

2021

## **The Legal Implications of a Reservation of Rights Defense Examined in the Context of Recoupment of Defense Costs and Tripartite Conflicts of Interest**

Johnny C. Parker  
*University of Tulsa College of Law*

Tim J. Schaefer

Follow this and additional works at: [https://digitalcommons.law.utulsa.edu/fac\\_pub](https://digitalcommons.law.utulsa.edu/fac_pub)



Part of the [Law Commons](#)

---

### **Recommended Citation**

90 UMKC L. Rev. 37 (2021).

This Article is brought to you for free and open access by TU Law Digital Commons. It has been accepted for inclusion in Articles, Chapters in Books and Other Contributions to Scholarly Works by an authorized administrator of TU Law Digital Commons. For more information, please contact [megan-donald@utulsa.edu](mailto:megan-donald@utulsa.edu).

## The Legal Implications of a Reservation of Rights Defense Examined in the Context of Recoupment of Defense Costs and Tripartite Conflicts of Interest

Johnny C. Parker\*  
Tim J. Schaefer\*\*

### INTRODUCTION

The standard language used in the insuring agreement of a general liability insurance policy provides that:

We will pay those sums that the insured becomes legally obligated to pay as damages because of “bodily injury” or “property damage” to which this insurance applies. We will have the right and duty to defend the insured against any “suit” seeking those damages. However, we will have no duty to defend the insured against any “suit” seeking damages for “bodily injury” or “property damage” to which this insurance does not apply. We may, at our discretion, investigate, any “occurrence” and settle any claim or “suit” that may result.<sup>1</sup>

The phrase—“duty to defend the insured against any ‘suit’”—or words of similar effect, imposes upon insurers a duty to defend the insured in any suit for harm potentially within the coverage of the policy.<sup>2</sup> Insurers, as a part of their duty to defend, are also contractually empowered to “investigate . . . and settle any claim or ‘suit’” against the insured.<sup>3</sup> This language has been broadly construed to impose two separate and distinct obligations upon the insurer: the duty to defend and the duty to indemnify the insured.<sup>4</sup>

---

\* Phyllis Hurley Frey Professor of Law, University of Tulsa College of Law. B.A., University of Mississippi, 1982; J.D., University of Mississippi Law School, 1984; LL.M., Columbia University Law School, 1987.

\*\* B.M., Oral Roberts University, 2009; M.M., University of Central Oklahoma, 2014; J.D., University of Tulsa College of Law, 2020.

<sup>1</sup> Ins. Servs. Office, Inc. (ISO), Com. Gen. Liab. Form CG 00 01 04 13, § I(1)(a) (2006).

<sup>2</sup> See *Hartford Cas. Ins. Co. v. Trinity Universal Ins. Co.*, 153 F. Supp. 3d 1323 (D.N.M. 2015); *Philadelphia Indem. Ins. Co. v. Chi. Title Ins. Co.*, 771 F.3d 391 (7th Cir. 2014) (noting that the duty to defend is contractual); *Johnson Controls, Inc. v. London Mkt.*, 784 N.W.2d 579, 586 (Wis. 2010); *Sentinel Ins. Co. v. First Ins. Co.*, 875 P.2d 894, 904 (Haw. 1994); *Thompson v. Md. Cas. Co.*, 84 P.3d 496, 502 (Colo. 2004).

<sup>3</sup> See *Centex Homes v. St. Paul Fire & Marine Ins. Co.*, 19 Cal. App. 5th 789, 797 (Cal. Ct. App. 2018); *Episcopal Church in S.C. v. Church Ins. Co. of Vt.*, 53 F. Supp. 3d 816 (D.S.C. 2014); *Kooyman v. Farm Bureau Mut. Ins. Co.*, 315 N.W.2d 30, 36 (Iowa 1982); *Int’l Ins. Co. v. Dresser Indus., Inc.*, 841 S.W.2d 437, 445 (Tex. App. 1992); *Lampley v. Davis Mach Corp.*, 530 A.2d 1254, 1258 (N.J. Super. 1987); *Wilson v. Liberty Ins. Underwriters, Inc.*, No. 2:07-0478, 2008 U.S. Dist. LEXIS 13860 (S.D. W. Va. Feb. 25, 2008). See also Robert E. Keeton, *Liability and Responsibility for Settlement*, 67 HARV. L. REV. 1136, 1152 (1954) (indicating that most insurance policies unambiguously give the insurer the right to control defense of claims under the policy).

<sup>4</sup> See *Murphy Oil USA, Inc. v. Unigard Sec. Ins. Co.*, 61 S.W.3d 807, 812-13 (Ark. 2001); *Powerline*

The insurer's duties to defend and indemnify the insured are the core principles of the general liability policy. While the two duties are interrelated, they are not coterminous. The purpose of the duty to defend is to avoid or minimize the insured's liability before liability is established.<sup>5</sup> Conversely, the purpose of the duty to indemnify is to resolve liability after liability has been determined.<sup>6</sup> The duties also differ with regard to triggers. The duty to indemnify arises only if the policy actually covers the insured's liability and damages are fixed in that amount.<sup>7</sup> The duty to defend emerges when the insurance policy under any circumstance potentially covers any allegation included in the complaint.<sup>8</sup> The duties can also be distinguished in terms of substance. The duty to defend involves the rendition of services—mounting a defense—while the duty to indemnify involves the payment of money.<sup>9</sup> A further distinction exists regarding the scope of the respective duties. The scope of the duty to defend is broader than that of the duty to indemnify.<sup>10</sup> The duty to defend requires insurers to show deference toward their insureds when determining whether the allegations of the complaint come within the coverage provided by the policy.<sup>11</sup> Likewise, “the duty to defend is not restricted to meritorious claims, but extends to claims that are groundless, false, or fraudulent, so long as the allegations of the complaint potentially implicate coverage.”<sup>12</sup> The duty is to defend the entire suit, even if the policy covers only

---

Oil Co. v. Super. Court, 118 P.3d 589, 593 (Cal. 2005); Johnson Controls, Inc. v. London Mkt., 784 N.W.2d 579 (Wis. 2010); Dairy Rd. Partners v. Island Ins. Co., 992 P.2d 93, 107 (Haw. 2000); Emps. Reinsurance Corp. v. E. Miller Ins. Agency, 773 N.E.2d 707, 714 (Ill. App. Ct. 2002); Skinner v. Allstate Ins. Co., 127 P.3d 359, 363 (Mont. 2005); United Nat'l Ins. Co. v. Frontier Ins. Co., 99 P.3d 1153, 1157-58 (Nev. 2004); Great Am. Dining v. Phil. Ins. Co., 62 A.3d 843, 854 (N.H. 2013); ZRZ Realty Co. v. Benefit Fire & Cas. Ins. Co., 266 P.3d 61, 66 (Or. 2011); Selective Way Ins. Co. v. Hosp. Grp. Servs., 119 A.3d 1035, 1049 (Pa. Super. Ct. 2015); Nat'l Sur. Corp. v. Immunex, 297 P.3d 688, 691 (Wash. 2013).

<sup>5</sup> See *Powerine Oil Co.*, 118 P.3d at 592; *Skinner*, 127 P.3d at 364.

<sup>6</sup> See *Powerine Oil Co.*, 118 P.3d at 600; *Skinner*, 127 P.3d at 364; *BP Air Conditioning Corp.*, v. One Beacon Ins. Grp., 33 A.D.3d 116, 125 (N.Y. App. Div. 2001).

<sup>7</sup> See *Outboard Marine Corp. v. Liberty Mut. Ins. Co.*, 607 N.E.2d 1204, 1221 (Ill. 1992); *Great Am. Dining*, 62 A.3d at 854; *Selective Way Ins. Co.*, 119 A.3d at 1046; *D.R. Horton-Texas, Ltd. v. Markel Int'l Ins. Co.*, 300 S.W.3d 740, 743 (Tex. 2009); *Am. Best Foods Inc. v. Alea London, Ltd.*, 229 P.3d 693, 696 (Wash. 2010).

<sup>8</sup> See *Capstone Bldg. Corp. v. Am. Motorist Ins. Co.*, 67 A.3d 961, 992 (Conn. 2013); *Emps. Reinsurance Corp. v. E. Miller Ins. Agency*, 773 N.E.2d at 714; *Skinner*, 127 P.3d 359 at 364; *United Nat'l Ins. Co.*, 99 P.3d at 1157 (Nev. 2004); *Great Am. Dining*, 62 A.3d at 853; *D.R. Horton-Texas, Ltd.*, 300 S.W.3d at 743; *Am. Best Foods Inc.*, 229 P.3d at 696.

<sup>9</sup> See *Skinner*, 127 P.3d at 364; *Great Am. Dining*, 62 A.3d at 854; *D.R. Horton-Texas, Ltd.*, 300 S.W.3d at 743.

<sup>10</sup> See *Powerine Oil Co.*, 118 P.3d at 599-600; *Cyprus Amax Mins. Co. v. Lexington Ins. Co. v. 74 P.3d 294, 298* (Colo. 2003); *Capstone Bldg. Corp.*, 67 A.3d at 993; *Emps. Reinsurance Corp.*, 773 N.E.2d at 714; *Skinner*, 127 P.3d at 363; *United Nat'l Ins. Co.*, 99 P.3d at 1158; *BP Air Conditioning Corp. v. One Beacon Ins. Grp.*, 33 A.D.3d 116 (N.Y. App. Div. 2001); *Am. Best Foods Inc.*, 229 P.3d at 696; *Johnson Control, Inc. v. Emps. Ins. Co.*, 665 N.W.2d 257, 283 (Wis. 2003).

<sup>11</sup> See *Emps. Reinsurance Corp.*, 773 N.E.2d at 716; *United Nat'l Ins. Co.*, 99 P.3d at 1158; *Am. Best Foods Inc.*, 229 P.3d at 696; *Luxury Living, Inc. v. Mid-Continent Cas. Co.*, No. H-02-3166, 2003 WL 22116202 (S.D. Tex. 2003).

<sup>12</sup> *Selective Way Ins. Co.*, 119 A.3d at 1046. See *Buss v. Super. Ct.*, 939 P.2d 766, 775 (Cal. 1997); *D.R. Horton-Texas, Ltd.*, 300 S.W.3d at 743.

one of multiple claims.<sup>13</sup> Once triggered, the duty to defend continues throughout the course of the litigation.<sup>14</sup> Consequently, an insurer's obligation to defend can exist even if coverage or the duty to indemnify is uncertain.<sup>15</sup>

"The right and duty to defend" clause affords insurers the right to control the defense.<sup>16</sup> This interpretation is supported by several provisions contained in the conditions section of the policy, which describes the rules of conduct and obligations required for coverage. The conditions section targets the insured, who may ultimately forfeit coverage by failing to comply with its provisions.<sup>17</sup> The conditions of coverage that support the insurer's right to control the defense include those which require the insured to: (1) notify the insurer in the event of a loss, occurrence, or filing of suit; (2) provide copies of all documents and information requested, such as any demands, notices, summonses or legal papers received in connection with the claim or suit; (3) obtain the insurer's consent before settling; and (4) cooperate with the insurer in the investigation, settlement of the claim, or defense against the suit.<sup>18</sup>

Liability policies that obligate the insurer to defend claims against the insured typically give the insurer "complete and exclusive control" of that defense.<sup>19</sup> This right is "a valuable one in that it reserves to the insurer the right to protect itself against unwarranted liability claims and is essential in protecting its financial interest in the outcome of litigation."<sup>20</sup> In essence, the right affords insurance companies an opportunity to ensure that a proper defense is made and that fraudulent, overvalued, and collusive claims are exposed and defeated—thus minimizing the insurer's duty to indemnify.<sup>21</sup>

---

<sup>13</sup> See *Phila. Indem. Ins. Co. v. Chi. Title Ins. Co.*, 771 F.3d 391, 394 (7th Cir. 2014). This is known as the "complete defense" rule. *Id.*

<sup>14</sup> See *United Nat'l Ins. Co.*, 99 P.3d at 1157; *Am. Best Foods, Inc.*, 229 P.3d at 696.

<sup>15</sup> See *Gen. Agents Ins. Co. v. Midwest Sporting Goods Co.*, 828 N.E.2d 1092, 1102 (Ill. 2005); *Chiquita Brands Int'l v. Nat'l Union Fire Ins. Co.*, 57 N.E.3d 97, 101 (Ohio Ct. App. 2015).

<sup>16</sup> See *Hansen v. State Farm Mut. Auto Ins. Co.*, No. 2:10-cv-01434-MMD-RJJ, 2012 U.S. Dist. LEXIS 176057 (D. Nev. 2012); *Selkirk Seed Co. v. Forney*, 996 P.2d 798, 804 (Idaho 2000); see also *Am. Safety Cas. Ins. Co. v. City of Waukegan*, 678 F.3d 475, 482 (7th Cir. 2012). The defense clause serves two purposes: (1) it provides insureds access to counsel with no obligation to pay in advance; and (2) gives the insurer the right to control the defense. *Id.*

<sup>17</sup> Johnny Parker, *The Role of Prejudice in Resolving Insurance Condition Clause Disputes: The Good, The Bad, & The Ugly*, 47 U. MEM. L. REV. 779, 793 (2017).

<sup>18</sup> *Id.* at 781.

