MANAGING THE TRI-PARTITE RELATIONSHIP FOR THE YOUNG PROFESSIONAL

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INTRODUCTION

Although the tri-partite relationship has been the subject of legal scholarship and substantial discussion, the ethical and practical dilemmas inherent in undertaking the representation of an insured and/or the insurer in an insurance defense context still present a murky quagmire, difficult for even a seasoned professional to navigate. Understanding and balancing the interests of the insured and insurer and the ethical responsibilities to each party is particularly important for younger lawyers or claims professionals as they assume more responsibility in handling their own cases or claims.

In addition to providing a basic roadmap to understanding the ethical concerns inherent in the tri-partite relationship, this paper will also provide practical examples that arise in the handling of any case or claim, such as settlement, coverage, and disclosure situations in which potential conflicts of interest could easily arise.

WHAT IS THE TRI-PARTITE RELATIONSHIP?

Tri-partite, quite simply, means "involving, composed of, or divided into three parts or elements."[1] In the insurance defense context, it is used to refer to the relationship between an insurer, its insured and the lawyer hired by the insurer to represent the insured. It arises because most liability policies provide that the insurer is contractually entitled to control the defense of the insured, including the hiring of defense counsel and decisions about settlement. The situation is further complicated by the fact that the insurer is paying the defense attorney, but the defense attorney's client is the insured. However, in some states, both the insured and insurer are considered clients, and in others the insured is considered the "primary" rather than only client. As you can see, this could very easily result in a conflict of interest in a variety of situations.

There are different approaches to how to ethically manage the tri-partite relationship used among the states. Certain states, such as Alaska, California and Florida, have attempted a legislative solution to address the inherent potential

[1] Black's Law Dictionary 1544 (8th ed. 2009).

conflicts of interest.[2] The laws of these states, however, vary significantly. The *"per se"* approach is quite simple – if an insurer reserves its right to deny coverage of a claim, the insured has the right to independent counsel because an insurer should not be allowed to control the defense of the claim unless it will cover it.[3] Most commonly, states rely on the ethical standards set forth by their respective version of the rules of professional conduct. Because the methods utilized by each state to address the tri-partite relationship differ, the American Bar Association's Model Rules of Professional Ethics and Formal Ethics Opinions regarding the tri-partite relationship will be utilized herein.

ETHICAL RULES AND GUIDELINES UNDERPINNING THE TRI-PARTITE RELATIONSHIP

At the outset of any tri-partite relationship, the lawyer must identify who the client is. For instance, will the lawyer be representing the insured alone, or, if allowed in the jurisdiction, the insurer as well?[4] What happens if the lawyer learns of something that may cause the insurer to deny coverage to the insured during his or her representation of the insured? How will the lawyer handle instructions given by the insurer regarding the defense or settlement of the case?

A. CONTROL AND SCOPE OF REPRESENTATION

Insurance contracts often include language related to control of defense and settlement. However, if the insured is a client, the applicable Rules of Professional Conduct will govern the relationship between the attorney and insured.[5]

ABA Model Rule of Professional Conduct 1.2 requires a lawyer to abide by his or her client's decisions regarding their representation and whether to settle a matter. Specifically, 1.2 (a) states in part as follows:

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[2] *See, e.g.,* AK ST. § 21.96.100 (Alaska);West's Ann.Cal.Civ.Code § 2860 (California); FL ST § 627.426 (Florida).

[3] Wagner, Christopher R., "Insurance Defense Conflicts of Interest: Three Main Approaches," August 2010, http://www.gordonrees.com/publications/2010/insurance-defense-conflicts-of-interest-three-main-approaches

[4] It is not settled as to whether the insurer is a client. The ABA does not take a position as to whether the client is the insured or both the insurer and the insured. Courts in certain states hold that an insurer cannot be a client in the tri-partite context. However, courts in other states allow an insurer to be a client, but maintain that the primary duty is always to the insured.

[5] American Bar Association Formal Ethics Opinion 96-403, entitled "Obligations of a Lawyer Representing an Insured Who Objects to a Proposed Settlement within Policy Limits."

> …a lawyer shall abide by a client's decisions concerning the objectives of representation and…shall consult with the client as to the means by which they are to be pursued. A lawyer may take such action on behalf of the client as is impliedly authorized to carry out the representation. A lawyer shall abide by a client's decision whether to settle a matter…[6]

However, Rule 1.2 (c) allows a lawyer to reasonably limit the scope of the representation as long as the client gives informed consent. Comment 6 to Rule 1.2 specifically explains that, "[w]hen a lawyer has been retained by an insurer to represent an insured, for example, the representation may be limited to matters related to the insurance coverage."

