REVISITING THE TRI-PARTITE RELATIONSHIP BETWEEN AN INSURANCE CARRIER, A POLICYHOLDER, AND AN INSURANCE DEFENSE ATTORNEY

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It is 6:00 p.m. on a Thursday, and Lisa is driving her son to basketball practice. At the same time, Josh is driving back home after a long day of work. Josh gets a phone call from his wife. He takes his eyes off the road and leaves one hand on the steering wheel while the other picks up the phone. In the few seconds that it takes to do so, he does not see that the light turned red and that Lisa's car is proceeding on the road perpendicular to him. Inevitably, he T-bones Lisa. Josh reports the accident to his insurance, confesses that he was at fault, and is told his insurance will take care of it since he has "full coverage."

While Josh is uninjured, Lisa cannot say the same. Lisa, a hardworking single mother, begins to suffer persistent headaches, neck and back pain caused by severe whiplash. She is left with permanent nerve damage that leaves her unable to work and provide for her children. Lisa tells the insurance company about her situation and requests payment of the limit of the insurance policy—not wanting to sue her neighbor. But the insurance company ignores Lisa and refuses to pay their policy limit.

Years later, Lisa finds an advocate to take her situation seriously. That lawyer demands full and fair compensation and trial by jury. Josh receives a certified letter in the mail. Josh opens it, sees a copy of the lawsuit, and wonders, "That crash hasn't been taken care of?" With a quick call to his insurance, he has a lawyer who says they will take care of everything.

This complex scenario is common in any city across the country. The relationship created when an insurance carrier (hereinafter insurer) hires an attorney to represent a policyholder (hereinafter insured) is known as the tripartite relationship. The tripartite relationship between an insurer, a defense attorney, and an insured poses various ethical dilemmas. This Article examines the tripartite relationship and provides a close look at ethical issues such as the dual client doctrine and the duties owed to specific parties. Additionally, this Article reviews the applicable ethics rules governing defense attorneys in the tripartite relationship, which gives rise to debate and serious

questions of loyalty for the attorney.[1] Finally, this Article concludes with a proposed solution to the conflicts arising out of the tripartite relationship.

I. EXPLANATION OF THE TRI-PARTITE DILEMMA

Generally, in a standard liability insurance policy, the insurer pays up to the coverage limits all amounts that the insured is legally obligated to pay to a third party for damages caused by an accident.[2] A standard liability insurance policy binds the insurer to provide its insured with a defense.[3] "Most policies promise that the insurer will defend 'any suit against an insured alleging damage within the scope of the policy even if such suit is groundless, false, or fraudulent.'"[4] Additionally, a policy typically "reserves to the insurer the right to settle" and exercise "broad control over the litigation."[5]

After a lawsuit is filed, the insurer employs defense counsel to protect the insured's interests. The defense counsel is selected from a group of firms who have a business relationship with the insurer, resulting in the creation of a tripartite relationship.[6] The unique tripartite relationship can create various conflicts of interest, putting the insurer's duty to defend and its right to control the litigation at odds.[7]

II. OVERVIEW OF THE PROBLEM: WHO IS THE CLIENT?

Conflicts arise from an insurer's duty to defend. Generally, the insurer's duty to defend is broad, as the insurer owes its insured a defense to any allegation in the complaint that is potentially

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[1] Amber Czarnecki, *Ethical Considerations Within the Tripartite Relationship of Insurance Law—Who Is the Real Client?*, 74 DEF. COUNS. J. 172 (2007).
[2] Douglas R. Richmond, *Walking a Tightrope: The Tripartite Relationship Between Insurer, Insured, and Insurance Defense Counsel*, 73 NEB. L. REV. 265 (1994).
[3] *Id.* at 265.
[4] *Id.* at 266 (quoting ROBERT H JERRY, II, UNDERSTANDING INSURANCE LAW 561 (1987)).
[5] *Id.*
[6] *Id.*
[7] *Id.* at 267.

covered by the policy.[8] Additionally, the insurer has a contractual right to control its insured's defense.[9] Included in this right is the insurer's ability to employ a defense attorney of its choosing. By selecting counsel of its choice, the insurer can economically and effectively defend claims and participate in strategic and settlement decisions.

However, this dynamic creates the potential for various conflicts of interest and sets the stage for the dual client doctrine. Only in the insurance defense context are parties routinely represented by counsel selected and paid for by a third party whose interests may differ from those of the individual that the attorney was hired to defend.[10] The dual client doctrine refers to insurance defense counsel having two clients in any given case: the insurer and the insured.[11] Thus, the defense counsel is left to wonder whether they have one or two clients and what duties are owed to whom, resulting in potential conflict.[12]

The conflicts presented by the dual client doctrine "rest on the premise that insurance defense counsel cannot loyally represent the insured in any situation posing an actual or potential conflict of interest with the insurer."[13] The close economic and personal relationships between defense attorneys and insurers can reduce insureds' interests in particular cases. This problem is aggravated by the defense attorney's ongoing relationship with an insurer—fueled by a desire for future business—but the limited relationship with the insured to the defense of a single case.[14]

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[8] Buss v. Superior Ct., 939 P.2d 766, 773 (Cal. 1997); Farmland Mut. Ins. Co. v. Scruggs, 886 So. 2d 714, 719 (Miss. 2004); Westlake Vinyls, Inc. v. Goodrich Corp., 518 F. Supp. 2d 902, 915 (W.D. Ky. 2007); Turk v. TIG Ins. Co., 616 F. Supp. 2d 1044, 1049 (D. Nev. 2009); Downhole Navigator, L.L.C. v. Nautilus Ins. Co., 686 F.3d 325, 328 (5th Cir. 2012); Pub. Risk Mgmt. of Fla. v. One Beacon Ins. Co., 569 F. App'x 865, 870 (11th Cir. 2014); Saarman Constr., Ltd. v. Ironshore Specialty Ins. Co., 230 F. Supp. 3d 1068, 1075–76 (N.D. Cal. 2017).

[9] Nat'l Cas. Co. v. Forge Indus. Staffing Inc., 567 F.3d 871, 874 (7th Cir. 2009); Gafcon, Inc. v. Ponsor & Assocs., 98 Cal. App. 4th 1388, 1407 (2002); Downhole Navigator, L.L.C., 686 F.3d at 328 (under Texas law, it is "well-settled that an insurer's 'right to conduct the defense includes the authority to select the attorney who will defend the claim and to make other decisions that would normally be vested in the insured as the named party in the case.'").

[10] Richmond, *supra* note 2, at 286.

[11] *Id.* at 270.

[12] Czarnecki, *supra* note 1, at 172–73.

[13] Richmond, *supra* note 2, at 270.

[14] *Id.* at 270–71.

