Insurer Litigation Guidelines: 
Ethical Issues for Insurer-Selected 
and Independent Defense Counsel¹

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any part of this paper. The paper is a joint product and none of the authors agree with everything 
that is said in it. Moreover, none of it represents the views of their firms or their clients.
I. Background: Relationships Between Insurers and Defense Counsel\(^2\)

A. Insurer Rights To Control the Defense

Many courts hold and insurers generally take the position that, in the absence of a coverage question or conflict of interest affecting the defense, a standard liability policy provision regarding the insurer’s right and duty to defend “gives the insurer the right to control the defense of the claim” and “the insured has no right to interfere with the insurer’s control of the defense.”\(^3\)

Where the insured has no personal exposure, that control “is virtually absolute.”\(^4\)

Ordinarily, the law in most jurisdictions recognizes both insurer and policyholder as clients of defense counsel.\(^5\) But the insurer’s right to select counsel and to control the defense is sometimes overridden in situations where the law entitles the insured to independent counsel; such independent counsel cannot represent or be directed by the insurer.\(^6\)

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See also Davenport v. St. Paul Fire & Marine Ins. Co., 978 F.2d 927, 931-932 (5th Cir. 1992) (policy “invest[s] the insurer with the complete control and direction of the defense . . . to the exclusion of the insured”) (collecting authorities); Unauthorized Practice of Law Comm. v. Am. Home Assurance Co., 261 S.W.3d 24, 26 (Tex. 2008) (“The right to defend in many policies gives the insurer complete, exclusive control of the defense”).


\(^5\) JEFFREY E. THOMAS & FRANCIS J. MOOTZ, III, THE NEW APPLEMAN ON INSURANCE LAW, LIBRARY EDITION, § 16.04 [2] (describing the basis for that rule). A table of jurisdictions accepting or rejecting that rule is contained in Appendix 16-A to that chapter.

\(^6\) See text at notes 8-48, infra.
B. Policyholder Rights to Independent Counsel

1. Defense Counsel Must Be Loyal to the Policyholder, and This Sometimes Requires Independent Counsel

Because the policyholder is a client (and regardless of whether the insurer is also a client), defense counsel owes the policyholder undivided loyalty. In ordinary cases this presents no problem, for the insurer’s interests will be fully consistent with those of the policyholder.

While the normal case involves only common interests of the insurer and the policyholder, defense counsel must be alert for interest conflicts that may exist in particular cases. The duty of undivided loyalty forbids defense counsel from handling any defense-related matter in a way that injures an insured client without that client’s informed consent.

Coverage issues inherently involve conflicts between the insurer and the policyholder. So, insurer-appointed defense counsel must avoid any involvement in those issues. In particular, defense counsel must not assist the insurer in defeating coverage, as such assistance would breach defense counsel’s duty of loyalty to the policyholder.

But conflicts must be considered even before undertaking a defense representation. The first question that any lawyer must answer when asked to undertake a representation is whether the representation will involve a conflict of interest. Insurance defense counsel is no different from any other lawyer in this respect. If representing the policyholder and the insurer jointly would create a conflict of interest, then joint representation is impermissible, absent informed consents by both the insurer and the policyholder.

The fact that joint representation is impermissible does not excuse the insurer’s duty to defend, but requires that the duty be discharged in a different manner. Independent counsel, representing only the policyholder, must be paid by the insurer. Otherwise, the policyholder would be put at risk that assigned counsel’s advice about the representation might be affected by assigned counsel’s loyalty to the insurer or personal interest in cultivating the insurer’s favor.

Essentially the same analysis would apply to preclude insurer direction even if applicable law did not consider an unconflicted insurer to be a co-client. A conflict that would preclude joint representation would also preclude, absent informed consent by the policyholder, acceptance of insurer direction by counsel. And if counsel had a regular ongoing relationship with the insurer,

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7 Material in this subsection is adapted from the forthcoming THE PROFESSIONAL RESPONSIBILITIES OF INSURANCE DEFENSE COUNSEL by Prof. Silver and Mr. Barker, to be published later this year by LexisNexis. Copyright © 2012 LexisNexis. Adapted with permission. All rights reserved.

8 E.g., RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 16 & cmt. e (perm. vol. 2000) (describing duty); Cinema 5, Ltd. v. Cinerama, Ltd., 528 F.2d 1384, 1386 (2d Cir. 1976) (attorney owes undivided loyalty to every client).


10 See, e.g.: Parsons v. Continental Nat’l Am. Group, 113 Ariz. 223 (Sup. Ct. 1976) (disclosure to insurer of confidential information indicating that insured’s actions were intentional rather than negligent); Betts v. Allstate Ins. Co., 154 Cal. App 3d 688 (1984) (defense counsel encouraged insured to adopt “no-settlement” position which improperly exposed insured to serious risk of personal liability); Fidelity & Cas. Co. v. McConnaughy, 228 Md. 1, 9-14 (1962) (taking deposition to establish lack of cooperation); Employers Cas. Co. v. Tilley, 496 S.W.2d 552 (Tex. 1973) (exploitation of position as defense counsel to develop late notice defense on behalf of insurer).

11 See, e.g., MODEL RULES OF PROFESSIONAL CONDUCT, Rules 1.8(f), 5.5(c) (ABA 2011).
the lawyer’s personal interest in pleasing the insurer could create a conflict in the same way that a legal duty of loyalty would.

If there were a conflict of interest, the defense lawyer retained by the insurer sometimes could have incentives to favor the insurer, whether or not the insurer is a co-client. It is the insurer who selects counsel and pays the fee, thereby earning a measure of gratitude not shared by the policyholder. More importantly, it is to the insurer, rather than the policyholder, that counsel looks for future referrals: “[t]he attorney’s relationship with the insurer is usually ongoing, supported by a financial interest in future assignments, and, like other long-term relationships, sometimes strengthened by real friendship.”12 Thus, it is all too easy for defense counsel to wish to protect the insurer from fraud or lack of cooperation by the policyholder or even to aid it in coverage disputes with the policyholder, forgetting the loyalty owed to the policyholder. As a result, before the use of independent counsel became common, some courts found it necessary to condemn such acts of disloyalty and to allow appropriate remedies against counsel or the insurer whose interests counsel sought to advance to the detriment of the client policyholder.13

When a conflict precludes a lawyer from agreeing to represent a policyholder subject to an insurer’s direction, insurance law requires the insurer to pay for independent counsel, who will represent the policyholder without any duties to or other relationships with the insurer that would create a conflict of interest.14 In some jurisdictions, insurance law goes further and requires the insurer to provide independent counsel in circumstances where no conflict of interest exists.15

2. A Disabling Conflict Exists When Insurer and Policyholder Have Divergent Interests in the Way the Case Is Defended

a) Coverage Related Conflicts

(1) General Principles

The governing standard is stated in ABA Model Rule 1.7, which is substantively identical on this point to the law in all states.

(a) Except as provided in paragraph (b), 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 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.

A material limitation (as that term is used in paragraph (a)(2) of the rule) exists when “there is a significant risk that a lawyer’s ability to consider, recommend or carry out an appropriate course of action for the client will be materially limited because of the lawyer’s other responsibilities or

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12 See 4 RONALD E. MALLEN & JEFFREY M. SMITH, LEGAL MALPRACTICE, §§ 30:3, at 150 (2010 ed.).
13 See, e.g., cases cited in note 11, supra.
14 See text at notes 17-48, infra.
15 See text at note 49, infra.
interests.” In applying this standard to insurance representations, courts have demanded special sensitivity to any situation where the choices made by defense counsel could benefit the insurer at the policyholder’s expense.

Where the existence of divergent interests in the conduct of the defense is inherent in the case, the conflict of interest rules require that representation on behalf of the insurer be declined, unless all affected clients give informed consent.

A leading legal malpractice treatise agrees:

Objectively, a conflict exists when the issue upon which the clients' interests diverge is within the scope of the attorney's retention. The dilemma is that competent representation of one client on the issue necessarily will be adverse to the interests of the other. A coverage issue rarely presents an objective conflict of interests if counsel's retention is limited to defending the liability claim.

The scope of representation determines the objectives of the representation and the range of services defense counsel is obliged to provide. The scope thus determines the set of actions (or possible actions) defense counsel must be able to provide without conflict. However, the scope of the representation does not limit the range of interests which defense counsel must avoid injuring. A lawyer must respect all interests a client has, including primary interests that relate to the agreed goal of a representation and secondary interests that do not. A policyholder's interest in preserving coverage and a carrier's interest in defeating it are secondary interests. They are not the interests defense lawyers sign on to advance. But they are interests nonetheless. Consequently, when acting within the scope of a defensive representation, defense lawyers must respect them. When defending liability suits, they must not knowingly act in ways that endanger clients' coverage-related interests without informing clients and obtaining consents.

(2) Examples

(a) Coverage Issues That May Not Create Conflicts

Whether a coverage dispute creates an interest conflict depends on the nature of the coverage issue. In other words, the mere existence of a question as to coverage (and a corresponding reservation of rights) may not always entail a disabling ethical conflict.

Some courts rest this conclusion, in part, on the assumed integrity of counsel:

“Public policy requires the insurer to act with the utmost good faith. As long as this standard is observed, the Court may not interfere with the terms of the parties' agreement. To hold

18 4 Ronald E. Mallen & Jeffrey M. Smith, Legal Malpractice, § 30:21, at 331 (2011 ed.).
that the insurer who, under reservation of rights, participates in selection of counsel, automatically breaches its duty of good faith is to indulge the conclusive presumption that counsel is unable to fully represent its client, the insured, without consciously or unconsciously compromising the insured's interests. The Court is unable to conclude that [the] law professes so little confidence in the integrity of the bar of this state.”

While the integrity of counsel is one protection for the policyholder, there is no need to rely on that unless counsel would have some opportunity to benefit the insurer, at the policyholder’s expense, by the way counsel handles the defense. It is the existence of such an opportunity that creates a ethical conflict of interest entitling the policyholder to independent counsel. In the absence of such an opportunity, there is no ethical conflict and no need to rely on counsel to resist a nonexistent temptation to favor the insurer.

Some courts treat the prospect of future employment by the insurer as a potential conflict of interest. But this often misses the central question, which is whether a particular case involves any concrete prospect that defense counsel would have an opportunity to favor the insurer at the expense of the policyholder. Only if the manner of handling the policyholder’s defense could affect the determination of coverage or otherwise benefit the insurer at the policyholder’s expense does an ethical conflict exist, and many coverage questions are unrelated to the matters at issue in the tort action. Ordinarily, actions reasonably calculated to minimize the expected loss in the liability action could only make both insurer and policyholder better off, regardless of any collateral dispute they may have regarding coverage. The reason for this is that the coverage dispute will determine whether the insurer or the policyholder bears the loss, and the loser, whoever it turns out to be, will be better off if the loss is smaller rather than larger. As long as there is no opportunity for defense counsel to shift liability between covered and noncovered grounds by defending the case one way rather than another, most cases do not regard mere lack of a duty to indemnify against some or all claims asserted in the suit as creating a conflict.

