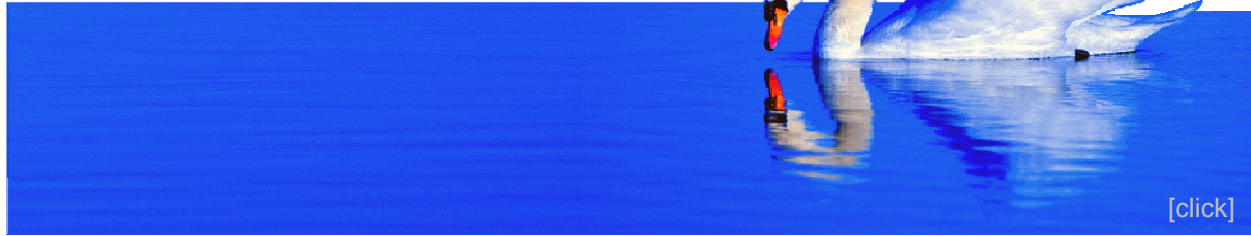


Reflections on Ethical Issues In the Tripartite Relationship



By Bruce A. Campbell¹

Introduction

In most areas of the practice of law, there are a number of ethical issues that arise on a frequent basis. The law involving insurance is no different because there are a number of issues that arise with some regularity. Below is a discussion of some of the more common issues that arise for lawyers who handle insurance related matters.

Potential for Conflicts of Interest

Within the tripartite relationship between insurer, insured, and defense counsel, there is often an inherent possibility for conflicts of interest to exist. The Restatement (Third) of the Law Governing Lawyers points out that a conflict of interest exists “if there is a substantial risk that the lawyer’s representation of the client would be materially and adversely affected by the lawyer’s own interests or by the lawyer’s duties to... a third person.” These conflicts of interest come from the competing goals of the parties involved: the insurer, the insured, and defense counsel. While the insured is usually looking for the best defense available, the insurer is typically looking to save costs and pay out the least amount of money possible. The attorney is left in the precarious position of providing a defense for the insured while still considering the interests of the insurer. Adding to the

difficulty for the attorney is the matter of precisely whom the attorney is representing. Unfortunately, there are differing views among the jurisdictions as to whether the attorney is representing only the insured, both the insurer and the insured, or some hybrid of the two. Depending on how that question is answered, the attorney’s duties can change drastically.

What types of potential conflicts exist?

Some of the most common potential conflicts stem from (1) insurer litigation guidelines which are sometimes coupled with third-party audits; and (2) when the insurer reserves its rights under the policy.

Billing Guidelines

Litigation controls, known as billing guidelines, can cover a variety of tasks that counsel may perform in providing a defense to the insured. Common areas covered within such guidelines include, among other things, whether experts and investigators may be hired, whether depositions may be taken, the extent of computer research permitted, whether written discovery may be sent, and how many attorneys may attend hearings and trials. Since the attorney’s duty is to the insured, he must determine

whether the carrier's guidelines impede or compromise the exercise of his professional judgment. If the attorney permits the guidelines to compromise his decision on how to handle the case, the attorney breaches his duty to the insured by allowing the insurer to interfere with his professional judgment. Identifying precisely when that professional judgment is compromised is not always easy to determine. There is a national trend towards cautioning insurance defense attorneys against the ethical pitfalls inherent in submitting to certain requirements set forth by carriers promoted for cost reduction.² For example, in Montana lawyers hired by insurers challenged the insurer's billing guidelines and procedures which required prior approval from the insurer before taking actions such as scheduling depositions, and legal research, contending that they violated ethics rules.³ The court held that the prior approval requirements, due to the threat of withholding payment, interfered with the lawyer's exercise of independent judgment. A guideline must not impede counsel's professional digression.⁴ The wary defense attorney may be best served by contacting the insurance company to discuss an acceptable course of action that permits him to fulfill his obligations to the client.

Reservations of Rights

When an insured is sued, the legal complaint filed against him may state several claims, some of which may be covered and some of which may not be covered. While the insurer may not be obligated to pay on all of the claims, the insurer is usually obligated by the terms of the policy to defend against all claims. The insurer may send a reservation of rights letter to the insured whereby the insurer explains that even

though it is providing a defense in the lawsuit, depending on what happens, certain claims may not be covered by the terms of the policy. There is a disagreement amongst the courts across the country as to whether there is automatically a duty to provide independent or cumis counsel when defending subject to a reservation of rights. Some courts require the carrier to pay for cumis counsel, selected by the insured, when defending subject to a reservation of rights. However other courts, have stated that "not every reservation of rights creates a conflict of interest requiring appointment of independent counsel."⁵ In Oklahoma, for example, the Court of Appeals held that an insurer's duty to hire independent counsel arose when the possibility existed that the insurer might be faced with the prospect of defending the insured under some but not all available defenses.⁶ The court reasoned that there was no duty to provide independent counsel when merely potential for a conflict over coverage existed.

