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# Independent Counsel and Defense under a Reservation of Rights: Where We Are and Where We Are Going

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# INDEPENDENT COUNSEL AND DEFENSE UNDER A RESERVATION OF RIGHTS: WHERE WE ARE AND WHERE WE ARE GOING

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When an insurance company representative contacts Indiana counsel either for an analysis of coverage or a summary of a potential defense of an insured, he often receives a less certain answer than he would like. "It depends" or "Indiana law is not clear" is less than a comforting answer, but it often is the best—if not only—response an attorney can muster.

That uncertainty remains in the all-too-common occurrence where an insurance company attempts to meet its obligation to retain defense counsel while asserting a reservation of rights to the insured. Doing so, of course, is a recognized means in Indiana of both handling the defense obligations under the policy and preserving any coverage dispute.

In that situation, the insured frequently fails to concern itself with whether it should have its own counsel or with the implications of the tripartite relationship. Instead, it recognizes the economic benefit of having a defense paid for by the insurer and moves on. Even in that situation, the relationship is fraught with peril if insurer and defense counsel do not carefully consider their positions. The relationship is one where each party must carefully navigate between parties and positions that at any moment could combust.[1]

In that tense relationship there appear to be increasing disputes by the insured (usually if represented by its own counsel) asserting that allowing the insurer to select and pay for counsel creates a conflict that would prejudice the insured. Those insureds often want to select independent or personal counsel and may go so far as to attempt to remove the insurer from any control of the defense. Motions for preliminary injunction, partial summary judgment, or disqualification follow.

So when an insurer receives a claim and asks an Indiana counsel if the insured is allowed to pick its own counsel (called *Peppers* counsel in Illi-

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[1] It is a relationship that one article describing Florida's statutory scheme for handling such situations calls "the dance of the porcupines." Andrew Grigsby, *The Dance of the Porcupines: Defense under a Reservation of Rights in Florida*, 83(2) FLA. BAR J. 8 (2009).

nois), it will likely receive the uncertain "It depends." Unlike some states, Indiana has established no bright line rule for such situations; nor does Indiana jurisprudence suggest it should. However, any counsel in these situations, whether coverage counsel, insurer-assigned defense counsel, or insured-selected counsel, should note the guidance provided by courts in Indiana.

## I. WHERE WE ARE

Indiana law does not expressly require that an insurer (if it defends under a reservation of rights) allow the insured to select counsel of its own choosing. Indiana has indicated that there is no inherent conflict of interest merely because an attorney is retained or employed by an insurance company. It is interesting to note that Indiana state courts have been silent on any form of bright line rule applicable to situations that seem to arise with increasing frequency: those situations where an insurance company seeks to defend a claim under a reservation of rights, and an insured prefers or insists on selection of its own counsel. Since Indiana has no *Peppers* rule,[2] insurers and attorneys in Indiana are left with uncertainty. However, there are some guidelines that should be considered.

### A. TRUST THE LAWYER

First, it is significant to note that Indiana has refused to identify any conflict of interest in the tripartite relationship per se. In *Cincinnati Insurance Co. v. Wills,*[3] the Indiana Supreme Court found no inherent conflict of interest in in-house counsel, or any counsel retained by an insurer, defending an insured. In expressly authorizing representation of an insured by in-house counsel, the Court noted:

> It is of course true that conflicts may arise in the course of representation of an insured by house counsel. The same is true if the insurer pays for a law firm to represent its insured. In either case there may be a conflict based on coverage disputes, the risk of a claim in excess of the policy limits, the acquisition of information from the insured that bears on coverage, or a variety of other items. If such a situation arises, retention of new counsel to represent the policyholder *may be either preferred or necessary.*[4]

The Supreme Court in *Cincinnati Insurance* made certain observations that bear significantly on the analysis and that differentiate Indiana law from that of Illinois. The Court noted that although there are always situa-

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[2] Maryland Cas. Co. v. Peppers, 355 N.E.2d 24 (Ill. 1976).

[3] 717 N.E.2d 151 (Ind. 1999).

[4] *Id.* at 162 (emphasis added).

tions that present a conflict of interest, the Court trusts Indiana attorneys to adhere to rules of ethics.

