Accurately Calculating the Costs of a Limited Representation

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Lawyers often contractually limit an engagement's scope based upon a client's limited goals or finances. In the latter circumstance, a lawyer may determine that the matter's opportunity cost would be too great if the client did not agree to a limited representation.

Such a circumstance is found in the insurance defense world when a lawyer calculates that a suit's value depends on a client agreeing to limit the scope of representation to covered claims. That determination is incomplete, however, if the lawyer does not analyze two hidden costs: 1) applicable professional conduct rules governing limited engagements; and 2) the greater potential for malpractice claims. These costs are especially pronounced where the limited representation excludes prosecution of an insured's potential affirmative claims.

This article analyzes a defense lawyer's obligations when confronted with that hypothetical circumstance. The first section analyzes a lawyer's obligations under applicable Georgia Rules of Professional Conduct in undertaking a limited representation. The second section reviews when an insured's affirmative claims are likely to trigger coverage disputes and the likely outcome of such disputes. The final section provides a framework for calculating the financial value of a limited engagement and for efficiently resolving conflicts

between professional obligations and financial motivations.

I. Professional Obligations When Undertaking Limited Insurance Defense Engagements

Lawyers must evaluate applicable Georgia professional conduct rules before undertaking a limited representation. Rule 1.2(c) provides that a lawyer may undertake a limited client representation only if: 1) the limitation is reasonable, and 2) the client gives informed consent. While Georgia case law does not explicitly evaluate what types of limited engagements are reasonable, Rule 1.2's sixth comment implies that a lawyer may reasonably limit a representation's scope to claims covered under an insurance policy.[1]

That commentary, however, is not a carte blanche for entering into limited engagements. In fact, such a limitation is unreasonable where it precludes the lawyer from representing the client competently.[2] For example, a limited engagement might motivate a lawyer not to carry out an appropriate course of action for the client, such as prosecuting a non-covered affirmative claim. Succumbing to that financial motivation likely violates the lawyer's loyalty duties under Rule 1.7 of the Georgia Rules of Professional Conduct.[3]

This example is not merely hypothetical, because many jurisdictions hold that an insurer's duty to defend covered claims does not include prosecuting related claims for affirmative relief.[4] The Northern District of Georgia holds that under this "tripartite relationship,"[5] an attorney represents both the insurer and the insured.[6] In navigating this relationship, a lawyer must diligently represent his client but must also recognize the insurer's right to contain legal defense costs.

Consequently, an insurance defense lawyer's professional and financial motivations may conflict where an insured's case demands the prosecution of a non-covered counterclaim. On the one hand, prosecuting the affirmative claim may result in huge opportunity costs, given that an insurer is not obligated to pay fees for these non-covered claims. On the other hand, a lawyer's decision against prosecuting the non-covered counterclaim increases the potential that a client will assert that the lawyer placed his own interests ahead of the client's defense.[7]

Thus, in calculating a new matter's potential value, a lawyer should evaluate whether the insured's case involves potentially non-covered affirmative claims. Such an evaluation turns on the insurer's duty to defend claims under Georgia law.

II. Coverage for Affirmative Claims

A. The Duty To Defend

Insurance companies' financial health depends on their ability to manage legal defense costs efficiently, given the growing attorney costs for insurance defense claims. To facilitate such management, insurance policies generally provide that the insurer controls the insured's defense.[8] Further, the insurance contract usually vests the insurer with control over the selection and payment of a defense attorney.[9] The insurer's control over an insured's defense, however, is limited by its defense obligations under state law.

Under Georgia law, an insurer's duty to defend is determined by comparing the allegations of the complaint with the provisions of the insurance policy.[10] In ascertaining whether a lawsuit is covered, Georgia courts look to the "four corners" of the complaint.[11] Doubts as to liability and the insurer's duty to defend are resolved in favor of the insured.[12] Accordingly, an insurer must defend a claim even when a complaint's allegations are ambiguous with respect to coverage.[13] In contrast, insurers appropriately decline defense coverage where, as a matter of law, the complaint's allegations unambiguously preclude coverage.[14] Thus, an insurer possesses a duty to defend if the claim *potentially* falls within the policy.[15]

In Georgia — unlike in other jurisdictions — it is unclear whether an insurer's defense duty extends to related affirmative claims.[16] Outside of Georgia, jurisdictions have grappled with this issue, reaching divergent results.

