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LAW

Navigating the Ethical Current

Evaluating Conflicts and
Other Ethical Issues in
The Tripartite Relationship

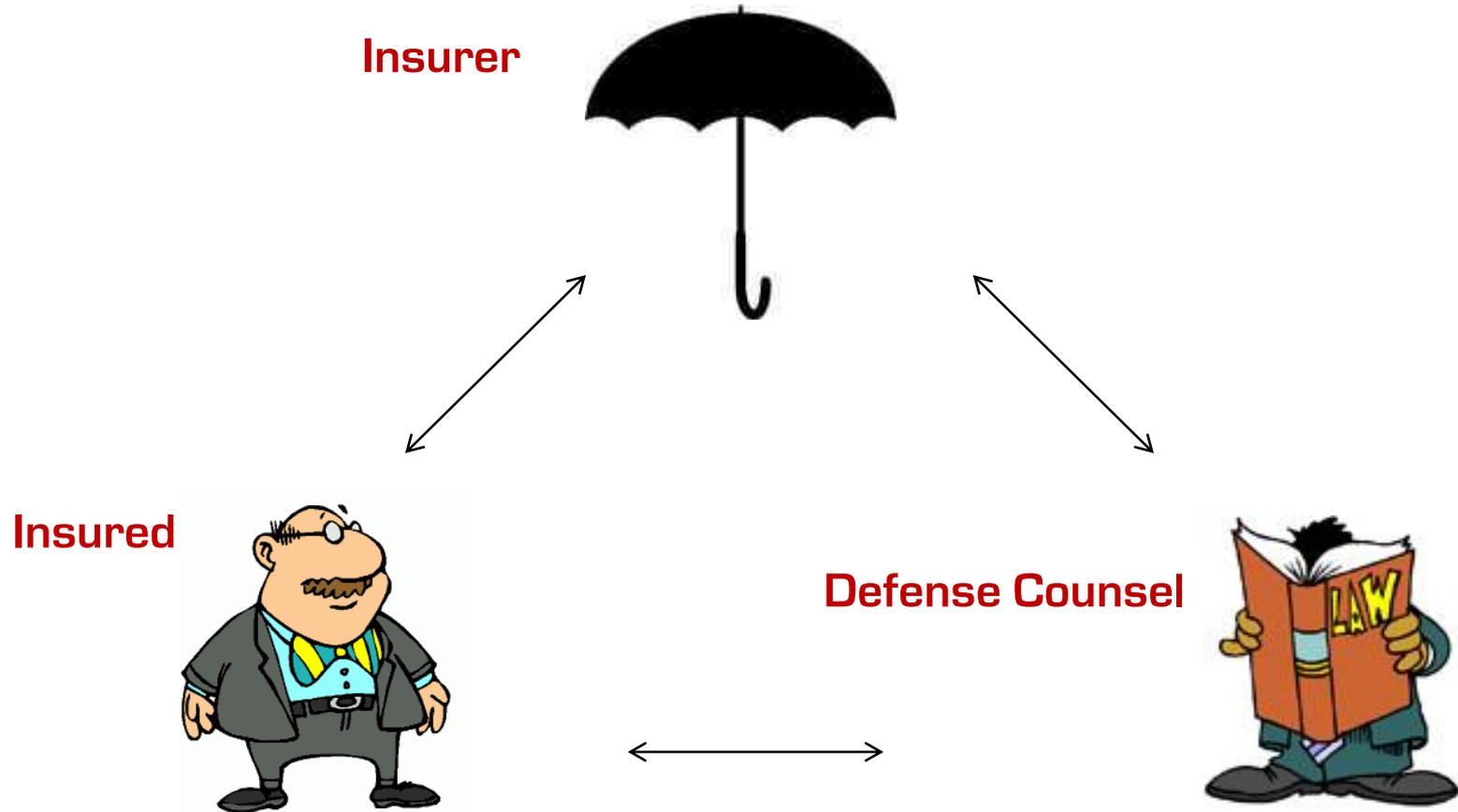
“[The] so-called tripartite relationship has been well documented as a source of unending ethical, legal and economic tension.”

