



RIGHT TO INDEPENDENT COUNSEL: OVERVIEW AND UPDATE

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**YOU HAVE SENT OUT THE ROR—
NOW WHAT?**





EXISTENCE OF DUTY TO DEFEND

- Background and Basis of the Duty to Defend
 - Duty to Defend – Eight Corners Rule.
 - Duty to Indemnify – Actual Facts Rule.



RESPONSE TO A REQUEST FOR A DEFENSE

- Insurer has three options:
 - Deny the request for a defense;
 - Provide an unqualified defense;
 - Provide a qualified defense pursuant to a reservation-of-rights letter.
- Can Also file a Declaratory Judgment Action.

NATURE OF CONFLICT BETWEEN INSURER AND INSURED

Subject to the terms of the insurance policy, if the insurer has a duty to defend with respect to any aspect of the lawsuit, it has the duty to defend with regard to every aspect of the lawsuit.

Heyden Newport Chem. Ins. Co. v. Southern Gen'l Ins. Co., 387 S.W.2d 22, 26 (Tex. 1965)



What are Insured's Options

- Accept the Defense (silence is implied consent);
- Reject the Defense.

What circumstances give rise
to the right to reject?



Northern County Mut. Ins. Co. v. Davalos

- Facts:

Davalos (a resident of Matagorda County) was involved in a car accident in Dallas County. Davalos brought suit in Matagorda County. The other driver brought suit against Davalos in Dallas County. Davalos moved to transfer venue to Matagorda County.



Northern County Mutual Ins. Co. v. Davalos

- Northern's letter stated that if Davalos' personal attorneys:
 - . . . continue to defend you in the Dallas County lawsuit and continue to pursue the motion to transfer venue, we will take the position that there is no liability protection under the [policy], and the outcome of the Dallas County case will be your personal responsibility.



Northern County Mut. Ins. Co. v. Davalos

- Trial Court's Holding:
 - Final judgment rendered in Davalos' favor for breach of contract and violation of article 21.55 of the insurance code.



Northern County Mut. Ins. Co. v. Davalos

- Court of Appeals' Affirmed:

In determining an Insurer's responsibilities under the standard form Texas personal auto policy, the Texas Supreme Court held that: "The insurer's control of the insured's defense under this policy thus includes authority to accept or reject settlement offers and, ***where no conflict of interest exists***, to make other decisions that would normally be vested in the client, here the insured." *State Farm Mutual Ins. Co. v. Traver*, 980 S.W.2d 625, 627 (Tex. 1998)



Northern County Mut. Ins. Co. v. Davalos

- Northern County's Position in the Supreme Court:
 - The “settle and defend” clause of a liability policy give the right to take exclusive control of the suit.
 - These provisions give the insurer “absolute and complete control of the litigation, as a matter of law.”
 - An insured must cooperate with his insurer and turn the defense over to the insurer when the insurer tenders an unconditional defense.
 - The insured's actions must not deprive the insurer of any valid defense.



Northern County Mut. Ins. Co. v. Davalos

- Northern County's Position in the Supreme Court:
 - A dispute as to the manner in which the defense should be conducted does not constitute a conflict in the sense of insurance coverage.
 - A conflict exists only when an insurer questions whether an event is covered by an insurance policy.
 - The Appellate Court's reliance upon *State Farm Mutual Ins. Co. v. Traver*, 980 S.W.2d 625, 627 (Tex. 1998) was misplaced.



State Farm Mutual Ins. Co. v. Traver, 980 S.W.2d 625,
627 (Tex. 1998)

- Facts:
 - Traver's Estate was sued by a party injured in an auto accident.
 - State Farm hired counsel to represent Traver.
 - Case went to trial – 100% fault attributed to Traver resulting in judgment in excess of policy limits.
 - Estate sued State Farm for breach of the duty to defend, alleging counsel committed malpractice.



State Farm Mutual Ins. Co. v. Traver, 980 S.W.2d 625, 627 (Tex. 1998)

- Supreme Court's Holding:

“We have recognized that a liability policy may grant the insurer the right to take complete and exclusive control” of the insured's defense...Here, the standard form Texas Personal Auto Policy provides that the insurer “will settle or defend, as [it] consider[s] appropriate, any [covered] claim or suit ...” The insurer's control of the insured's defense under this policy thus includes authority to accept or reject settlement offers and, where no conflict of interest exists, to make other decisions that would normally be vested in the client, here the insured. However, even assuming that the insurer possesses a level of control comparable to that of a client, this does not meet the requisite for vicarious liability.”



