THE RIGHT TO INDEPENDENT COUNSEL OF YOUR CHOICE IN THE DEFENSE OF A PROFESSIONAL LIABILITY CLAIM

By David J. Shuster, Esquire
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Professional liability lawsuits frequently include allegations of intentional wrongdoing—defamation, interference with economic relations, malicious prosecution, abuse of process, breach of fiduciary duty, fraud, conspiring with a client, or aiding and abetting a client's torts. But while insurance policies typically exclude coverage for most intentional wrongdoing, the insurer may still be required to provide a defense if the plaintiff has made at least one allegation that is potentially within the scope of coverage.[1] In general, the insurer cannot pick and choose among the covered and uncovered claims in those circumstances and defend only part of the case: if any claims potentially come within the policy coverage, the insurer must defend all of the claims.[2]

When a complaint includes both covered and uncovered allegations, the insurer will most likely defend the case under a reservation of rights.[3] In its reservation of rights, the insurer will state, among many other things, that it will not pay a judgment on any of the uncovered allegations.[4]

This reservation of rights can create a conflict between the insurer's interests and those of the insured. In this regard, insureds have an interest in seeing that liability, if any, is imposed on

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[1] *See, e.g., Utica Nat'l Ins. Co. of Tex. v. Am. Indem. Co.*, 141 S.W.3d 198, 201 (Tex. 2004) ("A liability insurer is obligated to defend a suit if the facts alleged in the pleadings would give rise to any claim within the coverage of the policy."); *Hartford Fire Ins. Co. v. Whitehall Convalescent & Nursing Home, Inc.*, 748 N.E.2d 674, 682 (Ill. App. Ct. 2001) ("If the underlying complaint alleges facts within or potentially within policy coverage, the insurer is obligated to defend its insured, even if the allegations are groundless, false or fraudulent."); *Litz v. State Farm Fire & Cas. Co.*, 695 A.2d 566, 572 (Md. 1997) ("If there is a possibility, even a remote one, that the plaintiffs' claims could be covered by the policy, there is a duty to defend.").

[2] *See Town of Massena v. Healthcare Underwriters Mut. Ins. Co.*, 779 N.E.2d 167, 172 (N.Y. 2002) ("If any of the claims against the insured arguably arise from covered events, the insurer is required to defend the entire action.") (internal quotation marks omitted); *see also Kubit v. MAG Mut. Ins. Co.*, 708 S.E.2d 138, 144 (N.C. 2011); *Utica Mut. Ins. Co. v. Miller*, 746 A.2d 935, 940 (Md. Ct. Spec. App. 2000).

[3] *See, e.g., Att'ys Liab. Prot. Soc. v. Reliance Ins. Co.*, 117 F. Supp. 2d 1114, 1122 (D. Kan. 2000) ("A reservation of rights is essentially an agreement between the insurer and the insured which allows the insurer to provide a defense while reserving its rights to later deny coverage or assert policy defenses."); *Knox-Tenn Rental Co. v. Home Ins. Co.*, 833 F. Supp. 665, 668 (E.D. Tenn. 1992) (explaining a reservation of rights gives notice to the insured that the insurer "is not waiving its right to deny liability under the policy").

[4] *See Kirk v. Mt. Airy Ins. Co.*, 951 P.2d 1124, 1127 n.3 (Wash. 1998) ("When [an insurer defends under a reservation of rights], the insured receives the defense promised and, if coverage is found not to exist, the insurer will not be obligated to pay."); *cf. VierraMoore, Inc. v. Cont'l Cas. Co.*, 940 F. Supp. 2d 1270, 1285 (E.D. Cal. 2013) (holding that when the insurer reserved its rights, it was entitled to recoup advanced sums that it was not obligated to pay under the policy).

covered claims (so that the insurer must pick up the tab), while the insurer has an opposite financial interest—preferring that liability be imposed only on uncovered claims.[5] Indeed, because the duty to defend may come to an end as soon as the covered claims fall out of the case,[6] the insurer may have an interest in securing the prompt dismissal of the covered claims—leaving the insured to obtain new counsel midway through litigation. Accordingly, a conflict of interest arises when the insured's defense is "outcome determinative of the insurer's coverage defense, and to the Policy's duty to indemnify."[7]

When this conflict of interest arises, the insured then has the right to control the defense. Indeed, the insurer has an obligation "either [to] provide an independent attorney to represent the insured or assume the reasonable cost of an attorney chosen by the insured, whichever the insured chooses."[8] In other words, in a professional liability case that involves both covered and uncovered allegations, an insured may select his or her own attorney and the insurer will be obligated to pay the "reasonable" fees that the attorney charges; the insured need not simply accept the attorney whom the insurer selects from its approved panel.

