

KENTUCKY BAR ASSOCIATION
Ethics Opinion KBA E-410
Issued: September 1999

Question 1: Does an attorney violate the Kentucky Rules of Professional Conduct if he discloses information to the Insurer in the course of defending the Insured if that information is damaging to the Insured on the issue of coverage but is not known by the attorney to be damaging when the information is disclosed?

Answer: An attorney must be ever vigilant, pursuant to KRPC 1.1 and 1.3, to identify information that might be disadvantageous to the client Insured and to refrain from disclosing such information absent fully informed client consent. If the attorney is competent and diligent in this regard and yet forwards to the Insurer information not known to the attorney to be damaging, no unethical conduct has occurred.

Question 2: May an attorney defend an Insured if the Insurer provides the defense under a reservation of rights?

Answer: Yes, if the relationship between the attorney and the Insurer and the reason for the reservation of rights does not create a situation in which the conflict of interest is so great that the client cannot consent under 1.7(b).

Question 3: May an attorney defending an Insured whose defense is provided by the Insurer under a reservation of rights communicate with the Insurer regarding the status and analysis of liability?

Answer: Yes, if the attorney protects the rights and confidences of the client Insured and discloses no information disadvantageous to the client without particularized consent.

Question 4: May an attorney continue to defend the Insured if the Insurer provides the defense and if the Insurer files an action for Declaration of Rights?

Answer: The attorney may continue to defend the Insured as long as no conflict violative of KRPC 1.7(b) exists. The attorney cannot represent either party in the Declaration of Rights action.

Question 5: May an attorney defending the Insured communicate about the status and analysis of liability with the Insurer who is providing the defense if the Insurer has filed an action for Declaration of Rights?

Answer: The attorney may communicate with the Insurer within the parameters discussed regarding Questions 1 & 3.

Question 6: May an attorney defend an Insured in a matter in which the Insurer is providing the defense is also a party when the attorney represents the Insurer in other unrelated matters?

Answer: Yes, if the matter in which the attorney defends the Insured and in which the Insurer is a party will not involve a development of facts and theories relating to coverage issues.

References: Kentucky Rule of Professional Conduct (KRPC)1.1) (SCR 3.130 (1.1)); KRPC 1.2(d); KRPC 1.3; KRPC 1.4; KRPC 1.6; KRPC 1.7; KRPC 1.8(f); KBA E-378 (1995) KBA E-368 (1994); KBA E-340 (1990); Cal. Civil Code sec. 2860 (1998); Ill. Op. 92-02 (1992); U.S. Fid. & Guar. Co., v. Louis A. Roser Co., 585 F.2d 932, 938 n.5 (8th Cir. 1978); Finley v. Home Insurance Co., 975 P.2d 1145 (Hawaii 1998); Douglas Richmond, *Lost in the Eternal Triangle of Insurance Defense Ethics*, 9 Geo. J. Legal Ethics 475, 486 (1996)

OPINION

Question 1:

When an Insurer provides the defense to an Insured, the attorney represents the Insured but not the Insurer. See KBA E-368 (1994); KBA E-378 (1995). The Insurer is a third-party payor and the situation is governed by Kentucky Rules of Professional Conduct (KRPC) 1.8(f), which states:

A lawyer shall not accept compensation for representing a client from one other than the client unless:

- (1) such compensation is in accordance with an agreement between the client and the third party or the client consents after consultation;
- (2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and
- (3) information relating to representation of a client is protected as required by Rule 1.6.

The confidentiality of client confidences is governed by KRPC 1.6, which states:

A lawyer shall not reveal information relating to representation of a client unless the client consents after consultation, except for disclosures that are impliedly authorized in order to carry out the representation, and except as stated in paragraph (b).

Paragraph (b) states:

A lawyer may reveal such information to the extent the lawyer reasonably believes necessary:

(1) to prevent the client from committing a criminal act that the lawyer believes is likely to result in imminent death or substantial bodily harm; or

(2) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client; or

(3) to comply with other law or court order.

