

Fifth Circuit Rejects Insured's Efforts to Secure Independent Counsel

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On October 15, 2012, the U.S. District Court of Appeals for the 5th Circuit – applying Texas law – addressed another *Cumis* counsel matter. See *Coats, Rose, Yale, Ryman & Lee, P.C. v. Navigators Specialty Ins. Co.*, No. 12-10055, 2012 WL 4858194 (5th Cir. Oct. 15, 2012). The court rejected efforts by a law firm to obtain reimbursement for its independent counsel, despite arguments that the allegations and insurer's reservation of rights would permit the appointed attorney to develop facts/steer the defense towards noncovered claims.¹ The opinion provides further guidance on how to draft a reservation of rights letter that can avoid raising a conflict of interest.

Coats, Rose, Yale, Ryman & Lee, P.C. (Coats Rose), was sued by a former client, Western Rim Investors 2006-3, L.P. (Western Rim), and others. Western Rim alleged that Coats Rose committed malpractice, engaged in improper/unethical billing practices and breached its fiduciary duty. Western Rim sought disgorgement of the fees charged by Coats Rose and declaratory relief. Coats Rose retained the law firm of Williamson and Rusnak (Williamson), and tendered its defense to its insurer, Navigators Specialty Ins. Co. (Navigators).

Navigators issued a reservation of rights letter stating that: (1) disgorged fees were not “damages” as defined by the policy; (2) Western Rim's declaratory claim was not within the scope of coverage; and (3) Navigators would not agree to the retention of Williamson, but would not object to Coats Rose's separate

retention of Williamson.² Navigators separately retained the law firm of Almanza, Blackburn & Dickie to represent Coats Rose. In a subsequent reservation of rights letter, Navigators noted its policy contained an exclusion for dishonesty, which it “was not asserting at this time.” Approximately three months before trial, Navigators stipulated that it would not rely on the dishonesty exclusion as a basis to deny coverage.

For a time, both firms represented Coats Rose and cooperated in the defense. Coats Rose incurred legal bills with Williamson in excess of \$250,000, which Navigators refused to pay. Coats Rose sued Navigators for reimbursement, arguing that it had the right to retain independent counsel for several reasons.

First, Coats Rose asserted that because Navigators referenced, but did not assert or rely on, the existence the “dishonesty” exclusion, a conflict of interest existed with regard to the appointment of defense counsel by Navigators. Coats Rose asserted it incurred months of costs before Navigators stipulated it would not ultimately assert the exclusion. Relying on *Northern County Mut. Ins. v. Davalos*³, where the Texas Supreme Court held that a conflict of interest would exist “when the facts to be adjudicated in the liability lawsuit are the same facts upon which coverage depends,” Coats Rose also argued counsel appointed by Navigators could steer the judgment towards a finding of fraud as opposed to a finding of negligence.

¹ In fact, the 5th Circuit, in a one paragraph *per curiam* opinion, held that the district court “committed no error warranting reversal.” 2012 WL 4858194 (5th Cir. 2012).

² Importantly, Williamson was recognized as a premier *plaintiff's* legal malpractice attorney. Case briefing suggests that Navigators objected to Williamson's retention for this reason.

³ See 140 S.W.3d 685 (Tex. 2004).

The district court held, and the 5th Circuit affirmed, that matters raised in a reservation of rights letter only created a potential conflict of interest, which was insufficient to entitle a policyholder to automatically select independent counsel. Coats Rose pointed to other cases involving Texas law⁴, which held that an actual conflict of interest would exist when the answers to jury questions would determine coverage. The district court noted Navigators stipulated it would not rely on the dishonesty exclusion and did not further discuss this issue. Importantly, the court did not discuss whether the assertion of the exclusion in a revoked reservation letter could allow for reimbursement of counsel fees during the interim period before the insurer withdrew the reservation. Thus, by ruling in favor of Navigators, the district court held that withdrawing the reservation removed any conflict and that no fees during the interim period were recoverable.

Second, Coats Rose argued that the existence of claims for noncovered damages (i.e., fee disgorgement based on a breach of fiduciary duty) would allow counsel appointed by Navigators to steer findings towards such uncovered damages, as opposed to

covered damages. Coats Rose also argued that existence of a claim for declaratory relief, which was not covered, would allow counsel appointed by Navigators to defend the overall action in such a way as to result in a decision based on the declaratory relief request rather than the claims for malpractice. The district court was unpersuaded by these “steering” arguments, holding that any admission regarding the “uncovered” damage or cause of action would create equal or greater exposure for “covered” damages and claims. Thus, the district court held that the interests of Navigators and Coats Rose were aligned, so as to avoid the existence of an actual conflict.

The holding of the district court, as affirmed by the 5th Circuit, appears to limit significantly the ability of a policyholder to secure independent counsel, and further provides guidance to a carrier on how to draft reservation letters to avoid raising the conflict issue.

To discuss any questions you may have regarding the opinion discussed in this Alert, or how it may apply to your particular circumstances, please contact:

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⁴ See *Downhole Navigator, L.L.C. v. Nautilus Ins. Co.*, 686 F.3d 325 (5th Cir. 2012); *Partain v. Mid-Continent Specialty Ins. Services*, 2012 WL 201864 (S.D. Tex. Jan. 5, 2012).