THE TRIPARTITE RELATIONSHIP: ETHICAL CONSIDERATIONS AND THE INSURED CLIENT'S RIGHTS

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I. THE TRIPARTITE RELATIONSHIP

A. Defined:

The "tripartite" relationship refers to the relationship among the three parties when a *lawyer* is hired by an *insurer* to defend a suit against its *policyholder* (the insured).

B. Three Parties to the Relationship:

1. *The Insured*: The insured wants the best defense possible.

2. *The Insurance Company*: The insurer wants to provide a defense at the lowest possible cost.

3. *The Lawyer:* The lawyer wants to provide a competent defense, yet knows who pays the bills and who is most likely to send new business.

C. The Defense Lawyer:

This relationship has provided many insurance defense lawyers with serious confusion as to what duties are owed to whom. The tripartite relationship is unique in that it often creates a situation in which the lawyer is unsure who he represents. This can create serious questions of loyalty for the lawyer.

II. WHO IS THE CLIENT?

A. One Client or Two:

The very nature of the tripartite relationship, the hiring of a lawyer by a non-party (the insurer) to represent another party (the insured) to a lawsuit, leaves the defense lawyer to wonder whether there is one client or two.

B. "Client" - An Important Label:

Being labeled a "client" can be advantageous:

1. *Suit for Malpractice*: A client has the ability to sue a lawyer for malpractice. Without this status, there is no privity with the attorney and thus, no recourse in the event that the attorney breaches the standard of care.

2. *Attorney-Client Privilege:* A client is entitled to confidential communications. Communications with a third-party non-client are not protected.

3. *Litigation Control:* A client defines the objectives of litigation and has the decision making power, including relative to settlement.

C. "Client" Theories:

There are three theories on the topic of representation in the tripartite relationship:

1. *The Two-Client Theory:*

   a. Both the insured and the insurer are clients of the defense attorney.
   b. Attorney owes a duty of care to both the insured and the insurer.
   c. Majority view on the tripartite relationship.

2. *The One-Client Theory*:

   a. The attorney's duty is to the insured.
   b. Preserves the attorney's duty of loyalty, and strict lines of privity.
   c. Current judicial trend.

3. *The Third-Party Payor Theory*:

   a. Known as the "One-and-a-Half Client" Theory.
   b. If the insurer can manage the litigation without compromising the attorney's loyalty to the insured, then the attorney can, and does, owe the insurer a duty of care.
   c. This allows the insurer to claim "client" status to such an extent that it has the right to manage the litigation.

III. CONFLICTS OF INTERESTS

A. Conflicts:

The tripartite relationship can present both actual or potential conflicts between the interests of the insurer and insured.

B. Types of Conflicts:

1. *Covered Claim:* Allegations in the claim that do not fit the scope of coverage.

2. *Exclusions*: Allegations fit an exclusion in the policy.

3. *Covered Damages:* Damages sought do not fit the covered damages in the policy.

4. *Excess Damages:* Damages sought exceed the policy limits.

5. *Coverage Erosion*: Coverage has been eroded under an "aggregate" limit of liability.

6. *Other Insurance:* Policyholder has other insurance which may be applicable.

7. *Breach*: The policyholder has breached a condition of the insurance contract.

C. Sources to Determine Conflict:

There are a number of sources to consult to determine whether a conflict exists between an insurer and insured:

1. *Statutes*
2. *The Insurance Contract*
3. *Insurance Case Law*
4. *Standards of Professional Ethics for Lawyers*

D. The Independent Counsel Doctrine:

This doctrine embodies the idea that the policyholder may be entitled to outside counsel. Under this doctrine, many jurisdictions require the appointment of independent counsel to represent the policyholder where certain conflicts of interest arise between the insurance company and the policyholder.

IV. CONFLICT STATUTES

A. Jurisdictions:

1. *Alaska*
2. *California*

3. *Florida*
4. *Guam*

B. Statutes:

Statutes specifically address when a conflict of interest exists between an insurer and its policyholder with respect to the defense of an underlying lawsuit.

C. Independent Counsel:

If a conflict does arise, most statutes require the right to independent counsel, unless the insured waives the right in writing.

D. Examples:

1. *Punitive Damages:* Most statutes specifically provide that reservations on punitive damages and claims for damages in excess of policy limits do not create conflicts that require the appointment of independent counsel.

2. *Coverage Defense*: Florida statute assumes a conflict between the insurer and the policyholder whenever the insurer asserts a coverage defense.

V. THE INSURANCE CONTRACT AND CASE LAW

A. The Insurance Contract:

A direct source of the mutual rights and obligations of the insurer and its policyholder is the insurance contract.

B. Silent on Conflicts:

Many contracts are silent on what constitutes a conflict of interest between the insurer and the policyholder, or what impact such a conflict of interests has on the insurer's contractual rights relating to the defense of suits against the policyholder.

C. Types of Contracts:

Some types minimize potential conflicts when they define rights related to settlement and choice of counsel.

1. *General Liability/Automobile:* Such policies often expressly endow the insurer with the unqualified right to defend, investigate and settle any claim or suit.

2. *Professional Liability Policies*: Usually give the policy holder, a professional, more control and can result in less conflicts.

D. Case Law:

Modern trend evinced by the recent decisions of a majority of jurisdictions is that not every reservation of rights letter will trigger the right to independent counsel. Only reservations that create actual conflicts between the carrier and insured that can influence both the defense and coverage.

1. *Standard in Ohio:* If the interests of the insured and the carrier's are "mutually exclusive," such that the carrier is unable to provide a defense on all claims then the carrier must pay for counsel of the insured's choosing. See *Red Head Brass, Inc. v. Buckeye Union Ins. Co.* (1999), 135 Ohio 3d 616.

