CLM CLAIMS & LITIGATION MANAGEMENT ALLIANCE™

ADVANCING ETHICS, COOPERATION AND EDUCATION

2014 CLM Annual Conference

April 9, 2014 – April 11, 2014

Boca Raton Resort
501 E. Camino Real
Boca Raton, FL 33432

Roundtable 3: Thursday, April 10, 2014 (3:30 pm – 4:30 pm)

Ethical Considerations Encountered By Insurers And Counsel When Handling Multiple Insureds Under A Single Policy

I. ADDITIONAL INSURED CLAIMS AND IDENTIFYING WHEN A CONFLICT EXISTS

A. Identifying issues to be addressed

Current insurance litigation often involves complex questions of insurance coverage, multiple insured endorsements, additional insured rights and responsibilities, and ethical rules and regulations that govern the conduct of attorneys and insurance professionals. As various companies become more aware of the advantages of being covered by another entity's policy, such as a subcontractor insuring the general contractor, these issues arise more and more frequently in multiple jurisdictions. Identifying when such a conflict exists and when action must be taken to prevent a potential ethical problem remain constant problems for attorneys and claims handlers throughout the country. By carefully observing the requisite rules of ethical conduct and by conscious and pointed communications with the insured, attorneys and insurance representatives can more easily navigate what can be a mine field of ethical problems and potential bad faith litigation during the course of managing these claims.

B. Reasons why representation by a single law firm is to the benefit of the insurers and insured

When a single policy covers multiple entities in a single occurrence (which has now given rise to a lawsuit), there are numerous beneficial results that may occur with one firm representing all parties insured under one policy. These results can be positive not only for the insurance company but for the insureds themselves. It is understandable that an insurance company, now handling multiple claims under a single policy, may wish to retain one law firm to represent all of these defendants. The first overriding concern of most carriers relates to the control of the defense. Within most insurance policies, the insurance company has a right to choose counsel for the defense of its insured with some rather

significant exceptions. By maintaining a common defense and one point of contact, the insurance company can handle what would ordinarily be unwieldy litigation with a minimum of conflict and a great deal of consistency in defense theory and case evaluation. Maintaining one law firm for this purpose can prevent in-fighting among the defendants that usually only causes substantially larger recovery by the plaintiff.

Additionally, panel counsel who are well acquainted with the insurance companies' detailed guidelines and who have substantial experience in the area of law related to this particular piece of litigation, provide a great deal of confidence for the insurance company that the case is being handled competently and in a cost effective manner. Often by maintaining a unified defense the insurance company can also avoid substantial costs related to multiple expert representations of the various entities involved.

It is also useful for the insurance company to be able to establish that there will be no conflict among the defendants when proceeding to settlement negotiations with the plaintiff thus often resulting in a much lower gross settlement number than would ordinarily be contemplated with multiple defendant representations.

For additional insureds, there are further advantages in that they do not need to submit the claims to their own carriers, in some jurisdictions, thus avoiding negative loss history reports and a potential increased future premium.

However, this representation must still be bound by the applicable rules related to representation of parties no matter how cost effective the case may be for the insurance company now insuring multiple parties.

C. Model Rule 1.7

As it relates to attorneys, these ethical requirements are contained in a number of different areas within the ABA's model rules of professional conduct and in the various adaptations of these rules which are contained within various states' code of ethics. However, as it relates to multiple insureds being represented by the same law firm, it is best to start with the requirements of Rule 1.7, Conflict of Interest as to Current Clients. This rule provides as follows:

> "(a) 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 lawyers."

ABA Model Rules 1.7

As is clear from Rule 1.7, a lawyer cannot represent a client when a concurrent conflict of interest may exist between multiple entities and that representation directly affects another client in an adverse way. There are numerous circumstances under which this can exist within a multiple insured, single defense situation. One of the most clear conflicts could exist if panel counsel, chosen by the insurance carrier for all of the defendants, becomes aware that a reservation of rights has been issued as to one or more entities that attorney is now assigned to represent. Anything which may affect the actions of

insurance counsel in defending every entity, equally, can give rise to a violation of Rule 1.7. Such a conflict can also give rise to the necessity of a retainer of independent counsel chosen by insured which is discussed in more detail later in this presentation.

