2020

Advanced insurance law

Indiana Continuing Legal Education Forum (ICLEF)

Advanced Insurance Law
September 17-18, 2020
Index

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ADVANCED INSURANCE LAW

September 17-18, 2020

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ADVANCED INSURANCE LAW

Agenda

September 17, 2020

1:30 P.M. **Program Registration and Refreshments – outside of EB Rhodes Room, lower level of WB**
- *John C. Trimble*, Program Chair

2:00 P.M. Appraisal of First Party Property Claims
- *Meghan E. Ruesch & Michael L. Schultz,* Discussion Leaders
  - Assignment of Claims and Assignee Rights / Duties
  - Rights and Obligations of Contractors
  - The Appraisal Process
  - When is Someone an "Impartial" Appraiser?
  - Duties Owed by all Parties in Appraisal
  - Ethical Considerations

3:30 P.M. **Refreshment Break**

3:45 P.M. Discussion of First Party Property Continues…

5:15 P.M. **Adjourn Day One**

5:30 P.M. Hosted Reception – Caddy Sinclair Room - located near WB Hotel Desk in Lobby

6:30 P.M. **Free Time**

September 18, 2020

8:00 A.M. **Continental Breakfast Items and Coffee Available – EB Rhodes Room, lower level of WB**

8:30 A.M. Clear Liability Excess Exposure Cases
- *Jerry E. Huelat and Anna Mallon*, Discussion Leaders
  - Time Limited Demands
  - Excess Exposure and Assignment of Claims
  - Obligations of Defense Counsel
  - Obligations of the Carrier
  - How to Handle Cases with Multiple Claimants with Inadequate Limits Where Liability is Clear
  - The Tripartite Relationship – Who is the Client? (Ethical Considerations)
  - Interpleader Issues

10:00 A.M. **Coffee Break**

10:15 A.M. Discussion of Clear Liability Continues…

11:45 A.M. **Adjourn**

September 17-18, 2020

ADVANCED INSURANCE LAW

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John maintains a practice that is dominated by catastrophic, complex, and class action litigation in the State and Federal Courts. He focuses much of his time on insurance coverage disputes, bad faith defense, lawyer and insurance agent malpractice, business litigation, and catastrophic damages caused by all types of casualty risks, including transportation, construction, product liability, fires, and governmental liability, to name a few. He has also argued numerous appeals in the State and Federal appellate courts as counsel for a party and as amicus counsel for lawyer and trade associations. Through the years, he has been admitted pro hac vice in more than 30 jurisdictions, and is frequently hired by out-of-state firms to serve as local counsel in Indiana.

For nearly 30 years, John has earned a reputation as one of Indiana's most sought after mediators. Because of the complexity of his litigation practice, John keeps the mediation to a manageable level, but he is frequently hired by judges and lawyers to mediate some of Indiana's largest and highest profile cases. He is also frequently named as an arbitrator in bodily injury, business dissolution, employment, and commercial disputes.

John has distinguished himself as a bar leader. He has been president of the state defense bar, and is a past Defense Lawyer of the Year honoree. He has also served on the Board of Directors of DRI, the largest national association of defense lawyers. In 2000, DRI named John its outstanding defense bar leader of the year. More recently, John has chaired DRI's national Judicial Task Force to explore and offer recommendations on how DRI can assist in maintaining a fair and impartial judiciary. John is a Past President of the Indianapolis Bar Association; President-Elect of the Indianapolis Legal Aid Society; and a past Chair of the Board of Visitors of Indiana University Robert H. McKinney School of Law. He is also President of the Texas based Association of Attorney Mediators.

John has been repeatedly listed in state and local polls of attorneys as one of the top lawyers. Since 2004, he has been selected for inclusion in *Indiana Super Lawyers*® and ranked number one overall in Indiana from 2011-2019. He was also selected by his peers for inclusion in *The Best Lawyers in America*® in the fields of Insurance Law; Mediation; and Personal Injury Litigation - Defendants. He was named Best Lawyers' 2013 Indianapolis Insurance Law - Lawyer of the Year, Best Lawyers' 2015 Indianapolis Personal Injury Litigation – Defendants - Lawyer of the Year and Lawyer of the Year, Best Lawyers' 2019 Indianapolis Person Injury Litigation - Defendants, Best Lawyers' 2020 Indianapolis Mediation - Lawyer of the Year.

Jerry E. Huelat - Mr. Huelat is a partner in the LaPorte firm of Huelat & Mack, P.C., and has over 35 years of litigation experience, including substantial trial experience with arson, fraud, products liability, construction, wrongful death, premises liability, municipal liability, Title VII claims, bad faith, and complex litigation. He was admitted to the Indiana bar in 1981, and was admitted to practice before the United States Supreme Court, the United States Court of Appeals, the Seventh Circuit, and the United States District Courts for the Northern and Southern Districts of Indiana. He graduated from Pennsylvania State University in 1977, and he obtained his J.D. from Northern Illinois University in 1981. He is a Member of the LaPorte County and Indiana State Bar Associations, and the Defense Research Institute. He was previously a member of the Indiana State Bar Association's Legal Ethics Committee. In 2013, he served as President for the Defense Trial Counsel of Indiana (DTCI). He is an author of many articles, and is a regular lecturer at insurance defense seminars. He received the 2016 DTCI Diplomat Award, and has been named an Indiana Super Lawyer for the last six years.

Anna Mallon
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Anna Mallon concentrates her practice in the areas of insurance bad faith, insurance coverage, third–party defense of insureds, and personal injury defense. Anna regularly practices in state and federal courts handling trials, summary judgment hearings, mediations and arbitrations. Prior to attending law school, Anna taught high school government.

When not practicing law, Anna enjoys traveling, ballet, and cheering on the Fighting Irish of Notre Dame and the Chicago Cubs. Anna is married and has two children.

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Robert J. Penney - Mr. Penney has over 16 years of litigation experience. He was admitted to the Indiana bar in 2001, the Ohio bar in 2003 (inactive), and the Illinois bar in 2012. He was also admitted to practice in the United States District Courts for the Northern and Southern Districts of Indiana. A Phi Beta Kappa graduate of the University of Illinois, he obtained his M.A. from UCLA in Political Science in 1997 and his J.D. from Indiana University-Bloomington in 2001.

Meghan E. Ruesch
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As a member of the Lewis Wagner's litigation group, Meghan primarily focuses on insurance coverage, reinsurance issues and bad faith issues. She also represents insurance companies, businesses, and individuals in all aspects of complex civil litigation involving business and contract disputes, catastrophic injuries, cybersecurity and data management, and general litigation matters involving transportation, construction, premises liability, and professional liability.

Prior to joining Lewis Wagner, Meghan was an associate in the New York firm Traub Lieberman Straus & Shrewsberry's insurance coverage group, where she represented insurance company clients in insurance coverage litigation, and advised insurers on exposure and liability issues in wide array of tort and commercial contexts, including mass tort and class action litigation involving pharmaceuticals, chemical, transportation, news and entertainment, and oil and gas; environmental suits; FDA compliance claims; unfair competition and false advertising claims; intellectual property claims; construction defect; personal injury; product liability; and associated breach of contract claims.

Meghan has also represented clients in wide array of civil lawsuits concerning construction accidents, labor and employment laws and regulations, professional liability and malpractice claims, constitutional claims, embezzlement, fraud, and best banking practices and standards. She frequently advises insurance company clients on issues of regulatory compliance and assisted in the drafting of insurance policies and associated endorsements to confirm with state, national, and international law.

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Mike Schultz concentrates his practice on representing commercial and residential policyholders in high risk, high value disputes over insurance claims and claim handling. He frequently litigates large property damage cases involving claims of breach of the insurance agreements and bad faith by insurance companies, as well as claims against third parties for personal injuries and property damage. Mike also has litigated extensively in the areas of employment law, civil rights, toxic torts, unincorporated associations, and general contract disputes. He routinely handles employment related disputes, representing both businesses and employees. Mike is also experienced representing the firm's electric generation and transmission and rural distribution cooperatives and serves as general counsel for the largest rural electric cooperative in the state. Mike lectures frequently on insurance litigation matters and federal employment law compliance. He represents clients in both state and federal appeals and has presented oral arguments before the Seventh Circuit Court of Appeals, the Indiana Supreme Court and the Indiana Court of Appeals.

Mike is admitted to practice before the United States Supreme Court, the United States Court of Appeals for the Seventh Circuit, all federal district courts in Indiana, the Indiana Supreme Court and in all Indiana state courts. He has extensive trial experience, including civil jury trials and bench trials in insurance, employment, civil rights, property damage and business matters.

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Robert J. Penney

Section One

Appraisal of First Party Property Claims

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Section One

Appraisal of First Party Property Claims…….. Meghan E. Ruesch
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A Brief Overview of the Analysis of "Impartiality" in Appraisals in Seven States

The Appraisal Process and the Insurer's Dilemma

Assigning Post-Loss Insurance Claims: History, State-of-the-Law, and Predictions for the Future

Mike Schultz, Parr Richey Frandsen Patterson Kruse LLP[1]

I. Introduction

Insurance companies calculate risk carefully. After all, their business has always been taking their best guess on whether the return on a policy will outweigh its long-term costs. For this reason, the common law has long recognized near ubiquitous "non-assignment" provisions as valid and enforceable in insurance contracts. These clauses prohibit assignment of a policy from the original insured to a third party, since such an assignment would expose the insurer to risks it did not calculate when it issued the policy in the first place. However, in an occurrence-based policy, after the coverage triggering occurrence has taken place, the benefits are no longer someone's "best guess," but are "fixed" and generally considered to be a vested property right in the hands of the insured. Accordingly, most jurisdictions in the United States, including Indiana, allow post occurrence (or, more commonly, "post-loss") assignment of insurance benefits. In Indiana, such benefits become a "chose in action" after the coverage triggering occurrence takes place and can be assigned freely to third parties without the insurer's consent, even in the face of any non-assignment clauses in the policy. This article seeks to provide a useful overview of the evolution, current state of the law, and predictions for the future of the assignability of insurance benefits. Part II explores the history of the "chose in action," Part III lays out the state-of-the-law in Indiana and across the nation, and Part IV makes predictions as to where Indiana's common law on the issue is heading next.

II. History

In Indiana, a claim on an insurance policy is assignable as a "chose in action."[2] A "chose in action" is defined as "[t]he right to bring an action to recover a debt, money, or thing."[3] Once someone owns this right, the chose in action may be sold or assigned to a third party.[4] This legal doctrine has deep roots, and some of the oldest surviving petitions from England's chancery courts are from

[1] With the assistance of Alex Pantos, Indiana University Maurer School of Law '21, and Eric Claxton, Indiana University Robert H. McKinney School of Law '21.

[2] *See New v. German Ins. Co.*, 31 N.E. 475, 476 (Ind. Ct. App. 1892) ("after a loss has occurred the policy becomes a chose in action . . . .").

[3] BLACK'S LAW DICTIONARY 304 (11th ed. 2019).

[4] *See generally* Walter Wheeler Cook, *The Alienability of Choses in Action*, 29 HARV. L. REV. 816 (1916).

"assignees seeking to recover in their own names debts which had been assigned to them."[5] However, such assignments were available only to transfer rights in equity, not at law.[6] To work around this limitation, common law attorneys began using the "device of the 'power of attorney' . . . to enable the assignee to obtain relief in common law proceedings by suing in the name of the assignor."[7] Under this theory, the assignee was acting as the agent or attorney of the assignor, and did not acquire any kind of "ownership" over the chose in action.[8]

As the common law developed, the formal requirements of express power of attorney began to erode, and, eventually, when an assignee sued to collect a chose in action in the assignor's name, power of attorney was implied.[9] The rule against the alienability of choses in action continued to give way in England,[10] and, once established, American courts were left to decide how to confront this "growing organism" of half-baked English common law.[11]

An early case, *Andrews v. Beecker*,[12] is illustrative. The case involved a debtor who had notice his claim had been assigned by the creditor to a third party.[13] The defendant acknowledged the debt, but, in his answer, he pled that the original creditor had released him from his debt.[14] However, the release

[5] W.T. Barbour, *The History of Contract in Early English Equity*, 4 OXFORD STUDIES IN SOCIAL AND LEGAL HISTORY 108 (1914).
[6] Cook, *supra* note 2, at 822.
[7] *Id.*
[8] *Id.* at 823 - 824 ("Originally, of course, the theory was that the assignee sued as the agent or attorney of the assignor, although entitled to appropriate the proceeds to his own use . . . . For a time after the legality of the 'power of attorney' came to be recognized it is undoubtedly true that the assignee had no greater rights in a court of law than [equitable rights] . . . ").
[9] *Id.* at 822 ("At first an express power of attorney was required, but later one was implied.").
[10] *Carrington v. Harway*, I Keble 803 (1676) (holding an assignor who had granted power of attorney to an assignee could not unilaterally enter satisfaction of a judgment); *Legh v. Legh*, I Bos. & Pul. 447 (1799) (finding a debtor could not use a release executed by the assignor as a defense because "The Defendant ought either to have paid the person to whom the bond was assigned, or have waited till an action was commenced against him, and then have applied to the Court.")
[11] Cook, *supra* note 2, at 826.
[12] 1 Johns. Cas. 411 (N.Y. 1800).
[13] *Id.*
[14] *Id.*

from the creditor was not executed and delivered until after the debt was assigned.[15] The court held "[a] release after the assignment of the bond and notice to the defendant is a nullity, and ought not to be regarded."[16] One commenter analyzing *Beecker* noted that "it is certainly perplexing [in the context of the English common law rule] to be told that the nominal plaintiff owns the *chose*, and the assignee does not; but that a release by the alleged owner, theoretically the plaintiff, is a legal nullity."[17] Across the country in the years surrounding and following *Beecker*, the seemingly useless legal formalism of assignments and power of attorney (and its attendant confusion), as with many English common law formalities, slowly gave way.[18]

By the time an Indiana court addressed the issue of the alienability of a chose in action, it was apparently clear that American law was no longer in step with the English common law rule prohibiting the assignment of the legal powers attendant to ownership of a chose in action. In *New v. German Ins. Co.*,[19] the Indiana Court of Appeals examined the enforceability of a non-assignment provision in an insurance contract.[20] While the court found the provision enforceable, it stated,

> Insurance policies are contracts of indemnity and are essentially personal in their nature. They relate to the insured rather than the subject-matter of insurance and at common law were non-assignable. There is no statutory provision changing the common law rule, but after a loss has occurred the policy becomes a chose in action and is assignable as other choses in action are. Courts know as a matter of general knowledge that the character of the insured is taken into account as affecting the moral hazard of a risk, and this is an additional reason why a change of indemnitee should not occur without consent of the indemnitor.

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[15] *Id.*
[16] *Id.*
[17] Cook, *supra* note 2, at 827.
[18] *Id.* at 828 ("The New York court seems to have carried to its logical conclusion its doctrine that after notice to the debtor the assignee in a court of law is to be treated as the owner for all puposes, with the one exception that in the title of the action the name of the assignor must be used.")
[19] 31 N.E. 475 (Ind. Ct. App. 1892).
[20] *Id.* at 475-76 ("If the property, or any part thereof, shall be sold, conveyed, encumbered by mortgage or otherwise, or any change takes place in the title, use, occupation or possession thereof whatever; or if foreclosure proceedings shall be commenced; or if the interest of the insured in said property, or any part thereof, now is, or shall become any other than a perfect legal and equitable title and ownership, free from all liens whatever except as stated in writing hereon . . . or if the policy shall be assigned without written consent thereon, then an in every such case this policy shall be absolutely void.")

This passage is notable for three reasons. First, it confirms, albeit in dicta, that the common law by 1892 had progressed to the point of identifying, without question, that a chose in action "is assignable." Second, it sets up the public policy behind non-assignment provision enforceability still in force today – that an insurer should not have to take on risk it did not account for without its consent. Third, it lays the foundation for the following section, namely that a non-assignment provision is only enforceable "pre-loss," and that, as the court stated, "after a loss has occurred the policy becomes a chose in action and is assignable . . . ." The question becomes, then, when exactly does a "loss" open the door to assignability? This question is one courts today are still struggling to answer.

III. Current State-of-the-Law

As outlined in *New*, most states allow assignment of *claims* on insurance policies after the coverage-triggering loss has occurred notwithstanding the existence of a non-assignment clause in the policy.[21] As the Indiana Supreme Court stated in a much more recent case, insured parties are not allowed to assign an entire *policy* to a third party because "[i]nsurance providers have a legitimate business interest in restraining assignment – these provisions protect them from a material increase in risk for which they did not bargain, specifically because of a change in the nature of the insured."[22]

a. Post-Loss Assignability in Indiana

Modern Indiana caselaw generally supports the idea in *New* that an insurance policy is assignable after the coverage triggering loss has occurred.[23] The caselaw on the subject is sparse, at best, but a recent line of cases provides good insight into the state of the law in Indiana.

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[21] *See, e.g.*, *Ohio v. Baird*, 567 F.3d 1207, 1214 (10th Cir. 2009) (anti-assignment clause no longer enforceable after loss); *Colo. Cas. Ins. Co. v. Safety Control Co.*, 230 Ariz. 560, 565-66 (Ariz. Ct. App. 2012); *Glenn v. Fleming*, 247 Kan. 296 (Kan. 1990); *Wehr Constructors Inc. v. Assur. Co. of Am.*, 384 S.W.3d 680, 683 (Ky. 2012); *Egger v. Gulf Ins. Co.*, 903 A.2d 1219, 1229 (Pa. 2006).

[22] *Travelers Cas. & Sur. Co. v. United States Filter Corp.*, 895 N.E.2d 1172, 1178 (Ind. 2008).

[23] *See United States Fid. & Guar. Ins. Co. v. Crawfordsville*, 2017 Ind. App. Unpub. LEXIS 1729 *1, *5-6.

In the early 2000s, a group of industrial corporations sued their respective insurance companies seeking indemnity and defense for products liability claims brought by workers injured from working near silica.[24] On its face this is a fairly straightforward claim, but there was a wrinkle – the workers were exposed to the silica in the 1980s, but their symptoms did not present until nearly two decades later.[25] The industrial corporations had an "extraordinarily complex" corporate history, leading to what became the central question in these cases: when the companies were sold, merged, and acquired, were the non-assignment provisions in the insurance contracts enforceable?[26]

The industrial corporations argued that when the workers were exposed, the coverage-triggering event had occurred, rendering any non-assignment provisions in the insurance policies unenforceable.[27] Accordingly, when the companies were reconfigured over the two decades since the exposure, the claims for indemnity and defense were assigned to each respective corporate predecessor.[28] At both the trial court and the court of appeals, this argument succeeded for one plaintiff – U.S. Filter Corporation.[29]

The Indiana Supreme Court disagreed. The *U.S. Filter* court stated the question as "whether such occurred but not yet reported losses can form the basis of choses in action that [plaintiffs] say transferred to them through the [original industrial corporation's] predecessors-in-interest."[30] This differed, the court reasoned, from cases where the loss was fixed and realized when the claim accrued.[31] Emphasizing the potential risk to insurers, the court proffered a new rule: "At a minimum, for an insured loss to generate an assignable coverage benefit, the loss must be identifiable with some

[24] *U.S. Filter*, *supra* note 21 at 1174-75.
[25] *Cont'l Ins. Co. v. Wheelabrator Techs., Inc.*, 960 N.E.2d 157, 159-60 (Ind. Ct. App. 2011).
[26] *See generally id.*
[27] *Id.* at 160.
[28] *Id.*
[29] *U.S. Filter*, *supra* note 21, at 1176.
[30] *Id.* at 1179.
[31] *Id.*

precision. It must be fixed, not speculative. . . . At a minimum, the losses must have been reported to give rise to a chose in action."[32]

A few years later, two of the other plaintiffs in *U.S. Filter* whose claims did not make the summary judgment cut at the trial court, Wheelabrator Technologies, Inc. and Waste Management Holdings, Inc. (collectively "Waste"), obtained a purported assignment of the original 1980s insurance policy from the original insured.[33] On resuming the stayed proceeding (pending the outcome of *U.S. Filter*), Waste argued that even if the losses were not "fixed" and were still "speculative" before they received the purported assignment, they were unquestionably fixed and certain now.[34]

The court of appeals did not take the bait. After citing the supreme court's decision in *U.S. Filter*, the court reasoned that, since the original insured was not liable for the injuries at issue, the chose in action was not theirs to assign.[35] The court described the later attempt at assignment as a "nonsensical attempt to travel back in time"[36] and soundly foreclosed any chance Waste had at circumventing the supreme court's decision in *U.S. Filter*.

While these cases present an extreme example of attempted assignment, they do provide a good overview of Indiana law. At bottom, a post-loss assignment is allowed even in the face of a non-assignment provision. However, as the court stated in *U.S. Filter*, that loss must be identifiable, fixed, and reportable for the chose in action to arise. Stated differently, benefits in Indiana are still considered contingent if the losses are not immediately, readily identifiable. As soon as the losses are identified and reported, however, the policy converts to a chose in action that is freely assignable. While the *U.S. Filter*

[32] *Id.* at 1180.
[33] *Wheelabrator*, *supra* note 24, at 161.
[34] *Id.* at 161.
[35] *Id.* at 164 ("[B]ecause Honeywell was no longer liable for the losses at issue on the date the 2009 Agreements were executed, it had no insurance rights to transfer by way of that transaction.")
[36] *Id.* at 165.

and *Wheelabrator* plaintiffs were left without recovery, the language in these cases still leaves the door open for other cases to land on the other side of the grey area.

For example, imagine a hypothetical. A homeowner with an occurrence-based homeowner's policy suffers a fire, causing a complete loss of the home. The homeowner files a claim, and the insurance company pays the Actual Cash Value (ACV) but informs the insured that they will not receive the depreciation holdback until after all repairs are made. The homeowner cannot afford the repairs, so they assign the insurance claim to a contractor who agrees to do the work. In this situation, can the insured assign the depreciation holdback, or is that claim still too speculative, since the repairs are not complete?

Section IV outlines where this line of cases might lead next, but first, let's look at how other states around the county handle these kinds of threshold questions.

b. Post-Loss Assignments Nationally

As noted above, the majority of states allow post-loss assignment of benefits notwithstanding a non-assignment provision. However, as with *U.S. Filter* and its progeny, the grey areas are more complicated and divisive. This section presents a brief overview of where states around the country have landed on the issue.

The court in *U.S. Filter* relied heavily on a California decision, *Henkel Corp. v. Hartford Accident & Indemnity Co*.[37] *Henkel* presented facts surprisingly similar to *U.S. Filter* – products liability claims by workers exposed to asbestos with symptoms arising many years after exposure.[38] The *Henkel* court came down the same way as *U.S. Filter* – namely, that the anti-assignment provision was valid and enforceable in the face injuries that were not determinable when the purported assignments took place.[39] However, in a more recent decision, the California supreme court changed its tune. In *Fluor*

[37] 62 P.3d 69 (Cal. 2003).
[38] *U.S. Filter*, *supra* note 21 at 1179-80.
[39] *Henkel*, *supra* note 36, at 75.