B. Majority Rule

The majority of jurisdictions hold that an insurer has no duty to prosecute an insured's affirmative claims for relief.[17] As a corollary, many jurisdictions hold that insurers have no duty to defend non-covered counterclaims. For example, in *Red Head Brass, Inc. v. Buckeye Union Ins. Co.*, the Ohio Court of Appeals held:

> The terms of the insurance contract, which defined [the insurer's] duty to defend, in no way obligated [the insurer] to compensate [the insured] for the expense of prosecuting its counterclaim. [The insured], in its contract with [the insurer], bargained only for the insurer to pay for defending the insured against litigation. It did not bargain for legal representation where the insured is the plaintiff. Nor does Ohio law mandate such services by an insurer. [The insured] would like this court to expand the duty to defend in Ohio, but we decline to do so.[18]

A myriad of approaches in other jurisdictions, however, muddy this majority rule.

C. The Inextricably Intertwined Doctrine

Under the "inextricably intertwined" theory, an insurer is required to fund claims "inextricably intertwined with the defense of the [insured's claims] and necessary to the defense of the litigation as a strategic matter."[19]

The theory was broadly applied by the court in *Safeguard Scientifics, Inc. v. Liberty Mutual Insurance Co.*, where the court held that an insurer's defense duty extends to counterclaims that are necessary to the defense of underlying litigation "as a strategic matter".[20] That declaratory judgment action arose out of a lawsuit between the insured business and its former president, where the former president asserted liability counts against the business for breach of contract, fraud, and breach of fiduciary duty. The business, in turn, asserted nearly identical liability theories against its former president as counterclaims.[21]

The insurer sought to deny defense coverage for the prosecution of the counterclaims, because "no term of the insurance policy imposes a duty to fund

counterclaims." As noted above, however, the court found defense coverage for the counterclaims, even though they were not compulsory, simply because they were very related to the underlying plaintiff's liability claims.[22]

Citing *Safeguard Scientifics, Inc.*, the United States District Court for the Northern District of Illinois held in *Great West Casualty Co. v. Marathon Oil Co.* that an insurer's defense duty extends to third-party indemnification and contribution claims that potentially reduced or eliminated the insured's liability.[23] There, a truck driver's estate had sued the insured for damages arising out of the driver's on-the-job wrongful death. In turn, the insured had sued two companies for contribution and indemnity.[24] The court held that the insurer's defense duty extended to the affirmative claims, because they were filed to limit the insured's liability for covered claims.[25]

D. Coverage for Defensive Affirmative Claims

Most jurisdictions, however, do not extend the insurer's duty to defend affirmative claims as broadly as the court did in *Safeguard Scientifics Inc.* Instead, these jurisdictions focus their coverage analysis for affirmative claims upon whether the affirmative claim is offensive or defensive in nature.

For example, the United States District Court for South Dakota held in *IBP, Inc. v. National Union Fire Insurance Co.* that a duty to defend extends to cross claims that are necessary to an insured's defense.[26] There, an insured had filed a cross claim against the underlying defendant in a related lawsuit, in lieu of answering the underlying lawsuit. Finding a duty to defend, the court stated that "even though an insured initiates a lawsuit, that fact does not automatically preclude coverage for defense-type legal fees and expenses where the insured is resisting a contention of liability for damages."[27]

In contrast, courts hold that offensive counterclaims—claims that do not serve solely to limit an insured's liability—are not covered under an insurance policy.[28] For example, in *International Insurance Co. v. Rollprint Packaging Products, Inc.*, the Illinois Court of Appeals held that an insurer had no duty to defend counterclaims that were seeking to enjoin a party from future use of trade secrets.[29]

In addition, an insurer has no duty to defend counterclaims that are unrelated to the covered claims asserted against the insured.[30] For example, an insurance company has no duty to defend an insured's counterclaim for a Langham Act violation in a trademark infringement lawsuit.[31]

III. Approaching the Issue in Georgia

Given the dearth of Georgia case law addressing the issue, Georgia insurance companies are likely within their rights to deny coverage for an insured's affirmative claims. As a practical matter, however, insurers might make a business decision to fund an affirmative claim's prosecution in order to minimize indemnity exposure.[32]

Regardless of whether the insurer can deny coverage for such additional claims, a lawyer must tread cautiously when representing an insured who has a potentially non-covered affirmative claim, so as to ensure compliance with applicable ethical rules and to minimize the

potential for malpractice claims. The following practices will help to accomplish these goals.

