Formal Ethics Opinion
KENTUCKY BAR ASSOCIATION

Ethics Opinion KBA E-452
Issued: September 18, 2020

The Rules of Professional Conduct are amended periodically. Lawyers should consult the current version of the rule and comments, SCR 3.130 (available at http://www.kybar.org/237), before relying on this opinion.

SUBJECT:

Ethical Duties of Lawyers Defending Insured Clients Without Separate Retained Counsel for the Client Where Insurance Carriers Have Reserved Rights to Coverage Defenses and Then Intervene to Determine Those Rights in the Same Litigation or in a Separately Filed Litigation.

QUESTIONS PRESENTED:

Question #1: May a lawyer be retained to defend an insured defendant where the retaining insurance carrier has reserved its rights to coverage defenses?

Answer: Yes. KBA Ethics Op. 410, Question #2 (1999).

Question #2: May a lawyer be retained to defend an insured defendant in litigation where the retaining insurance carrier has reserved its rights to coverage defenses and has commenced a separate civil action to determine the coverage questions?

Answer: Yes. KBA Ethics Op. 410, Question #4 (1999).

Question #3: May a lawyer defend an insured defendant in litigation where the retaining insurance carrier has reserved its rights to coverage defenses and has been permitted to intervene in the same civil action to determine the coverage questions?

Answer: Yes, if the insurance contract coverage issues are bifurcated from the liability issues and stayed pending the determination of the liability issues. See discussion below.

Question #4: May a lawyer defend an insured defendant in litigation where the retaining insurance carrier has reserved its rights to coverage defenses and has been permitted to intervene in the same civil action to determine the coverage questions, if the insurance contract coverage issues are not bifurcated from the liability issues and proceed through pre-trial practice collaterally with the determination of the liability issues?

Answer: Yes, if the insured defendant is represented by separate counsel with respect to the coverage questions in the combined liability and coverage proceedings. No, if the insured

defendant is and remains unrepresented by separate counsel as to the coverage questions in the combined liability and coverage proceedings. See discussion below.

PREFACE:

This opinion assumes that the insured defendant is unrepresented by separately retained counsel of the insured's choice to advise and to represent the insured defendant in all coverage issues that may arise in connection with a particular lawsuit or claim. If the insured defendant has retained separate counsel, then that counsel will undertake to address the coverage issues as they arise, and the attorney retained by the insurance company would proceed to defend the underlying litigation. Counsel retained for defense of an insured should confirm through insured's separately retained counsel the limited scope of representation in the underlying litigation. SCR 3.130 (Rule 1.2).

The immediate ethical issues presented in this opinion arise where the insured defendant does not have separate counsel to advise and represent the defendant in a case in which the insurer has intervened in the underlying litigation and there are combined discovery and pre-trial proceedings conducted concerning the simultaneously litigated coverage and tort or other liability causes of action.

BACKGROUND:

The stepping off point for the analysis is the premise under Kentucky law that

> When an Insurer provides the defense to an Insured, the attorney represents the Insured but not the Insurer. *See* KBA E-368 (1994); KBA E-378 (1995). The Insurer is a third-party payor and the situation is governed by Kentucky Rules of Professional Conduct (KRPC) 1.8(f), ...[1]

KBA Ethics Op. 410, p.1 (1999). *See also,* KBA Ethics Op. 368, p.1 (1994) ("We reiterate our view that the insured is defense counsel's client, and not the insurer. *See* KBA E-331 and 340.") *adopted, incorporated by reference in American Insurance Association v. Kentucky Bar Association, et al.*, 917 S.W.2d 568, 574 (Ky. 1999)("we find, as discussed above, that the language of E-368 is complete and articulate, and hold that the opinion clearly presents its stated purpose and rationale.); KBA Ethics Op. 416, p.5 ("when an insurance company engages a lawyer to defend an insured against a claim, the insured – not the insurer – is the lawyer's client.")