Corp. v. Superior Court,[40] the California supreme court was again faced with companies seeking defense and indemnity based on assignments of policies through corporate mergers following latent injury claims.[41] The court determined, based on antagonistic out-of-state precedent and California's statutory law, that the assignments were valid "even though the dollar amount of the loss remains unknown or undetermined until established later by a judgment or approved settlement."[42]

Notably, the court in *Fluor* pointed to *U.S. Filter* as "[the] only [] out-of-state exception to this line of authority" and noted "that [the Indiana] decision has not been followed by any other jurisdiction."[43] In this particular context, the *Fluor* court is correct – there are plentiful cases holding that exact losses need not be determined for an assignment to be considered "post-loss."[44]

The Supreme Court of Iowa's decision in *Conrad Brothers v. John Deere Ins. Co.*[45] provides another example of contingent post-loss assignments being upheld. In *Conrad*, the court was tasked with deciding whether "the rights of an insured to the replacement costs of damaged property covered under a casualty insurance policy were properly assigned by the insured to a mortgagee, and whether an assignee is required to make the repairs or replace the property before the insurer is obligated to pay replacement costs."[46] The court answered the former question in the affirmative and the latter in the negative, reasoning that the assignee stepped into the assignor's shoes,[47] and, as such, the assignee "possessed an absolute right to receive insurance proceeds up to the amount necessary to satisfy the outstanding debt."[48]

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[40] 354 P.3d 302.
[41] *See id.* at 305-06.
[42] *Id.* at 334.
[43] *Id.* at 327.
[44] *See, e.g.*, *Egger v. Gulf Ins. Co.*, 903 A.2d 1219, 1226-28 (Pa. 2006); *Pilkington North America, Inc. v. Travelers Casualty & Surety Co.*, 861 N.E.2d 121, 126, 129 (Ohio 2006); *In re Ambassador Ins. Co.*, 965 A.2d 486, 490-91 (Vt. 2008); *Viking Pump, Inc. v. Century Indemnity Co.*, 2 A.3d 76, 106 (Del. Ch. 2009).
[45] 640 N.W.2d 231.
[46] *Id.* at 233-34.
[47] *Id.* at 238.
[48] *Id.* at 239. *See also Antal's Restaurant v. Lubermen Mut. Cas. Co.*, 680 A.2d 1386 (D.C. App. 1996).

However, this leniency in defining "post-loss" does not hold in all jurisdictions. For example, in *Bronx Entertainment, LLC v. St. Paul's Mercury Insurance Co.*,[49] the New York court held that business interruption claims were not assignable when an entity purchased destroyed property seventeen days after the loss, reasoning:

> [P]laintiff is seeking to collect business interruption damages arising out of a business which did not come into existence until 17 days after the wind damage, and after . . . the named insured . . . had ceased to operate the business covered . . . . Therefore, plaintiff cannot assert a claim for losses it suffered.[50]

Similarly, in *Sherard v. Safeco Ins. Co.*,[51] an unpublished decision from Washington, the court determined that a cost holdback on a property insurance policy was not assignable until after repairs, upon which the payment was contingent, were completed.[52]

As is clear from these decisions, the law across the country is not consistent, and varies according to the specific facts and circumstances each case presents. However, the weight of authority seems to side with the *Fluor* and *Conrad* courts – that post-loss assignment is a broader concept than that conceived by Indiana's supreme court in *U.S. Filter*.

IV. What's to Come – Predictions Based on Indiana Precedent

Returning to our hypothetical from Section III(a), and with the perspective on the nation's approach to such claims outlined in Section III(b), the question is: how would an Indiana court likely decide this case?

On one hand, *U.S. Filter* appears to set a high bar. Any claims that are not fixed are not considered "post-loss" and thus cannot be assigned. The insurers would likely argue that such contingent benefits are definitively not fixed, since the required repairs have not been completed and

[49] 265 F. Supp. 2d 359, 361 (S.D.N.Y. 2003).
[50] *Id.* at 361-62.
[51] 2015 WL 5918397 (W.D. Wash.)
[52] *Id.*

the final monetary value of the depreciation holdback is not calculated. This argument would find additional support from *Wheelabrator*.

The insured, on the other hand, would likely argue, as did the insureds in *Fluor* and *Conrad*, that the "fixing" of the claim at an exact monetary value is not the point at which the claim is assignable – all that is required is that the loss has already occurred. While clearly persuasive nationally, as outlined by the *Fluor* court, this argument is not well supported by Indiana precedent.

In the face of contrary national direction, it is more likely an Indiana court would come down on the side of the insured in this circumstance. Clearly, the amount of a depreciation holdback is much more readily calculable (or, at least, capable of approximation) than the claims presented in *U.S. Filter* and *Wheelabrator*. Both the *U.S. Filter* and *Wheelabrator* courts left room for grey areas, and, armed with friendly out-of-state precedent, an industrious litigator would not be far off base in making these arguments in the face of Indiana's existing common law.

Further, the development of the common law assignability of choses in action supports allowing assignments of post-loss claims, even if the claim is not reduced to a monetary amount or is still contingent on some occurrence. Since the common law prohibition on assignment of choses in action at law, the walls around assignability have crumbled. Our clever litigator could likely use this history to their advantage, arguing that the organic growth of the common law includes loosening the reins on assignability in these cases, where formality and line-drawing are a worse fit than a factual and circumstantial review on a case-by-case basis.

V. Conclusion

The common law is ever-changing. Since American courts were established, they have gradually moved away from the traditional English common law rule prohibiting the assignment of choses in action. In the insurance context, this concept rears its head most obviously in the pre-loss and post-loss distinction between insurance claims that are assignable, and those that are not. While Indiana currently

has a restrictive view on the subject, case law around the nation is leaning the other direction, and this contradictory authority could lead to real change in Indiana in the coming years.

A Brief Overview of the Analysis of "Impartiality" in Appraisals in Seven States

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Many, if not most, insurance policies contain appraisal or arbitration provisions that provide for the use of "competent" and "disinterested" appraisers. Here is a snapshot of what that means in various contexts in seven states: Indiana, Colorado, California, Texas, Iowa, Kentucky and Illinois.

Indiana

In *Insurance Co. of North America v. Hegewald*, the insured filed a claim under his fire insurance policy, which led to appraisers estimating the damage. 161 Ind. 631, 633 (Ind. 1903). The appraisers were selected by the parties under the provisions and conditions of the policy, but the insured sought to set aside the appraisement. *Id*. The policy provided, "In case differences arise as the amount of loss, the matter shall, at the written request of either party, be submitted to two competent and disinterested appraisers sworn to decide impartially, the assured and the company each selecting one, who shall determine the amount of such loss, and failing to agree they shall select an umpire, to be sworn as aforesaid, to whom they shall submit their differences . . ." *Id.* at 634. It was later found out that the appraiser selected by the insurer was not a competent disinterested person, but in fact was one of the insurer's employees. *Id.* at 635. "During the arbitration of the matter in dispute it appears that he acted as the disbursing agent of the defendant in paying the expenses of the arbitration, and at all times during said appraisement he acted under the advice and the directions of the defendant, and acted entirely in its interest, with the purpose of procuring the appraisement of the loss in controversy at an amount less than one-half of that which the plaintiff had actually sustained on account of the fire." *Id.*

The court eventually provides a discussion of impartiality as an appraiser. *Id*. at 639-640. ". . .The authorities assert that bias and strong partiality on the part of one or more of the appraisers constitute a

[1] With the assistance of Alex Pantos, Indiana University Maurer School of Law '21, and Eric Claxton, Indiana University Robert H. McKinney School of Law '21.

serious objection to the award made in a matter of arbitration." *Id*. "Appraisers in cases like the one at bar are considered as acting in a *quasi*-judicial capacity, and in discharging their sworn duties they must act free from bias, partiality, or prejudice in favor of either of the parties." *Id.* (citing *Flatter v. McDermitt*, 25 Ind. 326 (Ind. 1865)). Throughout the court's discussion of impartiality, a New York Court of Appeals case is cited in support of what it means for an appraiser to be impartial. *Bradshaw v. Agricultural Ins. Co.,* 137 N.Y. 137 (N.Y. 1893). The New York Court of Appeals held in *Bradshaw* that "the term 'disinterested' does not simply mean an absence of pecuniary interests on the part of the appraiser but requires that he be one not biased or prejudiced in the matter of the loss." *Id.* Furthermore, the court in *Bradshaw* stated, "the duties of these appraisers are to give a just and fair award, one which shall honestly and fairly represent the real loss actually sustained by reason of the fire; and it is not the duty of either appraiser to see how far he can depart from that purpose, and still obtain the consent or agreement of his associate, or in case of his refusal, then of the umpire." *Id*. "The appraiser is in no sense for the purpose of an appraisal, the agent of the party appointing or nominating him, and he remains at all times under the duty to be fair and unprejudiced, or in the language of the policy, disinterested."

After a discussion of the *Bradshaw* case and analyzing the facts up against the intentions of being impartial as an appraiser, the court in *Insurance Co. of North America* concluded that the appraisals were to be set aside, and the insured was awarded a judgment for damages. *Insurance Co. of North America*, 161 Ind. 631, 646-647. In support of its holding, the court stated, "A rule which seems to be reasonable, and one well settled by authorities, is that a party to an arbitration, who by his own acts, either attempts to corrupt or improperly influence one or more of the arbitrators to make an award in his favor, can not be heard to say that such act or acts on his part were ineffectual to accomplish the purpose designed. If the conduct of such party had a tendency to affect improperly the decision of the arbitrator or arbitrators in the matter in issue, it will be held to be sufficient to invalidate the award,

without inquiring as to whether the conduct or act in question actually produced any harmful results as to the complaining party." *Id*. at 647 (citing *Catlett v. Dougherty*, 114 Ill. 568 (Ill. 1885).

Colorado

In *Owners Ins. Co. v. Dakota Station II Condo. Ass'n*, the Supreme Court of Colorado does an excellent job elaborating on what it means for an appraiser to be "impartial." 443 P.3d 47 (Colo. 2019). In support of what it means to be impartial, the court looks to none other than Black's Law Dictionary which defines "impartial" as "not favoring one side more than another; unbiased and disinterested; unswayed by personal interest." *Id*. at 52. Additionally, the court states, "in construing the phrase 'each party will select a competent and impartial appraiser,' we can't endorse a reading of the impartiality requirement that suggests one can simultaneously be an 'advocate' for one of the parties and be 'impartial.'" *Id*. "We conclude that the appraiser's conduct must be evaluated using the plain meaning of the word impartial. Thus, the policy requires the appraiser to be unbiased, disinterested, without prejudice, and unswayed by personal interest. She must not favor one side more than another. To conclude otherwise, in the words of Judge Terry, "reads the term 'impartial' completely out of the contract." *Id*. at 53.

The court then had a discussion as to whether contingent-cap fee agreements that tie appraisers' compensation to the ultimate appraisal award render appraisers partial as a matter of law. *Id*. "The trial court found that Dakota's appraiser drafted a document that included a provision capping the appraiser's recovery at five percent of the insurance award. However, 'clear' evidence showed that neither party thought that the five percent cap applied to this case. And, regardless of whose estimates the umpire adopted, the fee would have been well under the alleged cap. Even if the umpire had agreed with all six of Owners' appraiser's estimates, the total fees would have amounted to less than two percent of the final award." *Id*. at 53-54. As a result, the court concluded that "because the appraiser

didn't believe the cap was in place and the award didn't appear to correspond to the estimates put forth by the appraiser, the trial court concluded that the provision didn't render the appraiser impermissibly partial." *Id*. at 54.

California

In *Michael v. Aetna Life & Cas. Ins. Co.*, Aetna appealed from an order vacating a fire insurance appraisal award because of alleged corruption in a party-selected appraiser, pursuant to Code of Civil Procedure section 1286.2, subdivision (b). 88 Cal. App. 4th 925, 930 (2001). As mentioned by the court, Insurance Code section 2071 requires all appraisers to be "disinterested." *Id.* Additionally, the court concludes that since appraisal agreements are subject to the California Arbitration Act (§ 1280 *et seq*.), in order to be "disinterested," party-selected appraisers must make the disclosure that section 1281.9, subdivision (e) requires all arbitrators to make. *Id*. Section 1281.9, subdivision (e) requires appraisers to disclose matters that would a cause a person aware of the facts to reasonably entertain a doubt that the appraiser would be able to be impartial. *Id*. The court concludes that if an appraiser fails to make this required disclosure than it constitutes "corruption in any of the arbitrators," as applied to appraisers, and provides grounds for vacating an appraisal award under section 1286.2, subdivision (b). *Id*. Ultimately, the court finds that under section 1281.9, subsection (e), the facts in the case did not require disclosure by the party-selected appraiser, finding that no "corruption" existed in the appraiser and the appraisal award did not have to be vacated. *Id.*

Texas

In *General Star Indem. Co. v. Creek Vill. Apartments Phase V, Inc.*, a windstorm caused damage to Spring Creek Village Apartments and Spring Creek had insurance coverage with Reliance Insurance Company of Illinois for property damage and loss of business income up to $1 million. 152 S.W.3d 733, 735 (Tex. App. 2004). Additionally, Spring Creek had excess coverage exceeding $1 million through General Star. *Id*. Spring Creek's appraiser estimated the amount of loss to Spring Creek at $5,286,000

and the Reliance's appraiser estimated the loss at $367,842. *Id*. The umpire's issued award found the replacement cost value of the loss to be $2,105,790 and the actual cash value to be $1,566,673. *Id*. As a result of the award, Reliance filed a declaratory judgment to have the appraisal award declared invalid. *Id*. In response, Spring Creek filed a counterclaim seeking enforcement of the award and eventually filed a third-party action against General Star. *Id.* at 735-736. The trial court granted partial summary judgment in favor of Spring Creek that the appraisal award was binding. *Id.* at 736.

On appeal, the court addresses the agreement attached to General Star's response to Spring Creek's motion for summary judgment. *Id.* at 737. This agreement was between Spring Creek and its appraiser, setting forth that Spring Creek agreed to pay its appraiser for "its time and costs incurred in the process, but for an amount not to exceed five percent of the gross settlement amount." *Id*. Furthermore, there was provision in the agreement that provided, "In the event that the minimum gross settlement amount of the Spring Creek Village Apartments loss is at least 2 million dollars, Spring Creek hereby agrees to reimburse the appraiser for its additional time and costs and hereby assigns those costs to the appraiser, per its final invoice, up to but not in excess of six percent of the gross settlement amount." Id. The court concludes, "Because Edwards (the appraiser) had a financial interest in ensuring the appraisal award exceeded $2 million, General Star raised a fact issue with regard to whether Edwards was impartial." *Id*. "An appraiser with a financial interest in the outcome of the appraisal is not impartial." *Id.* (citing *Delaware Underwriters v. Brock*, 109 Tex. 425 (Tex. 1919)).

Iowa

The Supreme Court of Iowa in *Central Life Ins. Co. v. Aetna Casualty & Surety Co.* explained that Iowa has "long recognized that the object and purpose of an appraisal is to secure a fair and just evaluation by an impartial tribunal." 466 N.W.2d 257, 261-262 (Iowa 1991). The court then states, "Arbitrators or appraisers who may be selected to adjust a loss should be disinterested, and not represent the parties selecting them. The term 'disinterested' has been used in the sense of meaning

competent, impartial, and substantially indifferent between the parties. It is intended that such person shall be fair and unbiased, since they are acting in a quasi-judicial capacity. It means more than merely a lack of pecuniary interest in the outcome." *Id*. at 261. However, the court then recognizes that in *First Nat'l Bank v. Clay*, they acknowledged that "choosing arbitrators wholly disinterested is an admirable standard to aspire to, but the parties seldom do that, and if all awards were set aside in which it was not done, few awards would stand." *Id*. (citing 231 Iowa 703, 713-714 (1942)). Thus, the court understands that these two authorities discussed seem to pose inconsistencies, but states that "the intent of the appraisal procedure is not to provide appraisers who possess the total impartiality that is required in a court of law; the appraisers do not violate their commitment by acting as advocates for their respective selecting parties." *Id*. "However, appraisers should be in a position to act fairly and be free from suspicion or unknown interest." *Id*. (citing *Koopman v. Farmers Mut. Hail Ins. Ass'n*, 209 Iowa 958, 962 (1930)). Lastly, the court says, "the appointment of an appraiser with a concealed pecuniary interest in the outcome is a sufficient ground for voiding the award as a matter of law without a showing of prejudice." *Id.* at 262 (citing *Edwards v. Employers Mut. Liab. Ins. Co.*, 219 Ga. 121, 124-125 (1963)).

Kentucky

In *Hartford Fire Ins. Co. v. Asher*, the Kentucky Court of Appeals found that the facts of the case brought it to the conclusion that neither appraiser selected by the insurer or the insured was impartial, but instead "each was selected to protect the interests of the person who named him." 100 S.W. 233, 234 (Ky. Ct. App. 1907). "When the parties had appointed their respective appraisers, they should have left the appraisers to agree upon an umpire without any suggestions from them, and it was incumbent upon them to appoint as an appraiser, not a partisan to protect their interests, but a disinterested person." *Id.* With the two parties not appointing new appraisers after the original appraisers were very clearly not going to agree upon anything, the court stated, "It has been well said that a habitual

appraiser is not a disinterested person, within the meaning of the arbitration clause in insurance policies." *Id*.

Illinois

The Michigan Court of Appeals addressed impartiality by appraisers in *Linford Lounge, Inc. v. Michigan Basic Property Ins. Asso.* 77 Mich. App. 710 (Mich. Ct. App. 1977). In this case, the insured's building caught on fire and after the insurer sent a licensed public adjuster to the building, the insured disagreed with the appraisal and hired his own appraiser. *Id*. at 711. As a result, the insured demanded that an appraisal be performed pursuant to the insurance policy with the insurer, however, the insurer rejected the insured's request due to its belief that the insured's appraiser was not "disinterested." *Id*. at 711-712. This allegation was made by the insurer because the insured's appraiser and the insured had a contract, but "this contract was canceled before or at the time he was appointed as plaintiff's appraiser." *Id*. at 712.

Due to the insurer's rejection of the insured's demand for an appraisal, the insured filed a complaint for appointment of an umpire and appraisal as provided in its Standard Policy with the insurer. *Id*. Thus, an umpire was appointed upon which he issued an opinion finding that the amount of the loss exceeded the policy limit of $47,000. *Id*. The trial court refused to set aside the award on the insurer's motion and awarded the insured summary judgment for $47,000 plus interest. *Id*. The Court of Appeals then gets into the discussion of what is required for appraisers and states, "an appraiser is not necessarily 'interested' because he was once under contract with a party to adjust the loss." *Id*. at 713. "Similarly, the fact that an appraiser appointed by an insured has previously made a computation of the loss does not automatically disqualify the appraiser, absent a showing of prejudicial misconduct." *Id*.

It's a Twister!

The Appraisal Process and the Insurer's Dilemma

By John C. Trimble
and Meghan Ruesch

Counsel advising insurance companies can help them avoid some of the most common and recurrent problems and issues that arise in the appraisal process by providing practical and common-sense guidance to insurance companies handling appraisal demands.

It is a universally known fact that as lawyers, movies are forever ruined for us. We can no longer sit and watch with disinterest as the story unfolds on the silver screen without, at least once, the thought crossing our mind: "What are the legal ramifications of this?" This reaction cannot be helped. It has been ingrained in us through years of legal education and experience.

Take for example the beloved classic film, *The Wizard of Oz*. We can all picture the opening scene now, seeing the tornado tear across the Kansas plain, the wind blowing tree limbs and all nature of debris at Auntie Em's and Uncle Henry's farmhouse, tearing away fencing and siding and shingles, before finally carrying the farmhouse and Dorothy away to Oz. As we sit and watch all of this unfold in warm, sepia tones, we cannot help but wonder: How would Auntie Em's and Uncle Henry's homeowner's insurance respond? We imagine that their farmhouse was probably old and in disrepair. Would they demand that the insurance company undertake a full restoration of the damage from the storm? Probably. Would their insurance carrier disagree? Possibly. We can imagine the scenario unfolding, as it so very often does, that in the course of this disagreement over which repairs are or are not covered under their homeowner's policy, that inevitably Auntie Em and Uncle Henry will demand an appraisal. And, eventually, there will be confusion over the appraisal procedure. That is when we, the lawyers, become involved.

The appraisal procedure, and its inclusion in first-party property policies, has existed even longer than *The Wizard of Oz*, and yet it is a procedure that remains to this day one of the most undeveloped and uncertain. Because of this, the appraisal procedure is one of the most misunderstood and underutilized tools at an insurance company's disposal. Generally speaking, it is insureds who usually make the demand for appraisal in the first place. But should insurers demand appraisal more often? Perhaps they should.

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There are a litany of questions and issues that arise during the appraisal process, and below we will highlight what we have found to be the more pervasive and confusing aspects of appraisal, namely: (1) figuring out when a claim is subject to appraisal, or whether what is involved is a coverage dispute that cannot be appraised; (2) determining what constitutes a "competent and disinterested" appraiser; and (3) avoiding an unexpected appraisal award that is reduced to judgment without notice to the insurer. While these are recurring issues that insurers and their attorneys face, there are measures that counsel can advise insurers to take, and they should, to avoid the associated perils so that the appraisal process can serve its intended purpose as a neutral and less adversarial procedure for settling disagreements between insurers and their customers.

What the Appraisal Provision Says

As every good insurance practitioner should instinctively do, we start by looking to the policy language. Often when an insurer is faced with an appraisal problem, it is because the company has gotten caught up in certain assumptions about the appraisal procedure that the contract language may not support. Although appraisal provisions vary slightly in their precise language, standard appraisal language, as appears in the ISO HO3 form, provides as follows:

> If you and we fail to agree on the *amount of loss*, either may demand an appraisal of the loss. In this event, each party will choose a competent and impartial appraiser within 20 days after receiving a written request from the other. The two appraisers will choose an umpire. If they cannot agree upon an umpire within 15 days, you or we may request that the choice be made by a judge of a court of record in the state where the "residence premises" is located. The appraisers will separately set the amount of loss. If the appraisers submit a written report of an agreement to us, the amount agreed upon will be the amount of loss. If they fail to agree, they will submit their differences to the umpire. A decision agreed to by any two will set the amount of loss.
>
> Each party will:
>
> 1. Pay its own appraiser; and
> 2. Bear the other expenses of the appraisal and umpire equally.

(italics added).

Despite the general uniformity of the appraisal language across the board, it comes as no surprise that the interpretation and application of appraisal provisions vary vastly across jurisdictions. It is therefore imperative from the outset, before an insurer makes any determination whether to agree to a demand for appraisal, that it understand what the law of the applicable jurisdiction is, and how the courts have interpreted the role and duties of the appraisers.

The "Amount of Loss": Value vs. Causation or Coverage

If you and we fail to agree on the amount of loss, either may demand an appraisal of the loss.... The appraisers will separately set the amount of loss.

