When the Carrier and Insured Part Ways: The Insured's Right to Independent Counsel

By James A. Brown and Shannon S. Holtzman

Louisiana courts have begun to come to grips with the serious ethical problems that arise when an insurance carrier "reserves rights" as to coverage while simultaneously undertaking to provide its insured a defense. Recently, the Louisiana 1st and 5th Circuits ruled that the insurer's reservation of coverage denials or defenses sets up a conflict of interest between the carrier and insured that entitles the insured to select independent counsel at the carrier's expense.[1] This article addresses these important legal developments, their implications for insurers, insureds and their legal counsel, and some lingering unresolved issues.

The Carrier's Duty to Defend

It is settled Louisiana law that under a traditional "defense" policy (by which the insurance carrier agrees to defend the insured from claims covered under the policy), the carrier's obligation to *defend* the insured is separate and distinct from its obligation to *indemnify* the insured.[2] The carrier's separate obligation to defend its insured is "generally *broader* than its obligation to provide coverage [*i.e.*, indemnity] for damage claims."[3] Accordingly, an insurance carrier's duty to defend arises when a complaint against an insured party "discloses even a *possibility* of liability under the policy."[4] The carrier's failure to live up to its broad duty to defend its insured exposes the carrier to potentially severe sanctions under Louisiana's "bad faith" statutes.[5]

Previous Practices

Due to the breadth of the carrier's duty to defend, the carrier frequently finds itself in the position of undertaking its insured's defense while simultaneously asserting denials and/or defenses to cov-

erage of the claims asserted against the insured.[6] The law generally requires the carrier to articulate its coverage positions in a "reservation of rights" letter provided to the insured soon after the claim is reported to the carrier.[7] The carrier's reservation of coverage denials or defenses sets up an obvious conflict between the interests of the carrier (in avoiding coverage) and the insured (in seeking coverage).[8]

Notwithstanding a reservation of rights as to coverage issues, carriers often select counsel to defend the insured from a "panel" of pre-approved lawyers. "Panel" counsel, however, often has an ongoing attorney-client relationship with the carrier in other cases that prevents him/her from representing the insured on coverage issues against the carrier.[9] This practice forces the insured to retain separate "coverage" counsel at the insured's own expense. It has been thought that by so limiting the scope of the appointed counsel's representation, the appointed counsel ethically can defend the insured notwithstanding the counsel's professional relationship with the carrier in other matters. Because the carrier generally is not obligated to pay for the insured's coverage-related legal expenses, the practice of forcing the insured to retain separate legal counsel for coverage issues has been deemed appropriate.

Recognition of the Insured's Right to Independent Counsel

Recent Louisiana 1st and 5th Circuit decisions may well have signaled an end to the foregoing practices. For example, in *Belanger*,[10] apparently after refusing to accept the counsel appointed by the carrier, the insured retained independent counsel and sought reimbursement for that counsel's fees from the insurer. The court granted the insured's reimbursement claim by ruling, "[i]f an insurer chooses to represent the insured but deny coverage, separate counsel must be employed. Failure to do so subjects the insurer to attorney fees and costs the insured may incur for defending the suit."[11] The court thus held that the insured was "entitled by law to select independent counsel to represent them at [the insurance carrier's] expense."[12]

The *Belanger* court reasoned the appointed counsel's representation of the insured likely would constitute a breach of the duty of loyalty owed to the client under Louisiana Rule of Professional Conduct 1.7. According to the court:

> Such representation would ostensibly "be materially limited by [each] lawyer's responsibilities to another client or to a third person," *i.e.*, each attorney's responsibilities to Lexington [the carrier] inasmuch as Lexington retains/delegates an attorney for its insured, . . ., whose primary role at this juncture is addressing insurance coverage. Under the jurisprudence and the Rules of Professional Conduct, separate counsel must be employed to represent Gabriel Chemicals [the insured] to avoid a conflict of interest.[13]