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[1] SCR 3.130(Rule 1.8). **Conflict of interest: current clients: specific rules.**

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

(1) the client gives informed consent;

(2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and

(3) information relating to representation of a client is protected as required by Rule 1.6.

This "one client, and the insured is the one" rule for counsel retained to defend an insured is established firmly at this point in time. Notwithstanding the clarity of this premise, from the number of formal ethics opinions arising out of a carrier's retention of legal counsel to fulfill the contracted duty to defend its insured, it is clear that significant conflict issues continue to arise.

DISCUSSION:

KBA Ethics Op. 410 (1999) is instructive in this analysis. In that opinion, the Board of Governors reviewed the specific question of whether a lawyer is permitted to defend an insured in the tort or other liability action when the carrier has issued a reservation of rights and has brought an action for declaration of rights to determine the policy coverage.

The opinion acknowledges that the insurance carrier retained lawyer is to act in the "best interests of the insured", which may well place the lawyer into a conflicting position as respects the carrier which has retained the lawyer:

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

KBA Ethics Op. 410, p.5 (Emphasis Added). The opinion is unequivocal that the lawyer may continue to defend the insured, but cannot simultaneously defend the insured in the declaration of rights action arising out of the underlying claim or litigation. The opinion contemplates that the lawyer would continue to represent the client in the tort or other liability action only.

But it is clear KBA Ethics Op. 410 assumes the declaration of rights or other coverage case is a separate civil action, or at the least, is stayed pending the outcome of the liability action proceedings:

> *If the Insurer files an action for Declaration of Rights, the attorney representing the Insured cannot participate as counsel for Insurer because to do so would be to take an action directly adverse to a present client in a matter intimately related to*

> *the present client.* KRPC 1.7(a) states that an attorney "shall not represent a client if the representation of that client will be directly adverse to another client unless" the attorney reasonably believes that the representation will not adversely affect the representation and the client consents. Comment 4 to KRPC 1.7 states that the attorney should not request consent if a disinterested lawyer would conclude that the client should not consent. The Insured cannot be asked to consent to such representation of the Insurer in a Declaration of Rights action.
>
> *Nor can the attorney represent the Insured in the Declaration of Rights action. Though the Insurer is not a client of the attorney, the position the attorney would find himself or herself in litigating the coverage question against the Insurer who is paying the attorneys fees in the underlying matter is not one permissible under 1.7(b).*
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> *Assuming that both Insurer and Insured are represented by other counsel in the Declaration of Rights action, the attorney may continue to represent the Insured with the defense provided by the Insurer as long as the particular facts do not create a situation in which 1.7(b) would be violated*. In the vast majority of situations, the fact that a Declaration of Rights action is ongoing should not affect adversely the attorney's representation of the Insured.

Emphasis added.

As noted above, if the insured is represented separately for the coverage issues, then the consent of the insured to a limited representation that would cover only the tort or other liability action is a relatively straightforward matter. SCR 3.130 (Rule 1.2(c)) would permit an attorney and client to limit the scope of the representation to the underlying liability litigation "if the limitation is reasonable under the circumstances and the client gives informed consent."[2]

But a waiver or agreement by the otherwise insured defendant to a limited scope of representation excluding the coverage issues in a combined case (even if "informed consent" could be obtained without separate counsel for the insured to advise the "material risks" and "reasonably available alternatives"[3]) would leave the client without benefit of counsel as to the

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[2]The Comments to this rule include:

Agreements Limiting Scope of Representation

[6] The scope of services to be provided by a lawyer may be limited by agreement with the client or by the terms under which the lawyer's services are made available to the client. *When a lawyer has been retained by an insurer to represent an insured, for example, the representation may be limited to matters related to the insurance coverage.* A limited representation may be appropriate because the client has limited objectives for the representation. In addition, the terms upon which representation is undertaken may exclude specific means that might otherwise be used to accomplish the client's objectives. Such limitations may exclude actions that the client thinks are too costly or that the lawyer regards as repugnant or imprudent. (Emphasis added.)

