

11 ISSUES RELATED TO HANDLING THIRD-PARTY CLAIMS.

A. **An Insurer's Duties for Third-Party Liability Claims - Defend & Indemnify.** Under most common liability policies, such as a standard CGL policy, an insurer has two separate and distinct duties, the duty to defend, and the duty to indemnify.¹⁴⁴

- 1) **Duty to Defend.** Whether an insurer has a duty to defend an insured in a lawsuit is determined by the “**eight corners rule**” which compares the factual allegations of the plaintiff’s petition to the insurance policy.¹⁴⁵ When applying the eight corners rule, courts are to give the allegations in the petition a liberal interpretation, focus on the factual allegations that show the origin of the damages rather than on the legal theories alleged, and resolve all doubts concerning the duty to defend in favor of the insured.¹⁴⁶ “It is not the cause of action alleged that determines coverage, but the facts giving rise to the alleged actionable conduct.”¹⁴⁷ An insurer has a duty to defend if the facts as alleged by the plaintiff against the insured, when fairly and reasonably construed, whether true or not, state a cause of action potentially covered by the policy.¹⁴⁸ Where the petition does not state facts sufficient to clearly bring the case within or without the coverage, the general rule is that the insurer is obligated to defend if potentially, there is a case under the petition within the coverage of the policy.¹⁴⁹ Stated differently, in case of doubt as to whether or not the allegations of a petition or complaint against the insured state a cause of action within the coverage of a liability policy sufficient to compel the insurer to defend the action, such doubt is to be resolved in the insured's favor.¹⁵⁰ The duty to defend is broader than the duty to indemnify.¹⁵¹ Note that an insurer's duty to defend an insured is only triggered by the actual service of process of the pleading upon its insured and it is then relayed to the insurer.¹⁵²
 - a. **Excess Insurance.** The majority rule is that where the insured maintains both primary and excess policies, the excess liability insurer is not obligated to participate in the defense until the primary

¹⁴⁴ See *Trinity Universal Ins. Co. v. Callan*, 945 SW.2d 819, 921-22 (Tex. 1997); *Farmers Tex. County Mut. Ins. Co. v. Griffin*, 955 S.W.2d 81, 82 (Tex. 1997).

¹⁴⁵ See *Nat'l Union Fire Ins. Co. v. Marchs. Fast Motorlines, Inc.*, 939 SW.2d 139, 141 (Tex. 1997); *Tri-Coastal Contractors, Inc. v. Hartford Underwriters Inc. Co.*, 981 S.W.2d 861, 863 (Tex. App.–Houston [1st Dist.] 1998, writ denied).

¹⁴⁶ See *Nat'l Union Fire Ins. Co. v. Merchants Fast Motor Lines, Inc.*, 939 S.W.2d 139, 141 (Tex. 1997).

¹⁴⁷ See *Adamo v. State Farm Lloyds Co.*, 853 S.W.2d 673, 676 (Tex.App.- Houston [14th Dist.] 1993, writ denied).

¹⁴⁸ See *Folsum Investment, Inc. v. American Motorists Ins. Co.*, 26 S.W.3d 556, 558-9 (Tex. App. – Dallas 2000, n.w.h.); *Ranger Inc. Co. v. Ins. Co. of State of Pennsylvania*, 2000 WL 1281192 (Tex. App.–Dallas 2000, n.w.h.).

¹⁴⁹ See *St. Paul Ins. Co. v. Texas Dept. of Transp.* 999 S.W.2d 881, 84 (Tex. App.–Austin 1999, no writ).

¹⁵⁰ See *id.*

¹⁵¹ See *id.*

¹⁵² See *Travelers Indem. Co. v. Citgo Petroleum Corp.*, 166 F.3d 761 (Fifth Cir. 1999); see also *Members Ins. Co. v. Branscum*, 803 S.W.2d 462, 466-67 (Tex. App.–Dallas 1991, no writ).

policy limits are exhausted.¹⁵³

- 2) **Duty to Indemnify.** The duty to indemnify, unlike the duty to defend, arises only on proven, adjudicated facts establishing liability against the insured.¹⁵⁴ No duty to indemnify arises unless the underlying litigation establishes an insured's liability for damages covered by the insurance policy. An insurer has no duty to pay unless the insured's liability for covered damages is established in the underlying litigation.¹⁵⁵