The issue of cumis counsel is not determined solely by case authority. In some states, the legislature has enacted statutes, which set the standard. For example, California Civil Code § 2860 and Alaska Statute § 21.89.100 provide, generally, that if the provisions of a policy of insurance impose a duty to defend upon an insurer and a conflict of interest arises which creates a duty on the part of the insurer to provide independent counsel to the insured, the insurer shall provide independent counsel to represent the insured unless the insured waives the right. In Florida, § 627.426(2) provides a carrier that retains independent counsel shall pay agreed upon reasonable rates, or if agreement cannot be reached, a court will set the rate for payment.



Is there a concurrent conflict that prevents representation?

Under most formulations of lawyer ethics rules, lawyers are prohibited from undertaking representations in which they have a concurrent conflict of interest. For instance under the Model Rules, ordinarily lawyers may not enter into an attorney client relationship in which there would exist a concurrent conflict of interest. Model Rule 1.7 provides:

(a) ... a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client; or

(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

The issue of when there is a significant risk that a representation will be materially limited is not always an issue that is easy to answer. An example of a concurrent representation in which there was insufficient risk that the lawyers responsibility to one client was diminished by the representation of another client can be seen in Ethics opinion 05-435. In American Bar Association Formal Ethics Opinion 05-435 the Committee addressed whether under Rule 1.7 there was a conflict of interest when a lawyer who was representing a liability insurer as a named party in a civil action undertook to represent a plaintiff in a separate civil action against a defendant to whom a defense was being provided under a policy of insurance issued by that liability insurer. The committee concluded that "representation of the plaintiff was not directly adverse

and therefore does not present a concurrent conflict of interest to the lawyer's representation of the insurer in the other action." The Committee reasoned that simultaneous representation in unrelated matters of clients whose interests are only economically adverse does not ordinarily constitute a conflict of interest requiring consent of the respective clients.

Nevertheless, if there is a concurrent conflict, the Model Rules do allow for a waiver under certain circumstances. Model Rule 1.7 (b) permits the obtaining of a written waiver from both clients if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law;

(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

(4) each affected client gives informed consent, confirmed in writing.

A word to the wise, however, most legal malpractice plaintiff's lawyers will mark such waivers as "Exhibit 1" in any eventually filed malpractice claim. Waivers may be obtainable, but they can backfire on a variety of theories including allegations of insufficient disclosure of the conflict.

Does payment by the insurance company alone create a conflict?

Ordinarily, by itself, payment by the insurance company does not create a conflict of interest. The Model Rules do not expressly prohibit payment by the insurance company, so long as the insured gives informed consent. Model Rule 1.8(f), in pertinent part, provides that:



A lawyer shall not accept compensation for representing a client from one other than the client unless:

- (1) the client gives informed consent

Does the assignment of captive counsel create an irreconcilable conflict?

Assignment of captive counsel by the insurance company, by itself, in most instances does not create an irreconcilable conflict. In Virginia Ethics Opinion Number 589, the Committee stated that there “is no provision in the Virginia Code of Professional Responsibility that expressly prohibits representation of an insured by a staff attorney for a liability insurance carrier.” However, this is subject to the provisions of the code of professional responsibility which guide the conduct of the relationship. Namely, a lawyer must exercise independent judgment on behalf of a client, a lawyer must obtain the insured’s consent to the representation, and an attorney must preserve the confidences of the insured. Further, in American Bar Association Formal Ethics Opinion 03-430, the Committee addressed the issue of whether insurance staff counsel may represent both their employer and the insured in a civil lawsuit resulting from an event defined in the insurance policy. The committee concluded that “insurance staff counsel may ethically undertake the representations as long as the lawyers inform all insured whom they represent that the lawyers are employees of the insurance company and exercise independent professional judgment in advising or otherwise representing the insured.” But note that there is still a question pending before the Texas Supreme Court about whether staff counsel who represent insureds of the carrier are engaged in the unauthorized practice of law. In *American Home Assur. Co., Inc. v.*

Unauthorized Practice of Law Committee, 121 S.W.3d 831 (Tex.App.-Eastland 2003), the Court of Appeals reversed a trial court decision holding that an insurance company that used staff attorneys to represent the insured was engaged in the unauthorized practice of law. In April 2005, the Supreme Court granted review of the case, yet to date, no decision has been announced.

Can Counsel limit what they do for the insured?

It appears that an attorney may limit the scope of the representation provided that the limitation is reasonable under the circumstances, and the client gives informed consent. Model Rule 1.2, in pertinent part, provides that:

A lawyer shall... consult with the client as to the means by which they are to be pursued. A lawyer may take such action on behalf of the client as is impliedly authorized to carry out the representation. A lawyer shall abide by a client's decision whether to settle a matter...

