disclosure.⁵ (If defense counsel is not a coverage lawyer, it may be necessary to obtain coverage advice to determine what information is or is not coverage sensitive.) Disclosure may also be injurious to other interests of the policyholder, such as interests in reputation. And, of course, the policyholder may forbid disclosure of certain information even if not otherwise injurious to the policyholder.

If information to be withheld is not coverage sensitive, withholding it might breach the policyholder's duty of cooperation. The policyholder should be advised of this risk. If defense counsel is not able to evaluate that risk, the policyholder should be warned of it and advised to consult other counsel if evaluation is desired. (See § 9.02[5] & [7], above.)

[b] Avoiding Waiver and the Common Interest Rule

But counsel must also beware of the risk of waiving privilege for information communicated to the carrier. Voluntary disclosure of privileged information to a nonprivileged person can waive the privilege.⁶ Because the carrier shares common interests with the policyholder in defeating or minimizing the claim, it might be thought that information could be shared without risk of waiver under a common

⁴MODEL RULES OF PROF'L COND. Rule 1.6 (ABA 2011).

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IL—Illinois law is exceptional on this issue, taking the view that the insurer and policyholder are persons of common interest on all aspects of a defense representation, even where there is a coverage dispute and the policyholder is represented by independent counsel. *Waste Management, Inc. v. International Surplus Lines Ins. Co.*, 144 Ill. 2d 178, 194 (1991). Where this rule applies, the policyholder must be warned. As a practical matter, this results in an exception to what would otherwise be the applicable attorney-client privilege. Independent counsel subject to this rule should still not make disclosures of material damaging to the policyholder's interests without a court order to do so.

⁶RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 79 (2000).

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interest arrangement.⁷ But the exception to the waiver rule permitting sharing of information among persons of common interest has an additional requirement that is often overlooked: each party to the common-interest arrangement must be represented by a lawyer.

The rejected Federal Rule of Evidence 503 on attorney-client privilege formulated the common-interest rule as one permitting sharing between lawyers: the privilege extends to communications “by [the client] or his lawyer *to a lawyer representing another* in a matter of common interest.”⁸ While that rule never took effect, federal courts often look to it as a succinct statement of the common law that Rule 501 of the Federal Rules of Evidence makes authoritative in cases where federal law provides the rules of decision.⁹ The Third Circuit has explained the basis and evolution of the rule:

Recognizing that it is often preferable for co-defendants represented by different attorneys in criminal proceedings to coordinate their defense, courts developed the joint-defense privilege. In its original form, it allowed the attorneys of criminal co-defendants to share confidential information about defense strategies without waiving the privilege as against third parties. Moreover, one co-defendant could not waive the privilege that attached to the shared information without the consent of all others. Later, courts replaced the joint-defense privilege, which only applied to criminal co-defendants, with a broader one that protects all communications shared within a proper “community of interest,” whether the context be criminal or civil. Thus, the community-of-interest privilege allows attorneys representing different clients with similar legal interests to share information without having to disclose it to others. It applies in civil and criminal litigation, and even in purely transactional contexts.¹⁰

But, as implied by the statement in Rejected Rule 503, one noteworthy feature of the resulting rule is that “to be eligible for continued protection, the communication must be shared with the attorney of the member of the community of interest.”¹¹ The Restatement’s formulation of the common-interest rule also imposes this requirement: “If two or more clients with a common interest in a litigated or nonlitigated matter *are represented by separate lawyers* and they agree to exchange information concerning the matter, a communication of any such client that otherwise qualifies as privileged ... that relates to the matter is privileged as against third persons.”¹² As a result, “[a] person who is not represented by a lawyer and who is not himself or herself a lawyer cannot participate in a common-interest arrangement.”¹³

⁷ RESTATEMENT § 76.

⁸ Rule 503(b)(3), reprinted in 3 Joseph M. McLaughlin, WEINSTEIN’S FEDERAL EVIDENCE, SECOND EDITION § 503 (emphasis added).

⁹ 3 Joseph M. McLaughlin, WEINSTEIN’S FEDERAL EVIDENCE, SECOND EDITION § 501.02[1][c].

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US—Teleglobe Communs. Corp. v. BCE, Inc. (In re Teleglobe Communs. Corp.), 493 F.3d 345, 36364 (3rd Cir. 2007).

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US—493 F.3d at 364.

¹² RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 79 (2000) (emphasis added).

¹³ RESTATEMENT § 79, cmt. d.