The phrase "amount of loss" appears in the appraisal provision no less than four times, which would indicate its importance, and yet nowhere in the policy is the term "amount of loss" defined. Webster's dictionary defines the term "amount" as having two possible meanings: (1) a quantity of something; and (2) a quantity of money. *Merriam-Webster.com* (2015), http://www.merriam-webster.com/dictionary/amount (last visited Aug. 18, 2016). The effect of this

dual meaning has caused significant confusion and discord among courts because it raises the question of whether the appraisers are tasked purely with assessing the monetary value of the existing damage, or whether they are also tasked with determining the scope and the cause of the damage as well. As such, the appraisers' role in assessing the "amount of loss" has been and continues to be frequently misunderstood and heavily litigated.

The courts have split in interpreting what the term "amount of loss" means. This split stems from the notion that the question of "scope" and "causation" toe the line of a coverage question, an issue that most all courts agree is an issue of law within the province of the courts. Understanding this dichotomy, and understanding the laws of the jurisdiction in which an insurer assesses a loss, will help guide the company in deciding whether to participate in appraisal.

Appraisal for Value Only

A number of courts hold that issues of causation and coverage are, if not the same, then so comingled that they cannot be determined by an appraiser, but instead should be left solely to the courts. For instance, in *Rogers v. State Farm Fire and Cas. Co.,* 984 So. 2d 382 (Ala. 2007), the Supreme Court of Alabama relied on the decisions of numerous states, including Texas, Mississippi, California, Maine, Oregon, and Michigan, to hold that the appraisers' sole power is limited "to the function of determining the money value of property damage." *Rogers,* 984 So. 2d at 389 (quoting *Munn v. National Fire Ins. Co. of Hartford,* 115 So.2d 54 (Miss. 1959)). The court reasoned that the appraisers' role should be so limited because "appraisers are not vested with the authority to decide questions of coverage and liability," which "should be decided only by the courts." This logic, the court reasoned, is consistent with the principal that "the court must enforce the insurance policy as written…." *Rogers,* 984 So. 2d at 392 (quoting *Safeway Ins. Co. of Ala. v. Herrera*, 912 So. 2d 1140, 1143 (Ala. 2005)).

Similarly, in *American Family Mut. Ins. Co. v. Dixon,* 450 S.W.3d 831 (Mo. Ct. App. 2014), the Missouri Court of Appeals reasoned that the appraisers could not make determinations of causation because assessing causation is necessarily a determination of the existence of a "covered loss." *Id*. at 835. A disagreement over the existence of a "covered loss" is a coverage dispute and thus a legal issue. The court reasoned that questions of causation would be improper for appraisal because "the appraisal provision is being used as a means of arbitration to resolve issues of coverage, which is prohibited under [Mo. Rev. Stat.] Section 435.350." *Id*. at 836

Under this rationale, the effect is this: even if there is no disagreement between an insured and its insurer that certain damage to the property is not covered under the policy, if there is a dispute about the extent to which the policy would cover other damage, the parties would likely have to seek court intervention for such a determination. While this seems the most inevitable outcome, it also undermines the purpose of appraisal, to resolve disputes neutrally and without court intervention.

From a practical standpoint, in these states particularly, insurers will be less inclined to invoke or accept the appraisal process, because, with such a narrow scope of appraiser function, it is more probable that the matter will go to court.

Appraisal of Both Value and Causation/Coverage

In contrast, other courts hold that causation and coverage are completely distinguishable, and thus appraisers should assess both the cause of the damage, as well as the value. In *Quade v. Secura Ins.,* 814 N.W.2d 703 (Minn. 2012), the Minnesota Supreme Court highlighted this rationale. There, the court held that "an appraiser's assessment of the 'amount of loss' necessarily includes a determination of the cause of the loss, and the amount it would cost to repair that loss." *Id.* at 706. In coming to this conclusion, the court noted that in the insurance context, a "loss" is defined as "the amount of financial detriment caused by… an insured property's damage, *for which the insurer becomes liable*." As the term "loss," according to the court, already implicates the existence of coverage under the policy, the function of the appraiser is not only to quantify that covered loss, but also to "allocate damages between covered and excluded perils." *Id*. at 707.

Other courts have adopted the dual role of the appraisers discussed in the *Quade* decision. The Court of Appeals of Iowa specifically adopted the *Quade* rationale in *North Glenn Homeowners Assoc. v. State Farm Fire & Cas. Co.,* 854 N.W.2d 67 (Iowa Ct. App. 2014). There, the court, addressing appraisal for hail damage to the insured's roof, held that appraisers "must consider what damage was caused by hail, and what was not, or damage with which they are unconcerned, such as normal wear and tear." *Id*. at 71. The court reasoned that limiting the role of appraisers "would improperly limit the appraisal process to situations where the parties agree on all matters except the final dollar figure." *Id*. *See also, CIGNA Ins. Co. v. Didimoi Property Holdings, N.V.,* 110 F. Supp. 2d 259 (D. Del. 2000); *State Farm Lloyds v. Johnson,* 290 S.W.3d 886 (Tex. 2009).

Similarly, in *Philadelphia Indem. Ins. Co. v. W.E. Pebble Point,* 44 F.Supp.3d 813 (S.D. Ind. 2014), the federal district court concluded that the appraisers must evaluate the cause of damage in assessing the "amount of loss," finding that "it would be extraordinarily difficult, if not impossible, for an appraiser to determine the amount of storm damage without addressing the demarcation between 'storm damage' and 'non-storm damage.'" *Id*. at 818. The court there assessed the issue practically, noting that to hold otherwise would never be "in order unless there is only one conceivable cause of damage." *Id*.

In states that recognize the dual meaning of "amount of loss," it logically follows that appraisers have broader discretion in assessing the scope and value of the alleged damage. This principle was succinctly noted by one Florida court in *Cincinnati Ins. Co. v. Cannon Ranch Partners, Inc.,* stating as follows:

> [I]n evaluating the amount of loss, the appraiser is necessarily tasked with determining both the *extent* of covered damage and the *amount* to be paid for repairs.… Ipso facto, the scope of damage to a property would necessarily dictate the amount and type of repairs needed to return the property to its original state, and an estimate on the value to be paid for those repairs would depend on the repair methods to be utilized. The method of repair required to

return the covered property to its original state is thus an integral part of the appraisal, separate and apart from any *coverage* question.

Cincinnati Ins., 162 So. 3d 140, 143 (Fla. Dist. Ct. App. 2014) (emphasis in original).

Cautionary Notes and Practice Tips

If the appraisal process was not already confusing enough, this dichotomous split in authority has not made it easier. In assessing any appraisal demand, it is imperative that an insurance company know and understand the role of the appraiser in the particular jurisdiction where a claim is made. To this end, insurers should obtain the advice of counsel, either in-house or otherwise, before proceeding with the appraisal process, particularly when there is *any* disagreement over the causes of loss or any proposed denial of a loss that is not covered by the policy. The insurance company *must* exercise close oversight of the appraisal process. This means that the insurer must explicitly notify the insured of its concerns and positions with respect to scope of loss, causation, and non-covered elements of the claim. The appraisers and the umpire must be notified and instructed on how to conduct the appraisal. If the insurer cannot reach a clear written agreement with the insured on the process parameters, then the insurer should file a declaratory judgment action to seek clarity through a court order.

Most importantly, though, insurers must acknowledge that "coverage" questions and "causation" questions are entwined, as evidenced by the case law discussed above. What an insurer *cannot* do is refuse an appraisal demand and close its file based on a denial of "coverage." This is because if the insurer states that there is no "coverage," and refuses to participate in an appraisal, the insured will proceed with the appraisal anyway. Often the insured will unilaterally go to court, have an umpire appointed without sending notice to the insurer, and proceed with appraisal—without the insurer. This form of "unilateral" appraisal is likely to result in a friendly umpire who then conspires with the insured's appraiser to reach a large appraisal award. The first time that the insurer learns of the award is when it is reduced to a judgment and proceedings to collect the judgment have been instituted against the insurer. (More on this later in the article.)

If an insurer truly believes that there is no coverage for a claim, then the insurer must take a proactive approach to an appraisal demand by (1) going through appraisal under an objection based on coverage, and (2) giving strong consideration to urgently filing a declaratory judgment action.

Finding a "Competent and Impartial" Appraiser

In this event, each party will choose a competent and impartial appraiser within 20 days after receiving a written request from the other.

If either party is dissatisfied with an appraisal award, they may ask a court to set it aside. One challenge often raised to an appraisal award is to the competency and impartiality of the other's appraiser. Generally speaking, the issue of competence is rarely raised because competency can be judged objectively based on the experience that the appraiser has handling property loss claims. The issue of impartiality, however, has been the subject of more judicial attention. There is no established standard by which to judge the impartiality of an appraiser, and the courts will generally assess potential bias on a case-by-case basis.

In general, courts have indicated that to be disqualified as biased or prejudiced, an appraiser's interest "must be direct, definite and capable of demonstration…." *See, e.g., Giddens v. Bd. of Ed. of City of Chicago,* 75 N.E.2d 286, 291 (Ill. 1947). Frequently, paying appraisers via contingency fees will raise impartiality challenges. Some courts deny that employing an appraiser on a contingency fee basis should disqualify the appraiser. In *Rios v. Tri-State Ins. Co.,* 714 So. 2d 547 (Fla. Dist. Ct. App. 1998), the Florida appellate court reasoned that because the insurance policy required that each party pay its own appraiser, and did not limit the type of compensation that could be paid, then contingency fees were not improper. Similarly, in *Hozlock v. Donegal Mut. Ins. Co.,* 745 A.2d 1261 (Pa. Super. Ct. 2000), the Pennsylvania appellate court determined that as a matter of practicality, because appraisers will inevitably have some bias toward the party appointing them, the receipt of a contingency fee would not necessarily render the appraiser more biased than if he or she were paid on a flat fee basis.

In contrast, the Supreme Court of Iowa has ruled that a contingency fee arrangement renders an appraiser *per se* unfit because the method of payment necessarily gives the appraiser an interest in assessing a higher appraisal award. *Central Life Ins. Co. v. Aetna Cas. & Sur. Co.,* 466 N.W.2d 257 (Iowa 1991). Similarly, in *Shree Hari Hotels, LLC, v. Society Ins. Co.,* No. 1:11-CV-01324-JMS, 2013 WL 4777212 (S.D. Ind. Sept. 5, 2013), the court set aside an appraisal award in a case in which the insured's appraiser received a contingency fee, reasoning that the appraiser's financial interest in the award resulted in his assessing a higher appraisal award than was reasonable.

If either party is dissatisfied with an appraisal award, they may ask a court to set it aside.

Notwithstanding, even if an appraiser's receipt of a contingency fee is seen as possibly biasing the appraiser, that alone will not always undermine the final appraisal award. In *Aetna Cas. & Sur. Co., v. Grabbert,* 590 A.2d 88 (R.I. 1991), the Rhode Island Supreme Court found that the existence of a contingency fee constituted a "financial interest" in the appraisal award, but still upheld the appraisal award. The court found that despite the appraiser's financial interest, there was no evidence demonstrating "the required causal nexus between the party-appointed arbitrator's improper conduct and the award that was ultimately decided upon." *Id.* at 92.

Another consideration related to partiality to take into account is an appraiser's relationship with the party appointing him or her. In some instances, a prior relationship is not problematic. In *Franco v. Slavonic Mut. Fire Ins. Ass'n.,* 154 S.W.3d 777 (Tex. App.

2004), the insured challenged an appraisal award on the ground that it was obtained by fraud because the insurer-appointed appraiser had also been hired by the insurer to inspect the same premises in connection with a previous claim. The insured argued that the appraiser "had a predetermined opinion as to what the scope of his appraisal would be…." *Id*. at 786. The court rejected this argument, noting that the record did not present any other evidence beyond the prior relationship between the appraiser and the premises, which was insufficient as evidence of any bias.

On the other hand, in *Hill v. Star Ins. Co. of America,* 157 S.E. 599 (N.C. 1931), the court raised doubts related to whether an appraiser chosen by the insurer should be disqualified because the appraiser testified that he had worked for and on behalf of insurance companies for over six years. The court determined that the appraiser's history of working for the insurance companies for such a significant number of years did not *per se* render the appraiser biased, but that such evidence should be presented to the jury as a factor that was relevant to his qualifications and partiality in the outcome.

Likewise, in *Coon v. National Fire Ins. Co.,* 126 Misc. 75 (N.Y. Sup. Ct. Jefferson Ctny.1925), a New York trial court set aside an appraisal award because the insurance company's appraiser disclosed that he had acted as an appraiser for and on behalf of insurance companies on over 750 matters over a 10-year period. The evidence of the appraiser's historic association with the insurers, according to the court, demonstrated that "he rendered satisfactory returns for his compensation. Otherwise he would not have been continuously designated by insurers." *Id*. at 78.

Cautionary Notes and Practice Tips

It goes without saying that any appraiser chosen by either side will have some bias toward the party appointing that appraiser, and unfortunately, particularly in smaller communities, companies will tend to hire the same appraisers on a regular basis. To avoid the perception of partiality, insurers should avoid, as best as possible, retaining the same appraisers time after time. Paying appraisers a flat fee is obviously preferable to a contingency fee arrangement (although experience indicates that insurers typically pay flat fees, whereas insureds are more likely to pursue contingency fee arrangements).

The competency and the impartiality of an appraiser are issues that are best raised at the outset of the process. One might argue that the issues could be waived if either party proceeds with the process while knowing that grounds may exist to disqualify an appraiser. If a party adamantly refuses to remove an appraiser after a disqualification objection has been made, then once again, the insurer must proceed with appraisal while reserving an objection, or seek urgent court intervention.

If an insurer is confronted with a surprise appraisal award that has been obtained through the unilateral process described in the previous section, the impartiality of the insured's appraiser or the umpire may be the first and best avenue to convince a court to set aside an award.

Taking the Appraisal to Court—Insurer Passivity and the Problem of Default Judgments

The two appraisers will choose an umpire. If they cannot agree upon an umpire within 15 days, you or we may request that the choice be made by a judge of a court of record in the state where the "residence premises" is located.

Insurers are frequently caught off guard by the entry of a default judgment on an appraisal award that a company never even realized was taken to court in the first instance. We see this occurring consistently. In one typical scenario, the insured and the insurer have appointed appraisers, but the appraisers have not agreed on an umpire within 15 days. The insured gets an attorney and goes to court and gets an umpire appointed without notice to the insurer. The insured's appraiser and umpire then quickly agree on an appraisal award, and the insurer learns about it after judgment has been entered. Even more often, the insurer will refuse the insured's appraisal demand because of a denial of causation or coverage. The insured will then immediately go to court without notice to the insurer and will get a friendly umpire and an even friendlier (and generous) appraisal award.

You may be asking, "How could this happen, and how could the award be upheld?" The short answer is—the policy and case law allow it. (The longer answer resides in the hesitancy of insurers to seek the advice of counsel and the inadequacy of training on this issue in property claims offices.)

The appraisal provision specifies that either "you or we" may seek court intervention to appoint an umpire, in any court of the appropriate state, but the policy contains absolutely no provision requiring that the other party be notified if and when the first party goes to court. The courts have acknowledged that this problem exists, but because the unambiguous language of the policy does not require notice, the courts can offer no relief. *See, e.g., Cady Land Co. v. Philadelphia Fire & Marine Ins. Co.,* 218 N.W. 814 (Wis. 1928) ("This provision does not by its language require that prior notice shall be given of the intention by either party to apply for the appointment of an umpire…. The insurance companies here must stand or fall upon the one appointment made by a circuit judge… for no other or subsequent appointment was made on their application."); *Agricultural Ins. Co. v. Holter,* 299 S.W.2d 15 (Tenn. 1957) ("[I]t seems apparent that it was not necessary for this request to be made of the Judge in the form of a motion, nor that it be made in open Court, for under this language the request could have been made and acted upon by a Judge of a Court of record while he was on vacation and while Court was not in session."); *Caledonian Ins. Co. v. Sup. Ct. In & for Almada Cty.,* 295 P.2d 49 (Cal. Dist. Ct. App. 1956) ("This construction would result in the conclusion that both parties could simultaneously each procure the designation of an umpire, without notice to the other…."); *Atlas Const. Co., Inc. v. Indiana Ins. Co., Inc.,* 309 N.E.2d 810 (Ind. Ct. App. 1974) (holding failure to notify insurer's appraiser of meeting between umpire and insured's appraiser to finalize and sign appraisal award was not grounds to set aside appraisal award).

Because the application to appoint an umpire is not, by its nature, an action on the contract or other formal court proceeding, traditional, constitutional rules of notice do not apply. Even if one were to argue that notice is constitutionally mandated, under the specific language in the standard form, the parties have contracted the notice requirement away. While duties of good faith and fair dealing limit

an insurer from unilaterally obtaining a judgment against its insured on appraisal, insureds are not so constricted. Thus, the insurer's hands may be bound if a default judgment on an appraisal award is entered against it, and the costs can be significant.

Cautionary Notes and Practice Tips

There is an army of public adjusters and attorneys who have grown wise to the fact that insurance companies do not proactively demand and follow through on appraisal. Knowing that they can obtain a judgment on behalf of an insured based on a unilateral appraisal, they will continue to pursue default judgments for appraisal awards, and they can do so legally.

So how can insurers avoid this situation? The initial answer seems obvious: change the policy language to require notice of court intervention on an appraisal. Include language requiring that if either party seeks court intervention, the other party will have an opportunity to be heard on the court appointment of an umpire. As we know, though, altering industry-wide standard insurance policy language is a difficult process, requiring approval of not only industry representatives, but also of the state insurance departments.

If the policy language cannot change overnight, then the actions of the insurers must change. Implementing and following the protocol for the appraisal process, and being proactive in that process, would certainly be a huge step that would help avoid appraisal judgments. At the very least, an insurer, the insurer's appraiser, or the insurer's attorney should put an insured and its insured's appraiser on notice that the insurer expects notice if the insured goes to court. This notice should be part of any written communication in which the insurer or its appraiser identifies candidates for umpire. It is also that the insurer and its appraiser honor the policy time frame for suggesting an umpire or seek an agreed-to extension of the time frame. If the insurer has not honored the time frame, then a court may have less sympathy later if the insured has ignored the request for notice and has acted unilaterally.

Most significantly, though, and it bears repeating, an insurer *cannot* simply refuse or ignore an insured's demand for appraisal, particularly based on a perceived coverage defense. If the insurer truly believes that a coverage defense bars its insured's right to appraisal, then the insurer must actively enforce its coverage position through a declaratory judgment action. Simply denying coverage and refusing appraisal will not stop the insured from obtaining a judgment against the insurer. Ultimately, the cost of litigating a simple coverage action in the first instance will be far less than fighting to get an appraisal award and a default judgment set aside and then having to go through the whole process anew.

Avoiding the Maelstrom of Appraisal Problems

The above discussion only broaches the surface of the many issues that arise in the appraisal process. These problems are not new. However, problems with this process still plague insurance companies and their attorneys today. There are some practical steps that insurers, their adjusters, and their counsel can take to avoid many of these issues:

1. **Be proactive.** Insurers should have a protocol in place for handling appraisal demands and should make sure that everyone in the property claims department understands the pitfalls of making a wrong move or rejecting a demand for appraisal.
2. **Read the policy.** Do not make assumptions about the appraisal process. Although there is uniformity in most appraisal language, reading the policy will answer many of the questions and issues that appraisal raises. Many companies use different forms because the companies have multiple subsidiaries that they have acquired or formed for different markets. Property adjusters should never assume that the appraisal provisions are the same, and neither should attorneys.
3. **Know the laws and the standards of the jurisdiction.** As is obvious by the foregoing discussion, the states vary significantly in how they construe the appraisal process. If an insurer receives an appraisal demand, conferring with in-house or outside counsel to understand the law of the particular jurisdiction will go a long way toward understanding the appraisal process in that state. Understanding the rules of the jurisdiction will guide the insurer's strategy, and it will arguably help avoid ultimately having to litigate these issues, which is the entire purpose of the appraisal procedure.
4. **Communicate with the insured.** Clearly communicating with an insured is essential. It is not enough to cite policy language and deny coverage. Letters to insureds should explain and describe the basis for an insurer's position. If an insurer will agree to an appraisal, then a letter needs to spell out the insurer's expectations on impartiality, selection of the umpire, and notice of court assistance.
5. **Be prepared to go to court.** If a cooperative insured is involved, try to work out differences first. However, if any issue arises with coverage, causation, umpire selection, or anything else, file a declaratory judgment action urgently.

Most significantly, though, and it bears repeating, an insurer cannot simply refuse or ignore an insured's demand for appraisal, particularly based on a perceived coverage defense.

Understanding and advising insurance companies of the benefits of engaging in the appraisal process will ultimately save insurers and insureds alike the expense and hassle of protracted litigation, which is the whole purpose of having appraisal in the first place. Storms in nature, like the twister that takes Auntie Em's and Uncle Henry's farm in *The Wizard of Oz,* are inevitable. Storms that come while attempting to repair that damage can be avoided with vigilance, training, and communication. Don't be left in the path of the storm without shelter. FD

Section Two

Clear Liability Excess Exposure Cases

Where Liability is Clear

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Section Two

Clear Liability Excess Exposure Cases
Where Liability is Clear…….. Anna Mallon

Time Limited Demands

Indiana does not have a time requirement for the insurer to respond to a policy limits demand. However, the claimant, by counsel, often puts a response deadline on the demand. When a policy limits demand is made, the insurer should promptly put the insured on notice of the demand and, if applicable, the potential for an excess exposure. Unless the policy requires consent by the insured, the decision to settle or not settle a claim within policy limits is up to the insurer. Most liability policies contain the language: "We will settle or defend as we consider appropriate…." This language gives the insurer the right to control the settlement of a claim within policy limits.

Excess Exposure and Assignment of Claims

If the insurer chooses not to settle a claim within policy limits and an excess judgment is rendered against an insured, the insured may assign any potential cause of action it has against the insurer to the tortfeasor in exchange for the tortfeasor not executing any judgment against the insured. This often occurs in the context of a proceeding supplemental. The tortfeasor then steps into the shoes of the insured and brings a claim against the insurer for its failure to settle the claim within policy limits. In making this claim for failure to settle, the tortfeasor is seeking extra-contractual damages or more than the policy limits. The insurer will argue that the proper claim is a claim for bad faith failure to settle with the heightened clear and convincing standard. The tortfeasor, on the other hand, often argues that the claim is for negligent failure to settle.

