WHAT WE’VE GOT HERE IS A FAILURE TO COMMUNICATE: A POLICYHOLDER PERSPECTIVE

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INTRODUCTION

It commonly is said that communication is the key to any successful relationship. Ill- advised or inappropriate communications, however, are likely to be much more problematic than they are helpful. A more precise premise, then, might be that careful, thoughtful, and appropriate communication, flowing from a conscientious communication decision, is the key to a successful relationship.

Insurers and their policyholders, of course, have a relationship. The relationship is contractual, but in some jurisdictions it also may be one of utmost good faith and fair dealing, and, depending upon the circumstances, may even be fiduciary. In regard to communications, however, the relationship is fraught with complexities and challenges, which stem from the participants having interests that are aligned in some respects but significantly misaligned in others. In regard to commercial liability insurance claims, in particular, insurers commonly deny, partially deny, or reserve rights in regard to
claims, making the insurers adverse to their policyholders in many respects. It is this adversarial aspect of the insurer-policyholder relationship that gives rise to communication challenges and complexities and presents traps and risks for the unwary.

When there is a reservation of rights or a partial denial, the tension in the communications begins to arise during the very early stages of the claim (as early as the selection-of-defense-counsel stage), continues through the active defense stage, and becomes particularly acute during the settlement or mediation phase. This paper will explore various aspects of this communication dynamic, including the policy “cooperation clause” provisions which, on their face, encourage broad, unrestrained communications, and the ethical rules that govern counsel and limit and restrain such communications.1

I. TENSION BETWEEN “COOPERATION CLAUSES” AND ETHICAL RULES

A. COOPERATION CLAUSES

Liability insurance policies typically impose upon policyholders the duty to “cooperate” with their insurers. Such obligations may be express in a policy, as is common in primary or umbrella policies, or may arise as a result of following-form provisions, as is common in excess policies.

The extent of the purported duty to cooperate can vary substantially from policy to policy. Older policies may focus on the duty to cooperate in the actual defense of the claim and may impose specific duties related to the defense, such as the duty to “attend hearings or trials,” “secure or give evidence,” or “obtain the attendance of witnesses in legal proceedings.” Later policies may expand the duty to cooperate beyond the conduct of the actual defense and may include an obligation to cooperate in the “investigation” of a claim, such as through providing the liability insurer with “all information, assistance, and cooperation that the insurer reasonably requests.” These more expansive clauses can be used by insurers for purposes that transcend the defense of the underlying claim and include the insurer’s investigation for facts it might then use for purposes of denying defense and indemnity coverage for the claim, or at least indemnity coverage for it.

B. ETHICAL RULES

When insurers reserve rights regarding a claim, or partially deny it, the policyholder often engages coverage counsel to assist the policyholder in navigating the claim process, assuring that a proper defense is provided and protecting the policyholder’s rights in regard to indemnity matters. Such counsel typically understands his or her role, as does the insurer, and lines of communication with and through such counsel are clear. Coverage counsel may have little or no communication directly with the insurer, and when coverage counsel does have such interaction, he or she is understood by all to be acting for the policyholder on matters adverse to the insurer, protecting all confidences of the policyholder.

When an insurer provides a defense in such instances under a reservation of rights, however, a second lawyer for the policyholder also will be involved—defense counsel retained and paid by the insurer but engaged by the policyholder to function solely as the policyholder’s lawyer. Like coverage counsel, defense counsel also represents the policyholder exclusively, and not the insurer, but defense counsel is much more likely to have communications with the insurer than is coverage counsel, and those communications may encompass matters that are completely or partially within areas of common

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interest between the policyholder and its insurer. Because the interests of the policyholder and the
insurer are not completely aligned, however, such communications must be undertaken with great care.
A number of ethical rules operate to govern defense counsel in these situations, and they greatly restrict
the extent to which such counsel can share information with the insurer, the expansive phrasing of any
policy “cooperation” clause notwithstanding.

