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**ETHICAL DUTIES OF ATTORNEY SELECTED BY
INSURER TO REPRESENT ITS INSURED**

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Syllabus

A lawyer retained by a liability insurance carrier to defend a claim against the company's insured must represent the insured with undivided fidelity. For purposes of this opinion, that retention does not create an attorney-client relationship between the lawyer and the carrier. *See*, CBA Ethics Opinion 43 (December 13, 1969), which is supplemented by this opinion. The lawyer cannot ethically take any position which is potentially disadvantageous to the insured (or contrary to the insured's wishes even though not disadvantageous to the insured), even though that position may be advantageous to the carrier, except in situations that might exist by virtue of the insurance contract which may give the insurance company the right to control the defense or disposition of a claim.

Background

An attorney retained by an insurance company to represent its insured in the defense of a claim by a third party is typically paid by the insurance company. Nonetheless, the insured is the client to whom the lawyer's duty of loyalty is owed, regardless of the terms of any retention agreement the lawyer may have with the carrier.

The insurance company nevertheless requires from the attorney certain information about the insured and the facts of the case in order to exercise its decision-making powers in the handling of the defense. Thus, the attorney has an obligation to the carrier on behalf of the insured. This opinion does not address situations where the attorney is retained to represent the insurance company itself, except in those circumstances where the rights of an insured are involved.

The carrier controls the "purse-string" decisions, including what expenditures will be allowed for case preparation, settlement and cost of defense, including attorney fees. While the insured and the insurance company in general have a common interest, *i.e.*, the successful defense of a third-party claim, there may be times when the interests of the carrier and the insured diverge. Such differing interests may be found, for example, with respect to certain settlement negotiations, when the insured is represented under a reservation of rights, when the insured has a counterclaim against the third party, when some claims against the insured are covered by insurance and others are not, or when damages are sought in excess of policy limits.

The attorney's ethical duty is to assure that the interests of the insured are protected, while at the same time fulfilling the insured's contractual obligations to the carrier against a backdrop where the insurance company, by virtue of financing the defense, may effectively control the result and may have its own interests at stake.

The ethical issues raised by this unique relationship become even more complex when the retained attorney has an ongoing relationship with the carrier, is employed by the insurance company, or has certain fee agreements with the carrier whereby the lawyer's profitability is affected by the effort expended on the case. The individual insured, in contrast, usually requires relatively short-term representation.

Opinion**I. Introduction to the Tripartite Relationship**

An insurance company which is contractually bound to provide its insured a defense to a claim typically retains the attorney of its choice to defend that claim. "By virtue of the insurance contract, the insurer retains the absolute right to control the defense of actions brought against the insured. . . ."

Farmers Group, Inc. v. Trimble, 691 P.2d 1138, 1141 (Colo. 1984). Such a contractual provision has been construed as constituting consent by the insured for the carrier to select counsel for the defense. *Houston General Insurance Co. v. Superior Court*, 108 Cal.App.3d 958, 166 Cal.Rptr. 904 (1980). Notwithstanding these contractual rights of the carrier, the attorneys relationship to the insured is clear:

The intrusion of the insurance contract does not alter the fact that the relationship with the insured is that of attorney and client. Defense counsel owes the same unqualified loyalty as if he had been personally retained by the insured. . . . There is no diminishment in the ethical obligations and standard of care applicable to insurance defense counsel.

Mallen & Smith, *Legal Malpractice* (3d ed. 1989), § 23.3 at 365-367.

The nature of the relationship between the attorney and the insurance company is less clear. Some authorities hold there is no attorney-client relationship, while others hold that the carrier is a client of the attorney along with the insured. CBA Ethics Opinion 43 (December 13, 1969) makes clear that the insured is the client to whom the attorney's duty of loyalty is owed. The Colorado courts to date and the Colorado Rules of Professional Conduct ("the Rules") have not made clear whether the attorney represents both the insured and the carrier, or the insured alone. This Committee has concluded that in the context of this tripartite relationship, the better rule is that the lawyer's client is the insured and not the carrier.

ABA Informal Opinion 1476 (1981) asserts that "[w]hen a liability insurer retains a lawyer to defend an insured, the insured is the lawyers client." On the other hand, ABA Formal Opinion 282 (1950) claims that both the insured and the insurance company are clients (*i.e.*, the attorney is ethically obligated to represent the interests of each), but makes clear that the insured is the "primary" client. Under either analysis, if differing interests arise between the insurance company and the insured, the lawyer's ethical duty of undivided loyalty is owed only to the insured. *See*, B. Wunnicke, "The Eternal Triangle: Standards of Ethical Representation by the Insurance Defense Lawyer," *For the Defense* (Feb. 1989) at 9.

While there may be a split of authorities, under either approach the insured is unquestionably a client to whom the attorney owes the ethical duties owed to any client. The duties most significant to this opinion are the duty of loyalty, the duty to preserve the confidentiality of client information and the duty to advise the client concerning the client's legal interests.

