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Insurer's Liability for Independent Counsel Fees in "Bet The Company" Litigation

The United States Court of Appeals for the Second Circuit recently decided a case involving the issue of an insurer's liability for legal fees incurred as a result of the insured's retention of independent counsel to defend the insured in litigation arising from the Hurricane Katrina catastrophe in Louisiana in August, 2005. *New York Marine & General Insurance Company (NYMAGIC) v. LaFarge North America, Inc., et al.*, United States Court of Appeals for the Second Circuit, March 15, 2010.

LaFarge faced potentially enormous liability as the result of a barge which was moored at LaFarge's terminal amid allegations that LaFarge failed to properly secure the barge during the hurricane, and that the barge may have breached a levee permitting the Mississippi River to flood the area.

LaFarge immediately retained G.P., a law firm with a national reputation in mass tort litigation, and H&K, a prominent maritime investigation litigation practice. On the advice of G.P., it also retained local counsel in the New Orleans area, C.M. LaFarge notified its primary insurer, NYMAGIC, about the possibility of claims. The insurer suggested that it had approved counsel in the New Orleans area, S.W., who the carrier would like to involve if there was a significant claim. Subsequently, LaFarge advised NYMAGIC that it had retained independent counsel.

LaFarge never obtained NYMAGIC's prior consent to the retention of any of the three law firms. NYMAGIC provided the names of six New Orleans firms, including S.W., specializing in maritime litigation. LaFarge would not consent to any of the six law firms, and NYMAGIC then advised LaFarge that they were appointing S.W. as defense counsel.

At least four separate class action complaints were filed against LaFarge seeking damages of approximately \$100 billion.

LaFarge's insurers commenced three actions in the United States District Court for the Southern District of New York with respect to issues of coverage under primary and excess policies. NYMAGIC's primary policy paid the approved legal fees and expenses of S.W., and LaFarge's expert fees and costs which exhausted the primary policy's limit of \$5,000,000. Excess policies, with coverage up to \$50,000,000, paid the remaining legal fees of S.W. and expert expenses. None of the insurers paid any of the legal fees and expenses of G.P., H&K and C.M. The total legal fees and expenses of these three firms was over \$10,000,000.

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The NYMAGIC policy contained a “Naming Clause” which provided that NYMAGIC had the option of naming any mutually acceptable attorneys to represent LaFarge in the prosecution or defense of any claim for liability covered by the primary policy.

Another provision, the “Protection Clause”, obligated LaFarge to take steps to protect its own and NYMAGIC’s interests in respect to any occurrence likely to give rise to a claim under the primary policy. NYMAGIC argued that LaFarge retained G.P., H&K and C.M. without NYMAGIC’s knowledge or consent, that NYMAGIC had fulfilled its obligation under the Naming Clause by appointing S.W. for LaFarge’s defense, and was not obligated to pay for the legal fees earned by the three unauthorized firms. LaFarge contended that it took reasonable steps, pursuant to its obligations under the Protection Clause by immediately retaining qualified counsel to preserve evidence, investigate the cause of the breached levee and minimize exposure to liability.

On appeal, the Second Circuit found that LaFarge’s actions under the exceptional circumstances of Hurricane Katrina, were reasonable in retaining G.P., H&K and C.M. in the initial stage of the investigation:

to preserve evidence, investigate the cause of the breached levee, and minimize exposure to the damages that would be at stake in the foreseeable and inevitable lawsuits. Considering the level of complexity of the case in both procedural and substantive respects, as well as the possibility of being cast in damages that could exceed the value of LaFarge several times over, we agree with the District Court that ‘it was reasonable for LaFarge to retain at once a large firm such as [G.P.] with complex case and mass tort experience, to take immediate control of LaFarge’s defense against the anticipated litigation flood (which in fact materialized). It was also reasonable for LaFarge to retain an admiralty firm such as [H&K], with experience in the ‘rapid response’ investigation and evaluation of major marine casualties.

The Court held that under these circumstances, New York Law does not confer a right upon the insured to retain independent counsel at the insurer’s expense for the duration of the litigation. “The New York Court of Appeals has held that ‘[i]ndependent’ counsel is only necessary in cases where the defense attorney’s duty to the insured would require that he defeat liability on any ground and his duty to the insurer would require that he defeat liability only upon grounds which would render the insurer liable. ***Here, both NYMAGIC and LaFarge share a common interest in defeating LaFarge’s liability in the barge litigation.”

This case stands for the proposition that even in massive tort liability exposure cases, where the insured’s liability threatens the existence of the insured, and is substantially in excess of its policy coverage, the insurer still retains the right to appoint counsel of its choosing and to direct the defense of the action. ■

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