A. Lawyers Should Analyze Whether the Insured Possesses an Affirmative Claim

Upon receipt of a new insurance defense file, an attorney should analyze whether the insured's defense requires the assertion of non-covered affirmative claims. Such an analysis should include claims arising out of the same transaction or occurrence, as well as less related claims that potentially advance the insured's defense. The depth of the assessment should correspond to the size of each new matter—the greater the size, the greater the potential for a malpractice claim.

Next, the evaluation should be documented through an internal file memorandum which details the search's purpose. That record could provide key evidence in absolving a lawyer from a malpractice claim—it indicates that the lawyer undertook a diligent and exhaustive examination of a client's case. This is especially applicable where a strategic decision not to raise a compulsory counterclaim is later alleged to have been driven by counsel's belief that the claim was not covered.[33]

More importantly, the search allows a lawyer to better advise his client as to a potential, future need to retain personal counsel. Finally, the search apprises a lawyer of a case' latent cost and permits him to accurately calculate its value.

B. Advise the Insured of Any Counterclaims or Cross Claims

If the insured possesses an affirmative claim, a lawyer should advise the insured of the claim and apprise her of the viable options. In doing so, however, the lawyer must be careful to ensure that the client does not develop a reasonable belief that the lawyer represents her as to such counterclaims.[34]

First, the lawyer should explain that a counterclaim or cross claim is available, from which the insured possibly could receive damages. The lawyer should advise the insured in writing about the consequences of failing to raise compulsory counterclaims and evaluate whether the insured's affirmative claim is compulsory.

Second, the lawyer should advise the insured of the law regarding the prosecution of affirmative claims, particularly in instances where an insurer is funding the defense. The general rule that an insurer's duty to defend does not encompass a duty to prosecute affirmative claims of the insured should be conspicuously explained. Assuming that the respective insurance policy follows the general rule, the affirmative claim may be prosecuted only if it is funded by the insured or the defense attorney. If the claim is compulsory, which in Georgia both cross claims and counterclaims arising under the same transaction or occurrence as the underlying case are, it is imperative that the lawyer emphasize that such claims are waived if not raised.[35] A lawyer's argument that the insured was apprised of all of the legal ramifications and knowingly waived such a claim is augmented by documentation of such a discussion.

Lastly, the lawyer should expound upon the insured's options. First, the insured could personally fund the affirmative claim and seek

reimbursement from the insurer under a subsequent declaratory judgment action.[36] This avenue could prove costly, however, because the insured is required to front the expenses required for prosecution of the affirmative claim and must pay the declaratory judgments costs. Second, the lawyer could opt to personally fund the prosecution of the affirmative claim. Finally, the lawyer, on behalf of the insured, could petition for the insurance company to cover the claim, despite a possibility of its non-coverage. Ultimately, this dilemma will be resolved based upon the insured's ability or desire to fund the affirmative claim.

C. For Non-Covered Claims, the Lawyer Should Advise the Insured To Obtain Consultation from Personal Counsel

If the insured and insurer have elected not to fund a compulsory counterclaim, the lawyer should advise the insured to consult a separate lawyer to counsel the insured regarding a proper litigation strategy. Upon the insured obtaining separate counsel, the lawyer should communicate that his representation of the insured relates to the covered claims only, such that the defense lawyer's comments regarding the affirmative claim cede to those of the insured's personal lawyer. This course of action minimizes the probability that an insured would mistakenly presume that her insurance defense lawyer is advising her as to affirmative claims. Further, this communication serves to reinforce the value of personal counsel.

Ideally, the insured would retain separate counsel to prosecute the affirmative claim. To minimize potential conflicts pertaining to litigation strategy, the insured should be encouraged to retain separate counsel to fund only the affirmative claims. Having different lawyers defend and prosecute the respective claims greatly diminishes, if not eliminates, the likelihood of a conflict in litigation strategy.

Georgia law contemplates this situation and its purposes in the comment that "when an insurer and its insured have conflicting interests in a matter arising from a liability insurance agreement, and the insured is required to provide special counsel for the insured, the arrangement should assure the special counsel's professional independence."[37] The retention of special counsel assuages concerns regarding potential conflicts and furthers a lawyer's professional independence.

Although it is ideal that separate lawyers handle these two claims, it is not categorically necessary. Specifically, Rule 1.8 of the American Bar Association Model Rules of Professional Conduct and Model Code of Professional Responsibility provide:

> (f) a lawyer shall not accept compensation for representing a client from one other than the client unless:
>
> > (1) the client consents after consultation;
> > (2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and
> > (3) information relating to representation of a

client is protected as required by Rule 1.6

This rule has been incorporated in Georgia's State Bar Rules and Regulations.[38] Thus, a lawyer who satisfies these professional obligations can reasonably defend the insured and prosecute a related affirmative claim without serious exposure. As always, documenting one's actions further reduces one's potential exposure for conflicts.