—Gonzales, J., dissenting
State Farm v. Traver,
980 S.W.2d 625 (Tex. 1998)

The Tripartite Relationship

The **tripartite relationship** is the relationship between the insurer, its insured and defense counsel engaged by the insurer to represent the insured in a potentially covered third-party claim.

The Tripartite Relationship

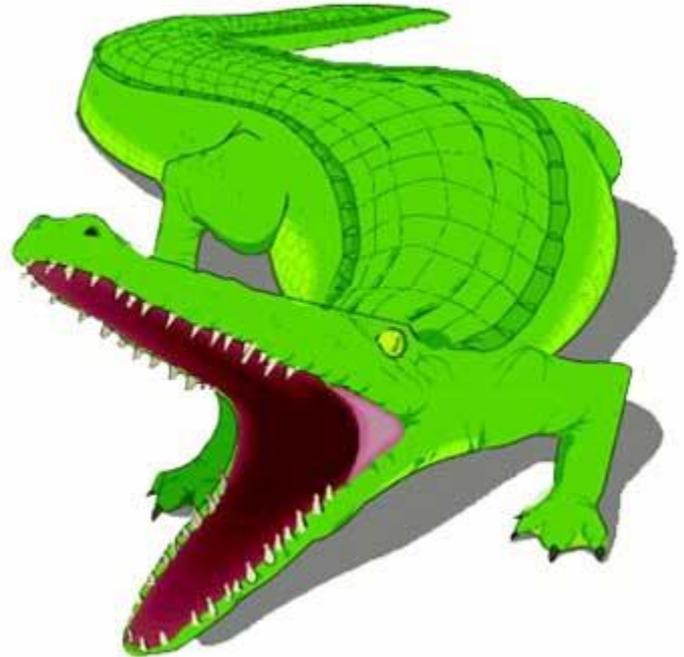


Dual Representation?

- Maybe? Contractually arranged dual representation?
- Practically speaking, defense counsel represents the interests of both the insurer and the insured.
 - The insurer is contractually obligated to defend its insured. Defense counsel provides the defense.
 - The insured typically has a contractual obligation to cooperate with the insurer's investigation and to provide information in a timely manner. Defense counsel often facilitates this cooperation.

Ethical Traps Abound

- Conflicts of interest may arise when the insurer has reserved rights and is providing a defense. Who is the client? What happens when interests collide?
- Right to independent counsel – when does the insured get to select its own counsel?
- Insurer's use of captive counsel to provide defense – what are the rules?
- When should the insured consult coverage counsel?



Adverse Interests ... Potential Conflict

- Insurer typically controls the defense under duty-to-defend policy
- Defense counsel has access to confidential, non-public information from her client, the insured
- Insurer's interests are adverse to insured's interests on coverage issues
- Defense counsel may have a financial or business incentive to accommodate the insurer (source of repeat business), which may compromise duty of undivided loyalty to insured



Tripartite Relationship Analyzed

Employers Cas. Co. v. Tilley, 496 S.W.2d 552 (Tex. 1973)

- Extreme facts = highlight the ethical problem
- Insurer filed a declaratory judgment action against insured, Joe Tilley, seeking determination that Tilley's late notice defeated coverage
- When underlying lawsuit filed against Tilley, insurer hired defense counsel to represent him

Tripartite Relationship Analyzed

***Employers Cas. Co. v. Tilley*, 496 S.W.2d 552 (Tex. 1973)**

- *While representing Tilley*, defense counsel simultaneously provided services to insurance company developing evidence adverse to Tilley on coverage issues
- Defense counsel did not advise Tilley of conflict
- Insurer used evidence developed by defense counsel against Tilley in the dec action

Tilley – Confronting the Ethical Issues

- “[S]erious questions involving legal ethics and public policy
....”
- “[C]ustom, reputation, and honesty of intention and motive are not the tests for determining the guidelines which an attorney must follow when confronted with a conflict between the insurer who pays his fee and the insured who is entitled to his *undivided loyalty* as his attorney of record.”
- Defense counsel owes the insured “the same type of *unqualified loyalty* as if he had been originally employed by the insured.”

