No. 93207-7

No. 46991-0-II

Court of Appeals, Div. II, of the State of Washington

Roff Arden and **Bobbi Arden,**

Appellants,

v.

Forsberg Umlauf, P.S., et al.,

Respondents.

Brief of Appellants

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1. Introduction

Forsberg & Umlauf attorneys John Hayes and William "Chris" Gibson were appointed by Hartford, Ardens' insurer, to defend Ardens under a reservation of rights. Forsberg had a long-standing attorney-client and business relationship with Hartford, but did not advise Ardens of that relationship. Forsberg's conflict of interest, which should have disqualified it from representing Ardens, caused Forsberg to breach its fiduciary duties of undeviating loyalty to Ardens. Forsberg failed to advise Ardens of potential and actual conflicts of interest, failed to confer with Ardens regarding settlement decisions, and ultimately placed the interests of Hartford above the interests of Ardens.

Ardens sued Forsberg for legal malpractice and breach of fiduciary duties. The trial court erroneously dismissed both claims on summary judgment. Ardens' evidence set forth specific facts supporting the elements of their claims. The undisputed facts show that Forsberg breached its fiduciary duties under the RPCs and under *Tank v. State Farm Fire & Cas. Co.*, 105 Wn.2d 381, 715 P.2d 1133 (1986), entitling Ardens to disgorgement of all fees and costs received by Forsberg in connection with the representation. This Court should reverse the trial court's erroneous orders.

Ardens ask this Court to also recognize that insurance-assigned defense counsel stands in the position of a trustee over the insurance defense asset, which it must manage for the sole benefit of the insured client. Breach of trust entitles the client to additional equitable remedies.

2. Assignments of Error

1. The trial court erred in granting Defendants' motion for summary judgment on Ardens' legal malpractice claims where there were material issues of fact as to proximate cause and the availability of emotional distress damages.

2. The trial court erred in denying Ardens' motion for reconsideration of the first summary judgment order.

3. The trial court erred in granting Defendants' motion for summary judgment on Ardens' breach of fiduciary duty claims where Ardens' evidence set forth specific facts supporting each of the elements of their claims.

4. The trial court erred in denying Arden's motion for partial summary judgment of liability for breach of fiduciary duty where the undisputed evidence established Forsberg's breach of fiduciary duties.

Issues related to assignments of error

Whether insurance-appointed defense counsel stands in the position of a trustee over the insured's asset of insurance defense (assignments of error 3 and 4).

Whether Forsberg breached its fiduciary duties as attorneys and trustees by failing to advise Ardens of potential or actual conflicts of interest and failing to resolve those conflicts in favor of Ardens (assignments of error 3 and 4).

Whether Defendants breached their fiduciary duties as attorneys and trustees by placing the interests of Hartford above the interests of Ardens (assignments of error 3 and 4).

Whether there were material issues of fact on the element of proximate cause in Ardens' legal malpractice claim, precluding summary judgment dismissal (assignments of error 1 and 2).

Whether there were material issues of fact regarding the availability of emotional distress damages under *Schmidt v. Coogan*, 181 Wn.2d 661, 335 P.3d 424 (2014) (assignments of error 1 and 2).

3. Statement of the Case

3.1 Forsberg was appointed by Hartford to defend Ardens in *Duffy v. Arden*.

Roff and Bobbi Arden were sued by Anne and Wade Duffy for negligent or intentional property damage and emotional distress. CP 855, 904. Ardens tendered defense of the case to their insurer, Property and Casualty Insurance Company of Hartford. CP 856, 904. Hartford initially refused to defend. CP 904. Ardens hired attorney Jon E. Cushman, who pressured Hartford to accept the tender of defense. CP 855-56.

Hartford eventually accepted, appointing attorneys John P. Hayes and William C. "Chris" Gibson of the firm Forsberg & Umlauf, P.S. to defend Ardens. CP 130; 445-46. Hartford informed Forsberg & Umlauf that the defense would be under a reservation of rights. *See* CP 208, 318, 320. Although the reservation of rights letter was not issued until months later,

Hayes and Gibson recognized from the outset that a coverage dispute was likely to arise between Ardens and Hartford. CP 169, 208.

Hartford was a long-standing client of Forsberg & Umlauf in coverage disputes. Four partners, including Hayes, regularly represented Hartford as coverage counsel. CP 203-04. Neither Hayes nor Gibson ever informed Ardens of this pre-existing attorney-client relationship with Ardens' insurer. CP 227, 229, 430. Neither Hayes nor Gibson ever informed Ardens of any potential conflict of interest that may have arisen from Forsberg & Umlauf's relationship with and duties to Hartford. CP 430. Had Ardens known of the relationship, they would not have accepted Forsberg & Umlauf as defense counsel. CP 227, 229.

Gibson met with Ardens and Cushman within a few weeks of being appointed. CP 483-84; 546. During that meeting, Gibson explained to Ardens that his duties were solely to Ardens as clients. CP 173. Gibson told Ardens that he would attempt to get Hartford to pay the full amount of any liability, despite the reservation of rights. CP 173. Cushman would remain involved in the case as personal counsel and to prosecute Ardens' counterclaims. CP 166.

Ardens explained to Gibson the circumstances surrounding Duffys' claims. Duffys alleged that Roff Arden negligently or maliciously shot and killed two of Duffys' dogs. CP 445. Duffys lived over 200 yards away from Ardens in a rural area in Mason County. CP 536. Duffys habitually allowed their dogs to roam free. CP 536. On multiple occasions, Duffys' dogs came onto the Arden property and threatened and chased Ardens. CP 536-37.

Roff Arden suffers from post-traumatic stress disorder (PTSD) as a result of physical and mental abuse as a child. CP 573. He was re-traumatized in 2010 by a painful, unexpected eye procedure. CP 572-73. His PTSD manifests as acute anxiety attacks or bouts of depression, difficulty trusting others, and an intense fight-or-flight response. CP 574, 586. Arden also suffers from a fear of dogs as the result of a previous dog attack. CP 589-90.

Arden had explained his mental condition to Anne Duffy in 2009. CP 538, 540. Two of Duffys' dogs startled Arden while he was working with caustic chemicals outside his studio. CP 540, 599. Arden warned Anne Duffy that the dogs could not be around the studio. CP 540, 599. Nevertheless, Duffys continued to allow their dogs to wander free and to menace Ardens on Ardens' property. *See* CP 538-39, 599. Arden admitted to Gibson that he shot Duffys' yellow lab in the midst of a PTSD-induced fight-or-flight response when two of Duffys' dogs chased Ardens halfway down their driveway. CP 585-86. A police report claimed that Arden admitted to having shot another dog 15 months earlier, but Arden maintained he did not. CP 585. The report, which Gibson reviewed, recommended felony criminal charges against Roff Arden. CP 484, 491.

Coming out of the meeting with Gibson, Ardens understood that Gibson would evaluate Hartford's exposure in the case and then get back in touch with Ardens. CP 546. Gibson had informed Ardens that it was his "practice," generally, to try to get the insurer to pay the full amount even in a reservation-of-rights case. CP 173. Neither Gibson nor Hayes ever contacted Ardens to discuss a specific litigation or settlement strategy. CP 574, 582.

3.2 Forsberg followed Hartford's settlement instructions despite opposition from Ardens.

On January 18, 2013, one month after this initial meeting, Duffys' attorney, Adam Karp, sent Gibson and Cushman a settlement demand for $55,000, which was set to expire on January 28. CP 255. After consulting with Ardens, Cushman informed Gibson that Ardens wanted to accept the offer so long as Hartford paid the settlement. CP 256, 617. Through Cushman, Ardens instructed Gibson to communicate their position to Hartford as a demand that Hartford fund the settlement. CP 256. Hayes claims he did so by phone, CP 214, but the written evidence shows only that when Gibson notified Hartford of the Duffys' offer, he blandly asked, "Please get back to me and Mr. Cushman very soon as to whether Hartford will fund a response to the offer accepting it." CP 328. Cushman immediately followed with an email to Hartford demanding that Hartford fund the settlement. CP 329. Gibson admits he did not communicate Ardens' demand to Hartford. CP 188.