D. Prosecuting the Affirmative Claim *Pro Bono* Could Prove Beneficial to Defense Lawyers

Finally, a defense lawyer may contemplate prosecuting an affirmative claim on a *pro bono* basis. Although such an effort has immediate and tangible costs, it does provide reputational benefits and certainly garners loyalty from the insured.

Moreover, this behavior serves to improve the public's perception of the legal profession, thereby helping not only the lawyer individually but also the profession as a whole. Public trust in lawyers has consistently been regarded as particularly low.[39] Any effort made at an individual level to correct this misperception helps to turn the tide on this issue. Finally, prosecuting affirmative claims on a *pro bono* basis might not be expensive, given that such claims often overlap with an insured's defense.

End Notes

[1] Comment 6 provides, "When a lawyer has been retained by an insurer to represent an insured, for example, the representation may be limited to matters related to insurance coverage."

[2] Comment 8 provides, "All agreements concerning a lawyer's representation of a client must accord with the Rules of Professional Conduct and other law."

[3] Notably, however, Georgia bankruptcy courts have addressed the propriety of a lawyer contractually limiting an engagement scope. *In re Mathis*, 465 B.R. 325 (N.D. Ga. 2012) (stating that it was improper for a bankruptcy attorney to contractually exclude the defense of adversary proceedings from an engagement's scope).

[4] *James 3 Corp. v. Truck Ins. Exch.*, 91 Cal. App. 4th 1093, 1104 (2001) ("[t]here is nothing in the policy that contractually obligates [insurer] to fund and prosecute an insured's affirmative relief counterclaims or cross-complaints"); *Red Head Brass, Inc. v. Buckeye Union Ins. Co.,* 135 Ohio App. 3d 616 (1999).

[5] The "tripartite" relationship is the term describing the relationship among an insurer, its insured, and defense counsel.

[6] *Underwriters Ins. Co. v. Atlanta Gas Light Co.,* 248 F.R.D. 663 (N.D. Ga. 2008).

[7] *See Kennedy v. Jones,* 44 F.R.D. 52 (1968) ("It has been suggested that perhaps the counterclaim was not filed because Kennedy's counsel did not think that there was any insurance on the Jones Automobile. Nevertheless, the filing of a counterclaim for tactical defensive reasons is generally recognized as good practice.") Further, O.C.G.A. § 9-11-13(a) provides, in pertinent part, that "[a] pleading shall state as a counterclaim any claim which at the time of serving the pleading the pleader has against any opposing party, if it arises out of the transaction or occurrence that is the subject matter of the opposing party's claim and does not require for its adjudication the presence of third parties of whom the court cannot acquire jurisdiction." Accordingly, a client who reasonably believes that a lawyer represented him might argue that the lawyer's fiduciary duties obligated him to prosecute the client's affirmative claims.

[8] *Appleman on Insurance* § 16.04.

[9] Karon O. Bowdre, *Conflicts of Interest Between Insurer and Insured: Ethical Traps for the Unsuspecting Defense Counsel*, 17 Am. J. Trial Advoc. 101, 103 (1993) ("Indeed, the costs of defense form one reason why coverage is purchased").

[10] *See Auto-Owners Ins. Co. v. State Farm Fire & Cas. Co.,* 297 Ga. App. 751, 678 S.E.2d 196 (2009); *Nationwide Mut. Fire Ins. Co. v. Kim*, 294 Ga. App. 548, 669 S.E.2d 517 (2008).

[11] *Auto-Owners Ins. Co.,* 297 Ga. App. 751, 678 S.E.2d 196; *Nationwide Mut. Fire Ins. Co.*, 294 Ga. App. 548, 669 S.E.2d 517*; see also Lawyers Title Ins. Corp. v. Stribling,* 294 Ga. App. 382, 670 S.E.2d 154 (2008).

[12] *Driskell v. Empire Fire & Marine Ins. Co.,* 249 Ga. App. 56, 547 S.E.2d 360 (2001); *Lavoi Corp., Inc. v. Nat'l Fire Ins.,* 293 Ga. App. 142, 666 S.E. 387 (2008).

[13] *Driskell,* 249 Ga. App. 56, 547 S.E.2d 360; *Lavoi Corp., Inc.,* 293 Ga. App. 142, 666 S.E. 387*; Fireman's Fund Ins. Co. v. Univ of Ga. Athletic Ass'n.*, 288 Ga. App. 355 (2007).