Example: Assigned counsel is asked to defend a case involving an auto accident in which the policyholder’s cousin was injured when the car operated by the policyholder ran into a tree. The cousin had been living with the policyholder while attending a nearby school, but has returned to his parents’ home after being

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21 See text at notes 38-48, infra. Some courts recognize a right to independent counsel even in the absence of an ethical conflict for assigned defense counsel. See text at note 49, infra.

22 E.g., Chi of Alaska, Inc. v. Employers Reins. Corp., 844 P.2d 1113, 1116-17 (Alaska 1993) (“Where there is a conflict between insurer and insured, appointed counsel may tend to favor the interests of the insurer primarily because of the prospect of future employment”).

23 RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 123, cmt. c(iii) (general antagonism between clients not conflict, so long as conflicting interests not implicated in particular representation).

released from the hospital. The claim representative assumes the policyholder’s defense, but reserves the right to deny coverage under the policy’s exclusion for injuries to relatives residing in the policyholder’s household. Coverage counsel brings a declaratory judgment action to resolve that issue. Because the resident relative issue does not overlap with the issues in the tort action, courts have found that it does not create any conflict of interest, and assigned counsel may undertake the defense.25

Policyholders also argue that the insurer may not have the incentive to fund a full and vigorous defense of a claim that, if established, will not be covered (even though the insurer would not benefit from a finding for plaintiff on that claim).26 But insurers respond that a defending insurer is obliged to provide a proper defense for even a noncovered claim. (By analogy to the law governing an insurer’s duty to settle,27 this should be a defense as vigorous as that would be provided by an insurer liable for the entire amount recovered.) Policyholders typically disagree because it is they, and not the insurer, that suffer the stigma and lasting impact of the adverse verdict. Insurers rejoin that liability insurance is insurance against loss in the form of defense costs, settlements or judgments, rather than against stigma or other “lasting effects.”

The insurer can be liable for any damage resulting from failure to provide an adequate defense.28 Both the propriety of any alleged skimping on the defense and the causal relation of any impropriety to any resulting noncovered liability are likely to be decided, after a bad result and in hindsight, by a jury unlikely to be sympathetic to the insurer. Insurers see this as an ample safeguard against skimping on defense funding.

Policyholders also argue that a conflict could also arise if, when handling the defense, defense counsel would gain access to confidential information which defense counsel would be obliged to disclose to the insurer and which the insurer would find useful in asserting its coverage defenses.29 But defense counsel would not be obliged to disclose (and would actually be prohibited from disclosing) confidential information that was not relevant to the actual defense of the case.30 Consequently, as long as the defense issues and the coverage issues do not overlap, insurers would argue that theoretical possibility ordinarily should not matter. A merely theoretical possibility is not enough to create a conflict, absent some concrete prospect that adverse disclosure might occur in the matter at hand.31

27 See William T. Barker & Ronald D. Kent, New Appleman Insurance Bad Faith Litigation, Second Edition § 2.03[[2][D]].
29 Chi of Alaska, Inc., 844 P.2d at 1116.
30 William T. Barker, Confidentiality Obligations of Insurance Defense Counsel, COVERAGE, vol. 21, # 2, at 1, 10 (Mar.-Apr. 2011).
31 Restatement (Third) of the Law Governing Lawyers, § 121, cmt. (iii) (perm. vol. 2000) (“There is no conflict of interest … unless there is a ‘substantial risk’ that a material adverse effect will occur…. In this context, ‘substantial risk’ means that in the circumstances the risk is significant and plausible, even if it is not certain or even probable that it will occur. The standard requires more than a mere possibility of adverse effect.”).
Additionally, it is sometimes suggested that “if there are several theories of recovery, at least one of which is not covered under the policy, the insurer might conduct the defense in such a manner as to make the likelihood of a plaintiff’s verdict greater under the uninsured theory.”32 If the different theories of recovery are alternate claims for the same injury (e.g., intentional v. negligent), that would involve a conflict, because the insurer might then recommend a defense calculated to increase the likelihood that a verdict adverse to the policyholder would be based on the uncovered theory (here, intent).33 But suppose the policy were an auto insurance policy and the complaint alleged both bodily injury and defamation in connection with an auto accident. Ordinarily, insurers would argue that there would be no plausible way to reduce the covered bodily injury liability by inflating the noncovered defamation claim. On that premise, a reservation of the right to deny coverage for the latter would not create a conflict of interest.

In sum, a reservation of rights can create a conflict of interest, but the particular facts of a given case must be examined to determine whether a actual conflict exists.

(b) Conflict-Creating Coverage Issues

The defense may affect a coverage determination if the same facts are implicated both in fixing liability and in determining coverage (such a fact being known as a “pivotal fact”). To be sure, the policyholder could not be estopped by an adverse determination if the litigation were controlled by an insurer with an adverse interest on that issue.34 But counsel would need to develop the evidence bearing on that issue, including the knowledge of the policyholder, would need to communicate with both insurer and insured about defense of the issue and evaluation of the prospects on it, and would need to present the evidence and argue it to the factfinder. Witness testimony may be shaped to some degree by the way the witness is prepared and questioned, and the shaping of the first presentation may affect the later testimony of the witness. Findings in the underlying case may affect the coverage case, even if they do not control that case. And a joint representation might give the insurer access to information from the policyholder that would otherwise be confidential.

So, if the case involves a “pivotal fact,” then there typically will be an irreconcilable conflict. Counsel must advocate a position and attempt to shape the evidence regarding the pivotal fact and any position will be contrary to the interests of one client or the other. By shaping the defense, counsel could thus shift liabilities found by the court between covered and non-covered status. Where the coverage issues present such an opportunity, the policyholder is entitled to independent counsel unless the policyholder gives informed consent to the conflict.

For example, if the policyholder is sued on alternative theories of negligence and battery, the former will typically be covered but the latter will not. Of course, the insurer and the

32 Chi of Alaska, Inc., 844 P.2d at 1116.
33 See, e.g., Boyles v. Kerr, 855 S.W.2d 593, 603-04 (Tex. 1993) (concurring op.). Plaintiff sued for intentional invasion of privacy, intentional infliction of emotional distress, and negligent infliction of emotional distress, based on defendant’s conduct in covertly videotaping her having sexual intercourse with him and then showing the tape to his friends. At the close of trial, plaintiff moved to drop the claims of intentional wrongs and defense counsel moved to dismiss the claim of negligent infliction of emotional distress on the ground that no such claim was recognized. Plaintiff’s motions were granted and a verdict for plaintiff returned, but the Texas Supreme Court agreed that there was no general claim for negligent infliction of emotional distress. Had the defense motion been granted and the case gone to verdict on the claims of intentional injury, that would have been injurious to defendant’s interests. The case does not indicate whether defense counsel was independent or whether the defendant gave informed consent to the defense strategy adopted.
34 See RESTATEMENT (SECOND) OF JUDGMENTS, § 58(1)(b) (1982) (indemnitor not estopped by judgment against indemnitee on issues where there is conflict of interest between them).
policyholder share an interest in defeating the suit entirely and in minimizing any judgment. But if liability is found, the policyholder would prefer that it be based on (covered) negligence, while the insurer’s interest would be served if it were based on (noncovered) battery. That is, in such a case, the insured’s intent is a pivotal fact. Because the way in which the case is defended has a real possibility of affecting the basis on which any liability would be found, this divergence of interest creates a conflict of interest for any defense counsel seeking to advance the insurer’s interest as well as that of the policyholder.35

In addition to the alternative allegations of negligent and intentional conduct already noted, such conflict-creating issues have been found in a number of other situations. Examples include

- whether or not the policyholder complied with applicable safety regulations relied upon in defining coverage;36
- whether products liability results from a design defect or a manufacturing error;37
- whether liability of an attorney trustee was based upon erroneous legal judgment or bad business judgment;38
- whether the injured claimant was an employee or an independent contractor;
- whether or not the subject property was damaged while in the policyholder’s possession, custody and control.39

Because a plaintiff’s pleadings do not bind an insurer, a reservation of rights can issue even when a complaint asserts only covered allegations. This may happen, for example, when a plaintiff sues only for negligence but the alleged misconduct by the policyholder may have been intentional. Recognizing that the plaintiff may obtain a judgment based on negligence, the insurer may want to preserve its ability to contend that the injury was really intentional in later coverage litigation, and may issue a reservation of rights letter for this reason. In crafting a negligence defense in this situation, counsel would necessarily be exposed to confidential information about the policyholder’s conduct, information that might be relevant to settlement evaluation or, possibly, even to defense against the negligence allegation. Accordingly, defense counsel could not engage in the free exchange of all defense-related information which is the norm for assigned counsel. That means that independent counsel can sometimes be required even where the complaint makes no allegation of noncovered liability.


Problems can arise in situations where two of the insurer’s policyholders assert covered claims against one another based on the same incident or where two insured defendants have inconsistent defenses. Typically, such situations require independent counsel.

Another type of conflict occurs when policyholders have inconsistent defenses. A leading case is Murphy v. Urso. Murphy was injured when the van in which she was riding struck several parked cars while traveling at excessive speed. The van was driven by James Clancey and owned by Marilyn Urso, owner of a pre-school and primary school. Urso maintained that Clancey had been fired as an employee of the schools and had no permission to use the van. Travelers defended Urso and refused to defend Clancey, who suffered a default judgment of $750,095. Murphy then brought this garnishment action against Travelers. The circuit court held that Clancey did not have permission to use the van (resulting in summary judgment for Urso), but that Travelers had breached its duty to defend Clancey and was estopped to deny coverage.

The Illinois Supreme Court held that Travelers owed a duty to defend, but was excused from defending by the existence of a conflict of interest. There was clear coverage for Urso and the schools and the contested issue of permission to use the van left a potential for coverage of Clancey, so there was a duty to defend both insureds. But the interests of the insureds conflicted:

An analysis of the possibilities reveals the dilemma in which Travelers found itself. It controlled both defenses. To best defend the preschool, it would try to show that Clancey did not have permission to use the bus at the time of the accident. To do this, it had to show either that he had been discharged or in any event was not operating within the scope of his employment, or that he had no explicit or implicit approval to use the bus. This would sever any connection between the preschool and Clancey, place all the liability on Clancey, and exonerate the school. But to best serve Clancey, Travelers had to try to show that he did have permission to use the bus. This would spread the liability to the schools. It was in Clancey's interest, then, to show that he had not been fired and that his use of the bus was within the scope of his employment, or that he had received approval for the use of the bus to help Ms. Murphy move.

This conflict excused Travelers’ duty to defend (though not its duty to fund a defense) and obviated any estoppel.

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42 Murphy v. Urso, 88 Ill. 2d 444 (1981).
43 88 Ill. 2d at 453. In fact, Clancey had no tort-law interest in inculpating the schools: if he were acting within the scope of a agency, he would still be obliged to indemnify his principal against liability for his own negligence. But, showing permission to use the van was essential to obtaining insurance coverage, so his interests were still inconsistent with the schools’ defense. And his coverage interests did create a defense-related conflict with Travelers.
44 88 Ill. 2d at 454-57.

