Ethical Issues in Liability Defense: How Do Insurers and Defense Counsel Properly Meet Their Obligations to the Insured Client?

By Michael H. Runyan

Lane Powell Spears Lubersky LLP
1420 Fifth Avenue, Suite 4100
Seattle, Washington 98101
Tel: (206) 223-7000
Fax: (206) 223-7107

“No man can serve two masters; for either he will hate the one and love the other, or he will be devoted to the one and despise the other.”

Matthew 6:24
It has been said that “[w]ithin the practice of law, there is no specialty more directly affected by conflict of interest problems than insurance defense.” Owens, J. Kevin, “Wrestling with the Tar Baby: Ethical Obligations of Mississippi Insurance Defense Lawyers,” 17 Miss. C. L. Rev. 359 (1997). Unfortunately, conflicts of interest also are one of the most litigated areas of professional liability. Moore, N., Ethical Issues in Third Party Payments, 16 Rev. Litig. 585 (1997). The relationship between the insurer, insured and defense counsel has been referred to the eternal or bermuda triangle, the triad, or the triadic or tripartite relationship among other things. The relationship has been characterized as “deeply and unavoidably vexing” and creating problems that would “tax Socrates.” Silver, C., “Does Insurance Defense Counsel Represent the Company or the Insured?” 72 Tex. L. Rev. 1583, 1587 (1999); Harland v. Foster, 528 So. 2d 255, 273 (Miss. 1988).

The problem has its roots in an attorney representing and having obligations to two clients. There is the inevitable tension and a potential that the attorney’s representation of one may be rendered less effective because of his representation of the other. Spindle v. Chubb/Pacific Indemnity Group, 152 Cal. Rpt. 776, 780-81 (Ct. App. 1979). Moreover,

Most insurance defense attorneys have an on-going relationship with their insurers, and they work hard at developing future business. Conversely, few defense attorneys enjoy continuing relationships with the insureds they are hired to represent. It is this strong and perpetual economic linkage between insurers and their regular counsel that most concerns courts and insureds.


Commentators have remarked on the fact that “[l]aw professors have written little about the impact of liability insurance on civil procedures,” or ethics for that matter. Silver & Syverud, “The Professional Responsibilities of Insurance Defense Lawyers,” 45 Duke L. J. 255, 257 (1995). Those authors recognize that the same is not true of practicing lawyers who have made the connection between procedure, insurance and professional responsibility “a primary focus of
attention and scholarship.” Id. In fact, the relationship between a defense attorney, the insured, and the insurer was the subject of an ethical opinion issued by the ABA as early as 1950.

Opinion 282 accepts unequivocally that a lawyer may ethically undertake the dual representation of the insurer and the insured in the defense of a third party action against the insured. The Opinion accepts this ethical premise because of the initial commonality of interest:

From an analysis of their respective undertakings [in the insurance contract] it is evident at the outset that a community of interest exists between the company and the insured growing out of the contract of insurance with respect to any action brought by a third person against the insured within the policy limitations. The company and the insured are virtually one in their common interest. [Emphasis added.]

Ethical problems arise in the tripartite relationship of the insurer, insureds, and the insurer-designated lawyer for the insured when this commonality of interest becomes questionable or ceases to exist.

So who is the client in the insurance defense situation? Opinion 282 states clearly that: “The essential point of ethics involved is that the lawyer so employed shall represent the insured as his client with undivided fidelity as required by Canon 6.”


Some of the conflict is due to the concept of dual representation or the dual client doctrine. Under this doctrine, the attorney represents both the insurer and insured. Richmond, Douglas R., “Lost in the Eternal Triangle of Insurance Defense Ethics,” 9 Georgetown Journal of Legal Ethics 475, 482 n.26 (1996). Washington does not follow the dual client doctrine: “RPC 5.4 demands that counsel understand that he or she represents only the insured, not the company.” Tank v. State Farm, 105 Wn.2d 381, 388, 715 P.2d 1133 (1986). To some extent, the distinction is without a difference or academic. A conflict must exist before an analysis of which approach applies is required. Even if a jurisdiction follows the dual client doctrine, upon discovery of a conflict, the insured becomes the sole client. Owens, supra at 370.
Even if the insurers are mere third party payors and not clients, they still will seek to give
direction to the litigation, if not attempt to control it. Regardless of the insurer’s status, the
attorney still will have to grapple with the requirements of RPC 1.7 and/or RPC 1.8(f) and
RPC 5.4. RPC 1.7(b) requires informed consent whenever the lawyer’s representation of one
client “may be materially limited by the lawyer’s responsibilities to another client.” RPC 1.8(f)
and RPC 5.4 prohibit an attorney from accepting compensation from someone other than the
client unless the client consults after consultation and there is no interference with the lawyer’s
independent professional judgment.