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[5] *See Brohawn v. Transamerica Ins. Co.*, 347 A.2d 842, 851 (Md. 1976); *see also Roussos v. Allstate Ins. Co.*, 655 A.2d 40, 44 (Md. Ct. Spec. App. 1995) ("Because it is in the insurer's interest to establish noncoverage and in the insured's interest to establish coverage" when "a plaintiff raises both covered and uncovered claims in a suit," the interests of the insurer and the insured are "diametrically opposed."). In *Armstrong Cleaners, Inc. v. Erie Ins. Exch.*, the court explains:

> The classic example in Indiana law is a lawsuit by a person who has been shot and injured by the insured. The victim alleges in Count One that the insured shot him intentionally and in the alternative in Count Two that the insured shot him negligently. Under a typical liability insurance policy, coverage is available for negligent acts but not for intentional acts. The insurer therefore would benefit from either a defense verdict or a finding of intentional wrongdoing. The insured, on the other hand, would benefit from either a defense verdict or a finding of negligence. Absent informed consent of both the insurer and the insured, an attorney trying to represent both the insured and the insurer would face an insurmountable conflict of interest.

364 F. Supp. 2d 797, 806 (S.D. Ind. 2005).

[6] *See Culver v. Cont'l Ins. Co.*, 1 F. Supp. 2d 545, 548 (D. Md. 1998) ("[T]he duty to defend plainly ends where a court, as here, has determined that a claim is not covered."); *see also Hugo Boss Fashions, Inc. v. Fed. Ins. Co.*, 252 F.3d 608, 622 (2d Cir. 2001); *Balt. Gas & Elec. Co. v. Commercial Union Ins. Co.*, 688 A.2d 496, 510 (Md. Ct. Spec. App. 1997).

[7] *Armstrong Cleaners, Inc.*, 364 F. Supp. 2d. at 808; *see also Nisson v. Am. Home Assur. Co.*, 917 P.2d 488, 489 (Okla. Civ. App. 1996) ("[N]either should the insurer be allowed to rely on a reservation of rights provision regarding coverage while subjecting its insured to a possible half-hearted defense by an attorney whose interests are subservient to that of the insurer and which could place such an attorney in an *ethically untenable position*.") (emphasis added).

[8] *Brohawn*, 347 A.2d at 852; *see also Exec. Risk Indem. Inc. v. Icon Title Agency, LLC*, 739 F. Supp. 2d 446, 450 (S.D.N.Y. 2010) (explaining that a "potential conflict of interest [was] sufficient to trigger a right to independent counsel"); *Utica Mut. Ins. Co. v. David Agency Ins., Inc.*, 327 F. Supp. 2d 922, 931 (N.D. Ill. 2004) ("Under the law, the insurer must pay for the defense of an insured who determines in a conflict of interest situation not to be represented by the insurer's chosen attorney."); *Gulf Ins. Co. v. Berger, Kahn, Shafton, Figler, Simon & Gladstone*, 93 Cal. Rptr. 2d 534, 545 (Cal. Ct. App. 2000).

The insured's right to select counsel is a significant right. To control defense costs, insurers routinely put in place procedures that potentially can limit a defense attorney's autonomy. For example, the insurer may require an attorney to first obtain the approval of an adjuster before taking depositions, interviewing witnesses, conducting legal research, and drafting or responding to pleadings. Indeed, the ability to direct what counsel may or may not do could conceivably allow the insurer to maneuver a case into a posture that is advantageous to its interests, but disadvantageous to those of its insured.[9] Thus, an insured may perceive that it can better protect its rights in the case by controlling the defense through independent counsel and requiring the insurer to pay the "reasonable cost" of an independent attorney.