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In 2012, the Texas Supreme Court applied the requirement that each party have counsel to deny privilege in a case where counsel for a workers compensation carrier had shared reports to the carrier with the employer, who was interested because payments under the policy were subject to a deductible of \$1 million per claim.¹⁴ Under Texas law, the carrier alone was liable, and the employer was not a party to the proceeding.¹⁵ There is no insurer-insured privilege, though communications between the two relating to liability insurance claims may sometimes be covered by the attorney-client privilege.¹⁶ Because the employer was not represented by counsel regarding the matter, the communications could not be protected from waiver by the common-interest exception (which the Texas court dubbed the “allied litigant doctrine”).¹⁷ Nor was the employer a joint client.¹⁸ Accordingly, disclosure to the employer had waived the privilege, making the disclosed communications available to the employee in a bad faith action against the carrier.

It would seem that the communications might still have been protected by the work product immunity. (See § 10.07[5], above.) But no argument based on that doctrine was made in the case. Unless that protection were available and adequate to prevent adverse effect on the policyholder, the resulting risk to privilege would have meant that independent counsel’s duty of confidentiality would preclude sharing of privileged information unless the carrier were represented by counsel, through whom the information was shared.

The Restatement of the Law of Liability Insurance provides that, even in an independent counsel situation, “[t]he insured’s provision of information to the liability insurer does not waive confidentiality of the information with respect to third parties.”¹⁹ It reasons that:

The grounds for protecting confidentiality in the independent counsel context are identical to those in ordinary-duty-to-defend context. The conflict of interest that lies behind the independent counsel requirement does not eliminate the common interest of insurer and insured in defeating the third-party claim; it does not change the fact that the insurer serves as the insured’s agent for purposes of settling; and it does not eliminate the need for the insurer and insured to share confidential information in a manner that is protected from third

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TX—*In re XL Specialty Ins. Co.*, 373 S.W.3d 46 (Tex. 2012).

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TX—373 S.W.3d 46, 53–54.

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TX—373 S.W.3d 46, 53–54.

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TX—373 S.W.3d 46, 54.

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TX—373 S.W.3d 46, 54–55.

¹⁹RESTATEMENT OF THE LAW OF LIABILITY INSURANCE § 17(5) (Prop. Final Dr. No. 1 Mar. 28, 2017).

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parties.²⁰

Notwithstanding the Restatement, the implication of the foregoing is that a carrier that wishes to receive privileged information from independent counsel may itself need to have counsel regarding the matter and conduct any sharing through counsel, lest a court take the view that sharing without such counsel waives the privilege. (See § 10.__, above)

[c] Courts Ought Not To Confuse the Common Interest Rule with the Joint Client Rule

In *Maplewood Partners, L.P. v. Indian Harbor Insurance Co.*²¹ the court treated a nondefending insurer as a co-client of the policyholder's defense counsel, thereby granting the insurer access to the policyholder's privileged and work product materials from the underlying litigation for use in the coverage litigation. The error of constructing an attorney-client relationship for that purpose is discussed in § 4.04[6], above. This section will contrast the court's handling of the waiver issue under the joint client rule with the treatment that should have been accorded under the common interest rule.

This was a coverage suit, in which Maplewood and related entities and individuals contended that Indian Harbor had paid less than was due for defense and indemnification of underlying suits. There were three of these, the "RRGC action," the "Slashy matter," and the "Green claim." Indian Harbor sought discovery of materials the Maplewood parties claimed were privileged. Indian Harbor argued that it had been a joint client, so that no privilege or immunity barred its access to the documents.²² The court essentially agreed.²³

The policy was a financial services liability policy, which did not impose a duty to defend, but did require the insurer to pay for defense expenses (along with damages, judgments, settlements, etc.) in excess of the \$250,000 retention. Defense expenses could not be incurred without Indian Harbor's consent, and the policyholders agreed "to provide the Insurer with all information, assistance, and cooperation that the Insurer may reasonably request."²⁴

Retention of defense counsel is not described, but it appears that they (two separate firms) were retained by the policyholders, as would be the norm under a duty to reimburse policy (in contrast to a duty to defend policy). In the RRGC action, defendants acted as a joint defense group. Defense counsel Miller communicated regularly with Indian Harbor, through the insurer's [monitoring] counsel. Miller provided assessments of liability, litigation updates, and settlement estimates, all pursuant to and consistent with

²⁰ RESTATEMENT § 17, cmt. *d* (citation omitted).

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US/FL—*Maplewood Partners, L.P. v. Indian Harbor Ins. Co.*, 295 F.R.D. 550 (S.D. Fla. 2013).

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US/FL—295 F.R.D. at 556–57.

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US/FL—295 F.R.D. at 603–04. The opinion extensively analyzed confidentiality issues, and that discussion is addressed in § 14.04[3], below. The discussion here focuses solely on whether there was joint representation.

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US/FL—295 F.R.D. at 557–58.

