Adding To The Debate: Defense Costs Create Conflict

*Law360, New York (July 08, 2013, 1:16 PM ET)* -- On the electronic pages of Insurance Law360, a debate has recently arisen over the insurance implications of the Ohio Supreme Court’s recent decision in Kaminski v. Metal & Wire Products Co., 927 N.E.2d 1066 (Ohio 2010), and its companion case Setter v. R.J. Corman Derailment Service LLC, 927 N.E.2d 1092 (Ohio 2010), which held that an employer is liable in tort and outside the workers' compensation system only when it acts with specific intent to cause injury.

Addressing the issue of who has the right to select counsel for the insured’s defense, commentators have focused on the potential liability for a judgment and whether that creates a conflict of interest between the insured and its insurer. Missing from the debate is a different point: The insurer’s obligation to pay for the defense is more than sufficient to entitle the insured to independent counsel if, as the commentators have argued, there is no potential for indemnity coverage.

In Thomas Palmer’s recent article, *The Evolution of Ohio’s Statute on Employer Tort Claims* (May 17, 2013), Palmer has argued that the Ohio holdings create a conflict of interest for insurers that provide a defense to employers for tort suits under a reservation of rights. Because intentional torts are uninsured, Palmer argues it is in the insurer’s best interest for the policyholder to be found liable for an intentional tort. Therefore, Palmer argues, the potential conflict of interest requires that insurers allow their policyholders to select their own, “independent” defense counsel.

Taking a contrary view, Charles Curley, in his article, *Another View of Ohio’s Statute on Employer Claims* (June 4, 2013), argues that any conflict is illusory. Curley claims that because damages for an intentional tort are uninsured, the insurer is actually disinterested in the outcome of the case — either the policyholder is liable, and the insurer does not have to pay the judgment because the tort was intentional, or the policyholder is not liable, and there is no judgment to pay. Curley contends that there is thus no conflict of interest and consequently, no right for the policyholder to select its own defense counsel.

Whether in fact there is no possibility of a covered judgment for an employee claim brought in tort is beyond the scope of this article. Cf. *Charles Beseler Co. v. O’Gorman & Young Inc.*, 911 A.2d 47 (N.J. 2006) (liability insurance policy covers injuries “substantially certain” to occur that are actionable outside workers’ compensation regime). However, if we take as our starting point Curley’s premise, a more complete analysis leads to a very different conclusion.
This is so because an insurer that defends its policyholder by definition incurs defense costs. And, in the hypothetical posed by Curley, defense costs are the insurer’s only exposure, since by hypothesis, the insurer cannot be liable for the judgment.

This fact pattern does indeed lead to a conflict of interest between the insurer and the insured. Specifically, the insured’s interest is in robustly defending the claim in order to minimize the risk of an adverse judgment, whereas the insurer’s interest is in paying the very least it can possibly pay in defense costs, since it has zero stake in the outcome of the litigation.

Courts have long recognized that where an insurer may be able to undermine its policyholder’s tort defense if it controls that defense, the policyholder is entitled to select its own independent counsel, notwithstanding policy provisions that, on their face, give the insurer the right to select counsel or to control the defense. See, e.g., San Diego Navy Fed. Credit Union v. Cumis Ins. Soc'y, 208 Cal. Rptr. 494 (Ct. App. 1984).

The reason is plain: The insured is entitled to a lawyer who feels no tug to undermine the client’s case. In a clear-eyed assessment of the economic incentives bedeviling a lawyer in an insurer-insured conflict situation, the Eighth Circuit observed, "Even the most optimistic view of human nature requires us to realize that an attorney employed by an insurance company will slant his efforts, perhaps unconsciously, in the interests of his real client [i.e.,] the one who is paying his fee and from whom he hopes to receive future business[.] the insurance company." U.S. Fid. & Guar. Co. v. Roser, 585 F.2d 932, 938 n.5 (8th Cir. 1978).

In Curley’s hypothetical, while the insurer cares not a whit about the outcome of the verdict because it has no indemnity exposure, it cares quite a bit about defense costs because it is obligated to pay them. And with no stake in the outcome, its interest is in minimizing those costs, period.

As any practicing lawyer will agree, there are more and less effective and thorough ways to defend a case, and the more effective and thorough frequently carry with them greater expense. Clients with a lot at stake willingly bear that greater expense because of the importance of the litigation. An insurer that stands behind the insured for a judgment or settlement does likewise, since it, too, stands to benefit from a vigorous defense in the tort suit.

But an insurer that is off the hook for any indemnity exposure has an incentive to minimize defense expenditures without a countervailing interest in the ultimate verdict or its relative magnitude. Defense counsel beholden to such an insurer may be instructed, cajoled or just subtly influenced by the insurer to skimp on the defense.

Throughout the life of the case, counsel will be faced with choices between two course of action, one of which involves less expense and one of which involves more. Do I take that particular deposition, file that particular motion to compel or that hire that particular expert? At each such juncture, a lawyer who is trying to please the insurer that selected her — and is in a position to do so again — would face a conflict.

While it is true, as Curley notes, that the ethics rules impose a duty on counsel to represent the client zealously, the very existence and widespread adoption of an “independent counsel” rule confirms that courts take the practical approach — that is, they prefer to remove from the outset the obvious perverse incentives that can plague counsel.
In short, even in Curley’s hypothetical, a real conflict of interest exists between the insurer, which has an incentive to minimize defense costs and can do so without the fear of absorbing a judgment, and the policyholder, which has paid for and is entitled to a full, complete and thorough defense.

Although not the typical conflict of interest posed by a reservation of rights in a case involving allegations of both negligence and intentional injury, this issue mirrors those conflicts already recognized in the courts and should, for the same reason, entitle a policyholder to select its own independent defense counsel.

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