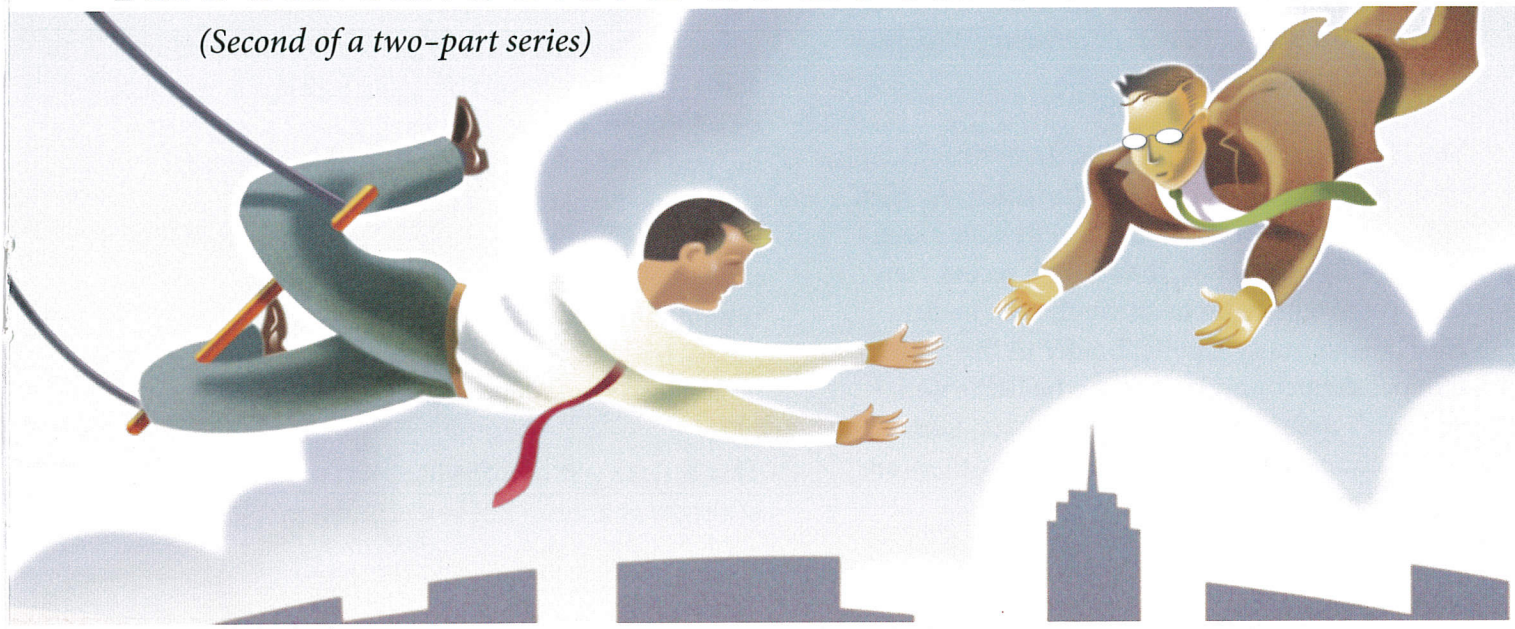
Appointing No. 2 To Look Out For No. 1

(Second of a two-part series)



When your insurer must provide you a second attorney

By David A. Shaneyfelt, Partner, Wood & Bender

You know what to do when you or your company are served with a lawsuit. As a policyholder, you tender that suit to your insurance carrier to defend you against any covered claims. But what should you do if your carrier writes back, saying it will defend the suit under a "reservation of rights"?

Your best defense is to know your rights, because when the insurer accepts the suit under a reservation of rights your defense is conditional. The insurer will defend you now, but down the road, you may be on your own. You may lose your rights to a defense and may even have to pay back your insurer for the costs of your defense.

At this point, you risk having a very different relationship with the attorney your insurer appointed to represent you. For reasons that may even be beyond the attorney's control, he or she may be put in the position of serving "two masters." And as the Holy Writ tells us – as quoted even in our court system – "no man can serve two masters."

THE TRIPARTITE RELATIONSHIP

Many courts refer to the relationship between the insurer, the appointed attorney and the insured as a "tripartite relationship." Each owes duties to the other: The insurer, to the policyholder to provide defense benefits under the policy; the policyholder, to pay premiums and cooperate in the defense; the appointed attorney, to defend against the claim.

But the appointed attorney also may have a very real – indeed, an umbilical – relationship with the insurer. The attorney who enjoys repeat business from the insurer is unlikely to bite the hand that feeds it.