The contract of insurance between the Insurer and the Insured pursuant to which the Insurer provides the defense commonly allows the Insurer to have some measure of control regarding the defense provided and commonly requires that the Insured cooperate in the defense. Such is a matter of contract and may govern the rights of the Insurer and the Insured as to each other.

The contract of insurance does not, however, define the ethical duties an attorney hired by an Insurer to defend an Insured owes to the client Insured. KRPC 1.4 states that the attorney should keep the client "reasonably informed" and that the attorney should "explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation." Thus, the attorney hired by the Insurer to defend the Insured should, at the beginning of the client-lawyer relationship, explain to the client the nature and requirements of the Insurer and Insured contract. As part of this explanation, the attorney should point out to the client that in order for the Insured to abide by his or her obligations under the insurance contract, that the attorney will be in communication with the Insurer about the defense. Having informed the client of the client's rights and obligations, and assuming that the client consents to the arrangement, including the usual and customary disclosures to the Insurer, the attorney may, throughout the defense have such usual and customary communications with the Insurer. Those communications are consistent with KRPC 1.6(a) as being communications done with actual or implied authorization.

However, an attorney defending an Insured must be ever cautious with regard to any information "relating to the representation" that might be disadvantageous to the client if it were disclosed to the Insurer. As was stated in KBA E-340 (1990):

Counsel should resist any [Insurer] ‘demand’ that might put the insured at risk. It is also clear that any intrusion into the attorney/client sanctum should be permitted only with the informed consent of the client.

When such potentially damaging information is revealed to the attorney, the attorney must consult with the client and obtain the client’s consent before disclosing the information. If the client directs the attorney to refrain from disclosing, the attorney must follow the instruction of the client as long as KRPC 1.2(d), which forbids assisting the client in a crime or fraud, is not implicated.

With regard to recognizing the information as damaging to the client, the attorney’s conduct is guided by KRPC 1.1. KRPC 1.1 states that a “lawyer shall provide competent representation to a client.” Competence is defined to require “the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.” KRPC 1.1. KRPC 1.3 requires a lawyer to “act with reasonable diligence and promptness in representing a client.” Comment 1 to 1.3 states: “A lawyer should act with commitment and dedication to the interests of the client and with zeal in advocacy upon the client’s behalf.” The attorney representing the Insured must be every vigilant and must abide by KRPC 1.1 and 1.3 with regard to protecting the client’s rights and identifying information that might be harmful to the Insured.

If the attorney is competent and diligent in this regard and yet forwards to the Insurer information not known to the attorney to be damaging, no unethical conduct has occurred.

Question 2:

All attorneys who are paid by Insurers to defend Insureds must scrupulously monitor the tripartite relationship to ensure that the attorney’s independence of judgment is not impaired, that the attorney’s representation of the Insured is not impaired, and that client confidences are protected. In so doing, the attorney must be ever mindful that with regard to this tripartite relationship the attorney’s client is the Insured and not the Insurer. As part of the duties of competence and diligence and the duty to communicate with the client discussed above, the attorney should explain the nature of a defense under reservation of rights to the client. When the Insurer provides the defense under a reservation of rights, the possibility exists that an impermissible conflict of interest is created.

An Insurer may offer a defense under a reservation of rights for a variety of reasons. For example, an Insurer may issue a reservation when the recovery against the Insured may exceed policy limits. An Insurer may offer a defense under a reservation of rights when the plaintiff asserts two or more claims, one of which is not within the insurance contract coverage. An Insurer may offer a defense under a reservation of rights when the possibility exists that no coverage is due because of the nature of the claim or facts providing the basis for the claim or because of an unrelated issue such as a misstatement on the policy application.

When an attorney represents an Insured and the Insurer is providing the defense under a reservation of rights, the attorney must analyze the situation under the general conflict of interest rule, KRPC 1.7(b). KRPC 1.7(b) states that a ‘lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer’s responsibilities to another client or to a third person, or by the lawyer’s own interests, unless” two conditions are satisfied. First, the lawyer must “reasonably believe that the representation will not be adversely affected.” Second, the client must consent after consultation.” Comment 4 to KRPC 1.7 states that “when a disinterested lawyer would conclude that the client should not agree to the representation under the circumstances, the lawyer involved cannot properly ask for such agreement, or provide representation on the basis of the client’s consent.”

