

50 State Survey

Do Conflicts of Interest Arising from a Liability Insurer's Reservation of Rights Require Payment of Independent Counsel?

Preface

“The mandatory rule of [lawyer] disqualification in cases of dual representations - analogous to the biblical injunction against ‘serving two masters’ (Matthew 6:24) - is self-evident.” (*Flatt v. Superior Court*, 9 Cal.4th 275, 286 (1994) (ellipses omitted).)

Introduction

This survey¹ collects published opinions from all 50 states, the Virgin Islands, and the District of Columbia addressing whether a liability insurer that reserves its rights to later deny coverage must pay for independent counsel to defend its policyholder. This body of law is developing slowly as discrete legal issues are framed by litigants and decided by the courts in piecemeal fashion. Thus, the collection of published opinion is like the blind men describing an elephant: most descriptions are accurate, but incomplete, often leaving courts and litigants confused. Only California has established a comprehensive body of law on this subject, although California's development of this law too is a work in progress. It was last updated on November 12, 2018.

An index of jurisdictions, table of contents, and table of cases follows the survey.

Editorial Note:

1. Three “Rules” Emerge Among the Jurisdictions

A reading of all of 102 cases collected here reveals, in the opinion of the editor, three broad categories of decisions, although it is often difficult to confidently assign a category to the often

¹ Several scholarly 50 State surveys address statutory and common law requirements that a liability insurer pay for independent counsel when an insurer's reservation of rights creates either insurer conflicts of interest or lawyer ethical conflicts for insurer appointed counsel. All of these other surveys collect most of the same cases. This survey is different in that it is continuously being updated and to the greatest extent possible, this survey expresses the decisions in the various jurisdictions in the language of the courts, rather than expressing the author's interpretation of the law. The other surveys include: **Independent Defense Counsel: When Can The Policyholder Select Its Own Defense Lawyer and How Much Does the Insurer Have to Pay? A 50-State Survey**

(http://www.americanbar.org/content/dam/aba/administrative/litigation/materials/2014_inscle_materials/written_materials/p3_2_independent_defense_counsel_50_state.authcheckdam.pdf) **Duty to Provide Independent Counsel: A 50-State Survey** (2009)

([http://www.tresslerllp.com/files/Publication/0e7da0e2-9d2c-4f3d-9888-eb641366e828/Preview/PublicationAttachment/f72aad8a-0ff0-4034-828a-07884c70d338/50-State%20Survey_Duty%20to%20Provide%20Independent%20Counsel%20\(Bondi%20Morrison\)%202012.pdf](http://www.tresslerllp.com/files/Publication/0e7da0e2-9d2c-4f3d-9888-eb641366e828/Preview/PublicationAttachment/f72aad8a-0ff0-4034-828a-07884c70d338/50-State%20Survey_Duty%20to%20Provide%20Independent%20Counsel%20(Bondi%20Morrison)%202012.pdf))

Reservation of Rights: Disclaimer letters, Non-waiver agreements, 50 State Survey, 2011

(http://www.munichreamerica.com/site/mram/get/documents_E-759630968/mram/assetpool.mr_america/PDFs/3_Publications/reservation_of_rights_2011.pdf)

cryptic language of some courts:

1) about two thirds of the jurisdictions conclude that a liability insurer's reservation of rights creates a conflict of interest that disqualifies insurer appointed defense counsel from ethically representing the policyholder. The rationale for this "per se" rule, where stated at all, is that an insurer that reserves any rights has little economic incentive to vigorously defend its policyholder. Jurisdictions the editor has placed in this category often offer mere dictum that does not rule out the possibility that any given jurisdiction may morph into another rule when the issue is next presented to its courts;

2) About ten jurisdictions have adopted a "disqualifying conflict" rule, a modified "per se" rule that conflicts of interest created by every reservation of rights do not necessarily disqualify "dependent counsel"² from ethically representing the policyholder. Under this rule, the insurer must pay for "independent counsel" to ethically represent the policyholder unless the insurer's reservation of rights is limited to grounds that "have nothing to do with" or are "unrelated to" any issues of fact or law that are being litigated in the liability dispute;

3) A small handful of jurisdictions follow a logically peculiar "enhanced duties" rule that a liability insurer that reserves its rights to deny coverage need not pay for independent counsel on two conditions: a) that the insurer and dependent counsel make adequate disclosure to the policyholder; and b) the policyholder fails to carry the burden to establish the existence of any disqualifying conflict of interest. These courts emphasize the importance that adequate disclosure by a reserving insurer and its lawyers plays in fashioning a fair rule;

4) A handful of jurisdictions do not appear to have addressed the issue of whether or when a liability insurer that reserves its rights must pay for independent counsel.

2. Editor's Critique of Each Rule

In the opinion of the editor, the majority "per se" rule is too rigid, the "enhanced duties" rule is too illogical, and the "disqualifying conflict" rule is the Goldilocks solution - it's just right. The whole fight over whether the insurer or the policyholder may control the defense by selecting and directing defense counsel focuses upon whether the conduct of the defense could possibly influence the outcome of any coverage dispute. If it can, the insurer will benefit by directing the defense away from coverage while the policyholder will benefit by directing the defense into coverage. This conflict of interest between the insurer and the policyholder precludes any attorney from representing both clients without analyzing potential conflict, making written disclosure, and obtaining informed written consent of both client. (ABA and California Rule 1.7.) This ethical prohibition is prophylactic, not remedial, so that a lawyer is prevented from "accepting or continuing" representation of the policyholder. If the insurer's lawyer cannot ethically represent the interests of both the insurer and the policyholder, then the solution must be for the insurer to pay for independent counsel who represents only the policyholder.

The majority "per se" rule is too rigid because not every reservation of rights necessarily creates a disqualifying conflict of interest for a lawyer who is loyal to the insurer. For example, when a liability insurer limits the ground of its reservation of rights to the failure of the policyholder to pay the premium on time, dependent counsel cannot possibly influence the outcome of this issue by the manner in which the defense is conducted. Payment of the premium

² "Dependent counsel" are lawyers selected and directed by a reserving insurer and describes the counterpart to "independent counsel" who are lawyers selected and directed by the policyholder.

simply has “nothing to do with” the defense of a liability dispute.

The “enhanced duties” rule does not withstand logical scrutiny. This rule assumes that the lawyer who is regularly hired by the insurer upon whom the lawyer depends for her or his livelihood does not represent the insurer’s interests and will not be influenced to advance the interests of the insurer over those of the policyholder, when a pessimistic view of human nature dictates the opposite. It also assumes that a policyholder whose interests are harmed by the insurer and/or its lawyers may effectively seek a remedy from them after the liability dispute ends badly. As a practical matter an attempt to unwind an entire lawsuit to imagine how it might have resulted in a different outcome is as difficult as it is to extract a whole raw egg capable of gestation from a baked cake. Also, both insurers and their lawyers have duties of good faith and disclosure to the policyholder of the “highest order”, so that enhancing these duties does nothing to augment them.

The “disqualifying conflict” rule is the Goldilocks solution. It does not improperly assume that every reservation of rights necessarily disqualifies a lawyer who is loyal to the insurer who regularly hires her or him. Instead, this rule is rooted in attorney ethics and flows naturally from a proper analysis of conflicts of interest between the insurer and the policyholder as those conflicts impact the lawyer’s duties of undivided loyalty, disclosure, and confidentiality. If each ground upon which the insurer may later deny coverage to the policyholder has “nothing to do with” the issues of fact or law being litigated in a liability dispute, the no disqualify conflict of interest exists for the insurer’s lawyer to represent both clients. But otherwise, the lawyer cannot ethically accept or continue employment and therefore, the insurer must pay for independent counsel.

Although development of the law in this field is too slow to identify any “trend”, Nevada and Indiana have recently issued thoughtful published opinions adopting the “nothing to do with” standard. No published opinion in this decade has adopted the “enhanced duties” rule.

3. The Practical Application of the Law

This body of law protects policyholders from insurers and their lawyers who may be tempted to influence the outcome of a liability dispute in a fashion that favors the insurer coverage position at the policyholder’s expense. The rationale for these rules is based on an A then B then C formula: A) an insurer’s reservation of rights creates conflicts of interest between the insurer and the policyholder; B) these client conflicts require dependent counsel to comply with the Canons of Ethics to analyze potential conflict, make written disclosure, and obtain informed written consent.

This body of law is very unpopular with liability insurers and their dependent counsel. Liability insurers want to control liability disputes brought against their policyholders and dependent counsel want to earn fees conducting the policyholders’ defenses. To prophylactically guard against abuses by reserving insurers and their dependent counsel, each of the three categories of rules conveys upon the policyholder the power to control one’s own defense unless the insurer and their dependent counsel analyze potential conflicts of interest and make written disclosure. The “per se” jurisdiction always require the policyholder’s informed written consent for the insurer to take control of the policyholder’s defense. The “nothing to do with” jurisdictions require the policyholder’s informed written consent for the insurer to take control of the policyholder’s defense unless dependent counsel’s analysis and disclosure reveal that the grounds upon which the insurer reserves its right to later deny coverage are limited to grounds that have “nothing to do with” disputed issues of fact or law in the liability dispute. The “enhanced duties” jurisdictions shift the burden to the policyholder to establish that an actual conflict of interest exists or that the reserving insurer and/or its dependent counsel have failed to make adequate “enhanced” disclosure. Under all three rules, a reserving insurer may start to earn control of the

policyholder's defense by making adequate analysis and written disclosure of potential conflicts to the policyholder.

In actual practice however, some insurers and their dependent counsel fail to take the initiative to adequately analyze conflicts of interest created by an insurer's reservation of rights or to make required written disclosure. When this occurs, the policyholder may take control of the defense by expressly withholding consent and authority for potentially conflicted dependent counsel to represent the policyholder until the insurer and dependent counsel have provided adequate responses to a Coverage Questionnaire and an Ethical Compliance Questionnaire.

Several themes emerge from reading the cases collected here:

4. Three Tussles; Three Venues: Three Sets of Laws

The tumult arising from a reservation of rights requires examination of three tiffs:

- a) the *liability dispute* by and injured plaintiff against a policyholder/defendant - governed by *tort law*;
- b) a *coverage contest* by an insurer against its policyholder - governed by *contract law*; and
- c) an *ethical imbroglio* by dependent counsel against its policyholder/client - governed by *Canons of Ethics*.

Each encounter deserves separate factual and legal analysis, even though the three squabbles influence each other like moving pieces in a game of three-dimensional chess.

5. Grounds to Distrust the Reserving Insurer and Dependent Counsel

A reservation of rights may render the liability insurer untrustworthy because:

- a) having conditionally denied coverage, it lacks an economic incentive to fund a vigorous defense;
- b) it may seek to influence the outcome of the liability dispute away from coverage; and
- c) it may seek to influence dependent counsel to develop admissible evidence adverse to coverage to be used by the insurer against the policyholder in a coverage contest.

Most jurisdictions are justifiably suspicious of the corrupting power of money on human nature - a very few are trusting of dependent counsel in the absence of any evidence of actual harm.

6. Dependent Counsel's Duties of Loyalty, Confidentiality, and Disclosure

A reservation of rights may render dependent counsel untrustworthy because:

- a) a lawyer's duty of undivided loyalty may preclude dependent counsel from representing the interests of both the insurer and the policyholder;
- b) dependent counsel's duty of confidentiality may be compromised regarding information that could adversely impact coverage; and
- c) dependent counsel's duty of disclosure does "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." (*San Diego Navy Fed. Credit Union v. Cumis Ins. Society, Inc.* 162 Cal.App.3d 358, 375 (1984) (*Cumis*).

7. The Need to Develop Admissible Evidence

Just as resolution of a liability dispute turns on the development of admissible evidence to be applied to rules of law framed by the pleadings, so too resolution of a coverage contest and an ethical imbroglio require the development of admissible evidence and the careful framing of legal issues. Many of the cases collected here were decided in a factual vacuum in which little or no evidence was presented to the court regarding the nature of the insurer's contractual conflicts of interest nor, separately, dependent counsel's ethical conflicts of interest. Accordingly many published opinions strive to achieve a challenging task - to fashion a just and reliable rule of law

based on factual assumptions that may not reflect the real world. In an expression of frustration and humor, one recent opinion stated: “We conclude the facts alleged by [the policyholder] do not support its claim of a conflict of interest with [the insurer]. . . . [The policyholder] argues . . . without giving any explanation about how [and] offers a host of allegations about how [the insurer] will control the litigation without describing how this is occurring. . . . [The policyholder] is alleging conclusions without substance, not facts. As Gertrude Stein famously said about Oakland, there is no there there.” (*Centex Homes v. St. Paul Fire & Marine Ins. Co.* 237 Cal.App.4th 23, 31-32 (2015).) A solution to this pervasive problem is for policyholder counsel to take preliminary steps to develop evidence before filing suit.

8. The Need to Carefully Frame Legal Issues

Common law tends to develop piecemeal. Courts tend to resolve precisely framed legal issues presented by them by the pleadings based upon the admissible facts before them. Thus, many of the cases collected here do not even attempt to exhaustively explain broad principles of law - instead they decide a limited legal issues based on limited facts. Very few reported opinion are for declaratory relief judgments that address whether a reservation of rights creates contractual conflicts of interest for insurers nor whether a reservation of rights creates ethical conflicts of interest for dependent counsel. Instead, many reported opinions address the availability or unavailability of specific remedies for alleged violations of conflicts of interest, such as whether an insurer is liable to pay non-covered defense costs or a non-covered settlement because of unproven conflicts of interest.