In the vast majority of cases, there is no conflict between the insured and the insurer. No
reservation of rights letter has been issued, no confidential information regarding coverage has
been passed between the insured and defense counsel, and the case is settled within policy limits
by insurer with the insured’s consent. This presentation addresses the unusual case as well as the
basic obligations owed the insured by the insurer and defense counsel and the consequences
when the obligations are not met. The obligations of the insurer are fixed by the case law,
statutes, regulations and insurance contract. See, e.g., Burnham v. Commercial Casualty Co., 10
Defense counsel’s obligations flow from the same sources. In addition, the attorney is subject to
ethical restrictions, such as the Rules of Professional Code in Washington.

Rules of Professional Conduct

The pertinent Rules of Professional Conduct include RPC 1.7, the general rule on
conflicts of interest, RPC 1.8(f) prohibiting a lawyer from accepting compensation from other
than the client except under certain circumstances, and RPC 5.4(3)(c) which restricts a person,
who pays a lawyer for legal services to another, from directing or regulating the lawyer’s
professional judgment.

RPC.1.7. In Washington, the relevant section is 1.7(b) which forbids a lawyer from representing a client if the representation will be materially limited by the lawyer’s
responsibilities to a third person. Such representation is permissible if the lawyer reasonably believes the representation will not be grossly or adversely affected and the client consents after consultation. There are certain representations which generally are unwaivable, e.g., representing opposing parties in the same lawsuit. Restatement (Third) of the Law Governing Lawyer § 122(2)(b)(1998). See, e.g., Booth v. Continental Ins. Co., 634 N.Y.S.2d 650 (1995): law firm could not represent insured employer and insurer in a lawsuit brought by a former employee:

However, sometimes even with full disclosure and consent, the interests represented are so adverse that dual representation is improper. Id.

Commentary from the Model Rule 1.7 suggests that the lawyer’s reasonable belief that the representation will not be grossly affected is tested by whether “a disinterested lawyer would conclude that the client should not agree to the representation under the circumstances. . . .” Model Rules of Professional Conduct, Rule 1:7, comment 5 (1983). It should be pointed out that the Washington version substitutes the word “adversely” for the word “grossly” which suggests that exception is narrower in Washington.

If representation will not be adversely affected, the client must consent in writing after a full disclosure of the material acts. The Washington version differs from the Model Rules in that the consent must be in writing and disclosure of material facts must occur. Under the Model Rules only oral consent after consultation is required. Under the Model Rules:

‘Consult’ or ‘consultation’ denotes communication of information reasonably sufficient to permit the client to appreciate the significance of the matter in question.


In Reynolds v. Marmorosch, 144 N.Y.S.2d 900 (1955), two infants brought an action against their father for their injuries suffered in an automobile accident. The attorneys, retained by the father’s insurer, brought a motion to dismiss based upon existing case law. The father
filed an affidavit in opposition denying the attorneys’ authority to proceed. The court held that although it ordinarily would grant the motion, it could not given the client’s objection.

It is our view that a principal in an action has the ultimate control of that litigation. If he does not desire to follow the advice, guidance or suggestion of his counsel, the attorney has the right to terminate the relationship, but he may not, against the express wish of the client, take any step in an action, no matter how appropriate it may be. Derickson v. McCardle, 2 How. Prac. 196.

It would seem, therefore, that the defendant’s attorney lacks the authority to make this application for a dismissal of the complaint. Ordinarily, the attorney’s authority is presumed from the filing of a notice of appearance. Corey v. Corey, Sup., 62 N.Y.S.2d 796. Nevertheless, the court has the power to inquire into the authority of the attorney. Ninety-nine Plaintiffs v. Vanderbilt, 1 Abb. Prac. 193. Defendant Reynolds’ affidavit denying McGarry & Sclafani’s authority to proceed with this motion places them under a disability within the meaning of section 240 of the Civil Practice Act. Thomas v. Thomas, 178 Misc. 349, 34 N.Y.S.2d 320.

At this point and on this application, the respective rights of Reynolds and his carrier are not before the court. The carrier may have the right to serve a notice of disclaimer upon this defendant for a breach of his contract with them and the attorneys have the right, if not the duty, to withdraw as the attorneys for this defendant in this action. Impellizzeri v. Haug, 282 App. Div. 742, 122 N.Y.S.2d 469. As this court has had occasion to comment, attorneys, although paid by an insurance carrier, are the attorneys for the assured and if there be a conflict of interest, they cannot continue to represent both. American Employers Ins. Co. v. Goble Aircraft Specialties, 205 Misc. 1066, 131 N.Y.S.2d 393; see also Heller v. Alter, 143 Misc. 783, 257 N.Y.S. 391.

It may well be that the defendant Reynolds has been ill-advised with respect to the position taken by him in this litigation. If he continues to maintain it, he may incur needless expense and find himself without the insurance coverage which he purchased. That however, is his responsibility and one which he has the right to assume if he sees fit, regardless of the lack of sound judgment involved.