A defense counsel may adhere to either of three representation theories to resolve who the client or clients are on a particular matter. These theories include (1) considering the insured as the sole client, (2) considering both insured and insurer as clients, and (3) representing both until there is a conflict, at which point the insurer is no longer a client.[15]

III. INSURANCE COMPANY OBLIGATIONS OWED TO ITS INSURED

Independent of what theory of representation is adopted by the defense counsel, there are other clear duties of the parties in the relationship. Generally, the insured owes the insurer the duty to give notice of all claims and to cooperate with the investigation, defense, and settlement of such.[16] The duties owed to the insurer by the defense counsel are found in the insurance policy and typically involve notice, reporting, and claim-handling requirements.[17]

The insurer owes its insured particular obligations, both in first-party and third-party claims. The relationship between an insured and the insurer implies confidence since "[a] consumer buys insurance for security, protection, and peace of mind."[18] Therefore, the insurer "is under a duty to negotiate with its insureds in good faith and to deal with them fairly."[19] The insurer's obligations to its insured flow from the "implied covenant of good faith and fair dealing in every contract that neither party will do anything which will injure the right of the other to

[15] *See infra* text accompanying note 90.
[16] Czarnecki, *supra* note 1, at 179.
[17] *Id.*
[18] Ainsworth v. Combined Ins. Co., 763 P.2d 673, 676 (Nev. 1988).
[19] *Id.*

receive the benefits of the agreement."[20] These obligations are also rooted in the fiduciary-like relationship that emanates from insurance transactions.[21]

The insurer has three primary duties: (1) investigate claims reasonably and properly,[22] (2) provide a defense if the potential for liability exists,[23] and (3) attempt to effect—on a timely basis—reasonable settlements of third-party claims within policy limits.[24] Embedded in these duties, the insurance company must consider the insured's interests.[25]

a. <u>The Insurance Company Must Investigate Claims Reasonably and Properly</u>

Courts have held that the duty to investigate a claim is an extension of the duty of good faith and fair dealing; thus, the investigation's adequacy is critical to the insurer's duty of good

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[20] Comunale v. Traders & Gen. Ins. Co., 328 P.2d 198, 200 (Cal. 1958); Egan v. Mut. of Omaha Ins. Co., 620 P.2d 141, 145 (Cal. 1979) ("In addition to the duties imposed on contracting parties by the express terms of their agreement, the law implies in every contract a covenant of good faith and fair dealing."); Hartman v. Est. of Miller, 656 N.W.2d 676, 680 (N.D. 2003) ("An insurer has a duty to act fairly and in good faith in dealing with its insured, including a duty of fair dealing in paying claims, providing defenses to claims, negotiating settlements, and fulfilling all other contractual obligations.").

[21] Nebraska courts have not fully recognized a fiduciary duty, but in some cases they have acknowledged such duty. *See* Braesch v. Union Ins. Co., 237 Neb. 44, 464 N.W.2d 769 (1991) (acknowledging that the Nebraska Supreme Court has supported the proposition that the insurer assumes a fiduciary position toward the insured), *overruled by* Wortman by & Through Wortman v. Unger, 254 Neb. 544, 578 N.W.2d 413 (1998)); Metro Renovation Inc. v. Allied Grp., Inc., 389 F. Supp. 2d 1131, 1134 (D. Neb. 2005) (noting that when the insurer takes on additional responsibility to protect the insured from third-party claims, such as assuming the responsibility of controlling litigation, a fiduciary relationship may be implied). Other jurisdictions have recognized a fiduciary duty. *See* Freeman v. Leader Nat'l Ins. Co., 58 S.W.3d 590, 598 (Mo. Ct. App. 2001) (holding that an insurer's right to control settlement and litigation under a liability insurance policy creates a fiduciary relationship between insurer and insured); Prosser v. Leuck, 592 N.W.2d 178 (Wis. 1999) ("By entering into an insurance contract and taking control of settlement or litigation the insurer assumes a fiduciary duty on behalf of the insured."); Asermely v. Allstate Ins. Co., 728 A.2d 461, 464 (R.I. 1999) (noting that the insurer's duty is a fiduciary obligation to act in the best interests of the insured); Purscell v. TICO Ins. Co., 790 F.3d 842 (8th Cir. 2015); *see also* Steven Plitt, *Are UM/UIM Insurers Obligated to Advance to Their Insureds Undisputed Partial Payments Before Total Claim Value is Determined?*, 36 INS. LITIG. REP. 49, 49 (2014) ("The insurance company's obligation to exercise good faith in evaluating and negotiating third-party claims against its policyholder/insured, is based on the insurance policy's implied covenant of good faith and fair dealing or upon a fiduciary-like relationship that emanates from the insurance transaction.").

[22] *Ainsworth*, 763 P.2d at 676 (insurer must fairly and thoroughly investigate the claim); Walz v. Fireman's Fund Ins. Co., 556 N.W.2d 68, 70–71 (S.D. 1996); Shade Foods, Inc. v. Innovative Prods. Sales & Mktg., Inc., 93 Cal. Rptr. 2d 364 (Cal. Ct. App. 2000); KPFF, Inc. v. Cal. Union Ins. Co., 66 Cal. Rptr. 2d 36, 45 (Cal. Ct. App. 1997) (stating that the insurer's duty to investigate arises from the covenant of good faith and fair dealing implied in all insurance contracts).

[23] Buss v. Superior Court, 939 P.2d 766, 773 (Cal. 1997); Truck Ins. Exch. v. Vanport Homes, Inc., 58 P.3d 276, 281 (Wash. 2002).

[24] *Comunale*, 328 P.2d at 200.

[25] *Egan*, 620 P.2d at 145.

faith.[26] A reasonable and proper investigation into the insured's claims must always be full, fair, and thorough.[27] During the investigation, the insurer must diligently search for evidence that supports its insured's claim. If it seeks to discover only evidence that defeats the claim, it holds its interest above that of the insured.[28] The insurer cannot ignore evidence supporting the claim or elect to focus on just those facts it contends support denial; instead, it must weigh all evidence that might establish coverage.[29] Denying a claim on a basis unfounded in the facts, or contradicted by facts known to the insurer, is unreasonable.[30] Consequently, the insurer acts in bad faith when it fails to fairly and adequately investigate a claim.[31]

b. <u>The Insurance Company Must Provide a Defense if the Potential for Liability Exists</u>

The insurer's "duty to defend arises when a lawsuit has been filed."[32] The duty to defend is broad, given that it is trigged by arguable coverage.[33] An insurer must defend if the policy potentially covers any allegation in the complaint against its insured.[34] In some jurisdictions, courts have held that allegations against the insured are to be liberally construed in favor of triggering the insurer's duty to defend.[35] The Nebraska Supreme Court has held that "in determining its duty to

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[26] *Shade Foods, Inc.,* 93 Cal. Rptr. 2d at 386 (Cal. Ct. App.2000); Physicians Ins. Co. of Wis., Inc. v. Williams, 279 P.3d 174, 181 n.7 (Nev. 2012).
[27] Jordan v. Allstate Ins. Co., 56 Cal. Rptr. 3d 312, 320 (Cal. Ct. App. 2007).
[28] Mariscal v. Old Republic Life Ins. Co., 50 Cal. Rptr. 2d 224, 225 (Cal. Ct. App. 1996); Wilson v. 21st Century Ins. Co., 171 P.3d 1082, 1087 (Cal. 2007) ("The insurer may not just focus on those facts which justify denial of the claim.").
[29] *Wilson*, 171 P.2d at 1087.
[30] *Id.*
[31] Walz v. Fireman's Fund Ins. Co., 556 N.W.2d 68, 70–71 (S.D. 1996).
[32] Chief Indus., Inc. v. Great N. Ins. Co., 268 Neb. 450, 460, 683 N.W.2d 374, 382 (2004).
[33] Lockwood Intern., B.V. v. Volm Bag Co., Inc., 273 F.3d 741, 746 (7th Cir. 2001); Federated Serv. Ins. Co. v. All. Const., LLC, 282 Neb. 638, 644, 805 N.W.2d 468, 474–75 (2011); Behrens v. Arch Ins. Co., 631 F.3d 895, 898–99 (8th Cir. 2011) ("An insurer's duty to defend is separate from, and broader than, the duty to indemnify.").
[34] Buss v. Superior Ct., 939 P.2d 766, 773 (Cal. 1997); Truck Ins. Exch. v. Vanport Homes, Inc., 58 P.3d 276, 281 (Wash. 2002).
[35] Ramara, Inc. v. Westfield Ins. Co., 814 F.3d 660, 673 (3d Cir. 2016); Osborne Constr. Co. v. Zurich Am. Ins. Co., 356 F. Supp. 3d 1085, 1091 (W.D. Wash. 2018); Amazon.com v. Am. Dynasty Ins. Co., 85 P.3d 974, 976 (Wash. Ct. App. 2004) ("If the complaint is ambiguous, it will be liberally construed in favor of triggering the insurer's duty to defend.").

