January 2014

Nevada Courts Appear Poised to Recognize Policyholder's Right to Independent Counsel Where Carrier Accepts a Defense Under a Reservation of Rights

On November 19, 2013, the United States District Court for the District of Nevada in *Hansen v. State Farm Mutual Automobile Ins. Co.*, Case No. 2:10-cv-01434-MMD-NJK, certified to the Nevada Supreme Court the question of whether an insurance carrier's defense of a lawsuit under a reservation of rights presents a conflict of interest entitling the policyholder to independent counsel. To date, Nevada has not expressly adopted or rejected the requirement to provide independent counsel — or *"Cumis"* counsel — in cases involving a potential conflict of interest between a policyholder and its carrier. That question can have important implications for policyholders, as carriers oftentimes appoint counsel whose own financial interests can incentivize the appointed counsel to favor protecting the carrier over its insured.

Background

In July 2003, plaintiff Stephen Hansen and two friends attended a party in the suburbs of Las Vegas. *Hansen v. State Farm Mut. Auto. Ins. Co.*, 2012 U.S. Dist. LEXIS 176056, 2 (D. Nev. Dec. 12, 2012). As they were leaving the party, Brad Aguilar, a member of a local gang, taunted the plaintiffs and eventually drove his jeep into the back of one of their cars. *Id*. The plaintiffs sued Aguilar and his father, alleging negligence, as well as intentional misconduct that included assault and battery. *Id*. at 3.

Aguilar's jeep was insured by State Farm Mutual Automobile Insurance Company (SFA), and the insurance policy issued by SFA covered damages resulting from negligent acts, but not intentional misconduct. *Id*. at 20. The carrier accepted the defense, but reserved the right to deny coverage for claims and damages relating to the intentional torts. *Id*. at 3. As a result, the carrier had a conflict of interest with its insured; while the carrier would have no responsibility if there were a finding of intentional tortious conduct such as assault or battery, the policyholder would be covered if there were a finding of only negligence. *Hansen v. State Farm Mut. Auto. Ins. Co*., 2012 U.S. Dist. LEXIS 176057, 32-33 (D. Nev. Dec. 12, 2012). The policyholder therefore contended the carrier had no right to appoint defense counsel, but instead was obligated to fund an independent counsel selected or approved by the policyholder. Given the absence of guidance on the issue from the Nevada Supreme Court, the district court certified two questions to the Nevada Supreme Court:

(1) Does Nevada law require a carrier to provide independent counsel for its policyholder when a conflict of interest arises between the carrier and the policyholder?

(2) If yes, would the Nevada Supreme Court find that a reservation of rights letter creates a *per se* conflict of interest?

Implications

The certified questions concern an issue of critical importance to policyholders. Generally, liability policies provide that the carrier has the right and the duty to defend covered claims. Carriers often interpret this clause to mean that, where they undertake a defense — even under a reservation of rights — the carrier, not the policyholder, has the right to select counsel. Policyholders need to be wary of such contentions.

The right to defend need not include the right to appoint counsel. Indeed, some policies actually include language specifying that the carrier has the right to select counsel, suggesting that in circumstances where that language is absent the policyholder should have the right to approve defense counsel funded by the carrier.

Complaints often allege noncovered claims as well as covered ones; yet the policyholder is entitled to a defense against the entire complaint. *San Diego Navy Fed. Credit Union v. Cumis Ins. Soc'y*, 162 Cal. App. 3d 358, 364 (1984). Where a carrier assumes a defense under a reservation of rights, the carrier may not be as concerned with appointing counsel qualified to defend noncovered claims, or may not have experience dealing with lawyers with experience in their area. This can undermine the "commonality of interest" between a carrier and its policyholder, and the carrier's counsel may be "placed in the dilemma of helping one of his clients concerning insurance coverage and harming the other." *Id*. at 364-65. Therefore, it is crucial that the policyholder ensure that any counsel defending the claim is qualified to defend both covered and noncovered claims.

Additionally, when reservations of rights are involved, questions regarding the scope of the attorney-client privilege may be implicated. Confidentiality becomes an issue when attorney-client communications address coverage issues. Where there is no confidentiality as between two clients seeking a common goal, defense counsel, even if appointed by the carrier, should not communicate information to the carrier that could support a denial of coverage. *See id*. at 366. Investigating and communicating matters concerning coverage, not the defense, falls outside the scope of the carrier's duty and right to defend and should not be passed on by defense counsel.