Indiana follows the Direct Action Rule, prohibiting a third party judgment creditor from directly suing a judgment debtor's insurance carrier to recover an excess judgment. *State Farm Mut. Auto Ins. Co. v. Estep,* 873 N.E.2d 1021, 1026 (Ind. 2007); *Menefee v. Schurr*, 751 N.E.2d 757, 760-761 (Ind. Ct. App. 2001)(any excess liability of insurance carriers arises out of a relationship between insurer and insured, and the insurance carrier owes no duty to third party). Under some circumstances, however, an insured can assign his/her claim for refusing to settle a liability claim within policy limits. *Pistalo v. Progressive Cas. Ins. Co.*, 983 N.E.2d 152, 158-159 (Ind. Ct. App. 2012); *Allstate Insurance Co. v. Axsom*, 696 N.E.2d 482 (Ind. Ct. App. 1998); *Economy Fire & Cas. Co. v. Collins*, 643 N.E.2d 382, 384 (Ind. Ct. App. 1994), *trans denied*.

Indiana law prohibits forced or involuntary assignments of claims against carriers "by insureds who do not believe they have been wronged by their insurance companies." *Estep*, 873 N.E.2d at 1027. The assignee of rights under a contract stands in the shoes of the assignor and can assert any rights that the assignor could have asserted. *Pistalo,* 983 N.E.2d at 159 (citations omitted). "A valid assignment gives the assignee neither greater not lesser rights than those held by the assignor." *Id.* (citations omitted).

Under Indiana law, an insurer may be liable for failing to settle a liability claim within policy limits. *Economy Fire & Casualty Co. v. Collins*, 643 N.E.2d 382 (Ind. Ct. App. 1995); *Bennett v. Slater,* 289 N.E.2d 144 (Ind. Ct. App. 1972). In *Bennett v. Slater,* the Indiana Court of Appeals explained:

> Plaintiff-appellant contends that an insurer can be held liable for a judgment in excess of the policy limits where the insurer has been guilty of negligence or bad faith in its settlement attempts. The case of Anderson v. St. Paul Mercury Indemnity Co. (7th Cir. 1965), 340 F.2d 406, held that a suit in tort could be brought for the negligent performance by the insurer of the duty to use due care in settlement of a claim. The rule is that a liability insurer, having assumed control of the right of settlement of claims against the insured, may become liable in excess of its policy limit if it fails to exercise due care in representing its insured….

The case law supports that in order to recover anything over the policy limits, bad faith must be shown on the part of the insurer in failing to settle a liability claim. *Id.* In fact, there is support for the position that if bad faith is shown, the recoverable damages are limited to the amount of the excess judgment. *Id.*

The tort of breach of an insurer's duty of good faith and fair dealing was first recognized in Indiana in *Erie Ins. Co. v. Hickman*, 622 N.E.2d 515 (Ind. 1993). The recognition of the tort of bad faith is based on the implied duty of good faith and fair dealing owed by an insurer to its insured. Although the *Erie* court did not establish the exact parameters of the duty owed by an insurer to an insured, it did state that the obligation of good faith and fair dealing with respect to the discharge of an insurer's contractual obligation includes the obligation to refrain from: (1) making an unfounded refusal to pay policy proceeds; (2) causing an unfounded delay in making payment; (3) deceiving the insured; and (4) exercising any unfair advantage to pressure an insured into a settlement of the claim. *Erie*, 622 N.E.2d at 519.

The Supreme Court has made it clear that a breach of the duty of good faith and fair dealing does not arise every time an insurance claim is erroneously

denied. A good faith dispute about the amount of a valid claim or about whether the insured has a valid claim at all will not supply the grounds for a recovery in tort for the breach of the obligation to exercise good faith. This is so even if it is ultimately determined that the insurer breached its contract. *Id*. at 519, 520. It is undisputed under Indiana law that insurers have an absolute right to dispute and litigate claims in good faith. *McLaughlin v. State Farm Mutual Auto. Ins. Co.*, 30 F.3d 861, 867-68 (7th Cir. 1994) (applying *Erie*).

Poor judgment or negligence does not amount to bad faith; an additional element of conscious wrongdoing must also be present. A finding of bad faith requires evidence of a state of mind reflecting dishonest purpose, moral obliquity, furtive design, or ill will. A bad faith determination inherently includes an element of culpability. *Hoosier Ins. Co. v. Audiology Foundation of America*, 745 N.E.2d 300, 310 (Ind. Ct. App. 2001); *Colley v. Indiana Farmers Mut. Ins. Group*, 691 N.E.2d 1259, 1261 (Ind. Ct. App. 1998). To breach its duty, an insurer must deny liability knowing that there is no rational, principled basis for doing so. *Erie*, 622 N.E.2d at 520 (emphasis added). The Indiana Supreme Court has also clarified that to prove bad faith, the insured must prove bad faith on the part of the insurer by the heightened burden of proof of clear and convincing evidence. *Freidline v. Shelby Ins. Co.*, 774 N.E.2d 37, 42 (Ind. 2002) (emphasis added).

A verdict in excess of policy limits, standing alone, is not evidence of bad faith. In *Bartlett v. State Farm Mutual Automobile Insurance Co.*, 2002 WL 31741473 (S.D. Ind. 2002), the District Court assessed an underinsured motorist claim wherein the parties proceeded to trial because the parties could

not reach agreement. The jury found that the plaintiff had suffered damages totaling $111,000 minus 10% for comparative fault. After this verdict, State Farm paid the Plaintiff the policy limits of $25,000 under the underinsured motorist coverage and the plaintiff then sued State Farm for bad faith. In granting State Farm's Motion for Summary Judgment on the bad faith claim, the District Court held that State Farm had a rational principled basis for valuing the plaintiff's underinsured motorist claim at no more than the $50,000 already advanced and for denying additional payments to the plaintiffs, and thus, no bad faith existed. 2002 WL 31741473 at * 25.

In *Watt v. State Farm Mut. Auto Ins. Co.*, 2006 WL 2798103 (N.D. Ind. 2006), the District Court assessed a bad faith claim in the context of an uninsured motorist claim wherein the claim proceeded to arbitration and the arbitration award was in excess of the policy limits. After the arbitration, State Farm paid the policy limits of $100,000 less the amounts already paid. The insured then sued State Farm for bad faith in an attempt to recover the excess amount. The Court found that there was no bad faith as a matter of law and explicitly stated that "the fact that [the insured's] claim proceeded to arbitration does not show bad faith… Although the arbitration award was $150,000, which is considerably greater than State Farm's settlement offer, the arbitration award itself does not show bad faith. That State Farm's evaluation of the claim was found incorrect by the arbitrators does not show bad faith." 2006 WL 2798103 at * 28.

Very recently, in *Travelers Indemnity Co. v. Johnson,* 440 F. Supp.3d 980 (N.D. Ind. 2020), the Northern District addressed whether a cause of action exists for negligent failure to settle. In this case, Johnson was injured in a collision with a semi-truck. Johnson brought suit against the operator of the truck, Horn, and Horn's employer, Sandberg Trucking. Horn and Sandberg Trucking were both represented by Travelers Indemnity Company. Travelers retained defense counsel to defend Horn and Sandberg Trucking in the suit brought by Johnson. Johnson repeatedly requested policy limits of $1,000,000.00 and Traveler's rejected the demands offering $75,000.00 to $150,000.00. At trial, the jury awarded Johnson $7,100,000.00. Horn was responsible for $2,130,000.00. Horn then assigned to Johnson any claims he had against Travelers. Travelers paid its $1,000,000.00 policy limits.

Travelers filed a Complaint for Declaratory Judgment seeking a declaration that it was relieved of any obligations since it paid its policy limits. Johnson counterclaimed alleging negligent failure to settle, bad faith failure to settle and breach of contract. Travelers moved to dismiss the claim for negligent failure to settle. In holding that the negligent failure to settle claim should be dismissed, the Court reviewed the history of claims for extracontractual damages against an insurer and concluded as a matter of law that an insurer does not breach the obligation of good faith and fair dealing when it negligently fails to settle a claim within policy limits. 440 F.Supp.3d at 990. The District Court noted that as early as 1990, the Seventh Circuit, relying on Indiana law, alluded to a negligent failure to settle. *See A&B v. Gen. Accident Ins. Co. of Am.,* 909 F.2d 228, 231 (7th

Cir. 1990), but that the seminal case of *Erie Ins. Co. v. Hickman*, 622 N.E.2d 515 (Ind. 1993), undercut this argument that negligence is sufficient. *Id.* at 989-990. Based on *Erie* and cases post *Erie*, the District Court held that there is no cause of action in tort for negligently failing to settle a claim within the policy limits. *Id.*

Interpleader Issues

If the insurer chooses to pay the policy limits during the course of litigation, the question then arises whether the insurer is relieved of its duty to defend. Insurers have filed interpleader actions and argued that once the interpleaded policy limits were paid into the court's registry, the insurer should be released from the duty to defend its insured.

The policy language may support this argument that the insurer should be released from its duty to defend upon the payment of policy limits:

> **PART A – LIABILITY COVERAGE**
>
> **INSURING AGREEMENT**
>
> A. We will pay damages for "bodily injury" or "property damage" for which any "insured" becomes legally responsible because of an auto accident. Damages include prejudgment interest awarded against the "insured". We will settle or defend as we consider appropriate, any claim or suit asking for these damages. In addition to our limit of liability, we will pay all defense costs we incur. Our duty to settle or defend ends when out limit of liability for this coverage has been exhausted by payment of judgments or settlements. We have no duty to defend any suit or settle any claim for "bodily injury" or "property damage" not covered under this policy.

(emphasis added). The argument against the insurer being released from its duty to defend after paying policy limits is that this payment is not a "judgment or settlement" as contemplated by the policy.

Neither the Indiana Supreme Court nor the Indiana Court of Appeals have addressed this issue of whether the insurer is released from its duty to defend upon interpleading the policy limits into the court. Recently, in *American Hallmark Ins. Co. v. Bohren Logistics*, 2020 WL 1043106 (N.D. Ind. 2020), the District Court summarized the decisions of other District Courts as it relates to this issue. In both *Carolina Cas. Ins. Co. v. Estate of Zinsmaster*, 2007 WL 3232461 (N.D. Ind. 2007) and *Carolina Cas. Ins. Co. v. Estate of Studer*, 555 F.Supp.2d 972 (S.D. Ind. 2008), the District Courts concluded in favor of terminating the insurer's duty to defend upon paying the interpleaded policy limits. This relinquishment of the duty to defend upon the payment of policy limits into the court appears to also be supported by the Seventh Circuit. *See Abstract & Tile Guaranty Co. v. Chicago Ins. Co.*, 489 F.3d 808 (7th Cir. 2007) (applying Indiana law).

After reviewing the history and decisions from other courts on this issue, as well as the decisions from other jurisdictions holding that interpleading the policy limits does not excuse the duty to defend, the *American Hallmark* Court followed the District Courts and the Seventh Circuit and held that "upon American Hallmark's unconditional tender of the policy limits, its duty to defend Bohren in the Nebraska Claims has been discharged."

Section Two

Duties of Insurers and Defense Counsel in Cases of Clear Liability and Excess Exposure

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Section Two

Duties of Insurers and Defense Counsel in Cases of Clear Liability and Excess Exposure…….…. Jerry E. Huelat
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DUTIES OF INSURERS AND DEFENSE COUNSEL IN CASES OF CLEAR LIABILITY AND EXCESS EXPOSURE

Jerry E. Huelat

Robert J. Penney

I What duties does an insurer have to insureds in cases of clear liability and excess exposure?

A. Indiana state and federal cases involving bad faith claims against insurers

In *Erie Ins. Co. v. Hickman by Smith*, 622 N.E.2d 515 (Ind. 1993), the Indiana Supreme court held that an insurer owes fiduciary duties of good faith and fair dealing to its insureds. In *Hickman*, an insured, Hickman, was involved in an automobile accident while driving an automobile owned by her mother, Nancy Smith. Smith's vehicle was insured by a policy issued by Erie, which provided only liability and uninsured motorist coverage. *Id.* at 521. Erie's adjuster initially believed that the other driver, Davis, had insurance, and therefore there was no coverage. *Id.* More than a year passed before Erie confirmed that Davis had been uninsured at the time of the collision. *Id*. In the meantime, after investigation into the facts of the collision was completed, the adjuster determined that Hickman was more than 50% at fault for the accident. *Id.* at 522. The adjuster then advised Smith's counsel that Erie would not pay the uninsured motorist claim. *Id.* The Plaintiffs, Hickman and Smith, later brought an action against Erie for breach of the insurance contract and for punitive damages because Erie denied their claims. The trial court entered judgment on the jury's verdict awarding both compensatory and punitive damages. *Id.* at 517. On appeal, the Court noted that under Indiana law, there was a legal duty implied with all insurance contracts that the insurer deal in good faith with its insured. *Id.* at 518. Whether breach of this duty constitutes a tort involves

a judicial balancing of three factors: (1) the relationship between the parties, (2) the reasonable foreseeability of harm to the person injured, and (3) public policy concerns. *Erie Ins. Co. v. Hickman by Smith*, 622 N.E.2d 515, 518 (Ind. 1993), citing *Webb v. Jarvis*, 575 N.E.2d at 995. **The Court held that although not the full extent of such duty, the obligation of good faith and fair dealing included: the obligation to refrain from (1) making an unfounded refusal to pay policy proceeds; (2) causing an unfounded delay in making payment; (3) deceiving the insured; and (4) exercising any unfair advantage to pressure an insured into a settlement of his claim.** *Id.* at 519. The Court also noted that this "new cause of action" did not arise every time an insurance claim was erroneously denied. *Id.* at 520. Therefore, a good faith dispute about the amount of a valid claim, or about whether the insured had a valid claim at all, would not supply grounds for a recovery in tort for the breach of the obligation to exercise good faith, even if the insurer breached the insurance contract. *Id.* The rule in Indiana had long been that insurers could, in good faith, dispute claims. *Id.* "On the other hand, for example, an insurer which denies liability knowing there is no rational, principled basis for doing so has breached its duty." *Id.* The Court ultimately found for the Plaintiffs on their claim for compensatory damages against Erie, but found that there was insufficient evidence to support their punitive damages claim. *Id.* at 521. Erie had information that it was Hickman, not Davis, who failed to yield the right-of-way at the intersection, and as such, the denial of the claim was made in good faith. *Id*. at 523. The Court therefore concluded that a reasonable jury could not find by clear and convincing evidence that Erie acted with the malice, fraud, gross negligence, or oppressiveness necessary for the imposition of punitive damages. *Id.* Therefore, the Court reversed the jury's award of punitive damages and affirmed the award of compensatory damages. *Id*.

In *Anderson v. St. Paul Mercury Indem. Co.*, 340 F.2d 406, 407 (7th Cir. 1965), a bad faith action that predated *Hickman*, an insured's bankruptcy trustee brought an action against an insurer, St. Paul, alleging that an excess verdict of $60,000.00 above policy limits was caused by the insurer's negligence, bad faith, and willfulness and gross negligence in failing to settle the claim of the Plaintiff in the underlying action within policy limits. As to the counts of bad faith and willfulness, the jury found for St. Paul, but as to the count alleging negligent handling of the claim, the jury found for the trustee. *Id.* The Court asked whether, to hold an insurer beyond policy limits, it was sufficient to prove mere negligent conduct in defending the claim, or whether the insurer had to be proved guilty of bad faith or fraud. *Id.* at 408. The Court ultimately concluded that Indiana, like Illinois and unlike Wisconsin, was a negligence as well as a bad faith state. *Id.* at 409. Therefore, an insurer's liability beyond policy limits might properly be predicated not only upon bad faith, but upon mere negligence as well. *Id*. The Court therefore affirmed the judgment of the trial court. *Id. C.F., Bennett v. Slater*, 289 N.E.2d 144, 149 (Ind. Ct. App. 1972) (Distinguishing *Anderson*, and holding that injured party, as judgment creditor, had no standing to bring suit for negligence in failure to settle against tortfeasor's liability insurer for recovery of judgment in excess of policy limits, where insurer paid policy limit as soon as judgment in excess of policy limits was rendered against insured, and insured refused to sue).

Similarly, in *Economy Fire & Cas. Co. v. Collins*, 643 N.E.2d 382, 383 (Ind. Ct. App. 1994), trans. denied, the Indiana Court of Appeals affirmed the recovery of an excess judgment by an injured party, as assignee of the insured's estate, against a deceased tortfeasor's insurer. After examining the two common approaches to measuring damages in cases where an insurer's bad faith failure to settle a claim results in an excess judgment, the Court adopted the "judgment rule," under

which an insurer may be liable for the entire excess judgment, despite the insured's lack of capacity to pay any part of the judgment. *Economy Fire & Cas. Co. v. Collins*, 643 N.E.2d 382, 385 (Ind. Ct. App. 1994). The Court reasoned that allowing full recovery to an insured who has not paid the excess judgment would prevent bad-faith practices in the insurance industry by eliminating the insurer's ability to hide behind the financial status of its insured. *Id*. Further, the judgment rule prevented an insurer from benefitting from the poverty of an insured who might have a meritorious claim, but could not pay the judgment imposed upon her. *Id*. If payment or demonstration of ability to pay a judgment were the rule, then an insurer might be encouraged to refuse to settle a claim merely because an insured was insolvent. *Id.* Such a course of action would impair the use of insurance by the poor. *Id*. *See also, Allstate Ins. Co. v. Axsom*, 696 N.E.2d 482, 486 (Ind. Ct. App. 1998) (Holding, in case where injured party received assignment of rights from tortfeasor, punitive damages claim against insurer for bad faith failure to settle was assignable, but claim for attorney fees was not).

Likewise, in *Pistalo v. Progressive Cas. Ins. Co.*, 983 N.E.2d 152 (Ind. Ct. App. 2012), an injured motorist brought an action against a deceased tortfeasor's automobile insurer, Progressive, seeking an excess judgment of $333,600. In the underlying action against its insured, Wilks, Progressive refused to settle for the $100,000 policy limits. *Id.* at 155. Later, a jury found Wilks's estate liable to Pistalo in the amount of $309,000. *Id.* Progressive paid the $100,000 coverage limits under Wilks's policy. *Id*. Pistalo later obtained from Wilks's estate an assignment of its right against Progressive, and filed a direct action against Progressive seeking a $333,600 excess judgment, which also included post-judgment interest. *Id.* The trial court granted summary judgment in favor of Progressive. *Id.* at 156. The Court, following *Collins*, held that Progressive

was not only obligated to insure Wilks for the $100,000 policy limit, but it also owed Wilks, pursuant to the insurance policy, an obligation to exercise good faith in handling Pistalo's claim against her. *Pistalo v. Progressive Cas. Ins. Co.*, 983 N.E.2d 152, 158 (Ind. Ct. App. 2012). Included in that good faith obligation was Progressive's duty to avoid exposing Wilks's estate to excess liability by refusing to settle for policy limits. *Id*. If Progressive failed to act in good faith, it risked liability to the estate for any excess judgment against it. *Id.* The Court held that once Pistalo obtained the assignment from Wilks's estate, she could file a direct action against Progressive for the entire amount of its obligation to the estate based on its alleged bad faith to settle for the policy limits. *Id.* at 160. Therefore, the trial court inappropriately granted summary judgment in favor of Progressive. *Id.*

But see, Austin v. Globe American Cas. Co., 863 N.E.2d 926 (Table)(Ind. Ct. App. 2007), where a deceased motorist's estate brought an action against a tortfeasor's insurer for bad faith and negligent failure to investigate and settle a wrongful death claim against the insured. The Court held that the insurer's delay in offering to pay policy limits resulted from information from its insured that the insured's brakes were broken, and that the insured had received money back from the repair shop that had allegedly fixed her brakes prior to the accident. *Id.* at *2. Therefore, there was no evidence that the insurer acted in bad faith, and the trial court properly granted summary judgment to the insurer. *Id*. at *7.

However, in a recent decision, *Travelers Indemnity v. Johnson*, 440 F. Supp.3d 980, 982 (N.D. Ind. 2020), a motor carrier's liability insurer, Travelers, brought an action against its insured's judgment creditor, Johnson, for a declaratory judgment that it had no responsibility after paying policy limits and interest following a judgment in excess of the limits. Johnson suffered a traumatic

brain injury in a collision with a semi-truck driven by Horn, an employee of Sanderberg Trucking. *Id*. Both Horn and Sanderberg were insured by Travelers. *Id.* After Johnson sued both Horn and Sanderberg in state court, Travelers took exclusive possession and control of the defense and all settlement negotiations. *Travelers Indemnity v. Johnson*, 440 F. Supp.3d 980, 982 (N.D. Ind. 2020). On numerous occasions, Johnson requested that Travelers pay its $1,000,000 policy limit, but Travelers rejected Johnson's demand and exposed its insureds to an excess verdict. *Id.* Throughout the negotiating process, Travelers responded with offers ranging from $75,000.00 to $150,000.00, all of which were rejected by Johnson. *Id.* The case ultimately proceeded to trial, and the jury returned a $7,100,000 verdict in favor of Johnson. *Id.* Horn was responsible for $2,130,000 of the verdict. *Id.* Horn later assigned to Johnson his right to sue Travelers. *Id.* Travelers filed a Complaint for Declaratory judgment against Johnson, alleging that it should be relieved of any future responsibility because it had paid Johnson the full amount of the insurance policy and statutory interest. *Id.* Johnson also brought counterclaims against Travelers, which included counts for negligent failure to settle, bad faith failure to settle, and breach of contract. *Id.* The Court concluded, based on the Indiana Supreme Court's decision in *Hickman* and its progeny, that "[under] Indiana law, an insurance provider does not breach the obligation of good faith and fair dealing that it owes to its insured when it merely acts negligently." *Id.* at 987. The Court noted that under *Hickman*, "a good faith dispute about the amount of a valid claim or about whether the insured has a valid claim at all will not supply the grounds for a recovery in tort for the breach of the obligation to exercise good faith. *This is so even if it is ultimately determined that the insurer has breached its contract*...Similarly, the lack of diligent investigation alone is not sufficient to support an award. On the other hand, for example, an insurer which denies liability knowing that there is no rational,

principled basis for doing so has breached its duty." *Id.* at 988, quoting *Hickman*, 622 N.E.2d at 520. Therefore, the District Court dismissed the Plaintiff's negligence claims, concluding that there was "no cause of action in tort for negligently failing to settle a claim within the policy limits of an insurance contract." *Travelers Indemnity v. Johnson*, 440 F. Supp.3d 980, 988 (N.D. Ind. 2020). Moreover, the Court concluded that based on the Indiana Supreme Court's analysis in *Hickman* and its progeny, the Seventh Circuit's reasoning in the *Anderson* and *Certain Underwriters* decisions, which predated *Hickman*, was "no longer authoritative." *Id*. at 988, discussing *Anderson v. St. Paul Mercury Indemnity Co.,* 340 F.2d 406, 408-408 (7th Cir. 1965) and *Certain Underwriters of Lloyd's, London v. Fidelity and Cas. Ins. Co. of New York*, 909 F.2d 228 (7th Cir. 1990). (It should be noted that neither the *Travelers* opinion nor the *Hickman* opinion addressed bad faith claims by an excess insurer. Hence, it is arguable that to the extent the *Lloyds* holding predicted that Indiana courts would recognize a cause of action by an excess insurer under the principle of equitable subrogation against a primary insurer for the bad faith refusal to settle a claim within the limits of the primary policy, that holding remains viable and authoritative notwithstanding the holding of the District Court in *Travelers*).