The problem then becomes one of a more practical nature – how should this be done in the context of an insurance defense relationship? The best method of handling this issue is to address the limitation of the representation with both the insured and the insurer early on in the representation. One way to do this is to provide written notice to the insured that "the lawyer intends to proceed as directed by the insurer in accordance with the terms of the insurance contract and what this means to the insured."[7] In doing so, the lawyer must "make appropriate disclosures sufficient to apprise the insured of the limited nature of his representation" and what the limitations are specifically, since Rule 1.2 requires *informed* consent.[8]

Despite the fact that Rule 1.2 allows an attorney to limit the scope of his or her representation and contemplates doing so in the context of the representation of an insured in the insurance defense context, the acceptability of this is seemingly contradicted by Rules 1.8 (f) and 5.4 (c). Rule 5.4 (c) specifically states that "[a] lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services." Additionally, Rule 1.8 (f) provides that a lawyer may only accept compensation from a third party as long as there is no interference with the lawyer's independent professional judgment and the client

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[6] ABA Model Rule 1.2 is also pertinent in the tri-partite context in determining from whom the lawyer should get authority to settle the case, as discussed *infra.*

[7] American Bar Association Formal Ethics Opinion 96-403.

[8] *Id.* Notably, the Formal Opinion specifically states that the lawyer need not obtain formal acceptance or written consent from the insured. Rather, the Opinion provides that the insured accepts the limited scope of representation by accepting the defense offered by the insurer.

gives informed consent.[9] How does a lawyer balance these ethical considerations with an insurer's right to control the defense?

B. LITIGATION GUIDELINES

An attorney in the tri-partite relationship must balance the insurer's goal of keeping defense costs down, while still ensuring that the lawyer is diligently and competently advocating for his client.[10] Luckily, in most cases, loyalty to the insured is fully consistent with loyalty to the insurer and it is rare that a limitation by the insurer will compromise the lawyer's ability to provide competent representation.[11]

ABA Formal Opinion 01-421 addresses an attorney's ethical obligations and responsibilities to the insured in the context of the attorney complying with the insurer's billing guidelines and stresses that the lawyer's paramount duty in the tri-partite context is to his or her insured client.[12] It provides that, "lawyers representing insured clients must not permit the client's insurance company to require compliance with litigation management guidelines the lawyer reasonably believes will compromise materially the lawyer's professional judgment or result in her inability to provide competent representation to the insured."[13] The Opinion

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[9] Comment 11 to ABA Model Rule of Professional Conduct Rule 1.8 warns about possible conflicts of interest in the tri-partite context: "[b]ecause third-party payers frequently have interests that differ from those of the client, including interests in minimizing the amount spent on the representation and in learning how the representation is progressing, lawyers are prohibited from accepting or continuing such representations unless the lawyer determines that there will be no interference with the lawyer's independent professional judgment and there is informed consent from the client."

[10] *See,* ABA Model Rule of Professional Conduct 1.1, which states that "competent representation" requires the lawyer to have the requisite "legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation."

[11] American Bar Association Formal Op. 01-421, entitled "Ethical Obligations of a Lawyer Working Under Insurance Company Guidelines and Other Restrictions."

[12] American Bar Association Formal Op. 01-421. It is conceivable that an attorney may have to decline an insurer's instruction if it hinders an ability to act in the best interest of the insured. *See also,* Comment 11 to ABA Model Rule of Professional Conduct Rule 1.8.

[13] *Id.*

also recognizes that the defense lawyer should be aware of the economic interests of the insurer.[14]

Reporting is often a requirement included in the insurer's billing guidelines. Defense counsel should explain the purpose and benefit of the guidelines to the insured at the outset. They should also consider including the billing guidelines with the initial engagement letter and involving the insured in the evaluation as the case progresses.

C. CONFIDENTIALITY

A lawyer's duty to maintain his or her client's confidentiality is another very real problem in the context of the tri-partite relationship. What can an attorney disclose to the insurer and how does the disclosure of that information potentially impact an insured? ABA Model Rule 1.6 mandates a lawyer keep confidential information "relating to the representation of a client" unless the client provides informed consent; the client gives implied authorization to make the disclosure; or, in certain specifically delineated circumstances, such as to prevent death or bodily injury, or to comply with a Court order.[15] Rule 1.6 is germane in situations in which a lawyer learns information from the insured which could potentially jeopardize coverage. Rule 1.6 is also applicable if a lawyer learns information during the representation of the client, i.e. if the lawyer obtains information from a third party source during the discovery process.

