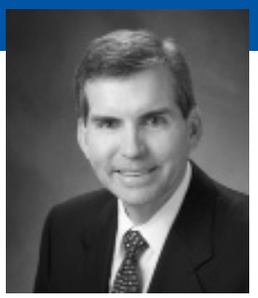
Insurance Carrier Suing Insurance Defense Counsel for Malpractice

Avoiding Liability



By Jeffrey P. Lewis

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Case law throughout the country has long established the proposition that insurance defense counsel — defense counsel appointed by the carrier to defend their insured — represents the insured, not the carrier. Notwithstanding, defense counsel maintains a relationship with both the insured and the carrier so that confidential communications between defense counsel and the carrier are subject to the attorney/client privilege. (That can change in the event of a subsequent bad-faith action by the insured against the carrier.) Although defense counsel does not represent the carrier, carriers have successfully asserted malpractice claims against counsel based upon a theory, for example, that it is an intended third-party beneficiary of defense counsel's representation of its insured. See, e.g., *Atlanta Int'l Ins. Co. v. Bell*, 475 N.W.2d 294 (Mich. 1991) ("permitting insurer to bring malpractice action where 'the interests of the insurer and the insured generally merge' ").

In a recent decision, the Supreme Court of Washington state bucked the trend of these cases and held that a title insurer could not sue the defense counsel that it appointed and compensated to defend against a mechanics' lien to a title that it had insured on behalf of a lender.

In *Stewart Title Guaranty Co. v. Sterling Savings Bank*, 311 Pa.3d 1 (Wash. 2013), the lender was insured to hold a first-priority security interest in the property and it apparently did not because "[T]he lender's title insurer … negligently failed to inspect the property before the loan went through; as a result, [it] failed to discover that the builder … had already started construction on the property." The builder, therefore, took the legal position that it, and not the lender, held the first-priority security interest. Defense counsel, whom the title insurer had appointed, agreed with this contention and, accordingly, stipulated that the builder had first priority and recommended that the title insurer settle the mechanics' lien claim.

Thereafter the title insurer fired defense counsel over a dispute about "whether equitable subrogation was a viable defense." The title insurer contended that it was and defense counsel disagreed. That defense was that the lender "was equitably subrogated to the prior interests it paid off and therefore had priority after all."

The title insurer then hired new defense counsel. He attempted to make the equitable-subrogation argument, but the court ruled that the parties were bound by the stipulation agreed to by the original defense counsel, which disallowed that defense.

The title insurer then sued the original defense counsel, contending that he had committed malpractice by failing to raise the equitable-subrogation argument and stipulating that the builder had priority. Defense counsel defended both on the grounds that he owed no duty to the title insurer upon which to base a malpractice claim and that the title insurer had suffered no harm because "an equitable subrogation argument would have failed under the facts of the case."

The trial court granted summary judgment for defendant, although it found, as a general proposition, that the title insurer could assert a malpractice claim against defense counsel. It based this conclusion upon the premise that the interests of the title insurer and its insured "were aligned during the representation" and upon the premise that the agreement of the parties and the terms stated in the retention letter created "a contractual basis for a duty running … to[the title insurer]." The court found in this instance that the defense lawyer was entitled to summary judgment, notwithstanding, because the title insurer had sustained no harm as a result of defense counsel's conduct, i.e., it found that the equitable-subrogation argument would not have prevailed on its merits.

The Supreme Court of Washington affirmed, but on a different basis. It applied a six-factor test recognized under Washington case law to determine, as an issue of first impression, "whether an attorney hired by a title insurer to represent its insured owed a duty to the non-client insurer. …" The court characterized the first of these six factors — "[t]he extent to which the transaction was intended to benefit the plaintiff [that is, the third party suing the attorney]" — as the " 'primary inquiry' in determining an attorney's liability to third parties." Quoting an earlier state Supreme Court decision, the court framed " 'the threshold question [as] whether the plaintiff is an intended beneficiary of the transaction to which the advice pertained' and that 'no further inquiry need by made unless such an intent exists.' "

The Supreme Court found that the mere fact that the client and third party had an alignment of interests, although not in all respects, was insufficient to establish the existence of a duty by the client's lawyer to the third party, i.e., the carrier. The court reasoned that this factor does not by itself "show that the attorney or client *intended* the insurer to benefit from the attorney's representation of the insured" (italics in original). The court recognized that this holding stood contrary to case law in other jurisdictions but found it consistent with previous Washington state case law and with Rule 5.4(c) of the Rules of Professional Conduct, which 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."

The Supreme Court rejected the trial court's reasoning with respect to defense counsel's duty to keep the title insurer informed, as established by terms stated in the retention letter, "could lead to a duty of care to an entity other than the client for malpractice purposes." In the Supreme Court's view, defense counsel's duty to keep the third party informed and the fact that the third party was paying for his services "does not show that the attorney's representation was *intended* to benefit the third party payor," as Washington state case law requires (italics in original).

Based upon the foregoing, the Supreme Court rejected the trial court's reasoning that defense counsel owed a duty of care to the title insurer. Accordingly the Supreme Court affirmed summary judgment without reaching the trial court's reasoning with respect to the lack of harm for defense counsel's failure to pursue the equitable-subrogation argument.

Not only did the Supreme Court of Washington rule in *Stewart Title* contrary to case law in other jurisdictions on this point, but the decision of the seven justices on the panel was unanimous. Maybe their decision will prompt this issue to be revisited in other jurisdictions. But for now, at least in Washington state, there could be instances where insurance defense counsel could engage in negligent conduct that causes harm to the carrier and for which the carrier will have no remedy.