See: Twin City Fire Ins. Co. v. Ben Arnold-Sunbelt Bev. Co., 433 F.3d 365, 374-75 (4th Cir. 2005) (inconsistent defenses entitled one defendant to independent counsel, but defendant forfeited that right by breaching duty to cooperate); Metlife Capital Corp. v. Water Qual. Ins. Syndicate, 100 F. Supp. 2d 90, 93
Other types of conflicts also exist, but these illustrations are enough for this paper..

3. **Minority Rule: Right to Independent Counsel Whenever Coverage Disputed (Reject the Defense Rule)**

Some states authorize the policyholder to reject the insurer’s defense whenever there is a reservation of the right to deny indemnification. In jurisdictions which follow this rule, the policyholder is never obliged to accept a defense under reservation of the insurer’s rights to deny indemnification for any judgment rendered. Under this view, the policyholder’s rejection of a defense under reservation may require the insurer either to affirm coverage unconditionally and defend or to disclaim coverage and refuse to defend, at the risk of breaching the policy if there actually was a duty to defend. Some jurisdictions permit the insurer to avoid the latter risk by agreeing to pay for a defense conducted by counsel selected and controlled by the policyholder. But none of the jurisdictions adhering to this rule permit the insurer, over the policyholder’s objection, to control the defense when there is any question of coverage for the liabilities asserted in the action to be defended. The insurer’s role is limited to payment of counsel who represents and is directed by the policyholder alone.

4. **New Jersey Holds that a Conflict Converts the Duty to Defend to a Duty to Reimburse**

New Jersey, uniquely, holds that, unless the policyholder agrees to a defense under reservation, a conflict converts the duty to defend into a duty to reimburse, after coverage is determined. This essentially forces the policyholder to fund the defense until coverage is determined. That denies the policyholder the full benefit of the duty to defend.

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n.3 (D.P.R. 2000) (“One of the most common conflicts of interest presented in the context of liability insurance is when the insurer insures two or more insureds with adverse interests. In such cases, it is generally accepted that in order to comply with its duty to defend the insured, the insurer must either retain or authorize the insured to retain independent counsel at the expense of the insurer.” (citations omitted)). Note that there would be no conflict on the permissive use issue if that issue were not contested. Allied Am. Ins. Co. v. Ayala, 616 N.E.2d 1349, 1358 (Ill. App. Ct. 1993).


II. Defense Counsel Must Communicate With the Policyholder About the Representation

An important duty whose ramifications are not well understood by all defense counsel is the duty to communicate with the policyholder. Yet this duty may be one of counsel’s most important duties from the standpoint of the policyholder. Most policyholders are completely unfamiliar with litigation. Many are anxious about it, even if there is no reason why they should be. They look to their lawyer for reliable information about the process. Providing them with the information they want (and information they need, but don’t know to want) is a critical part of the relationship. It builds trust, thereby facilitating an effective defense. Communication is also an ethical duty.

Model Rule 1.4 requires that:

(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 a client to make informed decisions regarding the representation.

Finally, communication is critical for defense counsel to learn of situations in which the interests of the policyholder may diverge from those of the insurer. Detection of such situations is the necessary first step in addressing them in ways that protect the interests of all concerned, possibly including provision of independent counsel.

A. Relationship with the Insurer

A particularly important time for communication is at the outset of the representation, when the insured does not know what to expect. One subject is defense counsel’s employment relationship with the insurer. Where an insurer assigns its own employees, known as staff counsel, it is well settled that the employment relationship must be disclosed to the policyholder.47 But this requirement may not be limited to staff counsel. Outside counsel with a regular relationship with the insurer, should disclose that fact. In addition to avoiding misunderstandings, disclosure on this point may be required by Model Rule 1.8(f).

Model Rule 1.8(f) provides that “[a] lawyer shall not accept compensation for representing a client from one other than the client unless … (1) the client gives informed consent.” Obviously, the insurer compensates defense counsel for representation of the policyholder. Of course, when requesting a defense from the insurer, the policyholder probably expected that the lawyer would be paid by the insurer. Even so, the fact of payment must be disclosed to the policyholder, and any regular relationship should be disclosed for reasons similar to those requiring disclosure of staff counsel’s employment relationship.

Model Rule 1.8(f) also requires that the payment of fees by one other than the client must result in no “interference with the lawyer’s independence of professional judgment.” Model Rule 5.4(c) similarly provides that:

A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another

47 E.g., ABA STANDING COMM. ON ETHICS & PROF. RESP, FORMAL OP. 03-430, Propriety of Insurance Staff Counsel Representing the Insurance Company and Its Insureds; Permissible Names for an Association of Insurance Staff Counsel (JULY 9, 2003).
to direct or regulate the lawyer’s professional judgment in rendering such legal services.

An employment relationship gives the insurer rights whose exercise could impact staff counsel’s professional judgment. Similarly, a regular relationship involving repeated retentions could give the insurer the ability to impact outside counsel’s professional judgment. The policyholder should be alerted to either.

**B. Counsel’s Acceptance of Direction**

Insurer-selected defense counsel typically works closely with the claim representative in handling a suit, and the claim representative may give directions on certain issues (e.g., to settle the case within limits or to limit the expense incurred for expert witnesses). (Independent counsel is not subject to direction in the same ways as an insurer’s regular insurance defense, so some of this analysis does not apply to independent counsel.) In many circumstances, such directions are authorized by the insurance policy, but the policyholder may not realize what role the claim representative will play in defense decisionmaking. An advisory opinion of the ABA Standing Committee on Ethics and Professional Responsibility has pointed out the need to inform the policyholder on this subject.⁴⁸

**1. ABA Opinion 96-403**

The opinion assumes that an insurer has issued a policy which authorizes it to settle claims against the policyholder in its sole discretion and without consulting the policyholder. It inquires whether counsel designated by the policyholder to defend the insured may follow the insurer’s instructions to settle without first consulting the policyholder. What disclosures to the insured are required if the lawyer expects to follow such instructions? How should counsel respond if the insurer proposes to settle but the policyholder objects?⁴⁹

The opinion treats the question of settlement authority as one of defining the objectives of the representation.⁵⁰ That is, is the attorney employed simply to seek resolution of the matter at the least cost (as the insurer presumably desires) or is the attorney also to consider reputational and other interests of the policyholder which might be injured by what the policyholder might consider an improvident settlement. If only the monetary stakes are to be considered, that is a representation whose objectives are limited.

Model Rule 1.2(a) requires a lawyer to follow client decisions about the objectives of the representation, including acceptance of settlements.⁵¹ But limitations of the objectives require not

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⁴⁸ ABA STANDING COMMITTEE ON ETHICS AND PROFESSIONAL RESPONSIBILITY, OP. 96-403 (1996).
⁴⁹ Op. 96-403, at 1-2. The opinion construed the version of the Model Rules then in effect, which called for client consents to be given “after consultation.” The Model Rules have been revised to require “informed consent.” But the substance of the requirement is unchanged.
⁵⁰ Op. 96-403, at 3-4.
⁵¹ (a) A lawyer shall abide by a client’s decisions concerning the objectives of representation, subject to paragraph[] (c) . . ., and shall consult with the client as to the means by which they are to be pursued. A lawyer shall abide by a client’s decision whether to accept an offer of settlement of a matter . . .

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(c) A lawyer may limit the objectives of the representation if the client consents after consultation.

MODEL R. PROF. COND. 1.2.
only client consent, but prior “consultation,” in which the client must receive “information sufficient to permit the client to appreciate the significance of the matter in question.”

(1) Manner of Required Disclosure

So, “[i]f the lawyer is to proceed with the representation of the insured at the direction of the insurer, the lawyer must make appropriate disclosure sufficient to apprise the insured of the limited nature of his representation as well as the insurer’s right to control the defense . . . .” Even though the insurer’s rights to control the defense and settle at its discretion are set forth in the insurance policy, the opinion found that the lawyer cannot “assume that the insured understands or remembers, if he ever read, the insurance policy, or that the insured understands that his lawyer will be acting on his behalf, but at the direction of the insurer without further consultation with the insured.” Accordingly, these points must be covered in the lawyer’s consultation with the policyholder.

The opinion expressed the view that this disclosure need not be unduly formal, presumably because it thought that “in the vast majority of cases the insured will have no objection to proceeding in accordance with the terms of his insurance contract.” Specifically, it concluded that the necessary information could be communicated in a short letter. In its view, “[t]he insured manifests consent to the limited representation by accepting the defense offered by the insurer after being advised of the terms of the representation offered.”

The letter contemplated by the opinion would state “that the lawyer intends to proceed at the direction of the insurer in accordance with the terms of the insurance contract and what this means to the insured.” All that is necessary is “that the insured be clearly apprised of the limitations of the representation offered by the insurer and that the lawyer intends to proceed in accordance with the directions of the insurer.”

(2) Timing of Required Disclosure

“A prudent lawyer hired by an insurer to defend an insured will communicate with the insured concerning the limits of the representation at the earliest practicable time.” The opinion suggests that some information “reasonably could be incorporated as part of any routine notice to the insured from the lawyer advising the insured that the lawyer has been retained to represent him.” But, if reasonably prompt, “the lawyer may wait until there is some other reason for communicating with the insured in connection with the claim, such as developing relevant facts, answering a complaint, responding to interrogatories, or scheduling a deposition.”

But, as the opinion notes, delay in providing this information and obtaining the policyholder’s consent to the terms of the representation is dangerous:

52 MODEL R. PROF. COND. 1.2(c).
53 MODEL R. PROF. COND. Definitions.
54 Op. 96-403, at 3.
60 Op. 96-403, at 4.
62 Op. 96-403, at 4-5.
63 Op. 96-403, at 5.
Failure to make the appropriate disclosures near the outset of the representation may generate wholly unnecessary, but difficult, problems for the insured, the insurer, and the lawyer. Thus, if the lawyer fails to advise the insured of the limited nature of the representation and his intention to proceed in accordance with the directions of the insurer early in the representation, the lawyer may find himself trying to advise the insured of a proposed settlement at the last minute under short time constraints, when the insured will have little practical opportunity to reject the defense offered by the insurer and assume responsibility for his own defense.\(^{64}\)

The opinion does not point out, but might have, that these problems may be especially difficult for the lawyer. The lawyer may have duties to the insurer (e.g., to disclose information concerning the representation) which cannot be carried out without violating duties to the policyholder. Had the policyholder been properly advised earlier, then either consent could have been obtained or the policyholder’s refusal to consent would have triggered a dispute between insurer and policyholder, with the representation placed on hold pending resolution of that dispute. Consequently, early disclosure to the policyholder is a critical means of keeping defense counsel from being caught in the middle of such disputes when there is no longer a way to obtain timely resolution.

To avoid such risks, it is a good idea that all known essential information about the nature and scope of the representation be included in correspondence at the outset of the representation.

