

Conflict of Interest Considerations



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Never overlook the possibility of a conflict of interest. And avert the problem as soon as you see it on the horizon.

EVERY YEAR, dozens of attorneys all over the country find themselves on the receiving end of disciplinary complaints because they either didn't recognize a conflict of interest or, even worse, ignored one. There is no question that the practice of law is fraught with potential conflicts of interest. It is imperative that all counsel carefully review the facts and circumstances of each representation and determine if a conflict of interest exists and, if so, determine the appropriate response to the conflict.

KNOW THE RULES • Before counsel can determine whether a conflict exists, he or she must first know the rules applicable to conflicts of interest. All states have enacted rules of professional conduct. Most are based on the ABA Model Rules. Counsel would be well served to read the model rules and, from time to time, review them. Among the rules counsel should be familiar with are the following:

**ABA Model Rule 1.7 – Conflict of Interest:
Current Clients**

(peppers) Except as provided in paragraph (b), 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.

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

- (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
- (2) the representation is not prohibited by law;
- (3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
- (4) each affected client gives informed consent, confirmed in writing.

**ABA Model Rule 1.8 – Conflict of Interest:
Current Clients-Specific Rules**

(a) A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:

- (1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;

(2) the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel on the transaction; and

(3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.

(b) A lawyer shall not use information relating to representation of a client to the disadvantage of the client unless the client gives informed consent, except as permitted or required by these Rules.

(c) A lawyer shall not solicit any substantial gift from a client, including a testamentary gift, or prepare on behalf of a client an instrument giving the lawyer or a person related to the lawyer any substantial gift unless the lawyer or other recipient of the gift is related to the client. For purposes of this paragraph, related persons include a spouse, child, grandchild, parent, grandparent or other relative or individual with whom the lawyer or the client maintains a close, familial relationship.

(d) Prior to the conclusion of representation of a client, a lawyer shall not make or negotiate an agreement giving the lawyer literary or media rights to a portrayal or account based in substantial part on information relating to the representation.

(e) A lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation, except that:

- (1) a lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter; and
- (2) a lawyer representing an indigent client may pay court costs and expenses of litigation on behalf of the client.

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

- (1) the client gives informed consent;
- (2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and
- (3) information relating to representation of a client is protected as required by Rule 1.6.

(g) A lawyer who represents two or more clients shall not participate in making an aggregate settlement of the claims of or against the clients, or in a criminal case an aggregated agreement as to guilty or nolo contendere pleas, unless each client gives informed consent, in a writing signed by the client. The lawyer's disclosure shall include the existence and nature of all the claims or pleas involved and of the participation of each person in the settlement.

(h) A lawyer shall not:

- (1) make an agreement prospectively limiting the lawyer's liability to a client for malpractice unless the client is independently represented in making the agreement; or
- (2) settle a claim or potential claim for such liability with an unrepresented client or former client unless that person is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel in connection therewith.

(i) A lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client, except that the lawyer may:

- (1) acquire a lien authorized by law to secure the lawyer's fee or expenses; and
- (2) contract with a client for a reasonable contingent fee in a civil case.

(j) A lawyer shall not have sexual relations with a client unless a consensual sexual relationship existed between them when the client-lawyer relationship commenced.

(k) While lawyers are associated in a firm, a prohibition in the foregoing paragraphs (a) through (i) that applies to any one of them shall apply to all of them.

ABA Model Rule 1.9 – Duties to Former Clients

(a) A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent, confirmed in writing.

(b) A lawyer shall not knowingly represent a person in the same or a substantially related matter in which a firm with which the lawyer formerly was associated had previously represented a client

- (1) whose interests are materially adverse to that person; and
- (2) about whom the lawyer had acquired information protected by Rules 1.6 and 1.9(c) that is material to the matter; unless the former client gives informed consent, confirmed in writing.

(c) A lawyer who has formerly represented a client in a matter or whose present or former firm has formerly represented a client in a matter shall not thereafter:

- (1) use information relating to the representation to the disadvantage of the former client except as these Rules would permit or require with respect to a client, or when the information has become generally known; or

(2) reveal information relating to the representation except as these Rules would permit or require with respect to a client.