Hayes suggested that Gibson ask Karp for an extension of the deadline, to give Hayes and Gibson time to receive Duffys' interrogatory responses and evaluate the damage claims. CP 189-90. Neither Hayes nor Gibson consulted with Ardens or Cushman regarding the extension. CP 189, 208. Hayes only informed Cushman after the extension had already been requested. CP 331. Cushman immediately expressed displeasure, asking if Hartford was refusing Ardens' demand to fund the settlement. CP 332. Hartford responded that it needed further information to evaluate the case

before funding a settlement. CP 333. Cushman pressured Hartford to fund the settlement or to defend without any reservation of rights. CP 336, 344. Karp extended the deadline on the offer to March 4 at 5 p.m. CP 341.

After receiving Duffys' discovery responses, Hayes and Gibson prepared a case analysis for Hartford. CP 253. They recommended attempting to settle the case at up to $35,000. CP 468-69. Cushman reviewed the report before it was sent to Hartford, recommending insertion of "negligence" throughout when describing Duffys' claims. CP 474. Although Cushman expressed confidence in being able to get the case settled at $35,000, he had previously noted that his review was "solely from a coverage perspective, not from case valuation perspective." CP 475.

On March 4 at 6:29pm, Hartford notified Cushman that it was letting the Duffys' settlement offer expire. CP 262. The next morning, Hayes notified Cushman that Hartford had given him settlement authority up to $35,000 and that he was going to start with a counteroffer of $18,000. CP 263. Eight minutes later, Gibson sent an email to Karp referencing a voice message he had already left at Karp's office that morning regarding "a settlement offer from the Ardens funded by Hartford." CP 878. Neither Hayes nor Gibson had consulted with Ardens or sought their approval of the counteroffer. CP 183, 210.

Karp responded to the $18,000 counteroffer on March 10, stating, "My clients reject the counteroffer as wholly inadequate and extend no new offer." CP 719. Cushman contacted Karp and convinced him to make a "last best offer" on behalf of Duffys. CP 760. Karp contacted Cushman and

Gibson on March 12 with an offer at $40,000, set to expire March 14 at 5 p.m., noting, "I have no more room to move." CP 882. Cushman, on behalf of Ardens, again demanded that Hartford fund the settlement. CP 883.

On March 14 at 10:47 a.m., Hartford notified Cushman and Hayes that it would not fund the settlement at $40,000 and that it intended to make a counteroffer at $25,000. CP 767. Cushman objected, warning Hartford and Hayes that their proposed course was bad faith. CP 770. By 11:34 a.m., Hayes had made Hartford's counteroffer. CP 267. Neither Hayes nor Gibson had consulted with Ardens or sought their approval before making the counteroffer. CP 198, 219. Neither Hayes nor Gibson had invited Ardens to contribute toward bridging the $5,000 gap between Hartford's funding and the Duffy's offer. CP 574-75.

Duffys rejected the $25,000 counteroffer and refused to negotiate further. CP 890. Karp later notified Hayes and Gibson that Duffys would not participate in any further negotiation unless Ardens offered over $55,000. CP 221. On March 19, Roff Arden learned that felony charges had been filed against him. *See* CP 798-99, 892.

Throughout the failed settlement process, Ardens felt that they were not being properly represented. CP 228. Ardens felt Gibson was not keeping them informed of developments. CP 655. Ardens felt Hayes and Gibson never explained any plan or strategy behind their settlement decisions. CP 574. Ardens felt Hayes and Gibson responded to and obeyed Hartford but never responded to Ardens. CP 582. Ardens felt Hayes and Gibson

ignored Roff Arden's mental infirmities and potential criminal jeopardy. CP 574, 582. Ardens felt Hayes and Gibson represented Hartford, not Ardens. CP 574.

Despite Ardens' desire for a quick settlement in hopes of avoiding criminal charges and minimizing the mental health impacts of the litigation, *see* CP 857, Hayes and Gibson followed Hartford's deliberate, low-ball strategy for settlement, *see* CP 111, 143, 152, 219. Despite Gibson's understanding that the insured client has the right to participate in settlement negotiations in a reservation-of-rights defense, CP 171-72, Gibson never involved Ardens in any settlement-related decisions, CP 865. Despite Hayes' understanding that he owed a duty of undivided loyalty to Ardens, CP 208, Hayes obediently carried out Hartford's instructions over Ardens' objections, CP 219.

Ardens sued Hartford for bad faith, later adding claims of legal malpractice and breach of fiduciary duties against Forsberg & Umlauf, Hayes, and Gibson. RP 19; Supp. RP 2. A global mediation was held, at which Ardens, Duffys, and Hartford settled the claims between them for $75,000 paid by Hartford to Duffys. RP 19. Only Ardens' claims against Forsberg & Umlauf, Hayes, and Gibson remained. RP 19.

3.3 The trial court dismissed Ardens' claims on summary judgment.

After a contentious discovery process, the parties made cross-motions for summary judgment on the legal malpractice claims. Defendants argued that Ardens could not produce evidence to support any of the

elements of duty, breach, proximate cause, or injury and damages. CP 825. Ardens' motion, which also served as their response to Defendants' motion, sought partial summary judgment of liability for legal malpractice. CP 396, 415. Ardens argued that Defendants committed malpractice by failing to communicate with and advise Ardens, failing to follow Ardens' direction, and placing the interests of Hartford above Ardens' interests. CP 404.

The trial court denied Ardens' motion and granted Defendants' motion, dismissing Ardens' legal malpractice claim but leaving Ardens' breach of fiduciary duty claim for later determination. CP 249-50; Supp. RP 2-3, 6.[1] The court held that it was clear that there was an attorney-client relationship between Ardens and Defendants giving rise to duties owed by Defendants to Ardens. Supp. RP 3-4. The court held that there were disputes of fact as to whether Ardens and Hartford's positions were in conflict and whether Defendants' conduct breached their duties to Ardens. *Id.* at 4. Nevertheless, the court held that any breach did not cause Roff Arden to be charged with a crime and that attorney fees and emotional distress damages were not recoverable in a legal malpractice claim. *Id.* at 5-6.

Ardens made a motion for reconsideration, arguing that there were material issues of fact as to causation of the criminal charges and the

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[1] The verbatim report of proceedings was supplemented by order of the commissioner on motion of the parties to include the October 1, 2014, oral ruling of the trial court. The supplemental transcript is referred to herein as "Supp. RP," while the originally filed report of proceedings is referred to as "RP."

availability of emotional distress damages. CP 78. The trial court denied the motion. RP 94; CP 19-20.

The parties made a second set of cross-motions for summary judgment to address the breach of fiduciary duty claim. Ardens argued that Defendants had breached their duty of loyalty to Ardens "by taking on a representation from which they were disqualified by conflicts of interest; failing to communicate with Ardens; failing to keep Ardens apprised of all activity involving settlement; failing to consider Ardens' mental helath condition and criminal jeopardy; and placing the interests of the insurer above the interests of Ardens, their clients." CP 236-37. Ardens argued that the fiduciary relationship between insurance defense counsel and the insured client is impressed with a trust, entitling Ardens to equitable remedies such as disgorgement of fees for Defendants' breach of trust. CP 241-43.

Defendants argued that there was no conflict of interest and therefore no breach of fiduciary duty. CP 89. Defendants argued that Ardens could not establish proximate cause of any injury and that Ardens were not entitled to disgorgement or other remedies. CP 93, 96.

The trial court denied Ardens' motion and dismissed the remainder of Ardens' claims. RP 94. The court ruled that there was no disqualifying conflict of interest in Defendants taking on the representation, and therefore no breach of fiduciary duty. RP 84-85. The court commented that Ardens' trust theory was "interesting and somewhat compelling," but the court did not find it supported by precedent. RP 94. The decision disposed of all of Ardens' claims. CP 24. Ardens appealed. CP 5.

