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Bringing Counsel in from the Cold: Reconciling Ethical Rules with the Quagmire of Insurance Defense Practice

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BRINGING COUNSEL IN FROM THE COLD: RECONCILING ETHICAL RULES WITH THE QUAGMIRE OF INSURANCE DEFENSE PRACTICE

Joseph Regalia* and V. Andrew Cass**

Litigators have a tough job: demanding clients, relentless deadlines, and constant pressure to get everything just right. But insurance defense attorneys deal with this and more. Being an insurance-defense attorney means satisfying two masters: the insurance company that pays the bills, and the insured who stands to lose if the case turns out badly. This is not merely a matter of having to field more phone calls and emails—insurance defense practice poses profound ethical dilemmas not adequately addressed by the existing rules of professional conduct. It is into this ethical morass that we will dive. Our proposed solution is to bring some light to the darkness in the form of specific ethical rules for insurance defense attorneys. To illustrate why change is needed, this article examines at length one of the most common (and yet unanswered) ethical dilemmas in this area: conflicts among insurance companies with competing interests in a case. After thoroughly reviewing the scant existing ethical guidance on this topic, we conclude that the sensible answer is a new set of ethical rules that will give more guidance to everyone involved. We finish with a first stab: a proposed ethical framework governing the insurer conflict we explore in this article. But this is only the first step. More thought and solutions are needed to plug the cost and uncertainty in this corner of legal ethics.

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The views expressed by the authors in this article are their own and do not necessarily reflect the views of their firms. Nothing in this article is intended to be legal advice

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INTRODUCTION

Litigators have a tough job: demanding clients, relentless deadlines, and constant pressure to get everything *just* right. But insurance defense attorneys deal with this and more. Being an insurance-defense attorney means satisfying two masters: the insurance company that pays the bills, and the insured. This is not merely a matter of having to field lots of phone calls—insurance defense practice poses profound ethical dilemmas not adequately addressed by the existing rules of professional conduct. It is into this ethical morass that we will dive.

Law library shelves strain under the weight of cases and law review articles about the ethical minefield created by the tripartite relationship—the three-party relationship created when a liability insurer retains an attorney to defend its insured. Despite this attention, and despite the frequency of these issues, insurance defense counsel in most jurisdictions are left without meaningful guidance on some important issues. This void creates uncertainty and cost to insurers, insureds, and insurance defense counsel; and, because of the pervasive role of liability insurance in every aspect of our lives—these costs ultimately are borne by consumers, that is, all of us.

Our primary purpose here is not to offer a silver bullet, but instead, to start a discussion about strategies for better combatting this glaring problem. We suggest that more specific ethical rules are needed in this area, but we do not propose a set of rules that are particularly favorable to any one group—insureds, insurers, or the attorneys themselves. We simply propose that everyone involved would benefit from more specific guidance for lawyers practicing insurance defense, in supplementation to the one-size-fits-all approach of the current ethical rules. We have some suggestions, but our goal is elucidation, not prescription.

Having a single set of uniform ethical rules governing all attorneys regardless of practice area has long been accepted as the best system. The consensus has been that this uniformity prevents the practice of law from fracturing and ensures that judges and state bar officials can easily apply the same set of rules. We don’t suggest a total upheaval of the American approach to ethics; we merely suggest a refinement of the rules when it comes to insurance defense practice.

Enacting particularized rules for specific practice areas is not unprecedented. For example, special ethical rules govern attorneys working for the government. Special rules also govern criminal defense attorneys who represent codefendants. And some scholars have advocated for increasing the number of practice-specific rules in other contexts. But whether states adopt these suggested reforms or not, we should at least consider creating some specific standards for

insurance defense practitioners. The cost of leaving these attorneys in an ethical minefield is simply too high.

We explore this area in three steps. First, we discuss the landscape for specialized ethical rules in general. Second, we consider the need for more specialized rules in the insurance defense context. In this section, which makes up the bulk of this article, we use a common ethical issue in insurance defense practice as a case study to demonstrate why specialized rules might be helpful. After reviewing this case study, and concluding that specialized ethical rules are preferred in the insurance defense arena, we propose a model regulatory framework as a first step in creating a solution.

Our case study is an ethical dilemma faced by insurance defense attorneys daily. An attorney is hired by Insurance Company A to defend an insured who is in a lawsuit over a car accident. Insurance Company A is one of the attorney's best clients, from whom he receives a steady stream of cases. Our attorney's investigation reveals good news—another driver not yet a party to the lawsuit may have contributed to the accident. This revelation has the potential to shift the blame, and all or part of the financial responsibility, onto the shoulders of the new potential party *and his insurer*. But, only after joining the new party to the lawsuit as a third-party defendant does our defense counsel learn that the insurer footing the bill on the other side is his second-best client, Insurance Company B. That seems like a problem: two major clients with two sets of diverging interests in this case. Does counsel have a conflict?

Technically, Insurance Company B is not a party to the case, so our attorney's client is not directly adverse to Insurance Company B. But at the same time, he is pursuing a claim against Company B's *insured*, which means this insurer will foot the bill, initially for the defense, and possibly later for indemnity. Does that make his client's interests adverse to those of Insurance Company B? And if that alone does not create a conflict, what if during settlement negotiations, Insurance Company B fails to step up and adequately contribute, thereby forcing the case to trial and exposing both carriers' insureds to potential liability in excess of their liability limits? Can defense counsel call out Insurance Company B for recklessly exposing its insured? Will defense counsel find himself holding back out of concern he will upset Insurance Company B? What does defense counsel need to reveal about all of this to the insured, Insurance Company A, or even Insurance Company B? Where are the boundaries? Unfortunately, as we will see, even this frequent and not-too-complex scenario is unanswered by existing ethical rules (at least in most jurisdictions).

I. BACKGROUND TO THE USE OF SPECIALIZED ETHICAL STANDARDS

Lawyers within a particular jurisdiction are all generally regulated by a single set of uniform ethical rules, regardless of their specific practice area. These rules, which are typically created by state supreme courts and enforced by state bars, are modeled in most jurisdictions on the American Bar Association's Model Rules.¹

1. See Mark J. Fucile, *River Pilot: Local Counsel in an Age of National Litigation*, DRI FOR THE DEF., Mar. 2015, at 76 (noting that "most states now use professional rules based on the ABA Model

The touchstone for any analysis of ethical rules is thus, in most states, the Model Rules.

The consensus, as adopted by the Model Rules, has long been that holding attorneys in all practice areas to a uniform set of ethical standards is usually the most sensible way to regulate attorneys.² The bar has a deep-rooted belief that the legal profession is unified and that holding attorneys to different rules, just because they practice in different arenas, is not only unnecessary but harmful to the profession's image.³ The Model Rules seem to take this approach. Indeed, this commitment to a unified approach to legal ethics is so strong that there has been relatively little said about whether the perspective still makes sense.

Although the Model Rules and many jurisdictions have adhered to a largely unified approach, some others have questioned whether a single set of rules makes sense. As these scholars and lawyers have acknowledged: the practice of law is quite stratified already—perhaps practice-specific rules might not be beyond the pale.⁴ This has led some scholars to question whether a one-size-fits-all ethical standard

Rules”); *see also* Hart v. Gaioni, 261 F. App'x 66, 68 (9th Cir. 2007); Miller v. State, 764 S.E.2d 135, 141 (Ga. 2014); Chauhan v. Dana-Farber Cancer Inst. Inc., 12 Mass.L.Rptr. 659 (Feb. 28, 2001); *In re* Application of Cnty. of Bergen, 633 A.2d 1017, 1020 (N.J. Super. Ct. App. Div. 1993); Shelby Cnty. Gov't v. City of Memphis, No. W2014-02197-COA-T10B-CV, 2015 WL 127895, at *6 (Tenn. Ct. App. Jan. 8, 2015); State v. McLeod, No. 50604-8-I, 2003 WL 21907636 (Wash. Ct. App. Aug. 11, 2003).

2. *See* David B. Wilkins, *Making Context Count: Regulating Lawyers After Kaye*, *Scholar*, 66 S. CAL. L. REV. 1147, 1148-49 (1993) (“Moreover, by resting their respective claims on rules that purport to be both general and universally applicable, both sides can tap into one of the legal profession's most important constitutive beliefs: that it is a single profession bound together by unique and specialized norms and practices distinct from the norms and practices of laypeople. For the government, the image of a unitary legal community supports the claim that lawyers, as ‘learned professionals,’ have a unique responsibility to place principle before profit.” (footnote omitted)); *see also* Jack R. Bierig, *Whatever Happened to Professional Self-Regulation?*, 69 A.B.A. J. 616 (1983).

3. Bruce A. Green, *Foreword: Rationing Lawyers: Ethical and Professional Issues in the Delivery of Legal Services to Low-Income Clients*, 67 FORDHAM L. REV. 1713, 1718 & n.24 (1999) (reflecting on the bars' “commitment to the principle that the legal profession is a unified profession with a universally applicable set of professional norms”); Dana A. Remus, *Out of Practice: The Twenty-First Century Legal Profession*, 63 DUKE L. J. 1243, 1245 (2014) (discussing the approach to ethics consisting of “a single, broadly applicable code of conduct”); *see* Wilkins, *supra* note 2, at 1218-19 (“By suppressing undeniably relevant differences among types of lawyers, the argument runs, uniform rules of professional responsibility foster a feeling of communal solidarity across the entire profession.”); Fred C. Zacharias, *Federalizing Legal Ethics*, 73 TEX. L. REV. 335, 385-86 (1994) (noting the ethics codes' “basic approach of considering lawyers' duties to be uniform, whatever role the lawyer plays”).

4. *See, e.g.*, JOHN P. HEINZ & EDWARD O. LAUMANN, CHICAGO LAWYERS: THE SOCIAL STRUCTURE OF THE BAR 3 (1982) (“[I]t has been] apparent for some time that the simple view of the bar as a single, unified profession no longer fits the facts.”); DOUGLAS E. ROSENTHAL, LAWYER AND CLIENT: WHO'S IN CHARGE? 146-48 (1974) (discussing the differences between the lawyer-client relationship in personal injury practice and in corporate defense practice); JOEL F. HANDLER, THE LAWYER AND HIS COMMUNITY 147-55 (1967) (arguing that lawyers in a midsized midwestern city have different ethical commitments from lawyers in Chicago or New York); David B. Wilkins, *Legal Realism for Lawyers*, 104 HARV. L. REV. 468, 515-18 (1990).

still makes sense today.⁵ Indeed, some commentators question whether this uniform approach was ever justified.⁶

Thus far, a few scholars have suggested that specialized ethical rules are needed in a few narrow areas, such as collaborative lawyering, capital criminal defense, juvenile justice, and elder law.⁷ The most heated debates have been over whether more specialized rules are needed for attorneys practicing in criminal law.⁸ Bars and legislatures have taken note of some of these arguments, incorporating specialized rules for a handful of practices such as government attorneys and securities practitioners.⁹ But all in all, the advocates of specialized ethical codes have made little headway.

With this article we hope to add one more data point for the argument that specialized ethical rules in some practice areas make sense. To be clear: whether specialized ethical rules should be adopted in all (or even many) practice areas is beyond the scope of this article. What we do hope to show is that the increased cost and uncertainty faced by practitioners and their clients in the insurance defense arena warrant targeted ethical governance. This brings us to the heart of this article: Why specific ethical regulation is desperately needed in insurance defense.

5. See, e.g., Keith R. Fisher, *The Higher Calling: Regulation of Lawyers Post-Enron*, 37 U. MICH. J.L. REFORM 1017, 1144 (2004) (“Manipulation, motivated by politics and self-interest, of the ideology of the bar to adhere to rules of ethics predicated on an antiquated and no longer realistic model of a unified profession has likewise been counterproductive.”); Rebecca Roiphe, *A History of Professionalism: Julius Henry Cohen and the Professions as a Route to Citizenship*, 40 FORDHAM URB. L.J. 33, 74 (2012) (arguing that the “unified profession” is a “myth”).

6. CHARLES W. WOLFRAM, MODERN LEGAL ETHICS 54 (1986) (noting that the idea that “all lawyers are sufficiently homogeneous to conform to common standards . . . was probably unfounded in 1908”).

7. See, e.g., Christopher M. Fairman, *Why We Still Need a Model Rule for Collaborative Law: A Reply to Professor Lande*, OHIO ST. L.J. ON DISP. RESOL. 707 (2007) (advocating special standards for collaborative lawyering); David R. Katner, *The Ethical Struggle of Usurping Juvenile Client Autonomy by Raising Competency in Delinquency and Criminal Cases*, 16 S. CAL. INTERDISC. L.J. 293, 323 (2007) (representing juveniles); Peter Margulies, *True Believers at Law: National Security Agendas, the Regulation of Lawyers, and the Separation of Powers*, 68 MD. L. REV. 1, 8 (2008) (national security lawyers); see also Peter A. Joy & Robert R. Kuehn, *Conflict of Interest and Competency Issues in Law Clinic Practice*, 9 CLINICAL L. REV. 493, 498–99 (2002) (public interest practice); Jan Ellen Rein, *Clients with Destructive and Socially Harmful Choices—What’s an Attorney to Do?: Within and Beyond the Competency Construct*, 62 FORDHAM L. REV. 1101, 1153 (1994) (elder law attorneys); cf. Jack B. Weinstein, *Ethical Dilemmas in Mass Tort Litigation*, 88 NW. U. L. REV. 469, 471 (1994) (mass tort cases); Richard E. Crouch, *The Matter of Bombers: Unfair Tactics and the Problem of Defining Unethical Behavior in Divorce Litigation*, 20 FAM. L. Q. 413, 435–38 (1986) (matrimonial practice); Nancy B. Rapoport, *Our House, Our Rules: The Need for a Uniform Code of Bankruptcy Ethics*, 6 AM. BANKR. INST. L. REV. 45 (1998); Stanley Sporkin, *The Need for Separate Codes of Professional Conduct for the Various Specialties*, 7 GEO. J. LEGAL ETHICS 149 (1993) (corporate and securities practice).

8. See, e.g., Fred C. Zacharias, *Reconceptualizing Ethical Roles*, 65 GEO. WASH. L. REV. 169, 190 (1997).

9. See, e.g., 8 C.F.R. § 292.3 (2011) (providing ethical standards for practicing immigration law before the Immigration and Naturalization Service); 31 C.F.R. pt. 10 (2011) (prescribing regulations for tax practitioners before the IRS); *Standards of Practice for Lawyer Mediators in Family Disputes*, 18 FAM. L.Q. 363 (1984); *Code of Ethics of the Association of Representatives of Professional Athletes* (prescribing rules of conduct for attorneys representing professional athletes), reprinted in Robert E. Fraley & F. Russell Harwell, *Ethics and the Sports Lawyer: A Comprehensive Approach*, 13 J. LEGAL PROF. 9, 88–95 (1988).