<sup>19</sup> *Unauthorized Prac. of Law Comm. v. Am. Home Ins. Co.*, 261 S.W.3d 24, 27 (Tex. 2008). See also *Centex Homes v. St. Paul Fire & Marine Ins. Co.*, 228 Cal. Rptr. 3d 228, 233 (Cal. Ct. App. 2018); *Travelers Int'l v. Savio*, 706 P.2d 1258, 1274 (Colo. 1985); *Episcopal Church*, 53 F. Supp. 3d at 823; *Kooyman v. Farm Bureau Mut. Ins. Co.*, 315 N.W.2d 30, 33 (Iowa 1982); *Int'l Ins. Co. v. Dresser Industries, Inc.*, 841 S.W.2d 437, 440 (Tex. App. 1992); *Lampley v. Davis Mach. Corp.*, 530 A.2d 1254, 1258 (N.J. Super. 1987); *Wilson v. Liberty Ins. Underwriters, Inc.*, No. 2:07-0478, 2008 U.S. Dist. LEXIS 13860 (S.D. W. Va. Feb. 25, 2008). See also Keeton, *Liability and Responsibility for Settlement*, 67 HARV. L. REV. 1136, 1152 (1954) (explaining that most insurance policies unambiguously give the insurer the right to control defense of claims under the policy).

<sup>20</sup> *Chi of Alaska v. Emps. Reinsurance Corp.*, 844 P.2d 1113, 1122 (Alaska 1993) (citing 7C John Appleman, *Insurance Law and Practice* § 4681 (rev. ed. 1979)).

<sup>21</sup> See *Sherwood Brands v. Hartford Accident & Indem. Co.*, 698 A.2d 1078, 1083 (Md. 1996); *Ill. Mun. Risk Mgmt. Ass'n v. Seibert*, 585 N.E.2d 1130, 1138 (Ill. App. Ct. 1992).

The right to control the defense is a core component of the duty to defend.<sup>22</sup> It extends to the negotiation of settlements<sup>23</sup> and includes the right to select defense counsel to represent the insured.<sup>24</sup> “A contrary rule would be inconsistent with the insurer’s right to control the defense and would place the insurer in the untenable position of being financially liable, but powerless to ensure the claim is properly defended.”<sup>25</sup> Simply stated, the right to control the defense operates as the mechanism that protects and minimizes the insurer’s duty to indemnify.

The insurer’s contractual right to control the defense and select defense counsel is not without exception. For example, a wrongful refusal or breach of the duty to defend an insured results in the loss of both rights.<sup>26</sup> When the insurer forfeits the right to control the defense, the insured is relieved of its contractual obligation to allow the insurer to manage the litigation and can proceed in whatever manner he deems appropriate.<sup>27</sup> This includes the right to refuse the insurer to re-enter the case and take control of it.<sup>28</sup> Accordingly:

[t]he insurer that refuses to defend does so at its own peril[:] . . . the insurer forfeits any right to control the defense costs and strategy, including the right to compel the insured’s cooperation in the defense of the claims; if it loses its claim of no duty to defend, it will be obliged to reimburse the insured for all reasonable defense fees and costs properly incurred.<sup>29</sup>

A liability insurer can, by appropriate action, provide an insured a defense without waiving its claim that the policy does not afford coverage. For example, the insurer can avoid being bound by a judgment against the insured if it obtains a non-waiver agreement or makes a reservation of rights. A non-waiver agreement is a bilateral contract entered into by the insurer and the insured after the occurrence leading to the claim against the insured arises. It provides that the insurer will defend the suit but reserves the right, at a later date, to assert that the policy does not provide.<sup>30</sup> Similarly, a reservation of rights is also “subject to the same limitations and restrictions.”<sup>31</sup> A reservation of rights is also considered less formal than the non-

<sup>22</sup> See *Hansen v. State Farm Mut. Auto Ins. Co.*, No. 2:10-cv-01434-MMD-RJJ, 2012 U.S. Dist. LEXIS 176057 (D. Nev. 2012).

<sup>23</sup> *Diamond Heights Homeowners Ass’n v. Nat’l Am. Ins. Co.*, 277 Cal. Rptr. 906, 914 (Cal Ct. App. 1991); *Bailey v. Allstate Ins. Co.*, 844 P.2d 1336, 1339 (Colo. 1992).

<sup>24</sup> See *Episcopal Church*, 53 F. Supp. 3d at 823.

<sup>25</sup> *Carolina Cas. Ins. Co. v. Bolling, Walter & Gawthrop*, No. Civ. S-04-2445, 2005 U.S. Dist. LEXIS 20485, at \*1 (E.D. Cal. May 31, 2005).

<sup>26</sup> See *Episcopal Church*, 53 F. Supp. 3d at 824; *Epstein v. Erie Indem. Co.*, 39 Pa. D. & C. 117, 126-27 (Pa. Com. Pl. 1940); *Well’s Dairy, Inc. v. Travelers Indem. Co.*, 266 F. Supp. 2d 964, 967-68 (N.D. Iowa 2003); *Am. Motorist Ins. Co. v. Trane Co.*, 544 F. Supp. 669, 695 (W.D. Wis. 1982); *Std. Construction Co. v. Maryland Cas. Co.*, 359 F.3d 846, 854 (6th Cir. 2004).

<sup>27</sup> See *Episcopal Church*, 53 F. Supp. 3d at 824; *Epstein*, 39 Pa. D. & C. at 126-27; *Am. Motorist Ins. Co.*, 544 F. Supp. at 695.

<sup>28</sup> See *Episcopal Church*, 53 F. Supp. 3d at 824.

<sup>29</sup> *Sentinel Ins. Co. v. First Ins. Co. of Haw.*, 875 P.2d 894, 908-09 (Haw. 1994); see also *Well’s Dairy, Inc.*, 266 F. Supp. 2d at 967-68; *Am. Motorist Ins. Co.*, 544 F. Supp. at 695.

<sup>30</sup> See *Michaelian v. State Comp. Ins. Fund*, 58 Cal. Rptr. 2d 133 (Cal. Ct. App. 1996).

<sup>31</sup> *Id.* at 143.

waiver and less tied to strict contractual principles.<sup>32</sup> In the reservation of rights context, the insurer need only notify the insured that it is conducting the investigation and defense of the claim and not waiving any non-coverage defenses it may have under the policy.<sup>33</sup>

A reservation of rights letter serves two purposes. First, it puts the insured on notice that its interests and the insurer's interests are not necessarily consistent, and, thus, the insured may potentially be subject to personal liability not covered by the policy.<sup>34</sup> Second, assuming the letter is both timely and meets the requirements for effectiveness, it protects the insurer from subsequent attacks on its coverage position based on the concepts of waiver or estoppel.<sup>35</sup> The insurer must meet certain requirements in order for a reservation of rights to take effect,<sup>36</sup> but a complete discussion of this topic is beyond the scope of this Article.

The legal effect of a reservation of rights can be examined from many perspectives, each depending upon the right purported to be reserved and the specific context in which the right is asserted. For example, a reservation of rights may trigger issues regarding the right of the insurer to control settlements; the right of the insurer to control the defense; the extent to which a reservation of rights constitutes a conflict of interest; and the right of the insured to independent counsel—to name a few. The legal implications of a reservation of rights are largely determined from an insurance law perspective. This perspective typically resolves reservation of rights issues by focusing on the relative obligations of the parties under the insurance policy. Thus, in cases where the parties, at the outset of the reservation of rights, agree that the insured is entitled to hire independent counsel at the insurer's expense, insurance law alone provides the exclusive rules for resolving disputes. One issue that frequently arises in this context is whether the insurer is entitled to reimbursement for the cost of the defense provided. Cases on the other end of the reservation of rights spectrum often involve situations in which the insured objects to the insurer's reservation of rights.

When a third party sues an insured, the language of the general liability insurance clause creates a notoriously unique tripartite relationship between the insurance company, insured, and defense counsel. In no other area of the law are parties routinely represented by an attorney chosen and paid for by a third party whose interests may differ from those of the individual the attorney was hired to

---

<sup>32</sup> *Id.*

<sup>33</sup> *See id.*; *see also* Tex. Ass'n Gov't Risk Mgmt. Pool v. Matagorda Cnty., 52 S.W.3d 128, 133 (Tex. 2000).

<sup>34</sup> *See* Atlanta Casualty Ins. Co. v. Stephens, 825 S.W.2d 330, 333 (Mo. App. 1992); First United Bank v. First Am. Title Co., 496 N.W.2d 474, 481 (Neb. 1993); Western Heritage Ins. Co. v. Love, 24 F. Supp. 3d 866, 877 (W.D. Mo. 2014).

<sup>35</sup> *See Atlanta Casualty Ins. Co.*, 825 S.W.2d at 333; *First United Bank*, 496 N.W.2d at 481; *Western Heritage Ins. Co.*, 24 F. Supp. 3d at 877.

<sup>36</sup> A proper reservation of rights is one that fairly informs the insured of the insurer's position in a way that permits the insured to make an intelligent choice to accept the insurer's attorney or retain his own. *See, e.g.*, Utica Mut. Ins. Co. v. David Agency Ins., Inc., 327 F. Supp. 2d 922, 926 (N.D. Ill. 2004). For a detailed discussion of what constitutes a proper or adequate reservation of rights, *see* Safeco Ins. Co. of Am. v. Liss, 2005 Mont. Dist. LEXIS 1073, 25. *See also* RESTATEMENT OF THE LAW: LIABILITY INSURANCE § 15 (AM. LAW INST., Proposed Final Draft No. 2, 2018).

represent. The tripartite relationship is further complicated when a reservation of rights is added to the equation. The insured creates several legal issues when he or she objects to the reservation of rights: the extent to which the insurer is disqualified from controlling the defense; the ethical obligations of insurer-retained defense counsel; and the insured's right to independent counsel at insurer's expense. Courts throughout the country have responded to these issues in a variety of ways.

This Article examines the legal implications of a reservation of rights in two distinct situations. The first involves situations where the insurer has agreed to relinquish control of the defense by providing insured with independent counsel at insurer's expense. The insurer, as a part of this agreement, reserves the right to assert any claims or defenses it possesses as a result of the policy. Following the termination of the underlying litigation, the insurer contends that its reservation of rights also entitles it to reimbursement for defense costs. The second situation involves circumstances in which the insured objects to the exercise of a reservation of rights, thus creating a potential rift—a tripartite conflict—between all three parties in the relationship. These situations were selected for discussion because they represent diametrically opposing perspectives from which to examine the legal effect of a reservation of rights. As evidenced by the division of authority and the multitude of legal standards used to resolve the respective issues, each perspective demonstrates, in its own way, the perplexing and complex nature of reservation of rights practice.

Section I of this Article examines the legal implications of a reservation of rights in the context of reimbursement of defense costs. It discusses insurance law responses to the problem. Section I discusses what was once considered the majority rule. It explains how that rule's justifications and rationales have eroded overtime. The law in this area has evolved along two distinct paths. The first is a quasi-contract path concerned with the validity and enforceability of unilateral contracts. The second is the expressed contract path, which focuses primarily on the enforceability of reimbursement provisions contained in a policy. Lastly, Section I examines the American Law Institute's proposed solution to the dispute regarding the right of insurers to recoup defense costs in the reservation of rights context.

Section II examines the effect of a reservation of rights in the context of tripartite conflicts of interest. This section examines the most widely recognized legal standards used by courts throughout the country to resolve these types of conflicts. These standards are discussed on an individual state basis, revealing the hypersensitive nature of the legal issues and interests involved in tripartite conflicts. They also demonstrate that a reservation of rights can create problems seemingly beyond the ability of insurance law alone to resolve. Following the discussion of tripartite conflict literature, Section III distills the literature in terms of insurance law, ethical rules, or both. Finally, Section IV discusses the American Law Institute's proposed rules that, while rejecting a minority rule allowing an insured to decline an insurer's offer to defend pursuant to a reservation of rights, also affords an insured independent counsel when common issues of fact exist that might lead an insurer to compromise the defense for its own benefit.

## I. RESERVATION OF RIGHTS AND REIMBURSEMENT OF DEFENSE COSTS

Courts throughout the country have struggled with the issue of whether an insurer's unilateral reservation of rights letter can establish an implied contractual obligation that requires the insured to reimburse defense costs expended by the insurer. According to one line of authority, a liability insurer is entitled, under a reservation of rights, to recoup the costs of defending against third party claims that were not potentially covered under the policy.<sup>37</sup> The rationale for this view is that if neither the complaint nor extrinsic facts indicate any basis for potential coverage, the duty to defend never arose in the first instance.<sup>38</sup> Consequently, the insurer, having reserved its rights, merely recovers defense costs that, in hindsight, it never owed. According to this logic:

[u]nder the policy, the insurer does not have a duty to defend the insured as to the claims that are not even potentially covered. With regard to defense costs for these claims, the insurer has not been paid premiums by the insured. It did not bargain to bear these costs. To attempt to shift them would not upset the arrangement. The insurer therefore has a right of reimbursement that is implied in law as quasi-contractual, whether or not it has one that is implied in fact in the policy as contractual.<sup>39</sup>

This view is based on the contractual premise that the insured paid for and is only entitled to a defense against any claims that are potentially covered by the policy. Furthermore,

where the insurer, acting under a reservation of rights, has prophylactically financed the defense of claims as to which it owed no duty of defense, it is entitled to restitution. Otherwise, the insured, who did not bargain for a defense of noncovered claims, would receive a windfall and would be unjustly enriched.<sup>40</sup>

Accordingly, an insured's failure to object to a reservation of rights constitutes acquiescence or consent to the implied agreement to reimburse.<sup>41</sup> Thus, the law of unjust enrichment and restitution can be used to bridge the gap between right and remedy.<sup>42</sup> In general, the decisions finding that an insurer is entitled to

---

<sup>37</sup> See *Buss v. Superior Court*, 939 P.2d 766, 776 (Cal. 1997).

<sup>38</sup> See *Scottsdale Ins. Co., v. MV Transp.*, 115 P.3d 460, 471 (Cal. 2005).

