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Fifth Circuit recognizes that not all coverage defenses give rise to obligation to provide independent counsel

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SUMMARY

The United States Court of Appeals for the Fifth Circuit held that an insured was not entitled to independent counsel where the facts to actually be adjudicated in the underlying lawsuit were not the same facts upon which coverage depended.

In *Downhole Navigator, L.L.C. v. Nautilus Ins. Co.*, No. 11-20469, 2012 WL 2477846 (5th Cir. June 29, 2012), the Fifth Circuit rejected an insured's claim for reimbursement from its insurer for the cost of hiring independent counsel. The insured, Downhole Navigator, L.L.C. ("Downhole"), alleged the insurer's reservation of rights created a conflict of interest that prevented the insurer from controlling the defense.

The insurer, Nautilus Insurance Company ("Nautilus"), had reserved its right to decline indemnity coverage if the underlying suit fell under one of three policy exclusions: (1) the "expected or intended injury" exclusion, which excluded coverage for injury or damage expected or intended from the standpoint of the insured; (2) the "property damage" exclusion, which excluded certain physical injury to property, including damage that occurred while occupied by the insured; and (3) the "testing or consulting" exclusion, which excluded damages arising out of an error or omission in performing a test, evaluation or consultation given by or on behalf of the insured. Although not mentioned in the reservation letter, the Fifth Circuit found that two other exclusions were also relevant: the "professional liability" exclusion, which excluded damages arising from the rendering or failure to render professional services; and the "data processing" exclusion, which excludes damages arising from the rendering or failure to render electronic data processing services.

Downhole argued that the reservation of rights letter presented a conflict of interest in the selection of defense counsel because facts which could be developed in the underlying litigation are the same facts upon which coverage depended. Downhole asserted that counsel selected by an insurer could develop facts during the course of litigation which would implicate one of the policy's exclusions. Downhole argued that the conflict of interest assessment should focus on the "facts to be developed" rather than the "facts to be adjudicated."

The Fifth Circuit rejected Downhole's argument, and held that a conflict of interest does not arise simply because the attorney provided by the insurer could develop facts in the underlying lawsuit that could exclude coverage. Instead, whether a conflict of interest exists is dependent upon whether the facts to be actually adjudicated in the underlying lawsuit are the same as the facts upon which coverage depends.

The panel noted that the underlying litigation concerned whether Downhole had negligently performed its work in redirecting an oil well. Therefore, the fact finder in the underlying litigation would determine whether Downhole had negligently provided services, and would not decide whether Downhole was "testing" or "consulting" for Sedona; whether Downhole provided "professional" or "data processing" services; whether it should have expected the damage to the well; or whether it occupied the property while providing services. Although facts relating to the coverage issues could arise during the course of that litigation, because the facts to be adjudicated in the negligence action were not the same as those facts that would decide coverage, the panel determined there was not a conflict of interest sufficient to necessitate independent counsel. Accordingly, the Fifth Circuit held Downhole was not entitled to reimbursement from Nautilus for the cost of hiring independent counsel.

The panel also noted a point often overlooked in this context, the defense counsel's duty to the insured. The panel wrote:

> Of course, the attorney hired by the insurer to represent the insured is duty-bound to defend the interests of the insured. *State Farm Mut. Auto. Ins. Co. v. Traver*, 980 S.W.2d 625, 628 (Tex. 1998) ("[B]ecause the lawyer owes unqualified loyalty to the insured, the lawyer must at all times protect the interests of the insured if those interests would be compromised by the insurer's instructions." (Citation omitted.)). Downhole's concern is thus somewhat overblown.

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