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Delicate Dance: Navigating Conflicts When Defending Under a Reservation of Rights

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Defending under a reservation of rights presents insurance defense counsel with unique conflict challenges. At the same time, the Washington Supreme Court has provided guidance for navigating these challenges in two significant decisions: *Tank v. State Farm Fire & Cas. Co.*, 105 Wn.2d 381, 715 P.2d 1133 (1986), and *Arden v. Forsberg & Umlauf, P.S.*, 189 Wn.2d 315, 402 P.3d 245 (2017). This article will survey both.

Before we do, however, two qualifiers are warranted.

First, although *Tank* and *Arden* address the duties and obligations of insurance defense counsel under a reservation of rights, many of the lessons they offer can be applied in other situations such as excess exposure cases and instances where bad faith issues have arisen.

Second, we'll focus on the role of defense counsel rather than lawyers involved in either the adjusting process or coverage work for carriers. *Cedell v. Farmers Ins. Co. of Washington*, 176 Wn.2d 686, 295 P.3d 239 (2013), addresses a lawyer's role in the adjusting process in the context of subsequent bad faith litigation. *Atlantic Specialty Insurance Company v. Premera Blue Cross*, 2016 WL 1615430 (W.D. Wash. Apr. 22, 2016) (unpublished), and *Plein*

v. USAA Casualty Insurance Company, 195 Wn.2d 677, 463 P.3d 728 (2020), discuss, respectively, current and former client conflicts involving coverage counsel.

Tank

Tank arose on prosaic facts. James Tank assaulted a person in a parking lot. The victim sued Tank. Tank, through personal counsel, tendered the defense to his insurer, State Farm. The latter accepted the defense under a reservation of rights because Tank's policy had an exclusion for intentional acts. State Farm appointed defense counsel who tried the case. The jury found that Tank had intentionally assaulted the victim and entered a judgment against him. Based on the jury's finding of intent and the policy exclusion, State Farm declined to pay the judgment. Tank then sued State Farm for bad faith—arguing that it had allegedly structured the defense so that the jury would find his acts were intentional and that it had failed to make reasonable efforts to settle the case.

The trial court granted State Farm summary judgment, but the Court of Appeals reversed. The Supreme Court affirmed in part and reversed in part. Although *Tank* focused largely on the duties of a carrier in the reservation of

rights context, the Supreme Court also spoke to two important aspects of the role of defense counsel.

First, the Supreme Court underscored that—absent specific arrangements to the contrary—insurance defense counsel only represent the insured.[1] The carrier, by contrast, stands in the position of third-party payor. Although *Tank* was a reservation of rights case, subsequent Washington authority has applied the "one client" principle generally. The Supreme Court in *Stewart Title Guar. Co. v. Sterling Sav. Bank*, 178 Wn.2d 561, 311 P.3d 1 (2013), for example, dismissed a legal malpractice claim by a carrier against insurance defense counsel in relevant part because the carrier did not meet the requirement of having an attorney-client relationship with the insurance defense firm. Similarly, the WSBA in Advisory Opinion 195 (rev. 2009) summarized (at 3) Washington law on this point: "[I]n Washington it is clear that legally and ethically the client of the lawyer is the insured."

[1] On a related point, insurance defense counsel are typically able to share information with the carrier relating to the defense of the case under the "common interest doctrine." *See generally Sanders v. State*, 169 Wn.2d 827, 853, 240 P.3d 827 (2010) ("The 'common interest' doctrine provides that when multiple parties share confidential communications pertaining to their common claim or defense, the communications remain privileged as to those outside their group."). *See also* RPC 1.6(a) (implied authority to disclose client confidential information); Robert H. Aronson, Maureen A. Howard & Jennifer Marie Aronson, *The Law of Evidence in Washington* § 9.05[2] (rev. 5th ed. 2023) (discussing work product in the insurance defense context).

Second, the Supreme Court outlined the duties of defense counsel in this scenario:

> [D]efense counsel owes a duty of full and ongoing disclosure to the insured. This duty of disclosure has three aspects. First, potential conflicts of interest between insurer and insured must be fully disclosed and resolved in favor of the insured. The dictates of RPC 1.7, which address conflicts of interest such as this, must be strictly followed. Second, all information relevant to the insured's defense, including a realistic and periodic assessment of the insured's chances to win or lose the pending lawsuit, must be communicated to the insured. Finally, *all* offers of settlement must be disclosed to the insured as those offers are presented. In a reservation-of-rights defense, it is the insured who may pay any judgment or settlement. Therefore, it is the insured who must make the ultimate choice regarding settlement. In order to make an informed decision in this regard, the insured must be fully apprised of all activity involving settlement, whether the settlement offers or rejections come from the injured party or the insurance company.
> 105 Wn.2d at 388-89 (emphasis in original).

