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OSBA - Insurance Law Basics

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Note: these materials are based substantially upon Richard D. Porotsky, Jr., OHIO INSURANCE LAW: POLICY ANALYSIS, BAD FAITH, AND ETHICAL CONFLICTS (Ohio State Bar Association CLE, 2011).

1. Definition of the Tripartite Relationship.

Conflicts of interest and ethical issues for counsel can arise whenever an insurer hires an attorney to defend a policyholder. These commonly arise when the insurer reserves its right to deny coverage. However, even where there is no reservation of rights, the policyholder will often want a case settled with minimal effort, regardless of the insurer's expense. The insurer, on the other hand, must seek reasonably to control its own settlement and defense costs. Defense counsel, paid by the insurer to represent the policyholder, may be stuck in the middle. Important disputes can develop from this dynamic in the "tripartite" relationship – the relationship created by the insurance policy between insurer, policyholder, and defense counsel. *E.g., Swiss Reinsurance Am. Corp., Inc. v. Roetzel & Andress* (9th Dist.), 2005-Ohio-4799 (discussed below, addressing an acute, settlement-related conflict in the "tripartite" relationship).

When conflicts arise in the tripartite relationship, there are issues about who should control defense counsel and who—between insurer and policyholder—can rightfully claim the attorney-client relationship. On these issues, several provisions of Ohio's Rules of Professional Conduct are particularly relevant. These are discussed below.

2. Ethical Considerations Relating to Conflicts of Interest Within the Tripartite Relationship Under the Ohio Rules of Professional Conduct.

a. Rule 1.8 and Its Required Statement of Insured Client Rights.

Ohio Rule of Professional Conduct 1.8 addresses counsel's ethical duties whenever one party pays another's legal bills. Under Rule 1.8(f), the represented party must be afforded the opportunity to provide "informed consent" to the payment arrangement.

Rule 1.8(f)(4) is a specific application of these rules to the unique tripartite relationship. It requires all insurer-hired defense counsel to provide a specific, detailed "Statement of Insurance Client's Rights" to the policyholder at the start of their representation. The text of the statement is set forth in Rule 1.8(f)(4). This Statement is generally consistent with previously-existing Ohio law and ethics provisions, but seeks to formalize counsel's duties in the process of requiring specific notice to the policyholder of its rights.

Consent to the insurer's payment can be inferred from the policy under the insurer-policyholder relationship. *See* cmt. 12A to Rule 1.8. But, the Statement and its detailed provision is required to be provided as part of the process. Further, the Rule makes clear that the

represented party is still entitled to "independence of professional judgment" from counsel, as well as confidentiality under Rule 1.6 relating to information provided to counsel.

Comments 12 and 12[A] to Rule 1.8 discuss the reasoning for the Statement by making several critical points:

1. Because an insured client "may not understand how defense counsel's relationship with and duties to the insurer will affect the representation," the lawyer should provide the insured client with the "Statement of Insured Client's Rights" at the start of the engagement.

2. Insurance defense counsel owes the insured client the "same duties to avoid conflicts, keep confidences, exercise independent judgment, and communicate as a lawyer owes any other client."

3. These duties are "subject only to the rights of the insurer, if any, pursuant to the policy contract with its insured to control the defense, receive information relating to the defense or settlement of the claim, and settle the case."

The required Statement thus provides as follows:

STATEMENT OF INSURED CLIENT'S RIGHTS

An insurance company has retained a lawyer to defend a lawsuit or claim against you. This Statement of Insured Client's Rights is being given to you to assure that you are aware of your rights regarding your legal representation.

1. Your Lawyer: Your lawyer has been retained by the insurance company under the terms of your policy. If you have questions about the selection of the lawyer, you should discuss the matter with the insurance company or the lawyer.

2. Directing the Lawyer: Your policy may provide that the insurance company can reasonably control the defense of the lawsuit. In addition, your insurance company may establish guidelines governing how lawyers are to proceed in defending you—guidelines that you are entitled to know. However, the lawyer cannot act on the insurance company's instructions when they are contrary to your interest.

3. Communications: Your lawyer should keep you informed about your case and respond to your reasonable requests for information.

4. Confidentiality: Lawyers have a duty to keep secret the confidential information a client provides, subject to limited exceptions. However, the lawyer chosen to represent you also may have a duty to share with the insurance company information relating to the defense or settlement of the claim. Whenever a waiver of lawyer-client confidentiality is needed, your lawyer has a duty to consult with you and obtain your informed consent.

5. Release of Information for Audits: Some insurance companies retain auditing companies to review the billing and files of the lawyers they hire to represent policyholders. If the lawyer believes an audit, bill review, or other action initiated by the

> insurance company may release confidential information in a manner that may be contrary to your interest, the lawyer must advise you regarding the matter and provide an explanation of the purpose of the audit and the procedure involved. Your written consent must be given in order for an audit to be conducted. If you withhold your consent, the audit shall not be conducted.
>
> 6. Conflicts of Interest: The lawyer is responsible for identifying conflicts of interest and advising you of them. If at any time you have a concern about a conflict of interest in your case, you should discuss your concern with the lawyer. If a conflict of interest exists that cannot be resolved, the insurance company may be required to provide you with another lawyer.
>
> 7. Settlement: Many insurance policies state that the insurance company alone may make a decision regarding settlement of a claim. Some policies, however, require your consent. You should discuss with your lawyer your rights under the policy regarding settlement. No settlement requiring you to pay money in excess of your policy limits can be reached without your agreement.
>
> 8. Fees and Costs: As provided in your insurance policy, the insurance company usually pays all of the fees and costs of defending the claim. If you are responsible for paying the lawyer any fees and costs, your lawyer must promptly inform you of that.
>
> 9. Hiring your own Lawyer: The lawyer hired by the insurance company is only representing you in defending the claim brought against you. If you desire to pursue a claim against someone, you will need to hire your own lawyer. You may also wish to hire your own lawyer if there is a risk that there might be a judgment entered against you for more than the amount of your insurance. Your lawyer has a duty to inform you of this risk and other reasonably foreseeable adverse results.