Although the carrier is not a client simply by retaining the attorney to defend its insured, the lawyer has obligations to the insurance company on behalf of the insured arising out of the insurance contract and, where applicable, the Rules of Professional Conduct. The attorney may have a formal or informal retention agreement with the insurer. The attorney should honor the terms of that agreement to the extent it does not conflict with the attorney's ethical duties.

At the beginning of the representation, insurance defense counsel should make the nature and scope of the relationship clear (preferably in writing) to the carrier and the insured.

II. Duties to the Insured

A. Duty of Loyalty. It is well recognized that as a part of the attorney-client relationship, the attorney must represent the insured with undivided loyalty.

Rule 1.7(b) states:

A lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer's responsibilities to another client or to a third person, or by the lawyer's own interests, unless: (1) the lawyer reasonably believes the representation will not be adversely affected; and (2) the client consents after consultation. . . .

Rule 1.8(f) prohibits the lawyer from accepting compensation for legal services from anyone other than the client without the client's consent after full disclosure. Rule 1.8(f) also protects the insured's interests by requiring that a lawyer assure that the party paying the legal fees does not interfere with the lawyer's responsibility to exercise independent professional judgment or with the attorney-client relationship with the insured. Additionally, information relating to representation of the client must remain confidential as required by Rule 1.6.

Rule 5.4(c) provides that a lawyer shall not permit one who employs or pays the lawyer to represent another to “direct or regulate the lawyer’s professional judgment in rendering such legal services.”

The lawyer’s duty of loyalty and duty to exercise independent professional judgment on behalf of the insured may compel defense counsel to disagree with the insurer regarding the strategy or procedures to be followed in the case, even though the insurer is paying defense costs.

1. **Restrictions on Defense Costs.** The insurance company may attempt to restrict the amount of discovery conducted by the lawyer, refuse to authorize the retention of expert witnesses, or refuse to authorize other work in order to reduce litigation costs. If the attorney believes that some particular action is reasonably necessary to protect the interests of the insured, the attorney must so advise the insurer and request authority from the insurer to take the requested action and incur the related fees and costs. If the insurer declines, the attorney must advise the insured of the insurer’s decision and why the action is necessary or recommended. If the insured nevertheless requests the attorney to take such action, the attorney may request payment of the legal fees and costs from the insured and should advise the insured to seek independent counsel. If the insured and the insurer are unwilling or unable to make satisfactory arrangements, the attorney should determine whether it is permissible or mandatory to withdraw.

States which seemingly adopt the view that the insured and the carrier are both clients may require withdrawal in such circumstances. Alabama Ethics Opinion 87-146; North Carolina Ethics Opinion 112; Kentucky Ethics Opinion E-331 (September 1988).

In states where it is recognized that the attorney’s duty of loyalty is to the insured, even when the insurance contract provides that the carrier will control the insured’s defense, the attorney’s ethical duty is to inform the insured about proposed courses of action. Absent objection by the insured after a reasonable period of time, the insured is deemed to have given tacit consent to the express terms of the contract and proposed course of action. If the insured objects, the attorney is obligated to inform the insured of possible ramifications of taking the chosen position, including impact on coverage, and to follow the insured’s wishes. Alaska Ethics Opinion 90-2.

2. **Flat Fee Agreements.** In the context of the tripartite relationship, a discussion of the attorney’s loyalty to the insured is not complete without addressing flat fee arrangements between the carrier and the attorney. Typically, these agreements fall into two categories: (1) flat fee per case, and (2) flat annual retainer for all of a company’s work regardless of the number of cases. While the Rules do not prohibit these arrangements, attorneys entering into them must be mindful to comply with the Colorado Rules of Professional Conduct, specifically Rule 1.5 requiring that the fees be reasonable, Rule 1.8(e) requiring that costs remain ultimately the responsibility of the client (here, to be paid by the carrier under the insurance contract), and Rules 1.7 and 5.4(c) requiring that the lawyer maintain independent judgment with regard to representation of the client.

The Rules prohibit fee agreements “whose terms might induce the lawyer improperly to curtail services for the client or perform them in a way contrary to the client’s interest.” Comment to Colorado Rules of Professional Conduct, Rule 1.5 (“Fees”). Therefore, the lawyer cannot ethically limit representation of the insured in a way that promotes the insurance company’s interests to the detriment of the insured’s best interests. Although the lawyer working on a flat fee basis may have a financial interest in disposing of any given case as quickly as possible with the minimum amount of time and effort, this alone does not require withdrawal. The lawyer is required to withdraw only if that interest affects the lawyer’s independent judgment to the detriment of the insured.

B. Duty to Maintain the Confidentiality of Client Information. Rule 1.6 prohibits the attorney from revealing “information relating to representation of a client unless the client consents after consultation, except for disclosures that are impliedly authorized in order to carry out the representation. . . .” The comment to this rule indicates that it applies “not merely to matters communicated in confidence by the client but also to all information relating to the representation, *whatever its source.*” [Emphasis added].

