THE PROFESSIONAL RESPONSIBILITIES OF INSURANCE DEFENSE LAWYERS

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INTRODUCTION

Law professors are fascinated by civil procedure. Many of us teach the subject and, at most law schools, we emphasize its importance by requiring law students to take our courses in the first year. We write innumerable articles, books, and treatises about

procedure. We convene symposia on every topic under the sun. We help judges design procedures for difficult cases. We serve as special masters. We advise judges and legislators on the merits of possible reforms. Few topics in procedure are too small or too arcane to occupy a law professor's time.

It must therefore seem extraordinarily unlikely that legal scholars could have missed any important set of procedural issues. Even so, we have. Law professors have written little about the impact of liability insurance on civil procedure,¹ and if casebooks can serve as a reliable guide, we have taught about the subject even less.² The omission is striking because insurance and procedure intersect at many points and in important ways.³

In stark contrast to law professors, practicing lawyers understand well the connections between procedure and insurance and make them a primary focus of attention and scholarship.⁴ They

1. Robert Keeton, a federal district court judge and professor at the Harvard Law School, is an important exception to this generalization. In the 1950s and 1960s, he wrote pathbreaking articles on procedural aspects of liability claims handling. See Robert E. Keeton, *Ancillary Rights of the Insured Against His Liability Insurer*, 13 VAND. L. REV. 837 (1960); Robert E. Keeton, *Insurance and Reciprocal Claims Arising from a Single Accident*, 408 INS. L.J. 29, 30-34 (1957) [hereinafter Keeton, *Reciprocal Claims*]; Robert E. Keeton, *Preferential Settlement of Liability-Insurance Claims*, 70 HARV. L. REV. 27 (1956); Robert E. Keeton, *Liability Insurance and Responsibility for Settlement*, 67 HARV. L. REV. 1136, 1168-71 (1954) [hereinafter Keeton, *Liability Insurance*]. The authors of this Article have gained immeasurably from Keeton's works.

2. Until this year, only one civil procedure casebook contained an index entry for insurance. DAVID W. LOUISELL ET AL., CASES AND MATERIALS ON PLEADING AND PROCEDURE: STATE AND FEDERAL 1354 (6th ed. 1989). For reasons not evident, even the authors of that book had a change of heart and omitted the index entry from the current edition. See GEOFFREY G. HAZARD, JR. ET AL., CASES AND MATERIALS ON PLEADING AND PROCEDURE: STATE AND FEDERAL xxvii-xxxviii (7th ed. 1994) (omitting index entry for "insurance"). In response to a suggestion from one of the authors of this Article, an index entry was added to the new edition of RICHARD W. MARCUS ET AL., CIVIL PROCEDURE: A MODERN APPROACH (2d ed. 1995).

3. The authors have contributed several recent works on the relationship between insurance and procedure. See Charles Silver, *Introduction* to VII INSURANCE LAW ANTHOLOGY xi (Donald J. Hoyes ed., 1994) [hereinafter Silver, *Introduction*]; Charles Silver, *Does Insurance Defense Counsel Represent the Company or the Insured?*, 72 TEX. L. REV. 1583 (1994) [hereinafter Silver, *Insurance Defense Counsel*]; Kent D. Syverud, *On the Demand for Liability Insurance*, 72 TEX. L. REV. 1629 (1994) [hereinafter Syverud, *Demand for Liability Insurance*]; Kent D. Syverud, *The Duty to Settle*, 76 VA. L. REV. 1113 (1990).

4. The leading lawyer-commentator is William T. Barker, a member of the IADC Special Committee on Professional Responsibility. His writings include William T. Barker, *Settling Without the Insurer's Consent*, 1992 A.B.A. SEC. TORT & INSUR. PRAC. 335 [hereinafter Barker, *Settling*]; William T. Barker, *"The Right and Duty to Defend": Con-*

know that liability insurance explains a great deal of what happens in litigation, including the decision to bring a lawsuit, the decision to plead certain theories of recovery and to omit others, the decision to try a lawsuit instead of settling it, and the decision to settle on particular terms. Practicing lawyers also know that the desire to preserve insurance coverage or to put policy proceeds beyond a claimant's reach accounts for many unusual and even bizarre acts of litigation conduct. Consider a few examples:

A lawyer representing a female plaintiff denies that a group of male defendants committed intentional misconduct even though the men schemed secretly to videotape the plaintiff having sex.⁵

Parents whose negligence allegedly caused the death of their 13-year-old son hire a family friend to sue them on behalf of their son's estate.⁶

A lawyer representing a female victim of sexual exploitation in a civil action argues that the male defendant was innocent of the crime of sexual assault because the victim was sexually promiscuous.⁷

flicts of Interest and Insurer Control of the Defense, 1992 A.B.A. SEC. TORT & INSUR. PRAC. 195 [hereinafter Barker, *Right and Duty to Defend*]; William T. Barker, *When Does the Insurer Lose the Right to Control the Defense?*, 58 DEF. COUNS. J. 469 (1991) [hereinafter Barker, *Right to Control*]; William T. Barker, *Defense Attorneys and Policy Limits Settlement Offers: Another View*, 1990 BAD FAITH L. REP. 141 [hereinafter Barker, *Defense Attorneys*]; William T. Barker et al., *Is an Insurer a Fiduciary to Its Insureds?*, 25 TORT & INS. L.J. 1 (1989) [hereinafter Barker, *Fiduciary*]. The authors have been greatly influenced by Barker's arguments, and are deeply grateful for his many comments on drafts of the report that they prepared for the IADC.