For a downloadable version of this Statement (and of all parts of the Ohio Rules), see the Ohio Supreme Court's website: http://www.supremecourt.ohio.govLegalResources/Rules/ ProfConduct/profConductRules.pdf.

In sum, Rule 1.8(f) and the Statement make clear to policyholders that they have a valid, enforceable attorney-client relationship with defense counsel. The Rule likewise makes clear that the insurer has certain rights, depending in part upon the policy terms. The Statement is thus consistent with prior Ohio case law, which indicates that "both" the insurance company and "its insured" are "clients" of the "legal counsel retained by [the insurance company]." *Netzley v. Nationwide Mut. Ins. Co.* (1971), 34 Ohio App. 2d 65, 79, 296 N.E.2d 550; *see also United States Fidelity & Guar Co., et al. v. Pietrykowski*, et al. (Feb. 11, 2000), 6th Dist. App. No. E99-38 (2000 Ohio App. LEXIS 460, *7-9), *appeal not allowed*, 89 Ohio St. 3d 1430; 729 N.E.2d 1199 (2000); see also *Carolina Cas. Ins. Co. v. Gallagher Sharp, et al.*, N.D. Ohio No. 1:10CV02492 (*2011 U.S. Dist. LEXIS 113184*, *10-13) (insurer found to be in privity with its

insured policyholder and able to sue defense counsel for malpractice). *But see Swiss Reinsurance American Corp., Inc. v. Roetzel & Andress* (9th Dist.), 2005-Ohio-4799, ¶¶ 18-20 (discussed below; due to conflict of interest, insurer could not claim attorney claim relationship for purposes of brining a malpractice suit against defense counsel). As discussed below, the respective rights of insurer and policyholder may not always be equal in the face of conflicts, but both insurer and policyholder have rights to certain information from the hired defense counsel. *Netzley*, 34 Ohio App. 2d at 79; Statement of Insured Client Rights.

b. Primary Allegiance of Defense Counsel to the Policyholder.

The Statement of Insured Client's Rights is also consistent with an interesting Ohio appellate case discussing the tripartite relationship. *United States Fidelity & Guar Co., et al. v. Pietrykowski*, et al. (Feb. 11, 2000), 6th Dist. App. No. E99-38 (2000 Ohio App. LEXIS 460), *appeal not allowed*, 89 Ohio St. 3d 1430; 729 N.E.2d 1199 (2000). The *Pietrykowski* court addressed whether an insurer's relationship with defense counsel was an attorney-client relationship or purely contractual. The answer, in turn, determined whether a one-year statute of limitations for malpractice applied or whether a longer contractual limitations period applied. In finding that the shorter limitations period for malpractice applied, the court stated that defense counsel "represented both the insurer and the insured." *Id.* at *9. "It is a multiple party, tripartite representation, with each party having different priorities and interests, but nevertheless one of lawyer-client as to each of the parties." *Id.* Indeed, defense counsel "'routinely and necessarily represents the interests of both the insurer and the insured'" as part of the "'tripartite relationship.'" *Id.* at *7 (citing LEGAL MALPRACTICE, 4th Ed., Mallen and Smith, § 28.3, "The Relationship of Counsel-The Tripartite Relationship," p. 487 et seq.); *see also See RPM Inc., et al. v. Hartford Accident & Indem. Co. et al.* (Apr. 11, 2006), N.D. Ohio No. 03-1322 (slip. op. at 7) (*citing and following Pietrykowski*); *Gallagher Sharp, 2011 U.S. Dist. LEXIS 113184*, *10-13) (insurer found to be in privity with its insured policyholder).

Both the Statement and *Pietrykowski* make clear that defense counsel's primary allegiance must be to the insured-policyholder. The Statement addresses this in its point 2, noting that "the lawyer cannot act on the insurance company's instructions when they are contrary to your [the client's] interest." *Id.* *10. *Pietrykowski* acknowledges that defense counsel owes "ethical and legal priority duties to the insured."

A similar point, prioritizing the policyholder's relationship, is made in *Swiss Reinsurance*

American Corp., Inc. v. Roetzel & Andress (9th Dist.), 2005-Ohio-4799. In *Swiss Reinsurance*, the court found that a conflict of interest stripped the insurer of the ability to claim the attorney-client relationship. The court noted the "inherent dangers of a conflict arising in a tripartite relationship" and concluded that, when there is a conflict, the policyholder alone may be left with the attorney-client relationship. *Id.* ¶¶ 18-20. The *Swiss Reinsurance* court thus acted to protect the policyholder in the tripartite relationship, recognizing that a defense attorney's financial incentives already often lie with pleasing the insurer. *Id.* ¶ 18.

The *Swiss Reinsurance* case involved an underlying medical malpractice action where the policyholder-defendant, a doctor, repeatedly requested the insurer to settle. The defense counsel also recommended settlement. Although the insurance company did not dispute that counsel's primary allegiance was to the doctor, *id.* at ¶ 19, the insurance company wished to proceed to trial. Thus, it hired new trial counsel on the eve of trial. After trial started, and a settlement was reached, the insurer then elected to sue the original defense attorney for malpractice. The court ruled, however, that because there was a clear conflict, it was not possible for the attorney (agent) to "serve two masters." *Id.* at ¶ 20. The policyholder-doctor had been happy with the original counsel's representation. The court thus refused to allow the insurer to sue for malpractice. The conflict of interest removed the necessary common interest in the relationship, stripping the insurer of the relationship necessary for a malpractice claim. The policyholder alone was left with the attorney-client relationship.

As seen in *Swiss Reinsurance*, defense counsel is often left in a difficult position. The insurance policy terms may provide the insurer with the right, as a contractual matter, to control the defense and decide whether to settle. Defense counsel must, for her livelihood, often seek to please the insurer. However, the existence of contractual terms between insurer and policyholder do not mean that defense counsel can reject or ignore the policyholder's position on settlement or other issues. Stated most bluntly, the policyholder may even be entitled to breach policy provisions while still retaining the allegiance of his or her counsel. A breach of the policy may create a conflict for the counsel to consider and may create payment issues, but the policy terms cannot dictate counsel's advice or alter his or her allegiance to her primary client.