B. Responding to the Insured's Tender of Defense. Generally, when an insurance company is asked to defend an insured against a liability claim, the insurer is required to either accept coverage or make a good faith effort to resolve coverage before adjudication of the Plaintiff's claim.¹⁵⁶ When an insurer is faced with a dilemma of whether to defend an insured against a particular claim, an insurer has four options: 1) completely decline to assume the insured's defense; 2) file a declaratory judgment lawsuit against the insured seeking a judicial determination as to the insurer's obligations and rights; 3) defend under a reservation of rights or a non-waiver agreement; or 4) assume the insured's unqualified defense.¹⁵⁷

C. Reservation of Rights. Because claims are often plead under several different causes of action, it is common to see an insurer defend under a reservation of rights. A reservation of rights is a written notice to the insured that the insurer may interpose a policy defense to deny coverage, following adjudication of the plaintiff's suit against the insured.¹⁵⁸ The rationale for requiring a reservation of rights letter when a duty to defend exists, is to avoid the potential conflict of interest between the insured and policyholder when the insurer defends, but at the same time is formulating its defense against the policyholder for non-coverage.¹⁵⁹

- 1) A reservation of rights letter should be sent as promptly as possible after receipt of the lawsuit. Recall that the Texas Insurance Code requires an insurer to promptly issue a reservation of rights letter to a policyholder.¹⁶⁰ Defending under a reservation of rights is a proper course of action when the insurer has a good faith belief that the petition alleges conduct which may not be covered by the policy.¹⁶¹ In such a situation, the reservation of rights will not breach the duty to defend if timely notice of intent to reserve rights is

¹⁵³ See *Texas Employers Ins. Ass'n v. Underwriting Members of Lloyds*, 836 F.Supp. 398, 404 (S.D.Tex.1993)

¹⁵⁴ See *Trinity Universal Ins. Co. v. Cowan*, 945 S.W.2d 819, 823 (Tex. 1997).

¹⁵⁵ See *Heyden Newport Chem. Corp.*, 387 S.W.2d at 25; *Reser v. State Farm Fire & Cas. Co.*, 981 S.W.2d 260, 263 (Tex. App.-San Antonio 1998, no pet.).

¹⁵⁶ See *State Farm Fire & Cas. Co. v. Gandy*, 925 S.W.2d 696, 714 (Tex. 1996).

¹⁵⁷ See *Farmers Tex. County Mut. Ins. Co. v. Wilkinson*, 601 S.W.2d 520, 522 (Tex. App. – Austin 1980, writ ref'd n.r.e.).

¹⁵⁸ See *Arkwright-Boston Mfrs. Mut. Ins. Co. v. Aries Marine Corp.*, 932 F.2d 442, 445 (5th Cir. 1991).

¹⁵⁹ See *Farmers Texas County Mut. Ins. Co. v. Wilkinson*, 601 S.W.2d 520, 522 (Tex. App.-Austin 1980, writ ref'd); *Employers Cas. Co. v. Tilley*, 496 S.W.2d 552,560 (Tex. 1973).

¹⁶⁰ See TEX. INS CODE ANN. 541.060(a)(4)(B)

¹⁶¹ See *American Eagle Ins. Co. v. Nettleton*, 932 S.W.2d 169, 174 (Tex. App. – El Paso 1996, writ denied).

sufficient to inform the insured of the insurer's position.¹⁶² Upon receiving notice of the reservation of rights, the insured may properly refuse the tender of defense and defend the suit personally.¹⁶³

- 2) For insurers, the reservation of rights letter or non waiver agreement is crucial for protecting itself against claims not covered under the policy. While Texas courts have held that the doctrines of waiver and estoppel cannot be used to create insurance coverage when none exists by the terms of the policy,¹⁶⁴ coverage defenses can be waived when an insurer, with knowledge of facts indicating non-coverage, assumes the defense of its insured without obtaining a non-waiver agreement or issuing a reservation of rights.¹⁶⁵ When an insurer has knowledge of facts indicating non-coverage, but yet assumes the defense of an insured without a reservation of rights or non-waiver agreement, in essence providing an unconditional defense, the **insurer may be forever estopped** from asserting policy defenses against coverage.¹⁶⁶

- 3) Carriers also need to be careful in terms of what is stated in the reservation of rights letter to the insured, especially with respect to such things as, whether the carrier intends to seek reimbursement of defense costs for uncovered claims, or provide any further notice to the insured should the carrier decide to withdraw the conditional defense it is providing to the insured. Generally, Texas courts look very strictly at the reservation of rights letters, and hold insurers to statements contained therein. Unless an insurer gives notice to the insured, usually in the reservation of rights letter, that it intends to seek reimbursement from the insured for defense costs of uncovered claims, then the insurer is precluded from later pursuing such a claim against the insured.¹⁶⁷ If an insurer indicates to the insured that further notice will be given before the defense is withdrawn, then the insurer is bound to follow that notice before being allowed to withdraw the defense.