defend, an insurer must look beyond the complaint and investigate and ascertain the relevant facts from all available sources."[36]

c. The Insurance Company Must Attempt to Effect—on a Timely Basis—Reasonable Settlements of Third-party Claims Within Policy Limits

Comunale established that "the implied obligation of good faith and fair dealing requires the insurer to settle in an appropriate case although the express terms of the policy do not impose such a duty."[37] Moreover, an insurer breaches the "implied covenant by unreasonably failing to accept a settlement offer within the policy limits."[38] This is because the insured has a legitimate right to expect that "the method of settlement within policy limits" will be used to protect him or her from liability.[39]

Bamford, Inc. v. Regent Insurance Co. discusses the insurer's bad faith to settle a third-party's claim within policy limits under Nebraska law.[40] The insured (Bamford) brought an action against his automobile liability insurer (Regent) to recover for bad faith refusal to settle for a $6 million policy limit.[41] On several occasions, Bamford's attorney demanded that Regent settle within the policy limits due to Bamford's exposure risk and stated that an excess verdict would

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[36] *Federated Serv. Ins. Co.,* 282 Neb. at 645, 805 N.W.2d at 468 (2011).

[37] Comunale v. Traders & Gen. Ins. Co., 328 P.2d 198, 201 (Cal. 1958) ("When there is great risk of a recovery beyond the policy limits so that the most reasonable manner of disposing to the claim is a settlement which can be made within those limits, a consideration in good faith of the insured's interest requires the insurer to settle the claim. Its unwarranted refusal to do so constitutes a breach of the implied covenant of good faith and fair dealing."); Brehm v. 21st Century Ins. Co., 83 Cal. Rptr. 3d 410, 417 (Cal. Ct. App. 2008).

[38] Archdale v. Am. Int'l Specialty Lines Ins. Co., 64 Cal. Rptr. 3d 632, 650 (Cal. Ct. App. 2007); Olson v. Union Fire Ins. Co., 174 Neb. 375, 379, 118 N.W.2d 318, 320–21 (1962) ("The liability of an insurer to pay in excess of the face of the policy accrues when the insurer, having exclusive control of settlement, in bad faith refuses to compromise a claim for an amount within the policy limit. . . . In the event the insurer elects to resist a claim of liability, or to effect a settlement thereof of such terms as it can get, there arises an implied agreement that it will exercise due care and good faith where the rights of an insured are concerned."); Hadenfeldt v. State Farm Mut. Auto. Ins. Co., 195 Neb. 578, 583, 239 N.W.2d 499, 502 (1976) (following *Olson*, 174 Neb. at 379, 118 N.W.2d at 321 (1962)); Graske v. Auto-Owners Ins. Co., No. 8:08CV407, 2010 U.S. Dist. LEXIS 147226, at *5 (D. Neb. May 17, 2010).

[39] *Archdale*, 64 Cal. Rptr. 3d at 650.

[40] Bamford, Inc. v. Regent Ins. Co., 822 F.3d 403 (8th Cir. 2016).

[41] *Id.* at 405.

"cripple Bamford, Inc. and may place its very existence at risk."[42] Regent's last offer, days before trial, was $2.05 million.[43] Regent had a very distinct view, as "one executive opined that, based on his perception of Nebraska as a conservative state, 'nothing is worth more than $2M in N[ebraska].'"[44] Ultimately, a jury returned a verdict of more than $10 million.[45]

The court held that an insurer's bad faith failure to settle within policy limits is established by:

> [1] the insurance company's unwarranted rejection of an offer to settle within the policy limits, or [2] a complete and total failure to take into account the potential liability of its insured for an excess judgment, or [3] an insurer's failure to timely and adequately inform its insured of the insurer's adverse interest, of settlement, demands, and offers, and of the potential value of the case.[46]

The third party's attorney warned that he planned to seek an excess judgment at trial, while Bamford's attorney repeatedly made demands to settle within the policy limits to avoid an excess judgment.[47] The court held that such actions show that Regent did not consider Bamford's potential liability in the settlement negotiations.[48] Thus, the jury could reasonably infer "a complete and total failure to take into account the potential liability of [Bamford] for an excess judgment" and "conclude from this inference that Regent acted in bad faith."[49]

In some jurisdictions, when there is a potential conflict of interest between the insurer and insured, the insurer must fulfill an enhanced obligation to its insured as part of its duty of good faith.[50] Failure to satisfy this enhanced obligation may result in liability of the company, the

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[42] *Id.* at 405–06, 408.
[43] *Id.* at 409.
[44] *Id.* at 406.
[45] *Id.* at 409.
[46] *Id.* at 410 (citing Hadenfeldt v. State Farm Mut. Auto. Ins. Co., 195 Neb. 578, 239 N.W.2d 499 (1976)).
[47] *Id.* at 413.
[48] *Id.*
[49] *Id.*
[50] Tank v. State Farm Fire & Cas. Co., 715 P.2d 1133, 1137 (Wash. 1986); Travelers Prop. Cas. Co. of Am. v. N. Am. Terrazzo Inc., No. C19-1175 MJP, 2020 U.S. Dist. LEXIS 212797, at *14 (W.D. Wash. Nov. 13, 2020) ("[A]n insurer defending its insured under a reservation of rights has 'an enhanced obligation of fairness toward its insured' because of the '[p]otential conflicts between the interests of insurer and insured, inherent in a reservation of rights

retained defense counsel, or both.[51] One aspect of this enhanced obligation includes the company fully informing the insured of all developments relevant to their policy coverage and the progress of the lawsuit, along with disclosure of all settlement offers.[52] Additionally, the "defense counsel owes a duty of full and ongoing disclosure to the insured."[53] Thus, defense counsel must disclose settlement offers to the insured as the offers are presented.[54]

d. The Insurance Company Must consider the Insured's Interests

The insurance company owes an obligation to the insured of equally considering the insured's interests against its own.[55] As the court stated in *Perkoski v. Wilson*, "Good conscience and fair dealing require[s] that the company pursue a course that [is] not advantageous to itself while disadvantageous to its policyholder."[56] Additionally, equal consideration of the insured's interest against the insurer's helps balance the parties' competing interests.[57]

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defense.'"); Mut. of Enumclaw Ins. Co. v. Dan Paulson Const., Inc., 169 P.2d 1, 7–8 (Wash. 2007); State Farm Fire & Cas. Co. v. Myrick, No. 2:06-cv-359-WKW [wo], 2008 U.S. Dist. LEXIS 38078, at *5 (M.D. Ala. May 9, 2008) (noting that under Alabama law, an enhanced obligation of good faith arises when an insurer defends an insured under a reservation of rights).