In conclusion, under Indiana law, Insurer's have a clear duty of good faith and fair dealing towards their insureds with regard to settling claims within the policy limits. Otherwise, an insurer may become responsible to its insured for an excess verdict. It has also been held, under *Anderson* and its progeny, insurers may also be held liable to insureds for negligent failure to settle. However, the Northern District of Indiana's recent holding in *Johnson* casts some doubt on this possibility.

B. Duty of a primary insurer to initiate settlement negotiations

Liability insurance policies, generally, allow insurers to exercise full control over the defense and settlement of third-party claims against their insureds. "Duty of liability insurer to initiate settlement negotiations," 51 A.L.R.5th 701 § 2. Consequently, this control gives rise to a fiduciary relationship between insurer and insureds, which imposes a duty on insurers to use good faith in defending and settling claims against their insureds. *Id*. When the claimant makes an offer to settle within policy limits, courts generally agree that the insurer has a good faith duty to accept the offer if it would be reasonably prudent to do so. *Id*., Introduction. In some jurisdictions, courts have recognized that a liability insurer may also have an affirmative duty to initiate settlement negotiations. *Id*., § 2.

In *Fulton v. Woodford*, 545 P.2d 979 (Az. Ct. App. 1976), an insured was sued by the heirs of an auto accident victim. The insured tendered defense of the lawsuit to the insurer, who provided a defense for the suit. *Id.* at 981. That suit resulted in a jury verdict against the insured for $200,000, of which only $100,000 was covered. *Id.* The insured then brought suit against his insurance company alleging bad faith for failing to settle the underlying suit prior to trial. *Id.* Although no firm offer to settle was made by the plaintiff in the underlying case, the insured argued that nevertheless, his insurer had an affirmative obligation to explore settlement possibilities within policy limits. *Id.* The Court held that "in the absence of a demand or request to settle within policy limits or within the limits of the insured's financial ability, plus policy limits, that a conflict of interest would give rise to a duty on behalf of the insurer to give equal consideration to the interest of its insured where there is a high potential of claimant recovery and a high probability that such a recovery will exceed policy limits." *Id.* at 984. (However, the Court ultimately concluded that there was no evidence that anyone could reasonably foresee that the verdict would exceed $110,

000.00, and therefore, the duty imposed on the insurance company to give equal consideration to its insured did not arise in that case. *Id.* at 985).

In cases where no firm settlement offer is made and the potential for liability is high, a conflict of interest will give rise to a duty by the insurer to initiate and attempt settlement negotiations. *Safeway Ins. Co. v. Botma*, 2003 WL 24100783 at *18 (D. Az, 2003). A failure to do so "may" constitute bad faith, and it is a factor to be considered in determining whether an insurer acted in bad faith. *Id*. The ultimate determination of bad faith requires an analysis of the reasonableness of the insurer's conduct under all the circumstances. *Id.,* citing *Brown v. Superior Court*, 670 P.2d 725, 734 (Az. 1983). *See also, Badillo v. Mid-Century Ins. Co.*, 121 P.3d 1080 (Okla 2005)(indicating that "if an insured's liability is clear and injuries of a claimant are so severe that a judgment in excess of policy limits is likely, the insurer has an affirmative duty to initiate settlement negotiations."); *Powell v. Prudential Property Casualty Ins. Co.*,584 So.2d 12,14(Fla. Ct. App. 1991). *See also, Stowers Furniture Co. v. American Indem. Co.*, 15 S.W.2d 544, 547 (Tx. Ct. App. 1929)(Where the Court set forth the "*Stowers*" doctrine, still followed by Texas courts, whereby an insured may recover from his insurer the entire amount of a judgment in excess of policy limits rendered against him, if prior to judgment, the insurer negligently failed to accept a settlement offer within the liability limits of the policy. Under *Stowers*, "**An insurer is held to that degree of care and diligence which an ordinary prudent person would exercise in the management of his own business**." *Id., emphasis supplied*).

In *Harvey v. GEICO General Ins. Co.*, 259 So.3d 1 (Fla. 2018), an insured, Harvey brought an action against its automobile insurer to recover for bad faith in handling a claim resulting in an excess judgment against the insured. GEICO's independent investigation of the facts had revealed,

within days of the accident, that it was a case of clear liability and substantial damages, and a jury verdict could exceed the insured's $100,000 policy limit. *Id.* at 8. Not only did GEICO know that Harvey was at fault for the accident, but it knew that John Potts, a husband and father of three children, died as a result. *Id.* In other words, it was a case of catastrophic damages. *Harvey v. GEICO General Ins. Co.*, 259 So.3d 1, 8 (Fla. 2018). Shortly after GEICO's claims adjuster, Korkus, sent Harvey a letter explaining that Potts' estate's claim could exceed policy limits, the office of the attorney representing the estate requested a statement from Harvey. *Id.* at 4. The statement was necessary to determine the extent of his assets, whether he had any additional insurance, and whether he was in the scope of his employment at the time of the accident. *Id.* Significantly, Korkus did not immediately communicate the request to Harvey, and in fact denied the request. *Id.* After similar delays caused by Korkus, approximately one month after the initial request for a statement, the estate filed a wrongful death suit against Harvey. *Id*. at 5. The jury found Harvey 100% at fault and awarded the estate $8.47 million in damages. *Id.* The Florida Supreme Court held that an insurer is not absolved of liability simply because it advises its insured of settlement opportunities, the probable outcome of litigation, and the possibility of an excess judgment. *Id.* at 7. Rather, the critical inquiry in a bad faith action is whether the insurer diligently, and with the same haste and precision as if it were in the insured's shoes, worked on the insured's behalf to avoid an excess judgment. *Id.* In a case where liability is clear, and injuries so serious that a judgment in excess of the policy limits is likely, an insurer has an affirmative duty to initiate settlement negotiations. *Id.* In a case "**where the financial exposure of the insured is a ticking financial time bomb and suit can be filed at any time, any delay in making an offer...even where there was no assurance that the claim could be settled could be viewed by a fact finder**

as evidence of bad faith." *Id.* at 7, emphasis supplied. The Court concluded that under the totality of the circumstances, there was competent, substantial evidence to support the jury's finding that GEICO acted in bad faith in failing to settle the claim. *Id.* at 8. GEICO failed to act as if the financial exposure to Harvey was a "ticking financial time bomb." *Id.* Instead of doing everything possible to facilitate settlement negotiations, when the estate's attorney requested a statement from Harvey, the claims adjuster refused the request, despite acknowledging that such statements were standard practice. *Harvey v. GEICO General Ins. Co.*, 259 So.3d 1, 9 (Fla. 2018). Additionally, not only did the adjuster refuse the request, but she did not inform Harvey of the request until two weeks later, when the adjuster received a letter from the estate's attorney stating that the request had been denied. *Id.* The estate's attorney, Domnick later testified that had he known that Harvey planned to give a statement, he would have recommended delaying the filing of the wrongful death suit. *Id.* Further, the estate's personal representative testified that she would have followed her attorney's advice and would have declined to file the lawsuit. *Id.* Thus, had GEICO acted in good faith "with due regard" for its insured, Harvey's interests, the excess judgment could have been prevented. *Id.* There was no showing that GEICO "used the same degree of care and diligence as a person of ordinary care and prudence should exercise in the management of his own business." *Id*. at 10. The Court further noted, "the focus in a bad faith case is not on the actions of the claimant but rather on the insurer in fulfilling its obligations to the insured." This is because, as the insured, Harvey "surrendered to the insurer all control over the handling of the claim." *Id.* The Court found that the totality of the circumstances supported the jury's finding that GEICO acted in bad faith in handing the defense of claims against Harvey. *Id.* at 11.

In *Tank v. State Farm Fire & Cas. Co.*, 715 P.2d 1133 (Wash. 1986), an insured brought an

action against State Farm alleging breach of duty to settle a claim. In the underlying action, Tank was sued by Walker after Tank assaulted him in a supermarket parking lot. *Id*. at 1135. State Farm advised Tank that if his acts were intentional, there was a specific policy provision excluding coverage. *Id.* After investigation of the incident, State Farm accepted the defense under a reservation of rights. *Id.* The attorney hired by State Farm for Tank maintained contact with the insured, the insured's personal attorney, and the insurer, providing a written evaluation to all parties prior to trial. *Tank v. State Farm Fire & Cas. Co.*, 715 P.2d 1133, 1135 (Wash. 1986) Defense counsel's opinion was that it was a case of clear liability, and that self-defense was a slim but possible defense. *Id.* Counsel also informed all parties that settlement in the $3,000 to $5,000 range had been rejected by Tank's personal lawyer. *Id.* No settlement was reached, and the court found Tank liable to Walker for $16,118.67 in damages and $305.40 in costs. *Id.* (It is surprising that the judgment in this case was so low). Tank sued State Farm for breach of duty of good faith in failing to make reasonable efforts to settle the Walker claim, maintaining that State Farm subordinated Tank's interests to its own interests by structuring a defense which would absolve State Farm of liability under Tank's insurance policy. *Id*. The trial court granted Tank's Motion for Summary Judgment. *Id.*

On appeal, the Supreme Court of Washington, held that an insurer defending under a reservation of rights owes an enhanced obligation of fairness towards its insured. *Id*. at 1137. "Both retained defense counsel and the insurer must understand that only the insured is the client." *Id.* The Court noted that Washington Rules of Professional Conduct 5.4(c) prohibits a lawyer, employed by a party to represent a third party, from allowing the employer to influence his or her professional judgment, and that the rule "demands that counsel understand that he or she represents only the

insured, not the company." *Id.* "The standards of the legal profession require undeviating fidelity of the lawyer to his client. No exceptions can be tolerated." *Id.*, quoting *Van Dyke v. White*, 349 P.2d 430 (Wash. 1960). The Court further determined, "defense counsel owes a duty of full and ongoing disclosure to the insured." This means that 1) potential conflicts of interest between insurer and insured must be fully disclosed and resolved in favor of the insured; 2) all information relevant to the insured's defense, including a realistic assessment of the insured's chances to win or lose the pending lawsuit, must be communicated to the insured, and 3) all offers of settlement must be disclosed to the insured as those offers are presented." *Tank v. State Farm Fire & Cas. Co.*, 715 P.2d 1133, 1137-1138 (Wash. 1986). However, the Court ultimately found, based on these criteria, that State Farm did not breach its duty to its insured. *Id.* at 1138. State Farm fully investigated the incident involving its insured and the plaintiff. *Id*. In addition, there were no allegations that State Farm neglected to hire competent defense counsel or failed to understand that defense counsel should only represent Tank. *Id.* In fact, State Farm retained counsel to represent the company's interests and then hired separate counsel for Tank. *Id.* Furthermore, State Farm fully informed Tank of all developments regarding policy coverage and the progress of the insured' lawsuit. *Id.* The Court held that as to Tank's allegations that State Farm had a duty to settle his lawsuit, it was the insured who must decide whether to settle a lawsuit defended under a reservation of rights. *Id.* To aid in this decision, the insured must be fully informed of all settlement activity. *Id.* There was no evidence to suggest that Tank was not fully informed. *Id.*

In conclusion, Courts have held that in cases where liability is clear and the Plaintiff's injuries are so severe that a judgment in excess of policy limits is likely, an insurer has an affirmative duty to initiate settlement negotiations. Courts have held insurers to "that degree of care and

diligence which the ordinary prudent person would exercise in the management of his own business." *Stowers*, 15 S.W.2d at 547. In cases where the financial exposure of the insured is a "ticking financial time bomb and suit can be filed at any time, any delay in making an offer...even where there was no assurance that the claim could be settled could be viewed as evidence of bad faith." *Harvey v. GEICO General Ins. Co.*, 259 So.3d 1, 7 (Fla. 2018).

C: Duty to keep insured informed of proceedings, and of the consequences of an excess verdict.

Courts have held that the duty of an insurer to exercise good faith includes an obligation to view the situation as if there were no policy limits applicable to the claim, and to give equal consideration to the financial exposure of the insured. *See, e.g., Short v. Dairyland Ins. Co.*, 334 N.W.2d 384, 387 (Minn. 1983). Components of this factor include whether the insurer gave equal consideration to the financial exposure of the insured and the insurer, *Lange v. Fid. & Cas. Co. of New York*, 185 N.W.2d 881, 884 (Minn 1971), whether the insurer informed the insured of all proceedings, including communications of settlement offers, *Short*, 334 N.W.2d at 389, whether the insurer informed the insured of any potential conflicts of interest between the insured and the insurer, and whether the insurer informed the insured of the consequences of an excess verdict. *Lange,* 185 N.W.2d at 886. In *Lange*, the jury returned a verdict that was $4,000 in excess of the insured's policy limits. *Id.* at 883. the plaintiff was willing to enter into a post-verdict settlement whereby it would accept the policy limits as full satisfaction of his claim, but the insurer refused to pay the policy limits of $25,000 and settle the claim. *Id*. Consequently, the court held that the insurer acted in bad faith by not settling the claim post-verdict for the policy limits. *Id.* at 886.

In *R.C. Wegman Const. Co. v. Admiral Ins. Co.*, 629 F.3d 724 (7th Cir. 2011) (applying

Illinois law), the Court examined whether the likelihood of an excess verdict could create a conflict of interest. In *Wegman*, the insurer, Admiral, issued a liability insurance policy to Wegman that provided a $1 million ceiling of coverage for a single occurrence. *Id*. at 725. While the policy was in effect, a subcontractor's employee, Budrik, was injured in a fall and sued Wegman, an additional insured on the policy which had been issued to his employer. *R.C. Wegman Const. Co. v. Admiral Ins. Co.*, 629 F.3d 724 (7th Cir. 2011). Budrik prevailed at trial, and a judgment for over $2 million was entered against Wegman. *Id.* Wegman then filed suit against Admiral, claiming that Wegman would not have been liable for damages in excess of the $1 million policy limit had Admiral discharged its duty of good faith that it owed its insureds. *Id.* Admiral accepted and controlled Wegman's defense. *Id.* Moreover, early on in the case, Admiral knew that Budrik had sustained serious injuries that had required a lumbar fusion, that he had experienced substantial ongoing pain and suffering, and that he had been unable to perform construction work since the accident. *Id.* at 727. Admiral also knew early on that Budrik was demanding almost $6,000,000 to settle the suit. *Id.* As a result, Admiral knew that the Budrik lawsuit presented a realistic possibility of a potential loss to Wegman in excess of policy limits. *Id.* Wegman argued that had Admiral promptly warned it of this possibility, Wegman would have sought indemnity from its excess insurer, since the policy limit in its excess policy was $10 million. *Id.* Instead, Wegman claimed that he did not realize that the lawsuit presented a realistic probability of a loss in excess of the Admiral policy limits until a few days before trial. *Id.* Although Wegman promptly notified its excess insurer, the later refused coverage due to untimely notice. *Id.* The Seventh Circuit held that an insurer must notify its insured of a "nontrivial probability" of an excess verdict, and that such notification provides that the insured has the option of hiring a new lawyer, one whose loyalty will be exclusively to him. *Id.* at 729. The

insurance company would be obligated to reimburse the reasonable expenses of the new lawyer. *Id.* The court reasoned that if the claim was for $2 million and the policy limit was $1 million, the Plaintiff would be willing to settle for the policy limit, but the insurer, Admiral's incentive would be to refuse to settle, since if it lost the trial, it would be no worse off than if it settled - in either case it would have to pay $1 million - but if it won it would have saved the insurer $1 million. *R.C. Wegman Const. Co. v. Admiral Ins. Co.*, 629 F.3d 724, 725-726 (7th Cir. 2011). The Court found that the conflict arose when Admiral learned that an excess judgment (and therefore a settlement in excess of the policy limits) was a nontrivial probability in Budrik's suit. *Id*. at 730. Had Wegman known it faced a judgment in excess of the limits of Admiral's policy, it would have notified its excess insurer. *Id.* at 731. The Court held that the duty to warn of a conflict of interest was not only the lawyer's duty, but it was also the insurer's. *Id.* Had Admiral warned Wegman of the likelihood of an excess judgment, Wegman would have sought and obtained coverage under its excess policy, and thus been freed from liability regardless of the outcome of Budrik's suit. *Id.* Therefore, the trial court's dismissal of Wegman's claim was premature. *Id*. *See also, Perma-Pipe, Inc. v. Liberty Surplus Ins. Corp*., 2014 WL 1600570 (N.D. Ill. 2014)(Where insured was being sued for more than $40 million and policy limit was $1 million per occurrence, there was a "nontrivial probability" that there would be an excess judgment in the underlying suit, and insurer breached duty to defend insured by refusing to pay for counsel of insured's choosing).

In summary, the duty of insurers to keep the insured informed of proceedings goes hand in hand with the duty of the insurer to place the interests of the insured above its own interests, and to exercise "that degree of care and diligence which the ordinary prudent person would exercise in the management of his own business." *Stowers Furniture v. American Indem. Co.*, 15 S.W.2d 544, 547

(Tex. Ct. App. 1929). Failing to do so may leave the insured saddled with an excess verdict, for which the insurer may ultimately become responsible.

D. Reliance on advice of counsel as a defense to bad faith claims

As previously noted, if the insured is sued for an amount in excess of policy limits and an offer to settle within the limits is made, the insurer must give some consideration to the insured's interest in such a situation. "Reliance on, or rejection of, advice of counsel as a factor affecting liability in action against insurer for wrongful refusal to settle claim," 63 A.L.R. 725 § 2[a]. Courts have generally agreed that reliance on the advice of counsel is only one of the factors to be considered in determining whether an insurer breached its duty to its insured by refusing to settle a claim against the insured. *Id. See e.g., Fowler v. State Farm Mut. Auto Ins. Co.*, 454 P.2d 76, (Mont. 1969) (In holding that the evidence of bad faith was insufficient to sustain a verdict against the insurer, the court noted that the insurer gave every consideration to the recommendation of trial counsel and acted accordingly); *Peckham v. Continental Cas. Ins. Co.*, 997 F. Supp. 73 (D. Mass. 1989) (Insurer's reliance on a diligent, good faith evaluation by counsel of its coverage obligations was evidence of insurer's good faith in interpreting automobile policy to preclude recovery for loss of consortium claims). *But see, Highway Ins. Underwriters v. Lutkin-Beaumont Motor Coaches, Inc*., 215 SW.2d 904 (Tex Ct. App.1948) (holding that the ultimate responsibility in settlement matters rests with the insurer, who cannot avoid that responsibility by showing that it followed the advice of an agent); *Allen v. Allstate Ins. Co.*, 656 F.2d 487 (9th Cir. 1981) (Insurer acted in bad faith where although insurer's distribution manager had estimated chances of losing action to be between

40 percent and 60 percent and had predicted that judgment five times the policy limit was likely, insurer nonetheless relied on its attorney's assurances that it could win). However, where the claimant offered to settle for an amount substantially below the policy limits and the insurer rejected the offer, the insurer, despite its reliance on the advice of counsel, has usually been held to have breached its duty to the insured. 63 A.L.R. 725 § 2[a]. Exceptions to this rule were where the insurer failed to notify counsel of facts bearing upon settlement value which were known to its agents. *Id*., citing *Douglas v. United States Fidelity & Guar. Co.*, 127 A 708 (NH 1924). The insurer's breach of duty to the insured has also been found where the insurer relied on the advice of counsel to reject a settlement offer after the return of an adverse verdict, regardless of whether counsel's advice was based on a belief that the claimant's evidence was insufficient as a matter of law. *Id. See, e.g., Bowers v. Camden Fire Ins. Asso*., 237 A.2d 857 (NJ 1968) (Where defense counsel had stated to insurer, with regard to settlement offer, that in his opinion, existing law did not justify verdict for the claimant, that a reversal on appeal was probable, and there was a good chance of defeating the claim at trial). In a case where counsel advised acceptance of a settlement offer after the return of an adverse verdict, the insured's liability was clear, and the insurer disregarded that advice, the insurer was found to have acted in bad faith. 63 A.L.R. 725 § 2[a] , citing *Olympia Fields Country Club v. Bankers Indem. Ins. Co.*, 60 N.E.2d 896 (Ill. C t App. 1995).

In summary, although some Courts may find it a viable defense, "an insurer should not assume that reliance on the advice of counsel will exonerate it from liability to its insured for wrongful refusal to settle a claim against the insured in excess of the policy limits." 63 A.L.R.3d 725 § 2[b].

E. Liability insurer's duty to defend action after full payment under the policy

Courts have been split on the issue of whether an insurer may absolve itself of the duty to defend the insured after tendering its policy limits into court. "Liability Insurer's duty to defend action against an insured after insurer's full performance of its payment obligations under policy," 27 A.L.R.3d 1057 § 2. Some courts have held that the insurer may not absolve itself of its duty to defend the insured after paying its policy limits, while other courts have found that the insurer's duty to defend ceased upon payment to the limits of the policy. 27 A.L.R.3d 1057 § 2. *See, e.g., Abstract & Title Guar. Co. Inc. v. Chicago Ins. Co.*, 489 F.3d 808 (7th Cir. 2007) (predicting that under Indiana law, insurer's payment of coverage limits to satisfy claims against insured for fraud by its employee exhausted insurer's duty to defend under policy, which provided that insured was not obligated to defend or continue to defend insured beyond policy limit for claims expenses); *Commercial Union Ins. Co. v. Adams*, 231 F. Supp. 860 (S.D. Ind. 1964) (duty of two comprehensive liability insurers to defend all pending and future suits against their respective insureds in connection with explosion at state fairgrounds terminated upon their payment to the court of their limit of their liability under the polices). *But see, Scottsdale Ins. Co. v. MV Transp.,* 115 P.3d 460 (Cal. 2005) (An insurer's duty to defend is a continuing one, arising from tender of defense and lasting until the underlying lawsuit is concluded or until it has been shown there is no potential for coverage) ; *Headwaters Resources, Inc. v. Illinois Union Ins. Co.*, 913 F. Supp.2d 1210 (D. Utah 2012) (Holding that if factual allegations in the underlying complaint leave coverage uncertain, the insurer must defend until those uncertainties can be resolved against coverage); *Atlantic Mutual Ins. Co. v. J. Lamb, Inc.*, 123 Cal. Rptr.2d 256 (Cal Ct. App. 2002) (Holding that the liability insurer's duty to defend is a continuing one, arising on tender of defense and lasting until the underlying

lawsuit is concluded or until it has been shown that there is no potential for coverage).

In summary, although courts are split on the issue, many have found that the insurer's duty to defend the insured does not cease after simply paying the policy limits into court. An insurer may not simply pay the policy limits when doing so would result in placing the burden of the defense on the insured, or in the insurer abandoning a defense to the insured's detriment.

