SUBJECT: Prohibiting insurer interference with legal representation of insured

COMMITTEE: Civil Practices — favorable, with amendment

VOTE: 5 ayes — Bosse, Dutton, Hope, Martinez Fischer, Smithee

1 nay — Clark

3 absent — Janek, Nixon, Zbranek

SENATE VOTE: On final passage, May 1 —voice vote (Haywood recorded nay)

WITNESSES: For — Thomas E. Bishop, Bishop & Hommert, P.C., and Texas Association of Defense Counsel; Hayes Fuller, Texas Association of Defense Counsel; Rob Roby

Against — Bill Downs, Farmers Insurance Exchange; Beaman Floyd, United Services Automobile Association; Katherine E. Giddings, American Insurance Association; Michael Sean Quinn, AIG Insurance; Jay Thompson, AFACT and Farm Bureau Insurance Cos.; Richard Werstein

BACKGROUND: An insurance contract not only provides that the insurer will pay for damages for which the insured becomes liable but also requires the insurer to defend covered claims against the insured. This duty to defend involves hiring attorneys for the insured.

Once the insurer hires the attorney, the attorney owes duties to the insured/client, including the duty of loyalty under Texas Disciplinary Rule of Professional Conduct (TDRPC) 1.06, and the duty to exercise independent professional judgment and give candid advice under TDRPC 2.01.

TDRPC 5.04(c) provides that a someone who "employs or pays the lawyer to render legal services for another" cannot "direct or regulate the lawyer's professional judgment in rendering such legal services."

DIGEST:

SB 1654, as amended, would prohibit a liability insurer from directing an attorney hired to defend an insured on how to conduct the representation or how to bill time for the representation, if the insurer's litigation-management guideline required or suggested that the attorney do something that:

- interfered with the attorney's duty of loyalty to the insured and the duty to exercise independent professional judgment;
- interfered with the attorney/client relationship between the attorney and the insured; or
- would result in the waiver of any privilege of the insured.

The bill would prohibit litigation-management guidelines that require that the attorney obtain the insurer's approval before performing a task or incurring an expense in the representation.

SB 1654 would void such an agreement between an insurer and an attorney hired to defend an insured as being against public policy. It also would void an agreement by which the insured would waive the bill's prohibition against such an agreement between the attorney and the insurer.

The bill would preserve the ability of the insurance company to challenge the reasonableness or necessity of the attorney's bills after the fact.

The insured would have a cause of action against the insurer for damages suffered due to a violation of the prohibition against using litigation-management guidelines and for an injunction against further use of such guidelines. The insured or the attorney could sue the insurer for the reasonable value of the services and expenses the attorney provided in representing the insured. A prevailing plaintiff in such a suit would be entitled to attorney's fees and costs.

An insurer would be subject to a civil penalty of up to $5,000 for the first and second violations and up to $10,000 for any subsequent violation. The insurance commissioner could ask the attorney general to file suit to collect the civil penalty.

The bill would take effect September 1, 2001, and would apply only to disclosures made on or after that date.

SUPPORTERS SAY:

CSSB 1654 would prevent insurance companies from soliciting attorneys to violate the attorney's ethical duties and rules. The Texas Supreme Court has held that if the insurer's directions would compromise the insured's interest, the attorney must protect the interests of the client, the insured (*State Farm Mutual Insurance Co. v. Traver*, 980 S.W.2d 625, 628 (Tex. 1998)). Likewise, in September 2000, the State Bar Committee on Professional Ethics issued Ethics Opinion 533, stating that if an insurer's litigation or billing guidelines control how the lawyer conducts the representation, the guidelines would result in a violation of the Disciplinary Rules by the lawyer. Since the attorney ethically cannot agree to adhere to such guidelines, such agreements that are made a condition of hiring the attorney should be statutorily prohibited as a matter of public policy.

CSSB 1654 properly would prevent insurers from requiring attorneys to adhere to the insurer's guidelines because an agreement to do so is contrary to the contractual rights of the insured. The insured paid premiums to be defended by an attorney. Implicit in that is the right to be defended by an attorney with the normal duties of loyalty who can use his or her independent professional judgment. Insured people often are receiving second-rate representation because the interest of the insurance company in keeping costs down drives the attorney to provide less of a defense than the insured is entitled to under the insurance contract.

