

**ETHICAL CURVE BALLS THROWN AT LAWYERS HANDLING INSURANCE
COVERAGE AND DEFENSE MATTERS**

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Much has been written about the duties and ethical obligations of insurance defense counsel and their responsibilities toward their client, the insured. What has not been written about as much or been the subject of much case law is the duties and obligations of coverage counsel. Although coverage counsel represents the insurer and the insured is not a client, are there any situations in which coverage counsel may have obligations towards the insured? How do those obligations, if any, change when the insured is unrepresented? The body of law pertaining to the ethical obligations of coverage counsel is still developing, thus in large part we must look to other types of practices to try to evaluate these potential obligations. These ethical issues can present dilemmas for attorneys that have not been addressed by the courts. They require us to consider our individual state's rules of professional conduct and a myriad of other sources of law. This paper discusses selected issues for coverage counsel and insurance defense counsel. We stand on the threshold of what is an evolving area of insurance law that requires our attention.

**DUTIES AND OBLIGATIONS OF COVERAGE COUNSEL WHEN INSURED IS
UNREPRESENTED**

There is no one source of law that governs the ethical obligations of counsel practicing in the United States. What we have is a patchwork of state disciplinary authorities, statutes, codes, and regulations. Typically each state also has its own

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“oracle” that hands down ethics opinions, which the lawyers who practice in the state are expected to know and follow. To add further complexity, each state has federal courts which quite often have their own rules, regulations, internal operating guidelines, and standing orders governing the lawyers who practice before them. It is from this thicket that lawyers must endeavor to discern their ethical obligations, and particularly in this area, must try to evaluate what the obligations will be in the future. It is within this context that we are beginning to see the impact of the Restatement (Third) Governing Lawyers (the “Restatement”). We are still in the early stages of acceptance by the courts across the country of various sections of the Restatement. Nevertheless, to try to highlight the trends that we will likely see across the country, we have referred to the Restatement even though it may or may not be authoritative on any given point in all jurisdictions. It at least is unified, and because of the depth and breadth of analysis should be persuasive authority on many issues.

The Restatement sets forth the obligations of an attorney when dealing with an unrepresented party.² Section 103 provides that:

In the course of representing a client and dealing with a nonclient who is not represented by a lawyer:

- (1) the lawyer may not mislead the nonclient, to the prejudice of the nonclient, concerning the identity and interests of the person the lawyer represents; and
- (2) when the lawyer knows or reasonably should know that the unrepresented nonclient misunderstands the lawyer’s role in the matter, the lawyer must make reasonable efforts to correct the misunderstanding when failure to do so would materially prejudice the nonclient.

² Many of you may be wondering how you missed the Restatement “One and Two” governing lawyers. You should not feel too bad. The Restatement for years was circulated in various drafts. It was only a couple of years ago that a “hard bound” set of volumes emerged, and they were named the Restatement (Third).

Does coverage counsel have an ethical obligation to determine if the insured is represented? Logic and common sense suggest that an attorney should be obligated to inquire. The rules of professional conduct and the Restatement set forth rules an attorney should abide in dealing with a nonclient, both represented and unrepresented. It would thus seem that an attorney would have a duty to inquire if a nonclient is unrepresented in order to follow the disciplinary rules.

In some jurisdictions, when a lawyer contacts an unrepresented person on behalf of a client, the attorney must identify himself and his representational role. *See Louisiana State Bar Ass'n v. Harrington*, 585 So.2d 514, 517 (La. 1990) (lawyer's failure to identify himself as a lawyer or carefully explain role in matter violated Rule 4.3 of the Rules of Professional Conduct of the Louisiana State Bar Association); *In re Air Crash Disaster Near Roselawn, Indiana on October 31, 1994*, 909 F.Supp. 1116, 1123 (N.D. Ill. 1995) (questionnaire sent to Defendant's employees that did not disclose on its face the fact that it was prepared on behalf of plaintiffs' attorney and implied that it was of a neutral and unbiased character violated Rule 4.3 of Rules of Professional Conduct for the Northern District of Illinois).³

Nevertheless, the Restatement section regarding an attorney's obligations in dealing with a represented nonclient only apply when the lawyer *knows* that the nonclient is represented by counsel. *See* Restatement (Third) Governing Lawyers, § 99 ("A lawyer

³ The rules in these two cases were modeled after Rule 4.3 of the Model Rules of Professional Conduct, which provides that:

In dealing on behalf of a client with a person who is not represented by counsel, a lawyer shall not state or imply that the lawyer is disinterested. When the lawyer knows or reasonably should know that the unrepresented person misunderstands the lawyer's role in the matter, the lawyer shall make reasonable efforts to correct the misunderstanding.

representing a client in a matter may not communicate about the subject of the representation with a nonclient whom the lawyer knows to be represented in the matter by another lawyer[.]”). However, there is a split in authority on the issue.

