POTENTIAL CONFLICTS IN THE TRIPARTITE RELATIONSHIP: THE USE OF BILLING GUIDELINES AND THE RIGHT TO INDEPENDENT COUNSEL

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I. AN INTRODUCTION TO THE TRIPARTITE RELATIONSHIP

The tripartite relationship is the relationship between the defense lawyer, the insurer, and the policyholder that is created when the defense lawyer is hired by an insurer to defend a suit against the policyholder. In some jurisdictions, like Minnesota and Alabama, the policyholder and the insurer have been considered dual clients.[1] Other jurisdictions, like Arizona and California, consider the policyholder the "primary client," implying that the lawyer has at least a secondary obligation to the insurer.[2] In Texas, Montana, Michigan, and Connecticut, the law is clear that the policyholder is the only client. *See Safeway Managing General Agency, Inc. v. Clark & Gamble*, 985 S.W.2d 166, 168 (Tex.App.-San Antonio 1998) (no attorney-client relationship exists between an insurance carrier and the attorney it hired to defend one of the carrier's insureds); *Bradt v. West*, 892 S.W.2d 56, 77 (Tex.App.—Houston [1st Dist.] 1998); *State Farm Mut'l Auto Ins. Co. v. Traver*, 980 S.W.2d 625-27 (Tex.1998) (the attorney owes unqualified loyalty to the insured).[3] This paper will provide guidance on how to handle the conflicts that will inevitably arise when an insurer hires staff counsel or outside counsel to defend the insured.

II. THE CARRIER'S DUTIES IN THE TRIPARTITE RELATIONSHIP

The players in the tripartite relationship can become somewhat of a dysfunctional family when the insurer agrees to defend the policyholder but does so under a reservation of rights. This becomes a problem when the potential exists for the defense lawyer to develop a case toward a result favorable to the insurer on the coverage issue, on the one hand, or to the policyholder on the other hand. For example, if an underlying complaint alleges mutually exclusive theories of recovery, such as negligence (covered) and intentional torts (not covered), both the carrier and the defense lawyer are put into difficult positions with potential ethical pitfalls. There are at least four main conflicts that may arise when there is a potential coverage dispute: (1) whether the insurer or the policyholder controls the defense; (2) whether the insurer or policyholder controls information; (3) the reasonableness of the attorney's fees and expenses and attempts by an insurer to manage litigation costs; and (4) whether the insurer or policyholder controls settlement. One of the best ways to deal with and avoid ethical dilemmas that may arise out of the tripartite relationship is to understand the roles and duties of all the players before engaging in the relationship. Accordingly, the insurer's selection of counsel should be exercised with a full awareness of the ramifications of the attorney-client relationship.

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[1] *See e.g. Shelby Mut'l Ins. Co. v. Kleman*, 255 N.W.2d 231, 235 (Minn. 1977); *Mitchum v. Hudgens*, 533 So.2d 194, 198 (Ala. 1988).

[2] *See e.g. Paradigm Ins. Co. v. Langerman Law Offices*, 24 P.3d 593, 602 (Ariz.2001)(although the insurer was not the "client," the defense lawyer nonetheless owed a duty to the insurer); *State Farm Mut'l Auto v. Federal Ins. Co.*, 86 Cal.Rptr.2d 20 (1999).

[3] Other jurisdictions like Montana, Michigan, and Connecticut also have held that the policyholder is the only client. *See e.g. In Re Rules of Professional Conduct and insurer Imposed Billing Rules and Procedures*, 2 P.3d 806 (Mont.2000); *Atlanta Int'l Ins. Co v. Bell*, 475 N.W.2d 294 (Mich.1991); *Metropolitan Life Ins. Co. v. Aetna Cas. & Sur. Cor.*, 730 A.2d 51 (Conn.1999).

A. RIGHT TO CONTROL THE DEFENSE

1. Policy Language Grants The Insurer The Exclusive Right to Control The Defense

Several provisions in a liability insurance policy express that the insurer, and not the policyholder, has the exclusive right to control the defense – the insuring agreement; the supplementary payments clause; the cooperation conditions; and the voluntary payments/obligations condition.[4] For example, a standard CGL policy Insuring Agreement to Coverage A provides, in relevant part:

SECTION I – COVERAGES

COVERAGE A BODILY INJURY AND PROPERTY DAMAGE LIABILITY

1. Insuring Agreement

a. We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. We will have the right and duty to defend any "suit" seeking those damages. However, we will have no duty to defend the Insured against any "suit" seeking damages for "bodily injury" or "property damage" to which this insurance does not apply. We may, at our discretion, investigate any "occurrence" and settle any claim or "suit" that may result.

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The Supplemental Payment provision provides, in relevant part:

SUPPLEMENTARY PAYMENTS –COVERAGE A AND B

1. We will pay, with respect to any claim we investigate or settle, or any "suit" against an insured we defend:

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The Conditions provision provides, in relevant part:

[4] Michael M. Marick and Karen M. Dixon, *The Insurance Contract "Right" to Defend: The "Tripartite" Relationship Reconsidered*, Tort Trial & Insurance Practice Law Journal, Summer 2004.

SECTION IV – COMMERCIAL GENERAL LIABILITY CONDITIONS

2. Duties In The Event of Occurrence, Offense, Claim or Suit

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c. You and any other involved insured must:

(1) Immediately send us copies of any demands, notices, summons or legal papers received in connection with the claim or "suit";
(2) Authorize us to obtain records and other information;
(3) Cooperate with us in the investigation or settlement of the claim or defense against the "suit"; and
(4) Assist us, upon our request, in the enforcement of any right against any person or organization which may be liable to the insured because of injury or damage to which this insurance may also apply.

d. No insured will, except at the insured's own cost, voluntarily make a payment, assume any obligation, or incur any expense, other than for first aid, without our consent.

