What Do I Do? Ethical Dilemmas Created by the Tripartite Relationship

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It should go without saying that litigation is stressful by nature. The parties are emotional and passionate about their positions. Parties may be licking their wounds after losing some battles in and outside of court. Court deadlines add further stress. The lawyers may be exhausted by constantly advocating for their clients while facing questions of legal strategy and the costs for that strategy. This does not account for the added stress caused when an insurer has an obligation to appoint defense counsel and the level of collaboration necessary between the insurer and the insured under these stressful conditions.

These stress levels can be kept in check when all the parties understand the complexities of the tripartite relationship shared between the insurer, the insured and defense counsel appointed by the insurer. While there are a number of potential pitfalls for insurers and insureds, defense counsel faces unique pressures in defending their clients which an insurer has agreed to defend and indemnify against the costs of the litigation. Thankfully, there is a significant body of law concerning the complexities of the tripartite relationship that provides guidance to defense counsel.

I. Introduction to the Complexities of the Tripartite Relationship

While often dismissed as an abstract concept, the obligations created by the tripartite relationship directly impacts coverage counsel while representing the insurer and defense counsel’s communications with both the insured and the insurer. At its most basic level, the tripartite relationship arises out of an insurer’s duty to defend and indemnify an insured found in most liability insurance policies. More precisely, the insuring agreement found in liability policies typically grants an insurer “the right and duty to defend an insured against a suit asking for such damages.” Likewise, the coverage grant in a liability policy will also require an insurer “pay all sums an insured must pay as damages because of bodily injury or property damages.” While these obligations seem straightforward, a substantial body has developed when the insurer and insured have divergent interests. It is at this point when even the lightest disagreement between an insurer and insured over the strategy about a liability case that coverage counsel and defense counsel may face any number of ethical dilemmas.

While the tripartite relationship has been thoroughly analyzed by a number of state and federal courts, the Wisconsin Supreme Court has provided the following analysis of the classic “tripartite” relationship:

In a typical tripartite insurance relationship, involving an insurer, the insured, and the insurance defense attorney, the insurer has a duty to retain and pay for an attorney to represent the policyholder/insured when the insured is sued by a third party. See Randall Riopelle,
Note, *When May an Insurer Fire Counsel Hired To Represent the Insured?,* 7 Geo. J. Legal Ethics 247 (1993). As such, the insurer maintains the right to control the defense, the settlement of a claim, and the payment of a claim within the policy limits.

*Marten Transport, Ltd. v. Hartford Specialty Co.*, 194 Wis. 2d 1, 18, 533 N.W.2d 452, 457 (1995).

Likewise, commentators have summarized the tripartite relationship as:

“[w]hen an insurance company hires and pays a lawyer to defend its insured, the resulting triangular or “tripartite” relationship among insured, insurer, and defense counsel may involve conflicting interests. Although the insurer and its insured almost always share the goal of defeating the third-party claim, the insured prefers that any settlement or judgment come out of the insurer’s pocket, while the insurer may have reserved its right to contest coverage for indemnity.”


Consequently, while the insured and insurer share a common goal in defending a claim, the strategy as to how to achieve that goal may differ. And, it is at this point, where strategies may diverge, where it potentially gets difficult for coverage counsel and defense counsel.

In *Continental Cas. Co. v. St. Paul Surplus Lines Ins.*, 265 F.R.D. 510, 522 (E.D. Cal. 2010), the District Court for the Eastern District of California provided the following additional guidance on the tripartite relationship:

The attorney-client relationship is more complex in the context of insurance litigation. When there is a single, common goal shared by an insurer and its insured of minimizing or eliminating liability to a third party, California courts have recognized that a unique tripartite relationship exists among those parties (the insurer and the insured) and the defense counsel hired to defend against third-party liability. In that tripartite relationship, both the insurer and the insured are considered the clients of the defense counsel, and an attorney-client privilege is shared among all of them. As the court explained in *San Diego Navy Federal Credit Union v. Cumis Insurance Society* (“Cumis”), 162 Cal.App.3d 358, 208 Cal.Rptr. 494 (1984), “[i]n the usual tripartite relationship existing between the insurer, insured and counsel, there is a single, common interest shared...
among them. Dual representation by counsel is beneficial since the shared goal of minimizing or eliminating liability to a third party is the same.” Id. at 364, 208 Cal.Rptr. 494. The theory is an extension of California Evidence Code section 952, which provides that confidential communications involve those communications between a client and his or her lawyer in confidence by a means which “discloses the information to no third persons other than those who are present to further the interest of the client in the consultation or those to whom disclosure is reasonably necessary for the transmission of the information or the accomplishment of the purpose for which the lawyer is consulted ....” Cal. Evid. Code § 952; see also Am. Mut. Liab. Ins. Co. v. Super. Ct., 38 Cal.App.3d 579, 593–594, 113 Cal.Rptr. 561 (1974); Glacier Gen. Assurance Co. v. Super. Ct., 95 Cal.App.3d 836, 157 Cal.Rptr. 435 (1979) (each a medical malpractice action in which the court found that counsel represented both the insured and insurer under a “joint defense” theory as set forth in Cal. Evid. Code § 962); see also Great Am. Surplus Lines Ins. Co. v. Ace Oil Co. 120 F.R.D. 533, 537 (E.D.Cal.1988) (relying on American Mutual to find a common interest between an insurer and its managing general agent who independently retained counsel); Britz Fertilizers, Inc. v. Bayer Corp., 2009 WL 604940 (E.D.Cal.2009) (relying on American Mutual and Glacier to find a “tripart relationship” among counsel, defendant, and defendant’s insurer which retained defendant’s counsel).

And, finally, many courts, realizing the complexities of the tripartite relationship, caution counsel on how “no man can serve two masters:”

Insurance-related litigation often involves a tripartite relationship between an insured, and insurer, and counsel hired by the latter to represent the interests of the former. In such a relationship, “the interest of the insured and the insurer frequently differ.” Kuhlman Electric Corp. v. Chappell, 2005 WL 3243498 (Ky.App.2005), aff'd, Chappell v. Kuhlman Electric Corp., 304 S.W.3d 8 (Ky.2009). Therefore, our Courts have, and out of necessity, established that, in the context of insurance litigation, “no man can serve two masters[.]” American Ins. Ass'n v. Kentucky Bar Ass'n, 917 S.W.2d 568, 571 (Ky.1996), citing Kentucky Fair Bd. v. Fowler, 221 S.W.2d 435 (Ky.1949). “[T]he defense attorney's primary duty of loyalty lies with the insured, and not the insurer.” Kuhlman at 18.
The pitfalls of the tripartite relationship are seen in *Parsons v. Continental Nat’l American Group*, 113 Ariz. 223, 550 P.2d 94 (1976), where the insurer hired defense counsel to defend the insureds after the insureds son was accused of assaulting their neighbors. During his representation, counsel learned the attack was deliberate and intentional and, therefore, potentially not covered under the liability policy. The insurer issued a reservation of rights letter on the basis that the damages resulting from the attack may not be covered. After trial, the verdict exceeded the policy limits. In later proceedings, the insurer took the position that coverage was excluded under the intentional acts exclusion. The Supreme Court of Arizona agreed with the insureds and found defense counsel abused his position:

> When an attorney … uses the confidential relationship between an attorney and a client to gather information so as to deny the insured coverage under the policy … we hold that such conduct constitutes a waiver of any policy defense, and is so contrary to public policy that the insurance company is estopped as a matter of law from disclaiming liability under an exclusionary clause in the policy.

Given these circumstances, the court held the insurer was responsible for the entire verdict, including the amount over the policy limits. This case demonstrates the fine line counsel may walk when key information is provided to the insurer that can prejudice an insured by causing a loss of insurance coverage or when information is covered up resulting in insurance coverage even though coverage should have been denied.

**II. Begin with the Rules (Unfortunately, It Is Not That Easy.)**

While this analysis will examine the duties of both coverage counsel and defense counsel, defense counsel will typically be on the front lines of the tripartite relationship. In general, defense counsel has an obligation to the insured to maintain the confidentiality of the insured’s information. The following Rules of Professional Responsibility (“ABA Rule”) provide the basic framework for defense counsel’s responsibilities to the insured:

- **ABA Rule 1.6: Confidentiality of Information.** This ABA Rule governs when defense counsel may provide information from the insured to the insurer.