While Rule 1.8 allows payment of fees by one other than a client, Section (f)(3) of the rule specifically requires the same protection of information relating to representation as that required by Rule 1.6.

The goal of Rule 1.6 is to assure that the client has confidential access to his or her attorney in order to facilitate communication and the successful disposition of the case. Whether or not information regarding the insured coincides with the interests of the carrier, the attorney's duty to preserve the confidentiality of that information requires the attorney to refuse to disclose certain information to the insurance company absent the insured's consent. *See, State Farm Mutual Ins. Co. v. Walker*, 382 F.2d 548, 552 (7th Cir. 1967); *Moritz v. Medical Protective Co.*, 428 F.Supp. 865 (W.D. Wis. 1977). *See also*, Morris, *Conflicts of Interest in Defending under Liability Insurance Policies*, 1981 Utah L.Rev. 457, 478-83. The principle supporting this view "is that the attorney does represent the insured and assumes all of the duties imposed by the attorney-client relationship." *Rogers v. Robson, Masters, Ryan, Brumund and Belom*, 74 Ill.App.3d 467, 392 N.E.2d 1365, 1372 (1979), *aff'd* 81 Ill.2d 201, 407 N.E.2d 47 (1980).

1. Disclosures Made Within the Attorney-Client Relationship. Where the insured discloses information to the attorney within the attorney-client relationship, the attorney cannot disclose that information to the carrier without the insured's express or implied consent. *See*, Rule 1.6(a). For example, an attorney retained by an insurance company to defend the insured against a third-party claim cannot disclose to the carrier facts that would eliminate the insured's coverage. Philadelphia Ethics Opinion 90-14. The attorney cannot risk disclosure of the insured's confidential information by allowing an employee of the insurance company to attend the attorney's interviews with the insured without the insured's informed consent. *See*, Kentucky Ethics Opinion E-340 (July 1990).

A more complex situation was the subject of New York County Ethics Opinion 669 (May 17, 1989). In that opinion, an attorney was retained by the carrier to represent both the insured-owner and the driver of an automobile. The opinion states that on learning that the driver did not have the owner's prior permission to drive the car [and assuming the exceptions cited in Rule 1.6(b) and (c) do not apply], the attorney may not disclose such information to the carrier absent the client's consent. However, according to the opinion, the attorney has an ethical duty to the owner to advise disclosure since failure to disclose may affect the owner's coverage under a cooperation clause. If the owner refuses to make the disclosure, the opinion states that the attorney should withdraw from representation of the owner since it would be impossible to adequately represent the owner's interests, but the attorney may not tell the carrier the reason for withdrawal.

2. Fraudulent Conduct. Even if the disclosed information involves perpetration of a fraud on the insurance company, the insured is still the client and the lawyer cannot disclose the information to the insurance company. However, the lawyer may neither assist the insured in fraudulent conduct [Rule 1.2(d)], nor use false evidence [Rule 3.3(a)(4)]. If the lawyer's services will be used to violate the Rules, withdrawal is mandatory pursuant to Rule 1.16(a)(1). The comment to Rule 1.6 states that the duty to maintain the confidentiality of the client's information continues even after the representation is terminated.¹

3. Disclosure of Information that is a Matter of Record. A more difficult situation arises when the attorney learns of information necessary to the carrier's evaluation of the case through the course of discovery, *i.e.*, the information becomes a matter of record not subject to the attorney-client privilege. The information may or may not be detrimental to the insured's coverage interests. Although the information may no longer be confidential, the attorney's duty of loyalty may limit disclosure.

a. Information Detrimental to Insured's Coverage. Where disclosure of the information is detrimental to the insured's coverage interests, but the failure to disclose may jeopardize coverage because of the insured's duty to cooperate in the defense of the lawsuit, the attorney must so advise the insured. If the insured consents, disclosure to the carrier should be limited to reporting the information or facts without advising the carrier of the potential effect on coverage. *See*, Oregon Ethics Opinion 1992-1.

If the insured does not consent to disclosure, the attorney should recommend that the insured retain separate counsel as to representation on the coverage issues. If separate representation is not obtained by the insured, the attorney cannot disclose the information without the insured's consent, even if the information is necessary to the carrier's evaluation of the case. Should the independent judgment of the attorney be compromised by the continued representation of the insured, the attorney should withdraw.

Under certain circumstances the attorney may find it necessary to disclose certain information to the insurer without the consent of the insured, such as the fact that the insured cannot be located.

b. *Information Not Detrimental to Insured's Coverage.* The attorney must decide whether or not disclosure of the information is "impliedly authorized to carry out the representation" under the insurance contract and, therefore, permitted unless the insured objects. The attorney may have an ethical duty to advise the insured of the intent to disclose the information to the carrier, along with any potential ramifications to the insured. Absent objection of the insured after a reasonable period of time, disclosure is permitted under Rule 1.6(a).