Liability insurance contracts generally provide that the insurer assuming the policyholder's defense is entitled to control that defense. In fact, the insurer's right to control the defense is an essential part of the business of insurance because the insurer needs to be able to manage its risks under the policy and predict its potential exposure.[5] Moreover, when there are no coverage issues, the insurer, who will ultimately have to pay any judgment within the policy, has an economic incentive identical to that of the insured.[6] Thus, the insured also benefits from the insurer's control of the litigation because the end objectives are the same for both the insurer and the insured - to win the case. In cases where settlement or judgment is unavoidable, then both the insurer and the insured want to minimize the financial impact. The disadvantages to this arrangement surface, however, when the insurer tries to restrict the lawyer's defense of the insured based upon cost control or other considerations, such as when the insurer and insured are not in agreement regarding a settlement.[7] Things get even more interesting when the insurer is providing a defense under a reservation of rights to disclaim its coverage obligation. In that instance, the insurer's motivation to establish that the claim does not fall within the policy's coverage may be perceived as overriding or interfering with its incentive to minimize the policyholder's liability.[8]

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[5] Tanya Bryant, *Loyalty Divided? Ethical Considerations of the Tripartite Relationship in Insurance Defense Litigation*, Oklahoma City Law Rev., Fall 2004.
[6] *Id.*
[7] Tanya Bryant, *Loyalty Divided? Ethical Considerations of the Tripartite Relationship in Insurance Defense Litigation*, Oklahoma City Law Rev., Fall 2004.
[8] *Id.*

2. The Right To Select Defense Counsel: A Multi-State Survey

a. Alabama

Under Alabama law, a carrier defending under a reservation of rights does not necessarily give the policyholder the right to select independent defense counsel at the insurer's expense. *See L&S Roofing Supply Co. v. St. Paul Fire & Marine Ins. Co.*, 521 So.2d 1298 (Ala. 1987) (carrier's defense under reservation of rights does not create a conflict of interest such that policyholder is entitled to engage defense counsel; carrier not obligated to pay for policyholder's independent counsel under reservation of rights); *See also Strength v. Alabama Dept. of Finance Div. of Risk Mgmt.*, 622 So.2d 1283, 1290 (Ala. 1993) (rejecting absolute approach in which any reservation of rights entitles policyholder to select own counsel).

b. California

California has codified the decision reached in the well known *Cumis* decision. Under California Civil Code §2860 (1996), a conflict of interest creates a duty for the carrier to provide independent counsel, unless the policyholder waives the right in writing. The policyholder's choice of counsel, however, is limited by the insurer's customary rates and minimum qualifications. *See San Diego Navy Federal Credit Union v. Cumis Ins. Society*, 162 Cal.App. 3d 358, 208 Cal.Rptr. 494 (1984)) (superseded by statute as stated in *United Enter. Inc. v. Superior Court,* 183 Cal. App. 4th 1004 (Cal. App. 4th Dist. – Div. 1, 2010). Moreover, the conflict of interest must be an *actual* conflict. A mere potential or theoretical conflict is not sufficient. *Id.; See also Center Foundation v. Chicago, Ins. Co.*, 227 Cal. App. 3d 547, 278 Cal. Rptr. 13 (Cal. App. Dist. 2 1991) (carrier may approve selection of counsel by policyholder). *Dynamic Concepts, Inc. v. Truck Ins. Exchange*, 61 Cal. App.4th 999, 1007, 71 Cal.Rptr. 882 (Cal.App. 4 Dist. 1998) (a mere possibility of an unspecified conflict does not require independent counsel; conflict must be significant (not merely theoretical) and actual (not merely potential)); *Clarendon Nat'l Ins. Co. v. Insurance Co. of the West*, 442 F. Supp. 2d 914 (E.D. Cal. 2006) (mere reservation of rights does not create conflict of interest requiring independent counsel; conflict must be actual and significant, not potential or theoretical). *Monarch Plumbing Co., Inc. v. Ranger Ins. Co.*, 2006 WL 2734391 (E.D. Cal. Sept. 25, 2006) (insurer has right to control defense so long as there is no conflict of interest; not every conflict entitles insured to independent counsel). For example, mere allegations of punitive damages are not sufficient conflicts to conflict *Cumis* counsel. *Foremost Ins. Co. v. Wilks*, 206 Cal.App. 3d 251, 253 Cal.Rptr. 596 (Cal.App. 3 Dist. 1988). However, even where the policyholder is entitled to select its own counsel, the carrier is not necessarily precluded from separately negotiating settlement. *Western Polymer Technology, Inc. v. Reliance Ins. Co.*, 32 Cal.App. 4th 14, 38 Cal.Rptr. 2d 78 (Cal.App. 1 Dist. 1995).

Despite the codification of the *Cumis* opinion, the Ninth Circuit has yielded some inconsistent opinions on this issue. *See e.g. Gafcon v. Ponsor & Assoc.*, 98 Cal.App. 4th 1388, 120 Cal.Rptr. 2d 392 (Cal.App. 4 Dist. 2002) (where insurance carrier opposes need for *Cumis* counsel, it must show that select defense counsel could not impact coverage outcome); *Cybernet Ventures, Inc. v. Hartford Ins. Co. of the Midwest*, 168 Fed. Appx. 850 (9th Cir. 2002) (unpublished) (reservation of rights relates only to amount of damages and not to question of

liability, no conflict requiring independent counsel); *Allstate Ins. Co. v. Breshearts*, 154 Fed. Appx. 671 (9th Cir. 2005) (unpublished) (where no conflict, no requirement to provide independent counsel).

c. Florida

Although Florida, like California, allows the policyholder to retain independent counsel under certain circumstances, Florida law puts a great deal more onus on the policyholder to establish why the insurer's counsel of choice is unacceptable. A federal district court concluded that the policyholder must show actual prejudice, harm, or some equally compelling reason why the insurer's appointed counsel was not agreeable. *Prime Ins. Syndicate, Inc. v. Soil Tech Distributors*, 2006 WL 1823562 (M.D. Fla. June 30, 2006). Moreover, the policyholder must affirmatively reject the carrier's defense offered under a reservation of rights before she can retain her own lawyer. *Aguero v. First American Ins. Co.*, 927 So.2d 894 (Fla.App. 3 Dist. 2005); *See also Continental Ins. Co. v. Miami Beach*, 521 So.2d 232 (Fla.App. 3 Dist. 1998) (policyholder's approval as to selection of independent counsel appointed by carrier is required; policyholder must mutually agree to the appointment of independent counsel). The policyholder is only entitled to reimbursement of the costs of its independent counsel if he can prove that the potential conflict of interest actually affected the representation. *Travelers Indem. Co. of Illinois v. Royal Oak Enterprises, Inc.,* 344 F. Supp. 2d 1358 (M.D. Fla. 2004). If there is a conflict of interest between the named insured and additional insured, the insurance company must pay for separate and independent defense counsel to defend its additional insured. *Univ. of Miami v. Great Am. Ins. Co.*, 112 So.3d 504 (Fla. 3d DCA Feb. 20, 2013).