> Ultimately all attorneys are bound by their professional obligations to place the interests of their policyholder-client ahead of their own if pressure from an employer or a co-client insurer conflicts with those of the policyholder. We will not assume that an attorney employed by an insurance corporation is in violation of any of the Rules based solely on that employment relationship.[5]

*Cincinnati Insurance* did not involve an insurer asserting a reservation of rights, and certainly that may alter the analysis. However, it is important in any situation to apply the Supreme Court's observations.

While Indiana law is not explicit in recognizing a right of the insurer to assign counsel, the case law suggests as much. In *Frankenmuth Mutual Insurance Co. v. Williams,*[6] the court stated that Frankenmuth should have hired independent defense counsel, despite the existence of an intentional acts exclusion and even if it were later determined there was no coverage. In that case, Frankemuth would have to pursue recovery of its defense costs.[7] The court also rejected Frankenmuth's allegation that a conflict of interest would have prevented its hiring counsel.[8] Indiana case law has repeatedly stated that if coverage is disputed, one option available to the insurer is to "hire independent counsel and defend its insured under a reservation of rights."[9]

As indicated, the court refrained from saying that a conflict necessitates retention of independent counsel, only that such conflicts may give rise to a situation requiring such retention. Indiana courts have not held that retention of counsel, even in the context of a reservation of rights, is an inherent conflict of interest. Nor have they raised the issue even where the facts clearly arise from the representation of an insured by retained counsel with a pending reservation of rights.[10] The courts do, however, note that certain situations may arise where the retention of new counsel may be preferred or necessary.

### B. FEAR THE RESERVATION OF RIGHTS

As counsel representing an insurer or insured in the tripartite relationship knows, often the wildcard in maintaining that relationship is the po-

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[5] *Id.* at 163.

[6] 690 N.E.2d 675 (Ind. Ct. App. 1997).

[7] *Id.* at 680.

[8] *Id.* at 679.

[9] *See* Newman Mfg., Inc. v. Transcontinental Ins. Co., 871 N.E.2d 396, 401 (Ind. Ct. App. 2007), *trans. denied.*

[10] *See, e.g.,* Gallant Ins. Co. v. Oswalt, 762 N.E.2d 1254 (Ind. App. 2002).

tential reservation of rights. It is well established that an insurer may defend an action under a reservation of rights and may even simultaneously pursue a declaratory judgment action to establish the existence or absence of coverage. As a result, it is increasingly common for the insured to question the ability of any counsel selected by the insurer to adequately represent the insured's interests. The determination that the insured may select its own counsel is the bright line rule established in *Peppers* and advocated at times in Indiana courts. As discussed above, Indiana's appellate courts have established no bright line rule and have left several questions unanswered.

The issue is not new but has been infrequently addressed in state court. In *Snodgrass v. Baize*, the court noted in dicta:

> In the instant case, the interests of the insured and the insurer were in partial conflict. The insured would benefit, to the extent of policy limits, from a finding of negligence which arguably was within the coverage of the policy. The insurer would favor a finding of an intentional tort which the policy did not cover. *See Farm Bureau Mutual Automobile Insurance Co. v. Hammer, supra.* In such a situation the insurer should not defend, but, rather, as here, should reimburse the insured's personal counsel. *All-Star Insurance Corp. v. Steel Bar, Inc.* (N.D. Ind. 1971) 324 F. Supp. 160, 165. Because there was a partial conflict of interest and because Penn Mutual could not rightfully have controlled Baize's defense, the rationale underlying the application of collateral estoppel does not apply.[11]

The court in *Snodgrass* recognized a potential conflict in the particular situation when an act by an insured may be negligent (and thus covered) or intentional (and not covered). While the statement by the court suggests the need for personal counsel, the court's conclusion offers little guidance. In *Snodgrass*, the insurer actually had noted a potential conflict and taken the necessary steps. The court of appeals was agreeing with the action taken by the insurer. It provided no analysis of the conflict or the circumstances that would result in the selection of personal counsel. Thus, it identified an option but articulated neither a bright line rule nor any additional test that could be applied.

Since *Snodgrass,* there has been no clarification by the Indiana appellate courts, but examples of such situations have been addressed in a variety of settings in federal courts. While the cases provide guidance, they too leave questions unanswered.

