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Whose Lawyer Are You Anyway?

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ARTICLES

WHOSE LAWYER ARE YOU ANYWAY?

Thomas D. Morgan†

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I. INTRODUCTION

Americans buy a lot of liability insurance. According to one recent study, annual premiums exceed $75 billion, or almost two percent of our gross domestic product.1 When we buy such insurance, we are essentially buying two things. First, we are buying a right to have the insurance company pay any liability we may be found to have for acts covered in the policy, up to the policy’s face amount and in excess of its deductible. Second, we buy the right to have the insurance company pay for our legal defense against the claimed liability.

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1. See Kent D. Syverud, On the Demand for Liability Insurance, 72 TEX. L. REV. 1629, 1629 (1994) (explaining why insurers and attorneys, with the cooperation and encouragement of legal and political institutions, have successfully driven people to over-consume liability insurance).
In addition to payment of our premiums, the insurance company has a right to expect at least two things from us. First is prompt notice of the event that may produce a claim; prompt notice allows the insurer to investigate the event and prepare the defense. Second is cooperation in helping to minimize liability by providing the company with information about the incident and by not trying to settle the case personally.

In the majority of potential liability cases, lawyers are not involved. Insurance companies use non-lawyer adjusters to estimate likely liability and seek a release from persons to whom the insured might be found liable in exchange for a cash payment of less than the policy limits.

In other cases, however, the plaintiff may use a lawyer to file or threaten to file a complaint, and the defendant will need someone to file an answer. A lawyer will be retained by the insurance company pursuant to the company's duty to defend its insured. Again, in the majority of such cases, the insurer and insured will have identical interests in disposing of the matter quickly and at the lowest possible cost.

At minimum, the lawyer retained by the defense represents the insured. It is the insured on whose behalf the lawyer will enter an appearance in the case. The question considered in this article is whether the lawyer also represents the insurance company as a co-client with the insured. Alternatively, is the insurance company simply an entity with a contractual duty to pay for the defense?

2. Indeed, the insured is likely to be the only named party because the very fact of insurance coverage is usually studiously suppressed. One issue testing whom the lawyer really represents is whom the lawyer is barred from suing because of their current client status. In McCourt Co. v. FPC Properties, Inc., a lawyer filed suit on behalf of a client against the opponent. 434 N.E.2d 1234 (Mass. 1982). The lawyer had been retained by the opponent's insurer to represent the opponent concurrently in an unrelated matter. Id. at 1236. The court concluded that both opponent and insurer were the lawyer's clients. Id. Thus, the lawyer could not be the one to sue the opponent on behalf of the client. Id. at 1238; see also ABA Comm. on Professional Ethics, Informal Op. 822 (1965) (stating that if a lawyer represents an insured under a reservation of rights, the lawyer may not later help the insurer prove there was no liability coverage); cf. Moritz v. Medical Protective Co., 428 F. Supp. 865, 874 (W.D. Wis. 1977) (explaining that the insured was a client of the lawyer retained by an insurance company in a prior matter, but because the two matters were not substantially related, the lawyer's current representation against the insured was not barred).

3. One answer to that question might be derived from cases deciding whether the lawyer could file an unrelated action against the insurance company,
The question of whom the lawyer represents in such cases is not new. It was implicit in articles written by Professor (now Judge) Robert Keeton beginning more than forty years ago. But it has been raised again with unusual intensity in response to publication of a recent draft of the Restatement (Third) of the Law Governing Lawyers.

The proposed final draft of the Restatement, first considered by American Law Institute (ALI) members in May 1996, deals with the lawyer retained by an insurance company to represent its insured. Section 215, “Compensation and Direction by Third Person,” states:

something it could not do if the insurer were a current client. In Gray v. Commercial Union Insurance Co., a lawyer represented the plaintiff against an insurance company in a case for wrongful discharge. 468 A.2d 721 (N.J. Super. Ct. App. Div. 1983). For 20 years, the lawyer had been retained by the insurance company to defend policyholders in personal injury cases. Id. at 723. The insurer alleged that the lawyer gave access to “confidential and proprietary information” such as how the company handled claims and litigation. Id.

The court said there was “no dispute” that the lawyer had “maintained an attorney-client relationship” with the insurance company. Id. at 724-25. “He owes to each a duty to preserve the confidences and secrets imparted to him during the course of representation.” Id. at 725. During his 20 years of work on insurance cases, the lawyer had access to enough of the company’s secrets that there was a “substantial relationship” between this case and prior work. Id. The prior cases made lawyer aware of the personnel policies about which the plaintiff complained. Id.

The basis of the court’s opinion was more than protection of confidences. See id. at 726. The court also noted that a lawyer may not sue one of his or her present clients, even in unrelated matters. Id. One of the personal injury cases was still outstanding, so the court said the insurance company was still the lawyer’s client. Id. at 723. Indeed, the court said the lawyer could not represent the wrongful discharge plaintiff even with the insurance company’s consent. Id. at 728; cf. Insurance Co. of N. Am. v. Westergren, 794 S.W.2d 812, 815 (Tex. App. 1990) (stating that the lawyer expressly undertook to make the indemnity insurer a client).

4. See generally Robert E. Keeton, Ancillary Rights of the Insured Against His Liability Insurer, 13 VAND. L. REV. 837 (1960); Robert E. Keeton, Liability Insurance and Responsibility for Settlement, 67 HARV. L. REV. 1136 (1954); Robert E. Keeton, Preferential Settlement of Liability-Insurance Claims, 70 HARV. L. REV. 27 (1956) (explaining in all three articles the potential problem or conflict that can arise when a lawyer is provided to the insured by an insurance company which may have divergent interests).

5. See generally Restatement (Third) of the Law Governing Lawyers § 215 (Proposed Final Draft No. 1, 1996). This Restatement has been a decade-long project of the American Law Institute and is designed to collect and organize numerous principles with legal force that regulate the practice of law. Professor Charles W. Wolfram of Cornell Law School serves as Chief Reporter; Professor John Leubsdorf of Rutgers (Newark) Law School and the author of this Article serve as Associate Reporters.
(1) A lawyer may not represent a client under circumstances in which someone other than the client will wholly or partially compensate the lawyer for the representation, unless the client consents... with knowledge of the circumstances and conditions of the payment.

(2) A lawyer’s professional conduct on behalf of a client may be directed by someone other than the client if:

(a) the direction is reasonable in scope and character, such as by reflecting obligations borne by the person directing the lawyer; and

(b) the client consents to the direction. ... 6

Section 215 applies to more than the insurance relationship. It applies to the lawyer paid by a corporation to represent an employee, for example, or to a lawyer paid by parents to represent their child. Comment f of section 215 applies specifically to the insurance situation, providing:

The lawyer represents the insured. The insurer is not, simply by the fact that it designates a lawyer, a client of the lawyer. Regardless of [w]ether a client-lawyer relationship also exists..., communications between the lawyer and representatives of the insured concerning such matters as progress reports, case evaluations, and settlement are communications with an agent of the client [and thus privileged]. Similarly, because and to the extent that the insurer is directly concerned in the matter financially, the insurer has standing to assert a claim for appropriate relief from the lawyer for financial loss proximately caused by professional negligence or other wrongful act of the lawyer. ... 7

This proposal has elicited an apoplectic response from the insurance industry, primarily led by law professors acting as consultants to the industry. Asserting that the only correct view is that defense counsel simultaneously represents the insured and the insurer, the Restatement’s critics have equated the Reporters with “politicians seeking votes [who] have incentives to distort

6. Id.
7. Id. cmt. f.
the truth." In some of the kinder references, the Restatement analysis has been said to be "conceptually impoverished," requiring practices that "torture the insured." The authors of these attacks call upon the defense bar to "sack the entire [Restatement] project [rather] than to permit it to become final in its present form."