d. Illinois

The cases applying Illinois law generally tend to favor the policyholder, although there are a few decisions holding to the principle that there must be a true conflict, not just possible or alleged conflicts of interest. *See e.g. Shelter Mut. Ins. v. Baily*, 513 N.E.2d 490 (Ill.App. 5th Dist. 1987); *Tews Funeral Home, Inc. v. Ohio Cas. Ins. Co.*, 832 F.2d 1037, 1047 (7th Cir. 1987) (applying Illinois law) (carrier entitled to control defense with attorneys it chose because interest in negotiating policy coverage is not enough for conflict). If there is a true conflict of interest, the carrier must decline to defend and pay for independent counsel. *Murphy v. Urso*, 88 Ill.2d 444, 454, 430 N.E.2d 1079, 1084 (1981) (carrier must decline to defend where conflict of interest and must pay for independent counsel; "the insured has the right to be defended by counsel of his own choosing"); *American Family Mut'l Ins. Co. v. W.H. McNaughton Builders, Inc.*, 363 Ill.App. 3d 505, 843 N.E.2d 492 (Ill.App. 2 Dist 2006) (where conflict of interest exists, policyholder is entitled to be defended by attorney of his own choosing). *See also Williams v. American Country Ins. Co.*, 359 Ill.App. 3d 128, 833 N.E.2d 971 (Ill.App. 1 Dist. 2005) (where conflict between carrier and policyholder, the carrier must pay costs of independent counsel); *Restoration Specialists, LLC v. First Specialty Ins. Corp.*, 403 F.Supp.2d 650 (N.D. Ill. 2005), vacated in part by *Restoration Specialists, LLC v. First Specialty Ins. Corp.*, 2006 WL 3347899 (N.D. Ill. October 6, 2006) (policyholder may appoint counsel to control litigation if its interests conflict with carrier; carrier must decline to participate in defense of policyholder).

e. Louisiana

Louisiana courts have not adopted a consistent approach to determining whether an insured can retain its own counsel at the insured's expense, and the outcome of each case is somewhat fact specific. *See e.g. Shehee-Ford Wagon & Harness v. Continental Cas. Co.*, 170 So. 249 (La.App. 2d Cir. 1936) (where liability carrier denies validity of policy, policyholder is warranted in hiring own counsel and carrier liable for expense of same); *Trinity Universal Ins. Co. v. Stevens Forestry Service, Inc.*, 335 F.3d 353 (5th Cir. 2003) (where carrier provides competent counsel, it is not required to cover attorneys fees of counsel hired by policyholder, regardless of reservation of rights, complexity of case, and whether independent counsel was beneficial to defense); *Dugas Pest Control of Baton Rouge v. Mut'l Fire, Marine & Inland Ins. Co.*, 504 So.2d 1051 (La.App. 1st Cir. 1987) (if carrier chooses to defend policyholder but deny coverage, it must hire separate counsel).

f. New Jersey

In New Jersey, when a conflict of interest exists, the insured may select independent counsel subject to the carrier's approval; if it is later determined that the claim was within the policy, the insurer's duty to defend converts into a duty to reimburse. *See Burd v. Sussex Mut. Ins. Co.*, 267 A.2d 7, 10 (N.J. 1970). In *Burd v. Sussex Mut. Ins. Co.,* the insured shot a man with a shotgun. 267 A.2d 7, 9 (N.J. 1970). The victim alleged both negligent and intentional tort claims against the insured, and the insurer refused to defend on the ground that the insured's Home Owner's policy excluded intentional actions. *Id.* The insured hired independent counsel and the plaintiff was awarded damages; subsequently, the insured brought action against the insurer to recover the amount of the judgment and the costs incurred in defending the action. *Id* The court explained, "the carrier should not be permitted to assume the defense if it intends to dispute its obligation to pay a plaintiff's judgment, unless of course the insured expressly agrees to that reservation. This is not to free the carrier from its covenant to defend, but rather to translate its obligation into one to reimburse the insured if it is later adjudged that the claim was one within the policy covenant to pay." *Id.* at 389.

g. New Mexico

In New Mexico, the existence of conflicts of interest does not excuse the insurer from its duty to defend. *See Am. Emp. Ins. Co. v. Cont'l Cas. Co.,* 512 P.2d 674, 679 (1973) ("…there are several methods of resolving the conflict, none of which involve an abdication of the insurer's duty to defend under the insurance contract."). The New Mexico courts have relied upon Rhode Island case law and determined that a conflict can be resolved by the insurance company either hiring two sets of attorneys, one to represent the insured and the other the company, or by the insurance company insisting that the insured hire independent counsel. *American Employers Ins. Co. v. Crawford.* 87 N.M. 375, 533 P.2d 1203 (1975) (citing *Employers' Fire Ins. Co. v. Beals*, 103 R.I. 623, 240 A.2d 397 (1968)).

h. New York

Under New York law, the insured is entitled to independent counsel at the carrier's expense if there is a clear conflict of interest. *New York State Urban Development Corp. v. VSL Corp.*, 563 F. Supp. 187 (S.D.N.Y. 1983) (where conflict of interest, carrier's choice of independent counsel upheld); *U.S. Underwriters Ins. Co. v. TNP Trucking, Inc.*, 44 F. Supp. 2d 489 (E.D.N.Y. 1999) (absent clear conflict of interest, policyholder not permitted to replace carrier's chosen counsel with its own independent choice); *Public Service Mut'l Ins. Co. v. Goldfarb*, 53 N.Y.2d 392, 425 N.E.2d 810, 442 N.Y.S 2d 422 (1981) (given actual conflict, policyholder entitled to attorney of his own choosing, whose reasoning fee is to be paid by carrier); *69th Street and 2nd Avenue Garage Assos. L.P. v. Ticor Title Guar. Co.*, 207 A.D.2d 225, 228, 622 N.Y.2d 13 (N.Y. App. Div. 1 1995) (crucial conflict of interest gave policyholder right to own attorneys); *Rimar v. Continental Cas. Co.*, 50 A.D.2d 169 (N.Y.App. 1975) (where conflict of interest, policyholder allowed to choose own counsel to be paid by carrier; control of defense must yield to obligation to defend).

Recently, a federal district court has held that the policyholder is entitled to select counsel at the carrier's expense only when there is conflict that places loyalty of counsel to the policyholder in doubt. *Coregis Ins. Co. v. Lewis, Johs, Avallone, Aviles & Kaufman, LLP,* 2006 WL 2135782 at *15 (E.D.N.Y. July 28, 2006) (finding no right to independent counsel because there was no actual or potential conflict); *See also Cunnif v. West field, Inc.*, 829 F. Supp. 55 (E.D.N.Y. 1993) (where conflict of interest arises such that question of loyalty to policyholder by its counsel policyholder is entitled to select its counsel).

If the policyholder is able to chose independent counsel, that counsel's fees must be reasonable; *Allstate Ins. Co. v. Noorhassan*, 158 A.D.2d 638 (N.Y. App. 1990) (policyholder is allowed to select own attorney with carrier to pay reasonable fees); *Emons Industries, Inc. v. Liberty Mut'l Ins. Co.*, 749 F. Supp. 1289, 1297 (S.D.N.Y. 1990) (where conflict of interest, policyholder entitled to select its counsel, whose reasonable fee is to be paid by carrier); *Prashker v. U.S. Guarantee Co.*, 136 N.E.2d 871 (1956) (where conflict of interest, policyholder selects counsel, carrier remains liable for payment of reasonable value of services of attorney selected by policyholder); *Cunnif,* 829 F.Supp. at 55 (same).

