

ETHICS OPINION

900517

QUESTIONS PRESENTED:

1. Would independent counsel violate Rule 1.7(b) of the Montana Rules of Professional Conduct by complying with an insurer's billing practices and procedures requirements where the insurer has agreed to defend the insured under a reservation of rights?
2. Would independent counsel violate Rule 1.8(f)(2) of the Montana Rules of Professional Conduct by complying with the insurer's billing practices and procedures requirements where the insurer has agreed to defend the insured under a reservation of rights?

ANSWER:

1. Yes.
2. Yes.

ANALYSIS: The insured is an individual named as an insured on a corporation's insurance policy. A claim has been made and a lawsuit filed against the insured and the corporation's insurance company (the "insurer") has agreed to defend the insured under a reservation of rights. The insurer has allowed the insured to obtain independent counsel. The insurer sent the insured's independent counsel a document entitled "Billing Practices and Procedures for Claim Litigation" and a document entitled "Litigation Plan of Action." In essence, the insurer, by requiring independent counsel to follow certain practices and procedures for conducting the insured's defense, seeks to exercise some degree of control over the independent counsel's representation of the insured.

1. Independent counsel refuses to comply with the insurer's required billing practices and procedures on the grounds that in doing so he would violate ethical obligations imposed by Rules 1.7(b) and 1.7(f)(2) of the Montana Rules of Professional Conduct. These rules provide as follows in pertinent part:

Rule 1.7 Conflict of Interest: General Rule

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(b) a lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer's responsibilities to another client or to a third person, or by the lawyer's own interests . . .

* * *

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

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

Independent counsel contends that the insurer's attempted control of the insured's defense would materially limit his representation of the insured.

Generally, the insurer enjoys some degree of control over the insured's defense. See 7C Appleman, *Insurance Law and Practice*, Section 4681, pp. 2-3 (1979); *Nandorf, Inc. v. CNA Ins. Companies*, 479 N.E.2d 988, 991 (Ill. App. 1985) (insurer's duty to defend includes right to assume control of litigation). However, if a conflict of interest exists between the insurer and its insured, the insurer may not itself participate in the defense and can only satisfy its obligation to defend the insured by reimbursing the insured's cost for independent counsel. *Nandorf*, 479 N.E.2d at 991 (insurer defending under reservation of rights must allow insured to assume control of defense); *Cooper Laboratories v. Intn'l Surplus Lines*, 802 F.2d 667, 675 (3rd Cir. 1986) (insurer's obligation to furnish defense is transformed to reimbursement to the insured) *San Diego Navy Fed. Credit Union v. Cumis Ins. Soc., Inc.*, 208 Cal.Rptr. 494 (Cal.App. 1984) (insurer required to surrender control of defense and pay for independent counsel where reservation of rights has created conflict of interest); *O'Bannon v. Northern Petrochemical Co.*, 447 N.E.2d 985, 989 (Ill.App. 1983) (insurer not permitted to participate in defense if conflict of interest exists); *U.S. Fld. & Guar. Co. v. Louis A. Roser Co.*, 585 F.2d 932, 939-941 (8th Cir. 1988) (independent counsel for insured cannot represent insurer if conflict exists and insurer must reimburse insured for reasonable value of counsel's services) *All-Star Ins. Corp. v. Steel Bar, Inc.*, 324 F.Supp. 160, 165 (N.D.Ind. 1971) (conflict of interest does not relieve insurer of duty to pay cost of insured's independent counsel); See generally, 7C Appleman, *Insurance Law and Practice*, Section 4681, p. 13, n. 49, p. 15, n. 56 (1979) (where conflict exists, insurer is obligated to furnish insured with attorney, but that attorney may not be associated with insurer; questionable coverage creates conflict of interest and insured cannot be required to surrender defense of insurer to raise question of coverage). By reserving the right to contest coverage, the insurer renounces control of the litigation and creates a conflict between the insurer and the insured's interest. Cf. *Cay Divers, Inc. v. Raven*, 812 F.2d 866, 870 (3rd Cir. 1987) (insurer's discharge of duty to defend by providing independent counsel while reserving right to contest coverage relieves insurer of control over litigation); *Nandorf*, 479 N.E.2d at 991 (ethical problem not resolved by insurer electing to defend under reservation of rights).

The insurer in this case has elected to defend under a reservation of rights and has allowed the insured to retain independent counsel. A conflict exists between the insurer's interest in contesting the coverage and the insured's interest in establishing coverage under the policy. As the insured's attorney, independent counsel may not compromise his duty of loyalty to his client. See Rule 1.7, Montana Rules of Professional Conduct, comment 9 (a lawyer may be paid from a source other than client if arrangement does not compromise the lawyer's duty of loyalty to the client; insurers' arrangement with insured's special counsel must assure special counsel's professional independence); *Parsons v. Continental National American Group*, 550 P.2d 94, 98 (Ariz. 1976) (attorney who represent insured owes undeviating and single allegiance to the insured regardless of whether attorney is compensated by the insurer or the insured). When a conflict of interest exists between the insured and the insurer, the insurer cannot control the insured's defense. Cf. *Penn Aluminum, Inc. v. Aetna Ca. & Sur. Co.*, 402 N.Y.S.2d 877, 879

(N.Y.App.Div. 1978) (in conflict of interest situation, insurer's desire to control defense must yield to obligation to defend insured); *Employer's Fire Ins. Co. v. Beals*, 240 A.2d 397, 403 (R.I. 1968) (insurer's desire to control defense must yield to its obligation to defend insured).

Independent counsel's client in this matter is the insured and he may not represent that client if such representation would be materially limited by responsibilities to the insurer. Rule 1.7(b), Montana Rules of Professional Conduct. In addition, independent counsel may not accept compensation from the insurer if, by accepting such compensation, there is interference with his independence of professional judgment and client-lawyer relationship. Rule 1.7(f), Montana Rules of Professional Conduct.

Under Montana's Rules of Professional Conduct, independent counsel must provide competent representation (Rule 1.1) at a reasonable fee (Rule 1.5) regardless of the source of payment. Independent counsel and the insurer are encouraged to work together to determine what basic information can be ethically divulged in order to keep the insurer apprised of the status of the litigation. Independent counsel may not comply with those billing practice and procedure requirements which materially limit his representation of the insured (Rule 1.7), which interfere with his independence of professional judgment, or which interfere with the client-lawyer relationship (Rule 1.7(f)(2)). However, independent counsel may comply with those of the insurer's requests for information which merely serve to keep the insurer apprised of the general status of the litigation and with those billing procedures which merely serve to keep the insurer informed as to what services it pays for. In the final analysis, independent counsel must determine on a situational basis what information he can supply to the insurer without violating the ethical duties to the client.

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