C. *Duty to Advise and Inform the Insured About Matters That May Affect the Insured's Interests, Rights and Obligations.* The lawyer's duty to inform the insured derives from the general rule stated in Rule 1.4:

(a) A lawyer shall keep a client reasonably informed about the status of a matter and promptly comply with reasonable requests for information.

(b) A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.

Even when the insured delegates authority in certain matters to the lawyer, the lawyer should advise the insured of the status of the matter, including legal ramifications of various courses of action or strategies. Comment to Rule 1.4. On request of the insured, the attorney should provide a copy of all correspondence between the attorney and the carrier concerning the case. North Carolina Ethics Opinion 90.

There are four situations where it is particularly important to inform and advise the insured:

1. *Settlement Offers.* The insured may be precluded by the insurance contract from interfering with settlement negotiations. *Farmers Group, Inc. v. Trimble, supra.* However, this does not abrogate the attorney's ethical duty to fully advise the insured of settlement negotiations and their ramifications. *Tank v. State Farm*, 105 Wash.2d 381, 715 P.2d 1133, 1138 (1986). Even if the attorney limits representation of the insured to those areas in which the insured has rights under the insurance contract and so advises the insured in advance, the insured should be advised of all settlement offers so that he or she can assert whatever rights or reputational interests may exist. *Compare*, Michigan Ethics Opinion CI-876 (June 9, 1983) (attorney need not communicate settlement offers to the insured if the insurance contract provides otherwise).

Certain insurance contracts give the insured the right to refuse or approve settlement. This is often the case with professional liability coverage, where there may be reputational or licensure ramifications of settlement. Where the insurance contract so provides, the attorney has an ethical duty to obtain specific authority from the insured to make, accept or refuse any settlement offer or demand.

The attorney's duty to maintain his or her independent judgment applies to settlement. The attorney may advise the insured and the insurer of the attorney's evaluation of the exposure and settlement value of the case. Although there may be potential ramifications for the insurance company, the attorney is well advised to document such advice in the interest of the insured. Where the insured wants the attorney to make a demand on the insurance company to pay policy limits where there is no basis to do so, the attorney should so advise the insured and advise the insured to seek independent counsel on that issue.

Other states' ethics opinions have addressed the role of the insurer in conducting settlement negotiations. In South Carolina, where the insurance company does not authorize the attorney to negotiate settlement, the attorney does not violate Rule 1.8(f) and Rule 5.4(c) by leaving settlement negotiations in the hands of the insurer so long as the negotiations are within policy limits. South Carolina Ethics Opinion 90-44. Kansas Ethics Opinion 91-05 (Dec. 10, 1991) imposes additional requirements that (1) the insured's interests must be known to and protected by the adjuster, (2) there are no known actual or potential conflicts of interest between the carrier and the insured, and (3) the insurance contract gives the insured no right to participate in or approve settlement offers. If these requirements are not met and the insured does not consent, the opinion states that counsel must advise the insured to retain separate counsel. If the insured fails to do so, according to the Kansas opinion, the attorney must follow the insured's directions,

so inform the carrier and keep the insured advised; continued refusal of the insurance company to honor the insured's wishes requires that the attorney withdraw.

Where there is uninsured exposure, the insured has a direct economic interest in the success of settlement negotiations. When there are significant issues of uninsured exposure (such as damages sought in excess of policy limits or uncovered claims), the defense counsel should so advise the insured and inform the insured that he or she has the right to retain independent counsel. The issues may be significant enough that counsel should recommend hiring independent counsel. *See*, North Carolina Ethics Opinion, No. 91. The insured should be advised that the issue of who pays for independent counsel should be discussed with independent counsel. Defense counsel should inform the insured regarding the carrier's position on such payment, if known to the lawyer.

2. Potential Counterclaims. To avoid loss of a counterclaim, insurance defense counsel should inform the insured about potential counterclaims to the extent necessary so the insured can decide whether to seek independent counsel.

Vermont Ethics Opinion 81-3 allows a plaintiff's attorney to defend the plaintiff's insurance company in a counterclaim filed by the defendant so long as careful attention is paid to DR 5-106 and EC 5-14 through EC 5-16.

Note that Rule 1.2(c) allows a lawyer to "limit the objectives of the representation if the client consents after consultation." The comment to this rule addressing representation of an insured states "[w]hen a lawyer has been retained by an insurer to represent an insured, the representation may be limited to matters related to the insurance coverage." A proper engagement letter with the insured could, under Model Rule 1.2(c) disclose that the attorney will not represent the insured on any counterclaims the insured may have.

Insurance defense counsel should, in most cases, recommend that another attorney pursue the counterclaim on the insured's behalf because of the potential for conflict between the insured and the insurance company. For example, if the insurance company desires to settle the case, but the insured wishes to pursue the counterclaim, a conflict would arise.