- 4) Accordingly, a reservation of right letter should specifically:
 - a. identify the pleading received from insured;
 - b. identify the insurance policies at issue, including policy periods;
 - c. identify the relevant facts plead in the latest lawsuit pleading that may affect coverage;
 - d. identify to the extent possible, any policy defenses that may be applicable to a given case, depending on the later fact determinations done in case;

¹⁶² *See id.*

¹⁶³ *See id.*

¹⁶⁴ *See Texas Farmers Ins. Co. v. McGuire*, 744 S.W.2d 601, 603 (Tex. 1988).

¹⁶⁵ *See Paradigm Insurance Co. v. Texas Richmond Corp.*, 942 S.W.2d 645, 652 (Tex. App.--Houston [14th dist.] 1997, pet. denied); *J.E.M v. Fidelity & Cas. Co. of New York*, 928 S.W.2d 668, 672 (Tex. App. - Houston [1st Dist.] 1996, no writ).

¹⁶⁶ *See Northern County Mut. Ins. Co. v. Davalos*, 140 S.W.3d 685, 689 (Tex. 2004).

¹⁶⁷ *See Alliance Gen. Ins. Co. v. Club Hospitality, Inc.*, 1999 WL 500229, p. 1, (N.D. Tex. 1999).

- e. identify the policy terms that may apply so as to limit or deny coverage;
- f. identify whether a defense is being provided or not;
- g. identify counsel retained for defense of insured,
- h. indicate carrier's intentions with regard to withdrawing defense of insured at some point in future of litigation;
- i. indicate whether carrier intends to seek reimbursement of defense costs, should a determination be made that carrier had no duty to defend ;
- j. if the defense is denied entirely, encourage insured to forward any new or revised pleadings for additional review.

D. **The Carrier's Right to Control the Defense.** Whether an insurer has the right to conduct its insured's defense is initially a matter of contract, i.e., does the insurance policy give the insurer the right to control the defense. The right to conduct the defense includes the authority to select the attorney who will defend the claim and to make other defense decisions, just as if the insurer was the client and named party in the case.¹⁶⁸ However where there is an actual "disqualifying" conflict of interest, an insured may rightfully reject the tendered defense and the insurer lose its contractual right to control the defense of the insured.¹⁶⁹

- 1) The Texas Supreme Court has held that if a disqualifying conflict of interest exists, an insured may rightfully refuse an inadequate defense and may also refuse any defense conditioned on an unreasonable, extra-contractual demand that threatens the insured's independent legal rights.¹⁷⁰ The court acknowledged five situations that would present a "disqualifying" conflict of interest:
 - a. when a carrier issues reservation of rights relating to existence or scope of coverage;
 - b. when the defense tendered is not a complete defense under circumstances in which it should have been;
 - c. when the attorney hired by the carrier acts unethically and, at the insurer's direction, advances the insurer's interests at the expense of the insured's;
 - d. when the defense would not, under the governing law, satisfy the insurer's duty to defend;
 - e. when, though the defense is otherwise proper, the insurer attempts to obtain some type of concession from the insured before it will defend.¹⁷¹
- 2) A disagreement between the insurer and insured about how the defense

¹⁶⁸ See State Farm Mut. Auto. Ins. Co. v. Traver, 980 S.W.2d 625, 627, 42 (Tex. 1998).

¹⁶⁹ See Northern County Mut. Ins. Co. v. Davalos, 140 S.W.3d 685, 689 (Tex. 2004).