1. Getting to know the ethics of insurance defense

“Insurance defense” is a broad term used to describe litigation practice involving attorneys hired by insurance companies to defend their insureds against claims potentially covered under insurance policies.¹⁰ Although insurance defense often brings to mind the defense of personal injury litigation, this world spans a broad spectrum of claims.¹¹ What these cases have in common is a complex web of relationships and ethical pitfalls. This is because litigation triggering a defense under a policy of liability insurance engrafts onto the traditional “two party” litigation model at least one more interested party: the insurer.¹²

To fully appreciate these complications, one must first understand the relationships between insurers, insureds, and defense counsel. In the most common case, an insurer has a policy with an insured requiring that the insurer defend a court case in which liability for claims might fall within the policy. With its obligation to defend triggered, the insurer hires counsel to defend the insured. But the insurer does not just pay the bills—it typically stays actively involved with the case. Insurers often control aspects of the litigation, such as by requiring the defense counsel to work within certain parameters set out in the insurer’s guidelines and (under many policies) maintaining the exclusive right to settle the plaintiff’s claims against the insured.¹³ Indeed, any insurance defense lawyer will tell you that one of the central requirements for a long stay on an insurer’s panel list is complying with carrier reporting requirements, a task which occupies a large part of every practitioner’s work load. Insurers use reports from defense counsel, along with their own independent investigation, to stay carefully apprised of everything that goes on. Insurers after all are in the business of managing risk, and liability insurance involves the handicapping of potential trial outcomes to set reserves (required by state insurance regulators) and make informed and rational decisions about settlement and trial. Liability insurers also closely monitor the evolution of the underlying factual record to consider whether emerging facts, theories of liability, and defenses bring the insured’s potential exposure to liability into or outside of the policy’s coverage.¹⁴

10. For a discussion of issues unique to insurance law, see generally Robert E. O’Malley, *Ethics Principles for the Insurer, the Insured, and Defense Counsel: The Eternal Triangle Reformed*, 66 TUL. L. REV. 511 (1991).

11. See generally, Herbert M. Kritzer, *Betwixt and Between: The Ethical Dilemmas of Insurance Defense* 132, in *LAWYERS IN PRACTICE: ETHICAL DECISION MAKING IN CONTEXT* (Leslie C. Levin & Lynn Mather eds., 2012) (noting that insurance defense attorneys handle claims other than those involving personal injury litigation).

12. *Allendale Mut. Ins. Co. v. Excess Ins. Co.*, C.A. No. 94-0614B, 1995 U.S. Dist. LEXIS 19882, at *16 (D.R.I. June 1, 1995) (“While K&T states it represented only the insureds and not Prudential directly, it has been held that where there is no dispute between an insurer and insured, ‘as a fundamental proposition a defense lawyer is counsel to both the insurer and the insured. He owes to each a duty to preserve the confidences and secrets imparted to him during the course of representation.’” (quoting *Gray v. Com. Union Ins. Co.*, 468 A.2d 721, 725 (N.J. Super. Ct. App. Div. 1983)).

13. Some policies, including commonly professional liability defense policies, require the insurer to obtain the consent of the insured in order to settle. Moreover, in some jurisdictions where the insurer is providing a defense under reservation of rights, control over whether to settle or not vests not with the insurer, but exclusively with the insured.

14. See *Parsons v. Cont’l Nat’l Am. Grp.*, 550 P.2d 94 (Ariz. 1976).

Insurers often hire counsel to represent their insureds from a “panel”—a list of preferred firms.¹⁵ Insurers use this go-to list of panel counsel because they offer cost-effective service, comply with the insurer’s litigation guidelines, and offer quality work product.¹⁶ It is not uncommon for panel counsel and insurers to have strong relationships, sometimes spanning decades and involving many different insureds over the years.¹⁷ With larger firms, these relationships often include defending claims across practice and geographical areas. The work of many panel attorneys and firms will frequently go beyond the defense of the insurer’s insureds, to include the defense of the insurance company itself in bad faith and other claims related to alleged failures to pay out insurance benefits.¹⁸

Indeed, the close-knit relationship between defense counsel and insurance companies has spawned a growing area of scholarship relating to “captive” counsel; the wide spread use of billing guidelines and billing audits; and the question of who, as between the insurer and the insured, has the right to “control the defense.”¹⁹ Despite these areas of tension, insurers and their defense counsel continue to have close relationships.²⁰

This web of multi-lateral relationships is a large cause of the ethical dilemmas which characterize insurance defense.²¹ Every jurisdiction treats the insurer/insured/attorney relationship slightly differently, twisting the ethical inquiry

15. See 2 CHRISTOPHER K. PFIRMAN & MICHAEL DEMARCO, *SUCCESSFUL PARTNERING BETWEEN INSIDE AND OUTSIDE COUNSEL* § 25:18 (discussing the practice of selecting “panel counsel”).

16. See Jeffrey W. Stempel, *Enhancing the Socially Instrumental Role of Insurance: The Opportunity and Challenge Presented by the ALI Restatement Position on Breach of the Duty to Defend*, 5 UC IRVINE L. REV. 587, 599 (2015) (“Typically, rates paid to insurer-selected panel counsel are significantly lower . . . insurers have largely succeeded in negotiating lower rates than those paid by policyholders for counsel competent to defend most claims due to the insurer’s ability to provide a high volume of repeat business in return.”); James L. Cornell & Trevor B. Hall, *What Every Business Lawyer Should Know About the Insurance Carrier’s Duty to Defend and the Policyholder’s Right to Select Counsel*, 42 TEX. J. BUS. L. 237, at 241 (2007) (explaining that “[i]n the usual case, carriers have ‘panel counsel’ with whom they have established relationships, many times spanning years, and to whom they refer multiple cases or even entire books of business in exchange for reduced hourly rates and adherence to ‘litigation guidelines’”); Daniel M. Martinez, *Insurance Companies Use of “Captive” or in-House Counsel to Represent Insureds Constitutes the Unauthorized Practice of Law: Is American Home the Right Decision for Texas?*, 34 ST. MARY’S L.J. 1007, 1026 (2003) (discussing trend of insurers using “captive” or house counsel for cost efficiency reasons).

17. See Cornell, *supra* note 16, at 241; see also Kritzer, *supra* note 11, at 135 (2012) (noting that insurance defense attorneys “rely on repeat business from a relatively small number of sources”).

18. See Kritzer, *supra* note 11, at 135.

19. See Michael D. Morrison & James R. Old, Jr., *Economics, Exigencies and Ethics: Whose Choice? Emerging Trends and Issues in Texas Insurance Defense Practice*, 53 BAYLOR L. REV. 349, 392 (2001); William W. Hurst et al., *Can Insurance Defense Firms Be Ethically Replaced by Staff Counsel? Ruling Says Use of Staff Counsel Constitutes UPL*, RES GESTAE, Aug. 1998, at 42, 42–44.

20. See Paula-Jane Seidman & John S. (Jack) Pierce, *A Continuing Crisis: Casualties on Both Sides in the Unholy War Between Insurers and the Defense Bar over Issues of Staff Counsel, Legal Audits and Billing Guidelines*, in INSURANCE LAW 2000: UNDERSTANDING THE ABCS 479, 485–86 (2000); Douglas R. Richmond, *Lost in the Eternal Triangle of Insurance Defense Ethics*, 9 GEO. J. LEGAL ETHICS 475, 481 (1996).

21. See Kritzer, *supra* note 11, at 137; Douglas R. Richmond, *Walking a Tightrope: The Tripartite Relationship Between Insurer, Insured, and Insurance Defense Counsel*, 73 NEB. L. REV. 265, 271 (1994) (discussing relationships that create common conflicts in insurance-related disputes).

so that no one can be sure what may cross the ethical line.²² One notable commentator in this area, Nathan Anderson, has noted that the rules surrounding insurance defense litigation “fail to provide clear and defensible answers to the most basic questions” such as when the attorney-client relationship exists.²³ Anderson goes on to explain that “[c]onsequently, ‘the obvious danger is that insurance defense lawyers will act improperly, even when they attempt to adhere to the law.’”²⁴

For example, does a lawyer paid by an insurance company to defend an insured even have an attorney-client relationship with the insurer? Or is the insurer a mere “payor” of legal services? This is an important distinction because some ethical duties only apply when an insurer becomes a “client” of an attorney. Whether defending an insured creates an attorney-client relationship with an insurer is settled in many states, but surprisingly for such a fundamental concern, this remains an open question in many jurisdictions, with states, and even individual ethics opinions, taking slightly different approaches.²⁵

Like many other ethical questions that arise for insurance defense counsel, the uniform ethical rules provide little help. For example, there is nothing in the Model Rules that says that paying for an insured’s representation creates an attorney-client relationship with the insurer. Nor are there any rules providing guidance about when a third party, like an insurer, can take on client-like status by virtue of controlling some aspects of the insured’s representation. The truth is, the insurer/insured/attorney relationship is an anomaly, and the uniform ethical rules are of little help. Consequently, everyone is left to the uncertainty of divining what they can from ethics opinions or other guidance (which often turns out to be wrong).

In some jurisdictions, the insurer is not automatically a “client” merely because it pays the bills for an insured’s representation.²⁶ But other jurisdictions may find an attorney-client relationship between the attorney and the insurer in such a situation.²⁷ And in some jurisdictions, it’s hard to tell what the rule is. All that said,

22. *Cont’l Cas. Co. v. St. Paul Surplus Lines Ins. Co.*, 265 F.R.D. 510, 519 (E.D. Cal. 2010) (“The attorney-client relationship is more complex in the context of insurance litigation . . . courts have recognized that a unique tripartite relationship exists among [the insurer and the insured] and the defense counsel hired to defend against third-party liability.”).

23. Nathan Andersen, *Risky Business: Attorney Liability in Insurance Defense Litigation—A Review of the Arizona Supreme Court’s Decision in Paradigm Insurance Co. v. Langerman Law Offices*, 2002 BYU L. REV. 643, 644 & n. 52 (2002) (quoting Charles Silver & Kent Syverud, *The Professional Responsibilities of Insurance Defense Lawyers*, 45 DUKE L.J. 255, 263 (1995)).

24. *Id.* at 644 (quoting Silver & Syverud, *supra* note 23, at 263).

25. *See id.* at 644 (“[T]he rules [surrounding insurance defense litigation] fail to provide clear and defensible answers to the most basic questions, such as whether an attorney-client relationship exists between the insurance company and the lawyer retained to handle the lawsuit against the insured.” (second alteration in original) (quoting Silver & Syverud, *supra* note 23, at 263)).

26. In fact, some courts have created a special rule in not finding direct conflicts with insurers even if they are considered “clients” in the jurisdiction. *See N. Sacca & Sons, Inc. v. E. Coast Excavators, Inc.*, 1992 Mass. App. Div. 6, 7 (1992) (declining to disqualify a lawyer from adversity to an insurance carrier even though the lawyer had represented the insurance carrier, because the carrier was “secondary”); *Tank v. State Farm Fire & Cas. Co.*, 715 P.2d 1133 (Wash. 1986); *Arden v. Forsberg & Umlauf, P.S.*, 373 P.3d 320, 327 (Wash. Ct. App. 2016).

27. *See Home Indem. Co. v. Lane Powell Moss & Miller*, 43 F.3d 1322, 1330–31 (9th Cir. 1995) (applying Alaska law); *Bank of Am., N.A. v. Superior Court of Orange Cty.*, 151 Cal. Rptr. 3d 526 (Ct. App. 2013); *State Farm Mut. Auto Ins. Co. v. Federal Ins. Co.*, 86 Cal. Rptr. 2d 20, 24 (Ct. App. 1999);

the trend to find an attorney-client relationship in this situation appears to be catching.²⁸ One illustrative case is *State Farm Mutual Automobile Insurance Co. v. Federal Insurance Co.*²⁹ There, the California Court of Appeal applied California's concurrent-conflict rule, Rule 3-310.³⁰ The attorney was retained by an insurance company to represent an insured in one action.³¹ In a second action, the attorney, on behalf of another client, filed a complaint against that insurance company in an

Unigard Ins. Grp. v. O'Flaherty & Belgum, 45 Cal. Rptr. 2d 565, 568–69 (Ct. App. 1995); Nandorf, Inc. v. CNA Ins. Cos., 479 N.E.2d 988, 991 (Ill. App. Ct. 1985); McCourt Co. v. FPC Props., Inc., 434 N.E.2d 1234, 1235 (Mass. 1982); Nev. Yellow Cab Corp. v. Eighth Judicial Dist. Ct ex rel. Cty. of Clark, 152 P.3d 737, 741 (Nev. 2007); Gray v. Commercial Union Ins. Co., 468 A.2d 721, 725 (N.J. Super. Ct. App. Div. 1983); Spratley v. State Farm Mut. Auto. Ins. Co., 2003 UT 39, ¶ 5 78 P.3d 603, 606. *But see* Michigan Millers Mut. Ins. Co. v. Bronson Plating Co., 496 N.W.2d 373 (Mich. Ct. App. 1992), *aff'd* 519 N.W.2d 864 (Mich. 1994), *overruled by* Wilkie v. Auto-Owners Ins. Co., 664 N.W.2d 776, 786 (Mich. 2003); Great Am. E & S Ins. Co. v. Quintairos, P.A., 2009-CT-01063-SCT (Miss. 2012); State Farm Mut. Auto. Ins. Co. v. Hansen, 357 P.3d 338, 340–41 (Nev. 2015).

28. *See* Nationwide Mut. Fire Ins. Co. v. Bournon, 617 S.E.2d 40, 46–48 (N.C. Ct. App. 2005) (“In construing the effect of the tripartite relationship between an attorney, an insurer, and an insured, several courts across the country have held that the ‘common interest’ or ‘joint client’ doctrine applies. Under this doctrine, communications between the insured and the retained attorney are not privileged to the extent that they relate to the defense for which the insurer has retained the attorney. . . . In light of the foregoing, we are persuaded that the common interest or joint client doctrine applies to the context of insurance litigation in North Carolina. Therefore, where, as here, an insurance company retains counsel for the benefit of its insured, those communications related to the representation and directed to the retained attorney by the insured are not privileged as between the insurer and the insured. Nevertheless, we note that application of the common interest or joint client doctrine does not lead to the conclusion that all of the communications between defendant and Patterson were unprivileged. Instead, the attorney-client privilege still attaches to those communications unrelated to the defense of the underlying action, as well as those communications regarding issues adverse between the insurer and the insured. Specifically, ‘communications that relate to an issue of coverage . . . are not discoverable . . . because the interests of the insurer and its insured with respect to the issue of coverage are always adverse.’ . . . [W]e are not persuaded that the trial court erred by concluding that Patterson was prohibited from providing the file to plaintiff in a wholesale manner. As discussed above, some communications contained in the file may have been privileged, including those communications unrelated to the underlying action or defendant’s counterclaims, those communications regarding coverage issues made prior to defendant’s counterclaims, and those communications unrelated to the conduct forming the basis of defendant’s counterclaims. Therefore, we agree that Patterson’s file should not have been provided to plaintiff in a wholesale manner. Instead, the file should have been submitted to the trial court for in camera review aimed at determining which documents in the file were privileged. Accordingly, we conclude that the trial court did not err by ruling that Patterson breached his attorney-client relationship with defendant when he provided plaintiff with the entire file from the underlying action.”) (alteration in original) (quoting *N. River Ins. Co. v. Phila. Reinsurance Corp.*, 797 F. Supp 363, 367 (D.N.J. 1992), *aff'd*, 625 S.E.2d 779 (N.C. 2006); *see also* *State Farm Mut. Auto. Ins. Co. v. Fed. Ins. Co.*, 86 Cal. Rptr. 2d 20, 24 (Ct. App. 1999) (assessing a situation in which a law firm hired by defendant Federal Insurance to represent one of its insureds simultaneously sued Federal Insurance on behalf of State Farm in a completely unrelated matter). In *State Farm*, the court noted that the law firm was simultaneously representing one of Federal Insurance’s insureds while representing State Farm in a lawsuit against Federal Insurance for three months. *See id.* This being so, the court disqualified the law firm from its representation of State Farm adverse to Federal Insurance, explaining the California position that a law firm representing an insured has a “triangular” arrangement in which the law firm also is deemed to represent the insurance company. *See id.*

29. 86 Cal. Rptr. 2d 20 (Ct. App. 1999).