2. **Direction on Subjects Other Than Settlement**

The Restatement has generalized the requirements of Opinion 96-403, conditioning counsel’s acceptance of insurer direction on virtually any subject on the policyholder’s acquiescence after receiving a short informative letter explaining the relationship.\(^{65}\)

C. **Lack of Representation on Affirmative Claims**

Unless the insurer and the policyholder agree otherwise, the only role an insurer’s regular defense counsel can properly play in the lawsuit is to defend the policyholder against the plaintiff’s claims. But the policyholder may have affirmative claims. The insurer is not obliged to prosecute such claims or to pay defense counsel to do so. If the policyholder is willing to pay for such prosecution, defense counsel could do that if the insurer is agreeable. Otherwise, affirmative claims can only be prosecuted by other counsel (or by the policyholder pro se). Most jurisdictions will treat them as compulsory counterclaims and bar them if not asserted in the original action.

Unless the policyholder is told that defense counsel will do nothing to present affirmative claims (absent a specific agreement to do so), the policyholder may rely on defense counsel to do so. If such a claim is then lost, either to the statute of limitations or by dismissal of the original action, the policyholder may have a malpractice action against defense counsel (and the Insurer). To protect the policyholder’s rights, defense counsel must explain the need to join related claims in the original action, the existence of time limits for doing so, and the fact that defense counsel will not be representing the policyholder with respect to such claims (absent a specific agreement to

\(^{64}\) Op. 96-403,

\(^{65}\) **RESTATEMENT(THIRD) OF THE LAW GOVERNING LAWYERS** § 134, cmt. f. (perm. vol. 2000). Florida and Ohio now have rules requiring assigned defense counsel to provide insured clients with a specified “Statement of Insured Client’s Rights.” *Fla. S. Ct. R. 4-1.8(j); Ohio R. Prof. Cond., Rule 1.8(f)(4).*
This should be explained in every case where there is any substantial possibility that the policyholder may have suffered an injury, regardless of apparent liability. Counsel should not be making the decision whether to assert a claim that even might be viable.

The limitations period applicable to any affirmative claims is not a subject pertinent to the defense of the claims made against the policyholder. Accordingly, it is outside the scope of a defense representation of the policyholder (unless there has been an agreement to expand the scope of the representation), and defense counsel ought not to advise the policyholder on what the applicable period is. But it is appropriate (and sometimes necessary) to warn the policyholder that the period may be about to expire or of a date by which it might expire, so that the policyholder appreciates the need to act promptly in retaining other counsel if the policyholder desires to pursue affirmative claims. Such a warning is especially necessary if expiration of limitations may be imminent when counsel receives the suit against the policyholder.

Once defense counsel has explained the limits of the defense representation, there should be no duty to explore possible affirmative claims that the policyholder might have. But, if defense counsel notices reasons to believe that the policyholder might have a claim worth asserting but has neither asserted it nor retained personal counsel, it is good practice for defense counsel to remind the policyholder of the possible utility of seeking personal counsel.

Occasionally, a policyholder may be involved in criminal or quasicriminal proceedings based on the same incident as the suit (e.g. a traffic ticket). If such proceedings are pending when the representation by defense counsel begins or are brought later, defense counsel should inform the policyholder that defense counsel cannot represent the policyholder in those proceedings. (This warning is not necessary if the policyholder already has counsel for those proceedings, unless the policyholder requests defense counsel to assume that defense.) If doing so will assist in defending the action against the policyholder, defense counsel may work with other counsel or with the policyholder, appearing pro se, in connection with such collateral proceedings.

### D. Sharing of Information

In a representation with only one client, all information concerning the representation is presumptively confidential, while a joint representation of two clients normally entails full sharing with both clients of all information received by the lawyer concerning the representation. Of course, even confidential information may be disclosed “when impliedly authorized in order to carry out the representation.” But sharing among joint clients may extend beyond that authorization. So, if the insurer is a co-client, the insured must be informed of this deviation from the rule applicable to sole representation.

Even if the insurer is not a co-client, it still has insurance policy rights to information about the representation, including information necessary to make settlement decisions and to manage the representation or consult with regard to it. Unless providing such information may be injurious to the policyholder or the policyholder has forbidden its disclosure, doing so is impliedly authorized to carry out the representation. Nonetheless, because the policyholder may expect absolute confidentiality, the expectation of information sharing should be disclosed.

Disclosure regarding information sharing may be even more important when considering joint representation of two policyholders. For example, where the defendants are employer and

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67 Model Rule 1.6(a).
68 RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 122, cmt. c(i) (perm. vol. 2000).
employee, the insurance may protect both from liability. But the employer might use information derived from the lawsuit as a basis for discipline of the employee. The employee must be advised of this possibility, so the employee can decide whether to proceed with a joint representation and what the employee will tell counsel.

E. Existence and Implications of Excess or Noncovered Exposure

But any allegation of liability in excess of policy limits or outside of policy coverage, even if factually insubstantial, must be discussed with the policyholder, so the policyholder can decide whether to retain personal counsel, watch the case more closely, or take some other action with respect to that exposure. Indeed, the policyholder is likely to inquire in many cases as to the meaning and implications of any reservation of rights letter or excess letter received from the claim representative.

In such discussions, it is appropriate to explain that the insurer is obliged (and that defense counsel personally is committed) to provide a full defense appropriate to the liabilities asserted, regardless of whether those liabilities are covered. It is also appropriate, where true, to note the apparent lack of factual basis for the allegations of excess or noncovered liability or the limited prospects for such liability to be proven. But it must also be noted that new evidence can always turn up to bolster what first seem unsupported allegations. Assigned defense counsel must take care not to understatement the risks facing the policyholder.

The policyholder must be told that personal counsel can be useful in advising the policyholder on settlement issues or even in bringing further insights to the defense. Assigned defense counsel should not advise a policyholder against retaining personal counsel, and should emphasize that this is a decision the policyholder must make, in light of the policyholder’s own weighing of the costs and benefits.

Even if the policyholder initially decides not to retain personal counsel, the policyholder must be informed of any new indications that the risks of excess or noncovered exposure are greater than they seemed before. This allows the policyholder to reconsider any actions to respond to those risks. In making the decision whether to retain personal counsel at the outset, the policyholder should be assured that any new information will be called to the policyholder’s attention.

III. Dealing With Insurer Litigation Guidelines

In selecting defense counsel, the insurer may seek to impose requirements regarding the conduct of the defense or require prior approval before counsel may undertake certain defense actions. Litigation management guidelines generally include a statement of the insurer’s goals; a breakdown of the respective duties of the claims professional and the attorney; and standard procedures for handling lawsuits, including required periodic consultations with the claims manager to permit the insurer to direct the case. Such guidelines also may include a delineation of tasks which requires the insurer’s prior approval, including selection and retention of investigators and experts; filing of motions; discovery; performance of computer research; in-firm conferences; travel; and multi-lawyer attendance at hearings, depositions, and trial. Additionally, the insurer may impose staffing guidelines and limitations, including guidelines that require significant work to be done by the lawyer to whom the insurer assigns the case, rather than by associates or paralegals with whom the lawyer works. Insurers normally have fee arrangements with their regular defense counsel calling for conformance with guideline requirements. They may also seek such agreements with independent counsel.

Often such guidelines will attempt to regulate the conduct of defense counsel by emphasizing what the insurance company will not pay for. For instance, the guidelines may provide that the insurance company will not pay for: (i) more than one attorney to attend a court conference or
deposition; (ii) any internal conferences between defense counsel; or (iii) any research unless prior approval is obtained from the insurance company. As a result of such restrictions, defense counsel must conduct the litigation under the watchful eye of the insurer, taking care to mount the best possible defense while simultaneously keeping costs down and the insurer happy. Similar requirements are sometimes imposed by self-insured clients managing their own defense.

Insurers frequently justify these guidelines by arguing that they help insurers make certain that defense counsel are providing the policyholder with a competent and economical defense. Indeed, managed litigation guidelines can establish deadlines by which depositions are taken, fact investigation and “paper discovery” are initiated, as well as how decisions are made regarding the filing of dispositive motions. Nonetheless, insurer-imposed defense guidelines could hamper defense counsel’s ability to effectively represent the policyholder and could pose ethical issues for defense counsel. And policyholders may have very real concerns regarding the defense that the insurer is providing and whether the insurer is fulfilling its duty to defend.

A. Guidelines and Insurer-Assigned Counsel

Both the Restatement and the ABA have examined the ethical obligations of insurer-assigned defense counsel in dealing with insurer guidelines and direction (both concluding that it makes little difference whether the insurer is considered a co-client).

Some issues require little analysis. If requested by the insurer (as it usually will be), counsel may and should consult with the claim representative about any investigation that appears necessary or desirable. Consultation may cover investigation already done or in progress, the timing of further investigation, whether the investigation should be conducted by the insurer or outside investigators, and any expense to be incurred. This topic preferably should be addressed as soon as practicable after assignment of the case.

Similarly, counsel may and should consult with the claim representative about strategy and tactics, including pleadings, discovery, and motion practice. Consultation may cover timing of various actions (e.g. possible deferral of depositions pending efforts to settle) and the expense to be incurred (e.g. for travel or expert witnesses).

After advising the claim representative on counsel’s recommendations and the pros and cons of various courses, (under the Restatement and ABA view) counsel may defer to the claim representative’s preferences, so long as doing so does not appear to involve any substantial risk to any interest of the policyholder. The Restatement considers this sort of situation as follows:

Insurer, a liability insurance company, has issued a policy to Policyholder under which Insurer is to provide a defense and otherwise insure Policyholder against claims covered under the insurance policy. A suit filed against Policyholder alleges that Policyholder is liable for a covered act and for an amount within the policy’s monetary limits. Pursuant to the policy’s terms, Insurer designates Lawyer to defend Policyholder. Lawyer believes doubling the number of depositions taken, at a cost of $5000, would somewhat increase Policyholder’s chances of prevailing and Lawyer so informs Insurer and Policyholder. If the insurance contract confers authority on Insurer to make such decisions about the expense of defense, and Lawyer reasonably believes that the additional depositions can be foregone without violating the duty of competent representation owed by Lawyer
to Policyholder, Lawyer may comply with Insurer’s direction that taking the depositions would not be worth the cost.\textsuperscript{70}

If the course preferred by the claim representative creates no substantial risk to any interest of the policyholder, following that course cannot violate the duty of competent representation owed to the policyholder. If counsel concludes that such a risk would result, counsel should so advise the claim representative, and elaborate the reasons for counsel’s recommendation and the reasons why the claim representative’s preference would create a substantial risk for the policyholder.

If the claim representative adheres to the preference that appears to pose such a threat, the \textit{policyholder must be promptly advised of that risk and consulted about its effect}. The insurer is not obliged to approve all recommendations of defense counsel, even where disapproval may entail some risk to the policyholder. Insurance law and insurance contract interpretation determine the extent to which the insurer is obliged to protect the policyholder’s interests (by settling or committing extra funds in support of the defense, e.g., by hiring experts). Authority to commit the insurer’s funds does not rest with counsel. If claims personnel decide that the protection of the policyholder recommended by defense counsel is not due, then the policyholder must be notified and allowed to make informed decisions about the representation.