9. Ethical Imbroglios Should be Resolved Promptly

Ethical imbroglios usually should be resolved before dependent counsel starts work representing the policyholder because Canons of Ethics are prophylactic, not punitive. Therefore, ethical compliance should be complete **before** dependant counsel appears as an attorney or record for the policyholder. “Any lawyer who attempts to represent two adverse masters places himself in a precarious, perilous position. [Rules of ethics] are distilled principles of ancient, time-honored, and judicially-enforced conduct on the part of lawyers in representing clients. Without them our system of justice would be doomed. It hardly needs to be added that no insurance policy can validly diminish a lawyer’s duty to his insured client. In sum, the ethical dilemma thus imposed upon the carrier-employed defense attorney would tax Socrates, and no decision or authority we have studied furnishes a completely satisfactory answer.” (*Hartford Acc. & Indem. Co. v. Foster* 528 So.2d 255, 269, 274 (Miss. 1988) (*Foster*)). “An insurer’s reservation of rights may create a disqualifying conflict of interest requiring the insurer to pay the cost of [independent] counsel. But not every reservation of rights entitles an insured to select [independent] counsel. The potential for conflict requires a careful analysis of the parties’ respective interests to determine whether they can be reconciled. Given the complexities of any [conflict of interest] analysis, insurers are entitled to a reasonable period of time to analyze a situation requiring a coverage decision.” (*Dynamic Concepts, Inc. v. Truck Ins. Exchange* 61 Cal.App.4th 999, 1006-10 (1998) (citations, ellipses, and quotation marks omitted, text in brackets added) (*Dynamic*)).

10. Consider Sending Coverage and Ethical Questionnaires

Negotiating resolution of conflict of interest issues may also serve as an opportunity to develop admissible evidence that is wholly missing from many of the following opinions. “There is no basis on the record to presume [a merely theoretical parade of horrors]. [The insurer] sought to meet with [independent counsel] to ascertain the nature of the conflict. But [independent counsel] repeatedly refused to do so.” (*Id.* at 1008-09 (citations, ellipses, and quotation marks omitted, text in brackets added).) One quick and easy option to develop this needed evidence is

for a policyholder to send a Coverage Questionnaire to a reserving insurer and an Ethical Compliance Questionnaire to dependent counsel. Forms of both questionnaires are available at DutytoDefend.com.

Three Alternate Rules

Three broad categories of rules emerge from this survey: 1) a “per se” rule; 2) a “disqualifying conflict” rule; or 3) an “enhanced duties” rule.

1. The “Per Se” Rule

About thirty³ states and the Virgin Islands adopt some form of a “per se” rule that requires all liability insurers who reserve their rights to later deny coverage on *any* ground to pay for independent counsel to conduct the policyholder’s defense. This rule is simple, rigid, and easy to enforce. However, it requires a reserving insurer to pay for independent counsel even when the insurer’s reservation of rights does *not* create an ethically disqualifying conflict of interest for dependent counsel.

2. The “Disqualifying Conflict” Rule

Ten states recognize that not all reservations of rights create a conflict of interest that necessarily disqualifies dependent counsel from ethically conducting the policyholder’s defense of a plaintiff’s liability dispute. These states, including California, adopt a “prophylactic” rule to prevent harm to the policyholder by compelling the insurer to pay independent counsel selected and directed by the policyholder if the basis of a reservation of rights raises “coverage defenses” or “confidentiality concerns”, but permits the insurer to control the defense through dependent counsel if the basis of a reservation of rights is limited to “policy defenses”. “Policy defense” are defined as defenses that relate to the policyholder’s violation of some insurance policy provision, such as non-payment of premium, or violation of the cooperation clause, that have nothing to do with the merits of the plaintiff’s liability disputes - and do not generally create an ethical dilemma. “Coverage defenses” relate to whether the outcome of a plaintiff’s liability dispute will or will not be covered for indemnity. “Confidentiality concerns” relate to the risk that dependent counsel may disclose confidential information to the insurer that it may use to defeat the policyholder’s coverage.

3. The “Enhanced Duties” Rule

Six states adopt some version of a complex rule that: 1) when there is no showing of an actual conflict of interest; 2) dependent counsel represents only the policyholder and not the insurer; but 3) both dependent counsel and the insurer must satisfy specified “enhanced duties” of good faith to analyze conflicts of interest, make written disclosure to, and obtain informed written consent from the policyholder; 4) whereupon the insurer may control the policyholder’s defense; and 5) dependent counsel may ethically represent the policyholder; but 6) if the policyholder suffers harm, both the insurer and dependent counsel may be liable to the policyholder for damages.

Completing the count of 52 jurisdictions, five states and the District of Columbia have not clearly litigated and held who may control the policyholder’s defense when an insurer reserves its rights nor whether a reserving insurer must pay for independent counsel selected and directed by the policyholder.

The following compendium of cases is organized into the foregoing four categories: 1) “Per

³ Placing some jurisdictions into one or another of the three categories is often judgmental, since many opinions collected here fail to explore the reasons for or public policy considerations that may inform the rule of law each court chooses to follow.

se”; 2) “Nothing to do with”; 3) “Enhanced Duties”; and 4) Undecided. Most jurisdictions are listed alphabetically by category, with a few exceptions where jurisdictions that enunciate a rule particularly well are examined first. Since this survey is published on line, the author welcomes feedback to make additions and corrections.

About Thirty Jurisdictions Adopt a “Per Se” Rule

(Arizona, Arkansas, Colorado, Connecticut, Florida, Georgia, Idaho, Iowa, Kansas, Kentucky, Louisiana, Maine, Massachusetts, Mississippi, Missouri, Montana, Nebraska, New Hampshire, New Jersey, New Mexico, North Carolina, Pennsylvania, Rhode Island, Tennessee, Utah, Vermont, The Virgin Islands, Wisconsin, and Wyoming.)

Arizona

“An insurer that performs the duty to defend but reserves the right to deny the duty to pay should not be allowed to control the conditions of payment. The insurer’s insertion of a policy defense by way of reservation or nonwaiver agreement narrows the reach of the cooperation clause and permits the insured to take reasonable measures to protect himself against the danger of personal liability. [A]n insured being defended under a reservation of rights may enter into a [settlement] agreement without breaching the cooperation clause. The insurer’s reservation of the privilege to deny the duty to pay relinquishes to the insured control of the litigation. By settling against the insurer’s instructions, the insured, in effect, ousts the insurer from the defense of the action and assumes the defense himself.” (*United Services Automobile Association v. Morris*, 154 Ariz. 113, 119-20, 741 P.2d 246 (1987) (citations, quotation marks, and ellipses omitted).)

“When an insurer reserves its rights to contest indemnification liability, a conflict of interest is created between the insurer and the insured. [W]hen a claimant seeks damages the insurer may contend are not covered under the policy, the interests of insured and insurer diverge. An insured is free to act to protect its rights in the litigation with the claimant.” (*Pueblo Santa Fe Townhomes Owners’ Ass’n v. Transcontinental Ins. Co.*, 178 P.3d 485, 491 (Ariz. 2008).

Arkansas

“[The insurer]’s reservation of rights puts [the insurer] and [the policyholder] in a conflict of interest situation. Due to this conflict of interest, the insurer must give up control of the litigation and retain an independent counsel for the insured. The question is whether, the insurer has the right to name the independent counsel, or whether the insured has the right to name independent counsel of its own choosing. Even the most optimistic view of human nature requires us to realize that an attorney employed by an insurance company will slant his efforts, perhaps unconsciously, in the interests of his real client - the one who is paying his fee and from whom he hopes to receive future business - the insurance company. Matthew 6:24 retains a particular relevancy, ‘No man can serve two masters’. The law of various states, which appears to be the ‘majority rule’ also supports giving the choice of counsel to the insured in a conflict situation. The authority favoring [the policyholder] is clearly in its favor. [T]he conflict situation cannot be eliminated so long as the insurance company selects the counsel. It is simply a matter of human nature.” (*Union Ins. Co. v. Knife Co., Inc.*, 902 F. Supp. 877, 880-81 (W.D. Ark. 1995) (citations, quotation marks, and ellipses omitted).)

“In order to effectuate [the insurer]’s duty to defend [the policyholder], [the policyholder] must be allowed to select its own legal counsel for defense. [The insurer] is hereby directed to reimburse [the policyholder] counsel for a reasonable attorney fee in defense of [liability] suit.”

(*Northland Ins. Co. v. Heck's Service Co., Inc.*, 620 F.Supp. 107, 108-09 (D.C. Ark. 1985) (citations, quotation marks, and ellipses omitted).)

Colorado

A federal court interpreting Colorado law denied a motion by a reserving insurer to disqualify independent counsel in a coverage contest and ruled that the insurer must pay the costs of defense incurred by independent counsel. “Here, [the policyholder] had already retained [independent counsel] to defend it [and] the insurance companies have purported to accept their duty to defend (under a reservation of rights) but have totally failed to do what that duty requires - pay for the defense or any portion of the defense. Because [the insurers] have refused to pay any portion of the costs of defense and all of those costs are being advanced by [the policyholder], there is no basis for the insurance companies’ refusal to fund efforts reasonably necessary to protect [the policyholder]’s interests in the underlying action.” (*Weitz Co., LLC v. Ohio Cas. Ins. Co.*, No. 11-cv-00694, 2011 WL 2535040 (D. Colo. 2011) (citations, quotation marks, and ellipses omitted).)

Connecticut

“The [insurer] should reimburse the [policyholder] for the full amount of the obligation reasonably incurred by it. [The policyholder] is entitled to recover of the [insurer] the amount of the settlement, together with the expenses and attorneys’ fees incurred by it in defending the case, with interest.” (*Missionaries of the Company of Mary, Inc. v. Aetna Cas. and Sur. Co.*, 155 Conn. 104, 112 (1967) (citations, quotation marks, and ellipses omitted).)

Florida

“[C]onflicting legal positions presented in defense exist. [W]e believe this legal dilemma clearly created a conflict of interest sufficient to qualify for indemnification for attorney’s fees and costs for independent counsel.” (*Univ. of Miami v. Great American Assur. Co.*, 112 So.3d 504, 507-08 (Fla. 2013) (citations and ellipses omitted).)

“[A]bsent consent, a lawyer may not represent [an insurer] if there is a *substantial risk* that the lawyer’s representation of the client would be materially and adversely affected by the lawyer’s duties to another current client [a policyholder]. An economic conflict occurs when the financial interests of the insurer and insured diverge.” (*U.S. Specialty Ins. Co. v. Burd*, 833 F. Supp.2d 1348, 1353, 1355 (M.D. Fla. 2011) (citations and ellipses omitted).)

“[T]he defendant [insurer] had a duty to defend the plaintiff without a reservation of rights or claim of nonwaiver, so long as it insisted on retaining control of the defense. [The policyholder] was therefore free to provide his own defense.” (*Taylor v. Safeco Ins. Co.*, 361 So.2d 743, 746 (Fla. 1978) (ellipses omitted).)

A Florida statute “does not provide that the insurer’s failure to obtain mutually agreeable counsel in the event of a coverage dispute entitles the insured to recover the fees and costs of its separately retained counsel. Accordingly, § 627.426(2) cannot serve as a basis for imposing a duty on Travelers to obtain mutually agreeable counsel for Royal Oak.” (*Travelers Indem. Co. of Ill. v. Royal Oak Enterprises, Inc.* 429 F.Supp.2d 1265, 1272 (Fla. 2004).)

Georgia

“[The insurer] offered to provide a defense at the time it denied coverage. When [the insurer] denied coverage, it created a conflict of interest between itself and [the policyholder]. The existence of a conflict of interest would have justified [the policyholder] in rejecting [the insurer]’s offer to provide a defense. [W]here a conflict of interest exists between the insurer and the insured in the conduct of the defense of the action brought against the insured, the insured has the right to refuse to accept an offer of the counsel appointed by the insurer. In such circumstances, [the insurer] would have been obligated to pay for [the policyholder]’s defense. Where an insured hires co-counsel instead of rejecting the defense offered by the insurance company the insurance company [has the burden] to choose between denying a defense and providing a defense in cooperation with co-counsel retained by the insured. Consequently, we affirm the judgment entered against [the insurer] for expenses [the policyholder] incurred in connection with its defense of the [liability] suit.” (*American Family Life Assur. Co. v. U.S. Fire Co.*, 885 F.2d 826 831-32 (11th Cir. 1989) (Ga. law) (citations and ellipses omitted).)

Idaho

“[The insurer] elected to go forward with defense of the [liability] suit after having notice [the policyholder] would not consent to reservation of [the insurer’s] right to withdraw, and its continued assertion of such right of withdrawal thereafter was a breach of its insurance contract and created a hazard, to protect itself from which, [the policyholder] was justified in employing attorneys. A fee paid the attorneys is thus properly chargeable against [the insurer].” (*Boise Motor Car Co. v. St. Paul-Mercury Indem. Co.*, 62 Idaho 438, 449, 112 P.2d 1011 (1941).

Iowa

“[A]n insurer who refuses, contrary to its contractual obligation, to defend a third-party action against its insured on the ground the policy involved affords no coverage is liable for attorney fees incurred by the insured in the defense of the action brought against him [or her].” (*Clarke-Peterson Co., Inc. v. Independent Ins. Assn. Ltd.*, 514 N.W.2d 912, 915 (Iowa 1994).)

Kansas

“[T]here was a conflict of interest between the insured and the insurer in a civil action. The insurance company hired independent counsel to defend the insured in the civil action and notified the insured that it was reserving all rights under the policy. This procedure protects both the insured’s and the insurer’s interests and rights. We believe this is the proper procedure to protect the rights of both parties under their contract.” (*Patrons Mut. Ins. Ass’n v. Harmon*, 240 Kan. 707, 712, 732 P.2d 741 (1987) (ellipses omitted).)

