AN ANALYSIS OF MARYLAND LAW REGARDING AN INSURER'S DUTY TO DEFEND INCLUDING AN ANALYSIS OF THE TYPES OF CONFLICTS OF INTEREST BETWEEN AN INSURED AND THE INSURER THAT MAY REQUIRE THE INSURER TO ACCEPT AND REIMBURSE DEFENSE COUNSEL SELECTED BY THE INSURED

Conflicts between the insurer and the insured can arise from the fact that the duty to defend is much broader than the duty to indemnify. The insurer's distinct and independent duty to defend its insured is triggered by claims that give rise to the "potentiality" of indemnification under the policy[1]. *Litz v State Farm Fire & Casualty Co.*, 346 Md. 217, 695 A.2d 566 (1997); *Fireman's Fund v Rairigh*, 59 Md. App. 305, 320, 475 A.2d 509, 516, cert denied, 310 Md. 176 (1984); *Rivera Beach Vol. Fire Co., Supra*. As the Maryland Court of Appeals held in *St. Paul Fire & Marine Ins. Co. v Pryseski*, 292 Md. 187, 193, 438 A.2d 282, 285 (1980) quoted more recently in *Clendenin Bros. v U.S. Fire Ins. Co.*, 390 Md. 449, 889 A.2d 387 (2006):

> In determining whether a liability insurer has a duty to provide its insured with a defense in a tort suit, two types of questions ordinarily must be answered: (1) what is the coverage and what are the defenses under the terms and requirements of the insurance policy? (2) do the allegations in the tort action potentially bring the tort claim within the policy's coverage? The first question focuses upon the language and requirements of the policy, and the second question focuses upon the allegations of the tort suit.

390 Md. 449 at 458. Given this potential tension between the insurer's obligations to indemnify and defend, cases do arise wherein conflicts (or the appearance of a conflict) can occur in the insurer's fulfillment of these two independent duties. In some of these situations, where the insurer sends a reservation of rights letter, the insureds assert the

[1] Maryland law does not follow the "exclusive pleading" rule in determining the potentiality of coverage. Instead in Maryland, in addition to the language found in the Complaint, an insured may rely upon extrinsic evidence (evidence not found on the face of the complaint) to establish the potentiality of coverage, triggering the duty to defend. Extrinsic evidence may not, however, be used by the carrier to defeat the potentiality of coverage. *Aetna Casualty & Surety Co. v Cochrane*, 337 Md. 98, 111-12, 651 A.2d 859, 866 (1995).

existence of a conflict and claim the right to select their own counsel, at the carrier's expense.

A true conflict which might require the selection of independent counsel to defend the insured arises in the carrier's fulfillment of its duty to defend only "when the outcome of a coverage issue can be affected by the manner in which the underlying action is defended." A. Windt, INSURANCE CLAIMS AND DISPUTES, §4:20, p. 4-177, (2007 Thompson/ West) quoting *Villcana v Evanston Ins. Co*., 33 Cal. Reptr 690, 699 (App. 2d Dist. 1994), *as mod. on denial of reh'g*, (Oct. 19, 1994); see also *Britamco Underwriters, Inc. v Nishi, Papagjika & Associates, Inc*., 20 F. Supp. 2d 73, 76 (D.DC 1998, decided on Maryland law). Therefore, a conflict requiring the retention of independent counsel does *not* arise just because: (1) The complaint contains multiple counts including some for which the policy does not contain coverage; (2) the insurer issues a reservation of its rights under the policy on an issue that will not be addressed in the lawsuit against the insured; (3) the insurer issues a reservation of rights based on the insured's failure to comply with the conditions of the insurance policy; (4) the insurer has issued a reservation of rights solely as to the existence of coverage for punitive or exemplary damages; (5) although coverage is not disputed, the amount of the claim exceeds policy limits; and (6) the insured and the insurer have differing views as to the potential liability of the insured. *Roussos v. Allstate Insurance Co*. 104 Md. App. 80, 655 A.2d 40, 44-45 (1995); Windt, *Supra* at § 4:21, pp. 4-177 – 4-181. In the above situations it is understood that the insurer is mindful that retained defense counsel must, as always, adhere to the general ethical obligations that counsel must maintain with any client.