Some courts have found that an attorney is in violation of the rules of professional conduct governing dealing with an unrepresented person when an inquiry into whether the nonclient is represented by counsel is not made. See *Monsanto Co. v. Aetna Cas. & Sur. Co.*, 593 A.2d 1013 (Del. Super. Ct. 1990) (attorneys for insurer who hired investigators to contact former employees of the insured violated Rules 4.2 and 4.3 of the Rules of Professional Conduct governing dealing with unrepresented person and governing communication with person represented by counsel when the investigators did not determine if the former employees were represented by counsel); *Upjohn Co. v. Aetna Cas. & Sur. Co.*, 768 F. Supp. 1186, 1215 (W.D. Mich. 1991) (Rule 4.3 of the Michigan Rules of Professional Conduct suggest that a lawyer should inquire whether a person is represented by an attorney and should clarify misunderstandings as to the lawyer’s interest and role in the matter to which the contact or communication relates).

On the other hand, courts have concluded that an attorney does not violate ethical rules by not inquiring whether an individual is represented by an attorney under certain circumstances. *Federal Savings & Loan Ins. Corp. v. Hildenbrand*, 1989 WL 107377 (D. Colo.) (Code of Professional Responsibility section regarding attorney’s dealings with represented party requires actual knowledge of representation and therefore attorney has no duty to inquire as to whether a person has legal counsel in the specific matter); ABA Formal Ethics Opinion No. 95-396 (1995) (no duty to inquire.).

As the discussion above indicates, there is no clear authority to guide coverage counsel in deciding whether to inquire whether the insured is represented by personal counsel as to coverage issues. As a “best practices” standard it would be wise to inquire whether the insured has personal counsel. But the lack of any inquiry by coverage counsel does not appear to be a clear violation of ethical obligations, at least in many jurisdictions. It may be that the circumstances of each situation where coverage counsel in dealing with the insured, such as the insured’s level of sophistication, will dictate whether or not coverage counsel is obligated to inquire whether the insured is represented by personal counsel. When disclosures are made, counsel should disclose the identity and interests of coverage counsel’s client, the insurer. At a minimum, coverage counsel should identify that the insurance company is his client and that his goal is to explore the factual background of the claims against the insured so as to determine if any of the claims against the insured are not covered by the insurance policy.

A second requirement, which may be trickier for coverage counsel under certain circumstances, arises when the insured misunderstands coverage counsel’s role in the matter. When coverage counsel knows or reasonably should know that the insured misunderstands coverage counsel’s role, coverage counsel may be required to take steps to correct the misunderstanding when failure to do so would materially prejudice the nonclient. Courts have found that an attorney in this situation should, at a minimum, spell out the exact nature of her role, whom she represents, and that she does not represent the nonclient. *See e.g. Branham v. Norfolk and Western Railway Co.*, 151 F.R.D. 67 (S.D. W. Va. 1997). Even if an insured expresses no confusion, the lawyer should be mindful of the individual insured and the context to avoid any type of

misunderstanding. *See* ABA/BNA Lawyers Man. on Prof. Conduct 71:505. Application of this section therefore depends in significant part on the lawyer's role, the status and role of the unrepresented nonclient, and the context. *See* Restatement (Third) Governing Lawyers, § 103, cmt. b.

Examining coverage issues may be an area where counsel must have a heightened awareness of any confusion or misunderstanding on the part of the insured. The potential for misunderstanding will depend for the most part on the background of the insured. If the insured is a sophisticated business person, or an attorney, then a misunderstanding does not seem likely and disciplinary violations should be of less concern to coverage counsel. However, if the insured is not sophisticated or lacks any legal background, that individual may not fully comprehend coverage counsel's role, let alone understand that a determination is being made about whether the claim(s) against the insured are covered by the insurance policy.