[51] *Tank.*, 715 P.2d at 1137; Carrier Exp., Inc. v. Home Indem. Co., 860 F. Supp. 1465, 1484 (N.D. Ala. 1994) (affirming a jury decision that the defendant was negligent or acted in bad faith in its failure to settle).

[52] *Tank*, 715 P.2d at 1137; Allstate Ins. Co. v. Miller, 212 P.3d 318, 325 (Nev. 2009) ("An insurer's failure to adequately inform an insured of a settlement offer may also constitute grounds for a bad-faith claim."); *see also* MODEL RULE OF PRO. CONDUCT r. 1.4 (AM. BAR ASS'N 1983) (stating that "a lawyer shall promptly inform the client of any decision or circumstance with respect to which the client's informed consent, as defined in Rule 1.0(e), is required" and shall "keep the client reasonably informed about the status of the matter"); MODEL RULE OF PRO. CONDUCT r. 1.4 cmt. (AM. BAR ASS'N 1983) (stating that a lawyer who receives from opposing counsel an offer of settlement must promptly inform the client of its substance unless the client has previously indicated that the proposal will be acceptable or unacceptable or has authorized the lawyer to accept or reject the offer).

[53] *Tank*, 715 P.2d at 1137.

[54] *Tank*, 715 P.2d at 1137; Metlife Auto & Home Ins. Co. v. Reid, Civil Action No. CV-09-S-01762-NE, 2013 U.S. Dist. LEXIS 179424, at *29 n.62 (N.D. Ala. Dec. 23, 2013) ("In order to make an informed decision in this regard, the insured must be fully apprised of all activity involving settlement, whether the settlement offers or rejections come from the injured party or the insurance company.").

[55] *See Allstate Ins. Co.*, 212 P.3d at 326; Van Noy v. State Farm, 16 P.3d 574, 579 (Wash. 2001) (finding that the fiduciary duty that an insurer owes to its insured "is a duty to exercise a high standard of good faith which obligates it to deal fairly and give "equal consideration" in all matters to the insured's interests"); *Tank*, 715 P.2d at 1139 (an insurer's duty of good faith suggests a duty to consider an insured's interest equally); Egan v. Mut. Omaha Ins. Co., 620 P.2d 141, 145 (Cal. 1979) (noting that the implied covenant of good faith and fair dealing requires the insurer when determining whether to settle a claim "give at least as much consideration" to the insured defendant's interest as it does to its own).

[56] Perkoski v. Wilson, 92 A.2d 189, 191 (Pa. 1952).

[57] W. Am. Ins. Co. v. RLI Ins. Co., 698 F.3d 1069, 1074 (8th Cir. 2012).

e. Duties Implied from the Model Unfair Claims Settlement Practices Act and the Nebraska Unfair Insurance Claims Settlement Practices Act (UICSPA)

In 1990, the National Association of Insurance Commissioners (NAIC) promulgated the Unfair Claims Settlement Practices Act (UCSPA) with the purpose of "set[ing] forth standards for the investigation and disposition of claims arising under policies or certificates of insurance."[58] The Model Act authorizes a state's insurance commissioner to enforce its provisions through statement of charges, cease and desist, and penalty orders.[59] The Act further outlines activities constituting unfair claims practices, which "include (1) misrepresentation of insurance policy provisions, (2) failing to adopt and implement reasonable standards for the prompt investigation of claims, (3) failing to acknowledge or to act reasonably promptly when claims are presented; and (4) refusing to pay claims without an investigation."[60]

States have largely enacted similar provisions of the Model UCSPA.[61] However, several states have expanded their criteria by providing time limits for acknowledging, investigation, and handling claims.[62] In Nebraska, the state legislature passed the Nebraska Unfair Insurance Claims Settlement Practices Act (the Act) in 1991 and amended it last in 2011.[63] The Act's purpose is to create "standards for the investigation and disposition of claims arising under policies issued to [Nebraska] residents."[64] The U.S. District Court for the District of Nebraska observed that the prohibited conduct outlined in the Act evidences bad faith settlement tactics, such as inadequate

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[58] MODEL UNFAIR CLAIMS SETTLEMENT PRACTICES ACT § 1 (1990).
[59] *Id*. §§ 5–7.
[60] Steven Plitt & Christie L. Kriegsfeld, *The Punitive Damages Lottery Chase is Over: Is There a Regulatory Alternative to the Tort of Common Law Bad Faith and Does It Provide an Alternative Deterrent?*, 37 ARIZ. ST. L.J. 1221, 1247–48 (2005).
[61] *See* Steven Plitt & Ryan Sandstrom, *Evaluating the Relationship Between Independent Insurance Adjusters and Insureds: The Case Against Imposing an Independent Duty of Care*, 48 CREIGHTON L. REV. 245, 247 (2015).
[62] *Id.*; Steven Plitt, *Supplementing the NAIC's Model Unfair Claims Settlement Practices Act: Accompanying State Regulations*, 37 No. 3 Cal. Ins. L. & Reg. Rep NL 1 (Mar. 2015).
[63] *See* NEB. REV. STAT. §§ 44-1537 to 44-1544 (Reissue 2010).
[64] NEB. REV. STAT. § 44-1537 (Reissue 2010).

investigation, delays in settlement, and false accusations.[65] The court also noted that the Act was intended to empower the Director of Insurance to take corrective action when insurers flagrantly or repeatedly engage in misconduct (as defined in statute or regulation) during the investigating of claims.[66]

The Act's provisions flow from the duty of good faith and fair dealing and the fiduciary-like relationship between the insurer and the insured. Section 44-1540 of the Act offers an overview of the insurer's obligations to its insured by describing conduct constituting unfair claim settlement practices, if committed flagrantly and in conscious disregard of the Act:

> (2) Failing to acknowledge with reasonable promptness pertinent communications with respect to claims arising under its policies;
> (3) Failing to adopt and implement reasonable standards for the prompt investigation and settlement of claims arising under its policies;
> (4) Not attempting in good faith to effectuate prompt, fair, and equitable settlement of claims submitted in which liability has become reasonably clear;
> . . . .
> (6) Compelling insureds or beneficiaries to institute litigation to recover amounts due under its policies by offering substantially less than the amounts ultimately recovered in litigation brought by them;
> (7) Refusing to pay claims without conducting a reasonable investigation;
> (8) Failing to affirm or deny coverage of a claim within a reasonable time after having completed its investigation related to such claim;
> (9) Attempting to settle a claim for less than the amount to which a reasonable person would believe the insured or beneficiary was entitled by reference to written or printed advertising material accompanying or made part of an application;
> . . . .
> (13) Failing, in the case of the denial of a claim or the offer of a compromise settlement, to promptly provide a reasonable and accurate explanation of the basis for such action.[67]

[65] J.L.'s Plaza v. Capitol Specialty Ins. Corp., No. 8:19-CV-184, 2019 U.S. Dist. LEXIS 228362, at *5 (D. Neb. Oct. 3, 2019) (including examples such as inadequate investigation, delays in settlement, and false accusations).
[66] Clausen v. Rsrv. Nat'l Ins. Co., No. 4:14CV3134, 2014 U.S. Dist. LEXIS 191578, at *4 (D. Neb. Sept. 25, 2014).
[67] NEB. REV. STAT. § 44-1540 (Reissue 2010).