  (a) A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).
(b) A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:

1. to prevent reasonably certain death or substantial bodily harm;
2. to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services;
3. to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services;
4. to secure legal advice about the lawyer's compliance with these Rules;
5. to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client;
6. to comply with other law or a court order; or
7. to detect and resolve conflicts of interest arising from the lawyer’s change of employment or from changes in the composition or ownership of a firm, but only if the revealed information would not compromise the attorney-client privilege or otherwise prejudice the client.

(c) A lawyer shall make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client.

- **ABA Rule 1.7: Conflict of Interest: Current Clients.** This ABA Rule addresses situations where defense counsel may have concerns about whether there is a conflict of interest.

(a) Except as provided in paragraph (b), 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 lawyer.
(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law;

(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

(4) each affected client gives informed consent, confirmed in writing.

- **ABA Rule 1.8: Current Clients: Specific Rules.** This ABA Rule provides guidance when defense counsel is worried about providing information obtained from the insured to the insurer that could impact coverage.

(a) A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:

(1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;

(2) the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel on the transaction; and

(3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.

(b) A lawyer shall not use information relating to representation of a client to the disadvantage of the client unless the client gives informed consent, except as permitted or required by these Rules.

(c) A lawyer shall not solicit any substantial gift from a client, including a testamentary gift, or prepare on behalf of a client an instrument giving the lawyer or a person related to the lawyer any substantial gift unless the lawyer or other recipient of the gift is related to the client. For purposes of this paragraph, related persons include a spouse, child, grandchild, parent,
grandparent or other relative or individual with whom the lawyer or the client maintains a close, familial relationship.

(d) Prior to the conclusion of representation of a client, a lawyer shall not make or negotiate an agreement giving the lawyer literary or media rights to a portrayal or account based in substantial part on information relating to the representation.

(e) A lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation, except that:

(1) a lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter; and

(2) a lawyer representing an indigent client may pay court costs and expenses of litigation on behalf of the client.

(f) A lawyer shall not accept compensation for representing a client from one other than the client unless:

(1) the client gives informed consent;

(2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and

(3) information relating to representation of a client is protected as required by Rule 1.6.

(g) A lawyer who represents two or more clients shall not participate in making an aggregate settlement of the claims of or against the clients, or in a criminal case an aggregated agreement as to guilty or nolo contendere pleas, unless each client gives informed consent, in a writing signed by the client. The lawyer's disclosure shall include the existence and nature of all the claims or pleas involved and of the participation of each person in the settlement.

(h) A lawyer shall not:

(1) make an agreement prospectively limiting the lawyer's liability to a client for malpractice unless the client is independently represented in making the agreement; or

(2) settle a claim or potential claim for such liability with an unrepresented client or former client unless that person is advised in writing of the
desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel in connection therewith.

(i) A lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client, except that the lawyer may:

(1) acquire a lien authorized by law to secure the lawyer's fee or expenses; and

(2) contract with a client for a reasonable contingent fee in a civil case.

(j) A lawyer shall not have sexual relations with a client unless a consensual sexual relationship existed between them when the client-lawyer relationship commenced.

(k) While lawyers are associated in a firm, a prohibition in the foregoing paragraphs (a) through (i) that applies to any one of them shall apply to all of them.

III. Considering the Conflict and the Potential for Conflict

While there has been a significant analysis of the tripartite relationship by courts, the best indicator of whether an insurer’s defense of an insured is appropriate is whether there is a conflict. Here, counsel is urged to consider the potential for a conflict in addition to any actual conflict. In this respect, commentators have stated:

The conflict analysis in these cases should measure the potential, as well as any actual, conflict of interest. In the case of the insurance relationship, an understanding of how the rights of the insured and insurance company may become or already are adverse is critical to determining whether the defense lawyer has a conflict of interest. The attorney must be able to adequately meet his or her ethical obligations to recognize a conflict of interest, explain the conflict to the insured, disclose the advantages and the risk of a continued attorney/client relationship, and determine whether the representation will be materially affected.

Illinois courts recognize two types of potential conflicts: (1) when issues or facts developed in the litigation could affect coverage and (2) when the insurer could benefit if the defense counsel provides a less than vigorous defense. Illinois courts have recognized that a conflict (and a right to independent counsel) can arise when a
complaint alleges both covered and noncovered acts, such as counts for negligent and intentional conduct or compensatory and punitive damages, as well as under a variety of other circumstances that can place the insurance defense lawyer in ethical quicksand.