Most states have adopted some version of the ABA’s Model Rules of Professional Conduct or have
adopted statutes or rules that are similar to the ABA’s Model Rules. For purposes of the discussion that
follows, the ABA’s Model Rules provide useful guideposts, although the precise rules applying to any
situation may vary by jurisdiction.

A few of the applicable Model Rules are obviously implicated in these situations, and some apply but
are less obvious. Among the more obviously applicable rules is Rule 1.6(a), which provides,

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

Hence, defense counsel must be guarded in his or her communications with an insurer, not revealing to
the insurer any confidential information without the policyholder client’s informed consent. Defense
counsel may be “impliedly authorized” by the policyholder client to reveal information to an insurer if
the information will not prejudice the policyholder in its coverage dispute with the insurer. Revealing
such confidential information would not be “impliedly authorized,” however, if doing so would
undermine or otherwise prejudice the policyholder’s coverage position. Such communications would
not be permitted to “carry out the representation,” which, it must be remembered, is representation of
only the policyholder.

Comment [2] to this Model Rule makes reference to “the trust that is the hallmark of the client-lawyer
relationship.” In an insurance defense situation, such trust should be jealously guarded and preserved.
A client relies upon its lawyer in these situations for its legal well-being, which in certain commercial
situations may rise to the level of business survival, and the client needs to have complete trust that its
lawyer has no mixed allegiance, operating to some extent for the benefit of the insurer that pays him or
her, rather than for the benefit of the client.

Another obviously applicable Model Rule is 1.7(a), which provides,

… a lawyer shall not represent a client if the representation involves a concurrent conflict
of interest. A concurrent conflict of interest exists if … there is a significant risk that the
representation of one or more clients will be materially limited by the lawyer’s
responsibilities to another client ….

It is this rule that, in large part, prohibits defense counsel from representing both a policyholder and an
insurer when the insurer has reserved rights and/or partially denied a claim, establishing an adverse
relationship between the policyholder and the insurer. Comment [13] to the rule addresses the situation
even more directly, noting, “A lawyer may be paid from a source other than the client” but such an
arrangement is proper only if it “does not compromise the lawyer’s duty of loyalty or independent
judgment to the client.” Further, comment [29] to the rule makes clear that the lawyer must avoid such
conflict situations even when the coverage dispute between the policyholder and its insurer is not yet
active or acute, stating that “a lawyer cannot undertake common representation of clients where
contentious litigation or negotiations between them are imminent or contemplated.”
In addition, Model Rule 1.8(f) is obviously applicable in these situations. It provides,

A lawyer shall not accept compensation for representing a client from one other than the client unless: … (2) there is no interference with the lawyer’s independence of professional judgment or with the client-lawyer relationship; and (3) information relating to the representation of a client is protected as required by Rule 1.6 [concerning maintaining client confidences].

The comments to this rule embellish these concepts. Comment [11] states, “Lawyers are frequently asked to represent a client under circumstances in which a third person will compensate the lawyer, in whole or in part. The third person might be … an indemnitor (such as an insurance company) …. Because third-party payers frequently have interests that differ from those of the client, including minimizing the amount spent on the representation and in learning how the representation is progressing, lawyers are prohibited from accepting or continuing such representation unless the lawyer determines that there will be no interference with the lawyer’s professional judgment ….”

Along the same lines, Model Rule 2.1 states,

In representing a client, a lawyer shall exercise independent professional judgment ….

Building on this concept, Model Rule 5.4(c) states,

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

Correspondingly, comment [1] to this rule states, “Where someone other than the client pays the lawyer’s fee or salary, or recommends employment of the lawyer, that arrangement does not modify the lawyer’s obligation to the client…. [S]uch arrangements should not interfere with the lawyer’s professional judgment.” Comment [2] then provides, “This rule … expresses traditional limitations on permitting a third party to regulate the lawyer’s professional judgment in rendering legal services to another.”