Kentucky

“We elect to align ourselves with those jurisdictions which hold that an insured is not required to accept a defense offered by the insurer under a reservation of rights. The reason for this is evident. When the insurer has the obligation to pay the judgment, it surely is entitled to control the defense of the claim. But when the insurer reserves a right to assert its nonliability for payment there is little or no reason to require the insured to surrender defense of the claim to a company which asserts that it has no obligation to satisfy the claim. Under such conditions the insured has the right to refuse the proffered defense and conduct his own defense.” (*Med. Protective Co. of Fort Wayne, Ind. v. Davis*, 581 S.W.2d 25, 26 (Ky. 1979) (citations omitted); see also, *Cincinnati*

Ins. Co. v. Vance, 730 S.W.2d 521, 524 (Ky. 1987).

“The true analysis of the relationship between the attorney hired by a liability insurer to represent the insured is that both are the attorney’s clients. The rules applicable to joint representation apply. In matters in which the interest of the company and the insured diverge, such as a coverage issue, the company is the primary client, so that advice given to the company on such an issue by the attorney is privileged as to the insured. If a conflict of interest arises, the attorney must so advise the insured and advise him or her and of his right to retain his own attorney. In such cases, the insured typically does retain her own attorney.” (*Lee v. Med. Protective Co.*, 858 F. Supp.2d 803, 806 (E.D. Ky. 2012) (ellipses omitted).)

Louisiana

“[W]here the insurer either denies coverage to the insured or reserves its rights to do so subsequently, it would be improper for the same attorney to represent both the insurer and the insured.’ Accordingly, if the insurer chooses to represent the insured but deny coverage, it must employ separate counsel.” (*Emery v. Progressive Cas. Ins. Co.*, 49 So.3d 17, 20-21 (La. 2010).

Maine

“[A]n insurer who reserves the right to deny coverage cannot control the defense of a lawsuit brought against its insured by an injured party. This position strikes a fair balance between the insurer and the insured. By allowing the insured to control his own case when the insurer issues a reservation of rights, the insured can protect himself from the sharp thrust of personal liability, and the insurer still has a meaningful opportunity to protect its own interests in a declaratory judgment action where it may assert, among other things, a coverage defense. Because [the insurer] chose to defend [the policyholder] under a reservation of rights, it gave up the ability to control [the policyholder]’s defense.” (*Patrons Oxford Ins. Co. v. Harris*, 905 A.2d 819, 825-26 (Me. 2006) (citations, quotation marks, and ellipses omitted).)

“[T]he well-established policy [is] 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. 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.” (*Travelers Indem. Co. v. Dingwell*, 884 F.2d 629, 638-39 (1st Cir. 1989) (Maine law) (citations, quotation marks, and ellipses omitted).)

Massachusetts

“When an insurer seeks to defend its insured under a reservation of rights, and the insured is unwilling that the insurer do so, the insured may require the insurer either to relinquish its reservation of rights or relinquish its defense of the insured and reimburse the insured for its defense costs.” (*Northern Security Ins. Co., Inc. v. R.H. Realty Trust*, 78 Mass. App. Ct. 691, 694-95, 941 N.E.2d 688 (2011).

“[The insurer] had a duty to defend the [the policyholder] in the actions at law without a reservation of rights or claim of nonwaiver, so long as it insisted on retaining control of the defence.” (*Three Sons, Inc. v. Phoenix Ins. Co.*, 357 Mass. 271, 277, 257 N.E.2d 774 (1970).)

Mississippi

“When defending under a reservation of rights, however, a special obligation is placed upon the insurance carrier. [O]ther jurisdictions have generally held that in such a situation, not only must the insured be given the opportunity to select his own counsel to defend the claim, the carrier must also pay the legal fees reasonably incurred in the defense. In cases where an insurer asserts either policy or coverage defenses, and defends its insured under a reservation of rights, there are various conflicts of interest between the insurer and the insured. First, if the insurer knows that it can later assert non-coverage, or if it thinks that the loss which it is defending will not be covered under the policy, it may only go through the motions of defending: ‘it may offer only a token defense. [I]t may not be motivated to achieve the lowest possible settlement or in other ways treat the interests of the insured as its own. Second, if there are several theories of recovery, at least one of which is not covered under the policy, the insurer might conduct the defense in such a manner as to make the likelihood of a plaintiff’s verdict greater under the uninsured theory. Third, the insurer might gain access to confidential or privileged information in the process of the defense which it might later use to its advantage in litigation concerning coverage.” (*Moeller v. American Guar. & Liab. Ins. Co.* 707 So.2d 1062, 1069 (Miss. 1996) (citations, quotation marks, and ellipses omitted).)

“Any lawyer who attempts to represent two adverse masters places himself in a precarious, perilous position. [Rules of ethics] are distilled principles of ancient, time-honored, and judicially-enforced conduct on the part of lawyers in representing clients. Without them our system of justice would be doomed. It hardly needs to be added that no insurance policy can validly diminish a lawyer’s duty to his insured client. In sum, the ethical dilemma thus imposed upon the carrier-employed defense attorney would tax Socrates, and no decision or authority we have studied furnishes a completely satisfactory answer.” (*Foster, supra*, 528 So.2d at 269, 274.)

Missouri

“Upon proper notice to the insured, Missouri law permits an insurer to defend its insured but reserve the right to later disclaim coverage. The insured then has the option of either accepting the insurer’s defense under a reservation of rights or refusing such defense. If the fully-notified insured accepts, the insurer’s defense under a reservation of rights will not be considered a denial of coverage. But, the decision is the insured’s, and [i]nsurers cannot force insureds to accept a reservation of rights defense. Should the insured reject the defense, the insurer then has one of three options: (1) [it] may represent the insured without a reservation of rights defense; (2) [it] may withdraw from representing the insured altogether; or (3) [it] may file a declaratory judgment action to determine the scope of [the] policy’s coverage. If the insurer chooses to defend without reservation, it has the opportunity to control the litigation. If the insurer chooses [to] files a declaratory judgment action, the decision is a risky one [because it] is treated as a refusal to defend an insured, and, if unjustified, the insurer is treated as if it waived any control of the defense [and rights to participate in] the underlying tort action. If its decision concerning coverage is wrong [the insurer] should be bound by the decision it has made.” (*Truck Ins. Exch. v. Prairie Framing, LLC*, 162 S.W.3d 64, 88 (Mo. 2005) (citations, quotation marks, and ellipses omitted).)

“[A] potential conflict between the interests of the insurer and its insured in this case is apparent. Common logic dictates that in such circumstances, counsel for [the insurer] would be inclined to bend his efforts, however unconsciously, toward establishing that any recovery by [the plaintiff] would be grounded on the theory of [the plaintiff’s] claim which was not covered by the policy. This potential conflict of interest, however, does not relieve [the insurer] of its contractual

obligation to defend [the policyholder]. To avoid the potential conflict of interest, [the insurer] must either provide an independent attorney to represent the insured or pay the costs incurred by the insured in hiring counsel of its own choice.” (*Howard v. Russell Stover Candies Inc.*, 649 F.2d 620, 625 (8th Cir. 1981) (Mo. law) (citations, quotation marks, and ellipses omitted).)

“In view of its attempt to reserve the coverage question, the insurer had no right to insist upon controlling the defense.” (*Butters v. City of Independence*, 513 S.W.2d 418, 425 (Mo. 1974); See also, *Mid-Century Ins. Co. v. McKelvey*, 666 S.W.2d 457, 459 (Mo. 1984).

Montana

“[The insurer] argues that it should be allowed to defend rather than paying counsel to defend the action. However, the inconsistent and yes, antagonistic positions that have developed make it clear that [the policyholder] was required to hire his own counsel.” (*St. Paul Fire & Marine Ins. Co. v. Thompson*, 433 P.2d 795, 799 (Mont. 1967).

Nebraska

“Reservation of rights is a means by which prior to a determination of the liability of the insured, the insurer seeks to suspend the operation of waiver and estoppel. When coverage is in doubt, the insurer may offer to defend the insured, reserving all of its policy defenses in case the insured is found liable. Upon such notification the insured may either accept the reservation of rights and allow the company to defend or it may reject the reservation of rights and take over the defense itself. The policy reasons underlying reservation of rights are two-fold: (1) to allow an insured to more ably protect its own interests by retaining control over its own defense, and (2) to avoid conflicts of interest between the insurer and its insured.” (*First United Bank of Bellevue v. First American Title Ins. Co.* 242 Neb. 640, 496 N.W.2d 474, 481 (1993)

“We are not to be understood as holding that an insurer may reserve its right to disclaim liability in a case and at the same time insist on retaining control of its defence. The unequivocal denial of all liability to pay a loss under its insurance policy, disqualifies the insurance company from defending a suit against the assured for the recovery of damages which the insurance company says is not covered by its policy. [The policyholders] had the right to defend the claim by securing the services of an attorney of their own selection. In the very nature of things, could it be expected of the [policyholders] that they would further entrust the defense of their damage cases to attorneys employed by the insurer after the insurer caused such attorneys to take a position directly opposed to their interests? We think not, especially in view of the Canons of Professional Ethics, the design of which canons was to guide the members of the legal profession and to protect the rights of litigants in their relations with legal representatives.” (*Hawkeye Cas. Co. v. Stoker*, 48 N.W.2d 623, 631-32 (Neb. 1951) (citations, quotation marks, and ellipses omitted).)

New Hampshire

“We find that the damages awarded by the trial court for attorney’s fees incurred in the defense of the underlying claim - were appropriate.” (*A.B.C. Builders, Inc. v. American Mut. Ins. Co.*, 139 N.H. 745, 751 (1995) (ellipsis omitted).)

New Jersey

“We envision possible conflicts in this defense because coverage may not exist if liability is fixed on some other predicate. Therefore, in the first instance the insured should select their own counsel, subject to the carrier’s approval. In the event such approval is not forthcoming the selection should be made by the assignment judge. Reasonable counsel fees and costs of defense are to be paid by [the insurer]. [The insurer] asserts that it should have no responsibility for counsel fees in that matter because it never declined coverage, but in fact retained counsel to defend him, albeit under a reservation of rights. While the argument may be facially correct, it overlooks the clear conflict of interest that infected the counsel selected by [the insurer] to defend [the policyholder]. Faced with conflicting assertions for which [the insurer] would afford no coverage, and [others] for which [the insurer] would afford coverage, [dependent counsel] could not proceed with undivided loyalty to defend.” (*Aquino v. State Farm Ins. Co.*, 349 N.J. Super. 402, 415-16, 793 A.2d 824, 828-30 (2002) (citations, quotation marks, and ellipses omitted).)

New Mexico

“It is generally recognized that coverage defenses may be properly preserved by a reservation of rights agreement. [The insurer] was not relieved of its duty to defend [the policyholder] merely because conflicts of interest appeared. [T]here are several methods of resolving the conflict. [A] conflict could be resolved by insisting that the insured hire independent counsel, or [the insurer] could hire two sets of attorneys, one to represent the insured and the other [the insurer].” (*American Employers Ins. Co. v. Crawford*, 87 N.M. 375, 533 P.2d 1203, 1208 (1975) (citations, quotation marks, and ellipses omitted).)

North Carolina

“Just as an insured is not required to accept a defense conditioned upon entering into a non-waiver agreement, he is not required to accept a defense rendered under a reservation of rights. [The policyholder] was entitled to reject the conditional offer by the [insurer] to defend and still seek indemnity for the costs of defending that action.” (*National Mortg. Corp. v. American Title Ins. Co.* 41 N.C. App. 613, 622-23, 255 S.E.2d 622, 629-30 (1979) (citations, quotation marks, and ellipses omitted).)

Pennsylvania

“The question presented in this case is one of first impression. [W]hen an insurer tenders a defense subject to a reservation, the insured may choose either of two options. It may accept the defense. Alternatively, the insured may decline the insurer’s tender of a qualified defense and furnish its own defense through independent counsel retained at the insured’s expense. In this event, the insured retains full control of its defense. Should the insured select this path, and should coverage be found, the insured may recover from the insurer the insured’s defense costs and the costs of settlement, to the extent that these costs are deemed fair, reasonable, and non-collusive.” (*Babcock & Wilcox Co. v. Am. Nuclear Insurers*, 76 A.3d 1, 11, 22 (Pa. Super. Ct. 2013) (citations and ellipses omitted).

“[The insurers] have breached their duty to defend by failing to provide conflict-free counsel and relinquish control of the defense. It is clear that in Pennsylvania, as in most other jurisdictions, if an insurance company breaches its duty to defend, it is liable to reimburse the [insured] the costs the latter incurred in conducting its own defense. An insurance company breaches its duty to defend when a conflict of interests arises between the insurer and its insured such that the

company's pursuit of its own best interests in the litigation is incompatible with the best interests of the [insured]. A conflict of interest between an insurer and its insured will not relieve insurer of its duty to provide a defense. Rather, courts have concluded that one appropriate resolution in this circumstance is for the insurer to obtain separate, independent counsel for each of its insureds, or to pay the costs incurred by an insured in hiring counsel. In support of its contention that it is entitled to remuneration for the procurement of conflict-free counsel. It is settled law that "where conflicts of interest between an insurer and its insured arise, such that a question as to the loyalty of the insurer's counsel to that insured is raised, the insured is entitled to select its counsel, whose reasonable fee is to be paid by the insurer. Because of the conflict of interests between the insurer and its insured, American National is obligated to provide conflict-free counsel and relinquish control of the defense." (*Rector v. Amer. Nat'l Fire Ins. Co.* No. Civ.A. 00-2806 (E.D. Pa. 2002) (citations, ellipses, and quotation marks omitted).)

