David Levin QC and Megan Fitzgerald
Melbourne TEC Chambers

Conflicts in construction law – acting for insurer and insured

Lawyers are familiar with conflicts – not just those battles being fought by clients and their opponents, but legal conflicts between our duties to our clients and our other professional duties. Representing both insurer and insured may create professional conflicts. The size and complexity of modern construction litigation bring the risk into focus, perhaps more than any other area, yet construction lawyers sometimes lose sight of issues outside their comfort zone. While there are no easy answers to the multitude of conflicts that may arise, there are a number of steps that lawyers can take to minimise the conflict risk.

Construction litigation can give rise to ethical conflicts in various ways. Take this scenario:

> *The client, a head contractor, faces a claim from an owner, which might be covered by construction liability insurance. The insurer appoints a lawyer from its panel to act for the contractor in defence of the claim. However, the contractor also has a claim for outstanding monies arguably due from the owner and for the return of a security bond, neither of which concerns the insurer.*
>
> *The liability claim requires the lawyer to consider who else might be responsible or might be liable to contribute to the claim. Enlarging the litigation will, however, cause inevitable delays for the contractor in the fee recovery, as the owner will argue that it is entitled to set off any outstanding fees against its claim. The interests of contractor and insurer will also differ should settlement discussions arise. While the contractor will want to pursue its fee claim, the insurer will have no interest in the contractor receiving those fees, if that is a bar to a commercial settlement.*

The first question the lawyer should ask at the outset of any matter is: 'Who is my client?' Identifying the client is particularly important when acting for insurer and insured. It is well established throughout the common law world that, where a lawyer acts for a defendant on the instructions of an insurer pursuant to a policy of insurance, the lawyer owes the same duties to the insured as it owes to the insurer. The lawyer is obliged to:[1]

1. avoid conflicts of interest between the two clients;
2. provide each client with relevant information in the lawyer's possession; and
3. in the event of a conflict, inform each client that they should obtain independent legal advice.

Therefore, at least in the UK, Australia and New Zealand, if you are acting for an insured on the instructions of the insurer, a lawyer–client relationship exists with respect to each. In any event, standard policy terms will usually require the insured to cooperate with the insurer and require the insured to disclose all information relevant to indemnity and to the defence of the proceedings. This requirement is enhanced in Australia by legislation.[2]

'It is well established throughout the common law world that, where a lawyer acts for a defendant on the instructions of an insurer pursuant to a policy of insurance, the lawyer owes the same duties to the insured as it owes to the insurer.'

In the US, the position is not so clear cut. In some jurisdictions, the lawyer appointed by the insurer is seen as acting for both insured and insurer,[3] whereas elsewhere the insurer-appointed (and paid) lawyer is seen as acting for the insured alone, to the exclusion of the insurer.[4]

Taking the scenario outlined above, the lawyer in the UK, Australia, New Zealand and parts of the US will be obliged to find a way to reconcile the interests of both the insurer and the head contractor. If they cannot do so and they continue to act for both, they may be breaching their duty to act in the interests of one or the other of their clients. In some parts of the US, the lawyer may be in the, perhaps fortunate, position of being able simply to act in the interests of the head contractor, while continuing to have its fees reliably paid by the insurer. The contractor will be able happily to pursue its fee claim and perhaps attempt to avoid the enlargement of the proceedings, while the insurer will be unable to minimise its costs by pursuing claims outside the interests of the contractor or settling the matter at the risk of the contractor's fee claim.

The resolution of one important issue may reduce the area for conflict. If the insurer accepts that it will grant indemnity for the claim being made, the risk of a conflict of interest between insurer and insured is to some extent narrowed. However, even once indemnity is granted, it will be granted subject to the information and facts that have been notified to the insurer by the insured. Therefore, it is possible for an indemnity issue to re-emerge, should new information come to light.

Indemnity and conflict

What if indemnity is in issue? Can the lawyer, acting for both insurer and insured, ethically advise the insurer about indemnity?