In addition to these obviously applicable Model Rules, certain other rules bear upon and limit permissible communications between policyholder and insurer conducted with or through defense counsel. For instance, Model Rule 1.1 requires a lawyer to “provide competent representation to a client” that “requires legal knowledge … reasonably necessary for the representation.” In insurance defense settings, such required knowledge would include knowledge of the rules that distinguish appropriate lines of communications from inappropriate ones.

Further, Model Rule 1.2 requires a lawyer to “abide by a client’s decisions concerning the objectives of the representation ….” Hence, defense counsel must take his or her direction from the policyholder client, not from the insurer, and the lawyer must conduct communications with the policyholder and protect from disclosure to the insurer confidential policyholder communications, as appropriate, to accomplish this. Comment [6] to this rule provides that in an insurance defense context, “the representation may be limited to matters related to insurance coverage,” such that a defense lawyer may be retained, for instance, only to conduct a defense, and not to prosecute a counterclaim, cross-claim, or third-party claim unrelated to the defense. Within the scope of any such limited representation, however, the Model Rules would still apply, requiring a defense lawyer to protect the policyholder’s confidences and serve only the policyholder’s interests to the extent they might conflict with the insurer’s.
Model Rule 1.3 also is implicated in these situations, requiring a lawyer to “act with reasonable diligence … in representing a client.” Comment [1] to this rule states, “A lawyer must also act with commitment and dedication to the interests of the client and with zeal in advocacy on the client’s behalf.” In regard to communications, these principles require defense counsel particularly to be on guard against attempts by an insurer paying such counsel to improperly obtain confidential information of the policyholder client that might disadvantage the client in the coverage dispute with its insurer. Defense counsel, under this rule, must be diligent, committed, dedicated, and zealous in protecting those confidences.

Further, Model Rule 1.4(a) requires a lawyer to “… (3) keep the client reasonably informed about the status of the matter; (4) promptly comply with reasonable requests for information ….” These rules, however, address the lawyer’s communication responsibilities to the client. In an insurance defense situation where there has been a reservation of rights or a partial denial, the lawyer’s only client is the policyholder. These rules do not apply to requests from the insurer for information, and the lawyer must be much more guarded in responding to insurer requests, so as to protect policyholder confidences. As if to emphasize these points, Model Rule 2.3(b) states, “When a lawyer knows or reasonably should know that [an] evaluation is likely to affect the client’s interests materially and adversely, the lawyer shall not provide the evaluation unless the client gives informed consent.”

Although defense counsel, then, must serve the interests of only his or her policyholder client, and must manage all communications toward this end, the lawyer also is prohibited from engaging in fraudulent communications to advance impermissibly the interests of the policyholder client. Model Rule 1.2(d), for instance, states, “A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is … fraudulent ….” Comment [10] to Rule 1.02 provides, “The lawyer is required to avoid … drafting or delivering documents that the lawyer knows are fraudulent ….” Hence, although a lawyer must protect privileged information, the lawyer’s duties do not extend to assisting or abetting in insurance fraud, and the lawyer must be careful not to be so used.

Finally, the Model Rules integrate with the closely related concept of attorney-client privilege. Comment [3] to Model Rule 1.6 states, “The principle of client-lawyer confidentiality is given effect by related bodies of law; the attorney-client privilege, the work product doctrine and the rule of confidentiality established in professional ethics.” Comment [30] to Model Rule 1.7 offers the following caution: “A particularly important factor in determining the appropriateness of common representation is the effect on lawyer-client confidentiality and the attorney-client privilege.”

II. CONTEXTS FOR COMMUNICATIONS CONFLICTS

A potential conflict may arise between a cooperation clause and rules of professional conduct, of course, only if there is an operative cooperation clause. Such, however, may not always be the case, and this threshold issue always should be analyzed. If there is no cooperation clause in the subject policy, or in an underlying policy to which the subject policy follows form, and if the applicable state law does not impose a duty to cooperate as a matter of law, then the policyholder and defense counsel can be as reticent in their dealings with an insurer as practical circumstances permit.