Another case which illustrates this principle is Montanez v. Irizarry-Rodriguez, 641 A.2d 1079 (N.J. Super. Ct. App. 1994), which involved a lawsuit by a wife against her husband for injuries sustained in a car accident. Initially, the husband and wife claimed that the accident was due to a defect in a tire. When the physical evidence proved otherwise, the insured husband
changed his story and supported his wife’s testimony that he was negligent. The insureds’ own lawyer was allowed to cross-examine his client, the husband, as a hostile witness. In reversing the defense verdict, the appellate court said:

. . . an insurer cannot impeach its own client. Impeachment is only relevant to the issue between the insured and insurer. An appropriate course would be for the attorney to withdraw and the insurer to refuse to pay the judgment of the basis of collusion or noncooperation.

Given that the consent must be in writing, the consultation and disclosure of material facts should be as well. The client should be counseled of the advisability of consulting independent counsel. According to an ABA Ethics Opinion,

If the lawyer is to proceed with the representation of the insured at the direction of the insurer, the lawyer must make appropriate disclosure sufficient to apprise the insured of the limited nature of his representation as well as the insurer’s right to control the defense in accordance with the insurance contract.


The opinion goes on to state that a short letter to the insured is sufficient. The letter should contain basic information about the nature of the representation and the fact that an insurer has the right to control the defense and settlement.

What if the insured refuses to agree to the letter and/or the attorney’s representation of him? “The insured retains the power to reject the defense offered by the insurer under the policy and to assume the risk and expense of his own defense.” ABA Formal Opinion 96-403 (August 2, 1996). “The insured, after all, can decide to use his or her own lawyer if the insured is willing to forego liability coverage.” Morgan, T., “Whose Lawyer Are You Anyway,” 23 Wm. Mitchell L. Rev. 11, 18 (1997). The newly adopted Restatement of Law Governing Lawyers provides in comment as follows:

With respect to client consent (see Comment b hereto) in insurance representations, when there appears to be no substantial risk that a claim against a client-insured will not be fully covered by an insurance policy pursuant to which the lawyer is appointed and is to be paid, consent in the form of the acquiescence of the client-insured to an informative letter to the client-insured at the outset of the representation should be all that is required. The lawyer should either
withdraw or consult with the client-insured (see § 122) when a substantial risk that the client-insured will not be fully covered becomes apparent (see § 121, Comment c(iii)).

What if the client is unavailable and consent to representation cannot be obtained before a default may be entered? Restatement (3rd) of Law Governing Lawyers, § 134, comment f (1998) provides:

In emergency situations in which the lawyer must take action to protect the interests of the client, as in filing an answer to avoid default, the lawyer may take such action even if a conflict appears to exist, but must promptly take action to address the conflict.

In *Gustafson v. City of Seattle*, 87 Wn. App. 278, 941 P.2d 701 (1997), a husband and wife retained an attorney to jointly represent them on their claims arising out of an auto accident. After the defendant counterclaimed against the husband driver, the attorney advised the wife to get her own attorney because of the conflict. The trial court ruled that the attorney had violated RPC 1.7 for failing to disclose the conflict at the outset and getting the clients’ informed written consent. The appellate court held that it was not apparent from the record whether the potential conflict was foreseeable and remanded. It noted that the RPC should be construed broadly and an attorney should resolve all doubts against undertaking dual representation.

**RPC 1.8(f).** RPC 1.8(f) is similar to 1.7(b) but more specific in that it governs situations where the limitations on representing a client may be affected by the fact that someone other than the client is paying for the lawyer’s services. Again, the client must consent after consultation and the lawyer’s independent professional judgment must not be affected. The most prevalent example of a third party compensation of an attorney is in an insurance contract. While the insurer has the right under the contract to direct the litigation, the attorney ultimately must obey the insured who is his only client.

An insurer’s right to control the litigation has been the subject of recent ethical opinions and court decisions. Most of the opinions and decisions uphold the insurer’s right to control the litigation through litigation guidelines as long as they do not impinge on the lawyer’s independent professional judgment. Washington is such an example. WSBA Formal Opinion
195 (1994) (Ethical to comply with billing guidelines that do not require disclosure of confidential information or interfere, direct or regulate an attorney’s independent professional judgment). There have, however, been notable exceptions. See, e.g., In re Rules of Professional Conduct, 2 P.3d 806 (Mont. 2000). (“We conclude that the requirement of prior approval fundamentally interferes with defense counsel’s exercise of their independent judgment . . .” Id. at 815.)

RPC 5.4. RPC 5.4(2)(c) is virtually the same as RPC 1.8(f). It says that a lawyer shall not permit a person who pays him to direct or regulate the lawyer’s professional judgment. Again, the insured is the client and the attorney must follow his directions. See, e.g., Conn. Bar Ass’n Comm. on Professional Ethics, Op. 97-37 (1997) (lawyer representing client in a slip and fall case should abide by client’s instructions not to file an indemnity claim against a third party, notwithstanding instructions to do so by the insurer and to ignore client wishes; lawyer should advise client of effect such decision may have on insurer’s responsibility for coverage of claim).

Conflicts of Interest

Conflicts of Interest between the insured and insurer raise even more dilemmas for the defense attorney. Common situations that involve a conflict include:

1. defense under a reservation of rights;
2. partial defense of covered claims;
3. defense of claims for damages in excess of policy limits;
4. defense of multiple insureds;
5. discovery of information relevant to coverage.