In dealing with separate counsel handling the counterclaim, the attorney defending the original claim should not take any action that is detrimental to the insured's interest in the counterclaim except that which is required to fulfill the insured's obligations under the insurance contract, unless the insured consents. If the insured does not consent to a proposed course of action after being advised of the potential ramifications under the policy, the attorney must follow the direction of the insured, or withdraw [*see*, Maryland Ethics Opinion 90-42 (July 2, 1990)].

3. Duties Where There are Multiple Covered and Non-Covered Claims or a Reservation of Rights. Often an attorney is retained by an insurance company to represent the insured in a case in which there is an issue as to coverage. Or, there may be multiple claims for relief, some of which might not be covered by insurance. Typically the insurance company advises the insured that it is providing a defense subject to a reservation of its rights to deny coverage as to those claims which may not be covered by the policy.

a. *Divergent Interests.* Defense counsel must be alert to ethical duties which prohibit actions by the attorney which favor the non-coverage interests of the carrier over the interests of the insured to establish coverage. Rules 1.7 and 5.4(c).

Rule 1.7(b) of the Colorado Rules of Professional Conduct states the general rule as follows:

(b) A lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer's responsibilities to another client or to a third person, or by the lawyer's own interests, unless:

- (1) the lawyer reasonably believes the representation will not be adversely affected; and
- (2) the client consents after consultation. 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.

The existence of a coverage question should not be allowed to interfere with the lawyer's duty to exercise independent professional judgment on behalf of the insured. Rules 1.8(f) and 5.4(c). Should a potential coverage issue arise, the attorney owes to the insured, as the client, full advice as to the potential conflict and its ramifications. *Tank v. State Farm, supra*, at 1137. This duty would include providing information to the insured that liability limits under the policy include defense costs and the amount of such costs incurred to date, if the policy so provides. Reporting to the insured about the status of settlement negotiations may be particularly critical when the insured is a professional corporation with a liability limit which includes defense costs; the shareholders may incur unexpected personal liability exposure because of depletion of indemnity coverage through expenditure of defense costs.

The attorney retained by the carrier may not defend the insured and at the same time exploit the attorney-client relationship in order to build a case of non-coverage. *See, Ashley, Bad Faith Action: Liability and Damages*, § 10:51 at 65 (1984); *Allstate Ins. Co. v. Keller*, 17 Ill.App.2d 44, 149 N.E.2d 482, 486 (1958). Where a declaratory judgment action and the third party claim are pending simultaneously, the interests of the insured must be protected. What action is appropriate, if any, depends on the circumstances of the case.

Whether a coverage question creates a conflict of interest depends on an assessment of the facts of each particular case. If the attorney determines that the interests of the insured and insurer "will be directly adverse to one another" or that the lawyer's representation of the insured "may be materially limited" by the lawyer's responsibilities to the insurance company, the lawyer would be prohibited from representing both the insured and the insurer and should recommend that both retain separate counsel on the coverage issue.

The duty to the client is always of primary concern. Thus, where the insurer has a duty to defend and pay on one claim only, the attorney cannot file a motion to dismiss or for summary judgment on the only covered claim, effectively leaving the insured without coverage on the remaining claim(s). *See, Farmers Group, Inc. v. Trimble, supra*; Oregon Ethics Opinion 1991-121 [citing, *Arana v. Koerner*, 735 S.W.2d 729, 733 (Mo. App. 1987); *Barmat v. John and Jane Doe Partners A-D*, 155 Ariz. 519, 747 P.2d 1218 (1987)]. Neither can the attorney resist an amendment to the pleadings which would increase exposure within liability limits but improve the insured's chance for coverage under the policy, unless the insured consents after full disclosure.

b. *Mutuality of Interest*. In most situations the objectives of the insurance company and the insured are parallel, *i.e.*, a successful defense of the lawsuit. This mutuality of interest has been extended to permit simultaneous representation of both the insured and the subrogated interests of the carrier in personal injury claims against third parties. Alabama Ethics Opinion 84-03.

4. Disclosures Required if Attorney's Firm is Retained by a Carrier on Numerous Cases or is Employed by Carrier. No conflict exists where attorneys handle a number of cases for insureds of one carrier. *See, Iowa Ethics Opinion 90-48*. However, a lawyer who has represented or is representing the insurance company in other matters must evaluate on a case-by-case basis whether the facts of the case present sufficient danger of a conflict of interest between the insured and the carrier to warrant disclosure to the insured. *See, Rule 1.7(b)*. An attorney should be careful not to take any action that misleads the insured into believing that the attorney has a relationship with the insurer other than that which actually exists.