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the Policy's cooperation clause. Miller also prepared a litigation budget and a "Pre-trial Report" for Defendant, who paid for the preparation of the Report, which included an assessment of the financial and legal risks of the litigation.²⁵

Miller told Indian Harbor's counsel that he was "'always happy to speak with [insurer's counsel] to answer any questions you may have [regarding potential liability and damages/value of the RRGC action].'"²⁶

Throughout the RRGC action, the Maplewood parties treated their interests as aligned, never discussing any allocation of responsibility among themselves.²⁷ Indian Harbor was included in settlement discussions.²⁸ It consented to the settlement and contributed to it. But another insurer, Travelers, and some of the Maplewood parties paid all defense expenses. They and Travelers paid the bulk of the settlement.²⁹ The Maplewood parties now sought reimbursement for some of the defense expenses and settlement costs they paid.

In the Shashy matter, all of the Maplewood parties were represented by Miller. The claims were resolved in a mediation, at which Indian Harbor was present. The Maplewood parties now sought reimbursement of defense expenses.³⁰

The Green claim originated as a counterclaim in the Shashy matter and was resolved by arbitration. The Maplewood parties now sought reimbursement of defense costs.³¹

The court concluded that all of the Maplewood parties were joint clients of Miller and his legal team, and then inquired whether Indian Harbor was also a client, observing that "'[a]s a general matter, no co-client is entitled to have a lawyer withhold material information from another. There is no reason to

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US/FL—295 F.R.D. at 563–65 (footnotes omitted).

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US/FL—295 F.R.D. at 565 n.54.

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US/FL—295 F.R.D. at 565–66.

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US/FL—295 F.R.D. at 566.

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US/FL—295 F.R.D. at 567–68.

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US/FL—295 F.R.D. at 569.

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US/FL—295 F.R.D. at 569.

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make insurance defense representations an exception to this rule.’ ”³²

The court relied on the fact that defense counsel provided extensive confidential information to Indian Harbor’s monitoring counsel, without ever seeking a waiver from the Maplewood parties permitting such disclosure.³³ It also relied on cases allowing policyholders to discover communications between the insurer and the defense counsel retained to defend the policyholders.³⁴

The court recognized that there were two distinct doctrines that would permit disclosure of privileged material without waiving the privilege:

The confidentiality element of the attorney-client privilege can be viewed as a limit on the scope of the privilege, i.e., the privilege does not extend past the boundary within which the attorney and client maintain confidentiality in common. Two doctrines protect from disclosure those items as to which a court might otherwise conclude that the privilege had been waived by a failure to maintain confidentiality: the “joint client” and the “common legal interest” doctrines. These two doctrines are distinct and do not overlap.³⁵

The court accurately described the common interest doctrine as follows:

The “common legal interest” rule is an exception to the general rule that disclosure of otherwise privileged communications eliminates, or waives, the privileged status of those communications. This rule “enables litigants who share unified interests to exchange this privileged information to adequately prepare their cases without losing the protection afforded by the privilege.”

Pursuant to this doctrine, attorneys representing clients with similar legal interests can share information without risk of being compelled to disclose such information generally. Interests of the members of the joint defense group need not be entirely congruent. One member of a joint defense group cannot waive the privilege that attached to the information shared by another member of the group without the consent of that member, but any defendant could, of course, testify as to her own statements at any time. By agreeing to be a part of a joint defense, she only agrees not to disclose anything learned from her co-defendants

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US/FL—295 F.R.D. at 595, quoting *Defense Lawyers’ Professional Responsibilities: Part II—Contested Coverage Cases*, 15 GEO. J. LEGAL ETHICS 29, 86 (2001) (citations and notes omitted).

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US/FL—295 F.R.D. at 597.

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US/FL—295 F.R.D. at 599–600.

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US/FL—295 F.R.D. at 594 (footnote omitted).

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through that joint arrangement, nor could any of those co-defendants disclose what she had told them or their attorneys in confidence. However, if the parties to that agreement are later in opposition with each other, statements which were made by one co-defendant to another defendant's attorney are not protected by privilege.³⁶

The court expressed “a healthy skepticism as to the doctrine’s worth” and an intent to “rein in what may be considered an overly broad interpretation of the ‘common legal interest’ (formerly ‘joint defense group’) exception to traditional concepts of waiver of the attorney-client privilege.”³⁷ Nonetheless, the court concluded that the doctrine “provides an alternative basis to support my conclusion that [the Maplewood parties] must disclose the documents listed in the privilege log.”³⁸

The court agreed that that the parties had a common legal interest in the underlying litigation: [Indian Harbor] also was engaged in [the Maplewood parties’] settlement discussions, as required by the Policy’s explicit terms which [the Maplewood parties] accepted when purchasing the Policy. It is evident that [Indian Harbor] shared a common legal interest in defending its insured in the underlying proceedings. This interest was legal, and not just financial, because of the multiple additional issues—including, e.g., the question of whether other entities might proceed against the insurer in the event of an unsatisfactory result.³⁹