"Plaintiff cites *San Diego Navy Federal Credit Union v. Cumis Insurance Society, Inc.* 162 Cal.App.3d 358, 208 Cal.Rptr. 494 (1984) for the premise that where a conflict arises between insurer and insured, the insurer is obligated under the policy to provide the insured with independent counsel at no expense to the insured. See also *St. Paul Fire and Marine Co. v. Roach Bros. Co.*, 639 F.Supp. 134 (E.D.Pa.1986). Much to its credit St. Paul acknowledges the wisdom of this recent trend and does not gainsay it. However, St. Paul does contend that no conflict of interest exists in the present case. We agree." (*Pennbank v. St. Paul Fire & Marine Ins. Co.* (1987) 669 F.Supp. 122, 126.)

Rhode Island

"If, however, an insured, after having been apprised of the conflicting interests existing between him and his insurer, declines to be represented by the insurer's attorney, we have a different situation. Concerned as we are that the public's trust in the judicial processes be maintained, this court cannot stand idly by in such circumstances. We are as conscious of an insurer's concern that it control the defense of any action brought against one of its insureds as we are of an insured's expectations that his rights will be properly protected. [A]n insured has a legitimate right to refuse to accept the offer of a defense counsel appointed by the insurance company; and when an insured elects to exercise this prerogative, the insurer's desire to control the defense must yield to its obligation to defend its policyholder. There is, therefore, a discernible need to discover a solution to this dilemma which will, at the same time, be mutually protective and satisfactory to the parties. Our search of the case law and scholarly works dealing with this particular problem plainly indicates to us that no unanimity exists as to any single answer. One novel solution to the problem posed [is] that where a conflict of interests has arisen between an insurer and its insured, the attorney to defend the insured in the tort suit should be selected by the insured and the reasonable value of the professional services rendered should be assumed by the insurer. While this suggestion seemingly would afford full protection to the insured's interests, we note that insurers may well be reluctant to endorse it since they feel that their right to rely on a policy's exclusionary clause may be jeopardized. Another possible solution to the problem under consideration would be to have the insured and the insurer represented by two different attorneys, each of whom is pledged to promote and protect the prime interests of the client he represents. In this way it appears that the deleterious conflict of interests imposed on an attorney who attempts the difficult task of representing both parties is also averted. Because the insurer has a legitimate interest in seeing that any recovery based on finding of negligence on the part of its insured is kept within reasonable bounds, and since the total expense of this defense is to be assumed by the

insurer under its promise to defend, we believe that in each of the above two suggestions the engagement of an independent counsel to represent the insured should be approved by the insurer. Such approval, however, should not be unreasonably withheld. While an insurer may be dismayed in its having to pay the cost of two attorneys for one civil suit, we are cognizant that the necessity for this action stems from its failure to provide within any degree of clarity for this contingency when it placed the exclusionary clause in its insured's contract. The insurer, being the draftsman, should have set forth its provisions in such clear and distinct language as would have avoided any doubt relative to the extent of its duty to defend. Under a well-established principle, the words of an insurance contract are construed against the insurer. Accordingly, the insurance company is bound by the terms of its own contract. We wish to make it plainly understood that the above two suggested procedures for avoiding the conflict of interests in cases similar to the one now before us, are not to be taken as the only avenues by which an attorney can act with due propriety in these cases. The decision as to which of these alternatives or as to any others which may be proposed in the future is of course to be made conjunctively by the insured, the insurer and the attorneys involved." (*Employer's Fire Ins. Co. v. Beals*, 103 R.I. 623, 240 A.2d 397, 403-04 (1968) (citations, quotation marks, and ellipses omitted).)

Tennessee

"[A]n insurer in Tennessee clearly possesses no right to control the methods or means chosen by an attorney to defend the insured. [T]he insurer cannot control the details of the attorney's performance, dictate the strategy or tactics employed, or limit the attorney's professional discretion with regard to the representation. [A]ny policy, arrangement or device which effectively limits, by design or operation, the attorney's professional judgment on behalf of or loyalty to the client is prohibited by the Code, and, undoubtedly, would not be consistent with public policy.[W]e simply cannot ignore the practical reality that the insurer may seek to exercise *actual* control over its retained attorneys in this context. While this practical reality raises significant potential for conflicts of interest, it does not become invidious until the attempted control seeks, either directly or indirectly, to affect the attorney's independent professional judgment, to interfere with the attorney's unqualified duty of loyalty to the insured, or to present a reasonable possibility of advancing an interest that would differ from that of the insured. To be clear, our recognition of the control exercised by insurers in this context does not condone this practice, especially when it works to favor the interests of the insurer over that of the insured; rather, we acknowledge this aspect of the relationship only because it would be imprudent for this Court to hold that attorneys are independent contractors vis-à-vis insurers, but then to ignore the practical realities of that relationship when it causes injury. Accordingly, we hold that an insurer can be held vicariously liable for the acts or omissions of an attorney hired to represent an insured when those acts or omissions were directed, commanded, or knowingly authorized by the insurer. [N]o doubt can exist that the insured is the sole client of an attorney hired by an insurer pursuant to its contractual duty to defend, and in the typical attorney-client relationship, the client maintains a significant right to control the objectives of the representation. [T]he client retains exclusive authority to direct all areas of the representation that affect the merits of the cause or substantially prejudice his or her rights." (*Givens v. Mullikin ex rel. Estate of McElwaney*, 75 S.W.3d 383, 394-97 (Tenn. 2002) (citations, quotation marks, and ellipses omitted).)

Utah

The injured plaintiff “was relying on three separate grounds for relief, two covered by the policy and one outside the scope of coverage. Common logic dictates that in such circumstances, counsel for [the insurer] would be inclined, albeit acting in good faith, to bend his efforts, however unconsciously, toward establishing that any recovery by [the injured plaintiff] would be grounded on the theory of [the injured plaintiff]’s claim which was not covered by the policy. Therein lay the conflict. [The insurer] was required to provide counsel free of the egregious conflict of interest present in this case, and that [the insurer] must now reimburse [the policyholder] for the fair and reasonable value of the services rendered by [the policyholder]’s independent counsel in defending the [liability action].” (*U.S. Fidelity & Guaranty Co. v. Louis A. Rosen Co.*, 585 F.2d 932, 938, 940-41 (8th Cir.1978) (Utah or Minn. law))

Vermont

“[W]e hold that [the policyholder] was entitled to recover attorney’s fees and costs incurred in prosecuting the appeal in the [liability] litigation. [fn.4.] [The insurer asserts] that the reservation-of-rights letter represented a separate and superseding agreement. Even if this were the case, the verdict in the [liability] litigation did not demonstrate that [the insurer] owed no duty to defend or indemnify, but precisely the opposite. Accordingly, the reservation-of-rights letter did not represent a basis for refusing to pay [the policyholder’s] defense costs on appeal.” (*Pharmacists Mut. Ins. Co. v. Myer*, 187 Vt. 323, 993 A.2d 413 (2010) (ellipses omitted).)

Virgin Islands

“[The insurer] chose to defend only by providing the insured with independent counsel, reserving the right to contest coverage. By this action it renounced control of the litigation and thereby thrust the responsibility for the litigation wholly upon the insured and its counsel. [The policyholder] had to proceed as best it could with its own defense, although assisted and advised by counsel. [The insurer] cannot now complain that [the policyholder] breached its obligations under the policy. We therefore hold that when a complaint, or a part of it, in an action against an insured is arguably within the scope of the insurance coverage, an insurer’s discharge of its duty to defend by providing independent counsel, even though reserving the right to contest coverage, relieves it of control over the litigation.” (*Cay Divers, Inc. v. Raven*, 812 F.2d 866, 870 (3rd Cir. 1987) (Virgin Islands law) (citations, quotation marks, and ellipses omitted).)

Wisconsin

“An insurance company that disputes coverage, and thus the duty to defend, has several choices. The company may enter into a nonwaiver agreement with the insured wherein the insurer would agree to defend and the insured would acknowledge the right of the insurer to contest coverage. The company may seek to bifurcate the trial and obtain a declaratory judgment on coverage in advance of the determination of liability. The company may defend the insured under a reservation of rights, that is reserving its right not to pay a judgment if it is determined that coverage does not exist. Or, the company may decline to defend and risk the consequences. When an insurer reserves rights the insured has the right to control the defense. Further, when an insurer determines to reserve its right to contest coverage, it must provide a defense immediately or use alternate methods to reduce costs until coverage is decided.” (*Lakeside Foods, Inc. v. Liberty Mut. Fire Ins. Co.*, 329 Wis.2d 270, 789 N.W.2d 754 (2010) (citations, quotation marks, and ellipses omitted).)

“A conflict of interest between the insured and insurer does not relieve the insurer of its contractual duty to defend. Where there is a conflict, the insurer must either provide an independent attorney to represent the insured or pay the costs incurred by the insured in hiring counsel of the insured’s own choice. Since [liability] claims gave rise to [the insurer’s] contractual duty to defend, [the insurer’s] failure to adopt either of these courses constituted a breach of its contractual obligation and makes it liable for appropriate damages.” (*American Motorists Ins. Co. v. Trane Co.*, 544 F.Supp. 669, 686 (W.D.Wisc. 1982).)

Wyoming

“[A]n insurer who reserves the right to deny coverage loses the right to control the litigation.” (*Ins. Co. of North Amer. v. Spangler*, 881 F.Supp. 539, 543-44 (D.Wyo. 1995).)

Eleven States Adopt a “Disqualifying Conflict” Rule

(California, Alaska, Illinois, Indiana, Maryland, Minnesota, Nevada, New York, Ohio, Oklahoma, and Texas.)

Eight states reject the per se disqualification rule and recognize that not all reservations of rights necessarily disqualify dependent counsel from ethically representing both the interests of the insurer and the policyholder as a client, nor do all reservations of rights require the insurer to pay for independent counsel selected and directed by the policyholder. Instead, these states analyze the nature of the scope of the insurer’s reservation of rights to determine whether dependent counsel is ethically prohibited from representing dual clients with conflicting interests. California has developed the most comprehensive body of law on this issue, by far.

California

California passed legislation rejecting the “per se” rule. (Civ. Code § 2860.) Instead, a liability insurer that reserves its right to deny coverage to its policyholder must pay for independent counsel to conduct its policyholder’s defense unless all grounds upon which the insurer may later deny coverage “have nothing to do with the issues being litigated in the underlying action.” (*Long v. Century Indemnity Co.* 163 Cal.App.4th 1460, 1470 (2008) (*Long*).

California leads the nation in the development of the law regarding a liability insurer’s duty to defend, including a reserving insurer’s obligation to pay for independent counsel selected and directed by the policyholder. California rejects the majority per se disqualification rule. “[N]ot every conflict of interest triggers an obligation on the part of the insurer to provide the insured with independent counsel at the insurer’s expense.” (*James 3 Corp. v. Truck Ins. Exchange* 91 Cal.App.4th 1093, 1101 (2001) (*James 3*); *Dynamic, supra* 61 Cal.App.4th at 1006.) In its place, California has developed a rich collection of thoughtful and comprehensive reported opinions that hold that a reserving insurer must pay for independent counsel if the insurer’s reservation of rights is “related to” disputed issues of fact or law in a liability dispute.

The leading California case is *Cumis, supra*, 162 Cal.App.3d 358, that has been codified by Civil Code § 2860, and followed by the California Supreme Court. “We conclude 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. If the insured does not give an informed consent to continued representation, counsel must cease to represent both. Moreover, in the absence of such consent, 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, the insurer must

pay the reasonable cost for hiring independent counsel by the insured. The insurer may not compel the insured to surrender control of the litigation. Disregarding the common interests of both insured and insurer in finding total nonliability in the third party action, the remaining interests of the two diverge to such an extent as to create an actual, ethical, conflict of interest warranting payment for the insureds' independent counsel." (*Cumis, supra*, 162 Cal.App.3d at 375 (citations omitted).)

California law states a general rule that a "[c]onflict of interest between jointly represented clients occurs whenever their common lawyer's representation of the one is rendered less effective by reason of his representation of the other." (*Spindle v. Chubb/Pacific Indemnity Group* 89 Cal.App.3d 706, 713 (1979).) A disqualifying conflict of interest exists unless "the coverage question is logically unrelated to the issues of consequence in the underlying case." (*Montrose Chemical Corp. v. Superior Court* 6 Cal.4th 287, 302 (1993) (*Montrose I.*) Other California courts have expressed this "related" test in a variety of ways, both positively and negatively. A disqualifying conflict of interest exists if coverage issues "overlap" issues in the third party liability action. (*United Enterprises, Inc. v. Superior Court* 183 Cal. App.4th 1004, 1010 (2010), ("[B]ecause factual issues to be resolved in the declaratory relief action overlap factual issues to be resolved in the underlying actions, the court was required to issue the stay"), A disqualifying conflict of interest exists if coverage turns on the nature of the policyholder's conduct (*Foremost Ins. Co. v. Wilks* 206 Cal.App.3d 251, 261 (1988) ("If the reservation of rights arises because of coverage questions which depend upon the insured's own conduct, a conflict exists."); *McGee v. Superior Court* 176 Cal.App.3d 221, 226 (1985) ("The crucial fact in *Cumis* was that the insurer's reservation of rights on the ground of noncoverage was based on the nature of the insured's conduct, which as developed at trial would affect the determination as to coverage"). A disqualifying conflict of interest exists if "the outcome of the coverage issue can be controlled by the way counsel defends the case." (*Novak v. Low, Ball & Lynch* 77 Cal.App.4th 278, 282 (1999).)