[3] SCR 3.130(Rule 1.0) **Terminology** states:

coverage case issues being simultaneously litigated. At the same time, in every deposition, discovery response, or pre-trial hearing, a separate lawyer retained by the carrier would be prosecuting the declarations action to establish the lack of coverage for the unrepresented, putative insured. All the while, retained defense counsel must sit idly by and cannot advise or assist his or her client across the table, or while standing before the bench, even though the lawyer is charged with the duty "to work in the best interests of the insured." This is an untenable position for any lawyer.

In evaluating the issues presented in combined litigation under Federal Rule 24(a), the court in *Travelers Indemnity Company v. Dingwell*, 884 F.2d 629 (1st Cir. 1989) made this observation:

> . . . . There can be no dispute that an insurer has a direct interest in a lawsuit brought by an injured party against its insured when the insurer admits that the claim is covered by the policy in question. ***When the insurer offers to defend the insured but reserves the right to deny coverage, however, the insurer's interest in the liability phase of the proceeding is contingent on the resolution of the coverage issue.*** *See Restor-A-Dent Dental Laboratories, Inc. v. Certified Alloy Products, Inc.*, 725 F.2d 871, 874-76 (2d Cir. 1984); *see also United States Fidelity & Guaranty Co. v. Adams*, 485 So. 2d 720, 721-22 (Ala. 1986) (Alabama Rules of Civil Procedure); *Kuperstein v. Superior Cour*t, 204 Cal. App. 3d 598, 251 Cal. Rptr. 385, 387 (1988) (California Code of Civil Procedure); *Cromer v. Sefton*, 471 N.E.2d 700, 704 (Ind.App. 1984) (Indiana Rules of Trial Procedure); *Donna C. v. Kalamaras*, 485 A.2d 222, 223-24 (Me. 1984) (Maine Rules of Civil Procedure); *Kaczmarek v. Shoffstall*, 119 A.D.2d 1001, 500 N.Y.S.2d 902, 903-04 (1986) (New York Code of Civil Procedure); *cf. Hartford Insurance Co. v. Birdsong*, 69 Md. App. 615, 519 A.2d 219, 221-22 (1987) (same result under

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(b) "Confirmed in writing," when used in reference to the informed consent of a person, denotes informed consent that is given in writing by the person or a writing that a lawyer promptly transmits to the person confirming an oral informed consent. See paragraph (e) for the definition of an informed consent. If it is not feasible to obtain or transmit the writing at the time the person gives informed consent, then the lawyer must obtain or transmit it within a reasonable time thereafter.

* * * *

(e) "Informed consent" denotes the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct.

The lawyer should note that SCR 3.130 (Rule 1.2(c)) does not refer to the informed consent being "confirmed in writing". However, to the extent that the lawyer must make the evaluation under SCR 3.130 (Rule 1.7(b)) that any potential for conflict of interest will not affect the representation, Rule 1.7(b)(4) requires that "each affected client gives informed consent, confirmed in writing."

> local rules of civil procedure when insurer denies coverage). Accordingly, the asserted interest is not cognizable for purposes of Rule 24(a)(2). We do not regard this conclusion as overly "legalistic" or "mechanical." *Guaranty National Insurance Co. v. Pittman*, 501 So. 2d 377, 384 (Miss. 1987). ***Instead, we view it as reflecting the well-established policy that an insurer who reserves the right to deny coverage cannot control the defense of a lawsuit brought against its insured by an injured party***. *See Cay Divers, Inc. v. Raven*, 812 F.2d 866, 870 (3d Cir. 1987); *United Services Automobile Association v. Morris*, 154 Ariz. 113, 741 P.2d 246, 252 (1987); *Three Sons, Inc. v. Phoenix Insurance Co.*, 357 Mass. 271, 257 N.E.2d 774, 777 (1970); *Butters v. City of Independence*, 513 S.W.2d 418, 424 (Mo. 1974); J. Appleman, 7C Insurance Law & Practice § 4686, at 176; A. Windt, Insurance Claims and Disputes § 4.24, at 188 (2d ed. 1988). ***Allowing the insurer to intervene to protect its contingent interest would allow it to interfere with and in effect control the defense. Such intervention would unfairly restrict the insured, who faces the very real risk of an uninsured liability, and grant the insurer "a double bite at escaping liability."*** *Morris*, 741 P.2d at 251.