ABA Model Rule 1.10 – Imputation of Conflicts of Interest

(a) While lawyers are associated in a firm, none of them shall knowingly represent a client when any one of them practicing alone would be prohibited from doing so by Rules 1.7 or 1.9, unless

(1) the prohibition is based on a personal interest of the disqualified lawyer and does not present a significant risk of materially limiting the representation of the client by the remaining lawyers in the firm; or

(2) the prohibition is based upon Rule 1.9(a) or (b) and arises out of the disqualified lawyer's association with a prior firm, and

(i) the disqualified lawyer is timely screened from any participation in the matter and is apportioned no part of the fee therefrom;

(ii) written notice is promptly given to any affected former client to enable the former client to ascertain compliance with the provisions of this Rule, which shall include a description of the screening procedures employed; a statement of the firm's and of the screened lawyer's compliance with these Rules; a statement that review may be available before a tribunal; and an agreement by the firm to respond promptly to any written inquiries or objections by the former client about the screening procedures; and

(iii) certifications of compliance with these Rules and with the screening procedures are provided to the former client by the screened lawyer and by a partner of the firm, at reasonable intervals upon the former client's written request and upon termination of the screening procedures.

(b) When a lawyer has terminated an association with a firm, the firm is not prohibited from thereafter representing a person with interests materially

adverse to those of a client represented by the formerly associated lawyer and not currently represented by the firm, unless:

(1) the matter is the same or substantially related to that in which the formerly associated lawyer represented the client; and

(2) any lawyer remaining in the firm has information protected by Rules 1.6 and 1.9(c) that is material to the matter.

(c) A disqualification prescribed by this rule may be waived by the affected client under the conditions stated in Rule 1.7.

Counsel should also make use of resources provided by the local bar when analyzing potential conflicts of interest. If a question arises, consult the Attorney Registration & Discipline website. Review state bar ethics opinions. Read the applicable case law. Perhaps most importantly, counsel must take the time to actually think about the issues. Review the facts of the case, apply the facts to the law regarding conflicts and determine whether a conflict exists.

SPECIFIC EXAMPLES • Although every case is different, and the possibilities for conflicts are infinite, there are certain specific fact patterns that should always raise the red flag of conflicts. Each of these will be addressed in turn.

Complaint Alleges Both Negligence & Intentional Acts

Say, for example, that the plaintiff is involved in an altercation with an armed security guard in a retail establishment. The plaintiff is subsequently shot in the altercation. The plaintiff then files a complaint alleging that the security guard was negligent in his use and discharge of his firearm. The plaintiff also alleges that the security guard intentionally shot the plaintiff during the fracas. This type of complaint gives rise to a classic conflict of interest scenario.

In this circumstance, the insurer for the store will most likely defend the security guard under a reservation of rights, noting that the negligence count would be covered by insurance and the intentional count would not be covered. In this circumstance, there is a conflict of interest between the interests of the insured and the interests of the insurer. The insured would like to have any verdict be predicated on the allegations of negligence—and hence be covered by insurance. The insurer would like to have any verdict be predicated on the security guard's intentional conduct—and thereby be outside the bounds of coverage. When a conflict such as this exists, counsel is required to notify the insured of the conflict and the insured is entitled to select defense counsel of its choice at the insurer's expense. *See, e.g., Brohawn v. Transamerica Ins. Co.*, 347 A.2d 842 (Md. 1975) (policyholder entitled to independent counsel where underlying complaint alleged both negligence and intentional tort); *Maryland Casualty Co. v. Peppers*, 64 Ill.2d 187, 355 N.E.2d 24 (1976); *San Diego Navy Fed. Credit Union v. Cumis Ins. Society, Inc.*, 162 Cal.App.3d 358 (Cal. Ct. App. 1984); *Patrons Mutual Ins. Assoc. v. Harmon*, 732 P.2d 741 (Kan. 1987).

Complaint Alleges Negligent Acts Occurring Both During and Outside the Policy Period

Perhaps an elderly plaintiff is involved in two separate slip and fall incidents at the same store. The first incident occurred when the store was insured; the second incident occurred after the store's policy of insurance had lapsed. A conflict arises in this situation because the insurer may be inclined to push the case toward the uncovered event. *Illinois Masonic Med. Ctr. v. Turegum Ins.*, 168 Ill.App.3d 158, 522 N.E.2d 611 (1st Dist. 1988) (policyholder is entitled to independent counsel where the underlying complaint alleged negligent treatment during one or more of three hospitalizations, one during the policy period and two after the policy's expiration).