[14] *Driskell,* 249 Ga. App. 56, 547 S.E.2d 360; *Lavoi Corp., Inc.,* 293 Ga. App. 142, 666 S.E. 387*; Fireman's Fund Ins. Co.*, 288 Ga. App. 355.

[15] *Driskell,* 249 Ga. App. 56, 547 S.E.2d 360; *Lavoi Corp., Inc.,* 293 Ga. App. 142, 666 S.E. 387*; Fireman's Fund Ins. Co.*, 288 Ga. App. 355.

[16] Regardless of coverage, however, an insurance company's interests may be best served through the assertion of a counterclaim to gain settlement leverage. *Wright v. Hartford Acc. & Indem. Co.*, 442 F. Supp. 155, 156 (N.D. Ga. 1977).

[17] *New Appleman on Insurance Law* § 16.06[ii].

[18] *Red Head Brass, Inc. v. Buckeye Union Ins. Co.,* 735 N.E.2d 48, 57 (1999).

[19] *Safeguard Scientifics, Inc. v. Liberty Mut. Ins. Co.,* 766 F. Supp. 324 (E.D. Pa. 1991), *reversed on other grounds*, 961 F.2d 209 (3rd Cir. 1992).

[20] *Id.*

[21] *Id.*

[22] *Id.*

[23] 315 F. Supp. 2d 879 (N.D. Ill. 2003)

[24] *Id.*

[25] *Id.*

[26] *IBP, Inc. v. Nat'l Union Fire Ins. Co.*, 299 F. Supp. 2d 1024 (D.S.D. 2003).

[27] *Id.* at 1030.

[28] *See, e.g., Int'l Ins. Co. v. Rollprint Packaging Prod., Inc.,* 312 Ill. App. 3d 998 (2000); *Duke Univ. v. St. Paul Mercury Ins. Co.,* 95 N.C. App. 63 (1989).

[29] *International Ins. Co.,* 312 Ill. App. 3d 998.

[30] *See, e.g., Smart Style Indus., Inc. v. Penn. Gen. Ins. Co.,* 930 F. Supp. 159 (S.D.N.Y. 1996); *Bennett v. St. Paul Fire & Marine Ins. Co.*, 2006 WL 1313059 (D. Me. 2006) ("counterclaim primarily seeks affirmative relief based on allegations that are only tangentially related to Liberty's complaint," and therefore the actions were not "inextricably intertwined").

[31] *Smart Style Industries, Inc.,* 930 F. Supp.159.

[32] *See generally Wright v. Hartford Acc. & Indem. Co.*, 442 F. Supp. 155, 156 (N.D. Ga. 1977).

[33] *See Kennedy v. Jones,* 44 F.R.D. 52 (1968) ("It has been suggested that perhaps the counterclaim was not filed because Kennedy's counsel did not think that there was any insurance on the Jones Automobile. Nevertheless, the filing of a counterclaim for tactical defensive reasons is generally recognized as good practice.").

[34] Thus, causing a potential malpractice claim.

[35] O.C.G.A. § 9-11-13 (counter-claims arising out of the same transaction or occurrence as the underlying case are compulsory and must be raised); *Fowler v. Vineyard*, 261 Ga. 454, 405 S.E.2d 678 (1991) and *Citizens Exch. Bank v. Kirkland*, 256 Ga. 71, 344 S.E.2d 409 (1986) (transactionally related cross-claims are mandatory).

[36] In Georgia, "an insured who has been compelled to conduct his own defense in a case in which the insurer had a duty to defend may recover the cost of the defense incurred (attorney's fees, etc.), and a bad faith (or stubbornly litigious) refusal to defend is the basis for an additional recovery for attorney's fees incurred by the insured in asserting his right of reimbursement against the insurer." *Am. Fid. & Cas. Co.,* 280 F.2d at 453 (applying Georgia law and citing *Md. Cas. Co. v. Sammons,* 63 Ga. App. 323, 11 S.E.2d 89 (1940)); *Milwaukee Mechs. Ins. Co. v. Davis,* 198 F.2d 441 (5th Cir. 1952).

[37] Rule 1.7, Georgia Rules of Professional Conduct.

[38] Rule 1.8(f), Georgia Rules of Professional Conduct.

[39] Paul M. Lisnek, *The Art of Lawyering* 12 (2010, Sphinx Publishing); Richard L. Abel, Phillip S. C. Lewis, *Lawyers in Society* 131 (1988, Univ. of Cal. Press).