At least one New York Court has determined that the carrier does not have an affirmative duty to inform the policyholder of its right to selection of counsel. *Sumo Container Station, Inc. v. Evants, Orr, Pacelli, Norton and Laffan, P.C.*, 278 A.D.2d 169 (N.Y.App. 2000) (no affirmative duty to inform policyholder of its right to selection of counsel).; *See also First Jeffersonian Assoc. v. Ins. Co. of N. America*, 262 A.D.2d 133 (N.Y.App. 1999) (under reservation of rights, policyholder entitled to counsel of own choosing and to reimbursement of reasonable costs; however, policyholder not entitled to recover legal expenses in action to recover those costs). Another New York intermediate appellate court held that where an insurer may face liability based upon some of the grounds for recovery asserted but not others, the insurer's failure to inform the insured that he is entitled to representation by an attorney of his own choosing at the expense of the insurer is a deceptive trade practice under New York's

General Business Law, § 349. *See Elacqua v. Physician's Reciprocal Insurers*, 2008 WL 2277860 (N.Y. App. Div. 3d Dep't, June 5, 2008).

i. Texas

In many discussions about the tripartite relationship, Texas is improperly lumped in with other states, like Alabama, Kentucky, and Florida that have determined that a policyholder is entitled to representation by independent counsel whenever the insurer issues a reservation of rights. Policyholder counsel frequently and incorrectly assert that under Texas law, an insured may choose its own counsel at the insurer's expense any time the insurer agrees to defend subject to a reservation of rights. *See e.g. Rx.com, Inc. v. Hartford Fire Ins. Co.*, 426 F.Supp.2d 546, 559 (S.D.Tex.2006). Texas law is actually narrower. An insurer's "right to defend" a lawsuit "encompasses the authority to select the attorney who will defend that claim and to make other decisions that would normally be vested in the insured as the named party in the case." *Id.; N. County Mut'l Ins. Co. v. Davalos*, 140 S.W.3d 685, 688 (Tex.2004). Not every reservation of rights creates a conflict of interest allowing an insured to select independent counsel. Rather, the existence of a conflict depends on the nature of the coverage issues as they relate to the underlying case. *Id.* If the insurance policy, like the policy at issue in the *Rx. Com* case, gives the insurer the right to control the defense of a case, the insured cannot choose independent counsel and require the insurer to reimburse the expenses unless "the facts to be adjudicated in the liability lawsuit are the same facts upon which coverage depends." *Davalos,* 140 S.W.3d at 689. If the issue on which coverage turns is independent of the issues in the underlying case, counsel selected by the insured is not required. A true conflict of interest does not arise unless the outcome of the coverage issue can be controlled by counsel retained by the insurer for the defense of the underlying claim. *Davalos*, 140 S.W.3d at 689. This rule allows insurers to control costs while permitting insureds to protect themselves from an insurer-hired attorney who may be tempted to develop facts or legal strategy that could ultimately support the insurer's position that the underlying lawsuit fits within a policy exclusion. *Rx.com*, 426 F.Supp. at 560.

For example, in *Rx.com*, the petition in the underlying claim asserted the following claims: breach of fiduciary duty; shareholder oppression; conspiracy; actual and/or constructive fraud; fraudulent inducement; conversion; intentional infliction of emotional distress; breach of contract; and negligent misrepresentation. *Id.* at 560. The underlying petition also included allegations that the defendants knowingly made false and misleading statements about one of the plaintiffs. The underlying plaintiffs also alleged the defendants intentionally made derogatory false statements to third parties about the plaintiffs in order to further their purposes and business. The Hartford reserved its rights on the basis that the certain facts in the amended petition did not allege an "occurrence" as that term was defined in the Hartford policy. *Id.* The reservation of rights letter did not reserve its rights on any exclusions in the policy; rather, it reserved on the basis of the limiting language in the insuring agreement. Hartford also included a blanket reservation of rights under the policy.

After receiving the reservation of rights letter, Rx.com hired independent defense counsel and filed a declaratory judgment action seeking reimbursement from Hartford for defense counsel's fees and expenses. The court held that Rx.com failed to show, as a matter of law, the facts to be decided in the underlying lawsuit were the same facts that would defeat coverage by

triggering a policy exclusion. The court observed that the Hartford reservation of rights letter did not invoke a coverage exclusion that would be established by proof of the same facts to be decided in the underlying lawsuit. Therefore, the court held that Hartford's refusal to pay Rx.com's independent counsel was not a breach of contract. *Id.* at 562.

There are certain fact scenarios which present a serious conflict between the interests of the insured and the insurer and, depending upon how the case is resolved, will dictate whether the insured will be entitled to any indemnity coverage. *See e.g. Houston Auth. of the City of Dallas, Tex. v. Northland, Ins. Co.*, 333 F.Supp.2d 595, 601 (N.D.Tex.2004) (because the liability facts and coverage facts were the same and because a potential conflict of interest was created by the issuance of the reservation of rights letter, a disqualifying conflict existed); *Cf. Davalos*, 140 S.W.3d at 685 (disagreement over the venue is not a sufficient reason to take the contractual right to conduct the defense away from the insurer). This type of conflict of interest was found in *Maryland Casualty v. Peppers*, 355 N.E.2d 24 (Ill.1976). In that case, Mims sued the insured, Peppers, in a personal injury action. The insurance carrier, St. Paul, issued a policy that did not cover intentional harm. The complaint contained allegations of both intentional and unintentional harm. The court recognized that the attorney who was retained by St. Paul as defense counsel faced a conflict. It was in St. Paul's interest for Peppers' actions to be found intentional so that they would have no indemnity obligation under the insurance policy. Peppers, on the other hand, hoped to be found negligent in order to be covered under the policy. The court stated that due to the conflict, Peppers had the right to be defended in the personal injury case by an attorney of his own choice who should have the right to control the conduct of the case. *Id.*

Recent decisions reinforce the rule that an insurer's obligation to pay for the insured's independent counsel is only triggered when the coverage issue turns on the same facts at issue as those in the underlying suit.

In *Downhole Navigator, L.L.C. v. Nautilus Ins. Co.,* Downhole, an oil drilling servicer, was hired by an oil well operator to redirect a well. 686 F.3d 325, 327 (5th Cir. 2012). Downhole developed a plan to conduct the deviation and participated in the deviation process; however, Downhole negligently executed the plan, and the well operator sued Downhole for negligence. *Id.* Downhole notified its commercial general liability insurer of the lawsuit, and the insurer tendered a qualified defense, reserving its right to decline coverage based on several policy exclusions. *Id.*

In response to the reservation of rights, Downhole notified the insurance company: "Your decision to act under a reservation of rights has created a material conflict with respect to the selection of counsel.... Downhole has been left with no choice but to select its own representation." *Id.* The insurer responded that it had "reserved [its] rights while investigating the matter," and insisted that "[u]ntil or unless a coverage issue develops, Downhole is not entitled to separate counsel." *Id.* Consequently, Downhole filed suit for declaratory judgment, claiming that the insurance company had a contractual duty under the policy to defend Downhole, cover the cost of their independent counsel, and indemnify Downhole in the underlying suit. *Id.* at 327-328.

