

**Lawyer Who Acts as Insurance Defense Counsel for an Insured May Not Later Represent the Insured against the Insurer in a Related Bad Faith Case**

*Counsel Retained by Liability Insurer to Defend Insured Represents Both the Insurer and the Insured in the Absence of a Conflict*

*Nevada Yellow Cab Corporation v. The Eighth Judicial District Court*, 152 P.3d 737 (Nev. 2007)

**Case at a Glance**

A liability insurer was a "former client" of an attorney in a firm retained to defend the insurer's policyholder and, therefore, had an attorney-client relationship necessary for seeking to disqualify attorney and his new firm in bad faith action. The attorney's prior representation of the liability insurer when his law firm acted as defense counsel for the policyholder could be treated as substantially related to attorney's representation of the policyholder in a bad faith action, and, thus, the prior representation justified the attorney's disqualification, even though the insurer hired a new firm to settle the tort case against the policyholder after firing the attorney.

**Summary of Decision**

**Facts.** From 1998 to 2001 the original law firm, *F*, was one of the law firms in Nevada ICW, the real party in interest in the case under discussion, used to defend insureds. Most of the work *F* performed for ICW's insureds was performed by a partner, *L*<sub>1</sub>, and an associate, *L*<sub>2</sub>. Lawyers at *F* also represented ICW in two first-party matters. *L*<sub>1</sub> was involved in both of these; *L*<sub>2</sub> was involved in one of them.

In 1999, ICW retained *F* to defend its insured YC in a personal injury case stemming from an auto

accident. The liability policy had limits of \$500,000 and a self-insured reserve of \$50,000. From the beginning of 1999 until nearly the end of 2002, *L*<sub>1</sub> and *L*<sub>2</sub> defended YC in this case and "regularly updated ICW on the status of the litigation." In November 2002, ICW terminated *F* and retained a different law firm to defend YC. This was done without YC's consent. The plaintiff offered to settle shortly before the trial for policy limits. ICW instructed new counsel to reject the offer. The case went to trial in March 2003. The first few days of the trial went poorly for YC, and the case was settled for \$1.3 million: \$800,000 in excess of YC's policy limits. YC had to pay \$500,000 towards settlement. (Why it paid only this amount was not explained in the court's opinion.)

In 2003, *F* split into two firms: *F*<sub>1</sub> (the breakaway firm) and *F*<sub>2</sub> (the surviving firm). *L*<sub>1</sub>, the partner at *F*, went with the new firm, while *L*<sub>2</sub>, the associate, stayed with *F*<sub>2</sub>. In June 2003, YC retained *F*<sub>2</sub> to sue ICW for bad faith. The theory of the suit had two components. The first one was that ICW wrongfully failed to accept the plaintiff's policy-limits offer shortly before trial. The second theory was that its subsequent settlement was erroneously too high. Interestingly, *F*<sub>2</sub> had already begun representing YC "on a regular basis" in a variety of its legal matters. Perhaps that work stretched back to *F* itself.

**Procedural History.** ICW almost immediately indicated that it thought there was a conflict, and it asked *F*<sub>2</sub> to withdraw. The parties agreed to mediate the case without changing counsel. There was understanding that mediation would not constitute a waiver by ICW of its right to seek disqualification. The mediation failed, and ICW moved to disqualify *F*<sub>2</sub>. The district judge concluded that there was a "potential conflict" that was too large to permit, and accordingly granted the motion to disqualify. YC filed a writ petition for mandamus; it was answered; and an oral argument was held.

**Result.** Given the facts of the evolution of the bad faith case, the Nevada Supreme Court held that ICW had not waived its right to seek disqualification. The court observed that ICW had notified the other side of the problem early on; had engaged in a mediation explicitly announcing that its involvement was not a waiver; and had filed its disqualification motion almost immediately thereafter. The court's key and quotable remark here is that "delay alone is

insufficient to establish waiver.”