A true conflict of interests between the carrier and the insured impacts the attorney's ethical responsibilities to both the insured and the insurance carrier. As the Court of Appeals held in *Fidelity and Cas. Co. of New York v McConnaughy*, 228 Md. 1, 179 A.2d 117 (1962):

> The customary clause in insurance policies requiring the insured to permit the insurer's lawyer to defend claims insured against is consent in advance by the insured to such dual representation and obviates an improper relationship, but if, in the course of the dual representation an actual conflict develops between the interests of the insured and those of the insurer, the lawyer must either withdraw entirely from the case or continue to represent one of the clients only. He can not further the interests of only one of the two while he still represents the other, or he breaches Canon 6. Various courts have condemned such dual representation in circumstances analogous to those in the instant case, and several have held that when it occurred, the insurance company had waived its right to disclaim or was estopped to do so.

McConnaughy at 228 Md. 10, 179 A.2d 121. See also, *Medical Mut. Liab. Soc. of Maryland v Miller*, 52 Md. App. 602, 609-610, 451 A.2d 930, 934 (1982).

The Canons of Professional Ethics, referenced in McConnaughy have been superseded by the Maryland Lawyers' Rules of Professional Conduct. Rule1.7 states:

> Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a conflict of interest. A conflict of interest exists if:
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> (1) the representation of one client will be directly adverse to another client; or
>
> (2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.
>
> (b) Notwithstanding the existence of a conflict of interest under paragraph (a), a lawyer may represent a client if:
>
> (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
>
> (2) the representation is not prohibited by law;
>
> (3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or another proceeding before a tribunal; and
>
> (4) each affected client gives informed consent, confirmed in writing.

Rule 1.8(f) goes on to state:

> A lawyer shall not accept compensation for representing a client from one other than the client unless:
> (1) the client gives informed consent;
> (2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and
> (3) the information relating to representation of a client is protected as required by Rule 1.6.

In situations where there are apparent conflicts or potential conflicts of interests between the insurer and the insured, and the insurer is called upon to provide a defense to the insured, insureds and their counsel often cite *Brohawn Supra*, as authority through which they seek to require the insurer to pay for defense counsel selected by the insured. The *Brohawn* holding is however very narrow and must be carefully reviewed. In *Brohawn*, several claimants had a physical altercation with an insured and alleged that they were assaulted by the insured. The insured was charged criminally with assault and kidnapping. The insured plead guilty to the assault charges and the court dismissed the kidnapping charges. Subsequently, the claimants filed a civil complaint against the insured that alleged both negligence and intentional assault on the part of the insured and sought damages for injuries received in the altercation. The insured requested a defense and indemnification under her homeowners' policy. The insurer took the position that the insured's guilty plea established that the insured acted intentionally and, thus, was not covered. Upon review, however, the Court of Appeals held that the insurer must provide a defense as to the entire claim because of the existence of the cause of action in negligence in the Complaint which gave rise to the potentiality of coverage under the policy. The Court of Appeals also held that, under these particular circumstances, in

which a conflict had arisen between the insured and insurer as to the conduct of the case, the insurer was obligated to: 1) notify the insured of the nature of the conflict; 2) give the insured the option of accepting an independent attorney selected by the insurer or 3) permitting the insured to select an attorney to conduct the defense.

> We hold that an insured is not deprived of his contractual right to have a defense provided by the insurer when a conflict of interest between the two arises *under circumstances like those in this case.* When such a conflict of interest arises, the insured must be informed of the nature of the conflict and given the right either to accept an independent attorney selected by the insurer or to select an attorney himself to conduct his defense. If the insured elects to choose his own attorney, the insurer must assume the reasonable costs of the defense provided.

Id. at 347 A.2d at 854. (Emphasis added.)