Further, even when an applicable policy contains a cooperation clause, a policyholder and its defense counsel typically can disregard the clause if the insurer is in breach of its obligations under the policy. If an insurer is in breach, it cannot insist upon performance by the policyholder of any duty under the policy, including the duty to cooperate—in other words, an insurer cannot have it both ways. Monaghan v. Admiral Ins. Co., 1994 WL 118021 at *5 (9th Cir. 1994) (“the insurer’s breach of its
duties released [the policyholder] from its covenant of cooperation….“); *Continental Cas. Co. v. City of Jacksonville*, 283 Fed. Appx. 686, 689 (11th Cir. 2008) (“An insurer’s wrongful refusal to defend forfeits its corresponding right to control the defense.”). In particular, if an insurer with a duty to defend is not defending, the policyholder has no duty to cooperate. *BellSouth Communications, Inc. v. Church & Tower of Fla., Inc.*, 930 So.2d 668, 672 (Fla. 3d Dist. Ct. App. 2006) (“[I]t is well established that an insurer’s unjustified refusal to defend a suit against the insured relieves the insured of his contract obligation to leave the management of such suit to the insurer …”); *Hospital Underwriting Group, Inc. v. Summit Health, Ltd.*, 63 F.3d 486, 496 (6th Cir. 1995) (It would be “illogic[al]” to “hold that where the insurer breaches by denying coverage and refusing to defend, it may still require the insured to abide by the cooperation clause in the policy …”).

Commonly, however, liability insurers do acknowledge some degree of defense obligation and undertake some efforts to defend, including the retention of defense counsel to appear as counsel of record for the policyholder and to actively defend the policyholder. In such circumstances, the conflicts between policyholder and insurer, and the impact such conflicts have upon communications, come to light.

**A. Selection of Defense Counsel**

The first contact between policyholder and insurer, after notice of the claim, often is a communication from the insurer to the policyholder acknowledging receipt of the notice, preliminarily reserving rights as to indemnity, and advising the policyholder of the insurer’s “selection” of defense counsel to appear and defend. As chronicled at length above, however, in these circumstances, ethical rules dictate that counsel will function only as counsel for the policyholder. The policyholder, accordingly, typically is permitted to treat the insurer’s “selection” as a mere recommendation and proceed to engage defense counsel of its choice. See, *e.g.*, *Asonia Associates Ltd. Partnership v. Public Service Mut. Ins. Co.*, 693 N.Y.S.2d 386, 390 (N.Y. Sup. Ct. 1998) (“In New York, ‘When a conflict of interest exists, the remedy is to permit the insured to select defense counsel …’”); *Rhodes v. Chicago Ins. Co.*, 719 F.2d 116, 120 (5th Cir. 1983) (“When a reservation of rights is made, … the insured may … pursue his own defense. The insurer remains liable for attorneys’ fees incurred by the insured and may not insist on conducting the defense.”); *Twin City Fire Ins. Co. v. City of Madison*, 309 F.3d 901, 907 (5th Cir. 2002) (“When an insurer is defending under a reservation of rights, the carrier ‘should afford the insured ample opportunity to select his own independent counsel to look after his interest.’”); *Moeller v. Amer. Guarantee and Liability Ins. Co.*, 707 So.2d 1062, 1071 (Miss. 1996) (“Because [policyholders were] being defended … under a reservation of rights, [insurer] was obligated to let them select their own attorney at [insurer’s] cost to represent them.”); *United Services Auto. Ass’n v. Morris*, 154 Ariz. 113, 119 (1987) (observing that the “majority” rule is that “an insurance carrier should not be allowed to insist upon exclusive control of the defense while reserving coverage issues…”).