In making the decision whether to disclose such other work performed for the insurer, the attorney should consider the factors set forth in this opinion, including the possibility of a judgment over the policy limits, the likelihood of conflict over terms of settlement and the likelihood of disputes over the scope of discovery. The duty to disclose may arise at any point in the representation, and the disclosure must be made by the attorney at the earliest possible time. 7 *CJS, Attorney and Client*, § 151; *Allstate Ins. Co. v. Keller, supra*; *Hawkins v. State Bar*, 23 Cal. App. 3d 622, 591 P.2d 524, 153 Cal. Rptr. 234 (1979); *Employers Casualty Co. v. Tilley*, 496 S.W.2d 552 (Texas 1973). The attorney's duty is to inform the insured not only of the facts giving rise to the potential conflict of interest, but also the legal implications of the conflict, including the possibility that the attorney will be required to withdraw from representation.

Disclosure of the attorney's relationship to the insurer is particularly important for in-house counsel. The term in-house counsel includes attorneys who are salaried employees of an insurer, whether or not the attorneys hold themselves out as a separate law firm. The ethical duties established by the Rules do not prevent representation of insureds by in-house attorneys employed by the insurer. *See*, California Ethics Opinion 1987-91, Connecticut Informal Ethics Opinion 87-13, Illinois Ethics Opinion 89-17, Iowa Ethics Opinion 88-14 and Philadelphia Ethics Opinion 86-108. However, the same ethical considerations and potential conflicts exist for in-house defense counsel as for private defense counsel. Both private and in-house defense counsel must defend the insured with undivided loyalty and must preserve the confidences of the insured. *See generally*, Mallen & Smith, *Legal Malpractice* (3d ed. 1989), § 23.7; Mallen, *A New Definition of Insurance Defense Counsel*, *Insurance Counsel Journal*, Jan. 1986 at 108; Edwards, *Survey of Developments in North Carolina Law*, 1986; *Professional Responsibility*, 65 N.C. L.Rev. (Aug. 1987) at 1422; *In re Allstate Insurance Co.*, 722 S.W.2d 947 (Mo. 1987); *Coscia v. Cunningham*, 250 Ga. 521, 299 S.E.2d 880 (1983); *Seiberg-Oxidermo v. Shields*, 430 N.E.2d 401 (Ind. App. 1982), *aff'd* 446 N.E. 2d 332 (Ind. 1983); *In re Rules Governing Conduct of Attorneys in Florida*, 220 So.2d 6 (Fla. 1969); and *Joplin v. Denver-Chicago Trucking Co.*, 329 F.2d 396 (8th Cir. 1964). In-house counsel should not, for example, advise the insurer regarding coverage and simultaneously defend the insured. *See generally*, Mallen, *supra*; Edwards, *supra*; *Professional Responsibility*, *supra*; *In re: Allstate Insurance Company*, *supra*; *Coscia v. Cunningham*, *supra*; *Seiberg-Oxidermo v. Shields*, *supra*; *In re: Rules Governing Conduct of Attorneys in Florida*, *supra*; and *Joplin v. Denver-Chicago Trucking Co.*, *supra*.

With the exception of the Supreme Court of North Carolina, *Gardner v. North Carolina State Bar*, 341 S.E.2d 517 (N.C. 1986), the courts which have analyzed the role of in-house counsel in defending insureds have concluded that such representation is permissible, within certain limits. The corporate environment must not restrict or imperil the ability of staff counsel to comport with the ethical requirements. *Mallen & Smith*, *supra*, at 380; Mich. St. B. Comm. on Prof. and Judicial Ethics, Opinion CI 1146 (June 1986). The structure of the staff counsel department should be designed to achieve an independence of judgment comparable to that of outside counsel.

An ethical opinion in Virginia has imposed the affirmative duty on in-house counsel to inform the insured of the employment relationship with the insurer and to obtain the insured's consent to the representation. Virginia St. B. Standing Comm. on Legal Ethics, Opinion 598 (1985). Although not stating the analysis in terms of the ethical duties of the in-house lawyer, the court in *Kaudern v. Allstate*, 277 F.Supp. 83, 91 (D.N.J. 1967), criticized the insurer's failure to disclose to the insured that the defense was being provided by the insurer's house counsel. The Supreme Court of Georgia in *Coscia v. Cunningham*, *supra*, at 881, n. 1, also implicitly criticized the failure to advise the insured of the method by which the attorney was compensated by the insurer.

For the purposes of this opinion a law firm whose practice consists exclusively of defense work for one insurance company is bound by the same ethical rules as in-house counsel. Additionally, these firms must take care to comply with Rules 7.1 and 7.5, which prohibit misleading communications with respect to the lawyer's services and the use of letterhead. California Ethics Opinion 1987-91 and Nassau County, New York Bar Association Ethics Opinion 89-41 equate this type of law firm with an "in-house counsel" arrangement.

