NAVIGATING THE ONE-CLIENT/TWO-CLIENT TRIPARTITE RELATIONSHIP BETWEEN THE CARRIER, INSURED, AND DEFENSE COUNSEL

WHAT STATE DO YOU LIVE IN?

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The tripartite relationship governing the rights and duties among the insured, its insurance carrier, and retained counsel to represent the insured is a complicated one that is like no other in the context of attorney-client relationships. The failure to understand this intricate relationship can not only increase the carrier's potential exposure, which may then lead to extra-contractual liability from its insured, it can also create exposure to retained counsel from the insured, and in extreme cases, exposure to retained counsel from the carrier who initially created the relationship. Understanding the tripartite relationship and respecting the roles of each party are critical to avoiding the breakdown of the relationship and the exposure that may follow. This article seeks to educate the reader on the basics of the tripartite relationship, how to identify key issues, and ways to prevent possible conflicts that may emerge.

The tripartite relationship is the relationship among the insurance carrier, its insured, and retained counsel. Typically, the insurance carrier employs the retained counsel to defend the claims brought against the insured pursuant to the policy agreement between the carrier and insured.

ONE-CLIENT, TWO-CLIENT, OR DUAL REPRESENTATION STATES

To effectively navigate this complex relationship, the first question that must be answered is with whom does the retained counsel have an attorney-client relationship. While the answer to this question may seem automatic, it is dependent on in which state the retained counsel practices law. In states such as New York, the retained counsel is charged with solely focusing on the interests of the insured[1] and has no direct duty to the carrier other than to report on the progress of the litigation. Even if retained counsel learns of information that might be deleterious to the relationship between the insured and the carrier, retained counsel must take the position that is favorable to the insured.

In a two-client state, such as Alabama, the retained counsel shoulders a greater duty by representing simultaneously both the interests of the insured and the carrier.[2] If the parties determine that there may be a conflict between the insured and the carrier, the retained counsel may be required to withdraw from the case altogether. In a state like Florida, where dual representation is allowed but not necessarily required, the initial agreement between retained counsel and the carrier determines the degree of loyalty and duty owed to the insured versus the carrier.[3] Once the initial determination is made on who the client is, the next step is to consider the language of the policy agreement and initial engagement letter among

the retained counsel, carrier, and insured.

The policy agreement and initial letter of engagement in many ways guide the tripartite relationship. The policy agreement sets forth all the intricacies of the relationship between the insured and the carrier, while the letter of engagement outlines the relationship among the retained counsel, carrier, and insured. The language of the policy agreement is of tantamount importance and generally addresses many questions that may arise, such as who has the right to settle the case and whose consent is needed to settle. The letter of engagement is also very important as it can serve to clearly establish who the client is and clarify the expectations of each party's role in the litigation.

Insurance carriers should exercise caution when formulating the policy agreement, and retained counsel must ensure familiarity with the terms of the policy agreement, keeping in mind that the very language in the policy agreement may later be the grounds for a bad faith or legal malpractice claim against the retained counsel. The policy agreement will almost always contain a provision detailing the carrier's duty to defend and indemnify against claims brought pursuant to the policy agreement. In some cases, the policy agreement will permit the carrier to control the defense of litigation, whereas others do not, and most will require the insured to cooperate with the carrier and retained counsel handling the claim. Knowing the language contained in the policy agreement will allow both the carrier and the retained counsel to act within the boundaries of their defined roles, thereby minimizing the risk of future conflicts and lawsuits.

Retained counsel should be meticulous when preparing the initial letter of engagement, being cognizant that the terms of the engagement letter may later be used as basis for a legal malpractice action against him/her. It is prudent that the retained counsel's role is clearly defined and the guidelines for potential conflict resolutions are outlined within the initial letter of engagement. Doing so can serve to preemptively address certain potentially contentious topics, such as the settlement rights of the insured and the carrier, the carrier's reservation of rights, availability of excess/other coverages, and whether the communication may be shared with the carrier.

APPLICABLE STATE PROFESSIONAL CODE OF CONDUCT

In addition to his/her obligations owed to the insured and carrier under the policy agreement and engagement letter, retained counsel must also be mindful of the applicable state professional code of conduct. For example, 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 some liability claims, the carrier has the right to settle a matter without the consent of the insured. Even assuming that the carrier's right to settle clearly was defined earlier on, retained counsel can be left in a predicament, especially when (i) the attorney is in a two-client state representing both the insured and carrier, and (ii) the insurer and carrier are in disagreement as to whether or not they should settle the matter.

NAVIGATING COMPETING DEFENSE STRATEGIES

Relatedly, retained counsel may encounter situations where the carrier and insured have differing opinions on defense strategies, which may be exacerbated if the carrier is defending the matter under a reservation of rights. For example, in addition to the potential liability imposed against him/her, the insured is often concerned with the reputational damage the litigation may cause collaterally, compared to the carrier's concern to control defense costs. In other instances, the retained counsel may favor a litigation approach that is not appreciated by the insured and/or carrier.

In such circumstances, the retained counsel must maintain the delicate balance of each party's interests, focusing on who the client is and what duty is owed to each party. Of course, in a one-client state, maintaining this balance may be easier as the counsel's paramount duty will be to the insured. However, in a two-client state, where retained counsel owes an additional duty to the carrier, finding the right balance can be a difficult task, and in some circumstances, may require the counsel to withdraw from his/her representation.

The reality is that even when retained counsel believes that he/she has skillfully maintained his/her balance in navigating across such tensional tripartite relationship, they may still be subjected to and plagued by a legal malpractice lawsuit. More often than not, such subsequent malpractice lawsuits are premised on the misunderstanding of who the client was and to whom the retained counsel owed a duty of professional care. Similarly, even when the carrier believes it has provided appropriate defense within the confines of the policy agreement, the insured may still pursue a bad faith claim against the carrier.

In sum, the very nature of the tripartite relationship, e.g. varying views on who the client is, the retained counsel's duties owed to each party, rights of and obligations owed to each party, etc., can place the retained counsel in a position that is susceptible to malpractice claims and the carrier to be subjected to bad faith claims. While one cannot absolutely prevent the filing of such actions by the insured, there are preventative steps that the retained counsel and carrier can take to reduce such risks and limit their respective potential exposure. First, the retained counsel and carrier should have a thorough understanding of the policy agreement and engagement letter, appreciating the implications such agreements can have. Second, the retained counsel should always remember to ensure that both the insured and carrier are aware of who is representing them and the duties owed to the respective parties. Lastly, retained counsel should try to balance delicately the interests of both the insured and the carrier while being guided by the terms of the liability policy, engagement letter, and the applicable state court decisions and rules of professional conduct.

1 *Feliberty v. Damon*, 72 N.Y.2d 112 (1988) (holding that "[t]he paramount interest independent counsel represents is that of the insured, not the insurer.").

2 *Mitchum v. Hudgens*, 533 So. 2d 194 (Ala. 1988) ("[w]hen an insurance company retains an attorney to defend an action against an insured, the attorney represents the insured as well as the insurance company in furthering the interest of each.").

3 R. Regulating Fla. Bar 4-1.7(e).

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