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Washington Makes it Riskier for Insurers to Talk to Lawyers

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In Washington, a lawyer owes a duty of care to a non-client third party, if the lawyer's work is "intended to benefit" that party. Where a non-client insurer hires a lawyer to represent its insured, some states presume that intent, so long as the interests of the insurer and the insured do not conflict. But in *Stewart Title Guaranty Co. v. Sterling Savings Bank*, a malpractice suit brought by a title insurance company against the attorneys it hired to represent an insured lender, the Washington Supreme Court declined to adopt this presumption. Consequently, it now takes more than the absence of a conflict to establish that insureds' attorneys owe a duty of care to the insurer. Unfortunately, the court's unanimous, *en banc* opinion gave no indication about what kind of additional evidence might suffice. As a result, plaintiffs who sue insured defendants now have an opening to demand access, through discovery, to communications between defense counsel and their clients' insurers. As conditions on a loan for the purchase and development of real property, Sterling Savings received a first-position security interest in the land, and Stewart Title issued a policy, guaranteeing the priority of Sterling's interest. When the loan closed, however, the borrower's contractor had already started its development work. In April 2008, as the real estate market fell, the contractor filed a mechanics' lien, which related back to the date on which development began. Thus, the entire lien had priority over Sterling's interest. The contractor then filed suit to establish its lien and foreclose against the property. Sterling hired counsel to defend the action, and Stewart Title subsequently agreed to retain those attorneys on the bank's behalf. Sterling's lawyers disagreed with Stewart over whether to assert a defense based on equitable subrogation. Counsel argued that the defense was not viable, and also that it would disserve Sterling's interests to delay resolution of the contractor's suit, because the value of the bank's remaining interest in the underlying property was rapidly falling. The attorneys agreed to amend Sterling's answer, but the contractor was awarded summary judgment anyway, and Stewart Title paid to remove the lien and restore Sterling's priority. Stewart Title then sued Sterling (which had allegedly known about the contractor's work) and its attorneys (for malpractice). Stewart could not assert *Sterling's* rights, under a subrogation theory, because it was also suing Sterling itself. But the trial court permitted the insurer to sue in its own behalf, on the theory that the attorneys' work was "intended to benefit" Stewart. It then granted summary judgment to the attorneys, finding that there had been no malpractice. According to the trial court, the attorneys owed a duty of care to their client's insurer, because (among other reasons)

the interests of insurer and insured were "aligned." In fact, there were good reasons to think otherwise: Stewart did not share Sterling's interest in resolving the case quickly, before the value of the property declined further; Stewart and Sterling's counsel disagreed about the subrogation defense; and Stewart ultimately sued Sterling, claiming it had known about the mechanics' lien all along. But the Supreme Court left this finding intact; it simply held that "an alignment of interests is insufficient to support a duty of care to a nonclient." On that basis, it held that Stewart had failed to establish that the attorneys owed it a duty of care, and it affirmed summary judgment on that basis alone. In February, in *Cedell v. Farmers Ins. Co.*, the same court created a presumption that the attorney-client privilege does not protect communications about claims handling from being disclosed in a subsequent, first-party bad faith suit. As a practical matter, insurers must now assume that their communications with Washington coverage counsel will be subject to (at least) *in camera* review. In *Stewart Title*, the Court left insurers without any guidance about how they can securely establish a privileged relationship with lawyers who represent their insureds. Until that issue is resolved, plaintiffs will be pursuing communications between defense counsel and insurers in discovery, and insurers will be well advised to manage such communications carefully.

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