Although insureds typically cite this portion of the *Brohawn* opinion in support of a request for the insurer to pay counsel selected by the insured, even though the insurer is prepared to offer representation through independent counsel, there are two important limitations to reliance on *Brohawn* to support that contention. First, the Court's holding that an insured may select the independent attorney and have the insurer pay the reasonable cost of that defense is limited to the facts of the *Brohawn* case. Second, the *Brohawn* Court emphasizes the ethical obligations of independent counsel provided by the insurer.

In *Brohawn,* there was a clear conflict of interest because the complaint clearly asserted that the operative acts of Ms. Brohawn were, in the alternative, either negligent or intentional. Perhaps more importantly, the carrier specifically asserted that a conflict existed and thereby sought to relieve itself of its duty to defend the insured. Under the circumstances, the insurer's interest would be furthered by a finding that the Plaintiff was

liable for intentional conduct and, thus not covered. The insured's interests, on the other hand would be furthered by a finding that her actions were negligent and that she was covered by the policy. In other words, the carrier could potentially manipulate the defense in such a way that it would have no duty to indemnify. The procedure adopted by the Court of Appeals in *Allstate v. Atwood*, 319 Md. 247, 572 A.2d 154 (1990) alleviates, but does eliminate the current potential conflict. *Atwood* explained the holding in *Brohawn,* indicating that in most cases a pre-tort trial declaratory judgment action is inappropriate and reiterated that, as a general matter, a liability insurer is bound by the finding in a tort action against its insured. However, the Court permitted a pre-tort trial declaratory action if the allegations against the insured in the tort suit obviously constitute a patent attempt to re-characterize as negligent an act that is clearly intentional. *Atwood* at 319 Md. 253. Further, the Court approved a post trial declaratory action, if a conflict of interest situation exists, to initially determine if, as a matter of law, any issues decided in the tort trial which might impact insurance coverage, were fairly litigated. If the court determines that they were fairly litigated, the carrier is bound by the findings in the tort suit. If the court determines that they were not fairly litigated in the tort trial the carrier is entitled to re-litigate those matters. *Atwood* at 319 Md. 262.

The *Brohawn* Court stressed importance of the ethical obligations that attorneys must always maintain toward all clients, including their insured clients. The Court recognized that the rights of an insured could usually be adequately protected by the duties imposed upon the attorney by the Canons of Professional Responsibility.

Although the insureds and their personal counsel often cite *Brohawn* as the basis for allowing the insured to select defense counsel at the expense of the insurer as the

result of an apparent conflict of interest, there are few conflicts so clear as the conflict presented in *Brohawn,* in which the carrier declared a conflict to exist and the outcome of a coverage issue could have been affected by the manner in which the underlying action was defended.

In *Cardin v. Pacific Employers Ins. Co.*, 745 F.Supp. 330 (1990) the United States District Court for the District of Maryland, interpreting Maryland law, stressed the fact that an insured cannot simply declare a conflict to exist, entitling the insured to select counsel of his own choosing, simply because covered and uncovered counts are present in a Complaint.

In *Cardin*, the insured defendant, Jerome S. Cardin was defending criminal actions arising out of his conduct as an officer of a failed savings and loan company. Contemporaneously Cardin was also defending related civil suits which sought the recovery of damages arising out of the failed savings and loan. The civil suits alleged professional negligence and intentional misconduct. Cardin's insurer provided a defense in the civil suit subject to a reservation of rights. Cardin and his personal counsel sought to have the insurer appoint his personal counsel as independent counsel for the defense and have the insurer pay the cost of that defense. The insurer declined. In a later suit by Cardin to recover these defense costs, the United States District Court held that the insured was not automatically entitled to select his own counsel. The Court found that the insurer had, in fact, selected counsel to independently represent Cardin. Counsel selected by the insurer was not representing the insurer in any aspect of the case and was given a *carte blanche* to fully defend Cardin and Cardin alone.