<sup>39</sup> *Buss v. Superior Court*, 939 P.2d at 776. See also *Chiquita Brands Int'l, Inc. v. Nat'l Union Fire Ins. Co.*, 57 N.E.3d 97, 101 (Ohio App. 2015) (relying on the principle of restitution for holding that insurer acting pursuant to a reservation of rights was entitled to reimbursement of defense cost.).

<sup>40</sup> *Scottsdale Ins. Co.*, 115 P.3d at 469 (holding that the *Buss* analysis applies to both mixed claims and cases where the insurer, acting pursuant to a reservation rights, defended an action in which no claim was ever potentially covered).

<sup>41</sup> See *Michaelian v. State Comp. Ins. Fund*, 58 Cal. Rptr. 2d 133, 143 (Cal. Ct. App. 1996).

<sup>42</sup> The law of restitution recognizes that, where one party to a contract demands from another a performance that is not due by the terms of the contract, under circumstances where it is reasonable



reimbursement of defense costs are based upon the legal fictions of implied contract and quasi contract and the equitable theory of unjust enrichment.<sup>43</sup>

Other jurisdictions have reached a different conclusion regarding whether a unilateral reservation of rights can establish an implied contractual obligation to reimburse defense costs. In these jurisdictions, a unilateral reservation of rights cannot create rights beyond those contained in the policy.<sup>44</sup> According to this view, the reservation of rights letter is simply a unilateral offer to add a reimbursement provision to the policy. That offer becomes binding only if the insured consents. However, neither the insured's silence nor its failure to object to the insurer's reservation constitutes consent.<sup>45</sup> In these jurisdictions, the insured's consent is dispositive of whether an insurer is entitled to recover said expenditures based on quasi contract theories, such as quantum meruit and unjust enrichment.<sup>46</sup>

---

to concede to the demand, and where the party on whom the demand is made renders such performance pursuant to a reservation of rights, a claim for restitution is preserved. The party upon whom the demand was made is entitled to recover the value of the benefit conferred in excess of the recipient's contractual entitlement. Restitution under these circumstances does not set aside the contract but merely provides a means to enforce adherence to a contract through ordering repayment of a sum to which the recipient was never entitled to under the contract. *Chiquita Brands Int'l, Inc.*, 57 N.E.3d at 101.

<sup>43</sup> See *Buss*, 939 P.2d at 776; *Hecla Mining Co. v. New Hampshire Ins. Co.*, 811 P.2d 1083, 1089 (Colo. 1991); *Colony Ins. Co. v. G&E Tires & Servs., Inc.*, 777 So. 2d 1024, 1038 (Fla. App. 2000); *Sec. Ins. Co. of Hartford v. Lumbermens Mut. Cas. Co.*, 826 A.2d 107, 125 (Conn. 2003); *Hebela v. Healthcare Ins. Co.*, 851 A.2d 75, 86 (N.J. Super. 2004); *Caitlin Specialty Ins. Co. v. CBL & Assocs. Props.*, 2018 Del. Super. LEXIS 342, 11 (applying Tennessee law); *Cincinnati Ins. Co. v. Grande Pointe, LLC*, 501 F. Supp. 2d 1145, 1169 (E.D. Tenn. 2007) (predicting Tennessee law); *Union Ins. Co. v. NRI Constr., Inc.*, 846 F. Supp. 2d 1366, 1377 (N.D. Ga. 2012) (predicting Georgia law); *Nat'l Trust Ins. Co. v. Heaven Hill Distilleries, Inc.*, 2018 U.S. Dist. LEXIS 52569, 26 (W.D. Ky. 2018); *United Nat'l Ins. Co. v. SST Fitness*, 309 F.3d 914, 921 (6th Cir. 2002) (predicting Ohio law).

<sup>44</sup> See *Shoshone First Bank v. Pacific Emps. Ins. Co.*, 2 P.3d 510, 515 (Wyo. 2000); *Am. & Foreign Ins. Co. v. Jerry's Sport Center, Inc.*, 2 A.3d 526, 544 (Pa. 2008); *Tex. Ass'n Gov't Risk Mgmt. Pool v. Matagorda Cnty.*, 52 S.W.3d 128, 131 (Tx. 2000); *Gen. Agents Ins. Co. of Am., Inc. v. Midwest Sporting Goods Co.*, 828 N.E.2d 1093, 1102 (Ill. 2005); *Nat'l Sur. Corp. v. Immunex Corp.*, 297 P.3d 688, 697 (Wash. 2013); *First Ins. Co. of Hawaii, Inc. v. State ex rel. Minami*, 665 P.2d 648, 654 (Haw. 1983); *Med. Liab. Mut. Ins. Co. v. Alan Curtis Enters., Inc.*, 285 S.W.3d 233, 237 (Ark. 2008); *Holyoke Mut. Ins. Co. v. Vibram, USA, Inc.*, 2017 Mass. Super. LEXIS 12, 16; *Perdue Farms, Inc. v. Travelers Cas. & Sur. Co. of Am.*, 448 F.3d 252, 259 (4th Cir. 2006) (predicting Maryland law); *Capital Indem. Corp. v. Blazer*, 51 F. Supp. 2d 1080, 1090 (D. Nev. 1999) (predicting Nevada law); *Evanston Ins. Co. v. Bosski, Inc.*, 2017 U.S. Dist. LEXIS 48177, 12 (D. Idaho 2017) (predicting Idaho law); *Gen. Star Indem. Co. v. Driven Sports, Inc.*, 80 F. Supp. 3d 442, 463 (E.D.N.Y. 2015) (predicting New York law); *Riley Stoker Corp. v. Fid. and Guar. Ins. Underwriters, Inc.*, 26 F.3d 581, 590 (5th Cir. 1995) (citing Louisiana and Illinois law); *Terra Nova Ins. Co. Ltd. v. 900 Bar, Inc.*, 887 F.2d 1213, 1219 (3rd Cir. 1989); *Westchester Fire Ins. Co. v. Wallerich*, 563 F.3d 707, 719 (8th Cir. 2009) (predicting Wisconsin law); *Westport Ins. Corp. v. Ong*, 2008 U.S. Dist. LEXIS 26683, 17 (D. Utah 2008) (predicting Utah law); *Pekin Ins. Co. v. Tysa, Inc.*, 2006 U.S. Dist. LEXIS 93525, 54 (S.D. Iowa 2006).

<sup>45</sup> See *Merchant's Indemn. Co. v. Eggleston*, 179 A.2d 505, 512 (N.J. 1967) (noting that consent can be inferred from the insured's silences only if the reservation of rights letter informs the insured of his right to reject the qualified defense); *Tex. Ass'n Gov't Risk Mgmt. Pool v. Matagorda Cnty.*, 52 S.W.3d 128, 135 (Tex. 2000).

<sup>46</sup> See *Tex. Ass'n Gov't Risk Mgmt. Pool v. Matagorda Cnty.*, 52 S.W.3d 128, 134 (Tex. 2000); *Merchant's Indemn. Co. v. Eggleston*, 179 A.2d 505, 512 (N.J. 1967).

Jurisdictions that have rejected the contract-based approach support that choice with the reasoning that the offer to defend subject to a reservation of rights is as much for the insurer's own benefit as the insured's.<sup>47</sup> As explained in *General Agent Insurance of North America, Inc. v. Midwest Sporting Goods Co.*:

A rule permitting such recovery would be inconsistent with the legal principles that induce an insurer's offer to defend under reservation of rights. Faced with uncertainty as to its duty to indemnify, an insurer offers a defense under reservation of rights to avoid the risks that an inept or lackadaisical defense of the underlying action may expose it to if it turns out there is a duty to indemnify. At the same time, the insurer wishes to preserve its right to contest the duty to indemnify if the defense is unsuccessful. . . . If the insurer could recover defense costs, the insured would be required to pay for the insurer's action in protecting itself against the estoppel to deny coverage that would be implied if it undertook the defense without reservation.<sup>48</sup>

Interestingly, public policy considerations have contributed little to the development of insurance law regarding whether a reservation of rights entitles an insurer to recoup defense costs. This lack of contribution may partially stem from the traditional reason for invoking public policy as a legal doctrine: to override expressed terms of insurance policies. Nevertheless, several jurisdictions that reject the rule that a unilateral reservation of rights entitles the insurer to reimbursement of defense cost have done so as a matter of public policy.<sup>49</sup>

### A. Expressed Reimbursement Provisions

Prior to 2016, insurance law addressing whether a unilateral reservation of rights entitled an insurer to reimbursement of defense costs developed along a single, implied contract right path, along which two distinct legal rules have developed. One rule—built on the principles of implied-in-fact or -law contracts, unjust enrichment, and restitution—led to the conclusion that a unilateral reservation of the rights, in the absence of an expressed provision in the policy, entitled the insurer to reimbursement.<sup>50</sup> At one time, this approach represented the

---

<sup>47</sup> *Terra Nova Ins. Co.*, 887 F.2d at 1219-20.

<sup>48</sup> *Gen. Agents Ins. Co. of Am., Inc. v. Midwest Sporting Goods Co.*, 828 N.E.2d 1093, 1102-03 (Ill. 2005) (citing *Terra Nova Ins. Co.*, 887 F.2d at 1219-20).

<sup>49</sup> *See id.*; *Medical Liability Mut. Ins. Co. v. Alan Curtis Enters.*, 285 S.W.3d 233, 237 (Ark. 2008) (rejecting both the majority and minority rules).

<sup>50</sup> *See Buss v. Superior Court*, 939 P.2d 766, 778 (Cal. 1997); *Hecla Mining Co. v. New Hampshire Ins. Co.*, 811 P.2d 1083, 1089 (Colo. 1991); *Colony Ins. Co. v. G&E Tires & Servs., Inc.*, 777 So. 2d 1024, 1039 (Fla. App. 2000); *Sec. Ins. Co. of Hartford v. Lumbermens Mut. Cas. Co.*, 826 A.2d 107, 124 (Conn. 2003); *Hebela v. Healthcare Ins. Co.*, 851 A.2d 75, 84 (N.J. Super. 2004); *Caitlin Specialty Ins. Co. v. CBL & Assocs. Props.*, 2018 Del. Super. LEXIS 342, 11 (applying Tennessee law); *Cincinnati Ins. Co. v. Grande Pointe, LLC*, 501 F. Supp. 2d 1145, 1168 (E.D. Tenn. 2007) (predicting Tennessee law); *Union Ins. Co. v. NRI Constr., Inc.*, 846 F. Supp. 2d 1366, 1377 (N.D. Ga. 2012) (predicting Georgia law); *Nat'l Trust Ins. Co. v. Heaven Hill Distilleries, Inc.*, 2018 U.S. Dist. LEXIS 52569, 27 (W.D. Ky. 2018); *United Nat'l Ins. Co. v. SST Fitness*, 309 F.3d 914, 921 (6th Cir. 2002) (predicting Ohio law); *Travelers Prop. Cas. Co. of Am. V. Hillerich & Bradsby Co.*,

majority view.<sup>51</sup> However, the other legal rule currently commands the majority view, recognizing that, in the absence of an expressed reimbursement provision in the policy or consent from the insured, a reservation of rights seeking reimbursement cannot be implied from the contract.<sup>52</sup>

In *Attorneys Liability Protection Society, Inc. v. Ingaldson Fitzgerald*,<sup>53</sup> the Alaska Supreme Court addressed, for the first and only time, the enforceability of an expressed reimbursement provision contained in an insurance policy. In *Ingaldson*, the court analyzed the issue by examining the nature and extent of the insurer's duty to defend. Alaska decisional law firmly established that, in the policy defense context, "the insured has a right to demand an unconditional defense."<sup>54</sup> An insurer seeking to satisfy this right has three options: "affirm the policy and defend unconditionally[,] . . . repudiate the policy and withdraw from the defense, or reserve rights and offer it's insured the right to retain independent counsel to conduct his [or her] defense, and agree to pay all the necessary costs of the defense."<sup>55</sup> Thus, Alaska law obligates the insurer to provide and "pay all the necessary costs of independent counsel when reserving the right to assert a later coverage defense."<sup>56</sup> Because the duty to defend is broad in scope, it attaches "on the basis of the complaint and known or reasonably ascertainable facts at the time of the complaint. Even if coverage is ultimately denied, and even if it were later determined that there was no possibility of coverage, that denial has no retroactive

598 F.3d 257, 265 (6th Cir. 2010) (predicting Kentucky law).

<sup>51</sup> See generally *Buss*, 939 P.2d at 776; *Hecla Mining Co.*, 811 P.2d at 1089; *Colony Ins. Co.*, 777 So. 2d at 1039; *Sec. Ins. Co. of Hartford*, 826 A.2d at 124; *Hebela*, 851 A.2d at 84; *Caitlin Specialty Ins. Co. v. CBL & Assocs. Props.*, 2018 Del. Super. LEXIS 342, 5 (applying Tennessee law); *Cincinnati Ins. Co. v. Grande Pointe, LLC*, 501 F. Supp. 2d 1145, 1151 (E.D. Tenn. 2007) (predicting Tennessee law); *Union Ins. Co. v. NRI Constr., Inc.*, 846 F. Supp. 2d 1366, 1374 (N.D. Ga. 2012) (predicting Georgia law); *Nat'l Trust Ins. Co. v. Heaven Hill Distilleries, Inc.*, 2018 U.S. Dist. LEXIS 52569, 19 (W.D. Ky. 2018); *United Nat'l Ins. Co. v. SST Fitness*, 309 F.3d 914, 917 (6th Cir. 2002) (predicting Ohio law); *Travelers Prop. Cas. Co. of Am. v. Hillerich & Bradsby Co.*, 598 F.3d 257, 265 (6th Cir. 2010) (predicting Kentucky law).