Defense Under a Reservation of Rights

Authorities in different jurisdictions vary as to whether defense under reservation of rights creates a potential conflict of interest. In San Diego Navy Federal Credit Union v. Cumis
Ins. Society, 162 Cal. App. 3d 358, 208 Cal Rptr. 494 (1984), a California Court of Appeals answered in the affirmative and required the insured to pay for independent counsel for the insured.

In Washington, the court in Tank v. State Farm, supra, held that defense under a reservation of rights did not create an automatic conflict of interest. Rather, it held that it required an “enhanced obligation of fairness” toward the insured and laid down specific criteria that defense counsel and the insurer must adhere to.

For the insurer:

This enhanced obligation is fulfilled by meeting specific criteria. First, the company must thoroughly investigate the cause of the insured’s accident and the nature and severity of the plaintiff’s injuries. Second, it must retain competent defense counsel for the insured. Both retained defense counsel and the insurer must understand that only the *insured* is the client. Third, the company has the responsibility for fully informing the insured not only of the reservation of rights defense itself, but of *all* developments relevant to his policy coverage and the progress of his lawsuit. Information regarding progress of the lawsuit includes disclosure of all settlement offers made by the company. Finally, an insurance company must refrain from engaging in any action which would demonstrate a greater concern for the insurer’s monetary interest than for the insured’s financial risk.

For defense counsel:

First, it is evident that such attorneys owe a duty of loyalty to their clients. Rules of Professional Conduct 5.4(c) prohibits a lawyer, employed by a party to represent a third party, from allowing the employer to influence his or her professional judgment. In a reservation of rights defense, RPC 5.4(c) demands that counsel understand that he or she represents only the insured, not the company. As stated by the court in Van Dyke v. White, 55 Wn.2d 601, 613, 349 P.2d 430 (1960), “[t]he standards of the legal profession require undeviating fidelity of the lawyer to his client. No exceptions can be tolerated.”

Second, defense counsel owes a duty of full and ongoing disclosure to the insured. This duty of disclosure has three aspects. First, potential conflicts of interest between insurer and insured must be fully disclosed and resolved in favor of the insured. The dictates of RPC 1.7, which address conflicts of interest such as this, must be strictly followed.
Second, all information relevant to the insured’s defense, including a realistic and periodic assessment of the insured’s chances to win or lose the pending lawsuit, must be communicated to the insured. Finally, *all* offers of settlement must be disclosed to the insured as those offers are presented. In a reservation of rights defense, it is the insured who may pay any judgment or settlement. Therefore, it is the insured who must make the ultimate choice regarding settlement. In order to make an informed decision in this regard, the insured must be fully apprised of all activity involving settlement, whether the settlement offers or rejections come from the injured party or the insurance company.

The court in *Johnson v. Continental Casualty*, 57 Wn. App 354, 788 P.2d 598 (1990) specifically rejected the requirement of Cumis counsel:

Therefore, the insurer has no obligation before the fact to pay for its insured’s independently hired counsel. Any breach of the “enforced obligation of fairness” in a reservation of rights situation might lead to after-the-fact liability of the insurer, retained defense counsel, or both. *Id.* at 363.

One of the requirements of *Tank* is that defense counsel keep the insured apprised of settlement offers and periodically advise the insured of his assessment of liability and damages. The reason, of course, is so that insured can decide whether it wants to contribute to settle the noncovered claim so that his whole lawsuit can be dispensed with. Failure to keep the insured so informed can be disastrous and result in loss of the insured’s coverage defenses. Alabama adopted the *Tank* criteria in *L&S Roofing Supply Co. v. St. Paul Fire & Marine Ins. Co.*, 521 So.2d 1298 (Ala. 1987). In *Shelby Steel Fabrications, Inc. v. USF&G*, 569 S.2d 309 (Ala. 1990). The defense attorney defended Shelby for more than two years under a nonwaiver agreement without keeping Shelby informed about the progress of the defense. The court held that as a result, USF&G failed to meet its enhanced obligation of good faith and was estopped from denying coverage. It particularly is important to inform the insured of all settlement offers and allow the insured to decide on acceptance or rejection. In *Carrier Express, Inc. v. Home Indemnity Co.*, 860 F. Supp 1465 (N.D. Ala. 1994), the court was found guilty of bad faith and
liability for the entire $7.2 million judgment including $4.8 million in punitive damages when it
did not allow its insured to make the final decision regarding settlement.