This Article will not try to match the rhetorical fervor of the industry, but it will try to explain why the Reporters have chosen the approach we have. In brief, I will argue that the abstract debate about whether an insurance defense lawyer has one client or two is ultimately unproductive. In the first place, binary distinctions between clients and non-clients ultimately prove inadequate in talking about the tripartite relationships between an insurance company, an insured, and a retained defense lawyer.


10. *Id.* at 38.

11. *Id.* at 39. The ALI membership voted in May 1996 to send section 215 back to the Reporters to try to reach an acceptable compromise with its critics. The issues are expected to come before the ALI membership next in May 1998.

12. Of the cases using the one-client or two-client language, more treat the insured as a second client. Those cases did not turn on the two-client characterization, and a one-client approach represents a clearer way to think about the outcomes.


Because the characterization seems to make a difference, I will be discussing five aspects: (1) selection of the lawyer, (2) directing the defense, (3) settling cases, (4) keeping communications privileged, and (5) the right to sue for malpractice. I conclude that the conflict questions are greater, not lesser, when the insurance company and the insured are considered as co-clients in a case.

II. THE RIGHT TO SELECT DEFENSE COUNSEL

One of the seemingly least controversial issues in the relationship between insurer and insured—the right to select defense counsel—is the first testing case for the "one client or two" dispute.

The basic rule of law is clear. When the insured refers a matter to an insurance company for defense, the company gets to pick the lawyer. In *In re Preferred Accident Insurance Co.*, the insurer not only selected counsel to provide defense, it later substituted new counsel without the consent of, and without even providing notice to, the insured. 14 The court held the insurance company was within its right when it did this. 15 That is what most policies provide and, after all, the insurance company is the one paying the lawyer's bill.

In a simple case where the insurer and insured share an interest in resolving the matter within policy limits, the insurance company has a right to keep costs down, use lawyers with whom it has had good experience, or both. Indeed, insurance companies increasingly have been assigning salaried lawyers, employed by the insurance company, to represent their insureds. 16

15. Id. (holding that "such implied authority included the power to change lawyers"); see also Moritz v. Medical Protective Co., 428 F. Supp. 865, 871 (W.D. Wis. 1977) (stating that the relationship between the insured and the attorney is chosen by the insurer); ABA Comm. on Professional Ethics and Grievances, Formal Op. 282 (1950) (stating an attorney may accept employment by an insurance company to handle an insured's claim without the request or approval of the insured).
16. See, e.g., *In re Youngblood*, 895 S.W.2d 322, 332 (Tenn. 1995) (reviewing and setting aside Formal Ethics Op. 93-F-132). The Tennessee court said: The employment of an attorney by an insurer to represent the insured does not create the relationship of attorney-client between the insurer and the attorney, nor does that employment necessarily impose upon the attorney any duty or loyalty to the insurer which impairs the attorney-client relationship between the attorney and the insured or impedes the
Apparantly one reason this issue has become so important to defenders of the two-client model is that in the traditional statement of the rule in Restatement section 215, when one person pays another's legal fees, the retained lawyer may not take the case unless the non-paying client consents to the arrangement with an understanding of the conflicts of interest that could arise. On the other hand, if insurer and insured are co-clients, the argument goes, the lawyer and insurer do not need the insured's consent. It is interesting to note that the consent requirement of the general conflicts provision in Rule 1.7(b) of the Model Rules of Professional Conduct is not triggered until "the representation of a client may be materially limited by the lawyer's responsibilities to another client or to a third person, or by the lawyer's own interests." Model Rule 1.8(f), on the other hand, requires consent whenever a third party pays the bill, whether any limitation on the representation is foreseeable.

The insurance industry's belief that the two-client model will simplify its handling of cases seems to stem, at least somewhat, from its desire to avoid seeking consent. The industry argues that in the majority of cases that settle quickly and within policy limits, the insured does not need to know whether counsel was appointed, much less to consent to that appointment.

I do not disagree with that practical argument. The argument, however, has little to do with the one-client/two-client distinction. The requirements in Model Rule 1.8(f) are not sus-
pended when one of two co-clients pays the legal expenses of the other. Unless one adopts the dubious fiction that the insurance company is paying the lawyer for representing it alone, while the lawyer represents the insured pro bono, the two-client model itself triggers the requirement of consent in Rule 1.8(f). Alternatively, even if one did assume the lawyer were representing two entities, only one of whom is paying for the service, the situation would almost by definition present a potential conflict that would trigger the consent requirement of Model Rule 1.7(b).

Indeed, the only useful way to deal with the consent dilemma is to make consent practical to acquire. Restatement section 215 proposes that insurance policy provisions explain to insured persons that the insurance company will select defense counsel, if counsel is necessary, and that tendering the case to the company for defense constitutes a consent to the company’s right to select counsel. The insured, after all, can decide to use his or her own lawyer if the insured is willing to forego liability coverage. The suggested approach does not provide the personal explanation from the lawyer required by Rule 1.8(f), but it should suffice in the typical case where the interests of insurer and insured seem to be aligned.

III. DIRECTION OF THE DEFENSE

A client may direct the lawyer’s conduct of a case. Lawyers do not ask their clients about matters such as when to object to a question at trial, but a client can direct the case by preventing the lawyer from asserting certain defenses, deciding whether the client will take the stand, and certainly by deciding whether to settle a case. Some of the most important disputes between insurers and their insureds arise around these issues.

A. Deciding What Defenses to Raise

Reynolds v. Maramorosch illustrates the problem. The insured was sued by his minor sons for injuries suffered in an auto accident. The lawyers retained by the father’s insurance company to conduct the defense filed a motion to dismiss the complaint under a doctrine that said children lack capacity to sue.

21. Id. at 902.
22. Id.
At that point, the father hired his own lawyer and submitted an affidavit stating that the motion had been filed without his knowledge or consent. He wanted to waive the capacity to sue defense.

The issue thus became who, insurer or insured, could decide what defenses would be interposed. The court ruled that the decision ultimately resided with the insured. So long as the lawyer represented the insured, the lawyer could not take an action “against the express wish of the client . . . no matter how appropriate it may be.”

As a practical matter, of course, decisions about which defenses to raise are typically left to the insurance company, both because of its experience defending countless cases and because of the insured’s contractual duty to cooperate in the effort to minimize liability. Recognizing the insurance company's contractual rights, however, did not turn it into the lawyer's client. “It may well be that the defendant Reynolds has been ill-advised,” the court said. “[H]e may incur needless expense and find himself without the insurance coverage which he purchased. That, however, is his responsibility and one which he has the right to assume if he sees fit, regardless of the lack of sound judgment involved.”

23. Id.
24. Id. at 903.
25. See id. at 903-04.
26. Reynolds, 144 N.Y.S.2d at 904-05.
27. Id. at 904.
28. Id.
29. Id. at 904-05. An interesting application of this principle is illustrated by Charter Oak Fire Insurance Co. v. Color Converting Industries Co., 45 F.3d 1170 (7th Cir. 1995). The insured corporation voluntarily paid $200,000 to settle a claim from a valued customer when the insured’s ink ruined the customer’s packaging. Id. at 1171. The insurance company refused to acknowledge the insured’s liability and refused to indemnify the insured, citing a violation of the “voluntary payments” clause of the policy. Id. at 1172. The insured charged the insurer with acting in bad faith, which would bar reliance on that clause. See id. at 1173. The customer had refused to turn certain records over to the insurer to assist its investigation of the claim. Id. at 1172. The insurer refused to use industry average cost figures as a sufficient measure of the loss. Id. When negotiations were at an impasse, the insured simply paid the customer for the loss suffered. Id.

