The Right to Independent Counsel

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ROADMAP

DUTY TO DEFEND

DAVALOS

POTENTIAL CONFLICTS

EXISTENCE OF DUTY TO DEFEND

DUTY TO DEFEND	DUTY TO INDEMNIFY
- Eight Corners Rule - Defend whole lawsuit, including covered and uncovered claims	- Actual Proven Facts Rule - Pay only damages covered under the policy

DUTY TO DEFEND

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).

DUTY TO DEFEND

RESPONSE TO A REQUEST FOR DEFENSE

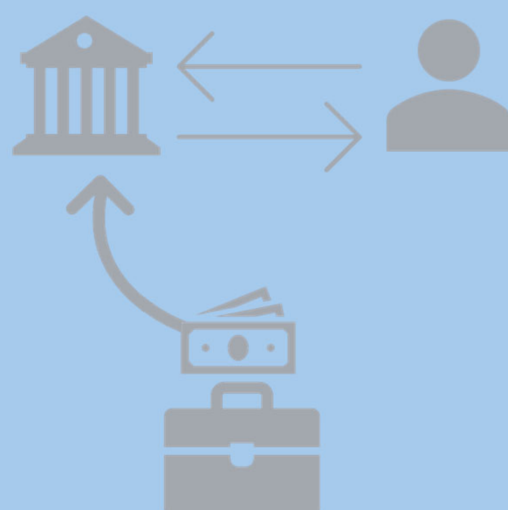
- Deny the request for a defense
- Provide an unqualified defense
- Provide a qualified defense pursuant to a ROR letter
- Send a ROR and file a Declaratory Judgment Action

DUTY TO DEFEND

TRIPARTITE RELATIONSHIP

Perception

Reality



DUTY TO DEFEND

Who is the Client?

Well settled issue:

No attorney-client relationship exists between an insurance carrier and the attorney it hires to defend its insured. See Employers Cas. Co. v. Tilley, 496 S.W.2d 552, 558 (Tex. 1973)

Defense counsel owes ethical duties to only the insured and must put the insured's interests first

DUTY TO DEFEND

Who Controls the Defense?

Controlled by the insurance agreement

The insurer has the right to control the defense, including:

Choosing who to hire

Deciding case strategy

Deciding whether and when to settle

Other similar decisions.

DUTY TO DEFEND

Northern County Mut. Ins. Co. v. Davalos

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.

140 S.W.3d 685 (Tex.2004).

DAVALOS

Northern County Mut. 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.

DAVALOS

Northern County Mut. Ins. Co. v. Davalos

Trial Court's Decision:

Final judgment rendered in Davalos' favor for breach of contract and violation of article 21.55 of the insurance code.

DAVALOS

Court of Appeals' Affirmed:

Citing *Traver:* "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)

State Farm Mutual Ins. Co. v. Traver

Traver's Estate was sued by a party injured in an auto accident.

State Farm hired counsel to represent Traver.

DAVALOS

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.

980 S.W.2d 625, 627 (Tex. 1998)

State Farm Mutual Ins. Co. v. Traver

"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."**

DAVALOS

Northern County Mut. Ins. Co. v. Davalos

North County's Position:

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* was misplaced.

DAVALOS

Northern County Mut. Ins. Co. v. Davalos

North County's Position:

The "settle and defend" clause of a liability policy gives 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.

DAVALOS

Northern County Mut. Ins. Co. v. Davalos

Davalos's Position:

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."

Northern County's venue choice was a conflict that would result in "race to trial" in the underlying matter.

Davalos' suit of North County on claim created conflict

Sought coverage advice from appointed counsel assigned to Davalos

DAVALOS

Northern County Mut. Ins. Co. v. Davalos

Davalos's Position:

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

DAVALOS

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

Supreme Court's Holding:

The insurer's 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 maybe exists 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.

DAVALOS

Northern County Mut. Ins. Co. v. Davalos

Supreme Court's Holding:

In this case, Davalos chose to reject Northern's tender and conduct his own defense because he really did not want the case defended in Dallas County. That was his right. *But having rejected the insurer's defense* without a sufficient conflict, Davalos *lost his right to recover the costs of that defense.* Because Northern's offer to defend Davalos in Dallas County satisfied its obligation under the policy, Northern did not breach its duty to defend.

DAVALOS

Northern County Mut. Ins. Co. v. Davalos

In the typical coverage dispute, an insurer will issue a reservation of rights letter, which creates a potential conflict of interest. And when the facts to be adjudicated in the liability lawsuit are the same facts upon which coverage depends, the conflict of interest will prevent the insurer from conducting the defense.

POTENTIAL CONFLICTS

Types of Conflicts That May Justify An Insured's Rejection

POTENTIAL CONFLICTS

- Defense tendered "is not a complete defense under circumstances in which it should have been
- "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"
- When though the defense is otherwise proper, "the insurer attempts to obtain some kind of concession from the insured before it will defend."

Housing Authority of Dallas, Tex. v. Northland Ins. Co.,

Insured hired its own lawyers after its insurer agreed to tender a defense, subject to ROR.