Although insurers, when pressed, often will yield on this point, they sometimes will insist on selecting defense counsel, particularly if the claim will be governed by state law on this issue that is undeveloped or, less commonly, favors the insurer. In such instances, it will be important for the policyholder, perhaps through its coverage counsel, to have a frank discussion with the defense counsel “selected” by the insurer, before agreeing to engage such counsel, to confirm that the lawyer (1) is competent to handle the matter; (2) understands that his or her only client will be the policyholder, and (3) is willing to take direction on the conduct of the defense only from the policyholder and to protect all confidences of the policyholder on matters where the policyholder’s interests and the insurer’s interests are not aligned. If the defense lawyer can provide these assurances, then the policyholder may be best served by living with the insurer’s “selection.” If the policyholder does not receive adequate assurance on
these points, however, it may be best served to engage a defense lawyer on its own and prosecute a coverage case and/or a bad faith case against the insurer.

**B. Conduct of the Defense**

Once the defense begins, an additional set of communications challenges arises—a large set. The “stark reality [is] that the relationship between an insurer and insured is permeated with potential conflicts.” *In re Rules of Professional Conduct*, 2 P.3d 806, 813 (Mont. 2000). The defense may be long and complicated, and the occasions for communications between defense counsel and the insurer, or between the policyholder and the insurer through defense counsel, can be numerous. It will be important for all parties, particularly defense counsel, to keep in mind the ethical rules discussed above, and their impact on communication responsibilities.

The importance of this is acknowledged in jurisdiction after jurisdiction. See *Jackson v. Trapier* 247 N.Y.S.2d 315, 316 (N.Y. Sup. Ct. 1964) (“defendant is the client and not the insurance carrier even though the latter may have chosen the counsel and may be paying his fee”); *Continental Cas. Co. v. Pullman, Comley, Bradley & Reeves*, 929 F.2d 103, 108 (2nd Cir. 1991) (“It is clear beyond cavil that in the insurance context the attorney owes his allegiance, not to the insurance company that retained him but to the insured defendant.”); *Point Pleasant Canoe Rental Inc. v. Tinicum Tp.*, 110 F.R.D. 166, 170 (E.D. Pa. 1986) (“When conflicts-of-interest arise between an insurance carrier and its insured, the lawyer representing the insured must act exclusively on behalf of, and in the bests interests of the insured.”); *First American Carriers Inc. v. Kroger Co.* 787 S.W.2d 669, 671 (1990) (“When a liability insurer retains a lawyer to defend an insured, the insured is considered the lawyer’s client”). An attorney’s loyalty to his or her client cannot be compromised by allegiance to others or by the attorney’s personal interests. *Smoot v. Lund*, 369 P.2d 933, 936 (Utah 1962).

In regard to matters of allegiance, and the corresponding impact upon proper communication lines, insurers may cite to “litigation guidelines,” which they often send to defense counsel in an attempt to control or at least influence the defense of a case. These guidelines can serve as traps for unwary defense counsel and may test their zeal, loyalty, and independent judgment, all of which are governed by the ethical rules discussed above and are absolute. The guidelines may seek to impose a number of inappropriate obligations on defense counsel, all of which will implicate communications, such as purporting to require defense counsel to obtain insurer approval of strategic litigation decisions, such as those concerning taking depositions, filing motions, retaining experts, staffing case initiatives, conducting research, and many other matters. Generally, an attorney may comply with such attempted restrictions only to the extent they do not interfere with the attorney’s independent professional judgment in representing the policyholder. *Ohio Bd. of Comm'r's on Grievances & Discipline*, Op. 2000-3. As a practical matter, defense counsel who agree to such guidelines, and, in particular agree to defer to an insurer in regard to matters of professional judgment, “violate their duties under the Rules of Professional Conduct to exercise their independent judgment and to give their undivided loyalty to [policyholder].” *In Re Rules of Professional Conduct*, 2 P.3d at 816; *Ohio Bd. of Comm'r's on Grievances & Discipline*, Op. 2000-3. Such counsel, therefore, need to be careful about what they say, and about whom they say it to.