One issue which often arises in this context deals with what exactly creates a conflict of interest particularly as it relates to a reservation of rights. Not all reservations of rights may necessarily give rise to a right to independent counsel or create a conflict of interest. While a lawyer representing a particular insured as to uncovered and covered counts, may often give rise to a conflict of interest, an issue regarding notice being given to the insured by the insurance company may have no effect on the actions taken by defense counsel and would not necessarily give rise to a withdrawal and retainer of independent counsel. Every jurisdiction seems to handle these situations in a multitude of different manners and counsel should examine carefully the laws of their state to determine when such a conflict exists. However, reflexive withdrawal or the allowance of independent counsel is not necessarily mandated in every potential conflict situation depending on the facts, the insurance policy involved, the nature of the defense and the law applicable in that jurisdiction.

There are also situations under which a concurrent conflict of interest could arise based on the case history in the particular lawsuit that is being defended. Often times the additional insured's own carrier will have chosen counsel who has been representing the defendant before a final decision is made on the additional insured endorsement and its applicability to this particular litigation. Under those circumstances, there may have been cross claims or counterclaims brought against these defendants which create actual pending claims, prohibiting a single attorney from representing multiple defendants.

There may also be times when a conflict is simply unavoidable. If one client indicates that statements were made before an accident which were denied by the other client which the attorney may be also representing under a single policy, it is difficult to imagine how one lawyer can represent these two competing interests. Quite simply, sometimes the nature of the case and the clear inconsistency in stories told by the parties may preclude a single representation.

D. Claims Professional Conflicts

Ethical and statutory requirements for the representation of multiple entities in a single case by a lawyer are relatively well outlined in individual states' rules and the ABA Model Rules of Professional Responsibility. Claims professional guidelines are not as clear.

Insurance claims professionals must deal with potential conflicts as they relate to handling multiple claims in the additional insured situation. Unlike lawyers, there seems to be no over-arching ethical standard applied to insurance adjustors in cases of potential conflicts of interest. It has been argued that providing such a logical framework for adjustors, basically tracking rules applied to lawyers under a particular jurisdiction's rules of professional conduct, may be long overdue. Law review articles have discussed the timing of discussion and implementation of broad legal guidelines on third party adjusting, which should be governed by the same or similar professional legal services and civil procedure standards that govern lawyers to facilitate civil claims settlement for their clients. See *J. Parnell, C*ivil Claims Settlement Talks Involving Third Parties and Insurance Company Adjustors: When should lawyer conduct standards apply? 77 St. John's Law Review, 603 (Summer 2003). It has been argued that separate adjustors, like separate defense counsel, may be required to preserve privileged information and to avoid direct conflicts of interest between the parties. Having an adjustor being forced to take sides in a particular lawsuit emphasizing the rights of one insured or another are clearly unacceptable and give rise to a potential for a bad faith claim by the insured.

An extreme example of this was indentified in the California case of *Betts vs. Allstate Insurance,*

154 Cal App.3d 688 (1984) that resulted in a $3,000,000 punitive damage award against the insurer. In that case, there was evidence that an adjustor in one part of the case was able to review the information contained in another insured's file thus giving unfair advantage to the defense of that claim. Such a bad faith action could very well occur in a multiple insured lawsuit context if proper separation of files does not occur when a conflict exists. For purposes of multiple insured defense by a single carrier, adjustors may look to the general rules of ethical deportment of the attorneys which can function as a guide for all professionals who are attempting to defend the case for multiple parties through the insurance policy issued to the named insured.

These concepts are summarized in the Restatement (3rd) of Law Governing Lawyers as follows:

…there is substantial risk that the lawyer's representation of the client would be materially and adversely affected by the lawyer's own interests or by the lawyer's duties to another current client, former client, or a third person.

See Restatement (3rd) of Law Governing Lawyers *§* 121 (perm. vol. 2000).