Writing for the court, Judge Posner stated that nothing in the law requires an insurer to minimize an insured’s business risk, as opposed to liability risk. Id. Only if liability is clear and payment slow, or if the insurer refuses to defend, is the threshold of bad faith met. Id. The court acknowledged cases holding that an insurer must defend a case so as to minimize the risk of an excess judgment against the insured. Id. That was not an issue in Charter Oak, however, because the claim was well below policy limits. Id. The only real risk for the insured here was that it
Even a legitimate concern about the problem of collusion is not enough to change the lawyer's obligation. In *Montanez v. Irizarry-Rodriguez*, a wife had sued her husband for injuries she sustained in a car accident. Originally they had filed a products liability action, claiming the tire had blown out, but when the physical evidence did not support that story, the wife argued that her husband had been negligent. When the husband took the witness stand, called by the lawyer retained to defend him by the insurance company, he confirmed his wife's story. Thereupon, the lawyer asked the judge for the right to cross-examine the husband as a hostile witness. He also said he would call as a rebuttal witness the insurance investigator who took the husband's statement. The trial judge allowed the lawyer to attack the husband's credibility, and the jury found no liability.

On review, the *Montanez* court followed the majority rule that a lawyer provided by an insurer cannot impeach his own client.

might lose a customer; the insurer did not contract to bear that risk. See *id.* at 1173.

When the customer in *Charter Oak* saw it had the upper hand, it made it hard for the insurer to get information. *Id.* at 1174. An insured would have incentive to collude with a customer if it could require the insurer to bear all the consequences of settlement. *Id.* It is not enough to say insured's settlement must be reasonable; the contract did not give the insured the right to settle at all. *Id.* at 1173. Even a rule that would say an insurer is required to settle whenever the insured would do so would go too far. See *id.* at 1176. An insured might settle groundless claims simply to make customers happy. See *id.* An insurer does not have to assume the risk such an approach would entail. *Id.*

In another case, the insured and his wife, the plaintiff, had moved from the jurisdiction. *Buchanan v. Buchanan*, 160 Cal. Rptr. 577, 578 (Cal. Dist. Ct. App. 1979). The insurer defended and got the case dismissed because the defendant could not be served at his new address. *Id.* at 582. The husband argued this defense was inconsistent with his interest in helping his wife prevail and that failure to warn him of the defense represented bad faith by the insurer. *Id.* at 582-83. However, the court reasoned that "when an attorney is retained to represent both the insured and the insurer . . . a potential conflict between the interests of the two parties may arise. In such a case, the primary duty is to further the best interests of the policyholder." *Id.* at 582 (citing *Ivy v. Pacific Auto. Ins.*, 320 P.2d 140 (Cal. Dist. Ct. App. 1958)). Here, the best interests of the defendant were to get the case dismissed; his interest in collusion need not be recognized by counsel. *Id.* at 583.

31. *Id.* at 1080.
32. *Id.* at 1081-82.
33. *Id.* at 1081.
34. See *id.*
35. See *id.* at 1082.
36. See *Montanez*, 641 A.2d at 1083 (relying upon *Crothers v. Caroselli*, 20 A.2d
The court reasoned that the insured's impeachment is only relevant to an issue between the insured and the insurer.37 "Nothing can be more devastating to an insured than to have his or her credibility challenged by assigned insurance counsel. In this case,

77 (N.J. 1941), in which the insurer also had tried to impeach the witness where collusion was suspected). The Montanez court held that the lawyer represents the party; the insurance carrier was not a party to the case and could not impeach the witness. Id. If an insurer wants to prove collusion, it has to do so in another forum. Id.

There are a number of such collusion cases. See, for example, Schwartz v. Sar Corp., where the plaintiff in an accident case was the defendant's uncle, who allegedly was hit when the car came over a curb. 195 N.Y.S.2d 496, 497 (N.Y. Sup. Ct. 1959), rev'd on other grounds, 195 N.Y.S.2d 819 (N.Y. App. Div. 1959). The insurance company thought the suit was collusive, and the lawyer retained by the company moved to dismiss and filed an affidavit saying he thought the accident had never happened. Id. at 498-99. On review, the court found the affidavit inadequate to defeat summary judgment on liability, saying:

The lawyer may not take up the cudgels of this insurance carrier, when its interests are diametrically opposed to the interests of the assured. A lawyer who represents a client is required to do so wholeheartedly and with full determination to assert his client's cause and to protect his rights. He is not required to participate in or to help in perpetrating a fraud, and if he is satisfied that his client is so conducting himself, it is his duty as an officer of the court to withdraw as counsel. He may not, however, take up the defense of one upon whom the fraud is sought to be practiced, particularly where he has already received the confidence of his client.

The court may not close its eyes to the obvious. The prime interest of these attorneys is the insurance company, in whose behalf they defend many cases year after year. Where the interests of the carrier and the client run parallel with each other, the attorneys undoubtedly will exert their best efforts to protect the interests of their client, since in so doing, they will also be protecting the interests of their real principal. But where, as in this case, the interests are adverse one to the other, then the attorneys may not assist the lost traveler along the road and at the same time prepare a trap into which he will ultimately fall.

Id. at 503 (internal quotation omitted).

The insurer was held to a strict duty of good faith. Id. at 504. There are not two standards, one applicable to private counsel and one to lawyers paid by an insurance company. Id. "If the interests of the carrier and the assured are or are likely to become diverse, [the lawyer] cannot represent both." Id. at 505. The court ultimately held that the insured should be permitted to retain a lawyer at the expense of the insurer. Id. Thus, summary judgment for the plaintiff was reversed, and the right to defend on both liability and damages was given. Id.

In contrast, the defense lawyer in Christie v. Eager was permitted to introduce evidence that there was insurance and evidence of the relationship between plaintiff and defendant. 26 A.2d 352, 353 (Conn. 1942). The court said it went to the credibility of the insured's current story in relation to the statement he had signed earlier claiming no negligence. Id. at 354.

37. Montanez, 641 A.2d at 1083.
defendant was left essentially defenseless to his attorney's attack on his credibility." 38 The lawyer could have sought to withdraw, and the insurer could have refused to pay the judgment, but in these instances the insured could have sued the insurer and the insurer could have made the defense of non-cooperation or collusion in that proceeding. 39 The court held that at least when the interests of the insurer and the insured differ, the lawyer's client is the insured, not the insurance company. The judgment was reversed, and the case was remanded for a new trial. 40

B. The Breadth of the Duty to Defend

A large part of the issue about whom the lawyer represents is created by the difference in scope between the insurer's duty to defend and its duty to indemnify the insured. For example, if an insured person is sued both for negligently injuring the plaintiff, and alternatively for intentionally doing so, an insurer typically will acknowledge coverage of the negligence claim. Most policies, however, have an exclusion expressly denying coverage for an insured's intentional torts.

The fact that an insurance company may not be liable for a judgment does not mean the company will not have a duty to finance the insured's defense. In American Employers Insurance Co. v. Goble Aircraft Specialties, Inc., a boat was lost at sea with many casualties and claims well in excess of policy limits. 41 The insurer asked the court to allow the insurer to pay the coverage limit and

38. Id. at 1084.
39. See id. at 1085.
40. Id.; see also Friedman v. Berkowitz, 136 N.Y.S.2d 81 (N.Y. Civ. Ct. 1954). In Friedman, the defendant obligingly testified that he had indeed negligently created a condition that injured his son-in-law. Friedman, 136 N.Y.S.2d at 82. The court refused to permit the lawyer to impeach the insured, stating, "The lawyer is only the agent of the client and, so long as he continues in that capacity, he must follow the directions of his client, and not prolong the litigation to test an issue between his client and a possible third party." Id. at 83. The court stated that the insurer must try the collusion issue in another forum. Id.; accord Katz v. Ross, 216 F.2d 880, 885 (3d Cir. 1954) (explaining that a lawyer defending an insured is not permitted to cross-examine him about his behavior at the time of the accident); Spadaro v. Palmisano, 109 So. 2d 418, 422 (Fla. Dist. Ct. App. 1959) (holding that issues of fraud and collusion must be tried in a separate proceeding); Gass v. Carducci, 185 N.E.2d 285, 290 (Ill. App. Ct. 1962) (stating that Illinois follows the majority rule) ("Insurance counsel may not impeach his client, the insured, for the benefit of his employer, an insurance company not a party to the suit.").
avoid any duty to defend the lawsuits, but the court refused. The duty to defend is not subordinate to the duty to indemnify. It is a separate benefit for the insured, not just a way for the insurer to avoid liability of its own. The court asserted, "The principle that 'the duty to defend is broader than the duty to pay' is now beyond cavil." The complaints were sufficient to allege a covered event, so the insurer had a duty to defend regardless of the degree to which it ultimately bore the losses.