Id. at 638-39. [Emphasis added]. *See, e.g., United States Fidelity & Guaranty Co. v. Adams*, 485 So. 2d 720, 722 (Ala. 1986).

An agreement to limit the scope of the defense lawyer's representation in a combined liability and declaratory judgment coverage proceeding would require the insured to have separate counsel to advise the client on the merits of so doing. The retained defense counsel attempting to advise the insured client would do so from a position of conflict and could not do so without being subject to questioning the lawyer's impartiality. KBA Ethics Op. 378 (1995) addresses the question of a collateral defense in a tort action against the insured and a UCSPA[4] claim against the insurer in the same action. The opinion rejects the idea that a limited scope and collateral defense of both the carrier and the insured would be possible in view of the conflicting duties that would arise in the litigation.

The same result would be present in the situation of the combined tort or other liability claims and defense of the declaratory judgment claim. It would be extraordinarily difficult to comply with SCR 3.130 (Rule 1.7(b)) and SCR 3.130 (Rule 1.0(e)) and consult with the insured client to obtain informed consent of a limited representation in the combined coverage and liability action. The insured client would have no way of determining during the combined proceedings when the insured's lawyer would be acting in the insured best interests for the underlying tort or other liability action or refraining from acting in the interests of the insured in the declaratory judgment action.

If the insured client retains separate counsel or is provided separate representation for the insurance policy coverage claims, the liability defense lawyer would not violate the Rules of Professional Conduct by continuing in this representation limited to the underlying tort or other liability claims. But the lawyer should confirm the limited role through the insured's personal counsel following SCR 3.130 (Rule 1.2(c)).

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[4] Unfair Claims Settlement Practices Act, KRS §304.12-230.

If in the combined litigation the parties and the court bifurcate the coverage issues and stay the litigation on those issues until determination of the liability issues, then the lawyer would be able to consult with the insured client and may be able to obtain the consent of the insured client to the limited scope of representation in the liability issues only under SCR 3.130 (Rule 1.2(c)). If such is obtained, the lawyer should make the judgment under SCR 3.130 (Rule 1.7(b)) as to whether "the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client" in the liability claims alone.

If in the combined litigation the parties and the court do not bifurcate the coverage issues and stay the litigation on those issues until determination of the liability issues, then a lawyer may not represent the insured on the tort or other liability claim defense and leave the lawyer's client exposed and unrepresented on the policy claims. Without the putative insured having counsel to advise the insured in the combined policy and liability litigation, either personally retained or through additional counsel retained by the carrier for that purpose, the retained liability defense counsel is put in an untenable position. Under KBA Ethics Op. 410, a carrier retained defense lawyer may not represent the insured on the policy claims in either separate or combined proceedings. But at the same time a lawyer representing a client cannot act in the "best interests of the insured" during combined discovery, pretrial, and trial proceedings defending solely on the tort or other liability claims, leaving the lawyer's client without the advice of counsel and unrepresented on significant litigation issues that will be taking place right in front of the lawyer and are of significant importance to the client.

If the insured client does not have separate counsel to advise and represent the client on the insurance policy coverage claims, and the parties and the court determine the litigation will be combined and refuse to sever the matters for discovery, pretrial and trial proceedings, then the liability defense lawyer should withdraw from the client's representation. *See* SCR 3.130(1.16).

Note To Reader

This ethics opinion has been formally adopted by the Board of Governors of the Kentucky Bar Association under the provisions of Kentucky Supreme Court Rule 3.530. This Rule provides that formal opinions are advisory only.