

Handling Professional Indemnity Coverage Issues in Cases of Suspected Fraud

Part II: Handling Conflicts of Interest between Insured and Insurer: The Lawyer's Dilemma

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A. Introduction

1. This paper considers the difficult area of the handling of a conflict of interest between insured and insurer where a solicitor is acting for both parties pursuant to a joint retainer.
2. A conflict may arise in various contexts, but perhaps the most common is the case of suspected fraud. It is usually in the insurer's interest to prove fraud, as that may entitle the insurer to reject the claim in its entirety, or, even in the case of an innocent partner, showing that multiple claims were part of a fraud may trigger the application of an aggregation clause, thereby reducing, perhaps significantly, the overall amount of the indemnity payable by the insurer. Clearly, either of these outcomes would be prejudicial to the insured: hence the conflict of interest.
3. This paper also considers, briefly, the related area of the handling of issues of conflict of interest in the context of legal expenses insurance where there is no liability cover.

B. Professional Indemnity Policy with Claims Control Clause and/or Cover for Defence Costs

4. Key issues:
 - a. When is it permissible for a solicitor to accept instructions to act for both insured and insurer in relation to a claim to which a policy of professional indemnity insurance may respond?
 - b. Having done so, when must a solicitor cease acting for one or both parties?
 - c. What are the potential consequences of breach of the solicitor's obligations in this regard?

5. Key materials:
- a. [EU Directive 87/344/EEC](#) of 22 June 1987 on the coordination of laws, regulations and administrative provisions relating to legal expenses insurance
 - b. Insurance Companies (Legal Expenses Insurance) Regulations 1990 (SI 1159/1990, as amended)
 - c. [Groom v Crocker](#) [1939] 1 KB 194, CA
 - d. [Brown v Guardian Royal Exchange](#) [1994] 2 Lloyd's Rep 325, CA
 - e. [TSB Bank plc v Robert Irving & Burns](#) [1999] Lloyd's Rep IR 528, CA
 - f. Solicitors' Code of Conduct 2007, [Rule 3: Conflict of interests](#) and [Rule 4: Confidentiality and disclosure](#)
6. It is normal practice in England and Wales for a liability insurer to appoint a firm of solicitors to act jointly for both insurer and insured in relation to a third party claim to which a policy of professional indemnity insurance may respond. This is usually done pursuant to a claims control clause. This is a policy condition which gives the insurer the right to take over and conduct in the name of the insured the defence or settlement of the third party claim. Standard policy terms also include an obligation on the insured to co-operate with the insurer (which may of course be required in relation to the conduct of the defence or settlement of the claim); an express right to an indemnity in respect of defence costs may or may not be included.
7. For example, the 2010/11 ARP Policy for solicitors includes the following provisions:

'1.2 Defence Costs

The Insurer will also indemnify the Insured against Defence Costs in relation to:

- (a) any Claim referred to in clause 1.1, 1.4 or 1.6; or*
- (b) any Circumstances first notified to the Insurer during the Period of Insurance; or*
- (c) any investigation or inquiry (save in respect of any disciplinary proceeding under the authority of The Law Society of England and Wales (including, without limitation, the Solicitors Regulation Authority*

and the Solicitors Disciplinary Tribunal)) during or after the Period of Insurance arising from any Claim referred to in clause 1.1, 1.4 or 1.6 or from Circumstances first notified to the Insurer during the Period of Insurance.

...

7.2 *Co-operation and assistance*

Each Insured will give the Insurer and any investigators or solicitors appointed by the Insurer all information and documents they reasonably require, and full co-operation and assistance in the investigation, defence, settlement, avoidance or reduction of any actual or possible Claim or any related proceeding.

7.3 *Conduct of any proceeding*

The Insurer may at its option take over and conduct in the name of any Insured any proceeding arising out of or relating to any Claim in respect of which the Insurer is liable to indemnify any Insured under this contract.'