5. *Boyles v. Kerr*, 855 S.W.2d 593, 604 (Tex. 1993) (Gonzalez, J., concurring) (observing that "[i]t does not take a rocket scientist to determine why Ms. Kerr's lawyers elected to proceed solely on the tort of negligent infliction of emotional distress," quoting the record in the trial court where one of the plaintiff's attorneys stated that he would not request a jury charge of intentional misconduct because doing so would "drop[] his client in the grease" by taking her claim "totally out of coverage," and explaining the decision to plead only negligence by citing the lawyers' belief that a finding of negligence would enable the plaintiff to "tap the homeowners policies owned by the parents" of the defendants).

6. The parents arranged a suit against themselves in *Myers v. Robertson*, 891 P.2d 199 (Alaska 1995), because they, as beneficiaries of their son's estate, would receive any funds paid by their homeowners' liability insurance carrier on their behalf. The lawsuit became particularly bizarre when the parents testified in a way that was calculated to emphasize their negligence in the death of their son, and when their insurer attempted to impeach that testimony with exculpatory statements the parents had previously made to the police.

7. Professor Silver testified as an expert witness in a bad faith case brought against

A lawyer representing a defendant in an automobile accident case subjects his own client to hostile cross-examination and accuses his own client of perjury, all in an effort to show that his client knowingly misdescribed how the accident occurred.⁸

A lawyer representing an employer facing potential liability for the negligent acts of an employee fails to inform the injured plaintiff that the employee actually worked for someone else.⁹

A lawyer defending a doctor in a medical malpractice action settles with the plaintiff despite a clear instruction from the doctor to reject the plaintiff's demand.¹⁰

A lawyer representing a defendant files a meritorious motion or reply to a motion for (take your pick) summary judgment on the merits,¹¹ disqualification of opposing counsel,¹² dismissal for de-

an insurance company in which the lawyer representing the woman employed this odd strategy in an effort to help her recover against the insurance policy covering the school where the defendant was employed. The policy excluded coverage for losses stemming from acts of abuse or molestation. The insurance company contended that the exclusion applied because the defendant committed the crime of sexual assault by having sex with a minor. However, under the state penal code, a defense to the charge of sexual assault existed if the victim had a prior history of sexual promiscuity. The woman's lawyer could therefore preserve her ability to recover against the insurance policy by showing that she had been sexually promiscuous at the age of 14. See Silver, *Introduction*, *supra* note 3, at xi-xii, for a discussion of the case.

8. The conduct described occurred most recently in *Montanez v. Irizarry-Rodriguez*, 641 A.2d 1079 (N.J. Super. Ct. App. Div. 1994). The lawyer, who was hired by the company insuring the defendant, believed that the defendant hoped to increase the recovery for the plaintiff, his injured spouse, by testifying falsely. The lawyer acted in a manner calculated to reduce the amount the company would have to pay. The court found that there was no "actual proof" that the defendant's testimony contradicted earlier statements. *Id.* at 1084.

9. The identity of the true employer was hidden in *Zielinski v. Philadelphia Piers, Inc.*, 139 F. Supp. 408 (E.D. Pa. 1956). The explanation appears to be that the same insurance carrier covered both the named defendant and the actual employer and hoped to profit by maintaining the deception until the statute of limitations against the actual employer expired. *Id.* at 411, 413.

10. In *Rogers v. Robson, Masters, Ryan, Brumund & Belom*, 392 N.E.2d 1365, 1370 (Ill. Ct. App. 1979), *aff'd*, 407 N.E.2d 47 (Ill. 1980), the lawyer settled the case at the request of the doctor's malpractice insurer, which found the plaintiff's offer more attractive than the doctor did.

11. See *Schwartz v. SAR Corp.*, 195 N.Y.S.2d 496 (N.Y. Sup. Ct. 1959) (Attorney representing insured-defendant, who was the plaintiff's nephew, opposed plaintiff's motion for summary judgment by filing an affidavit alleging a conspiracy among the plaintiff, the defendant, and a doctor-relative who examined the plaintiff to defraud the defendant's insurance company.), *rev'd*, 195 N.Y.S.2d 819 (N.Y. App. Div. 1959).

12. See *State Farm Mut. Auto. Ins. Co. v. K.A.W.*, 575 So. 2d 630 (Fla. 1991) (attor-

fective service of process,¹³ or dismissal for lack of capacity to sue,¹⁴ but does so over the defendant's objection.