The issue in the underlying case was whether Downhole negligently performed its work for the oil well operator. The coverage dispute, on the other hand, turned on various insurance policy exclusions. Whether Downhole acted negligently, which would be decided in the underlying case, did not impact the coverage issues. The court held that because the facts to be adjudicated in the underlying lawsuit were not the same facts upon which coverage depends, the potential conflict in the case did not disqualify the attorney offered by the insurance company to represent Downhole. *Id.* at 331.

In *Partain v. Mid-Continent Specialty Ins. Servs., Inc.*, the insureds brought suit against their general liability insurer seeking a declaration that that the insureds were entitled to independent counsel after their insurer issued a reservations of rights in an underlying action arising from the unauthorized use of copyrighted architectural designs. 838 F. Supp. 2d 547, 553 (S.D. Tex. 2012). The court found that the issues presented in the insurer's reservation of rights—facts upon which coverage depends—were not the same facts as those to be adjudicated in the underlying copyright suit. *Id.* at 568-572. Applying the rule that a conflict of interest only entitles the insured to select independent counsel at the insurer's expense where "the facts to be adjudicated in the liability lawsuit are the same facts upon which coverage depends," the court found that the insureds were not entitled to independent counsel. *Id.* at 568-569 *quoting* Davalos, 140 S.W.3d 685, 689 (Tex. 2004).

j. Washington

Washington courts have rejected the contention that a conflict of interest automatically exists when an insurer agrees to defend an insured under a reservation of rights. *Johnson v. Continental Cas. Co.*, 788 P.2d 598 (Wash. 1990) (no requirement for carrier to pay for policyholder's personal attorney absent clear of interest). Further, even where there is a conflict of interest, Washington law may still allow the carrier to select defense counsel, but the carrier will be charged with an "enhanced duty of good faith" in those limited situations. *Tank v. State Farm Fire & Cas. Co.*, 715 P.2d 1133 (Wash. 1986).

B. WITHDRAWING A DEFENSE

In most jurisdictions, when a defense is undertaken through a valid reservation of rights, the insurer may withdraw its defense when it becomes clear there is no coverage under the policy. *See Keterndahl v. State Farm Fire & Cas. Co.*, 961 S.W.2d 518, 512 (Tex.App.-San Antonio 1997).[9] Proper notice is required to be given by the insurer when it discovers a valid policy defense and intends to withdraw. *See W. Cas. & Sur. Co. v. Newell Mfg. Co.*, 566 S.W.2d 74 (Tex.App.-San Antonio 1978). An insurer withdrawing a defense should provide its insured with a detailed explanation of the insurer's coverage position. Moreover, the insurer should allow the insured sufficient time to respond and/or provide the insurer with evidence the insured may have that it would like considered in the carrier's coverage analysis. Further, carriers should be mindful of the timing of the withdrawal and avoid being perceived as acting in bad faith.

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[9] It is important to know whether the jurisdiction you are in allows the use of extrinsic evidence to determine the duty to defend.

C. CONTROL OF INFORMATION

Once in litigation, additional difficulties can arise regarding the responsibilities of the insurer, the policyholder, and defense counsel with respect to information generated and accumulated as the litigation unfolds. Difficult questions often arise concerning the duties of the policyholder and defense counsel to share with the insurer information discovered in the underlying action.

Generally speaking, the defense counsel has a duty to disclose to the insurer all information concerning the action relevant to the underlying lawsuit, and to timely inform and consult with the insurer on all matters relating to the action. The duty to disclose does not include privileged or confidential information pertaining to coverage information to the insurer.[10] For example, Texas Civil Procedure Rule 192.4 specifically states that insurers are protected by the work product doctrine. Thus, status reports and other information prepared for the carrier by defense counsel are privileged. Other jurisdictions, however, do not protect the work product of the client.

D. REASONABLENESS OF DEFENSE COSTS

1. The Duty To Defend Includes Reimbursing Counsel For Its Reasonable Fees.

The duty of good faith imposed on the insurer includes the obligation to act reasonably in selecting as defense counsel an experienced attorney qualified to present a meaningful defense and willing to engage in ethical billing practices susceptible to review at a standard stricter than that of the marketplace.[11] Moreover, it is generally accepted that the insurer can require the defense counsel to follow written billing guidelines.

Texas courts have held that attorney's fees incurred involving litigation with a third party are recoverable as actual damages for breach of the duty to defend. *Rx.com, Inc. v. Hartford Fire Ins. Co.*, 426 F.Supp.2d 546, 559 (S.D.Tex.2006); *Am. Home Assur. Co. v. United Space Alliance*, 378 F.3d 482 (5th Cir. 2004). The insurer's defense obligation extends to reimbursing counsel for its "reasonable" fees and expenses incurred in conducting the defense. The existing body of case law on what constitutes "reasonable" attorneys' fees is sparse. *Center Foundation v. Chicago Ins. Co.*, 278 Cal.Rptr.13 (Cal.App.1991) offers some guidance. The *Center Foundation* court suggests that defense counsel may be subjected to stricter-than-normal standards in its billing practices and should be prepared for heightened scrutiny regarding its conduct of the defense. *Id.*

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[10] Dale Hausman, *Conflict Issues in the Tripartite Relationship*, Practicing Law Institute and Administrative Practice Course Handbook Series, Litigation, Insurance Law 2006.

[11] Dale Hausman, *Conflict Issues in the Tripartite Relationship*, Practicing Law Institute and Administrative Practice Course Handbook Series, Litigation, Insurance Law 2006.