The key words and phrases of the restatement are "interests," "substantial risk," and "materially and adversely affected." When analyzing a potential conflict the attorney should consider the following: (1) what interest is at stake; (2) what is a "substantial risk"; and (3) what does "materially and adversely affected" mean under the circumstances.

II. WHEN SEPARATE COUNSEL MUST BE RETAINED

A. Cumis and Peppers Counsel

There are times when an actual conflict of interest may occur in the representation of multiple insureds. Despite the best efforts of defense counsel, there are times when the facts simply are not consistent between the parties and finger pointing may occur which would prohibit a successful representation of multiple parties. In that circumstance it is almost certain that separate counsel must be retained occasionally with the insured having the right to choose that counsel.

Some states, such as California and Alaska, have statutes which outline conflict rules and the necessity of employment of independent counsel. In Illinois, this has been discussed by the Illinois Supreme Court in *Maryland Casualty Company vs. Peppers,* 355 N.E. 2d 24 (1976). In that case, an insured was claimed to have injured a trespasser on his land. The lawsuit contained both allegations of negligence and intentional wrong doing. In that circumstance the insurer was obligated to defend the insured because the insurance policy provided for coverage for negligent acts but not for those damages which were intended or expected by the insured, and a conflict arose between the insurer and the insured. The Court recognized that insurance defense counsel retained by the insurance company, who have a long term relationship with that carrier, may give rise to an ethical issue as to the appointed counsel representing the insured's interest zealously. There would also be a question as to whether the defense counsel could emphasize one part of the case over another which would result in a finding of intentional conduct thus negating insurance coverage.

Situations where the attorney's conduct may provide for less than vigorous defense to certain allegations contained within the complaint, can give rise to the necessity of the retainer of an independent counsel. See *Nandorf, Inc. vs. CNA Insurance Company,* 479 N.E. 2d at 988, (Ill. App. 1985). The incentive to maintain amity among the defendants to prevent conflicts and for the insurer to not enforce spurious reservations of rights can eliminate the applicability of the *Peppers* rule in multiple jurisdictions. In California, *Cumis* independent counsel can often be viewed as having questionable effectiveness due to

a lack of experience in insurance defense litigation and a complete lack of interest in maintaining a positive relationship with the insurer. Even under the California rules developed after the *Cumis* decision, it has been held that while *Cumis* may prohibit an insurer from dictating the tactics of litigation and retainer of counsel, it does not delegate to *Cumis* counsel a meal ticket immunized from judicial review for reasonableness. See *United Pacific Insurance Company vs. Hall*, 199 CAL App.3d 551 (1988). While the responsibilities of *Cumis* counsel in California are to operate reasonably and may possess an implied covenant of good faith and fair dealing, most insurers would agree that the control of independent counsel in these circumstances is often difficult and court intervention of limited efficacy.

III. DISCLOSURE AND INFORMED CONSENT

A. A Waiver Through Informed Consent

Whenever the insured is presented with a situation where one counsel may represent multiple parties through litigation, and there is a potential for a conflict of interest, there is always the option of pursuing a waiver of any conflict through informed consent. Informed consent generally denotes an agreement by a client to a proposed course of action after the lawyer has communicated adequate information and explanation about the material risks and reasonably available alternatives to the proposed course of conduct. See *ABA Model Rule 1.0.*

In the context of a representation of multiple insureds, this would include a revelation to these multiple insureds that the lawyer representing multiple parties would share no confidential information without permission, and that the lawyer will handle the representation in a balanced way. Taking into account all the parties' interests equally as is observed in ABA Model Rule 1.8, a lawyer shall not use information relating to the representation of a client to the disadvantage of the client unless the client gives informed consent, except as permitted by these rules.

B. Actual and Potential Conflicts

Included within this requirement of informed consent is a full disclosure of all both actual and potential conflicts which may exist between the parties. The lawyer should also disclose any and all claims which may exist between the parties but which would be potentially waived due to the lawyer's role representing multiple parties. For example, one defendant may be inclined to seek an allocation of liability at the trial of a particular action as they believe that their responsibility for a particular injury may be substantially less that of a co-defendant. By agreeing to the representation of one counsel and the applicability of a single policy to the occurrence, any such allocation may by law be waived and no contribution claim would be brought. All parties must be informed of this result and the potential that they may be considered of equal liability to all defendants found liable by the jury.