If a lawyer reports to the insurer information that could create a possible basis for denying coverage, he or she is arguably taking an action adverse to the insured client. Conversely, failing to report that information to the insurer, who may also be the lawyer's client, could potentially be a violation of ABA Model Rule 1.4, which requires the lawyer to keep the client reasonably informed about the status and substance of the representation. It is likely that none of the exceptions to Rule 1.6 would apply to the disclosure of this information and the insured/client would generally not provide informed consent, when it means that it would result in no insurance coverage afforded to them. ABA Formal Opinion 08-450 unambiguously concludes that, when presented with such a situation, a lawyer is prohibited from revealing any information to another client or third person which

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[14] *Id.,*"[D]efense lawyers must be sensitive to the economic interests of the insurance companies that employ them and cognizant of the fact that costs of litigation ultimately are borne by insureds through premiums."

[15] ABA Model Rule of Professional Conduct 1.6.

may be harmful to the client.[16] Moreover, it states that, if a lawyer would violate its duty under 1.4 to the insurer client by failing to disclose the information, but is prohibited from doing so, the lawyer may have to withdraw under Rule 1.16(a)(1).[17]

As a practical matter, this sort of conflict can be avoided if clear disclosures are made and agreed to at the outset of the litigation. The insured must understand what information the lawyer will be communicating to the insurer. Conversely, the insurer needs to understand that the lawyer will not be communicating any information to it that would impact the insured's coverage. Any other limitations should also be set forth and discussed with both the insurer and the insured to avoid potential problems during the course of the representation.

THE IMPACT OF THE TRI-PARTITE RELATIONSHIP IN PRACTICAL SITUATIONS

Lawyers should remain vigilant of potential or actual conflicts arising during any representation, but especially those involving an insurer and insured. Two common situations in which conflicts may arise are in the context of settlement and decisions that could bear on coverage for the insured.

A. LITIGATION DECISIONS THAT MAY IMPACT COVERAGE

A lawyer representing an insured may be forced to make litigation decisions that can impact the insured's coverage. This may arise when the insured has a declining limits policy, or, the plaintiff asserts insured and uninsured claims in the same action.

1. Declining Limits Policies

Policies in which the limits of liability available are reduced by the costs of defense can put a strain on the tri-partite relationship.[18] These policies, sometimes called "eroding," "wasting," or "declining limits," effectively reduce the amount of insurance coverage that can be used to pay a judgment or settle a claim. As a result

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[16] American Bar Association Formal Op. 08-450, entitled "Confidentiality When Lawyer Represents Multiple Clients in the Same or Related Matters."

[17] Comment No. 2 to ABA Model Rule 1.16 further elaborates, stating that "[a] lawyer ordinarily must decline or withdraw from representation if the client demands that the lawyer engage in conduct that is illegal or violates the Rules of Professional Conduct or other law. The lawyer is not obliged to decline or withdraw simply because the client suggests such a course of conduct; a client may make such a suggestion in the hope that a lawyer will not be constrained by a professional obligation."

[18] *Helfand v. National Union Fire Ins. Co.,* 13 Cal.Rptr.2d 295, 298 (Cal. Ct. App. 1992).

of such a policy, the insured may want to settle the case as soon as possible, before a full defense in mounted, to maximize the amount of coverage.[19] This may be particularly true where the exposure from potential damages in the case exceeds the limit of liability.[20]

Alternatively, the insured may wish the lawyer to provide a more aggressive defense than the insurer may want, who has a direct interest in reducing the cost of litigation.[21] The defense attorney may feel prohibited from conducting necessary discovery to mount a successful defense due to the direction of the insurer.

In order to avoid potential conflicts, it is important to keep the insured and insurer advised of the ongoing liability and damages evaluation. Cases involving policies with declining limits provisions should be addressed at the outset of the litigation with the insured and the insurer in the context of developing a defense strategy.

2. Insured and Uninsured Claims

Problems may also arise in cases where the plaintiff asserts both claims which are covered along with causes of action which are not covered. The attorney will likely be required to defend all claims in the litigation, as long as there is at least one claim covered by the policy. However, this could change during the pendency of the litigation.

For instance, the dismissal of a professional negligence cause of action against a defendant lawyer may leave claims which are not covered such as fraud or other claims involving intentional acts. The dismissal of all covered claims may enable the insurer to withdraw the defense if it has reserved the right to do so.[22] Whether defense counsel should proceed where summary judgment will likely result in the dismissal of covered claims and leave non-covered claims pending depends on

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[19] David Grossbaum & Marian Rice, "The Art of Risk Management for Lawyers Representing Lawyers," 76 Def. Couns. J. 405 (2009).

[20] If it appears that the policy limits will not cover the potential exposure, the insured should be advised immediately as they may wish to retain personal counsel. *Id.*

[21] *See,* Ellen S. Pryor & Charles Silver, "Defense Lawyers' Professional Responsibilities: Part I - - Excess Exposure Cases," 78 Tex. L. Rev. 599 (2000).