**Partial Defense of Only Covered Claims**

Some jurisdictions require defense of all claims where the complaint alleges at least some
claims that are covered by the insurance policy. See, e.g., Fire Insurance Exchange v. Bentley,

Washington allows the insurer to defend only covered claims only and to require the
insured to hire independent counsel at his own expense to defend it with regard to noncovered
claims. Waite v. Aetna Casualty & Surety Co., 77 Wn.2d 850, 467 P.2d 846 (1970); Seaboard
Surety Co. v. Ralph Williams’ Northwest Chrysler Plymouth, Inc., 81 Wn.2d 740, 741 n.4, 504
suggests that insurer must provide a defense for noncovered claims where that defense is
reasonably related to the defense of covered claims. Of course, when the insurer wrongfully
refuses to defend and there is no reasonable means of prorating the costs of defense between the
covered and uncovered items, the insurer is liable for the entire cost of the defense. National

**Defense of Damages in Excess of Policy Limits**

An insurer has a duty to attempt to settle a case within policy limits even if no policy
demands have been made. Although a failure to do so resulting in an excess verdict does not
mean per se bad faith by the insurer, the retrospectoscope makes the decision not to settle very
difficult to defend. An example is Hamilton v. State Farm, 83 Wn. 2d 787, 523 P.2d 193 (1974)
which involved our venerated colleague, Fred Betts. Fred was successful the first time around in
obtaining a defense verdict. Following appellate reversal, he was not as successful the second
time and a verdict of $45,000 was obtained by the plaintiff. The issue in the bad faith case was
whether the defendants were fairly represented by Betts in the settlement negotiations. The court
held that the lawyer must conduct himself “as if his client either (1) had no insurance, or (2) as if
the insurance policy has no limits.” Despite the fact that Fred was successful in the first trial on
liability, the court upheld the bad faith case jury verdict against the insurer for failing to settle the
case within policy limits before the second trial.

**Defense of Multiple or Joint Insured**

Defense of multiple insured leads us back to RPC 1.7. Again representation of multiple
clients only is allowed if it will not adversely affect representation and the client consults after
consultation. The model rule and the Washington rule both have the following requirement:

> When representation of multiple clients in a single matter is undertaken, the
consultation shall include explanation of the implications of the common
representation and the advantages and risks involved.

Obviously one of the disclosures would be that there is no confidentiality between the
two clients.

The Restatement provides than an attorney in civil litigation may not represent two or
more clients in a matter if where is a substantial risk that one client representation would
materially and adversely affect the other[s]. Restatement (Third) of the Law Governing
Lawyers, § 128 (1998). According to the Restatement, there are four fundamental and
sometimes competing values to be reconciled:

1. Confidential information of one client cannot be used to benefit another client’
2. The attorney’s loyalty will be tested;
3. The tribunal must be assured that each client will be vigorously represented.
4. The client appreciates the reduction in cost and benefits of a coordinated position. 

_Id., Comment b._

The comment also suggests that a contract between parties can eliminate any conflict. 

_Id., comment (ii). In addition, in complex and multi-party litigation:

Determination whether a conflict of material interest exists requires careful attention to the context and other circumstances of the representation and in general should be based on whether (1) issues common to the clients’ interests predominate, (2) circumstances such as the size of each client’s interest make separate representation impracticable, and (3) the extent of active judicial supervision of the representation. _Id., comment (iii)._ 

In _Eriks v. Denver_, 118 Wn.2d 451, 457, 824 P.2d 1207 (192), the court held that if a lawyer accepts dual representation and the client’s interests thereafter come into actual conflict, the lawyer must withdraw. To avoid this hardship and expense on the clients, “[a]n attorney must discuss all potential conflicts of interest of which he or she is aware prior to undertaking the multiple representation.” _Id._ at 461. The attorney should resolve all doubts against undertaking dual representation.

**Confidential Information**

Occasionally during the course of representing the insured, defense counsel may come across information on his own or disclosed by the insured which affects coverage. The modern authorities are uniform that defense counsel generally is barred from sharing this information with the insurer. _Richmond, supra_ at 497.

In _Parsons v. CNA_, 550 P.2d 94 (Ariz. 1976), the defense attorney obtained the insured’s confidential file from a juvenile facility and determined that the assault he was defending was known and deliberate. He told CNA which issued a reservation of right letter. Judgment was entered in excess of the policy limits. CNA successfully defended his garnishment action asserting the intentional act exclusion with the same attorney defending it, who had defended the
insured. The appellate court held that the use of confidential information to deny the insured coverage was so contrary to public policy as to estop the insurance company from denying coverage.

In *American Mutual Liability Co. v. Superior Ct.*, 113 Cal. Rptr. 561, 572 (Cal. Ct. App. 1974), the court even imposed a duty of confidentiality as to confidential information disclosed by an insured that had no bearing on coverage.

**Bad Faith**

Bad faith and the duty to act in good faith generally refer to the same obligation. *Tank*, *supra* at 385. Good faith connotes a broad obligation of fair dealing and a responsibility to give equal consideration to the insured’s interest. *Id.* An insurer may not show greater concern for its own well being than that of the insured. *Id.* When defending under a reservation of right, an enhanced obligation of good faith is owed. *Id.* at 387.

Nonetheless, an insurer has the right to be wrong and not incur further liability as long as it has a reasonable justification for its actions and the issue is fairly debatable. *Transcontinental Ins. Co. v. WPUDUS*, 111 Wn.2d 452, 471, 760 P.2d 337 (1988).