The simple answer is 'no'; however, the reality is that insurance lawyers will often file an appearance and take conduct of a defence on behalf of an insured, subject to a

reservation of rights in relation to indemnity. In this situation, it may be acceptable for the lawyer to advise the insurer in relation to indemnity. This will, of course, raise no issue provided indemnity is granted. However:

1. if providing indemnity advice, the lawyer should bear in mind its requirement to provide each client with relevant information;[5]
2. if the lawyer advises the insurer to deny indemnity while still acting for both insured and insurer, that advice should properly be available to the insured;[6] this may place the insurer at a disadvantage in the event of proceedings in relation to a denial of indemnity;
3. if indemnity becomes an issue, the lawyer should usually cease acting and advise each client to obtain independent legal advice;
4. if the lawyer has been acting pursuant to a reservation of rights and that reservation specifically stated that the lawyer could continue to act for the insurer in the event of a denial of indemnity, the lawyer may be able to retain instructions from the insurer, although this situation will be dependent on the terms of the reservation of rights and the ability of the lawyer to establish that the insured gave fully informed consent (probably with the benefit of independent legal advice) to the lawyer continuing to act for the insurer in the event of a denial of indemnity.[7]

In reality, insurers are likely to prefer to instruct new lawyers, because:

1. they do not want to be drawn into conflict of interest proceedings against the lawyers;
2. such an arrangement could be said to be a breach of the insurer's statutory duty of good faith or a breach of any good faith provisions in the insurance policy;
3. a reservation of rights letter that includes a waiver of any future right to object to the lawyers continuing to act for the insurer is likely to cause concern to the insured and may damage relations between the insured and its lawyer, causing prejudice to the conduct of the proceedings; and
4. they do not want to damage relations with valued insureds.

Conflict in a reservation of rights

In most of the common law world it is seen as acceptable for a lawyer to act for the insured, on instructions from the insurer, pursuant to a reservation of rights. The lawyer will cease to act if indemnity is then denied. In some US states this is also the case. There are, however, certain US states that take the view that the potential for conflict raised by a reservation of rights is sufficient to require the insurer to appoint separate counsel to represent the insured.[8]

In California, the requirement has also been codified, by section 2860 of the California Civil Code;[9] however that section only requires the insurer to appoint separate counsel for the insured if the reservation of rights raises an *actual*, as opposed to *potential*, conflict of interest. A midway position is adopted elsewhere: in Alabama, for example, the insurer must act pursuant to an enhanced duty of good faith, where it has reserved its rights and appointed a lawyer to act on its own and the insured's behalf. Under this enhanced duty, the insurer is obliged to:

1. thoroughly investigate the claims against the insured;
2. fully inform the insured of all developments relevant to policy coverage;
3. allow the insured to make the ultimate choice regarding settlement; and
4. pursue a course of action that is advantageous to the insured.[10]

'...certain US states ... take the view that the potential for conflict raised by a reservation of rights is sufficient to require the insurer to appoint separate counsel to represent the insured.'

Privilege and conflicts

The conflict inherent in the situation is highlighted when specific (and relatively common) issues arise, such as privilege. Can the lawyer communicate the insured's privileged information to the insurer, or vice versa? After all, there is a single client before the court represented by a single legal team: how can there be privileged documents of which the lawyer is aware and to which the lawyer has access but cannot show to or discuss with the client? Provided the insured and insurer's interests are aligned, a lawyer acting for each of them is entitled to – and, if it is relevant to the client, must – communicate information provided by insured or insurer to the other.[11]

If the lawyer obtains information from one client that raises an actual conflict, for

example, information that puts indemnity in issue, the position becomes more complicated. There is no uniform position on what the lawyer's duty requires. It is clear that, in the absence of an appropriate waiver, the lawyer must cease to act for *both* insured and insurer. As fiduciary duties can be displaced by contract, it may be possible to formulate a reservation of rights and waiver that allows the lawyer to continue to act for the insurer, in the event of a conflict over indemnity. The threshold for a fully informed waiver will be very high, requiring the lawyer to demonstrate that the insured gave consent with a full understanding of rights. This will usually require a recommendation to the insured that independent legal advice is obtained before any waiver is given.[12]

In *Nicholson v Icepak Coolstores Ltd*,[13] the New Zealand High Court in Hamilton held that a solicitor who communicated information provided to him by the insured to the insurer, resulting in a denial of indemnity, was acting in conflict of interest and, instead, should have given up each retainer without disclosing the information to the insurer. The court also held that the information was privileged and could not be elicited in evidence from the lawyer.

In the absence of a clear reservation of rights and waiver, a lawyer who brought about a denial of indemnity by communicating an insured's confidential information to an insurer would be acting in conflict of interest and breaching the retainer. However, it may be an answer to any claim against the lawyer to say that the insured should have disclosed the information anyway, whether pursuant to the disclosure term that would inevitably be included in the policy of insurance or pursuant to a duty of good faith.[14]

Settlement and conflicts

Another step, which every construction lawyer should take, is to determine who is providing instructions whether to settle and at what figure. Most construction litigation settles prior to commencement of any hearing. Construction litigation usually involves complexities of fact that cause costs to be incurred irrespective of the value of the ultimate claim. This makes a sensible negotiated settlement a very desirable end.