Addressing a similar reimbursement claim by an insured, the Louisiana 5th Circuit followed *Belanger* in *Smith v. Reliance Ins. Co.*[14] The *Smith* court expressly *rejected* the carrier's argument that, notwithstanding its assertion of coverage exclusions, the carrier had the right to select defense counsel for the insured. According to the court:

> The plaintiffs' allegations and Reliance's claim of coverage exclusions create a conflict of interest between the insurer and its insured which entitles the insured to assume control of the defense of the tort action and to select its own counsel. Reliance must underwrite reasonable costs incurred by the insured.[15]

However, in a more recent decision, the United States 5th Circuit applied Louisiana law to retreat somewhat from *Belanger* and *Smith.* In *Trinity Universal Ins. Co. v. Stevens Forestry Serv., Inc.*,[16] the court *denied* the insured's claim for reimbursement of its independently selected counsel's fees on the ground that defense counsel selected by the carrier was adequate and competent. The court found "[t]he fact that Trinity [the carrier] reserved the right to later deny coverage does not negate the fact that it fulfilled its duty of providing Stevens with adequate counsel."[17] Accordingly, the court held the insurer was "not required to reimburse [the insured] for the fees or costs associated with [its] hiring of additional counsel where [the insurer] . . . provided [the insured] with competent counsel in the Underlying Action."[18] Significantly, the court distinguished *Smith* and *Belanger* on the grounds that in those cases the insured explicitly *rejected* the defense counsel appointed by the carriers:

> These cases are distinguishable . . . and not on point in this case. Both involved an insured who wished to reject the insurer's proffered counsel and instead employ independent counsel . . . . Here . . . the insured accepted insurer's counsel, but also wished to receive reimbursement for independent counsel.[19]

Obviously, the insured's failure to explicitly *reject* the counsel appointed by the carrier limits the import of *Trinity*. It does not seem unreasonable to deny the insured reimbursement of the fees of *additional* counsel employed by him after he has accepted (or not rejected) the counsel appointed by the carrier.

Unresolved Issues

The *Trinity* decision nonetheless leaves some important issues unresolved. It is not clear from the decision's text whether the defense counsel appointed by the carrier had an ongoing attorney-client relationship with the carrier. The absence of any discussion of ethical constraints limiting the appointed counsel's ability to represent the insured suggests there may have been no such relationship. In such cases, the appointed counsel presumably is free to represent the insured on coverage issues against the carrier unless the carrier has sought to limit the scope of the appointed counsel's representation to

defensive issues. The *Trinity* decision thus leaves open the argument that, even after a reservation of rights as to coverage, the carrier may control the appointment of defense counsel provided the appointed counsel has no professional relationship with the carrier and is otherwise "adequate and competent."

What happens if the carrier appoints "independent" counsel for the insured (meaning counsel that has no attorney-client relationship with carrier), but limits the appointment to defensive issues? Such constraints can become particularly troublesome when the line between "defensive" and "coverage" issues becomes blurred. For example, issues of whether an individual acted within the course and scope of his employment with the insured corporation, or in his capacity as a partner or member of an insured entity, may determine both liability to the claimant and the availability of insurance coverage. Similarly, issues relating to the degree of an insured's culpability may control both liability and insurance coverage. Negligent or grossly negligent conduct typically is covered by insurance, while fraud and dishonesty are not covered.

One could make a strong case that it is impossible for the appointed "defense" counsel to draw the line between defensive and coverage issues when, as so often happens in complex tort and professional liability cases, the issues overlap. Otherwise stated, when the carrier reserves rights as to coverage, the insured needs a "full" lawyer (one who can represent him on all issues in the case). "Half" a lawyer won't do. Hence, *any* limitation by the carrier on the scope of appointed counsel's representation of the insured arguably renders that counsel "inadequate" and not "independent," thereby entitling the insured to choose other counsel at the carrier's expense.