8. The provision of ancillary legal expenses insurance in this way by a professional indemnity insurer is expressly exempted from the scope of the Insurance Companies (Legal Expenses Insurance) Regulations 1990, the relevant parts of which '*do not apply to anything done by a person providing civil liability cover for the purpose of defending or representing the insured in an inquiry or proceedings which is at the same time done in the insurer's own interest under such cover*' (reg 3(3)). The 1990 Regulations implement the EU Directive on legal expenses insurance, the purpose of which is to open up the market for legal expenses insurance, while at the same time protecting the insured from conflicts of interest.
9. The joint retainer carries with it an implied waiver of privilege by the insured, based on the normal rules for the implication of terms, the effect of which is to entitle the insurer to information provided by the insured to the solicitor:
 - a. Brown v Guardian Royal Exchange at 329 (Neill LJ)
 - b. TSB Bank plc v Robert Irving & Burns paras 11 and 13 (Morritt LJ)
10. The relationship between the insured, the insurer and the solicitor appointed to defend the claim against the insured will usually be as described by Neill LJ in Brown v Guardian Royal Exchange (at 330) (the case concerned an express provision entitling insurers to reports from the solicitors, but it is clear, following the TSB case, that the principles are of general application):

'The policy and the instructions given to RPC established a tripartite arrangement on the following lines: (1) RPC became Mr Brown's solicitors for the purpose of defending the claim. As far as the outside world was concerned the relationship was the usual one between a solicitor and his client and their communications were protected by legal professional privilege. (2) At the same time a separate relationship of solicitor and client came into existence between RPC and the insurers. The insurers became liable to pay RPC's fees and in return RPC became liable to report to the insurers about the progress of the case. (3) By accepting the benefit of legal representation made available in accordance with the terms of the policy Mr Brown waived his rights quoad the insurers to claim legal professional privilege in relation to communications about the claim between himself and RPC during the period that representation under the policy continued.

In these circumstances the insurers were entitled to regular reports from the solicitors as to the progress of the case. These reports would be expected to include some indication of the evidence which had been collected or which might be available to support the insured's case.'

11. There may in fact be two retainers: a joint retainer of the solicitors by the insurer and the insured, and a separate retainer of the solicitors by the insurer, but this does not affect the analysis in relation to the joint retainer:

- a. TSB Bank plc v Robert Irving & Burns paras 11 and 13 (Morritt LJ)

12. A potential conflict of interest is inherent in, and therefore no bar to, a joint retainer or corresponding implied waiver of privilege:

'I do not think that a possible conflict would suffice to entitle an insured to maintain privilege against his insurer. It is of the essence of the original joint retainer and the basis for the implied waiver that there is such a possible conflict of interest'

TSB v Robert Irving & Burns, para 15 (Morritt LJ)

13. However, the position changes when an actual conflict of interest emerges:

'... the waiver of privilege inherent in the joint retainer extends to (a) all communications made by the insured to the solicitors down to such time as an actual conflict of interest emerges and (b) to all communications made by the insured to those solicitors after the notification by the solicitors to the insured of such conflict and the lapse of such further time as the insured reasonably requires to decide whether to instruct further solicitors.'

TSB v Robert Irving & Burns, para 17 (Morritt LJ)

14. Brown v Guardian Royal Exchange and TSB v Robert Irving & Burns illustrate the dividing line between a merely potential, and an actual, conflict of interest in these circumstances:

a. Brown v Guardian Royal Exchange:

i. A solicitor was appointed by the insurer to act for the insured and the insurer in the usual way (ie pursuant to a joint retainer), and the insured was expressly informed that insurers' rights were reserved while the solicitor was investigating the claim. An express term in the policy entitled insurers to disclosure of any communications which the solicitors received from the insured or from third parties concerning the subject-matter of the claim. At this stage, the insured was invited to a meeting with the solicitor and asked questions about the claim, including questions the answers to which could, potentially, have resulted in insurers declining to indemnify the insured.

(1) This was acceptable:

(a) Hoffmann LJ described the situation in this way (at 327 to 328, and at 329):

'Such disclosure is of course necessary to enable the insurers to make an informed decision about whether to make an offer of settlement or payment into Court or to defend the claim. It causes no difficulty in cases in which the insurers have accepted liability to indemnify the insured or cannot reasonably dispute it. But problems may arise when the investigation of the claim also touches upon questions relevant to whether the insurers are liable. So in this case, the claim for negligence against Mr Brown required an investigation of exactly what he knew or did not know at the time when he agreed to exchange contracts. The insurers could not decide whether or not to defend the claim without full information on these matters. But lurking within them was an issue on which Mr Brown and the insurers had conflicting interests, namely the possibility that the

investigation might reveal that Mr Brown had been dishonest.