Applying *Groom v Crocker*,[15] it is apparent that both insured and insurer are required to give instructions to settle. Of course, the terms of the policy may provide the insurer with control in the event of a stalemate or may require the insurer to appoint independent counsel to provide advice. The provision of instructions to settle will also be subject to any good faith requirements (statutory[16] or otherwise), so neither insured nor insurer can unreasonably force or prevent a settlement. The lawyer should bear in mind, however, when an insurer is involved, that the case should not be settled without the insured's authority.[17]

The settlement conflict might present itself in different guises; for example:

- Should there be a settlement?
- With whom should settlement be effected?
- At what figure should settlement be struck?

The interests of a party to a complex construction contract and its insurer might conflict on any and each of these issues. A like conflict can arise when consideration is being given to the appropriate figure for an offer of compromise, *Calderbank* offer[18] or payment into court.

'Another step, which every construction lawyer should take, is to determine who is providing instructions whether to settle and at what figure.'

Take the scenario we discussed earlier. Say the head contractor, our insured, is managing the construction of a large bridge that is alleged to have failed. There have been a number of factors affecting the construction project and it has garnered considerable media attention. The head contractor is concerned that any settlement will be reported in the media and, if the settlement involves a payment by the contractor, it will create an impression that the company admits it did a bad job. The insured is therefore reluctant to concede. The insurer may wish to settle for commercial reasons, but the insured may wish to fight on (at the insurer's expense, once the excess is paid) to protect its reputation.

Using the same scenario, but without the media interest in the case, assume that the head contractor has a policy with coverage up to $2.5m and is facing a liability claim for $2m. Say a settlement offer of $1m is made,

but the insured would have to relinquish its claim for unpaid fees, which amounts to $500,000. The insurer sees this as a good outcome, because the settlement is only half of the claim being advanced; however, the insured has to pay its deductible, which may be considerable, and relinquish what it views as a good fee claim for $500,000. The lawyer cannot, in this situation, encourage either party to accept a settlement that is not in the individual interests of each.

Take the basic scenario again but assume that the insured's fee claim is for only $20,000 and, being a large construction company, the insured's deductible is $500,000. The insured's company will lose considerably more if its director and several employees are forced to miss work for the duration of the trial as well as in preparation. An offer of $1m is made and the insured wants to accept it. But the insurer thinks it may do better by contesting the claim, given it will incur the legal costs to date anyway and the settlement amount, over the $500,000 deductible. Again, the lawyer must act in the interests of each of its clients and is in a position where those interests cannot be reconciled.

In *Hartford Accident & Indemnity Co v Foster*,[19] the Mississippi Supreme Court described the issue of whether a settlement offer should be accepted by the insurer, where it is inside the limit of cover, lower than the total amount claimed by the plaintiff, but above what the insurer deems reasonable, as a problem that 'would tax Socrates'. In cases such as these, there is no simple answer.

It may be that the best course is to advise the insured and insurer about the merits of the settlement offer, without regards to the insurance position, and recommend to each party that they act as if there were no deductible or policy limit (whichever is affecting the inclinations of the party) or obtain independent legal advice. Alternatively, it may be possible to force one or the other's hand pursuant to any good faith provision in statute or policy. The outcome, of course, will turn on the facts of the case, along with the policy and legislation that govern the relationship between insured and insurer.

In many cases, settlement conflicts can be minimised if the issues are considered at the outset and advice is given about the likelihood of issues arising in the event of settlement discussions. Each client can then consider its position and instruct the lawyer so that they are prepared and can manage the case appropriately.

Co-insureds and conflicts

Complex construction litigation often raises the further difficulty that more than one defendant may be insured by the same insurer. Certainly, in Australia, the number of insurers accepting indemnity risks for major projects is restricted. As construction projects become increasingly complex and involve more parties, this problem is more likely to arise. This presents many potentially complex conflict situations. For example, there may be two defendants, each wishing to blame the other, but the insurer may sit behind both and want them to avoid implicating each other; or, an insured defendant may wish to join a third party who is insured by the same insurer.

