INDEPENDENT COUNSEL LAW IN THREE KEY JURISDICTIONS

TRIGGERING THE INSURED'S RIGHT TO INDEPENDENT COUNSEL

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The right of an insured to have independent counsel is generally based on an attorney's ethical obligations to his client to avoid conflicts of interest and on the insurer's obligation to defend its insured. Different states have different requirements triggering the insured's right to independent counsel and the insurer's corresponding duty to pay independent counsel's reasonable attorneys' fees. The triggering event often turns on creation of a conflict of interest in the defense of the underlying action. Local rules of professional conduct guide courts in determining the reasonableness of independent counsel's fees, which may be limited to "panel counsel" rates.

For the purposes of this article we have chosen to examine an insured's right to independent counsel in New York, California and New Jersey. A majority of states that have analyzed the right to independent counsel follow the same analysis as New York's highest court, the New York Court of Appeals. California is one of only a handful of states where an insured's right to independent counsel is set forth by statute as well as common law. New Jersey is unique in that once the insured's right to select independent counsel is determined, an insurer's duty is not to retain counsel to defend the insured, but rather to reimburse its insured the reasonable and necessary costs incurred by independent counsel to defend covered claims.

CALIFORNIA

California has a statute addressing an insured's right to independent counsel and the insurer's corresponding duty to pay independent counsel's reasonable attorneys' fees. California Civil Code § 2860, enacted following a seminal decision on the right to independent counsel in *San Diego Navy Fed. Credit Union v. Cumis Ins. Soc'y, Inc.*,[1] provides that if the insurer owes a duty to defend and a conflict of interest arises, the insured is entitled to independent counsel, unless the insured is informed that a possible conflict may arise or does exist, and the insured expressly waives its right to independent counsel.

In defining a conflict of interest, the Code provides that when an insurer reserves its rights on a given issue and the outcome of that coverage issue can be controlled by counsel retained by the insurer for the defense of the claim, a conflict may exist. The Code also provides that no conflict will arise merely because the underlying complaint contains a request for punitive damages or if the insured is sued for an amount in excess of the policy limits.

Not every reservation of rights will entitle an insured to independent counsel. The California Court of Appeals has held that there is no automatic entitlement to independent counsel where a coverage issue is independent from the issues in the underlying action or where damages are only partially covered by the policy. (*Dynamic Concepts, Inc. v. Truck Ins. Exch.*[2]) However, where a significant actual conflict (not a theoretical or potential one) triggers the right to independent counsel, the Code protects the insurer's rights to: (a) agree upon the methods of selecting counsel, (b) remain informed of the status of the litigation and be consulted with respect thereto, and (c) pay limited counsel fees. The Code also permits the insurer to require that independent counsel possess certain minimum qualifications, such as five years of civil litigation experience with substantial defense experience in the subject matter at issue. As such, a certain level of control over independent counsel may still be retained by the insurer.

Independent counsel's fees are also limited to rates actually paid by the insurer to attorneys in the ordinary course of business in the defense of similar actions in the community where the claim arose or is being defended. Such rates are called "panel rates," which are often much lower than market rates. Panel rates must be reasonable. In most jurisdictions, local Rules of Professional Conduct guide courts in determining a fee's reasonableness. California Rule 4-200, for example, provides that in determining the "conscionability" of a fee the factors to be considered are, among others:

(1) The amount of the fee in proportion to the value of the services performed.

(2) The relative sophistication of the member and the client.

(3) The novelty and difficulty of the questions involved and the skill required to perform the legal service properly.

(4) The likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the member.

(5) The amount involved and the results obtained.

It is important to note that an insurer who wrongfully denies coverage may not rely on the limitation of counsel fees to reasonable panel rates once it has agreed – or been found obligated to – provide a defense.

NEW YORK

The guiding case in New York with respect to independent counsel is *Pub. Serv. Mut. Ins. Co. v. Goldfarb.*[3] Pursuant to *Goldfarb,* an insured's right to independent counsel is triggered when the attorney's duty to the insured would be to defeat liability on any ground, but his duty to the insurer would be to defeat liability on only those grounds for which the insurer might be liable.