Insurers have argued, and some courts have opined, that an actual conflict does not necessarily arise whenever the insurer reserves its rights in response to uncovered claims and, therefore, the insureds are not necessarily entitled to counsel of their choice.[10] When there is a potential conflict of interest, rather than an actual conflict of interest, an insured may have a difficult time establishing his or her right to obtain independent counsel. But when the "insurer reserves its rights on a given issue *and* the outcome of that coverage issue can be controlled by the insurer's retained counsel," then the insurer has an obligation to provide the insurer with independent counsel.[11] The key focus is thus to determine the insured's and insurer's interests and then analyze whether the insurer has an in interest in providing "a less than vigorous defense" on behalf of the insured to determine if an actual conflict exists, creating the need for independent counsel.[12]

For a variety of legitimate reasons, an insurer may prefer to assign the defense to panel counsel. But, doing so over the objection of the insured in a conflict situation may be more

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[9] *See Ill. Mun. League Risk Mgmt. Ass'n v. Siebert*, 585 N.E.2d 1130, 1138 (Ill. App. Ct. 1992) (holding the insured was entitled to independent counsel where the insurer would have greatly benefited from decisions that were adverse to the insured).

[10] *See, e.g., Coats, Rose, Yale, Ryman & Lee, P.C. v. Navigators Specialty Ins. Co.*, 830 F. Supp. 2d 216, 221–22 (N.D. Tex. 2011) (finding that although the insurer had a reservation of rights as to the costs for a declaratory judgment, the insurer had an incentive to vigorously defend the insured in the declaratory action because the claims at issue were partially covered under the policy and thus no conflict existed); *Cardin v. Pac. Emp'rs Ins. Co.*, 745 F. Supp. 330, 336–38 (D. Md. 1990) (noting, in dicta, that no conflict of interest existed); *James 3 Corp. v. Truck Ins. Exch.*, 111 Cal. Rptr. 2d 181, 186 (Cal. Ct. App. 2001) ("For independent counsel to be required, the conflict of interest must be significant, not merely theoretical, actual, not merely potential.") (internal quotation marks omitted); *Johnson v. Cont'l Cas. Co.*, 788 P.2d 598, 600 (Wash. Ct. App. 1990) ("[N]o actual conflict of interest necessarily exists in a reservation of rights defense.").

[11] *James 3 Corp.*, 111 Cal. Rptr. 2d at 186 (internal quotation marks omitted); *see also Belanger v. Gabriel Chems., Inc.*, 787 So.2d 559, 565 (La. Ct. App. 2001) ("If an insurer chooses to represent the insured but deny coverage, separate counsel must be employed.").

[12] *Mobil Oil Corp. v. Md. Cas. Co.*, 681 N.E.2d 552, 561 (Ill. App. Ct. 1997); *see also Hartford Cas. Ins. Co. v. A&M Assocs., Ltd.*, 200 F. Supp. 2d 84, 93 (D. R.I. 2002) (explaining that the Rules of Professional Conduct require independent counsel when the "insurer and its insured hav[e] conflicting interests") (internal quotation marks omitted); *Siebert*, 585 N.E.2d at 1139 (explaining that a conflict of interest existed when the insurer had an interest to provide the insured with a weak defense as to some allegations).

costly to the insurer. In a suit to enforce its legitimate right to select counsel, the insured can recover not only the attorneys' fees expended in paying counsel of choice to defend the insured, but also the fees incurred by the insured in establishing that the insurer breached its duties.[13]

Ideally, at the inception of the professional liability suit, the insured and insurer should attempt to resolve any dispute concerning the selection of counsel. Typically, such efforts include discussions about the "reasonable" rate that the insurer is willing to pay for the insured's selected counsel. While the reasonable rate may vary among cases,[14] it seems doubtful that an insurer should be able to succeed in requiring the insured's counsel of choice to work on panel counsel's pay scale.[15] For panel counsel, the modest rate reflects a kind of volume discount: they expect to receive a steady flow of business from the insurer, a solvent and creditworthy payment source, and they reduce their rates accordingly. By contrast, the insured's counsel of choice may not have such a relationship with the insurer and are thus unlikely to have any rationale or incentive to discount their rates. Indeed, if counsel of choice cannot or will not work at the discounted rate that the panel counsel agrees to accept, the insureds may well be wrongly denied their counsel of choice.