When defending under a reservation of rights, attorneys may be put in a position in which their control of the case will dictate whether a claim is or is not covered. Naturally, the policyholder wants to maximize or protect benefits under the policy; the insurer wants to minimize or neglect those benefits. What happens, then, when the appointed

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attorney's actions benefit one party and burden the other? That would be to maximize benefits to the policyholder or to escape coverage and, thus, benefit the insurer.

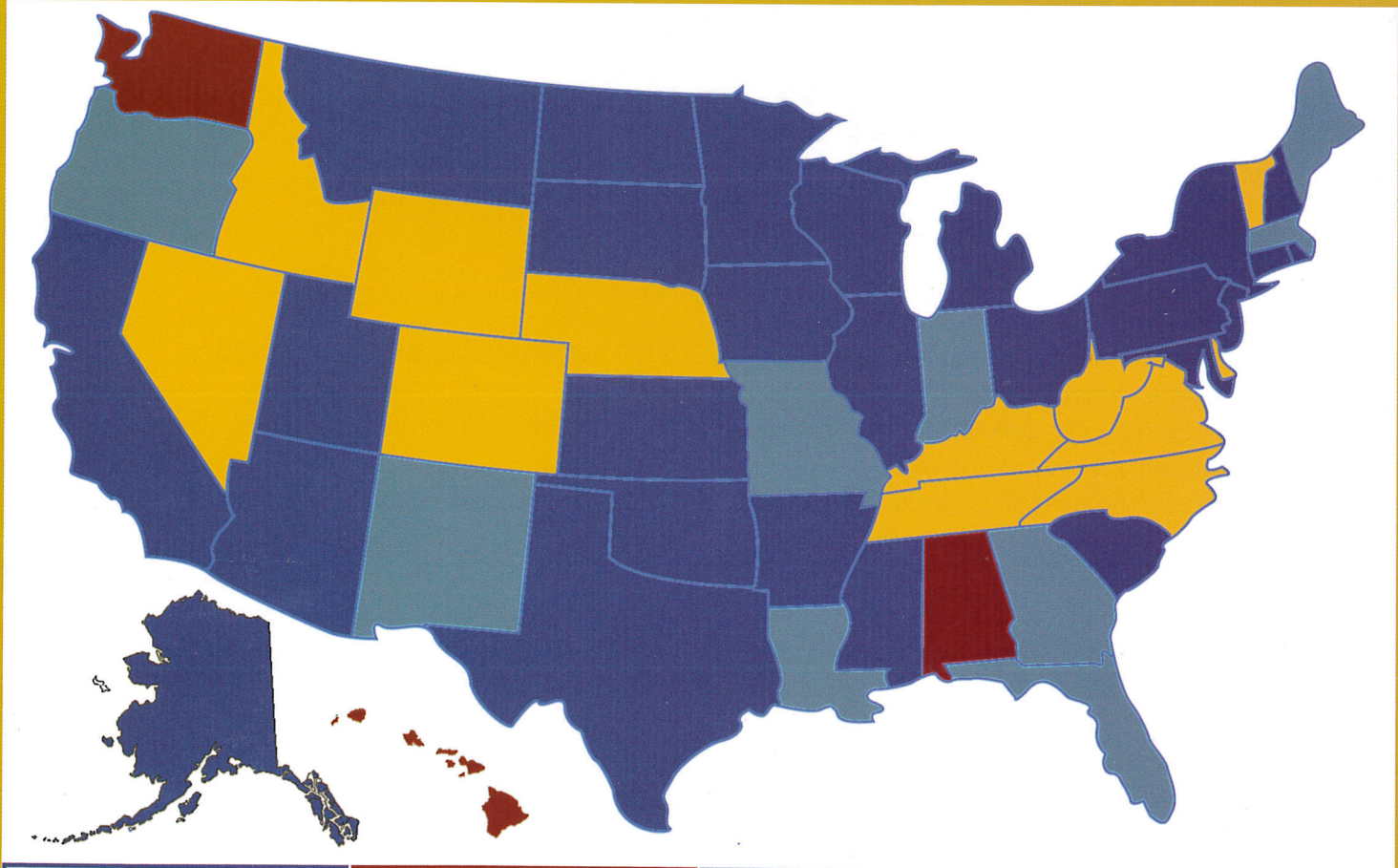
The courts have struggled to address this dilemma over the past several decades. Jurisdictions such as California, New York and Illinois have a well-developed body of law. In fact, one recent New York case went so far as to say that an insurer who fails to notify a policyholder of the right to independent counsel may even be liable under the state's unfair business practices act. Some jurisdictions have no law at all, while others are still in development.

