

INSURER MUST PAY INSURED’S COUNSEL A REASONABLE HOURLY RATE WHEN RESERVING RIGHT TO DENY COVERAGE

What You Need to Know

Massachusetts law now provides an insured with greater leverage against its insurer to insist that the insured be defended by its private counsel.

The Massachusetts Appeals Court recently determined that an insurance company is obliged to pay reasonable legal fees to its insured’s private counsel if the insurer reserves its right to withdraw coverage. The decision, Northern Security Insurance Co., Inc. v. R.H. Realty Trust, 78 Mass. App. Ct. 691 (2011), will permit more freedom of choice for insureds in selecting attorneys to defend their interests. This advisory explains the practical effect of this important decision for insureds.

The Effect of an Insurer Reserving its Rights when Defending its Insured

Liability insurers often agree to defend lawsuits brought against their insureds under a “reservation of rights.” When a liability insurer does so, it reserves its right to withdraw coverage for the claims brought against its insured. The insured then is exposed to the risk that it may be required to pay “out of pocket” if it loses the case.

Massachusetts law provides that if an insurer reserves its right to withdraw coverage then the insured has the right to hire its own private counsel to defend the claims at the insurer’s expense. However, insurers often have refused to pay the insured’s private counsel’s regular hourly rates. Instead, insurers often have insisted on paying only the reduced hourly rates they pay their “panel counsel” (attorneys with whom the insurer has an ongoing relationship and to whom the insurer sends

large volumes of work in exchange for lower hourly rates). Prior to the Northern Security decision, when the insurer took this position the insured was faced with two unsatisfactory alternatives. Either the insured could pay the difference between panel counsel’s hourly rate and private counsel’s hourly rate, or the insured could allow the insurer’s panel counsel to defend. The Northern Security decision drastically alters the balance of power between insurer and insured on this issue, permitting the insured greater freedom of choice for its defense counsel.

The Northern Security Decision

In Northern Security, the insurer reserved its right to withdraw coverage for the claims against its insured, and the insured retained private counsel to defend. The insured and private counsel then agreed to an hourly rate for the attorney’s work that was substantially above what the insurer paid its panel counsel. The insurer refused to pay the agreed-upon hourly rate, and sought a declaration from the Court providing that it only had to pay private counsel the same lower hourly rates it paid its panel counsel. Private counsel counterclaimed, asserting that the insurer’s refusal to pay the agreed-to hourly rate constitutes unfair or deceptive business practices.

The Court sided with private counsel. The Court determined that if an insurer reserves its right to withdraw coverage and the insured retains private counsel, then the insurer must pay private counsel’s “reasonable charges” based on “market rates.” What constitutes a market rate for private counsel is a factual determination, and includes considerations such as the hourly rate charged by attorneys with similar skills, private counsel’s reputation, and the complexity of the case. Often the hourly rate ordinarily charged by private counsel will be the determining factor.

What this Means to the Insured

Northern Security is important because it allows an insured, where the insurer has reserved its right to withdraw coverage, to freely retain private counsel at the insurer's expense. Because an insurer must pay reasonable charges based on market rates, the insurer no longer can pressure its insured into retaining less expensive panel counsel. The insured now can retain counsel who already is familiar with the insured's business, with whom the insured has a pre-existing

relationship, and in whom the insured has the confidence that a vigorous and quality defense will be asserted on its behalf.

If an insured is sued and the insurer reserves its right to withdraw coverage, the insured should retain private counsel of its choosing and insist that the insurer pay private counsel's market rates. Private counsel often can, and should, assist the insured in making such a demand.

*This client advisory was written by **Kurt B. Fliegauf**. If you wish to inquire further about this advisory, please contact him or your attorney at **Conn Kavanaugh Rosenthal Peisch & Ford, LLP**.*

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