Defense counsel is tasked with properly representing the policyholder, sharing certain information with the insurer, and navigating the conflicts of interest that periodically arise between policyholder and insurer. In addition to Rule 1.8(f), there are other laws and ethical

rules that are pertinent to the potential conflicts of interest that can arise between insurer, policyholder, and defense counsel. These include Rule 1.7 (Conflict of Interest: Current Client); Rule 1.9 (Duties to Former Clients); Rule 1.10 (Imputation of Conflicts of Interest: General Rule); and Ohio Rev. Code § 2317.02 (Privilege). These rules and some specific conflict situations are addressed below.

c. Rule 1.7 Addresses Typical Conflicts Between Insurer and Policyholder.

Defense counsel face conflicts of interest between insurer and policyholder in certain common situations, including: (1) decisions regarding settlement of the claim; and (2) defense of a claim where a reservation of rights has been issued by the insurer with respect to coverage. Ohio case law, discussed below, has provided some guidance on how these potential conflicts should be handled. Rules 1.7 through 1.12 also provide guidance for all counsel, not just insurance defense counsel, in handling conflicts of interest.

Rule 1.7, containing ethical duties relating to the representation of multiple current clients, is the Rule most directly implicated when defense counsel faces a conflict. In pertinent part, the rule states as follows:

RULE 1.7: CONFLICT OF INTEREST: CURRENT CLIENTS

(a) A lawyer's acceptance or continuation of a client creates a conflict of interest if either of the following applies:

(1) the representation of that client will be directly adverse to another current client;

(2) there is a *substantial* risk that the lawyer's ability to consider, recommend, or carry out an appropriate course of action for that client will be materially limited by the lawyer's responsibilities to another client, a former client, or a third person or by the lawyer's own personal interests.

(b) A lawyer shall not accept or continue the representation of a client if a conflict of interest would be created pursuant to division (a) of this rule, unless all of the following apply:

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

(2) each affected client gives informed consent, confirmed in writing;

(3) the representation is not precluded by division (c) of this rule.

(c) Even if each affected client consents, the lawyer shall not accept or continue the representation if either of the following applies:

(1) the representation is prohibited by law;

(2) the representation would involve the assertion of a claim by one client against another client represented by the lawyer in the same proceeding.

As discussed below, not all conflicts of interest are waivable by the clients. Some conflicts require counsel to withdraw from representing a party in the issue at hand. When a waivable conflict arises, then if counsel wishes to proceed in representing the client, Rule 1.7 requires a client's "informed" consent, "confirmed in writing." The writing must either be signed by the client or must appear in correspondence from the attorney that timely confirms the waiver. Rule 1.7(b)(2) and cmt. 31.

For waivable conflicts arising from an initial reservation of rights within the tripartite relationship, the consent and/or waiver of the policyholder is inferred from the insurance contract. This assumes that the Statement of Insured Client Rights is provided and a proper reservation of rights letter is provided.

However, as discussed below, further conflicts can arise after the initial retention. Each lawyer must use his own discretion in addressing conflict issues under these Rules. The lawyer must determine whether a conflict is present, and if so, whether it is waivable. Sometimes, if the conflict becomes intense, and the client does not agree to waive it, a court may be asked to address the issue. That is what occurred in *R.E. Kramig Co. Inc. v. Resolute Management Inc., et al*. (May 18, 2009), S.D. Ohio No. 07-658 (2009 U.S. Dist. LEXIS 48838) (finding a conflict and disqualifying counsel under Rule 1.9 where counsel sought to represent a policyholder in a case against an insurer who had previously been represented by the same counsel); *see also Stanley v. Bobeck* (8th Dist.), 2009-Ohio-5696 (finding no conflict and no disqualification under Rule 1.7).

Two common conflict situations that arise under Rule 1.7 in the insurance context are discussed below.

3. Selection and Control of Defense Counsel in Conflict Situations.

a. Settlement-Related Conflicts: Identifying Them, and Then Providing for Selection and Control of Counsel.

The policyholder's interests will often dictate settlement at any amount under the policy limits. On the other hand, the insurer must seek reasonably to control its settlement and defense

costs. To reduce the potential for accusations of ethical breaches, a defense attorney should communicate all settlement demands from a plaintiff to both the policyholder and the insurer. Likewise, before a defense attorney makes or accepts a settlement offer, the defense attorney should generally obtain the approval of both the insurer and the policyholder. The policy language may state that the insurer has a right to control defense and settlement, and counsel may advise the policyholder of this language, but the policy language does not strip the policyholder of his or her right to be informed by his or her counsel and to object.

If a divergence of opinion arises between insurer and policyholder with respect to settlement, the defense attorney should advise the two parties of the conflict and (if not resolved) should ordinarily cease representation of one or both parties *in the settlement negotiations*. The defense attorney may well be able to remove himself from settlement negotiations while retaining his role as trial counsel. This limited withdrawal of defense counsel from settlement negotiations, due to a conflict of interest in those negotiations, occurred in *Romstadt v. Allstate Insurance Co.*, 59 F.3d 608, 610-612 (6th Cir. 1995) (approving of the actions of counsel and insurer with respect to the limited withdrawal). Other than for efficiency, there is no reason why the defense attorney needs to fill the role of both settlement negotiator and trial counsel. If a limited withdrawal of trial counsel is necessary due to a settlement-related conflict, the policyholder may arguably be entitled to additional counsel, paid by the insurer, for the limited purpose of advising the policyholder with respect to settlement.

Each defense attorney should also be mindful that if the insurer objects to a plaintiff's settlement offer within policy limits, or if the insurer otherwise fails to reasonably settle within limits, the policyholder may later be able to maintain a cause of action for the insurer's bad faith failure to settle. It is also possible that a policyholder may object to settlement within policy limits while the insurer insists upon settlement. For example, the policyholder may wish to achieve full vindication and/or may not wish to have the settlement affect future insurance premiums. In these latter circumstances, if the insurer objects, the policyholder has the option of continuing the litigation on his or her own without further insurance coverage. Again, in these situations where the policyholder's settlement views diverge from the insurer's, the defense attorney should ordinarily not represent both the policyholder and insurer *in settlement negotiations*.