30. *Id.*

31. *Id.* at 22.

unrelated matter.³² The court concluded that the insurer was a client of the attorney based on the attorney's representation of its insured.³³

Interestingly, this was so even though nothing in the state's ethical rules implied that an attorney-client relationship existed. This meant that the attorney could not represent the second client, who was taking an adverse position against the insurer by filing a complaint against it.³⁴ And the attorney had risked his own ethical compliance by even taking the case. Indeed, courts have pointed out that the uniform ethical rules do not address this issue:

Concededly, it can be said that “[t]hese interrelationships among a liability insurer, its insured, and the attorney chosen by the insurer to represent the insured, are sui generis. The canons and disciplinary rules do not address themselves frankly and explicitly to this special set of relationships, and there is awkwardness in attempts to apply the canons and rules.” . . . [T]his ambiguity exists only as to instances of a conflict of interest between the insurer and the insured, which raise the question of the lawyer's primary allegiance.³⁵

Now, insurers could create their own affirmative attorney-client relationships through contract by stating that the attorney has taken on a representation role.³⁶ But even so, as we explain below, what loyalties the attorney will owe the insurer, and the potential conflicts between insurer and insured—create an ethical quagmire all their own.

Determining whether an insurer and defense counsel even have an attorney-client relationship is merely a threshold issue. Whether a client or mere payor, what ethical challenge is posed by the fact that the insurer is footing the bill for the insured's representation? And what is counsel to do when the insurer seeks to control or even just guide defense counsel? At what point is the attorney improperly taking direction from a third party about the representation?³⁷ Ethical rules generally give some guidance for when third parties pay for legal bills, but they don't address the unique situation present when that third party is a very involved insurance company, which ultimately may be responsible for paying the judgment which might be entered against the insured, and which generally to one degree or another controls the settlement purse strings.³⁸

32. *Id.* at

33. *Id.* at 23–25.

34. *Id.* at 22–27; *see also* Flatt v. Superior Court, 36 Cal. Rptr. 2d 537 (1994).

35. Gray v. Commercial Union Ins. Co., 468 A.2d 721, 724–26 (N.J. Super. Ct. App. Div. 1983) (first alteration in original) (quoting Moritz v. Med. Protective Co., 428 F.Supp. 865, 872 (W.D. Wis. 1977)).

36. *See* Cont. Cas. Co. v. Huizar, 740 S.W.2d 429, 434 (Tex. 1987); Richmond, *supra* note 21, at 269 (“Because of its financial interest in the effective resolution of a claim, the insurer has a contractual right to control its insured's defense.”); Matthew L. Sweeney, Note, Tank v. State Farm: *Conducting a Reservation of Rights Defense in Washington*, 11 U. PUGET SOUND L. REV. 139, 163 (1987) (“When defending unconditionally, the insurer has complete control of the defense.”).

37. *See, e.g.*, Kritzer, *supra*, note 11, at 137.

38. *See generally* Roman M. Roszkewycz, *Third Party Payment of Criminal Defense Fees: What Lawyers Should Tell Potential Clients and Their Benefactors Pursuant to (an Amended) Model Rule 1.8(f)*, 7 GEO. J. LEGAL ETHICS 573, 575 (1993), for a discussion on attorney procedure in potential conflicts during a tripartite claim.

2. The ethical elephant in the room: conflicts of interest

The term “conflict of interest” is attributed to the New Testament, and Matthew’s proscription that “no man can serve two masters.”³⁹ And this issue is one of the most complex and difficult ethical quandries for defense counsel.

A. *The Model Rules and conflicts of interest*

Attorneys owe their clients a duty of undivided loyalty.⁴⁰ The Model Rules, and virtually all states, break conflicts of interest into two broad categories: conflicts related to current clients and conflicts related to former clients.⁴¹

Whether there is a concurrent conflict is measured in two ways: by a standard of “adverse” clients and also by a complementary standard of “impaired representation.”⁴² The Model Rules set out a standard for each type of concurrent conflict, as well as some specific rules for curing conflicts in some situations:

(a) Except as provided in paragraph (b), 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.

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client 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.⁴³

This Rule thus requires the lawyer to: 1) identify the clients; 2) determine whether a conflict exists; 3) decide whether the conflict is consentable; and 4) if so, consult with the clients affected.⁴⁴ The comments to this rule explain that “[a] conflict

39. Joseph F. Johnston Jr., *Natural Law and the Fiduciary Duties of Business Managers*, 8 J. MARKETS & MORALITY 27, 29 (2005); see also Blaine F. Aikin & Kristina A. Fausti, *Fiduciary: A Historically Significant Standard*, 30 REV. BANKING & FIN. L. 155, 157–158 (2010).

40. See MODEL RULES OF PROF’L CONDUCT r. 1.7 (AM. BAR ASS’N 2016).

41. See *id.*; *id.* r. 1.8.

42. “Even though the simultaneous representations may have *nothing* in common, and there is *no* risk that confidences to which counsel is a party in one case have any relation to the other matter, disqualification may nevertheless be *required*.” *Flatt v. Superior Court*, 36 Cal.Rptr.2d 537, 542 (Cal. 1994).

43. MODEL RULES OF PROF’L CONDUCT r. 1.7 (AM. BAR ASS’N 2016).

44. See *id.*

of interest may exist before representation is undertaken, in which event the representation must be declined, unless the lawyer obtains the informed consent of each client under the conditions of paragraph (b).⁴⁵

Critically, under the adverse conflict prong, “a lawyer may not act as an advocate in one matter against a person the lawyer represents in some other matter, even when the matters are wholly unrelated.”⁴⁶ More importantly, a conflict arises whenever two of an attorney’s clients are “directly adverse” to each other—not merely when two clients are formally named as parties in a litigation against each other.⁴⁷

The fact that a conflict can exist under the “directly adverse” standard even when a lawyer’s current client is not a named party in litigation—is crucial to this article. If there were a bright line rule, insurance defense lawyers would never need to worry about a conflict. If the insurer is a party, they would have a conflict; if not, they would not. But the ethical rules make this situation more complicated.

The Model Rules explain that direct adversity is not limited to adversity between clients named in litigation because “[t]he client as to whom the representation is directly adverse is likely to feel betrayed, and the resulting damage to the client-lawyer relationship is likely to impair the lawyer’s ability to represent the client effectively.”⁴⁸ There is no talismanic rule that allows a facile determination of whether a disqualifying conflict of interest exists. Instead, “[t]he potential for conflict requires a careful analysis of the parties’ respective interests to determine whether they can be reconciled . . . or whether an actual conflict of interest precludes insurer-appointed defense counsel from presenting a quality defense for the insured.”⁴⁹

In general, current client vs. current client litigation is a direct conflict per se.⁵⁰

The difference in their interests is an inevitable aspect of the unilinear, win-lose nature of litigation—one client will lose to the extent that the other gains. The clients are clearly antagonistic in economic terms or, more broadly stated, in terms of their expressed preferences given their contending positions in the litigation in question.⁵¹

No other nation has such an aggressive, per se conflict of interest rule.⁵²

45. *Id.* r. 1.7 cmt. 3.

46. *Id.* r. 1.7 cmt. 6.

47. *Id.* r. 1.7(a)(1).

48. *Id.*

49. Johnny Parker, *The Expansion of Defense Counsel Liability to Include Malpractice Claims by Insurance Companies: How the West Was Won*, 46 TORT TRIAL & INS. PRAC. L.J. 33, 51 (2010) (alteration in original) (quoting *Gulf Ins. Co. v. Berger*, 93 Cal. Rptr. 2d 534, 546 (Ct. App. 2000)); see also MODEL RULES OF PROF’L CONDUCT r. 1.7 (AM. BAR ASS’N 2016).

50. See Charles W. Wolfram, *Competitor and Other Finite-Pie Conflicts*, 36 HOFSTRA L. REV. 539, 546–47 (2007).

51. *Id.* at 547.

52. Daniel J. Bussel, *No Conflict*, 25 GEO. J. LEGAL ETHICS 207, 209–11 (2012) (“This rule is unique to the American legal profession; no other profession imposes a comparable restriction. . . . Similarly, neither accountants, nor bankers, nor brokers, nor clergy are precluded from concurrently advising or representing parties in unrelated matters that are adverse to one another. A rabbi may counsel one congregant about ritual religious matters while also counseling another congregant, who happens to be

Aside from client vs. client litigation, the Model Rules are far from clear on what constitutes “direct[] advers[ity] to another client.”⁵³ There are some obvious areas where “direct adversity” exists and a conflict arises. But figuring out the marginal cases is notoriously tough.⁵⁴ As explained by one commentator: “The decisions themselves—those of both courts and bar association ethics committees—have sometimes been quite unhelpful in providing a definition of the term ‘directly adverse’”⁵⁵ Even the comments to the Model Rules highlight the uncertain, factual nature of this inquiry: “[w]hether clients are aligned directly against each other within the meaning of this paragraph requires examination of the context.”⁵⁶

Also complicating the definition of adversity is that some states have departed from the model rules in their adversity definitions.⁵⁷ In California, for example, the 1992 amendments to the California Bar’s Rules of Professional Conduct expanded the realm of impermissible conflicts to include the representation of a client adverse to another client the lawyer represents in an unrelated matter.⁵⁸ Before 1992, the relevant rule read differently.⁵⁹

As noted above, a concurrent conflict of interest may arise in situations other than simply bringing a claim against a current client. A disqualifying conflict can also arise where the attorney has some other interest—whether it be personal, financial, or professional—that materially limits the attorney’s ability to represent a current client.⁶⁰ The Rules explain that even merely cross-examining a current client is likely to suffice—even if the client is not in the action.⁶¹ Some ethics opinions in some jurisdictions have held that merely seeking discovery against a current client

the first congregant’s business partner, about a dispute involving the two partners without obtaining written waivers. A real estate broker may represent a buyer in one transaction while representing that buyer’s seller in another. An accountant may concurrently serve one client in one corporate transaction as a corporate advisor while rendering unrelated tax advice or providing expert testimony in an unrelated matter on behalf of a competing bidder. And bankers would be astonished and appalled to hear that, by virtue of financing one firm, the bank was precluded from rendering advice or financing to a competitor in an unrelated transaction in which the first borrower happened to be interested in some way.”)

53. See *id.* (quoting MODEL RULES OF PROF’L CONDUCT r. 1.7(a) (AM. BAR ASS’N 2016)) (indicating that the model rules and commentary merely state that the facts must be considered).

54. For example, the ABA Ethics Committee’s consideration of “adversity” has been inconsistent. Compare, e.g., ABA Comm’n on Ethics & Prof’l Responsibility, Formal Op. 05-434 (2004) (“[O]rdinarily there is no conflict of interest when a lawyer undertakes an engagement by a testator to disinherit a beneficiary whom the lawyer represents on unrelated matters.”), and ABA Comm’n on Ethics & Prof’l Responsibility, Formal Op. 95-390 (1995) (giving a very limited scope to the concept of “adverse” representation in of corporations), with, e.g., ABA Comm’n on Ethics & Prof’l Responsibility, Formal Op. 97-406 (1997) (taking a much more broad view of “adverse interest” that can create a conflict).

55. Wolfram, *supra* note 50, at 546.

56. MODEL RULES OF PROF’L CONDUCT r. 1.7 cmt. 17 (AM. BAR ASS’N 2016).

57. See Ze-ev Eiger & Brandy Rutan, *Conflicts of Interest: Attorneys Representing Parties with Adverse Interests in the Same Commercial Transaction*, 14 GEO. J. LEGAL ETHICS 945, 949–52 (2001) (providing specific examples of differences in California and New York).

58. See CAL. RULES OF PROF’L CONDUCT r. 3-310(C)(3) (STATE BAR OF CAL. 2017).

59. See *id.* r. 3-310(D). Other states have also created unique definition of adversity, including New York, Texas, the District of Columbia, and Florida.

60. See MODEL RULES OF PROF’L CONDUCT r. 1.7 (AM. BAR ASS’N 2016); see also Bussel, *supra* note 52.

61. See MODEL RULES OF PROF’L CONDUCT r. 1.7 cmt. 6 (AM. BAR ASS’N 2016).

can create a concurrent conflict.⁶² “On the other hand, simultaneous representation in unrelated matters of clients whose interests are only economically adverse, such as representation of competing economic enterprises in unrelated litigation, does not ordinarily constitute a conflict of interest and thus may not require consent of the respective clients.”⁶³ Further, the mere fact that an attorney may be advocating a legal position that could create negative precedent for an attorney’s other clients is not a conflict unless “there is a significant risk that a lawyer’s action on behalf of one client will materially limit the lawyer’s effectiveness in representing another client in a different case.”⁶⁴

For example, there may be a conflict where the recovery of one client is at the expense of recovery of another. In *Ferrara v. Jordache Enters. Inc.*, the court disqualified an attorney from representing both the driver of a bus that was in a traffic accident and the matron on the bus.⁶⁵ The court noted that dual driver-passenger representation is prohibited because it is likely that the passenger will interpose counterclaims against the driver, thus pitting the two clients against each other.⁶⁶

The model rules explain: “A conflict of interest exists, however, if there is a significant risk that a lawyer’s action on behalf of one client will materially limit the lawyer’s effectiveness in representing another client in a different case.”⁶⁷ It gives as an example “when a decision favoring one client will create a precedent likely to seriously weaken the position taken on behalf of the other client” with a number of open-ended factors to consider.⁶⁸ Another source of guidance on concurrent conflicts is the *Restatement (Third) of The Law Governing Lawyers*.⁶⁹ This treatise offers the following guidance:

“Adverse” effect relates to the quality of the representation, not necessarily the quality of the result obtained in a given case. The standard refers to the incentives faced by the lawyer before or during the representation because it often cannot be foretold what the actual result would have been if the representation had been conflict-free.

.....
 “*Materially*” adverse effect. Materiality of a possible conflict is determined by reference to obligations necessarily assumed by the lawyer (see § 16), or assumed by agreement with the client either in the retainer agreement (see § 19) or in the course of the representation (see § 21). An otherwise immaterial conflict could

62. The State Bar of Cal. Standing Comm. on Prof’l Responsibility & Conduct, Formal Op. 2011-182 (2011) (“[P]roounding discovery on an existing client may affect the quality of an attorney’s services to the client seeking the discovery, resulting in a diminution in the vigor of the attorney’s discovery demands or enforcement effort. In addition, it is possible the documents sought could expose the client from whom discovery is being sought to claims from the client serving the discovery.”).