2. Billing Guidelines

Billing guidelines are commonplace for insurance companies that routinely hire defense counsel to represent their insureds. Generally speaking, these guidelines serve two main purposes. First, billing guidelines are utilized by insurers as an attempt to control costs, ensure that the lawyer's fees are "reasonable and necessary," and also to provide a consistent guideline for defense lawyers. Second, insurers also use billing guidelines to eliminate confusion that may later arise regarding a particular matter. Defense counsel should be familiar with and willing to live by the carrier's billing guidelines before engaging in a contractual relationship with the carrier.[12]

Conflicts over billing requirements can be alleviated when carriers and defense counsel communicate and work together to efficiently prepare and present the best possible defense for the insured. Insurance carriers should be mindful that a defense lawyer may be in a difficult situation if he or she is prohibited or restricted from performing tasks that would benefit the defense of the insured. At the time the lawyer agrees to the carrier's billing guidelines, she is likely unaware of exactly what a specific case may entail. Each case is different and may require more or less of the tasks necessary to defend the insured. Additionally, defense lawyers should be aware that insurers are generally willing to cooperate with lawyers with whom they have had a long standing relationship, and revising the "litigation budget" is an ongoing processes. A lawyer should not just "eat" the loss without first consulting with the insurer. The lawyer should document every task performed whether covered or not.[13]

a. California

Some argue that, under certain circumstances, the use of billing and litigation guidelines can interfere with the insurer's duty to defend and can violate independent counsel's ethical duty to exercise his or her independent professional judgment. *See e.g., Dynamic Concepts, Inc. v. Truck Ins. Exch.*, 71 Cal. Rptr. 2d 882, 889 fn. 9 (Cal. Ct. App. 1998) (insurer's billing guidelines limiting types of discovery or legal research and prohibiting retention of experts or the filing of certain pre-trial motions may impermissibly impede independent counsel's duty to exercise professional judgment); *Pepsi-Cola Metro. Bottling Co. v. Ins. Co. of North America*, 2010 U.S. Dist. LEXIS 144401 (C.D. Cal. Dec. 28, 2010) (use of billing guidelines and reduction of independent counsel's hourly rates was not a breach of the duty to defend because the guidelines' purpose was to reduce overall fees based on objective standards and because the guidelines did not influence independent counsel's substantive strategy decisions).

b. Rhode Island

When an insurer's billing guidelines capped attorneys' fees at $105 per hour for attorneys and $55 per hour for paralegals, with no reimbursement for secretarial overtime, and no

[12]Tanya S. Bryant, *Loyalty Divided? The Ethical Considerations of the Tripartite Relationship in the Insurance Defense Litigation*, Oklahoma City University Law Rev., Fall 2004.

[13]Tanya S. Bryant, *Loyalty Divided? The Ethical Considerations of the Tripartite Relationship in the Insurance Defense Litigation*, Oklahoma City University Law Rev., Fall 2004.

reimbursement for meals or overnight travel without pre-approval, a Rhode Island court held that the insurer breached its duty to defend by its failure to reimburse independent counsel for all reasonable fees and expenses incurred. *Nortek, Inc. v. Liberty Mut. Ins. Co.*, 858 F. Supp. 1231 (D.R.I. 1994).

E. CONTROL OF SETTLEMENT

1. The Insurer's Duty To Settle

Liability insurance contracts generally provide that the insurer may assume the control over the settlement of any litigation against its insured.[14] When a settlement offer is made which may favor one party's interest over the other party's interest, difficult questions arise relating to the varying, and often conflicting, interest of the insurer on the one hand, and those of the policyholder and defense counsel on the other.[15] Under the terms of most liability policies the insurer has the right when a settlement offer is presented to receive all relevant information necessary to evaluate the settlement offer in the context of the litigation. Some jurisdictions impose a duty on insurers to consider the policyholder's interest at least equally with its own when considering a potential settlement. *See e.g. Merritt v. Reserve Ins. Co.*, 110 Cal.Rptr. 511 (Ct.App.1974); *Fulton v. Woodward*, 545 P.2d 979 (Ariz.Ct.App. 1976); *Hartford Accid. & Indem. v. Foster*, 528 So.2d 255 (Miss. 1988). Moreover, the insurer may be held liable for damages in excess of policy limits if it fails to accept a settlement within policy limits without making a diligent assessment of the issue.[16]

Rule 1.2 of the Model Rules of Professional Conduct states that "[a] lawyer shall abide by a client's decision whether to accept an offer of settlement of a matter." In most liability claims, the insurer has the right to settle a matter without the consent of the insured. The insured usually does not have a say in the matter except in the limited circumstances involving professional liability insurance. Even though the insurer does not require the insured's consent before settlement, the attorney's role is problematic especially in cases where (a) the attorney represents both the insured and the insurer and (b) the insurer and the insured are not in agreement on whether or not to settle the matter.[17]

Although liability insurance contracts generally provide that the insurer may assume control over the settlement of any litigation against its insured, there are certain situations that may arise that create questions as to whether the insurer or the policyholder should assume

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[14] Some liability policies provide a "consent clause," which requires the carrier to obtain the policyholder's consent before settling a claim. If an insured refuses to consent to a settlement amount posed by the carrier and the case settles for a higher amount, most "consent clauses" provide the insurer with the opportunity to recoup the difference in the settlement amounts from the insured.

[15] Dale E. Hausman, *Conflict Issues in the Tripartite Relationship*, Practicing Law Institute Litigation and Administrative Practice Course Handbook Series Litigation, Insurance Law 2006: Understanding the ABC's, April 2006.

[16] *Id.*

[17] Shawn McParland Baldwin, *One Step Beyond Meadowbrook: Can an Insurer Direct Defense Counsel to Dismiss Covered Claims?* An Examination of Insurance Defense Attorney's Roles and Ethical Duties, Defense Counsel Journal April, 2005.

control over the settlement negotiations or decisions when a true coverage conflict exists.[18] For example, if a policyholder has assumed control of its own defense because of a true coverage conflict with the insurer, it can be argued that the policyholder should also be vested with the authority over settlement decisions as well. On the other hand, it has been argued that because the duty to defend is distinct from the duty to indemnify, the policyholder should not be afforded the same control over settlement as it has over the defense.[19]

2. The Duty to Settle in Texas - The *Stowers* Demand

Texas law is very instructive on the insurer's role in settlement negotiations. Under the *Stowers* doctrine, the insurer must act with "that degree of care and diligence which an ordinarily prudent person would exercise in the management of his own business" in responding to settlement demands within policy limits. *G.A. Stowers Furniture Co. v. Am. Indem. Co.*, 15 S.W.2d 544, 547-48 (Tex.Comm'n App. 1929, holding approved). According to *Stowers*, the insurer is exposed to this additional risk because that insurer was presented with a reasonable opportunity to settle within policy limits, but failed to do so. *American Pysicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 849 (Tex. 1994).

The imposition of the *Stowers* duty is intended to protect the policyholder from an insurer abusing the control of defense and settlement. The threat of having to pay an excess judgment seeks to prevent an insurer from gambling at the policyholder's risk and expense by failing to settle a claim that can and should be settled within the policy limits, thereby leaving the policyholder responsible for an uninsured loss beyond those primary limits.