The “*Tilley* Doctrine”

“IV. CONFLICTS OF INTEREST GENERALLY—DUTIES OF ATTORNEY. In any claim or in any suit where the attorney selected by the company to defend the claim or action becomes aware of facts or information which indicate to him a question of coverage in the matter being defended or any other conflict of interest between the company and the insured with respect to the defense of the matter, the attorney should promptly inform both the company and the insured, preferably in writing, of the matter and the extent of the conflicting interest”

[cont.]

The “*Tilley* Doctrine”

“V. CONTINUATION BY ATTORNEY EVEN THOUGH THERE IS A CONFLICT OF INTEREST. Where there is a question of coverage or other conflict of interest, the company and the attorney selected by the company to defend the claim or suit should not thereafter continue to defend the insured in the matter in question unless, after a full explanation of coverage question, the insured acquiesces in the continuation of such defense”

- *Tilley*, 496 S.W.2d, at 559
quoting American Bar Association
National Conference of Lawyers
and Liability Insurers –
List of Guiding Principles

The *Tilley* Takeaways

- Insurance company also has a duty to advise its insured of conflicts.
- Non-waiver agreement does not relieve insurer of duty to inform of specific conflict.
- Failure to inform:
 - By defense counsel – breach of the duty of undivided loyalty; an ethical violation.
 - By the insurer?

Coffee Break!

Note: Audience Participation Rewarded

Defense counsel owes no duties to the insurer; all duties are owed to the insured.

False

Defense counsel owes the insured a duty of confidentiality and may not reveal to the insurer information relating to the defense of the insured unless the insured consents.

True

Defense counsel must have the insured's fully informed consent before filing a motion for summary judgment that would leave only non-covered claims.

True

Tripartite Relationship Analyzed

***State Farm Mut. Auto. Ins. Co. v. Traver*, 980 S.W.2d 625 (Tex. 1998)**

- Texas Supreme Court again addressed the tripartite relationship in *Traver*, analyzing the respective roles of the parties and concluding that the insurer is not vicariously liable for the misconduct of an independent attorney selected to defend its insured.
- State Farm retained separate lawyers to represent two insureds named as defendants in an auto case.

Tripartite Relationship Analyzed

***State Farm Mut. Auto. Ins. Co. v. Traver*, 980 S.W.2d 625 (Tex. 1998)**

- Settlement attempts failed, case went to trial and jury found one defendant insured 100% liable.
- In subsequent litigation against State Farm, insured defendant argued that her defense counsel committed malpractice by failing to attend key depositions and that State Farm orchestrated the malpractice to avoid *Stowers* liability.

Tripartite Relationship Analyzed

State Farm Mut. Auto. Ins. Co. v. Traver, 980 S.W.2d 625 (Tex. 1998)

- Supreme Court considered the relative roles of the insurer and defense counsel in the tripartite relationship, reaching several conclusions:
 - Vicarious liability turns on whether the principal has the ***right to control the agent*** with respect to the details of the conduct.
 - Defense counsel, as an independent contractor, has discretion regarding day-to-day details of conducting the defense and is not subject to the “client’s” control.

Tripartite Relationship Analyzed

State Farm Mut. Auto. Ins. Co. v. Traver, 980 S.W.2d 625 (Tex. 1998)

- Because the lawyer owes his client unqualified loyalty, he must at all times protect the interests of the insured if those interests would be compromised by the insurer's instructions.
- Under these circumstances, the insurer cannot be vicariously liable for the lawyer's conduct.
- The lawyer's *undivided loyalty* to her client is paramount.
- Justice Gonzales' dissent explores the inherent tension in the relationship and proposed that the insurer should be liable for its own conduct if it harms the insured in the course of providing a defense.

Coffee Break!