63. MODEL RULES OF PROF’L CONDUCT r. 1.7 cmt. 6 (AM. BAR ASS’N 2016).

64. *Id.*

65. See *Ferrara v. Jordache Enters. Inc.*, 819 N.Y.S.2d 421, 422 (Sup. Ct. 2006).

66. See *id.* at 423; see also *Farb v. Baldwin Union Free Sch. Dist.*, No. CV 05-0596(JS)(ETB), 2011 WL 4465051, at *13 (E.D.N.Y. Sept. 26, 2011).

67. MODEL RULES OF PROF’L CONDUCT r. 1.7 cmt. 24 (AM. BAR ASS’N 2016).

68. *Id.*

69. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS (AM. LAW INST. 2000).

be considered material if, for example, a client had made clear that the client considered the possible conflict a serious and substantial matter.⁷⁰

Notably, most conflicts of interest, in most jurisdictions, are imputed to an attorney's entire firm. The main exception is personal conflicts of interest, which are unlikely to be at issue here.⁷¹ Conflicts are generally imputed to and from attorneys serving merely as "of counsel."⁷² In fact, in some jurisdictions a conflict of interest can be imputed from a co-counsel's firm.⁷³ In other words, merely working closely enough with another law firm can cause an attorney's conflicts to impute to that firm, and the firm's conflicts to impute to that attorney.⁷⁴

Rule 1.8 is also worth noting, which guides lawyers who have a "business interest" adverse to a client.⁷⁵ This is analogous, in some marginal way, to the business interest a lawyer has with an insurer. Rule 1.8 states "[a] lawyer *shall not* . . . knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless" several requirements are met.⁷⁶ The attorney must make sure "the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client," and the attorney must also get the client's informed consent.⁷⁷

Let's assume a conflict is found. If a concurrent conflict permits consent, in other words if the conflict is not unconsentable, the rules set forth requirements for ensuring the consent is given in an informed manner: all issues on which the clients' interests might diverge must be fully disclosed in writing and with "adequate information and explanation about the material risks of and reasonably available alternatives" to enable them to make decisions regarding the subject matter of the representation.⁷⁸

Under the model rules, concurrent conflicts can sometimes be cured if the affected clients consent.⁷⁹ However, there is one situation where there can be no cure: if one client asserts a claim against another client in the "same litigation."

Ordinarily, clients may consent to representation notwithstanding a conflict. However, as indicated in paragraph (b), some conflicts are nonconsentable, meaning

70. *Id.* § 121.

71. Although an attorney in an insurer-client conflict may be materially limited by a financial interest in the opposing insurer, this same interest would likely apply to other attorneys at the firm.

72. *See People ex rel. Dep't. of Corps. v. Speedee Oil Change Sys., Inc.*, 980 P.2d 371 (Cal. 2000) (noting that like a law firm's partners, associates and members, the "close, fluid, and continuing relationship [between a law firm and its of counsel lawyers], with its attendant exchanges of information, advice, and opinions, properly makes the of counsel attorney subject to the conflict imputation rule"); *see also Value Prop. Trust v. Zim Co. (In re Mortg. & Realty Tr.)*, 195 B.R. 740, 754-57, (Bankr. C.D. Cal. 1996) (firm disqualified from representing because firm's "of counsel" attorney had served on P's board of directors).

73. *See Fund of Funds, Ltd. v. Arthur Andersen & Co.* 567 F.2d 225, 233-36 (2d. Cir. 1977).

74. *See id.*

75. *See* MODEL RULES OF PROF'L CONDUCT r. 1.8 (AM. BAR ASS'N 2016).

76. *Id.* (emphasis added).

77. *Id.*

78. *See id.* r. 1.0.

79. *See id.* r. 1.7.

that the lawyer involved cannot properly ask for such agreement or provide representation on the basis of the client's consent. When the lawyer is representing more than one client, the question of consentability must be resolved as to each client.

Consentability is typically determined by considering whether the interests of the clients will be adequately protected if the clients are permitted to give their informed consent to representation burdened by a conflict of interest. Thus, under paragraph (b)(1), representation is prohibited if in the circumstances the lawyer cannot reasonably conclude that the lawyer will be able to provide competent and diligent representation. See Rule 1.1 (competence) and Rule 1.3 (diligence).⁸⁰

All potentially affected clients must be advised of the consequences of the potential conflicts and must be kept apprised of future potential conflicts as they develop.⁸¹

Some jurisdictions have attempted to temper the effects of direct adversity conflicts of interest in a limited number of circumstances.⁸² The District of Columbia's version of Rule 1.7 contains an exception for what are called "thrust upon" conflicts of interest: situations in which a lawyer or law firm represents two clients in unrelated matters where there is no adversity, then direct adversity arises after the representation commences that was not foreseeable at the outset and is not otherwise waived. In these unique situations, a D.C. lawyer need not withdraw.⁸³

B. Conflicts of interest in insurance defense

With a general understanding of conflicts under the Model Rules, we can now turn to conflicts in the context of insurance defense specifically. Conflicts stemming from the tripartite relationship, the inherent structure of which requires insurance defense counsel to serve two masters, the insurer and the insured, are some of the most written-about ethical problems in American law.⁸⁴ Courts and ethics authorities generally recognize that in the tripartite relationship, the hiring of counsel creates a relationship between the attorney and both the insured and the insurer.⁸⁵

80. *Id.* r. 1.7 cmt. 14, 15.

81. *See id.*; *see also* Egedi v. Egedi (*In re* Marriage of Egedi), 105 Cal. Rptr. 2d 518, 522–23 (Ct. App. 2001) (citing Klemm v. Super. Ct., 142 Cal. Rptr. 509, 514 (Ct. App. 1977)); Spindle v. Chubb/Pac. Indem. Grp., 152 Cal. Rptr. 776, 780 (Ct. App. 1979) (highlighting the duty to disclose conflicts between insurer and insured); Klemm, 142 Cal. Rptr. at 514 (warning attorneys of their stringent duty to disclose conflicts to their potentially affected clients); L.A. Cty. Bar Ass'n Comm. on Prof'l Responsibility and Ethics Comm., Formal Op. 471 (1992) (explaining the purposes of the rules requiring disclosure of conflicts).

82. *See, e.g.*, Jill B. Berkeley, *Tripartite Ethics Confidential Communications Among the Insured, the Insurer, and Defense Counsel*, 26 BRIEF 23, 26 (1997).

83. *See* RULES OF PROF'L CONDUCT r. 1.7 (D.C. BAR 2006).

84. *See, e.g.*, Berkeley, *supra* note 82; Jeffrey W. Stempel, *The Relationship Between Defense Counsel, Policyholders, and Insurers: Nevada Rides Yellow Cab Toward "Two-Client" Model of Tripartite Relationship. Are Cumis Counsel and Malpractice Claims by Insurers Next?*, NEV. LAW., June 2007, at 20, 22.

85. *See generally* John F. Tratnyek, *Tripartite Relationship - Insurer, Insured and Defense Counsel*, N.J. LAW., AUG. 2012, at 71 (presenting the view that an attorney representing both the insured and the insurer in a tripartite situation is not universal, however, in most jurisdictions and under most authority, attorneys have some sort of attorney-client relationship with both parties).

Often the insurer and insured have the same interests in the outcome of litigation and there is little concern of a conflict.⁸⁶ But in many situations the insured's and insurer's interests diverge and authorities must decide at what point a conflict of interest arises, and how it is managed.⁸⁷

Conflicts of interest in a tripartite relationship often arise when “the insurer issues a reservation of rights to deny coverage partially or fully, when claimed damages exceed coverage, when the insurer attempts to limit the costs of the defense to reduce expenses, or when the insurer and insured disagree over whether to settle or litigate the claims.”⁸⁸ In addition to conflicts triggered when the insurer reserves rights, actual or perceived conflicts can arise for defense counsel in the following settings: (1) reciprocal claims; (2) multiple defendants conflicts; (3) punitive damage claims; (4) when the defense continues after the policy limits have been exhausted; (5) if the insured violates a policy provision, (6) creation of bad law for future cases, (7) publicity, and (8) delay of a case (where the insurer can wait before paying out benefits).⁸⁹

Despite the profound risk of conflict in the tripartite relationship, there is no clear yardstick for determining when a conflict of interest exists.⁹⁰ The Model Rules, and virtually all jurisdictions, allow a third party to pay for a client's legal fees.⁹¹ This is so even though the lawyer's interest in being paid would presumably align the attorney's interests with the payor—not necessarily the client.⁹² The Model Rules explain that third party payors are permitted if the client is informed of the payment and “the arrangement does not compromise the lawyer's duty of loyalty or independent judgment to the client.”⁹³ Notably, even though an attorney in this situation has clear economic interests in satisfying the interests of the payor, the Rules do not presume that this poses a conflict of interest, leaving it to the attorney to determine whether the representation may proceed.⁹⁴ Even if “acceptance of the payment from any other source presents a significant risk” of a conflict of interest—the rules still do not foreclose representation.⁹⁵ The attorney must, without any clear

86. For example, if the insured wins a full dismissal, there is little question the insurer and insured have the same interests served.

87. For example, where the insured faces large exposure, but the insurer has relatively little on the line in the form of low policy limits.

88. *Tratnyek*, *supra* note 85, at 72; *see also* *Betts v. Allstate Ins. Co.*, 201 Cal. Rptr. 528, 545 (Ct. App. 1984); *Purdy v. Pac. Auto. Ins. Co.* 203 Cal. Rptr. 524, 534 (Ct. App. 1984); *San Diego Navy Fed. Credit Union v. Cumis Ins. Soc'y.*, 208 Cal. Rptr. 494, 498 (Ct. App. 1984); State Bar of Cal. Standing Comm. On Prof'l Responsibility & Conduct, Formal Op. 1995-139 (1995) (counsel's discovery of fraud by insured). *See generally*, *Emp'rs Cas. Co. v. Tilley*, 496 S.W.2d 552 (Tex. 1973) (while defending policyholder Tilley at trial, defense counsel was simultaneously collecting evidence to buttress insurance company policy defense to coverage for late notice and briefing the legal question for the benefit of insurance company).

89. *See* Sharon K. Hall, *Confusion over Conflicts of Interest: Is There a Bright Line for Insurance Defense Counsel?*, 41 DRAKE L. REV. 731, 733–34 (1992).

90. *Id.*

91. *See* MODEL RULES OF PROF'L CONDUCT r. 1.8 (AM. BAR ASS'N 2016); *see also* *Devaney v. United States*, 47 F. Supp. 2d 130, 133 (D. Mass. 1999) *aff'd*, 229 F.3d 1133 (1st Cir. 2000).

92. *See* Roszkewycz, *supra* note 38, at 575.

93. *See* MODEL RULES OF PROF'L CONDUCT r. 1.7 cmt. 13 (AM. BAR ASS'N 2016).

94. *See id.*; Roszkewycz, *supra* note 38, at 575.

95. *See* MODEL RULES OF PROF'L CONDUCT r. 1.7 cmt. 13 (AM. BAR ASS'N 2016).

criteria to guide him, judge whether a conflict arises and ensure the attorney's current client is fully informed of all the risks incumbent in the representation.⁹⁶

Despite the potential that the attorney will have a financial bias in favor of the insurer, and despite the fact that there will often be at least subtle conflicts between the insured and insurer, courts have not created a per se bar to this tripartite relationship.⁹⁷ It is only when a factual conflict arises that most courts disqualify attorneys in the insurance-defense tripartite relationship (assuming that the jurisdiction allows such representations in the first place).⁹⁸ In other words, the need for a resolution arises only where the insurer and the insured have an actual conflict of interest, and where the manner in which the attorney conducts the defense can affect the outcome of the issue between the insurer and the insured.⁹⁹

The decision of the Supreme Court of Alaska in *CHI of Alaska v. Employers Re Insurance Corp* is illustrative. There, the court analyzed the manner in which the interests of the insurance company and policyholder diverge once the possibility arises that the insurance company may be absolved of its duty to indemnify its policyholder.¹⁰⁰ The court recognized the insurance company's competing interest (where the insurance company has asserted defenses to coverage) to motivate the attorney to "offer only a token defense," or to "conduct the defense in such a manner as to make the likelihood of a plaintiff's verdict greater under the uninsured theory."¹⁰¹

Courts treat tripartite conflicts in a variety of ways. Although most jurisdictions accept that merely because an insurer regularly hires an attorney does not in itself create a conflict—that is where the agreement ends.¹⁰² Some courts allow insureds to hire independent counsel (on the insurer's dime) in certain circumstances. Different jurisdictions set the threshold for when an actual conflict exists at different points.¹⁰³ Many jurisdictions have consent rules that require defense counsel to disclose her relationships with the insurer to the client, as well as the possibility that the interests of the insurer and the insured may conflict, for example, with respect to a coverage issue. Some jurisdictions have resolved this issue by finding, in the reservation of rights setting where defense counsel has the potential to influence the outcome of the coverage issue by the manner in which defense is conducted, that panel counsel is disqualified from the representation and the insurer is required to engage separate counsel to defend the insured.¹⁰⁴ But, again, when this separate counsel is needed is unclear from the existing rules in many jurisdictions. (In California, most notably, the groundbreaking *Cumis* decision generated so much dissatisfaction and uncertainty that within a short time, the legislature was required

96. See generally *id.*

97. *Id.*

98. See, e.g., *CHI, Inc. v. Emp'rs Reinsurance Corp.*, 844 P.2d 1113 (Alaska 1993).

99. *Id.*

100. *Id.*

101. *Id.* (first quoting then citing *Cont'l Ins. Co. v. Bayless & Roberts, Inc.*, 608 P.2d 281, 289).

102. See generally *Tratnyek*, *supra* note 85, at 72.

103. *Id.*

104. See, e.g., *San Diego Navy Fed. Credit Union v. Cumis Ins. Soc'y*, 208 Cal. Rptr. 494, 501–02 (Ct. App. 1984), *superceded by statute*, CAL. CIV. CODE § 2860 (West 2017); *Pub. Serv. Mut. Ins. Co. v. Goldfarb*, 425 N.E.2d 810, 815 (N.Y. 1981); see also CAL. CIV. CODE § 2860 (West 2017).

to step in and create a framework for managing the tumult which had ensued.) And this resolution is expensive and unrealistic in many small cases. Further, even when separate, non-panel, counsel is hired, the new counsel is still likely to face potentially conflicting loyalties to the insurer that is now paying her.¹⁰⁵

The potential for conflict in the insurance defense setting goes beyond just the tripartite relationship. Various insurers, some or all of whom may be clients of insurance defense counsel in unrelated matters, may also be adverse to each other in any given case. In today's complex liability environment, people and companies often purchase distinct insurance policies covering different aspects of their business or activities. Often these policies may overlap—leading to complex coverage disputes between different insurers.¹⁰⁶ Whether coverage is triggered under different policies will often depend on the actual or alleged actions of the insured. If the insured acted one way—one insurer's policy may be triggered.¹⁰⁷ If she acted another way—perhaps another policy, or policies, may be triggered.¹⁰⁸ What is an attorney to do if she has loyalties to both insurers involved in this case?

