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When Worried About Collusion, Insist on Independent Counsel

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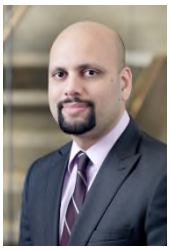
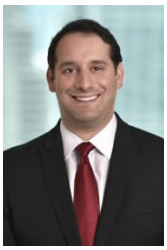

In addition to being a part of the news recently, the need for independent counsel is an important topic for liability insurance, too, as demonstrated by a recent decision by the U.S. Court of Appeals for the Fifth Circuit Court. No matter a company's line of business, most in-house attorneys or risk managers have likely reported liability claims or lawsuits to an insurer. The ensuing script is familiar, in that the insurer will often agree to defend while raising coverage issues and insisting on appointing defense counsel of its choosing. The insurer may even force its own choice of counsel, despite the insured's preference for another attorney or its reasonable request for independent counsel. A recent Fifth Circuit case highlights significant coverage implications for insureds that can arise under these circumstances.

In *Grain Dealers Mutual Insurance Company v. Cooley*, the Cooleys owned a gas station that was insured by Grain Dealers under a business owners' policy. After Pine Belt Oil Co. purchased the station from the Cooleys, a neighboring property owner notified the Mississippi Department of Environmental Quality that gas was leaking into a pond on his property. The MDEQ sent a letter to Pine Belt requesting an assessment of the gas station's fuel lines, which was then forwarded to the Cooleys. The Cooleys requested a defense and indemnification from Grain Dealers.

After receiving the MDEQ's letter, Grain Dealers asserted that coverage was unavailable under the policy, if the Cooleys were ordered to take part in the actual clean-up. Grain Dealers nonetheless concluded that the policy provided a defense and hired an attorney to defend the Cooleys in the MDEQ proceedings. The insurer did not, however, offer the Cooleys the opportunity to hire an attorney of their choice.

The MDEQ subsequently concluded that the Cooleys and Pine Belt must remediate the spill site. While the order gave the Cooleys 30 days to request a hearing, neither they nor the insurer's hired counsel did so. Counsel also failed to advise the Cooleys of their right to request a hearing. Years later, Pine Belt demanded indemnification from the Cooleys for the cost of compliance with the MDEQ order. The Cooleys, in turn, sought a defense and indemnification from Grain Dealers, which denied both requests on the grounds that the policy excluded coverage.

Grain Dealers subsequently filed a declaratory judgment action in Federal District Court seeking a determination that it had no duty to defend or indemnify. The court granted summary judgment in the insurer's favor, finding that the Cooleys could not show prejudice resulting from the insurer's failure to provide independent counsel. The Fifth Circuit disagreed and reversed, holding that the Cooleys suffered sufficient prejudice and that the insurer could not deny coverage under Mississippi insurance law.

As the appellate court reasoned, an insurer does not have the luxury of refusing to acknowledge coverage while unilaterally selecting defense counsel for the policyholder. When an insurer elects to defend under a reservation of rights, "the insured must be given the opportunity to select his own counsel to defend the claim." The obligation to provide independent counsel stems from the various conflicts of interest that can exist between the insurer and insured when the insurer asserts coverage defenses. An insurer that breaches its duty in this regard may be precluded from denying liability if its conduct results in prejudice to the insured—even if a policy exclusion would have otherwise apwplied to bar coverage.

Grain Dealers provided a defense but simultaneously disclaimed coverage if the Cooleys were ordered to clean the spill. The Cooleys were never informed of their right to hire independent counsel, which foreclosed Grain Dealers from denying coverage if the Cooleys were later prejudiced. The court found that prejudice existed when the Cooleys were not informed of their right to challenge the MDEQ decision and lost their ability to do so. Accordingly, Grain Dealers was obligated to defend and indemnify, even if the policy did not provide coverage.

Cooley is a prime example of why businesses must push for independent counsel when a claim is asserted or a lawsuit is filed. The facts of this case are hardly uncommon. Liability insurers often do not acknowledge coverage from the outset, and most defenses are offered pursuant to a reservation of rights. When this occurs, businesses should not allow an insurer to straddle the fence on coverage while simultaneously selecting the attorney to defend the case. Instead, it is incumbent on general counsel and risk managers to insist on alternative representation from counsel of their choice.

Insurers may raise a variety of issues in response to this demand, including independent counsel's qualifications, rates and staffing. They may even threaten to withhold a defense entirely. But under *Cooley* and jurisdictions with similar law, carriers that employ these tactics do so at their own peril. If counsel prejudices the insured through the defense, the insurer can be found liable, regardless of whether there was coverage based on the terms of the policy.

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