...

There is no suggestion that RPC should have advised Mr. Brown to seek separate representation at an earlier stage. The purpose of the conference with Mr. Dagnall was simply to enable him to advise on the claim and settle the defence.'

(b) Similarly, Neill LJ said this (at 329):

'In August, 1989 Mr Dagnall [counsel] was instructed to advise Mr Brown in conference and to settle the defence. The insurers were entitled to know what instructions were put before Mr Dagnall and what his advice was and also to know what transpired at the conference which the insurers were paying.

It seems clear that something emerged at the conference which led RPC to believe there might be a conflict of interest between Mr Brown and the insurers and that they should no longer continue to act. But while the representation under the policy subsisted RPC were under a duty to make a full and not merely a partial report of how matters had progressed. Suppose the possibility of a conflict had come to light because of a statement obtained from another witness who was not only able to give evidence about a number of important matters of fact but who could also testify to Mr Brown's state of knowledge at a relevant time. Is it to be said that the insurers were only entitled to have an edited version of that evidence?

In my view the suggested limitation as to the contents of any report does not give effect to the waiver of privilege implicit in cl 8. Furthermore, it seems to me to be clear that the duty to report about matters which happened while the joint representation still subsisted continued thereafter.'

b. TSB v Robert Irving & Burns:

i. Once again, a solicitor was appointed by the insurer to act for the insured and the insurer in the usual way (ie pursuant to a joint retainer), and the insured was expressly informed that insurers' rights were reserved while the solicitor was investigating the claim. At this stage, the insured was invited to a meeting with the solicitor and asked questions about the claim, including questions the answers to which could, potentially, have resulted in insurers declining to indemnify the insured.

(1) This conduct was acceptable, and information provided by the insured to the solicitor at this stage were covered by the implied waiver of privilege, and therefore could be communicated by the solicitor to the insurer for the purpose of deciding whether to confirm cover.

ii. The solicitor advised the insurer that cover should be confirmed, and the insurer agreed. In the event, cover was never expressly confirmed, but the judge at first instance found that the solicitor had unequivocally conveyed the impression that liability had been accepted, which came to the same thing.

iii. Several months later, after disclosure and consideration of a draft expert report, the solicitor instructed counsel to advise in conference on behalf of the insured '*who may have the benefit of cover from professional indemnity underwriters*', to advise on the draft expert report and the insured's factual evidence, and, following the conference with the insured, '*to consider again on behalf of Underwriters their liability to indemnify the [insured] under the terms of the policy*'.

(1) This conduct was not acceptable, and information provided by the insured to the solicitor at this stage was not covered by the implied waiver of privilege, and therefore could not be communicated by the solicitor to the insurer for the purpose of deciding whether to confirm cover. Morritt LJ described the position as follows (at para 20):

'Some of the questions were undoubtedly directed to the conduct of the defence. Nevertheless, in my view, it is clear that one of the principal purposes of the conference as a whole was to elicit information to justify a repudiation of liability and the description

of that process as a cross-examination does not appear to me to be unfair. It is true that some of [the insured's] most damaging answers were volunteered in the sense that his answer was in terms even more favourable to Colonia than would have been a mere acceptance of the question; but that merely emphasises the conclusion of the [judge at first instance] that the treatment of [the insured] was manifestly very unfair.'

15. The Solicitors' Code of Conduct 2007 includes the following relevant Rules (see also the associated Guidance):

'3.01 Duty not to act

- (1) *You must not act if there is a conflict of interests (except in the limited circumstances dealt with in 3.02).*
- (2) *There is a conflict of interests if:*
- (a) *you owe, or your firm owes, separate duties to act in the best interests of two or more clients in relation to the same or related matters, and those duties conflict, or there is a significant risk that those duties may conflict; ...*

3.02 Exceptions to duty not to act

- (1) *You or your firm may act for two or more clients in relation to a matter in situations of conflict or possible conflict if:*
- (a) *the different clients have a substantially common interest in relation to that matter or a particular aspect of it; and*
- (b) *all the clients have given in writing their informed consent to you or your firm acting.*
- ...
- (3) *When acting in accordance with 3.02(1) ... it must be reasonable in all the circumstances for you or your firm to act for all those clients.*