All parties in the tripartite relationship owe duties to each other. Although it is sometimes difficult to determine these duties, the obligations the insurer owes to the insured are clear. The Model UCSPA and the Nebraska UICSPA highlight these duties.

IV. CONFLICTS OF INTEREST

The tripartite relationship between the insurance company, the insured, and the defense counsel creates various potential conflicts of interest. The insured wants the best defense possible. Conversely, the insurer wants to provide a defense at the lowest cost possible and may find that potential conflicts of interests could take away coverage defenses and expose the company to extracontractual damages. The defense counsel retained by the insurer to defend the insured is caught in the middle and is threatened by potential malpractice claims.[68]

It must be noted that a potential conflict of interest does not categorically prohibit representation. Instead, the issue for the attorney is to determine whether a possible conflict "will *materially* interfere with the laywer's professional judgment."[69] However, to avoid losing business (namely with the insurer), the attorney might conclude there is no significant limitations as a result of the dual representation.[70] The following section analyzes some of the common potential conflicts of interest in the tripartite relationship that an attorney should consider before accepting a case.

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[68] *See* Richmond, *supra* note 2, at 277; Czarnecki, *supra* note 1, at 173.

[69] Czarnecki, *supra* note 1, at 181 (emphasis added); *see* Armstrong Cleaners, Inc. v. Erie Ins. Exch., 364 F. Supp. 2d 797, 808 (S.D. Ind. 2005); Dynamic Concepts v. Truck Ins. Exch., 71 Cal. Rptr. 2d 882, 888 (Cal. Ct. App. 1998) ("The potential for conflict requires a careful analysis of the parties' respective interests to determine whether they can be reconciled . . . or whether an actual conflict of interest precludes insurer-appointed defense counsel from presenting a quality defense for the insured."); Gulf Ins. Co. v. Berger, 79 Cal. App. 4th 114, 130 (2000) ("The conflict must be significant, not merely theoretical . . . .").

[70] *Gulf Ins. Co.*, 79 Cal. App. 4th 130.

a. Reservation of Rights

An insurer often undertakes an insured's defense, despite unresolved coverage questions or issues.[71] To foreclose possible waiver or estoppel arguments, the insurer commonly sends a reservation of rights letter to the policyholder.[72] An effective reservation of rights letter must reference the policy defense being relied upon by the insurer and its basis for its position.[73] "[T]he insured must be fairly and timely informed of the insurer's position."[74]

However, the insurer's reservation of rights creates a conflict of interest since the insurer may have a diminished interest in the insured's defense due to the potential to prevail on the coverage issue.[75] Defense counsel may direct litigation toward a coverage result favorable to the insurer, for example, by eliciting deposition testimony that supports a coverage defense. To avoid a conflict, defense counsel must then withdraw, or in some jurisdictions, the insured must be permitted to select independent counsel at the insurer's expense.[76]

b. Claimed Damages Exceed Coverage

A potential conflict arises in cases in which the claimed damages exceed coverage. In such cases, an attorney "must at a minimum inform both the insured and insurer of any settlement offer

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[71] Richmond, *supra* note 2, at 272.
[72] *Id.*
[73] *Id.*
[74] Bogle v. Conway, 433 P.2d 407, 412 (1967).
[75] *See* Rockwell Int'l Corp. v. Superior Ct., 32 Cal. Rptr. 2d 153, 158 (Cal. Ct. App. 1994); *Gulf Ins. Co.*, 79 Cal. App. 4th at 131 ("[T]he potential for conflict requires a careful analysis of the parties' respective interests to determine whether they can be reconciled or whether an actual conflict of interest precludes insurer-appointed defense counsel from presenting a quality defense for the insured.").
[76] *See* Santa's Best Craft, L.L.C. v. Zurich Am. Ins. Co., 941 N.E.2d 291, 299 (Ill. App. Ct. 2010) (explaining that when a conflict of interest arises between the insurer and the insured, the insurer may not undertake the insured's defense but instead "remains bound under the insurance policy to provide the insured with a defense and, therefore, must permit the insured to be represented by counsel of its own choosing"); Twin City Fire Ins. Co. v. City of Madison, Miss., 309 F.3d 901 (5th Cir. 2002) (noting that, under Mississippi law, the carrier should afford the insured ample opportunity to select his independent counsel to look after his interest when an insurer is defending under a reservation of rights); Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. Circle, Inc., 915 F.2d 986, 991 (5th Cir. 1990) (requiring the insurer to provide separate counsel when the insured establishes that counsel provided by the insurer was "objectively inadequate" under Louisiana law).

so that they may take steps necessary to protect their interests."[77] In *Hartford Accident & Indemnity Co. v. Foster*, a case involving an excess of policy limits, the court held that a defense attorney should limit his role to responding to questions of law and facts of the case and should be careful not to violate the "absolute, nondelegable responsibility not to urge, recommend or suggest any course of action to the carrier which violates his conflict of interest obligation."[78] Other courts continue to follow *Hartford*'s ruling. [79]

Moreover, "[a] defense attorney who fails to settle a case within policy limits despite the opportunity to do so may be personally liable for any excess judgment."[80] The decision of whether to settle a controversy is ultimately left to the client. In the context of legal malpractice, litigants rely heavily on the professional advice of counsel when they decide whether to accept or reject offers of settlement. The Nebraska Supreme Court has insisted that the lawyers of this state advise clients concerning settlements with the same skill, knowledge, and diligence with which they pursue all other legal tasks.[81]

c. Defense Costs Reduce Available Coverage

There are three types of policies providing liability coverage: a "defense within limits" policy, a "wasting" policy, and "ultimate net loss" policy.[82] A "defense within limits" policy is "[a] policy in which the limit of liability available for paying losses is reduced by the costs of defense."[83] Essentially, defense costs erode available coverage. An insured is potentially harmed

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[77] Richmond, *supra* note 2, at 278.
[78] Hartford Accident & Indem. Co. v. Foster, 528 So. 2d 255, 273 (Miss. 1988).
[79] *See, e.g.*, Ill. Cent. R.R. Co. v. Robinson, Mabry, Selders & Hawkins, NO. 96-CA-00181 COA, 1998 Miss. App. LEXIS 507, at *22–24 (June 9, 1998); U.S. Fire Ins. Co. v. Tel. Elecs. Corp., No. 3:00CV97LN, 2003 U.S. Dist. LEXIS 28225, at *72 (S.D. Miss. Mar. 28, 2003).
[80] Richmond, *supra* note 2, at 278–79.
[81] *See* Bellino v. McGrath N. Mullin & Kratz, PC LLO, 274 Neb. 130, 143, 738 N.W.2d 434, 455 (2007).
[82] Richmond, *supra* note 2, at 279.
[83] Gregory S. Munro, *Defense Within Limits: The Conflicts of "Wasting" or "Cannibalizing" Insurance Policies*, 62 MONT. L. REV. 131, 133 (2001).

every time their defense counsel acts since every attorney fee reduces the available coverage. In such a case, the insureds "must always be timely informed of defense expenditures and the amount of remaining coverage."[84]

d. Counsel's Defense Activities Generate Information Suggesting a Possible Coverage Defense