In perhaps the leading case on the issue, the U.S. District Court for the Southern District of Indiana has recognized that a conflict may exist as a

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[11] Snodgrass v. Baize, 405 N.E.2d 48, 51 (Ind. Ct. App. 1980).

result of a reservation of rights. In *Armstrong Cleaners, Inc. v. Erie Insurance Exchange*[12] the court analyzed a conflict of interest under Rule of Professional Conduct 1.7(a)(2) and whether there was a significant risk that an attorney selected by the insurer may be materially limited in his defense of the insured when the insurer has issued a reservation of rights.

The court did note that although there is no inherent conflict of interest, the representation of counsel must be analyzed on a case-by-case basis. The court recognized that not every reservation of rights presents a conflict of interest, then provided some guidance.

> How should courts, insurers, and policyholders distinguish between reservation of rights that create conflicts requiring informed consent by the insured and those that do not? The problem is governed at its core by the Rules of Professional Conduct that address conflicts of interest where an attorney has multiple clients or where a third party is paying the attorney to represent a client (such as the insured).[13]

The court analyzed each basis for the reservation and concluded that under certain policy exclusions or a blanket reservation there was no conflict. But where investigation and facts will be provided to the insurer that may affect the coverage dispute, a conflict did exist that required the insurer to allow the insured to select its own counsel paid for by the insurer.[14]

The U.S. District Court for the Northern District of Indiana has also addressed the issue, concluding that a claim that included a "negligent vs. intentional" analysis and a punitive damages claim weighed in favor of allowing for independent counsel. The issue was whether a conflict of interest existed that warranted independent counsel in *Auto-Owners Insurance Co. v. Lake Erie Land Co.*,[15] In that case, Auto-Owners offered a defense under a reservation of rights, asserting a potential expected or intended harm exclusion. Punitive damages and a risk of an excess verdict existed. The court concluded that the risk that a jury would determine facts that had a direct impact on coverage in the intentional harm exclusion warranted independent counsel. A claim for punitive damages warrants independent counsel for the same reason. The court was "disinclined" to find a conflict based on the potential excess verdict and the absence of Indiana law supporting such a conflict but concluded that the coverage dispute warrants the retention of independent counsel.

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12 364 F. Supp. 797 (S.D. Ind. 2005).

13 *Id*. at 807.

14 *Id.* at 817.

15 2013 WL 4401834 (N.D. Ind. 2013) ("Simply put, the Court believes that, on the facts of this case, the significant risk that the dispositive coverage issue of intent will be decided in the underlying lawsuit creates a conflict of interest under the governing rule and necessitates the appointment of independent defense counsel at the Plaintiff Insurer's expense.").

More recently, the *Armstrong Cleaners* analysis concluded that a conflict existed that required independent selection of counsel. Similarly, *Valley Forge Insurance Co. v. Hartford Iron & Metal, Inc.*[16] held that the remediation efforts for an environmental claim before IDEM would result in a conflict of interest when certain interests of the insurer and insured differ in such a way to affect counsel's apparent dual representation. The court concluded that the insured had a right to control the defense, including remediation, and that the insurer did not. In reaching that conclusion, the court analyzed substantial evidence related to the potential conflict, including testimony from the insured's prior counsel explaining the position she would have to take and how it might be affected by any relationship with the insurer.

At this point, there are two clear examples of potential conflicts recognized in Indiana: (1) when a claim may be the result of covered negligence or uncovered intentional acts and (2) environmental claims. What is potentially significant is that Indiana courts have yet to weigh in since the Supreme Court noted there is no inherent conflict in insurer-assigned or employed counsel and since the federal courts first identified a conflict in *Armstrong Cleaners* twelve years ago. The silence is not expected to last, but what additional guidance may be provided remains to be seen.

## II. WHAT WOULD ILLINOIS DO?

With limited examples in Indiana, practitioners and courts alike have looked at other jurisdictions. *Armstrong Cleaners* cited to several examples, including cases that often refer to counsel selected by the insured as *Cumis* counsel.[17] Attorneys in Indiana who work with insurers or handle insurance defense have likely been asked about *Peppers* counsel. In discussing Indiana's approach to defense under a reservation of rights and in analyzing future situations, it is helpful to understand the broad application of the *Peppers* and *Cumis* cases.

