

CONFLICTS: THE PROBLEMS FOR INSURERS AND THEIR LAWYERS OF HANDLING THIRD PARTY CLAIMS UNDER A RESERVATION OF RIGHTS AND OTHER RELATED PROBLEMS

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Over what is now quite a number of years of practice, I have seen many insurance related cases which pose conflict problems ideal as exam questions, such is their apparent complexity. Insurers, insureds and their solicitors have managed to get themselves into what appear to be impossible situations with no obvious solution and yet, like so many things in the law, nothing is ever as impenetrable as it seems. Before turning to some examples of cases where particular problems have arisen it is essential to have a clear understanding of the law in this area so that the practical problems can be solved within that framework.

Legal Framework

The decision in Prince Jefri Bolkiah v KPMG [1999] 2 AC 222 has had the effect of bringing issues relating to conflicts of duty and the protection of confidential information to the forefront of clients', insurers' and lawyers' minds. Questions concerning these issues are now more likely to arise among all the professions. The principles set out in the KPMG case are derived from the general common law duties of agents and are not specific to solicitors or accountants.

Although questions of conflicts of duty and confidentiality often overlap, they are in fact separate and distinct principles which should be distinctly defined.

1. A professional owes an obligation of loyalty to each of his clients. One incident of that obligation is that he must not allow himself to be in a position where either he owes conflicting duties to different clients (a conflict of duties), or where his duty to his client conflicts with his personal interest (a conflict of duty and interest). Clearly this rule prevents the professional

acting concurrently for two clients with opposing interests. However, it does not necessarily prevent him acting consecutively for two such clients, because once his retainer is terminated, his duty of loyalty ends.

2. Second, in most circumstances, a professional owes an obligation of confidentiality in respect of his clients' affairs. He must not deliberately breach this confidence, nor must he put himself in a position where there is a risk of inadvertent breach.

The first principle can be circumvented by the professional ceasing to act for one or other of the clients. He cannot be prevented from doing so although it may constitute a breach of his retainer which makes him liable in damages (the court will not grant a mandatory injunction to compel him to act) see Young v Robson Rhodes [1999] 3 All ER 524.

However, the duty of confidence is a continuing duty which survives the termination of the retainer. It is also, of course, a duty owed by the whole firm and the two recent cases referred to above highlight the problems encountered by firms of solicitors or accountants who have attempted to use different staff for different clients but engaged on the same subject matter.

If there is a problem with either a conflict or a breach of the duty of confidentiality, it can often be circumvented by obtaining the express consent of the relevant client. However, in order to be effective, the client's consent must be fully informed.

Thus, the Privy Council decided, in Clark Boyce v Mouat [1994] 1 AC 428, that a solicitor might act for two parties whose interests may conflict providing that he had obtained the informed consent of both of them to him acting (see 435F-H). The importance of consent was also stressed by Lord Millett in his speech in the KPMG case. Equally, the Law Society's Guide (8th Edition, 1999), makes it clear that express consent by a client to disclosure of confidential information relating to his affairs overrides any duty of confidentiality (see para 16.02 and the notes thereto at 2 see appendix at the back).

Whilst express and informed consent by both clients will solve problems of conflict or confidentiality, the cases serve to underline the heavy burden of establishing such consent, see for example Mahoney v Purnell [1996] 3 All ER 61 (per May J at 93a to 94j).

In the absence of such consent from both clients whose interests conflict, the solicitor will usually have to stop acting for both. The Solicitors' Guide makes it clear that the solicitor may only carry on acting for one of the two clients if he is not in possession of confidential information concerning the other client acquired when acting for that client (para 15.3, notes at 1 see appendix).

The starting point in the insurance context is the legal relationship between the insurer, the insured and the solicitor. The terms of the insurance policy form part of this retainer: Brown v GRE [1994] 2 LLR 325 (a typical modern form of clause is set out in the Appendix). The policy will show what the insurer is entitled, or obliged to do, vis a vis the defence of any claim against the insured. Thus, if the solicitor receives conflicting instructions from insured and insurer and acts in accordance with the insurer's wishes in an area in which, under the terms of the policy, the insurer has absolute control, the insured will not be able to complain: see Groom v Crocker [1939] 1 KB 194.