<sup>52</sup> See *Shoshone First Bank v. Pacific Emps. Ins. Co.*, 2 P.3d 510, 515 (Wyo. 2000); *Am. & Foreign Ins. Co. v. Jerry's Sport Center, Inc.*, 2 A.3d 526, 540 (Pa. 2008); *Tex. Ass'n Gov't Risk Mgmt. Pool v. Matagorda County*, 52 S.W.3d 128, 131 (Tx. 2000); *Gen. Agents Ins. Co. of Am., Inc.*, 828 N.E.2d at 1103; *Nat'l Sur. Corp. v. Immunex Corp.*, 297 P.3d 688, 697 (Wash. 2013); *First Ins. Co. of Hawaii, Inc. v. State ex rel. Minami*, 665 P.2d 648, 654 (Haw. 1983); *Med. Liab. Mut. Ins. Co. v. Alan Curtis Enters., Inc.*, 285 S.W.3d 233, 235 (Ark. 2008); *Perdue Farms, Inc. v. Travelers Cas. & Sur. Co. of Am.*, 448 F.3d 252, 259 (4th Cir. 2006) (predicting Maryland law); *Capital Indem. Corp. v. Blazer*, 51 F. Supp. 2d 1080, 1090 (D. Nev. 1999) (predicting Nevada law); *Evanston Ins. Co. v. Bosski, Inc.*, 2017 U.S. Dist. LEXIS 48177, 12 (D. Idaho 2017) (predicting Idaho law); *Gen. Star Indem. Co. v. Driven Sports, Inc.*, 80 F. Supp. 3d 442, 461 (E.D. N.Y. 2015) (predicting New York law); *Riley Stoker Corp. v. Fid. and Guar. Ins. Underwriters, Inc.*, 26 F.3d 581 (5th Cir. 1995) (citing Louisiana and Illinois law); *Terra Nova Ins. Co.*, 887 F.2d at 1220; *Westchester Fire Ins. Co. v. Wallerich*, 563 F.3d 707, 719 (8th Cir. 2009) (predicting Wisconsin law); *Westport Ins. Corp. v. Ong*, 2008 U.S. Dist. LEXIS 26683, 17 (D. Utah 2008) (predicting Utah law); *Pekin Ins. Co. v. Tysa, Inc.*, 2006 U.S. Dist. LEXIS 93525, 55 (S.D. Iowa 2006).

<sup>53</sup> *Attys. Liab. Prot. Soc'y, Inc. v. Ingaldson Fitzgerald, P.C.*, 370 P.3d 1101 (Alaska 2016). See also *RESTATEMENT OF THE LAW: LIABILITY INSURANCE* § 21 (AM. LAW INST., Proposed Final Draft No. 2, 2018).

<sup>54</sup> 370 P.3d at 1106.

<sup>55</sup> *Id.* (internal quotation marks omitted).

<sup>56</sup> *Id.* (internal quotation marks omitted).

effect on the duty to defend.”<sup>57</sup> Consequently, Alaska law prohibits reimbursement of defense costs incurred by an insurer defending claims under a reservation of rights, even when it is later discovered that there was no possibility of coverage under the policy.<sup>58</sup> When an insurer has a duty to defend, Alaska law prohibits enforcement of a policy provision entitling the insurer to reimbursement of defense costs incurred while defending the claim under a reservation of rights. This is true even when “(1) an insurer explicitly reserved the right to seek such reimbursement in its offer to tender a defense provided by independent counsel, (2) the insured accepted the defense subject to the reservation of rights, and (3) the claims are later determined to be excluded from coverage under the policy.”<sup>59</sup> The court based its conclusions in large part on Alaska’s independent counsel statute—Alaska Statute 21.96.100(d)—which provides that an insurer required to provide independent counsel “shall be responsible for the fees and costs of defending those allegations for which the insurer either reserves its position as to coverage or accepts coverage.”<sup>60</sup> According to the court, because the statutory scheme mandates payment and does not expressly provide for reimbursement of fees and costs, reimbursement is prohibited and cannot be avoided by a contract provision to the contrary.<sup>61</sup> The court in *Ingaldson* also held that this conclusion applies to situations in which the duty to defend never actually arises, but the insurer nevertheless provides a defense that is subject to a reservation of rights “out of an abundance of caution.”<sup>62</sup>

### B. Reshaping the Reservation of Rights—Reimbursement of Defense Costs Landscape

As illustrated by *Ingaldson*, when the claim hinges on a contractual right to reimbursement—whether because of an expressed provision in the policy or a subsequent agreement with the insured—the relevant issue is the enforceability of the agreement. An insurer’s potential entitlement to reimbursement of defense costs becomes more controversial without an expressed reimbursement provision or subsequent agreement with the insured. In response to the latter situation, the American Law Institute proposed a default rule of no recoupment unless otherwise stated in the policy or otherwise agreed to by the insured, even if it is subsequently determined that the insurer did not have a duty to defend or pay defense costs.<sup>63</sup>

This proposed default rule was selected as the most desirable approach for multiple reasons. The rule would conceivably lower litigation costs more than an

---

<sup>57</sup> *Id.* at 1111.

<sup>58</sup> *Id.* at 1112.

<sup>59</sup> *Id.* at 1106.

<sup>60</sup> *Id.* at 1105.

<sup>61</sup> *Id.*

<sup>62</sup> *Id.* at 1112 (concluding that no incentive for an insurer to “automatically reserve rights in hopes of obtaining reimbursement for attorney’s fees and to protect itself from claims of bad faith or breach that could result from a repudiation of the policy” should exist).

<sup>63</sup> RESTATEMENT OF THE LAW: LIABILITY INSURANCE § 21 (AM. LAW INST., Proposed Final Draft No. 2, 2018).

alternative rule of recoupment.<sup>64</sup> As only a default rule, it would also allow insurers to include an expressed reimbursement provision in their policies if a recoupment rule proves to be easier to administer or costs would otherwise justify the expense.<sup>65</sup> Additionally, expressing the right to recoup defense costs in the policy has many advantages. For example, it puts the legal basis of the insurer's entitlement beyond dispute and specifies the contours of that entitlement in advance of a dispute, allowing for easier evaluation for the parties.<sup>66</sup> Finally, the default rule of no recoupment places the burden of contracting on the party primarily responsible for drafting to do so.<sup>67</sup>

## II. TRIPARTITE CONFLICT OF INTEREST LITERATURE

In most situations, liability insurers and insureds share a common goal or objective. However, situations do arise in which the interests of these parties diverge or differ in a way that produces the potential for a disqualifying conflict of interest, which may require the insurer to relinquish control of the defense and provide the insured with independent counsel at insurer's expense. The potential for conflict exists in every case and can arise over the existence of coverage, the manner in which the case is to be defended, the information to be shared, the desirability of settling at a particular figure or the need to settle at all, and an array of other factors related to the circumstances of a particular case. Still, not every conflict of interest is disqualifying.

Many jurisdictions recognize that when an insurance company hires an attorney to defend an insured, the attorney must work to further the interests of the insured and insurer.<sup>68</sup> The attorney-client relationship between the insured and the attorney, however, triggers the same professional obligations as if the insured personally retained the attorney.<sup>69</sup> It is widely accepted that an attorney hired by an insurance company may feel more aligned with the insurer's interests. Insurer-retained defense counsel may find it more financially advantageous to protect the insurer's interest to the detriment of the insured.<sup>70</sup> If the insurer refuses to concede control of the defense and reserves its right to contest coverage, a disqualifying conflict of interest may exist or later arise between all three parties to the relationship. The conflict can arise from the inconsistent position taken by the insurer, which simultaneously provides representation and seeks a basis to quit the case, and the retained counsel, who represents diametrically opposed clients. In

---

<sup>64</sup> *Id.*

<sup>65</sup> *Id.*

<sup>66</sup> *Id.*

<sup>67</sup> *Id.*

<sup>68</sup> See *San Diego Fed. Credit Union v. Cumis Ins. Soc'y*, 208 Cal. Rptr. 494, 496 (Cal. Ct. App. 1984); see also *Chi of Alaska v. Emps. Reinsurance Corp.*, 844 P.2d 1113, 1116 (Alaska 1993); *Ill. Mun. League Risk Mgmt. v. Siebert*, 585 N.E.2d 1130, 1135 (Ill. App. Ct. 1992).

<sup>69</sup> *San Diego Fed. Credit Union*, 208 Cal. Rptr. at 496; see also *Chi of Alaska*, 844 P.2d at 1116; *Ill. Mun. League Risk Mgmt.*, 585 N.E.2d at 1135.

<sup>70</sup> *San Diego Fed. Credit Union*, 208 Cal. Rptr. at 496; see also *Chi of Alaska*, 844 P.2d at 1116-17; *Ill. Mun. League Risk Mgmt.*, 585 N.E.2d at 1135.

this context, both insurance law and ethical rules guide the rectification and determination of the respective parties' rights and obligations.

### A. California

Most jurisdictions recognize that the tripartite relationship between appointed counsel, insured, and insurer poses the potential for a disqualifying conflict of interest. For example, in the seminal case of *San Diego Federal Credit Union v. Cumis Insurance Society*, the court addressed “whether an insurer is required to pay for independent counsel for an insured when the insurer provides its own counsel but reserves its right to assert non-coverage at a later date.”<sup>71</sup> The *Cumis* court began its analysis by assessing whether the reservation of rights created an actual or merely a potential conflict of interest between the insurer, retained defense counsel, and the insured. Concluding that a reservation of rights in the context of a coverage dispute constitutes an actual conflict of interest between insurer and insured, the court recognized that the insurer could not compel the insured to surrender control of the defense.<sup>72</sup> It necessarily followed that where an actual conflict of interest exists and the insured objects to the insurer's reservation of rights, the insured may rightfully hire independent counsel at the insurer's expense.<sup>73</sup>

The assessment of the effect of a reservation of rights on insurer-retained defense counsel proceeded down an entirely different path from that used to ascertain the obligations of the insurer. Though the litigation of the third-party lawsuit did not involve coverage issues, the force of the opposing interests of the insurer and insured as they operate on the attorney hired and paid by the insurer persisted, nevertheless. Because defense counsel had a dual agency status and represented both insurer and insured, she was ethically bound to investigate all conceivable bases on which liability might attach. These investigations and client communications may provide information relating directly to coverage issues. In such a case,

[a]s between counsel's two clients, there is no confidentiality regarding communications intended to promote common goals. . . . But confidentiality is essential where communication can affect coverage. . . . Thus, [insurer retained counsel] is forced to walk an ethical tightrope, and not communicate relevant information which is beneficial to one or the other of his clients.<sup>74</sup>

According to the *Cumis* court, a reservation of rights can create a potential conflict of interest between insurer-retained counsel and the insured. These potential

---

<sup>71</sup> *San Diego Fed. Credit Union*, 208 Cal. Rptr. at 496.

<sup>72</sup> *Id.*

<sup>73</sup> *Id.* The term “Cumis counsel” derives from *San Diego Fed. Credit Union v. Cumis Ins. Soc'y*, 208 Cal. Rptr. 494, 496 (Cal. Ct. App. 1984). The term “Cumis Counsel” and “independent counsel” are synonymous. *Behnke v. State Farm Gen. Ins. Co.*, 127 Cal Rptr.3d 372, 375 (Cal. Ct. App. 2011).

<sup>74</sup> *San Diego Fed. Credit Union*, 208 Cal. Rptr. at 496.

conflicts trigger ethical considerations governed by the Code of Professional Responsibility.

“The Canons of Ethics impose upon lawyers hired by the insurer an obligation to explain to the insured and the insurer the full implications of joint representation in situations where the insurer has reserved its rights to deny coverage.”<sup>75</sup> If the insured does not give informed consent to continued representation, counsel may not represent both parties.<sup>76</sup> Further, if the insured does not consent and divergent interests are created by the insurer’s reservation of rights based on possible non-coverage, then the insurer must pay the reasonable cost of independent counsel hired by the insured.<sup>77</sup>

The *Cumis* doctrine was subsequently codified in 1987. The statute recognizes the insured’s right to retain independent counsel at the insurer’s expense in the event of an actual conflict of interest.<sup>78</sup> Pursuant to the statute, an insurer’s reservation of rights may create a disqualifying conflict of interest requiring the insurer to pay the cost of independent counsel to represent the insured in the underlying action. As evidenced by the term “may,” not every reservation of rights entitles the insured to independent counsel. The statute, however, does not clearly state when the right to independent counsel arises. Consequently, potential conflicts of interest require a careful analysis of the parties’ respective interests to determine whether they can be reconciled or whether an actual conflict of interest that prevents insurer-retained defense counsel from presenting a quality defense for the insured exists.<sup>79</sup> There is no entitlement to independent counsel when the coverage issue is independent of, or extrinsic to, the issues in the underlying case, or when the policy only partially covers damages.<sup>80</sup>

The insured, after being informed that a possible conflict exists or may arise, may waive this right in writing.<sup>81</sup> According to the statute, “a conflict of interest does not exist as to allegations or facts in the litigation for which the insurer denies coverage.”<sup>82</sup> Nevertheless, “when an insurer reserves its rights on a given issue and the outcome of that coverage issue can be controlled by counsel retained by the insurer, a conflict may exist.”<sup>83</sup> Furthermore, conflicts of interests do not arise out of allegations of punitive damages or solely because an insured is sued for an amount in excess of the policy limits.<sup>84</sup> When the right to independent counsel is exercised, the insured and independent counsel are duty bound to disclose to the insurer all information concerning the case except privileged materials relevant to coverage disputes.<sup>85</sup> They are also obligated to inform and

---

<sup>75</sup> *Id.*

<sup>76</sup> *Id.*

<sup>77</sup> *Id.*

<sup>78</sup> CAL. CIV. CODE § 2860(a) (Deering 2021).