4. Summary of Argument

The trial court erred in denying Ardens' motion for partial summary judgment on Forsberg's liability for breach of fiduciary duties and in dismissing Ardens' claims. Part 5.2 outlines the fiduciary duties Forsberg owed to Ardens as clients: the ordinary duties owed by an attorney to a client, enhanced duties under *Tank*, and the duties of a trustee over the insurance defense asset. Part 5.3 demonstrates that Forsberg breached those duties by failing to disclose and resolve conflicts of interest in favor of Ardens and by placing the interests of Hartford above the interests of Ardens, the insured clients. Part 5.4 explains how the remedy of disgorgement of fees for breach of fiduciary duties and other equitable remedies for breach of trust naturally follow.

Ardens presented sufficient evidence to the trial court to establish Forsberg's duties and breach. This Court should reverse the trial court's second summary judgment order, grant summary judgment in favor of Ardens on the issues of duty and breach, and remand to the trial court for a determination of damages.

The trial court also erred in granting summary judgment dismissal of Ardens' legal malpractice claim. Part 5.5 demonstrates that there were material issues of fact precluding summary judgment on the legal malpractice claim. This Court should reverse the trial court's first summary judgment order and remand for further proceedings.

5. Argument

5.1 Summary judgment rulings are reviewed *de novo.*

This Court reviews summary judgment orders *de novo. Schmitt v. Langenour*, 162 Wn. App. 397, 404, 256 P.3d 1235 (2011). The Court engages in the same inquiry as the trial court. *Labriola v. Pollard Group, Inc.*, 152 Wn.2d 828, 832, 100 P.3d 791 (2004). Summary judgment is only proper where there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. CR 56(c). In determining the existence of an issue of material fact, the court views all facts and inferences in favor of the nonmoving party. *Michael v. Mosquera-Lacy*, 165 Wn.2d 595, 601, 200 P.3d 695 (2009). "[A] court must deny summary judgment when a party raises a material factual dispute." *Smith v. Safeco Ins. Co.*, 150 Wn.2d 478, 485-86, 78 P.3d 1274 (2003).

5.2 Forsberg owed fiduciary duties of undeviating loyalty to Ardens.

It is undisputed that Hayes, Gibson, and Forsberg & Umlauf (collectively, "Forsberg") had an attorney-client relationship with Ardens. Forsberg was assigned to represent Ardens in the *Duffy* matter under a reservation of rights. By virtue of the appointment as insurance defense counsel under a reservation of rights, Forsberg owed some specific, fiduciary duties to Ardens. First, Forsberg owed the ordinary fiduciary duties of any attorney to a client. Second, Forsberg owed enhanced *Tank* duties because of Hartford's reservation of rights. Third, Forsberg owed duties of a trustee over Ardens' insurance defense asset.

5.2.1 Forsberg owed Ardens the fiduciary duties ordinarily owed by an attorney to a client.

"[T]he attorney-client relationship is a fiduciary one as a matter of law and thus the attorney owes the highest duty to the client." *Versuslaw Inc. v. Stoel Rives, LLP*, 127 Wn. App. 309, 333, 111 P.3d 866 (2005). An attorney's fiduciary duties are outlined in the Rules of Professional Conduct. *See Cotton v. Kronenberg*, 111 Wn. App. 258, 265-66, 44 P.3d 878 (2002) (holding the RPCs may be considered in determining whether an attorney breached fiduciary duties). An attorney owes undeviating loyalty to a client.

The client of insurance-appointed defense counsel is the **insured defendant,** not the insurance company. *Tank v. State Farm Fire & Cas. Co.*, 105 Wn.2d 381, 388, 715 P.2d 1133 (1986). An insurance company has only a "quasi-fiduciary" duty: to never put its own interests ahead of the interests of its insured. *Am. Best Food, Inc. v. Alea London, Ltd.*, 168 Wn.2d 398, 405, 229 P.3d 693 (2010). However, **counsel** appointed by an insurer is a **true fiduciary,** owing "undeviating fidelity" solely to the **insured client—"No exceptions can be tolerated."** *Tank*, 105 Wn.2d at 388 (quoting *Van Dyke v. White*, 55 Wn.2d 601, 613, 349 P.2d 430 (1960)) (emphasis added).

Insurance defense counsel cannot allow the interests of the insurance company to influence his or her professional judgment under any circumstances. *Tank*, 105 Wn.2d at 388; *see* RPC 1.8(f)[2]; RPC 5.4(c)[3]. Defense

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[2] RPC 1.8(f) allows third-party payment of the lawyer's fee for representing a client only if "there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship."

counsel must consider all interests of the insured client, including interests that are secondary to the goal of defending the claim. William T. Barker, et al., *Insurer Litigation Guidelines: Ethical Issues for Insurer-Selected and Independent Defense Counsel*, ABA Section of Litigation 2012 Insurance Coverage Litigation Committee CLE Seminar, March 1-3, 2012, at p. 5.[4] The insured client should never have cause to question who defense counsel actually represents. Thomas V. Harris, *Washington Insurance Law*, § 17.05 (3d ed. 2010).

The Rules of Professional Conduct provide that "a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if: (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." RPC 1.7(a).

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[3] RPC 5.4(c) provides: "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."

[4] available at http://www.americanbar.org/content/dam/aba/administrative/litigation/materials/2012_inscle_materials/23_1_guidelines.authcheckdam.pdf (accessed May 7, 2015). This multi-state source speaks largely in terms of the majority rule that defense counsel represents both the insured and the insurer as joint clients. However, the principles apply with even greater force to Washington's minority rule, in which the insured is defense counsel's **only** client. "A conflict that would preclude joint representation would also preclude, absent informed consent by the policyholder, acceptance of insurer direction by counsel. And if counsel had a regular ongoing relationship with the insurer, the lawyer's personal interest in pleasing the insurer could create a conflict in the same way that a legal duty of loyalty would." Barker, et al., *Ethical Issues*, at 3-4.

Rule 1.7 requires a lawyer to withdraw or obtain informed consent not only when there is an actual conflict, but any time there is **potential** conflict. *In re Disciplinary Proceeding Against Marshall*, 160 Wn.2d 317, 336-37, 157 P.3d 859 (2007). A potential conflict exists when a lawyer foreseeably might be tempted to favor an interest of the lawyer or of a non-client at the expense of an interest of the client; an actual conflict ripens when a lawyer must choose a course of action and the question is whose interest will be sacrificed. *See* William T. Barker & Charles Silver, *Professional Responsibilities of Insurance Defense Counsel*, § 12.02 (2014).

A direct conflict exists when the manner of handling the defense could affect the determination of coverage or otherwise benefit the insurer at the policyholder's expense. Barker, et al., *Ethical Issues*, at 6. For example, where a claim alleges in the alternative that the policyholder's conduct was either negligent (covered) or intentional (generally not covered), the insurer might request a defense that would increase the likelihood of a finding of intent. *Id.* at 8, 9. This is one of the conflicts "inherent" in a reservation of rights defense. *See Tank*, 105 Wn.2d at 387.

A conflict can arise when the insured client has collateral interests that lead to a desire for a defense or settlement strategy different from the favored strategy of the insurer (which is generally to minimize the total cost of the claim). Barker & Silver, *Professional Responsibilities*, § 12.01. For example, a desire to avoid criminal jeopardy arising from the facts of the case would be one such collateral interest. *Id.* Any indication that the policyholder may

have divergent interests from those of the company requires defense counsel to consult with the policyholder to identify and address any conflict. *Id.*

A conflict also arises when instructions from the insurer are contrary to the expressed desires of the insured client. Defense counsel's duty of loyalty does not permit him or her to disregard instructions from the insured client. *See* RPC 1.2(a); RPC 1.4(a)(2). Even where the insurer has the right to control the defense,[5] counsel must obtain the client's prior approval regarding settlement decisions. Barker, et al., *Ethical Issues*, at 13-15.

