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Insurance Defense: Conflicts and Confidentiality

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ABA Formal Opinion 01-421 describes the "tripartite relationship among defense lawyer, insured, and insurer" as "a delicate balance of rights and duties." Two of the most delicate—and the most central to any representation—are conflicts and confidentiality. In this column, we'll look at both.

Conflicts

The starting point for conflicts analysis is a simple one: who is my client? An earlier ABA ethics opinion—Formal Opinion 96-403—noted that this simple question has a not-so-simple answer in the insurance defense context: "The Model Rules of Professional Conduct offer virtually no guidance as to whether a lawyer retained and paid by an insurer to defend its insured represents the insured, the insurer, or both."

The ABA Model Rules and state Rules of Professional Conduct patterned on their ABA counterparts do not define the attorney-client relationship. Paragraph 17 to the Scope section of the ABA Model Rules puts it this way: "[F]or purposes of determining the lawyer's authority and responsibility, principles of substantive law external to these Rules determine whether a client-lawyer relationship exists."

Both of the ABA opinions noted above find that the lawyer, the insured and the carrier can agree who the client will be in a given case—most often at the outset of the representation through an engagement agreement. Absent the kind of clear identification afforded by an engagement agreement, however, the client of an insurance defense counsel is determined in most jurisdictions by a combination of case law and ethics opinions. Some are "two-client" states, with both the insured and the carrier considered clients. Others are "one-client" states, with only the insured considered the client. ABA Formal Opinion 01-421 includes a useful, but not comprehensive, catalog of these two approaches. These contrasting approaches, in turn, have important implications for conflicts.

ABA Formal Opinion 96-403, for example, discusses the sensitive situation where an insured objects to a proposed settlement within policy limits. The opinion observes that, as a matter of contract law, an insured generally retains the ability to reject the defense offered by an insurer and to assume the risk and expense of handling the matter involved directly. In a "two-client" state, an open dispute between jointly represented clients over handling a material component of the case in most circumstances triggers a conflict under ABA Model Rule 1.7(a)(1)—which governs multiple-client conflicts. Comment 29 to ABA Model Rule 1.7 outlines the impact of such a conflict, which, in most jurisdictions is not waivable because it arises in the same matter: "Ordinarily, the

lawyer will be forced to withdraw from representing all of the clients if the common representation fails."

Even in "one-client" states, conflicts may develop under local equivalents of ABA Model Rule 1.7(a)(2)—which addresses "material limitation" conflicts. A recent Washington case offers an illustration. Washington is a "one-client" state. In *Arden v. Forsberg & Umlauf, P.S.*, ___P.3d ___, 2017 WL 4052300 (Wash. Sept. 14, 2017), defense counsel represented an insured under a carrier's reservation of rights. The carrier eventually funded a settlement but the clients later sued the defense firm anyway claiming that the firm should have disclosed that it did other unrelated coverage work for the carrier involved. The Washington Supreme Court affirmed dismissal, finding no damages. In doing so, the majority opinion took a detour to address—but not resolve—the asserted conflict. The majority observed that the Washington version of ABA Model Rule 1.7(a)(2) is framed in terms of "significant risk" that a lawyer's professional judgment may be "materially limited" by, among other factors, its relationship with another client. Having framed the issue, the majority noted that whether such a risk existed in the instance involved had drawn dueling expert opinions cast under the standard of care and the court refused to draw a bright line. *Arden* highlights, however, that conflicts may be lurking for insurance defense counsel even in "one-client" states.

Confidentiality

The "one-client" and "two-client" dynamic also affects confidentiality and privilege.

In "one-client" states, communications between insurance defense counsel and a carrier's claims staff on case developments and strategy usually fall within state versions of the "common interest" doctrine—which preserves privilege for communications between parties who, as the name implies, share a common interest in the litigation involved. ABA Formal Opinion 01-421, however, discusses situations—such as some third-party audits—where a proposed disclosure may put privilege at risk because it does not go to the defense of the case. In that circumstance, the opinion finds that the disclosure could only be made with the informed consent of the client under the "confidentiality rule"—ABA Model Rule 1.6 and its state counterparts.

In "two-client" states, communications between insurance defense counsel and the two clients normally fall within the attorney-client privilege and are, therefore, protected from disclosure to parties outside the joint representation. ABA Formal Opinion 08-450 wrestles, nonetheless, with the difficult situation arising when the lawyer learns information from an insured that may affect the carrier's duty to defend. It concludes that the lawyer in this situation is prevented by ABA Model Rule 1.6 from revealing the information but must withdraw because there is now a nonwaivable conflict.

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