In Illinois, the general rule is that an insurer controls the defense of its insured.[18] But a *Peppers* conflict, which gives rise to an insured's right to select independent counsel (commonly referred to as *Peppers* counsel) at the insurer's expense, is held to exist where there is an actual conflict of interest between an insurer and insured. In *Peppers*, the Illinois Supreme Court determined that where an insurance policy covered only the negligent actions of the insured, and the insured was charged in a lawsuit with both negligent and intentional conduct, the insured "ha[d] the right to be de-

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16 148 F. Supp. 3d 743 (N.D. Ind. 2015).

17 San Diego Navy Fed'l Credit Union v. Cumis Ins. Soc'y, 162 Cal. App. 3d 358 (Cal. Ct. App. 1984).

18 Nandorf, Inc. v. CNA Ins. Cos., 134 Ill. App. 3d 134, 137 (1985).

fended in the personal injury case by an attorney of his own choice who shall have the right to control the conduct of the case."[19]

However, a *Peppers* conflict does not arise merely because an insurer has an interest in negating coverage.[20] The test articulated by the Illinois courts is whether "when comparing the complaint's allegations to the policy's terms, the insurer's interest 'would be furthered by providing a less than vigorous defense to those allegations.'"[21] If it appears that factual issues will be resolved in the underlying suit that "would allow insurer-retained counsel to 'lay the groundwork' for a later denial of coverage, then there is a conflict between the interests of the insurer and those of the insured."[22] "Put another way, if, in the underlying suit, insurer-retained counsel would have the opportunity to shift facts in a way that takes the case outside the scope of policy coverage . . . the insured is entitled to defend the suit with counsel of its choosing at the insurer's expense."[23]

In *Peppers* itself, the conflict was found where it was alleged that the insured shot someone who he thought was breaking into his store.[24] The court determined that the insurer had an interest in finding that the insured acted intentionally, rather than negligently, because the policy excluded coverage for intentional acts.[25] Other *Peppers* conflicts found by Illinois courts have included *Murphy v. Urso*,[26] (whether driver of a preschool van was a permissive user of the van where coverage would exclude drivers lacking permission from the owner); *American Family Mutual Insurance Co.*[27] (insurer of builder would be protected if mold damage occurred before inception of policy); and *Illinois Masonic Medical Center v. Turegum Insurance Co.*[28] (conflict existed where insurer had an interest in fixing liability outside of the policy period).

When a potential conflict of interest between insured and insurer arises, the insurance company's duty of good faith requires it to notify the insured. Once notified by the insurer of the conflict, the insured has the option of hiring a new lawyer, whose loyalty will be exclusively his.[29] If he exercises that option, the insurance company will be obligated to reimburse the rea-

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19 Maryland Cas. Co. v. Peppers, 64 Ill. 2d 187, 198-99 (Ill. 1976).

20 Shelter Mut. Ins. Co. v. Bailey, 160 Ill. App. 3d 146, 154 (1987).

21 Royal Ins. Co. v. Process Design Assocs., Inc., 221 Ill. App. 3d 966, 974 (1991).

22 American Family Mut. Ins. Co. v. W.H. McNaughton Builders, Inc., 363 Ill. App. 3d 510, 511 (2006).

23 *Id*.

24 *Peppers*, 64 Ill. 2d at 191-92.

25 *Id*.

26 88 Ill. 2d 444, 448-53 (1991).

27 363 Ill. App. 3d 510 (2006).

28 168 Ill. App. 3d 158 (1988).

29 *Eg*., *Peppers*, 64 Ill. 2d at 187; *Illinois Masonic Med. Ctr.,* 168 Ill. App. 3d at 512.

sonable expense of the new lawyer.[30] A *Peppers* conflict can be waived if the insurer adequately informs the insured that it is proceeding under a reservation of rights and the insured accepts defense counsel provided by the insurer.[31] In practice, this may be done by sending a *Peppers* letter to the insured that explains the conflict, the right to retain independent counsel at the insurer's expense, and that requires the signature of the insured in order for the insurer to proceed with the defense on its own.