Similarly, in Farmers Insurance Co. v. Vagnozzi, the insured knocked another player to the ground during an informal basketball game. If the act was intentional, it was not covered by policy; if it was an accident, it was covered. Again, the insurance company sought a declaratory judgment that it had no duty to defend. And again, the court refused to let the insurer avoid the obligation. The blow was intentional in the sense that both players voluntarily participated in a rough basketball game, but the incident clearly was different from sluging someone on the street. The only way to decide whether the blow was intentional

42. Id.
43. See id. at 401.
44. See id. at 399.
45. Id.
46. Id. at 401; see also Prashker v. United States Guar. Co., 136 N.E.2d 871, 875 (N.Y. 1956) (stating that the insurer's liability for the cost of a defense must await proof at trial as to the cause of the accident).
47. 675 P.2d 703, 703 (Ariz. 1983).
48. See id. at 704.
49. Id. at 705.
50. Id.; see also Southern Md. Agric. Ass'n v. Bituminous Cas. Corp., 539 F. Supp. 1295, 1304 (D. Md. 1982) (forcing insurer to defend suit accusing insured employees of stealing ticket revenues); All-Star Ins. Corp. v. Steel Bar, Inc., 324 F. Supp. 160, 161 (N.D. Ind. 1971) (enforcing insurer's duty to defend against suit by bar patron even though incident occurred after closing time); Gray v. Zurich Ins. Co., 419 P.2d 168, 178 (Cal. 1966) (stating whether act be intentional or done in self-defense must await determination at trial); Crum v. Anchor Cas. Co., 264 Minn. 378, 387-88, 119 N.W.2d 703, 709 (1963) (stating that insurer had duty to defend regardless if the tenant's injury occurred while tenant was acting as employee); American Home Assurance Co. v. Weissman, 434 N.Y.S.2d 410, 412 (N.Y. 1981) (stating whether acts done in covered role as attorney or non-covered role as investment advisor could only be determined after trial); Employers' Fire Ins. Co. v. Beals, 240 A.2d 397, 402-03 (R.I. 1968) ("[T]he insurer's duty to defend a suit brought against one of its policyholders is determined by the allegations contained in the complaint. [A] liability insurer's duty to defend is predicated not upon information in its possession which indicates or even proves non-coverage, but instead upon the allegations in the complaint filed against the insured.").

51. Vagnozzi, 675 P.2d at 710.
was to go to trial.52

C. The Conflict of Interest Thus Presented

If the defense provided by the insurance company succeeds in excusing the insured from all liability to the plaintiff, in most cases both the insured and the insurer will be happy. That is the ideal, but not very interesting, objective.

Realistically, the insured often will be found guilty of something. When one basis of liability will require the insurer to pay the judgment against the insured, while another basis will require the insured to pay the judgment alone, it is easy to see that a lawyer representing the insurer and insured as separate and equal co-clients faces a serious conflict of interest. To compound the problem, the lawyer likely will never see the insured again, whereas the insurance company is a prospective source of many more legal fees. It is easy to imagine which “client’s” interest the lawyer will have an incentive to favor.

Indeed, the conflict problem is so serious that the insurance company must announce that its provision of the defense is under a “reservation of rights” if it wants to later have a right to raise a coverage or policy defense.53 When such a reservation of rights is asserted, the insured may either be defended by the insurer’s lawyer or seek separate and independent counsel.

Even if the representation is by the lawyer selected by the insurance company, however, it is clear the lawyer’s duty is to the in-

52. Id.; see also Transamerica Ins. Group v. Meere, 694 P.2d 181, 187 (Ariz. 1984) (claiming that a blow was struck in self-defense is enough to remove the case from the intentional act exclusion of the policy); Brohawn v. Transamerica Ins. Co., 347 A.2d 842, 848 (Md. 1975) (stating that insured’s guilty plea to criminal assault was not determinative of whether act was intentional and thus did not eliminate insurer’s duty to defend).

53. See, e.g., Tomerlin v. Canadian Indemn. Co., 394 P.2d 571, 574 (Cal. 1964) (holding that a lawyer had actual and apparent authority to bind the insurer by his representation that reservation of rights would not be asserted; thus, the insurer was estopped from denying coverage); Meirthew v. Last, 135 N.W.2d 553, 355 (Mich. 1965) (failing to reserve rights estops the insurer from asserting policy defense); Perkoski v. Wilson, 92 A.2d 189, 191 (Pa. 1952) (“It was . . . incumbent upon the company to inform its policyholder of its prospective adverse interest with respect to the extent of its liability under the terms of the policy. [It did not do that.] Good conscience and fair dealing required that the company pursue a course that was not advantageous to itself while disadvantageous to its policyholder; and, not having so acted, the company was estopped thereafter to the extent of its liability to the insurer on account of the judgment against him in favor of the [plaintiff].”).
sured. One court put the rule this way:

When counsel, although paid by the casualty company, undertakes to represent the policyholder and files his notice of appearance, he owes to his client, the assured, an undeviating and single allegiance. His fealty embraces the requirement to produce in court all witnesses, fact and expert, who are available and necessary for the proper protection of the rights of his client. It is immaterial that such procedure increases the cost to the carrier beyond the policy coverage limit. 54

Alternatively, the insured may select counsel of its own. In many states, the insurance company must pay the reasonable bill for that lawyer’s services. 55 These principles were described clearly in San Diego Navy Federal Credit Union v. Cumis Insurance Society. 56 The credit union had been sued by a former employee for wrongful discharge. 57 The plaintiff sought general and punitive damages. 58 The insurer agreed to defend all issues, but it expressly reserved coverage questions, especially as to punitive damages. 59 The credit union hired independent counsel and the issue was who must pay the additional expense. 60

The court noted that typically the insurer and insured have the same interest in defeating a plaintiff, but it noted that “there has been recognition that, in reality, the insurer’s attorneys may have closer ties with the insurer and a more compelling interest

57. Id. at 496.
58. Id.
59. Id.
60. See id. at 497.
in protecting the insurer's position, whether or not it coincides with what is best for the insured.\textsuperscript{61} The basis of liability may or may not be found within the terms of the policy. The defense team would have to make trial decisions that might or might not benefit the insured.\textsuperscript{62} The same could be true in settlement talks and pretrial discovery.\textsuperscript{63} In cases like this one, the court said, the lawyer hired by the insurer must tell both insurer and insured the risks of joint representation.\textsuperscript{64} If the insured does not agree to those lawyers continuing in the case, they must cease representing both the insurer and the insured.\textsuperscript{65} At that point, the insurer must pay for insured's counsel and give the insured the right to control the litigation.\textsuperscript{66}

Thus, on the issue of direction of the defense, in cases where the only lines of defense are clearly within the terms of the insur-

\textsuperscript{61} Id. at 498 n.3 (quoting Purdy v. Pacific Auto. Ins. Co., 203 Cal. Rptr. 524, 534 (Cal. Ct. App. 1984)).

\textsuperscript{62} Cumis, 208 Cal. Rptr. at 498.

\textsuperscript{63} Id. at 499. The court also saw a problem with the handling of confidential client information if the lawyer had to represent two clients:

\begin{quote}
As between counsel's two clients, there is no confidentiality regarding communications intended to promote common goals. But confidentiality is essential where communication can affect coverage. Thus, the lawyer is forced to walk an ethical tightrope, and not communicate relevant information which is beneficial to one or the other of his clients.
\end{quote}

\textit{Id.}

\textsuperscript{64} Id.