(c) A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent.

What can counsel disclose during the course of representation?

Common issues involving confidentiality and communications by defense counsel concern what information should be provided to the insured and the insurer, and whether information should be withheld from either. For example, policies usually do not provide coverage for damages that are caused intentionally. This begs the question of whether an attorney is obligated to inform the insurer of information that might provide coverage defenses. In general, an attorney is to maintain the privileged



and confidential information of a client. However, under certain circumstances an attorney may disclose all information that is reasonably necessary to secure information relating to the representation, to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, or to comply with a court order. Model Rule 1.6, in pertinent part, provides that:

(a) A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).

(b) A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:

(4) to secure legal advice about the lawyer's compliance with these Rules;

(5) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client; or

(6) to comply with other law or a court order.

In California Professional Conduct and Formal Opinion Interim Number 96-0012, the Committee addressed whether there are ethical obligations for an insurance defense attorney when the carrier requests access to the attorney's file, including communications between the attorney and the insurer to which the carrier was not privy and whether the attorney may return the original file materials to the insured. The Committee opined that under California law, the "insurer and insured are joint clients." Joint clients generally have "no expectation of confidentiality between themselves concerning the

matter on which they are joint clients." The committee also stated, "joint clients usually have an equal right to the attorney's original file." However, the attorney should, on request, return to each respective client papers and property belonging to that client which each client provided to the attorney during the representation. Many states, however, take a different view of the relationship and hold that only the insured is the client of the lawyer. These states are often referred to as one client states and often times there is substantial friction between the insurance carrier's demand for file information and the client's expectation of confidentiality.

What is Counsel's duty of independent judgment?

Another common problem arises where the insured's potential liability exceeds the policy limits. Here, the insurer may try to restrict the lawyer on the expenditures of the defense, such as limiting experts, and discovery. While the insurer may be in control of the litigation due to the language of the insurance contract, the defense lawyer must maintain his obligations to the insured by doing everything necessary to defend the insured. In general, an attorney must not allow the insurer to direct or regulate the lawyer's professional judgment in rendering legal services. Model Rule 5.4, in pertinent part, provides that:

(c) A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services.

In Virginia Ethics Opinion Number 1789, the Committee was presented with a hypothetical question inquiring whether a medical record obtained in the course of litigation and submitted to the tribunal in support of the client's case



is part of the client's file requiring disclosure to the client and whether the insurance carrier and/or psychologist can prohibit a lawyer from providing this report to a client. The Committee opined that the "attorney must be mindful of the fact that he represents the patient, and not the carrier or the psychologist. The attorney should not follow the instruction of these non-clients to breach the duties owed to his client."

If counsel disagrees with the positions taken by either the carrier or client, can he withdraw?

In general, an attorney may withdraw from representation if the client persists in a course of action the lawyer reasonably believes is criminal, fraudulent, or repugnant. An attorney may also withdraw if the client insists upon taking action with which the lawyer has a fundamental disagreement. Model Rule 1.16, in pertinent part, provides that:

A lawyer shall not represent a client or, where representation has commenced, shall withdraw from the representation of a client if:

(2) the client persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent;

(4) the client insists upon taking action that the lawyer considers repugnant or with which the lawyer has a fundamental disagreement;

(5) the client fails substantially to fulfill an obligation to the lawyer regarding the lawyer's services and has been given reasonable warning that the lawyer will withdraw unless the obligation is fulfilled;

(6) the representation will result in an unreasonable financial burden on the lawyer or has been rendered unreasonably difficult by the client; or

(7) other good cause for withdrawal exists.

Conclusion:

Counsel who handle insurance related matters must be ever mindful of potential ethical traps which can arise at the outset of the representation, or during the course of the representation. Scrupulous observance of the ethical rules will serve counsel well. Yet, the continually changing legal environment will continue to spawn challenging issues for the practitioner.

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² Michael D. Morrison and James R. Old, Jr., "Economics, Exigencies and Ethics: Whose Choice?" *Emerging Trends and Issues in Texas Insurance Defense Practice*, 53 Baylor L. Rev. 349-418 (2001).

³ *In re Rules of Prof'l Conduct*, 2 P.3d at 815 (2000).

⁴ *Dynamic Concepts, Inc. v. Truck Ins. Exch.*, 61 Cal. App. 4th 999 (1998); *In re Youngblood*, 895 S.W.2d 322 (Tenn. 1995).

⁵ *Blanchard v. State Farm Fire & Casualty Co.*, 2 Cal.App.4th 345, 350 (1991).

⁶ *Nissan v. American Home Assur. Co.*, 917 P.2d 488 (Okl. App. 1996).

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