However, even where the insurer has, under the terms of the policy, complete control over the conduct of proceedings which have been brought against his insured, the insurer is nevertheless obliged to act bona fide in what he considers to be the joint best interests of the insured and himself: see Groom v Crocker [1939] 1 KB 194, at 203. The solicitor must act in the interests of both.

The significance of the terms of the policy in the context of the relationship between the three parties is well illustrated by the Brown v GRE decision. In that case, the insurers had repudiated liability under the policy after litigation had begun in which solicitors had been instructed to act for them and for the insured. In the subsequent coverage dispute with insurers, an issue arose as to whether communications between the insured and the solicitors during the period when the solicitors were also acting for the insurer were privileged as against the insurer. The Court of Appeal's decision was based not on

considerations of general principle but on the clause in the relevant policy, which was held to form part of the retainer: see Hoffmann LJ and Neill LJ at 329.

Before turning to some examples of conflicts in practice, it may be helpful if I set out one or two suggestions to keep in mind when approaching conflicts issues which arise in the insurance context.

As in scouting, the watchwords are: be prepared. The starting point must be a full understanding of the relevant policy terms and these need to be well understood by insurer, insured and the solicitor. The solicitor may be well advised when preparing a retainer or engagement letter to make it very clear what his or her obligations are to both the insurer and the insured. The possibility that conflicts may arise in the future should be flagged. The clients should be left in no doubt as to the firm's procedures for dealing with such conflicts as and when they arise. The consequences for both clients (in terms of the free flow of information, for example) should be described.

It will not be possible for full consent to be obtained at the outset of the relationship because one cannot have fully informed consent until the factual circumstances in which the conflict has arisen are known. However, that does not make it any less sensible for all to understand what the position is from the outset.

Conflicts may arise in relation to coverage (does the claim fall within the scope of the policy; was the matter properly notified within the policy period). Issues of non-disclosure or misrepresentation by the insured may arise. The insured may seek advice as to the notification of further claims under the policy. There may be disputes as to the handling of the litigation, not least in relation to settlement (the insured wants to settle within the policy limits whereas the insurer is willing to fight; the insurer wants to settle but the insured wishes to protect his professional reputation).

Clearly, in relation to settlement there may well be a QC clause which may assist, but very often nobody wants to go to the time, or expense, of instructing a QC. If a conflict problem is spotted, then the solicitor must speak up and tell both clients what the position is so that they are both in a position to give the informed instructions as to how to handle the problem. It is of course common practice for solicitors to continue to

conduct the entire defence of an action under a reservation of rights for both insured and insurer. It is my experience that insurers still sometimes consider that it is their right to have advice from their solicitors on questions of coverage, albeit that the solicitors are also acting for the insured.

As far as confidential information generally is concerned, a solicitor acting for both insurer and insured may use the information communicated to him by one client for the benefit of both. In short, there will, generally, be no confidence between the clients: see Rix J in The Sagheera [1997] 1 LLR 160 at 165. However, where the solicitor receives information in his capacity as solicitor for one of the clients in connection with an issue where there is no joint interest between his clients, he should, generally, keep that information from the other client.

It is at this point that the battle between the duty of confidentiality and the duty of disclosure takes place. Para 16.06 of the Solicitors Guide (see Appendix) makes it clear that the solicitor must disclose all relevant information to his client. The notes suggest no specific guidance for the solicitor as between insurer and insured. However, the comments there about lenders and borrowers suggest, as would general principles, that, in the absence of consent to disclosure by one client, the duty of confidentiality to that client must prevail. As the notes indicate, however, in that situation and in the absence of consent, the solicitor is likely to have to withdraw from the field anyway because of the irreconcilable conflict of the two clients' interests.

The Law in practice

Case 1

There is a very substantial claim by a bank against a valuer for allegedly preparing negligent valuations. There is considerable doubt as to whether the valuer has been involved in a dishonest scheme with the promoter of the property schemes. There are three layers of insurance. The first layer insurers decide to avoid the policy although there seems to be very little hard evidence upon which that decision is based. The second layer insurers are extremely concerned that the action which is being brought against the valuer will go undefended and if they do turn out to be liable, they will

face very substantial losses. The third layer insurers are minded to follow the line of the first layer, but haven't made up their mind. The second layer insurers decide to defend the action under a reservation of rights and fund the valuer's own solicitors to instruct Counsel to defend the action while at the same time instructing their own solicitors to oversee the litigation and to liaise with the same Counsel who are instructed by the insureds' solicitors. The action is defended and the bank's claim fairly dramatically reduced. The second layer insurers and the valuers do a deal with the bank settling their liability leaving on one side the liability of the other insurers. Thereafter, an action is brought against the other insurers who lose their avoidance case and end up picking up a substantial bill.