Indeed, the majority of jurisdictions now recognize the conflict of interest that arises between a carrier and its policyholder when the carrier assumes a defense while reserving a right to later deny coverage.[1] Nevada appears poised to follow that trend and it should do so. Some jurisdictions have codified this right under state statute, including recognizing the precise parameters of the attorney-client privilege in this tripartite relationship. *See,* e.g., *California Civil Code section 2860*. Under many states' professional responsibility rules, where a conflict of interest arises between a carrier and a policyholder, it is inappropriate for a single attorney to represent both. These states have established a requirement that a conflict attendant with defending subject to a reservation of rights must be mitigated by requiring the carrier to pay the reasonable expenses of independent counsel. *See,* e.g., *Federal Ins. Co. v. X-Rite, Inc.,* 748 F. Supp. 1223, 1228 (D. Mich. 1990). Nonetheless, some jurisdictions follow the reasoning that the carrier is not, simply by the fact that it designates the lawyer, a client of that lawyer. Under this view, the appointed counsel owes a duty of loyalty to the policyholder only, and thus no conflict arises. *See,* e.g., *Twin City Fire Ins. Co. v. Ben Arnold-Sunbelt Beverage Co. of S.C.,* 433 F.3d 365, 373 (4th Cir. 2005). Even in these jurisdictions, however, the counsel appointed may have an interest in pleasing the carrier,

[1] *E.g., Federal Ins. Co. v. X-Rite, Inc.,* 748 F. Supp. 1223, 1228 (D. Mich. 1990) (stating "*Cumis* is representative of a growing body of case law which would give the insured an absolute right to choose counsel where a conflict exists"); *Moeller v. Am. Guar. & Liab. Ins. Co.,* 707 So. 2d 1062, 1069 (Miss. 1996) (noting that "other jurisdictions have generally held that in such a situation [defending under a reservation of rights], not only must the insured be given the opportunity to select his own counsel to defend the claim, the carrier must also pay the legal fees reasonably incurred in the defense"); *Union Ins. Co. v. Knife Co.*, 902 F. Supp. 877, 880 (W.D. Ark. 1995) (stating "[d]ue to this [coverage] conflict of interest … the insurer must give up control of the litigation and retain an independent counsel for the insured"); *CHI of Alaska v. Employers Reins. Corp.,* 844 P.2d 1113, 1121 (Alaska 1993) (concluding that "the insured should have the right to select independent counsel" subject to the "implied covenant of good faith and fair dealing"); *Village of Lombard v. Intergovernmental Risk Mgmt. Agency,* 681 N.E.2d 88, 94 (Ill. 1997) (holding that the insured can select independent counsel except where the insurer and insured contractually agree to limit scope of the defense and liability obligations); *Brohawn v. Transamerica Ins. Co.*, 347 A.2d 842, 854 (Md. App. 1975) (requiring the insurer to inform the insured of the conflict and provide the insured with the option of accepting counsel selected by the insurer or selecting independent counsel whose reasonable expenses will be paid by the insurer).

and may "favor the insurance company over the insured due to a desire to receive future legal work from the insurance company." *Id*. at 371. There still exists a risk that, notwithstanding the formal professional requirements, financial incentives may operate to the policyholder's disadvantage. *See Nandorf, Inc. v. CNA Ins. Cos*., 479 N.E.2d 988, 991 (Ill. App. Ct. 1985); *Purdy v. Pac. Auto. Ins. Co*., 157 Cal. App. 3d 59, 76 (1984) ("As a practical matter, however, there has been recognition that, in reality, the insurer's attorneys may have closer ties with the insurer and a more compelling interest in protecting the insurer's position.")

Policyholders are entitled to counsel that recognize these issues and can take steps to ensure that the privilege is not breached. Among other things, joint defense agreements might be obtained from carriers that make clear that the carrier will not use communications from defense counsel in any manner that does not advance the policyholder's interests. Oftentimes, a policyholder may be better served by its own choice of firm or by a firm with particular experience handling the sorts of claims alleged, and in most states the policyholder is entitled to reimbursement for reasonable expenses incurred in retaining such counsel. Indeed, "the insurer's desire to exclusively control the defense must yield to its obligation to defend its policy holder." *San Diego Navy Fed. Credit Union*, 162 Cal. App. 3d at 371 (citing *Prashker v. United States Guarantee Company*, 1 N.Y.2d 584 (1956)). No matter what the ultimate outcome in *Hansen*, policyholders should take affirmative steps to ensure that conflicting incentives do not interfere with their right to a defense.

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