\textsuperscript{65} Id. at 500.

\textsuperscript{66} Id. at 506. California codified the Cumis decision in its civil code, which summarily provides:

\begin{enumerate}
\item [(a)] If the policy gives the insurer a duty to defend, the insured must be given a right to independent counsel.
\item [(b)] No conflict of interest shall be deemed to exist as to allegations of punitive damages or for a demand in excess of policy limits.
\item [(c)] An insurer may demand that the insured's counsel be experienced and carry liability insurance.
\item [(d)] The duty of independent counsel must disclose to insurer all relevant material, except that which is privileged.
\item [(e)] The insured may waive its right to select independent counsel.
\item [(f)] Both insured and insurer's counsel may participate in all aspects of the litigation and nothing shall lessen the insured's duty to cooperate with insurer.
\end{enumerate}

\textsuperscript{67} CAL. CIV. CODE § 2860 (West 1987); see also Employers Ins. v. Albert D. Seeno Constr. Co., 692 F. Supp. 1150, 1153 (N.D. Cal. 1988) (implementing Cumis); Jon R. Mower & James P. Schratz, \textit{The Other Side of the Cumis Coin: The Insurer's Ability to Select Associate Defense Counsel Under Civil Code Section 2860(f)}, 20 W. ST. U. L. REV. 569, 573 (1993) (explaining that under California statute, the insurer may select independent defense counsel to assist the insured's independently selected counsel).
ance policy, it really does not matter how one talks about whom the lawyer represents. Whether one says there is one client or two, no one’s behavior will change. Where policy or coverage defenses are involved, however, it is clear that the lawyer’s duty is to the insured alone. Given that fact, there is no productive reason not to treat the insured as the client and the insurance company as a third party paying the bill. Indeed, discussing the relationship any other way can only be misleading.

IV. THE DECISION TO SETTLE

Perhaps the single most important decision for a defendant in a lawsuit is deciding when and whether to settle the case. The cost of continuing to litigate and the risk that a verdict would exceed the settlement must be balanced against the amount of the settlement. In a case where a defendant is not insured, the defendant can strike the balance in terms of his or her own interests.

When insurance is involved, however, the calculation changes. The cost of continuing to litigate will be borne by the insurer alone, as will the cost of any settlement within policy limits. The risk that a verdict will exceed the face amount of the policy would be borne by the insured alone. Once again, then – in many if not most cases – the interests will differ; the conflict of interests is clear.

A. Bad Faith Failure to Settle a Case

The most common way the conflict of interest arises is when the plaintiff makes an offer to settle the case for a sum equal to or less than the insured’s policy limits. Acceptance of a policy limit offer would, in most cases, be an unqualified benefit to the insured; the insured’s possible liability for a large excess judgment would be extinguished. The insurer, on the other hand, may have little to gain by accepting the offer. It may have at stake only whatever additional litigation costs are foreseeable, whereas there is always the chance the jury might find the defendant not liable at all.

For many years, courts have sought to design a rule that would allow the insurance company to decide whether and when to settle, but that would require the insurer to apply an equitable standard. For example, in Comunale v. Traders & General Insurance
plaintiffs were struck by an insured truck driver. The insurance company refused to defend, claiming the truck was not owned by the insured. The insured notified the insurer that the case could be settled within policy limits but the company refused to settle, and the final verdict was well above the face amount of the policy. The question was whether the insurer could be forced to pay the liability in excess of policy limits.

The court said an insurer has an implied duty of fair dealing with its insured, which requires the insurer to settle in an appropriate case although the express terms of the policy do not impose such a duty. The insurer, in deciding whether a claim should be compromised, must take into account the interest of the insured and give it at least as much consideration as it does to its own interest. When there is great risk of recovery beyond the policy limits so that the most reasonable manner of disposing of the claim is a settlement which can be made within those limits, a consideration in good faith of the insured's interest requires the insurer to settle the claim. Its unwarranted refusal to do so constitutes a breach of the implied covenant of good faith and fair dealing.

Henke v. Iowa Home Mutual Casualty Co. refined the insurer's required calculation even further. The Henke court said that "if an insurer acts in complete good faith as to all investigation and negotiations concerning the catastrophe involved, it is not liable for excess judgments above policy limits." If the insurer acts in bad faith, however, the trial court will have to submit the question of recovery to the jury, because "[b]ad faith requires more than a showing of inadvertence or honest mistake of judgment." The court added this caveat:

The insurer must give equal consideration to the interests of the insured as it does its own interests, and the failure to do so can be one element of bad faith. Re-

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68. Id. at 200.
69. Id.
70. Id.
71. Id. at 201.
72. 97 N.W.2d 168 (Iowa 1959).
73. Id. at 172.
74. Id.
jecting settlement proposals which the insurer [knows] to be reasonable, and which [are] within the policy limits, manifests bad faith towards the insured's interest....

The insurer must not refuse to make a settlement, if it knows that it has no more than an equal, or less than 50-50, chance of winning the case and if the case is lost the verdict against insured will without doubt exceed the policy limits, provided settlement can be made within policy limits.\textsuperscript{75}

In \textit{Henke}, several claims had been filed; the insurer had refused to try individual settlements, wanting instead to pay the face amount of the policy in a single case to save litigation costs.\textsuperscript{76} The insurer had to pay the full amount of the verdicts because its refusal to settle the claims individually constituted bad faith.\textsuperscript{77}

In \textit{Lysick v. Walcom},\textsuperscript{78} the bad faith issue hit the lawyers in the

\textsuperscript{75} Id. at 173-74.

\textsuperscript{76} Id. at 171.

\textsuperscript{77} Id. at 177; see also American Fidelity & Cas. Co. v. G.A. Nichols Co., 173 F.2d 830, 833 (10th Cir. 1949) (holding it was bad faith not to settle when highly likely the verdict would exceed policy limits); Crisci v. Security Ins. Co., 426 P.2d 173, 178 (Cal. 1967) (finding that where lawyer had predicted $100,000 exposure and verdict came in for $101,000, it was bad faith not to have settled for $10,000 face value of policy; awarding insured additional damages for her mental suffering); Betts v. Allstate Ins. Co., 201 Cal. Rptr. 528, 541 (Cal. Ct. App. 1984) (holding that where company offered nothing in settlement and damage exposure was high, punitive damages were available for bad-faith failure to settle); Davy v. Public Nat'l Ins. Co., 5 Cal. Rptr. 488, 492 (Cal. Ct. App. 1960) (explaining it was bad faith for the insurer to gamble the insured's exposure to $19,000 excess judgment against its chance to save $4500 if the jury found no liability); Ranger County Mut. Ins. Co. v. Guin, 723 S.W.2d 656, 659 (Tex. 1987) (imputing negligence of a lawyer in failing to settle to the insurer); G.A. Stowers Furniture Co. v. American Indem. Co., 15 S.W.2d 544, 547 (Tex. Comm'n App. 1929) (explaining that negligent failure to settle, not lack of good faith, is the standard).