Once the right is triggered, the insurer must inform the insured that she has a right to independent counsel; otherwise, the insurer may be liable under New York General Business Law § 349 for deceptive acts and practices in the conduct of a business, trade or commerce or in furnishing services. Most New York courts (and federal courts interpreting New York law) find that once the obligation to supply independent counsel arises, the insurer must pay independent counsel's reasonable attorneys' fees. (*Ceres Envtl. Servs., Inc. v. Arch Specialty Ins. Co.*[4]) New York courts will rely on the principle that "without such an understood qualification of reasonableness, insurers would be at the mercy of their insured's attorneys" and on the New York Rules of Professional Conduct prohibiting collection of unreasonable fees. *Id.*

New York Professional Conduct Rule 1.5(a) is similar to California Rule 4-200 in analyzing reasonable attorneys' fees based on certain factors including, but not limited to, the amount involved and the results obtained, the time and labor required and the novelty and difficulty of the questions involved. However, the New York Rule differs from California in that it provides that the fee customarily charged in the locality for similar legal services may be considered in determining a fee's reasonableness. Rule 1.5(a) may thus allow panel rates to serve as a benchmark for independent counsel's attorneys' fees.

NEW JERSEY

New Jersey follows the so-called "Burd Rule," based on *Burd v. Sussex Mut. Ins. Co.*[5] The Burd Rule holds that, where a conflict exists when the insurer reserves its right to disclaim, the insurer is not obligated to defend, but should allow the insured to conduct its own defense and await determination on whether the underlying claim falls within the policy's indemnity obligation. In other words, where a conflict exists between an insurer and its insured by virtue of the insurer's duty to defend mutually exclusive covered and non-covered claims, the duty to defend is translated into a duty to reimburse the insured for the cost of defending the underlying action if it should ultimately be determined, based on the disposition of that action, that the insured was entitled to a defense. (*Grand Cove II Condominium Association, Inc. v. Newark Insurance Co.*[6]) An insurer is not required to defend or pay independent counsel fees for uncovered claims where the underlying plaintiff alleges covered and non-covered claims against the insured. However, where the insured was defended by independent counsel and the loss is found to fall within coverage, the insurer must pay reasonable and necessary costs of the insured's defense.

The insured bears the burden of (a) showing that his legal fees and expenses are reasonable and necessary and (b) justifying the hourly rates charged. New Jersey courts will analyze the insured's proof of the reasonableness of sought-after attorneys' fees rather than grant an application for fees outright. The Appellate Division of the Superior Court of New Jersey has stated that "lawyers who perform insurance defense work may bill at a significantly lower hourly rate than do lawyers rendering other legal services," referring to panel rates. Independent counsel's fees must be reasonable in that they (a) must relate to the defense of the underlying action (rather than to monitoring insurer-appointed counsel's work) and (b) occur during the existence of the conflict of interest (rather than work performed after the facts underlying the conflict of interest end). Moreover, the insurer is required to pay only those fees that are incurred after independent counsel files a notice of appearance in the underlying case.

In determining "reasonable attorneys' fees," New Jersey courts, like California and New York, look to local Rules of Professional Conduct (New Jersey Rule 1.5) for guidance. As in New York, the fee customarily charged in the locality for similar legal services is considered, such that panel rates may serve as a benchmark for independent counsel's reasonable attorneys' fees.

The insured's right to independent counsel will be triggered when a conflict of interest exists between the insurer and the insured. Once the right is triggered insurers and insureds should be guided by their jurisdiction's applicable statutes and/or case law to determine their respective rights and obligations. Insureds should be mindful of the fact that even if they do have the right to select counsel of their choice, their insurer is only obligated to pay reasonable and necessary attorneys' fees and, in some jurisdictions, the "panel rates" which are likely lower than independent counsel's usual and customary hourly rates. What this means is that the insured will have to make up the difference between independent counsel's hourly rates and what the insurer is willing pay.

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1 162 Cal. App. 3d 358, 361, 208 Cal. Rptr. 494, 496 (Ct. App. 1984).
2 61 Cal. App. 4th 999, 1001, 71 Cal. Rptr. 2d 882, 883 (1998), *as modified* (Mar. 27, 1998).
3 53 N.Y.2d 392, 401, 425 N.E.2d 810, 815 (1981).
4 853 F. Supp. 2d 859, 863 (D. Minn. 2012).
5 56 N.J. 383, 386, 267 A.2d 7, 8 (1970).
6 291 N.J. Super, 58, 676, A.2d 1123 (App. Div. 1996).