Northern County Mut. Ins. Co. v. Davalos

- Davalos' Position in the Supreme Court:
 - An insurer may assume the control over the insured's defense only where no conflict of interest exists. A conflict of interest exists where there is a dispute between the insurer and the insured *with regard to how the lawsuit should be defended.*
 - A conflict existed between Northern County's and Davalos because Northern County's insistence upon Dallas as the venue of choice would result in "race to trial" in the underlying matter.
 - A conflict existed between Northern County and Davalos because Davalos sued Northern County over the same claim where a defense was requested.
 - The conflict persisted because Northern County sought coverage advice from the very lawyer it selected to defend Davalos. Specifically, Steven W. Drinnon, Northern County's choice of counsel, provided advice on "coverage" solicited by Northern County.



Northern County Mut. Ins. Co. v. Davalos

- Davalos' Position in the Supreme Court:
 - Northern County forfeited its right to control the defense by attempting to impose a condition not mandated by its policy with Davalos, and acting directly contrary to ethical considerations and duties to its insured.
 - Northern County is not entitled, by virtue of its insurance policy, to compromise Davalos's affirmative claims against a third party including his claim against Northern County.
 - Since Northern breached the duty to defend, Davalos was entitled to assume control over his own defense.



Northern County Mut. Ins. Co. v. Davalos

- **Holdings of the Supreme Court:**
 - **The supreme court held that the right to conduct the defense by the insurer is a matter of contract.**
 - **The insurer has the right to make defense decisions as if it were the client “*where no conflict of interest exists.*” *State Farm Mutual Automobile Ins. Co. v. Traver.***
 - **A disagreement about how the defense should be conducted is not a conflict of interest under *Traver.***
 - **Where there is a question regarding the existence of scope of coverage and the duty to indemnify the insured, there may be exist a right for disqualifying conflict. A disqualifying conflict exists when the facts to be adjudicated in the liability lawsuit are the same facts upon which coverage depends.**



Types of Conflicts That May Justify Rejection

- **When the defense tendered “is not a complete defense under circumstances in which it should have been.”**
- **When the “attorney hired by the carrier acts unethically and, at the insurer’s direction, advances the insurer’s interest at the expense of the insured’s.”**
- **When “the defense would not, under the governing law, satisfy the insured’s duty to defend,” and**
- **When though the defense is otherwise proper, “the insurer attempts to obtain some type of concession from the insured before it will defend.”**



Housing Authority of Dallas, Tex. V. Northland Ins. Co., 333
F.Supp.2d 595 (N.D. Tex. 2004)

Reservation of rights issued on “willful violation of statute” exclusion created disqualifying conflict in the face of allegations that the insured willfully violated U.S.C.S., Title VII.



Downhole Navigator, LLC v. Nautilus Ins. Co., 686 F.2d 325
(5th Cir. 2012)

- Nautilus insured Downhole under a CGL policy;
- Downhole was sued by Sedona for damage to oil well sustained while Downhole was engaged to redirect the well (deviation);
- Sedona sued for loss profits, damage to the well, loss of business opportunity, loss of value in lease, loss of minerals, costs of delay, exemplary damages and attorney's fees.



Downhole Navigator, LLC v. Nautilus Ins. Co., 686 F.2d 325
(5th Cir. 2012)

- Nautilus reserved its rights under professional liability and testing exclusions, as well as a data processing exclusion;
- Downhole attempted to reject, citing a disqualifying conflict of interest between Downhole and Nautilus;
- Nautilus refused to pay Downhole's attorney's fees. Downhole sued.



Downhole Navigator, LLC v. Nautilus Ins. Co., 686 F.2d 325
(5th Cir. 2012)

- After granting of Summary Judgment for Nautilus, the Fifth Circuit held:
 - Under *Davalos*, a disqualifying interest exists “when the facts to be adjudicated in the liability lawsuit are the same facts upon which coverage depends.”
 - A conflict does not arise unless the *outcome* of the coverage issue can be controlled by counsel retained by the insurer for the defense of the underlying suit. *Rx.com, Inc. v. Hartford Fire Ins. Co.*, 426 F.Supp. 546 (S.D. Tex 2006).



Allstate County Mutual Ins. Co. v. Wootton, 494 S.W.3d 825 (Tex. App. – Houston [14th Dist.] 2016)

- Post-Downhole Navigator application
- Insureds contended that they had a right to independent counsel because of a conflict of interest because of the underlying plaintiffs allegations of vicarious liability, that if proven, would show that the insured was acting in the course and scope of employment, which would bring the claim into a coverage exclusion
- Trial court granted declaratory judgment that Allstate had to provide independent counsel



Allstate County Mutual Ins. Co. v. Wootton, 494 S.W.3d 825 (Tex. App. – Houston [14th Dist.] 2016)

- On appeal, the 14th Court of Appeals reversed based upon *Downhole Navigator*.
- Whether that fact could be proven presented a “potential conflict of interest.”
- “The Woottons are not entitled to independent counsel simply because there is a potential conflict of interest.”