When any of these conflicts arise, potential or actual, it is defense counsel's duty to consult with the insured client to seek a resolution and informed consent or to withdraw. *See* RPC 1.7, Comments [2]-[4].

5.2.2 Forsberg owed enhanced duties under *Tank* because the defense was under a reservation of rights.

When insurance defense is undertaken under a reservation of rights, both insurers and defense counsel have **enhanced obligations** due to the potential conflicts of interest inherent in that type of defense. *Tank*, 105 Wn.2d at 387. Defense under a reservation of rights is "fraught with potential conflicts." *Nat'l Sur. Corp. v. Immunex Corp.*, 176 Wn.2d 872, 879, 297 P.3d 688 (2013). Because of these potential conflicts, the insured client is put at risk that insurance-assigned defense counsel's advice might be affected by counsel's loyalty to the insurer or personal interest in cultivating the insurer's favor. Barker, et al., *Ethical Issues*, at 3. To fulfill the duty of loyalty,

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[5] Note, however, that in a reservation of rights defense it is the insured client who is entitled to control settlement. Harris, *Washington Insurance Law*, § 17.07

defense counsel "must be vigilant in identifying any potential conflicts of interest" and must resolve them in favor of the insured client. Harris, *Washington Insurance Law*, § 17.05.

Defense counsel retained by an insurer to defend the insured under a reservation of rights must meet distinct criteria.

> Rules of Professional Conduct 5.4(c) prohibits a lawyer, employed by a party to represent a third party, from allowing the employer to influence his or her professional judgment. In a reservation of rights defense, RPC 5.4(c) demands that counsel understand that he or she represents only the insured, not the company. As stated by the court in *Van Dyke v. White*, 55 Wn.2d 601, 613, 349 P.2d 430 (1960), "[t]he standards of the legal profession require undeviating fidelity of the lawyer to his client. No exceptions can be tolerated."

Tank, 105 Wn.2d at 388.

In addition to absolute loyalty to the insured client, defense counsel owes a three-part duty of "full and ongoing disclosure to the insured:"

1. "potential conflicts of interest between insurer and insured must be fully disclosed and resolved in favor of the insured;"
2. "all information relevant to the insured's defense … must be communicated to the insured;" and
3. "all offers of settlement must be disclosed to the insured as those offers are presented. … [T]he insured must be fully apprised of all activity involving settlement."

Tank, 105 Wn.2d at 388-89. This duty of communication is not well understood by all defense counsel but may be one of counsel's most important duties, particularly from the standpoint of the insured client. Barker, et al., *Ethical Issues*, at 12.

When a potential conflict is identified, defense counsel's duty of "full and ongoing disclosure" requires in-depth consultation with the insured client, which should include the following:

- Explain the nature of the potential conflict.
- Identify defense counsel's obligation to the insurer[6] to defend in a manner that will minimize the loss.
- Identify defense counsel's duty to the policyholder not to act in disregard of the policyholder's express desires.
- Explain that the representation can continue as long as the potential conflict is not likely to ripen into an actual conflict.
- Explain the costs and benefits to the policyholder of waiving the potential conflict.
- Explain that a time may come when defense counsel's responsibilities to the insurer and the policyholder will actually conflict. When this happens the policyholder will have to decide whether to protect the identified interest or to compromise that interest and permit counsel to proceed as desired by the insurer.
- Explain that defense counsel will respect the policyholder's decision, but may withdraw if the policyholder refuses to consent to the insurer's desired course of action.
- Explain, as applicable, that the policyholder's decision involves questions on which defense counsel cannot advise the policyholder (such as coverage) but concerning which the policyholder may obtain advice from independent counsel retained and paid for by the policyholder.

Barker & Silver, *Professional Responsibilities*, § 12.03.

When the insured client disagrees with a course of action directed by the insurer, defense counsel must first confer with the insurer's representative

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[6] Although defense counsel owes no duties of loyalty to the insurer, counsel does have contractual obligations and may have a personal interest in pleasing the insurer.

and explain how the insurer's proposed course of action places the insured client's interests at risk. Barker, et al., *Ethical Issues*, at 19. If the insurer does not withdraw or modify its instruction, defense counsel must consult with the insured client, as above, to seek informed consent to proceed according to the insurer's instruction. *Id.* at 20. If the insured client does not consent, defense counsel must withdraw. *Id.* at 21.

5.2.3 Forsberg owed the fiduciary duties of a trustee over Ardens' asset of insurance defense.

In addition to the ordinary fiduciary duties of any attorney to his or her client and the enhanced duties of insurance-assigned defense counsel under a reservation of rights, defense counsel owes the insured client the duties of a trustee managing a valuable asset for the benefit of the client.

When a person purchases a liability insurance policy, they purchase two valuable insurance assets: defense and indemnity. *See Woo v. Fireman's Fund Ins. Co.*, 161 Wn.2d 43, 54, 164 P.3d 454 (2007) ("The duty to defend is a valuable service paid for by the insured and one of the principal benefits of the liability insurance policy."); CP 106, 107 (Forsberg's expert Jeffrey Tilden described the insurance policy as consisting of these two, valuable "assets"). When the insured is sued and the insurer carries out its duty to defend, defense counsel assigned in accordance with the policy becomes a trustee over the insurance defense asset. Defense counsel's fees and costs of the defense are paid out of that asset, which is managed on the basis of defense counsel's independent, professional judgment. Defense counsel's fiduciary duties, outlined above, require him or her to manage the insurance defense

asset for the sole benefit of the insured. This relationship has all of the essential elements of a trust.

A trust is "a fiduciary relationship in which one person holds a property interest, subject to an equitable obligation to keep or use that interest for the benefit of another." Bogert, George G., et al., *The Law of Trusts and Trustees*, § 1 (3d ed. 2007); *see also* Restatement 2d of Trusts, § 2. Here, the trust property is the insurance defense asset. The trustee who holds and manages that property is insurance-assigned defense counsel. Defense counsel is under an obligation to use the property solely for the benefit of the insured client. Defense counsel owes fiduciary duties to the insured client, including duties of care and undeviating loyalty in managing the defense. The parties create the trust by way of the insurance policy and the acceptance by the insured client of representation by assigned counsel. All of the essential elements of a trust relationship are present.

Even if an insurance policy is not expressly intended to create a formal trust, this result is appropriate. It is a resulting trust, which exists by implication, "based on the idea that the law should presume or infer or create a trust if parties put themselves into a certain situation." Bogert, *Trusts and Trustees*, § 452. Here, the parties—the insurer, the insured, and insurer-assigned defense counsel—have structured a relationship that bears all of the characteristics of a trust. This Court should hold that the fiduciary relationship between insurance-assigned defense counsel and the insured client is impressed with a trust, in which insurance defense counsel becomes

a trustee over the insurance defense asset, which counsel must manage for the sole benefit of the insured.

Because the relationship is a trust, defense counsel owes the insured client the duties of a trustee and is subject to the remedies imposed for breach of trust duties. The most fundamental duty of a trustee is that of loyalty: the trustee must display "complete loyalty to the interests of the beneficiary and must exclude all selfish interest and all consideration of the interests of third persons." Bogert, *Trusts and Trustees*, § 543. The trustee may not take a position in which his personal interest or the interest of a third party is or becomes adverse to the interest of the beneficiary. *Id.* A trustee with a conflict of interest must eliminate the conflicting interest or resign as trustee. *Id.* A trustee also has a duty to deal with the beneficiary with "utmost frankness and fair play," including "full disclosure and high regard for the interest of the [beneficiary]." *Id.*, § 544.

The trustee's duty of loyalty is so important that, when crafting an equitable remedy for breach of trust, actual financial damage to the beneficiary is immaterial; rather, the court seeks to render the disloyalty of the trustee "so prejudicial to him that he and all other trustees will be induced to avoid disloyal transactions in the future." Bogert, *Trusts and Trustees*, §§ 543, 543(V).