¹⁷⁰ See *id.*

¹⁷¹ See *id.*

should be conducted does not amount to a disqualifying conflict.¹⁷²

- 3) The defense attorney hired by the insurance carrier to represent an insured is considered an independent contractor,¹⁷³ whose ethical duty requires unqualified loyalty to the insured.¹⁷⁴ The lawyer must at all times protect the interests of the insured even if those interests would be compromised by the insurer's instructions.¹⁷⁵ Accordingly, an insurer cannot be vicariously responsible for the conduct of an independent attorney it selects to defend an insured.¹⁷⁶

E. Should a Declaratory Judgment Action be Commenced on Coverage?

- 1) Generally speaking a declaratory judgment action should only be filed if the carrier believes it has no duty to defend. First, the duty to defend is much broader than the duty to indemnify, and if the carrier can show that it has no duty to defend that should resolve all issues relating to that suit. Second, while the duty to defend is determined by the policy and pleading, the duty to indemnify is based on adjudicated facts. In most cases, factual liability issues exist that would prevent courts from making a decision on indemnity until the underlying litigation is resolved and facts determined.
 - a. An exception to this rule exists where the same reasons that negate the duty to defend, likewise, negate any possibility that the insurer will have a duty to indemnify for any judgment.¹⁷⁷ In such a case, a declaratory judgment action is appropriate and can decide both the defense and indemnity issue.

- F. The Carrier's Risk Related to Third-party Claims.** Thanks to the Texas Supreme Court's 1996 decision in *State Farm Fire and Cas. Co. v. Gandy*,¹⁷⁸ carriers have some greater latitude in determining how to handle third-party claims with coverage issues. Prior to *Gandy*, Plaintiffs and Defendants could agree to settle a case at their discretion, and then an assignment from the Defendant to Plaintiff of the Defendant's rights against his insurance carrier, would set the insurance company up for an action against the carrier, without the underlying claim facts being litigated. Such deals are now prohibited as against public policy. *Gandy* held that a defendant's assignment of his claims against his insurer to a plaintiff is invalid as against public policy if: (1) it is made prior to an adjudication of the plaintiff's claim against the defendant in a fully adversarial trial; (2) the defendant's insurer has tendered a defense; and (3) either: (a) the defendant's insurer has accepted coverage, or (b) the defendant's insurer has made a good faith effort to adjudicate coverage

¹⁷² *See id.*

¹⁷³ *See State Farm Mut. Auto. Ins. Co. v. Traver*, 980 S.W.2d 625, 628-629 (Tex. 1998).

¹⁷⁴ *See Employers Cas. Co. v. Tilley*, 496 S.W.2d 552, 558 (Tex.1973).

¹⁷⁵ *See Traver* at 628-629.

¹⁷⁶ *See id.*

¹⁷⁷ *See Farmers Tex. County Mut. Ins. Co. v. Griffin*, 955 S.W.2d 81, 84 (Tex.1997).

¹⁷⁸ *See State Farm Fire and Cas. Co. v. Gandy*, 925 S.W.2d 696 (Tex.1996).

issues prior to the adjudication of the plaintiff's claim.¹⁷⁹ *Gandy* further held that in no event is a judgment for a plaintiff against a defendant, rendered without a fully adversarial trial, binding on the defendant's insurer or admissible as evidence of damages in an action against the defendant's insurer by the plaintiff as the defendant's assignee.¹⁸⁰ The rationale underlying this decision is that, if an insurer's liability is to be litigated in an action by a plaintiff as a defendant's assignee after a judgment is rendered, then it should be done on the strength of the plaintiff's claims rather than on the generosity of the defendant's concessions.¹⁸¹ Thus, in no event are agreed judgments negotiated between a plaintiff and defendant, binding on a defendant's insurer.¹⁸²

G. Settlement issues.

- 1) **Insurer's Statutory Duty regarding settlement.** Under the Texas common law, an insurer generally had no obligation to settle a third-party claim against its insured unless the claim is covered under the policy.¹⁸³ But as discussed above, the Texas Insurance Code requires a carrier to attempt in good faith to effectuate a prompt, fair, and equitable settlement of a claim with respect to which the insurer's liability has become reasonably clear.¹⁸⁴ This extends to third-party claims. The Supreme Court has held that to trigger an insurer's statutory duty to reasonably attempt settlement of a third-party claim against its insured, **the policy must cover the claim and the insured's liability to the third party must be reasonably clear, such that an ordinarily prudent insurer would accept it.**¹⁸⁵ Accordingly, to impose liability against an insurer under the insurance code for the failure to effectuate a prompt, fair, and equitable settlement of a claim with respect to which the insurer's liability has become reasonably clear, the insured must prove the following elements: 1) the policy covers the claim; 2) the insured's liability is reasonably clear; 3) the claimant has made a proper settlement demand within policy limits; and 4) the demand's terms are such that an ordinarily prudent insurer would accept it.¹⁸⁶
- 2) **Hospital and Medicare Liens.** Section 55.001 of the Texas Property Code provides a mechanism for Texas hospitals who provide emergency medical services to file a valid lien against any cause of action the injured party may have arising out of the incident. While a full analysis of this provision is beyond the scope of this article, it is important to note that checking for liens can mean paying a claim twice. The Texas hospital lien is enforceable against a Defendant even if the Plaintiff and Defendant have already settled

¹⁷⁹ *See id.* at 714.