An insurer-assigned lawyer’s duties in dealing with insurer guidelines requiring the insurer’s approval for various litigation activities were in American Bar Association ethics opinion 01-421.\textsuperscript{71} That opinion assumes that the insurer has directed the lawyer to proceed in a particular way, rather than merely declining to pay for services the lawyer has recommended.

First, in an elaboration of Opinion 96-403, the ABA Opinion concluded that the insurer and policyholder must be advised about how the representation will be conducted. Counsel must tell the insurer that counsel may not be able to follow insurer directions if they would harm the interests of the policyholder. Counsel must also tell the policyholder about the insurer’s normal practices in directing representations:

\begin{quote}
If the lawyer is hired to defend an insured pursuant to an insurance policy that authorizes the insurer to control the defense and, in its sole discretion, to settle within policy limits, the lawyer must communicate these limitations on his representation of the insured to the insured, preferably early in the representation. The lawyer should "make appropriate disclosures sufficient to apprise the insured of the limited nature of his representation as well as the insurer's right to control the defense in accordance with the terms of the insurance contract.... No formal acceptance or written consent is necessary. The insured manifests consent to the limited representation by accepting the defense offered by the insurer after being advised of the terms of the representation being offered."\textsuperscript{72}
\end{quote}

The Tennessee Bar offered similar advice on the initial consultation with the policyholder:

\begin{quote}
It is not proper to call upon the insured to make a decision about the directives in question (to always appeal adverse general sessions verdicts, to never agree to mediation and to never waive...
\end{quote}

\textsuperscript{70} \textsc{Restatement (Third) of the Law Governing Lawyers} § 134 cmt. f, Illus. 5 (perm. vol. 2000).

\textsuperscript{71} \textsc{American Bar Ass’n Standing Committee on Ethics & Professional Responsibility, Formal Opinion 01-421} (Ethical Obligations of a Lawyer Working Under Insurance Company Guidelines and Other Restrictions).

\textsuperscript{72} ABA 01-421, at 3.
the right to a jury) at the outset of the representation, at a time when it is unclear that any of these situations are likely to occur and at a time when the insured cannot readily assess what interests she might have that could be affected by those decisions. Rather, the insured should be informed at the outset that the insurer ordinarily issues such directions. Counsel may further explain that, in light of the insurance policy and the insured’s tender of defense, counsel assumes that such directions should be followed unless counsel identifies some reasonable probability that following the directive might differ from an interest of the insured (such as by exposing her to or increasing her exposure to liability in excess of limits). But if counsel identifies a reasonable possibility of an interest being advanced that differs from that of the insured, counsel will consult with the insured about the decision at the time it is to be made and in light of all the circumstances then prevailing.73

On this view, counsel may then proceed so long as there appears to be no threat to the policyholder’s interests from any direction the insurer gives. This ordinarily means that ethical problems cannot arise unless there is some question as to coverage or the suit presents a genuine possibility of liability in excess of policy limits.74 If counsel believes that some insurer decision poses a substantial risk to the policyholder, counsel should point that out to the insurer and request reconsideration.75 If the insurer will not reconsider, then counsel must inform the policyholder, fully describe the risks and benefits, and inquire whether the policyholder will consent to having counsel proceed on the basis the insurer requests. The Tenneesee Bar describes such a consultation as follows:

Counsel should describe the decision and its risks and benefits from the standpoint of the insured. Of course, these will include whatever risks to the insured that counsel believes might result from the compliance. But objection to the insurer’s directive would also have risks and therefore, where appropriate, counsel should point out that the insurer might take the position that any unjustified refusal to permit counsel to follow its direction would breach the insurance contract. If the insurer were correct in so contending an objection would endanger the insured’s coverage. On the other hand, if the insured permits counsel to follow the insurer’s directive, the insured could also reserve the right to hold the insurer responsible for any resulting damage to the insured. (The insurer would be liable if the directive were found to breach its duties under the insurance policy.) The insured should be advised of the utility of obtaining independent counsel,

74 In some special circumstances, as with a doctor sued for malpractice, the insured may have reputational or other collateral interests beyond avoiding any personal payment. Where such interests are implicated, the lawyer would treat them in the same way as the more common financial interests, by implementing the procedures described here.
75 The procedures approved in ABA Opinion 01-421 for handling particular conflicts in insurance defense representations appear to have been first recommended in Ellen S. Pryor & Charles Silver, Defense Lawyers’ Professional Responsibilities: Part I—Excess Exposure Cases, 78 TEX. L. REV. 599, 644 (2000). But, under the view taken by the ABA, those procedures are logically implied by the conflicts rules applicable to all representations involving duties to multiple persons.
at the insured’s own expense, in considering whether to
acquiesce in the insurer’s directive (perhaps under protest). If
the insured acquiesces, after being properly advised, counsel
may comply with the insurer’s directive.\textsuperscript{76} If
the policyholder refuses to consent, then counsel cannot proceed in the way the insurer
requests. If the insurer will not rescind the disputed decision, counsel must then withdraw.\textsuperscript{77}
The ABA Opinion reached a similar conclusion:

\begin{quote}
If the lawyer reasonably believes her representation of
the insured will be impaired materially by the insurer’s
guidelines or if the insured objects to the defense provided by a
lawyer working under insurance company guidelines, the lawyer
must consult with both the insured and the insurer concerning the
means by which the objectives of the representation are being
pursued. "If the lawyer is to proceed with the representation of
the insured at the direction of the insurer, the lawyer must make
appropriate disclosure sufficient to apprise the insured of the
limited nature of his representation as well as the insurer's right
to control the defense in accordance with the terms of the
insurance contract."\textsuperscript{78} If the insurer does not withdraw or
modify the limitation on the lawyer’s representation and the
insured refuses to consent to the limited representation, the
resulting conflict implicates Rule 1.7(b) and unless the lawyer is
willing to represent the insured without compensation from the
insurer, requires the lawyer to terminate the representation of
both clients.\textsuperscript{79}
\end{quote}

Insurers would argue that the procedure described by these opinions fully protects policyholders
in what they say would be the infrequent cases where insurer guidelines or direction might create
problems, while allowing such guidelines and direction to operate in the multitude of cases where
they do not cause problems.\textsuperscript{80} That procedure was subsequently approved by the Pennsylvania
Bar Association.\textsuperscript{81} It is also approved by an opinion of Professor Geoffrey C. Hazard, Jr., the
Reporter for the Model Rules and a leading academic authority on professional responsibility.\textsuperscript{82}

\textsuperscript{76} TENN. BD. OF PROF. RESP., FORMAL ETHICS OP. 2000-F-145, 2000 WL 1687507, at *3.
\textsuperscript{77} A request to withdraw will necessarily involve the court, which may resolve any dispute between insurer
and insured. [The footnotes to this quotation are original, but renumbered to fit this paper.]
\textsuperscript{78} Id. \textit{See also} Rule 1.8(f)(2); Board of Professional Responsibility of the Supreme Court of Tennessee
\textsuperscript{79} ABA Op. 01-421, at 4.
\textsuperscript{80} The ABA had previously reached similar conclusions regarding defense counsel’s acceptance of insurer
instructions regarding settlement. \textit{AMERICAN BAR ASS'N STANDING COMMITTEE ON ETHICS &
PROFESSIONAL RESPONSIBILITY, FORMAL OPINION 96-403 (1996), at 2 (defense counsel may accept insurer
instructions regarding settlement so long as insured acquiesces in insurer direction).}
\textsuperscript{81} PENNSYLVANIA BAR ASS'N COMM. ON LEGAL ETHICS AND PROF. RESP., FORMAL OP. 2001-200.
\textsuperscript{82} Opinion of Geoffrey C. Hazard, Jr., at 4-5 & 13-23, \textit{In re Rules of Prof. Cond.}, 2 P.3d 806, 2000 MT
110 (Mont. 2000). Prof. Hazard did not analyze the full set of preliminary steps that attempt to resolve the
conflict, as described in ABA Opinion 01-421. He simply approved the adequacy of the means available to
the lawyer to comply with ethical duties if the conflict could not be resolved: either perform the services
and seek payment later or, to avoid the risk of nonpayment, withdraw. Dean Syverud concurs. Kent D.
Syverud, \textit{The Ethics of Insurer Litigation Management Guidelines and Legal Audits}, \textit{21 INS. LITIG. RPTR.}
180, 188 (1999)
Policyholders argue that a defense attorney cannot be bound to an insurance company’s imposition of guidelines that interfere with the attorney’s effective representation of the client. Indeed, in New Jersey the duty of an attorney hired by the insurance company runs to the policyholder and the fact that the attorney is to be paid by the carrier does not dilute that duty.83 Furthermore, Ohio has held that “it is improper under [Disciplinary Rule] 5-107(B) for an insurance defense attorney to abide by an insurance company’s litigation management guidelines in the representation of an insured when the guidelines interfere with the professional judgment of the attorney.”84 Similarly, New York holds that while an “insurance contract between the insurance company and the insured often gives the insurer a limited right to participate in the insured’s defense [,] the consent of the insured to such participation does not entitle the carrier to impose conditions that would lead to inadequate representation or constrain the lawyer’s independent professional judgment on behalf of the client.”85

As a result of such rules, insurer-imposed billing guidelines have been criticized and even rejected by many states. Policyholders also argue that courts have heavily weighed in on the issues posed by insurer-imposed defense guidelines. In light of such opinions, “it is clear that insurance counsel is required to represent the insured’s interest as if the insured hired counsel directly.”86 For example, in DHA v. Northland Insurance Co., in response to a claim, the insurer issued a reservation of rights letter, which created a potential conflict of interest.87 The court held that “when the facts to be adjudicated in the liability lawsuit are the same facts upon which coverage depends, the conflict of interest will prevent the insurer from conducting the defense.”88

Courts have also held that insurer-imposed restrictions in litigation costs may violate an insurer’s duty to defend and an attorney’s ethical responsibilities to exercise independent professional judgment.89 Indeed, an attorney’s loyalty to his or her client cannot be compromised by allegiance to others or by the attorney’s personal interests.90

Insurers do not disagree with the policyholder’s right to an adequate defense or to defense counsel’s undivided loyalty. Rather, they argue that, where there is no ethical conflict in undertaking the representation, insurer-assigned counsel can comply with all ethical duties by following the procedure outlined in Opinion 01-421. Those objecting to insurer direction usually rely on the lawyer’s duty to exercise independent judgment on behalf of each client, and in particular on behalf of the policyholder. This ignores the protections provided by the conflict rules, as just described. If the lawyer consults with the policyholder about a decision that presents risks to him or her, the claim representative’s directions cannot control counsel’s actions unless the policyholder gives informed consent. If the policyholder does give informed consent,91

84 SUPREME COURT OF OHIO BD. OF COMM’RS ON GRIEVANCES & DISCIPLINE, Op. 2000-3 (June 1, 2003).
88 333 F. Supp. 2d at 601. That conclusion accords with the analysis of the right to independent counsel set forth in text at notes 17-48, supra. Insurers would argue that it has little bearing on the ethical obligations of insurer-assigned counsel in cases where there is no such conflict.
90 Smoot v. Lund, 369 P.2d 933, 936 (Utah 1962); see also Continental Cas. Co. v. Pullman, Comley, Bradley & Reeves, 929 F.2d 103, 108 (2d Cir. 1991) (holding that attorney owes duties and allegiances to the policyholder, not to the insurer); Lieberman v. Employers Ins. of Wasau, 419 A.2d 417, 424 (N.J. 1980) (holding defense counsel retained to represent the policyholder owed his sole duty to the policyholder).
91 An insured giving such consent may, of course, reserve the right to hold the insurer responsible if the insurer directive leads to a bad result for the insured. This option is one the insured would consider in deciding whether to consent.
defense counsel can treat the direction as coming from the policyholder. If the policyholder objects, then either the insurer’s acquiescence in the policyholder’s wishes or counsel’s withdrawal will likewise prevent the insurer from controlling the policyholder’s representation. The authorities that policyholders rely upon to argue that defense counsel cannot accept insurer guidelines never addressed the adequacy of such a procedure to satisfy ethical requirements.