Adding another layer of difficulty to the problem, a single lawsuit may contain, explicitly or subtly, alternative allegations—each of which could if proven at trial push the insured's liability out of coverage altogether. Defense counsel may, consciously or unconsciously, affect the outcome of a coverage dispute by the manner in which he or she responds in pleadings and discovery and in how the case is presented at trial. Even a task as integral to the defense of the case as proposing jury instructions or jury questions could have a profound effect on whether the insured's exposure to liability is covered by one or more of its policies. Such considerations about how litigation tactics or strategy might impact the availability of liability insurance coverage may be technically outside the scope of defense counsel's retention to defend the insured. But will that principle provide a complete defense to counsel if the insured loses the case and is ultimately bereft of insurance coverage for the adverse verdict, then sues or brings a bar complaint against defense counsel? After all, defense counsel may have been making the best argument she could for the insured—but if that argument means the insurance company no longer has to cover the insured's bill, is that not another breach of loyalty in itself?

Take this already-complex dance and add in more defendants, more policies, and more coverage disputes. Litigation triggering a defense obligation under a liability policy often arises in the context of tort claims.¹⁰⁹ Perhaps the most common is an auto accident involving multiple vehicles.¹¹⁰ Quite often there are

105. See, e.g., Ben L. Kessinger, Jr., *Ethical Problems Confronting Insurance Defense Counsel*, KY. BENCH & B., Jan. 1983, at 10 (discussing insurance lawyers' loyalties related to future business from insurer); O'Malley, *supra* note 10.

106. See Susan Randall, *Coordinating Liability Insurance*, 1995 WIS. L. REV. 1339, 1363 (1995) (discussing coverage overlaps and "other insurance" disputes).

107. *Id.* at 1362–65; see Samuel M. Taylor, *Duke University v. St. Paul Fire & Marine Insurance Co.: The Court of Appeals Brings Ambiguity to the Interpretation of "Professional Services"*, 69 N.C.L. REV. 1644, 1658 (1991).

108. Randall, *supra* note 106, at 1362–65.

109. See, e.g., Amy Dunn Taylor, *Mass Tort Litigation Management and Ethics*, 44 S. TEX. L. REV. 483, 484 (2003) (examining ethical issues in mass torts).

110. See generally Thomas A. Gordon & Roger Westendorf, *Liability Coverage for Toxic Tort, Hazardous Waste Disposal and Other Pollution Exposures*, 25 IDAHO L. REV. 567, 573 (1989).

multiple defendants, and plaintiffs, in these cases. This means more insurance companies, and more policies, all battling with each other to point the liability in the others' direction.¹¹¹ And more potential problems for insurance defense counsel, who will likely be asked to shift liability onto another party (and by extension, another insurer).¹¹²

Making all this worse is that insurance litigation sometimes encapsulates two separate disputes. On one level is the obvious tort dispute. Plaintiff sues defendant for running a red light and hitting the plaintiff's car, for example. But on another level, there are often disputes about whether the relevant insurance companies satisfied their obligations under the insurance policy—which can involve allegations of unfair claims handling statutes, or common law bad faith claims.¹¹³ Insurers in virtually all states are charged with special duties towards their insureds.¹¹⁴ If an insurer unreasonably refuses to pay out benefits to an insured, (or more apt in the liability setting, unreasonably fails to defend a claim against the insured, fails to settle claims against the insured where the insurer has a reasonable opportunity to do so, or violates various statutory or regulatory standards in the handling of a claim) the insurer can be exposed to liability for extra-contractual damages -- either to the insured directly or to the tort plaintiff after taking an assignment of rights from the insured.¹¹⁵ What is the insurance defense attorney to do: protect the insurer's potential liability for a bad faith claim, or protect the insured's best interest with respect to these claims (even though the attorney was not hired or paid to do so)? Even a careful practitioner seeking to stay out of the fray may find herself having to undertake steps in the defense of the tort claim which will inevitably help either the insured or the insurer in the subsequent extra-contractual litigation.

Pre-litigation interaction among attorneys and insurers for potential defendants is a hazard-fraught environment for insurance defense counsel. In most jurisdictions, insurance companies are rarely parties to the litigation brought against their insureds. However, defense attorneys, whether or not they will eventually assert a cross-claim or third-party claim on behalf of their clients, will often be required to develop facts and legal arguments and engage with such other actors who are involved in the underlying dispute. These other actors may eventually be brought into the litigation, either by the plaintiff or by a defendant, without a defense attorney knowing the identity of these actors' liability insurers, some of whom may turn out to be other clients of the attorney or her firm.¹¹⁶ The attorney shooting in the pre-

111. See Taylor, *supra* note 106, at 484 (discussing conflicts arising in multi-party litigation situations); Gordon & Westendorf, *supra* note 110, at 573.

112. See generally Hawkins Inc. v. Am. Int'l Specialty Lines Ins. Co., No. A07-1529, 2008 WL 4552683 (Minn. Ct. App. Oct. 14, 2008) (discussing this conflict of shifting liability in the context of co-defendant representations, which raise similar issues); *Insurer Dodges Most of \$4m Settlement in Mislabeled-Drug Case*, ANDREWS BAD FAITH LITIG. REPORTER, Nov. 18, 2008, at 4.

113. See generally Victor E. Schwartz & Christopher E. Appel, *Common-Sense Construction of Unfair Claims Settlement Statutes: Restoring the Good Faith in Bad Faith*, 58 AM. U. L. REV. 1477, 1482 (2009) (discussing the history and development of the bad faith claim).

114. *Id.*

115. *Id.*

116. 1 STEVEN PLITT & JORDAN ROSS PLITT, PRACTICAL TOOLS FOR HANDLING INSURANCE CASES § 4:4, Westlaw (database updated Jul. 2017); *Cont'l Cas. Co. v. Peerless Indus. Inc.*, No. 06-4621, 2007

litigation dark may merely request information, or she may be required to engage a potential party, whose insurer is unknown at this point, in a frank discussion about the potential assertion of a claim, and demand indemnity, contribution towards a settlement, or that the party assume or share the burden of defending a claim. Now the attorney is taking adverse positions against a party, whose yet-unknown insurer may well be a firm client, outside of the court process altogether. Does this violate a rule? The Model Rules certainly do not tell us. And if engaging with a potential future adverse party in this manner is forbidden, what is counsel to do when it is usually impossible pre-litigation to determine the identity of the liability insurers covering potential adversaries?

What if insurance defense counsel has in the course of unrelated assignments acquired information about an insurance company client's practices which become relevant during the course of defending an insured? Is defense counsel disqualified anytime that insurance company foots the bill for a defendant that might, at some point, become adverse to the insurer? Does defense counsel have a duty to disclose this "insider information" to his current client and carrier? If he discloses, has he breached a duty to his former client? If he fails to disclose it in order to protect the adverse insurer, does he breach an obligation to his current client and insured?

Professional liability policies, which insure doctors, lawyers, and other professionals, often include consent to settle provisions, whereby the insurer's right to settle a liability claim is limited to those situations where the insured has provided written consent. When an opportunity to settle a case emerges, the insurer and the insured begin a dance which might affect whether the case settles and on what terms, and might have the effect of shifting the risk of an excess verdict to the insurer. These scenarios can create significant conflicts of interest between the insurer and the insured. How far can insurance defense counsel go in counseling the insured professional on the challenging and sometimes complex issues which surround these scenarios? Can or must insurance defense counsel give advice to the client on whether, when, or how to consent? What if insurance defense counsel knows that it may be in the insured's best interests to demand that the insurer settle the case—is defense counsel duty bound to give that advice? Or should defense counsel stay out of the dispute because it is beyond the scope of his or her representation? Does the answer change if the client is also represented by personal counsel?

Unlike other types of practice areas where an attorney or firm can build a continuing relationship with a set of clients and have little risk of having to bring cross claims (for example, in representing employers in discrimination suits),¹¹⁷ insurance defense attorneys do not have this luxury. Because attorneys constantly face at least a potential of taking an adverse position against an insurer (and because the chances of that insurer being a client is high given the small panel-attorney playing field) a framework for dealing with these specific issues is desperately needed.¹¹⁸

WL 2029298 (E.D. Pa. July 11, 2007) (addressing cross-claim situation between insurers); *Pa. Fed. Court Finds Jurisdiction over Asbestos Insurance Case*, ANDREWS ASBESTOS LITIG. REPORTER, July 27, 2007, at 7.

117. WOLFRAM, *supra* note 6, at 555.

118. *Id.*

II. A CASE STUDY IN INSURANCE DEFENSE ETHICS

To illustrate the extent of ethical uncertainties for insurance defense counsel, and the cost of and difficulty of resolving these issues without more targeted guidance, we now offer a case study in a common ethical situation in the conflict of interest arena. We first explain the ethical situation; we then put ourselves in the shoes of each of the interested parties (insurer, attorney, and client) to see if the existing uniform ethical rules offer an answer.

The common situation we use for this case study is as follows. An attorney is hired by an insurance company to represent one of the company's insureds in a personal injury case. Although the insured is the primary (or, depending on the jurisdiction, sole) client, defense counsel's relationship with the insurer goes back many years, and dozens of cases. Our attorney files a series of discovery requests and realizes, good news, it looks like another driver may have contributed to the accident. This revelation has the potential to shift some of the liability onto the shoulders of the new party *and his insurer*. Only after joining the new party to the lawsuit and serving basic discovery on him does defense counsel learn that this other insurer is the counsel's second-best client, Insurance Company B. The question is: Do we have a conflict of interest here?

Our attorney would first turn to the ethical rules on conflicts of interest. As explained above, authorities on conflicts of interest generally tell us a few things. Current conflicts exist when an attorney's current clients are "directly adverse" to each other.¹¹⁹ We know that "directly adverse" means, at least, when two clients are named parties opposed in the same litigation—in other words, two clients have official claims against each other.¹²⁰ Outside of that, authorities provide little specific guidance on what other situations might create "direct adversity."¹²¹ But we know that the circumstances must be examined in their totality.¹²²

In addition, we know that, aside from direct adversity, a current conflict exists when an attorney will be materially limited in her representation of a client.¹²³ Material limitations can come from any personal or professional interest that prejudices the attorney's ability to represent clients.¹²⁴ Again, material limitations are a fact intensive question that will vary under the circumstances.

Finally, we know that some concurrent conflicts can be cured.¹²⁵ Whether a concurrent conflict can be cured depends on whether the conflict is client vs. client in the same litigation (which means that it cannot be cured) or whether the attorney cannot provide adequate representation to a client because of the conflict (another

119. MODEL RULES OF PROF'L CONDUCT r. 1.7 (AM. BAR ASS'N 2016).

120. *Id.*

121. *Hawkins Inc. v. Am. Int'l Specialty Lines Ins. Co.*, No. A07-1529, 2008 WL 4552683 (Minn. Ct. App. Oct. 14, 2008) (discussing this conflict of shifting liability in the context of co-defendant representations, which raise similar issues); *Insurer Dodges Most of \$4m Settlement in Mislabeled-Drug Case*, ANDREWS BAD FAITH LITIG. REPORTER Nov. 18, 2008, at 4.

122. *See* MODEL RULES OF PROF'L CONDUCT r. 1.7 (AM. BAR ASS'N 2016).

123. *Id.*

124. *Id.*

125. *Id.*

fact intensive inquiry).¹²⁶ Whatever the case, curing a conflict always requires informed consent of all affected clients.¹²⁷

The Model Rules don't give us a clear answer yet, just some general principles. We now turn to the relevant caselaw and ethics opinions in this area for more guidance.

1. Whether counsel has breached an ethical obligation to the adverse insurer

Turning back to our factual scenario, we first consider whether the attorney has breached ethical obligations towards the insurer for the party that counsel is targeting with a potential third-party complaint where it turns out that insurer is a client of defense counsel or her firm.

As explained above, the adversity requirement does not require formal adversity, such as litigation between two clients.¹²⁸ Instead, the attorney merely needs to be "adverse" to her client for a conflict to exist. What constitutes "adverse" is unclear.¹²⁹ If an attorney merely prepares an opinion letter for an adverse insurer (but never appears in court), is that enough? What if an attorney sends a demand letter to her current client? What if an attorney litigates a dispute in a manner that will ensure the opposing party's insurer will have to provide coverage?

The insurer for the third-party defendant will have two potential ethical grounds to challenge defense counsel in our hypothetical. First, the insurer could allege that the duty of loyalty the attorney owes to the insurer creates a direct conflict where the attorney somehow acts "adverse" to the insurer outside of the named-party context.¹³⁰ Second, the insurer could challenge the attorney on the grounds that the attorney will be materially limited in representing the insured, most likely because of the possession of the insurer's relevant confidential information or because of financial bias towards the insurer (who sends the attorney work).¹³¹

As explained by the California Court of Appeal, "[t]he proscription [against adverse representation] exists whe[never] counsel's employment is 'adverse to the client or former client,' and can exist even though a prior client is not a party to the litigation."¹³² Concurrent conflicts of interest may arise in a variety of circumstances where an attorney assumes a role other than as an attorney who has filed suit against an existing client.¹³³ One court states that the duty of loyalty "seek[s] to avoid

126. *Id.*

127. *Id.*

128. *Am. Airlines, Inc. v. Sheppard, Mullin, Richter & Hampton*, 117 Cal. Rptr. 2d 685, 701 (Ct. App. 2002); L.A. Cty. Bar Ass'n Prof'l Responsibility & Ethics Comm., Formal Op. 513 (2005) (discussing cross examination of former client as expert witness).

129. *See supra* Part III.

130. *See supra* Part III; MODEL RULES OF PROF'L CONDUCT r. 1.7 cmt. 6 (AM. BAR ASS'N 2016).

131. MODEL RULES OF PROF'L CONDUCT r. 1.7 cmt. 8 (AM. BAR ASS'N 2016). Of course, it is really the insured which counsel represents in the litigation, and not the insurer for the third-party defendant, who should be concerned that counsel might not aggressively pursue the third-party claim against the driver insured by a firm client. Nevertheless, the insurer for the third-party defendant may well raise the material limitation grounds as part of its effort to disqualify defense counsel.

132. *Metro-Goldwyn-Mayer, Inc. v. Tracinda Corp.*, 43 Cal.Rptr.2d 327, 334 (Ct. App. 1995).

133. *Manfredi & Levine v. Super. Ct.*, 78 Cal. Rptr. 2d 494, 497-98 (Ct. App. 1998).

allowing an attorney to take a role that places him in actual or potential conflict with a client.”¹³⁴ But an attorney can be “potentially” in conflict with one of her clients by taking almost any insurance defense case.¹³⁵ As the court explained in *State Farm vs. Federal*, this duty of loyalty includes the “attorney’s duty to protect the client in every possible way.”¹³⁶ Consequently, “[i]t is a violation of the duty of loyalty for the attorney to assume a position adverse of or antagonistic to his or her client without the client’s free and intelligent consent given after full knowledge of all the facts and circumstances.”¹³⁷

The Restatement Third of The Law Governing Lawyers provides an extremely broad concept of “adverse” conflicts in the insurance context.¹³⁸ The Restatement suggests that an attorney may be in a conflict if she provides “advice and other legal services to the insured concerning . . . claims against other persons insured by the same insurer, and the advisability of asserting other claims against the insurer.”¹³⁹ The Restatement goes on to state that in such a situation, at the least “the lawyer must inform the insured in an adequate and timely manner of the limitation on the scope of the lawyer’s services and the importance of obtaining assistance of other counsel with respect to such matters.”¹⁴⁰ This language suggests that an attorney is prohibited from even providing advice or any other “legal service” concerning any possible claim against persons insured by the insurer-client.¹⁴¹ The Restatement does not suggest that informed consent be obtained—but instead, that this is a “limitation” that must be communicated to the client.¹⁴² In other words, the attorney cannot even advise about bringing claims against an insurer-client (much less prepare such a claim).¹⁴³

Instructive authority is found in a California Court of Appeal case and the ensuing modification to California’s ethical rules.¹⁴⁴ In *State Farm Mutual Automobile Insurance Co. v. Federal Insurance Co.*, the California Court of Appeal held that an attorney was prohibited from filing a case against an insurer where the insurer is a current client of the attorney.¹⁴⁵ Following the decision in *State Farm*, the California State Legislature asked the State Bar to conduct a study to determine when and whether an attorney may litigate against an insurer-client.¹⁴⁶ After the

134. *Am. Airlines, Inc. v. Sheppard, Mullin, Richter & Hampton*, 117 Cal. Rptr. 2d 685, 702 (Ct. App. 2002).