These scenarios may be moderated by the duty of utmost good faith in Australia. In all common law jurisdictions and the US, if the two insureds have differing interests, the insurer will be required to appoint separate lawyers to represent each, and those lawyers will owe their insured clients the duties inherent in a lawyer–client relationship. Therefore, if it is in the interests of the insured to sue a fellow insured, they will be entitled to do so. An insurer would be likely to be seen as acting in bad faith if it was to try to prevent them doing so. The insured may, however, be required to pay the costs attributable to that part of the contested claim, as the costs of bringing proceedings against another are unlikely to fall within the defence costs provision of any insurance policy.

'In all common law jurisdictions and the US, if the two insureds have differing interests, the insurer will be required to appoint separate lawyers to represent each.'

Further potential conflicts arise when one lawyer is appointed to represent multiple defendants with aligned interests. Not only is there the potential for conflict between the insureds and the insurer, but there is also now the potential for conflict between insureds.

These conflicts can arise in the same circumstances as described above. For example, one insured may wish to settle and another may not. This may be because of the impact they believe it will have on their professional reputation, the amount of their deductible or the limit of their policy. If these conflicts arise, they should be dealt with in the same way as those between insurer and insured, save for the fact that the insureds do not have a policy in existence between them or a duty of good faith towards each other.

Costs and conflicts

A further issue for construction lawyers to bear in mind is that defence costs provisions in insurance policies commonly provide that the insurer may appoint a lawyer to act on behalf of the insured. Indeed, this is understood to be the usual position.[20] However, in some cases – particularly in the case of large companies – an insured may have a policy that entitles it to appoint its own choice of lawyer. The insurer is usually then required to indemnify the insured for 'reasonable' defence costs.

Such an arrangement has created a new mini industry in double handling. For example, a large construction company appoints a top-tier law firm to act on its behalf in the defence of a claim against it. The top-tier law firm charges the construction company at its normal rates and the construction company pays those bills, then submits them to the insurer for reimbursement. Meanwhile, the insurance company has appointed a mid-tier law firm from its panel to monitor the proceedings (attending court hearings, reviewing publicly available documents, etc) and is paying its negotiated rates to that law firm. The insurer then provides the top-tier firm's bills to the mid-tier firm to review for 'reasonableness' in accordance with the policy. A proportion of the amount paid to the top-tier firm is then reimbursed to the insured.

While it is not yet common, there seems to be a growing trend towards policy disputes over the amounts reimbursed for costs. This will only increase as companies become larger, take greater control of the proceedings in which they become involved and draft and invoke appropriate terms in their insurance policies. It appears that this issue may have appeared more commonly in the US, where some states have even enacted legislation in an attempt to control the situation.[21] Australian and NZ construction lawyers should take note.

In Australia and New Zealand, there is precedent to suggest that an insured may be entitled to appoint, and pay for, a lawyer of its own choice to act alongside its insurer's defence lawyer, where it wishes to bring an uninsured claim, for example a counterclaim, in proceedings in which it is insured for defence costs.[22] This course of action naturally presents many complications, and experience suggests that an arrangement for fee splitting will usually be negotiated with the insured, rather than having a separate lawyer appointed for the uninsured part of the claim.

In some cases, the arrangement is not settled at the outset, but rather an agreement to negotiate it at the conclusion of the proceedings, with the option of appointing an arbitrator if negotiations are unsuccessful, is made. Indeed, in *McKnight v Davis*,[23] the NZ Court of Appeal held that there could not be two separate counsel representing the one party and the insured would have to decide which lawyer would represent him.

'…there seems to be a growing trend towards policy disputes over the amounts reimbursed for costs.'

Conclusion

The possibilities for conflict between insurer and insured are real and complex. Construction lawyers should keep the situation in the forefront of their minds. If conflict is found to exist immediately prior to or during a lengthy arbitration or trial the financial consequences are grave. Then it will be the lawyers who end up looking to their own insurance cover for protection – an unsatisfactory outcome for all concerned.

David Levin QC has been a silk at the Victorian Bar since 1997 specialising in construction and computer litigation. He has been a member of MTECC since its inception. He also practises as an arbitrator and mediator from Fenners Chambers in Cambridge. **Megan Fitzgerald** is a barrister at the Victorian Bar. She practises in insurance litigation for plaintiffs and defendants, and has a particular interest in professional ethics, negligence and regulation. Prior to joining the bar Megan worked in insurance litigation, specialising in claims against legal professionals.