PROVE CONFLICT OF INTEREST

What has become clear in surveying jurisdictions across the country on this issue is that a genuine development of law is occurring, and it appears headed in one direction: When a policyholder can show the carrier-appointed attorney has an actual conflict of interest in representing both the policyholder and the insurer, then the policyholder is entitled to have the insurer appoint a second, independent attorney to represent the exclusive interests of the policyholder.

This is not a gift or a freebie from the insurer – it is a right as a matter of law. Unlike many

Does Your State Require Your Insurer To Pay For A Second Independent Counsel?



An insurer likely must provide an insured with independent counsel when a conflict of interest exists between the insurer and the insured:	An insurer owes an enhanced duty of good faith to the insured, even if the insurer is not necessarily required to provide the insured with independent counsel:	An insurer could be required to provide an insured with independent counsel under certain other circumstances:	No Relevant Decisions:
AK, AR, AZ, CA, CT, IA, IL, KS, MD, MI, MN, MS, MT, ND, NH, NJ, NY, OH, OK, PA, RI, SC, SD, TX, UT, WI	AL, HI, WA	FL, GA, IN, LA, MA, ME, MO, NM, OR	CO, DE, ID, KY, NC, NE, NV, T N, VA, VT, WV, WY

The state-by-state survey on the appointment of a second independent attorney is available online at www.wood-bender.com/library.html. The author wishes to acknowledge Richard F. Marotti (J.D. candidate 2009, the University of California Hastings College of Law) and Rafael Orellana (J.D. candidate 2010, University of Virginia School of Law) for their assistance on this project.

other aspects of state law development where jurisdictions divide into "majority vs. minority" views, the trend here tends to be more predictable, and differences between jurisdictions usually are one of degree, not kind. All courts recognize something must be done to protect the interests of a policyholder when a conflict of interest arises during the course of a defense.

The most extreme view has been adopted by courts in Alaska and Mississippi. Those states hold if an insurance carrier undertakes any defense of a policyholder under a reservation of rights, then that, in itself, creates a conflict of interest sufficient to require the carrier to appoint a second attorney to defend the policyholder's interests.

The vast majority of states, however, insist on seeing something more than just a reservation-of-rights letter. They seek additional, tangible evidence of a conflict of interest between the appointed attorney and the policyholder. The gist of the emerging standard is if an attorney is capable of steering a case toward non-coverage, then the policyholder has a right to an independent counsel.

Again, in these states, once a conflict of interest is shown, the policyholder has a right to independent counsel. A smaller number of states has not quite reached this conclusion. Courts there have held that appointment of a second attorney is one option, among others, that an insurance carrier may take to address the conflict of interest. In some cases, that other option consists of a carrier filing suit for declaratory relief to determine whether coverage exists - an unsatisfying option to pursue while a third-party action is pending.

In contrast to Alaska and Mississippi, courts in Alabama, Hawaii and Washington have held that if a conflict of interest is shown to exist then a policyholder may pursue an independent suit against the appointed attorney for "breach of an enhanced duty of good faith" in the event the attorney harms the policyholder. This, of course, is the least satisfying remedy for policyholders. They will have to mount a separate suit against the former attorney at the conclusion of the underlying case, and against the superior resources of the carrier and the joint cooperation of the carrier and attorney.

Whose suit is it anyway?

When you are being represented by your insurer's attorney, here is what is expected of you.

YOUR DUTIES:

- To cooperate reasonably with the appointed attorney and follow the strategic litigation plan;
- Supply all information requested;
- Make witnesses available.

YOUR RIGHTS:

- To be represented zealously by your appointed attorney;
- To be represented by a second, independent attorney should a conflict of interest arise, depending on the laws in your jurisdiction.

Case development nationwide varies on who gets to appoint the independent counsel and how that counsel is to be paid. In jurisdictions where independent counsel is the policyholders' right, they generally are permitted to select counsel and force the carrier to foot the bill, albeit at the same rates the carrier is paying for initial defense counsel. In jurisdictions where the right is less clear, the rule on these details is murkier as well.

In short, policyholders must be vigilant in protecting their rights in the event an insurer defends a third-party action under a reservation of rights. Where a policyholder suspects a conflict of interest, the policyholder should notify the carrier immediately and involve the insurance broker and, if possible, the insurer's underwriter, in the issue and aim to resolve it upfront. Disputes over such issues as hourly rates of independent counsel can be resolved through arbitration separately.

Although the trend appears to be in policyholders' favor, disputes over whether independent counsel should be appointed at all may ultimately have to be resolved in court.

All of which illustrates that the best defense, without reservation, rests on a knowledge of your rights.