135. *See, e.g., id.*

136. *State Farm Mut. Auto. Ins. Co. v. Fed. Ins. Co.*, 86 Cal. Rptr. 2d 20, 26 (Ct. App. 1999).

137. *Id.*

138. *See* RESTATEMENT (THIRD) OF LAW GOVERNING LAWYERS § 121 cmt. a–g. (AM. LAW INST. 2000).

139. *Id.* § 134 cmt. f.

140. *Id.*

141. *Id.*

142. *Id.*

143. *Id.*

144. *See generally* *State Farm Mut. Auto. Ins. Co. v. Fed. Ins. Co.*, 86 Cal. Rptr. 2d 20 (Ct. App. 1999).

145. *Id.* at 29.

146. CAL. BUS. & PROF. CODE § 6068.11 (Deering 2002) (repealed 2003); *see* CAL. RULES OF PROF’L CONDUCT r. 3-310 (STATE BAR OF CAL. 1992); *see also* Phillip Feldman, *Time for Change: California Needs Some of the ABA Ethics Rules*, ORANGE COUNTY LAW., Aug. 2001, at 16, 16 (noting that *State Farm* “seemed to prompt *Business & Professions Code* §6069.11 [sic]).

study's commission, the discussion section of California's direct conflict rule, Rule 3-310, was amended.¹⁴⁷ That discussion section now provides that "[n]otwithstanding *State Farm*, [subparagraph (C)(3) of this provision] . . . is not intended to apply with respect to the relationship between an insurer and a member when, in each matter, the insurer's interest is only as an indemnity provider and not as a direct party to the action."¹⁴⁸ Critically, California's ethical rules appear to draw the ethical line at the point in which an insurer is a direct party in the action. In other words, this language suggests that, at least in California, an attorney may litigate against an insured indemnified by an insurer-client without creating a disqualifying conflict.¹⁴⁹ On the other hand, the language still does not address the situation where an attorney may be pursuing, preparing, or advising her client about a lawsuit against the insurer-client (without actually filing a formal lawsuit against the insurer) or perhaps even negotiating adverse to the insurer-client.¹⁵⁰ Although one could presume that the safe-harbor created by the amendment to California's ethical rules protects defense counsel, both pre-litigation and after filing suit as long as the firm-client insurer is not itself eventually named as a party, the rule and the comments remain silent on whether pre-litigation advice and conduct which might otherwise be considered materially adverse to the insurer are permissible.

Moreover, California's safe harbor is not the rule in many other jurisdictions. Comments to many states' ethical rules, and cases interpreting various rules, suggest that an attorney may not represent one client against another of the attorney's clients in negotiations.¹⁵¹ This indicates that an attorney might be prevented from carrying out actions adverse to an insurer-client, such as writing a demand letter, even where the insurer is not a party to the litigation.¹⁵² For example, Idaho's version of Model Rule 1.7(a)(1) prohibits a lawyer from simultaneously representing current clients if "the representation of one client will be directly adverse to another client" and "a lawyer cannot undertake common representation of clients where contentious litigation or negotiations between them are imminent or contemplated."¹⁵³ This would indicate that an attorney should be prohibited from adversely negotiating against one of her client insurers.

Curtis v. Radio Representatives, Inc. is illustrative.¹⁵⁴ The case presented an interesting procedural stance: A law firm represented the defendant client in renewing its broadcast license with the Federal Communications Commission

147. See CAL. RULES OF PROF'L CONDUCT r. 3-310 (STATE BAR OF CAL. 1992).

148. *Id.*; see also BUS. & PROF. § 6068.11.

149. BUS. & PROF. § 6068.11 (not addressing these issues).

150. See *id.* Although the Rules of Professional Conduct are not binding on civil courts in determining disqualification motions, they are commonly relied upon for guidance. No published opinion, however, has considered this revised discussion to Rule 3-310.

151. See, e.g., *In re CMH Homes, Inc.*, No. 04-13-00050-CV, 2013 WL 2446724, at *7 (Tex. Ct. App. June 5, 2013); Wyshak, No. 92-O-20339, 1999 WL 778086, at *1 (Review Dep't of the State Bar Court of Cal. Sept. 21, 1999); see also Eiger & Rutan *supra* note 57, at 949.

152. See, e.g., Eiger & Rutan *supra* note 57, at 949.

153. IDAHO RULES OF PROF'L CONDUCT r. 1.7(a)(1) (IDAHO STATE BAR 1986); *id.* r. 1.7 cmt. 29; see also *Storfer v. Dwelle*, No. 3:12-CV-00496-EJL, 2014 WL 3965033, at *8 (D. Idaho Aug. 13, 2014) (citing IDAHO RULES OF PROF'L CONDUCT r. 1.7, cmt. 29 (IDAHO STATE BAR 1986)).

154. See generally *Curtis v. Radio Representatives, Inc.*, 696 F. Supp. 729 (D.D.C. 1988).

(“FCC”).¹⁵⁵ The law firm then sued the client for unpaid fees.¹⁵⁶ In defending against the suit for unpaid fees, the client claimed it should not have to pay because the law firm had violated its ethical obligations regarding concurrent conflicts.¹⁵⁷

The client’s theory was that the firm had concurrently represented competing radio and television station owners in obtaining or renewing broadcast licenses from the FCC.¹⁵⁸ The client argued it should be relieved of its obligation to pay its legal fees based on the contention that the attorney had conflicting interests in representing multiple parties for a small number of fixed licenses.¹⁵⁹ The attorney’s representation would, practically, have negative effects on its other clients who were also seeking the licenses.¹⁶⁰ The *Curtis* court held that this was not an “adverse representation” within the meaning of the rules because there was insufficient indication that representation of one client would create directly adverse consequences for other clients.¹⁶¹ After all, it was not clear that by procuring a license for one client another client would not be able to get a license.¹⁶² Notably, however, the court did suggest that there may be a concurrent conflict if the same attorney represented one client against the interests of the others with respect to “objectionable electrical interference [that] existed between two stations.”¹⁶³ In other words, if there was more direct evidence that the representation of one client, practically, would have directly harmful implications on another of the attorney’s clients, there may be a concurrent conflict.¹⁶⁴

Another federal court held that clients would be “adverse” within the meaning of the rules if an attorney represented two competing shopping centers, both competing to acquire a certain tenant, and helped one shopping center negotiate a lease with the desired tenant.¹⁶⁵ In other words, because a favorable outcome for one client would mean that the attorney’s other client would be directly im-pacted in a negative manner (it could no longer procure the tenant), there was a conflict of interest potentially.¹⁶⁶

Potentially illustrative, the Seventh Circuit in *Analytica, Inc. v. NPD Research, Inc.* addressed a law firm which was hired to represent one client before the FCC to encourage the agency to pursue an investigation against another of the attorney’s clients.¹⁶⁷ While this appears to be an obvious conflict, it is important to consider that the reason this is a conflict is because the attorney is pursuing a course of action that could have adverse consequences against one of the attorney’s

155. *Id.* at 731.

156. *Id.* at 730.

157. *Id.*

158. *Id.* at 731–32.

159. *Id.* at 730–31.

160. *Id.* at 736–37.

161. *Id.* at 736.

162. *Id.*

163. *Id.*

164. *Id.*; see also RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 121 cmt. c(i), illus. 1 (AM. LAW. INST. 2000).

165. *Bieter Co. v. Blomquist*, 132 F.R.D. 220, 221–24 (D. Minn. 1990).

166. *See id.*

167. *Analytica, Inc. v. NPD Research, Inc.*, 708 F.2d 1263 (7th Cir. 1983).

clients—but that client is not a party to any litigation.¹⁶⁸ In *Reis v. Barley, Snyder, Senft & Cohen L.L.C.*, the issue was that a firm, while representing one corporate client, secretly helped another client to set up a corporation that was intended by that client to compete directly with the firm's first client.¹⁶⁹ The court refused to dismiss the first client's claim on these facts.¹⁷⁰

A District of Columbia decision, *Avianca, Inc. v. Corriea*,¹⁷¹ is similar. A lawyer represented an aircraft maintenance company while also incorporating and representing another company that was directly competing with the first client.¹⁷² The court granted summary judgment that the lawyer breached his fiduciary duty, calling this breach "patent."¹⁷³ Also illustrative are cases where a firm provides a patent opinion letter to one client explaining ways to copy another client's art without infringing any patents—which the same firm is also handling in another matter.¹⁷⁴

A Louisiana decision provides another perspective on this issue.¹⁷⁵ In *Suard*, the court applied Louisiana's concurrent conflict rule and found a conflict of interest where a law firm filed a motion to compel discovery responses and seek sanctions against an insurer in one proceeding—when in a second proceeding, that insurer had retained the same law firm to represent one of its insured.¹⁷⁶

A Michigan Bar Association opinion letter appears to find a conflict of interest in the insured-client situation.¹⁷⁷ In that opinion, the state bar committee held that a clear conflict exists where a law firm represents a plaintiff who sues a defendant insured by an insurer if that insurer regularly sends business to the law firm.¹⁷⁸ Even if the law firm only receives a small number of cases from the insurer, client consent should be obtained.¹⁷⁹

In a 2008 decision, the Georgia Supreme Court held that an attorney representing an insured could not in an unrelated matter also concurrently represent an insurance company which claimed subrogation rights against the lawyer's client.¹⁸⁰ The court explained that this rule does not apply if the insurer in the other

168. *Id.* at 1270.

169. *Reis v. Barley, Snyder, Senft & Cohen L.L.C.*, 484 F. Supp. 2d 337, 345 (E.D. Pa. 2007) *aff'd in part, rev'd in part sub nom.* *Reis v. Barley, Snyder, Senft & Cohen L.L.C.*, 426 F. App'x 79 (3d Cir. 2011).

170. *Id.* at 343.

171. *Avianca, Inc. v. Corriea*, 705 F. Supp. 666 (D.D.C. 1989), *vacated sub nom.* *Avianca, Inc. v. Harrison ex rel. Estate of Corriea*, No. 94-7053, 1995 WL 605521 (D.C. Cir. Oct. 17, 1995), *and aff'd sub nom.* *Avianca, Inc. v. Harrison ex rel. Estate of Corriea*, No. 94-7053, 1995 WL 650232 (D.C. Cir. Oct. 24, 1995).

172. *Id.* at 680.

173. *Id.*

174. *See, e.g., Andrew Corp. v. Beverly Mfg. Co.*, 415 F. Supp. 2d 919, 924 (N.D. Ill. 2006).

175. *See In re Suard Barge Servs., Inc.*, No. 96-3185, 1997 U.S. Dist. LEXIS 12364 (E.D. La. Aug 14, 1997).

176. *Id.* at *13.

177. *See State Bar of Mich., Formal Op. C-234* (1984).

178. *See id.*

179. *See id.*

180. *See* 4 RONALD E. MALLEN, LEGAL MALPRACTICE § 30:86, WESTLAW (database updated Jan. 2018).

matter is another insured (not the insurer).¹⁸¹ “Then, consent could be sought regarding the lawyer’s personal interest in the business relationship with the insurer.”¹⁸²

Another relevant case is a New Jersey Superior Court decision, *Gray v. Commercial Union Ins. Co.*¹⁸³ A lawyer represented an insured in litigation.¹⁸⁴ Later, the attorney represented a different client in a different case in which the client was directly adverse to the insurer.¹⁸⁵ The court disqualified the attorney to prevent him from bringing the claim against the insurer.¹⁸⁶ The court had no problem finding that the attorney had a client-relationship with the insurer given the attorney’s prior representation of its insured.¹⁸⁷ The court then held that “it is evident that neither [the attorney] nor any members of the firm in which he is a member can properly represent [the insured] in this action against [the insurer].”¹⁸⁸ The court relied on its assumption that the attorney would have confidential information and special knowledge that would prejudice the insurer if the attorney were permitted to sue it:

It may not be seriously disputed that as a result of his 20 years as one of Commercial Union’s lawyers, [the attorney] has obtained confidential information and possesses knowledge of certain internal policies of Commercial Union that he will be able to use against it in the Gray litigation. . . . Although this general information may not be specifically relevant to the merits of the Gray-Commercial Union dispute, it constitutes secrets or confidences . . . that could be used against it to its substantial disadvantage.¹⁸⁹

Interestingly, courts that prohibit firms from being adverse to an insurance company which has retained the attorney to represent insureds often focus on the confidential information the attorney received while working for the insurer.¹⁹⁰ It seems speculative to suggest that panel attorneys would have access to enough confidential information from the insurer merely as a result of acting as insurance defense counsel in other cases. It appears unlikely that an insurer would have a

181. But this distinction probably holds little value given that most jurisdictions would find a client relationship by the mere act of representing an insured.

182. MALLEN, *supra* note 180.

183. 468 A.2d 721, 724–26 (N.J. Super. Ct. App. Div. 1983).

184. *See id.* at 724–26.

185. *See id.* at 723.

186. *See id.*

187. *See id.* at 724.

188. *Id.*

189. *Id.* at 725–26.

190. *See, e.g., Allendale Mut. Ins. Co. v. Excess Ins. Co.*, C.A. No. 94-0614B, 1995 U.S. Dist. LEXIS 19882, at *16 (D.R.I. June 1, 1995) (assessing the situation in which a law firm had represented many insurance companies and insureds on unrelated matters and disqualifying the law firm from representing plaintiffs in actions against the insurance companies because the law firm had represented the company in several matters). In *Allendale*, the court noted,

Prudential’s insureds were being represented by K&T at the time this instant complaint was filed. While K&T states it represented only the insureds and not Prudential directly, it has been held that where there is no dispute between an insurer and insured, “as a fundamental proposition a defense lawyer is counsel to both the insurer and the insured. He owes to each a duty to preserve the confidences and secrets imparted to him during the course of representation.”

Id. (quoting *Gray*, 468 A.2d at 725)).

legitimate concern that confidential information would be used to its detriment where defense counsel is suing one of its insureds in a matter unrelated to any that prior counsel has done on behalf of other insureds. Such concerns would appear to have greater legitimacy where defense counsel has represented the insurer directly in coverage or bad faith actions (during which counsel may have learned much more sensitive information) and where defense counsel in the instant action is pursuing claims directly against the insurer, and not merely pursuing claims against a party insured by the insurer-client.

