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By Jennifer A. Becker

Zenith Ins. Co. v. O'Connor (2007) 148 Cal. App. 4th 998

The Second District holds that counsel for a carrier has not attorney-client relationship with the carrier's reinsurer.

Zenith Insurance Company (Zenith), entered into a contract with Royal Insurance Company (Royal) to reinsure 100% of Royal's exposure under certain liability policies. Royal retained Cozen O'Connor (Cozen) to defend claims against its insured. Zenith contacted Cozen regarding Royal's failure to seek contribution from other insurers who, as Zenith understood it, were also on the risk. Cozen advised Zenith that because of certain conflicts of interest, Cozen was not able to pursue any of the potential contribution claims. Zenith then demanded that Royal retain other counsel to pursue those claims and Royal did so.

Royal ultimately agreed to pay indemnity due to claims against its insured and then demanded payment from Zenith. Zenith refused to pay Royal's demand and filed a lawsuit against Royal for mishandling the claims. In an amended complaint Zenith added a cause of action against Cozen for professional negligence. The trial court sustained a demurrer to Zenith's claim that it had an attorney-client relationship with Cozen.

Zenith acknowledged that there was no express agreement with Cozen to provide legal services. Zenith argued there was an implied contract and that it was the intended beneficiary of the Royal-Cozen agreement. Zenith maintained that this relationship existed based on Royal's retention of other counsel to pursue the contribution claims that Cozen could not pursue due to conflicts of interest; Cozen's strategy discussions with Zenith; Royal's assurance that Cozen was looking out of both insurers' best interests; Cozen's knowledge that Zenith had reinsured 100% of Royal's obligation; Zenith's reliance on Cozen's services; Cozen's failure to state that it did not represent Zenith or that it should seek separate counsel; and the fact that Zenith would ultimately be paying Cozen's fees due to its agreement with Royal.

Zenith alleged that Cozen improperly maintained relationships with other clients that resulted in a conflict of interest with Zenith and failed to disclose such conflicts to Zenith and Royal; failed to act in Zenith's best interests; failed to handle the underlying

claims properly; and failed to pursue rights of contribution and indemnity from third parties with respect to the underlying claims.

The Court of Appeal held that a contract of reinsurance does not alter the ceding insurer's relationship with its policyholder, as it still remains responsible for defending, settling and paying covered claims against the insured. The ceding insurer has a right to seek reimbursement from the reinsurer for the reinsured portion of the claim. Royal expressly retained the exclusive power to investigate, defend and settle any claim and Zenith had no right or authority to participate. A reinsurer has no control over claims settlement and cannot raise coverage defenses to avoid paying its share of the loss.

The Court noted that while an attorney owes a duty of care to an intended beneficiary of the attorney's services, a prerequisite of this theory is that both the attorney and the client intend that the legal services benefit the third party. Incidental benefit to a third party is not sufficient. Royal and Zenith did not have identical interests and their interests were potentially adverse since Zenith had no right to dictate how to resolve the claim. Cozen was therefore ethically precluded from representing both Royal and Zenith and could not have intended to benefit Zenith. This factor is dispositive since an attorney's undertaking should be the result of a conscious decision and the attorney given the opportunity to consider the third party's interests and decline the representation if there are conflicts of interest. An adverse party cannot be the intended beneficiary of an attorney's services because to hold otherwise would compromise the attorney's

undivided, fiduciary duty of loyalty owed to his client.

Zenith's obligation to reimburse Royal for Cozen's fees did not create an obligation. Mere payment of fees does not establish an attorney-client relationship. Otherwise every reinsurer would be in an attorney-client relationship with the ceding insurer's counsel, regardless of whether this is ethically proper due to conflicts of interest.

Cozen's communication with Zenith was not relevant because Cozen's communications were to assist Royal in complying with its statutory obligation to provide claim settlement and adjustment information.

Nor could Zenith claim an implied relationship. Zenith's belief in an attorney-client relationship, standing alone, cannot create it. The intent and conduct of the parties controls the creation of the relationship. In the context of this commercial arrangement between a ceding insurer and a reinsurer Zenith had no obligations to the insured; no involvement in the selection of counsel; and no right to participate in the litigation. Zenith's rights to claims files, legal opinions and access to Royal's agents explains the communications between Zenith and Cozen.

Cozen refused to follow Zenith's direction to seek indemnity from other tortfeasors negating any conclusion by Zenith that Cozen was its counsel.

Comment: Courts are skeptical of claims that third parties who are potentially or actually adverse to a client are entitled to the benefit of an attorney-client relationship.

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