See, Thomas D. Morgan, Whose Lawyer Are You Anyway?, 23 Wm. Mitchell L. Rev. 11 (1997). Spotting potential conflicts early allows the insurer to advise the insured early and keep them apprised if a conflict of interests develops. Coverage counsel may be in the best position to identify potential and actual conflicts.

There are a handful of scenarios which are ripe for conflict and should be closely monitored:

- **Claimed Damages Exceed Policy Limits**

  The situation where the allegations against the insured in the underlying lawsuit potentially exceed the policy limits may create a conflict if the insurer and insured do not share a common interest in defending the claim against damages for amounts that may exceed the policy limits.

- **Insured’s Own Interests In the Litigation Not Shared By Insurer**

  The insurer and insured may have different strategies to defend the case. For example, the insured may not want to settle a case if it is worried about the potential for similar cases down the road or reflect poorly on the insured’s business. On the other hand, the insurer may not be concerned with how a settlement impacts the insured’s business and may see value in a settlement. Likewise, an insured may want to settle a case in order to avoid negative publicity. Of course, the insurer may not include negative publicity as a factor in deciding to settle a particular matter. Either of these scenarios can create a conflict.

- **When the Underlying Action Is Based on Covered and Uncovered Claims**

  A conflict may arise when the insurer arguably has a stronger interest in defending the covered claims and having less interest in defending the uncovered claims against the insured. For example, one Illinois court viewed this potential for conflict in the following manner:

  The attorney hired by the insurance company to defend in an action against the insured owes fiduciary duties to two clients: the insurer...
and the insured. The attorney-client relationship between the insured and the attorney hired by his insurer imposes upon the attorney the same professional obligations that would exist had the attorney been personally retained by the insured.… Courts have recognized, however, that in reality, the insurer’s attorneys may have closer ties with the insurer and a more compelling interest in protecting the insurer’s position, whether or not it coincides with what is best for the insured.… This reality frequently gives rise to conflicts of interest between insurer and insured.


- **Insured’s Desire for Good Precedent over Bad Precedent**

An insured’s decision to push forward with litigation to develop favorable law may misalign its interests with the insureds. An insurer may seek to resolve a particular matter in the most efficient way possible and may not share an insured’s concern to develop a favorable body of law.

- **Insurer’s Interest in Containing Litigation Costs**

A potential conflict may arise when an insured faces what it perceives as an existential threat and wants to spare no expense. An insurer is controlled by the terms and conditions of its insurance policy regardless of how much of a threat the litigation may pose to the insured’s business. Defense counsel may find their defense strategy is being controlled by two different philosophies.

These commonly seen conflicts may inevitably place stress on defense counsel. In the end, defense counsel may need to defend the case as they see fit and keep both the insurer and insured advised of all developments.

**IV. Reservation of Rights Letter and Ongoing Insurance Coverage Disputes**

While we throw around the term “reservation of rights” it may be worth spending a little time to think about this tool for insurers. Commentators offer the basics on reservation of rights letters:

...the reservation of rights letter is intended to inform the policyholder why coverage may not exist, based on the facts revealed by investigation, and policy provisions. Also, as discussed
above, the reservation of rights letter attempts to preserve the insurer's right to dispute coverage at a later time on grounds that may be demonstrated by information developed after the issuance of the letter, or on the basis of determinations that must be made in the future. As a result, in the event of a dispute, the reservation of rights letter is perhaps the most important written document other than the insurance policy. Consequently, careful attention should be given to the content of the letter.

As a reservation of rights letter may be sent to (or ultimately considered by) persons who are neither attorneys, nor are familiar with insurance concepts, the reservation of rights letter should recite in clear, concise, nonlegalese terms:

1. The policies claimed to be applicable;
2. The claims tendered;
3. The facts revealed by communications from the policyholder and/or through the insurer's investigation;
4. The reasons why coverage does not exist; and
5. The rights reserved if different than, or in addition to, policy provision grounds, such as the reservation of the right to seek reimbursement of defense costs or late notice.