Subsequently, the United States District Court for the District of Maryland, in the case of *The Driggs Corporation v Pennsylvania Manuf. Assoc. Insurance Company*, 3 F.Supp. 657 (1998), approved the holding in *Cardin* and found it to be consistent with Maryland law as discussed in *Allstate Ins. v Campbell*, 334 Md. 381, 639 A. 2d 652 (1994) which also cited *Cardin* with approval in rejecting the "*per se"* rule" which would require an insurer to pay counsel selected by the insured any time there was a potential conflict. In Driggs, the Court rejected: a) the insured's contention that the issuance of a reservation of rights letter created a conflict; b) the insured's contention that a hypothetical question posed to the insurer's selected counsel regarding a potential conflict in fact created a true conflict and; c) insured's contention that the carrier's selection of defense counsel that was not part of a "mega-firm" was a breach of the duty to defend.

> In *Brohawn* and most of the cases citing it, the insurer declared a conflict to exist and sought to terminate the defense altogether as a result of the professed conflict. *Brohawn* did not necessarily establish that such a conflict arose in all such circumstances. The Court in *Cardin*, citing *Native Sun Inv. Group v Ticor Title Ins. Co*., 189 Cal App. 3d 1265 (1987), stressed that, because the coverage question would not be resolved in the underlying tort suit, there was no genuine conflict between the insurer and the insured. 745 F.Supp 330. The Court went on to hold that even if the facts developed in the underlying tort suit might have affected the coverage dispute, that fact would not necessarily have required the carrier to pay the fees of the insured's selected counsel, because the insurer gave the defense counsel that the it had selected, as in *Native Sun*, "carte blanche to litigate all the issues, covered and uncovered" and that counsel was defending solely the insured and never the insurer. *Id*.

The *Cardin v. Pacific Employers* decision has been cited with approval in two Maryland cases in which insureds have sought payment from the insurer for attorney fees of their personal counsel. In *Roussos v. Allstate Ins. Co.*, 104 Md. App. 80, 655 A.2d 40 (1995) the insured was dissatisfied with the defense strategy of the insurance company

and sought independent counsel to represent her interests. The insured later attempted to recover her attorney's fees from the insurer. In holding for the insurer, the Court said:

> We decline to extend an insurer's duty to provide independent counsel to a situation where the insured merely disagrees with the manner in which he or she is to be defended. See *Cardin v. Pacific Employers Ins. Co.*, 745 F.Supp. 330, 336-38 (D.Md. 1990) (rejecting a per se rule that would require an insurer to pay for counsel selected by the insured where there is only the possibility that the insurer and the insured might have different objectives in regard to the suit being defended by the insurer-selected counsel).

104 Md. App. at 90-91, 655 A.2d at 44-45.

In *Allstate Ins. Co. v. Campbell,* 334 Md. 381, 639 A.2d 632 (1994), the insured hired personal counsel after there was a demand to settle the suit against him for policy limits and his insurer declined to do so and declined to allow assigned defense counsel to conduct certain discovery. Ultimately, the underlying law suit against the insured was settled for policy limits, but the insured pursued a declaratory judgment action against the insurer for bad faith and seeking payment of the fees incurred by him for his personal counsel. The Court of Appeals affirmed the trial court's dismissal of the declaratory judgment action. The Court of Appeals noted:

> Of course, where there is the possibility of a judgment in excess of policy limits, it is appropriate for the appointed counsel to make the insured aware that there exists a *potential* for a conflict of interest and to advise the insured to consult independent counsel regarding any excess liability. But the existence of a potential conflict does not require the insurer to pay for independent counsel to take over the defense of the insured. In the absence of a conflict of interest on other grounds that would necessitate the retention of independent counsel for the insured, the defense of the claim in such a situation remains in the control of the insurer.

334 Md. 397, 639 A.2d 659-660; citing with approval *Cardin v. Pacific Employers Insurance Company* rejecting a *per se* rule which would require an insurer to pay counsel selected by the insured. 334 Md. 397, 639 A.2d 659, FN.4.

It appears that the Maryland Courts will interpret *Brohawn* narrowly and that an insurer will not be required to pay for counsel selected by the insured unless there is a true conflict of interest in the defense of the tort action against the insured. Mere potential conflicts, potential excess verdicts or preferences for different strategies are insufficient to require the selection of insured-selected counsel.

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