Bad faith claims have been made on the following types of policies:


It also has been recognized against sureties, Nyby v. Allied Fidelity Ins. Co., 42 Wn. App. 543, 712 P.2d 861 (1986); and on behalf of umbrella and excess insurers, Transcontinental Ins. Co. v. WPUDUS, supra.

In Ellwein v. Hartford, 142 Wn.2d 766, 15 P.3d 640 (2001), the court was faced with the issue of whether the insurer was guilty of bad faith for contesting a UIM claim. It held:

Applying the bad faith standard in the summary judgment context, the insurer is ordinarily entitled to summary judgment dismissal of a bad faith claim unless the insured shows there is no reasonable basis for the insurer’s actions. Stated another way, where there is no real dispute that an insurer had a reasonable basis for its actions, dismissal of a bad faith claim on summary judgment is appropriate. Id. at 776.

Subsequent cases have differed on whether Ellwein applies outside the UIM context: Cf. Griffin v. Allstate, 108 Wn. App. 133, 29 P.3d 777 (2001), with American States v. Symes of Silverdale, 111 Wn. App. 477, 45 P.3d 610 (2002). In Overton v. Consolidated Ins., 145 Wn.2d 417, 38 P.2d 322 (2002), a pollution coverage case, the Supreme Court cited to Ellwein and held that there was no bad faith as a matter of law where the insured’s denial of coverage was reasonable.

If an insurer is guilty of bad faith in Washington, it can be liable for all damages resulting from its bad faith. In addition, likely it will have violated the Consumer Protection Act. RCW

**Requesting a Trial De Novo**

In his paper on the “Plaintiff and the Missing Insured,” Philip Buri discusses an insurance defense counsel/insurer’s request for a trial de novo without express the consent of the insured. He suggests that an insurer may not file a request for a trial de novo without the insured’s consent, even when the insured defendant is unavailable, citing Wiley v. Rehak, 143 Wn.2nd 339, 20 P.3rd 404 (2001). I think that he is over-reading this case and that although strict compliance with the arbitration rules was central to the Supreme Court’s ruling in that case, I disagree that the Supreme Court and lower courts would look unkindly on an insurance company filing a request for trial de novo without the insured’s consent, particularly where the insured was unavailable to give that consent. Moreover, the fact that MAR 7.1 provides that only an aggrieved party may file a request for a trial de novo is not unusual. Most often court rules are written from the perspective of this party.

In an earlier part of this paper, I cited the Restatement (3rd) of the Law Governing Lawyers, Section 134, comment (F) (1998) to the effect that in emergency situations in which the lawyer must take action to protect the interests of the client, as in filing an answer to avoid a default [or in filing a timely request for a trial de novo], the lawyer may take such action even if a conflict appears to exist but must promptly take action to address the conflict. In my opinion,
this section would allow the attorney/insurer to file the request for trial de novo without obtaining the insurer’s express consent if he was unavailable, and then promptly seek the insured’s consent to do so.

An ABA Ethics Opinion also suggests that insured can agree at the outset of the litigation to having his attorney follow the directions of insurer and thereafter specific consent to each act or decision of the attorney is not necessary:

“As long as the insured is clearly apprised of the limitations on the representation being offered by the insurer and that the lawyer intends to proceed in accordance with the directions of the insurer, the insured has sufficient information to decide whether to accept the defense offered by the insurer or to assume responsibility for his own defense at his own expense. No formal acceptance or written consent is necessary. The insured manifests consent to the limited representation by accepting the defense offered by the insurer after being advised of the terms of the representation being offered.

Once the lawyer has apprised the insured of the limited nature of his representation and that he intends to proceed in accordance with the directions of the insurer, he has satisfied the requirements of Rule 1.2(c).”

If, however, the insured disagrees later with the course desired by the insurer, the attorney must, of course, follow the wishes of the insured client:

“If after accepting the limited representation offered under the insurance contract, the insured and the insurer disagree as to whether a proposed settlement is acceptable and, moreover, who has the right to decide that question under the insurance contract, the lawyer may consult with his client or clients as to the likely consequences of a proposed course of conduct or advise the parties to seek independent counsel, and indeed in some circumstances he may be required to do so. Rule 1.7(a). Thus, for example, the lawyer might remind the insured that the policy gives the insurer the right to control the defense and settle the claim without the consent of the insured or that rejecting the proposed settlement might result in a forfeiture of his rights under the policy. Ultimately, however, although the insurer hires the lawyer and pays his fee, the insured retains the power to reject the defense offered by the insurer under the policy and to assume the risk and expense of his own defense. Rule 1.16.

ABA Formal Opinion 96-403 (August 2, 1996)
See also Connecticut Bar Association Committee on Professional Ethics Opinion 97-37 (1997). The lawyer must follow the wishes of the client and decline or withdraw the request for a trial de novo, but should advise the client of the potential effect of such decision on the insurer’s responsibility for coverage of claims, i.e., no coverage for breach of the cooperation clause.