A disqualifying conflict of interest does **not** exist if all grounds on which the insurer may later deny coverage "have nothing to do with the issues being litigated in the underlying action." (*Long, supra* 163 Cal.App.4th at 1470. No disqualifying conflict of interest exists if "the coverage questions are logically unrelated (that is, irrelevant) to the issues of consequence in the (third party litigation which might) prejudice [the insured] in the underlying actions". (*Montrose Chemical Corp. v. Superior Court (Canadian Universal Ins. Co.)* 25 Cal.App.4th 902, 909 (1994) (*Montrose II.*) Nor does a disqualifying conflict of interest exist "where the coverage issue is 'independent of, or extrinsic to, the issues in the underlying action'" (*Gafcon, Inc. v. Ponsor & Associates* 98 Cal.App.4th 1388, 1422 (2002)); *Blanchard v. State Farm Fire & Casualty Co.* 2 Cal.App.4th 345 (1991) (*Blanchard*) ("If the issue on which coverage turns is independent of the issues in the underlying case, *Cumis* counsel is not required.") In another context, the California Supreme Court observed that: "These shifting names have led counsel and the courts into confusion, thinking that they were dealing with different bodies of law. In fact, all these labels denominate the same basic legal claim." (*Hartford Casualty Ins. Co. v. Swift Distribution, Inc.* 59 Cal.4th 277, 289 (2014).)

A rationale for this "nothing to do with" or "related" test is that a coverage dispute cannot be allowed to prejudice the policyholder's defense. (See, *Montrose II, supra*, 25 Cal.App.4th at 909 ["Accordingly, the question before us is whether the coverage questions are logically unrelated (that is, irrelevant) to the issues of consequence in the (third party litigation which might) prejudice [the insured] in the underlying actions"]; *Haskel, Inc. v. Superior Court* 33 Cal.App.4th

963, 980 (1995) (ellipses omitted) [“The trial court should determine: . . . (5) to what extent, if at all, will [the policyholder] suffer prejudice by evidence which tends to support or defeat its claim of coverage or the defenses raised by the insurers.”])

California law recognizes that “[s]ome of the circumstances that may create a conflict of interest requiring the insurer to provide independent counsel include: (1) where the insurer reserves its rights on a given issue and the outcome of that coverage issue can be controlled by the insurer’s retained counsel; (2) where the insurer insures both the plaintiff and the defendant; (3) where the insurer has filed suit against the insured, whether or not the suit is related to the lawsuit the insurer is obligated to defend; (4) where the insurer pursues settlement in excess of policy limits without the insured’s consent and leaving the insured exposed to claims by third parties; and (5) any other situation where an attorney who represents the interests of both the insurer and the insured finds that his or her ‘representation of the one is rendered less effective by reason of his [or her] representation of the other.’” (*James 3, supra*, 91 Cal.App.4th at 1101.) “A disqualifying conflict exists if [i]nsurance counsel had . . . incentive to attach liability to [the insured].” (*Gulf Ins. Co. v. Berger, Kahn, Shafton, Moss, Figler, Simon & Gladstone* 79 Cal.App.4th 114, 131 (2000).)

Alaska

In a thoughtful and comprehensive opinion, *CHI of Alaska, Inc. v. Employers Reinsurance Corp.*, 844 P.2d 1113, (Alaska 1993) (*CHI of Alaska*), Alaska recognized three different types of conflicts of interest, one of which does not create disqualifying conflicts of interest. Nonetheless, Alaska adopted “the general rule that the insurer must surrender its right to control the defense to the insured if the insured refuses to accept a defense under a reservation of rights: [T]he general rule is that, if an insured refuses to accede to the insurer’s reservation of rights, the carrier must either accept liability under the policy and defend unconditionally or surrender control of the defense. [T]hese conflicts might be avoided if the insured were offered the right to retain independent counsel. The possibility of a conflict might be avoided in such cases if the insurance company were to offer its insured the right to retain independent counsel to conduct his defense, and agree to pay all the necessary costs of that defense. In that event, it would seem that the company should be entitled to reserve the right to later litigate an alleged policy defense.” (*CHI of Alaska, supra*, 844 P.2d at 1118 (citations and ellipses omitted).)

Three Types of Conflicts of Interest - Policy Defenses, Coverage Defenses, and Confidentiality Conflicts

“Sometimes, the insurer claims that the policy has been breached by the insured. These are so-called policy defenses of which the insured’s failure to give notice or to cooperate are typical examples. Similarly, the insurer may claim that a particular claim made by the plaintiff does not come within the coverage of the policy. Such defenses are *called coverage defenses*. The most typical example is the coverage defense in this case where alternative theories of negligent and intentional tort are plead and negligent acts are covered by the policy but intentional acts are not. In cases where an insurer asserts either policy or coverage defenses, there are various conflicts of interest between the insurer and the insured. First, if the insurer may offer only a token defense. Second, the insurer might conduct the defense in such a manner as to make the likelihood of a plaintiff’s verdict greater under the uninsured theory. Third, the insurer might gain access to confidential or privileged information in the process of the defense which it might later use to its advantage in litigation concerning coverage.

“Where there is a conflict between insurer and insured, appointed counsel may tend to favor

the interests of the insurer primarily because of the prospect of future employment. Even the most optimistic view of human nature requires us to realize that an attorney employed by an insurance company will slant his efforts, perhaps unconsciously, in the interest of his real client - the one who is paying his fee and from whom he hopes to receive future business - the insurance company. [T]he attorney's economic interests weigh heavily in favor of the insurer, which, after all, may retain his services in other cases; yet the rules of professional responsibility tip the scales toward the insured. Although [some] courts seem to trust the insurer and attorney to act in the best interests of the insured, the more common view is that the longstanding ties that defense counsel has with the insurer will inevitably influence his conduct of the case. The attorney, wishing to maintain the insurer's business, does not want to aggravate the company. Insurance counsel's relationship with the insurer is contractual, usually ongoing, supported by strong financial interests, and often strengthened by sincere friendships.). In recognition of this, most courts hold that in conflict situations the insured has the right to independent counsel to conduct its defense and the insurance company has the obligation to pay the reasonable value of the defense conducted by independent counsel.

[Confidentiality conflicts may arise from] "access of appointed counsel to information in possession of the insured which may be used against the insured in subsequent coverage litigation. [D]uring the initial litigation, the insured may transmit information to counsel that the insurer could use in subsequent litigation to the insured's disadvantage. A heavy burden of silence falls on the attorney the insurer selects to defend the insured. The fact that [independent] counsel is acting as co-counsel with [dependent] counsel appointed by the insurer also does not eliminate this conflict. [Dependent] counsel has and should have full access to the client so that the defense may be effectively conducted. [T]he opportunity to direct a case through witness selection, interrogation, and discovery may afford a dispositive advantage in subsequent litigation. [T]he insured's attorney has the opportunity to develop the facts through discovery and to shape the case for, and present the evidence at, the trial. So even though the insured or the insurer may relitigate the coverage issue in a subsequent proceeding, controlling the defense in the main proceeding could be critical. Testifying under oath in the main proceeding may freeze in the witnesses' minds one version of the facts. Very little latitude may remain in subsequent proceedings to mold the evidence bearing upon coverage. We conclude therefore that the two-counsel solution does not satisfactorily resolve the conflicts which have given rise to the right to independent counsel." (*CHI of Alaska, supra*, 844 P.2d at 1115-20 (citations and ellipses omitted).)

Policy Defenses Do Not Warrant Independent Counsel

"All three general types of conflicts of interests between insurer and insured - the insurer may offer mere token defense, the insurer may steer result to judgment under an uninsured theory of recovery, the insurer may gain access to confidential or privileged information which it may later use to its advantage - apply in coverage defense cases. However, the second reason does not apply in policy defense cases. Policy defenses, such as lack of notice or noncooperation, involve facts which are generally irrelevant to the litigation between the plaintiff and the insured. Therefore, appointed counsel has no opportunity to covertly frame [a] defense to achieve a verdict based upon [a theory under which no coverage would result] so that [the insurer] could later assert that the defense was not covered. Thus, the need for independent counsel is, if anything, greater in coverage than in policy defense cases. We conclude that the right to independent counsel should also apply to cases involving coverage defenses. Merely because the insurer and the insured have divergent interests when the insurer seeks to defend under a

reservation of rights does not necessarily mean that appointed counsel also has conflicting interests. (*CHI of Alaska, supra*, 844 P.2d at 1118, 1115 (citations and ellipses omitted).)

Policyholder's Unilateral Right to Select Counsel

“We conclude that the insured should have the unilateral right to select independent counsel and that this right should be subject to the implied covenant of good faith and fair dealing. In our view the covenant of good faith and fair dealing in this context requires that the insured select an attorney who is, by experience and training, reasonably thought to be competent to conduct the defense of the insured. Such a result, in our view, fairly balances the interest of the insured - being defended by competent counsel of undivided loyalty - with the interests of the insurer - having the defense of the insured conducted by competent counsel. The insurer is only required to pay the reasonable cost of the defense. [The] insurer must underwrite reasonable costs incurred by the insured in defending the action. This provides a measure of protection for insurers against overbilling - and overlitigating - by independent counsel.” (*CHI of Alaska, supra*, 844 P.2d at 1121 (citations and ellipses omitted).)

See also, AS § 21.96.100; and *Continental Ins. Co. v. Bayless & Roberts, Inc.*, 608 P.2d 281 (Alaska 1980).

“We conclude that Alaska law prohibits reimbursement of fees and costs incurred by the insurer defending claims under a reservation of rights, even in circumstances where it is later discovered that there was ‘no possibility of coverage’ under the policy.” (*Attorneys Liab. Pro. Soc. v. Ingaldson Fitzgerald, PC* Supreme Court No. S-15683 (Ala. 2016).)

Illinois

“[S]erious ethical questions prohibit an attorney from representing both the interests of [the insurer] and of [the policyholder]. [The policyholder] has the right to be defended in the [liability action] by an attorney of his own choice who shall have the right to control the conduct of the case. [The insurer has a] contractual obligation to reimburse [the policyholder] for the reasonable cost of defending the action.” (*Maryland Cas. Co. v. Peppers*, 64 Ill.2d 187, 198-99, 355 N.E.2d 24, 31 (Ill. 1976) (citation and ellipses omitted).)

“Notwithstanding the common interest of both insurer and insured in finding total nonliability in the third-party action, the remaining interests of the two conflicted to such an extent as to create an actual ethical conflict of interest warranting payment of the insured’s independent counsel by the insurer.” (*Nandorf, Inc. v. CNA Ins. Co.* (1985) 134 Ill. App.3d 134, 140, 479 N.E.2d 988)

“[I]f insurer-retained counsel would have the opportunity to shift facts in a way that takes the case outside the scope of policy coverage, then the insured is not required to defend the underlying suit with insurer-retained counsel. Rather, the insured is entitled to defend the suit with counsel of its choosing at the insurer’s expense. [I]n conflict situations, the insurer’s obligation to defend is satisfied by reimbursing the insured for the costs of independent counsel. [A] ruling that required an insured to be defended by what amounted to his enemy in the litigation would be foolish. Thus, [the policyholder] should not be forced to use [the insurer]’s attorneys to defend against [the injured plaintiff]’ claims. [The policyholder is] permitted to retain its own legal counsel to defend it against [the injured plaintiff]’ allegations at [the insurer]’s expense.” (*Amer. Family Mut. Ins. Co. v. W.H. McNaughton Builders, Inc.*, 843 N.E.2d 492, 498, 501-02 (Ill. 2006) (citations, quotation marks, and ellipses omitted).)

“Under the ‘familiar general rule of estoppel,’ if an insurer takes the position that a

potential insured is not covered, it must defend the suit under a reservation of rights or seek a declaratory judgment. *Murphy*, 88 Ill.2d at 452. If the insurer fails to do this and wrongfully denies coverage, it is estopped from raising policy defenses to coverage.” “While [an insurer] did undertake the defense without a reservation of rights, that did not remove the possible conflict of [the insurer] benefitting by not providing a vigorous defense for [the policyholder].” (*Econ. Premier Assur. Co. v. Faith in Action of McHenry County*, Nos. 1-11-2329, 1-11-2457, IL App (2013).)

“[D]efending both claims, intentional and negligent acts, would have put [the insurer] in a position of conflict, since a verdict based on an intentional act would free [the insurer] from coverage, while a verdict based upon negligence would result in coverage. When such conflicts arise, insurance companies must be freed from the responsibility to defend, but are generally responsible for paying the expenses incurred by the insured in defending.” (*American Family Mut. Ins. Co. v. Blackburn*, 566 N.E.2d 889 (Ill. App. 1991).)

Indiana

“[ABA Rules of Professional Conduct] Rule 1.7(a) does not create a per se rule of any sort: Under this standard, attorneys, parties, and courts cannot resort to easy rules of thumb. [T]he question of whether an impermissible conflict of interest exists under Rule 1.7 often is one of proximity and degree. The critical questions are the likelihood that a difference in interests will eventuate and, if it does, whether it will materially interfere with the lawyer’s independent professional judgment in considering alternatives or foreclose courses of action that reasonably should be pursued on behalf of the client.” “[T]he Court notes that claims involving an attorney’s conflict of interest present mixed questions of law and fact. In short, resolution of the issue [whether a disqualifying conflict of interest exists] requires a close look at the nature of the conflicting interests, the issues in the underlying litigation, and the risk that the attorney’s relationship with the insurer will materially limit his representation of the insured. It is a case-specific and fact-sensitive inquiry in which the Court must look at which issues will necessarily be evidenced or proved in the underlying litigation, and whether there is a significant risk that any issues will be resolved which will in turn affect the coverage determination.” (*Auto-Owners Ins. Co. v. Lake Erie Land Co.* 2:12-CV-184 JD (N.D. Ind. 2013) (citations, ellipses, and quotation marks omitted).)

“[A]n insurer must either file a declaratory judgment action or hire independent counsel and defend its insured under a reservation of rights. [A]n insurer can refuse to defend or clarify its obligation by means of a declaratory judgment action. If it refuses to defend it does so at its peril.” (*National Union Fire Ins. Co. v. Standard Fusee Corp.*, 917 N.E.2d 170, 187 (Ind. 2009) (ellipses omitted).)