B. Guidelines and Independent Counsel

1. Even with Independent Counsel, Insurers Argue That They Are Entitled To Advance Consultation About Defense Expenditures and Activities

Once counsel has been selected, “[t]he Cumis rule requires complete independence of counsel.”92 “Cumis counsel represents solely the insured.”93 The insurance contract does not govern the relationship between the insurer and defense counsel. But counsel (especially counsel representing and answerable solely to the policyholder) could injure the policyholder’s coverage by failing to act in accordance with the policyholder’s duties under the policy (e.g., by failing to communicate information the insurer is entitled to receive). At least so long as consulting with the insurer does not entail any substantial risk of harm to the policyholder, counsel’s duties to the policyholder require counsel to engage in such consultation (if requested by the insurer) to avoid any risk of injuring the policyholder’s coverage interests. Moreover, disclosure to the insurer of information relating to the representation is impliedly authorized to the extent necessary to avoid the risk of breaching the insurance policy, so long as disclosure does not endanger any policyholder interests and so long as the policyholder has not directed that such information be kept confidential.

California Civil Code § 2860 codifies some of these obligations and imposes them directly on defense counsel:

(d) When independent counsel has been selected by the insured, it shall be the duty of that counsel and the insured to disclose to the insurer all information concerning the action except privileged materials relevant to coverage disputes, and to timely inform and consult with the insurer on all matters relating to the action....

Insurers argue that these duties to disclose relevant information and to consult with the insurer are especially well founded in the insurance contract. While a conflict of interest denies the insurer the right to direct counsel,94 to receive information prejudicial to the policyholder on the subject of the conflict, and to impede actions beneficial to the policyholder on that issue, it does not eliminate the insurer’s interest in the defense. The insurer still desires the most effective and efficient defense, as the insurer is still obliged to pay defense costs and may be required to pay any judgment or settlement. The policyholder is still bound by the contractual duty of cooperation except insofar as that duty is excused by the conflict. Moreover, the insurer retains

the right to settle at its own expense and the right to deny payment of any settlement not approved by it. Exercise of these rights requires full and timely information, so the insurer can consider settlement opportunities and actions that may be necessary to fulfill any duty to the policyholder to accept reasonable settlement demands.

Moreover, insurers claim, the insurer should at least be entitled to make suggestions on defense options and decisions and to have the information necessary to do so. While the policyholder and defense counsel are not bound by any such suggestions, they cannot be harmed and may be helped by receiving them. As Dean Syverud observed with respect to common defense counsel guidelines, “[t]he advance consultation by defense counsel contemplated by the guidelines is as minimal a form of cooperation as one can imagine.”

Consultation is valuable, in and of itself, in achieving an economical defense. Lawyers make money by delivering services. Their incentive is, therefore, to maximize service levels, which is antithetical to minimizing costs. “Even a lawyer who aims to provide only worthwhile defense efforts can subconsciously resolve doubts in favor of doing more, and so earning more.”

In insurers’ view, consultation, even without required approval, tends to restrain inefficient efforts:

The lawyer’s evaluation is sharpened by responding to the adjuster’s comments and questions. Consultation also allows the claims staff to consider with counsel whether the effort proposed could safely be postponed, particularly when there is still a possibility of settlement.

In short, consultation is valuable to the insurer and cannot be prejudicial to the policyholder (so long as any confidential information bearing on coverage is withheld from the insurer, as all agree it must be). Moreover, “[t]o the extent that such consultation avoids unnecessary discovery or motion practice, it also benefits the judicial system.”

Even in the case which most severely restricts insurer use of prior approval requirements, it was conceded that requirements of advance consultation are permissible. At oral argument, Justice Gray had the following exchange with one of Petitioners’ counsel, Robert James:

Mr. James: Rule 1.8 is fairly straight forward. A lawyer shall not accept compensation for representing a client from one other than the client unless there is no interference with the lawyers independence of professional judgment. Rule 5.4 is very similar. It essentially says the same thing. 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. When the billing rules say that we need pre-approval to hire experts to conduct research to file a motion, to file pleadings, to engage in trial preparation or to decide how to staff a case we simply can’t agree to do so. Why? Our position is that the plain and ordinary meaning of these ethical rules prohibit us from allowing an insurance

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97 Hazard Op. 15; see Hazard Op. at 15-17 (expanding on the point)
company from directing and regulating our judgment to do so. It’s just that simple.

Justice Gray: Counsel, if the billing rules said “consult” instead of “approve,” would they still violate the rules?

Mr. James: No, I think that we consult with the insurance company all the time with insurance adjusters and tell them here’s what we think should be done so I think that one of the things that the insurance companies can expect defense counsel to do is to consult with them and find out what our thinking is, why we are thinking and in many cases an adjuster may say let me question you about that. Maybe this isn’t a good thing at this particular time and maybe you will agree or maybe you will disagree.99

Advance consultation on substantial expenses may also lead the insurer to settle to avoid that cost or to withdraw its reservation of rights to regain control of the defense. Either of these results would be beneficial to the policyholder.

Were the insurer unaware that independent counsel was representing only the insured, the provision of legal advice to the carrier could result in creation of an attorney-client relationship not intended by the lawyer100 (and creating the very conflicts that the counsel’s independence was intended to avoid). But that could occur only if the insurer had a reasonable belief that the lawyer was acting on its behalf, and the process by which independent counsel was retained ordinarily should negate any such expectation.101 Any communication or consultation between independent counsel and the insurer is purely informational.102 If there is any doubt about the lawyer’s relationship with the insurer, the lawyer should clarify that the insurer is not a client. And, in some jurisdictions, the fact that the lawyer is independent counsel will automatically preclude existence of any attorney-client relationship with the insurer, without regard to the insurer’s belief.103

2. Even with Independent Counsel, Insurers Argue That They Are Entitled To Challenge Defense Expenditures and Activities That They Regard as Inappropriate and To Withhold Payment for Costs and Services They Have Not Approved

Even where there is a conflict of interest, an insurance policy is not a blank check, requiring payment for whatever work defense counsel chooses to do. An insurer is entitled not to pay for

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100 RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS, § 14 (perm. vol. 2000).
services that are overpriced or inappropriate to the case.\textsuperscript{104} The provider of services is not the sole judge of their necessity.\textsuperscript{105} Insurers must also be able to review all legal bills, including those submitted by independent counsel, to protect against fraud. For example, they must be able to determine that all services billed were actually performed, that lawyers are not turning expense items into profit centers by tacking surcharges onto them, etc.

So, sooner or later, a representative of the insurer must decide whether particular services are appropriate and should be paid for. Insurers argue that a preapproval requirement simply requires that question to be addressed before the services are rendered instead of afterwards.

Consequently, the insurer is entitled to challenge defense activities and expenditures it thinks excessive or inappropriate, and do so before they are executed, to the point of warning that it will not voluntarily pay for them. Accordingly, even where the policyholder is represented by independent counsel, insurers argue that they are still “entitled to apply billing Guidelines for purposes of obtaining the most effective, professional and efficient defense possible for their insureds.”\textsuperscript{106}

Of course, the insurer’s refusal to pay does not end the matter. The policyholder can direct counsel to execute the disputed recommendations for expenses or activities, and counsel will be obliged to do so. Either before or after that is done, the policyholder or counsel can seek to collect from the insurer for those expenses or services. If a court or arbitrator finds the expenses or services appropriate, the insurer will have to pay. Otherwise, the policyholder will have to pay, unless the inappropriateness of the expenses or services prevents counsel from collecting from anyone.

In short, neither party may sit as judge in its own case. If disputes cannot be compromised, they must be submitted to an outside adjudicator. Both sides must take account of the likely rulings of such an adjudicator on the facts presented, and disputes are unlikely to be pressed unless the parties have very different predictions about such a ruling.

Outright refusal to pay has significant risks for the insurer. If held to be incorrect, it is likely to be deemed a breach of the duty to defend, freeing the policyholder from policy restrictions on refusal to settle.\textsuperscript{107} To avoid these risks, an insurer may wish to advance the disputed funds, while reserving the right to seek to recoup them.\textsuperscript{108} But the ability to recoup may be problematic where the policyholder is impeded, and counsel may have defenses to recoupment not available to the policyholder. If recoupment is to be sought, the insurer should either (1) obtain an agreement that the advances will be returned if the insurer prevails in later litigation or (2) seek prompt adjudication of the propriety of the expenses or services in question. Failure to do one or the other may prevent recoupment even if the expenses or services might be found beyond the insurer’s obligations to pay.

\textsuperscript{105} Sarchett v. Blue Shield, 233 Cal. Rptr. 76, 80-82, 729 P.2d 267, 272-273 (Cal. 1987) (medical insurance, requiring payment for all “necessary” services) (collecting cases from other jurisdictions).
\textsuperscript{106} Kent D. Syverud, The Ethics of Insurer Litigation Management Guidelines and Legal Audits, 21 INS. LITIG. Rptr. at 187; accord Hazard Op., 3-4.
\textsuperscript{107} See JEFFREY E. THOMAS & FRANCIS J. MOOTZ, III, THE NEW APPLEMAN ON INSURANCE LAW, LIBRARY EDITION, §§ 17.02, 20.04[2][b].
\textsuperscript{108} Buss v. Superior Court, 65 Cal. Rptr. 2d 366, 939 P.2d 766 (Cal. 1997);
WILLIAM T. BARKER & RONALD D. KENT, NEW APPLEMAN INSURANCE BAD FAITH LITIGATION, SECOND EDITION, § 2.11.
Apart from the possibility of freeing the policyholder to settle, an unreasonable refusal to pay could be the basis of a bad faith claim, as defense costs are a form of first-party benefit.109

3. Insurers Argue That the Montana Supreme Court’s Rejection of Prior Approval Requirements Is Unlikely To Be Applied in an Independent Counsel Context

The Montana Supreme Court has held that any requirement of prior approval impermissibly interferes with a lawyer’s obligation to exercise independent judgment on behalf of the policyholder.110 The decision was rendered with respect to insurer-assigned defense counsel, and insurers argue that the concern that motivated it does not justifiably extend to the representation in which independent counsel represent policyholders. This is so because independent counsel recommend options to policyholders and follow policyholders’ instructions. They do not follow insurers’ instructions and, therefore, are not subject to insurers’ prior approval. They may learn that an insurer will not willingly pay for a defense-related service they believe should be employed, but they are nonetheless entirely free to recommend the service to the policyholder, to perform it at the policyholder’s request, to bill for it, and to help the policyholder sue for reimbursement. As insurers view the matter, independent counsel thus stands in the same position as any other lawyer whose client has arguable contractual rights against another party which the latter disputes.