An insurer with a conflict of interest who fails to offer independent counsel to the insured while defending the insured is estopped from relying on these defenses to later deny coverage.[32] Under Illinois law, when insurer chooses to defend its insured, it must provide effective defense, and it must not put its own interests ahead of those claiming to be insureds; if insurer fails to meet these obligations and insured is prejudiced, insurer can be estopped from asserting policy defenses.[33]

California maintains a similar requirement, commonly referred to as *Cumis* counsel, which was codified in 1987 with more explicit requirements.[34] In the original decision, the California Court of Appeal explained "the Canons of Ethics impose upon lawyers hired by the insurer an obligation to explain to the insured and the insurer the full implications of joint representation in situations where the insurer has reserved its rights to deny coverage."[35] In the absence of informed consent of the insured, the insurer must pay the reasonable costs for hiring independent counsel for its insured where there are "divergent interests of the insured and the insurer brought about by the insurer's reservation of rights based on possible noncoverage under the insurance policy."[36]

Under California Civil Code § 2860(c), the insurer retains the right to determine whether insured-selected independent counsel meets certain minimum qualifications, such as having five years civil litigation experience and rates that comport with ordinary local rates for the type of defense work being performed. Elsewhere in the code, independent counsel are required to disclose all information concerning the action to the insurer except for privileged materials related to the coverage dispute.[37] The insured may

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30 *Peppers,* 64 Ill. 2d at 198-99.

31 Royal Ins. Co. v. Process Design Assocs., Inc., 221 Ill. App. 3d 966, 974 (1991).

32 *See, e.g.,* Williams v. American Country Ins. Co., 359 Ill. App. 3d 128, 130 (2005) (affirming holding of trial court that insurer was estopped from asserting any coverage defenses in underlying action where insurer provided defense in underlying action for nearly three years despite conflict of interest and had the opportunity to mold discovery and defense to the prejudice of the insured).

33 Willis Corroon Corp. v. Home Ins. Co., 203 F.3d 449 (7th Cir. 2000); *see also* Utica Mut. Ins. Co. v. David Agency Ins., Inc., 327 F. Supp. 2d 922 (N.D. Ill. 2004).

34 CAL. CIV. CODE § 2860.

35 San Diego Fed'l Credit Union v. Cumis Ins. Soc'y, 162 Cal. App. 3d 358 (1984).

36 CAL. CIV. CODE § 2860.

37 CAL. CIV. CODE § 2860(d).

waive its right to independent counsel by signing a statement that contains language stating that he has been informed of his right to select independent counsel, waives that right, and authorizes the insurer to select defense counsel.[38]

While Indiana has followed neither *Peppers n*or *Cumis*, those cases are often referenced by insurance adjusters, attorneys, and courts familiar with those standards, and have been cited in briefing and cases in Indiana. It is helpful to Indiana attorneys to be familiar with the cases and to understand the framework in which other states operate when analyzing similar situations in Indiana.

## III. Where Are We (or Could We Be) Going?

### A. THE FORGOTTEN ATTORNEY

In the "eternal triangle" of the liability insurance company, the insured, and the insurance defense attorney,[39] the relationship between insurer and insured has often been the focus. More specifically, whether an insurer selecting and paying counsel presents the conflict that would prevent the defense attorney from performing her ethical duty in representing her client. Often, the nature of the conflict is speculative or theoretical, and counsel for insureds seeking to assert the right to select counsel often argue that there is an inherent conflict: no attorney selected and paid by the insurance company can ever avoid a conflict of interest in the presence of a reservation of rights.

The focus on the insurers and insureds constitutes only two-thirds of the triangle. (What position would the insurer prefer in the litigation? What is in the best interest of the insured?) What is missing from the Indiana examples is evidence of a specific conflict with a specific attorney retained to defend the insured. The analysis in those cases, by focusing on two-thirds of the triangle, seems to ignore the position of the attorney who is stuck in the middle. And any argument that there is an inherent conflict with insurer-selected counsel fails to apply the test that has been articulated in Indiana law.

In fact, failure to consider the position of the attorney in the middle ignores the Supreme Court's inclination to trust attorneys to follow their ethical obligations to their clients and adopts several damaging fallacies regarding the relationship between the attorneys and the insurers that retain them. First, there is the common misconception that insurance companies and the defense bar have a close relationship; so close, in fact, that defense counsel would automatically favor the insurer despite its ethical obligation to the insured. Any argument for an inherent conflict relies on the presumption that the insurance industry and defense bar maintain a

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38 Cal. Civ. Code § 2860(e).

