

Alert

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Washington Bars Insurers from Maintaining Legal Malpractice Suit Against Policyholder Defense Counsel

In *Stewart Title Guar. Co. v. Sterling Savings Bank, et al.*, Wash. No. 87087-0 (October 3, 2013), the Washington Supreme Court held that a nonclient insurer may not pursue a malpractice claim against appointed defense counsel for failure to assert defenses desired by the insurer, unless the insurer could show it was an intended beneficiary of the legal services provided by appointed defense counsel. The court reasoned that neither an alignment of interest between an insurer and policyholder nor appointed counsel's duty to inform the carrier regarding case activity equated to an actionable duty of care owed by appointed defense counsel to the appointing insurer. The court declined to reach the parties' equitable subrogation arguments that formed the basis of the actual legal malpractice claim.

Factual Background

In the underlying case, Sterling Savings Bank (Sterling) loaned a borrower money to purchase development property. As a condition for the loan, Sterling required a first priority security interest in the property. Sterling's title insurer, Stewart Title Guaranty Company (Stewart Title), negligently failed to discover that Mountain West Construction had started building on the property; by statute, the builder obtained a mechanics' lien superior to the bank's security interest. A payment dispute ultimately arose and Mountain West initiated foreclosure proceedings. Because Stewart Title's policy covered mechanics' liens, Stewart Title hired Witherspoon, Kelley, Davenport & Toole PS (Witherspoon), to defend Sterling in the foreclosure action.

Witherspoon Does Not Raise an Equitable Subrogation Defense

In the foreclosure action, Witherspoon did not raise an equitable subrogation defense and instead stipulated that Mountain West had first priority in an effort to obtain a swift settlement with the builder. Stewart Title ultimately fired Witherspoon over disagreements regarding the viability of an equitable subrogation defense. Even though Stewart Title then hired new counsel who argued differently than Witherspoon, the trial court held that Sterling was bound by the earlier stipulation, and refused to consider the newly asserted equitable subrogation claim.

Stewart Title then sued Witherspoon for legal malpractice based on the firm's failure to raise equitable subrogation as a defense for Sterling. Witherspoon argued that: (1) its client was Sterling, not Stewart Title, and that its failure to raise defenses specified by Stewart Title would not serve as the basis for a legal malpractice lawsuit; and (2) an equitable subrogation defense would have failed under the facts of the case. The trial court rejected Witherspoon's argument that it owed no duty to Stewart Title, but agreed with Witherspoon that an equitable subrogation defense would not have succeeded under the circumstances.

Stewart Title appealed the trial court's summary judgment order dismissing its malpractice case against Witherspoon.

No Duty of Care to Third-Party Payor Absent an Intent to Benefit the Third-Party Payor

The Washington Supreme Court held that, under the facts of the case, Witherspoon's only client



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was Sterling, and that Stewart Title was a nonclient third-party payor. In reaching this conclusion, the court evaluated the parties' relationship under the six factors described in *Trask v. Butler*, 123 Wn.2d 835, 872 P.2d 1080 (1994).¹ The court emphasized that the "primary inquiry" in determining the existence of a duty of care "is whether the plaintiff is an intended beneficiary of the transaction to which the advice pertained," and that "no further inquiry need be made unless such an intent exists." *Trask*, 123 Wn.2d at 842-83.

The Washington Supreme Court disagreed with the trial court's conclusion that Stewart Title was an intended beneficiary of Witherspoon's representation of Sterling because: (1) finding a duty based merely on "aligning interests" would undermine the *Trask* holding and potentially create an ethical dilemma for appointed counsel; and (2) Witherspoon's retention letter provided a contractual basis for the firm's duty to inform the Stewart Title about the underlying litigation.

Aligning Interests Insufficient to Establish Duty of Care

The Washington Supreme Court held that aligning interests between a third-party payor/insurer, and the law firm it hires to defend a policyholder are insufficient to establish an actionable duty of care. The court expressly rejected Stewart Title's argument that a nonclient insurer is presumed to be an intended beneficiary, and thus may bring a malpractice claim unless there is an actual conflict of interest between an insurer and its insured. It noted the *Trask* standard requires that a "transaction was *intended* to benefit" a third party to some extent before it is entitled to sue for malpractice. *Trask*, 123 Wn.2d at 843 (emphasis added).

The court found the simple fact that some aligning interests existed between Stewart Title and its policyholder, Sterling, did not by itself show that Witherspoon or Sterling intended that Stewart Title benefit from Witherspoon's representation of Sterling. It considered this apparent given Witherspoon's strategy of seeking a speedy, yet just, settlement in contrast with Stewart Title's desire to assert an equitable subrogation defense. The court acknowledged that courts in other jurisdictions have concluded the exact opposite. The court further held that a contrary conclusion would not only conflict with the *Trask* standard, but could also cause legal counsel to violate the ethical guidelines found in RPC 5.4(c).²

Duty to Inform Insufficient to Establish Duty of Care

The Washington Supreme Court concluded that Witherspoon's duty to inform Stewart Title about the defense of Sterling was only a limited obligation, one insufficient to establish the broader duty of care. The court found that assigned defense counsel's mere duty to inform a third party payor does not permit a legal malpractice claim for the same reasons articulated in its alignment of interests analysis: (1) attorneys who accept a duty to inform a nonclient third-party payor about legal matters, do not presumptively intend to benefit that third party through their lawyering as *Trask* requires; and (2) attorneys cannot contract away, or have their professional legal judgment be directed or regulated by a third-party payor of these services. RPC 5.4(c).

Conclusion

Ultimately, *Stewart Title* could broadly affect the relationship that insurers share with appointed attorneys pursuant to their duty to defend. This decision makes it increasingly difficult for insurers to maintain legal malpractice actions against counsel assigned to defend their policyholders when acting as nonclient third-party payors. Insurers who hire defense counsel should be cautious when litigating in Washington state, and should understand that hired defense counsel may not be required to assert particular defenses or claims desired by the insurer unless hired defense counsel is specifically retained to assert those issues. And, when a conflict exists between the interests of an insurer and its policyholder, it appears Washington courts will favor resolving the claim on the insured's behalf, rather than accommodating the insurer in recovering expenses.

To discuss any questions you may have regarding the issues discussed in this Alert, or how they may apply to your particular circumstances, please contact William F. Knowles at 206.224.1289 or wknowles@cozen.com.

¹ The *Trask* factors are: (1) the extent to which the transaction was intended to benefit the plaintiff [that is, the third party suing the attorney]; (2) the foreseeability of harm to the plaintiff; (3) the degree of certainty that the plaintiff suffered injury; (4) the closeness of the connection between the defendant's [that is, the attorney's]

conduct and the injury; (5) the policy of preventing future harm; and (6) the extent to which the profession would be unduly burdened by a finding of liability.

² RPC 5.4(c) states: "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."