These duties are familiar. As discussed above, an attorney owes undeviating loyalty to his or her client. Insurance-assigned defense counsel owes an additional, enhanced duty of loyalty, including "full and ongoing disclosure" of information related to the defense. The duties of a trustee are

similar. Formally recognizing that the parties to an insurance defense arrangement have created a trust relationship would not significantly change defense counsel's duties to the insured client, which already require the utmost fidelity to the client's interests. Defense counsel's status as a trustee over the insurance defense asset is the natural result of the relationship the parties have voluntarily created.

This Court should hold that insurance-assigned defense counsel stands in the position of a trustee managing the insurance defense asset for the benefit of the insured client. Because Forsberg breach its duties—its ordinary fiduciary duties, its enhanced *Tank* duties, and trust duties—the trial court erred in denying Ardens' motion and dismissing Ardens' claims. This Court should reverse.

5.3 Forsberg breached its duty of loyalty to Ardens.

As set forth above, Forsberg, as insurance-assigned defense counsel under a reservation of rights, owed Ardens specific, enhanced duties. Forsberg breached those duties by taking on the representation without ever advising Ardens or seeking Ardens' informed consent for actual and potential conflicts of interest in the representation. Forsberg also breached its duties by placing the interests of Hartford above the interests of Ardens. These breaches also constitute breaches of Forsberg's duties as trustee over the insurance defense asset. The trial court should have granted Ardens' motion for partial summary judgment of liability for Forsberg's breach of fiduciary duties.

5.3.1 Forsberg failed to advise Ardens and seek Ardens' informed consent for actual and potential conflicts of interest in the representation.

Under *Tank*, Forsberg had heightened duties, including a duty to fully disclose not only actual, concurrent conflicts of interest but potential conflicts of interest as well, and to resolve those conflicts in favor of Ardens. Forsberg breached that duty by taking on the representation of Ardens under a reservation of rights without advising Ardens of potential conflicts of interest that were readily foreseeable from the outset. Forsberg further breached its duties by failing to advise Ardens of potential conflicts arising from Ardens' interest in swift resolution. Finally, Forsberg breached its duties by failing to advise Ardens or seek Ardens' informed consent when Ardens' settlement instructions conflicted with instructions from Hartford.

Whether an attorney's conduct violates ethical rules, thereby breaching fiduciary duties, is a question of law that can appropriately be determined on summary judgment. *Hizey v. Carpenter*, 119 Wn.2d 251, 264, 830 P.2d 646 (1992) (citing *Eriks v. Denver*, 118 Wn.2d 451, 457-58, 824 P.2d 1207 (1992)).

5.3.1.1 Potential conflicts relating to coverage and to Forsberg's long-standing relationship with Hartford.

Forsberg initially breached its fiduciary duties by taking on the representation without advising Ardens of potential conflicts of interest arising from the reservation of rights defense and from Forsberg's long-standing relationship with Hartford and without seeking informed consent to waive the conflicts (if they could be waived at all). Defense counsel must

consider conflicts before accepting the defense assignment. Barker, et al., *Ethical Issues*, at 3. Potential conflicts that may arise from coverage issues under a reservation of rights or from an existing relationship between the insurer and defense counsel are easily foreseeable from the outset. Forsberg should have recognized these potential conflicts and advised Ardens. Forsberg did not.

Hartford informed Forsberg immediately upon appointment that Hartford intended to defend under a reservation of rights. *See* CP 208, 318, 320. Hayes and Gibson recognized from the outset that a coverage dispute was likely to arise between Ardens and Hartford. CP 169, 208. Forsberg should have recognized the risk that at some point during the litigation, Forsberg would have to choose between Ardens' interest in a finding of negligence (covered) and Hartford's likely interest in a finding of malicious intent (not covered). Forsberg should have informed Ardens of this potential conflict.

Another potential conflict arose from Forsberg's long-standing relationship with Hartford. Hayes was Forsberg's "go-to" attorney in the Seattle area. CP 120. The vast majority of Gibson's practice is insurance defense work assigned by Hartford. CP 165. Forsberg regularly serves as coverage counsel for Hartford. CP 203-04.

When an ongoing relationship exists between defense counsel and the insurer, "the lawyer's personal interest in pleasing the insurer could create a conflict in the same way that a legal duty of loyalty would." Barker, et al., *Ethical Issues*, at 3-4. The comments to RPC 1.7 describe precisely this type of

conflict: "[T]he client on whose behalf the adverse representation is undertaken [Ardens] reasonably may fear that the lawyer will pursue that client's case less effectively out of deference to the other client [Hartford], i.e., that the representation [of Ardens] may be materially limited by the lawyer's interest in retaining the current client [Hartford]." RPC 1.7, Comment [6]. Alternatively, there is a conflict if there is "significant risk that the lawyer's representation of the client will be materially limited by the lawyer's own interest in accommodating the person paying the lawyer's fee or by the lawyer's responsibilities to a payer who is also a co-client." RPC 1.7, Comment [13].

"Insurers should not retain their own panel counsel to defend an insured when that attorney is also representing the insurer as a current client. Such a dual representation violates RPC 1.7." Harris, *Washington Insurance Law*, § 11.02. At the very least, "counsel with a regular relationship with the insurer, should disclose that fact." Barker, et al., *Ethical Issues*, at 12. Forsberg was duty-bound to inform Ardens of this potential conflict at the outset of the representation.

Given the high likelihood that these potential conflicts would ripen into actual conflicts, Forsberg should never have accepted the assignment as defense counsel for Ardens. *See* CP 422. Forsberg's *Tank* duties required Forsberg to fully disclose these conflicts and their likely ramifications and to resolve the conflicts in favor of Ardens. Knowing that Ardens' interests were likely to become directly adverse to Hartford, Forsberg's existing client, the conflict was not consentable. *See* RPC 1.7; CP 422. The only way to resolve

the conflict in favor of Ardens would have been to decline the representation. *See* RPC 1.7, Comment [3].

Obviously, Forsberg did not decline. Rather, Forsberg took on the representation without ever informing Ardens of either of these potential conflicts. Forsberg never informed Ardens of its long-standing relationship with Hartford. CP 227, 229, 430. Forsberg did not inform Ardens of any potential conflict arising from Hartford's coverage position, but simply told Ardens that Forsberg would not give any coverage advice to Ardens or Hartford. CP 901. Forsberg neither sought nor obtained Ardens' informed consent to waive either of these conflicts. Forsberg's failure to fully disclose and resolve conflicts of interest in favor of Ardens was a breach of Forsberg's fiduciary duties.

5.3.1.2 Potential conflicts arising from Ardens' secondary interests in swift resolution of the litigation.

Forsberg continued to breach its fiduciary duties in the same manner as the representation continued. During Gibson's initial investigation, he learned that the county prosecutor was considering filing felony charges against Roff Arden arising from the same facts as the *Duffy* matter. CP 484. At Gibson's initial meeting with Ardens, he learned that Roff Arden suffered from depression and PTSD. CP 179, 586. Arden's mental health condition and potential criminal jeopardy created a strong, secondary interest in obtaining a swift resolution to the *Duffy* litigation. *See* CP 857. Gibson should have recognized that Ardens' interest in swift resolution would likely conflict with Hartford's deliberate, low-ball negotiation strategy.

Forsberg has argued that it did not need to consider Ardens' secondary interests because, it argued, those interests were outside the scope of the representation. *E.g.*, CP 523. However, a limited scope of representation does not limit the range of interests which defense counsel must bear in mind. Barker, et al., *Ethical Issues*, at 5. "A lawyer must respect all interests a client has, including primary interests that relate to the agreed goal of a representation and secondary interests that do not." *Id.* "The point for counsel to remember is that any indication that the policyholder may have divergent interest from those of the company must be explored. At a minimum, any such divergence calls for consultation with the policyholder. Any conflict must be identified and addressed." Barker & Silver, *Professional Responsibilities*, § 12.01. Ardens' immediate insistence that the first settlement offer be accepted should have been a signal to Forsberg of Ardens' divergent interest. Forsberg failed to communicate with Ardens sufficiently to identify and address the potential conflict. In failing to even recognize Ardens' strongly held secondary interest, Forsberg breached its duty of loyalty to Ardens.