But even while analyzing application of the common interest doctrine, the court relied on its conclusion that Indian Harbor was a co-client:

The interests of [the Maplewood parties] (and their entire joint defense group) were aligned with Indian Harbor as all had an interest in minimizing liability in the Underlying Matters. [The Maplewood parties] have declared that: “No legal effort was made in connection with the prosecution of Maplewood’s counterclaims in RRG or Shashy that did not operate to minimize the potential liability of an insured on a claim made against the insured.” In other words, all of Miller’s efforts were geared toward minimizing liability, which would be the goal of Indian Harbor as well. The law provides that *all of these joint clients, including Indian Harbor*, could freely communicate (without waiving any

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US/FL—295 F.R.D. at 605–06.
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US/FL—295 F.R.D. at 606–07 & n.232.
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US/FL—295 F.R.D. at 607 n.232.
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US/FL—295 F.R.D. at 610.

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privilege) in order to prepare a successful defense.⁴⁰

The joint client conclusion cannot be right in connection with a common-interest arrangement. The common interest doctrine applies only when the cooperating parties do *not* share an attorney (typically because they have conflicting interests on matters related to the one in which they share a common interest). As the court itself recognized, the two rules do not overlap.⁴¹

The court continued by reasoning that

if it is assumed that the insurer shares a “common legal interest” with [the Maplewood parties], then Miller’s communications to Defendant on behalf of all of his clients and as to all details of the RRG settlement are construed to be two client’s “consulting in common” of an attorney. Miller communicated, presumably, at all times with the permission of Maplewood Partners, acting through Glaser. The other clients cannot now claim that certain aspects were privileged, as they apparently raised no objection at the time and, in any event, Glaser apparently granted permission for the disclosures on behalf of the corporate entity holding the privilege.

That is true enough *as to information that was voluntarily shared* pursuant to the common-interest arrangement. It is wrong, as it applies to information and documents not voluntarily shared. If two clients were indeed consulting the lawyer in common, the lawyer would have a fiduciary duty to each client to provide full information as to all matters within the scope of the relationship. Clients who permit their lawyers to share certain matters bearing on their common interests do not thereby assume any duty to share other information which, while related to their common interest, may also pertain to matters where there are conflicting interests. Thus, except in Illinois,⁴² existence of a common legal interest does not provide a basis for one party to demand access to information about another party’s privileged communications that were not voluntarily shared with it.⁴³

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US/FL—295 F.R.D. at 607 (emphasis added, footnote and citation omitted).

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US/FL—295 F.R.D. at 594.

⁴² See

IL—Waste Mgmt., Inc. v. Int’l Surplus Lines Ins. Co., 144 Ill. 2d 178, 193–95 (1991), criticized in § 2.06[2], above. The court based the requirement of disclosure, alternatively, on the insured’s duty to cooperate and on the common-interest doctrine. The discussion in § 2.06[2] specifically addresses the cooperation clause rationale. But, the criticism expressed there applies equally to the common-interest rationale. Additional reasons to reject the cooperation-clause rationale are set forth in this sub-subsection.

⁴³ E.g.,

US/CT—Remington Arms Co. v. Liberty Mut. Ins. Co., 142 F.R.D. 408, 418 (D. Del. 1992) (“ ‘the rationale which supports the ‘common interest’ exception to the attorney-client privilege simply doesn’t apply if the attorney never represented the party seeking the allegedly privileged materials.’ ”), quoting Bituminous Casualty Corp. v. Tonka

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The discovery request pursuant to which the court ordered production was not limited to information that had been voluntarily shared, but rather demanded:

3. All documents and communications between You and any of Your Agents, including but not limited to [defense counsel], pertaining to the Underlying Matters.
4. All documents and communications pertaining to estimates, evaluations and/or assessments of your potential legal liability and/or settlement values in the Underlying Matters made by You and/or Your Agents.⁴⁴

Nonetheless, having concluded that the parties “consulted [defense counsel] in common, the court applied what it thought to be the applicable Florida rule: “ ‘There is no lawyer-client privilege ... [as to] a matter of common interest between two or more clients ... or their successors in interest, if the communication was made by any of them to a lawyer retained or consulted in common when offered in a civil action between the clients.’ ”⁴⁵ But that statute, on its face, applies to joint client relationships, not common-interest arrangements, where the parties have separate attorneys and do not “consult in common” with either of those attorneys in the way joint clients would do.