39 *See* Armstrong Cleaners v. Erie Ins. Exch., 364 F. Supp. 979 (S.D. Ind. 2005).

tight relationship. But some would disagree. Michael Marick and Karen Dixon outlined the fallacy of the close and harmonious relationship in *The Insurer's Contract "Right" to Defend the "Tripartite" Relationship Reconsidered.*[40]

Marick and Dixon contend that other fallacies exist in the situation where the insured selects counsel. Most significant to the analysis in Indiana, the presumption is that insureds must be protected from inadequate lawyering by defense counsel and that the insurer that selects counsel is considered a "client" as a matter of law. The presumption is flawed. As the authors state, "The notion that an insurer prefers an insurance defense firm because it will cut corners or subjugate the insured's interests to the insurer's is flatly wrong."[41]

But if the focus is on the attorney in the middle, concluding that there is a conflict would require specific evidence to support the conclusion. The relationship with that particular attorney and the insurer that retained her would have to be analyzed, as would any consideration that the attorney has a client relationship with the insurer. Several other factors would need to be considered, but that attorney-insurer relationship is a threshold.

There are, of course, cases of clear conflict. If there is a coverage dispute and the attorney hired to represent the insured is the same attorney that gave coverage advice to the insurer, the conflict is certainly apparent. But in many cases the insurer has secured a coverage opinion from in-house counsel or separate coverage counsel. In those cases the counsel retained to represent the insured may very well be independent counsel.

### B. APPLYING THE APPROPRIATE TEST

Since Indiana state courts have provided no additional guidance, there remain some questions about the framework required for a thorough analysis of any potential conflict. The district court in *Armstrong Cleaners* pointed first to the Rules of Professional Conduct. Marick and Dixon in their article suggest the contractual relationship between insurer and insured, rather than the ethical conflict rules, should be the focus. Other states, including Illinois, focus on the nature of the coverage defenses that may exist under the reservation of rights.

The contract approach is not without support in Indiana case law. In *Cincinnati Insurance*, the Supreme Court noted:

> Although issues may arise in dual representation, none are apparent in this case. In any event, [the insurer] has by contract subordinated its interests as a client to those of [the insured]. Presumably, this resolves by agreement the priority of counsel's

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[40] Michael Marick and Karen Dixon, *The Insurer's Contract "Right" to Defend the "Tripartite" Relationship Reconsidered*, 39 TORT & INS. L.J. 1119 (Fall 2004).

[41] *Id.*

> obligations if, for example, counsel learns of information that affects the insurer's and the policyholder's interests differently.[42]

Moreover, the contractual relationship dictates certain elements of the relationship. Although there is some concern that insurer-hired counsel may share certain information with the insurer that would be detrimental to the insured, any attorney would have the obligation to report to the insurer under the contractual requirements for cooperation by the insured. And it is typical that the insurer is required to provide a defense since the duty to defend is broader than the duty to indemnify. In addition, other provisions, such as the voluntary payment provision, may be implicated if the insurer is excluded from the selection and control of the defense.

That being said, the focus on counsel necessitates that the Rules of Professional Conduct be considered. Rule 1.7(a) recognizes a conflict of interest for concurrent clients in two situations:

> (1) the representation of one client will be directly adverse to another client; or
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> (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.

Application of Rule 1.7(a) determines whether there is any potential conflict or limitation of the attorneys' ability to offer proper representation to her client. As the court notes in *Armstrong Cleaners*, the conflict is more likely to arise in the second situation where representation may be materially limited by responsibility to a third person, in this case the insurer that pays the attorney.

Once there is a potential conflict under Rule 1.7(a), there also must be an analysis under 1.7(b), which allows representation even if a potential conflict occurs under certain circumstances, including these: (1) the lawyer believes she will be able to provide competent representation, (2) the representation is not prohibited by law, (3) it does not involve the assertion of one claim by one client against another client, and (4) each client has given informed consent in writing.

It is clear Indiana recognizes no inherent conflict similar to that recognized in *Peppers* or *Cumis*. The analysis of those cases, while popular and often of concern to insurers, is not the appropriate standard in Indiana. Instead, the test should follow a pattern similar to this:

> 1. Is there an issue of joint or concurrent representation? Perhaps the situation is such that there is no true concurrent rep-

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42 Cincinnati Ins. v. Wills, 717 N.E.2d 151, 161 (Ind. 1999).

resentation issue at all, and the remainder of the analysis is unnecessary. If the insurer is in no way the client of the attorney, then the issue is limited to whether representation may be materially limited by the relationship to the third-party insurer. In this analysis, the contract between the insurer and insured may also be relevant depending on the terms included in the policy. Certainly, the policy cannot authorize an attorney to ignore a conflict of interest or otherwise violate the Rules of Professional Conduct, but the policy may make it clear that the retained defense counsel has no obligation to the insurer or may outline the duty to defend.