\textsuperscript{78} 65 Cal. Rptr. 406 (Cal. Ct. App. 1968).
pocketbook. Lysick was a wrongful death action.\(^{79}\) The policy limits were $10,000.\(^{80}\) The plaintiff demanded the face amount of the policy, but Allstate offered only $9,500 which the plaintiff refused.\(^{81}\) The plaintiff sued, asking for damages of $450,000 but offering to accept $12,500.\(^{82}\) The insured's private lawyer demanded that Allstate accept the offer and pay $10,000, with the insured paying the $2,500 in excess of the policy limit.\(^{83}\)

Allstate continued to offer only $9,500, and the plaintiff continued to reject it.\(^{84}\) Later, Allstate authorized an offer of the full $10,000 if "wise and expedient to do so," but said it would not pay before trial.\(^{85}\) Finally, when Allstate offered the full $10,000, the insured defendant was not able to pay the extra $2,500.\(^{86}\) When the case went to trial, the verdict came back for $225,000.\(^{87}\) Walcom, the lawyer retained to defend the insured, was sued for his conduct in failing to get the case settled.\(^{88}\)

The court held that the provision in the policy giving the insurer the right to defend claims normally constitutes consent to have the insurer conduct the defense.\(^{89}\) The attorney, however, nevertheless owes the insured "the same obligations of good faith and fidelity as if [the insured] had retained the attorney personally."\(^{90}\) Sometimes, conflicts may arise. They do not necessarily mean the lawyer must withdraw, but "when an attorney attempts a dual relationship without making the full disclosure required of him, he is civilly liable to the client who suffers loss caused by lack of disclosure."\(^{91}\) Lawyer Walcom would be liable for the jury verdict in excess of the policy limit if his breach of duty were found to be a proximate cause of the loss.\(^{92}\) Although the bad faith doc-

\(^{79}\) Id. at 410.
\(^{80}\) Id.
\(^{81}\) Id.
\(^{82}\) Id.
\(^{83}\) Id.
\(^{84}\) Lysick, 65 Cal. Rptr. at 410-11.
\(^{85}\) Id. at 411.
\(^{86}\) Id. at 412. The defendant was an estate, and the individual who had offered to pay the extra $2,500 had himself died. Id.
\(^{87}\) Id.
\(^{88}\) Id.
\(^{89}\) Id. at 413.
\(^{90}\) Lysick, 65 Cal. Rptr. at 413.
\(^{91}\) Id. at 414.
\(^{92}\) Id. at 418 (relying generally on Lucas v. Hamm, 364 P.2d 685 (Cal. 1961), cert. denied, 368 U.S. 987 (1962)). The traps for the unwary in this area have generated a group of cases that might be called the "bad-faith setup." Basically, the
trine primarily relates to insurance company liability, any lawyer who treats an insurance company as his or her client, rather than treating the insured or both as clients, is taking a foolhardy risk.

B. Settlement of a Case Without the Insured’s Consent

The flip side of failing to settle when the opportunity arises is deciding to settle when the insured would prefer to fight. Sometimes settlements can do collateral damage to an insured, as when a malpractice settlement hurts a doctor’s reputation. On this issue the insurance policy typically is clear; the insurer reserves to itself the right to settle cases. This does not, however, always govern the lawyer’s duty to the client, the insured.

In Rogers v. Robson, a doctor was sued for malpractice. His malpractice insurer retained counsel to defend the action. Although his policy did not give him a veto over settlements, the doctor made clear to the law firm that he did not want the case settled without his consent. The lawyer did settle, however, for $1250. In the settlement agreement, the patient expressly denied the doctor’s liability.

Nevertheless, the doctor filed an action against the lawyer for wrongful settlement. The court agreed that the doctor’s malpractice policy gave the insurance company the right to settle with-
out approval of the insured. The court said the duty of the lawyer still could be breached. The insured is the client; the insurer is merely the lawyer's employer. The lawyer owes the insured the same duties he or she would owe a client paying his or her own bills. When an opportunity for settlement arose, the lawyer had a conflict. He had to explain everything to both clients. The doctor might have lost coverage from a failure to cooperate and to allow the insurer to settle, but those consequences would have been the doctor's choice.

99. Rogers, 392 N.E.2d at 1370; accord Caplan v. Fellheimer, Eichen, Braverman & Kaskey, 68 F.3d 828, 836-37 (3d Cir. 1995) (allowing insurer to settle employment discrimination suit without approval of insured, even though such a settlement precluded insured's future malicious prosecution claim); Feliberty v. Damon, 527 N.E.2d 261, 262 (N.Y. 1988) (holding that insurer had the absolute right to settle claim according to the contract provisions); see also Jon Epstein, Annotation, Liability of Insurer to Insured for Settling Third-Party Claim Within Policy Limits Resulting in Detriment to Insured, 18 A.L.R.5th 474, 482-524 (1994) (compiling decisions regarding insurer's liability for damage to particular interests of insured resulting from settlement).

100. Rogers, 392 N.E.2d at 1370-71.

101. Id.

102. Id. at 1371.

103. Id.

104. Id.

105. Id. at 1371-72. The Rogers decision was affirmed by the Illinois Supreme Court. In its short opinion, the court said:

Although defendants were employed by the insurer, plaintiff, as well as the insurer, was their client and was entitled to a full disclosure of the intent to settle the litigation without his consent and contrary to his express instructions. Defendants' duty to make such disclosure stemmed from their attorney-client relationship with plaintiff and was not affected by the extent of the insurer's authority to settle without plaintiff's consent.


The Missouri Court of Appeals reached a similar conclusion:

The obligations of an attorney to his client "are in no way abridged by the fact that an insurer employs him to represent an insured." The attorney owes the insured the same obligation of good faith and fidelity as if the insured had retained the attorney personally and at his own expense.

Arana v. Koerner, 735 S.W.2d 729, 733 (Mo. Ct. App. 1987) (quoting Betts v. Allstate Ins. Co., 201 Cal. Rptr. 528, 545 (Cal. Ct. App. 1984)). Failure to recognize and clear the conflict between insurer and insured here was breach of his duty as the doctor's lawyer, not as an agent of the insurance company. Id.; accord Lieberman v. Employers Ins., 419 A.2d 417, 425 (N.J. 1980) (representing insurer in settlement agreement despite insured's legitimate objections breaches lawyer's duty to insured). But see Mitchum v. Hudgens, 533 So. 2d 194, 202 (Ala. 1988) ("[E]ven if the insured objects to a settlement of a claim, the attorney is not thereby precluded from negotiating a settlement at the direction of the insurer where the insurer has, by the terms of the policy, the exclusive right to settle or compromise claims against its insured.").
V. THE SANCTITY OF COMMUNICATIONS

One of the central concerns of insurance companies seeking co-client status with their insureds has been the attorney-client privilege. Normally, if a lawyer tells a non-client about a communication with a client, the privilege is lost. If the communication involves two co-clients, however, the privilege is preserved.

In *Goldberg v. American Home Assurance Co.*, Goldberg, an attorney, and his law firm were sued by a client for damages sustained by the client when the firm filed a false SEC registration statement on the client's behalf.\(^\text{106}\) Goldberg answered the complaint, using private counsel and making affirmative claims against both the client and the law firm.\(^\text{107}\) He asked the insurer to provide him a defense lawyer and the insurer assigned Bergadano to the matter.\(^\text{108}\) Bergadano made periodic reports to the insurer without sending copies to Goldberg.\(^\text{109}\) The court found no problem with that:

Inasmuch as Bergadano was acting as counsel not only for plaintiff-insured but also for defendant-insurer in defending the federal claim against plaintiff, it was only natural that Bergadano provide periodic status reports to the client paying his fee. Although the better practice might be to provide plaintiff with courtesy copies of all of these communiques, there was no obligation to do so.\(^\text{110}\)

This same logic has made it possible for an insured to see confidential communications about the case sent to the insurance company by the lawyer. In *E.W. Henke v. Iowa Home Mutual Casualty Co.*, the insured wanted documents to prove a bad-faith failure to settle.\(^\text{111}\) The company said the materials were privileged and denied that the insured was the lawyer's client at all.\(^\text{112}\) The court stated: "The fact that another selects and pays an attorney does not control the relationship of attorney-client . . . . When with due knowledge one assents to the appearance in court of an

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\(^\text{107}\) *Id.* at 4.
\(^\text{108}\) *Id.*
\(^\text{109}\) *Id.*
\(^\text{110}\) *Id.* at 5 (citations omitted).
\(^\text{111}\) 87 N.W.2d 920, 920 (Iowa 1958).
\(^\text{112}\) *Id.* at 922.
attorney in his behalf, an attorney-client relationship must be presumed.\textsuperscript{113} The court found the lawyer represented two clients and, thus, there was no privilege between them.\textsuperscript{114} The insured could get the correspondence.\textsuperscript{115}

Defenders of the two-client model should not get too excited. Co-client status is a sufficient but not a necessary way to preserve the protection of the privilege. When confidentiality of the insured's communications with the insurance company is important, courts have consistently resisted the efforts of insurance companies to access them.