Under the Nevada Rules of Professional Conduct, which closely resemble the ABA Model Rules, if *L* has represented a client (*C*<sub>1</sub>) in a given matter, *L* may not represent another client (*C*<sub>2</sub>) against *C*<sub>1</sub> in a matter which is “substantially related” to the former representation. Thus, the key question in this case is whether ICW was a former client of anyone in *F*<sub>2</sub>. If any lawyer in *F*<sub>2</sub> represented it in a substantially related matter, then no one in that firm can represent anyone against it in a substantially related matter.

Resolution of this question raised the classic issue of whether insurance defense counsel is involved in a “tripartite” relationship, wherein s/he represents both the insured, which is obviously *L*’s client, and the liability insurer that is funding and directing the defense. According to the court, “the majority rule is that counsel represents both the insurer and the insured in the absence of a conflict.” The “primary client” is the insured; however, in representing the insured, counsel has duties running to the insurer, as well. Thus, the insured is the “primary client,” but the insurer is also a client. Most significantly, the insured’s “counsel generally learns confidential information from both the insured and the insurer and thus owes both of them a duty to maintain this confidentiality[.]” In addition, “since counsel generally offers legal advice to both the insured and the insurer, counsel owes a duty of care to both of them.” Under Nevada rules, like those of most jurisdictions, there is a principle authorizing dual-representation in insurance defense cases, when there is no conflict of interest.

The court based its reasoning on other considerations, as well. It had already “explicitly recognized that an attorney-client relationship exists between a medical malpractice insurer and the lawyer retained to defend its insured doctor.” *Semenza v. Nevada Med. Liability Ins. Co.*, 765 P2d 184 (Nev. 1988) (“permitting an insurer to sue a lawyer retained to defend its insured physician”). In addition, the court observed that it has permitted insurers to assert an attorney-client privilege and a work product privilege “for documents prepared during the representation of an insured[.]” In doing this, the court has necessarily presumed that an attorney-client relationship exists between the insurer and the counsel it retained for its insured.” *C.S.A. v. District Court*, 788 P2d 1367 (Nev. 1990) and *Ballard v.*

*District Court*, 787 P2d 406 (Nev. 1990).

Virtually the sole question remaining, given that there was dual representation, was whether the two representations were “substantially related,” which is one of the dueling dualities the rule forbids. The criteria for determining this has already been established in Nevada law: “(1) Make a factual determination concerning the scope of the former representation, (2) evaluate whether it is reasonable to infer that the confidential information allegedly given would have been given to a lawyer representing a client in those matters, and (3) determine whether that information is relevant to the issues raised in the present litigation.” *Waid v. District Court*, 119 P3d 1219, 1223 (Nev. 2005). It was virtually certain, given (1)-(3), that a bad faith case like this one is *substantially related* to the previous representations.

Hence, the disqualification order issued by the district court was justified. The court recognized that disqualification decisions are delicate and sometimes require the balancing of the competing interests of a current client, a past client (especially with respect to confidential information), and the public interest. The court also acknowledged that disqualification should not be a permitted tool in practical litigation tactics. Significantly, the court concluded that “doubts should generally be resolved in favor of disqualification[.]”

## Comment

The Nevada Supreme Court described itself as joining the majority. The idea of a judicial majority is an ambiguous one. There is a difference between (1) most courts having decided an issue and most of them having come out with the same holding and (2) a few courts having decided an issue, with most of them having come out endorsing the same rule. Consider the difference between (1) 26+ of 50 state supreme courts deciding an issue in the same way, when all have considered it, and (2) there being 4 courts which have considered an issue, and 3 of them have come out the same way.

Nevertheless, the central argument of the Nevada Supreme Court is correct. It is very seldom indeed that insurance defense counsel in a contested case does not provide some lawyer-to-client advice to the adjuster at the carrier running the show. See Michael Sean Quinn, *Whom Does the Insurance Defense*

*Lawyer Represent?*, 2 JOURNAL OF TEXAS INSURANCE LAW  
12 (Spring 2000). Alas, the Nevada Supreme Court did  
not actually cite this logically authoritative—if not  
conclusive—and well-reasoned article. Then again,  
nobody else has either, alas. // Quinn