Even if there is informed consent, the insurance defense counsel faces serious disclosure and communication problems. For example, a conflict of interest arises when the defense counsel discovers information suggesting a possible coverage defense while representing the insured.[85] Courts have explained that an attorney retained by an insurer to defend an insured owes the insured undeviating allegiance to the insured as if the attorney had been retained and compensated by the insured.[86] Additionally, the court held that an insurer defending an insured owes the insured an "undeviating and single allegiance."[87] These principles have been followed in some jurisdictions.[88]

e. The Insurer Attempts to Limit Counsel's Defense Activities to Reduce Expenses

An insurance company may seek to restrict the defense counsel's activities to decrease litigation costs by including litigation guidelines in its insurance policy. Litigation guidelines give the insurer the right to control potential litigation. However, in the insurance context, these

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[84] Richmond, *supra* note 2, at 279.
[85] *See id.* at 280.
[86] Parsons v. Cont'l Nat'l Am. Grp., 550 P.2d 94, 98–99 (Ariz. 1976); *see* Newcomb v. Meiss, 116 N.W.2d, 593, 598 (Minn. 1962); Am. Emp'rs Ins. Co. v. Goble Aircraft Specialties, Inc., 131 N.Y.S.2d 393, 401 (N.Y. App. Div. 1954).
[87] *Parsons*, 550 P.2d at 98.
[88] *See, e.g.*, Lennar Corp. v. TransAmerica Ins. Co., No. 1 CA-CV-10-0686, 2011 WL 5374434, at *3 (Ariz. Ct. App. Nov. 8, 2011); *Navigators Specialty Ins. Co.*, 50 F. Supp. 3d at 1198; Rogers v. Robson, Masters, Ryan, Brumund & Belom, 392 N.E.2d 1365, 1372 (Ill. App. Ct. 1979) (applying Illinois law, the court held that when engaged in dual representation, the attorney representing the insured assumes all duties imposed by the attorney-client relationship, including advising the client of progress in a case and this duty is not altered by the presence of a third-party insurer whom the lawyer also represents); *see also* MODEL CODE OF PRO. RESP. EC 5-1 (AM. BAR ASS'N 1980) ("The professional judgment of a lawyer should be exercised, within the bounds of the law, solely for the benefit of his [or her] client and free of compromising influences and loyalties. Neither his [nor her] personal interests, the interests of other clients, nor the desires of third persons should be permitted to dilute his [or her] loyalty to his [or her] client.").

guidelines are unique because the insurer, not the insured, creates them.[89] The guidelines include an attorney's understakings in defending an insured that require the insurer's preapproval, such as "(1) hiring an expert; (2) hiring an investigator; (3) taking depositions; (4) videotaping depositions; (5) filing motions; (6) undertaking discovery; (7) expenditures for travel; [and] (8) computerized legal research."[90] Such limitations "create potential conflicts of interest if they inhibit an attorney's ability to adequately defend a case, or interfere with the attorney's independent professional judgment."[91]

The insurer's attempt to limit discovery to decrease litigation expenses conflicts with general ethical rules. For example, Rule 5.4(c) of the Model Rules of Professional Conduct provides that "[a] lawyer shall not permit a person who recommends, employs, or pays the lawyer to [represent another] to direct or regulate the lawyer's professional judgment in rendering such legal services."[92] A defense attorney may have to conduct discovery even if the insurer is unwilling to bear the cost. To avoid conflicts, "[a]n insured may have to be informed of imposed discovery limitations, or written consent to counsel's continued representation may be required."[93]

V. ETHICS RULES GOVERNING INSURANCE DEFENSE COUNSEL

Counsel trapped in the tripartite relationship is bound by ethics rules governing lawyers. The following section outlines the relevant Model Rules of Professional Conduct with the corresponding Nebraska Rules of Professional Conduct and the applicable provisions of the Nebraska Code of Professional Responsibility.

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[89] Czarnecki, *supra* note 1, at 182.
[90] *Id.*
[91] Richmond, *supra* note 2, at 283.
[92] MODEL RULES OF PRO. CONDUCT r. 5.4(c) (AM. BAR ASS'N 1983).
[93] Richmond, *supra* note 2, at 283.

a. Model and Nebraska Rules of Professional Conduct

The ABA House of Delegates adopted the American Bar Association's (ABA) Model Rules of Professional Conduct (Model Rules) in 1983. The rules serve as model ethics rules for most jurisdictions. In 2005, Nebraska adopted the Nebraska Rules of Professional Conduct (Nebraska Rules).[94] The Nebraska Rules govern lawyers in the state and create an understanding of lawyers' relationship to the legal system.

i. *Model Rule 1.7 and Nebraska Rule § 3-501.7: Conflict of Interest*

Model Rule 1.7 and Nebraska Rule § 3-501.7 pertain to conflicts of interest. According to both rules, "a lawyer shall not represent a client if the representation involves a concurrent conflict of interest."[95] A conflict of interest is defined as the representation of one client that will be directly adverse to another client or a situation in which "there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer."[96]

The tripartite relationship between the insurer's defense counsel, the insured, and the insurer contradicts Model Rule 1.7 and Nebraska Rule § 3-501.7. The conflict of interest is present because the defense counsel's representation of the insured can become directly adverse to the insurance company's interest and vice versa. Additionally, the insured's representation will be limited by the counsel's responsibility to the insurer and the counsel's interest in continuing to be employed by the insurer. Furthermore, if the attorney represents both clients and a conflict arises such that each client desires a different outcome of the litigation, it would be impossible for the

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[94] *Article 5: Neb. Rules of Pro. Conduct*, STATE OF NEB. JUDICIAL BRANCH, https://supremecourt.nebraska.gov/supreme-court-rules/chapter-3-attorneys-and-practice-law/article-5-nebraska-rules-professional (2021).

[95] MODEL RULES OF PRO. CONDUCT r. 1.7(a) (AM. BAR ASS'N 1983); NEB. CT. RULES OF PRO. CONDUCT § 3-501.7(a) (2008).

[96] MODEL RULES OF PRO. CONDUCT r. 1.7(a)(2) (AM. BAR ASS'N 1983).

attorney to represent both interests adequately. Thus, the requirements of Model Rule 1.7(b)(1) and Nebraska Rule § 3-501.7 cannot be met.[97] To comply, defense counsel must take the necessary steps to avoid such conflict and or withdraw when the conflict is inevitable. Another solution is to provide the insured with independent counsel, paid for by the insurer, with the caveat that the agreement must ensure the independent counsel's professional independence.[98]

ii. *Model Rule 1.8(f) and Nebraska Rule § 3-501.8: Compensation*

Compliance with Model Rule 1.8(f) and Nebraska Rule § 3-501.8 presents another dilemma for defense counsel. These rules state that "[a] lawyer shall not accept compensation for representing a client from one other than the client unless: (1) the client gives informed consent; (2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship."[99]

In the tripartite relationship, the defense counsel is compensated by the insurer, with the insured's consent. However, a personal relationship between the insurer and defense counsel forms when the insurer regularly employs the same defense counsel to represent its insureds. This dynamic may open the door for the insurer to interfere with the counsel's control of the litigation. However, because a defense counsel has an ethical obligation to maintain the independence of professional judgment in defending the insured, the insurer has no right to control the attorney's methods to defend the insured.[100] Thus, the insurer "cannot control the details of the attorney's performance, dictate the strategy or tactics employed, or limit the attorney's professional discretion