"*Cumis*" Endorsements

Louisiana has lagged well behind other jurisdictions in clearly recognizing the insured's right to select independent counsel when the carrier reserves rights as to coverage.[20] The principle has become so familiar that carriers now include so-called *Cumis* endorsements in their liability insurance policies that seek to regulate the insured's selection of independent counsel.[21] Generally, a *Cumis* endorsement permits an insurance carrier to require the insured's independent counsel to have certain minimum qualifications for insurance defense practice and meet minimum requirements as to professional liability insurance and related matters.[22]

Typically, *Cumis* endorsements also seek to limit the billing rates of independent counsel to the rates customarily paid by the insurance carrier to appointed counsel in the relevant community. In *Belanger*, the court appeared to give effect to the *Cumis* endorsement set forth in the policy by stating:

> Application of the *Cumis* endorsement requires by its plain language that the attorney fees and all other litigation expenses Lexington [the insurance carrier] must pay to counsel selected by Gabriel Chemicals are limited to the rates Lexington actually pays to counsel the insurer retains in the ordinary course of business in the defense of similar claims.[23]

The court, however, stopped short of deciding the issue of fees, concluding "the quantum of any reimbursement claim incurred thus far cannot be, and [is] not, decided."[24] The *Smith* and *Trinity* cases did not address the issue of *Cumis* endorsements.[25]

Cumis endorsements become problematic when the billing rates customarily paid by the carrier to "panel" counsel in the relevant locale are significantly lower than the rates of the independent counsel that the insured desires to retain. The panel rate may not be acceptable to the counsel selected by the insured. It seems only a matter of time before an insured argues that the carrier's attempt to limit the billing rates of its chosen counsel impermissibly inhibits the freedom to select independent counsel. This significant unresolved issue can supply leverage to both the carrier and the insured's counsel in the negotiation of a billing rate somewhere between the carrier's "panel" rate and the higher standard rate of the insured's chosen counsel.

Critical Privilege Issues

The independent counsel selected by the insured must remain ever mindful that her client is the insured — not the carrier — and that the client's interests are adverse to the carrier on coverage issues. She must be prepared to vigorously litigate the client's coverage positions *against* the carrier and must resist any and all attempts by the carrier's representatives to constrain her advocacy on issues of coverage. In many cases, the insured's independent counsel becomes equally adverse to the carrier and the plaintiff.

Additionally, the insured's independent counsel must remember her communications with the client on coverage issues are privileged and must not be shared with the carrier. The issue of privilege becomes particularly important in the

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context of narrative fee billing. Narrative fee bills for *defensive work only* should be addressed to the insured, but copied to the carrier for payment by the carrier. Coverage work, which is *not* properly billed to the carrier, should be *separately* billed to the insured, under a separate file or billing number, to avoid any possibility that the carrier will become privy to details of coverage advice and work performed for the insured. Failure to follow such procedures threatens to compromise the attorney-client privilege with the insured and undermine the effectiveness of the attorney's representation of her client.

Conclusion

Louisiana appears to be catching up to other states in recognizing the insured's right to independent counsel when the carrier reserves rights as to coverage. Previous practices that arguably blurred the lines of representation and loyalty and constrained the effectiveness of appointed counsel are coming to an end. Louisiana courts, however, have yet to resolve several important issues with potentially serious legal, ethical and economic implications for carriers, insureds and their counsel. Stay tuned.

FOOTNOTES

1. Belanger v. Gabriel Chems., Inc., 00-0747 (La. App. 1 Cir. 5/23/01), 787 So.2d 559, 564, *writ denied*, 802 So.2d 612 (La. 2001); Smith v. Reliance Ins. Co., 01-888 (La. App. 5 Cir. 1/15/02), 807 So.2d 1010, 1022.

2. Steptore v. Masco Constr. Co., 643 So.2d 1213, 1218 (La. 1994).

3. *Id.* at 1218 (emphasis added).

4. Smith v. Reliance Ins. Co., 01-888 (La. App. 5 Cir. 1/15/02), 807 So.2d 1010, 1021 (original emphasis) (citing Jensen v. Snellings, 841 F.2d 600, 612 (5 Cir. 1988)).