¹⁸⁰ *See id.*

¹⁸¹ *See id.* at 719.

¹⁸² *See id.*

¹⁸³ *See Farmers Tex. County Mut. Ins. Co. v. Griffin*, 955 S.W.2d 81, 82 (Tex.1997)

¹⁸⁴ *See* TEX. INS CODE ANN. 541.060(a)(2)(A).

¹⁸⁵ *See Rocor Int'l Inc. v. Nat'l Union Fire Ins. Co.*, 77 S.W.3d 253, 261, 265 (Tex.2002).

¹⁸⁶ *See id.* at 262.

the claim. A similar lien attaches for medical services provided under Medicare and Medicaid. Because these liens can be enforced directly against the Defendant, even if a settlement has already taken place and a release from the injured party received, it is important to check for any liens before a settlement is consummated. Hospital liens can be found in the County Clerk's records, while other liens have to be determined through the agency that administers the program. If such a lien is discovered, the name of the lien holder needs to be put on any settlement check or arrangements made for the negotiation and release of that lien as a part of the settlement.

- 3) **Texas' New Settlement statute.** As a part of the continuing tort reform process, a new settlement statute was enacted in 2003, adding Chapter 42 to the Texas Civil Practice and Remedies Code. At first blush, this looks like a convenient mechanism to try to resolve nuisance cases, and perhaps get some defense costs back in a no liability case. *But care should be exercised by a carrier that tries to use this. Because of the costs shifting provisions in the statute, if a carrier makes an offer and invokes this statute, but ultimately gets hit at trial, the carrier could unwittingly make the insured liable for additional damages that are not covered by the insurance policy. If a carrier is interested in using the statute on a particular case, the carrier should discuss the impact with the insured before invoking this statute.*
- a. This law provides, with respect to claims seeking monetary relief, a framework for the recovery of litigation costs, including attorneys fees, after the rejection of a favorable settlement offer.¹⁸⁷ Specifically, if a settlement offer is made and rejected and the judgment of the trial court is significantly less favorable to the rejecting party than the settlement offer, the offering party is entitled to recover from the rejecting party, litigation costs incurred by the offering party after the date of the rejection.¹⁸⁸ A judgment is significantly less favorable to the rejecting party than the settlement offer if either: 1) the rejecting party is a claimant and the award is less than 80 percent of the rejected offer; or 2) the rejecting party is a defendant and the award is more than 120 percent of the rejected offer.¹⁸⁹ Litigation costs refers to money actually spent and obligations actually incurred that are directly related to the case in which a settlement offer is made and includes reasonable attorney's fees, court costs, reasonable fees for not more than two testifying expert witnesses.¹⁹⁰ Litigation costs recoverable are limited to a calculated amount of the sum of 50 percent of the economic damages, plus all of the noneconomic, exemplary, or additional damages to be awarded to the claimant in the judgment, minus the amount of any statutory or contractual liens in connection with the

¹⁸⁷ See TEX. CIV. PRAC. & REM. CODE § 42.001 *et seq.*

¹⁸⁸ See TEX. CIV. PRAC. & REM. CODE § 42.004(a), (c).

¹⁸⁹ See TEX. CIV. PRAC. & REM. CODE § 42.004(b).