The court supported its analysis by concluding that it would be difficult, burdensome, and potentially complicated for defense counsel to distinguish and separately treat coverage sensitive information, while freely sharing information relating only to the defense:

As defense counsel, Miller is not charged with knowledge of coverage issues. To effectively defend his clients, Miller needed the trust and confidence of his clients, and his primary objective was loss minimization in the Underlying Matters, an objective shared by the clients who hired him and the “client” who was potentially responsible for any judgment, and for Miller’s fees. Miller was not being compensated to establish coverage (or lack thereof), but rather was contracted to advance his clients’ interests, as they defined them, in the Underlying Matters. Nor should Miller, or any defense counsel, need to spend much time deciding who they represent as a client. Miller could get a waiver from [the Maplewood parties] as to his ability to communicate with the insurer and, if his clients are not willing, then perhaps they need other counsel. If Miller is going to disclose information to Indian Harbor that might be adverse to the coverage question, then Miller needs to tell his clients in advance. If the clients object to the disclosure, then they face the risk that the cooperation clause of the insurance policy will have been breached and there will be no coverage. If the clients agree to the disclosure, then Miller might need

Corp., 140 F.R.D. 381, 386 (D. Minn. 1992).
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US/FL—*Maplewood*, 295 F.R.D. at 580.
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US/FL—295 F.R.D. at 594 n.189, quoting FLA. STAT. § 90.502(4)(e).

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to withdraw as defense counsel rather than straddle the line between two sets of interests. There is no rational basis to burden Miller or other defense attorneys with the dual role of protecting privileged items while also trying to obtain reimbursement for defense expenses as to underlying claims defended before the insured ends up in litigation against its own insurer. Thus, the conception of a joint client relationship as to all communications relating to the Underlying Matters provides clear guidance as to boundaries of privilege.⁴⁶

The Maplewood parties and defense counsel certainly could have proceeded in that way, if they were willing to accept the duties of disclosure which would flow from making Indian Harbor a joint client. But if the Maplewood parties desired to retain discretion as to what information would be shared (perhaps at the cost of facing accusations of noncooperation), they were free to accept the difficulties, burdens, and complexities of a common-interest arrangement without the duties of disclosure which would flow from making Indian Harbor a joint client. The court improperly conflated the common-interest doctrine with the joint client rules, thereby depriving the Maplewood parties of the benefits of their choice not to be joint clients with Indian Harbor. Other courts should not make that mistake.

[4] Honesty and Avoidance of Fraud [a] Deceptive Statements or Omissions

Representation of a policyholder by independent counsel typically takes place in a context where the policyholder and the insurer are adversaries with respect to coverage. As a result, both policyholder and counsel are entitled to withhold from the insurer information relating to the defense representation that is coverage sensitive. But even in the context of an adversarial relationship, the lawyer is not permitted to lie to the insurer. Model Rule 4.1 provides that “[i]n the course of representing a client, a lawyer shall not knowingly ... make a false statement of material fact or law to a third person”⁴⁷ (*i.e.*, someone other than the client). Moreover, Model Rule 8.4 provides that “[i]t is professional misconduct for a lawyer to ... (c) engage in conduct involving dishonesty, fraud, deceit, or misrepresentation.”⁴⁸

Professor Fischer has noted the following implications of these rules:

An attorney may not make a misrepresentation and may not use the rule of confidentiality to justify the speaking of untruths. When the attorney speaks, the attorney must speak honestly. A statement that is a half-truth because it omits material facts needed to put the statement in its proper context may be deemed a misrepresentation subjecting the speaker to civil liability. As recently noted by the Montana Supreme Court, the privilege to withhold client confidential information does not provide a license or justification for misleading utterances. An attorney who discloses information to the insurer to enable the insurer to determine its duties and obligations under the insurance contract must take care to disclose accurately and truthfully or not disclose at all. Even a negligent

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US/FL—295 F.R.D. at 609–10 (footnote omitted). Of course, there would be no need for Miller to straddle any line if Miller never undertook any duties to Indian Harbor, beyond the general legal duty to refrain from misrepresentation.

⁴⁷ MODEL RULES OF PROF’L COND. Rule 4.1 (ABA 2011).

⁴⁸ MODEL RULES OF PROF’L COND. Rule 8.4 (ABA 2011).