\textit{Allstate Insurance Co. v. Keller} was a suit for declaratory judgment to determine whether the insurer was liable on a policy because of the insured's breach of the duty to cooperate.\textsuperscript{116} The insured reported to the insurer that he had been driving at the time of an accident, but the insurance company's lawyer took a state-

\begin{itemize}
  \item \textsuperscript{113} \textit{Id.} at 923.
  \item \textsuperscript{114} \textit{Id.}
  \item \textsuperscript{115} \textit{Id.} at 927; see also \textit{Longo v. American Policyholders' Ins. Co.}, 436 A.2d 577 (N.J. Super. Ct. Law Div. 1981). The \textit{Longo} court stated, "A lawyer so retained [by the insurer] is duty bound to represent the insured with undivided fidelity. His ethical obligation is in no sense diminished by reason of his relationship with the insurer." 436 A.2d at 580. In \textit{Longo}, the lawyer represented both insurer and insured and could not subordinate the rights of one client to the other. \textit{Id.} If the interests were in conflict, the lawyer had a duty to resign. \textit{Id.} Thus, the court assumed the interests were coincident and there was nothing to fear from disclosure. \textit{Id.}

  The opposite situation occurred in \textit{Liberty Mutual Insurance Co. v. Engels} where the insurer wanted to see a statement by the insured. 244 N.Y.S.2d 983, 984-85 (N.Y. Sup. Ct. 1963), aff'd, 250 N.Y.S.2d 851 (N.Y. App. Div. 1964). The court approved the insurer's request, again citing the co-client exception to the privilege. \textit{Id.} Further, to permit the insured to make conflicting statements would be to let the privilege be used "as a sword and not as a shield, a use not condoned by the courts." \textit{Id.} at 986.

  Some courts have taken a different approach. In \textit{American Mutual Liability Insurance Co. v. Superior Court}, the court stated that "the attorney has two clients whose primary, overlapping and common interest is the speedy and successful resolution of the claim and litigation." 113 Cal. Rptr. 561, 576 (Cal. Ct. App. 1974). The trio is "a loose partnership, coalition or alliance directed toward a common goal." \textit{Id.} Communications between them and the lawyer are thus privileged. \textit{Id.} However, "there is a sense in which each is independent of the other." \textit{Id.} at 572. It may be that the lawyer may tell the insurer in confidence some things he wouldn't tell the insured - for example, what kind of witness he will make. \textit{Id.} at 572-73. "Similarly there may be confidences indulged by the insured to the attorney which in turn are not intended for the insurer." \textit{Id.} at 572; see also \textit{State Farm Fire & Cas. Co. v. Superior Court}, 285 Cal. Rptr. 372, 375-76 (Cal. Ct. App. 1989) (stating that insured who had \textit{Cumis} counsel was not entitled to see communications between insurance adjuster and insurer).

  \textsuperscript{116} 149 N.E.2d 482, 482 (Ill. App. Ct. 1958).
ment from the insured, in which he admitted he had not been the driver.\footnote{117} The lawyer took the statement to support the insurer's effort to assert the policy defense.\footnote{118} The court acknowledged that an insurer must depend on the veracity of an insured's report and that the cooperation clause serves a public purpose.\footnote{119} Nonetheless, the court stated, "[w]here an insurer's attorney has reason to believe that the discharge of his duties to his client, the insured, will conflict with his duties to his employer, the insurer, ... it becomes incumbent upon [the lawyer] to terminate his relationship with the client."\footnote{120} The lawyer's misconduct was imputed to the insurer, and the insurer could not avoid liability.\footnote{121}

\begin{enumerate}
  \item \textit{Id.} at 483.
  \item \textit{Id}.
  \item \textit{Id.} at 484-85.
  \item \textit{Id.} at 486.
  \item \textit{Id.} In an effort to guide lawyers in their dealings with the confidential information of insurers and insureds, in 1970 the ABA National Conference of Lawyers and Liability Insurers drafted what came to be called the "Guiding Principles," a portion of which are shown here:

  \textbf{IV. CONFLICTS OF INTEREST GENERALLY - DUTIES OF ATTORNEY.}

  In any claim or in any suit where the attorney selected by the company to defend the claim or action becomes aware of facts or information which indicate to him a question of coverage in the matter being defended or any other conflict of interest between the company and the insured with respect to the defense of the matter, the attorney should promptly inform both the company and the insured, preferably in writing, of the nature and extent of the conflicting interest. In any such suit, the company or its attorney should invite the insured to retain his own counsel at his own expense to represent his separate interest.

  \textbf{V. CONTINUATION BY ATTORNEY EVEN THOUGH THERE IS A CONFLICT OF INTERESTS.}

  Where there is a question of coverage or other conflict of interest, the company and the attorney selected by the company to defend the claim or suit should not thereafter continue to defend the insured in the matter in question unless, after a full explanation of the coverage question, the insured acquiesces in the continuation of such defense.

  \textbf{VI. DUTY OF ATTORNEY NOT TO DISCLOSE CERTAIN FACTS AND INFORMATION.}

  Where the attorney selected by the company to defend a claim or suit becomes aware of facts or information, imparted to him by the insured under circumstances indicating the insured's belief that such disclosure would not be revealed to the insurance company but would be treated as a confidential communication to the attorney, which indicate to the attorney a lack of coverage, then as to such matters, disclosures made directly to the attorney should not be revealed to the company by the attorney nor should the attorney discuss with the insured the legal significance of the disclosure or the nature of the coverage question.

  ABA National Conference of Lawyers & Liability Insurers, \textit{Guiding Principles}, 20

\end{enumerate}
Moreover, the insurer had waived the breached cooperation clause by waiting one and one-half years after the false report to complain.122

Similarly, in Parsons v. Continental National American Group, the insured's son had assaulted a neighbor child.123 It appeared the son had not acted intentionally, and the insurance company was prepared to take its adjuster's advice to settle.124 When counsel was assigned to take over the defense, however, he obtained a confidential psychological file on the son and learned that the attack probably was intentional.125 This additional information led to a reservation of rights letter.126 The lawyer later interviewed the son and got a statement from him admitting willfulness.127

The court did not defend insurance fraud, but said, "The attorney in the instant case should have notified CNA that he could no longer represent them when he obtained any information (as a result of his attorney-client relationship with [the insured's son]) that could possibly be detrimental to [the son's] interests

FED'N INS. COUNS. Q. 95 (1970); see also Employers Cas. Co. v. Tilley, 496 S.W.2d 552 (Tex. 1973). Tilley was a suit for declaratory judgment as to whether late notice of an accident relieved the insurer of its obligation to defend. 496 S.W.2d at 554. Employers had retained a lawyer to defend Tilley, and he had done so for one and one-half years, but at the same time he was gathering information to show that Tilley had indeed known of the accident earlier than when suit was filed and thus could have notified the carrier. See id. The lawyer never told Tilley of this work for the carrier. Id. The policy provided that the lawyer was to be "selected, employed and paid" by the carrier. Id. at 558. However, such attorney becomes the attorney of record and the legal representative of the insured, and as such he owes the insured the same type of unqualified loyalty as if he had been originally employed by the insured. If a conflict arises between the interests of the insurer and the insured, the attorney owes a duty to the insured to immediately advise him of the conflict. Id. at 558-59 (relying on the "Guiding Principles" as the public policy of Texas; concluding that the principles are not changed by the reservation of rights issued by the insurer here). "An attorney employed by an insurer to represent the insured simply cannot take up the cudgels of the insurer against the insured. . . ." Id. at 560. The insurer could and should have developed the evidence as to coverage through other agents, investigators, or lawyers, not the one assigned to represent Tilley. Id. at 560-61. Thus, the insurer was estopped from denying coverage. Id.