In conclusion, it is unclear whether an insurer can disqualify one of its panel attorneys from litigating against one of the insurer's insureds.¹⁹¹ It is probable that, at some point, an attorney can be so "adverse" against the insurer-client, or materially limited by duties of confidentiality or financial interest, so that a conflict exists. But that line is difficult, if not impossible, to draw given the existing authority (most of which is not directly on point). Whether this conflict would be curable is another open question. About all we can say for sure is that in most jurisdictions, an attorney is not disqualified from representing a party in litigation merely because the interests of that client are directly adverse to another party which is insured by a current firm client, even if that representation is potentially adverse to the insurer-client's financial interests. But at what point a concrete conflict arises is unclear. More persuasive may be the argument that the attorney will be biased in favor of the insurer against the insured-client.

2. Whether counsel has breached an ethical obligation to her current client and her current client's insurer

Whether there is a conflict is similarly uncertain from the current-client's perspective.¹⁹² In some ways, the attorney's new client has the most to lose if the attorney's interests are compromised.¹⁹³ It should be noted that, generally, clients can fire their attorneys at any time.¹⁹⁴ The question, however, is whether a conflict exists.¹⁹⁵

As one of us explained in a prior article:

191. Phillip Feldman, *Time for Change: California Needs Some of the ABA Ethics Rules*, ORANGE COUNTY LAW., Aug. 2001, at 16, 16 (noting that "from the time an insured completes an application for insurance until the time the case is resolved, there are many cross roads where going one way benefits the insured, at the expense of the insurance company and vice versa" and that rules put these lawyers in an unfair position).

192. This is particularly true given that, when a client has a right to select new paid-for counsel is unclear as a general matter. *See supra* Part III.

193. After all, the current client has to worry about whether the attorney might change her representation style based on allegiance to the opposing insureds insurer.

194. *See* MODEL RULES OF PROF'L CONDUCT r. 1.16(a)(3) (AM. BAR ASS'N 2016); *id.* r. 1.16 cmt. 4 ("A client has a right to discharge a lawyer at any time, with or without cause. . . ."); WOLFRAM, *supra* note 6, at 318.

195. This question also can be relevant to whether a client has a right to have her insurer pay for replacement counsel. Also, it is technically true that presiding judges may prohibit discharge of counsel where it would be unduly disruptive. *See, e.g.,* United States *ex rel.* Maldonado v. Denno, 348 F.2d 12, 15 (2d Cir. 1965).

[A] concurrent conflict of interest may occur where the lawyer is materially limited by her interests to some third party. Ethical rules and court opinions carefully scrutinize such a possibility whenever a third party pays an attorney's bills. The rules and authorities also look closely anytime a lawyer has some sort of financial or personal interest in an opposing party. These concerns are, arguably, important in the context of opposing-insurer-client situations. "House counsel" or "panel counsel" models inherent in modern insurance practice involve a long-term conditional employment or contractual relationship for the services of the lawyer on behalf of the insurer. "It is understood that so long as the payments result in a benefit to the enterprise, the lawyer will continue to represent its members. Otherwise, the retention of the lawyer will come to an end." And interest in pleasing other parties does not always have to be merely financial. For example, under California law, merely "propounding discovery on an existing client may affect the quality of an attorney's services to the client seeking the discovery, resulting in a diminution in the vigor of the attorney's discovery demands or enforcement effort."¹⁹⁶

There is an important feature of our scenario that may buffer the contention that defense counsel may be materially limited due to her relationship with the third-party defendant's insurer from vigorously pursuing relief on behalf of the insured against the third-party defendant. In the most common tripartite scenario, the attorney has a long-term client or fiscal relationship with the insurer, and a one-time relationship with the insured.¹⁹⁷ In contrast, here, the attorney has a long-term relationship with insurers on both ends: the insurer defending and potentially indemnifying the current insured-client, and the insurer covering the third-party defendant.¹⁹⁸

But some authority indicates that there may be a material limitation inherent in an attorney representing an insured where an insurer-client stands to lose. The second circuit has probably given this question the most thought in the often-analyzed *United States v. Schwarz*.¹⁹⁹

In *Schwarz*, a firm represented a police officer accused of assaulting someone.²⁰⁰ The firm's fees were paid by the Patrolman's Benevolent Association, a labor union that represented police officers.²⁰¹ The PBA had a long-term contract with this particular firm, which included representation of it in other matters.²⁰² The police officer client wanted to pursue a strategy of casting blame on the conduct of

196. Joseph Regalia, *Bringing Ethical Challenges Against Insurance Defense Counsel as a Government Lawyer*, (Gov't L. Committee Newsl., Chicago, Ill), Spring 2016, at 1, 10 (quoting first Aviva Abramovsky, *The Enterprise Model of Managing Conflicts of Interest in the Tripartite Insurance Defense Relationship*, 27 CARDOZO L. REV. 193, 196 (2005) then quoting State Bar of California Standing Comm. on Prof'l Responsibility & Conduct Formal Op. 2011-182 (2011)).

197. CAL. RULES OF PROF'L CONDUCT r. 3-310(C)(3) (STATE BAR OF CAL. 1992).

198. *See supra* Part II.

199. 283 F.3d 76 (2d Cir. 2002).

200. *See id.*

201. *Id.* at 81.

202. *Id.*

another officer, also covered under the PBA umbrella, but defense counsel declined to adopt this strategy. The case did not go well, and the officer defendant blamed his lawyer's failure to pursue the requested blame-shifting strategy for the adverse result.

On appeal, Schwarz argued that the firm's financial interest in maintaining its contract with the PBA created a conflict of interest.²⁰³ He argued that this was a per se conflict that violated his attorney's duty of undivided loyalty.²⁰⁴ He specifically raised the firm's 10 million dollar contract with the PBA, which was conditioned on the PBA's "satisfaction" with the firm's performance generally.²⁰⁵ The court found an actual conflict of interest, explaining that that lawyer "had a strong personal interest in refraining from any conduct to which the PBA might object."²⁰⁶ The Court held that the firm had a strong interest in not shifting blame to another co-defendant officer.²⁰⁷ The mere fact that a plausible strategy would have pitted the firm's current client against another officer the PBA had an interest in protecting, created a conflict according to this court.²⁰⁸

Schwarz is a court's recognition that long-term future fee considerations may constitute a conflict of interest.²⁰⁹ *Schwarz* also stands for the proposition that, under certain circumstances, such a conflict may "so permeate[] the defense that no meaningful waiver [can] be obtained."²¹⁰ The court stated:

[T]he conflict between [the firm's] representation of Schwarz, on the one hand, and his ethical obligation to the PBA as his client and his self-interest in the PBA retainer, on the other, was so severe that no rational defendant in Schwarz's position would have knowingly and intelligently desired [the firm's] representation . . . we hold that Schwarz's counsel suffered an actual conflict, that the conflict adversely affected his representation, and that the conflict was unwaivable.²¹¹

This reasoning directly applies to the insurance defense relationship. In *Schwartz*, the firm receiving future work hinged on "satisfaction with the [] firm's performance." Insurers also explicitly or implicitly condition counsel's continuing on panel and receipt of future assignments on "satisfaction" with an attorney's performance.²¹² It could be argued that client satisfaction is always a factor when a client is considering whether to rehire an attorney, but here the key is that this satisfaction is measured by a third party to the litigation, not the attorney's performance with the current client.²¹³

Courts also search for evidence that insurance defense counsel will carry out the case in a way in which the opposing party wins, but the resulting judgment falls outside the insurer's coverage. In a traditional tripartite relationship—as

203. *Id.* at 82.

204. *Id.* at 94.

205. *Id.* at 91.

206. *Id.*

207. *Id.* at 99.

208. *See id.* at 94–95.

209. *See id.*

210. *Id.* at 96.

211. *Id.* at 96–97.

212. *See supra* Part I.2.

213. *See United States v. Schwarz*, 283 F.3d 76, 94 (2d Cir. 2002).

explained above—one of the concerns is that an unscrupulous attorney will jeopardize the insured's case to build a record that will (later) get the insurer off the hook for indemnification. In practice, this risk may be minimal, both because most defense practitioners take their obligations to the insured-client seriously and steer clear of coverage issues, and also because the attorney may not have examined carefully the grounds for a reservation of rights and how particular defense tactics and strategies might affect coverage under the policy. Nevertheless, the risk for such objectionable intermeddling by defense counsel in coverage issues is built into the structure of the tri-partite relationship and the dynamic intersection of liability and coverage issues and must be guarded against.

At bottom, we are left with many questions and few answers. Does having some financial interest in an adverse insurer mean that an attorney is being unethical towards her current insured-client? At what point are those interests severe enough to create a conflict? We simply do not know.

3. Whether counsel has breached ethical obligations to any other parties

The third-party defendant may also have an interest in disqualifying the allegedly conflicted attorney. After all, the attorney's relationship with the third-party defendant's insurer may give the attorney a leg up in prosecuting the third-party complaint. The attorney is likely to know the insurer's general methods for handling cases, such as their settlement policies or budgets. This could theoretically disadvantage the adverse insured, not just the adverse insurer.

Although generally one must have an attorney-client relationship to challenge a conflict of interest, some courts have allowed third parties to the attorney-client relationship to enforce a conflict violation. The Supreme Court of Delaware, for example, has held that a non-client has standing to enforce a violation of the conflict of interest rule if it can "prove by clear and convincing evidence (1) the existence of a conflict and (2) demonstrate how the conflict will prejudice the fairness of the proceedings."²¹⁴ We do not consider the issue at length because it is outside the scope of this article, but it is possible that the other insured would have standing depending on how egregious a conflict was.

4. Conclusion: we just don't know

It is unclear at what point an attorney may have a conflict. Under some authority, such as the Restatement, the lawyer may be conflicted anytime she brings a lawsuit against an insured indemnified by a current-client insurer. If this is the case, the second question becomes whether the conflict is consentable.²¹⁵ Most authorities, including the Model Rules, state that representation involving "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" is unconsentable.²¹⁶ There is some indication that an insurer indemnifying a party is not "in the litigation." But this is

214. Melissa Moreau, *Nonclients Enforcing Conflict of Interest Violations*, 17 J. LEGAL PROF. 305, 306 (1992).

215. See *supra* Part I.2.A.

216. See MODEL RULES OF PROF'L CONDUCT r. 1.7 (AM. BAR ASS'N 2016).

far from certain. Some cases have found conflicts to be unconsentable even where a third party is not a named party in the case—leaving the consent question unclear.

Even if consent were potentially allowed, consent only cures if all relevant parties agree. It is unclear who must agree: the opposing insurer, the current insurer, the current client, and the opposing insured? If so, there is a substantial possibility at least one of these parties will not consent.

Other authority suggests that the lawyer has some leeway when determining whether a conflict exists in the opposing-insurer situation. In these jurisdictions, lawyers must use their own judgment and discretion to determine whether they will be “materially limited” in their interests or loyalties to the opposing insurer.

At bottom, confidently navigating this situation in a way that keeps defense counsel clearly within the lines is almost impossible. There are no clear answers in virtually any jurisdiction. The Model Rules provide merely general standards with no sense of when a conflict might arise. And given how common this issue is, all of the above parties are left at sea in a number of cases—and told to simply proceed at their own risk.

III. THE COSTS OF UNCERTAINTY: THE RISING COSTS OF INSURANCE, THE RISING COSTS OF LITIGATING ETHICS DISPUTES, AND THE VARIOUS INTERESTS OF ALL INVOLVED IN INSURANCE DEFENSE

To craft a better solution than the vague standards out there now, it will help to have an idea about what policy interests are at play. Several players have interests at stake here—the insurers; the attorneys; the clients themselves; and yes, even the public, which stands to lose money in the form of rising insurance premiums. By leaving everyone in the dark about these ethical pitfalls, everyone loses.

The first policy interest in play is confidentiality. Representing adverse interests in unrelated matters may compromise confidential information that attorneys have a continuing duty to protect.²¹⁷ This duty of confidentiality is generally broad and could easily encapsulate the types of information panel counsel would learn about an insurer.²¹⁸ For example, panel attorneys may have access to confidential information about how a specific insurer works—their business practices and management processes—which provide a strategic advantage.²¹⁹ Insurers often use “litigation guidelines” which contain information about how the insurer prefers to handle cases, its strategies, and other information which an attorney (on the other side) could use to the insurer’s advantage.²²⁰ These guidelines can

217. See, e.g., TEX. DISCIPLINARY RULES OF PROF’L CONDUCT r. 1.05 (STATE BAR OF TEX. 1989) (requiring information to be kept confidential even if it is not privileged).

218. For example, Texas’s rules, which are standard, creates confidentiality duties covering “all information relating to a client or furnished by the client . . . acquired by the lawyer during the course of or by reason of the representation of the client.” *Id.*

219. See MODEL RULES OF PROF’L CONDUCT r. 1.7 cmt. 11, 30–31 (AM. BAR ASS’N 2016); Gregory Zimmer, *Suing a Current Client: Responsibility and Respectability in the Conduct of the Legal Profession*, 11 GEO. J. LEGAL ETHICS 371 (1998).

220. See Michael D. Morrison & James R. Old, Jr., *Economics, Exigencies and Ethics: Whose Choice? Emerging Trends and Issues in Texas Insurance Defense Practice*, 53 BAYLOR L. REV. 349, 382–83 (2001).

contain information about experts the insurer uses, for example; what types of legal research can be conducted; rules about when and how depositions are to be taken; which types of motions to file; and more.²²¹ Insurers are likely to be concerned that, armed with this general information about how an insurer runs its insured's cases, the opposing attorney could have an advantage.

Next, the public image of the bar, or in other words the appearance of impropriety, is an issue. Representing an insurer in some cases, and then taking positions adverse to that insurer in other cases, suggests that lawyers will do anything for the money, casting a negative light on the profession.²²² And without clear ethical guidelines, neither the attorneys nor the public know what is unethical.

The trial process demands direct confrontation, particularly during public cross-examination of witnesses. Cross-examining a current client is distasteful and awkward. The current lawyer-client relationship between the witness and the examiner may either give the examiner an unfair advantage in exposing bias or equivocation or give the examiner an incentive to "go easy" and compromise his duties to the other client.²²³

Zeal of advocacy is perhaps the most important policy interest here. The risk is that a lawyer may not fight as hard where his current insurer-client has an interest in the opposing party winning.²²⁴ At the least, a worry is that the lawyer will not pursue claims with as much zeal as she otherwise would. As explained in detail by one commentator, many scholars and courts have recognized an inherent financial interest, and potential conflict, when an attorney is asked to take a position adverse to an insurer-client:

The influence of the relational nature of defense counsel's long-term pecuniary interests, like the potential for conflict identified above, pose an "inherent danger." In order to further analyze the magnitude of this risk, it is important to focus upon the business realities of defense counsel lawyers and the type of firm structures where such counsel are generally found.²²⁵

In an often-cited dissent in *State Farm Mutual Auto. Insurance Co. v. Traver*, Justice Gonzalez of the Texas Supreme Court explained that this has led to a proliferation of "captive law firms."²²⁶ Ethics scholars such as Professor Stephen L. Pepper explain the concern:

The [insurance] companies control the livelihood of the lawyer; if they decide to stop purchasing a particular lawyer's or firm's services it may well mean economic disaster. (The lawyer will have to retool in mid-career; essentially learn a

221. *Id.*

222. *See, e.g.*, Grievance Comm. of the Bar v. Rottner, 203 A.2d 82, 84 (Conn. 1964); ABA Comm. on Ethics and Prof'l Responsibility, Informal Op. 1495 (AM. BAR ASS'N 1982).