Complaint Seeks Both Compensatory and Punitive Damages

Assume, for a moment, that a plaintiff is detained in a store for shoplifting. The plaintiff files a complaint against the store in question alleging false imprisonment and sets forth claims for severe emotional distress. The plaintiff's complaint seeks \$10,000 in compensatory damages and \$1,000,000 in punitive damages. There is no insurance for the punitive damages sought in plaintiff's complaint. Because the insured rather than the insurer is at risk for punitive damages, the two have "differing levels of motivation in defending a suit that requests large punitive damages." *Utica Mutual Ins. Co. v. David Agency Ins., Inc.*, 327 F.Supp.2d 922, 929 (N.D. Ill. 2004).

There is a difference of opinion on whether a conflict exists where punitive damages have been claimed. The courts in some states have held that a conflict of interest arises when an insurer offers to defend its insured while disclaiming coverage for punitive damages. *See, e.g., Nandorf v. CNA Insurance Cos.*, 479 N.E.2d 988 (1st Dist. 1985) (a conflict exists, and the policyholder is entitled to independent counsel where the complaint sought minimal compensatory damages for which coverage was acknowledged, but substantial punitive damages for which coverage was disputed); *Illinois Municipal League Risk Mgmt. Assoc. v. Seibert*, 223 Ill.App.3d 864 (1992) (where a claim of punitive damages exists in underlying complaint, a conflict of interest arises between the insurer and the insured); *Parker v. Agricultural Ins. Co.*, 109 Misc.2d 678 (N.Y. Sup. Ct. 1981) (conflict exists and retention of independent counsel is necessary where a reservation of rights is filed based on a punitive damages exclusion and the presence of actual evidence or a severe financial exposure to the insured creates a real disparity of interest). Other states have held that the inclusion of a claim for punitive damages in a complaint does not, in and of itself, give rise to a conflict of interest. *See, e.g., Alaska Stat. §21.96.100(c)*(1996); Cal. Civ.

Code §2860(b) (West 1996); *Pennbank v. St. Paul Fire & Marine Insurance Co.*, 669 F.Supp. 122 (W.D. Pa. 1987)(the inclusion of a punitive damages claim does not automatically create a conflict of interest).

Amount Sought Exceeds the Amount of Coverage

Say, for example, that the president of a highly successful manufacturing company is stopped in a line of traffic waiting to pay a toll. The driver of a semi-tractor and trailer fails to appreciate the fact that the line of cars is stopped and plows into the back of the executive's car. The executive is severely injured in the accident. He files a complaint against the driver and the trucking company. The ad damnum clause of the complaint seeks a judgment in excess of \$5,000,000. The trucking company has insurance coverage of \$2,000,000. Is there a conflict of interest in that circumstance? Many states indicate that, "[n]o conflict of interest shall be deemed to exist...solely because an insured is sued for an amount in excess of the insurance policy limits." *Golden Eagle Ins. Co. v. Foremost Ins. Co.*, 20 Cal.App.4th 1372, 1394, 25 Cal.Rptr.2d 242, 257 (2nd Dist. 1993); *See also*, Cal. Civil Code §2860(b) ("No conflict of interest shall be deemed to exist... solely because an insured is sued for an amount in excess of the insurance policy limits."); *Littlefield v. McGuffey*, 979 F.2d 101, 108 (7th Cir. 1992) ("The possibility of liability exceeding coverage" does not "trigger a conflict of interest...([T]he one is not the conceptual equivalent of the other."). However, counsel should be aware of the Seventh Circuit case of *R.C. Wegman Construction Co. v. Admiral Ins. Co.*, 629 F.3d 724 (7th Cir. 2011). Some have argued that *Wegman* holds that a conflict exists and an insured is entitled to independent counsel to be paid by the insurer whenever there is a "non-trivial probability" of an excess verdict. The authors would argue that the discussion of a conflict and entitlement to independent counsel whenever there

is a "non-trivial probability" of an excess verdict is *dicta* and is not controlling law in Illinois.

Consent After Full Disclosure

It is important to note that an insurance company retained defense attorney may represent an insured even in the presence of a conflict that normally would require independent counsel if the insured consents after "full disclosure." *See, e.g., Maryland Casualty Co. v. Peppers*, 64 Ill.2d 198, 355 N.E.2d 24 (1976); Cal. Civil Code §2860(a) ("If the provisions of a policy of insurance impose a duty to defend upon an insurer and a conflict of interest arises which creates a duty on the part of the insurer to provide independent counsel to the insured, the insurer shall provide independent counsel to represent the insured unless, at the time the insured is informed that a possible conflict may arise or does exist, the insured expressly waives, in writing, the right to independent counsel...").