This type of settlement-related conflict arose in *Swiss Reinsurance American Corp., Inc.*

v. Roetzel & Andress (9th Dist.), 2005-Ohio-4799. As described above, the court heavily criticized the insurer for failing to properly address the "inherent dangers of a conflict arising in a tripartite relationship." *Id.* at ¶ 18. Since the policyholder and his counsel wished to settle, and the insurer refused, there was a clear conflict, and it was not possible for the attorney to "serve two masters." *Id.* at ¶ 20. Because of the conflict, the insurer could not establish the attorney-relationship necessary for its later malpractice claim; the insurer was deemed to have been stripped of that relationship due to its actions. This problem probably could have been averted if the parties had employed the procedure noted above in *Romstadt*, using separate counsel in settlement negotiations.

b. Conflicts Relating to the Insurer's Reservation of Rights, Leading to Issues of Selection and Control of Counsel.

Both the policyholder and the insurer will always have an interest in seeing that the policyholder prevails against an underlying plaintiff. However, if the insurer has issued a reservation of rights, a *potential* conflict exists with respect to the conduct of the policyholder's defense. This is because the insurer and policyholder may have divergent views on how to handle the defense, views that may cause the judgment in the underlying case to be determinative of the coverage issue in one way or another.

As noted above, this type of conflict (if waivable) is addressed by the policyholder's implied waiver and consent through the insurance contract. This assumes that a proper reservation of rights letter and Statement of Insured Client Rights is provided. The Statement of Insured Client Rights and Ohio law make clear that defense counsel's primary allegiance in these circumstances shall be to the policyholder. *See* Part 2.b. above.

However, the conflict may not always be waivable; it may present an irreconcilable conflict, as discussed below. In addition, beyond pure conflict issues, policyholders may have good reasons for preferring certain defense counsel over the insurer's chosen defense counsel. This preference may legitimately be based upon counsel's background or qualifications. Policyholders may be able to negotiate with the insurer on this point, arguing that using the insurer's chosen counsel would not be appropriate or reasonable under the circumstances. This point could potentially be pressed in Court as a basis for the insurer's breach of the duty to defend. Conflict issues are inevitably mixed into these types of discussions and arguments.

If a true, irreconcilable conflict exists, the insurer may be required to hire independent

counsel for the policyholder or allow the policyholder to hire his or her own private counsel. *See* Allen D. Windt, INSURANCE CLAIMS & DISPUTES, § 4.18 (McGraw Hill, 2d Ed. 1988). As discussed below, the mere issuance of a reservation of rights letter does not automatically create a material, irreconcilable conflict of interest under Ohio law. Courts will look closely at the facts and issues before finding that a conflict requires the insurer to pay for private counsel selected by the policyholder. As a practical matter, absent extreme or unusual circumstances, Ohio have been reluctant to find such irreconcilable conflicts of interest.

i. Reservations of Rights Do Not Always Create Irreconcilable Conflicts Under Ohio Law.

Ohio courts have made clear that the insurer need only pay for the policyholder's private counsel when the insurer's stance renders it "impossible" for it to "protect both its own interests and those of the insured." *Redhead Brass, Inc. v. Buckeye Union Ins. Co.* (9th Dist. 1999), 135 Ohio App. 3d 616, 626, 735 N.E.2d 48, 55. Stated another way, the interests must be "mutually exclusive," or irreconcilable on an issue material to coverage, before the insurer must pay the costs of private counsel for the policyholder. *Id*. Thus, where the insurer reserves its right to deny coverage, but the facts present "no conflict of interest," the insurer need not pay for private counsel. *Lusk v. Imperial Cas. & Indem. Co.*, (10th Dist. 1992), 78 Ohio App. 3d 11, 16, 603 N.E.2d 420, 423-24.

In at least four types of situations involving a reservation of rights, there should normally be no conflict with respect to the conduct of the defense: (1) the coverage question involves a fact that will not be addressed in the underlying suit (i.e., whether the defendant was a named insured); (2) the coverage question is based upon the policyholder's failure to comply with policy conditions (i.e., timely notice); (3) the reservation simply concerns punitive damages; or (4) there are multiple unrelated, independent claims, and one or more of these claims is clearly not covered (i.e., one breach of contract claim and one unrelated tort claim). *See* Windt, at § 4.18; *HK Sys. v. Admiral Ins. Co.* (June 24, 2005), E.D. Wis. No. 03-C-0795 (2005 WL 1563340, at *8-9) (detailed discussion of types of conflicts, and finding that not all reservations of rights create a conflict); *see also Twin City Fire Ins. Co. v. Ben Arnold-Sunbelt Beverage Co. of S.C.*, 433 F.3d 365, 370-74 (4th Cir. 2005) (survey of various states' views on whether all reservations of rights create a conflict per se, and rejecting a per se rule for South Carolina). Cases that fall within the last of these four categories may be difficult to analyze for conflicts,

since it may be difficult to determine whether claims are truly unrelated to each other.

ii. Handling Irreconcilable Coverage-Related Conflicts Between Insurer and Policyholder.

Defense attorneys should be particularly wary of potential conflicts where the underlying complaint contains some claims that are covered and some that are not covered. In this situation, if the judgment in the underlying case will resolve factual issues pertinent to the coverage dispute, the insurer and policyholder will have differing interests in shaping defense of the case. They will each have an interest in advocating for a resolution that favors their respective coverage position.

When a material, irreconcilable conflict ("true conflict") arises, the ensuing problems can become quite thorny. These conflicts can preclude a defense attorney from continuing to simultaneously represent both the insurer and its policyholder. Separate counsel may be needed. There may then be numerous questions about who should control the defense, who should select counsel, what rates the insurer is obligated to pay, and what actions the insurer's counsel may take in the underlying trial. For most of these issues, Ohio courts have not addressed them in any depth, if at all. For a discussion of other states' rules on the selection of counsel in light of a conflict of interest, see *Twin City Fire Insurance Co.*, 433 F.3d at 372-73 (but making no conclusion on the issue, since the court ruled that new counsel was not required in this case); *see also HK Systems v. Admiral Insurance Co.* (June 27, 2005), E.D. Wis. No. 03-C-0795 (2005 WL 1563340, at *8-9) (detailed discussion of these issues under Wisconsin law).