“In cases where the handling of the underlying litigation may affect whether the claim is covered or not covered, the conflict of interests may be sufficiently clear and immediate that one attorney cannot represent the interests of both the insurer and the insured. At the same time, not every reservation of rights poses a conflict for defense counsel. If the coverage dispute turns on issues that are independent of the issues in the underlying lawsuit, one lawyer selected by the insurer can handle the underlying litigation, and the insured and insurer can resolve the coverage dispute separately. How should courts, insurers, and policyholders distinguish between reservations 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. Whether the potential conflict of interest is sufficient to require the insured’s consent is a question of

degree that requires some predictions about the course of the representation. If there is a reasonable possibility that the manner in which the insured is defended could affect the outcome of the insurer's coverage dispute, then the conflict may be sufficient to require the insurer to pay for counsel of the insured's choice. Evaluating that risk requires close attention to the details of the underlying litigation." (*Armstrong Cleaners, Inc. v. Erie Ins. Exch.* 363 F.Supp.2d 797, 806-08 (S.D. Ind. 2005) (citations and ellipses omitted).)

"[C]onflict does not relieve the insurance company of the responsibility for providing for the defense of the insured. The insurer must either provide an independent attorney to represent the insured, or pay for the cost of defense incurred by the insured hiring an attorney of his choice." (*All-Star Ins. Corp. v. Steel Bar, Inc.*, 324 F.Supp. 160, 165 (N.D. Ind. 1971) (ellipses omitted).)

Maryland

"When a conflict of interest arises, the insured must be informed of the nature of the conflict and given the right either to accept an independent attorney selected by the insurer or to select an attorney himself to conduct his defense. If the insured elects to choose his own attorney, the insurer must assume the reasonable costs of the defense provided." (*Brohawn v. Transamerica Ins. Co.* 276 Md. 396, 414-15, 347 A.2d 842] (1975).

"[I]f an insurer breaches its contractual duty to defend a claim that falls within or potentially falls within the policy's coverage, then the insurer is liable for attorneys' fees incurred in the underlying defense of that claim." (*Campbell v. Allstate Ins. Co.*, 96 Md. 277, 624 A.2d 1310 (1993)

The interests of insurer and policyholder "may diverge at times, creating a potential or actual conflict of interest. A common situation creating a conflict of interest is one where coverage is an issue [such as where a plaintiff raises] both covered and noncovered claims against the insured. Because it was in the insurer's interest to establish noncoverage, and in the insured's interest to be found liable only for the covered claims, it was necessary for the insurer to allow the insured to choose independent counsel." (*Allstate Ins. Co. v. Campbell*, 334 Md. 381, 392, 639 A.2d 652, 657 (1994) (citations and ellipses omitted).)

Minnesota

"When a conflict of interest exists - such as when an insurer accepts the tender of defense but also disputes coverage - the insurer's duty to defend is transformed into a duty to reimburse [the insured] for reasonable attorneys' fees. In such circumstances, an insurer is only required to reimburse its insured for 'reasonable' attorney's fees. [The insurer]'s duty to defend was transformed into a duty to reimburse [the policyholder] for reasonable defense costs." (*Continental Cas. Co. v. National Union Fire Ins. Co. of Pittsburgh, Pa.*, 940 F. Supp.2d 898, 928-29 (D. Minn. 2013) (citations, quotation marks, and ellipses omitted).)

"[B]efore an insured will be entitled to counsel of its own choice, an actual conflict of interest, rather than an appearance of a conflict of interest, must be established. However, the determinative issue must be what effect the [reservation of rights] letter actually had in this case. A finding of conflict of interest must rest on more substantial evidence, such as actions which demonstrate a greater concern for [the insurer]'s interests than [the policyholders]' interests. The underlying litigation in this matter provided almost no opportunity for manipulation of liability toward non-covered claims. That litigation has been settled." (*Mutual Service Cas. Ins. Co. v. Luetmer*, 474 N.W.2d 365, 368-69 (Minn. Ct. App. 1991) (ellipses omitted).)

"[O]rdinarily an insurer's breach of its duty to defend subjects it to liability for the insured's

litigation expenses.” (*Capitol Indemnity Corp. v. St. Paul Fire & Marine Insurance Co.*, 357 F.Supp. 399, 414 (W.D.Wis. 1972) (Minn. law).

Nevada

“Nevada law requires an insurer to provide independent counsel for its insured when a conflict of interest arises between the insurer and the insured. Nevada recognizes that the insurer and the insured are dual clients of insurer-appointed counsel. When the insured and the insurer have opposing legal interests, Nevada law requires insurers to fulfill their contractual duty to defend their insureds by allowing insureds to select their own independent counsel and paying for such representation. We further conclude that an insurer is only obligated to provide independent counsel when the insured’s and the insurer’s legal interests actually conflict. A reservation of rights letter does not create a per se conflict of interest.

“Courts rejecting the *Cumis* rule have not recognized the existence of a conflict of interest in such cases. These courts have reasoned that the sole client is the insured and, therefore, counsel only owes a duty to the insured. True, some courts have mentioned other rationales, such as that professional ethics rules will keep counsel honest and that insureds have other remedies against unethical counsel. But the main rationale is still that there is no conflict: The sole client is the insured, not the insurer. Nevada, in contrast, is a dual-representation state: Insurer-appointed counsel represents both the insurer and the insured.

“Jurisdictions are divided on whether a reservation of rights creates a per se conflict of interest. Some jurisdictions apply a per se rule that a reservation of rights creates a conflict of interest between the insured and insurer-appointed counsel. Courts in these jurisdictions have reasoned that, if an insurer could control the case under a reservation of rights, it could insist on full litigation. The insurer would thereby expose the insured to the risk of personal liability and then seek to deny coverage if the verdict is unfavorable to the insured. Courts see it as unfair to give insurers an opportunity for a second bite of the apple. Other jurisdictions look to the facts of the case to determine whether there is an actual conflict. Courts in these jurisdictions stress that the point of the *Cumis* rule is to enforce conflict-of-interest rules, so the focus should be on whether there is actually a conflict. Courts must therefore consider whether a conflict of interest exists and not simply look for a reservation of rights.” (*State Farm Mut. Auto. Ins. Co. v. Hansen*, 131 Nev. Adv. Op. 74 (2015) (citations, quotation marks, and ellipses omitted).)

New York

“[T]he insurance carrier is obligated immediately to pay or provide for the defense of the pending [liability] actions and to reimburse the assureds for what the defense has cost them to date. . . . If any . . . conflict of interest arises, as it probably will, the selection of the attorneys to represent the assureds should be made by them rather than by the insurance company, which should remain liable for the payment of the reasonable value of the services of whatever attorneys the assureds select.” (*Prashker v. United States Guar. Co.* 1 N.Y.2d 584, 593 (1956).)

“It is also well-established [under New York law] that when the insurer and the insured have a potential conflict of interest, the duty to defend includes a duty to provide independent defense counsel to the insured, whose reasonable fee is to be paid by the insurer but who is to be appointed by the insured. It is important to recognize that independent counsel is not necessary in all cases where multiple claims are made. It is only necessary where the ‘question of insurance coverage is intertwined with the question of the insured’s liability. Such a case arises when the defense attorney’s duty to the insured would require that he defeat liability on any ground and his

duty to the insurer would require that he defeat liability only upon grounds which would render the insurer liable.” (*Golotrade Shipping & Chartering, Inc. v. Travelers Indem. Co.*, 706 F.Supp. 214, 219 (S.D.N.Y. 1989) (citations, quotation marks, and ellipses omitted).)

“An insurer is obligated to defend the insured against lawsuits where the insurer would be liable only upon some of the grounds for recovery. However, because the insurer’s interest in defending the lawsuit may be in conflict with the insured, the insured is entitled to defense by an attorney of his or her own choosing, whose reasonable fee is to be paid by the insurer. We agree with the Supreme Court that the insurer’s obligation to reimburse its insured for reasonable counsel fees is a substantial right under the policy. At bar, there is no evidence establishing that the plaintiff was ever aware that his attorneys had agreed to place a cap on fees expended in his defense. Nor has the defendant submitted proof that the plaintiff’s attorneys were empowered to bind the plaintiff to such an agreement. Moreover, the defendant’s conclusory assertions that such authority nevertheless existed, or that the plaintiff knew of, and somehow ratified the agreement, neither entitle the defendant to judgment as a matter of law nor create triable issues of fact precluding the granting of judgment to the plaintiff.” (*Bryan v. State-Wide Ins. Co.*, 144 A.D.2d 325, 327, 533 N.Y.S.2d 951 (1988) (citations, quotation marks, and ellipses omitted).)

“It is not inherently objectionable to permit an insurer to participate in the selection of independent counsel for the insured as long as the insurer discharges its obligation in good faith and the attorney chosen is truly independent and otherwise capable of defending the insured. The decisions that appear to indicate that the insured has the absolute right to choose counsel where a conflict exists. The contract here provided that [the insurer] was not obligated to pay for [the policyholder]’s counsel unless it consented to the choice of counsel. The terms of the contract govern unless they are against public policy. The participation of an insurer in the selection process does not automatically taint the independence of chosen counsel. Therefore, this provision is not contrary to public policy. It was not unreasonable for [the insurer] to insist on counsel independent of both itself and [the policyholder].” (*New York State Urban Development Corp. v. VSL Corp.*, 738 F.2d 61, 65-66 (2nd Cir. 1984) (N.Y. law) (citations, quotation marks, and ellipses omitted).)

Ohio

“A liability insurance company breaches its contract to defend by making to the insured such a claim of nonliability for indemnification as to render it impossible for such company, in making defense, to protect both its own interests and those of the insured. When there is such a breach of contract, accompanied by an invitation to insured to employ its own counsel to participate in the defense for its own protection, the insured, protesting against such action, may employ counsel with notice to the insurance company that it must bear the expense, and the company will be liable for reasonable attorney fees and proper expenses incurred in making defense. [A]n insurer in Ohio may proceed to defend the insured so long as the situation does not arise that the insurer’s defense of the insured and its defense of its own interests are mutually exclusive. In such a case, the insurer, still bound in its duty to defend the insured, would have to pay the cost of the insured’s private counsel.” (*Red Head Brass, Inc. v. Buckeye Union Ins. Co.*, 135 Ohio App.3d 616, 626, 735 N.E.2d 48, 55 (Ohio Ct. App. 1999) (citations, quotation marks, and ellipses omitted); see also, *Lusk v. Imperial Cas. & Indem. Co.* 78 Ohio App.3d 11, 19 (1992).)

Oklahoma

“The parties fail to cite any Oklahoma authority on-point, and we find none. Some other jurisdictions have adopted a rule requiring, under a duty-to-defend clause of an insurance policy, an insurer to pay for independent counsel upon the filing of a complaint alleging covered and non-covered claims. However, other jurisdictions allow an insurer to fulfill its obligation to defend when a conflict of interest arises by refraining from activity which would show a greater concern for its monetary interest than for its insured’s financial risk or, in a case where damages claimed were in excess of coverage, by fully defending the insured regardless of the insured’s disagreement with the manner in which the case is defended. [N]ot every perceived or potential conflict of interest automatically gives rise to a duty on the part of the insurer to pay for the insured’s choice of independent counsel. Independent counsel is only necessary in cases where the defense attorney’s duty to the insured would require that he defeat liability on any ground and his duty to the insurer would require that he defeat liability only upon grounds that would render the insurer liable. Conversely, absent a threat of divided loyalty between the insured and insurer, no need for retention of independent counsel arises because the issue of coverage is then separate from the issue of liability. [The insurer] recognized prior to trial that a potentially detrimental conflict of interest existed. Thus, the need for [policyholder] to hire independent counsel arose when the possibility existed that [the insurer] might be faced with the prospect of defending [policyholder] under some but not all available defenses. [W]e hold [the insurer] - when faced with such a conflict of defense strategy - had a duty to pay reasonable fees for the independent representation of [policyholder] under the duty to defend clause of the insurance contract.” (*Nisson v. Am. Home Assur. Co.*, 917 P.2d 488, 490-91 (Okla. 1996) (citations, quotation marks, and ellipses omitted).)

Texas

“[W]hen an insurer makes a reservation of rights which creates a potential conflict of interest. Such reservations create an actual conflict of interest when the facts to be adjudicated in the liability lawsuit are the same facts upon which coverage depends. A 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. In other words, if the attorney appointed by the insurance company would have an incentive to act for the insurance company’s interest rather than the insured’s interest, and therefore deprive the insured of its right to independent counsel, a conflict of interest exists triggering the insured’s right to select counsel. 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. When a conflict of interest exists, the insurer may not insist upon its contractual right to control the defense. But every disagreement between the insurance company and the client about how the defense should be conducted cannot amount to a conflict of interest.” (*Coats, Rose, Yale, Ryman & Lee, P.C., v. Navigators Specialty Ins. Co.*, 830 F. Supp.2d 216, 219 (N.D. Tex. 2011).)