223. Zimmer, *supra* note 219, at 374-75 (discussing effects on "trial strategy" when representing adverse parties).

224. *See, e.g.*, IBM Corp. v. Levin, 579 F.2d 271, 280 (3d Cir. 1978).

225. Aviva Abramovsky, *The Enterprise Model of Managing Conflicts of Interest in the Tripartite Insurance Defense Relationship*, 27 CARDOZO L. REV. 193, 219 (2005).

226. *State Farm Mut. Auto. Ins. Co. v. Traver*, 980 S.W.2d 625, 633 (Tex. 1998) (Gonzalez, J., dissenting in part).

new kind of lawyering and compete for an economically viable position within the profession.) The lawyers are thus small economic fish dependent upon the much larger insurance companies. If the companies prefer that the interests of a few insureds be risked or sacrificed here and there in favor of the larger interests of all insureds (that is, the well being—profit—of the insurance company), then what's a well-meaning lawyer to do?²²⁷

At least one court has recognized that “[e]ven the most optimistic view of human nature requires us to realize that an attorney employed by an insurance company will slant his efforts, perhaps unconsciously, in the interest of his real client—the one who is paying his fee and from whom he hopes to receive future business. . . .”²²⁸

A client also expects personal loyalty from his attorney. An insurer which has sent its panel counsel many cases over the years may feel betrayed when that same lawyer turns up representing a party adverse to the insurer's insured.²²⁹ Under current rules, attorneys contemplating a claim against a party insured by a client face a minefield on one side (bring the claim at your own professional peril because the rules and case law do not tell you if it is safe), and on the other (withdraw or refrain from bringing the third-party claim thereby potentially compromising your insured-client's position or causing the client or his insurer to hire new counsel). Well-intended insurance defense counsel should not be placed into ethical harm's way by this absence of clear guidance.

As things now stand, the concurrent conflict rules can be said to allow large institutions, like insurers, to disqualify large swathes of lawyers from taking any adverse action against them.²³⁰ Considering how small some markets are, this could be a significant burden.²³¹ The uncertainty of these rules may discourage careful attorneys from even entering dangerous waters, which ultimately harms insureds who might benefit from the services of such professionals. Allowing conflicts of interest to exist merely because an attorney's current-client insurer may dislike it

227. Stephen L. Pepper, *Applying the Fundamentals of Lawyers' Ethics to Insurance Defense Practice*, 4 CONN. INS. L.J. 27, 46 (1997).

228. *United States Fid. & Guar. Co. v. Louis A. Roser Co.*, 585 F.2d 932, 938 n. 5 (8th Cir. 1978); see also *Richmond*, *supra* note 20, at 481 (“To protect its insureds' interests when suit is filed, insurers typically hire defense counsel from among a panel of firms with which each carrier regularly deals.”); *Abramovsky*, *supra* note 225, at 195–96; *Richmond*, *supra* note 21, at 271.

229. See, e.g., *Jeffry v. Pounds*, 136 Cal. Rptr. 373, 376–77 (Ct. App. 1977); ABA Comm. on Ethics and Prof'l Responsibility, Informal Op. 1495 (AM. BAR ASS'N 1982).

230. *Manning v. Waring*, 849 F.2d 222, 224–25 (“Unquestionably, the ability to deny one's opponent the services of capable counsel, is a potent weapon.”); see also Mark F. Anderson, *Motions to Disqualify Opposing Counsel*, 30 WASHBURN L.J. 238, 239 (1991) (noting increased frequency of tactical disqualification motions); John Lande, *Using Dispute System Design Methods to Promote Good-Faith Participation in Court-Connected Mediation Programs*, 50 UCLA L. REV. 69, 122 (2002) (“In recent decades, lawyers have used any available litigation procedure to pressure the other side into a favorable settlement. These ‘Rambo tactics’ include motions to disqualify attorneys for conflicts of interest. . . .” (footnote omitted)). But see, Ronald D. Rotunda, *Resolving Client Conflicts by Hiring “Conflicts Counsel”*, 62 HASTING L.J. 677, 678 & n.2 (2011) (arguing that all trial motions are strategic, and judges ought to rule on the merits of attorney disqualification motions without regard to the trial strategy of the movant).

231. See Linda Ann Winslow, Comment, *Federal Courts and Attorney Disqualification Motions: A Realistic Approach to Conflicts of Interest*, 62 WASH. L. REV. 863, 876–77 (1987).

would, arguably, give insurers an improper ability to control attorneys' ability to practice. As explained by one notable commentator:

Broad conflict rules create the danger that [attorneys] will be manipulated by giant corporate clients to create conflicts of interest among all of the best available lawyers, thus blockading legal talent from potential adversaries . . . Overly restrictive conflict rules [in small communities] might mean that only the most substantial of small community clients would have effective freedom in choosing counsel.²³²

In *Atlanta International Insurance Co. v. Bell*, the Michigan Supreme Court considered, for the first time at the state level, whether an insurer had standing to assert a conflict of interest challenge against an attorney representing an insured.²³³ A judgment was subsequently entered against Securities Services, whose primary insurer, Atlanta, was required to satisfy.²³⁴ Atlanta then filed suit against Bell and Hertler alleging malpractice for having failed to raise comparative fault as a defense.²³⁵

In a motion for summary judgment, Bell acknowledged that his failure to plead comparative fault constituted a breach of the professional standard of care.²³⁶ He argued, however, that because no attorney-client relationship existed between the parties, his sole duty was to his client, the insured.²³⁷ The trial court agreed with Bell and dismissed the case.²³⁸ After Atlanta appealed, the Michigan Court of Appeals affirmed, holding that “[n]o attorney-client relationship exists between an insurance company and the attorney representing the insurance company’s insured. . . . Rather, an attorney’s sole loyalty and duty is owed to the client alone, the client being the insured, not the insurance company.”²³⁹

The Michigan Supreme Court reversed, holding that although something less than an attorney-client relationship existed between the insurance company and the defendant, social policy justified expanding the defendant’s liability to include actions by an insurance company where no conflict of interest existed.²⁴⁰ The court began its analysis by recognizing that liability policies typically include language that “both obligate the insurer to provide the insured with a defense and entitle the insurer to control the defense.”²⁴¹ “The insurer typically hires, pays and consults with defense counsel.”²⁴² “It has been appropriately recognized that ‘[defense counsel] occupies a fiduciary relationship to the insured, as well as to the insurance company. . . .’”²⁴³ The court also recognized, however, that the tripartite relationship

232. WOLFRAM, *supra* note 6 at 318.

233. *Atlanta Int’l Ins. Co. v. Bell*, 475 N.W.2d 294 (Mich. 1991).

234. *Id.* at 296.

235. *Id.*

236. *See id.*

237. *Id.*

238. *Id.*

239. *Id.* (second alteration in original) (quoting *Atlanta Int’l Ins. Co. v. Bell*, 448 N.W.2d 804, 805 (Mich. Ct. App. 1989)).

240. *Id.* at 297.

241. *Id.* (quoting ROBERT E. KEETON & ALAN I. WIDISS, *INSURANCE LAW: A GUIDE TO FUNDAMENTAL PRINCIPLES, LEGAL DOCTRINES, AND COMMERCIAL PRACTICE* 822 (1988)).

242. *Id.* at 298.

243. *Id.* at 297 (alteration in original) (quoting KEETON & WIDISS, *supra* note 241).

among insured, insurer, and defense counsel often creates the possibility of a conflict of interest.²⁴⁴ If a conflict arises, appointed counsel's primary duty of loyalty must be to the client and not to the insurer.²⁴⁵

Because defense counsel owed a fiduciary duty to the insured and the insurer, and the insurer was ultimately responsible for satisfying a judgment arising out of defense counsel's malpractice, special circumstances justified removing the case from the general prohibition against third-party liability.²⁴⁶ "Consequently, because no conflict of interest existed between the insured and the insurer, 'the attorney-client relationship, the interests of the client, the interest of the insurer, and ultimately the public, which otherwise would absorb the costs of the malpractice, all benefit from [the attorney's] exposure to suit [by the insurance company].'"²⁴⁷

Finally, we must consider pure monetary costs. Significant scholarship has analyzed the rising costs of litigation in general and insurance litigation specifically. The uncertainty presented by these ethical issues delays cases and costs insurers and insureds money. Most insurers' guidelines make clear the insurer will not pay for defense counsel to research and analyze conflicts, so the cost of this frequently-required and usually uncompensated work must be borne by the attorneys. And, it is defense counsel who must answer for an ethical breach (even if inadvertent, because the guidance is so sparse). Insureds, too, are burdened when actual or perceived conflicts must be dealt with, and where defense counsel, whose relationships with adverse insurers has triggered the conflict, is not in a position to give advice, and where the policy of insurance does not require the insurer to hire counsel to assist with this discrete problem.

The need for clear governing rules in this situation is in the interest of all involved. Insurance defense counsels face potential malpractice liability. Clients need to be fully informed of their rights and the attorneys' and insurers' interests, and insurance companies need to be able to conform their hiring and management practices to the ethical rules.

IV. SOME GUIDANCE FOR A BETTER PATH FORWARD

The answer to the insurance defense ethical quandary is not an easy one. And we don't mean to suggest that we have the panacea. But we do know that there is a need for solutions.

Our case study is a good starting point for ideas. We outline below principles that might be used to create a more detailed framework for dealing with potential conflicts with third-party insurers.

As a preliminary note, in terms of the tripartite issue, it may be helpful to recognize that for insurance defense attorneys, some loyalty is owed to both insurer and insured. Having more nuanced guidance on what attorneys can appropriately do for insurers and insureds without raising conflict issues would alleviate a lot of the

244. *Id.*

245. *Id.*

246. *See id.* at 298.

247. Parker, *supra* note 49, at 49 (alteration in original) (quoting Atlanta Int'l Ins. Co. v. Bell, 448 N.W.2d 804, 805 (Mich. Ct. App. 1989)).

confusion in this area. Specialized rules might need to depart from the traditional standards in defining conflicts in these situations.

A statutory or rule-based scheme should also make clear whether, when a liability insurer retains defense counsel to defend an insured, the only attorney-client relationship established is that between the insured and defense counsel. The scheme should thus explicitly clarify whether an attorney-client relationship is established between the liability insurer and defense counsel *merely* as a result of the insurer's retention of defense counsel to represent the insured. We would suggest that, given the Model Rules' preference for not creating an automatic relationship, that insurers and defense counsel not have an automatic relationship. But a clear rule either way will help.

Next, the scheme should address whether a mere pre-existing attorney-client relationship between defense counsel and the insurer for an adverse party in litigation constitutes a conflict of interest for defense counsel.

The scheme should also address the impacts of defending an insured under a reservation of rights—and how to address the potential conflicts of interest claims stemming from this situation. For example, the scheme should detail requirements for defense counsel to follow when defending an insured under a reservation of rights, such as confidentiality requirements so that the insurer cannot use defense counsel to mine facts to use against the insured in later coverage litigation.

A scheme should similarly clarify that insurers may not expect defense counsel to assist in its investigation and analysis of coverage defenses while representing the insured—and that the insurer shall defer to defense counsel's professional judgment in declining to share information which defense counsel reasonably believes is confidential and which may bear on the insurer's coverage defenses.

The scheme should make clear, consistent with the Model Rules, that the insured shall have the right to control her defense, including all decisions related to conducting discovery, motion practice, and trial.

The scheme should also address the common dispute about whether an insured has the right to select her own defense counsel paid for by the insured. This is an important issue and creates endless litigation across the country.

The scheme should also address the scope of defense counsel's obligations to the insured. This includes defense counsel's obligations to provide timely and updated reporting on the facts underlying the dispute; the relevant claims and defenses; the plan of action for discovery, investigation and trial, including a budget; the potential verdict exposure in the event of trial; the chance of prevailing at such a trial; the potential allocation of fault among the various parties to the action; and any other material information reasonably needed by the insurer and the insured to assess their respective exposure in the action. Another common question where guidance would be welcome is whether, and the extent to which, defense counsel is obligated to provide advice regarding potential affirmative claims for relief like counterclaims, cross-claims, third-party claims or otherwise. While it is well-settled that the insurer is not required to fund, as part of the defense provided under the policy, the prosecution of affirmative claims for relief, the fact of the matter is that the work required to prosecute such claims often substantially overlaps with defense tasks,

and the insurer may directly or indirectly benefit from the pursuit of such claims. Guidance here would be helpful.

A scheme must also address how settlement offers are handled. Insurance policies often detail the parties' various rights to control or consent to settlement offers. And defense counsel need to know how these contractual obligations interact with their ethical duties to allow their client to control the litigation.

Then, of course, the scheme should address what to do with defense counsel's potential interests related to third-parties. The scheme should clarify whether the mere fact that defense counsel may have an existing or prior relationship with a liability insurer providing a defense to one or more of the other parties to the action will itself constitute a conflict of interest for defense counsel, and if not, under what circumstances it will.

Related to these third-party issues, the scheme should consider whether defense counsel's relationship with other insurers or parties in the action must be disclosed to the insured—when, whether the insured must consent to continued representation, and what, precisely, should be disclosed.

The scheme should also explain whether defense counsel has obligations to inform or seek consent from defense counsel's non-party clients when those clients' interests might be put into issue—like when defense counsel proposes a course of action in a case that might affect the interests of a non-party insurer-client.

Our proposal is just a starting point—the takeaway, we hope, is that states should consider taking a more measured, careful look at how insurance defense attorneys are regulated and give them more guidance about how to practice law in this complex web of ethical duties.

We suggest a scheme that does not result in per se conflicts or disqualifications. Of course, lawyers will still be responsible for fully advocating their clients' cases. So, for example, if a lawyer decides not to pursue an insurer-client because of personal loyalties—the attorney would be violating ethical rules of loyalty to the current client.

On the other hand, we would also propose that attorneys are free to voluntarily withdraw anytime their representation of an insured places them in the position of taking adverse steps against an insurer-client. This gives attorneys the ability to police themselves if a material limitation (such as confidences or personal loyalties) may interfere with their representation.²⁴⁸ While many courts and authorities are concerned about whether insurance defense attorneys are “ethical”—in fact insurance defense attorneys, like most attorneys, are highly competent.²⁴⁹ While courts have the ultimate say in granting attorney withdrawals, our proposed rule framework makes clear the preference for allowing attorneys in these situations to be released.

248. See 1 GEOFFREY C. HAZARD, JR. ET AL., *THE LAW OF LAWYERING: A HANDBOOK ON THE MODEL RULES OF PROFESSIONAL CONDUCT* § 6.12, at 6–33 (4th ed. 2017) (“[L]awyers are members of society too, and should be given outlets for exercise of their own moral autonomy, lest they become mere legal technicians or automatons.”); Bruce A. Green, *Lawyers’ Professional Independence: Overrated or Undervalued?*, 46 AKRON L. REV. 599 (2013) (discussing lawyer independence).

249. Nancy Lewis, *Lawyers’ Liability to Third Parties: The Ideology of Advocacy Reframed*, 66 OR. L. REV. 801, 832 (1987) (“Most attorneys are competent, ethical, and feel unfairly maligned when examples of vicious, sensational advocacy are publicized.”).