Tripartite Relationship: Insurers suing panel counsel lawyers

USA | August 22 2018

Recently, South Carolina joined the ranks of jurisdictions that allow insurers to sue their panel counsel when the counsel allegedly commits malpractice in representing the insured. Answering a certified question from the U.S. District Court, the South Carolina Supreme Court in *Sentry Select Ins. Co. v. Maybank Law Firm, LLC* held that an insurer can bring a direct malpractice action against its panel counsel even though the insured is not harmed by panel counsel's alleged negligence.

Briefly, the insurer in *Sentry Select* hired panel counsel to represent a driver in a motor vehicle accident. Counsel represented the settlement range was $75,000 to $100,000. Thereafter, counsel failed to answer requests to admit, which are deemed admitted under South Carolina law. As a result of this failure, the insurer settled the claim for $900,000. Arguing the panel counsel's failure to answer the requests to admit increased the settlement amount of the case, the insurer sued.

South Carolina's Supreme Court recognized a direct action under these circumstances, but limited the right of action "only for the breach of [counsel's] duty to his client, when the insurer proves the breach is the proximate cause of damages *to the insurer*." The court further held the right of action does not exist if there is any conflict between the insured and the insurer created by panel counsel's alleged negligence. In so holding, South Carolina joined the majority of states allowing insurers to initiate a direct action. However, while a majority of states allow the claim, the underlying theories of liability in these jurisdictions vary. In addition to the duty-to-insured-damages-to-insurer theory espoused by South Carolina, there are three theories of liability: insurer as co-client, third-party beneficiary and equitable subrogee.

Insurer as Co-Client

States like California have found the insurer can sue panel counsel because the insurer is a co-client to whom counsel owes a fiduciary duty. In *Golf Ins. Co. v. Berger, Kahn, Shafton, Moss, Figler, Simon & Gladstone*, 79 Cal.App.4th 114 (2000), the California Court of Appeal put it quite simply: "[c]ounsel retained by an insurer to defend its insured has an attorney–client relationship with the insurer." *Id.* at 127. In *Berger, Kahn*, the California Court of Appeal considered whether the insurance company could sue the law firm that was first retained by the insured, but later approved and retained by the insurer pursuant to the terms of the underlying insurance contract. After finding that an attorney–client relationship existed under the circumstances presented, the court analyzed whether the insurer could bring a direct action against the attorneys. Quoting an earlier California case, the *Berger, Kahn* court said,

"***We conclude that where the insurer hires counsel to defend its insured and does not raise or reserve any coverage dispute, and where there is otherwise no actual or apparent conflict of interest between the insurer and the insured that would preclude an attorney from representing both, the attorney has a dual attorney–client relationship with both insurer and insured.***" *Id.* at 129.

Based, again, on this duel-attorney client relationship, the *Berger, Kahn* court found the insurer could sue the panel counsel "so long as there existed no conflict of interest in the dual representation." *Id.*

Insurer as Third-Party Beneficiary

States like Arizona have found the insurer can sue panel counsel because the insurer is a third-party beneficiary of the attorney's services to the insured. Analogizing other professional malpractice actions involving damages incurred by third-party non-clients, Arizona's Supreme Court in *Paradigm Ins. Co. v. Langerman Law Offices, P.A.*, 24 P.3d 593 (Az.S.C.

2001), observed, "[i]f design professionals cannot escape liability to foreseeably injured third parties who, although lacking privity, are harmed by a designer's negligence, we cannot see why lawyers should not likewise be held to a similar standard." *Id*. at 601. Turning to the question of the insurer's position in relation to panel counsel, the Arizona court found that, because insured's interests in underlying litigation often coincide with the insurer's interests, the "lawyer's duties to the insured are often discharged for the full or partial benefit of the nonclient." *Id*. at 602.

Insurer as Equitable Subrogee

States like Michigan resolved the question slightly differently than the foregoing decisions. Although no attorney–client relationship exists between panel counsel and the insurer, Michigan allows a direct action based on principles of equitable subrogation. Recognizing "to hold that an attorney–client relationship exists between insurer and defense counsel could indeed work mischief," the Michigan Supreme Court in *Atlanta Int'l Ins. Co. v. Bell*, 475 N.W.2d 294, 297 (1991), applied the doctrine of equitable subrogation, thus "permit[ing] one party [the insurer] to stand in the shoes of another [the insured]." *Id*. at 298. The court was careful to note that subrogation "cries out" to place the loss for the attorney's misconduct on the proper party—the attorney. *Id*.

While the theories undergirding the right to sue differ, a majority of states now allow some form of direct action by the insurance company against its panel counsel.

Practitioners representing panel counsel must identify the underlying theory and determine, like in South Carolina and Michigan, whether a conflict of interest existed that may defeat a claim by the insurer, or whether some other defense exists based on the unique relationship between insurer, insured and panel counsel.

This article originally appeared in 2018 Riding the E&O Line: Volume 10, Issue 1 - DRI's Professional Liability Committee's newsletter.

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