2. If there is concurrent or joint representation, identify the specific attorney assigned to the defense to determine if that specific attorney has any conflict of interest. Again, are there any contractual terms that would implicate the selection of counsel?

3. Apply Rule 1.7(a) to determine if a conflict or material limitation in representation may exist. In doing so, the factors include the nature of the reservation of rights and the potential that issues that might need to be resolved in the litigation, the nature of any information the attorney may need to share with the insurer, the extent to which the attorney feels she is limited by her relationship with the insurer, if the attorney represents or has represented the insurer in litigation or is exclusively assigned to defend insureds, if there is separate coverage counsel that further removes defense counsel from any coverage issue, and whether the coverage issues could be affected by defense counsel's handling of the claims. On a case-by-case basis, there may be other factors.

4. After applying Rule 1.7(a), confirm that 1.7(b) does not apply. Again, this allows defense counsel, if she so chooses, to first assert that she can adequately represent the insured regardless of any potential issue, and then seek to secure informed consent of the arrangement.

5. Finally, whether the parties can reach an agreement on the representation or the court must determine there is a conflict, that does not resolve the extent of control the insurer retains or the means of handling representation going forward. There are significant issues to be resolved here that will not be addressed in this article, but it seems likely that the degree of control or cooperation depends in part on the nature and de-

> gree of the conflict. The insurer's right to receive timely reports and the control of costs may become factors. Early resolution of these issues would help in managing the relationship as all parties attempt to move the claim toward resolution.

### C. SELF-AWARENESS IS A VIRTUE

Critical to the appropriate emphasis on the specific attorney is the reliance on that attorney to meet her ethical obligations from the beginning of the relationship. In other words, that attorney must also recognize potential conflicts of interest.

Both the insurer and counsel should insist on the attorney being comfortable analyzing her own potential conflict. If any questions arises, counsel should immediately advise the insurer of the conflict to allow the matter to be appropriately addressed. An analysis of the potential conflicts should be made in any case but are even more significant in the middle of the tripartite relationship. It requires the insurer to tell the attorney about any reservation of rights and the basis for the reservation early in the retention so the attorney may evaluate issues or circumstances that could create a conflict.

Panel counsel for an insurer may be reluctant to address a potential conflict in a close case. We all know the business of law, and citing a conflict means the case is sent to other counsel. But in meeting our ethical obligations, a full analysis needs to be completed. The insurer should be reminded that ignoring the potential conflict can create more problems in the form of future litigation over selection of counsel or, in extreme cases, a bad faith claim.

It is vital that counsel openly and honestly address the potential for such conflicts. Doing so also allows the possible clarification of the terms of Rule 1.7(b). Even in situations where the insured raises no issue with the selection of counsel, informed consent may be warranted. Therefore, the attorney should address such issues early with both the insurer and insured. As indicated above, a key component of Rule 1.7 is the material limitations on an attorney's ability to provide competent and diligent representation, and the lawyer's reasonable belief she can, in fact, provide that representation.

### D. DO THE RULES APPLY TO INSURED-SELECTED COUNSEL?

There is another issue that has been left unaddressed by Indiana courts. Does Rule 1.7(a) and its concomitant ethical obligations also apply to any lawyer selected by the insured. Is that attorney's representation hampered by its seeking reimbursement, at a minimum, from the insurer? If the insurer must pay defense costs on an ongoing basis, does that inject the attorney's personal interest in the relationship? Does the agreement to receive

payment from the insurer create the same concurrent relationship that doomed the insurer-selected counsel?

The situation in some cases is further complicated when the attorney selected to defend the insured also represents the insured in coverage matters, up to and including filing a bad faith claim against the same insurance company paying his bills. There certainly may be an argument that such representation, now seeking extra-contractual damages from the insurance company, also presents a conflict because the relationships are such that the attorney's representation is materially limited by other interests.

*Peppers* counsel situations do present additional problems. Some counsel see the defense of the insured at the insurers' expense as an opportunity to maximize rate or defense costs (sometimes legitimately and other times less so), and may make defense decisions based on that opportunity. Attorneys who stand to profit from a bad faith or extra-contractual claim may have personal interests at stake. At times, this results in defense counsel continuing an adversarial relationship with the insurer during the defense that might provide evidence against the insurer later.