To determine if the insured properly rejected the proffered defense, the court looked at the underlying complaint, in which "the plaintiff ... alleged violations of Title VII and characterized the [insured's] conduct as willful." Id.

Because the insurer had "reserved its rights to disclaim coverage on ... a willful violation of a statute," the court found that it was "undisputed that the facts to be decided in the [underlying] lawsuit are the same facts upon which coverage depends."

A "disqualifying conflict of interest" existed which entitled the insured to choose its own attorney.

333 F.Supp.2d 595 (N.D. Tex. 2004).

POTENTIAL CONFLICTS

Downhole Navigator, LLC v. Nautilus Ins. Co.

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

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

686 F.3d 325 (5th Cir. 2012)

POTENTIAL CONFLICTS

Downhole Navigator, LLC v. Nautilus Ins. Co.

POTENTIAL CONFLICTS

Nautilus responded that it had "reserved [its] rights while investigating the matter," and insisted that "[u]ntil or unless a coverage issue develops, Downhole is not entitled to separate counsel."

Nautilus refused to pay Downhole's attorney's fees. Downhole sued.

Nautilus referred to *Unauthorized Practice of Law Committee v. American Home,* 261 S.W. 3d 24, 39 (Tex. 2008).

Unauthorized Practice of Law Committee v. American Home

POTENTIAL CONFLICTS

The Texas Supreme Court held that a liability insurer may use its staff attorneys to defend a claim against an insured provided that the interests of the insured and the insurer are congruent.

As part of the reasoning, the court observed that "the most common conflict between an insurer and an insured" is whether a claim falls within the policy, and then stated:

The court further noted that "[o]ther coverage issues may also depend on facts *developed in the litigation."*

261 S.W. 3d 24, 39 (Tex. 2008).

Downhole Navigator, LLC v. Nautilus Ins. Co.

POTENTIAL CONFLICTS

Downhole argued that the court should apply a more relaxed standard than in *Unauthorized Practice*

Downhole argued a conflict of interest arises if facts that *could be developed in the underlying litigation are the same facts upon which coverage depends.*

If Nautilus were permitted to select Downhole's attorney, that attorney could steer the defense to develop facts supporting the theory that goes against coverage.

Downhole Navigator, LLC v. Nautilus Ins. Co.

POTENTIAL CONFLICTS

The Fifth Circuit rejected the "facts to be developed" argument by Downhole

In a footnote, the Fifth Circuit stated that although the Texas Supreme Court has not clarified the meaning of "facts to be adjudicated," the term "adjudicate" plainly means "to rule upon judicially."

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 Navigator, LLC v. Nautilus Ins. Co.

The Fifth Circuit opinion, in response to Davalos, further clarified:

The facts to be adjudicated may be the same facts upon which coverage depends in other situations, such as where the insurer reserves the right to deny coverage based upon a breach of contract exclusion and the underlying litigation raises a claim for breach of contract, or where the insurer reserves the right to deny coverage for damages taking place outside the contract period and the underlying action involves the issue of when damages took place. The Davalos standard, as applied here, is not so “meaningless.”

POTENTIAL CONFLICTS

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

POTENTIAL CONFLICTS

Post-Downhole Navigator application

Insureds contended a conflict of interest existed because the underlying plaintiffs alleged 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)

POTENTIAL CONFLICTS

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.”

Graper v. Mid- Continent

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

756 S.W.3d 388 (5th. Cir. 2014)

POTENTIAL CONFLICTS

Graper v. Mid- Continent

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

POTENTIAL CONFLICTS

Graper v. Mid- Continent

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.

POTENTIAL CONFLICTS

Graper v. Mid- Continent

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

POTENTIAL CONFLICTS

When Independent Counsel is Required

Covered vs Non-Covered Claims

Plaintiff alleges a defendant-insured is liable of either negligence or an intentional tort

Insurance policy does not provide coverage for intentional torts.

Insurer 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 liable of an intentional tort.

A conflict of interest, therefore, does exist in that situation.

When Independent Counsel May Be Required

Breach of Duty to Defend:

When the insurer breaches its duty to defend, the insured may engage their own counsel and either litigate or settle as the insured chooses

"An additional consequence of a breach of the duty to defend is the inability to enforce against the insured any conditions in the policy[.]"

As the right to control the defense is a condition of the policy, the insurer loses that right when the duty to defend is breached

Yowell v. Seneca Specialty Ins. Co., 117 F. Supp. 3d 904, 908–09 (E.D. Tex. 2015)

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

Advising Insured of Right to Independent Counsel

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

The letter said: “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. . . .”

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):

Plaintiffs argued the reservation letter did not adequately advise the defendants of the potential conflict of interest between themselves and the carrier.

The Court found that this case did not present a Tilley problem because there is no allegation that the insurer used the same attorneys to defend the defendants that it used to determine coverage issues.

The reservation of rights letter in this case detailed specific coverage problems that the defendants might face and informed them they had the 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):

The letter said: “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.”

The Court noted: “Although the words “conflict of interest” do not appear in the letter, the letter makes clear the possibility that Fidelity may have an adverse position to the defendants on the issue of coverage.”

QUESTIONS

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