

THE RIGHT TO INDEPENDENT COUNSEL

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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 (Independent Counsel)?

Northern County Mut. Ins. Co. v. Davalos

- Facts:

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

- 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.

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.
- 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 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.”**

When is Independent Counsel Required

- Claim Against Multiple Insureds;
- Insured Suit Against Other Insureds;
- Suit for money in excess of policy limits;
- Punitive Damages;
- Policy Period;
- Person insured;
- Property insured;
- Covered verses non-covered damages;
- Covered verses non-covered claims.

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. (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. (5th Cir. 2012)

- Nautilus reserved its rights under intentional injury, damage to property occupied by insured and testing exclusions;
- 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. (5th Cir. 2012)

- Summary Judgment Granted (Nautilus):
 - 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).

*Downhole Navigation, LLC v.
Nautilus Ins. Co. (5th Cir. 2012)*

- Nautilus Argued: Conflict only arises when coverage facts will be actually adjudicated in lawsuit.
- Downhill Argued: Conflict arises where facts effecting coverage will be part of discovery in lawsuit.

Downhole Navigation, LLC v. Nautilus Ins. Co. (5th Cir. 2012)

■ Court Held:

- Conflict only arises where coverage facts will be actually adjudicated.
- Rejects Downhill's position – Lawyer's ethical obligation will prevent.
- Jury would be asked if downhill was negligent. Jury would not decide if conduct was intentional, whether conduct constituted "testing" or whether Downhill occupied well.

Downhole Navigation, LLC v. Nautilus Ins. Co. (5th Cir. 2012)

- Conflicts:
 - Reserve on contractual liability exclusion and breach of contract alleged.
 - Reserve on damage not within policy period and case involves when damage occurred.

Graper v. Mid-Continent Cas. Co.,
756 F.3d 388 (5th Cir. 2014).

- Copyright infringement case where Mid-Continent agreed to defend, subject to reservation of rights
- Mid-Continent reserved rights based on possibility that alleged injury occurred outside of policy period
- Also reserved rights as to intentional or willful conduct of insured
- Insured asserted it had right to independent counsel due to conflict of interest

Graper v. Mid-Continent Cas. Co., 756 F.3d 388 (5th Cir. 2014).

- Insured alleged a statute of limitations defense in Underlying Action
- Insured argued that timing relating to coverage and timing relating to accrual of the claims for statute of limitations run on same factual track, so conflict of interest existed.
- Court rejected the argument, noting distinction between adjudicating when a claim accrued (for SOL purposes) and when acts of infringement occurred (for coverage purposes).
- Occurrence determines date of actual injury
- Accrual determines the date of the discovery of injury

Graper v. Mid-Continent Cas. Co., 756 F.3d 388 (5th Cir. 2014).

- Insured argued that issue of “willingness of insured’s conduct” created a conflict of interest because statutory damages for copyright infringement under 17 U.S.C. Sec. 504(c) can be increased if the infringement was willful.
- Court rejected, noting that policy requires a knowing violation of another.
- Statute requires infringement to be committed willfully, but does not require proof of knowing conduct (as the policy does).
- Jury could find willful copyright infringement, without a finding of knowing infringement.

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