¹⁹⁰ See TEX. CIV. PRAC. & REM. CODE § 42.001(5).

occurrences or incidents giving rise to the claim.¹⁹¹ If litigation costs are to be awarded against a claimant, those litigation costs will be awarded to the defendant in the judgment as an offset against the claimant's recovery from that defendant.¹⁹²

- b. This settlement procedure does not apply until a defendant files a declaration that this particular settlement procedure is available in the action. The declaration must be filed no later than 45 days before the case is set for trial.¹⁹³ If there is more than one defendant, this settlement procedure is available only in relation to the defendant that filed the declaration and to the parties that make or receive offers of settlement in relation to that defendant.¹⁹⁴ To be in compliance with this law, a settlement offer must: (1) be in writing; (2) state that it is made pursuant to Rule 167 and Chapter 42 of the Civil Practice and Remedies Code; (3) identify the parties making the offer and the parties to whom the offer is made; (4) state the terms by which the monetary claims may be settled; (5) state a deadline by which the settlement offer must be accepted; and (6) be served on all parties to whom the settlement offer is made.¹⁹⁵ An offer under this law, must not include non-monetary claims.¹⁹⁶ The offer may be made subject to reasonable conditions such as the execution of appropriate releases and other documents. Unless an offeree objects by written notice within the specified time deadline, the condition is presumed reasonable.¹⁹⁷ Rejection of an offer subject to a condition that is subsequently found to be unreasonable by the trial court cannot be the basis of an award of litigation costs.¹⁹⁸
- c. An offer made under this statute may not be made before a Defendant files a declaration, and may not be made within 60 days after the appearance in the case of the offeror or offeree, whichever is later.¹⁹⁹ Additionally, the offer may not be made within 14 days before the case is set for conventional trial on the merits, except that an offer may be made within 14 days of trial if it is in response to and within seven days of a prior offer.²⁰⁰ A party is permitted to make an offer after having made or rejected a prior offer.²⁰¹ An offer can be withdrawn in writing before it is accepted.²⁰² Acceptance of an offer

¹⁹¹ See TEX. CIV. PRAC. & REM. CODE § 42.004(d).

¹⁹² See TEX. CIV. PRAC. & REM. CODE § 42.004(f).

¹⁹³ See TEX. R. CIV. P. 167.2(a).

¹⁹⁴ See TEX. CIV. PRAC. & REM. CODE § 42.002(c).

¹⁹⁵ See TEX. CIV. PRAC. & REM. CODE § 42.003; TEX. R. CIV. P. 167.2(b)

¹⁹⁶ See TEX. R. CIV. P. 167.2(d).

¹⁹⁷ See TEX. R. CIV. P. 167.2(a).

¹⁹⁸ See *id.*

¹⁹⁹ See TEX. R. CIV. P. 167.2(e)(2).

²⁰⁰ See TEX. R. CIV. P. 167.2(e)(3).

²⁰¹ See TEX. R. CIV. P. 167.2(f).

²⁰² See TEX. R. CIV. P. 167.3(a).

can only be done by written notice served on the offeror before the deadline stated in the offer.²⁰³

- d. This law is applicable only to actions filed on or after January 1, 2004. But it does not apply to class actions, shareholder derivative actions, actions by or against a governmental unit, actions brought under the Family Code, actions to collect workers' compensation benefits, or actions filed in justice of the peace court.²⁰⁴ If a claimant or defendant is entitled to recover fees and costs under another law, that claimant or defendant may not recover litigation costs in addition to the fees and costs recoverable under the other law. This procedure does not affect the ability of any party to make an offer to settle a case, or any other law regarding settlement offers in a particular case,²⁰⁵ but an offer not made in compliance with this settlement procedure or in a case where this provision is not applicable does not allow the offering party to recover litigation costs.²⁰⁶

H. **Attorney Billing Guidelines and Attorney Ethical Issues.**

- 1) **Attorney's duty to insured.** The relationship between insured, carrier and attorney has been described as a tripartite relationship, a term suggestive of an uneasy alliance.²⁰⁷ The defense attorney is often faced with competing ethical concerns, created by law which imposes on him an absolute loyalty to the insured and yet subjects him to controls imposed by an insurance carrier.²⁰⁸ In Texas, a defense attorney hired by an insurance carrier, is an independent contractor, and has discretion regarding the day-to-day details of conducting the defense and is not subject to the client's control regarding those details.²⁰⁹ Because a lawyer owes unqualified loyalty to the insured,²¹⁰ the lawyer must at all times protect the interests of the insured even if those interests would be compromised by the insurer's instructions.²¹¹ That is, a lawyer must act in the client's best interest even if it conflicts with guidelines or instructions from the insurance carrier. It is for this reason that an insurer is not vicariously responsible for the defense lawyer's conduct on behalf of the insured.²¹² Over the last several years, the State Bar of Texas Professional Ethics Committee has issued opinions on issues related to an attorney's duties when representing a client where the defense is being paid

²⁰³ See TEX. R. CIV. P. 167.3(b).