The *HK Systems* court in Wisconsin reasonably held that where there is a true conflict, the insurer cannot control the defense. It must either allow the policyholder to select counsel or must hire a truly independent counsel. If it allows the policyholder to select counsel, the rates charged are subject to review for reasonableness, and if the insurer selects independent counsel, the counsel cannot have a close, prior relationship with the insurer.

Similar principles were raised in Ohio, without much discussion or clear conclusions, in *Socony-Vacuum Oil Co. v. Continental Casualty Co.* (1945), 144 Ohio St. 382, 396, 59 N.E.2d 199, 204-05. In *Socony-Vacuum*, the underlying complaint present multiple grounds for recovery from the policyholder. There was a conflict because the insurer had an interest in having any "recovery based on the sole ground that [a certain person] was an employee of the insured and guilty of negligence in the course of his employment," while the policyholder had an interest to

have such a recovery based upon other grounds within the policy. Apparently finding this to be a true, material conflict, the *Socony* court required the insurer to pay for the policyholder's private counsel. The *Socony* court was not explicit about who should control defense after independent counsel was hired. But, only one party can ultimately be in control, and the attorney "cannot serve two masters." *Swiss Reinsurance Am. Corp., Inc. v. Roetzel & Andress* (9th Dist.), 2005-Ohio-4799, ¶ 20; Windt, at § 4.20 ("[c]ontrol of the defense cannot be split"). Thus, it is reasonable to conclude the *Socony-Vacuum* court placed control in the hands of the policyholder's private counsel, due to the true conflict.

4. Role of Coverage Counsel.

a. For the Policyholder.

Because insurer-hired defense counsel owes certain duties to the insurer, she should not simultaneously represent the policyholder in both the defense of the underlying case and the pursuit of insurance coverage. The policyholder should, in those circumstances, have separate coverage counsel.

The need for separate coverage counsel is not as clear in the case where the insurer refuses to defend the policyholder. In that situation, policyholders sometimes prefer to use the same counsel, with whom they are familiar, for both defense of the underlying case and pursuit of coverage. That may be ethically permissible and may seem economically efficient for the policyholder. However, the perspective and expertise of separate coverage counsel will be beneficial to the policyholder. Further, there are potential pitfalls, including the fact that counsel may have dealings with the insurer which become relevant to a bad faith claim, making counsel into a potential witness. For an example of the problems that can arise on this point, see *155 North High Ltd. v. Cincinnati Insurance Co.*, 72 Ohio St. 3d 423, 1995-Ohio-85, 650 N.E.2d 869. In *155 North High*, the policyholder-client claimed that his insurer acted in bad faith prior to the coverage lawsuit being filed. The attorney for the policyholder-client had significant dealings with the insurer in the pre-suit period during which the alleged bad faith occurred. When the insurer moved to disqualify the policyholder's attorney as trial counsel in the coverage matter, the trial court refused to do so, but the court of appeals reversed. The Supreme Court then upheld the disqualification because it found that counsel's testimony was necessary, based upon his extensive pre-suit involvement, for his client's bad faith claim. *Id.* For more on this issue of disqualification in bad faith cases, see Porotsky, OHIO INSURANCE LAW, Chp 27.

b. For the Insurer.

i. Initial Analysis, Opinions, and Reservations of Rights

Coverage counsel for the insurer can play a valuable role starting from the time a claim is first submitted to the insurer. For unique, controversial, or complex claims, counsel may be requested to provide an initial coverage opinion. A proper coverage opinion will help the insurer to make reasonable decisions, which in turn should limit the risks of coverage litigation. Counsel should be mindful, as noted above, that if the opinion is provided before a denial and if a bad faith action ensues, the opinion and surrounding correspondence will likely be discoverable at some point in the bad faith action.[1] However, in these situations, if counsel and the insurer have acted reasonably, the opinion and correspondence should assist the insurer in proving reasonable justification for the denial.

Counsel will often be asked to advise on the extent of the insurer's risk and exposure arising from a claim. This can involve assessment of potential defense and indemnity costs, punitive damages for bad faith, interest, and attorney fees. For more on the types of exposure, see Porotsky, OHIO INSURANCE LAW, Chp 35.

Coverage counsel may also be asked to play a lead role in drafting a denial letter or reservation of rights letter. T=he letter should fully and fairly apprise the policyholder of the basis for the insurer's position. It should also invite the policyholder to provide any and all facts, analysis, or information that the policyholder deems relevant. Finally, it should make clear that the insurer reserves the right to rely upon additional policy provisions or facts that may be relevant after further review. If and when additional reasons for denial or reservation of rights are determined, a supplemental letter should be sent. By specifying all possible grounds for denying coverage, the insurer prevents the policyholder from later making allegations, possibly in a bad faith claim, that the insurer failed to deal reasonably with the policyholder or induced reliance upon the insurer-provided counsel who had a conflict of interest.

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[1] Specifically, in 2001, the Ohio Supreme Court issued a controversial, ground-breaking decision relating to discovery in insurance bad faith cases. *Boone v. VanLiner Ins. Co.*, 91 Ohio St. 3d 209, 2001-Ohio-27, 744 N.E.2d 154. The *Boone* court held that "in an action alleging bad faith denial of insurance coverage, the insured is entitled to discover claims file materials containing attorney-client communications related to the issue of coverage that were created prior to the denial of coverage." *Id*., syl. The court reasoned that "claims file materials that show an insurer's lack of good faith in denying coverage are unworthy of protection." *Id*. at 213, 2001-Ohio-27, 744 N.E.2d 144. This ruling has been qualified and clarified in a number of subsequent decisions in Ohio appellate courts and Ohio federal courts. For more on this issue, see Porotsky, OHIO INSURANCE LAW, Chp 38.