Notes

1 *Groom v Crocker & Ors* [1939] 1 KB 194 (especially McKinnon LJ at 227).
2 The insured in Australia has a statutory duty of utmost good faith: Insurance Contracts Act 1984 (Cth), Section 13.
3 See, for example, North Carolina (*Nationwide Mutual Fire Ins Co v Bourlon*, 617 SE 2d 40 (NC App 2005)); Nevada (*Nevada Yellow Cab Corp v Eighth Jud Dist Ct*, 152 P 3d 737 (Nev 2007)); California (*JR Marketing, LLC v Hartford Cas Ins Co*, 2007 Cal App Unpub LEXIS 8797 (Cal App, 30 October 2007)).
4 See, for example, New York (*Federal Ins Co v North American Specialty Ins Co*, 47 AD 3d 52 (NY App, 8 November 2007)); Ohio (*Weitz Co, LLC v Ohio Cas Ins Co*, 2011 US Dist LEXIS 68801 (D Col, 27 June 2011)); Maryland (*Pennsylvania Nat'l Mut Cas Ins Co v Perlberg*, 2011 US Dist LEXIS 54763 (D Md, 20 May 2011)).
5 See *Groom v Crocker*, note 1 above.
6 *Verson Clearing International v Ward & Partners* (1997) 9 ANZ Insurance Cases 61–352.
7 *CI & D Industries Pty Ltd v Keeling* (unreported, NSW Supreme Court (Abadee J), 26 March 1997).
8 See, for example, *San Diego Navy Federal Credit Union v Cumis Insurance Society, Inc*, 208 Cal Rptr 494 (Ct App 1984), which requires the appointment of separate lawyers for the insured in the event of a reservation of rights, even if it only raises a possible conflict and section 627.426 of the Florida Claims Administration Statute (**http://archive.flsenate.gov/Statutes/index.cfm?App_mode=Display_Statute&URL=0600-0699/0627/0627.html**), which assumes a conflict of interest where a reservation of rights is given to the insured.
9 See **www.leginfo.ca.gov/cgi-bin/displaycode?section=civ&group=02001-03000&file=2860**.
10 *L&S Roofing Supply Co, Inc v St Paul Fire & Marine Ins Co*, 521 So 2d 1298 (Ala 1987).
11 *Groom v Crocker*, note 1 above; *Brown v Guardian Royal Exchange* [1994] 2 Lloyd's Rep 325, CA, at 329 per Neill LJ; *TSB Bank plc v Robert Irving & Burns* [1999] Lloyd's Rep IR 528, (CA) per Morritt LJ at paras 11 and 13.
12 *Kennedy Pty Ltd v Cynstock* (1993) 3 NTLR 108; *National Mutual Property Services (Australia) Pty Ltd v Citibank Savings Ltd*, Fed Ct unreported, 28 May 1998, per Lindgren J.
13 [1999] 3 NZLR 475 at 500.
14 See, for example, *Oceanic Life Ltd v HIH Casualty & General Insurance Ltd & Ors*, unreported, SCNSW, Equity Division, 1999, at paras [67]–[69], where it was held that no sensible possibility of conflict could exist in relation to the disclosure of the insured's information to the insurer where that information should properly have been disclosed to the insurer, in any event, pursuant to the duty of utmost good faith.
15 Note 1 above.
16 In *CGU Insurance Limited v AMP Financial Planning Pty Ltd* (2007) 62 ACSR 609, a majority of the High Court of Australia said that the requirement of utmost good faith 'may require an insurer to act with due regard to the legitimate interests of an insured, as a well as its own interests'.
17 *Hansen v Marco Engineering (Aust) Pty Ltd* [1948] VLR 198.
18 *Calderbank v Calderbank* [1976] Fam 93; [1975] 3 WLR 586.
19 528 SO 2d 255, 273 (Miss 1988).
20 *Club Motor Insurance Agency Pty Ltd v Swann* [1954] VLR 754.
21 For example, the Alaska Statute (1995), section 21.98.100(d) (access at **www.legis.state.ak.us/basis/folio.asp**), and the California Civil Code (1987), section 2860(c) each provides that the fees of independent lawyers are limited to the rates ordinarily paid by the insurer to their usual lawyers.
22 *Club Motor Insurance Agency v Swann* [1954] VLR 754; *Carter v Marine Helicopters Ltd* (1996) 9 ANZ Ins Cas 61–299 (NZHC).
23 [1968] NZLR 1164 at 1171 per Turner J.