²⁰⁴ See TEX. CIV. PRAC. & REM. CODE § 42.002(b).

²⁰⁵ See TEX. CIV. PRAC. & REM. CODE § 42.002(d).

²⁰⁶ See TEX. CIV. PRAC. & REM. CODE § 42.002(e).

²⁰⁷ See *In re Cooper*, 47 S.W.3d 206, 210 (Tex. App.- - Beaumont 2001, no pet.)(Gaultney, J. concurring).

²⁰⁸ See *id.*

²⁰⁹ See *State Farm Mut. Auto. Ins. Co. v. Traver*, 980 S.W.2d 625, 627 (Tex.1998)(citing RESTATEMENT (SECOND) OF AGENCY, § 385, cmt. a).

²¹⁰ See *Employers Cas. Co. v. Tilley*, 496 S.W.2d 552, 558 (Tex.1973).

²¹¹ See *State Farm Mut. Auto. Ins. Co. v. Traver*, 980 S.W.2d at 627-628.

²¹² See *id.*

for by an insurance company.²¹³ In this regard, the Committee has opined that it is impermissible, under the Texas Disciplinary Rules of Professional Conduct, for a lawyer to agree with any insurance company restriction which interferes with the lawyer's exercise of his or her independent professional judgment in rendering such legal services to the insured-client.²¹⁴ As a practical matter, most billing guidelines do not interfere with the lawyer's ability to defend the client. This issue can come into play when an attorney's request for permission to do a certain activity on a case, such as hire an expert, is denied by the carrier. In such a case, the attorney has to weigh the issue and determine whether he believes it is essential to the defense. If it is, he will need to discuss the issue with the insured, and possibly go forward with the task of doing the activity even if it is not reimbursed by the carrier.

- 2) **Use of Third-Party Auditors for Attorney Bills.** The Texas Disciplinary Rules of Professional Conduct provide that a lawyer shall not undertake representation where someone else pays for a client's defense, such as in the insurer/insured context, unless: 1) the client consents; 2) there is no interference with the lawyer's independent professional judgment or with the client-lawyer relationship; and 3) information relating to representation of a client is protected as required by Rule 1.05. Rule 1.05 provides that a lawyer shall not knowingly reveal a client's confidential information. Because a lawyer's invoice or bill contains information describing the legal services rendered on behalf of the client, the Professional Ethics Committee for the State Bar of Texas has opined that attorneys in Texas are not permitted to forward any legal bills to an outside auditor without first obtaining the client's informed consent.²¹⁵ Accordingly, if a carrier requires an attorney to send his bills to an outside third-party auditor, the attorney is only able to send bills to the outside auditor if the insured-client consents to the disclosure. If the client will not consent to the disclosure, the attorney is required to send his bills directly to the carrier for payment.

12 **COVERAGE ISSUES AND THE INSURANCE POLICY.**

- A. **Texas Rules of Policy Interpretation.** Insurance contracts are generally subject to the same rules of construction as ordinary contracts.²¹⁶ When construing a written contract, a court is primarily concerned with ascertaining the true intent of the parties as expressed in the contract.²¹⁷ Contracts are considered as a whole with each clause

²¹³ See Tex. Comm. on Prof'l Ethics, Op. 552, 67 TEX. B. J. 981 (2004); Tex. Comm. on Prof'l Ethics, Op. 533, 63 TEX. B. J. 806 (2000); Tex. Comm. on Prof'l Ethics, Op. 532, 63 TEX. B. J. 805 (2000).

²¹⁴ See Tex. Comm. on Prof'l Ethics, Op. 533, 63 TEX. B. J. 806 (2000).

²¹⁵ See Tex. Comm. on Prof'l Ethics, Op. 552, 67 TEX. B. J. 981 (2004); Tex. Comm. on Prof'l Ethics, Op. 532, 63 TEX. B. J. 805 (2000).

²¹⁶ See *Kelley-Coppedge, Inc. v. Highlands Ins. Co.*, 980 S.W.2d 462, 464 (Tex.1998); *Trinity Universal Ins. Co. v. Cowan*, 945 S.W.2d 819, 823 (Tex. 1997); *State Farm Life Ins. Co. v. Beaston*, 907 S.W.2d 430, 433 (Tex.1995).

²¹⁷ See *National Union Fire Ins. Co. v. CBI Indus., Inc.*, 907 S.W.2d 517, 520 (Tex.1995).