

# A Policyholder's Right to Independent Counsel

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► An insurance company's broad duty to defend usually benefits the policyholder, but a conflict arises when the insurer issues a reservation of rights.

What is a policyholder to do when their insurance company assumes its obligations to provide coverage, but only after issuing a reservation of rights? Can a policyholder trust that the insurance company-appointed defense counsel is working in their best interest, as opposed to in the interests of the insurance company? When is a policyholder entitled to "independent counsel" – counsel selected by the policyholder but paid for by the insurance company?

The short answer: whenever in the course of a defense the policyholder's interests potentially diverge from the insurance company's. Below, we examine when and how such conflicts of interest occur.

## The Tripartite Relationship

The tripartite relationship is the relationship between the policyholder, the insurance company and the defense counsel hired by the insurance company to defend the policyholder. The tripartite relationship stems from an insurance company's broad duty to defend, which is triggered if there is a potential for coverage under a policy. This means that an insurance company owes the policyholder a defense even if it is ultimately found that there is no coverage for the claim against the policyholder. Pursuant to its duty to defend, the insurance company will select defense counsel from a panel of firms that it regularly deals with.

While the insurance company's broad duty to defend benefits the policyholder in so far as they are not paying for a defense out their own pockets, a conflict arises when the insurance company issues a reservation of

rights. A reservation of rights places the policyholder on notice that the insurance company is looking for a way to limit, or even terminate, its obligations under the insurance policy. In such a scenario, the interests of the policyholder and the insurance company are no longer aligned, and the insurance company-appointed defense counsel may be unable to adequately represent the policyholder's interests. This is especially true in situations where in the course of defending the policyholder, defense counsel acquires information that may negatively impact the policyholder's coverage. This conflict of interest necessitates the policyholder's right to independent counsel.

## Independent Counsel

Courts throughout the country have recognized that there is a fundamental issue when defense counsel is left to balance the divergent interests of the policyholder and the insurance company.<sup>1</sup>

In the seminal case of *San Diego Federal Credit Union v. Cumis Insurance Society*, 162 Cal. Pp. 3d, 358 (Cal. App. 1984), the policyholder brought suit against Cumis Insurance Society for the expense of hiring the independent counsel that the policyholder retained for its defense in a third-party action. In *Cumis*, the insurance company appointed defense counsel for the policyholder, but it also issued a reservation of rights. The policyholder viewed this as a conflict



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of interest and hired independent counsel, requesting that the insurance company pay the cost. The court found that “where there are divergent interests of the insured and the insurer brought about by the insurer’s reservation of rights based on possible noncoverage under the insurance policy, the insurer must pay the reasonable cost for hiring independent counsel by the insured.” *Id.* at 375.

A policyholder’s right to independent counsel has been recognized by courts and state legislatures throughout the country.<sup>2</sup> Furthermore, “Restatement of the Law, Insurance Liability” has recognized that: “[w]hen an insurer with the duty to defend provides the insured notice of a ground for contesting coverage ... and there are facts at issue that are common to the



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legal action for which the defense is due and to the coverage dispute, such that the action could be defended in a manner that would benefit the insurer at the expense of the insured, the insurer must provide an independent defense of the action.”<sup>3</sup> Accordingly, policyholders should be vigilant in protecting their own interests, especially when the insurance company has given notice that it may seek to avoid its coverage obligations. The retention of independent counsel can

provide peace of mind that the underlying dispute is being vigorously defended without undue influence from the insurance company.

### Ethical Considerations

All attorneys are bound by rules of professional conduct. Many states base their rules on the American Bar Association’s Model Rules of Professional Conduct, which provides guidance to policyholders when dealing with defense counsel. In pertinent part, Rule 5.4: Professional Independence of a Lawyer states: “(c) a lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer’s professional judgment in rendering such legal services.” Furthermore, rule 1.8 states the following:

A lawyer shall not accept compensation for representing a client from one other than the client unless:

- ▶(1) the client gives informed consent;
- ▶(2) there is no interference with the lawyer’s independence of professional judgment or with the client-lawyer relationship; and
- ▶(3) information relating to representation of a client is protected as required by Rule 1.6.

These rules serve as a reminder that in the tripartite relationship, the policyholder is the client, and that in rendering services, defense counsel must perform ethically and in the best interests of the policyholder.

### Conclusion

Although navigating the relationship between the insurance company and defense counsel may be difficult, policyholders should remember that they are in control of the litigation. In the event that defense counsel is left managing the conflicting interests of an insurance company and a policyholder, the right to independent counsel allows the policyholder to ensure that their positions are adequately represented. ■

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