The *Stowers* duty is triggered by a claimant's settlement demand when the following three prerequisites are met: (1) the claim against the insured is within the scope of coverage; (2) the demand is within the policy limits, and (3) the terms of the demand are such that an ordinarily prudent insurer would accept it, considering the likelihood and degree of the insured's potential exposure to an excess judgment. Under *Stowers*, an insurer is not required to affirmatively initiate any settlement offer nor is it required to engage in any give-and-take settlement negotiations. The *Stowers* duty arises solely in relation to the actual settlement demand proposed by the claimant. *Id.; Garcia*, 876 S.W.2d at 849-51; *Birmingham Fire Ins. v. American Nat'l Fire*, 947 S.W.2d 598, 597-99 (Tex.App.-Houston [1st Dist.] 1995).[20]

A *Stowers* demand is not required to be in writing, although a demand in writing is clearly preferable in order to ensure there is no question of its terms. Regardless of whether it is memorialized, the demand should be clear and undisputed. *Rocor Int'l, Inc. v. Nat. Union Fire*

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[18] Dale E. Hausman, *Conflict Issues in the Tripartite Relationship*, Practicing Law Institute Litigation and Administrative Practice Course Handbook Series Litigation, Insurance Law 2006: Understanding the ABC's, April 2006.

[19] *Id.*

[20] The Texas Supreme court has once said that an insurer owes its insured a duty of ordinary care that includes "investigation, preparation for defense of the lawsuit, trial of the case, and reasonable attempts to settle." *Ranger County Mut'l Ins. v. Guin*, 723 S.W.2d 656, 659 (Tex.1987), the *Garcia* court declared that the statement was to be taken in the limited context of examining the insurer's fulfillment of its *Stowers* duty. *See also* Russell H. McMains, *Updating the Stowers Minefield*, University of Houston Law Foundation Advanced Insurance and Tort Claims, June 2006.

Ins. Co. of Pittsburg, Pa., 77 S.W.3d, 253, 263 (Tex.2002). The demand must specifically offer a settlement within the policy limits, although this can be accomplished by substituting "policy limits" for a sum certain. *Garcia,* 876 S.W.2d at 848. The demand must release all claims, including applicable liens, and the demand must be unconditional. *Ins. Corp. of America v. Webster*, 906 S.W.2d 77 (Tex.App.—Houston [1st Dist.] 1995, writ denied)(no valid *Stowers* demand where settlement was conditioned on a plaintiff's understanding that there was not additional insurance available).[21]

The third prong of the *Stowers* test, the reasonable demand requirement, has not been clearly interpreted by the courts. Certainly, a third party liability insurer must exercise "that degree of care and diligence in the management of his own business" in responding to settlement demands within policy limits. *Stowers,* 15 S.W.2d at 547. The terms of the demand must be such that an ordinarily prudent insurer would accept it, considering the likelihood and degree of the insured's potential exposure to an excess judgment. *Id.* at 849. [22]

3. The Duty to Settle In Florida

In Florida, an insurer has a statutory duty to attempt in good faith to settle claims. Fla. Stat. § 624.155. The Florida courts have required strict performance of this duty in dealing with claims from third-parties. Florida attributes the insurer-insured relationship to be akin to a fiduciary relationship requiring the insurer to act fairly and honestly with due regard for the insured's interests. *Berges v. Infinity Ins. Co.*, 896 So.2d 665 (Fla. 2004). Whenever a claim may be in excess of the policy limits the courts place a burden on the insurer to comply with any reasonable settlement demand under the policy limits. *Id.*

Additionally, in Florida anyone may file suit against the insurer for recovery of excess damages for the insurer's failure to attempt settlement in good faith. Fla. Senate Comm. on Judiciary, *Interim Report 2012-13: Insurance Bad Faith*, 2 (November 2011). There have been several cases where the plaintiffs have engineered settlement demands that were either difficult or impossible for the insurer to comply with. *Id.* at 3. Then, after the insurer fails to settle, the plaintiff files a bad faith claim against the insurer for damages beyond the insured's policy limits.

Claims for bad faith are evaluated under a totality of the circumstances standard. *Berges v. Infinity Ins. Co.*, 896 So.2d 665 (Fla. 2004). Each case is determined on its own facts, and thus the question whether the insurer acted in good faith is a question for the jury. *Id.* However, the courts have determined at least five relevant factors:

(1) whether the insurer was able to obtain a reservation of the right to deny coverage if a defense were provided;

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[21] Arguably, a demand above the primary policy limits might still be effective, if the primary insurer is notified that the policyholder or excess insurer is prepared to pay the settlement amount excess to primary limits. *See State Farm Lloyds Ins. Co. v. Maldonado*, 963 S.W.2d 38 (Tex.1998).

[22] If an insurer has accepted the defense of an insured facing multiple claims or the defense of an insured being sued by multiple claimants, the insurer's duty to accept a reasonable settlement offer is examined by viewing each claim separately. *See* Russell H. McMains*, Updating the Stowers Minefield*, University of Houston Law Foundation Advanced Insurance and Tort Claims, June 2006.

(2) efforts or measures taken by the insurer to resolve the coverage dispute promptly or in such a way as to limit any potential prejudice to the insureds;
(3) the substance of the coverage dispute or the weight of legal authority on the coverage issue;
(4) the insurer's diligence and thoroughness in investigating the facts specifically pertinent to coverage; and
(5) efforts made by the insurer to settle the liability claim in the face of the coverage dispute.

State Farm Mut. Auto. Ins. Co. v. Laforet, 658 So.2d 55, 62-63 (Fla. 1995).

Additionally, the outer boundaries of what does and does not constitute bad faith can be shown through select case opinions. Courts have found the following did not preclude a bad faith determination: when the insurer was not provided a formal settlement offer;[23] when there was no settlement offer from the plaintiff;[24] and when the settlement offer contained requirements such as time restrictions or sworn affidavits for the insured's net worth.[25] Conversely, insurers have been found not liable for bad faith claims when an insurer did not offer its policy limits because the insured's liability was not clear;[26] the lowest settlement offer was considerably higher than the policy limits;[27] and the insurer failed to inform the insured if a settlement offer.[28] More clear is the insurer's duty to initiate a settlement whenever the insured's liability is clear and the injuries are so serious that an excess judgment is likely. *Powell v. Prudential Property & Casualty Ins. Co.*, 584 So.2d 12, 12-14 (Fla. Dist. Ct. App. 1991).

4. The Duty to Settle In New Jersey

A *Rova Farms* claim in New Jersey is a claims that an insurer in bad faith failed to settle a claim within the policy limits, therefore exposing the insured to liability for excess damages. *Wood v. New Jersey Mfrs. Ins. Co.*, 21 A.3d 1131 (N.J. 2011). A successful claim results in the insurer being held liable for the entire judgment, even in excess of the policy limits. *Rova Farms Resort, Inc., v. Investors Insurance Co.*, imposed an affirmative duty on an insurer to initiate settlement negotiations because the court deemed the insurer a fiduciary of the insured in the settlement and defense of third party claims. *Rova Farms*, 323 A.2d 495 (N.J. 1974). In the wake of *Rova Farms*, failing to explore settlement opportunities by taking the initiative to attempt to negotiate a settlement within the policy coverage constitutes bad faith. *Wood*, 21 A.3d at 1135; *Rova Farms*, 323 A.2d at 504-05, 07.