The lawyer must also be aware that conflicts may arise during the course of litigation that were not anticipated when the lawyer was first hired to represent different parties in the same lawsuit. In that circumstance there is a continuing obligation on the part of the attorney and the insurance company to make sure that if such conflicts arise all parties are informed of the conflict or potential conflict and that all parties agree to the continued representation of that lawyer. If the lawyer in his professional judgment determines that it is impossible for him to continue to represent multiple parties based on these conflicts, withdrawal with court consent is required. See ABA Model Rules of Professional Conduct Rule 1.16.

To ensure that the lawyer complies with all necessary rules and regulations of the Code of Professional Responsibility, waivers of potential conflicts should be obtained in writing from each of these multiple insureds individually. An electronic acknowledgement of their informed consent to the potential conflicts and their agreement to waive any such issue is acceptable. See ABA Model Rules of

Professional Conduct Rule 1.0(n).

IV. PROTECTION OF PRIVILEGE AND ALLOCATION OF LIMITS

A. Protection of Privilege Information Among Multiple Parties

Because an attorney is representing multiple parties there may be a number of different communications which may be known to that lawyer which could give rise to a potential conflict among his or her clients. This confidential information must of course not be shared absent appropriate informed consent and may give rise to the necessity of the lawyer withdrawing from representation of a client in that litigated matter. These rules are contained in Model Rules 1.6 and 1.16 regarding the lawyer's obligation to maintain privileged information among clients in the same lawsuit.

Under the requirements of Rule 1.8, the lawyer must be aware of potential ethical traps which may arise during the disclosure of information in that lawyer's role as counselor to particular defendants. A fact obtained from one client may be critical to establishing a defense for another client, but the disclosure of that fact my cause harm to the first client, thus giving rise to this ethical issue. The lawyer must weigh the impact of this information between the defendants he or she is representing, giving equal weight to all parties regardless of who paid the premium on the policy now defending these multiple entities. If there is a time that arises where the lawyer must reveal such information obtained from one client relevant to the defense of another, the lawyer must first make full disclosure and obtain the informed consent of the first client before proceeding. If that consent cannot be obtained, the attorney must terminate the representation as the competing ethical obligations are impossible to resolve within the pending litigation.

Insureds in this circumstance may have no difficulty in approving of the disclosure of this information as it can be positive to the collective defense of all defendants and is not costly to the first client as they are being indemnified regardless of the result of the underlying case by the applicable insurance. Their likelihood of approving the revelation of this information may also relate to the value of the claim and the necessity of their own insurance policy being involved in an excess manner above and beyond the primary limits issued by the additional insured carrier. There are also times when the multiple insureds represented by one lawyer may have continued business relationships which would be affected adversely by the revelation of information critical to the defense but bad for the continuing business relationship. Subcontractors do not wish to cause annoyance to general contractors who may be hesitant to hire them on the next job project if they reveal unflattering information regarding their business practices or safety rules in litigation. Under those circumstances, while the cooperation clause in an insurance policy may require that the insured participate in the defense, this does not mean that they must commit professional suicide simply for the betterment of the collective defense of a particular piece of litigation or to save an insurance company from paying a substantial amount of money under their policy terms.

A lawyer in these situations learning privileged information should be prompt in making decisions necessary to obtain informed consent and continue to keep the clients reasonably aware of all such potential or actual conflicts of interest that may result from the release of privileged information for the determination as to a particular course of defense strategy which is beneficial to one party but not the other. Keeping all of these clients in the loop on decision strategy and court proceedings will allow them to make informed decisions and prevent problems between parties as the case progresses.