5.3.1.3 Actual conflict between Ardens' settlement instructions and settlement instructions from Hartford.

The potential conflict of interest arising from Ardens' interest in swift resolution of the litigation ripened into an actual conflict when Ardens' settlement instructions conflicted with instructions Forsberg received from Hartford. Ardens consistently insisted that Duffys' settlement demands be accepted with funding from Hartford. Hartford refused to fund the demands

and instructed Forsberg to allow the offers to expire and then make low-ball counteroffers. Hartford's instructions conflicted with Ardens' instructions. Forsberg could not follow both. Forsberg could not follow Hartford's instructions without sacrificing Ardens' interests. What was originally only a potential conflict had ripened into an actual conflict.

When instructions from the insurer conflict with the expressed desires of the insured client, RPC 1.2 and RPC 1.4 require consultation with the client before defense counsel may take action. Defense counsel's duty of undeviating loyalty to the insured client does not allow counsel to disregard the client's instructions. *See* RPC 1.4, Comment [2].

> [A] lawyer shall abide by a client's decisions concerning the objectives of representation and, as required by Rule 1.4, shall consult with the client as to the means by which they are to be pursued. A lawyer may take such action on behalf of the client as is impliedly authorized to carry out the representation. A lawyer shall abide by a client's decision whether to settle a matter.

RPC 1.2(a). When a client and lawyer disagree about the means to be used to accomplish the client's objectives, the lawyer should consult with the client to seek a mutually acceptable resolution to the disagreement. RPC 1.2, Comment [2]; RPC 1.4(a)(2). The lawyer must explain the matter to the extent reasonably necessary to permit the client to make an informed decisions. RPC 1.4(b). Except in exigent circumstances (such as during a trial), the lawyer must consult with the client prior to taking action. RPC 1.4, Comment [3]. If, after consultation, the lawyer and client still disagree and

the client has not given consent to the lawyer's proposed course of action, the lawyer should withdraw. RPC 1.2, Comment [2].

These rules envision the lawyer as the source of the proposed course of action with which the client disagrees. However, the rules apply equally when the proposed course of action originates from the insurer, if defense counsel intends to follow it. It is the client's divergent interests and the lawyer's duty of loyalty to the client that require consultation and resolution prior to taking any action.

Because defense counsel owes undeviating loyalty to the client, counsel's first attempt at resolution should be with the insurer. *See* Barker, et al., *Ethical Issues*, at 19. If defense counsel can convince the insurer to change its desired course of action, counsel will have succeeded in fully protecting the client's interests, in keeping with counsel's duty of loyalty. If the insurer persists, defense counsel still cannot follow the insurer's instructions without first obtaining informed consent from the client. *See Id.* at 20. This requires full consultation in keeping with RPC 1.4. If the client refuses to consent to the insurer's proposed course of action, defense counsel cannot proceed and has no choice but to withdraw.[7] *See* Barker, et al., *Ethical Issues*, at 21.

Forsberg did not consult with Ardens when it was faced with conflicting instructions. After Forsberg obtained an extension of the

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[7] In this situation, defense counsel's duty of undeviating loyalty to the client does not permit counsel to follow the insurer's instructions without the informed consent of the client. On the other hand, defense counsel's obligations to the insurer likely would not permit counsel to follow the client's instructions without being discharged by the insurer. The only viable choice is to withdraw.

deadline, the Duffys' first settlement demand of $55,000 was set to expire on March 4 at 5 p.m. *E.g.,* CP 457. At 8:49 a.m. on March 5 (after the offer had already expired), Forsberg notified Ardens, through Cushman, that Hartford chose not to fund the $55,000 demand and that a counteroffer would be made at $18,000. CP 263. The counteroffer was proposed by Hartford. CP 141. Within eight minutes of the 8:49 a.m. email to Cushman, Gibson had already left a voice message and email with Karp attempting to communicate the counteroffer. CP 878. Forsberg never sought an opportunity to consult with Ardens or obtain their informed consent regarding Hartford's settlement decision and instructions, which were contrary to Ardens' repeatedly expressed desire for immediate settlement. *See* CP 183, 575-76.

Ardens demanded acceptance of Duffy's second settlement demand of $40,000. CP 883. On March 14 at 10:47 a.m., Hartford notified Cushman and Hayes of its contrary instruction to reject and counter at $25,000, alternatively inviting Ardens to contribute to settlement. CP 767. Forsberg made no attempt to consult with Ardens or obtain Ardens' informed consent regarding Hartford's instructions or invitation to contribute. *See* CP 142, 198, 219, 579. Within 47 minutes of Hartford's email, Hayes had communicated the rejection and counteroffer to Karp. CP 267.

Forsberg made no attempt to reach out to Ardens. Forsberg did not contact Ardens directly for a consultation. Forsberg did not ask Cushman to consult with Ardens, to explain the situation to Ardens, or to ask Ardens for their consent to the Hartford's proposed courses of action. Forsberg did not

even allow Cushman the time to independently consult with Ardens to help them react to the developing situations. Forsberg breached its duty to fully disclose and resolve these conflicts in favor of Ardens.

Forsberg had a duty to fully disclose any potential or actual conflict of interest to Ardens and resolve those conflicts in favor of Ardens. Forsberg failed to consult with Ardens regarding potential conflicts arising from Forsberg's long-standing relationship with Hartford, from the reservation of rights defense, and from Ardens' interest in swift resolution of the case. Forsberg never sought consent from Ardens to waive any of these conflicts. Forsberg should have declined the assignment due to the seriousness of these potential conflicts. Having taken the representation, Forsberg failed to consult with Ardens regarding the actual conflict between Ardens' expressed desire for swift settlement and contrary instructions Forsberg received from Hartford. Forsberg breached its fiduciary duties of undeviating loyalty to Ardens, the insured client.

5.3.2 Forsberg placed the interests of Hartford above the interests of Ardens.

Not only did Forsberg fail to disclose and resolve the conflicts, but Forsberg favored the interests of Hartford, an adverse client, over the interests of Ardens, the clients Forsberg should have been representing with undeviating loyalty. Forsberg should have been assisting Ardens to understand Hartford's position relative to settlement and making sure that Ardens had the knowledge and opportunity necessary to appropriately react to the developing situation.

> "The company's decision to reject a within-limits demand requires special treatment [by defense counsel]. This is so whether a rejection is carried out by an affirmative act or by a failure to respond favorably before a deadline expires. A defense lawyer should **immediately** communicate a company's decision to a policyholder. If a deadline is approaching without any decision to accept the demand, **the policyholder must be warned.**
> …
> If the company decides to reject the demand, that should be communicated to the policyholder **before any communication with the claimant,** to give the policyholder a chance to act before the demand is rejected."

Barker & Silver, *Professional Responsibilities*, § 12.05 (emphasis added).

Rather than consulting with Ardens to help them understand and appropriately react to settlement developments, Forsberg blithely and obediently marched to Hartford's drum, following Hartford's every command with exactness and speed. *See, e.g.,* CP 143, 152. Forsberg did not warn Ardens of Hartford's decisions until minutes before Forsberg communicated the unauthorized counteroffers to Karp. Forsberg made no attempt to consult with Ardens prior to taking action. Forsberg gave Ardens no time or opportunity to react or to protect their own interests. Forsberg's actions demonstrate an utter disregard for the interests of Ardens, the insured client to whom Forsberg owed a duty of undeviating loyalty. Instead, Forsberg gave its loyalty to Hartford, ignoring Ardens' desires and following Hartford's instructions without a second thought. Forsberg betrayed Ardens' trust and egregiously breached its fiduciary duties to Ardens by placing the interests of Hartford above the interests of Ardens.