<sup>79</sup> *Dynamic Concepts v. Truck Ins. Exch.*, 71 Cal. Rptr. 2d 882, 888 (Cal. Ct. App. 1998).

<sup>80</sup> *Id.* at 887.

<sup>81</sup> CIV. § 2860(a), (e).

<sup>82</sup> CIV. § 2860(b).

<sup>83</sup> *Id.*

<sup>84</sup> *Id.*

<sup>85</sup> CIV. § 2860(d).

consult with the insurer regarding all matters relating to the action.<sup>86</sup> Additionally, the statute establishes the right of an insurer to require that counsel appointed by the insured possess minimum qualifications such as “at least five years of civil litigation experience, which includes substantial defense experience in the subject of the litigation and, errors and omissions coverage.”<sup>87</sup> Independent counsel selected by the insured and counsel provided by the insurer are allowed to participate in all aspects of the litigation. This includes “cooperating fully in the exchange of information that is consistent with each counsel’s ethical and legal obligation to the insured.”<sup>88</sup>

### B. Alaska

Alaska’s decisional law regarding reservations of rights and the insurer’s right to control the defense was carefully crafted by the court in two opinions.<sup>89</sup> In *Chi of Alaska v. Employers Reinsurance Corp.*,<sup>90</sup> the Alaska Supreme Court recognized that when an insurer asserts either a policy defense or coverage defense and defends its insured under a reservation of rights, various conflicts of interest arise between the insurer and insured. Such conflicts exist:

[f]irst, if the insurer knows that it can later assert non-coverage, or if it thinks that the loss which it is defending will not be covered under the policy, it may only go through the motions of defending: “it may offer only a token defense. . . . It may not be motivated to achieve the lowest possible settlement or in other ways treat the interests of the insured as its own.” Second, if there are several theories of recovery, at least one of which is not covered under the policy, the insurer might conduct the defense in such a manner as to make the likelihood of a plaintiff’s verdict greater under the uninsured theory. Third, the insurer might gain access to confidential or privileged information in the process of the defense which it might later use to its advantage in litigation concerning coverage.<sup>91</sup>

These conflicts share a common characteristic: each reflects a situation in which the insurer has an incentive to place its interests ahead of that of the insured. Consequently, they constitute actual disqualifying conflicts pursuant to which the insurer forfeits its right to control the defense if the insured refuses to accept a

---

<sup>86</sup> *Id.*

<sup>87</sup> Civ. § 2860(c).

<sup>88</sup> Civ. § 2860(f).

<sup>89</sup> *See* Cont’l Ins. Co. v. Bayless & Roberts, 608 P.2d 281 (Alaska 1980) (holding that where an insurer challenges an insured’s right to enforce the policy on breach of a policy condition the insured has a right to demand an unconditional defense); *see also* *Chi of Alaska v. Emps. Reinsurance Corp.*, 844 P.2d 1113 (Alaska 1993).

<sup>90</sup> 844 P.2d at 1113.

<sup>91</sup> *Id.* at 1116.



defense under a reservation of rights.<sup>92</sup> The insurer is also obligated to pay the reasonable value of the defense conducted by independent counsel.<sup>93</sup>

The existence of a conflict of interest between the insured and the insurer seeking to defend under a reservation of rights does not automatically establish a conflict of interest for appointed counsel. Even though that counsel, appointed and paid by the insurer, has two clients, said attorney owes the insured an undeviating allegiance and cannot act to harm the insured by providing detrimental information to the insurer.<sup>94</sup> “Counsel has ‘an absolute duty of fidelity to the insured over the interests of the insurer.’”<sup>95</sup> Conflicts between insureds and appointed counsel can be avoided if the appointed counsel explains to insured, at the beginning of the engagement, that he will only be involved in the defense of the liability claims, not in coverage disputes.<sup>96</sup>

Alaska has codified its common law regarding reservation of rights, conflicts of interest, and the right to independent counsel.<sup>97</sup> According to the statute, if an insurer has a duty to defend an insured and a conflict of interest that imposes a duty on the insurer to provide independent counsel arises, independent counsel must be provided unless the insured waives the right in writing.<sup>98</sup> Neither a claim for punitive damages or damages in excess of the policy limit, nor a claim for facts in a civil action for which the insurer denies coverage, constitutes a conflict of interest.<sup>99</sup> However, “if the insurer reserves the insurer’s right on an issue for which coverage is denied, the insurer must provide independent counsel” at its expense to the insured.<sup>100</sup>

The insurer, if independent counsel is selected at its expense, may require that independent counsel has at least four years of civil litigation experience, including defense experience in the general area at issue in the underlying case, and malpractice insurance.<sup>101</sup> The insured and independent counsel must also consult with the insurer on all matters related to the case and disclose, in a timely manner, all unprivileged information relevant to the case and to disputed coverage issues.<sup>102</sup> The statute entitles both independent counsel and counsel representing the insurer to participate in all aspects of the case, and it requires both parties to cooperate “in exchanging information that is consistent with ethical and legal obligations to the insured.”<sup>103</sup> The insurer, when providing independent counsel, “is not responsible for the fees and costs of defending an allegation for which coverage is properly denied.”<sup>104</sup> Insurer’s obligation to pay is limited to the fees

---

<sup>92</sup> *Id.* at 1118.

<sup>93</sup> *Id.* at 1120.

<sup>94</sup> *Id.* at 1116.

<sup>95</sup> *Id.*

<sup>96</sup> *Id.*

<sup>97</sup> ALASKA STAT. § 21.96.100 (2020).

<sup>98</sup> § 21.96.100(a), (f).

<sup>99</sup> § 21.96.100(b).

<sup>100</sup> § 21.96.100(c).

<sup>101</sup> § 21.96.100(d).

<sup>102</sup> § 21.96.100(e).

<sup>103</sup> § 21.96.100(g).

<sup>104</sup> § 21.96.100(d).

and costs to defend those allegations “for which the insurer either reserves its position as to coverage or accepts coverage.”<sup>105</sup>

### C. Hawaii

In Hawaii, when an insurer and insured have conflicting interests, the insurer must provide special counsel.<sup>106</sup> The contract between the insurer and special counsel must assure counsel’s professional independence.<sup>107</sup> Thus, the problem created by a reservation of rights—potential conflict—is to be resolved entirely by the integrity of insurer-retained defense counsel.<sup>108</sup> This rule is justified on the basis that the Hawaii Rules of Professional Conduct (HRPC) implicitly recognizes that retained counsel has only one client—the insured—when a conflict arises between the interests of the insurer and the insured.<sup>109</sup>

The insurer’s interests “must yield to the attorney’s professional judgment and his or her responsibility to provide competent, ethical representation to the insured.”<sup>110</sup> The *Finley* court thought it better to refrain from interfering with the insurer’s contractual right to select defense counsel and leave the resolution of the conflict to the integrity of retained defense counsel, since adequate safeguards—the Hawaii Rules of Professional Conduct—exist to protect the insured in case of retained defense counsel’s misconduct.<sup>111</sup> The insured’s interests remain protected if retained defense counsel carefully adheres to the mandates of the HRPC.<sup>112</sup> Conversely, if retained defense counsel “violates the HRPC the insured has recourse against both retained defense counsel and the insurer.”<sup>113</sup>

As explained in *Finley v. Home Insurance Co.*,<sup>114</sup> when a conflict of interest arises, Rule 1.7(b) does not contemplate dual representation of both the insurer and the insured by a single attorney. In addition, other provisions of the HRPC, such as Rules 1.2(a), 1.8(f), and 5.4(c), are relevant to the tripartite relationship that exists between the insurer, the insured, and retained defense counsel.<sup>115</sup> In order to satisfy these ethical obligations, an attorney retained by an insurer to represent an insured 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

---

<sup>105</sup> *Id.*

<sup>106</sup> *Finley v. Home Ins. Co.*, 975 P.2d 1145, 1152 (Haw. 1998).

<sup>107</sup> *Id.* at 1152-53.

<sup>108</sup> *Id.* at 1151-52.

<sup>109</sup> *Id.* at 1152.

<sup>110</sup> *Id.* at 1154.

<sup>111</sup> *Id.* at 1151-52.

<sup>112</sup> *Id.*

<sup>113</sup> *Id.* at 1152.

<sup>114</sup> *Id.* at 1153.

<sup>115</sup> *Id.*

direct or regulate the lawyer's professional judgment in rendering such legal services."<sup>116</sup>

"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."<sup>117</sup>

Hawaii's ethical rules prevent an attorney from representing a party if that representation will be "materially limited by his responsibilities to another client or third person."<sup>118</sup> Therefore, the insurer's contractual right to control the defense is subject to retained counsel's professional judgment and obligation to provide competent, ethical representation to the insured.<sup>119</sup> The rules of professional conduct, the threat of malpractice liability against retained counsel and bad faith litigation, and estoppel against the insurer provide sufficient assurances that retained counsel will not represent the insured where a conflict of interest interferes with counsel's ability to adhere to the rules of professional conduct.<sup>120</sup>

If an insured rejects the offer to provide a qualified defense, the insurer has two options: the insurer must either provide an unqualified defense or allow the insured to conduct its own defense.<sup>121</sup> If the insured decides to conduct its own defense, he is responsible for all attorney's fees related to the action.<sup>122</sup> If an insurer, when requested to do so by the insured, refuses to withdraw from the qualified defense and instead continues to represent the insured in the action, it is estopped from later asserting such right if sued by the insurer for failure to properly defend.<sup>123</sup>

#### D. Illinois

Illinois law recognizes two exceptions to the general rule that an insurer is entitled to control the defense of its insured.<sup>124</sup> The exceptions apply when the insured's interests would be prejudiced by the insurer's representation. When a conflict exists and the insured rejects the insurer's offer to defend under a reservation of rights, the insurer forfeits control of the defense in two circumstances. The first is when "the insurer is obligated to provide defenses for two or more insureds who have adverse interests."<sup>125</sup> The second is when "proof of certain facts would shift liability from the insurer to the insured."<sup>126</sup> The latter

---

<sup>116</sup> *Id.*

<sup>117</sup> *Id.*

<sup>118</sup> *Id.* at 1152.

<sup>119</sup> *Id.* at 1153.

<sup>120</sup> *Id.* at 1155.

<sup>121</sup> *Id.*

<sup>122</sup> *Id.*

<sup>123</sup> *Id.* at 1155.

<sup>124</sup> *Nandorf, Inc. v. CNA Ins. Cos.*, 479 N.E.2d 988, 991 (Ill. App. Ct. 1985).

<sup>125</sup> *Ill. Mun. League Risk Mgmt. Ass'n v. Seibert*, 585 N.E.2d 1130, 1136 (Ill. App. Ct. 1992).

<sup>126</sup> *Id.*

exception encumbrances situations in which the insurer may be motivated to provide a sub-standard defense for the insured.<sup>127</sup>

The challenge presented by the second exception, however, is determining whether an actual conflict of interest exists. In Illinois, courts consider whether “in comparing the allegations of the complaint to the policy terms, the interest of the insurer would be furthered by providing a less-than-vigorous defense to those allegations.”<sup>128</sup> The reservation of rights does not, by itself, create a disqualifying conflict sufficient to preclude the insurer from controlling the defense of its insured.<sup>129</sup> Actual conflicts may exist where the underlying action asserts multiple claims: some that are covered by the policy and others in which the insurer is required to defend while asserting that they are not covered by the policy. If a disqualifying conflict exists, the insurer’s duty to defend is satisfied by reimbursing the insured for the cost of independent counsel.<sup>130</sup>

Illinois decisional law also recognizes that a conflict of interest raises concerns about the ethical representation of the insured by the insurer and retained counsel. Because of a conflict of interest, serious ethical concerns prohibit an attorney from representing both the interests of the insurer and insured.<sup>131</sup> Pursuant to the Code of Professional Responsibility, this conflict cannot be resolved unless the insured is willing to accept the insurer’s retained counsel after a full disclosure of the conflict of interest.<sup>132</sup> Without a full disclosure to and acceptance by the insured, the conflict can only be resolved if the insurer allows the insured to select independent counsel to control the action and reimburses the insured for the cost thereof.<sup>133</sup>

### E. Minnesota

Minnesota law disagrees with the assumption that a conflict of interest arises when an insurer defends under a reservation of rights. It recognizes that an insured may not select independent counsel at the insurer’s expense, except in cases where an actual conflict of interest is proven to exist.<sup>134</sup> This requirement imposes an obligation on the insured to demonstrate that, in the context of the specific circumstances of the underlying suit, a real conflict of interest arose. This approach seemingly necessitates a resolution of the issue of whether a disqualifying conflict exists on a case-by-case basis, in contrast with the law in

---

<sup>127</sup> See, e.g., *Nandorf, Inc.*, 479 N.E.2d at 992.

<sup>128</sup> *Id.*

<sup>129</sup> *Id.*

<sup>130</sup> *Nandorf, Inc.*, 479 N.E.2d at 992; *Ill. Mun. League Risk Mgmt. Ass’n*, 585 N.E.2d at 1137.

<sup>131</sup> *Md. Cas. Co. v. Peppers*, 355 N.E.2d 24, 30 (Ill. 1976); see also *Utica Mut. Ins. Co. v. David Agency Ins., Inc.*, 327 F. Supp. 2d 922, 930 (N.D. Ill. 2004).

<sup>132</sup> *Md. Cas. Co.*, 355 N.E.2d at 31; see also *Utica Mut. Ins. Co.*, 327 F. Supp. 2d at 930.

<sup>133</sup> *Md. Cas. Co.*, 355 N.E.2d at 31; see also *Utica Mut. Ins. Co.*, 327 F. Supp. 2d at 930.