Note: Audience Participation Rewarded

Q: Seeking to conserve policy limits that are eroded by defense costs, the carrier asks defense counsel in a multi-party case to appoint lead counsel for all defendants and to allow lead counsel to attend depositions, hearings, etc. Other counsel would attend only those matters that specifically involve their own clients. What should the non-lead defense counsel do?

A: Defense counsel should consider the insured's interests, identify any potential conflicts of interest, keep his client fully advised and proceed with the client's thoroughly informed consent.

Potential Conflicts

Defense under Reservation of Rights

- Insurer reserves right to deny coverage in reservation of rights letter (“ROR”).
- ROR is based on the policy terms – limitations on coverage applicable to the case at hand.
- ROR preserves insurer’s right to withdraw defense at a later time and to refuse to indemnify non-covered claims.
- Insurer assumes control of defense and settlement.
- Insurer selects and pays defense counsel.
- Insurer monitors litigation to determine whether duty to defend exists and scope of duty to indemnify.

Potential Conflicts

Control of defense & settlement

- Insurer typically controls the defense under a liability policy (but the terms of the contract control).
- What happens when insurer interferes with defense counsel's ability to represent the insured vigorously?
- What happens when insurer's view of coverage impedes ability to settle case?

Addressing the Conflicts

Independent Counsel

- Material Overlapping Conflicts → Independent Counsel
- When is an insured entitled to independent counsel in Texas?
- **General Rule:** If the insured's liability and the coverage issues turn on the same facts, the insured is entitled to independent counsel.
- *Northern Co. Mut. Ins. Co. v. Davalos*, 140 S.W.3d 685 (Tex. 2004).

Coffee Break!

Note: Audience Participation Rewarded

You are defense counsel. Your client, the insured, wants to take a deposition that is, in your professional judgment, completely unnecessary and does not advance the merits of the case. Your client (both a doctor *and* a lawyer) admits he only wants the deposition to vindicate his opinions on an issue of interest to medical reviewers and to expose the deponent as a fraudster. He is not willing to pay for the deposition himself and wants the insurer to cover the cost of the deposition. **What should you do?**

Addressing the Conflicts

Independent Counsel

- In *Davalos*, the insurer was obligated under an automobile liability policy to provide a defense for covered claims.
- The policy gave the insurer the right to conduct the defense.
- Because of a disagreement over the proper venue in which the case should be tried, the insured refused the defense tendered by the insurer.
- Court faced the issue of whether a disagreement over venue is a sufficient reason for the insurer to lose its right to conduct the defense, ***while remaining obligated to pay for it.***

Addressing the Conflicts

Independent Counsel

- The Texas Supreme Court recognized at the outset that, under certain circumstances, an insurer may not insist on its contractual right to control the defense.
- What are those circumstances?



Addressing the Conflicts

Independent Counsel

“Every disagreement about how the defense should be conducted cannot amount to a conflict of interest within *Traver*’s meaning. If it did, the insured, not the insurer, could control the defense by merely disagreeing with the insurer’s proposed actions. This is not at all what we contemplated in *Traver*.”

—*Davalos*, 140 S.W.2d at 689.

Addressing the Conflicts

Independent Counsel

- Ordinarily, the existence or scope of coverage is the basis for a disqualifying conflict. The reservation of rights letter creates a potential conflict of interest.
- When the facts to be adjudicated in the liability lawsuit are the same facts upon which coverage depends, the conflict of interest will prevent the insurer from conducting the defense.
- If, however, the insurer defends unconditionally – no potential for conflict.

Addressing the Conflicts

Independent Counsel

- Other types of conflicts may also justify an insured's rejection of the tendered defense:
 1. when the defense tendered is not a complete defense, though it should have been;
 2. when the attorney hired by the carrier "acts unethically and, at the carrier's direction, advances the insurer's interests at the expense of the insured's";
 3. when the defense would not, under governing law, satisfy the insurer's duty to defend; and
 4. when, though the defense is otherwise improper, the insurer attempts to obtain some kind of concession from the insured before it will defend.

