

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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Devereux

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.

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

3. 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?

4. 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](#)
5. 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.
6. 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.'

7. 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 (including the freedom of choice of legal representative) '*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.
8. 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)
9. 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.'

10. 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)

11. 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)

12. 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)

13. 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 [insurers] 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.'

14. 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.

...

4.03 Duty not to put confidentiality at risk by acting

If you are a lawyer or other fee earner and you personally hold, or your firm holds, confidential information in relation to a client or former client, you must not risk breaching confidentiality by acting, or continuing to act, for another client on a matter where:

- (a) *that information might reasonably be expected to be material; and*
- (b) *that client has an interest adverse to the first-mentioned client or former client,*

except where proper arrangements can be made to protect that information in accordance with 4.04 and 4.05 below.

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.’*
15. The [draft Solicitors Code of Conduct 2011](#), due to come into force on 6 October 2011, includes the following:

‘Chapter 3 – Conflicts of interests

This chapter deals with the proper handling of conflicts of interests, which is a critical public protection. It is important to have in place systems that enable you to identify and deal with potential conflicts.

Conflicts of interests can arise between:

- (a) *you and current clients (“own interest conflict”); and*

(b) two or more current clients (“client conflict”).

You can never act where there is a conflict, or a significant risk of conflict, between you and your client.

If there is a conflict, or a significant risk of a conflict, between two or more current clients, you must not act for all or both of them unless the matter falls within the scope of the limited exceptions set out at Outcomes 3.6 and 3.7. In deciding whether to act in these limited circumstances, the overriding consideration will be the best interests of each of the clients concerned and, in particular, whether the benefits to the clients of you acting for all or both of the clients outweigh the risks.

You should also bear in mind that conflicts of interests may affect your duties of confidentiality and disclosure which are dealt with in Chapter 4.

The outcomes in this chapter show how the Principles apply in the context of conflicts of interests.

Outcomes

You must achieve these outcomes:

...

Prohibition on acting in conflict situations

O(3.4)

you do not act if there is an own interest conflict or a significant risk of an own interest conflict;

O(3.5)

you do not act if there is a client conflict, or a significant risk of a client conflict, unless the circumstances set out in Outcomes 3.6 and 3.7 apply;

Exceptions where you may act, with appropriate safeguards, where there is a client conflict

O(3.6)

where there is a client conflict and the clients have a substantially common interest in relation to a matter or a particular aspect of it, you only act if:

- (a) *you have explained the relevant issues and risks to the clients and you have a reasonable belief that they understand those issues and risks;*
 - (b) *all the clients have given informed consent in writing to you acting;*
 - (c) *you are satisfied that it is reasonable for you to act for all the clients and that it is in their best interests; and*
 - (d) *you are satisfied that the benefits to the clients of you doing so outweigh the risks;*
- ...

Indicative behaviours

Acting in the following way(s) may tend to show that you have achieved these outcomes and therefore complied with the Principles:

...

IB(3.5)

declining to act for clients under Outcome 3.6 (substantially common interest) or Outcome 3.7 (competing for the same objective) where the clients cannot be represented even-handedly, or will be prejudiced by lack of separate representation;

...

Acting in the following way(s) may tend to show that you have not achieved these outcomes and therefore not complied with the Principles:

...

IB(3.11)

acting for two or more clients in a conflict of interests under Outcome 3.6 (substantially common interest) where the clients' interests in the end result are not the same, for example one partner buying out the interest of the other partner in their joint business or a seller transferring a property to a buyer;

IB(3.12)

acting for two or more clients in a conflict of interests under Outcome 3.6 (substantially common interest) where it is unreasonable to act because there is unequal bargaining power;

...

Chapter 4 – Confidentiality and disclosure

...

The duty of confidentiality to all clients must be reconciled with the duty of disclosure to clients. This duty of disclosure is limited to information of which you are aware which is material to your client's matter. Where you cannot reconcile these two duties, then the protection of confidential information is paramount. You should not continue to act for a client for whom you cannot disclose material information, except in very limited circumstances, where safeguards are in place. Such situations often also give rise to a conflict of interests which is discussed in Chapter 3.

The outcomes in this chapter show how the Principles apply in the context of confidentiality and disclosure.

Outcomes

You must achieve these outcomes:

O(4.1)

you keep the affairs of clients confidential unless disclosure is required or permitted by law or the client consents;

O(4.2)

any individual who is advising a client makes that client aware of all information material to that retainer of which the individual has personal knowledge;

O(4.3)

you ensure that where your duty of confidentiality to one client comes into conflict with your duty of disclosure to another client, your duty of confidentiality takes precedence;

O(4.4)

you do not act for A in a matter where A has an interest adverse to B, and B is a client for whom you hold confidential information which is material to A in that matter, unless the confidential information can be protected by the use of safeguards, and:

- (a) you reasonably believe that A is aware of, and understands, the relevant issues and gives informed consent;*

- (b) *either:*
- (i) *B gives informed consent and you agree with B the safeguards to protect B's information; or*
 - (ii) *where this is not possible, you put in place effective safeguards including information barriers which comply with the common law; and*
- (c) *it is reasonable in all the circumstances to act for A with such safeguards in place;*

O(4.5)

you have effective systems and controls in place to enable you to identify risks to client confidentiality and to mitigate those risks.

Indicative behaviours

Acting in the following way(s) may tend to show that you have achieved these outcomes and therefore complied with the Principles:

IB(4.1)

your systems and controls for identifying risks to client confidentiality are appropriate to the size and complexity of the firm or in-house practice and the nature of the work undertaken, and enable you to assess all the relevant circumstances;

IB(4.2)

you comply with the law in respect of your fiduciary duties in relation to confidentiality and disclosure;

...

IB(4.4)

where you are an individual who has responsibility for acting for a client or supervising a client's matter, you disclose to the client all information material to the client's matter of which you are personally aware, except when:

the client gives specific informed consent to non-disclosure or a different standard of disclosure arises;

...

IB(4.5)

not acting for A where B is a client for whom you hold confidential information which is material to A unless the confidential information can be protected.

...'

16. The consequences of getting it wrong may 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. Any attempt to do so may give rise to an interim application, as happened in TSB v Robert Irving & Burns, and in the recent case of Love v Fawcett [2011] EWHC 1686 (Ch) (contested application two weeks before trial in relation to witness statement of B, solicitor previously acting for claimant and defendant; claimant ordered to withdraw B's witness statement and serve two new witness statements of B, one of which was to contain any arguably privileged material, so trial date could be retained and further issues of privilege could be restricted so far as possible and determined by trial judge).
 - b. The insured may have a cause of action against the solicitor for breach of contract. Remedies may include damages and, in appropriate cases, injunctive relief.
 - c. There may be disciplinary proceedings against the solicitor for breach of the Code of Conduct and/or a service complaint to the Legal Ombudsman, with a maximum compensatory award of £30,000 excluding interest, costs and any limiting or refund of fees.

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