<sup>134</sup> *Mut. Serv. Cas. Ins. Co. v. Luetmer*, 474 N.W.2d 365, 369 (Minn. Ct. App. 1991).

jurisdictions that recognize certain specific circumstances that give rise to a perceived actual conflict of interest.

Minnesota law strongly advises insurers to bring declaratory judgment actions to prevent a reservation of rights from becoming an actual conflict during trial.<sup>135</sup> However, if a declaratory judgment is sought, the insurer should provide the insured with separate counsel.<sup>136</sup> An actual disqualifying conflict of interest does not arise out of an insurer's insisting upon being fully informed of the progress of the underlying case while also litigating the declaratory judgment action.<sup>137</sup>

### F. Missouri

Missouri, along with a minority of other jurisdictions, allows the insured to reject a defense subject to a reservation of rights.<sup>138</sup> In these jurisdictions, the insurer may not reserve the right to deny coverage and, at the same time, insist upon controlling the defense.<sup>139</sup> Thus, the insured may, if it wishes to do so, accept a qualified offer to defend, but the insurer cannot compel it to do so. The minority rule is justified on one or a combination of the following rationales:

1. by defending under a reservation of rights the insurer is imposing conditions on the insured's defense;
2. an insurer's defense under a reservation of rights amounts to a breach of the duty to defend;
3. an insurer's defense under reservation amounts to a denial of its duty to indemnify the insured and accordingly deprives the insurer of its right to control the defense; and
4. an insurer that reserves its rights may not properly defend the insured because it may be more interested in avoiding coverage than in defeating the plaintiff's claim.<sup>140</sup>

The rule is also said to protect the insured against a conflict of interest.<sup>141</sup>

If an insured rejects a reservation of rights defense, the insurer has limited options, which vary by jurisdiction.<sup>142</sup> Namely, the insurer may represent the

---

<sup>135</sup> *Id.*

<sup>136</sup> *Id.*

<sup>137</sup> *Id.* at 368-69.

<sup>138</sup> See, e.g., *BellSouth Telecomms., Inc. v. Church & Tower of Fla., Inc.*, 930 So. 2d 668, 671 (Fla. Dist. Ct. App. 2006); *Aguero v. First Am. Ins. Co.*, 927 So. 2d 894, 898 (Fla. Dist. Ct. App. 2005); *Finley v. Home Ins. Co.*, 975 P.2d 1145, 1155 (Haw. 1998); *First United Bank v. First Am. Title Ins. Co.*, 496 N.W.2d 474, 481 (Neb. 1993); *Chi of Alaska v. Emps. Reinsurance Corp.*, 844 P.2d 1113, 1118 (Alaska 1993); *Allen v. Bryers*, 512 S.W.3d 17, 32 (Mo. 2016); *Patrons Oxford Ins. Co. v. Harris*, 905 A.2d 819, 825 (Me. 2006); *OneBeacon Am. Ins. Co. v. Celanese Corp.*, 84 N.E.3d 867, 871-72 (Mass. App. Ct. 2017); *Merchant's Indem. Corp. v. Eggleston*, 179 A.2d 505, 511 (N.J. 1962).

<sup>139</sup> See, e.g., *BellSouth Telecomms., Inc.*, 930 So. 2d at 672; *Aguero*, 927 So. 2d at 898; *Finley*, 975 P.2d at 1155; *First United Bank*, 496 N.W.2d at 480; *Chi of Alaska*, 844 P.2d at 1118; *Allen*, 512 S.W.3d at 32; *Patrons Oxford Ins. Co.*, 905 A.2d at 825; *OneBeacon Am. Ins. Co.*, 84 N.E.3d at 872.

<sup>140</sup> Douglas R. Richmond, *Reconnoitering Reservations of Rights in Liability Insurance*, 51 TORT TRIAL & INS. PRAC. L.J. 1, 33 (2015).

<sup>141</sup> See, e.g., *Rhodes v. Chicago Ins. Co.*, 719 F.2d 116, 120-21 (5th Cir. 1983).

<sup>142</sup> See *Appleton Papers, Inc. v. Agric. Ins. Co.*, 727 N.W.2d 373, 373 (Wis. Ct. App. 2006) (holding

insured without a reservation of rights.<sup>143</sup> The insurer can also withdraw from representing the insured altogether.<sup>144</sup> Finally, the insurer can file a declaratory judgment motion to determine coverage.<sup>145</sup> An insurer's decision to file a declaratory judgment action is a risky one because if that decision is later determined to be unjustified, it is treated as a refusal to defend and a waiver of the right to control the litigation.<sup>146</sup> Withdrawing from representation is equally perilous: if the insurer's withdrawal of the defense was unjustified, it is bound by the decision and its consequences.<sup>147</sup> In Missouri, the insurer can only control the litigation by accepting the defense without a reservation of rights.<sup>148</sup> In similar jurisdictions, when an insurer offers a reservation defense, the insured may reject the offer and conduct its own defense.<sup>149</sup> The insured is entitled to reimbursement of defense costs if he actually rejects the offer and it is subsequently determined that he was entitled to coverage.<sup>150</sup>

### G. Nevada

Nevada law requires an insurer to provide independent counsel for its insured when a conflict of interest arises between the parties.<sup>151</sup> This obligation only arises when an actual conflict of interest exists between the parties.<sup>152</sup> An insurer's reservation of rights, however, does not create a per se conflict of interest.<sup>153</sup> Consequently, "[c]ourts must inquire, on a case-by-case basis, whether there is an actual conflict of interest."<sup>154</sup> The rules of ethics supply the standard for determining whether an actual conflict exists.

Nevada recognizes that insurer-appointed counsel has two clients.<sup>155</sup> However, insurer-retained counsel may not represent both the insurer and the

---

that insurer has four options); *Nat'l Fire & Marine Ins. Co. v. Certain Underwriters at Lloyd's London*, 2012 Wash. App. LEXIS 1623, 1623 (Wash. Ct. App. 2012) (holding that insurer has three options); *Finley*, 975 P.2d at 1155 (holding that insurer has two options); *Allen v. Bryers*, 512 S.W.3d 17, 32 (Mo. 2016) (holding that insurer has three options).

<sup>143</sup> *Allen*, 512 S.W.3d at 23.

<sup>144</sup> *Id.*

<sup>145</sup> *Id.*

<sup>146</sup> *Id.* at 23-24.

<sup>147</sup> *State ex rel. Rimco, Inc. v. Dowd*, 858 S.W.2d 307, 308 (Mo. Ct. App. 1993); *Versaw v. Versaw*, 202 S.W.3d 638, 651-52 (Mo. Ct. App. 2006).

<sup>148</sup> *State ex rel. Rimco, Inc.*, 858 S.W.2d at 309; *Versaw*, 202 S.W.3d at 651.

<sup>149</sup> *See, e.g.*, *BellSouth Telecomms., Inc. v. Church & Tower of Fla., Inc.*, 930 So. 2d 668, 670-71 (Fla. Dist. Ct. App. 2006); *Aguero v. First Am. Ins. Co.*, 927 So. 2d 894, 898 (Fla. Dist. Ct. App. 2005); *Finley*, 975 P.2d at 1155; *First United Bank v. First Am. Title Ins. Co.*, 496 N.W.2d 474, 481 (Neb. 1993); *Chi of Alaska v. Emps. Reinsurance Corp.*, 844 P.2d 1113, 1121 (Alaska 1993); *Allen*, 512 S.W.3d at 32; *Patrons Oxford Ins. Co. v. Harris*, 905 A.2d 819, 826 (Me. 2006); *OneBeacon Am. Ins. Co. v. Celanese Corp.*, 84 N.E.3d 867, 873 (Mass. App. Ct. 2017); *Merchant's Indemn. Corp. v. Eggleston*, 179 A.2d 505, 512 (N.J. 1967).

<sup>150</sup> *BellSouth Telecomms., Inc.*, 930 So. 2d at 671; *Aguero*, 927 So. 2d at 898.

<sup>151</sup> *State Farm Mut. Ins. Co. v. Hansen*, 357 P.3d 338, 339 (Nev. 2015).

<sup>152</sup> *Id.* at 343.

<sup>153</sup> *Id.* at 339.

<sup>154</sup> *Id.* at 343.

<sup>155</sup> *Id.* at 339.

insured when a conflict of interest exists and no exception to the ethical rules applies.<sup>156</sup> The conflict must be significant and actual for independent counsel to be required.<sup>157</sup> The dispositive issue is whether an actual conflict, as contemplated by Rule of Professional Conduct 1.7, exists.<sup>158</sup>

#### H. New Jersey

In New Jersey, an insurer may control the defense while simultaneously reserving the right to deny coverage, though only with the consent of the insured.<sup>159</sup> The insured's consent may be inferred from the insured's failure to reject the qualified offer to defend, but if the consent is to be inferred from the insured's silence, the reservation of rights letter "must fairly inform the insured that the offer may be accepted or rejected."<sup>160</sup> If the insurer fails to inform the insured of her right to accept or reject the terms of the defense, the insurer is estopped from later denying coverage.<sup>161</sup> In the absence of an expressed rejection of the offer of a qualified defense, the dispositive issue is not whether the reservation of rights caused a forfeiture of the insurer's right to control the defense, but, rather, whether the reservation of rights letter was adequate to preserve that right.<sup>162</sup> The insured, if it rejects the offer of a defense subject to a reservation of rights, may select its own counsel and subsequently seek reimbursement of attorney fees from the carrier if it is determined that coverage existed under the policy.<sup>163</sup>

#### I. New York

An insurer does not forfeit the right to control the insured's defense merely by undertaking to defend pursuant to a reservation of rights.<sup>164</sup> Rather, it is a conflict of interest that strips the insurer of its right to choose counsel for the insured.<sup>165</sup> If a potential or probable conflict of interest exists and the insurer offers to defend its insured under a reservation of rights, the interest of the parties are accommodated by allowing the insured to select their own counsel at the insurer's expense.<sup>166</sup> A disqualifying conflict of interest requiring retention of separate counsel does not arise in every case involving multiple claims.<sup>167</sup> "Independent counsel is only necessary in cases where the defense attorney's duty to the insured

---

<sup>156</sup> *Id.* at 341.

<sup>157</sup> *Id.* at 343.

<sup>158</sup> *See id.* at 343.

<sup>159</sup> *Merchants Indem. Corp. v. Eggleston*, 179 A.2d 505, 512 (N.J. 1962).

<sup>160</sup> *Id.* at 512.

<sup>161</sup> *See id.* at 158; *see also Nazario v. Lobster House, et al.*, Nos. L-159-05, L-304-05 & L-171-06, 2009 WL 1181620, at \*7 (N.J. Super. Ct. App. Div. May 5, 2009).

<sup>162</sup> *See Nazario* at \*4.

<sup>163</sup> *Hartford Accident & Indemn. Co. v. Aetna Life & Cas. Ins. Co.*, 483 A.2d 402, 406 (N.J. 1984).

<sup>164</sup> *Liberty Mut. Fire Ins. Co. v. Hamilton Ins. Co.*, 356 F. Supp. 3d 326, 337 (S.D.N.Y. 2018).

<sup>165</sup> *Id.* at 338.

<sup>166</sup> *Augeri v. Fid. Nat'l Title Ins. Co.*, No. 5919/11, 2011 N.Y. Misc. LEXIS 5885, at \*4 (N.Y. App. Div. Dec. 8, 2011).

<sup>167</sup> *Pub. Serv. Mut. Ins. Co. v. Goldfarb*, 425 N.E.2d 810, 815 n.1 (N.Y. 1981).

would require that he defeat liability on any ground and his duty to the insurer would require that he defeat liability only upon grounds which would render the insurer liable.”<sup>168</sup> A disqualifying conflict also arises when an attorney represents clients on opposite sides of a lawsuit (e.g., the underlying case and the declaratory judgment action).<sup>169</sup>

New York law turns upon whether the conflict caused retained counsel, who had a duty to protect the interest of the insured, to actually commit an ethical violation.<sup>170</sup> “Under New York law, counsel chosen by the insurer has an ethical obligation not to take actions which would, in effect, leave the insured exposed to liability for the sake of preventing exposure of the insurer to liability.”<sup>171</sup> Insurer-retained counsel who breach their ethical obligation to the insured are subject to disciplinary action, as well as claims for monetary damages.<sup>172</sup>

### J. Pennsylvania

If an insurer reserves its right to later assert coverage defenses, the reservation, at best, creates the possibility of a conflict of interest.<sup>173</sup> Thus, a reservation of rights does not automatically produce a conflict of interest that deprives the insurer of the right to control the defense.<sup>174</sup> A disqualifying conflict arises when actual proof shows that an attorney has violated their ethical duty, as provided for in the professional rules of conduct, to the insured.<sup>175</sup>

If a conflict of interest arises between an insurer and insured, insurer-selected counsel must act exclusively on behalf of the insured.<sup>176</sup> A conflict of interest exists between the parties when the insurer’s pursuit of its own interests in the case is inconsistent with the best interest of the insured.<sup>177</sup> If the conflict raises a question regarding the loyalty of insurer-selected counsel to the insured, the insured may choose independent counsel at insurer’s expense.<sup>178</sup> Pennsylvania law rejects the view that a reservation of rights in specific circumstances can justify a conclusive presumption that insurer-retained counsel is unable to provide independent representation to the insured.<sup>179</sup>

---

<sup>168</sup> *Id.* at 815.

<sup>169</sup> *Sofiel, Inc. v. Dragon Med. & Sci. Commc’ns, Ltd.*, 1995 U.S. Dist. LEXIS 2088, at \*7 (S.D.N.Y. Feb. 22, 1995).