II. Duty of a primary insurer to an excess insurer to settle within policy limits in Indiana

No court applying Indiana law has held or even intimated that a primary insurer owes a direct duty of care to the excess insurer. *Phico Ins. Co., Inc. v. Aetna Cas. and Sur. Co. of America*, 93 F. Supp.2d 982, 989 (S.D. Ind. 2000). A few cases from other jurisdictions have suggested that such a duty exists, but the majority of jurisdictions describe the duty owed by the primary insurer to the excess insurer as derivative from that owed to the insured. *Id.* The Indiana Court of Appeals in *Querrey & Harrow, Ltd.* noted in particular that although the issue had "not been decided by an Indiana Court," "at least one federal court predicted that Indiana [would] allow an excess insurer to bring an action against a primary insurer under equitable subrogation for negligent defense of a claim against an insured." *Querrey & Harrow, Ltd. v. Transcontinental Ins. Co.*, 861 N.E.2d 719, n. 3 (Ind. Ct. App. 2007), discussing *Phico Ins. Co., Inc. v. Aetna Cas. and Sur. Co. of America*, 93 F. Supp.2d 982, 990 (S.D. Ind. 2000). The rationale for applying the doctrine of equitable subrogation in favor of excess insurers against primary insurers is to prevent injustice and to shift the economic burden to the party responsible for the loss. *Phico*, 93 F. Supp.2d at 991. "Regarding whether a coinsurer who has settled the excess judgment against the insured is entitled to recover against a primary insurer because of its wrongful refusal to compromise the claim, such recovery has generally been

allowed." 44 Am. Jur. 2d Insurance § 1399 (Updated November 2015), citing *Certain Underwriters of Lloyd's and Companies v. General Acc. Ins. Co. of America*, 909 F.2d 228 (7th Cir. 1990); *Portland General Elect. Co. v. Pacific Indem. Co.*, 574 F.2d 469 (9th Cir. 1978); *St. Paul Fire & Marine Ins. Co. v. U.S. Fidelity & Guaranty Co.*, 375 N.E.2d 733 (N.Y. 1978). "An excess insurer is under no duty to defend an insured; thus it is not barred from bringing an action against the primary insurer alleging that the primary insurer acted negligently and in bad faith in pursuing settlement negotiations in an action notwithstanding the primary insurer's contention that the excess insurer failed to take any steps of its own to effect settlement." 44 Am. Jur. 2d Insurance § 1399 , citing *Insurance Co. of North America v. Medical Protective Co.*, 768 F.2d 315 (10th Cir. 1985). "Even where liability is clear, however, the primary insurer's rejection of a settlement offer demand in excess of its policy limits only constitutes bad faith as to an excess insurer if the insurer fails to make any attempt to engage the plaintiff in discussions to reduce the demand and fails the inform the excess insurer of the demand." *Id., citing California Union Ins. Co., Ltd.*, 780 F. Supp. 1010 (10th Cir. 1985).

In *Certain Underwriters of Lloyd's v. General Accident Insurance Co. of America* , 909 F.2d 228 , 229 (7th Cir. 1990), an Indiana cargo carrier's excess insurer, Underwriters, sought to recover from a primary insurer, General Accident, the portion of a personal injury settlement it paid that was in excess of the primary policy limits. The district Court denied General Accident's motion for directed verdict. *Id.* On appeal, the 7th Circuit recognized that an excess insurer had a right against a primary carrier based upon equitable subrogation. *Id.*, 231-234. The Court noted that the excess insurer faced the hazard that the primary insurer would refuse to settle the case within the primary limits. *Id.* at 232. The primary insurer's duty to act with due care and in good faith did not disappear

simply because the insured purchased excess insurance. *Id*. **The Seventh Circuit ultimately predicted that Indiana would allow an excess carrier to sue a primary carrier on the basis of equitable subrogation**. *Id.* at 233, emphasis supplied. Although General Accident alleged that the insured consented to the settlement, the Court noted that an insurer must conduct settlement negotiations in good faith regardless of whether the insured eventually consents to the settlement. *Id.* at 234, discussing *Insurance Co. of North America v. Medical Protective Co.*, 768 F.2d 315 (10th Cir. 1985). Although the Court acknowledged that the insured, CFE's consent to the settlement would bar Underwriters' recovery, whether the insured consented in General Accident's handling of the litigation was a question of fact. *Certain Underwriters of Lloyd's v. General Accident Insurance Co. of America* , 909 F.2d 228 , 229 (7th Cir. 1990). The insured, CFE, did not refuse to settle, nor did it direct General Accident to take the case to trial. *Id.* In fact, CFE was quite worried about the possibility of an excess judgment. *Id.* Since CFE's actions did not amount to consent, the District Court correctly refused to direct a verdict in General Accident's favor. *Id.*

See also, Phico Ins. Co., Inc. v. Aetna Cas. and Sur. Co. of America, 93 F. Supp.2d 982, 991-95 (S.D. Ind. 2000)(Although District Court predicted that Indiana Supreme Court would probably recognize a cause of action by an excess insurer against a primary insurer under a theory of equitable subrogation, excess insurer could not recover where failure to participate in defense of insured before primary insurer paid policy limits amounted to willful misconduct). *But see, Robertson v. Medical Assur. Co., Inc*., No. 2:13-CV-107JD, 2014 WL 1338638 at *2 (N.D. Ind. Apr. 3, 2014) (Reasoning that the Indiana Supreme Court's opinion in *State Farm Mut. Auto Ins. Co. v. Estep*, 873 N.E.2d 1021 (Ind. 2007) cast "at least some degree of doubt" on the accuracy of the Seventh Circuit's prediction that the Indiana Supreme Court would allow an excess insurer to recover against a primary

insurer under a theory of equitable subrogation. The District Court explained that in *Estep*, the Indiana Supreme Court held that while an insured party was free to voluntarily assign a claim against its insurer to a third party, Indiana law prohibited courts from involuntarily assigning such claims to a third party judgment creditor. *Id.* Therefore, since equitable subrogation could be characterized as an involuntary assignment, (since resorting to equitable subrogation would be unnecessary where the insured voluntarily assigned its claim in the first place), the Court reasoned that *Estep*'s holding could arguably extend to prohibiting the equitable subrogation of an insured's claim against its insurer. *Robertson v. Medical Assur. Co., Inc.*, No. 2:13-CV-107JD, 2014 WL 1338638 at *2 (N.D. Ind. Apr. 3, 2014).

In any event, regardless of the Seventh Circuit's prediction regarding the viability of suits against primary insurers by excess carriers, it is clear that Indiana law remains unsettled on this question.

III. Duty of a lawyer representing an insured

"When an insurer appoints counsel to defend an insured, many analysts believe that a triprartite relationship is formed....The tripartite relationship refers to the relationship among an insurer, its insured, and defense counsel retained by the insurer to defend the insured against third party claims. This relationship can present actual or potential conflicts between the insurer and the insured, placing defense counsel in difficult, often confusing positions." *The Relationship between Defense Counsel, Insurer and Insured: Deciphering the Tripartite Mystery*, Indiana Civil Litigation Rev., Vol. XIII (2016), attached as Appendix 1. Indiana Rule of Professional Conduct, Rule 1.8 (f) mandates that a lawyer cannot accept compensation for representing a client from a third party unless

certain conditions are met, including that the lawyer's judgment remain independent.

Indiana Rules of Professional Conduct, Rule 1.8 (f) provides:

(f) 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 a client is protected as required by Rule 1.6.

Ind. R. Prof. Conduct, Rule 1.8(f).

The commentary to Rule 1.8(f) explains:

"Because third-party payers frequently have interests that differ from those of the client, including interests in minimizing the amount spent on the representation and in learning how the representation is progressing, lawyers are prohibited from accepting or continuing such representations unless the lawyer determines that there will be no interference with the lawyer's independent professional judgment and there is informed consent from the client. See also Rule 5.4(c) (prohibiting interference with a lawyer's professional judgment by one who recommends, employs or pays the lawyer to render legal services for another).

Sometimes, it will be sufficient for the lawyer to obtain the client's informed consent regarding the fact of the payment and the identity of the third-party payer. If, however, the fee arrangement creates a conflict of interest for the lawyer, then the lawyer must comply with Rule 1. 7. The lawyer must also conform to the

requirements of Rule 1.6 concerning confidentiality. Under Rule 1.7(a), a conflict of interest exists if there is significant risk that the lawyer's representation of the client will be materially limited by the lawyer's own interest in the fee arrangement or by the lawyer's responsibilities to the third-party payer (for example, when the third-party payer is a co-client). Under Rule 1.7(b), the lawyer may accept or continue the representation with the informed consent of each affected client, unless the conflict is nonconsentable under that paragraph. Under Rule 1.7(b), the informed consent must be confirmed in writing."

Official Comment, Ind. R. Prof. Cond., Rule 1.8(f).

Additionally, Indiana Rule of Professional Conduct 5.4 (c) provides:

(c) a lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services."

Ind. R. Prof. Conduct, Rule 5.4(c).

A. When can an insurer or an insured bring an action against attorney for malpractice?

1. Malpractice actions by insureds

The Indiana Rules of Professional conduct impose duties on counsel to faithfully represent insureds. As clients of the lawyer, insureds have the right to bring suit against counsel for malpractice.

In *Fulton v. Woodward*, 545 P.2d 979 (Ariz. Ct. App. 1976), previously discussed regarding the duty to initiate settlement negotiations, an insured brought an action against his insurer,

Harleysville, for failing to settle a wrongful death case against the insured prior to trial, and against an attorney employed by the insurer for malpractice in connection with his handling of the wrongful death case. At the time of the accident, Fulton was insured by Harleysville under a general automobile liability policy having $100,000.00 limits. *Id.* at 981. The jury eventually returned a verdict of $200,000,00. *Id.* Fulton admitted that prior to the verdict in the underlying wrongful death case, the Plaintiff's attorney never made a firm offer to settle the litigation within policy limits, nor did Fulton or his personal attorneys demand that Harleysville settle within policy limits. *Id*. The Court noted that Fulton and his personal attorneys acquiesced and consented to the continued representation afforded by Harleysville after a reservation of rights letter was sent. *Fulton v. Woodward*, 545 P.2d 979, 982 (Ariz. Ct. App. 1976). Under these circumstances, this conflict of interest in and of itself did not constitute bad faith on the part of the insurer or malpractice on the part of the attorneys. *Id*. **Regarding Fulton's claim against the attorney, Woodford for malpractice in failing to effectuate a settlement of the underlying litigation, the Court opined that to find in Fulton's favor would essentially require it "to hold in every case in which an attorney was unable to obtain a settlement within policy limits that attorney would be guilty of malpractice."** *Id*. at 986, emphasis supplied. This the Court refused to do. *Id.* **Woodford simply did not have the money authorization from Harleysville to settle the case, and there was no showing that Harleysville would have given him sufficient authorization to settle**. *Id*. Therefore, the trial court properly granted Woodford's motion for a directed verdict. *Id*.

See also, Ecotech Intern., Inc. v. Griggs & Harrison, 928 S.W.2d 644 (Tx. Ct. App. 1996), where an insured brought an action against liability insurers and defense counsel for negligent failure to accept a settlement offer within policy limits. The Court held that the attorneys could not be held

liable under the "*Stowers* doctrine" for negligent failure to accept a settlement offer within policy limits. *Id*. at 649. Under *Stowers Furniture v. American Indem. Co.*, 15 S.W.2d 544 (Tex. Ct. App. 1929), an insured may recover from his insurer the entire amount of a judgment in excess of policy limits rendered against him, if prior to judgment, the insurer negligently failed to accept a settlement offer within the liability limits of the policy. *Id.* at 646. Under *Stowers*, "**An insurer is held to that degree of care and diligence which an ordinary prudent person would exercise in the management of his own business**." *Id., emphasis supplied.* The insured, Ecotec, brought an action against its insurer and the law firm hired to represent it after a judgment in excess of the policy limits was entered against it in an underlying wrongful death action. *Ecotech Intern., Inc. v. Griggs & Harrison*, 928 S.W.2d 644 (Tx. Ct. App. 1996). As to the law firm, the Court held that "an attorney cannot be held liable for an alleged Stowers violation. The *Stowers* duty is imposed only on an insurer and not on any other party." *Id*. at 649. However, since the attorneys' motions for summary judgment failed to address other causes of action that were alleged, the Plaintiff could still pursue other claims brought against the law firm, including misrepresentations concerning legal services, misrepresentations of authority to negotiate final terms of settlement, breaches of implied warranty of fitness of services, failure to disclose information to Ecotech to induce it to continue in the litigation, engaging in unconscionable conduct, and allegations of malpractice. *Id.*

Likewise, in *Santiago v. Fellows, Epstein & Hymowitz, P.C.*, 66 A.D.3d 758 (N.Y. App. Div. 2009), an insured brought a legal malpractice action against attorneys after the insurer failed to settle within the policy limits. The Defendant attorneys established that during their representation of the Plaintiff in the underlying action, Selective, the insurer of two of the four defendants in the underlying action, did not offer to settle the matter on behalf of its insureds for the $1,000,000 policy

limit. *Id.* at 758. Selective tendered its $1 million single limit policy to Travelers, and requested that Travelers assume the handling and defense of the action. *Id*. at 759. Then, a mere nine days later, Selective retracted the tender. *Id.* According to the attorney, Fellows, it was not until almost a year later that the plaintiff directed him to settle the underlying action with Selective for a total sum of $1,000.00. *Id*. **However, Selective never made such an offer.** *Id.* **Thus, Fellows could not possibly have acted on the Plaintiff's behalf to settle the case, and his failure to do so could not be deemed malpractice**. *Id.*

In conclusion, insureds have the right to bring malpractice actions against counsel retained by insurers to represent them. However, Courts have been unwilling to hold an attorney responsible where the attorney was not given sufficient direction or authority from insurers to negotiate a settlement.

2. Malpractice actions by insurers, and the duties owed by defense counsel to insureds

Courts have been unwilling to find attorneys responsible for malpractice in actions by insurers. This issue goes to the heart of the tripartite relationship and duties owed by attorney to the insured as a client.

In *Querry*, the Indiana Court of Appeals emphasized the importance of safeguarding the attorney/client relationship from outside influence. *Querry & Harrow, Ltd. v. Transcontinental Ins. Co.*, 861 N.E.2d 719, 723 (Ind. Ct. App. 2007), affirmed, 885 N.E.2d 1235, 1237 (Ind. 2008). In *Querry*, a manufacturer's excess liability insurer, Transcontinental Insurance Company ("CNA"), brought a legal malpractice action against attorneys and law firms hired by a primary liability insurer

to represent an insured manufacturer in a products liability action. *Id.* at 720. CNA alleged that had the attorneys from the law firms timely raised a non-party defense, the underlying litigation would have been settled, or a verdict would have been reached that was substantially less than the $6,300,00.00 settlement amount. *Id.* The trial court denied the law firms' motions for summary judgment, holding that an excess insurer could bring an action for legal malpractice against an insured's attorneys, and that a genuine issue of material fact existed as to whether an attorney-client relationship existed between the insured's attorneys and CNA. *Id*. at 721. On appeal, the Court expressed concern about the potential for insurers to interfere with the sanctity of the attorney-client relationship. "When lawyers must be concerned about their potential liability to third parties, the resultant self-protective tendencies may deter vigorous representation of the client. Attention to third-party risk might cause the attorney improperly to consider 'personal interests' or 'the desires of third parties' above the client's interests. This would contravene the lawyer's duty of loyalty to the client." *Querry & Harrow, Ltd. v. Transcontinental Ins. Co.*, 861 N.E.2d 719, 722 (Ind. Ct. App. 2007), affirmed, 885 N.E.2d 1235, 1237 (Ind. 2008), quoting Jack I. Samet et al., *The Attack on the Citadel of Privity*, 20 A.B.A. Winter Brief 9, 40 (1991)(footnotes omitted).

The Court examined cases in other federal and state courts that addressed the issue of whether an insurer could pursue a legal malpractice action against an insured's attorney. It observed that "a number of jurisdictions have held as a matter of public policy that such an action would interfere with the attorney-client relationship and would run counter to the jurisdiction's prohibition of the assignment of legal malpractice actions." *Id.*, discussing *Essex Ins. Co. v. Tyler*, 309 F.Supp.2d 1270, 1274 (D. Colo. 2004)(Allowing excess insurer to pursue legal malpractice action against insured's attorney would compromise the duty of loyalty to the attorney's client based on the

anticipation of "possible legal malpractice claims by third parties."); *Fireman's Fund Ins. Co. v. McDonald, Hecht & Solberg*, 30 Cal. App.4th 1373 (Cal. Ct. App. 1994), *rev. denied* (Public policy would not allow insurers to violate the sanctity of the attorney-client relationship by pursuing an action against insured's attorneys); *National Union Fire Ins. Co. v. Salter*, 717 So.2d 141 (Fla. Ct. App. 1988), rev. denied (holding that policy reasons for prohibiting assignment of legal malpractice claims apply to prohibition of subrogation of legal malpractice claims); *American Continental Ins. Co. v. Weber & Rose, P.S.C.*, 997 S.W.2d 12 (Ky. Ct. App. 1998), *rev. denied* (holding that "allowing excess insurers to maintain legal malpractice actions against insured's attorneys, based upon theories of equitable subrogation, would undermine the jurisdiction's adherence to a view promoting the preservation of traditional attorney-client relationships"); *American Employers' Insurance Co. v. Medical Protective Co.*, 419 N.W.2d 447 (Mich. Ct. App. 1988), *appeal denied* (holding that allowing excess insurer to pursue a legal malpractice action against the insured's attorneys would "contradict the personal nature of the attorney-client relationship, which permits a legal malpractice action to accrue only to the attorney's client").

The *Querry* Court also examined the issue of whether an attorney-client relationship existed between defense counsel and CNA. Although CNA received routine and confidential client communications which the defendant attorneys were sending to CNA's insured, there wasn't "any indicia of dual representation at the time of the alleged malpractice or any time thereafter." *Querry & Harrow, Ltd. v. Transcontinental Ins. Co.*, 861 N.E.2d 719, 724-725 (Ind. Ct. App. 2007), affirmed, 885 N.E.2d 1235, 1237 (Ind. 2008). The correspondence fell "far short of establishing a fact question as to whether [the insured's] attorneys consented to represent both their client and the excess insurer." *Id*. at 725. The Court held that the excess insurer could not bring a malpractice

action under the doctrine of equitable subrogation. *Id*.

The *Querry* Court did not address the situation where a primary insurer brings a malpractice action against counsel it hired to defend its insured, and Indiana state courts have not addressed whether such suits are permissible. However, the Northern District of Indiana, in *Mcgrath* held that an insurer that retained defense counsel was "in privity" with defense counsel, and had the independent right to sue for legal malpractice. *See Mcgrath v. Everest Nat. Ins. Co.,* No. 2:07-cv-34, 2009 WL 3080275 at *5 (N.D. Ind., Sept. 24, 2009), citing *TIG Ins. Co. v. Giffin Winning Cohen & Bodewess, P.C.*, 444 F.3d 587 (7th Cir. 2006)(insurance company brought malpractice action against law firm and one of its attorneys stemming from firm's representation of insured); *Jones Motor Co., Inc. v. Holtamp, Liese, Beckemeir & Childress*, P.C., 197 F.3d 1190 (7th Cir. 1999) (trucker and its insurer brought legal malpractice action against attorneys that unsuccessfully defended trucker in lawsuit); *American Intern. Adjustment Co. v. Galvin*, 86 F.3d 1455 (7th Cir. 1996) (insurer brought legal malpractice action against firm and attorney who defended client in tort action). Regardless of whether Indiana allows such malpractice actions by primary insurers, the Court of Appeals' concerns voiced in *Querry* remain at the heart of the tripartite issue. If an insurer who hires defense counsel can be considered a "client," the attorney could improperly "consider personal interests or the desires of third parties" above the insured's interests. *Querry & Harrow, Ltd. v. Transcontinental Ins. Co.*, 861 N.E.2d 719, 722 (Ind. Ct. App. 2007), affirmed, 885 N.E.2d 1235, 1237 (Ind. 2008). This would "contravene the lawyer's duty of loyalty to the client." *Id.* Such concerns would be obviated if defense counsel makes it clear at the outset, to both insured and insurer, that the insured is his sole client.

The Northern District of Illinois, in *National Union* permitted a trucking company's excess

insurer to bring a malpractice claim, under a theory of equitable subrogation, against a law firm retained by its insured. *National Union Ins. Co. v. Dowd*, *P.C.*, 2 F. Supp.2d 1013, 1022 (N.D. Ill. 1998). The Court reasoned that "a primary insurer's duty to defend its insured generally includes the right to select the attorney to control the litigation. Since the primary insurer contracts the attorney, pays the attorney's legal fees, and directs the litigation or settlement of the claim, it stands to reason that the primary insurer is one of the attorney's clients." *Id*. at 1017. However, "the excess insurer generally has no legal or contractual duty to defend...Thus, unlike a primary insurer, an excess insurer has no direct relationship with the attorney retained to defend an action against the insured..." *Id.* at 1018. The Court determined that "under the theory of the tripartite relationship, no attorney-client relationship existed between [the excess insurer] and [the law firm], and [the law firm] owed no fiduciary duty to [the excess insurer]." *National Union Ins. Co. v. Dowd*, *P.C.*, 2 F. Supp.2d 1013, 1018 (N.D. Ill. 1998) However, the Court did recognize the excess insurer's right to be equitably subrogated to its insured's right to bring a malpractice action against the firm. *Id*. at 1022.

In *U.S. Specialty Ins. Co. v. Burd*, 833 F. Supp.2d 1348, 1350 (M.D. Florida 2011), an insurer that issued a premises liability policy brought a legal malpractice action against an attorney it had hired to defend its insured, an air museum, in a personal injury action involving an aircraft that fell on top two people, killing one and seriously injuring the other. The District Court permitted the insurer's malpractice action, holding that it was "clear that under Florida law, a tripartite relationship normally exist[ed] between the insurer, the insured and the lawyer retained to represent the insured." *Id.* at 1353. Further, the court noted that the comments to Rule Regulating Fla. Bar 4-1.7(c) "recognize[d] that the lawyer may represent both the insurer and the insured in the absence of a

disqualifying conflict of interest." *Id.*, discussing 4-1.7 cmt. "A conflict of interest is involved if there is a substantial risk that the lawyer's representation of the client would be materially and adversely affected by the lawyer's own interests or by the lawyer's duties to another current client, a former client, or a third person." *Id.* at 1355, quoting the Restatement (Third) of the Law Governing Lawyers § 121. The District Court held that because a tripartite relationship existed, the insurer could bring a malpractice action against defense counsel. *Id*. at 1357.