122. Keller, 149 N.E.2d at 486.
124. Id. at 96.
125. Id.
126. Id.
127. Id.
under the coverage of the policy." 128 When a lawyer uses his confidential relationship with the insured to gather evidence for the insurer, allowing it to deny coverage under the policy, the insurer is estopped from disclaiming liability under the policy. 129 The insurance company was liable for the full $50,000 judgment. 130

Again, calling the insurance company a co-client of the insured can lead the lawyer, and the insurance company, astray. Calling the insurer an agent of the insured for communication with counsel would be sufficient to protect as privileged those communications that are necessary and in the interest of both the insurer and the insured. The cases are clear: the insured is the only client in any relevant sense.

VI. THE RIGHT TO SUE FOR MALPRACTICE

The final issue is what happens if the lawyer commits malpractice. The traditional view long has been that only a client may sue for malpractice. Yet in a case where the result of the malpractice is a judgment paid by the insurer, it might seem that no one could call the lawyer to account.

In some cases the insured will have a personal right to damages for the malpractice. In *Central Cab Co. v. Clarke*, for example, a passenger was hurt riding in a taxicab. 131 The passenger sued the taxicab company, and the company referred the matter to its insurance company, which was obligated to defend. 132 Clarke was retained to handle the case. 133 He secured an extension of time to answer, but he sent the file back when the insurer did not send him a retainer fee. 134 He misdirected a copy of his letter to an-

128. *Id.* at 98.
130. *Id.* at 100; *see also* ABA Comm. on Ethics and Professional Responsibility, Informal Op. 949 (1966) (stating where the lawyer learns of a factual basis for a failure to cooperate while representing the insured, he or she may not disclose that factual basis to the insurer). *But see* Lockhart v. Allstate Ins. Co., 579 P.2d 1120, 1123 (Ariz. Ct. App. 1978) (claiming insurer may use against insured a statement that when given was intended to be self-serving); Shafer v. Utica Mut. Ins. Co., 289 N.Y.S. 577, 587 (N.Y. App. Div. 1936) (holding that a lawyer who represented both insured and insurer is not obliged to keep the insured's statement from the insurer or to fail to use it against insured; stating that the privilege may be used as a shield but not a sword).
131. 270 A.2d 662, 663 (Md. 1970).
132. *Id.*
133. *Id.* at 663-64.
134. *Id.* at 664.
other company, so even the insured, which was in receivership, did not know what was happening with the case. The plaintiff ultimately accepted a default judgment the insured was required to pay, so the insured sued its lawyer, Clarke, for malpractice.

The question was whether a lawyer-client relationship had been established by the insurer's sending him the file. The court said that when a liability insurer obtains counsel to defend the insured, counsel "represents the insured as well as the insurance carrier[,] and the attorney-client relationship is thus established between the insured and the attorney selected for the insured by the insurance company." Thus, Clarke should have known he had to notify the insured when he terminated the representation, and he was the one who misdirected the letter. The court found a lawyer-client relationship with the insured for purposes of a suit for malpractice.

The more difficult question is whether the insurance carrier also has a right to sue for malpractice. The Restatement indicates yes, relying on what might be called a third-party beneficiary theory. Courts often have rejected the theory, but this may be changing. In Atlanta International Insurance Co. v. Bell, a worker had fallen to his death in a hole on a job site. Atlanta International, which insured the security service that guarded the prem-

135. Id. at 665.
136. Id.
137. Central Cab, 270 A.2d at 666.
138. Id.
139. Id.
140. Id. at 667; see also Purdy v. Pacific Auto. Ins. Co., 203 Cal. Rptr. 524 (Cal. Ct. App. 1984). Malpractice action in California is more tort than contract. See Purdy, 203 Cal. Rptr. at 533. "In the case at bench, however, there were in fact two clients, the insurance carrier and the insured ... The attorney's primary duty has been said to be to further the best interests of the insured." Id. And the insured may have a cause of action against the insurance company for the malpractice of the lawyer. See id. at 534. But see Continental Ins. Co. v. Bayless & Roberts, Inc., 608 P.2d 281, 293 (Alaska 1980) (contending that negligent failure to settle within policy limits falls short of bad faith).
ises, retained the Bell law firm to provide the defense. The firm filed an answer but failed to plead comparative negligence as a defense. Atlanta had to pay a higher judgment than it should have had to pay, so it sued the lawyers for legal malpractice.

The court started from the position that a lawyer is liable for malpractice only to a client. Allowing third-party liability could create conflicts of interest and discourage a lawyer's full representation of a client. The court added, "The relationship between the insurer and the retained defense counsel, while less than a client-attorney relationship, unquestionably differs from the relationship between a defense counsel and a party-opponent." The lawyer even has fiduciary obligations to the insurance company. Furthermore, only the insurer has any real incentive to sue for malpractice.

The interests of insurer and insured can differ, and the court made clear that "the defense attorney's primary duty of loyalty lies with the insured, and not the insurer." An equitable subrogation theory of the insurance company's recovery avoids all conflict of interest when it comes to suing for malpractice. Thus, the insurance company in Bell was permitted to stand in the shoes of the insured, so the financial loss could be borne by the appropriate party.

143. Id.
144. Id.
145. Id.
146. Id.
147. Id.
148. Bell, 475 N.W.2d at 297.
149. Id.
150. Id.
151. See id. at 298.
152. Id. at 298-99. Justice Cavanagh, writing for the three dissenting justices, stated that at the outset of most representations, there is a community of interests of insurer and insured. Id. at 301. The "special relationship" between attorney, insurer and insured arises from the consent of the insured. Id.

The reason ... for allowing the attorney to make disclosures to the insurance carrier is not that there is an attorney-client relationship between the insurer and the attorney, but that the client waives this confidentiality with regard to the insurance carrier and agrees to cooperate in the defense of a claim upon signing the contract of insurance. Thus, it is the insurance contract that creates a special relationship between the attorney, the insured, and the insurer. This unique relationship, however, does not rise to the status of an attorney-client relationship.

Id. The insurer really only pays the lawyer's fee. Id. Allowing equitable subrogation, the dissenters feared, could "substantially impair an attorney's ability to make
Unigard Insurance Group v. O'Flaherty & Belgum reached a similar result with a more direct theory. Hunn sued Wilkinson for injuries sustained at work. The answer did not allege worker's compensation as the exclusive remedy or claim a right of set-off. Unigard had to pay policy limits to avoid the insured's facing an even larger judgment. Unigard sued O'Flaherty, the lawyer.

The court held that a lawyer "owes a duty of care to the insurer[,] which will support its independent right to bring a legal malpractice action against the attorney for negligent acts committed in the representation of the insured." The right was not based on equitable subrogation. Allowing such suits, based on a breach of duty, provides redress to the party suffering the loss without undercutting the lawyer's duty of loyalty to the insured.

VII. CONCLUSION

When all is said and done, asking whether a lawyer retained by an insurance company represents one client or two probably is not worth the ink spent on it. Clearly, more judicial opinions have used two-client language than one-client, but when the characterization makes a difference, the insured has been the only client worth the name.

The insurance industry may complain that the one-client ap-
proach renders insurance companies second-class citizens, but if they strip away the rhetoric, surely they must see that to act as though the insured is not the only client will almost inevitably involve them in a claim of bad faith that will be a very expensive balm for their pride. On the other hand, the lawyer who thinks of the insured as the client and the insurer as the third party paying the bill will not be led astray.\footnote{161. The first proposed final draft of the Restatement tried to convey that accurate message. See \textit{Restatement (Third)}, supra note 5, § 215.}