

Tri-Partite Relationship Did Not Result in Bad Faith Exposure

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Summary: The insureds sued their homeowners' insurer and the defense attorneys hired by the insurer alleging bad faith in handling their claim, legal malpractice, and breach of fiduciary duty. The insurer resolved the bad faith claim by funding a settlement of the underlying third party claim. The Court of Appeals affirmed judgment entered in favor of the defense attorneys after an analysis of the challenging relationship between insurer, defense attorney, and insured. This case serves as a reminder that proper handling of the tri-partite relationship is necessary whenever the insurer has a duty to defend; otherwise, the insurer may face bad faith exposure.

Arden v. Forsberg & Umlauf, P.S.

The Ardens were sued by their neighbors after Mr. Arden shot and killed the neighbors' puppy. Hartford insured the Ardens and agreed to provide them with a defense under a reservation of rights. Hartford hired attorneys Hayes and Gibson from the law firm of Forsberg & Umlauf, P.S. to defend the Ardens. This firm had handled other matters for Hartford, including its coverage matters.

The Ardens accepted the defense from Hartford under a reservation of rights, but also hired their own private counsel. At the beginning of the representation, Hayes and Gibson sent a letter to the Ardens explaining they represented the Ardens and not Hartford in the lawsuit.

The neighbors made an early settlement demand to the Ardens. Hartford requested a delay in responding to the initial settlement demand until discovery was answered. Thereafter, several settlement offers and demands were exchanged. The Ardens and/or their personal counsel were advised of the demands and offers. Eventually settlement negotiations broke down. Immediately thereafter, the County Prosecuting Attorney filed criminal charges against Mr. Arden related to the death of the puppy.

The Ardens then filed a lawsuit against Hartford and the defense attorneys asserting claims for bad faith handling of the claim, legal malpractice, and breach of fiduciary duty. Settlement negotiations with the neighbors resumed, and Hartford funded a settlement. The neighbors agreed to recommend to the prosecutor that the criminal charges be dropped, and the Ardens dismissed their claim against Hartford. The trial court granted the defense attorneys' summary judgment on the legal malpractice and breach of fiduciary duty claims, and the Ardens appealed.

On appeal, the Ardens first argued the firm breached its fiduciary duty of loyalty to them by defending them in a reservation of rights context while also representing Hartford in other cases, including in coverage cases. The court held as a matter of law that the firm's representation of Hartford did not create a conflict of interest and that the firm had no obligation to notify the Ardens that they represented Hartford in other matters. The court concluded that an attorney who represents an insurer in coverage cases is not automatically prohibited from representing that insurer's insured when the insurer reserves its right to deny coverage.

Second, the Ardens argued the firm breached its fiduciary duty of loyalty to them during settlement negotiations. The court held (1) the firm had no duty to persuade Hartford to accept the settlement offers, especially since the Ardens had personal counsel that could do that, (2) there was no evidence the firm breached a duty regarding the Ardens' interest in a swift resolution to the lawsuit, and (3) there was no evidence that any alleged breach of the firm's duty to consult with the Ardens before rejecting settlement demands injured the Ardens.

Third, the Ardens argued the firm was negligent in requesting an extension of the start of settlement negotiations when the Ardens had an interest in a prompt settlement. The court held the evidence did not support that there was any such negligence, and that the attorney judgment rule precluded liability.

The court affirmed summary judgment in favor of the firm. This case helps demonstrate that it is possible for both defense counsel and the insurance carrier to protect themselves from bad faith and legal malpractice exposure when the same firm sometimes defends insureds and at other times handles coverage matters for that carrier.

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