5. *See, e.g.,* La. R.S. 22:1220; La. R.S. 22:658.

6. *See* Belanger, *supra* note 1, 787 So.2d at 564.

7. *See, e.g.,* Peavey Co. v. M/V ANPA, 971 F.2d 1168, 1175 (5 Cir. 1992) (applying Louisiana law).

8. *See, e.g.,* H. Alston Johnson III, *Insurer's Responsibilities in First Party & Third Party Actions: Bad Faith and Other Issues* 18, in Hittin' the High Notes: 18th Summer School for Lawyers (La. State Bar Ass'n ed., 2002); *see also* Belanger, *supra* note 1, 787 So.2d at 564.

9. It is fairly well settled that, when the carrier reserves rights as to coverage, the appointed "panel" counsel cannot simultaneously represent the carrier and the insured in the particular matter to which the appointment pertains. *See* Dugas Pest Control of Baton Rouge, Inc. v. Mutual Fire, Marine & Inland Ins. Co., 504 So.2d 1051, 1054 (La. App. 1 Cir. 1987) (holding appointed counsel ethically prohibited from simultaneously representing carrier and insured when carrier reserves rights on coverage). Previous precedents, however, did not specifically address the practice that is the focus of the instant article — the carrier's appointment of one of its "panel" counsel to represent *the insured* on defensive matters, but *not* coverage issues.

10. *Supra*, note 1.

11. *Id.* at 565 (citing Dugas Pest Control of Baton Rouge, Inc. v. Mutual Fire, Marine & Inland Ins. Co., 504 So.2d 1051, 1054 (La. App. 1 Cir. 1987)).

12. *Id.* at 566.

13. 787 So.2d at 565. The factual recitation in the Belanger opinion indicates the insurance carrier appointed counsel to represent the insured on *both* defensive and coverage issues. *Id.* It is unclear from the opinion whether the appointed counsel had an ongoing attorney-client relationship with the carrier, although the court seems to have assumed there was such a relationship. It would seem obvious that in such a case the appointed counsel could not ethically represent the insured on coverage issues adverse to the carrier. The court, however, recognized the insured's right to select independent counsel on all issues, without drawing a distinction between coverage and defense. *Id.*

14. 01-888 (La. App. 5 Cir. 1/15/02), 807 So.2d 1010.

15. *Id.* at 1022.

16. 335 F.3d 353, 356 (5 Cir. 2003).

17. *Id.*

18. *Id.* The Trinity court followed Nat'l Union Fire Ins. Co. v. Circle, Inc., 915 F.2d 986, 991 (5 Cir. 1990), where the 5th Circuit noted an insured could state a claim for breach of the insurer's duty to defend if the insured could prove the separate counsel provided by the insurer was "objectively inadequate." The Nat'l Union court, however, did not discuss or define what might amount to "objectively inadequate" counsel.

19. *Id.* at 356, note 3 (internal citations omitted).

20. *See* Todd R. Smyth, Annotation, *Duty of Insurer to Pay for Independent Counsel When Conflict of Interest Exists Between Insured and Insurer,* 50 A.L.R.4th 932 (1986). Some states have even codified the insured's right to select independent counsel. *See, e.g.*, Cal. Civ. Code § 2860; *see also* Alaska Stat. § 21.89.100.

21. These endorsements are regularly referred to as "*Cumis* endorsements" in reference to a policy described in San Diego Navy Federal Credit Union v. Cumis Ins. Soc., 162 Cal. App. 3d 358, 208 Cal. Rptr. 494 (Cal. Ct. App. 1984).

22. Johnson, *supra* note 8, at 19.

23. 787 So.2d at 566-67.

24. *Id.* at 567.

25. *See* Johnson, *supra* note 8, at 20-21 ("The insurer [in Smith] did not argue that it had a *Cumis* endorsement, which it almost certainly would have done if its policy had contained such an endorsement.").

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