[22] 76 Def. Couns. J. 405, citing, *County of Nassau v. Michigan Mut. Ins. Co*., 714 N.Y.S.2d 886 (App. Div. 2000); *Conway Chevrolet-Buick v. Travelers Indem. Co.,* 136 F.3d 210, 213-14 (1st Cir. 1998).

the facts of the case and, once again, requires communication among the parties. Defense counsel must disclose and discuss the risks involved in proceeding with the dispositive motion, and the parties should come to an agreement before the motion is heard as to how the ruling will impact the insurer's duty to defend and indemnify.

B. THE POTENTIAL FOR CONFLICTS IN THE CONTEXT OF SETTLEMENT

Settlement discussions can present a risk of conflicting interests between an insured and insurer. Professional liability insurance contracts often provide the insured with the right to approve or reject a settlement negotiated by the insurer.[23] These policy provisions, referred to as "consent to settle" clauses, provide that the insurer may not settle a claim without the written and/or oral consent of the insured. The clause is designed "to prevent settlements which might be regarded in the community as an admission of wrongdoing by the insured, thus injuring the insured's professional reputation."[24]

However, often times the consent to settle clauses also include a provision in which the insured is liable for any amounts the insurer is obligated to pay at the conclusion of a case if the insured refused to provide his or her consent to an earlier settlement offer that was within policy limits.[25] This is where potential conflicts may arise. When exploring possible settlement opportunities, the lawyer will have to carefully weigh his ethical and professional obligations to both the insured and the insurer when recommending settlement.[26]

The American Bar Association Formal Ethics Opinion 96-403 offers guidance regarding a lawyer's obligations in representing an insured related to settlement negotiations. Although the opinion examined the obligations of a lawyer in a

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[23] It is important to note that, although most professional liability policies do have a "consent to settle" clause, some automobile and general liability policies do not. The ethical and practical concerns discussed herein apply to all applications of the tri-partite relationship, not simply those arising in a professional liability context.

[24] *Robertson v. Chen* (1996) 44 Cal.App.4th 1290, 1294, citing, Croskey et al. Cal. Practice Guide: Insurance Litigation 2 (The Rutter Group 2013) ¶7:2492 et seq., pp. 7K-26 to 7K-28.

[25] Conversely, the insured can require its lawyer to settle a claim at his or her own expense if the insurer will not do so.

[26] If the defense attorney follows the guidance of the insurer and refuses settlement offers within the policy limits and litigates the case, the defense attorney may then become personally liable for any excess judgment awarded at trial. The Ninth Circuit awarded a $2,183,381 malpractice verdict for the plaintiff when a defense counsel refused to settle within the policy limits. *Mutuelles Unies v. Kroll & Linstrom*, 957 F.2d 707 (9th Cir. 1992).

situation where the *insurer* controls the right to settle a claim in its sole discretion, it set forth principles that are applicable to the settlement of any claim involving an insurer and insured. If a disagreement arises regarding settlement over who has the right to decide whether to accept a particular settlement, the lawyer may consult with both the insured and insurer regarding the likely consequences of a proposed course of conduct or may be required to advise the parties to seek independent counsel.[27] If the dispute cannot be resolved, the lawyer must consider whether he or she should withdraw from the representation.[28] Moreover, if the lawyer knows that the insured objects to the settlement, the lawyer may not proceed with the settlement without giving the insured an opportunity to assume responsibility to defend the case at his or her own expense. In a circumstance in which a lawyer represents both the insurer and the insured, an insured's decision to reject the defense could terminate the attorney's representation of the insured, in which case ABA Model Rule 1.9 could preclude the lawyer from continuing to represent the insurer without the consent of the insured.[29]

CONCLUSION

In a healthy tri-partite relationship, the insurer and defense counsel work together to efficiently and strategically prepare the best possible defense and resolution for the insured client. Communication and early evaluation are essential to maintain an amicable relationship among insured, insurer, and defense counsel. This includes a clear understanding of the scope of representation and ethical responsibilities, and a familiarity with the insurer's coverage position without advocating for the position.

Defense counsel should take reporting and budget estimate requirements seriously and provide a concise and thoughtful analysis of liability and damages early in the case. To avoid surprises and conflicts, it is important to keep] the insured and insurer informed as to the exposure and the basis for the evaluation, especially in cases with high exposure or low or declining policy limits. Counsel must remain cognizant of the impact of information obtained and to whom it is disclosed. When a case starts with open lines of communication and disclosure, it often continues with the goals of the insured and insurer in alignment.

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[27] *Id.*

[28] *Id.*

[29] *Id.*