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[23] *Shin Crest PTE, LTD v. AIU Ins. Co.*, 605 F. Supp. 2d 1234 (M.D. Fla. 2009) *order aff'd*, 368 Fed. Appx. 14 (11th Cir. 2010) (Florida Law).
[24] *Davis v. Nationwide Mut. Fire Ins. Co.*, 370 So.2d 1162 (Fla. Dist. Ct. App. 1st Dist. 1979).
[25] *Berges v. Infinity Ins. Co.*, 896 So.2d 665 (Fla. 2004); Fla. Senate Comm. on Judiciary, *Interim Report 2012-13: Insurance Bad Faith*, 3 (November 2011).
[26] *Shin Crest PTE, LTD v. AIU Ins. Co.*, 605 F. Supp. 2d 1234 (M.D. Fla. 2009) *order aff'd*, 368 Fed. Appx. 14 (11th Cir. 2010) (Florida Law).
[27] *Bush v. Allstate Ins. Co.*, 296 F. Supp. 368 (S.D. Fla. 1969), *judgment aff'd*, 425 F.2d 393 (5th Cir. 1970) (Florida law).
[28] *Berges v. Infinity Ins. Co.*, 896 So.2d 665 (Fla. 2004).

However, there are factors that may evidence that despite the *Rova Farms* claim, the insurer was acting in good faith. *Rova Farms*, 323 A.2d at 504-05. Among these factors are whether an offer of settlement was made by the plaintiffs; the view of the carrier or its attorney regarding liability; the range of the verdict; the strengths and weaknesses of the evidence; the history of similar cases; and the relative appearance, persuasiveness, and appeal of the parties and witnesses. *Id*. at 503-05. Recent case law has determined that a *Rova Farms* claim is really a breach of contract claim whereby the insurer breaches the implied covenant of good faith and fair dealing. *Wood*, 21 A.3d at 1132.

5. The Duty to Settle In New York

In New York, it is an unfair practice under N.Y. Insurance Law Section 2601, for insurers "not to attempt in good faith to effectuate prompt, fair and equitable settlements of claims submitted in which liability has become reasonably clear". *State v. Merchants Ins. Co.*, 486 N.Y.S.2d 412, 413 (N.Y. App. Div. 3d Dep't 1985). An insurer may be liable to an insured in excess of the policy limits when an insured losses an actual opportunity to settle a claim within the coverage limits of the policy because of the insurer's bad faith. *Id*. “The plaintiff must establish that the insurer's conduct constituted a "gross disregard" of the insured's interests—that is, a deliberate or reckless failure to place on equal footing the interests of its insured with its own interests when considering a settlement offer.” *Pavia v. State Farm Mut. Auto. Ins. Co.*, 626 N.E.2d 24, 27 (N.Y. 1993). In determining bad faith the “plaintiff's likelihood of success on the liability issue in the underlying action, the potential magnitude of damages and the financial burden each party may be exposed to as a result of a refusal to settle the insurer's failure to properly investigate the claim and any potential defenses thereto and the information available to the insurer at the time the demand for settlement is made” should all be evaluated. *Id*. at 28. Additionally, an insurer’s failure to communicate a settlement offer to an insured, even when it exceeds the policy limits, should be evaluated. *Smith v. Gen. Acc. Ins. Co.*, 91 N.Y.2d 648, 652-55 (1998).

F. MEDIATION

A carrier or coverage counsel’s role in mediation of an underlying claim can be complicated. Generally, there are two bases for conflicts between the insurer and the insured in mediation: either there is a conflict over the scope of the insurer’s duty to defend or there is an unresolved issue regarding the insurer’s indemnity obligation. In either event, the insured believes that the insurer is not providing the full measure of protection afforded under the liability policy.[29] One of the most important things for the carrier or coverage counsel to know going into a mediation is whether the insured has a right to consent to the settlement, or if the carrier has the full authority to settle the case without the insured’s consent. Further, it is important to remember that a large part of mediation is “going through the process” and making all participants feel like they are working together to reach the settlement. In some cases, the dynamics of the tripartite relationship can throw the mediation process off balance, and the carrier can be perceived as a “roadblock” to settlement. In order to conduct a productive and

[29] *See* Samuel F. Barnum and James Laflin, *Resolving the Trilema Within the Cumis Triangle: A Progressive Negotiation Strategy*, 4 Cal. L. & Reg. Rep. 68 (1998).

successful mediation, all participants should be able to identify and appreciate the varied interests represented by each party.[30]

From the outset of a mediation, the representative of the insurance company, whether it is an adjuster or coverage counsel or both, should keep in mind both the priority of issues on the defense agenda and the coverage issues at play in each of the defense's issues, and then consider whether reordering those priorities would make the mediation more productive. For example, in some cases it may be more productive to discuss the claims that may not be covered under the liability policy first because uncovered claims can be used as leverage against the plaintiff's counsel. On the other hand, if the defense is not willing to concede that certain claims may not be covered, it may be more beneficial to focus on the merits of the underlying case and see if the entire case can be settled in a cost effective manner that is beneficial to all the parties. Typically, a mediation will be more productive if the insured and insurer can work out apportionment issues prior the mediation. If this can be accomplished, the negotiations can be focused on the underlying case.[31] If this cannot be accomplished, it is important for coverage counsel to consider the priority and structure of the negotiations and the order in which the two disputes, the underlying case and the coverage dispute, should be discussed.

Regardless of the order the issues in the case are addressed, most insureds and insurers agree on at least one important aspect of mediation – the two must show a unified front for the purposes of the liability case in the open session.[32] Coverage counsel should allow defense counsel to lead the defense's opening statement. The defense counsel can use this opportunity with all parties present to speak directly to the plaintiff, request additional information from the plaintiff, clarify certain points, highlight the weaknesses in the plaintiff's case, and note the defense's strong points. The insurer and insured forming a united front in the open session is not only a wise strategy but plays into the established principle that the insurer cannot do anything to sabotage the insured's defense.

III. CONCLUSION

The tripartite relationship can have its difficulties, but it generally behooves all parties for the insurer to maintain the control of the defense to a degree. In many cases, the goals of the insured and insurer are perfectly aligned. In those cases in which the insurer defends under a reservation of rights, the insured can take comfort in the fact that defense lawyers are by and large trustworthy and ethical and follow the mandates of the law and the Professional Rules of Conduct to zealously represent the insured's interest, and only the insured's interest.

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[30] *Id.*
[31] *Id.*
[32] *See* Samuel F. Barnum and James Laflin, *Resolving the Trilema Within the Cumis Triangle: A Progressive Negotiation Strategy*, 4 Cal. L. & Reg. Rep. 68 (1998).