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The Insured's Right to Select Defense Counsel

Part Two of a Two-Part Article

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Last month, we discussed “substantial conflicts of interest” in various cases involving an insured’s right to select its own defense counsel. In a review of case law, we outlined the case of *Emons Industries, Inc. v. Liberty Mutual Insurance Co.*, 749 F.Supp. 1289 (S.D.N.Y. 1990). We pointed out that, as the *Emons* case establishes, an insured and its insurer can have conflicting litigation and settlement strategies. Part Two herein continues this discussion.

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EMONS CONTINUED

In a major exposure case, the insurer’s larger exposure is often the defense costs, which, in such a case, can easily outstrip even a multimillion-dollar indemnity limit. As a result, the insurer’s financial incentive often is to litigate on the cheap. By contrast, a policyholder facing potential exposure in catastrophic amounts if it is held liable may need to litigate as though the fate of the company hangs in the balance.

The conflict of interests in a major exposure case could play out at virtually every step of the way from the selection of counsel through resolution of the case. At the very outset, it could infect the decision of whom to retain as counsel. It would be against the insurer’s economic interest, for example, to retain experienced, creative, and highly competent counsel to defend the insured if doing so would cost more than retaining less-experienced or less-competent counsel.

Once counsel was retained, the same perverse incentive to litigate cheaply would tug constantly at counsel who was in any way beholden to the insurer, as counsel faced decisions about what discovery to take or to forgo, how diligently to prepare for depositions, what motions to file or not file, how deeply to research a given legal issue, and, in a multi-defendant case, how substantial a role to play at trial, to name but a few. This enormous disparity of incentives would plague any lawyer who was trying to please both the insurer and the policyholder.

A STRUCTURAL SOLUTION

As in the classic “*Cumis*” example (*San Diego Navy Federal Credit Union v. Cumis Insurance Society, Inc.*, 162 Cal. App. 3d 358 (1984), from which the term “*Cumis* counsel,” meaning “independent, policyholder-selected counsel,” derives), the solution to the problem is a structural one: requiring the insurer to fund the defense, but allowing

the insured to select independent counsel. Simply put, the defense of a major exposure case is too important to leave to a lawyer who is beholden to the insurer for future work.

WHEN NO CONFLICT IS FOUND

To be sure, not every disparity between a policy limit and the potential exposure will cause a cognizable conflict. If the gap between the limit and the potential exposure is small, no conflict is likely to be found. Thus, in *Roussos v. Allstate Insurance Co.*, 655 A.2d 40 (Md. Ct. Spec. App. 1995), the court held that the mere fact that a complaint purports to seek damages that exceed the limits of liability “does not automatically” create a conflict of interests between the insurer and the insured. *Id.* at 44. In that case, the insured was found to be liable for only \$7,500 more than the coverage limit, and in any event its potential liability was no more than \$80,000 above its coverage limit. *Id.* at 42 n.1, 43. Nonetheless, the court analyzed the facts of the case in order to determine that those facts did not present a conflict,

implicitly recognizing that a more significant disparity could well have created a conflict.

However, even in cases in which the insured’s potential exposure is not vast, a marked disparity can create a conflict of interest. For example, in *Nandorf (Nandorf, Inc. v. CNA Ins. Cos.*, 479 N.E.2d 988, 991 (Ill. App. Ct. 1985), acknowledging that the attorney owes ethical duties to the insured but recognizing that “in reality, [the insurer’s chosen attorney] may have closer ties with the insurer and a more compelling interest in protecting the insurer’s position”) [internal quotation marks omitted], the insurer’s exposure was limited to a covered amount of \$5,000 in compensatory damages, whereas the insured’s liability potentially included punitive damages of \$100,000, an award of which would have no economic consequence for the insurer. *See* 479 N.E.2d at 990, 992. In light of the substantial disparity between the insurer’s exposure and the insured’s 20-times-greater potential liability, the court found that the insurer and its insured had unequal interests

in vigorously defending the claim. The court therefore held that the insured was entitled to select defense counsel.

CONCLUSION

In the more typical major exposure case, the disparity between the primary limit and the insured’s possible exposure will be great both in ratio and in absolute dollars. In mass tort claims, for example, the amount sought by the plaintiffs can run to the hundreds of millions of dollars (or higher). Even where the insurer stands ready (and perhaps eager) to pay a sizeable primary limit and does not reserve the right to deny indemnity coverage, the wild divergence of interests created by the risk of substantial excess liability threatens the integrity of the defense if the policyholder is not allowed to select independent counsel.

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