It is especially important for defense counsel to be careful to protect the confidentiality of privileged communications he or she has with the policyholder client. Discerning such communications, however, requires constant care, and defense counsel can become disoriented by the fact that that an insurer in some respects is not a third-party vis-à-vis its policyholder, which means that that the policyholder and the insurer can share certain information within the penumbra of the privilege that exists as against third parties such as underlying claimants, and they may share such information without risk of waiving the
privilege. Such instances, however, are limited only to situations where the information being shared pertains solely to the defense being provided by the insurer, as opposed to matters at issue in the coverage dispute between the policyholder and the insurer. In regard to the defense of the underlying claim, the insurer and policyholder typically have a common interest, rather than an adverse one. Northwood Nursing & Convalescent, 161 F.R.D. 293, 296 (E.D. Pa. 1995). However, that common interest does not extend beyond the defense of the underlying claim. Remington Arms Co. v. Liberty Mut. Ins. Co., 142 F.R.D. 408, 417 (D. Del. 1992) (“[T]he cooperation clause here does not imply a duty to produce documents protected by the attorney-client privilege in a coverage dispute. [The insurer] does not seek these documents in order to cooperate on underlying litigation, but to succeed in [the] coverage dispute ....”).

An illustrative case is Bituminous Cas. Corp. v. Tonka Corp., 140 F.R.D. 381 (D. Minn. 1992). In that case, the insurer filed a declaratory judgment action seeking a determination that there was no coverage for an environmental claim, and the insurer sought production, based on the cooperation clause in the policy, of documents generated during the investigation and cleanup of the site. The insurer argued that the documents sought were discoverable in the coverage case because they contained information about the circumstances of the contamination, which circumstances were relevant to the coverage issues. Id. at 385. The court acknowledged that the documents would be relevant, but it “rejected the insurer’s contention that the attorney-client privilege is unavailable” to the policyholder. Id. at 387. It also rejected the insurer’s contention that the policyholder, by purchasing a policy that imposed a duty to “cooperate,” thereby “forever contractually waived the attorney-client privilege.” Id. at 386. Instead, the court held that a policyholder could protect as privileged confidential matters which bore on the coverage dispute. Id. at 387.

Many jurisdictions have embraced the view of the Bituminous court. In State v. Hydrite Chemical Co., 582 N.W.2d 411 (Wis.Ct.App. 1998), for instance, the policyholder filed a third-party action against its insurers to obtain defense of an underlying claim and indemnification for possible damages. The insurers, on the basis of the cooperation clause, requested copies of confidential, privileged documents withheld by the policyholder. The court found that the cooperation clause imposed no duty to produce in the coverage case documents protected by the attorney-client privilege: “To hold that an insurance policy creates a contractual waiver of the attorney-client privilege, even when the insurance company later sues the insured contending the insured’s claim is not covered by the policy, would completely eviscerate the attorney-client privilege.” Id. at 421.

A similar case is Nationwide Mutual Fire Insurance Company v. Bourlon, 617 S.E. 2d 40, 47 (N.C. App. 2005). In that case, the court held that that a policyholder and defense counsel can have privileged communications as against an insurer and that the privilege protects communications which are unrelated to the defense of the underlying action, but, rather, are related to the coverage dispute between insurer and policyholder. The court recognized that a policyholder always will be adverse to its insurer regarding contested coverage issues. Id; see also, Eastern Air Lines, Inc. v. U.S. Aviation Underwriters, Inc., 716 So.2d 340, 343 (Fla. 3rd Dist.Ct.App. 1998) (noting that in a coverage dispute the policyholder and its insurer are adverse and that the cooperation clause in such instances will not override the attorney-client privilege).