If counsel has recognized that a conflict exists, and ascertains that it would be acceptable (and prudent) to seek to have the insured waive the conflict, counsel must obtain the insured's consent after full disclosure. Full disclosure must include an explanation of:

- The attorney's relationship to the insurer;
- The attorney's own interests;
- The nature of the conflict between the insurer and the insured and how the defenses may impact the coverage;
- Limitation of the scope of representation to defending the third-party claim only, thus limiting the ability to maximize coverage;
- The insured's option to retain separate counsel to advise about coverage issues; and
- The insured's right to independent counsel to defend, whose fees will be reimbursed by the insurance company.

CLIENT CONSIDERATIONS • Most lawyers find themselves in the unenviable position of always

trying to bring in the next big case or the next big client or the next big line of business. While it is laudable to be focused on the bottom line, it is also important to be focused on the potential for conflicts—especially when dealing with clients.

Antagonistic Insureds

Counsel must be particularly wary of conflicts when representing two or more insureds who could be antagonistic toward each other. Suppose, for example, that a plaintiff is injured when a store manager runs into her in the parking lot. The plaintiff files suit against the manager and the store for the injuries she suffered in the accident. She seeks to hold the store liable under a theory of respondeat superior. Defense counsel is hired to represent both the manager and the store. During the course of investigating the claim, counsel finds out that the manager is no longer employed by the store. The store wants to argue that the former manager was acting outside the scope of his employment at the time of the accident. In that situation a conflict exists and independent counsel must be retained for one of the defendants. *Williams v. American Country Ins. Co.*, 359 Ill.App.3d 128, 833 N.E.2d 971 (1st Dist. 2005).

Two or More Insureds Have Adverse Interests

A young man is driving an automobile owned by his father. He is out for a joyride with one of his friends. The vehicle is involved in a serious, single-car accident. The passenger in the vehicle brings suit against his friend, the driver, and his friend's father, the owner of the car. According to some courts, the driver's interests conflict with the owner's interests. It is in the driver's best interest to be viewed as an agent of the owner; the owner's interest, however, would be best served by arguing that the driver had not been given permission to drive the vehicle. In that case, a conflict exists and separate outside counsel must be paid for by the

insurer. *Murphy v. Urso*, 88 Ill.2d 444, 430 N.E.2d 1079 (1981).

Representation of Opposing Parties

This issue is particularly troublesome in firms with a large number of lawyers. Say, for example, that Attorney Smith represents the plaintiff in a premises liability case against Acme Grocery Store. His partner, Attorney Jones, is contacted by Acme's insurer to represent Acme in the suit. Attorney Jones cannot take the case. The firm cannot represent the plaintiff and the defendant in the same case.

Here is a real life scenario. A law firm in Massachusetts maintained a website that contained a link that allowed visitors to send e-mails directly to lawyers in the firm. The site did not contain any type of warning or disclaimer regarding the confidentiality (or lack thereof) of information sent to lawyers at the firm. A company, ABC Corporation, sent an e-mail to one of the firm's attorneys regarding a possible legal action against XYZ Corporation. The problem? The firm already represented XYZ Corporation. According to the Massachusetts Bar Association Committee on Professional Ethics, a conflict existed in this situation. According to the committee, because the firm failed to provide the necessary disclaimers, the lawyer who received the e-mail from ABC Corporation was required to maintain the confidentiality of the information provided by the company. In addition, the committee opined that the firm could not continue to represent XYZ Corporation if protecting ABC Corporation's confidential information would materially limit its ability to represent XYZ Corporation. Massachusetts Bar Association Committee on Professional Ethics Opinion 07-01 (May 23, 2007).

Reservation of Rights Letters

Conflict of interest questions frequently arise in situations where the insurer has a duty to defend the policyholder but disclaims (either in whole or in

part) a duty to indemnify the insured on the basis of one or more coverage defenses. Where the duty to defend exists, but the company seeks to limit or avoid indemnifying the insured for the loss, the insurance company will typically issue a reservation of rights letter. For example, say a concert venue takes out a multi-million dollar policy to cover events at its venue. A patron is injured at a concert and files suit. The venue, despite receiving a copy of the complaint, waits several months to tell its insurer of the potential loss. The insurer, once it receives notice of the suit, sends the insured concert venue a reservation of rights letter. The insurer claims it is reserving its rights to defend and indemnify because the insured failed to satisfy a condition precedent to coverage (providing timely notice of the suit). Does the issuance of the reservation of rights letter create a conflict entitling the insured to counsel of its own choosing?