There is a significant amount of case law on reservations of rights in Ohio and elsewhere. Here are some details from those cases. Each policyholder is entitled to enough information in a reservation of rights letter to make a "knowing choice whether to proceed with representation [provided by the insurer] and the possible conflict, or obtain independent counsel." *Dietz-Britton v. Smythe, Cramer Co.* (8th Dist. 2000), 139 Ohio App. 3d 337, 345, 743 N.E.2d 960, 966. An insurer is not permitted to lull a policyholder into inaction while "'conduct[ing] the defense of the action without the knowledge of the insured that a conflict of interest exists….'" *Fairfield Mach. Co., Inc. v. Aetna Cas. & Surety Co.* (7th Dist.), 2001-Ohio-3407, ¶¶ 37-40 (*quoting Equity Gen. Ins. Co. v. C&A Realty Co.* (Ariz. 1985), 715 P.2d 768, 771). For a unique and informative case on this point, see *Utica Mut. Ins. Co. v. David Agency Ins., Inc.*, 327 F. Supp. 2d 922 (N.D. Ill 2004). The *Utica Mutual* court faulted the insurer under Illinois law for inadequate disclosure of a conflict, and then estopped the insurer from raising policy defenses. No Ohio court has been so precise in its requirements to date, but the same requirement of an adequate reservation of rights, so the policyholder can make a "knowing choice," is clear under Ohio law.

In deciding whether an insurer's reservation of rights letter is sufficient, a key question will be whether the policyholder was "prejudiced" by a lack of information. If so, a waiver of coverage defenses may be found. An insurer may waive its coverage defenses if it defends the policyholder without providing a timely, appropriate reservation of rights. *Dietz-Britton v. Smythe, Cramer Co.* (8th Dist. 2000), 139 Ohio App. 3d 337, 345, 743 N.E.2d 960 (finding a waiver); *Collins v. Grange Mut. Cas. Co.* (12th Dist. 1997), 124 Ohio App. 3d 574, 706 N.E.2d 856 (finding waiver). The reservation of rights should be provided at the start of any defense that is provided by the insurer. If its issuance is delayed, then the question will be whether the policyholder was prejudiced by that delay. If prejudice resulted, then defenses are waived.

The *Dietz-Britton* court noted a number of factors to consider in determining whether a policyholder has been prejudiced by the delay. These factors include:

> loss of a favorable settlement opportunity, inability to produce all testimony existing in support of a case, inability to produce favorable witnesses, loss of benefit of any defense in law or fact through reliance upon the insurer's promise to defend or withdrawal so near the time of trial that the insured is hampered in the preparation of its defense.

Id., at 348, 743 N.E.2d at 968.

Insurers may choose to include at least two other provisions in a reservation of rights letter. First, an insurer may choose to state that it reserves the right to later discontinue and withdraw from defense of the case upon proper notice and explanation to the policyholder. As a practical matter, insurers do not often withdraw a defense without court approval. However, such approval should not strictly be necessary if the investigation or analysis clarifies the absence of the duty to defend. Second, an insurer may choose to carefully state that it is agreeing to provide this defense while reserving the right to recover defense costs if the court later determines that no duty to defend existed. This recovery of defense costs by an insurer has been permitted by some courts, but is a fairly recent development in insurance law. For more on this issue, see Porotsky, OHIO INSURANCE LAW, Chp. 10.

Outside of the context of defending third-party claims, the issuance of a reservation of rights letter is still often necessary. The insurer should always protect against the possibility that the policyholder could claim that the insurer induced the policyholder into taking certain actions. In addition, policyholders are entitled to a prompt response to any claim, even if the response simply notes the need for further investigation. *See* Ohio Admin. Code § 3901-1-54(F) and (G) (insurer should acknowledge claims within 15 days and provide settlement or request additional time within 21 days); *see also* Porotsky, OHIO INSURANCE LAW, Chp. 34 (discussing an insurer's duty of good faith, including proper and timely handling of claims). Thus, before the insurer undertakes any substantial investigation, it should inform the policyholder that it has made no coverage determination and that it reserves its right to either grant or deny coverage based upon the results of its investigation.

ii. Litigation and/or Intervention in the Underlying Case

After the insurer evaluates a claim, it has three main options: (1) accept coverage, including defending any third-party claim unconditionally; (2) deny coverage, leaving defense of any third-party claim to the policyholder; or (3) further investigate while defending any third-party claim under a reservation of rights. Option one will not involve litigation, but options two and three might. In fact, as discussed below, the insurer may be required to intervene in certain instances of underlying litigation in order to avoid a detrimental collateral estoppel effect. In other cases, litigation may be a prudent strategic step in attempt to limit the insurer's exposure to defense costs, indemnity costs, or bad faith claims.

When an insurer denies coverage or reserves its right to do so, the insurer then has several further options for proceeding. The selection of the best option is likely to depend in part upon whether the underlying case involves a fact issue that will be relevant to the insurance coverage determination. Some facts, such as the identity of the named insured or the failure to timely notify the insurer, are not typically at issue in the underlying case. In those circumstances, the insurer has maximum flexibility and it may reasonable choose to: (a) file a separate declaratory judgment action to determine the merits of its coverage determination; (b) intervene in the underlying lawsuit to determine the merits of its coverage determination; or (c) do nothing and wait to see if the policyholder brings suit or if the underlying plaintiff brings a direct action via supplemental complaint under R.C. § 3929.06 after obtaining a judgment against the policyholder. In any of these cases, the insurer should be able to raise its coverage defenses when sued. Thus, in these cases, it is not strictly necessary for the insurer to make an early decision to intervene or otherwise litigate.

On the other hand, if the insurer denies coverage (or reserves its right to deny) and the underlying case involves a fact issue which is important to the insurance coverage determination, the insurer will usually want to act more quickly. Action may be needed to avoid a collateral estoppel effect from the underlying judgment. *Howell v. Richardson* (1989), 45 Ohio St. 3d 365, 367-68, 544 N.E.2d 878 (underlying complaint containing alternative claims for negligence and intentional conduct), syl. corrected; *Grange Mut. Cas. Co. v. Uhrin* (1990), 49 Ohio St. 3d 162, 550 N.E.2d 950 (minor correction). In *Howell*, the court ruled that the finding of negligence in the underlying case was binding on insurer via collateral estoppel. The insurer could not re-litigate the issue of whether the policyholder intentionally caused injury, due to the collateral estoppel effect of the judgment. *Id. But see Staley v. Grant* (11th Dist. 1993), 1993 WL 130100 (finding *Howell* inapplicable where the precise issue in question, involving culpable mental state, was not litigated). Thus, coverage counsel for the insurer is needed to address these situations where coverage may be determine by the underlying judgment.

