Abstract
This article discusses ethical issues related to the relationship among an insurer, its insured, and appointed counsel—the tripartite relationship. An overview of issues related to this complex relationship is presented, along with limitations on an insurer’s right to defend its insured; approaches taken by various states, including regarding an insurer’s requirement to appoint independent counsel; and ethical considerations for defense counsel and claims handlers.

Editor’s Note
This article contains material from Harold Weston’s book, Insurance Practice and Coverage in Liability Defense, 2d edition (Wolters Kluwer, 2015). The opinions expressed in the article are those of the authors and do not necessarily reflect those of their clients, employers, and/or firms.

Ethics, Communication, and Control in the Tripartite Relationship
by Harold Weston and Paul Rosner

When an insurer accepts the defense of a liability case, whether unconditionally or under a reservation of rights, three parties are involved: the insurer, the insured, and the defense lawyer. This is known as the tripartite relationship.

The tripartite relationship has several elements. One is communication among the parties before the attorney is appointed and during the attorney’s representation in the case. Second is control of the litigation, which is further affected in some states by whether the insurer has reserved rights to the claim. A third element that suffuses the entire relationship is legal ethics, specifically conflict of interest rules.

In many states, the defense attorney has two clients, the insurer and insured, in recognition of the insurer’s stake in the case: it must not only pay any settlement or judgment above the deductible or self-insured retention but also be granted its contractual right to control the defense. Appointed defense counsel must understand ethical obligations within the tripartite relationship and how the related jurisdiction treats attorney-client privilege. Clear expectations, established at the outset, may avoid problems down the road for defense counsel, the insured, and the insurer.

Continued on page 14
A Question of Privilege
A crucial communication in the life of a claim occurs when the insured first contacts the insurer, before the insurer appoints an attorney. Sensitive information may be discussed during these calls, some of which may be recorded. But are such conversations privileged against discovery by the claimant? The states are split on this question.

Many states say the communication is privileged because the reason the insured has notified the insurer is to obtain a defense, and the insurer has the right and duty to control the defense. How else can the insured comply with the notice requirements and cooperate? Besides, the notice is intended to be passed to the attorney who will be appointed.

At the other end, some states hold that the communication is not privileged because it does not directly involve an attorney. These states contend that the purpose of the notice to the insurer is to obtain a defense, and the insurer has the right and duty to control the defense. How else can the insured comply with the notice requirements and cooperate? Besides, the notice is intended to be passed to the attorney who will be appointed.

The Alaska Supreme Court’s decision in *Champion v. Langdon* states that the insurer is neither a “representative” of a nonexistent attorney nor eligible for the insured to bring within that harbor. Even the work product privilege is nonapplicable because no attorney is attached to, or corresponds with, the work.

Between these two poles comes the middle position, the case-by-case approach. Several states and the majority of federal courts follow this approach, considering how and why documents were prepared, and, when relevant, reviewing the insurers and indemnitors protected against discovery, as listed in Rule 26 of the Federal Rules of Civil Procedure.

An insurer that accepts tender for defense under a reservation of rights may create a conflict of interest between the insurer and the insured.

Limitations on an Insurer’s Right to Defend
An insurer that accepts tender for defense under a reservation of rights may create a conflict of interest between the insurer and the insured. This can extend to the attorney the insurer might appoint to defend the insured.

If conflict is recognized by applicable state law—in which the lawyer’s decisions in handling the liability case affect coverage—a number of states allow the insured to select defense counsel. However, some qualifications exist among states:

- Three states—Alaska, California, and Florida—have statutes dealing with conflicts of interest and selection of independent counsel. These statutes in many ways codify and elucidate existing law allowing the insured to select independent counsel.

- Five states—Georgia, Minnesota, Missouri, New Hampshire, and Wisconsin—allow the insured to select its own lawyer. But because they require the insurer to seek declaratory relief promptly, and thus coverage is decided before the underlying case is, the issue is effectively moot. In these states, the insurer can usually stay the underlying action, or even intervene to have the

coverage established. Once the court decides coverage, there is no longer a conflict because the insurer either does or does not defend.

- Six states—Alabama, Hawaii, Michigan, Oregon, Virginia, and Washington—have decided the insured is not entitled to select his or her own lawyer because the lawyer appointed by the insurer is already under an ethical duty to act solely in the interest of the insured in structuring a defense. Maine holds that the insured controls the defense with appointed counsel, but it has not officially rejected the notion of an insured selecting its own lawyer.

- One state—New Jersey—takes a sort of middle ground, stating that the insurer has a duty to reimburse the insured if coverage is later found to exist, but that no ongoing duty to reimburse exists.

- Several states—such as Arizona, Texas, and Ohio—have not decided the issue at all, or the law is so conflicting that the matter remains unresolved.

- In two states—Arkansas and Pennsylvania—federal court decisions have addressed the subject without any guidance from the state court, thus giving guidance without authority.

- Kansas seems to cover all the possibilities: It recognizes that the insured may be entitled to control the defense and select counsel, but its cases fail to provide specifics and instead indicate that the insurer can appoint an attorney, regardless.

Appointing Independent Counsel
When an insurer reserves its rights to deny coverage, courts in many states hold that the insured need not accept the insurer-appointed attorney. These rationales reflect a sampling of representative rulings:
• “The insurer’s desire to control the defense must yield to its obligation to defend its policyholder.”

• “In actions in which the insurer lacks an economic motive for a vigorous defense of the insured, or in which the insurer and the insured have conflicting interests, the insurer may not compel the insured to surrender control of the litigation.”

• “A ruling that required an insured to be defended by what amounted to his enemy in the litigation would be foolish.”