VI. PROFESSIONAL ETHICS OF ATTORNEYS

A. The Ohio Rules of Professional Conduct:

1. *Supreme Court of Ohio:* The new Ohio Rules of Professional Conduct, which are based upon the ABA Model Rules, were adopted by the Supreme Court of Ohio in 2007.

2. *Client Communication:* The Ohio Rules of Professional Conduct place an emphasis on communication, both oral and written, between an attorney and client, especially where conflicts may arise or actually exist.

B. Compensation by Third-Parties:

Rule 1.8(f) governs compensation of lawyers by third parties and allows a lawyer to accept such compensation as long as:

1. *Consent*: The client gives informed consent;

2. *Duty of Loyalty:* There is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship;

3. *Privilege*: Information relating to representation of a client is protected;

4. *Insurance Defense*: If the lawyer is compensated by an insurer to represent an insured, the lawyer delivers a copy of the "Statement of Insured Client's Rights" to the client in person at the first meeting or by mail within ten days after the lawyer receives notice of retention by the insurer.

C. Statement of the Insured Client's Rights:

Outlines a number of insured client's rights, including.

1. *Selection of Counsel*
2. *Control of Defense/Lawyer*
3. *Communications*
4. *Confidentiality*
5. *Release of Information*
6. *Conflicts of Interest*
7. *Settlement*
8. *Fees & Costs*
9. *Hiring Personal Counsel*

VII. TYPES OF CONFLICTS

A. Reservation of Rights & Coverage Disputes:

Conflict of interests most frequently arise in situations where the insurer has a duty to defend the policyholder, but disclaims, either in whole or in part, a duty to indemnify based on one or more coverage defenses.

B. Insurer Covers Multiple Insureds with Adverse Interests:

In many cases an insurer will have a duty to defend two insureds whose interests are adverse to each other, and may be adverse to the insurer.

> *Example*: It is relatively common for two drivers who are involved in an accident, and who by coincidence are insured by the same carrier, to sue one another, thus triggering the insurer's duty to defend each against the other. In this situation, the insurer should not be permitted to control the defense of either policy holder, and must retain independent counsel.

C. Full Disclosure:

When defense counsel learns about potential coverage defense.

> *Example:* What if defense counsel becomes privy to facts that indicate the policyholder committed an intentional act thereby negating coverage under the policy. The attorney's duty to preserve the confidentiality of information under the ethical rules may require the attorney to refuse to disclose certain information to the insurance company absent the insured's consent.

D. Right to Control Defense:

The interests of the insurer and insured also conflict when the insured desires the best possible defense and the insurer desires a cost-effective defense.

> *Example:* Insured wants to retain a high-end expert, when carrier seeks a more economical expert. The question of whether the fees of a "gold-plated" defense are necessary and reasonable.

E. Limits and Deductibles:

1. *Large Deductible*: The insurer might want to settle for an amount within, or close to, the deductible while the policyholder might prefer to go to trial to avoid liability altogether.

2. *Declining Limits:* The insured may desire an early settlement, before the indemnification dollars are reduced by defense costs, while carrier may want to put up a strong defense.

3. *Defense Outside Limits:* The insurer may want to resolve quickly to avoid mounting defense counsel, while insured may want to defend through trial.

F. Coverage not Disputed, but Exposure Exceeds Limits:

Claims for damages in excess of the applicable limits raise the potential for a conflict of interest between an insurer and its policy holder. This is true because the insurer and policy holder may take opposite views about settlement of the claim.

G. Settlements and Punitive Damage Exposure:

1. *Excess of Limits:* Conflicts of interest arise in connection with judgments or settlements in excess of policy limits.

    a. *Question:* Can a carrier negotiate a settlement without the insured's consent that is in excess of the policy limits which would, therefore, require the insured to contribute to any recovery by the claimant?

    b. *Question:* Does a carrier have an obligation to post a bond on an excess verdict (above the limits) in order for the insured to perfect an appeal?

VIII. THE ROLE OF CONFLICT COUNSEL AND PERSONAL COUNSEL

A. Conflict Counsel:

Conflict counsel, retained by the insurer, can be utilized to handle sensitive aspects of litigation and safely navigate between the insurer and insured relative to disputed claims with respect to coverage, etc. without comprising the loyalty and duty of defense counsel. On such questions of coverage, the defense attorney retained to represent the insured steps out and the insurer relies on conflict counsel to provide advice and counsel in dealing directly with the insured or the insured's personal counsel.

B. Personal Counsel:

Personal counsel, retained directly by the insured at the insured's own expense, represents the insured's interests directly with the carrier, again leaving defense counsel out of areas of conflicts.

IX. MALPRACTICE CLAIMS INVOLVING INSURANCE DEFENSE COUNSEL

A. Malpractice Claim by Insurer:

In Ohio, the insurance carrier lacks standing to maintain a legal malpractice action against an attorney it hires to represent an insured. Ohio follows a strict line of privity for malpractice actions. The attorney-client relationship is considered to be between the attorney and the insured, even though the carrier pays the fees. The insurer is essentially a stranger to the relationship for the purposes of privity. See *Swiss Reinsurance America Corp. v. Roetzel & Andress,* Summit App No. 22523, 2005-Ohio-4799.

B. Vicarious Liability of Insurer:

Under the same logic, the insurer would appear to be isolated from being held vicariously liable for the negligence of insurance defense counsel. Insurance defense counsel acts as an independent contractor. See *Mentor Chiropractic Center, Inc. v. State Farm Fire & Casualty Co.* (2000), 139 Ohio App. 3d 407.