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[97] *See* Finley v. Home Ins. Co., 975 P.2d 1145, 1152–53 (Haw. 1998).
[98] *See id.* at 1153.
[99] Subsection (3) of the rule states that "information relating to representation of a client is protected as required by Rule 1.6." MODEL RULES OF PRO. CONDUCT r. 1.8(f) (AM. BAR ASS'N 1983); NEB. CT. RULES OF PRO. CONDUCT § 3-501.8 (2008).
[100] *See* Barefield v. DPIC Cos., Inc., 600 S.E.2d 256, 270 (W. Va. 2004); Petition of Youngblood, 895 S.W.2d 322, 328 (Tenn. 1995).

with regard to the representation [of the insured]."[101] Defense counsel's compliance with Model Rule 1.8(f)(2) might require counsel to disagree with the insurer's attempt to control the litigation.[102]

iii. *Model Rule 5.4(c) and Nebraska Rule § 3-505.4: Professional Independence of a Lawyer*

Model Rule 5.4(c) and Nebraska Rule § 3-505.4 come into play when an insurer tries to limit defense counsel's activities to reduce defense costs. The rule provides that "a lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services."[103] Defense counsel's compliance with Rule 5.4(c) and § 3-505.4 requires that counsel remains objective despite being paid by the insurance company. At times this might include going against the insurer's efforts to control or interfere with the insured's representation. Another interpretation of the rule is that when a conflict of interest between the insurer and the insured obligates to provide counsel for the insured, the arrangement should assure the counsel's professional independence.[104]

b. Nebraska Code of Professional Responsibility

The Nebraska Code of Professional Responsibility (the Code) also governs attorneys in the state.[105] The Code's canons create duties applicable to insurance defense lawyers.

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[101] *Youngblood*, 895 S.W.2d at 328.
[102] *See Finley*, 975 P.2d at 1153 (stating that the attorney's conduct will comply with the rules only if the insurance defense attorney does not allow the insurer to interfere with the attorney's independence of professional judgment or with the client-lawyer relationship, among other things).
[103] MODEL RULES OF PRO. CONDUCT r. 5.4(c) (AM. BAR ASS'N 1983); NEB. CT. RULES OF PRO. CONDUCT § 3-505.4 (2008).
[104] Pine Island Farmers Coop v. Erstad & Riemer, P.A., 636 N.W.2d 604, 608–09 (Minn. Ct. App. 2001), *aff'd*, 649 N.W.2d 444 (Minn. 2002).
[105] NEB. CODE OF PRO. RESP. (2000).

i. *Canon 4: Confidentiality*

Under Canon 4, "[a] lawyer should not use information acquired in the course of the representation of a client to the disadvantage of the client."[106] Additionally, attorneys should be careful to prevent "the disclosure of the confidences and secrets of one client to another, and no employment should be accepted that might require such disclosure."[107] Consequently, to remain in compliance, defense counsel may not engage in activities that suggest a possible coverage defense, nor can counsel be used as an insurer's agent to supply information designed to deny coverage to the insured.

ii. *Cannon 5: Independent Professional Judgement*

The Code establishes that lawyers must not accept "employment that will adversely affect [their] judgment on behalf of or dilute loyalty to a client".[108] This employment issue arises when a lawyer represents two or more clients that have conflicting or differing interests.[109] Canon 5 states that for a lawyer to fulfill their obligation to exercise professional judgment solely on behalf of their client, the lawyer must disregard others' desires that might interfere with the lawyer's judgment.[110] For instance, a lawyer might find themself in such a situation when the third party exerting pressure against the lawyer's independent judgment is the person or organization paying the lawyer. [111] As stated in the Code, "[s]ome employers may be interested in furthering their own economic, political, or social goals without regard to the professional responsibility of the lawyer to his or her individual client."[112] Thus, "[a] lawyer shall not permit a person who recommends,

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[106] NEB. CODE OF PRO. RESP. EC 4-5 (2000).
[107] *Id.*
[108] NEB. CODE OF PRO. RESP. EC 5-14 (2000).
[109] *Id.*
[110] NEB. CODE OF PRO. RESP. EC 5-21 (2000).
[111] NEB. CODE OF PRO. RESP. EC 5-23 (2000).
[112] *Id.*

employs, or pays him or her to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services."[113]

The tripartite relationship conflicts with this rule when the insurer provides a defense within limits policy and when the insurer attempts to limit discovery to reduce expenses. The insurer, who has the right to employ the defense counsel of its choosing and has a right to control the litigation, may attempt to limit the counsel's activities to reduce costs at the expense of the insured's defense. In these scenarios, the defense counsel's independent professional judgment is threatened by the employing insurer.

Insurance defense counsel must abide by the Model Rules of Professional Conduct. Particularly, counsel must consider the rules regarding conflict of interest, compensation, and professional independence. In Nebraska, defense counsel is also bound by the Nebraska Code of Professional Responsibility; therefore, counsel must adhere to the confidentiality and independent professional judgment provisions. Ensuring that defense counsel follows these essential rules can help reduce potential conflicts in the tripartite relationship.

VI. PROPOSED RESOLUTION OF CONFLICTS

The area of law governing the tripartite relationship is inconsistent, and arriving at a solution that will address the potential for various conflicts of interest is not an easy task. This creates a problem for insureds who are denied loyal representation and are threatened with financial ruin, as well as for ethical attorneys caught in the middle.[114] However, it is crucial to remember that despite inconsistency across jurisdictions and the complexity of the problem, there are principles that transcend jurisdictional boundaries: "defense counsel must serve insureds loyally and with the fidelity afforded to all other clients; client confidences must be respected,

[113] NEB. CODE OF PRO. RESP. DR 5-107(B) (2000).
[114] *See* Czarnecki, *supra* note 1, at 185; Richmond, *supra* note 2, at 297.

communication obligations having been established in advance, the representation of multiple insureds should be carefully scrutinized, and insureds and insurers must be involved in settlement."[115]

a. Defense Counsel Must Treat the Insured as the Sole Client

One way of decreasing potential conflicts is for defense counsel to adopt the One-Client Theory. There are three theories of representation in the tripartite relationship: (1) the Two-Client, (2) the One-Client Theory, and (3) the Third-Party-Payor Theory.[116] Although the Two-Client Theory is the majority view among U.S. courts, the judicial trend is shifting toward the "supremacy of the attorney's obligation to the insured."[117]

The potential for conflict is present regardless of which representation theory is adopted. However, as argued in this Article, the One-Client Theory avoids certain conflicts by placing the insured as the defense counsel's primary client.[118] For example, when the defense counsel is representing both the insured and the insurer, it is possible that the counsel could generate

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[115] Richmond, *supra* note 2, at 297.

[116] Czarnecki, *supra* note 1, at 174–78. The Two-Client Theory considers both the insured and the insurer as clients of the defense attorney, while the opposing One-Client Theory states that the defense counsel's primary client is the insured. The Third-Party-Payor Theory or the One-and-a-Half-Client Theory argues that the attorney represents both the insurer and insured until there is a conflict, at which point the insurer is no longer a client.