Similarly, in holding that a conflict of interest requiring the insurer to hire independent counsel for the insured was not created simply because an attorney was defending the insured under a reservation of rights, the Fourth Circuit was "unable to conclude that the Supreme Court of South Carolina would profess so little confidence in the integrity of the South Carolina Bar." *Twin City Fire v. Ben-Arnold-Sunbelt Beverege Co. of S.C.*, 433 F.3d 365, 373 (4th Cir. 2005). The Court, discussing South Carolina Rule of Professional Conduct 1.8(f), which closely resembles Indiana's rule, noted, "[rigorous] ethical standards govern South Carolina Attorneys. Rule 1.8(f) of the South Carolina Rules of Professional Conduct mandates that a lawyer cannot accept compensation for representing a client from a third party unless certain conditions are met, including that the lawyer's judgment must remain independent." *Id*. Likewise, the Hawaii Supreme Court in *Finley*, interpreting Hawaii Rules of Professional Conduct, Rule 1.8(f), which closely resembles Indiana's rule, concluded:

> "We believe that an attorney may accept payment for a defense of the insured without compromising his or her duty of loyalty to the client. Having determined that the sole client of the attorney is the insured, an attorney who follows the above-cited requirements of the HRPC 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." Only if these requirements are met will the representation of an insured, paid for by an insurer with a conflicting interest in the outcome of the litigation, comport with the mandates of the HRPC."
>
> *Finley v. Home Ins. Co.*, 975 P.2d 1145, 1553 (Haw. 1998).

The Hawaii Supreme Court refused to "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 1154. While the insurer may have a contractual right to select defense counsel, "the insurer's desire to limit expenses must yield to the attorney's professional judgment and his or her responsibility to provide competent, ethical representation to the insured." *Finley v. Home Ins. Co.*, 975 P.2d 1145, 1554 (Haw. 1998). "Whatever the rights and duties of the insurer and the insured under the insurance contract, that contract does not define the ethical responsibilities of the lawyer to his client." ABA Committee on Ethics and Professional Responsibility, Formal Op. 96-403. "When retained counsel, experienced in the handling of insurance defense matters, is allowed full rein to exercise professional judgment, the interests of the insured will be adequately safeguarded. If the insurer or retained counsel fail to meet the professional standards mandated by the [state rules of professional conduct], alternate remedies exist which can be utilized by the insured." *Finley,* 975 P.2d at 1154.

However, as noted by the *Armstrong* court, "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." *Armstrong Cleaners, Inc. v. Erie Exchange,* 364 F. Supp.2d 797, 807 (S.D. Ind. 2005). "There is no talismanic rule" to determine whether a disqualifying conflict of interest exists. Instead, "[t]he potential for conflict requires a careful analysis of the parties' respective interests to determine whether they can be reconciled...or whether an actual conflict of interest precludes insurer-appointed defense counsel from presenting a quality defense for the insured." *Id.* at 808. **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**. *Id*. (emphasis added).

The Indiana Supreme Court in *Cincinnati Ins. Co. v. Wills,* 717 N.E.2d 151 (Ind. 1999) was careful to state that "attorneys who are employees of insurance companies do not *necessarily* trigger an impermissible conflict in violation of the Rules of Professional Conduct when they appear as counsel to defend claims against the companies' policyholders." *Id.* at 165 (emphasis added). Evaluating that risk requires close attention to the details of the underlying litigation. The court must then make a reasonable judgment about whether there is a significant risk that the attorney selected by the insurance company will have the representation of the insureds significantly impaired by the attorney's relationship with the insurer. *Armstrong Cleaners v. Erie Exchange*, 364 F.Supp.2d 797, 808 (S.D. Ind. 2005).

In summary, an attorney employed by an insurer to defend an insured is bound by the same high standards which govern all attorneys and owes the insured the same duty as if he were privately retained by the insured. *Finley v. Home Ins. Co.*, 975 P.2d 1145, 1153 (Haw. 1998), quoting *State*

Farm Fire & Cas, Co. v. Mabry, 497 S.E.2d 844, 847 (Va. 1998). It is for this reason that Courts have been reluctant to permit insurers to bring malpractice actions against counsel retained to represent insureds. Courts should be confident that defense counsel provide insureds the competent, diligent, and faithful representation they deserve.

DATE

RE:
Cause No.
Date of Loss:
Our File No.

Dear _____:

This office has been retained by _____ to represent you in the above-captioned lawsuit which was filed against you by _____ in the _____ Court.

I would ask that you not discuss any aspect of this case with anyone other than representatives of _____ Insurance Company, or members of this office.

Pursuant to Rule 1.8(f) of the Indiana Rules of Professional Conduct, I am required to tell you that my services are being paid for by a third party, that being your insurance carrier. These arrangements have been made pursuant to your policy of insurance, and I can assure you that there will be no interference with my independence of professional judgment or with the client-lawyer relationship. Further, any information relating to the representation shall not be revealed unless you consent after consultation, except for disclosures that are impliedly authorized in order to carry out the representation. Rule 1.8(f) requires further that we obtain your consent to these arrangements, and I would ask that you provide your consent by signing the space provided below which indicates your understanding and consent to these arrangements, and returning this signed letter to me.

Obviously, should you have any questions or comments with regard to my handling of this case, please feel free to call me directly.

Very truly yours,

_____

XXX:xxx

I, _____, hereby agree to permit the law firm of _____ to represent me in this case, despite the fact that their fees will be paid by _____ Insurance Company.

Date: _____ _____
NAME

cc: Adjuster

The Relationship Between Defense Counsel, Insurer and Insured: Deciphering the Tripartite Mystery

Indiana Rule of Professional Conduct 1.6:

(a) A lawyer shall not reveal information relating to representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).

(b) A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:

(1) to prevent reasonably certain death or substantial bodily harm;

(2) to prevent the client from committing a crime or from committing fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services;

(3) to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services;

(4) to secure legal advice about the lawyer's compliance with these Rules;

(5) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client; or

(6) to comply with other law or a court order.

(c) In the event of a lawyer's physical or mental disability or the appointment of a guardian or conservator of an attorney's client files, disclosure of a client's names and files is authorized to the extent necessary to carry out the duties of the person managing the lawyer's files.

Indiana Rule of Professional Conduct 1.7:

(a) 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.

Indiana Rule of Professional Conduct 1.8(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.

Indiana Rule of Professional Conduct 5.4(c):

> A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services.

A. The Tripartite Insurance Defense Relationship: Two approaches.

Insurance defense lawyers dwell in a unique landscape within the attorney-client relationship. Although there are other areas of the law where it is not necessarily uncommon for a third party to pay the legal fees for a lawyer's client (e.g., criminal law where a parent may pay the fees to obtain legal representation for a son or daughter), legal ethics clearly identify that the attorney's loyalty lies with the client, not with the party paying for the fees. The third party has no control over the attorney's professional judgment and no right to control the litigation. In fact, absent consent from the client, the third party has no right to even be apprised of how the representation is proceeding or the content of communications between the attorney and client. See Indiana Rules of Professional Conduct 1.6 and 1.8(f). The attorney client relationship under these circumstances is relatively straight forward.

In the context of insurance defense representation, the relationship is defined less clearly. This is due to the fact that the third party (i.e., the insurer) has certain contractual rights under the terms of the policy with the client (i.e., the insured). These rights include the right to choose the legal counsel who will handle the case as well as the right to control how the claim is defended. Additionally, the insurer has a right to be informed of how the litigation is developing. Perhaps most important is the fact that the insurer has a duty to indemnify the insured pursuant to the terms and limits of the underlying policy. These contractual rights and obligations of the insurer complicate the attorney client relationship and, in some cases, even obfuscate the issue of whom the attorney is representing.

It is interesting to note that the Code of Professional Conduct does not define the word "client." Likewise, Indiana case law does not provide such a definition. According to Black's Law Dictionary, Revised Fourth Edition (1968), client is defined as:

> A person who employs or retains an attorney, or counsellor, to appear for him in courts, advise, assist, and defend him in legal proceedings, and to act for him in any legal business. *McCreary v. Hoopes*, 25 Miss. 428; *McFarland v. Crary*, 6 Wend., N.Y., 297; *Cross v. Riggins*, 50 Mo. 335. It should include one who disclosed confidential matters to attorney while seeking professional aid, whether attorney was employed or not. *Sitton v. Peyree*, 117 Or. 107, 241 P. 62, 64.

The Seventh Circuit Court of Appeals has noted that the, "primary definition of 'client' in modern dictionaries is a person who receives services or advice from a professional such as an attorney, indicating personalized advice." *Commodity Trend Serv., Inc. v. Commodity Futures Trading*

Comm'n, 233 F.3d 981, 989 (7th Cir. 2000). Additionally, in a case involving the court appointment of a criminal defense counsel for the indigent, Chief Justice Burger wrote, "[t]he obligations owed by the attorney to the client are defined by the professional codes, not by the governmental entity from which the defense advocate's compensation is derived." *Polk Cnty. v. Dodson*, 454 U.S. 312, 327, 102 S. Ct. 445, 454, 70 L. Ed. 2d 509 (1981) (concurring opinion)(footnote omitted).

When an insurer appoints counsel to defend an insured, many analysts believe that a "tripartite relationship" is formed. "The debate regarding this controversial relationship between the insurer, the attorney hired by the insurer, and the insured is not new. In the 1940s through the 1960s Professor (now Judge) Robert E. Keeton brought the issues surrounding the tripartite relationship to the forefront of scholarly attention; . . . ." Nathan Anderson, *Risky Business: Attorney Liability in Insurance Defense Litigation - A Review of the Arizona Supreme Court's Decision in Paradigm Insurance Co. v. Langerman Law Offices*, 2002 B.Y.U. L. Rev. 643, 650-51 (2002) (footnote omitted). "The 'tripartite' relationship refers to the relationship among an insurer, its insured, and defense counsel retained by the insurer to defend the inured against third party claims. This relationship can present actual or potential conflicts between the insurer and the insured, placing defense counsel in difficult, and often confusing positions." Stephen E. Whitehead, Jennifer W. Wall, *The Insurance Tripartite Relationship: "Who is my client anyway?*", 69 Ala. Law. 416, 417 (2008).

This tripartite relationship has created enough confusion in the area of the attorney-client relationship that it has even been compared to the Bermuda Triangle:

> To many travelers and observers, the Bermuda Triangle is a mystery. Far closer to home, but perhaps no less a mystery to most lawyers, lies the "eternal triangle" of insurance defense. The eternal triangle refers to the tripartite relationship created when a liability insurer hires counsel to defend its insured when the insured is sued by a third party claimant. This relationship is unique. In no other area of the law are parties routinely represented by counsel selected and paid by a third party whose interests may differ from those of the individual or entity the attorney is defending. The insurer, the insured and insurance defense counsel form the points of the eternal triangle.

Douglas R. Richmond, *Lost in the Eternal Triangle of Insurance Defense Ethics*, 9 Geo. J. Legal Ethics 475, 476-77 (1996).

Central to the tripartite relationship is the question of whether the lawyer represents the insured alone or both the insured and insurer. The prevailing model seems to be the two client model, with the one client model gaining approval. Jean Fleming Powers, *Advantages of the One-Client Model in Insurance Defense*, 45 N.M. L. Rev. 79, 81 (2014). While under the one client model, the insurance defense attorney represents the insured alone, under the two client model, the attorney represents both the insured and the insurer who hired him. Thus, under the latter, any

potential conflicts include those between two current clients, as opposed to merely arising from the fact that the insurer is paying for the representation. *Id.*

Most courts follow a variation of the two client model, the "favored client model," where they essentially acknowledge the existence of two clients, the insured and the insurer, but when there is a conflict, they tend to stress the attorney's obligation to the insured. *Id*. *See also*, New Appleman on Insurance Law Library Edition - §16.04[1]: The Tripartite Relationship Among the Insured, the Insurer and Insurer-Directed Defense Counsel (2011) ("Except in the unusual case where insurer and insured have a conflict of interest precluding joint representation..., the law in most jurisdictions recognizes both as clients of defense counsel. Thus, both as a client and pursuant to the insurance contract, the insurer usually has the right to make expenditure and strategic decisions.")

It should only make sense, however, that the insurance defense attorney has only one primary client, the insured, to whom all ethical duties are owed. If defense counsel faithfully represents his or her client, the insured, adhering to the standards set forth in state rules of professional conduct, such "conflicts" can be greatly lessened, or will cease to exist entirely. The "mystery" of the "tripartite relationship" becomes merely smoke and mirrors.

B. The Two Client/Favored Client Model

Regarding the tripartite issue, the Nevada Supreme Court has noted:

> [w]ith respect to the relationship between an insurer and counsel the insurer retains to defend its insured, the majority rule is that counsel represents both the insurer and the insured in the absence of a conflict. This rule requires that the primary client remains the insured, but counsel in this situation has duties to the insurer as well. Courts adopting this rule note that, while the insured is the primary client, counsel generally learns confidential information from both the insured and the insurer and thus owes both of them a duty to maintain this confidentiality; and, since counsel generally offers legal advice to both the insured and the insurer, counsel owes a duty of care to both.

Nevada Yellow Cab Corp. v. Eighth Judicial Dist. Court, 152 P.3d 737, 741 (Nev. 2007) (footnotes omitted). *See also, Home Indem. Co. v. Lane Powell Moss and Miller*, 43 F.3d 1322, 1330-31 (9th Cir. 1995)(applying Alaska law); *State Farm v. Federal Ins. Co.*,72 Cal. App. 4th 1422, 1429 (Cal. Ct. App. 1999); *Unigard Ins. Group v. O'Flaherty & Belgum*, 38 Cal.App.4th 1229, 1236 (Cal. Ct. App. 1995); *Nandorf, Inc. v. CNA Ins. Companies*, 479 N.E.2d 988, 991 (Ill. Ct. App. 1985); *Gray v. Commercial Union Ins. Co.*, 468 A.2d 721, 725 (N.J. Super. A.D.,1983); *Spratley v. State Farm Mut. Auto Ins. Co.*, 78 P.3d 603, 607 (Utah 2003).

Accord, National Union Ins. Co. v. Dowd & Dowd, P.C., 2 F. Supp.2d 1013, 1017 (N.D. Ill. 1998) ("In Illinois, it has long been recognized that an attorney retained by a primary insurer to represent its insured has a fiduciary duty to two clients: (1) the insured and (2) the primary insurer

. . . . Consequently, either the insured or the primary insurer can sue the retained attorney for legal malpractice") (citations omitted). *See also*, New Appleman on Insurance Law Library Edition §16.04[2][b], *supra* ("Of course, the insurer could ask the lawyer to provide legal services only for the insured, in which case it would not be a client. But the insurer's own interests are at stake in litigation of a claim where it may be called upon to indemnify, so it has reason to want the lawyer to perform legal services for itself as well . . . . When an insurer with these interests calls upon a lawyer to defend an insured, one would expect that the insurer desires legal services for itself as well as for the insured.")

The question that immediately comes to mind is why it even matters whether an insurer is deemed to be a client, as opposed to merely being a third party payor. Is it possible for counsel to represent an insured where he owes a duty of care to both the insurer and the insured at the same time? It has been observed:

> While it may seem like a small distinction, being labeled a "client" can be very advantageous. First, a client has the ability to sue a lawyer for malpractice. This is essentially the client's means of holding the attorney accountable. Without this status, the client has no recourse in the event that the attorney fails to perform his duties. Second, a client is entitled to confidentiality. This ensures that the client's discussions with his attorney will not be disclosed and used against him later. Finally, a client gets to define the objectives of the representation, gets to decide when and if settlement is appropriate, and is to be kept informed by the attorney throughout the representation.

Amber Czarnecki, *Ethical Considerations Within the Tripartite Relationship of Insurance Law - Who is the Real Client*?, 74 Def. Couns. J. 172, 173 (2007) (footnotes omitted). Such considerations are logical, especially in light of the fact that the insurer has an obligation to indemnify in relation to the claim against the insured.

In *Paradigm Ins. Co. v. Langerman Law Offices*, 24 P.3d 593, 594 (Az. 2001), the Arizona Supreme Court addressed the issue of whether an attorney could be held liable to an insurer which assigned him to represent an insured, where the attorney's negligence damaged only the insurer. Paradigm, the insurer of a physician in a malpractice case, brought an action against former defense counsel, Langerman, for failing to discover that the healthcare provider where the physician was employed had liability coverage through Samaritan Insurance Funding (SIF). This coverage not only included the claim against the insured, but probably operated as primary coverage. *Id.* at 595.

Paradigm had previously terminated Langerman's representation of its insured for unrelated reasons. *Id.* Upon learning of this primary coverage, the insured's new counsel immediately tendered the claim to SIF, which rejected it on the grounds that tender was untimely. *Id.* Since the underlying action was eventually settled for an amount within Paradigm's policy limits, the insured physician, Vanderwerf, was not damaged in any way. *Id.* However, Paradigm alleged that because

it was compelled to act as Venderwerf's primary carrier, it was forced to settle the malpractice claim with its own funds and without being able to look to SIF for contribution or indemnification. *Id.*

Langerman sued Paradigm for non-payment of fees and Paradigm filed a counterclaim based on malpractice. *Id.* The trial court granted summary judgment to Langerman on the grounds that no attorney-client relationship existed between defense counsel and insurer. *Id.* Therefore, according to the trial judge, Langerman owed no duty of care to Paradigm, and could not be held liable for negligence that injured only Paradigm, but not Langerman's client, Vanderwerf. *Id.*

On appeal, the Arizona Supreme Court held that a lawyer has a duty to the insurer, even if the insurer is a non-client. *Id*. at 602. The Court found it unnecessary to resolve the "the thorny issue of whether the facts of the underlying case permitted both insurer and insured to be Langerman's clients." *Id.* at 599. However, it noted that:

> both insurer and insured often share a common interest in developing and presenting a strong defense to a claim they believe to be unfounded as to liability, damages or both. Usually, insured and insurer have a joint interest in finding additional coverage from another carrier. Thus, by serving the insured's interests the lawyer can serve the insurer's, and if no question arises regarding the existence and adequacy of coverage, the potential for conflict may never become substantial.

Id. at 598. In such cases, the Court saw representation of both the insurer and the insured as permissible. However, "in the unique situation in which the lawyer actually represents two clients, he must give primary allegiance to one (the insured) to whom the other (the insurer) owes a duty of providing not only protection, but of doing so fairly and in good faith." *Id.* The Court ultimately held that when "an insurer assigns an attorney to represent an insured, the lawyer has a duty to the insurer arising from the understanding that the lawyer's services are ordinarily intended to benefit both insurer and insured when their interests coincide. This duty exists even if the insurer is a nonclient." *Id*. at 602.

Similarly, in *Nevada Yellow Cab Corp. v. Eighth Judicial Dist. Court ex. rel.*, 152 P.3d 737 (Nev. 2007), the Nevada Supreme Court held that counsel from a law firm previously retained by an insurer to defend a policyholder was disqualified from subsequently representing the policyholder in a bad faith claim against the insurer. In upholding the trial court's disqualification of the attorney and his law firm, the Court held that,

> while the insured is the primary client, counsel generally learns confidential information from both the insured and the insurer and thus owes both of them a duty to maintain this confidentiality; and, since counsel generally offers legal advice to both the insured and the insurer, counsel owes a duty of care to both. Finally, as most states, including Nevada, have a rule that permits joint representation when no actual

> conflict is present, courts that have adopted a dual-representation principle in insurance defense cases reason that joint representation is permissible as long as any conflict remains speculative.

Id. at 741 (footnotes omitted). According to Professor Jeffrey W. Stempel, however, "because both the policyholder/defendant and the insurer are 'clients' of the lawyer, greater potential for disqualifying conflict of interest arises, a fact reflected in *Yellow Cab* itself." Jeffrey W. Stempel, *The Relationship Between Defense Counsel, Policyholders, and Insurers. Nevada Rides Yellow Cab Toward "Two-Client" Model of Tripartite Relationship. Are Cumis Counsel and Malpractice Claims by Insurers Next?*, 15-JUN Nev. Law. 20, 21 (2007).

An Illinois federal court permitted a trucking company's excess insurer to bring a malpractice claim, under a theory of equitable subrogation, against a law firm retained by its insured. *National Union Ins. Co. v. Dowd & Dowd*, *P.C.*, 2 F.Supp.2d 1013, 1022 (N.D. Ill. 1998). In reaching that conclusion, the court recognized that:

> a primary insurer's duty to defend its insured generally includes the right to select the attorney to control the litigation. Since the primary insurer contracts with the attorney, pays the attorney's legal fees, and directs the litigation or settlement of the claim, it stands to reason that the primary insurer is one of the attorney's clients.

Id. at 1017 (citation and footnote omitted). With respect to the excess insurer, the result is different because it generally has no duty to defend. Therefore, the excess insurer has no right to choose the defending counsel or direct his actions and has no direct relationship with the defense counsel. *Id.* at 1018. The court determined that no attorney-client relationship existed between the excess insurer and the law firm under the tripartite relationship. Therefore, the law firm owed no fiduciary duty to the excess insurer. *Id.*

However, the Court did recognize the excess insurer's right to be equitably subrogated to its insured's right to bring a malpractice action against the firm. The court reasoned, "it is equitable and just to allow the excess insurer to recoup its losses by way of equitable subrogation if the primary liability insurer's failure to settle the claim in good faith within its policy limit exposed the insured, and therefore the excess insurer, to a judgment in excess of the primary liability insurer's policy limit." *Id*. at 1022 (citations omitted). Further, "Illinois courts have stated that 'the doctrine of subrogation is broad enough to include every instance in which one person, not a mere volunteer, pays a debt for which another is primarily liable and which in equity and good conscience should have been discharged by the latter." *Id*. (quoting, *Am. Nat. Bank & Trust Co. of Chicago v. Weyerhaeuser Co.*, 692 F.2d 455, 460 (7th Cir. 1982)). Thus, the Court was "convinced that the Illinois Supreme Court would recognize an excess liability insurer's right to be equitably subrogated to its insured's rights unless the nature of the claim sought to be subrogated and the public policy considerations implicated dictate a contrary conclusion." *Id.*

Florida law generally recognizes a tripartite relationship between the insurer, the insured, and the lawyer assigned to defend the insured in which the lawyer owes a duty of care to the insurer as well as the insured. In *U.S. Specialty Ins. Co. v. Burd*, 833 F.Supp.2d 1348, 1350 (M.D. Florida 2011), an insurer that issued a premises liability policy brought a legal malpractice action against an attorney it had hired to defend its insured, an air museum, in a personal injury action involving an aircraft that fell on two people, killing one and seriously injuring the other. The District Court permitted the insurer's malpractice action, holding that it was clear under Florida law that a tripartite relationship normally existed in such cases. *Id.* at 1353. Further, the court noted that the comments to Rule Regulating Fla. Bar 4-1.7(c) recognized that, in the absence of a conflict of interest, a lawyer may represent both the insurer and the insured. *Id.*, discussing 4-1.7 cmt. "A conflict of interest is involved if there is a substantial risk that the lawyer's representation of the client would be materially and adversely affected by the lawyer's own interests or by the lawyer's duties to another current client, a former client, or a third person." *Id.* at 1355, quoting the Restatement (Third) of the Law Governing Lawyers § 121. The District Court held that because a tripartite relationship existed, the insurer could bring a malpractice action against defense counsel. *Id*. at 1357.