When Independent Counsel is Required

- Example (Covered Verses Non-Covered *Claims*):

Assume that a plaintiff alleges that a defendant-insured is guilty of either negligence or an intentional tort because of his wrong doing, and the insurance policy does not provide coverage for intentional torts. The insurer, under those circumstances, would be benefited, at the expense of the insured, if the insured's counsel shaped the defense so that, in the event he was unable to prove that the insured was not liable, the insured would be found guilty of an intentional tort. A conflict of interest, therefore, does exist in that situation.



When Independent Counsel Is Not Required

- Claim Against Multiple Insureds;
- Insured Suit Against Other Insureds;
- Suit for money in excess of policy limits;
- Person insured;
- Property insured;
- Policy period;
- Covered vs. non-covered damages.

When Independent Counsel Is Not Required:

Graper v. Mid-Continent, 756 S.W.3d 388

(5th. Cir. 2014)

- Coverage Issues Where Facts Will Not Be Decided in the Underlying Case
- Court applied the “same facts” analysis in *Davalos* and *Downhole Navigator* to allegations of “willful conduct” for alleged violations of the Copyright Act in a claim where Mid-Continent reserved rights based upon coverage exclusions for intentional acts
- Court held that despite the fact that the Court would be determining whether or not the insureds conduct was willful, it would not violate the “same facts” because “willful” does not necessarily imply “knowing”, which is required under the policy exclusion
- Demonstrates that it will take a rare case to meet the “same facts” standard



Poll Question

- Your policyholder brings you a claim where the request a defense for both their company and a vendor who they are forced to provide a defense under an indemnification agreement. You review the agreement and believe it might be unenforceable under Texas law. Has a right to independent counsel arisen?
 - A: Yes
 - B: No



Punitive Damages?

- *Fairfield Ins. Co. v. Stephens Martin Paving, LP*, 246 S.W.3d 653 (Tex. 2008).
 - whether the plain language excludes coverage for punitive damages;
 - If the policy provides coverage, does Texas law allow or prohibits coverage in the circumstances of the underlying suit.
 - In determining policy, a central concern exists when shifting the risk from the insured to the insurer in cases where “extreme and avoidable conduct that causes injury” may warrant consideration. *See also American Int’l Sp. Lines Ins. Co. v. Res Care*, 529 F.3d 649 (5th Cir. 2008).



What About Limitations?

- *Gilbert Texas Constr., L.P. v. Underwriters at Lloyd's London*, 327 S.W.3d 118 (Tex. 2010)
 - Holding: Exclusion 2(b) applies when liability is based upon breach of contract or other contract theory.
 - Conflict: Filing a Motion for Summary Judgment on Limitations for Negligence Claims.

Advising Insured of Right to Independent Counsel

- *Ideal Mutual Ins. Co. v. Myers*, 789 F.2d 1196 (5th Cir. 1986):

You are at liberty to secure counsel of your own choice, at your expense, to represent you in regard to the amount [sued] which is in excess of your insurance coverage. . . .

Advising Insured of Right to Independent Counsel

- *Ideal Mutual Ins. Co. v. Myers*, 789 F.2d 1196 (5th Cir. 1986):

The defendants do not show how the reservation of rights letter from Charles England of Aero Adjust Bureau was defective. On the contrary, the letter adequately apprised the buyers' estate of Ideal's position and the estate's rights. The letter specifically identified the policy in question; and informed the estate that McElhaney had been retained to defend the Rockwall action and apprise the estate of the initial results of Ideal's investigation and of Ideal's reservation of rights under the policy, including the right to withdraw from the defense of the Rockwall action.

Advising Insured of Right to Independent Counsel

- *J.E.M. v. Fidelity and Casualty Co. of New York*, 928 S.W.2d 668 (Tex.App.—Houston [1st Dist.] 1996, no writ):

This case does not present a *Tilley* problem because there is no allegation that Fidelity used the same attorneys to defend the defendants that it used to determine coverage issues.

Furthermore, the reservation of rights letter in this case detailed specific coverage problems that the defendants might face, and informed them they had a right to seek outside counsel.

Advising Insured of Right to Independent Counsel

- *J.E.M. v. Fidelity and Casualty Co. of New York*, 928 S.W.2d 668 (Tex.App.—Houston [1st Dist.] 1996, no writ):

We therefore wish to advise you that you may, at your own expense, retain outside counsel to oversee you in this litigation. We are not suggesting that you do so but merely advising you of your right.



Actual Selection of Counsel

- Qualifications
- Fees
- Scope of Representation
- Reporting
- Record Keeping



Questions?

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