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Should Independent Counsel Fees Be Charged Against Policy Limits?

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In a number of states, when an insurance company has a duty to defend its insured and reserves its rights in a certain way, the carrier must pay for independent counsel selected by the policyholder to defend the action alongside insurer-selected panel counsel. This is to cure the panel lawyer's conflict of interest created where the interests of the carrier and the defended policyholder diverge. The U.S. Court of Appeals for the Fifth Circuit decided recently that the carrier's duty to pay independent counsel's fees under *Moeller v. American Guar. & Liab. Ins. Co.* is governed by the terms of the policy, including erosion of limits. In a case from this spring, *Fed. Ins. Co. v. Singing River Health Sys.*, the Fifth Circuit denied, on public policy grounds, a policyholder's attempt to keep its policy limits from being eroded by defense costs. Rejecting this argument, the Fifth Circuit cited a Mississippi Supreme Court's decision in *Southern Healthcare Services, Inc. v. Lloyd's of London* for the rule that "the general duty to provide independent counsel set forth in *Moeller* is subject to the terms of the applicable policy." Based on this decision, the Fifth Circuit decided the eroding limits provisions of the policy would be upheld. Paying for independent counsel is not the insurance company's only option: it can always withdraw its reservation of rights and eliminate the conflict, allowing panel counsel to defend the litigation alone. But the situation creating the right to independent counsel is entirely within its control. The policyholder has done nothing to bring about these events. They are the product of the insurer's choices only. Accordingly, where panel counsel and independent counsel co-defend, there is no reason to penalize the policyholder by charging independent counsel's fees against policy limits. When the defense is outside limits, attorneys' fees and costs incurred by panel defense counsel do not reduce the amount available under the policy to pay settlements or judgments. Defense costs are unlimited. This is not so when the defense is inside limits. In that instance, defense expenses erode limits as the carrier pays them, leaving less available for settlements or judgments. Under a duty to defend policy where the defense is inside limits, fees incurred by panel defense counsel are properly charged against limits. Where independent counsel is brought in to co-defend as a cure for panel counsel's conflict, there is no rationale for reducing limits by independent counsel's fees as well. Yet the Mississippi Court never ruled that "the general duty to provide independent counsel set forth in *Moeller* is subject to the terms of the applicable policy." Not even close. In *Southern Healthcare*, the

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insured public entity claimed the carrier should defend it on a first-dollar basis because it did not understand it was buying coverage subject to a $250,000 per-claim deductible. The Mississippi Supreme Court cited *Moeller* for the rule that "[a]n insurer has an absolute duty to defend those claims against the insured covered by the insurance policy." *Id.* at 747. The case wasn't about the duty to provide independent counsel, and the Court said nothing about this issue. Moreover, the *Singing River* case wasn't about independent counsel either. The Fifth Circuit's reference to the duty to provide independent counsel as being "subject to the policy," including the policy's eroding limits provisions, is simply erroneous. In "tripartite" states like California, *i.e.*, those in which panel counsel dually represents both policyholder and carrier, panel counsel and independent counsel often defend together. If the insurer withdraws panel counsel and allows independent counsel to defend the case alone, it might be fair for his or her fees to erode limits. But where independent counsel is in the case to cure a conflict created by the carrier without any fault of the insured, it stands to reason that panel counsel's fees should reduce limits, but independent counsel's should not.