<sup>170</sup> *See United States Underwriters Ins. Co. v. TNP Trucking Inc.*, 44 F. Supp. 2d 489, 491 (E.D.N.Y. 1999).

<sup>171</sup> *Id.* at 491.

<sup>172</sup> *Id.* at 492.

<sup>173</sup> *Yaron v. Darwin Nat’l Ins. Co.*, 2011 Phila. Ct. Com. Pl. LEXIS 167, at \*10.

<sup>174</sup> *Id.*

<sup>175</sup> *Id.* at \*12.

<sup>176</sup> *Id.* at \*6.

<sup>177</sup> *Id.* at \*6-8.

<sup>178</sup> *Id.* at \*8.

<sup>179</sup> *Id.* at \*10.



### K. Texas

While an insurer in Texas may lose the right to control the defense of a claim under certain circumstances, not every reservation of rights creates a conflict that allows the insured to select independent counsel at the insurer's expense.<sup>180</sup> The mere exercise of a reservation of rights, by itself, creates a potential conflict of interest.<sup>181</sup> Whether a disqualifying conflict arises from a reservation of rights depends upon the nature of the coverage issue as it relates to the facts of the underlying case.<sup>182</sup> Due to the insurer's contractual right to defend, the insured may not select independent counsel and require the insurer to reimburse the cost, unless "the facts to be adjudicated in the liability lawsuit are the same facts upon which coverage depends."<sup>183</sup> A disqualifying conflict of interest arises only if the outcome of the coverage issue can be controlled by counsel retained by the insurer for the defense of the underlying claim.<sup>184</sup> This rule allows insurers to control costs, while also permitting insureds to protect themselves from an insurer-hired attorney—who may be tempted to develop facts or legal strategy that would ultimately support the insurer's position that the underlying lawsuit fits within a policy exclusion.<sup>185</sup>

Insurer-retained counsel owes an unqualified loyalty to the insured.<sup>186</sup> Such counsel is duty-bound to fully disclose to the insured conflicts of interest, whether because of the attorney's relationship with the insurer or otherwise.<sup>187</sup> "That obligation is independent of the insurer's issuing a valid reservation of rights or obtaining a non-waiver agreement."<sup>188</sup> If a conflict of interest arises between the insurer and the insured, insurer-retained counsel must immediately advise the insured of the conflict.<sup>189</sup> An insurer-appointed counsel's breach of ethical obligations may impute to the insurer if it prejudices the insured.<sup>190</sup>

### L. Washington

In Washington, a reservation of rights creates an inherent potential conflict of interest, which triggers an enhanced obligation of good faith for both the insurer and insurer-retained defense counsel.<sup>191</sup> Failure to comply with the enhanced duty

---

<sup>180</sup> See *N. Cnty. Mut. Ins. Co. v. Davalos*, 140 S.W.3d 685, 689-90 (Tex. 2004).

<sup>181</sup> *Id.* at 689.

<sup>182</sup> *Id.*

<sup>183</sup> *Id.*

<sup>184</sup> *Id.*

<sup>185</sup> See, e.g., *Hous. Auth. of City of Dallas, Tex. v. Northland Ins. Co.*, 333 F. Supp. 2d 595, 601 (N.D. Tex. 2004).

<sup>186</sup> *N. Cnty. Mut. Ins. Co.*, 140 S.W.3d at 686.

<sup>187</sup> *Id.*

<sup>188</sup> *Ulico Cas. Co. v. Allied Pilots Ass'n*, 262 S.W.3d 773, 786 (Tex. 2008).

<sup>189</sup> *Emp. Cas. Co. v. Tilley*, 496 S.W.2d 552 (Tex. 1973).

<sup>190</sup> *Id.*

<sup>191</sup> *Tank v. State Farm Fire & Cas. Co.*, 715 P.2d 1133 (Wash. 1986).

may create a liability exposure for the insurer, insurer-retained counsel, or both.<sup>192</sup> The insurer meets its enhanced obligation by fulfilling four specific requirements:

First, the company must thoroughly investigate the cause of the insured's accident and the nature and severity of the plaintiff's injuries. Second, it must retain competent defense counsel for the insured. Both retained defense counsel and the insurer must understand that only the insured is the client. Third, the company has the responsibility for fully informing the insured not only of the reservation of rights defense itself, but of all developments relevant to his policy coverage and the progress . . . of his lawsuit. Information regarding progress of the lawsuit includes disclosure of all settlement offers made by the company. Finally, an insurance company must refrain from engaging in any action which would demonstrate a greater concern for the insurer's monetary interest than for the insured's financial risk.<sup>193</sup>

Defense counsel retained by insurer to represent the insured under a reservation of rights must also meet specific criteria as well. First, retained counsel owes a duty of loyalty to the insured, not the insurer.<sup>194</sup> Second, defense counsel owes the insured a duty of full and ongoing disclosure.<sup>195</sup> This obligation has three components:

First, potential conflicts of interest between insurer and insured must be fully disclosed and resolved in favor of the insured. The dictates of RPC 1.7, which address conflicts of interest such as this, must be strictly followed. Second, . . . all information . . . relevant to the insured's defense, including a realistic and periodic assessment of the insured's chances to win or lose the pending lawsuit, must be communicated to the insured. Finally, *all* offers of settlement must be disclosed to the insured as those offers are presented.<sup>196</sup>

In *Tank v. State Farm Fire & Cas. Co.*, the court recognized that “[f]ailure to satisfy this enhanced obligation may result in liability of the company, or retained defense counsel, or both.”<sup>197</sup> This observation arguably negated the need for the court to resolve whether a reservation of rights, under any circumstances, could entitle the insured to select independent counsel at the insurer's expense. The significance of this question was addressed by the court in *L&S Roofing Supply*

---

<sup>192</sup> *Id.* at 1137.

<sup>193</sup> *Id.*

<sup>194</sup> *Id.*

<sup>195</sup> *Id.*

<sup>196</sup> *Id.* at 1137-38.

<sup>197</sup> *Id.* at 1137.

*Co. v. St. Paul Fire & Marine Ins. Co.*<sup>198</sup> Therein, the Alabama Supreme Court, after adopting the enhanced obligation of good faith criteria articulated in *Tank*, concluded that when the enhanced obligation of good faith “ha[s] not been met in whole or in part . . . the insured is entitled to retain defense counsel of its choice at the expense of the insurer.”<sup>199</sup>

### III. DISTILLING THE LITERATURE

Courts have responded to questions regarding the legal implications of a reservation of rights on the insurer’s right to control the defense in numerous ways. Each response turns on the perspective from which the reservation of rights problem is viewed. For example, some courts view the problem bilaterally. From this perspective, courts examine the effect of a reservation of rights on both the relationship between the insurer and insured and the relationship between insurer-defense counsel and the insured.<sup>200</sup> Other courts view the problem unilaterally, solely from the perspective of the insurer/insured relationship.<sup>201</sup> Finally, some courts assess the legal implications of a reservation of rights solely from the unilateral perspective of the relationship between insurer-retained defense counsel and the insured.<sup>202</sup>

The perspective from which the problem is viewed significantly influences courts when analyzing and resolving tripartite conflict problems. In jurisdictions that view the problem from a bilateral perspective, courts tend to create or adopt existing insurance law in response to the problem inflicted by a reservation defense on the insurer/insured relationship.<sup>203</sup> The effect of the reservation of rights on the second component of the bilateral perspective—relationship between insurer-retained defense counsel and insured—is resolved pursuant to the rules of professional conduct.<sup>204</sup> When the focus of the unilateral perspective is solely on

---

<sup>198</sup> *L & S Roofing Supply Co. v. St. Paul Fire & Marine Ins. Co.*, 521 So. 2d 1298 (Ala. 1987).

<sup>199</sup> *Id.* at 1304.

<sup>200</sup> See *San Diego Fed. Credit Union v. Cumis Ins. Soc’y*, 208 Cal. Rptr. 494, 496 (Cal. Ct. App. 1984); *Chi of Alaska v. Emps. Reinsurance Corp.*, 844 P.2d 1113, 1121 (Alaska 1993); *Ill. Mun. League Risk Mgmt. Ass’n v. Seibert*, 585 N.E.2d 110, 115 (Ill. App. Ct. 1992); *Mut. Serv. Cas. Ins. Co. v. Luetmer*, 474 N.W.2d 365, 368 (Minn. App. 1991); *Augeri v. Fid. Nat’l Title Ins. Co.*, 2011 N.Y. Misc. LEXIS 5885, \*8; *N. Cnty. Mut. Ins. Co. v. Davalos*, 140 S.W.3d 685, 689 (Tex. 2004); *Tank v. State Farm Fire & Cas. Co.*, 715 P.2d 1133, 1136 (Wash. 1996).

<sup>201</sup> See *Patrons Oxford Ins. Co. v. Harris*, 905 A.2d 819 (Me. 2006); *OneBeacon Am. Ins. Co. v. Celanese Corp.*, 84 N.E. 3d 867 (Mass. App. Ct. 2017).

<sup>202</sup> See *Finley v. Home Ins. Co.*, 975 P.2d 1145 (Haw. 1998); *State Farm Mut. Ins. Co. v. Hansen*, 357 P.3d 338 (Nev. 2015); *Pub. Serv. Mut. Ins. Co. v. Goldfarb*, 425 N.E.2d 810 (N.Y. 1981); *Yaron v. Darwin Nat’l Ins. Co.*, Nos. 11012209/10122559, 2011 Phila. Ct. Com. Pl. LEXIS 167 (C.P. Ct. of Phila. Cnty. July 5, 2011); *Nissan v. Am. Home Assurance Co.*, 917 P.2d 488 (Okla. Civ. App. 1996).

<sup>203</sup> See *San Diego Fed. Credit Union*, 208 Cal. Rptr. at 496; *Chi of Alaska*, 844 P.2d 1113 at 1130; *Ill. Mun. League Risk Mgmt. Ass’n*, 585 N.E.2d at 871; *Mut. Serv. Cas. Ins. Co.*, 474 N.W.2d at 368; *Augeri*, 2011 N.Y. Misc. LEXIS 5885 at \*9; *Davalos*, 140 S.W.3d at 690; *Tank*, 715 P.2d at 1136.

<sup>204</sup> See *id.*

the relationship of insurer-retained defense counsel and insured, the problem is typically resolved using only the ethical rules.<sup>205</sup>

Several courts that analyze the reservation of rights problem from a unilateral—insurer/insured relationship—perspective have adopted a per se rule that an insurer forfeits the right to control the defense when it reserves the right to deny coverage for a particular claim.<sup>206</sup> Pursuant to this rule, the insured may require the insurer to either relinquish its reservation of rights or allow insured to select counsel at the insurer's expense.<sup>207</sup> "In other words, 'an insurer may [not] reserve its right to disclaim liability in a case and at the same time insist on retaining control of its defense.'"<sup>208</sup> The per se rule evidently strikes a balance between the insurer and the insured. The logic underlying the rule explains:

[i]f the insurer could continue to control the insured's defense despite reserving its rights to later deny coverage, it could assert a liability defense and insist on fully litigating the insured's case, thus exposing the insured to personal liability if there is a verdict favorable to the claimant. If the verdict is favorable to the claimant, the insurer still has another opportunity to avoid liability by . . . litigating coverage in a declaratory judgment action. . . . By allowing the insured to control his own case when the insurer issues a reservation of rights, the insured can protect himself "from the sharp thrust of personal liability," and the insurer still has a meaningful opportunity to protect its own interests in a declaratory judgment action where it may assert, among other things, a coverage defense.<sup>209</sup>

Massachusetts law, which follows the per se approach, recognizes that a conflict of interest, even when the insurer agrees to defend without a reservation of rights, entitles the insured to independent counsel paid for by the insurer.<sup>210</sup> Therein, a conflict of interest may arise out of circumstances other than a coverage dispute. A disqualifying conflict exists:

1. when the defense tendered is not a complete defense under circumstances in which it should have been, 2. when the attorney hired by the carrier acts unethically and, at the insurer's direction, advances the insurer's interests at the expense of the insured's, 3. when the defense would not, under the governing law, satisfy the insurer's duty to defend, and 4. when, though the defense is otherwise proper, the insurer attempts to obtain some type of concession from the insured before it will defend.<sup>211</sup>

---

<sup>205</sup> See *Finley*, 975 P.2d at 1154; *State Farm Mut. Ins. Co.*, 357 P.3d at 343; *Goldfarb*, 425 N.E.2d at 812; *Yaron*, 2011 Phila. Ct. Common Pl. LEXIS at \*10; *Nisson*, 917 P.2d at 489.

<sup>206</sup> See *Patrons Oxford Ins. Co.*, 905 A.2d at 825-26; *OneBeacon Am. Ins. Co.*, 84 N.E. 3d 867 at 873.

<sup>207</sup> *Herbert A. Sullivan, Inc. v. Utica Mut. Ins. Co.*, 788 N.E.2d 522 (Mass. 2003).

<sup>208</sup> *OneBeacon Am. Ins. Co.*, 84 N.E. 3d at 872.

<sup>209</sup> *Patrons Oxford Ins. Co.*, 905 A.2d at 826.

<sup>210</sup> *OneBeacon Am. Ins. Co.*, 84 N.E. 3d at 872.

<sup>211</sup> *Id.* at 873.