- (4) *If you are relying on the exceptions in 3.02(1) or (2), you must:*
- (a) *draw all the relevant issues to the attention of the clients before agreeing to act or, where already acting, when the conflict arises or as soon as is reasonably practicable, and in such a way that the clients concerned can understand the issues and the risks involved;*
 - (b) *have a reasonable belief that the clients understand the relevant issues; and*
 - (c) *be reasonably satisfied that those clients are of full capacity.*

3.03 Conflict when already acting

If you act, or your firm acts, for more than one client in a matter and, during the course of the conduct of that matter, a conflict arises between the interests of two or more of those clients, you, or your firm, may only continue to act for one of the clients (or a group of clients between whom there is no conflict) provided that the duty of confidentiality to the other client(s) is not put at risk.

...

4.04 Exception to duty not to put confidentiality at risk by acting - with clients' consent

- (1) *You may act, or continue to act, in the circumstances otherwise prohibited by 4.03 above with the informed consent of both clients but only if:*
- (a) *the client for whom you act or are proposing to act knows that your firm, or a lawyer or other fee earner of your firm, holds, or might hold, material information (in circumstances described in 4.03) in relation to their matter which you cannot disclose;*
 - (b) *you have a reasonable belief that both clients understand the relevant issues after these have been brought to their attention;*
 - (c) *both clients have agreed to the conditions under which you will be acting or continuing to act; and*
 - (d) *it is reasonable in all the circumstances to do so.*

- (2) “Both clients” in the context of means [sic]:
- (a) an existing or former client for whom your firm, or a lawyer or other fee earner of your firm, holds confidential information; and
 - (b) an existing or new client for whom you act or are proposing to act and to whom information held on behalf of the other client is material (in circumstances described in 4.03 above).
- (3) If you, or you and your firm, have been acting for two or more clients in compliance with rule 3 (Conflict of interests) and can no longer fulfil its requirements you may continue to act for one client with the consent of the other client provided you comply with 4.04.’

16. The potential consequences of getting it wrong include:

- a. The insurer will not be entitled to rely on communications made to the solicitor after the implied waiver of privilege has come to an end.
- b. The insured may have a cause of action against the solicitor for breach of contract.
- c. There may be disciplinary proceedings against the solicitor for breach of the Code of Conduct and/or, from 6 October 2010, a service complaint to the Legal Ombudsman with a maximum compensatory award of £30,000.

17. A footnote: [Quinn Direct Insurance Ltd v The Law Society of England & Wales](#) [2010] EWCA Civ 805 (para 24, The Chancellor of the High Court):

‘... no doubt the solicitor/insured owes duties of good faith to the insurer. He cannot justify any concealment of a material matter on the ground that he, personally, is privileged from disclosing it (see March Cabaret Club & Casino Ltd v The London Assurance [1975] 2 Lloyd’s Rep 169, 77) nor, perhaps, on the ground that the information he failed to disclose was confidential (see Blackburn Low & Co v Haslam (1888) 21 QBD 144, 153-4). Nevertheless the privilege is that of his client and cannot be broken or waived without the client’s consent. It may be that, if the client will not waive his privilege to enable proper disclosure to be made, the consequence of the resulting conflict of interest will be that the insurance is vitiated or the notification inadequate but that is the problem of the solicitor not the client, cf Hilton v Barker Booth & Eastwood [2005] 1 WLR 567. The solicitor’s duty of disclosure cannot override the entitlement of the client.’

C. Legal Expenses Insurance with No Liability Cover

18. Key issue:

- a. When is the insured under a policy of legal expenses insurance with no associated liability cover entitled to choose his or her own legal representative?

19. Key materials:

- a. [EU Directive 87/344/EEC](#) of 22 June 1987 on the coordination of laws, regulations and administrative provisions relating to legal expenses insurance
- b. Insurance Companies (Legal Expenses Insurance) Regulations 1990 (SI 1159/1990, as amended)
- c. Case C-199/08 [Erhard Eschig v UNIQA Sachversicherung AG](#), ECJ, judgment of the Court of 10 September 2009

20. An insured under a policy of legal expenses insurance governed by English law is entitled to choose his or her own legal representative:

- a. In any case in which there is a conflict of interest between the insured and the insurer, whether or not legal proceedings have started
- b. Where there is no such conflict of interest, only once legal proceedings have started
- c. Unless the legal expenses insurer carries on other types of business and does not take the steps prescribed in Art 3 of the EU Directive (and reg 5 of the 1990 Regulations), in which case the right arises from the moment the insured has a right to claim under the policy of legal expenses insurance.