In *Howell*, the Ohio Supreme Court set forth its vision for how an underlying lawsuit can proceed where a coverage-related conflict of interest is present between insurer and policyholder. The court stated that a conflict is "not necessarily inevitable." 45 Ohio St. 3d at 367, 544 N.E.2d 878 (apparently referring to a possible conflict of interest in counsel handling the defense of the case). To prevent the conflict, stated the Court, the insurer should "decline to defend"—

presumably by either paying for the policyholder's independent counsel or by refusing coverage entirely (at its option)—and then enter the underlying case as a third-party defendant to attempt to defeat coverage. *Id.* A conflict of interest is avoided by placing full control of the defense in the hands of the policyholder.

The resolution provided by *Howell* solves the conflict of interest problem while creating other problems. These problems include the fact that the insurer may be placed in the position of advocating for a finding of intentional conduct in the underlying case, effectively undermining its policyholder whose interests it is supposed to protect. Indeed, the insurer's advocacy against its policyholder, if permitted, could result in an increased award or increased punitive damages in the underlying case. Surely, an Ohio court would not fault the insurer for bad faith in opposing its policyholder under the approved *Howell* procedure. Yet, the procedure seems far from ideal if carried to this extreme.

As discussed above, insurers often choose to take a middle ground that does not involve active advocacy against the policyholder but that allows them to address the coverage issue. Indeed, some courts have approved a limited use of the *Howell* procedure to allow an insurer to intervene in the underlying case simply to submit jury interrogatories relating to coverage. *See Alhamid v. Great Am. Ins. Cos.* (7th Dist.), 2003-Ohio-4740, at ¶¶17-22 (reversing trial court for refusing to allow this limited intervention); *Red Head Brass, Inc. v. Buckeye Union Ins. Co.* (9th Dist. 1999), 135 Ohio App. 3d 616, 625, 735 N.E.2d 48, 54; *cf. Nationwide Ins. Co. v. Phelps* (7th Dist.), 2004-Ohio-1200 (insurer may intervene in underlying case to establish facts, while also bringing separate declaratory judgment action as to coverage). Coverage counsel can assist the insurer in making this important decision about whether to intervene and what position to take as an intervening party.

Some courts have actually denied insurers' attempts at intervention, raising the issue of whether such denials are immediately appealable. The Ohio Supreme Court has ruled that denials of intervention are not final appealable orders, at least absent special language in the ruling as to "no just reason for delay." S*ee Gehm v. Timberline Post & Frame* (9th Dist.), 2005-Ohio-5222, ¶¶ 3-6, *aff'd Gehm v. Timberline Post & Frame* (2007), 112 Ohio St. 3d 514, 2007-Ohio-607, 861 N.E. 2d 519, (denial of intervention is not a final appealable order under Ohio Rev. Code § 2502.02). The Ninth District in *Gehm* made clear, however, that the insurer's attempt to intervene ensures that the insurer will be able to contest coverage in the future, unlike in *Howell*

where the insurer made no attempt to intervene.

Coverage counsel may also advise the insurer about other options for resolving coverage disputes amid true conflicts of interest. All viable options require separate defense counsel to be hired to represent the policyholder. The real issue then becomes how and where to resolve the coverage dispute. One potential option could involve an agreement that the underlying action be non-binding for insurance coverage purposes. This creates extra litigation costs, but perhaps the parties could reach an agreement as to the payment of these costs. Another potential option involves bi-furcating the underlying trial. This may eliminate or postpone a conflict in some cases, but probably not in all cases. The parties to the tripartite relationship simply need to be mindful of the pertinent ethical rules, including those involving informed consent, in devising solutions.

5. Handling of Privileged or Confidential Information Within the Tripartite Relationship and Under Ohio's Rules of Professional Conduct.

a. Common Interest Normally Requires Defense-Related Information to Be Shared Within the Tripartite Relationship.

When defense counsel is hired by an insurer, the insurer and policyholder share a common interest in the handling of the defense vis-à-vis the claimant. *See RPM Inc., et al. v. Hartford Accident & Indem. Co., et al.* (Apr. 11, 2006), N.D. Ohio No. 03-1322 (slip. op. at 6-7 and 12-13) (*citing Emley v. Selepchak* (1945), 76 Ohio App. 257, 262, 63 N.E.2d 919, 922 (relating to common interest generally). Most privileged information shared by the policyholder with defense counsel will relate to that common interest. Thus, while that information is protected from disclosure to outsiders and opponents, it is accessible to the three parties in the tripartite relationship—insurer, policyholder, and defense counsel. *Id.* In other words, due to the "common interest," the policyholder generally cannot claim confidentiality vis-à-vis the insurer and cannot prevent disclosure of information by defense counsel to the insurer. *Id.* The *RPM* court thus forced the policyholder to produce information in discovery when it was demanded by the insurer in a subsequent coverage dispute. *Id. But cf. Owens Corning Fiberglass Corp. v. Allstate Ins. Co., et al.* (Lucas Cty. Comm. Pl. 1983), 74 Ohio Misc. 2d 174, 180-81, 660 N.E.2d 765 (insurer cannot access information where it refused to defend and was adverse to the policyholder at the relevant time; there was not a common interest at that time).

b. Conflicts of Interest and Other Issues May Render Certain Communications Confidential, Requiring Them to Be Withheld From the Insurer.

Despite the holding in *RPM* requiring disclosure due to common interest, there will be times when certain privileged communications from policyholder to defense counsel should not be disclosed to the insurer. This may occur where the insurer is defending the policyholder under reservation of rights, especially where there is a conflict or potential conflict between insurer and policyholder. In such situations, counsel must be mindful of pertinent ethics rules and Ohio law relating to privileged information.

An example of a difficult conflict situation involving confidentiality was raised to the Supreme Court's task force during the public comment period in 2005 leading up to adoption of the Rules of Professional Conduct. Specifically, the task force was asked to consider the duties of defense counsel in the scenario where his or her policyholder-client caused an accident while the policyholder-client may have been intoxicated. The intoxication could adversely affect the policyholder's premium or renewal status. It could also potentially violate an exclusion in the policy. The policyholder's privileged communications were thus confidential vis-à-vis the insurer, but these communications also provided a reason for settling as soon as possible. The best answer is that if there are appropriate screening procedures within the insurance company, then disclosure to a screened insurance representative may not harm the policyholder. But, the consent of the policyholder to the disclosure may still be required.

