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Liability of Insurers for Conduct of Insurer-Retained Defense Counsel under the Restatement, Law of Liability Insurance

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Early versions of what is now § 12 of the Restatement, Law of Liability Insurance provided that a liability insurer exercising its right to defend by hiring counsel to defend its policyholder is vicariously liable for any breach of professional obligation by defense counsel and related service providers. Imposing vicarious liability on insurers for the conduct of defense counsel would have resulted in a major change in the law in the majority of jurisdictions that treat defense counsel as independent contractors whose conduct cannot be imputed to the retaining insurer. Comment b to § 12 in previous drafts justified imposing vicarious liability on insurers without regard for whether the attorney is an employee or an independent contractor on the grounds that doing so will give liability insurers an "incentive" to monitor the actions of defense counsel and because insurers are "in the best position to shift or spread losses if they do occur." The drafters noted that "[t]he insurer may shift the risk to the defense lawyers through, for example, an indemnity agreement with a liability insurance requirement."

Broad Vicarious Liability Rejected

Given the lack of authority for the broad vicarious liability rule in earlier drafts, and the Restatement's goal of describing the law as it is, the Restatement's most recent draft replaces the broad rule imposing vicarious liability for the acts of independent contractors with a narrow vicarious liability rule that more closely conforms to the Restatement Third, Agency, and a direct-liability rule that is consistent with traditional tort liability while clarifying that part of insurers' duty of reasonable care includes making sure that their defense lawyers have adequate liability. Section 12 now imposes liability on an insurer for breach of insurer-appointed defense counsel's professional duties when either "(1) [d]efense counsel is an employee of the insurer

acting within the scope of employment; or (2) [t]he insurer negligently selects or supervises defense counsel, including by retaining a lawyer who carries inadequate liability insurance." Comment (b) to § 12 points out that requiring insurers to confirm the adequacy of defense counsel's liability insurance provides insureds with adequate protection without the need to abandon the traditional distinction between employees and independent contractors.