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statement may be actionable if it contains a material misrepresentation on which the recipient of the information (the insurer) reasonably relies to its detriment. The scope of a lawyer's liability for negligent misrepresentation has been hotly debated and disputed. The fact that the identity of the recipient of the information is known and the specific end and aim of the communication is to induce action by the insurer are factors enhancing the likelihood that the court would find *Cumis* counsel owed a duty of candor to the insurer. *Cumis* counsel must be careful not to confuse the absence of a duty of care owed to the insurer with the existing duty to avoid making material misrepresentations to the insurer.⁴⁹

The lawyer need not even be the source of the false statement. Douglas Richmond notes that “a lawyer may violate Rule 4.1(a) by knowingly affirming or ratifying another person's false statement, or by failing to correct it.”⁵⁰

These rules can be triggered by very limited culpability. The Rule 4.1 requirement that the misrepresentation be made “knowingly” requires only actual knowledge of the falsity, not any “evil intent or a bad purpose.”⁵¹ Many courts require knowing falsehood to establish violation of Rule 8.4(c).⁵² But others hold that even statements made with reckless disregard for their truth or falsity can constitute violations.⁵³ Indeed, at least one jurisdiction will find a violation based on grossly negligent misstatements.⁵⁴

⁴⁹ James M. Fischer, *The Professional Obligations of Cumis Counsel Retained for the Policyholder but not Subject to Insurer Control*, 43 TORT TRIAL & INS. PRAC. L.J. 173, 187–88 (2008) (footnotes omitted).

⁵⁰ Douglas R. Richmond, *A Professional Responsibility Perspective on Independent Counsel in Insurance*, 33 No. 1 INS. LITIG. REP. 5, 18 (2011).

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ND—*In re Edison*, 724 N.W.2d 579, 584 (N.D. 2006).

⁵² *See, e.g.,*

FL—*Fla. Bar v. Mogil*, 763 So. 2d 303, 309–11 (Fla. 2000);

MA—*In re Firstenberger*, 878 N.E.2d 912, 913–14 (Mass. 2007);

OR—*In re Conduct of Skagen*, 149 P.3d 1171, 1184 (Or. 2006).

⁵³ *E.g.,*

DC—*In re Ukwu*, 926 A.2d 1106, 1113–14 (D.C. 2007);

IA—*Iowa Supreme Court Atty. Disciplinary Bd. v. Gottschalk*, 729 N.W.2d 812, 818 (Iowa 2007);

PA—*Office of Disciplinary Counsel v. Surrick*, 749 A.2d 441, 445 (Pa. 2000).

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AR—*Walker v. Supreme Court Comm. on Prof'l Conduct*, 246 S.W.3d 418, 424 (Ark. 2007).

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Nor does a violation of these rules require that anyone be misled or harmed by the misrepresentation.⁵⁵ Rule 8.4(c) contains no express requirement of materiality, though some courts will imply one.⁵⁶

Thus, independent counsel must take care to avoid false or misleading statements or omissions in communicating with the insurer. Moreover, independent counsel must be careful in advocating the policyholder's position to the insurer. Thus, in trying to induce the insurer to settle, it may be useful to argue that there is a great risk of excess liability if the case is tried. And it may be possible to argue that the likelihood or likely magnitude of the judgment is greater than counsel personally believes it to be. If so, counsel must avoid stating any opinion regarding the risk that does not reflect counsel's actual beliefs.

[b] Assisting Fraud

Model Rule 1.2(d) forbids a lawyer to "counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent."⁵⁷ If independent counsel learns that the policyholder is perpetrating a fraud, counsel may not assist in doing so. The first step will usually involve remonstrance with the policyholder to correct any prior misrepresentations and refrain from any in the future. If the policyholder will not do so, it may sometimes be sufficient for independent counsel to withdraw from the representation. But, as Prof. Fischer points out, in some instances

[o]ne may even argue that counsel has affirmative disclosure obligations here and may not simply remain silent if counsel is aware that the policyholder client is perpetrating a fraud on the insurer. Rule 4.1(b) provides that an attorney must disclose a material fact when necessary to prevent assisting a criminal or fraudulent act by the client, unless disclosure is prohibited by Rule 1.6. Traditionally, the Rule 1.6 confidentiality exception swallowed the rule. Recent amendments to Rule 1.6 have, however, added exceptions that "permit" the attorney to disclose client confidential information to prevent "the client from committing a crime or fraud reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services." Disclosure is no longer "prohibited," as that term is used in Rule 4.1(b) because Rule 1.6(b)(2)–(3) permits disclosure; therefore, the exception no longer significantly constrains the duties set forth in Rule 4.1(b), i.e., disclose material facts "to avoid assisting a criminal or fraudulent act by a client."⁵⁸

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CT—*Ansell v. Statewide Grievance Comm.*, 865 A.2d 1215, 1223 (Conn. App. Ct. 2005).

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OR—*In re Conduct of Skagen*, 149 P.3d 1171, 1184 (Or. 2006).

⁵⁷ MODEL RULES OF PROF'L COND. Rule 1.2(d) (ABA 2011). *Accord* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 94(2) (2000).