Courts, then, generally recognize that as long as the documents relating solely to underlying claims are produced by a policyholder in a coverage case, the duty to cooperate under the insurance policy is satisfied. Courts consistently hold, however, that policyholders are not required to produce documents or otherwise reveal communications concerning legal advice or other information transmitted between policyholder and defense counsel with a reasonable expectation of confidentiality, such as communications relating to coverage disputes. Gulf Ins. Co. v. Transatlantic Reinsurance Comp., 788 N.Y.S.2d 44, 46 (N.Y. 1st App. Div. 2004).
Although insurers may be frustrated by this state of the law, they should draw some solace from the fact that these principles similarly protect them in their reinsurance disputes, shielding from discovery confidential documents sought by reinsurers in coverage disputes with ceding, direct insurers. *North River Insurance Co. v. Philadelphia Reinsurance Corp.*, 797 F. Supp. 363, 369 (D.N.J. 1992).

In regard to the active defense of cases under reservations of rights or following partial claim denials, one type of confidential communication merits particular caution—defense fee bills. When an insurer is paying for the defense, the policyholder may send defense fee bills to the insurer without waiving the attorney-client privilege that protects fee bills from production to the underlying claimants. *In Re Rules of Professional Conduct*, 2 P.3d at 818-19. Waiver may arise, however, and severely prejudice the policyholder, if the insurer shares the defense bills with a third-party bill auditor. Absent the policyholder’s consent, therefore, defense counsel typically may not provide detailed billing information to an insurer if the insurer will be transmitting that information an outside auditing company. *Id.* at 822; Ohio Bd. of Comm’rs on Grievances & Discipline, Op. 2000-2. Rather, an attorney may provide detailed billing information to an insurer only if doing so will not adversely affect the policyholder’s interests. ABA Formal Ethics Op. 01-421 (2001). An attorney cannot agree to or follow any guidelines from an insurer that contemplate the transmission of fee bills to an outside auditor, unless the policyholder consents. *In Re Rules of Professional Conduct*, 2 P.3d at 816, 822; Ohio Bd. of Comm’rs on Grievances & Discipline, Op. 2000-2. A prudent policyholder engaged in a coverage dispute with its insurer is unlikely to provide such consent.

**C. Mediation or Settlement**

Lines of communication may become the most complicated when an underlying claim reaches the stage of settlement discussions or mediation. When an insurer has reserved rights or partially denied a claim and the policyholder, as often happens, disagrees with the insurer about whether the insurer has a complete obligation to indemnify, settlement discussions over the underlying claim often merge with settlement discussions over the corresponding coverage claim. The policyholder will be involved, necessarily, in both discussions, as should be the policyholder’s defense counsel. The insurer will be involved in the coverage claim settlement discussions, of course, but it may or may not be directly involved in the underlying claim settlement discussions. In fact, it may be counterproductive for an insurer which has reserved rights in regard to or partially denied a coverage claim to be involved in the settlement discussions over the corresponding underlying claim. Its participation may send a false signal to the underlying plaintiff regarding the extent, if any, to which insurance funds may be available to settle the underlying claim.


These principles notwithstanding, there are likely to be communications between policyholder and insurer at the settlement stage regarding which party has underlying case settlement authority, and neither will wish the underlying claimant to be privy to such discussions. In addition, there may be
better opportunities for the policyholder to negotiate a favorable settlement with the underlying claimant during settlement discussions the insurer is not privy to. The potential complexities and nuances of the various communication dynamics in these situations are virtually limitless. During the entire process, however, defense counsel needs to keep straight what he or she may say, and to whom.

CONCLUSION

Even when an insurer has reserved rights or partially denied a claim, it will be important for the insurer and its policyholder to communicate effectively. Working through defense counsel or sometimes communicating directly with the policyholder, however, an insurer will have substantial opportunities to overreach in these situations, obtaining or using information to the disadvantage of its policyholder in regard to the coverage dispute. Moreover, the risks may be quite subtle, and the applicable ethical and privilege rules may be less than obvious. Hence, all parties, including insurers, need to be vigilant to maintain appropriate lines of communication. It does an insurer no good, after all, to effect a waiver of privilege that might lead to greater indemnity exposure for the underlying claim, or to put defense counsel at risk of violating his or her ethical obligations.