On the other end of the spectrum, coverage counsel must be careful not to be "coopted" by the insured as the insured's lawyer. We have observed a trend of non-lawyers who after being interviewed by coverage counsel later asserted that coverage counsel "gave them legal advice" or told them they "didn't need a lawyer" and then asserted that the coverage counsel was their lawyer. This is a particularly troubling problem because in most jurisdictions the issue of whether an attorney forms an attorney client relationship with a client is a question of fact that turns on the intent of the parties.⁴ We have seen several instances in which a letter stating the attorney's role, before any

⁴ *See Roberts v. Healey*, 991 S.W.2d 873, 880 (Tex. App.—Houston [14th Dist.] 1999, *pet. denied*) ("In order to establish an attorney-client relationship, both parties must explicitly or by their conduct manifest an intention to create it.").

interview, has been the critical issue that determined whether the insured was successful in turning coverage counsel into “their lawyer”.

AT WHAT POINT IN TIME DOES COVERAGE COUNSEL HAVE AN OBLIGATION TO TELL THE INSURED THAT HE MAY WANT TO OBTAIN PERSONAL COUNSEL AND/OR ADVISE THE INSURED THAT HE NEEDS TO GET PERSONAL COUNSEL?

If the insured is unrepresented by personal coverage counsel, is there an obligation on the part of coverage counsel to advise the insured to obtain personal counsel and if so, at what point in time does that obligation arise? The comment to Rule 4.3 of the Model Rules of Professional Conduct states that “[d]uring the course of a lawyer’s representation of a client, the lawyer should not give advice to an unrepresented person other than the advice to obtain counsel.” It is clear that lawyers are permitted to advise an unrepresented person to obtain independent counsel. Lawyers, however, are generally not required to advise an unrepresented person to seek counsel. *See W.T. Grant Co. v. Haines*, 531 F.2d 671, 675 (2nd Cir. 1976) (plaintiff’s attorney did not violate Code of Professional Responsibility by not advising employee of Defendant that he had a right to counsel before interrogating him, immediately prior to initiation of the litigation)⁵; *Marcus v. Sullivan*, 701 So.2d 660, 663 (Fla. 3rd Dist. Ct. App. 1997) (attorney need not require the payee of a note to secure counsel prior to signing a note to secure the legal fees of another).

⁵ The case was interpreting Model Code of Professional Responsibility, Disciplinary Rule 7—104(A), which regulates an attorney’s conduct when communicating with one of adverse interest and has been adopted by the New York State Bar Association. It provides in part that “[d]uring the course of his representation of a client a lawyer shall not:

- (2) Give advice to a person who is not represented by a lawyer, other than the advice to secure counsel, if the interests of such person are or have a reasonable possibility of being in conflict with the interests of his client.”

But what if the unrepresented insured misunderstands coverage counsel's role in the matter despite coverage counsel's reasonable efforts to correct the misunderstanding? Courts have held that where an unrepresented party misunderstands an attorney's role in a specific matter, and the attorney is aware of the misunderstanding, an attorney violates Rule 4.3 by not advising the unrepresented party to seek legal counsel. *See In re Faraone*, 722 A.2d 1 (Del. 1998) (purchaser's attorney committed professional misconduct by failing to advise sellers to seek legal counsel when the sellers asked the purchaser's attorney about their potential liability with respect to property transfers). And, the circumstances of a case may require that an attorney advise an unrepresented party to seek legal counsel. *See Bohn v. Cody*, 832 P.2d 71 (Wash. 1992), *modified on other grounds by Trask v. Butler*, 872 P.2d 1080 (Wash. 1994). In *Bohn*, the parents of the borrower sued borrower's attorney after the borrower failed to repay a loan made by the parents. The parents, before loaning money to their daughter, met with their daughter's attorney to discuss aspects of the loan. At the outset, the attorney advised the parents that he represented the daughter and her husband in the matter and then proceeded to discuss the transaction with the unrepresented parents. The Supreme Court of Washington held that it was not enough that the attorney told the parents that he was not acting as their attorney in the matter. *See Bohn v. Cody*, 832 P.2d at 77. The Court stated that the attorney should have advised the unrepresented party to seek independent legal counsel at the outset, before the borrower's attorney proceeded to discuss the transaction with the lenders. *Id.*⁶

