

PERSPECTIVES ON THE LAW

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Caught in the Middle The Triparte Relationship of Insured, Insurance Company and Defense Counsel — by Rudy R. Lachenmeier

It has been said that “no man can serve two masters.” Matthew 6:4. Yet the insurance defense attorney is required to do so every time counsel undertakes the defense of an insured in a liability case. To do so ethically often requires the defense counsel to find his or her way through a mine field trying to follow general principles that only dimly illuminate the playing field. It is the purpose of this article to set forth some of those guiding principles, leaving to future articles to fill in the details.

First of all, there is no question that an insurance defense attorney on a liability case has two clients, the insurer and the insured. *OSB Legal Ethics Opinion Number 1991-77*. In that ethics opinion dealing with a complaint under which there was a duty to defend, but not a duty to pay, the opinion says: “Simultaneous representation insurance defense cases will generally be permissible because a conflict that falls within DR 5-105 generally will not exist”. A footnote to that sentence then makes it clear that if there is an “actual conflict” it would never be acceptable to represent both.

DR 5-105 (A) provides:

“(A) *Conflict of Interest*....

(1) An ‘actual conflict of interest’ exists when the lawyer has a duty to contend for

something on behalf of one client that the lawyer has a duty to oppose on behalf of another client.

(2) A ‘likely conflict of interest’ exists in all other situations in which the objective personal, business or property interests of the clients are adverse. A ‘likely conflict of interest’ does not include situations in which the only conflict is of a general economic or business nature.”

DR 5-105 (E) tells us that:

“Except as provided in DR 5-105(F), a lawyer shall not represent multiple current clients in any matters when such representation would result in an actual or likely conflict.

DR 5-105(F) then continues:

“A lawyer may represent multiple current clients in instances otherwise prohibited by DR 5-105 (E) when such representation would not result in an actual conflict and when each client consents to the multiple representation after full disclosure.”

Yet another rule, DR 10-101 (B) explains that:

“‘Full disclosure’ means an explanation

sufficient to apprise the recipient of the potential adverse impact on the recipient, of the matter to which the recipient is asked to consent.... Full disclosure shall also include a recommendation that the recipient seek independent legal advice sufficient to determine if consent should be given. Full disclosure shall be contemporaneously confirmed in writing.”

In Opinion 1991-77 cited above, the same lawyer had done the coverage analysis and advised the company re coverage before he undertook the defense. Nonetheless the Opinion said that defending after the coverage analysis was over was only a “likely conflict” and curable with full disclosure saying the disclosure

“...must include a discussion of the fact of the prior representation of Insurer on the coverage question and it’s potential significance.”

Interestingly it was on very similar facts that our neighbors to the south found it necessary to create “Cumis counsel”(independent counsel hired by the insured but paid for by the insurer). In that landmark California case, *San Diego Navy Federal Credit Union vs. Cumis Insurance Society, Inc.* 162 Cal.App.3rd 358, 208 Cal Rptr. 494 (1985) the court opined:

“Here it is uncontested the basis for liability, if any, might rest on conduct excluded by the terms of the insurance policy. Goebel and Monaghan (the defense counsel) will have to make certain decisions at the trial of the Eisenmann (plaintiff) action which may either benefit or harm the insureds. For example, it will have to seek or oppose special verdicts, the answers to which may benefit the insureds by finding non-excluded conduct and harm either

Cumis’ position on coverage or the insureds by finding excluded conduct. These decisions are numerous and varied. Each time one of them must be made, the lawyer is placed in the dilemma of helping one of his clients concerning insurance coverage and harming the other.”

For this reason the court’s holding was:

“We conclude under these circumstances there is a conflict of interest between the insurer and the insured, and therefore the insured is entitled to independent counsel paid for by the insurer.”

Many states have addressed this “conflict” situation and it appears there are generally two approaches: (1) requiring independent counsel or (2) trying to avoid all “actual” conflicts, but when in doubt favoring the insured. This latter approach is the Oregon approach, but it lacks the clear lines of “Cumis” and requires much vigilance on the part of defense attorneys.

The driving force in the Cumis decision was the unfairness of having facts determined in a liability case which also determined coverage when the perceived bias of the attorney representing the insured would be to favor the insurance company for whom counsel works on a regular basis. The Oregon rule is facilitated by the decision in *Ferguson vs. Birmingham Fire Insurance Co.* 254 Or 496, 460 P2d 342 (1969), wherein the court, recognizing the potential conflict, chose to remove the conflict by holding that the result of a case defended on a reservation of rights could NOT be used as Estoppel by Judgment in a subsequent case over coverage. Thus, the court reasoned, the defense attorney would have no reason to do anything that was not beneficial to the insured and the case as a whole.