Tank clarifies conflicts analysis considerably by limiting the representation in this context to the insured only. That lessens the risk of multiple-client conflicts under RPC 1.7(a)(1) in most situations. Depending on the circumstances, however, the potential for multiple-client conflicts may remain if, for example, the law firm does both defense and coverage work for the carrier involved—with the carrier being a client for the coverage work.[2] *Tank* then suggests the clearest

[2] Firms with multi-state offices or practices should be attentive to the fact that not all states take Washington's "one client" approach to insurance defense. *See generally* ABA Formal

path to avoiding multiple-client conflicts in this situation: defend the case without offering coverage advice to either the insured or the carrier. This approach is also consistent with RPC 1.2(c), which generally allows a lawyer to limit the scope of a representation—in this setting to only defending the case.[3] *Tank* concludes its analysis of the role of defense counsel with the caution that even if the carrier is not considered a client, the law firm must maintain its professional judgment on behalf of the client under RPC 1.7(a)(2)—particularly when the carrier has a significant economic relationship with the law firm. *Arden* picks up on this last thread that we'll turn to next.

Op. 01-421 (2001) at 3 (noting that some jurisdictions take a "two client" approach with both the insured and the carrier considered clients). Oregon, for example, is a "two client" state absent specific agreement to the contrary. *See generally* OSB Legal Ethics Op. 2005-121 (rev. 2016) at 2 ("As a general proposition, a lawyer who represents an insured in an insurance defense case has two clients: the insurer and the insured."). Although there may be a choice-of-law argument under RPC 8.5(b) to avoid a conflict in this scenario, law firms are generally held to the client classification they have in their own internal systems. *See, e.g., In re Egger*, 152 Wn.2d 393, 411, 96 P.3d 477 (2004) (looking to law firm's internal records listing person as a client in finding an attorney-client relationship and resulting conflict).

[3] Disputes over settlement between an insured and the carrier pose particularly sharp issues that should typically be left to personal counsel for the insured and coverage counsel for the carrier. *See generally* ABA Formal Op. 96-403 (1996) (discussing the position of defense counsel in disputes between the insured and the carrier over settlement); *see also Besel v. Viking Ins. Co. of Wisconsin*, 146 Wn.2d 730, 736, 49 P.3d 887 (2002) (addressing the right of an insured to independently negotiate settlement if an insurer refuses in bad faith to settle a claim). Similar considerations can arise in the context of reasonableness hearings involving covenant judgments. *See, e.g., CBS Corporation v. Ulbricht*, 2020 WL 622940 (Wn. App. Feb. 10, 2020) (unpublished) (counsel for plaintiffs and remaining defendant deposed in connection with reasonableness hearing involving covenant judgment following intervention by carrier).

Arden

Arden arose under equally prosaic facts. Roff Arden killed his neighbor's dog. The neighbor sued Arden. Arden tendered the defense to his insurer, Harford. Although Hartford initially rejected the tender under an intentional act exclusion in its policy, Hartford later accepted the defense under a reservation of rights and appointed defense counsel. Hartford eventually funded a settlement of the claim. Although Arden had also been represented by personal counsel, he later sued the defense firm for breach of the fiduciary duty of loyalty.
Arden argued that the law firm had a conflict under RPC 1.7(a)(2), which governs "material limitation" conflicts, based on unrelated coverage work it did for Hartford.

The trial court granted summary judgment to the law firm and the Court of Appeals affirmed. The Supreme Court unanimously affirmed the dismissal by the lower courts based on Arden's lack of damages since the carrier had funded the settlement and paid for the defense of the underlying case. A five-member majority then went beyond this unremarkable result to suggest that when an insurance defense firm does other coverage work directly for a carrier—and, therefore, the carrier is also a client of the firm—the firm may need to disclose

that to the insured and obtain a conflict waiver. The majority, however, did not resolve that question on the facts before it because the parties had offered dueling expert opinions on that point. A four-member concurrence characterized the detour into conflicts as "dicta" and concluded that the lack of damages was dispositive. *Arden* injects a degree of uncertainty into the defense of cases under a reservation of rights and, at least as a matter of risk management, counsels that a law firm should consider obtaining a conflict waiver from the insured if the firm represents the carrier directly in other matters or has other significant economic relationships with the carrier.

Summing Up

Defending under a reservation of rights can put insurance defense counsel in an uncomfortable position. *Tank* and *Arden* offer prudent guidance to navigate this often delicate dance.

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