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ALERT

Reservation of Rights Letter Does Not Entitle Policyholder to Independent Counsel and Excess Policy Does Not Cover Costs of Independent Counsel

August 1, 2011

The Pennsylvania Court of Common Pleas of Philadelphia County has held that the mere existence of a reservation of rights letter does not create a conflict of interest sufficient to entitle a policyholder to independent counsel. *Yaron and Goldberg v. Darwin Nat'l Ins. Co. and Philadelphia Indem. Ins. Co.*, No. 502 (Phila. Ct. Com. Pl. July 4, 2011). The court also held that the excess insurer does not have an obligation to fund independent counsel because the excess policy's definition of "Loss" carved out such defense costs and this provision was not an impermissible escape clause.

The policyholders were sued for malicious prosecution, common law conspiracy and invasion of privacy. The primary insurer provided a defense, with separate defense counsel for each policyholder, under a reservation of rights with respect to exclusions for dishonesty, fraud and willful statutory violations. The policyholders secured independent counsel in addition to defense counsel provided by the insurer and sought a declaration that the insurer must pay the fees of their independent counsel. The policyholders argued that the reservation of rights created a conflict of interest sufficient that the insurer must fund the policyholders' independent counsel.

The court held that the "existence of a reservation of rights letter does not automatically give rise to a conflict of interest between the insurer and the insured with regard to the conduct of the insured's defense." A reservation of rights letter "presents the possibility of a conflict of interest," but "[a]ctual proof that attorneys have disregarded their

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ethical duties to their clients as set forth in the professional rules of conduct is necessary to establish the conflict of interest." In order to meet this standard, "there must be some evidence to suggest that the conflict between the insurer and the insured actually affected counsel's representation so that it may be said that counsel's actions elevated the interest of the insurer over those of his client, the insured." The policyholders failed to produce any such evidence and, accordingly, the court granted summary judgment to the primary insurer.

The policyholders next argued that their costs of securing independent counsel were a covered "Loss" under their excess policy. The excess policy defined "Loss" to include "Defense Costs" and defined "Defense Costs" as any "reasonable and necessary legal fees and expenses incurred in the defense of a Claim ... except that Defense Cost [sic] shall not include ... any amounts incurred in the defense of any Claim for which any other insurer has a duty to defend, regardless of whether or not such other insurer undertakes such a duty." It was uncontested that the primary insurer had a duty to defend the policyholders in this action. The court therefore held that the costs of independent counsel clearly were not covered pursuant to the excess policy's definition of "Loss." The policyholders argued, however, that this provision constituted "an unenforceable 'escape clause'" because it sought to relieve the excess carrier of any obligation to an insured if the insured has other available coverage. The court disagreed and opined that there is "a distinct difference between an escape clause that seeks to avoid all liability and an excess clause that seeks to limit the insurer's liability to the excess over any other collectible insurance." Here, the court found, "the definition of defense costs ... does not constitute an 'escape clause.'" Accordingly, the court granted the excess insurer's motion for summary judgment.