In applying this rule, the attorney must consider his or her relationship with the Insurer as well as the reason for the reservation of rights to decide whether the client’s representation “may be materially limited.” For example, an attorney who receives a large percentage of the attorney’s total fees from cases in which the Insurer is providing the defense may have a more significant motivation to please the Insurer than an attorney who depends on the Insurer for a small percentage of his or her total fees. An attorney dependent on the Insurer for a substantial part of his or her fees may conclude that the allegiance to the Insurer may adversely affect the representation of the Insured. Likewise, an attorney who represents the Insurer in unrelated matters may have more of an allegiance to the Insurer and that allegiance may adversely affect the representation of the Insured.

When the reason for the reservation of rights is a misstatement on the application or some other issue not involved in the matter in which the attorney represents the Insured, even an attorney who receives a substantial amount of his or her fees from the Insurer may conclude that the representation would not be ‘materially limited.” The same can be said about the situation in which the reservation of rights issues as a result of the possibility of a judgment in excess of policy limits.

When the reason for the reservation of rights is one involving the facts and theories to be developed in the matter in which the attorney defends the Insured, the Insurer’s and the Insured’s interests diverge more significantly and the attorney must always be vigilant to protect the client’s rights and confidences and pursue the best defense for the client. This may require the attorney to be more adversarial in dealing with the Insurer because the Insurer may, consciously or unconsciously, desire to tilt the defense in a way to minimize its own liability. See Douglas Richmond, *Lost in the Eternal Triangle of Insurance Defense Ethics*, 9 *Geo. J. Legal Ethics* 475, 486 (1996) (“An insurer’s reservation of rights presents a potential conflict of interest because the insurer may be more concerned with developing facts showing non-coverage than facts defeating liability.”). The attorney, representing only the Insured, should seek to act in the best interest of the Insured, which usually means insuring that if there is a judgment, it will be covered by the Insurer. If the attorney also receives a significant percentage of his or her business from the Insurer, under 1.7(b), the attorney may have a conflict that cannot be waived by the client, the Insured.

We note that some jurisdictions have taken the position that, as a matter of law, not ethics, a reservation of rights issued on certain bases creates a conflict of interest such that the Insured is entitled to “independent counsel” paid for by the Insurer. See Cal. Civil Code sec. 2860 (1998) (a conflict of interest does not arise with a reservation of rights based on a claim for punitive damages or the possibility of a judgment in excess of policy limits but “may exist” in other reservation of rights scenarios “when the outcome of that coverage issue can be controlled by counsel first retained by the insurer for the defense of the claim”). See also U.S. Fid. & Guar. Co., v. Louis A. Roser Co., 585 F.2d 932, 938 n.5 (8th Cir. 1978). We caution that those statements are statements of what the law of the relevant jurisdiction requires regarding the insurance contract and does not involve what the rules of professional conduct require regarding attorney conduct. In addition, the stance is based on the notion that the attorney has as clients both the Insured and the Insurer, a view to which Kentucky does not adhere. See Finley v. Home Insurance Co., 975 P.2d 1145 (Hawaii 1998). In Finley v. Home Insurance Co., 975 P.2d 1145 (Hawaii 1998), the Hawaii Supreme Court refused to set a hard and fast rule with regard to when an Insurer must provide “independent counsel” on the basis that in Hawaii the attorney hired to defend the Insured has only one client, the Insured, and that the rules of professional conduct for attorneys in Hawaii should appropriately police conflict of interest.