To some extent, I think this is a tempest-in-a-teapot. Understandably, plaintiffs’ counsel are aggrieved at the conduct of certain insurers who routinely file requests for trial de novo. The best way to deter the requests is not to argue that they are ethical breaches by the insurance defense attorney. For the most part the insured does not care whether the insurer requests a trial de novo and is willing to consent to them. The best way to discourage the request is by getting as good a result at trial as at arbitration so that the insurers have to pay the plaintiffs’ attorneys’ fees. The reason why certain insurers routinely file requests for trial de novo is because typically they do better at trial then they do at mandatory arbitration.

Selection of Counsel/Staff Counsel

Although it has not been addressed in any of the papers that I have reviewed, some plaintiffs’ counsel take the position that where a reservation of rights is issued, the insurer cannot refer the matter to panel counsel, and certainly not to staff counsel, because of a conflict of interest. They argue that because of panel and staff counsel’s close relationship with the insurer, they impermissibly will favor the insurer over the insured in their defense. These plaintiffs’ counsel seek assignment to defense attorneys who have had no prior relationship with the insurer.

There is no authority in the State of Washington compelling or even suggesting this result. In fact, the rejection of Cumis’ counsel in Johnson v. Continental Casualty, supra, is at
least a suggestion by the Washington courts that defense counsel is presumed to follow the Rules of Professional Conduct and fulfill the enhanced obligation of fairness imposed by the courts in the *Tank v. State Farm* decision. Moreover, the *Johnson* court observed that “[a]ny breach of the enhanced obligation of fairness in a reservation of rights situation might lead to after-the-fact liability of the insurer, retained counsel, or both.” *Id.* at 363.

In other jurisdictions, the courts have differed as to the propriety of staff counsel representing an insured. *In Re Allstate Insurance Company*, 722 SW.2d 947, 952 (Mo. 1987) approved the relationship, observing that “…There is no basis for concluding that employed counsel has less regard for the rules of professional conduct then private practitioners do.” Similarly, in *Arizona Commission On Professional Ethics*, Opinion 75.4 (1975) provided that “…With respect to ethical considerations, there is little, if any, difference between independently retained attorneys’ duties and responsibility to the insurer and insureds and those of house counsel performing the same legal services.” *See also Coscia v. Cunningham*, 2506 at 521, 299 S.E.2d 880 (1983), *In Re Youngblood*, 895 S.W.2d 322 (Tenn. 1995). However, jurisdictions vary on this. *See for example American Insurance Association v. Connecticut Bar Association*, 917 S.W.2d 568, 571 (Ky. 1996); *Gardner v. North Carolina State Bar*, 341 S.E.2d 517, 523 (N.C. 1986).

One commentator suggests that with regard to staff counsel the avoidance of a conflict can be ensured by case selection, disclosure and supervision. He recommends that staff counsel should not defend insureds under a reservation of rights or in cases in which the claimed damages exceed coverage or where there is particularly aggravating circumstances. This limitation was important to the Court in *In Re Allstate Insurance Company*, supra. Even where no conflicts of interest are likely, staff counsel should inform the insured that they are employed
by the insurer. Finally, staff counsel should be supervised by an attorney whose sole responsibility is the staff counsel operation and who is independent of the insurer’s claims operation. Richmond, supra, at 518-519.

**How Does an Insurer Protect Its Interests in Good Faith While Providing a Defense?**

In his excellent paper for the panel discussion, “How an Insurer Protects Its Interests in Good Faith While Providing A Defense,” Joe Hampton suggests that Washington appellate judges have encouraged carriers to defend under a reservation of rights while simultaneously pursuing declaratory relief action to settle coverage issues. See page 2. I don’t think that can be recommended in all cases.

First of all, a distinction has to be made between a duty to defend and a duty to indemnify. Simply referring to coverage issues muddies the waters because it is not clear which duty is being referred to. Unlike the duty to defend which arises at the time of the filing of the complaint and is based on the allegations of the complaint, the duty to indemnify only occurs when judgment is entered and is based on the facts proven at the time of trial. Holland America Insurance Co. v. National Indemnity, 75. Wn.2d 409, 454 P.2d 383 (1969).

Not all issues with regard to the duty to indemnify can be resolved prior to the tort action being concluded, for example where a plaintiff alternatively alleges that he was injured either by the intentional or negligent act of the insured. That issue must be resolved in the tort action before the insurer will know if it has a duty to pay. Either the court must decline to rule on the duty to indemnify, if the underlying case has not been resolved, or must stay the declaratory judgment until all the facts have been determined in the underlying tort action. Western National Assurance v. Hecker, 43 Wn.App. 816, 821-822 n.1, 719 P.2d 954 (1986). A court can determine the duty to indemnify in a declaratory action prior to the tort action being resolved if it
has substantial evidence to support the ultimate factual issue and a determination can be made as a matter of law. Id. Other exceptions include instances where there is no duty to defend or pay even though the allegations of the complaint are otherwise covered:

1. the person claiming coverage is not an insured. See e.g., Navajo Freight Lines v. Liberty Mutual Insurance Co., 12 Ariz.App. 424, 471 P.2d 309 (1970);

2. a relevant act extrinsic to liability establishes no coverage. See e.g., Gonzalez v. American States, 628 S.W.2d 184, 187 (Tex. Ct. App. 1982);

3. the insured has breached the contract, e.g., lack of timely notice. See e.g., Continental Casualty Co. v. Parker, 288 S.E.2d 776 (67 App. 1982); and

4. the policy was not in effect at the time of the occurrences. See e.g., American Policy Holder Ins. Co. v. Cumberland Cold Storage Co., 373 A.2d 247 (Me 1977); Windt, supra at § 8:03.