Even when all parties—the insurer, the insured, and preferred counsel—reach an agreement as to the hourly rate, there are other practical considerations that must be resolved. The most notable is whether and to what extent the insured's preferred counsel must comply with the payment guidelines that insurance companies provide to their panel counsel. Such guidelines may say that the insurance company will not pay for certain items of expense, like Westlaw research charges, travel expenses, or photocopy costs. Again, it is best to discuss and hopefully resolve such matters at the beginning of the engagement.

Finally, it is important to note that regardless of whether defense counsel is selected by the insured, by the insurer, or by both as the result of a compromise between insured and insurer, defense counsel has an ethical obligation under the Rules of Professional Responsibility to avoid

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[13] *See, e.g.*, *Woo v. Fireman's Fund Ins. Co.*, 164 P.3d 454, 468 (Wash. 2007) ("Attorney fees are recoverable at trial, and if the plaintiff prevails on appeal . . . . In a duty to defend action, an insured is entitled to fees on appeal . . . because the insurer compels the insured to assume the burden of legal action, to obtain the full benefit of his insurance contract.") (internal quotation marks omitted); *Belanger*, 787 So.2d at 565 ("Failure to [provide independent counsel] subjects the insurer to the attorney fees and costs the insured may incur for defending the suit."); *Litz*, 695 A.2d at 573 ("[A]n insured may recover attorneys' fees incurred due to the insurer's wrongful denial of a duty to defend.").

[14] A reasonable rate is one that is comparable to the prevailing market rate. *CoStar Grp. Inc. v. LoopNet, Inc.*, 106 F. Supp. 2d 780, 788 (D. Md. 2000); *see also Am. Charities for Reasonable Fundraising Reg., Inc. v. Pinellas Cnty.*, 278 F. Supp. 2d 1301, 1310 (M.D. Fla. 2003); *Conner v. Mid S. Ins. Agency, Inc.*, 943 F. Supp. 663, 667 (W.D. La. 1996).

[15] *But see Belanger*, 787 So.2d at 566–67 (holding that the insured was entitled to independent counsel but "by [the] plain language [of the policy] the attorney fees and all other litigation expenses [the insurer] must pay to counsel selected by [the insured] are limited to the rates [the insurer] actually pays to counsel the insurer retains in the ordinary course of business in the defense of similar claims").

any conflict of interest.[16] When "there is a significant risk that the representation of [the insured] will be materially limited by the lawyer's responsibilities to [the insurer]," then all the parties ought to recognize the necessity of independent counsel.[17]

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David J. Shuster *is the Managing Principal of Kramon & Graham, P.A. He has particular experience representing professionals and high-level executives in professional liability, business, and commercial disputes. David also has significant experience representing plaintiffs in claims involving serious personal injuries.*

Kaitlin D. Motley *contributed substantially to this article. Ms. Motley served as a summer associate for Kramon & Graham during the summer of 2014 and as a law clerk at the time of the publishing of this article. After her anticipated graduation from law school in May 2015, Ms. Motley will serve as a judicial law clerk to Mary Ellen Barbera, Chief Judge, Court of Appeals of Maryland.*

[16] MODEL RULES OF PROF'L CONDUCT r. 1.7; *see also* MODEL RULES OF PROF'L CONDUCT r. 1.7 cmt. 8 ("Even where there is no direct adverseness, a conflict of interest exists if there is a significant risk that a lawyer's ability to consider, recommend or carry out an appropriate course of action for the client will be materially limited as a result of the lawyer's other responsibilities or interests . . . . The critical questions are the likelihood that a difference in interests will eventuate and, if it does, whether it will materially interfere with the lawyer's independent professional judgment in considering alternatives or foreclose courses of action that reasonably should be pursued on behalf of the client.").

[17] MODEL RULES OF PROF'L CONDUCT r. 1.7.