It is important to note that not every reservation of rights creates a conflict sufficient to obligate the insurer to provide independent counsel. In Nandorf, the court stated that to determine whether an insurer’s reservation of rights warrants independent counsel, the courts have considered whether, “in comparing the allegations of the complaint to the policy terms, the interest of the insurer would be furthered by providing a less than vigorous defense to those allegations…. An insurer’s interest in negating policy coverage does not, in and of itself, create sufficient conflict of interest to preclude the insurer from assuming the defense of its insured.... However, conflict of interest has been found where the underlying action asserts claims that are covered by the insurance policy and other causes which the insurer is required to defend but asserts are not covered by the policy.” 134 Ill.App.3d at 137-138 (citations omitted).

- **Peppers** Conflict

Under Illinois law, if a reservation of rights creates a real conflict of interest, the insurer must advise the insured of the conflict and of the insured’s right to retain independent counsel at the insurer’s expense. *Murphy v. Urso*, 88 Ill.2d 444 (1981); *Maryland Cas. Co. v. Peppers*, 64 Ill.2d 187 (1976). In Peppers, the Illinois
Supreme Court held the insurer appointed defense counsel could represent the insured even if there was a conflict that would require independent counsel as long as the insured consents after “full disclosure.” While it is unclear exactly what “full disclosure” entails, the general consensus is an insurer should provide: (1) the attorney's relationship to the insurer, (2) the attorney's own interests, (3) the nature of the conflict between the insurer and the insured and how the defense may impact the coverage; (4) limitation of the scope of representation to defending the third-party claim only, thus limiting the ability to maximize coverage; (5) the insured's option to retain separate counsel to advise about coverage issues; and (6) the insured's right to independent counsel to defend, whose fees will be reimbursed by the insurance company.

V. Other Tough Questions Presented by the Tripartite Relationship

- Reasonable Fees for Defense Counsel

   Inevitably, the tripartite relationship may give rise to a dispute over defense counsel’s hourly rate. These disputes typical occur when the insurer has been paying defense costs for its own defense prior to tendering the claim. In general, courts have found that when an insurer is required to provide independent counsel, it is obligated to pay independent counsel’s reasonable fees. *Nisson v. American Home Assur. Co.*, 917 P.2d 488, 490-91 (Okla. 1996); *Pistolese v. North Country Ins. Co.*, 210 A.D.2d 961, 622 N.Y.S.2d 172, 173 (1994); *CHI of Alaska, Inc. v. Employers Reinsurance Corp.*, 844 P.2d 1113, (Alaska 1993). California provides more insight on this question under Cal. Civ. Code § 2860(c), which states that where independent counsel is provided, the insurer’s obligation to pay fees is limited to the rates which are actually paid by the insurer to attorneys retained by it in the ordinary course of business to defend similar cases.

- Malpractice Claims

   Under the tripartite relationship, an attorney has two clients--the insured and the insurer. Here, the question is what party has a viable cause of action in the case of legal malpractice. South Carolina provides an example where insurers can sue panel counsel that commits malpractice while representing an insured. Specifically, the South Carolina Supreme Court held in *Sentry Select Insurance Company v. Maybank Law Firm, LLC*, 426 S.C.154, 15 6, 826 S.E.2d 270, 271 (2019) that an insurer can bring a direct malpractice action against its panel counsel even though the insured is not harmed by panel counsel’s alleged negligence.
Likewise, California has also found an insurer can sue panel counsel because the insurer is a co-client to whom counsel owes a fiduciary duty. *Golf Ins. Co. v. Berger, Kahn, Shafton, Moss, Figler, Simon & Gladstone*, 79 Cal.App.4th 114 (2000).

**CONCLUSION**

Defense counsel can resolve ethical questions created by the tripartite relationship by relying on a healthy mix of legal support and having a practical approach.

From a *legal* standpoint, while there are a number of complex issues created when defense counsel gets appointed by an insurer, defense counsel has a significant body of law to resolve ethical issues. Defense counsel should be able to spot ethical pitfalls and know where to look to bring resolution to these issues.

From a *practical* standpoint, defense counsel should take an active role in making sure both their client, the insured, and the insurer understand the complexities caused by the tripartite relationship. While making sure the insurer stays informed about the underlying litigation and making it clear that the insured controls the litigation will be a delicate balance, defense counsel has significant guidance to walk this fine line.

In the end, both the insurer and the insured have the same common goal: an efficient and successful defense of the claims against the insured. This creates more than sufficient common ground for defense counsel to survive the ethical pitfalls related to the tripartite relationship.