⁵⁸ James M. Fischer, *The Professional Obligations of Cumis Counsel Retained for the Policyholder but not Subject to Insurer Control*, 43 TORT TRIAL & INS. PRAC. L.J. 173, 189 (2008) (footnotes omitted). *See* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 67(1)–(2) (2000) (authorizing disclosure on the same basis as Model Rule 1.6(b)(2)–(3)). The Restatement explains that these exceptions to the duty of confidentiality

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Of course, even if that argument is accepted, it would still be necessary to determine when disclosure is necessary to prevent assisting a fraud.

[5] Involvement in Policyholder Disputes with the Insurer

[a] Disputes Regarding the Representation

If there are disagreements with the insurer on conduct of the defense, the policyholder will require advice on the risks and benefits of acceding to the insurer's wishes or proceeding contrary to those wishes. Defense counsel is better positioned than any other lawyer in evaluating the impact on the lawsuit being defended of proceeding one way or another. After all, defense counsel may have considered both alternatives before making a recommendation and certainly considered both alternatives before concluding that another course was preferable to the one recommended by the insurer. Defense counsel might not be competent to advise on the risks of breaching insurance policy duties by proceeding contrary to the insurer's wishes. But the insured will require advice on this subject, and if defense counsel is competent to provide that advice, defense counsel is the most logical person to do so.

Such advice might be considered coverage advice, for which the policyholder, rather than the insurer, should pay. But it might not be separable from advice regarding the defense or any separable component might be too small to be worth trying to break out.

[b] Disputes Regarding Coverage and Claim Handling

Because the insurer is not a client of independent counsel, there is no ethical obstacle to counsel also representing the policyholder on coverage and other disputes with the insurer.⁵⁹ But there is an argument that, as a matter of insurance law, "an insurer is within its rights to insist that lawyers serving as independent counsel not advise insureds on coverage."⁶⁰

reflect a balance between the competing considerations of protecting interests in client confidentiality and lawyer loyalty to clients, on the one hand, and protecting the interests of society and third persons in avoiding substantial financial consequences of crimes or frauds, on the other The exceptions are ... justified on the ground that the client is not entitled to the protection of confidentiality when the client knowingly causes substantial financial harm through a crime or fraud and when ... the client has in effect misused the client-lawyer relationship for that purpose. In most instances of unlawful client acts that threaten such consequences to others, it may be hoped that the client's own sober reflection and the lawyer's counseling will lead the client to refrain from the act or to prevent or mitigate its consequences. [RESTATEMENT, § 67, cmt. b.]

⁵⁹ See, e.g.,

US/PA—*Maddox v. St. Paul Fire & Mar. Ins. Co.*, 2002 U.S. Dist. LEXIS 26686, at *10 n.6 (W.D. Pa. May 29, 2002), *appeal dismissed*, 2003 U.S. App. LEXIS 14715 (3d Cir. Jul. 22, 2003);

US/NY—*Emons Indus, Inc. v. Liberty Mut. Ins. Co.*, 747 F. Supp. 1079, 1083–84 (S.D.N.Y. 1990). See also Douglas R. Richmond, *Independent Counsel in Insurance*, 48 *SAN DIEGO L. REV.* 857, 894 (2011).

⁶⁰ 48 *SAN DIEGO L. REV.* at 895.

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This argument is not very strong. It relies on two cases,⁶¹ which both take the position that the insurer is entitled to approve the policyholder's selection of defense counsel, such approval not to be unreasonably withheld.⁶² Those cases are therefore unlikely to be followed in jurisdictions holding that the policyholder is entitled to select independent counsel unilaterally. (See § 14.02 above.)

More importantly, both cases proceed on the basis that the insurer is under a duty to provide only an impartial defense—not to sacrifice its own interests. [The policyholder's] defense counsel must not be motivated to slant the defense in any manner relating to whether a claim is or is not in the scope of coverage. Allowing [the policyholder] to appoint as “independent counsel” a firm that bears its loyalty to [the policyholder] or any animus to [the insurer] would reintroduce, albeit in a converse manner, the very difficulties that necessitate in the first instance the appointment of independent counsel.⁶³

But this ignores the fact that defense counsel often must advocate a position on coverage sensitive issues. Thus, when the policyholder is alleged to have harmed the plaintiff either negligently or intentionally, the policyholder surely does not receive a complete defense unless defense counsel argues that the injury was no more than negligent. A policyholder defended other than in this way could be subjected to both an unjustified finding of intentional injury (with the resulting increased damages) and, in consequence, a loss of coverage. Such a policyholder could wind up worse off than had there been no insurance. The insurer's protection is not some artificial “impartial” defense; it is the right not to be bound on coverage by the findings made in a case where control of the defense rested in the hands of a policyholder with coverage interests adverse to those of the insurer.⁶⁴

More generally, the right to independent counsel exists only because of a conflict arising out of the manner in which the defense can be conducted. The point of giving the insured independent counsel is to ensure that judgment calls relating to the defense are made in the way that benefits the policyholder rather than the insurer. Independent counsel must therefore be able to advise the policyholder as to how different defense choices could impact coverage.

