

# ETHICS ADVISORY OPINION

FROM THE STATE BAR OF NEW MEXICO ETHICS ADVISORY COMMITTEE

Formal Opinion No. 2011-01

## Conflict of Interest

**RULES IMPLICATED:** NMRA 16-107 (conflict of interest—material limitation on representation), 16-108 (compensation from third parties), and 16-307 (lawyer as witness). This opinion is based upon the Rules as amended effective as of February 14, 2011. Subsequent changes in the Rules could impact the opinion provided.

**DISCLAIMER:** The Ethics Advisory Committee of the State Bar of New Mexico (“Committee”) is constituted for the purpose of advising inquiring lawyers on the application of the New Mexico Rules of Professional Conduct in effect at the time the opinion is issued (the “Rules”) to the specific facts as supplied by the inquiring lawyer. The Committee does not render opinions on matters of substantive law. Lawyers are cautioned that should the Rules subsequently be revised or different facts be presented, a different conclusion may be appropriate. The Committee’s opinions are advisory only, and are not binding on the inquiring lawyer, the disciplinary board, or any tribunal. The statements expressed in this opinion are the consensus of the Committee members who considered the request.

### QUESTIONS PRESENTED:

1. May a lawyer represent an insured client against that client’s insurer for breach of contract and bad faith when:

- the insurer initially hired and paid the lawyer to defend the insured client in a liability case out of which the alleged breach of contract and bad faith conduct arises; and
- the lawyer presently is defending other insureds of this same insurer in other liability cases?

2. Under these circumstances, may the lawyer represent an insured client against that client’s insurer for breach of contract and bad faith once the insurer withdraws a defense and denies indemnity in the liability case?

**SUMMARY ANSWER:** No to both questions. There is a significant risk that the lawyer’s representation of the insured against the insurer will be limited materially by the lawyer’s responsibilities to a third person in violation of Rule 16-107A (2) and Rule 16-108F (2). Further, the lawyer may become a necessary witness of facts material to the breach of contract or bad faith action that will require his disqualification as an advocate under Rule 307A. The timing of the lawyer’s action against the insurer is irrelevant to the ethical analysis.

**FACTS:** An insurance company hired a lawyer to defend its insured. The insurer was providing a defense to the insured under reservation of rights. Recently, the insured pled guilty to state criminal charges that may arise out of the same conduct that formed the basis of the civil lawsuit.

The insurer now has notified the insured that due to his guilty plea, it will withdraw its defense and deny indemnity. The lawyer also notes that the insurer “has retained me on several other matters which I am currently handling.”

The lawyer believes the insurer’s determination is erroneous and prejudicial to the insured and may give rise to a claim by the insured against the insurer.

**ANALYSIS:** All parties, the insurer, the insured, and the lawyer agreed to representation under a tri-partite arrangement; that is:

- the insurer agreed to provide and pay for a defense for its insured reserving the right to withdraw a defense or deny indemnity, or both, at a later time;
- the insured agreed to accept the defense under reservation of rights; and
- the lawyer agreed to provide the insured client with a defense to the liability claim under the contractual parameters set forth by the insurer, including the reservation of rights.

Many times a defense lawyer in lawyer’s position walks a tight-rope.<sup>1</sup> The Committee has found no New Mexico case that clearly identifies whether the insured *alone* is the client or whether *both* the insured and the insurer have an attorney-client relationship with lawyer. Windt has identified at least two schools of thought on this issue.<sup>2</sup> In one line of cases, an attorney like the lawyer in this matter has both the insured and the insurer as a client.<sup>3</sup> In another line, an attorney represents the interest of the insured only.<sup>4</sup> For the Committee’s analysis, it is neither necessary nor appropriate for us to express an opinion concerning which line of cases, if any, will be adopted substantively by New Mexico courts.

Irrespective of which theory New Mexico courts ultimately adopt, the reality is that there are practical pressures upon this tri-partite relationship. These pressures blur the lines that otherwise separate the ethical obligations a defense lawyer owes to the insured whom he is defending and to the insurer that hired him and pays his legal fees.<sup>5</sup> The challenge to the defense lawyer is to fulfill his ethical duties to his insured client while performing his contractual obligations to the insurer who hired him and pays his bills.<sup>6</sup>

In fulfilling those ethical obligations, the lawyer is constrained by our conflict of interest rules. The lawyer in this case, like all lawyers, shall not allow the tri-partite relationship at issue here to “interfere with the lawyer’s professional judgment”.<sup>7</sup> Rule 16-107 prohibits a lawyer from representing a client “if the representation involves a concurrent conflict of interest”.<sup>8</sup> Such a conflict of interest exists if “there is a significant risk that the representation of . . . [a] client . . . will be materially limited by the lawyer’s responsibilities to . . . a third person or by a personal interest of the lawyer”.<sup>9</sup>

The lawyer here provides us with a fact situation in which there is such a concurrent conflict of interest: the lawyer, in discharging his fiduciary obligations to his client who is an insured under the insurer’s liability policy, recognizes that this same insurer has retained him in several other matters that he presently is handling. The pressures applied by this tripartite arrangement, whether subtle or overt, are such that the Committee believes that there is a significant risk that the lawyer’s representation of the insured will be limited materially by the lawyer’s responsibilities to another (the insurer) or by the personal interest of the lawyer (the interest of the lawyer is securing and retaining other business).