5.3.3 Forsberg's breach of duties also constitutes breach of trust.

As outlined in Part 5.2.3, above, a trustee's duties are similar to the duties of insurance-assigned defense counsel under a reservation of rights. A trustee has duties of absolute loyalty and full disclosure to the beneficiary. A trustee with a potential or actual conflict of interest must either eliminate the conflicting interest or resign as trustee. Bogert, *Trusts and Trustees*, § 543. Forsberg had potential and actual conflicts of interest, yet Forsberg did not disclose or eliminate those conflicts. Forsberg did not resign its position of trust. Instead, Forsberg attempted to serve two masters, which a trustee is absolutely forbidden to do. *See Id.* Forsberg breached its duties as trustee over the insurance defense asset and should be subject to the broad, equitable powers of the court to craft a remedy that both makes Ardens whole and prevents Forsberg from benefitting from its breach of trust.

The undisputed evidence demonstrates that Forsberg breached its duties to Ardens. This court should reverse the trial court's second summary judgment order, grant partial summary judgment in favor of Ardens on the issue of Forsberg's liability for breach of fiduciary duties, and remand to the trial court for a determination of damages.

5.4 Ardens are entitled to broad equitable remedies for Forsberg's breach.

When a lawyer breaches fiduciary duties to a client, the client may be entitled to recover the lawyer's fees from the representation without any further showing of causation or damages. *Eriks v. Denver*, 118 Wn.2d 451,

462-63, 824 P.2d 1207 (1992). When a trustee breaches fiduciary duties, the court has broad equitable powers to craft a remedy to make plaintiffs whole and to prevent the trustee from benefitting from the breach of trust. *Gillespie v. Seattle-First Nat'l Bank*, 70 Wn. App. 150, 173, 855 P.2d 680 (1993); Restatement 2d of Trusts, § 205. Forsberg should be compelled to (1) disgorge all fees and costs paid to it by Hartford; (2) reimburse Ardens for attorney fees that they would not have incurred but for Forsberg's breach of trust; and (3) compensate Ardens for emotional distress caused by Forsberg's breach of trust.

5.4.1 Ardens are entitled to disgorgement of all fees paid to Forsberg for the representation.

Forsberg was disqualified from taking on the representation of Ardens. Forsberg breached its fiduciary duties by accepting the assignment without recognizing, disclosing, and resolving the conflict. Forsberg could not adequately and faithfully represent Ardens, as demonstrated by Forsberg's conduct after accepting the representation. When an actual conflict finally ripened, Forsberg ignored Ardens' interests and gave its full loyalty to Hartford. Forsberg was unjustly enriched by collecting fees and costs from Ardens' insurance defense asset when Forsberg utterly failed to faithfully represent Ardens. Disgorgement of those fees and costs to Ardens is the natural remedy for Forsberg's breach of fiduciary duties.

Disgorgement of fees is a reasonable and well-recognized way to deter breach of ethical or fiduciary duties. *Eriks*, 118 Wn.2d at 463. In *Eriks*, the defendant, Denver, was an attorney who represented the promoters of

an investment advertised as a tax shelter. *Id.* at 454. The promoters set up a fund that would pay Denver to represent any investors in IRS audits or tax court cases arising from the tax shelter. *Id.* Denver knew, before taking on the representation of any of the investors, that the investors would potentially have civil claims against the promoters, who were also his clients. *Id.* at 455. Denver never advised his investor clients of these potential conflicts of interest and proceeded to represent the investors. *Id.* After the conflicts ripened, the investors sued Denver, and the trial court found that Denver's failure to disclose the conflict was a breach of his fiduciary duties to the investors. *Id.* The trial court ordered Denver to disgorge all fees collected from representing the investors. *Id.* at 455-56.

The Washington Supreme Court affirmed the trial court judgment. *Eriks*, 118 Wn.2d at 463. In doing so, the court relied in part on the U.S. Supreme Court's opinion in *Woods v. City Nat'l Bank & Trust Co.*, 312 U.S. 262, 85 L. Ed. 820, 61 S. Ct. 493 (1941):

> Where [an attorney] … was serving more than one master or was subject to conflicting interests, **he should be denied compensation.** It is no answer to say that fraud or unfairness were not shown to have resulted…
>
> A fiduciary who represents [multiple parties] … may not perfect his claim to compensation by insisting that, although he had conflicting interests, he served his several masters equally well.

Eriks, 118 Wn.2d at 462 (quoting *Woods*, 312 U.S. at 268-69) (alterations in *Eriks*, emphasis added). The court further explained that the remedy of disgorgement follows directly from the finding of breach of fiduciary

duties—no showing of causation or actual damages was necessary. *Eriks*, 118 Wn.2d at 462.

Similarly, in *Behnke v. Ahrens*, 172 Wn. App. 281, 294 P.3d 729 (2012), the court awarded the plaintiffs all fees received for representing them, plus prejudgment interest, *Id.* at 289, even though half of those fees were paid to the defendant attorney by a third party on the plaintiffs' behalf, *Id.* at 286. Even though a jury found that plaintiffs' only actual damages were the attorney fees plaintiffs paid, *Id.* at 287, the court found that the defendant attorney had violated the RPCs and that disgorgement of **all** fees was the proper remedy, *Id.* at 298.

Here, as in *Eriks* and *Behnke*, Forsberg took upon itself a representation from which it was disqualified by conflicts of interest because of its pre-existing duties to and relationship with Hartford, whose interests would foreseeably become directly adverse to Ardens. By taking on the representation, Forsberg, like Denver and Ahrens, breached its fiduciary duties to its new client, Ardens. Disgorgement of all fees and costs received by Forsberg is the natural remedy.

5.4.2 Ardens are entitled to emotional distress damages.

In the recent Washington Supreme Court decision in *Schmidt v. Coogan*, 181 Wn.2d 661, 335 P.3d 424 (2014), the court held that emotional distress damages are recoverable in a legal malpractice case "when significant emotional distress is foreseeable from the sensitive and personal nature of representation or when the attorney's conduct is particularly egregious." *Id.*,

at 671. The court supported this holding on common law principles applicable to emotional distress damages in other contexts. The court noted that the nature of the parties' relationship is relevant to whether an award of emotional distress damages is proper. *Id.*, at 672-73. Where the relationship is such that a person standing in the defendant's shoes could foresee that its breach is likely to cause emotional distress, such damages are proper. *See Id.* The same rule should apply in cases of breach of an attorney's fiduciary duties.

As expounded above, the parties' relationship here was that of a trust. Forsberg owed the highest fiduciary duties to Ardens. Forsberg knew of Ardens' existing mental condition and of the possibility of criminal jeopardy that Arden faced. Forsberg could have reasonably foreseen that a breach of trust would be likely to cause Ardens to suffer emotional distress. *See* CP 223-24. This is precisely the kind of relationship that should give rise to an award of emotional distress damages. *See Schmidt*, 181 Wn.2d at 673 ("Thus, emotional-distress damages are ordinarily not recoverable when a lawyer's misconduct causes the client to lose profits from a commercial transaction, but are ordinarily recoverable when misconduct causes a client's imprisonment."); *Id.*, at 687 (Stephens, J., dissenting) ("These situations reveal a common thread justifying the imposition of liability for emotional distress: a special relationship based on trust. When such a special relationship exists, … 'a reasonable person standing in the defendant's shoes would easily foresee that its breach is likely to cause significant emotional distress. It will support emotional distress damages without proof of physical impact or

objective symptomatology.'" (quoting *Price v. State*, 114 Wn. App. 65, 73, 57 P.3d 639 (2002)).

Alternatively, emotional distress damages should be considered as part of an equitable remedy for breach of trust. Remedies for breach of trust seek to both prevent unjust enrichment of the trustee and to make the beneficiary whole. Ardens cannot be made whole unless they are able to recover for their emotional distress resulting from Forsberg's breach of trust.

Where Ardens have presented evidence of both a sensitive representation and egregious conduct by Forsberg, this Court, or the trial court on remand, should award Ardens' emotional distress damages caused by Forsberg's breach of fiduciary duties.

5.4.3 Ardens are entitled to attorney fees incurred as a result of Forsberg's breach of trust, including fees incurred in this malpractice litigation.