⁶¹ See:

US/NY—*N.Y. State Urban Dev. Corp. v. VSL Corp.*, 563 F. Supp. 187 (S.D.N.Y. 1983), *aff'd in pertinent part*, 738 F.2d 61, 65–66 (2d Cir. 1984);

US/PA—*Maddox v. St. Paul Fire & Mar. Ins. Co.*, No. 01-1264, 2002 U.S. Dist. LEXIS 26686 (W.D. Pa. May 29, 2002), *appeal dismissed*, 2003 U.S. App. LEXIS 14715 (3d Cir. Jul. 22, 2003).
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US/NY—In *VSL Corp.*, that position was based, in part, on policy language found to reserve that right. 738 F.2d at 65. That makes the case even less likely to be followed in the absence of such policy language.
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US/NY—563 F. Supp. at 190 n.1, *followed by* 2002 U.S. Dist. LEXIS 26686, at *8–9.

⁶⁴ RESTATEMENT (SECOND) OF JUDGMENTS § 58(2) (1982).

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The insurer is entitled to have bills limited to services required to defend the policyholder, so it does not pay for the policyholder's representation in coverage disputes. But there is no reason to deny the policyholder the right to the economies of using one law firm for both defense and coverage, if the lawyers in that firm are competent to render both types of service and the policyholder wishes them to do so.⁶⁵

A different view was taken in *General Insurance Co. of America v. Walter E. Campbell Co.*⁶⁶ Walter E. Campbell Co. ("WECCO") had, "for decades, engaged in the business of handling, installing, disturbing, removing, and selling asbestos-containing insulation materials."⁶⁷ This was a coverage action regarding defense and indemnification of many underlying asbestos-personal-injury cases.⁶⁸ The principal coverage issues were (1) when the claimant in each case was exposed to asbestos (which affected allocation of coverage) and (2) whether and when the claimant had been exposed to asbestos during WECCO's ongoing operations (to which only per-occurrence limits applied) as opposed to injury resulting from completed operations (to which aggregate limits applied).⁶⁹

WECCO settled with two of its insurers, agreeing to assume their obligations and to reduce any claims against non-settling insurers by any amounts allocable to settling insurers.⁷⁰ By stepping into the shoes of the settling insurers, WECCO had the largest share of the defense obligation, so the court agreed that it should take the lead in managing the defense.⁷¹

WECCO had substituted its coverage counsel, Morgan Lewis & Bockius ("MLB") as defense counsel in the underlying actions and the non-settling insurers objected, arguing that it had a conflict of interest, and the court agreed: "Given the long and protracted efforts of [MLB] to pull cases into coverage under the Non-Settled Insurers' policies, [MLB] cannot also be placed into the position where it can slant the defense in a manner that could render the claims covered claims."⁷² Accordingly, as long as MLB remained counsel, the non-settled Insurers would have "no defense or indemnity obligations with respect to those suits."⁷³

But this would appear to be an ordinary situation in which a pivotal issue (when exposure occurred and in what circumstances) is involved in both defense of the underlying action and the coverage dispute. If so, WECCO would have a right to independent counsel, even had it not assumed the rights of the settling insurers to defend. For the reasons stated above, WECCO would have had the right to have its counsel defend in a manner that maximized its interests, including its coverage interests.

If WECCO did not have a right to independent counsel, then the claim of the non-settling insurers

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US/NY—Emons Indus, Inc. v. Liberty Mut. Ins. Co., 747 F. Supp. 1079 (S.D.N.Y. 1990).

⁶⁶ Gen. Ins. Co. of Am. v. Walter E. Campbell Co., 2016 U.S. Dist. LEXIS 62842 (D. Md. May 12, 2016).

⁶⁷ 2016 U.S. Dist. LEXIS 62842, at *7.

⁶⁸ Gen. Ins. Co. of Am. v. Walter E. Campbell Co., 107 F. Supp. 3d 466 (D. Md. 2015).

⁶⁹ 107 F. Supp. 3d at 473.

⁷⁰ 107 F. Supp. 3d at 480.

⁷¹ 2016 U.S. Dist. LEXIS 62842, at *14–15.

⁷² 2016 U.S. Dist. LEXIS 62842, at *15.

⁷³ 2016 U.S. Dist. LEXIS 62842, at *15.

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would have depended on some right to have the settling insurers defend impartially on behalf of all insurers. We are not aware of any authority on whether such a right would exist. But even if it did, MLB would not have been conflicted. It would defend in whatever manner its client, WECCO directed. If that defense were improperly conducted, the responsibility would have rested on WECCO, not MLB.

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