There was clearly a problem right the way through due to the allegations being made by the first and third layer insurers, namely that the valuer himself had been dishonest. The insured had to consent to the solicitors for the insurers being involved in the litigation but, as so often happens, had there been no consent then there would have been insufficient funds for the claim to be properly defended. It is for this reason, more than any other, that insurers are able to conduct litigation under a reservation of rights since only the richest insureds could possibly afford to conduct the litigation themselves and then risk not recovering those costs from their insurers. If the insurers choose to conduct the litigation and later it is shown that they are entitled to avoid the policy, they will not be able to recover their costs back from the insured. Therefore the insured will have had the benefit of that legal support which, without that insured's consent, he would never have had. In this case there was a definite separation between the two firms of solicitors and it was known by the insured that the supervising solicitors were giving advice as to coverage issues as well as advising on the litigation. A decision had to be reached as to whether the second layer were also going to avoid the policy and again it was essential that informed consent was obtained. Although on the face of it the arrangements that were made were somewhat messy, it worked very well. The second layer insurers were able to dramatically reduce their liability under the policy, the insured was able to have a full defence of the claim and so both insured and insurer were satisfied. Since it turned out that the first and third layer insurers were not entitled to avoid coverage, they had to pick up a substantial proportion of the claim and the costs.

Case 2

Solicitors are accused of negligence by a former client for negligently drafting agreements which have the result of making that client liable for substantial sums of money. The solicitors are insured in two layers: (a) up to £1m; and (b) above £1m. They also have a substantial claim for outstanding fees. The client brings proceedings and the solicitors counter-claim for their fees. The upper layer insurers are keen to settle the case for up to £3m, but it then appears that they take the view that there are three claims so that each claim should be picked up by the first layer insurers. The first layer insurers think there is only one claim and also think that it would be absurd to pay as much as £3m. The solicitors don't think anything should be paid and think they should recover the whole of their costs. Counsel is instructed effectively for all three parties, who are supposedly all on the same side, although at times it is difficult to believe that that is the case. The matter goes to Court and is eventually settled after about a week of trial. The solicitors get their fees and an agreement is reached between the two layers of insurers. The settlement of the case would not have been possible had the insurers' difficulties been allowed to get in the way.

Case 3

Solicitors are instructed to act for accountants in a professional negligence claim against those accountants as well as acting for the accountants' insurers. During the course of the litigation, and shortly before the existing period of cover expires, the accountants approach the solicitor and say that they have a number of other matters, which might in due course become claims, and what advice would the solicitor give in relation to what should be done in terms of notifying insurers. The solicitor, conscious of the fact that the period of insurance is about to expire, and conscious of the fact that if these matters are reported to the present insurers they will then be on the hook, is in a dilemma. As it happens, the matters are not reported to insurers, not as a result of any deliberate intent on the part of the solicitor but merely because time elapses and the coverage comes to an end before any notice is given to them.

This case put the solicitor in a very difficult position. He was acting for both insurer and insured and yet he was suddenly faced with a request for advice from the insured which was going detrimentally to affect his other client. It is easy with hindsight to see what the solicitor should have done but it was no doubt less clear at the time. Any lawyer

being asked to give advice to one client which is detrimental to another client must immediately inform the client asking for that advice to go elsewhere. This is easier said than done. The insured is likely to be fairly outraged at the idea that his solicitor will not give him some fairly simple advice. It will probably cause additional expense to that insured and will do nothing for the relationship. Nevertheless, there can be no doubt that, in the situation which arose, the solicitor should immediately have said to the insured that they should go and seek advice elsewhere and do that as a matter of urgency.

An interesting question then arises as to whether there is an obligation on that solicitor to say anything to his insurer client about the question that he has been asked. I take the view that in this situation for that short time while the insured is asking this particular question there is a separation between the solicitor's relationships with his two clients. Accordingly, I do not believe that the solicitor would either be obliged or permitted to pass on that confidential information to his insurer client. However, I do not pretend that the matter is free from doubt.