In addition to the remedies of disgorgement of fees and costs and recovery of emotional distress damages, Forsberg is subject to the court's broad, equitable powers to craft a remedy to both make Ardens whole and prevent Forsberg from benefiting from its breach of trust. In order for Ardens to be made whole, they must be reimbursed for attorney fees that they were compelled to incur as a result of Forsberg's breach of trust. As a result of Forsberg's breaches, Ardens had to incur fees for personal counsel to represent their interests in the *Duffy* matter free from any conflicts, as well as in this matter seeking redress for Forsberg's breach. As a result of

Forsberg's breaches, Roff Arden was charged with a felony and had to incur fees for criminal defense counsel. *See, e.g.,* CP 418, 424-25.

Where litigation is necessitated by the inexcusable conduct of a trustee, the trustee is liable to pay those expenses. *Allard v. Pac. Nat'l Bank*, 99 Wn.2d 394, 408, 663 P.2d 104 (1983). Such an award of attorney fees caused by a breach of trust is within a trial court's discretion as a part of making the plaintiff whole from the defendant's breach. *Allard v. First Interstate Bank, N.A.*, 112 Wn.2d 145, 151-52, 768 P.2d 998 (1989). The award can include fees incurred throughout the litigation for breach of trust, including all fees at trial and on appeal. *Id.* Breach of trust is thus a recognized ground in equity for an award of attorney fees. This Court, or the trial court on remand, should award Ardens all of their fees incurred in the *Duffy* matter, in this case, and in the criminal case.

The trial court erred in denying Ardens' motion for partial summary judgment on Forsberg's liability for breach of fiduciary duties and in dismissing Ardens' claims. As demonstrated above, Forsberg owed Ardens the highest fiduciary duties—the ordinary duties owed by an attorney to a client, enhanced duties under *Tank*, and the duties of a trustee over the insurance defense asset. Forsberg breached those duties by failing to disclose and resolve conflicts of interest in favor of Ardens and by placing the interests of Hartford above the interests of Ardens, the insured clients. The remedies of disgorgement for breach of fiduciary duties and other equitable remedies for breach of trust naturally follow.

Ardens presented sufficient evidence to the trial court to establish Forsberg's duties and breach. At the very least, Ardens' evidence was sufficient to raise a material issue of fact to preclude summary judgment dismissal of Ardens' claims. This Court should grant summary judgment in favor of Ardens on these issues and remand to the trial court for a determination of damages.

5.5 The trial court erred in dismissing Ardens' legal malpractice claim where there were material issues of fact precluding summary judgment.

The trial court correctly held that there was a clear attorney-client relationship between Ardens and Forsberg giving rise to a duty of care owed by Forsberg to Ardens. Supp. RP 3-4. The trial court correctly held that there were disputes of fact as to whether Forsberg's conduct breached its duties to Ardens. *Id.* at 4. However, the trial court erred by failing to recognize material issues of fact precluding summary judgment on the issues of damages and proximate cause.

5.5.1 There were material issues of fact regarding the availability of emotional distress damages under *Schmidt v. Coogan*.

Emotional distress damages are recoverable in a legal malpractice case (1) when emotional distress is foreseeable from the nature of the representation or (2) when the attorney's conduct is particularly egregious. Ardens have presented evidence in support of both alternatives. *Schmidt*, 181 Wn.2d at 671.

Emotional distress was foreseeable from the nature of the representation here. The parties' relationship here was that of a trust. Forsberg owed the highest fiduciary duties to Ardens. Forsberg knew of Ardens' existing mental condition and of the possibility of criminal jeopardy that Arden faced. *E.g.,* CP 179, 484. Ardens demonstrated their interest in swift resolution of the *Duffy* matter by insisting on immediate settlement. *E.g.,* CP 865. Forsberg knew that it was representing frail clients. Forsberg also knew that it was acting under a reservation of rights and that the defense was fraught with potential conflicts of interest. Forsberg should have known that it needed to tread lightly and make sure it lived up to its duties of loyalty. Given the circumstances, Forsberg could have reasonably foreseen that a breach of trust would be likely to cause Ardens to suffer emotional distress. *See* CP 223-24, 857.

Defendants' conduct was also particularly egregious. As demonstrated above, Forsberg took on a representation from which it was disqualified by conflicts of interest. Forsberg failed to advise Ardens of any potential or actual conflicts of interest. Forsberg failed to resolve the conflicts in favor of Ardens. Forsberg failed to communicate information relevant to the defense to Ardens. Forsberg failed to keep Ardens apprised of all activity involving settlement. Forsberg ignored Ardens' expressed desires regarding settlement and instead followed instructions from Hartford without giving Ardens any opportunity to understand or react to those instructions before Forsberg carried them out.

Because a reasonable fact-finder could conclude from the evidence that Ardens' emotional distress was compensable, the trial court should have denied summary judgment dismissal. The issue should have gone to trial.

5.5.2 There were material issues of fact as to whether Forsberg's malpractice was a proximate cause of Roff Arden being charged with a felony.

Ardens presented evidence that, had Defendants settled the Duffy matter sooner, Roff Arden would not have been charged with a crime. Ardens presented opinion testimony of three qualified experts that the prosecutor's office most likely would not have charged Roff Arden with a felony if the *Duffy* matter settled before the charging decision was made. *See* CP 417-18, 424-25, 924-25. Duffys had been lobbying the prosecutor's office to bring felony charges against Roff Arden. CP 279-84. However, as soon as Duffys notified the prosecutor's office of the settlement, Arden was sent to "friendship diversion" and the charges were dropped. CP 270, 272. Forsberg was aware of the prosecutor's pending decision, CP 484, but decided it had no duty to consider Ardens' interest in avoiding charges, CP 170. Viewing the evidence and reasonable inferences in a light favorable to Ardens, a reasonable fact-finder could conclude that, had the matter settled earlier, as repeatedly urged by Ardens, Roff Arden would not have been charged with a felony. This creates a material issue of fact as to damages and causation, precluding summary judgment dismissal of Ardens' claim. This Court should reverse the trial court's first summary judgment order, reinstate Ardens' legal malpractice claim, and remand for further proceedings.

5.6 Ardens request an award of attorney fees on appeal.

Where litigation is necessitated by the inexcusable conduct of a trustee, the trustee is liable to pay those expenses. *Allard v. Pac. Nat'l Bank*, 99 Wn.2d 394, 408, 663 P.2d 104 (1983). Such an award of attorney fees caused by a breach of trust is within a trial court's discretion as a part of making the plaintiff whole from the defendant's breach. *Allard v. First Interstate Bank, N.A.*, 112 Wn.2d 145, 151-52, 768 P.2d 998 (1989). The award can include fees incurred throughout the litigation for breach of trust, including all fees at trial and on appeal. *Id.* Breach of trust is thus a recognized ground in equity for an award of attorney fees. If Ardens prevail on appeal, this Court should direct the trial court to determine the amount of fees and expenses to be awarded for the appeal.

6. Conclusion

The undisputed facts demonstrate that Forsberg breached its fiduciary duties to Ardens. The trial court erred in denying Ardens' motion for partial summary judgment and dismissing Ardens' claims. The trial court also erred in granting Forsberg's motion for summary judgment on Ardens' legal malpractice claim when there were material issues of fact as to the issues of breach, proximate cause, and damages. This Court should reverse the trial court's summary judgment orders, grant partial summary judgment to Ardens on Forsberg's liability for breach of fiduciary duties, and remand to the trial court for further proceedings.

Respectfully submitted this 11th day of May, 2015.

/s/ Kevin Hochhalter
Kevin Hochhalter, WSBA #43124
Attorney for Appellants

CERTIFICATE OF SERVICE

I certify, under penalty of perjury under the laws of the State of Washington, that on May 11, 2015 I caused the original of the foregoing document, and a copy thereof, to be served by the method indicated below, and addressed to each of the following:

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DATED this 11th day of May, 2015.

/s/ Rhonda Davidson
Rhonda Davidson, Legal Assistant

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