The propriety of this conclusion is arguably supported by the similarity of the procedure to that approved by the ABA Standing Committee on Ethics for cases in which counsel is not independent. ABA Opinion 01-421 assumes that the insurer has directed the lawyer to proceed in a particular way, rather than merely declining to pay for services the lawyer has recommended. Because actual direction of the lawyer creates no insurmountable problem, insurers argue that a mere threat to withhold payment can hardly do so.

With insurer-assigned counsel, disagreement between insurer and policyholder about proposed defense activities can make it necessary for counsel to withdraw.111 In an independent counsel situation, there will be no possible need for withdrawal and no need to get the insurer’s consent for proposed activities or expenses. The lawyer and the policyholder need only discuss whether to assume the risk of nonpayment and the burden of litigating for payment. If the policyholder is willing to advance the necessary funds or if the lawyer is willing to extend credit (possibly on a nonrecourse basis), they may proceed and pursue the insurer later. In the meantime, the insurer remains obligated to continue funding agreed expenses and activities.

While the Montana Supreme Court presumably would reject the ABA analysis, insurers would argue that its opinion is both distinguishable when the problem is presented in an independent counsel context and should be rejected by other courts even where it is not distinguishable.112


WILLIAM T. BARKER & RONALD D. KENT, NEW APPLEMAN INSURANCE BAD FAITH LITIGATION, SECOND EDITION, § 3.08[3].

110 In re Rules of Prof. Cond., 2 P.3d 806, ¶¶ 43-51 (Mont. 2000).

111 See text at notes 81-83, supra.

4. Even with Independent Counsel, Insurers Argue That They Are Entitled To Pay No More Than Market Rates for the Type and Quality of Service Reasonably Necessary to the Defense of the Case

In a few states, statutes limit the fees insurers must pay independent counsel. Thus, in California, [t]he insurer’s obligation to pay fees to the independent counsel selected by the insured is limited to the rates which are actually paid by the insurer to attorneys retained by it in the ordinary course of business in the defense of similar actions in the community where the claim arose or is being defended.\(^{113}\)

Absent such a statute, lawyers are still limited to charging fees permissible under the applicable Rules of Professional Conduct. Most such rules are based on ABA Model Rule 1.5.

Insurers, of course, argue that a reasonable fee for defense services is established by the rates charged by lawyers from whom the insurers regularly purchase similar services. In their view, the cost of defending the insured ought not to be increased by the fortuitous existence of circumstances entitling the insured to independent counsel.

But lawyers not regularly retained by the insurer obliged to pay for independent counsel will resist accepting payment at the rates that insurer normally pays for similar services. Insurers are able to provide their regular counsel with a volume of work warranting a significant discount in the rates charged for that work. Independent counsel do not receive a similar volume of work. If they have adequate business at rates not affected by such a discount, they have no incentive to accept the discounted rates charged by firms the insurer regularly retains.

If the insurer were obliged to pay no more than its customary discounted rates, a policyholder seeking independent counsel might find it necessary to supplement the insurer’s payments to obtain comparable counsel or accept the services of less able (and therefore less expensive) counsel than would normally be retained for the particular case. Accordingly, policyholders would argue that the insurer’s customary discounted rates are not adequate or reasonable for independent counsel.

The policy promises the policyholder an adequate and appropriate defense to any suit seeking any relief that, if established, would be covered.\(^{114}\) This is promised at no cost to the policyholder. To fulfill this promise, policyholders argue that the insurer must be obliged to pay independent counsel fees equal to “the prevailing market rates in the relevant community” for the type and quality of services reasonably necessary to defense of the particular lawsuit.\(^{115}\) The market rate will typically reflect the factors enumerated in Model Rule 1.5.

The market rate may or may not be the customary rate charged by the lawyer(s) the insured has chosen to retain, depending on whether they are appropriate to the case. If a policyholder chooses to use more capable attorneys than the case requires, insurers argue that the policyholder may have to pay the extra cost beyond what would be required for less capable, but adequate attorneys. And disputes regarding the required level of capability (and the corresponding reasonable rate) may need to be adjudicated. Pending adjudication, insurer, policyholder, and lawyers need to have some agreement on payment of fees as the litigation proceeds.

\(^{113}\) CAL. CIV. CODE § 2860(c); see also ALASKA STAT. § 21.89.100(d) (similar provision).

\(^{114}\) JEFFREY E. THOMAS & FRANCIS J. MOOTZ, III, THE NEW APPLEMAN ON INSURANCE LAW, LIBRARY EDITION, § 17.01; WILLIAM T. BARKER & RONALD D. KENT, NEW APPLEMAN INSURANCE BAD FAITH LITIGATION, SECOND EDITION, § 3.02[1]-[4].

IV. Dealing with Outside Bill Reviewers

At least at one time, many insurers attempted to require defense lawyers (both assigned and independent) to submit detailed bills to outside firms for review before the claim representative would consider them for payment. (These bill reviewers were often referred to as “auditors,” but many did not make independent review of material beyond the bills themselves, and the authorities addressing the propriety of this practice generally focused on bill review.) As discussed here, many bar ethics committees and at least one court concluded that counsel could not submit detailed bills to outside reviewers without informed consent of the policyholder. While insurers questioned that conclusion, many either moved the review process entirely in-house or switched to using outside services purely to provide computerized processing of bills, without the actual content of the bills being reviewed by any outside personnel, arguing that this change eliminated any problem identified by opinions critical of outside bill reviewers.

A. Confidentiality Generally

One of the fundamental duties of attorneys is to maintain the confidentiality of information they acquire in connection with representation of clients. Model Rule 1.6(a) states this duty as follows:

A lawyer shall not reveal information relating to representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation, or the disclosure is permitted by paragraph (b) [whose terms are not relevant here].

Model Rule 1.8(b) supplements this prohibition on disclosure of information by prohibiting its use “to the disadvantage of the client unless the client gives informed consent, [with exceptions not relevant here].”

It is important to remember that these limits on use or disclosure of confidential information are not limited to the types of information protected from compelled disclosure by the attorney client privilege. They broadly limit voluntary use or disclosure of any nonpublic information derived from the representation for purposes other than carrying out the representation. That is, confidentiality is broader than privilege.

B. Implied Authority To Disclose

Implied authority to disclose generally arises when utility to the representation combines with lack of any apparent risk to the interests of the client.116 “Except to the extent that the client's instructions or special circumstances limit that authority, lawyer is impliedly authorized to make disclosures about a client when appropriate in carrying out representation.”117 This standard is taken from the law of agency, under which implied authority is inferred from the nature of the representation, the “general usages” of similar relationships, and those acts which “usually accompany” or are “reasonably necessary” to the representation.118 For example, attorneys do not ask client consent in sharing their confidential information with non-attorneys within a law firm such as secretaries, copy clerks, and accountants, because such disclosure is a necessary and usual part of any representation. The same is true of potential expert witnesses. ABA Opinion 95-398

116 See RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 61 (perm. vol. 2000) (“RESTATEMENT LGL”). The test stated there has been approved by the ABA as the equivalent of the standard under Model Rule 1.6. ABA Standing Comm. on Ethics and Prof’l Responsibility, Formal Op. 01-421 n.25 (2001).
117 MODEL RULES PROF. COND. R. 1.6, cmt. 5.
extended this reasoning to outside copy services and data processing services used to produce billing statements from firm time records.

The authorization for disclosures “impliedly authorized in order to carry out the representation” most obviously permits disclosure “when the lawyer reasonably believes doing so will advance the interests of the client in the representation.”\textsuperscript{119} Except where there is a right to independent counsel, the insured has contractually committed management of the defense to the insurer, a commitment confirmed when the insured acquiesces in counsel’s explanation of the way in which the representation is to be conducted. Moreover, the insurer needs full information about the progress and prospects for the case to perform its duties to the insured regarding settlement. On this basis, disclosure to the claim representative of most information regarding the defense is impliedly authorized unless if bears on an issue where the insurer and the policyholder have conflicting interests.

Implied authorization (by the insured) for such disclosure normally would not exist, however, if counsel knows of a reasonable prospect that disclosure could be injurious to the insured or if the insured requested that the information not be disclosed.

Based on these principles, ABA Opinion 01-421 concluded that:

- Informing the insurer about the litigation through periodic status reports, detailed billing statements and the submission of other information usually is required, explicitly or implicitly, by the contract between the insurer and the insured and also is appropriate in those jurisdictions where the insurer is regarded as a client and there is no conflict between the insurer and insured. The disclosure of such information usually advances the interests of both the insured and the insurer in the representation and such disclosures are, therefore, “impliedly authorized to carry out the representation.” In those relatively rare situations when the lawyer reasonably believes that disclosure of confidential information to the insurer will affect a material interest of the client-insured adversely, the lawyer may not disclose such confidential information without first obtaining the informed consent of the client-insured. [Footnotes omitted.]\textsuperscript{120}

On the latter point, the potential for adverse effect on the policyholder may arise when the information to be disclosed jeopardizes the insured’s coverage under the insurance policy; reveals extremely sensitive or personal, irrelevant information about the insured; or otherwise implicates a conflict between the insurer and insured. In these relatively infrequent situations, it is essential that the lawyer obtain the informed consent of the client-insured before disclosing the confidential information in question.\textsuperscript{121}

\textbf{C. Impact of Attorney-Client Privilege on Implied Authority To Disclose}

One type of adverse effect that could result from disclosure to a person other than the policyholder would be impairment of the attorney-client privilege for the policyholder’s

\textsuperscript{119} \textsc{Restatement LGL} § 61.
\textsuperscript{120} \textsc{American Bar Ass’n Standing Committee on Ethics & Professional Responsibility}, \textsc{Formal Opinion} 01-421, at 5.
\textsuperscript{121} ABA Op. 01-421, at 7.
communications to defense counsel. Disclosure to the insurer generally does not create a problem when defense counsel is insurer assigned and or when independent counsel discloses only matters not related to any conflict between insurer and policyholder.