Case 4

A very substantial fire on a farm destroys a neighbouring building. The farmer has been negligent in causing the fire. He has cover up to £2m. A claim brought by the neighbour is £4m. The farmer has a good claim against the manufacturers of the insulation to his building which has caused the fire to spread and to get out of control contrary to the supposed properties of that insulation. Proceedings are started by the neighbour against the farmer who joins in the manufacturer of the foam. Not only does the farmer have cover limited to £2m but, unlike most farmers, he also has substantial assets which would be available if the action against the neighbour succeeds and the farmer is unable to pass on that liability to the manufacturer of the foam. There is thus a real possibility, if the action doesn't settle, of the farmer being wiped out, due to his under-insurance. Solicitors are instructed by his insurers to act both for them and for the farmer. Happily the action is fought and a substantial proportion of the liability is passed on to the manufacturer of the foam and thus the farmer's claim falls within his insurance cover.

This was yet another situation that arises very often. The only difference from the norm here was that the farmer actually had the wherewithal to pay sums over the sum insured. He faced personal ruin. In professional indemnity insurance, the problem is more often to do with the reputation of the insured. In my experience, one has very different approaches depending on the insured. On the one hand there is the insured who is outraged that he should be sued because he feels that he has done absolutely nothing wrong. He is therefore prepared to have a full trial and risk being criticized. There is then another sort of insured who is terrified of having the problem aired in public and fearful that he will be criticized and his reputation damaged.

The farmer in this case had an entirely legitimate interest in that he wanted any judgment or settlement to avoid him having to pay outside the sum insured. The insuring clause provides the answer to this difficulty. The insurer is entitled to conduct the litigation and, subject to any QC clause, is entitled to make the decision as to whether a case should be fought or settled. In making that decision the insurer must have regard to the interests of the insured (and must not have regard to extraneous matters: see Groom v Crocker) but otherwise is entitled to make the decision even if the insured objects.

Conclusion

Problems do arise whenever insurers wish to conduct litigation under a reservation of rights. Many insurers are very familiar with the difficulties and, with their solicitors, have little difficulty in reaching the right answer. However, there is no doubt that very often insurers seek advice from their solicitor on coverage issues while that solicitor is acting for both insurer and insured in defending third party litigation. We all know that these issues arise, whether relating to non-disclosure or notification or whatever. It is sometimes possible for the solicitors to appoint one lawyer to deal with the litigation and have another lawyer dealing with coverage and to build an information barrier between the two. That will tend to add expense to the insurer, but is probably preferable to having to seek advice from a different firm. However, the recent cases in this field (including the KPMG case and Young v Robson Rhodes) illustrate the practical difficulties inherent in establishing "Chinese Walls" which will satisfy the Court.

As a result of the KPMG case, professionals, their clients and their insurers, are all much more aware of conflicts arising and if these problems are not brought out into the open then difficulties are likely to arise. In my view, the key to the whole thing is to remember that when one is defending third party claims, everyone is on the same side, although at times it is difficult to believe that that is the case. Informed consent is the key but if the insured or the insurer does not consent to the situation that has arisen, then it is essential that proper advice is given by the lawyer to ensure that, if possible, any conflict is removed. Provided the difficulties that arise are brought into the open, then most can be overcome.

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APPENDIX

Guide to the Professional Conduct of Solicitors 1999:

1. 15.03 paragraph 1. “If a solicitor has already accepted instructions from two clients in a matter or related matters and a conflict subsequently arises between the interests of those clients, the firm must usually cease to act for both clients. The solicitor may only continue to represent one client if not in possession of relevant confidential information concerning the other obtained whilst acting for the other”.
2. 16.01 paragraph 5. “Information given to the solicitor in the context of a joint retainer must be available between the clients; they must, however, all consent to a waiver of the duty of confidentiality before that information may be disclosed to a third party. However, information communicated to the solicitor in the capacity of solicitor for only one of the clients in relation to a separate matter must not be disclosed to the other clients without the consent of that client”.
3. 16.02 paragraph 2. “Express consent by a client to disclosure of information relating to his or her affairs overrides any duty of confidentiality...”

A typical modern clause permitting insurers to take over conduct:

“The insured shall not admit liability or make or promise any payment in respect of any claim to which this policy may apply or incur any costs or expenses in connection therewith without the written consent of the insurers who if they so wish, shall be entitled to take over and conduct the investigation, defence and/or settlement of any claim in the name of the insured for which purpose the insured shall give all such information and assistance as the insurers may reasonably require”