⁶ Courts in certain practice areas such as marital property law have gone even further and held that advising an unrepresented party to seek independent legal counsel is not enough. *See In re Marriage of Foran*, 834 P.2d 1081 (Wash. App. Ct. 1992). Although counsel for the husband advised the wife to seek independent legal counsel, the Court held that the attorney should have

WHERE THERE ARE COVERAGE DEFENSES TO SOME PORTION OF A CLAIM, ARE THERE ETHICAL CONSIDERATIONS FOR COVERAGE COUNSEL CONCERNING DISCLOSURE OF CONDUCT THAT IS NOT COVERED?

Coverage counsel's job in investigating claims against an insured frequently is to determine what aspects of a claim are potentially covered or not covered by the insured's policy. What if the scope of the conduct discovered is criminal in nature? Does coverage counsel have a duty to not disclose that information to authorities? If there is an examination under oath, does coverage counsel have an obligation to bring out the conduct under oath? Is there an obligation to "Mirandize" an insured? Are there any limitations on what coverage counsel can disclose to the insurer regarding what is learned in an examination?

We have found no specific disciplinary authority that would bar coverage counsel from disclosing conduct of the insured that is potentially not covered by the insured's policy. Instead, coverage counsel's obligations will almost always require disclosure of the information, to his client, the insurer. Disclosing the information to the insurer is going to advance the insurer's interests.⁷ And the matters are generally within coverage counsel's scope of representation, as coverage counsel's overriding obligation is to examine the claims against the insured to determine if any aspect of the claims against

gone further and explained to the wife why independent legal counsel was so important before entering into the prenuptial agreement. *Id.* at 1088. Nevertheless in the ordinary situation of coverage counsel communication with an insured, the factors involved in *Foran* are not present. That is, the husband and wife relationship is a fiduciary relationship in which the mere appearance of overreaching may be sufficient to trigger greater safeguards. The insurer versus insured relationship is contractual in nature and should not justify the imposition of further obligations on counsel.

⁷ One of a lawyer's duties to the client is to "proceed in a manner reasonably calculated to advance a client's lawful objectives, as defined by the client after consultation[.]" See Restatement (Third) Governing Lawyer, §16(1).

the insured are beyond the coverage of the insured's policy.⁸ Additionally, it is logical to conclude that coverage counsel is obligated to disclose the conduct potentially not covered by the insured's policy as attorneys are generally permitted to disclose a client's confidential information if that will advance the client's interests.⁹

Furthermore, depending on the insured's background, coverage counsel may have an obligation of disclosure of conduct that may go beyond advising the insurer. For instance, if the insured is an attorney with an E & O policy, coverage counsel may have an obligation to report certain misconduct to the appropriate disciplinary bodies. For example, Texas, like most every other jurisdiction, requires attorneys to report certain misconduct of fellow attorneys to the state's disciplinary body.¹⁰

Scenarios where coverage counsel could be obligated to not disclose conduct potentially outside the insured's policy, or be restricted in how thoroughly coverage counsel investigates the conduct, are scant. If the conduct involves information that

⁸ *Id.*

⁹ "A lawyer may use or disclose confidential client information when the lawyer reasonably believes that doing so will advance the interests of the client in the representation." *See id.* at § 61.

¹⁰ In Texas, the reporting rule is set forth in Rule 8.03 of the Texas Disciplinary Rules of Professional Conduct. Rule 8.03 provides:

- (a) Except as permitted in paragraphs (c) or (d), a lawyer having knowledge that another lawyer has committed a violation of applicable rules of professional conduct that raises a substantial question as to that lawyer's honesty, trustworthiness or fitness as a lawyer in other respects, shall inform the appropriate disciplinary authority.

Paragraph (c) applies to peer assistance programs aimed at assisting lawyers impaired by chemical dependency, alcohol or mental illness. Paragraph (d) applies to confidential information; *See* Bruce A. Campbell, *To Squeal or Not to Squeal: A Thinking Lawyers Guide to Rule 8.03*, published in the January, 1999 edition of the *Tex. B. J.*; reprinted *Fla. Coastal L. Rev.*, Vol. 1, Summer (1999).

coverage counsel reasonably knows the insured may not reveal without violating a duty of confidentiality to another imposed by law, then coverage counsel may be under an obligation not to seek to obtain the information.¹¹ For example, the conduct may involve attorney-client or patient-doctor privileged information. The extent that coverage counsel investigates and describes the conduct that falls outside policy coverage may be restricted if that investigation is unduly burdensome or harassing to the insured.¹² Finally, coverage counsel may be restricted in how thoroughly he investigates the conduct that may fall beyond the insured's policy coverage if to do so would unnecessarily increase the client insured's litigation costs.