One formulation of the scope of the protection is provided by proposed federal rule of evidence 503 on attorney-client privilege. Though never effective, federal courts commonly look to it as a succinct statement of the common law that Rule 501 of the Federal Rules of Evidence makes authoritative in cases where federal law provides the rules of decision. Proposed rule 503(b) provided a privilege for communications among a client, the client’s lawyer(s) and representatives of either. Similarly, the Restatement privileges qualifying communications “made between privileged persons.” “Privileged persons” are defined to be “the client …, the client’s lawyer, and agents of either.”

For privilege purposes, the Restatement defines an agent as one whose involvement on behalf of the client is reasonably necessary and whom the client reasonably expects to maintain confidentiality. One type of agent a client may utilize is one who manages the matter on the client’s behalf. The Restatement recognizes an insurer as such an agent. Thus, it states that “a client need not personally seek legal assistance, but may appoint a third person to do so as the client’s agent (e.g. § 134, Comment f).” The referenced comment states, in pertinent part:

It is clear in an insurance situation that a lawyer designated to defend an insured has a lawyer-client relationship with the insured. The insurer is not, simply by the fact that it designates the lawyer, a client of the lawyer. Whether a client-lawyer relationship also exists between the lawyer and the insurer is determined under § 14. Whether or not such a relationship exists, communications between the lawyer and representatives of the insurer concerning such matters as progress reports, case evaluations, and settlement should be regarded as privileged and otherwise immune from discovery by the claimant or another party to the proceeding.122

Moreover, as used in the RESTATEMENT, “agents … who facilitate communication” include not only true agents of lawyer or client, but also

persons who hire the lawyer as an incident of the lawyer’s engagement. Thus, the privilege covers communications by a client insured to an insurance company investigator who is to convey the facts to the client’s lawyer designated by the insurer, as well as communications from the lawyer for the insured to the insurer in providing a progress report or discussing litigation strategy.123

These specific statements are reinforced by broad rules permitting sharing of information among co-clients and among other parties of common interest.124 The relevant interest is one in the “matter” that is the subject of the representation.125 But their interests in the matter “need not be entirely congruent”126. Joint representation or common interest sharing is permissible for joint

122 RESTATEMENT LGL. § 134, cmt. f (emphasis added).
123 Id. (emphasis added).
124 Id. §§ 75, 76.
125 Id. § 76.
126 Id. cmt e.
defense or prosecution of a lawsuit, even if the parties may have divergent interests in allocating any resulting recovery or liability.127

So an insurer who hires the lawyer pursuant to a standard liability insurance policy is a privileged party. This is so regardless of whether it be regarded as a co-client, the insured’s agent for managing the representation, or simply a contractually interested third party. Even where defense counsel is independent counsel, the insurer is a person of common interest with respect to matters not implicating any conflict of interest with the policyholder.

D. Disclosure of Attorney-Client Privileged Information to Outside Bill Reviewers Is Impermissible Unless the Policyholder Gives Informed Consent

While outside bill review was considered in ABA Opinion 01-421, that opinion considered a broader range of auditing, which might go well beyond mere bill review: “The phrase ‘legal bill audit’ encompasses a range of services, from an examination of the face of the legal bill for improper charges or errors to a detailed analysis of original time records, attorney work product, expenses and hourly rate benchmarks, and more.”128 The Opinion further explained:

An audit may include an examination of hourly rates and background information about the legal matters for which the bill was submitted, including examination of the lawyer’s work product and opposing counsel’s work product in order to gauge “quality, tactic, strategy, and performance in context.” A detailed bill review might include “verification of raw data, interviews of key personnel, examination of firm billing systems, checking the original time records against time entries in invoices, and reconciling receipts for expenses with the bill.”129

Information in detailed billing statements might and the more detailed material described in that passage likely would disclose the contents of privileged communications. While insurers argue that a confidential outside bill reviewer is an agent of the insurer to whom disclosure does not endanger the privilege, at least one court has disagreed.130 No matter how strong the arguments of insurers to the contrary, that ruling prevents defense counsel from concluding that disclosure of privileged information to the bill reviewer would entail no significant risk to the policyholder. That is the apparent basis of ABA Opinion 01-421’s conclusion that

the lawyer [may not] disclose the insured’s confidential information to a third-party auditor designated by the insurer without the insured’s informed consent. Unlike the disclosure of the insured’s confidential information to secretaries and interpreters, the disclosure of such information to a third-party auditor, a vendor with whom the lawyer has no employment or direct contractual relationship, may not be deemed essential to the representation and may, therefore, result in a waiver—albeit unintended—of the privilege. Therefore, since such disclosures always involve the risk of loss of privilege, the lawyer must obtain the insured’s informed consent before sending bills with

127 See FDIC v. Ogden Corp, 202 F.3d 454 (1st Cir. 2000) (parties had joint attorney-client relationship for prosecution of insurance claim, despite potential disputes about allocation of proceeds among themselves); information shared was confidential against outsiders, but usable in dispute inter se).
129 Id. (footnote omitted).
130 In re Rules of Prof’l Conduct, 2 P.3d 806, 818-21 (Mont. 2000).
such information to a third party hired by the insurer to audit the bills.\textsuperscript{131}

E. **Insurers Argue That Detailed Billing Statements Excluding any Privileged Information May Be Disclosed to Confidential Outside Services That Use Computer Software To Preliminarily Process Bills for Review by In-House Claim Adjusters**

Some insurers have reacted to the consensus on the impermissibility (absent informed policyholder consent) of disclosure to outside bill reviewers by calling for bills to be submitted to confidential outside data processing services for preliminary processing. Such a service processes the billing information through its proprietary software and presents it for review by the insurer personnel responsible for the matter the lawyer is handling. The service exercises no discretion and makes no decisions regarding the bills submitted. The insurer instructs defense counsel along the following lines regarding billing descriptions:

The bill must be prepared with daily entries … showing (a) the date the work was performed; (b) the UBTM task or expense code; (c) the UBTM activity code; (d) the timekeeper ID; (e) a

description of the work performed (single activities must be described such that no client confidential information is contained in written descriptions; entries should be limited to strategic tasks); (f) the actual time in tenths of an hour and (g) line item total.

In the event that documentation of lawyer work is necessary to support billing entries, that information will be submitted directly to the insurer by the law firm, and it will not share that information with the processing service.

Disclosure of billing statements runs no risk of waiving the privilege if those billing statements are not themselves privileged (at least in part). To be privileged, the billing statements would have to reflect the content of a privileged communication in a way that allowed that to “be traced to a privileged person as its expressive source”132 Most bills do not allow such tracing, and deciding whether a particular bill does so requires specific analysis of that bill.

As required by the instruction just quoted, a lawyer can exercise care in composing billing descriptions that do not disclose the contents of privileged communications. Neither the Montana case nor any of the bar opinions have considered this method of avoiding the risk they perceived. Most appear to have either expressly or silently presumed that it would not be possible to compose adequately detailed billing statements that did not disclose privileged communications or that the auditor’s review would extend to other materials which would disclose the contents of privileged communications.

In the context of insurance defense, and even apart from the billing instruction described, bills are particularly unlikely to disclose the contents of privileged communications. The insured’s motive in seeking legal counsel is not confidential, but open and obvious: the need to respond to the suit. Much of the activity reflected in the bills will result from the need to respond to actions of the plaintiff (e.g., researching the law on issues raised by the suit) or will result from interactions with witnesses or information sources other than the client. Even if they do reflect communications with the client, it will usually be impossible for an outside observer to determine that, given the other possible sources.

And the bills will be directed to an adjuster familiar with the lawsuit and the agreed plan of defense. As a result, what is adequate detail for the adjuster may be relatively uninformative to an outside observer (at least as regards the contents of privileged communications). Indeed, the billing instructions require this, by directing that client confidential information not be included. On this point, such a program is different from the legal auditing that was the subject of ABA Opinion 01-421, the Montana case, and the host of other bar opinions. In the legal auditing context, the bills were to be reviewed by an auditor who would generally not be familiar with the case. So the bills would have had to be more detailed to give the auditor a basis to decide whether the work reflected was proper That is also why the auditors might sometimes have found it necessary to go behind the bills and look at the actual work product. Even if the bills submitted to auditors would necessarily have revealed privileged communications (which insurers would deny), that would not mean that bills in a program such as that described would do so.

If the bills do not contain privileged information to begin with, disclosing them cannot implicate the special confidentiality protections for such information and there can be no risk that disclosing them would waive any privilege.

132 RESTATEMENT LGL §69 cmt h.
F. Even If the Privilege Were Lost (and With Respect To Significant Nonprivileged Material Contained In the Bills), the Protections Of Work Product Immunity Would Be Unaffected By Disclosure To a Confidential Outside Processing Service

An insurer would have no occasion to assign counsel to an insured unless the insured had been sued or, at least, was faced with a claim likely to result in a suit (absent a pre-suit settlement). So all of counsel’s services will be in anticipation of litigation or for trial.

If the litigation is brought in federal court, all documents reflecting counsel’s activities (including the bills) will be subject to a qualified immunity from discovery, requiring a showing of substantial need and undue hardship to obtain discovery. Moreover, even if the necessary showing is made to obtain discovery, “the court shall protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of an attorney or other representative of a party concerning the litigation.” Such “opinion work product” is given nearly absolute protection. State courts generally provide similar protections.

Litigation bills should ordinarily be protected by these immunities, unless they are so general as to be useless. Bills might reveal witness identities, but these are discoverable by interrogatory without requiring any showing of need or hardship. It is hard to see how there could be substantial need for any information shown in the bills that is not either freely discoverable in other ways or almost absolutely protected as “opinion work product” or its state counterpart.

Work product immunity is less easily waived than attorney-client privilege. Work product protection is not waived by disclosure to a third party unless that party is an adversary of the client for whom the work product was generated (or likely to disclose to such an adversary). The processing service is not an adversary of the insured, nor, given its confidentiality obligations, is it likely to disclose to such an adversary. So, even if the attorney-client privilege were waived by disclosure to LexisNexis, the work product immunity would not be affected.

Accordingly, under the circumstances described here, insurers would argue that there should ordinarily be no risk to the insured client’s interests from disclosing to the processing service information which the lawyer is properly disclosing to the insurer.

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133 FED. R. CIV. P. 26(b)(3).
134 8 CHARLES ALAN WRIGHT, ARTHUR MILLER & RICHARD L. MARCUS, FEDERAL PRACTICE & PROCEDURE § 2026 (1994).
135 E.g., Permian Corp. v. U. S., 665 F.2d 1214, 1219 (D.C. Cir. 1981) (only disclosures “inconsistent with the adversary system” waive work product protection); In re Will of Pretino, 567 N.Y.S.2d 1009, 1012 (N.Y. App. Div. 1991) (“[t]o constitute a waiver, disclosure must be inconsistent with maintaining secrecy as against an adversary and it must significantly increase the possibility that the opposing party will obtain the information”); RESTATEMENT LGL § 91(4) & cmt. b.