This especially is a problem when the potential liability greatly exceeds the policy limits for which the insurer can be liable. In such a case, the insurer's interest is to settle the case quickly (regardless of the settlement amount, since the insurer's liability is capped at the policy limits) to avoid having to incur further expenses defending the insured. But the insured's interest is in defending as vigorously as possible in order to keep liability in excess of the policy limits to a minimum. In such a situation, the insurer's interest in keeping legal costs low makes its control of the insured's defense a real conflict. This bill would take that control away from the insurer and leave it where it should be — with the insured/client and the attorney.

The bill properly would prohibit contractual arrangements or waivers that would circumvent the bill's prohibition against litigation-management

guidelines. Such contracts should be prohibited as against public policy because they contravene the lawyer's ethical duties. Likewise, a waiver by the insured should be unenforceable because the insured cannot negotiate to change the policy, even if they understood the implications of the waiver and did not want to make it. Thus, enforcing such an insurer-imposed waiver also should be prohibited as against public policy.

The complaint that the bill would prevent insurers from consulting with attorneys about how to pursue the insured's representation is unfounded. As amended by the House committee, the bill only would prohibit agreements that constrained the attorney's judgment by requiring insurer approval before an attorney could take some action in the case.

SB 1654 would not result in higher insurance costs. First, that assumes incorrectly that most attorneys would overcharge if given the chance. Also, because an insurer has great bargaining power in hiring attorneys, an attorney who abused the right to make decisions about the insured's representation would not be hired again. The bill would preserve the insurer's ability to contest the attorney's fees in cases in which the attorney truly had overcharged the insurer. Thus, the insurer would retain many ways to keep costs low without interfering with the attorney-client relationship.

Many insureds have been harmed by the insurers' interference with their representation. Many insureds must sue their insurers every year in bad-faith cases for just the sort of conduct that SB 1654 would prohibit. If insureds are not up in arms about their mistreatment, it may be because their insurer-hired counsel cannot tell them that their defense is being constrained by the insurance company, because insurers forbid the attorneys they hire from revealing that information.

OPPONENTS SAY:

SB 1654 is unnecessary and potentially would be counter-productive for insurance consumers. Though the Texas Supreme Court acknowledged in the *Traver* case that allowing an insurer to direct litigation against the insured/client could result in a violation of the attorney's duty to the insured, the court in also recognized that because of the insurer's financial interests in the case, as long as the insurer has no conflict of interest, the insurer has the right to make decisions controlling the case that normally would be the insured's.

A conflict of interest is the only time when the insurer's financial interests would interfere with the insured's receiving a vigorous defense. If the claim is within policy limits, the insurer is equally as interested in keeping liability low as the insured, and any interference with the defense only would harm the insurer.

Seeking to codify Ethics Opinion 533 would be misguided for several reasons. First, the opinion is not a court opinion and has not been reviewed by any elected tribunal. As such, it is nonbinding and wholly advisory, even for attorneys. Also, the opinion does not forbid attorneys from using an insurer's litigation guidelines. The opinion makes clear that the attorney "is free to enter into an agreement with the insurer regarding his fee and services to be rendered," but it simply says that in the case of a conflict between the attorney's judgment and the agreement, the attorney's ethical responsibilities must prevail. That is what happens in practice.

No evidence exists that insureds are being harmed by insurers' guidelines. When Florida commissioned a study on this issue and held public hearings, no insureds came to tell how they had been harmed by their insurance companies interfering with their defenses, nor is there any evidence of this in Texas. The reason is that insureds already are protected by Texas law, which imposes liability on an insurer who settles a claim in bad faith to avoid defending the insured or who otherwise interferes with an insured's defense, as well as making an attorney who fails to provide a competent and vigorous defense liable for malpractice. Thus, the cause of action that SB 1654 would create is unnecessary to protect insureds.

While there is no good reason to interfere with the rights of sophisticated parties such as attorneys and insurance companies to contract with each other in the manner they see fit, there are good reasons not to impose this bill's restrictions on them. SB 1654 would make it dangerous for an insurer even to consult with the attorney about the defense. Few parties who hire an attorney give the attorney free rein to bill hours and incur expenses entirely as the attorney sees fit, but the bill would require insurers to do this. The result would be exorbitant legal fees for insurers and ultimately increases in the cost of insurance for consumers.

NOTES:

The Senate engrossed version of SB 1654 would have prohibited litigation-management guidelines that require “or suggest” that a defense “should or must” obtain the insurer’s approval before taking an action.