“[A]n insurer’s right of control generally includes the authority to make defense decisions as if it were the client where no conflict of interest exists. Ordinarily, the existence or scope of coverage is the basis for a disqualifying conflict. In the typical coverage dispute, an insurer will issue a reservation of rights letter, which creates a potential conflict of interest. [W]hen the facts to be adjudicated in the liability lawsuit are the same facts upon which coverage depends, the conflict of interest will prevent the insurer from conducting the defense. On the other hand, when

the disagreement concerns coverage but the insurer defends unconditionally, there is, because of the application of estoppel principles, no potential for a conflict of interest between the insured and the insurer. Other types of conflicts may also justify an insured's refusal of an offered defense. One authority lists four separate circumstances in which the insured may rightfully refuse to accept the insurer's defense: (1) when the defense tendered is not a complete defense under circumstances in which it should have been, (2) when the attorney hired by the carrier acts unethically and, at the insurer's direction, advances the insurer's interests at the expense of the insured's, (3) when the defense would not, under the governing law, satisfy the insurer's duty to defend, and (4) when, though the defense is otherwise proper, the insurer attempts to obtain some type of concession from the insured before it will defend. Thus, the insured may rightfully refuse an inadequate defense and may also refuse any defense conditioned on an unreasonable, extra-contractual demand that threatens the insured's independent legal rights. That lawyer owes unqualified loyalty to the insured, [and] must at all times protect the interests of the insured if those interests would be compromised by the insurer's instructions. The choice of venue should ordinarily have no impact on the insured's legitimate interests under the policy. [H]aving rejected the insurer's defense without a sufficient conflict, [the policyholder] lost his right to recover the costs of that defense. Because [the insurer]'s offer to defend [the policyholder] satisfied its obligation under the policy, [the insurer] did not breach its duty to defend." (*Northern County Mut. Ins. Co. v. Davalos*, 140 S.W.3d 685, 688-90 (Tex. 2004). (citations, quotation marks, and ellipses omitted).)

"When the alleged cause of action is neither clearly without nor clearly within coverage, the insurer is obligated to defend if there is, potentially, a cause under the complaint within the coverage of the policy. If there is doubt as to whether the complaint states a covered cause of action, doubt will be resolved in insured's favor. It is well settled that once an insurer has breached its duty to defend, the insured is free to proceed as he sees fit; he may engage his own counsel and either settle or litigate, at his option. [A] consequence of a breach of the duty to defend is the inability to enforce against the insured any conditions in the policy; the insured is no longer constrained by no action or no voluntary assumption of liability clauses. The insurer may be liable for attorneys' fees incurred by the insured in order to defend the suit.

"A reservation of rights is a proper action if the insurer believes, in good faith, that the complaint alleges conduct which may not be covered by the policy. In such a situation, reservation of rights will not be a breach of the duty to defend, but notice of intent to reserve rights must be sufficient to inform the insured of the insurer's position and must be timely. When a reservation of rights is made, however, the insured may properly refuse the tender of defense and pursue his own defense. The insurer remains liable for attorneys' fees incurred by the insured and may not insist on conducting the defense. Refusal of the tender of defense is particularly appropriate where, the insurer's interests conflict with those of the insured. When the insurer is denying coverage and where coverage will depend upon the finding of the trier of facts as to certain issues in the main case, the insurer is not in a position to defend the insured." (*Rhodes v. Chicago Ins. Co.*, 719 F.2d 116, 119-21 (5th Cir. 1983) (Texas law).)

"A disqualifying conflict of interest exists where the facts to be adjudicated in the liability lawsuit are the same facts upon which coverage depends. The Texas Supreme Court has not offered further clarity on what is meant by *Davalos*' 'same facts' requirement, or how the requirement is to be applied. Thus, the Court is tasked with interpreting the term and determining whether any fact upon which coverage depends also will be adjudicated in the Underlying Suit. In order for a disqualifying interest to exist, then, it must be apparent that facts upon which coverage

depends will be ruled upon judicially in the Underlying Suit. It is not until the facts to be adjudicated in the liability lawsuit are the same facts upon which coverage depends' that a potential conflict becomes a disqualifying one, entitling an insured to select independent counsel." (*Partain v. Mid-Continent Spec. Ins. Serv.*, 838 F.Supp2d 547, 555 (S.D. Tex. 2012) (citations, quotation marks, and ellipses omitted).)

Six States Adopt an "Enhanced Duty" Rule

(Hawaii, Washington, Alabama, Oregon, Michigan, and South Carolina.)

Six states have rejected the majority per se disqualification rule while recognizing that an insurer's reservation of rights *may* create a disqualifying conflict of interest that requires an insurer to pay for independent counsel selected and directed by the policyholder. Each opinion is limited to its peculiar facts in which little or no evidence of conflicts of interest exist. But each opinion rejects the per se rule, declines to automatically distrust the ethics of dependent counsel, interprets that state's rules of professional conduct to limit dependent counsel's representation to the solely the policyholder, and outlines in dicta an elaborate set of requirements to be met by the insurer and dependent counsel to avoid liability to the policyholder.

Hawaii

In *Finley v. The Home Insurance Company* (1990) 90 Hawai'i 25, 975 P.2d 1145, the Hawaii Supreme Court ruled in a lengthy and complex opinion that "an actual conflict of interest could . . . warrant the withdrawal or dismissal of retained counsel and the appointment of new counsel" because "where the carrier questions the availability of coverage and provides a defense . . . subject to a reservation of rights, a conflict exists." But notwithstanding this, dependent counsel represents only the policyholder so that the policyholder is **not** entitled to retain independent counsel at the insurer's expense if the insurer and dependent counsel satisfy "enhanced" standards of good faith and imposing liability upon them if they fail to do so.

Actual Conflict May Warrant Disqualification

"[W]e do not rule out the possibility that, during the pendency of the action, an actual conflict of interest could develop that would warrant the withdrawal or dismissal of retained counsel and the appointment of new counsel." (*Id.* at 1554.)

A Reservation of Rights Creates Conflicts of Interest

"[W]here the carrier questions the availability of coverage and provides a defense in the third party action subject to a reservation of rights, a conflict exists - because the insured's goal is coverage, which flies in the face of the insurer's desire to avoid its duty to indemnify. 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." (*Id.* at 1550) (citations, quotation marks, and ellipses omitted).)

Dependent Counsel Represents Only the Policyholder

"Whether the attorney has an attorney-client relationship with the insurer is a matter of substantive law and varies by state. [The ABA rules] offer virtually no guidance as to whether a lawyer retained and paid by an insurer to defend its insured represents the insured, the insurer, or both. The record on appeal does not contain any information on the specific arrangement between [the insurer and dependent counsel]. [The Hawaii Rules of Professional Conduct are interpreted to mean] that retained counsel *solely* represents the insured when a conflict arises between the interests of the insurer and the insured. The [Hawaii Rules of Professional Conduct] do not allow an attorney to represent a client if this representation will be materially limited by his

responsibilities to another client or a third person. If both the insured and the insurer were clients of the attorney and a conflict existed, such that each desired a different outcome to the litigation, it would be impossible for the attorney to adequately represent the interests of both, and the requirements of [Hawaii Rules of Professional Conduct] could not be met.” (*Id.* at 1552-53) (citations, quotation marks, and ellipses omitted.)

Consent after Consultation, Independent of Judgment, and Protection of Confidential Information Satisfies Ethical Obligations

[Hawaii Rules of Professional Conduct provide that] “A lawyer shall not accept compensation for representing a client from one other than the client unless: (1) the client consents after consultation; (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. [Thus dependent counsel] must: (1) consult with the client as to the ‘means by which the objectives [of the representation] are to be pursued’; (2) not allow the insurer to interfere with the attorney’s ‘independence of professional judgment or with the client-lawyer relationship’; and (3) not allow the insurer ‘to direct or regulate the lawyer’s professional judgment in rendering such legal services.’” (*Id.* at 1553) (ellipses omitted.)

No Per Se Disqualification

[We do not] “hold that the insurer who, under reservation of rights, participates in selection of counsel, automatically breaches its duty of good faith is to indulge in the conclusive presumption that counsel is unable to fully represent its client, the insured, without consciously or unconsciously compromising the insured’s interests. [We do not have] so little confidence in the integrity of the bar of this state. [T]he retained attorney is sufficiently ‘independent’ that we will not adopt a blanket rule based on the assumption that the attorney will slant his or her representation to the detriment of the insured.” (*Id.* at 1554) (citations, quotation marks, and ellipses omitted.)

Policyholder May Defend at Own Expense

“[T]he insured must have the right to reject this tender [of a defense under a reservation of rights]. [T]he insured may properly refuse the tender of defense and pursue his own defense. Therefore, if the client does not desire the representation under the terms offered by the insurer, the insurer must either choose to defend unqualifiedly or allow the insured to conduct its own defense of the action. If the insured chooses to conduct its own defense, the insured is responsible for all attorneys’ fees related thereto. The insurer is still potentially liable for indemnification for a judgment within the scope of insurance coverage.” (*Id.* at 1554-55) (citations, quotation marks, and ellipses omitted.)

Policyholder May Sue for Breach

“If the duties prescribed by the [rules of ethics] are not followed by retained counsel, various remedies exist to protect the insured: (1) professional malpractice; (2) bad faith; and (3) estoppel of the insurer to deny indemnification. [T]he insurer may also be liable if its actions caused the attorney’s breach of its duties.” (*Id.* at 1555-56) (citations, quotation marks, and ellipses omitted.)

Washington

In *Tank v. State Farm Fire & Cas. Co.*, 105 Wash.2d 381, 715 P.2d 1133 (1986) (*Tank*), Washington created “enhanced obligations” on the part of dependent counsel and a reserving insurer.

[T]he duty of good faith of an insurer requires fair dealing and equal consideration for the

insured's interests. [T]he potential conflicts of interest between insurer and insured inherent in [a defense under a reservation of rights] mandate an even higher standard: an insurance company must fulfill an enhanced obligation to its insured as part of its duty of good faith. Failure to satisfy this enhanced obligation may result in liability of the company, or retained defense counsel, or both. This enhanced obligation is fulfilled by meeting specific criteria. First, the company must thoroughly investigate the cause of the insured's accident and the nature and severity of the plaintiff's injuries. Second, it must retain competent defense counsel for the insured. Both retained defense counsel and the insurer must understand that only the *insured* is the client. Third, the company has the responsibility for fully informing the insured not only of the reservation of rights defense itself, but of *all* developments relevant to his policy coverage and the progress of his lawsuit. Information regarding progress of the lawsuit includes disclosure of all settlement offers made by the company. Finally, an insurance company must refrain from engaging in any action which would demonstrate a greater concern for the insurer's monetary interest than for the insured's financial risk. In addition to the above specific criteria to be met by the company, defense counsel retained by insurers to defend insureds under a reservation of rights must meet distinct criteria as well. First, it is evident that such attorneys owe a duty of loyalty to their clients. [Rules of ethics] prohibits a lawyer, employed by a party to represent a third party, from allowing the employer to influence his or her professional judgment. In a reservation of rights defense, [one rule of ethics] demands that counsel understand that he or she represents only the *insured*, not the company. [T]he standards of the legal profession require undeviating fidelity of the lawyer to his client. No exceptions can be tolerated. Second, defense counsel owes a duty of full and ongoing disclosure to the insured. This duty of disclosure has three aspects. First, potential conflicts of interest between insurer and insured must be fully disclosed and resolved in favor of the insured. [Rules of ethics] which address conflicts of interest such as this, must be strictly followed. Second, all information relevant to the insured's defense, including a realistic and periodic assessment of the insured's chances to win or lose the pending lawsuit, must be communicated to the insured. Finally, *all* offers of settlement must be disclosed to the insured as those offers are presented. In a reservation of rights defense, it is the insured who may pay any judgment or settlement. Therefore, it is the insured who must make the ultimate choice regarding settlement. In order to make an informed decision in this regard, the insured must be fully apprised of all activity involving settlement, whether the settlement offers or rejections come from the injured party or the insurance company. [T]here is no evidence on the record to suggest that the company engaged in actions which demonstrated greater concern for its own interests than for the interests of its insured. [W]e may take into account only those materials upon which the trial court relied in making its ruling. Even assuming the existence of attorney misconduct, which we do not, we must disregard it. [T]he company must always give equal consideration in all matters to the well being of its insured. Good conscience and fair dealing [require] that the company pursue a course that [is] not advantageous to itself while disadvantageous to its policyholder." (*Tank, supra*, 105 Wash.2d at 387-91 (citations, quotation marks, and ellipses omitted))

Alabama

"Those authorities which stand for the proposition that, *in all cases* where there is a reservation of rights, regardless of the actual circumstances of the defense provided by the insurer, the insured is *entitled* to defense counsel of its choice who shall control the defense, and whose reasonable fees the insurer is required to pay, in our view go too far. The objective in a reservation-of-rights situation is to put in place a procedure by which the insured can be confident

that his interests will not be compromised nor in any way subordinated to those of the insurer as a result of the defense he is required to accept under the contract of insurance. The standard set forth in [Washington State] requiring an enhanced obligation of good faith coupled with the specific criteria that must be met by both the insurer as well as the defense counsel retained by the insurer, provides an adequate means for safeguarding the interests of the insured without, at the same time, engaging in the presumption that any and all defense counsel retained by the insurance industry to represent its insureds under a reservation of rights are conclusively unable to do so without consciously or unconsciously compromising the interests of the insureds. The mere fact that the insurer chooses to defend its insured under a reservation of rights does not *ipso facto* constitute such a conflict of interest that the insured is entitled at the outset to engage defense counsel of its choice at the expense of the insurer. We hold that, if the insurer and the defense counsel retained by the insurer to *represent its insured* meet the specific criteria [adopted in Washington], the insurer has met its enhanced obligation of good faith, and the defense provided by the insurer may proceed under a reservation of rights. It is only when those criteria have not been met in whole or in part that the insured is entitled to retain defense counsel of its choice at the expense of the insurer.” (*L & S Roofing Supply Co. v. St. Paul Fire & Marine Ins. Co.*, 521 So.2d 1298, 1304 (Ala. 1987) (citation and ellipses omitted).)