Nor are insurers always innocent in such situations. Some insurers may believe that a questionable claim need not be given the commitment the insured believes it warrants; or the insurer may seek settlement before offering a defense the insured wants presented at trial.

If there are no inherent conflicts, and the courts must apply the proposed standards to any situation involving independent counsel, the same test should apply. There would be situations where either a prudent attorney recognizes and avoids the potential conflict or a court may find a conflict. The respective positions of insurer and insured, as well as the role of the attorney, are all factors in the analysis. The potential conflict certainly is an element of the relationship that bears consideration any time the circumstances arise.

### E. CAN WE AVOID "IT DEPENDS"?

At the end of the day, Indiana courts have yet to provide certainty on the selection of counsel. If an insurer issues a reservation of rights, can it select counsel? If it does so, how much is it allowed to control? Is there a conflict of interest? The absence of a bright line rule makes predictability in Indiana difficult, and insurers and attorneys dislike uncertainty or unpredictability. At this point, no one can be certain that Indiana appellate courts will follow the interpretation of federal courts in *Armstrong Cleaners*, *Auto-Owners,* or *Valley Forge*. Any application that relies on a case-by-case analysis leaves that uncertainty.

There are alternatives. Other states, courts, and commentators have proposed various approaches. Certainly, Indiana courts appear unwilling to follow Illinois and its *Peppers* analysis. They appear to prefer an approach that recognizes that the vast majority of defense counsel—whether selected

by the insurer or insured—are going to adhere to their ethical obligations and handle any potential conflict appropriately. Most will want to avoid any appearance of impropriety.

Insurers and insureds, similarly, would both want some degree of certainty. If there is uncertainty at the outset of the handling of a claim defense, the risk of costly litigation is increased. Those risks may prompt some cooperation between insurer and insured: an insurer may make a strategic decision to agree to insured-selected counsel to avoid a conflict of interest, or the insured may elect to agree to insurer-selected counsel to avoid additional expense. But even those agreements are difficult if there is little certainty in the outcome.

Indiana could recognize some general rules that would help the situation become more manageable. Where an insurer must provide independent counsel, it may not necessarily have to be insured-selected counsel. Instead, the insurer could choose counsel who practices in the area where the claim arises and who is qualified to represent the insured. The company need not necessarily select panel counsel or an attorney that is otherwise handling coverage claims.[43] The insurer can select an attorney who does not have the financial incentive, long-term relationship, or appearance of preference for the insurer that would create a potential conflict. Insurers could even provide a list of nearby qualified attorneys and allow the insured to select from the list. This would present a fair middle-ground between the all-or-nothing of insurer-assignment or insured-selected counsel. In any event, insurers that took these steps could argue to the courts that the conflict had been addressed.

Another alternative would be to clarify the attorney-client relationship with the selected counsel. As *Cincinnati Insurance* indicated, the insurer has likely already limited its involvement contractually such that its interests are subordinated to that of the insured. The attorney may further clarify that relationship by confirming that the attorney is hired to represent the insured exclusively and that she declines in an engagement letter any representation of the insurer.[44]

The attorney in the middle can articulate that position in its engagement letters and in early communication with the insured. The insurer should acknowledge that while it may consult with counsel and the insured on defense handling, all final decisions are made by counsel. If this position is articulated by counsel, that may well eliminate any conflict under Rule 1.7(a) and provide a clear basis for meeting the requirements of 1.7(b). If an insured signs off on these terms, informed consent is obtained.

If the insurer takes certain steps to insure independent counsel, and the attorney takes certain steps to avoid any potential conflict of interest, then

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[43] Of course, counsel representing the insurer for purposes of coverage and the insured on defense would not be allowed.

[44] Marick and Dixon, *supra* note 40, at 1135.

it would be incumbent on the insured to accept those measures. In that situation, all three parties are aware of the steps necessary to insure a working relationship in most circumstances. Most of all, it provides some certainty while recognizing Indiana's preference to trust its attorneys.

This is no panacea. Where attorneys are involved and learned minds can disagree, there will always be disputes and uncertainty. However, some of the measures discussed above may provide a means of balancing the tripartite relationship and bring some certainty to an uncertain world.