The answer depends on the state where the suit is pending. Some states have adopted a fact-dependent test to determine whether independent counsel is necessary when a reservation of rights letter is issued. In these states, the determination of whether a conflict exists, and whether independent counsel is necessary, is based on: (i) whether the insurer would be able to direct the insured's defense in a manner adverse to the insured on the disputed coverage issue; and/or (ii) which party, the insurer or the insured, bears the greater financial stake in the underlying litigation. *See, e.g.*, Cal. Civil Code §2860(b) (a policyholder may have the right to independent counsel when the "insurer reserves its rights on a given issue and the outcome of that coverage issue can be controlled by counsel first retained by the insurer for the defense of the claim."); *Illinois Masonic Medical Center v. Turegum Inc. Co.*, 168 Ill.App.3d 158, 425 N.E.2d 810 (1st Dist. 1988); *Public Service Mutual Ins. Co. v. Goldfarb*, 425 N.E.2d 810 (N.Y. 1981); *St. Paul Fire & Marine Ins. Co. v. Roach Brothers Co.*, 639 F.Supp. 134 (E.D. Pa. 1986). Other states have appeared to adopt a *per se*

rule that the policyholder is entitled to independent counsel whenever an insurer issues a Reservation of Rights letter. *See, e.g.*, *L&S Roofing Supply Co., Inc. v. St. Paul Fire & Marine Ins. Co.*, 521 So.2d 1298 (Ala. 1987); *United Services Auto. Assoc. v. Morris*, 741 P.2d 246, 252 (Ariz. 1987)("[t]he insurer's reservation of the privilege to deny the duty to pay relinquishes to the insured control of the litigation."); Florida St. Ann. §627.426(1)(b) (West 1996)(absent a non-waiver agreement, when the insurer reserves rights, the insured is entitled to "mutually acceptable" independent counsel); *Medical Protective Co. v. Davis*, 581 S.W.2d 25 (Ky. App. 1979); *State Farm Mut. Auto Ins. Co. v. Ballmer*, 899 S.W.2d 523 (Mo. 1995).

SETTLEMENT • Counsel must always be wary of conflicts that may arise in the context of settlement negotiations.

Plaintiff's Demand Exceeds Policy Limits

Assume, for the sake of illustration, that a driver is involved in an accident with a pedestrian. The pedestrian is severely injured in the accident and has medical bills in excess of \$300,000 and a lost wage claim in excess of \$100,000. The insured has a \$500,000 policy of insurance. The plaintiff pedestrian offers to settle her claims for \$600,000. Some courts have recognized that a conflict exists between the insurer and the insured if the insured is willing and able to pay the amount in excess of the policy limits in order to settle the case. *See, e.g.*, *Merritt v. Reserve Ins. Co.*, 34 Cal.App.3d 858 (1973).

Plaintiff Offers To Settle Within Policy Limits and Insurer Does Not Want To Settle

Perhaps the most common conflict in the settlement arena arises when the plaintiff has indicated that he or she will settle for an amount at or below the policy limits and the insurer is not inclined to settle (in most cases because the insurer believes that it has a strong liability and/or damages

defense). The insured would like the insurer to settle at or within policy limits since such a settlement would obviate the possibility of a verdict in excess of the policy limits (an excess verdict that the insured would be responsible for, absent a finding of bad faith on the part of the insurance company).

It is well-settled law that an insurer is required to give “equal consideration” to the interests of the insured when evaluating settlements. *Comunale v. Traders & General Ins. Co.*, 50 Cal.2d 654, 328 P.2d 198 (Cal. 1958); *American Home Assurance Co. v. Hermann’s Warehouse Corp.*, 117 N.J. 1, 563 A.2d 444 (N.J. 1989); *Eastham v. Oregon Automobile Ins. Co.*, 273 Or. 600, 540 P.2d 364 (Or. 1975). That means that an insurer must diligently analyze the strengths and weaknesses of the underlying claim, notify the policyholder of any settlement demands and follow

the reasonable advice of retained defense counsel to settle claims. *See, e.g., Commercial Union Ins. Co. v. Liberty Mutual Ins. Co.*, 426 Mich. 127, 393 N.W.2d 161 (Mich. 1986). Failure to do so may result in a finding of bad faith.

CONCLUSION • Most attorneys (most people for that matter) are creatures of habit. We like to do the same things in the same way, day in and day out. That tendency can be a recipe for disaster when it comes to conflict analysis. Counsel must break out of the rut of complacency and analyze his or her cases with a fresh approach and a new perspective—one which looks beyond the simple and the ordinary and analyzes cases with an eye toward recognizing, identifying, and dealing with potential—or very real—conflicts of interest.

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