C. Indiana appears to follow the Two Client/Favored Client model.

Indiana courts have not directly addressed the issues related to the tripartite relationship. However, the Indiana Supreme Court has offered dicta in a couple of cases which provides an indication that the court may be inclined to adopt the two client/favored client model.

Justice Boehm discussed the tripartite issue in the Indiana Supreme Court's opinion in *Cincinnati Insurance v. Wills*, 717 N.E.2d 151 (Ind. 1999). In *Wills*, the defendant in a personal injury action was being represented by an in-house lawyer of the insurer. The plaintiffs moved to disqualify the defense counsel on the grounds that his representation of the defendant constituted the unauthorized practice of law by the insurer. *Id*., pp.153. The Court held that a liability insurer does not necessarily engage in the unauthorized practice of law when it employs in-house counsel to represent its insured in claims litigation. *Id.* at 155. Morever, attorneys who are employees of insurance companies defending an insured do not necessarily trigger an impermissible conflict in violation of the Rules of Professional Conduct. *Id.*

The Court noted that Indiana Rule of Professional Conduct 1.7(b) prohibits an attorney from representing a client if the representation of that client may be materially limited by the lawyer's responsibilities to another client or to a third person. *Id.* at 161. Further, Rule 5.4(c) provides that the professional independence of a lawyer is not impaired so long as the lawyer does not "permit a person who recommends, employs or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment." *Id*. "Where someone other than the client pays the lawyer's fee or salary, or recommends employment of the lawyer, that arrangement does not modify the lawyer's obligation to the client." *Id.*, quoting Prof. Cond. R. 5.4 cmt. (The plaintiffs also contended that defense counsel, Faber violated Rule 1.8(f), but the majority did not address that issue. *Id.* at 161 - 162.)

The Court found that counsel's employment by Defendant's insurer did not inherently result in an unethical practice or conflict of interest. Indeed, "the vast majority of practicing attorneys discharge their obligations" to their clients and the Court under the Admission and Discipline Rules and the Rules of Professional Conduct "without complaint over an entire career," and as to the remainder, "this state, like all others, has in place disciplinary procedures to protect the public." *Id.* at 162. In this respect, Indiana joined "the several states that reject the contention that house counsel representation of insureds presents an inherent conflict in violation of the Rules of Professional Conduct." *Id.* "There is no basis for a conclusion that employed lawyers have less regard for the Rules of Professional Conduct than private practitioners do." *Id*., quoting *In Re Allstate Ins. Co.*, 722 S.W.2d 947, 953 (Mo. 1987).

Justice Boehm, in dicta, also briefly discussed the issue of whether defense counsel jointly represented both the insured and insurer. He noted that the Supreme Court of Florida and the Supreme Court of Georgia have held that the defense attorney represents both the insured and the insurer. *Id*. at 162. Regarding Indiana's treatment of the tripartite relationship, Justice Boehm stated:

> there is extensive debate in the literature as to whom the attorney represents in this situation. Specifically, whether the attorney is an employee or **an outside lawyer**, the debate focuses on whether only the insured or both the insured and the insurer should be viewed as the client. **We think it unrealistic to ignore the client relationship with both. Joint representation may become problematic, particularly if issues of disclosure of confidences arise.** For example the attorney may gain information from the policyholder-client that may affect the insurer-client's coverage obligation. **But that is no basis for prohibiting the arrangement in all cases**. Whatever issues joint representation raises appear to be wholly independent of the attorney's status as an employee of the insurer or a member of a law firm. Second, **there is nothing inherently wrong in common representation of two parties where their interests are aligned**. Professional Conduct Rule 1.7 provides direction "[w]hen representation of multiple clients in a single matter is undertaken . . . ." In this respect, the insured and insurer present no qualitatively different situation from any other pair of commonly represented clients.
>
> If a conflict arises, it will have to be handled, and there are a variety of means to do that. But a vast number of claims have been and presumably will be handled with no significant issue between the insurer and the policyholder. Interests of economy and simplicity dictate that this be permitted to continue. Any abuses can be handled on a case-by-case basis rather than by adoption of the broad prohibition the Wills seek. Although issues may arise in dual representation, none are apparent in this case. In any event, **[the insurer] has by contract subordinated its interests as a client to those of [the insured]. Presumably, this resolves by agreement the priority of counsel's obligations** if, for example, counsel learns of information that affects the insurer's and the policyholder's interests differently.

Id. at 161 (emphasis added) (footnote omitted).

It should be noted that the Court was not specifically addressing Rule 1,8(f), but was focusing its attention on the representation of the insured by in-house counsel. Further, that rule does not apply to in-house counsel, since it addresses "receiving compensation" from one other than a client for representing a client. Ind. R. Prof. Cond., R. 1.8(f). In-house counsel, by contrast, is typically a salaried employee of the insurance company.

Based on the above quotation, it appears that the Indiana Supreme Court may subscribe to the majority view which considers both the insurer as well as the insured to be clients of the attorney. However, in *Wills*, the Court recognized that, pursuant to the terms of the insurance agreement, representation of the insured is the primary obligation of the attorney in the event of a conflict. This preferred status of the insured was previously recognized by the Court in the case of *Siebert Oxidermo, Inc. v. Shields*, 446 N.E.2d 332 (Ind. 1983).

In *Siebert*, a default judgment was entered in favor of the plaintiff in a personal injury action. Shortly after entry of the default judgment, an attorney representing the defendant filed a motion to vacate the default judgment, which the trial court denied. *Id*. at 334. The appellate court affirmed the trial court's ruling. On transfer to Supreme Court, several arguments were made in support of reversing the trial court's ruling. One of those arguments was based on the fact that the original attorney representing the defendant was actually employed by the defendant's insurer. It was argued that the attorney did not actually represent the insured's interests. According to the defendant, the insurer's lawyer did not really want the default judgment to be vacated because the insurer would not be liable for paying a default judgment. *Id*. at 341.

In rejecting that argument, the Court agreed with the Court of Appeals when it said:

> [W]e point out that on a daily basis defense attorneys employed by insurance carriers on behalf of policyholders are called upon to deal with matters in litigation where the interests of the policyholder and the carrier do not fully coincide. **Under such circumstances the attorney's duty is, of course, to the insured whom he has been employed to represent.** In response the defense bar has exhibited no inability to fully comply with both the letter and the spirit of Canon 5 of the Code of Professional Responsibility. If it were otherwise we suspect the desirability of requiring carriers to supply defense counsel would have long since disappeared as a term of the policy.

Siebert Oxidermo, Inc. v. Shields, 446 N.E.2d 332, 341 (Ind. 1983) (quoting *Siebert Oxidermo v. Shields*, 430 N.E.2d 401, 403 (Ind. Ct. App. 1982)) (emphasis added). Consequently, it seems clear that, when there is a conflict between the interests of the insurer and the insured, the role of an insurance defense attorney is to represent the insured. Otherwise, based on the above quotation from *Wills*, the attorney represents both the insured and the insurer.

A more recent case further emphasizes the importance of safeguarding the attorney-client relationship from outside influence. *Querry & Harrow, Ltd. v. Transcontinental Ins. Co.*, 861 N.E.2d 719 , 723 (Ind. Ct. App. 2007), *affirmed and adopted*, 885 N.E.2d 1235, 1237 (Ind. 2008). In *Querry*, a manufacturer's excess liability insurer, Transcontinental Insurance Company ("CNA"), brought a legal malpractice action against attorneys and law firms hired by a primary liability insurer to represent an insured manufacturer in a products liability action. *Id.* at 720. CNA alleged that had the attorneys from the law firms timely raised a non-party defense, the underlying litigation would have been settled or a verdict would have been reached that was substantially less than the $6,300,00.00 settlement amount. *Id.* The trial court denied the law firms' motions for summary judgment, holding that an excess insurer could bring an action for legal malpractice against an insured's attorneys, and that a genuine issue of material fact existed as to whether an attorney-client relationship existed between the insured's attorneys and CNA. *Id*. at 721.

On appeal, the court expressed concern about the potential for insurers to interfere with the sanctity of the attorney-client relationship. Citing to public policy concerns expressed in the case of *Keybank Nat. Ass'n v. Shipley*, 846 N.E.2d 290, 300 (Ind. Ct. App. 2006), the court stated:

> When lawyers must be concerned about their potential liability to third parties, the resultant self-protective tendencies may deter vigorous representation of the client. Attention to third-party risk might cause the attorney improperly to consider "personal interests" or **"the desires of third parties" above the client's interests**. This would contravene the lawyer's duty of loyalty to the client.

Querry & Harrow, 861 N.E.2d at 722, *quoting* Jack I. Samet et al., *The Attack on the Citadel of Privity*, 20 A.B.A. Winter Brief 9, 40 (1991) (footnotes omitted).[1] (Emphasis added.)

The Court examined cases in other federal and state courts that addressed the issue of whether an excess insurer could pursue a legal malpractice action against an insured's attorney. It observed that "a number of jurisdictions have held as a matter of public policy that such an action would interfere with the attorney-client relationship and would run counter to the jurisdiction's prohibition of the assignment of legal malpractice actions." *Id.*, discussing *Essex Ins. Co. v. Tyler*, 309 F.Supp.2d 1270, 1274 (D. Colo. 2004) (Allowing excess insurer to pursue legal malpractice action against insured's attorney would compromise the duty of loyalty to the attorney's client based on the anticipation of "possible legal malpractice claims by third parties."); *Fireman's Fund Ins. Co. v. McDonald, Hecht & Solberg*, 30 Cal.App.4th 1373, 1384 (Cal. Ct. App. 1994), *rev. denied* (Public policy would not allow insurers to violate the sanctity of the attorney-client relationship by pursuing an action against insured's attorneys); *National Union Fire Ins. Co. v. Salter*, 717 So.2d 141, 142 (Fla. Ct. App. 1988), rev. denied (holding that policy reasons for prohibiting assignment of legal malpractice claims apply to prohibition of subrogation of legal malpractice claims); *American Continental Ins. Co. v. Weber & Rose, P.S.C.*, 997 S.W.2d 12 (Ky. Ct. App. 1998), *rev. denied*

[1] This quoted language is perhaps the best indication that Indiana courts follow the one client model.

(holding that "allowing excess insurers to maintain legal malpractice actions against insured's attorneys, based upon theories of equitable subrogation, would undermine the jurisdiction's adherence to a view promoting the preservation of traditional attorney-client relationships"); *American Employers' Insurance Co. v. Medical Protective Co.*, 419 N.W.2d 447 (Mich. Ct. App. 1988), *appeal denied* (holding that allowing excess insurer to pursue a legal malpractice action against the insured's attorneys would "contradict the personal nature of the attorney-client relationship, which permits a legal malpractice action to accrue only to the attorney's client").

The Court also examined the issue of whether an attorney-client relationship existed between defense counsel and CNA. Although CNA received routine and confidential client communications which the defendant attorneys were sending to CNA's insured, there was "no indicia of dual representation at the time of the alleged malpractice or any time thereafter." *Id.* at 725. The correspondence fell "far short of establishing a fact question as to whether [the insured's] attorneys consented to represent both their client and the excess insurer." *Id*. at 725. The Court held that the excess insurer could not bring a malpractice action under the doctrine of equitable subrogation. *Id*.

The *Querry* Court did not address the situation where a primary insurer brings a malpractice action against counsel it hired to defend its insured, and Indiana state courts have not addressed whether such suits are permissible. However, the Northern District of Indiana, in *Mcgrath*, an unpublished case, held that an insurer that retained defense counsel was "in privity" with defense counsel, and had the independent right to sue for legal malpractice. *See Mcgrath v. Everest Nat. Ins. Co.,* No. 2:07-cv-34, 2009 WL 3080275 (N.D. Ind., Sept. 24, 2009), citing *TIG Ins. Co. v. Giffin Winning Cohen & Bodewess, P.C.*, 444 F.3d 587 (7th Cir. 2006) (insurance company brought malpractice action against law firm and one of its attorneys stemming from firm's representation of insured); *Jones Motor Co., Inc. v. Holtamp, Liese, Beckemeir & Childress*, P.C., 197 F.3d 1190 (7th Cir. 1999) (trucker and its insurer brought legal malpractice action against attorneys that unsuccessfully defended trucker in lawsuit); *American Intern. Adjustment Co. v. Galvin*, 86 F.3d 1455 (7th Cir. 1996) (insurer brought legal malpractice action against firm and attorney who defended client in tort action).

Regardless of whether Indiana allows such malpractice actions by primary insurers, the Court of Appeals' concerns voiced in *Querry* remain at the heart of the tripartite issue. If an insurer who hires defense counsel can be considered a "client," the attorney could improperly "consider personal interests or the desires of third parties" above the insured's interests. *Querry*, supra at 722. This would "contravene the lawyer's duty of loyalty to the client." *Id.* Such concerns would be obviated if defense counsel makes it clear at the outset, to both insured and insurer, that the insured is his sole client.

D. The Advantages of the One Client Model.

Although the two client/favored client Model is currently the majority view, the One Client model is gaining sway, and is the rule in many states. Jean Fleming Powers, Advantages of the One-Client Model in Insurance Defense, 45 N.M. L. Rev. 79, 81. In light of this more recent trend, it is

respectfully suggested that when the Indiana Supreme Court directly addresses the issues of the tripartite relationship, it should focus on the applicable Rules of Professional Conduct. Such a focus should lead the Court to the conclusion that the one client model is the better method to protect the sanctity of the attorney-client relationship. As previously noted, a discussion of Rule 1.8(f) was absent in the *Wills* opinion. In reaching its conclusion that the attorney is engaged in dual representation of the insurer and the insured, the Court only considered Rule 1.7 and Rule 5.4. However, Rule 1.8(f) places the focus of the attorney's duties squarely on the insured, not on the third party who is "paying the freight" as it were.

Under Indiana R. Prof. Cond. 1.8(f), a lawyer may not accept compensation to represent a client from one other than the client in the absence of informed consent.[2] Moreover, the fact that a non-client is paying the bills must not interfere with the lawyer's professional judgment, or with the attorney-client relationship. Rule 1.8 (f) provides:

> 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 a client is protected as required by Rule 1.6.

The commentary to Rule 1.8(f) explains:

> Because third-party payers frequently have interests that differ from those of the client, including interests in minimizing the amount spent on the representation and in learning how the representation is progressing, lawyers are prohibited from accepting or continuing such representations unless the lawyer determines that there will be no interference with the lawyer's independent professional judgment and there is informed consent from the client. See also Rule 5.4(c) (prohibiting interference with a lawyer's professional judgment by one who recommends, employs or pays the lawyer to render legal services for another).
>
> Sometimes, it will be sufficient for the lawyer to obtain the client's informed consent regarding the fact of the payment and the identity of the third-party payer. If, however, the fee arrangement creates a conflict of interest for the lawyer, then the lawyer must comply with Rule 1.7. The lawyer must also conform to the requirements of Rule 1.6 concerning confidentiality. Under Rule 1.7(a), a conflict of

[2] For an example of a client engagement letter which complies with Rule 1.8(f), see Appendix A.

> interest exists if there is significant risk that the lawyer's representation of the client will be materially limited by the lawyer's own interest in the fee arrangement or by the lawyer's responsibilities to the third-party payer (for example, when the third-party payer is a co-client). Under Rule 1.7(b), the lawyer may accept or continue the representation with the informed consent of each affected client, unless the conflict is nonconsentable under that paragraph. Under Rule 1.7(b), the informed consent must be confirmed in writing.

The jurisdictions that have adopted the one client model similarly focus on protecting the autonomy of the lawyer in representing the insured. In point of fact, how can there be dual representation if one client is favored over another client? As we have seen, the majority view permits dual representation so long as there is no conflict of interests between the insured and the insurer. However, it can be argued that dual representation is actually a fallacy since the two client model inevitably requires that the attorney's ultimate allegiance be bestowed upon the insured, not the insurer. If the attorney were truly representing both the insured and the insurer, the development of a conflict between the two clients would ordinarily require the attorney to withdraw from representing both clients. *See, e.g.,* Ind. R. Prof. Cond. 1.7, Comment [29].

In *Tank v. State Farm Fire & Cas. Co.*, 715 P.2d 1133, 1137 (Wash 1986), the Supreme Court of Washington, in support of its holding that an insurer defending under a reservation of rights owes an enhanced obligation of fairness towards its insured held that, "[b]oth retained defense counsel and the insurer must understand that only the insured is the client." The Court noted that Washington Rules of Professional Conduct 5.4(c) prohibits a lawyer, employed by a party to represent a third party, from allowing the employer to influence his or her professional judgment, and that the rule "demands that counsel understand that he or she represents only the *insured*, not the company." *Id.* "The standards of the legal profession require undeviating fidelity of the lawyer to his client. No exceptions can be tolerated." *Id.*, quoting *Van Dyke v. White*, 349 P.2d 430, 437 (Wash. 1960). The Court further determined, "defense counsel owes a duty of full and ongoing disclosure to the insured." This requires that 1) potential conflicts of interest between insurer and insured must be fully disclosed and resolved in favor of the insured; 2) all information relevant to the insured's defense, including a realistic assessment of the insured's chances to win or lose the pending lawsuit, must be communicated to the insured, and 3) all offers of settlement must be disclosed to the insured as those offers are presented. *Id.* at 1137- 1138.

Other examples where courts have adhered to the one client model include *L & S Roofing Supply Co., Inc. v. St. Paul Fire & Marine Ins. Co.*, 521 So.2d 1298, 1304 (Al. 1987) (adopting the standard for defense under a reservation of rights set forth in *Tank*); *United States v. Daniels*, 163 F.Supp.2d 1288, 1290 (D. Kansas 2001) ("an insurance carrier necessarily understands that retained counsel owes its duty of loyalty to the defendant, not the insurance carrier who pays them."); *State Farm Mut. Ins. Co. v. Traver,* 980 S.W.2d 625, 628 (Tex. 1998) (stating that the defense counsel "must at all times protect the interests of the insured if those interests would be compromised by the insurer's instructions"); *Employer's Cas. Co. v. Tilley*, 496 S.W.2d 552, 558 (Tex. 1973) (finding that defense counsel owes the insured the same type of loyalty as if the insured had originally hired

him); *Weitz Co., LLC v. Ohio Cas. Ins. Co.*, No. 11-CV-00694-REB-BNB, 2011 WL 2535040, at *3 (D. Colo. June 27, 2011) (quoting Colorado Ethics Opinion 91, concluding,"the better rule is that the lawyer's client is the insured and not the carrier").

A default rule that the attorney represents only the insured and not the insurer is the better approach because it makes clear to both insured and insurer, from the outset, who the attorney represents and the scope of that representation. Moreover, it avoids the possibility that the attorney will face a conflict of interest between two current clients. Of course, that does not mean that a conflict between the client and the attorney's own interest (in keeping the insurer happy) will not arise. Nevertheless, the one client model minimizes the types of conflicts that may arise.

According to Jean Fleming Powers, the one client model has the advantage of focusing representation on the insured. Under the terms of the insurance policy, the insured cedes control of the defense of the claim to the insurer. In exchange for that control, the insured gets the benefit of the insurer's resources and expertise in handling the claim, including the benefit of indemnity for any liability related to the claim. In this context,

> it is clear that the attorney can both represent the insured as his sole client and still honor the insured's contractual obligations. Nothing in the ethics rules suggests that the attorney should not protect his client's contractual obligations to the insurer. Such protection is, in fact, required for effective representation. Failure to abide by the terms of the contract, at best, would be a breach of contract, and, at worst, would void coverage. Thus, even an attorney with a primary obligation to represent the insured must advise him in ways that protect his contractual rights and honor his contractual obligations. The insurer is then protected by his contract, not by an attorney with divided loyalties.

Jean Fleming Powers, 45 N.M. L. Rev. 79, 87 (footnotes omitted).

The concern raised by many courts and analysts that attorneys will favor the interests of the insurer, as their bill payor, is sufficiently addressed under the one client model. Such conflicts are essentially conflicts between the insured and the attorney's personal interests. The Rules of Professional Responsibility clearly mandate how an attorney should address such conflicts:

> It is possible in self-interest conflicts to subordinate one's own interest and adequately represent the client. Any resulting harm is to the attorney's interest, not that of another client. Likewise, in insurance cases, an attorney hoping to please an insurer for his own economic benefit can, and must, subordinate such inclinations to his obligations to the insured. However, if both the insured and the insurer are clients, the potential for insoluble conflicts increases - a problem the one-client model avoids.

Id. at 90-91 (footnotes omitted).

Regarding a lawyer's duty of confidentiality, the one client model still allows for communication between insurer and defense counsel while protecting its confidentiality. The policy gives the insurer the contractual right to be informed as to the status of the litigation. Hence, the attorney is not violating his duty to maintain confidentiality of communications with the client. Additionally, the protection of the attorney-client privilege is not lost. *See, e.g.*, *Richey v. Chappell*, 594 N.E.2d 443, 446 (Ind. 1992) (where the policy of insurance requires the insurer to defend claims against the insured, the attorney-client privilege attaches to an insured's statement given to the insurer for possible use by the insured's attorney).

It should be noted that, even when the one client model is utilized, there could still be situations when the attorney may have to withdraw from representing the insured. However, the one client model minimizes these situations. As an example, consider a situation where the attorney recommends a certain defense strategy that requires use of an expert witness, but the insurer refuses to authorize the expense. Under the two client model, the attorney has a conflict between his two clients which, if it cannot be reconciled, will result in the attorney withdrawing representation from both the insured and the insurer. Under the one client model, there is no conflict of interest between clients. The attorney can pressure the insurer to approve of the expenses without having to choose one client over another. However, if the insurer persists in its refusal, the attorney may have to withdraw pursuant to Rule 1.8(f) and Rule 5.4(c) to prevent interference with his professional judgment in handling the case.

Another problem area can arise when the attorney is attempting to settle a claim. Assume that plaintiff's attorney has made a policy limits demand. Defense counsel has evaluated the case and determined that there is a high probability that a trial will result in an excess verdict, but the insurer refuses to offer the policy limits to settle the claim. Under the two client model, there is a clear conflict of interests between the insured and the insurer. The attorney cannot advocate for one client without potentially harming the other client. It is hard to imagine how this conflict could be resolved short of the attorney withdrawing from the case. Under the one client model, the attorney is free to pressure the insurer to settle the case for policy limits or potentially expose itself to a claim from the insured of bad faith. *Erie Ins. Co. v. Hickman by Smith*, 622 N.E.2d 515, 519 (Ind. 1993).

In conclusion, defense counsel must at all times realize, unless the insured gives informed consent to dual representation, that the insured is his sole client. He must make it clear to both insured and insurer that he represents only the insured. That way, both insurer and insured understand, from the outset, the scope of the representation, counsel's contractual obligations to the insurer, and counsel's ethical duties to the insured. So long as defense counsel abides by the ethical standards set forth in the Rules of Professional Responsibility, no unresolvable conflicts of interest will arise. If the insurer acts in a way that would compromise the interests of the insured, and no resolution can be reached, the attorney should simply withdraw from representation.