[117] Nathan Andersen, *Risky Business: Attorney Liability in Insurance Defense Litigation—A Review of the Arizona Supreme Court's Decision in* Paradigm Insurance Co. v. Langerman Law Offices, 2002 BYU L. REV. 643, 666 (2002); *see also* Jean Fleming Powers, *Advantages of the One-Client Model in Insurance Defense*, 45 N.M.L. REV. 79, 81–82 (2014) (noting that although the Two-Client Model is the "prevailing model," the One-Client Model is increasing in popularity); State Farm Fire & Cas. Co. v. Admiral Ins. Co., 225 F. Supp. 3d 474, 480 (D.S.C. 2016) (stating that an insurance company that retains counsel to defend an insured is not a joint client together with the insured, but the attorney's sole client is the insured); Finley v. Home Ins. Co., 975 P.2d 1145, 1153 (Haw. 1998) (holding that "the sole client of the attorney is the insured"); Metro Life Ins. Co. v. Aetna Cas. & Sur. Co., 730 A.2d 51, 65 (Conn. 1999) ("[W]e have long held that even when an insurer retains an attorney in order to defend a suit against an insured, the attorney's only allegiance is to the client, the insured."); Pine Island Farmers Coop v. Erstad & Riemer, P.A., 636 N.W.2d 604, 609 (Minn. Ct. App. 2001) ("[W]e hold that the insured is the sole client of the defense attorneys hired by the insurer.").

[118] *See* State v. Avina-Murillo, 301 Neb. 185, 198, 917 N.W.2d 865, 875 (2018) ("Multiple representation conflicts tend to present the most problems, because whatever path the attorney takes will likely harm the interests of at least one client."); Czarnecki, *supra* note 1, at 176; *see also* Atlanta Int'l Ins. Co. v. Bell, 475 N.W.3d 294, 518–19 (Mich. 1991) (explaining that the rule that only a person in the privity of the attorney-client client relationship may sue an attorney for malpractice serves to ensure the inviolability of the attorney's duty of loyalty to the client).

information suggesting a coverage defense. However, as the Arizona Supreme Court stated, counsel should not communicate such information received in confidence because to do so would "destroy public confidence in the legal profession" and "make defense attorneys investigators for [insurers]."[119] This conflict can be avoided if the defense counsel treats the insured as the sole client and recognizes that the counsel owes the insured "undeviating and single allegiance," regardless of whether counsel is paid by the insurer or the insured.[120] In a different case, the Minnesota Court of Appeals concluded that Minnesota Rules of Professional Conduct 1.7 and 5.4(c) "require that when an insurer hires counsel for the insured, and the insurer and the insured have conflicting interests, the attorney's duty of loyalty is to the insured."[121]

Furthermore, the Nebraska Code of Professional Responsibility supports the One-Client Theory. Under Canon 5:

> The professional judgment of a lawyer should be exercised, within the bounds of the law, solely for the benefit of the lawyer's client and free of compromising influences and loyalties. Neither the lawyer's personal interests, the interests of other clients, nor the desires of third persons should be permitted to dilute the lawyer's loyalty to his or her client.[122]

This principle is reflected in the Minnesota Rules of Professional Conduct, which "require that when an insurer hires counsel for the insured and the insurer and the insured have conflicting interests, the attorney's duty of loyalty is to the insured."[123]

Some practicing attorneys have adhered to the practice of recognizing the insured as their sole client.[124] A managing attorney at an in-house counsel office explained that he has a greater

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[119] Parsons v. Cont'l Nat'l Am. Grp., 550 P.2d 94, 98 (Ariz. 1976).
[120] *Id.*
[121] *Pine Island Farmers Coop*, 636 N.W.2d at 608–09.
[122] NEB. CODE OF PRO. RESP. EC 5-1 (2000).
[123] *Pine Island Farmers Coop*, 636 N.W.2d at 608.
[124] Czarnecki, *supra* note 1, at 178. The author collected answers from a questionnaire sent to practitioners throughout the Midwest. Among other answers received, the following responses support the one-client theory: "[T]his attorney is advocating the One-Client Theory, stating that he must do what is best for his client, the insured, regardless of what the insurer's wishes may be. An attorney . . . said that 'it is important for the lawyer to remember that their client is

duty to the insured, and that he must explain the nature of the relationship to the insured and confirm that the insurer understands the relationship's limits.[125] Another attorney stated that "he must do what is best for his client, the insured, regardless of what the insurer's wishes may be."[126] If this advice is followed, the attorney may avoid the problematic position of serving two masters with differing interests.[127]

b. The Imbalance of Information Must be Reduced by the Defense Counsel's Communication to the Insured

In the tripartite relationship, the insurer's and defense counsel's continuing business relationship and the insurer's power of the purse may alienate the insured from important communications. The One-Client Theory reduces this imbalance.[128] Nonetheless, the attorney still owes some duties to the insurer, as generally outlined in the insurance policy.[129] These duties usually include notice and reporting requirements, claims-handling procedures, and notice of any settlement offers made by opposing counsel.[130] However, the defense counsel may still ensure that their primary client is the insured by informing and consulting the insured for all important communications, strategies, and settlement offers. Doing so reduces the imbalance of information present in the tripartite relationship.

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the insured . . . The lawyer must proceed under the same ethical considerations as if the insured were paying for the representation himself.'" *Id.*

[125] *Id.*

[126] *Id.*

[127] *See* Fleming Powers, *supra* note 117, at 90–91; *see also* MODEL RULES OF PRO. CONDUCT r. 1.7(a) (AM. BAR ASS'N 1983) ("[A] lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if: (1) the representation of one client that will be directly adverse to another client; or (2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.").

[128] In contrast, supporters of the Two-Client Theory argue that having the insurer as a client, who is familiar with the litigation process, actually benefits the insured. *See* Czarnecki, *supra* note 1, at 175.

[129] Subscribers of the Two-Client Theory owe the insurer the duties as outlined in the insurance policy, in addition to the standard obligations owed to a client: loyalty, confidentiality, and competence.

[130] Czarnecki, *supra* note 1, at 179.

Further, the defense "counsel's [continuing] business relationship with the insurer must not be allowed to interfere with the duties of confidentiality, disclosure, honesty, and loyalty owed the insured."[131] This means that although the insurer who is paying the attorney may want to know what is going on with the case, there might be things the attorney cannot tell the insurer without violating ethical rules.[132] Even if the insurer wants to exercise some control over the litigation costs, "the lawyer must do what he sees fit and what is best for the insured . . . includ[ing] spending money that the insurer has not approved."[133]

VII. CONCLUSION

The tripartite relationship between the insured, insurer, and appointed defense counsel poses inherent conflicts of interest and ethical dilemmas. All parties are affected by the problems arising out of the relationship. The insured is in a vulnerable position when they are denied loyal representation and are threatened with financial ruin. Special attention must be placed on the insurer's obligations to its insured, including completing a reasonable and proper investigation of the claim, providing a defense if the potential for liability exists, timely effecting a reasonable settlement, and giving equal consideration to the insured's interest.

On the defense counsel's side, the counsel must identify potential conflicts of interest before agreeing to defend the insured and abide by the ethics rules governing insurance defense counsel. Further, adopting the One-Client Theory may help attorneys reduce such conflicts. At the end of the day, adhering to the duties owed and avoiding conflicts of interest protects everyone's interest—the injured human, the policyholder who is dragged into litigation, the attorney whose reputation and business is on the line, and the insurer's credibility and financial stakes.

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[131] Richmond, *supra* note 2, at 294–95.
[132] Czarnecki, *supra* note 1, at 174.
[133] *Id.*