The reasoning around this centers on estoppel: whether the insurer created a hazard or prejudice for the insured that could have been avoided if the insured had been in control of the defense.

Typical claims that trigger the potential for a conflict because of how the defense might conduct the case are dual claims for negligence and intentional conduct. Dual claims for breach of contract and tort can go either way, with some court decisions finding a conflict of interest and other court decisions not finding a conflict. Claims for punitive damages alone, or for claims in excess of the policy limits, do not usually create potential conflicts; however, in such cases, the insured should ask its own attorney to guide the case to avoid a conflict, including regarding whether to settle and contribute to the excess exposure.

Some courts say the conflict arises from the insurer’s appointment of the insured’s attorney, as the attorney may then face an ethical conflict in representing the two clients. Yet, jurisdictions that do not allow the insured to select counsel when the insurer has a conflict reject this presumption, saying that the attorney’s loyalty is clearly to the insured.

Numerous cases have refused to allow the insured the right to select counsel if the conflict is theoretical or speculative, or if the attorney cannot effectively defend the insured because the insured’s acts are extraneous to the coverage (for example, if the insured misrepresented information on the insurance application or if actions occurred outside of the policy period). If the attorney appointed to defend the insurer has no real opportunity or motive to favor the insurer over the insured in the handling of the defense of the liability case, then there is no conflict.

In the states that do not allow insureds to select independent counsel (Alabama, Hawaii, Michigan, Oregon, Washington, and Virginia), the view is that attorneys have an ethical obligation to defend their clients, the insureds. The courts reject the presumption that attorneys will violate this obligation.

The lead case on rejecting independent counsel is from Washington, Tank v. State Farm Fire & Casualty Co. In this case, the Washington Supreme Court established the duties of both an insurer and an appointed defense attorney in instances in which the insurer defends under a reservation of rights with appointed counsel. The Tank court stressed to both defense counsel and the insurer that the insured, and only the insured, is the client of defense counsel. Further, the court obligated the defense lawyer to fully disclose to the insured all pertinent information, including settlement offers, for the insured’s consideration. Under both Washington and Alabama law, the insurer also then has an “enhanced obligation” of good faith in handling the case.

The Alabama Supreme Court, in deciding whether to allow or reject the right to select independent counsel, stated that jurisdictions that hold that a reservation of rights in all cases triggers a need for independent counsel “go too far.” The court instead put in place “a procedure by which the insured can be confident that his interest will not be compromised nor in any way subordinated to those of the insurer as a result of the defense he is required to accept…. Both retained defense counsel and the insurer must understand that only the insured is the client.”

The Hawaii Supreme Court spoke similarly: “Upon balancing the respective pros and cons of suggested solutions to the issue [of conflicts of interest], we are convinced that the best result is to refrain from interfering with the insurer’s contractual right to select counsel and leave the resolution of the conflict to the integrity of retained defense counsel. Adequate safeguards are in place already to protect the insured in the case of misconduct.” An Oregon court rejected the idea that an insurer would provide only a token defense, knowing it would face a jury later in trying to avoid coverage.

These states do not ignore the potential or actual conflict presented, but instead require the appointed attorney to tackle it and the insurer to focus on keeping the insured’s interest paramount.

Other Points

Some policies include endorsements that specify how independent counsel will be employed if a conflict arises. This follows from statutory allowances in Alaska and California, though nothing restricts the use of such endorsements in other states.

Some insurers choose to waive the potential conflict rather than allow an insured to

Continued on page 16
select counsel. This is a practical business decision. The effect is to control the defense expenses—which some attorneys may otherwise inflate after learning that an insurer may be obligated to pay unlimited expenses. Some prominent case examples support this. Although by waiving the potential conflict, the insurer becomes liable for any indemnity, the cost will likely be less overall.

Sometimes the insurer will appoint an attorney even when there is a conflict and the insured is using independent counsel. Doing so allows the appointed attorney to be on the proof of service and to therefore obtain all discovery and attend all hearings and depositions. The attorney can then provide privileged communications back to the insurer. As long as the appointed attorney does not interfere with litigation strategy, this arrangement generally presents no problems and actually helps if the attorney-client privilege might otherwise be jeopardized by communications to the insurer.

Some insureds will choose to waive the conflict, likely because they do not fully understand the issue or lack any better way to manage the case and select an attorney.

Ethical Considerations

To avoid ethical pitfalls, claims professionals and appointed defense counsel should adhere to applicable laws, good claims handling practices, company claims handling guidelines, and any applicable claims handling regulations. When in doubt, a claims handler should consult with someone familiar with the law of the jurisdiction, such as a supervisor or coverage counsel.

If an attorney understands that the insured is a, or in some states the only, client, the rules of professional conduct should guide the attorney’s ethical responsibility. If asked to do something not in the insured’s best interest—whether by plaintiff’s counsel, a claims adjuster, or anyone else—defense counsel should firmly explain that the insured is the client. Indeed, most, if not all, insurers want defense counsel to let them know of any ethical issues related to the defense of the insured.

The high ethical standards of The Canons, Rules, and Guidelines of the CPCU Code of Professional Conduct, available at TheInstitutes.org/doc/canons.pdf, specifically pertain to CPCUs, of course. These are relevant to CPCU Society membership ideals, but are not legally enforceable standards and are not applicable to non-CPCUs—particularly attorneys, whose regulations and codes of conduct are the controlling writ.

Many thanks to the Ethics Committee and Coverage, Litigators, Educators & Witnesses Interest Group for their contributions to this article.

Endnotes

5. 105 Wash. 2d 381, 391, 716 P.2d 1133 (1986).
6. Tank, 716 P.2d 1133 (1986); L & S Roofing Supply Co., Inc., 521 So. 2d at 1304.