Defense counsel must proceed in this situation, and in all conflict situations, with caution. Before sharing with the insurer privileged communications that may involve a conflict or a coverage issue, defense counsel should obtain an understanding of the ethical screening that is in place at the insurance company. He should also advise his client that coverage counsel could be needed should seek his client's consent to share the information with a screened insurance adjuster.

c. Rules and Statutory Provisions Pertinent to Confidentiality and Privilege Within the Tripartite Relationship.

Ethical provisions relating to confidentiality and privilege appear in Rule 1.8(f) with its Statement of Insured Client Rights, Rule 1.6 on Confidentiality, and Ohio Rev. Code § 2317.02, which defines privileged information. These are addressed in turn, below.

Rule 1.8(f) and its Statement of Insured Client Rights provides the most specific guidance on this issue, as it is directed precisely toward issues arising within the tripartite relationship. Parts of point 2, 4, and 6 of the Statement are pertinent to confidentiality as follows:

> 2. Directing the Lawyer: Your policy may provide that the insurance company can reasonably control the defense of the lawsuit.... However, the *lawyer cannot act on the insurance company's instructions when they are contrary to your interest.*
>
> * * *
>
> 4. Confidentiality: *Lawyers have a duty to keep secret the confidential information a client provides*, subject to limited exceptions. However, the lawyer chosen to represent you also may have duty to *share with the insurance company information relating to the defense or settlement* of the claim. *Whenever a waiver of lawyer-client confidentiality is needed, your lawyer has a duty to consult with you and obtain your informed consent.*
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> * * *
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> 6. Conflicts of Interest: *The lawyer is responsible for identifying conflicts of interest and advising you.... If a conflict of interest exists that cannot be resolved, the insurance company may be required to provide you with another lawyer.*

(Emphasis added.) These provisions make clear that defense counsel's first responsibility is to the policyholder and that in certain situations, counsel may need to keep specific policyholder communications confidential from the insurer.

Beyond the Statement of Insured Client Rights, general statutory and common-law provisions exist to define the concept of protected, privileged communications. In general, "[t]he attorney-client privilege bestows upon a client a privilege to refuse to disclose and to prevent others from disclosing confidential communications made between the attorney and client in the course of seeking or rendering legal advice." *First Union Nat'l Bank of Delaware v. Maenle* (6th Dist.), 162 Ohio App. 3d 479, 2005-Ohio-4021, 833 N.E.2d 1279, at ¶ 28, *appeal dismissed*, 110 Ohio St. 3d 1240, 2006-Ohio-3820, 851 N.E.2d 507, *abrogated on other grounds, Jackson v. Greger* (2006), 110 Ohio St. 3d 488, 2006-Ohio-4968, 854 N.E.2d 487. Thus, a policyholder client who communicates privileged information to defense counsel may have the privilege to prevent its disclosure to others, including the insurer. The key concepts are whether the communication is confidential, whether it was made by a client, and whether it was made in the course of seeking or rendering legal advice.

As made clear in *Jackson v. Greger* (2006), 110 Ohio St. 3d 488, 2006-Ohio-4968, 854 N.E.2d 487, syl. 1, privilege issues involving attorney client communications in Ohio are governed by statute. "R.C. 2317.02(A) provides the exclusive means by which privileged communications directly between an attorney and a client can be waived." *Id.* (following *State v. McDermott* (1995), 72 Ohio St. 3d 570, 651 N.E.2d 985). Under *Jackson*, judicially created or implied waivers are no longer permitted. *Id.* at ¶ 12. The statute discusses privilege and waiver, in pertinent part, as follows:

> **2317.02 Privileged communications and acts**
>
> The following persons shall not testify in certain respects:
>
> (A) An attorney, concerning a communication made to the attorney by a client in that relation or the attorney's *advice* to a client, except that the attorney may testify by express consent of the client or, if the client is deceased, by the express consent of the surviving spouse or the executor or administrator of the estate of the deceased client and...if the client voluntarily testifies or is deemed by section 2151.421 of the Revised Code to have waived any testimonial privilege under this division, the attorney may be compelled to testify on the same subject;
>
> * * *

Thus, an attorney may not testify as to privileged matters, and may not disclose them to others, absent a waiver by the client as defined by this statute.

Rule 1.6 specifies an attorney's ethical duties with respect to client confidences, generally requiring that lawyers not disclose confidential or privileged information to others absent informed consent or implied authorization by the client.[2] This is common sense, and the thrust of this Rule is familiar to most attorneys. The difficulty arises in its application, which will vary from situation to situation. Defense counsel must always be mindful that there may be confidential information from the policyholder which cannot be shared with the insurer.

About the Author and Speaker

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[2] Rule 1.6 contains exceptions allowing disclosure of privileged information in limited circumstances. For example, Rule 1.6(b)(1) allows disclosure necessary to "prevent reasonably certain death or substantial bodily harm." Rule 1.6(b)(2) permits it if necessary to "prevent the commission of a crime by the client or other person." Rule 1.6(b)(4) permits it if necessary to allow the lawyer to secure ethics advice. Rule 1.6(c) *requires* counsel to disclose privileged information if reasonably necessary to prevent a court or other "tribunal" from being misled or defrauded.

coverage disputes as well as on business and commercial litigation. He has extensive experience with insurance policy analysis, bad faith claims, and damages analysis. In other commercial disputes, Rick's work often involves detailed analysis of business data, including accounting reports, marketing issues, profitability levels, and business valuation data. Rick participates frequently as a speaker on insurance coverage litigation, and in 2011, his insurance book was published through the Ohio State Bar Association (OSBA). It is entitled Ohio Insurance Law: Policy Analysis, Bad Faith, and Ethical Conflicts. It covers some of the finer points of Ohio insurance law while breaking down key principles and issues. For more information or to purchase the book, please visit the CLE Publications portion of the OSBA website. Email him at Richard.Porotsky@dinsmore.com.

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