**WHAT ARE INSURANCE DEFENSE COUNSEL'S OBLIGATIONS TO THE
INSURED WHEN THE CLAIM AGAINST THE INSURED INVOLVES
COVERAGE ISSUES**

To this point we have focused on the obligations and duties of coverage counsel towards the insured. But what obligations does insurance defense counsel have towards the insured when coverage defenses arise or reasonably could arise? Generally speaking, insurance defense counsel is not required to know coverage law.¹³ Insurance defense counsel is retained to defend the lawsuit on which liability is claimed. They are not retained to provide coverage advice.¹⁴ Nor are they retained to investigate coverage matters—that is the job of coverage counsel.

¹¹ See Restatement (Third) Governing Lawyers, § 102.

¹² See Model Rules of Professional Conduct, Rule 4.4 (“[i]n representing a client, a lawyer shall not use means that have no substantial purpose other than to embarrass, delay, or burden a third person, or use means of obtaining evidence that violate the legal rights of such a person.”).

¹³ See Ellen S. Pryor & Charles Silver, *Defense Lawyers' Professional Responsibilities: Part II—Contested Coverage Cases*, 15 GEO. J. LEGAL ETHICS 29 (2001), at p. 65.

But many insurance defense lawyers are familiar with coverage issues and are able to spot when coverage defenses are possible, or likely. If an insurance defense counsel becomes aware of a coverage defense during his representation of the insured, there are circumstances where he may have an obligation to disclose the coverage defense to his client.¹⁵ Some commentators have argued that insurance defense counsel may also be required under certain circumstances to advise the insured that the coverage defense is beyond the scope of his representation and that the insured should seek independent legal counsel for the matters that are beyond the scope of his representation.¹⁶ The duties to warn and educate the insured may arise when insurance defense counsel comes into possession of confidential information that may also be coverage-related and therefore adverse to the insured. When this is the case, there may be instances when counsel is required to warn of the possible consequences of the information.¹⁷ Nevertheless, that theoretical obligation has been rejected by the better reasoned authority.

¹⁴ *Id.* at 65-66. See Restatement (Third) Governing Lawyers, § 16 (lawyers must “act with reasonable competence and diligence” on matters “within the scope of the representation”).

¹⁵ See Pryor & Silver, *supra* note 13, at 70.

¹⁶ *Id.* at 69-70. The authors cite *Nichols v. Keller*, 19 Cal. Rptr. 2d 601 (Cal. App. Ct. 1993). *Nichols* was a workman’s compensation case where the California court held that an attorney, who was a workman’s compensation expert and was retained to prosecute the workman’s compensation claim against the employer, should have alerted the injured employee to the possibility of a third-party claim. *Id.* at 608. However, *Nichols* does not require unsolicited action on the part of an attorney, reaffirms the right of a lawyer to limit the scope of his representation, and does not require the lawyer to broaden the scope of his contract with the client. Therefore, the attorney in *Nichols* was not required to file the third-party claim or represent the client in the third-party matter. See *Berggreen v. Gordon*, 1994 WL 700244 *7 (N.D. Ill. 1994).

¹⁷ See Pryor & Silver, *supra* note 13, at 88; See also Restatement (Third) Governing Lawyers, § 134, cmt. f (“When there is a question whether a claim against the insured is within the coverage of the policy, a lawyer designated to defend the insured may not reveal adverse confidential client

CONCLUSION

The body of law pertaining to the ethical obligations of coverage counsel is not well developed. The Restatement and the authorities cited above will undoubtedly be expanded upon in the future. We will have to wait and see how these ethical issues develop for attorneys handling insurance coverage issues. Hopefully, the Restatement and authorities cited above will better equip counsel to handle the ethical curve balls that come their way in this practice area.

information of the insured to the insurer concerning that question without explicit informed consent of the insured.”).