A conflict of interest is also present “if the defense provided by the counsel selected by the insurer was materially inadequate.”<sup>212</sup> A simple disagreement between the insurer and the insured regarding the insured’s potential liability, in and of itself, is not, however, the type of conflict of interest that entitles the insured to select its own counsel at the insurer’s expense.<sup>213</sup>

In essence, even in the context of a per se approach, conflicts of interest, unlike reservation of rights, may be subject to a list of perceived conflicts based on specified circumstances that result in a forfeiture of the insurer’s right to control the litigation. Outside of these specified circumstances, the insured must prove that an actual conflict of interest exists in order to select its own counsel at insurer’s expense. Interestingly, the reservation of rights issue is resolved from a unilateral, insurer/insured relationship perspective, while the conflict of interest problem, as evidenced by the list of specific circumstances that constitute perceived actual conflicts, is resolved from a bilateral, insurer/insured relationship and insurer-retained defense counsel/insured relationship perspective.

Some courts maintain that the reservation of rights creates a perceived or probable conflict of interest, resulting in a forfeiture of the insurer’s right to control the defense.<sup>214</sup> Courts that adhere to the perceived or probable conflict of interest theory have identified specific circumstances that legally deprive the insurer of the right to control the defense. Outside of the list of perceived disqualifying conflicts, the obligation to provide insured with independent counsel only arises if it is proven that an actual conflict of interest exists between the parties. In jurisdictions that adhere to the perceived or probable conflict of interest approach, an insurer’s reservation of rights does not create a per se conflict of interest.<sup>215</sup> Consequently, courts must inquire on a case-by-case basis whether an actual conflict of interest exists.<sup>216</sup> Courts that recognize the perceived or probable conflict of interest approach have all expressed concerns regarding the ethical obligation of insurer-retained defense counsel in the context of a reservation of rights.<sup>217</sup>

Other courts reject both the per se and perceived conflict of interest standards. Thus, a reservation of rights will not result in the forfeiture of the insurer’s rights to control the defense and select defense counsel to represent the insured in the absence of proof of an actual conflict of interest.<sup>218</sup> Among the courts that reject the per se and perceived conflict of interest standards, some rely exclusively upon the rules of ethics to supply the standard for determining the

---

<sup>212</sup> *Id.*

<sup>213</sup> *Id.* at 874.

<sup>214</sup> See *San Diego Fed. Credit Union v. Cumis Ins. Soc’y*, 208 Cal. Rptr. 494 (Cal. Ct. App. 1984); *Chi of Alaska v. Emps. Reinsurance Corp.*, 844 P.2d 1113 (Alaska 1993).

<sup>215</sup> *State Farm Mut. Ins. Co. v. Hansen*, 357 P.3d 338, 339 (Nev. 2015).

<sup>216</sup> See *id.* at 343.

<sup>217</sup> See *San Diego Fed. Credit Union*, 208 Cal. Rptr. at 494; *Chi of Alaska*, 844 P.2d at 1116.

<sup>218</sup> See *Hansen*, 357 P.3d at 338; *Pub. Serv. Mut. Ins. Co. v. Goldfarb*, 425 N.E.2d 810 (N.Y. App. 1981); *Yaron v. Darwin Nat’l Ins. Co.*, Nos. 11012209/10122559, 2011 Phila. Ct. Com. Pl. LEXIS 167 (C.P. Ct. of Phila. Cnty. July 5, 2011); *Mut. Serv. Cas. Ins. Co. v. Luetmer*, 474 N.W.2d 365 (Minn. App. 1991); *Nandorf, Inc. v. CNA Ins. Cos.*, 479 N.E.2d 988 (Ill. App. Ct. 1985).

existence of an actual conflict.<sup>219</sup> In these jurisdictions, “[i]ndependent counsel is only necessary in cases where the defense attorney’s duty to the insured would require that he defeat liability on any ground and his duty to the insurer would require that he defeat liability only upon grounds that would render the insurer liable.”<sup>220</sup> Thus, “absent a threat of divided loyalty between the insured and insurer, no need for retention of independent counsel arises because the issue of coverage is then separate from the issue of liability.”<sup>221</sup> Other jurisdictions resolve actual conflicts of interest on a case-by-case basis.<sup>222</sup>

Hawaii approaches the problem from the unilateral perspective of the insurer-retained defense counsel and insured relationship. It relies exclusively on the rules of professional conduct to resolve the potential conflict of interest created by a reservation of rights.<sup>223</sup> In Hawaii, insurer-retained defense counsel owes its ethical obligations to the insured. If retained defense counsel breaches an ethical obligation in the context of a reservation of rights, the insured has recourse to common law remedies against both retained counsel and the insurer.<sup>224</sup>

Similar to New York and Oklahoma, Hawaii focuses on the unilateral relationship that exists between the insured and insurer-appointed defense counsel. However, Hawaii law differs from that of New York and Oklahoma in that the court in *Finley* expressly recognized that common law remedies adequately protect the insured in the event retained counsel violated the HRPC. New York and Oklahoma law recognize that the insured is entitled to independent counsel when an actual conflict of interest exists as a consequence of ethical considerations. This remedy supplements the implicit common law remedies otherwise available in both states.

Washington views the problem from a bilateral perspective, though it has adopted a purely insurance law approach to the problem. In Washington, potential conflicts of interest inherent in a reservation of rights defense mandate even higher standards of good faith from both the insurer and insurer-retained counsel.<sup>225</sup> The enhanced obligation imposes specific obligations on both the insurer and insured.<sup>226</sup> If the enhanced obligations are breached, either or both may be held liable for damages.<sup>227</sup>

Regardless of the effect accorded to a reservation of rights, if a conflict actually exists, courts must consequently determine how to remedy the issue. Courts universally require that the insured receive counsel but are divided into three groups regarding who they believe should control the selection. Some courts adhere to the view that if an actual conflict exists, the insured has the right to select

---

<sup>219</sup> See *Hansen*, 357 P.3d at 339; *Goldfarb*, 425 N.E.2d 810; *Yaron*, 2011 Phil. Ct. Common Pl. LEXIS 167; *N. Cnty. Mut. Ins. Co. v. Davalos*, 140 S.W.3d 685 (Tex. 2004); *Nisson v. Am. Home Assurance Co.*, 917 P.2d 488 (Okla. Civ. App. 1996).

<sup>220</sup> *Nisson*, 917 P.2d at 490 (citing *Goldfarb*, 425 N.E.2d at 815).

<sup>221</sup> See *id.*

<sup>222</sup> *Mut. Serv. Cas. Ins. Co. v. Luetmer*, 474 N.W.2d 365 (Minn. Ct. App. 1991).

<sup>223</sup> See *Finley v. Home Ins. Co.*, 975 P.2d 1145 (Haw. 1995).

<sup>224</sup> *Finley*, 975 P.2d at 1152.

<sup>225</sup> *Tank v. State Farm Fire & Cas. Co.*, 715 P.2d 1133, 1137 (Wash. 1986).

<sup>226</sup> See *id.*

<sup>227</sup> See *id.*

its own counsel at insurer's expense.<sup>228</sup> One court held that the insurer had the right to provide counsel or allow the insured to choose counsel. In either case, the insurer must bear the expense.<sup>229</sup> Other courts recognize that an insurance company retains the right to select counsel to represent the insured or acknowledge the insured's right to counsel, without specifying who is entitled to make the selection.<sup>230</sup>

#### IV. PUTTING THE TEMPEST BACK IN THE TEAPOT

The American Law Institute's proposed solution to the inherent conflict of interest created by a reservation defense begins by rejecting the minority rule that an insured may deny an insurer's offer to defend pursuant to a reservation of rights.<sup>231</sup> The rationale for this rejection indicates that while "[a] reservation of rights undeniably reduces the alignment of interest between insurer and insured," the insured receives greater protection from the rules governing the duty to defend and the duty to make reasonable settlement decisions.<sup>232</sup> Thereafter, the American Law Institute suggests that the mechanics typically used by courts to determine the legal implications of a reservation defense should be overhauled and replaced with a "structural solution."<sup>233</sup> The change to a "structural solution" is important for several reasons. The solution is grounded in the universally recognized fact that a reservation defense undeniably reduces the alignment of interests between insurer and insured.<sup>234</sup> Consequently, other rules governing the duty to defend are necessary to better protect the insured.<sup>235</sup> Because the duty to defend is an insurance law obligation, the "structural solution" also reflects that a reservation defense creates uniquely insurance law, rather than ethical law, problems. Thus, the structural solution requires viewing the problem as a unilateral insurer/insured matter, recasting the solution as a purely insurance law rule.

The American Law Institute, as a part of the "structural solution" to the problems created by reservation defenses, has proposed the independent counsel rule, which provides:

---

<sup>228</sup> See *San Diego Fed. Credit Union v. Cumis Ins. Soc'y*, 208 Cal. Rptr. 494 (Cal. Ct. App. 1984); *Chi of Alaska v. Empls. Reinsurance Corp.*, 844 P.2d 1113 (Alaska 1993); *Ill. Mun. League Risk Mgmt. Ass'n v. Seibert*, 585 N.E.2d 110, (Ill. App. Ct. 1992); *Mut. Serv. Cas. Ins. Co. v. Luetmer*, 474 N.W.2d 365 (Minn. App. 1991); *State Farm Mut. Ins. Co. v. Hansen*, 357 P.3d 338 (Nev. 2015); *Augeri v. Fid. Nat'l Title Ins. Co.*, 2011 N.Y. Misc. LEXIS 5885; *Yaron v. Darwin Nat'l Ins. Co.*, Nos. 11012209/10122559, 2011 Phila. Ct. Com. Pl. LEXIS 167 (C.P. Ct. of Phila. Cnty. July 5, 2011); *N. City Mut. Ins. Co. v. Davalos*, 140 S.W.3d 685 (Tex. 2004); *Nisson v. Am. Home Assurance Co.*, 917 P.2d 488 (Okla. Civ. App. 1996).

<sup>229</sup> See *HK Sys., Inc. v. Admiral*, 2005 U.S. Dist. LEXIS 39939.

<sup>230</sup> See *Twin City Fire Ins. Co. v. Ben Arnold-Sunbelt Bev. Co. of S.C., LP*, 433 F.3d 365 (4th Cir. 2005).

<sup>231</sup> RESTATEMENT OF THE L. OF LIAB. INS.: RESERVING THE RIGHT TO CONTEST COVERAGE § 15 cmt. e (AM. L. INST., Proposed Final Draft No. 2, 2018).

<sup>232</sup> *Id.*

<sup>233</sup> See RESTATEMENT OF THE L. OF LIAB. INS.: THE OBLIGATION TO PROVIDE AN INDEPENDENT DEFENSE § 16 cmt. a (AM. L. INST., Proposed Final Draft No. 2, 2018).

<sup>234</sup> RESTATEMENT OF THE L. OF LIAB. INS.: RESERVING THE RIGHT TO CONTEST COVERAGE § 15 cmt. e (AM. L. INST., Proposed Final Draft No. 2, 2018).

<sup>235</sup> *Id.*

[w]hen an insurer with the duty to defend provides the insured notice of a ground for contesting coverage under § 15 and there are facts at issue that are common to the legal action for which the defense is due and to the coverage dispute, such that the action could be defended in a manner that would benefit the insurer at the expense of the insured, the insurer must provide independent counsel.<sup>236</sup>

The independent counsel rule is grounded in the reality that when there are facts that are common to the plaintiff's allegations for which the defense is sought and to the insurer's asserted grounds for contesting coverage, there is a risk that the defense of the action might be conducted in a manner that advantages the insurer's interest in defeating coverage.<sup>237</sup> Under these circumstances,

[l]eaving the management of this conflict of interest to the professional judgment of the defense lawyer selected by the insurer may in fact be adequate to protect insureds in most situations, but there are enough examples of mistakes having been made at the insured's expense to justify a structural, rather than a disciplinary and malpractice-liability solution.<sup>238</sup>

Furthermore, the independent counsel rule also incorporates the requirements of Restatement Third, The Law Governing Lawyers § 134, which recognizes the potential for conflicts of interest whenever a question concerning insurance coverage exists.<sup>239</sup> Section 134, therefore, expands an insurer's duty to defend through independent counsel to situations beyond those articulated in the Restatement of the Law Liability Insurance.

## CONCLUSION

There is little agreement on how best to approach the issues regarding whether to allow reimbursement costs for defense by an insurer or how to treat potential conflicts in the tripartite relationship. Some jurisdictions require that an insured reimburse the insurer's defense costs, while others refuse to imply this contractual right. When determining whether a conflict of interest exists within the tripartite relationship, jurisdictions like Hawaii rely entirely on the ethical rules to determine conflicts of interest, while, on the other end of the spectrum, jurisdictions like Washington hold that a reservation of rights defense creates an inherent conflict of interest. Ignoring both of those approaches are jurisdictions

---

<sup>236</sup> RESTATEMENT OF THE L. OF LIAB. INS.: THE OBLIGATION TO PROVIDE AN INDEPENDENT DEFENSE § 16 cmt. a (AM. L. INST., Proposed Final Draft No. 2, 2018).

<sup>237</sup> *Id.*

<sup>238</sup> *Id.*

<sup>239</sup> *Id.*



that apply the per se rule, which instead purports to solve potential conflicts by only allowing an insurer either to reserve its rights or control the defense.

In light of the myriad approaches applied across the country, the proposed rules by the American Law Institute, perhaps, offer an acceptable middle ground. On the one hand, the ALI proposal rejects the insured-friendly minority rule that allows any insured to deny an insurer's right to defend. While this denial is seemingly antagonistic to insureds, the underlying rationale provides that the interests of insureds are better served through other devices. On the other hand, the ALI proposal also goes farther than leaving the decision of whether a conflict exists to ethical rules and, instead, looks to insurance law to protect the interests of insureds. This approach stems from the reasoned acceptance that while ethical rules may sufficiently resolve many situations, more than enough real-world examples demonstrate that insureds may be better served by a "structural approach" governed by insurance law. While no approach may satisfy every side, the ALI proposal may, at the very least, be a good place to start.