The safest thing for an insurer to do is to defend under reservation of right and to litigate the duty to indemnify after the tort action has concluded. It is for this reason that the court in Wear v. Farmers Insurance Company, 49 Wn.App. 655, 745 P.2d 526 (1987) held that an insurer can defend an action under a reservation of rights and not be bound by the findings in the liability action in a later declaratory judgment action to determine whether the insurance company must pay a judgment entered in the liability action. This is because the court wants to encourage the insurers to defend under a reservation of rights and to fully and adequately represent the insured’s interest in that matter without being concerned as to how that defense may later impact the declaratory judgment action. Because of the conflict of interest between the insurer and insured, the court held that the insurance company is not bound by the prior findings in the later declaratory judgment action:
“This rationale [collateral estoppel] should not apply, however, when the insurer’s and insured’s interests diverge on coverage issues. When an insurance company disputes coverage but agrees to defend the insured under a reservation of rights, a direct conflict of interest may arise if the facts at issue in the liability trial conceivably are germane to coverage issues. In such a case, the insurance company is placed in an untenable position if it would find itself barred from asserting its position on coverage issues in a later declaratory judgment action because of determination in the liability action.

In that case, the insurer would have an interest in establishing one set of facts, and the insured would have an interest in establishing another set of facts. However, the insurance company would be prevented from asserting a position in the liability action that is contrary to the insured’s interests because it owes a fiduciary duty to the insured, even when it is defending under a reservation of rights. *Tank v. State Farm Fire & Casualty Company*, 105 Wn.2d 381, 387, 715 P.2d 1133 (1986).

To bind the insurance company in spite of the apparent conflict, would be grossly unfair. Thus, I think the *Wear* case is not unusual and should be relied on carrier’s in reservation of rights situations.

Obviously where defense costs are going to be substantial, an insurer may be unwilling to wait to institute the declaratory action. However, I don’t think an insurance company should be allowed to pursue a declaratory action simultaneously while the liability action is still pending, if the facts sought to be proven by the insurer would adversely affect the defense of the insured in the liability action.

“*See generally* Fidelity & Cas Co v. Enviroyne Engrs, Inc, 122 Ill App 3d 301, 461 NE2d 471, 473-74 (1983) (insurer can institute a declaratory judgment action in order to adjudicate a factual issue, relevant to the existence of a duty to defend, if the issue is not “crucial to the determination of the underlying lawsuit”); Continental Cas Co v Schaubel, 380 So 2d 483, 484-85 (Fla Dist Ct App 1980) (reversing trial court’s finding that insurer was obligated to defend because the holding was based on the trial court’s conclusion that the insured did not, in fact, commit an intentional tort, rather than on an analysis of whether the injured party was contending that the insured had committed an intentional tort)."
According to Allan Windt, insurance companies rarely should file declaratory judgment on the duty to defend. 2 Windt, Insurance Claims and Disputes, § 8:02 (4th ed. 2001). It is his position that all the insurance companies need to know about their duty to defend is in the Complaint or its investigation so that resort to a declaratory judgment action rarely is needed or cost effective. However, he recognizes two exceptions to this rule. The first is where the insurer will be estopped from denying coverage if it has breached its duty to defend. Since this is a real possibility in Washington, the exception swallows the rule. See e.g., East v. Fields, 42 Wnd.2d 924, 925, 259 P.2d 639 (1953); an insurer who rejected a tender of defense is estopped to deny material findings of fact determined in underlying tort action. Thus, where the tort action will involve an issue central to coverage, the insurer should defend under a reservation of rights. It can institute the declaratory action later without fear of estoppel and without prejudicing its insured’s defense in the tort action. The second exception is the case where a judgment might be entered in excess of the policy limits. A declaratory action will avoid the insurer’s exposure to damages in excess of those policy limits.

Joe suggests one action that Viking could have taken in the Bessell v. Viking Insurance Company case to prevent the problem from snowballing out of control would be to commence a declaratory judgment action, name all the claimants as defendants and interplead the policy limits, seeking a declaration that the entire amount of indemnity Viking would have to pay would be those policy limits, and attempt to settle all claims on behalf of the insured. Presently, I am defending a bad faith case where the insurer did exactly that. The insured is arguing that the carrier committed bad faith by instituting the interpleader action, since it only protected the insurer and not the insured.