It should be noted that the Supreme Court of Missouri expressly limited its approval of the use of house counsel to situations where "there is no question of coverage and when the claim is within the policy limits." *In re Allstate*, *supra*, at 951. The court concluded that the assignment of house counsel to defend claims against the insured would not introduce impermissible conflicts of interest, but limited that approval to situations where "only the insurer's money is involved." If house counsel were used in other situations, the court commented that such activity "could be challenged in appropriate proceedings." 722 S.W.2d at 952. The court went on to confirm that "employed lawyers are bound by the same rules of professional conduct as are independent practitioners. . . . There is no basis for a conclusion that employed lawyers have less regard for the rules of professional conduct than private practitioners do." 722 S.W.2d at 953. *See also*, Iowa Ethics Opinion 88-14.

III. Waiver or Consent to Certain Conflicts

Some conflicts of interest can be waived by the insured after full disclosure. As discussed in Section II(B) above, an informed insured may consent to disclosure of matters which otherwise would be protected under Rule 1.6(a) of the Colorado Rules of Professional Conduct. *See, Matter of Farr*, 340 N.E.2d 777 (Ind. 1976). *Fulton v. Woodford*, 545 P.2d 979 (Ariz.App. 1976) holds that representation under a reservation of rights is a conflict that may be waived by informed client consent. *Compare*, Oregon Ethics Opinion 1991-77 (an attorney who offered an opinion to the carrier that it could defend under a reservation of rights cannot subsequently represent the insured).

One area where significant problems may arise is when a lawyer is asked both to render a coverage opinion and to defend an insured in the tort case. The lawyer cannot ethically perform both services at the same time, since the insured's representation may be materially limited by the lawyer's responsibilities to the carrier. Rule 1.7(b). If the lawyer is first asked only to analyze coverage and finds that there is coverage for some or all of the claims, then after that coverage analysis is concluded the lawyer may defend the insured at the request of the carrier, provided both the insured and the carrier consent after consultation. Once the coverage analysis concludes, the carrier becomes a "former client" regarding that analysis, and the restrictions of Rule 1.9 apply. In all situations where the lawyer first analyzes coverage and later is asked to defend the insured, the lawyer must determine that the defense of the insured is not "materially limited by the lawyer's responsibilities" to the carrier as a result of doing the earlier work on coverage.

The lawyer may obtain the consent of the insured to proceed with the representation notwithstanding a conflict, but in some situations even a waiver will not solve the ethical concern. An insured may not waive a conflict and allow continued representation if the attorney recognizes a divided duty of loyalty between an insured and the insurer.

Rule 1.7(c) states the general rule as to non-waivable conflicts as follows:

- (c) For the purpose of this Rule, a client's consent cannot be validly obtained in those instances in which a disinterested lawyer would conclude that the client should not agree to representation under the circumstances of the particular situation.

In these situations, the lawyer is obligated to decline representation or, if representation has already been commenced, to withdraw. Rule 1.16. *See, Nassau County, New York Ethics Opinion 90-29* (attorney cannot represent the carrier in a subrogation matter and in a separate no-fault action against the insured, who is the real party in interest in the subrogation matter). Where there is actual adversity, one attorney cannot adequately represent the interests of the insured. *Sapienza v. New York News, Inc.*, 481 F.Supp. 676 (S.D.N.Y. 1979).

For example, when the insurer has filed a declaratory judgment action seeking to establish lack of coverage, the attorney defending the insured in the third-party claim cannot ethically represent the insurer in the declaratory judgment action. *See, New Jersey Ethics Opinion 502* (September 23, 1982). In these circumstances, it is clear that the attorney *cannot* adequately represent the interests of the insured. Moreover, in the course of representing the insured, the attorney may have come into possession of information that would affect the insured's coverage. Regardless of whether the source of the information is the insured or the attorney's own investigation, such information cannot be later divulged by the attorney to justify non-coverage. *See, Parsons v. Continental Nat'l American Group*, 550 P.2d 94 (Ariz. 1976).

If a non-waivable conflict arises, the insurance defense attorney must withdraw. In addition, if the consent of both the insured and insurer cannot be obtained where a waivable conflict exists, the attorney must withdraw from representing the insured. *Hamilton v. State Farm Ins. Co.*, 9 Wash.App. 180, 511 P.2d 1020 (1973); *aff'd* 83 Wash.2d 787, 523 P.2d 193 (1974).

IV. Limited Exceptions by Virtue of the Insurance Contract

Absent a provision in the insurance contract to the contrary, the insurance company has the right to control the defense of a third party claim against its insured. *Farmers Group, Inc. v. Trimble, supra*. It is the insurance contract which guides the attorney in determining what obligations are owed to the insurance company on behalf of the insured. Typically, these obligations derive from general clauses found in most

insurance policies, such as the insured's agreement to cooperate with the insurance company in the defense of the case. There may be other more specific clauses which either create an obligation for the insured or grant specific rights to the carrier which the insured has waived. *See, e.g.*, North Carolina Ethics Opinion 118 (the attorney is permitted to grant an extension of the statute of limitation without consent of the insured if the insurance contract specifically gives the carrier the authority to waive affirmative defenses).