Michigan

In *Federal Ins. Co. v. X-Rite, Inc.*, 748 F. Supp. 1223, (W.D. Mich. 1990), a federal court interpreting Michigan law ruled that an insurer’s reservation of rights creates a conflict of interest that requires the insurer to hire independent counsel, but that the insurer may select the “independent” counsel if the policyholder fails to object and show that dependent counsel was not “independent”.

“[W]hen a conflict of interest between the [insurer and the policyholder] arises and a conflict of interest arises, the insured must be informed and given the right either to accept an independent attorney selected by the insurer or to select an attorney himself to conduct his defense; if the insured elects to choose his own attorney, the insurer must assume the reasonable costs of the defense provided. [T]he Michigan Supreme Court is open to permitting the insured to control the litigation, by either accepting the insurer’s proposed independent counsel or, at the insured’s option, selecting its own, at the insurer’s expense. On the other hand, it may choose to provide a defense with a reservation of rights. In the latter case the insurer’s desire to control the litigation must give way to its obligation to defend the insured. [T]he insurer should provide independent counsel to control the defense or allow the insured to hire his own counsel to be paid by the insurer. [W]hen the insurer controls the litigation, defense counsel may be faced with a conflict of interest which creates a real danger that the insured will be prejudiced. Because specific instances of prejudice are difficult to prove after the fact, a prophylactic rule was justified. There is widespread agreement in the case law [of other states] that, where there is a conflict of interest, the insurer ought to retain independent counsel or pay for one chosen by the insured. Yet, there is little consensus as to who ultimately has the *right* to choose counsel where the insurer and insured cannot agree. The *Cumis* approach is not exclusive, however. Many cases have recognized a right in the insurer to determine whether to provide independent counsel of its choosing or to reimburse the insured for counsel of its choice. [U]nder the facts of this case, [the policyholder] was not entitled to insist on counsel of its choice at [the insurer]’s expense. Several factors contribute to this conclusion. [The insurer] tendered the representation of ‘independent counsel,’ [insurer appointed counsel]. [The policyholder] objected not because it believed [insurer

appointed counsel] was not ‘independent’. Accordingly, the Court concludes, under the present facts, that the conflict of interest posed by [the insurer]’s reservation of rights did not automatically entitle [the policyholder] to select counsel of its choice at [the insurer]’s expense. There being no showing that [insurer appointed counsel] was not independent or that representation by [insurer appointed counsel] represented a breach of [the insurer]’s duty of good faith or resulted in an actual conflict or created a substantial risk of prejudice to [the policyholder]’s interests, [the policyholder] was not justified in refusing the tendered representation of [insurer appointed counsel]. Hence, [the policyholder], cannot avoid its obligation under the policy to bear the expenses which it voluntarily incurred by retaining the services of [private counsel].” (*Id.* at 1226-30, (citations, quotation marks, and ellipses omitted).)

Oregon

In *Ferguson v. Birmingham Fire Ins. Co.*, 460 P.2d 342, 348-49 (Or. 1969), Oregon rejected the majority per se rule and found that a policyholder who insists that a reserving insurer waive coverage defenses breaches the terms of the policy, but that the insurer is still liable for costs of defense if coverage is found.

“[While] the insurer may offer only a token defense or be less prone to effect a settlement [w]e think that this danger is minimal. [By the policyholder’s] insistence that the [the insurer] defend only if it waived the right to later litigate the question of coverage constituted an unreasonable condition imposed by [the policyholder] upon [the insurer] constituted a breach of the contract. However, we do not feel that this breach on the part of [the policyholder] should exonerate [the insurer] from liability if there is coverage. When [the policyholder] refused to permit [the insurer] to defend the action and at the same time reserve its right to raise the question of coverage, [the policyholder] was acting in accordance with the rule adopted by most, if not all, courts. Our rejection of that rule and our holding that [the policyholder] breached his contract when he relied upon that rule should not prejudice [the policyholder] to any greater extent than is necessary in this case. We hold, therefore, that if on remand the question of coverage is resolved in favor of [the policyholder], [the insurer] will be liable for the amount of the judgment in the [liability] actions and the costs of defense.” (*Id.* at 349 (citations, quotation marks, and ellipses omitted).)

South Carolina

In *Harleysville Group Insurance v. Heritage Communities, Inc.* 420 S.C. 321, 803 S.E.2d 288 (SC 2017), the court stated: “It is axiomatic that an insured must be provided sufficient information to understand the reasons the insurer believes the policy may not provide coverage. [G]eneric denials of coverage coupled with furnishing the insured with a verbatim recitation of all or most of the policy provisions (through a cut-and-paste method) is not sufficient.

“A basic understanding of reservation of rights to contest coverage may be helpful. A unilateral reservation of rights is a notice given by the insurer that it will defend [the insured in the lawsuit] but reserves all rights it has based on noncoverage under the policy. A reservation of rights is a way for an insurer to avoid breaching its duty to defend and seek to suspend operation of the doctrines of waiver and estoppel prior to a determination of the insureds liability. Although a reservation of rights may protect an insurers interests, it also is intended to benefit the policyholder by alerting the policyholder to the potential that coverage may be inapplicable for a loss; that conflicts may exist as between the policyholder and the insurer; and, that the policyholder should take steps necessary to protect its potentially uninsured interests.

“A reservation of rights letter must give fair notice to the insured that the insurer intends to assert defenses to coverage or to pursue a declaratory relief action at a later date. Moreover, because an insurer typically has the right to control the litigation and is in the best position to see to it that the damages are allocated, courts have found that where an insurer defends under a reservation of rights, an insurer has a duty to inform the insured of the need for an allocated verdict as to covered versus noncovered damages. [W]here an insurer reserves the right to control the defense, the insured is directly deprived of a voice or part in such negotiations and defense and noting that if an insurers interests conflict with those of its insured, the insurer is bound, under its contract of indemnity, and in good faith, to sacrifice its interests in favor of those of the [insured]). [W]hen an insurer notifies its insured that it accepts the defense of a claim under a reservation of rights that includes covered and noncovered claims, the insurer not only has a duty to defend the claim, but also to disclose to its insured the insureds interest in obtaining a written explanation of the award that identifies the claims or theories of recovery actually proved and the portions of the award attributable to each); id. (reasoning that the insurer is in a unique position to know the scope of coverage and exclusions in its policies and the duty to notify [the insured] is not onerous).

“The right to control the litigation carries with it certain duties, including the duty not to prejudice the insureds rights by failing to request special interrogatories or a special verdict in order to clarify coverage of damages. [I]f the burden of apportioning damages between covered and non-covered were to rest on the insured, who is not in control of the defense, the insurer could obtain for itself an escape from responsibility merely by failing to request a special verdict or special interrogatories. Therefore, by virtue of its duty to defend, an insurer gains the advantage of exclusive control over the litigation, and it would be unreasonable to permit the insurer to not disclose potential bases for denying coverage.

“If the insured does not know the grounds on which the insurer may contest coverage, the insured is placed at a disadvantage because it loses the opportunity to investigate and prepare a defense on its own. Indeed without knowledge of the bases upon which the insurer might dispute coverage, the insured has no reason to act to protect its rights because it is unaware that a conflict of interest exists between itself and the insurer. Thus, [t]he general rule precluding an insurer from raising new grounds contesting coverage in a subsequent action is justified in this context. Where the insurer fails to adequately reserve the right to contest coverage, the insurer may be precluded from doing so. [A]n insurer [may] not assert a defense of noncoverage based on its failure to effectively reserve the right to contest coverage. For a reservation of rights to be effective, the reservation must be unambiguous; if it is ambiguous, the purported reservation of rights must be construed strictly against the insurer and liberally in favor of the insured. [W]here an insurer undertakes and exclusively controls the defense of the insured under a reservation of rights, prior to undertaking the defense, the insurer must specify in detail any and all bases upon which it might contest coverage in the future since [g]rounds not identified in the reservation of rights may not be asserted later by the insurer. [T]he existence of a potential conflict of interest between insured and insurer is what requires the insured to set forth the bases upon which it might contend damages are not covered in a greater amount of detail than would otherwise be required. [W]hen an insurer controls the defense of the action against its insured, a high fiduciary duty [i]s owed by the insurer to the insured and observing a general notice of reservation of rights failing to refer specifically to the policy provision upon which the insurer wished to rely may be insufficient.” (*Id.*, 420 S.C. 321, 338-340 (citations, quotation marks, and ellipses omitted).)

In Twin City Fire Ins. Co. v. Ben Arnold-Sunbelt Beverage Co. of S.C., LP, 336 F. Supp.2d

610 (D.S.C., 2004), a federal court interpreting South Carolina law rejected the majority per se rule in the absence of proof that dependent counsel conducted a conflicts analysis that concluded that he or she had a disqualifying conflict of interest.

“[B]ecause [the insurers] reserved their rights as it related to indemnification coverage, a conflict of interest was created whereby [the policyholders] were entitled to retain counsel of their choosing with the reasonable fees for said counsel to be paid by [the insurers]. This court is reluctant to predict that South Carolina would adopt a disqualification rule that appears to be premised upon the supposition that attorneys employed by insurance carriers will always behave unethically. In other words, the argument for the per se disqualification rule is based upon the assumption that attorneys employed by insurance carriers will seek to direct the course of litigation in a manner so as to achieve success on the claims that are covered under the policy, giving scant attention to the non-covered claims. This court declines to formulate a rule of law based upon the notion that attorneys will violate ethical obligations when employed by insurance companies. It is well-settled that an insurer’s obligation to provide independent counsel is not based on insurance law; rather, it is based on a lawyer’s duty of loyalty which prohibits him or her from representing conflicting interests. A pertinent provision of the South Carolina Rules of Professional Conduct governs a lawyer’s ethical obligation when paid by an insurance company to represent an insured: Members of the South Carolina bar are charged with the responsibility of properly determining whether an actual or potential conflict exists and, if so, whether withdrawal from the representation is required. Any conflict of interest determination in this case should have been made by [dependent counsel], not [the policyholder]. Nowhere has it been suggested that [dependent counsel] determined a conflict of interest arose that disqualified him from representing [the policyholder]. In fact, [the policyholder] never allowed [dependent counsel] to participate, so no conflict analysis was ever rendered by the lawyer who had the duty to make the call.” (*Id.* at 615-16 (citations, quotation marks, and ellipses omitted).)

Six Jurisdictions Have Not Clearly Decided

(Delaware, the District of Columbia, North Dakota, South Dakota, Virginia, and West Virginia.)

Six jurisdictions have not yet litigated and held whether an insurer that reserves its rights to later deny coverage to its policyholder must pay independent counsel selected and directed by the policyholder.

Delaware

“[W]hen [the insurer] has a conflict of interest, its conduct (and its right of recovery) is governed by equitable principles.” (*Baio v. Comm’l Union Ins. Co.*, 410 A.2d 502, 507 (Del. 1979).)

“It has also been recognized that where the settlement or recovery under the claim may exceed coverage limits the insurer has a heightened duty to advise the insured of such implications and a duty to permit the insured an opportunity to participate through independent counsel.” (*Corrado Bros., Inc. v. Twin City Fire Ins. Co.*, 562 A.2d 1188, 1192 (Del. 1989).)

District of Columbia

The District of Columbia is silent on this issue. But see, *O’Connell v. Home Ins. Co.*, CIV. A. No. 88-3523, 1990 WL 137386 (D.D.C. Sept. 10, 1990) unpublished opinion that equitable principles should apply.)

North Dakota

“Interestingly, in any situation where the insurance company is permitted to undertake a dual representation the most favorable result for the company would preclude the insurance company’s liability. To contend for this most favorable result, however, makes for a conflict of interest between the insurance company and both the insured and the [injured plaintiff]. The court [does] not believe that an insurance company should be permitted to voluntarily place itself in a position under an ancillary policy provision where it cannot ethically fulfill its basic contractual obligation to defend its insured.” (*Fetch v. Quam*, 530 N.W.2d 337, 339 (N.D. 1995) (citations, quotation marks, and ellipses omitted).)

South Dakota

[The insurer] defended [the policyholder] under a reservation of rights. A reservation of rights is a notice to the insured that the insurer will defend the insured but that the insurer is not waiving any defenses it may have under the policy. By this method, insurers can provide the insured a defense to liability and reserve for later the question whether the policy provides coverage. As in most jurisdictions, acting under a reservation of rights is an established procedure in South Dakota. An insurer is not estopped notwithstanding participation in defense of an action against insured to assert noncoverage if timely notice was given to the insured that it has not waived benefit of its defense under the policy. (*St. Paul Fire and Marine Ins. Co. v. Engelmann*, 639 N.W.2d 192, 201 (S.D. 2002) (citations, quotation marks, and ellipses omitted).)

Virginia

“Clearly there was not an unconditional defending in the instant case in view of the reservation of rights letter to [the policyholder] by the company and its suggestion that he employ private counsel to represent him.” (*Norman v. Ins. Co. of North Amer.*, 218 Va. 718, 239 S.E.2d 902, 908 (1978).)

West Virginia

“Attorneys have long struggled with the contractual and ethical quandaries presented by the ‘tripartite’ relationship between defense attorney, insurance company, and insured. [T]he ‘ethical dilemma thus imposed upon the carrier-employed defense attorney’ by the relationship between insurer, client-insured, and insurance-company-paid defense attorney is one that ‘would tax Socrates.’ [A] defense attorney, employed to represent an insured in a liability matter is professionally obligated to represent only the interests of the client/insured, not the interests of the insurance company. [W]e concluded that a defense attorney represents only the insured, and not the insurer that is paying the defense attorney’s fee. While it has been argued that the attorney represents both the insurer and insured, we acknowledged that ‘[i]n reality, the insurer actually hires the attorney to represent the insured.’” (*Barefield v. DPIC Co.’s, Inc.*, 215 W.Va. 544, 600 S.E.2d 256, 268 (2004).)

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