21. These principles are derived from the following sources:

- a. EU Directive 87/344/EEC, Art 4:

'1. Any contract of legal expenses insurance shall expressly recognize that:

- (a) where recourse is had to a lawyer or other person appropriately qualified according to national law in order to defend, represent or serve the interests of the insured person in any inquiry or*

proceedings, that insured person shall be free to choose such lawyer or other person;

(b) the insured person shall be free to choose a lawyer or, if he so prefers and to the extent that national law so permits, any other appropriately qualified person, to serve his interests whenever a conflict of interests arises.'

b. Eschig v UNIQA (ECJ, paras 47, 52 and 53):

'47. ... Article 4(1) of Directive 87/344 recognises the right of the insured person to choose his representative but, other than in cases where a conflict of interests arises, restricts that right to inquiries and proceedings. The use of the adjective "any" as well as the tense of the verb "to recognise" demonstrate the general application and obligatory nature of that rule.

...

52. In addition, the 11th recital in the preamble to Directive 87/344 confirms that the right to freely choose a representative in the context of an inquiry or proceedings is not connected to the occurrence of a conflict of interests.

53. In that regard, it is true that the words "und zwar immer" in the German-language version of that recital in the preamble to Directive 87/344 could be interpreted as tying the right to freely choose a representative to the occurrence of a conflict of interests. However, such an interpretation cannot be relied upon in support of a restrictive reading of Article 4(1)(a) of that directive.'

c. Insurance Companies (Legal Expenses Insurance) Regulations 1990, reg 6:

'Freedom to choose lawyer

(1) *Where under a legal expenses insurance contract recourse is had to a lawyer (or other person having such qualifications as may be necessary) to defend, represent or serve the interests of the insured in any inquiry or proceedings, the insured shall be free to choose that lawyer (or other person).*

(2) *The insured shall also be free to choose a lawyer (or other person having such qualifications as may be necessary) to serve his interests whenever a conflict of interests arises.*

(3) *The above rights shall be expressly recognised in the policy.'*

22. Member states are not permitted to derogate, in domestic legislation, from the right to choose a legal representative as set out in the Directive:

a. In the Eschig case, the European Court of Justice decided that the Directive did not permit a legal expenses insurer to reserve the right, where a large number of insured persons suffered loss as a result of the same event, itself to select the legal representative of all the insured persons concerned (by way of test cases or group litigation), and the domestic (Austrian) legislation which did permit this was therefore not in accordance with the Directive.

23. Other than in relation to the right to choose a legal representative, and by requiring the inclusion of an arbitration clause, the Directive and the domestic implementing Regulations do not regulate the content of a legal expenses insurance policy. This was noted, in the case of the Directive, by the Advocate General in her [Opinion of 14 May 2009 in the Eschig case](#) (paras 83 to 85):

'83. *I also doubt very much whether Article 4(1)(a) of Directive 87/344 can be regarded as going further than intended.*

84. *First, the matters governed in Article 4(1)(a) of Directive 87/344 are limited. That provision provides only for a right to a legal representative of one's choice where recourse is had to a legal representative in order to defend, represent or serve the interests of the insured person in any inquiry or proceedings. Conversely, the circumstances under which a person with legal expenses insurance has a right against his legal expenses insurer to engage a legal representative are not laid down in Article 4(1)(a) of Directive 87/344, and are thus governed by the legal expenses insurance contract, subject to other relevant Community or national provisions.*

85. *Secondly, Directive 87/344 contains only a few specific pointers to the substantive content of legal expenses insurance policies. In particular, there is no provision saying which sectors must be covered by legal expenses insurance. Subject to national pointers, it is open to the insurance undertakings to exclude sectors susceptible to mass torts or to demand higher premiums to cover these sectors.'*

24. Breach of the 1990 Regulations by an insurer is treated as a contravention of a requirement under the Financial Services and Markets Act 2000, and Part XIV of the 2000 Act (Disciplinary Measures) applies in the event of any such breach:
- a. See regulation 11 of the 1990 Regulations.

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