Likewise, there is the danger that the defense lawyer, while in the course of defending the liability claim, may become a necessary witness in an action against the insurer for conduct occurring during the defense of the case. Rule 16-307, with certain exceptions inapplicable here, prohibits a lawyer from acting as an advocate at a trial in which the lawyer is likely to be a witness.<sup>10</sup>

In the present fact situation, it appears that the defense lawyer, in the course of defending the insured in the liability claim, necessarily will be a witness to material facts relevant to any action for breach of contract or bad faith against the carrier. His status as a material witness will obligate the defense lawyer to remove himself as counsel for the insured in a case against the insurer.

As Windt also notes, the defense lawyer has a very precise charge in representing the insured in the liability claim:

Counsel is obligated to provide the insured with a vigorous defense to those claims, and in so doing, counsel must not either (a) consider the interests of the insurer, or (b) take any actions adverse to the interests of the insured. The insured is entitled to loyalty from the counsel provided to it by the insurer. The insured is not, however, entitled to look to such counsel to provide representation that the attorney was not retained to provide: representing the insured's interest against the insurer.<sup>11</sup>

While representing the insured client, the lawyer fulfills his ethical obligations when he vigorously defends the liability claim.

The fact that there is an ethical impediment to *this lawyer* providing legal services to the insured in a case against the insurer does not mean that the insured is left without a legal remedy. Should he believe that the insurer has violated some duty that it owes the insured client, the lawyer is free to refer the insured client to another competent lawyer who has no ethical impediment to the representation.

The Committee's analysis does not depend upon the timing of an action brought by the defense lawyer against the insurer. The conflicts addressed by Rules 16-107, 16-108, and 16-307 persist in the case presented irrespective of the timing of any such action.

**CONCLUSION:** Under the facts presented, the lawyer may not represent the insured client in an action against the insurer who hired him to defend the insured client and pays his legal fees since that same insurer has retained the lawyer in other active matters to defend other insureds. In the instant case, there is a significant risk that the lawyer's representation of the insured client will be limited materially by the lawyer's responsibilities to another (the insurer) or by the personal interest of the lawyer (the interest in securing and retaining other business) in violation of Rules 16-107A(2) and 16-108F(2). Further, by representing the insured client in an action against the insurer, the lawyer may well inject himself into the case as a necessary witness who must withdraw pursuant to the constraints of Rule 16-307. The timing of such an action does not remove the ethical prohibitions.

#### Endnotes:

<sup>1</sup>See Douglas R. Richmond, *Walking a Tightrope: The Tripartite Relationship Between Insurer and Insured, and Insurance Defense Counsel*, 73 NEB. L. REV. 265 (1994).

<sup>2</sup>See Allan D. Windt, *INSURANCE CLAIMS AND DISPUTES Representation of Insurance Companies and Insureds* (Fifth Ed. 2010) at § 4:19.

<sup>3</sup>See *id.* at page 4-165, n. 2 and n. 3.

<sup>4</sup>See *id.* at page 4-165, n. 2, citing *inter alia*, *Kirschner v. Process Design Associates, Inc.*, 459 Mich. 587, 592 N.W.2d 444, 451-52 (1999).

<sup>5</sup>See *State Farm Mutual Insurance Company v. Traver*, 980 S.W.2d 625, 629 (Tex. 1998) (Gonzales, J., concurring and dissenting).

<sup>6</sup>As one jurist has noted:

The duty to defend in a liability policy at times makes for an uneasy alliance. The insured wants the best defense possible. The insurance company, always looking at the bottom line, wants to provide a defense at the lowest possible cost. The lawyer the insurer retains to defend the insured is caught in the middle. There is a lot of wisdom in the old proverb: He who pays the piper calls the tune. The lawyer wants to provide a competent defense, yet knows who pays the bills and who is most likely to send new business. This so-called tripartite relationship has been well documented as a source of unending ethical, legal, and economic tension.

See *id.* at 633 (Gonzales, J., concurring and dissenting).

<sup>7</sup>See Rule 16-108F, NMRA. It provides:

**F. Compensation from third party.** A lawyer shall not accept compensation for representing a client from one other than a client unless:

- (1) the client gives informed consent;
- (2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and
- (3) information relating to the representation of a client is protected as required by Rule 16-106 of the Rules of Professional Conduct.

<sup>8</sup>See Rule 16-107A, NMRA. The rule provides, in pertinent part:

A. Representation involving concurrent conflict of interest. Except in Paragraph B of this rule, a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

- (1) the representation of one client will be directly adverse to another client; or
- (2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client, or a third person or by a personal interest of the lawyer.

Requestor does not indicate that he obtained informed, written consent from either the insured client or the insurer in this matter. Therefore, the Committee does not believe that any exception available in Rule 107B applies. See Rule 16-107B(4), NMRA.

<sup>9</sup>See Rule 16-107A (2), NMRA.

<sup>10</sup>The rule provides, in pertinent part:

A. Necessary witness. A lawyer shall not act as advocate at a trial in which the lawyer is likely to be a necessary witness unless:

- (1) the testimony relates to an uncontested issue;
- (2) the testimony relates to the nature and value of legal services rendered in the case; or
- (3) the disqualification of the lawyer would work substantial hardship on the client.

See Rule 16-307A, NMRA.

<sup>11</sup>See Windt, *supra* at § 4:19 p.4-169. One court noted that the insurer does not have the duty to provide counsel to the insured who would not only defend against the liability claim, but also assert claims by the insured against the insurer. See *id.*, citing *Ramsey v. Lee Builders, Inc.* 32 Kan App.2d 1147, 95 P.3d 1033, 1040 (2004).