Addressing the Conflicts

Independent Counsel

- The *Davalos* Court concluded that the venue impasse was not a sufficient reason to take the contractual right to defend away from the insurer.
- Where the facts to be adjudicated in the liability lawsuit are the same facts upon which coverage depends, however, the conflict of interest disqualifies the insurer from conducting the defense. The insured may defend the case on its own and hold the insurer responsible for the fees and costs *reasonably* incurred.

Addressing the Conflicts

Control of defense & settlement

- Can insurer control defense even if insured is represented by independent counsel? What issues does this present for independent counsel?
- More specifically, does the insurer effectively take control of the litigation by engaging in discussions with independent counsel?
- In *Gilbert Tex. Constr., L.P. v. Underwriters*, the Texas Supreme Court analyzed this issue and concluded, on the facts of that case, that the insurer did not assume control.

Addressing the Conflicts

Control of defense & settlement

- *Gilbert Tex. Constr., L.P. v. Underwriters*, __ S.W.3d __, 53 Tex. Sup. Ct. J. 780 (Tex., June 4, 2010)
- In addition to disputing the insurer's denial of coverage, the insured argued that the insurer asserted control over the defense, prejudicing the insured.
- Gilbert sought to recover the amount it paid in settlement as damages on an estoppel theory.
- HELD: The conduct alleged did not rise to the level of assuming control – and Gilbert was not prejudiced.

Counsel for the Insured

- In order to provide the best representation:
 - Understand the coverage issues – avoid recommending a course of action that would defeat or reduce your client’s coverage
 - If you can’t do this because you have a business relationship with the insurer, you need to advise your client and make sure you have consent to proceed notwithstanding the conflict and inherent limitations on your ability to represent the client’s interests vigorously

Counsel for the Insured

- In order to provide the best representation (cont.):
 - This conflict potential should be assessed early to avoid prejudicing the insured by raising it too late in the game
 - If there's a conflict, recommend that insured retain coverage counsel to work solely on the coverage issues and consult with you on the defense, or refer the insured to independent counsel

Insurer's Coverage Counsel

- In order to provide the best representation:
 - Remember your client's obligations under the policy and under applicable law.
 - Expect defense counsel to represent his client's interests with undivided loyalty. His duty is to the insured, even if your client is paying him.
 - Remember that the insurer (and therefore you) should not pressure defense counsel to provide services or take any action adverse to the interests of the insured.

Insured's Coverage Counsel

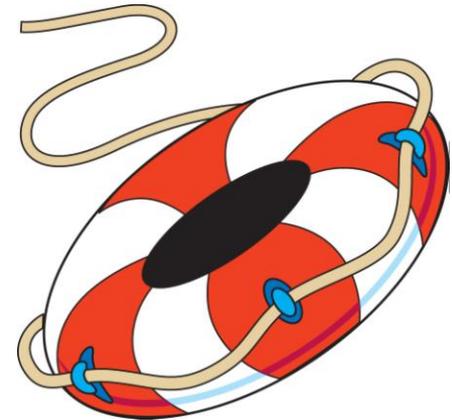
- In order to provide the best representation:
 - The insured's coverage counsel does not typically face as many competing interests as the other players and is not part of the tripartite relationship.
 - Understanding the dynamics of the tripartite relationship, however, helps the insured's coverage counsel navigate the dispute more effectively.

Plaintiff's Counsel?

- In order to provide the best representation:
 - Know the coverage issues; consult coverage counsel for assistance with strategy to maximize coverage.
 - Understanding the dynamics of the tripartite relationship also helps plaintiff's counsel navigate the dispute more effectively.

Tips for Avoiding Certain Calamity

- Be clear about who your client is
- Remember duty of undivided loyalty ... to client
- Defense counsel, pay attention to coverage issues – can't bury your head in the sand
- If you can't advise fully due to business conflicts, refer client to independent counsel – *early!*
- Engage coverage counsel or ethics counsel if needed



Questions?



Thank you!

Special thanks to Robert Tobey for the use of his article,
Ethical Issues in the Tripartite Relationship

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