Question 3:

An attorney defending an Insured under a reservation of rights may continue to communicate with the Insured within the bounds outlined in the discussion of Question 1 above. The attorney must protect the rights and confidences of the client. While the client may consent generally to the sharing of information with the Insurer, the Insured must be specifically consulted with regard to any information that is injurious to the client and, in particular, injurious to the Insured’s rights in the potential coverage dispute. If the Insured forbids release of the harmful information, the attorney must follow the instruction of the client. See Ill. Op. 92-02 (1992) (in a jurisdiction recognizing that the attorney represents both the Insured and the Insurer, attorney has duty to not disclose facts to the Insurer which might prejudice the Insured’s rights in a potential coverage dispute). The attorney must be cautious that the inability to share information creates a division of loyalty for the attorney such that KRPC 1.7(b) would prohibit continued representation.

Question 4:

If the Insurer files an action for Declaration of Rights, the attorney representing the Insured cannot participate as counsel for Insurer because to do so would be to take an action directly adverse to a present client in a matter intimately related to the present client. KRPC 1.7(a) states that an attorney “shall not represent a client if the representation of that client will be directly adverse to another client unless” the attorney reasonably believes that the representation will not adversely affect the representation and the client consents. Comment 4 to KRPC 1.7 states that the attorney should not request consent if a disinterested lawyer would conclude that the client should not consent. The Insured cannot be asked to consent to such representation of the Insurer in a Declaration of Rights action.

Nor can the attorney represent the Insured in the Declaration of Rights action. Though the Insurer is not a client of the attorney, the position the attorney would find himself or herself in litigating the coverage question against the Insurer who is paying the attorneys fees in the underlying matter is not one permissible under 1.7(b).

Assuming that both Insurer and Insured are represented by other counsel in the Declaration of Rights action, the attorney may continue to represent the Insured with the defense provided by the Insurer as long as the particular facts do not create a situation in which 1.7(b) would be violated. In the vast majority of situations, the fact that a Declaration of Rights action is ongoing should not affect adversely the attorney's representation of the Insured.

Likewise, the fact that the Declaration of Rights action may be held in abeyance should have no independent effect on the 1.7(b) analysis in most cases because the Declaration of Rights action should not create an impermissible conflict even if it occurs at the same time as the underlying action. If the particular facts create a situation in which 1.7(b) prohibits continued representation, the fact that the Declaration of Rights action is held in abeyance may serve to lessen the conflict.

Question 5:

The attorney may communicate with the Insurer within the parameters discussed in Question 1 and 3.

Question 6:

When the attorney represents the Insured in a matter, represents the Insurer in unrelated litigation, and the Insurer is added as a party to the same action, the attorney must withdraw from the representation of the Insured if the representation of the Insured is "directly adverse" to the Insurer, a client, and if a disinterested lawyer would not conclude that the Insurer should consent to such representation. KRPC 1.7 & cmt. 4. If, in effect, the involvement of the Insurer in the matter in which the attorney represents the Insured will involve a development of facts and theories relating to coverage issues, the attorney, in representing the Insured, is pursuing a representation "directly adverse" to a client, the Insurer. In addition, KRPC 1.7 would prevent obtaining the Insurer's consent to the representation because no disinterested attorney would conclude that the Insurer should consent.

We note that even if the Insurer consented, the attorney would have to consider the effect the representation of the Insurer in unrelated matters would have on the representation of the Insured in this matter involving the Insurer. The attorney may have a significantly enhanced allegiance to the Insurer as a result of the attorney-client relationship on other matters. Applying 1.7(b) as described in the discussion of Question 2, the allegiance created by the attorney-client relationship along with the adversarial nature of the proceedings in which the Insurer and the Insured now both appear may "materially limit" the representation of the Insured. Thus, the

attorney would be required to obtain the consent of the Insured, if a disinterested attorney would conclude that the Insured should consent.

Note to Reader

This ethics opinion has been formally adopted by the Board of Governors of the Kentucky Bar Association under the provisions of Kentucky Supreme Court Rule 3.530 (or its predecessor rule). Note that the Rule provides: "Both informal and formal opinions shall be advisory only; however, no attorney shall be disciplined for any professional act on his part performed in compliance with an opinion furnished to him on his petition, provided his petition clearly, fairly, accurately and completely states his contemplated professional act."