Now consider the following scenario. Assume that a couple of neighbors have been feuding over a property line and eventually one of them punches out the other. A lawsuit is then filed by neighbor (1) against neighbor (2), alleging both intentional and negligent conduct in separate claims. The insurer determines that under their policy there are possible exclusions and sends the case to defense counsel asking counsel to defend (2) “under reservation of rights”. What is defense counsel ethically required to do, and what are the areas likely to come up where careful ethical analysis is required?

To start with, the fact that the insurance company and the insured’s interests are not identical, leads to the inevitable conclusion that there is a “likely conflict”. In order to minimize this potential conflict and to permit joint representation, the insurance law and ethical rules as discussed in Formal Ethical Opinion 1991-121 at page 3 states:

“...both the ethical rules and the insurance law require that an attorney hired by the insurer to defend an insured must treat the insured as ‘the primary client’ whose protection must be the attorney’s ‘dominant’ concern. *See, e.g.,* ABA Standing Comm on Ethics and Professional Responsibility Informal Op No 1476 (1981).”

The first obligation then to this “primary” client is to fully and fairly disclose the conflict issue and to obtain permission to proceed. It is a problem, however, if the insured does not want to proceed with the attorney after the disclosure. The attorney presumably then must resign, leaving the insurance company with a policy that allows them to hire counsel of their choice, a duty to do so and an inability to achieve it without the insured’s acquiescence.

Presumably defense counsel would have put in counsel’s opening letter to the insured language referencing the reservation of rights and telling the insured he has a right to employ his own counsel at his own expense to deal with the coverage issue, and that the defense attorney cannot be involved in any coverage dispute. What are the duties to explain the insurance policy if the insured asks? Clearly, the counsel cannot, without an actual conflict, represent the insured against the insurance company or vice-versa, but telling the insured he has the right to his own counsel may not prevent the insured from requesting an explanation of the coverage issue. Presumably the insured is entitled to an explanation. Query: as the “primary client,” is the insured entitled to an explanation of why the insurance company’s position is wrong if counsel believes that to be the case? Does it matter if the insured tells counsel that he can not really afford coverage counsel unless he is assured that it will be money well spent?

The next issue comes up when defense counsel sets up the initial meeting with the insured and the insurance company wants to come and listen in to that initial conversation to help it make it’s own determination of whether or not there is coverage.

DR 4-101 (A) defines “confidences” and “secrets” of a client, essentially saying that a “confidence” is something protected by the attorney/client privilege under applicable law and a “secret” is information gained in a professional relationship that the client has requested to be held inviolate or the disclosure of which would be embarrassing or would likely be detrimental to the client. DR 4-101 (C) provides:

“.... a lawyer may reveal: 1. Confidences or secrets with the consent of the client or clients affected, but only after full

disclosure to the client or clients.
2. Confidences or secrets when permitted by a disciplinary rule or required by law or court order or secrets which the lawyer reasonably believes need to be revealed to effectively represent the client.”

Those exceptions are rare. Practically, if the insured has told the attorney a confidence or secret concerning facts, which if disclosed to the insurance company would provide a basis for denying coverage, defense counsel cannot ethically pass that information on to the insurance company.

In the example above the insured has not yet told the lawyer anything, and the insurance company wants to listen when he does. While with full disclosure that might not be unethical, it certainly puts defense counsel in a bad light if the insured is denied coverage based on an interview done in front of defense counsel and without independent counsel. It also is arguably impossible to make a full disclosure re the consequences of divulging facts the counsel has not yet heard.

Even deposition summaries or notes to the file either need to be edited or not forwarded to insurance companies when the facts would be detrimental to the interests of the insured and were provided to the attorney as a confidence or secret. Given the insured's status as “primary client” this would be true of any information detrimental to the insured on coverage, whether or not the information was a “confidence or secret”.

Next, on the fact scenario outlined above, assume that only the negligence claim is covered under the involved policy but the way it is plead the negligence claim does not legally state a claim. Defense counsel, representing the insured as his “primary client” cannot move to strike the only

covered claim, leaving the insured with a Complaint that has no duty to defend. In Formal Ethical Opinion No. 1991-121 the bar wrote:

“... An attorney who is hired to defend the insured in a situation such as the one described in this Opinion cannot file a Motion that would adversely affect the insured's right to a defense or coverage, but must indeed act in a manner that is consistent with the interests of the insured.”

As indicated, it is the purpose of this article to simply highlight some of the guiding principles. Future articles will likely discuss one or more of the following areas in which there are sticky ethical issues for an insurance defense lawyer:

1. Compliance with insurance defense guidelines.
2. Determining insurance coverage and then defending the insured.
3. Sending detailed bills to a third-party auditing service.
4. Uncooperative insureds.
5. Going to trial with either actual or theoretical likelihood that a judgment would exceed the policy limit.
6. What happens when one client wants to settle and the other emphatically does not?

If any of these topics are of particular interest or if there are other parts of the tripartite relationship that you wish addressed in this column, please feel free to contact the author, Rudy R. Lachenmeier by phone at (503) 768-9600, or by email at rudy@lerlaw.com. For past articles visit www.lerlaw.com.