B. Conflicts as to Settlement Allocation

Typically, if a single policy is covering multiple insureds it is not significant to the individual

defendants how much money is allocated to each individual defendant from the common insurance fund. Often, the settlement is made with one settlement amount applicable to all defendants. However, counsel representing defendants in such claims need to be aware of potential pitfalls which arise under these settlement parameters. It should be noted, however, that some insureds may have a strong incentive to not have an allocation made as to their relative liability for reasons related to their individual business requirements. There also may be simple psychological reasons as to why they do not wish to have a majority of the liability imposed on them on a particular lawsuit. Again, the attorney and insurance company must balance these issues when determining whether and how an allocation may be made. It should be noted that proportional allocation is sometimes required for a good faith settlement to be obtained. Executing a release which does not define the specific payments by the various parties may prohibit their obtaining of a good faith finding of settlement from the court. This would mean that they may not have an immunity to other suits by other parties and would not receive a credit for their payments against any additional recovery made by parties not being defended by the same carrier and counsel. Again, informed consent to these facts is essential to ensure no attorney misconduct and the proper balancing of interest among the various defendants.

Additionally, issues may arise where the various defendants believe, mistakenly, that not only would the additional insured policy cover their damages, but the additional insureds' excess policies may apply as well. In Illinois, this issue was addressed specifically in *Kajima Services, Inc. vs. St. Paul Fire & Marine*, 879 N.E. 2d 305 (Ill. 2007). In that case, an employee was injured on the job site and the general contractor and subcontractor were sued for injuries sustained. The general contractor tendered to the subcontractor's carrier for defense and indemnity. The subcontractor's carrier eventually accepted that tender under reservation of rights but the Illinois Supreme Court determined that this acceptance was relevant only to the primary coverage of the additional insured's policy, not its excess coverage. Therefore, when the primary limits of the subcontractor's insurance were exhausted, the next layer came from the general contractor's own carrier's coverage, not the subcontractor's umbrella policy. Issues regarding horizontal versus vertical exhaustion must therefore be again noted by the multiple insured counsel and an explanation of the impact of horizontal exhaustion, particularly in tender cases, must be made under the informed consent rules previously discussed.

V. UNIQUE ISSUES RELATED TO TARGETED TENDERS

A. Selective Tender

On occasion when multiple insureds are defended under the same policy, the issue of a selective tender may arise. The selective tender Rule exists only in a few jurisdictions but can again complicate the attorney's representation of multiple insureds. Under the selective tender rules, where an insured has multiple policies providing coverage for a claim, the insured may designate which of its insurers will defend the case. The duty to defend falls solely upon the selected insurer, and the insurer may not, in turn, seek equitable contribution from the other insurers who are not designated by the insured.

The duty to defend is normally triggered by the insurer receiving actual notice of the lawsuit. The insured must make clear that it does not wish to invoke coverage from a particular insurer before that insurer is relieved of that duty to defend. The selected insurer may not seek to share defense costs with other insurers under the policy's "other insurance clauses" if the insured has refused to invoke coverage under those policies. See *John Burns Construction vs. Indiana Insurance Company*, 727 N.E. 2d 211 (Ill. 2000).

An attorney under a selective tender rule must now balance an additional competing interest, the case where the insured is specifically declining to have his own insurance policy cover a particular loss. However, as has been discussed previously under the horizontal exhaustion concept, that primary policy

may still be in play depending on whether the limits obtained by the additional insured policy are sufficient to cover a particular loss. Under those circumstances all of the insureds must be aware of the potential conflicts of interest which may arise and the fact that the choice of selection of carrier can be significant as to the applicability of umbrella policies. Also, if there is a reservation of rights applicable to defense of a particular insured it may again raise the issue of retainer of independent counsel. Both the insurance carrier under the additional insured endorsement and defense counsel chosen by them should be aware of this ethical limitation. If one or more carriers under the additional insured endorsement maintains a reservation of rights, it is possible that that carrier under the named insurance policy could have its own defense counsel continue the defense of the case, with their fees paid by the additional insured carrier. The requirements of the conflict of interest rules outlined in 1.7 of the ABA Model Code of Professional Responsibility would assist the allocation of responsibility in these cases and the lawyer's responsibility to determine the proper method of handling them on an individual basis.