If the scope of the attorney's representation of the insured is limited pursuant to Rule 1.2 to those issues arising out of the insurance contract, the attorney's duty is to inform the insured of all significant matters which are the subject of the attorney's correspondence with the insurance company and the proposed course of action, along with the ramifications of such actions. Absent objection from the insured after a reasonable period of time, the attorney may embark on the disclosed course of action since the insured has assented that these are objectives of the representation as set forth in Rule 1.2 or has "impliedly" consented to a proposed disclosure as addressed in Rule 1.6.

Other duties owed to the insurance company derive directly from the Colorado Rules of Professional Conduct concerning the lawyer's duties to third parties. Rule 4.1 requires that the lawyer be truthful in statements to the insurer. Rule 1.5 requires that the lawyer's fees be reasonable and for work necessary to the representation.

Thus, the lawyer's utmost concern is the ethical representation of the insured, who is the client. Nonetheless, the lawyer must also be mindful of his or her obligations to the insurance company, whether they derive on behalf of the insured out of the insurance contract or from the Colorado Rules of Professional Conduct.

2013 Addendum

Following the issuance of Opinion 91, the Supreme Court repealed and reenacted all of the Colorado Rules of Conduct (Colo. RPC or Rules), effective January 1, 2008. Fundamentally, the reenacted Rules do not change the duties an attorney owes to the client, and perhaps to the third-party payor. The current Rules, however, do make some important changes relative to what constitutes "informed consent" and the process of securing a client's consent within this tripartite relationship. The current Rules use the term "informed consent" instead of "consent after consultation." Under the repealed Rules, "consultation" required only "communication of information reasonably sufficient to permit the client to appreciate the significance of the matter in question." Although the American Bar Association Ethics 2000 Committee has stated that it intended no substantive change by replacing "consent after consultation" with "informed consent," the current requirement of "informed consent" "denotes the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct." Colo. RPC 1.0(e).

As discussed in the original Opinion, obtaining the client's consent (now informed consent) is of paramount importance within the tripartite relationship of insurer, insured, and counsel. For example, the lawyer must obtain the client's informed consent in order to accept fees from the insurance company or third party, Colo. RPC 1.8(f); to represent the client on less than all the issues in a particular litigation, Colo. RPC 1.2(c); to disclose client information to the insurance company or third-party payor, Colo. RPC 1.6(b); and to deal with conflicting or divergent interest between the paying party and the client regarding settlement or other issues, Colo. RPC 1.7(b).

Comment [6] to Rule 1.0 indicates that the crux of "informed consent" is that "the lawyer must make reasonable efforts to ensure that the client or other person possesses information reasonably adequate to make an informed decision." Current Rule 1.4(a)(1) also requires the lawyer to "promptly inform the client of any decision or circumstance with respect to which the client's informed consent . . . is required[.]" In circumstances where the Rules require informed consent, the mere communication of information by the lawyer is not sufficient; the client must actually give the required informed consent. Actually, if the representation involves a concurrent conflict of interest between the client and the insurer

or other third-party payor, the consent must be confirmed in writing. Colo. RPC 1.7(b)(4). These rule changes emphasize the need for full communication and candid explanation.

Additionally, the original Opinion states: "Even if the disclosed information involves perpetration of a fraud on the insurance company, the insured is still the client and the lawyer cannot disclose the information to the insurance company." However, current Rule 1.6 recognizes circumstances under which a lawyer may disclose fraudulent conduct of the client to the insurance company. In particular, Rule 1.6(b)(3) authorizes (but does not require) a lawyer to reveal information relating to the representation of the client which the lawyer "reasonably believes [is] necessary . . . to prevent the client from committing a fraud that is reasonably certain to result in substantial injury to the financial interests or property of another [including an insurance company] and in furtherance of which the client has used or is using the lawyer's services." Rule 1.6(b)(4) provides that a lawyer may reveal information relating to the representation of the client which the lawyer "reasonably believes [is] necessary . . . to prevent, mitigate or rectify substantial injury to the financial interests or property of another [including an insurance company] that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services."

Similarly, a lawyer may be required to disclose to a tribunal information that would otherwise be protected by Colo. RPC 1.6 in order to remedy a prior offering of false evidence. *See* Colo. RPC 3.3(a)(3); CBA Formal Op. 123, "Candor to the Tribunal and Remedial Measures in Civil Proceedings" (2011).

NOTE

1. *Compare*, Alabama Ethics Opinion 90-99, where the policy was procured by fraudulent conduct of the insured and a third party after the occurrence of the event triggering coverage. According to the opinion, the attorney, who was considered to represent both the insured and the insurer, must withdraw pursuant to Rule 1.16 if the client refuses to disclose the fraudulent act or the lawyer does not make limited disclosure. The Alabama opinion stated that under Rule 1.6 the lawyer is "impliedly" authorized to disclose the existence of an insurance question and to request separate counsel for the insured with regard to coverage.