A defendant instructs defense counsel to admit liability and damages even though both can properly be contested.¹⁵

An insurance company intentionally pays more to settle a claim than the claim is worth.¹⁶

An attorney representing an automobile accident victim rescinds a settlement demand at the policy limits on a wholly pretextual ground after the offer was accepted by the defendant's insurance company.¹⁷

In each instance and in thousands of others equally strange, insurance considerations motivate the conduct described. Experienced litigators would see that immediately, but many fine civil procedure teachers would not.¹⁸

ney moved to disqualify opposing counsel over insured defendant's objection and despite defendant's attempt to waive the asserted conflict of interests).

13. See *Buchanan v. Buchanan*, 160 Cal. Rptr. 577 (Cal. Ct. App. 1979) (dismissal on service of process grounds despite insured defendant's objection and attempt to waive defect).

14. See *Reynolds v. Maramorosch*, 144 N.Y.S.2d 900 (N.Y. Sup. Ct. 1955) (denying motion to dismiss for plaintiffs' lack of capacity to sue on ground that the insured-defendant, the father of plaintiff children, wished to litigate the case on the merits).

15. *Collins v. Coastline Constr.*, 820 F. Supp. 270 (E.D. La. 1993) (declining to enter a proposed stipulated judgment between the plaintiff and the insured defendant to protect the insurance broker's rights and defenses); *Friedman v. Berkowitz*, 136 N.Y.S.2d 81 (N.Y. City Ct. 1954) (holding the insurance company liable on the basis of the insured father-in-law's admission of liability, despite the possibility of collusion between the plaintiff and defendant, who were related by marriage).

16. This possibility, perhaps the most striking of all, was suggested by Michael Sean Quinn, an experienced insurance lawyer who is now a visiting professor at the University of Texas School of Law. The company's aim in overpaying would be to exhaust its limits and thereby free itself from having to bear the greater cost of defending the insured in other litigation. The prospect that a company could employ this strategy successfully is raised by cases like *Texas Farmers Ins. Co. v. Soriano*, 881 S.W.2d 312 (Tex. 1994) (reversing a \$5.5 million judgment against the insurance company on the ground there was no bad faith in deciding which of the several claims pending against the insured to settle).

17. The conduct, which occurred in *Matt v. Liberty Mut. Ins. Co.*, 798 F. Supp. 429 (W.D. Ky. 1991), *aff'd*, 968 F.2d 1215 (6th Cir. 1992), was an unsuccessful attempt by the plaintiff's attorney to convert \$60,000 in coverage to more than \$1 million in coverage by tagging the insurance company with a claim of bad faith. For a discussion, see Stephen R. Schmidt, *The Bad Faith Setup*, 29 TORT & INS. L.J. 705, 710-12 (1994).

18. Law professors operate at a disadvantage partly because works on the relationship between insurance and procedure appear mainly in practitioner-oriented journals, less

Insurance companies and their commercial policyholders also understand the manifold connections between insurance and civil procedure. They have to; their money is at stake.¹⁹ Because they appreciate the importance of procedure, they have urged congressional Republicans to make procedural reform a central theme of the Common Sense Legal Reforms Act,²⁰ the Securities Litigation Reform Act,²¹ the Attorney Accountability Act,²² and other bills proposed as part of the Contract With America.²³ Tort reform pro-

prestigious law reviews, and continuing legal education materials. Professors rarely consult these sources.

19. In legal fees alone, the burden on insurance companies is staggering. One source found that property-casualty insurers spent \$11.8 billion on legal services in 1988, up from \$2.8 billion only a decade earlier. Robert E. Litan & Steven C. Salop, *More Value for the Legal Dollar: A New Look at Attorney-Client Fees and Relationships*, in A.B.A. SECTION OF LITIGATION, VALUE BILLING AND GAINING A COMPETITIVE ADVANTAGE IN THE LEGAL MARKETPLACE 2-4 (1992) (citing industry data). A sense of the magnitude of the stakes for insurance companies can also be gained from an empirical study of California civil trials by Professor Kent Syverud and Professor Samuel Gross. They found that the defendant is fully covered by liability insurance in 67% of all personal injury trials, partially covered by insurance in 18% of all personal injury trials, and completely uninsured in only 16% of all personal injury trials. In commercial cases, the defendant is fully covered in only 17% of all trials, partially covered in 42%, and uninsured in 42%. Samuel R. Gross & Kent D. Syverud, *Don't Try: Civil Jury Verdicts in a System Geared to Settlement*, Table 12 (Aug. 29, 1995) (unpublished manuscript on file with authors). Insurance companies are therefore involved in the vast majority (85%) of personal injury trials and carry the entire financial burden of liability and defense costs more than two-thirds of the time.

20. H.R. 10, 104th Cong., 1st Sess. (1995) (proposing "loser-pays" rule, tightening standards for use of expert witnesses, limiting liability for noneconomic damages, and capping punitive damages).

21. H.R. 1058, 104th Cong., 1st Sess. (1995) (making securities class actions more difficult to wage).

22. H.R. 988, 104th Cong., 1st Sess. (1995) (proposing "loser-pays" rule and early settlement rule).

23. The Congressional Record is replete with discussions of the impact of punitive damages, frivolous litigation, contingent fees, unsupported expert witness testimony, securities class actions, fee- and cost-bearing rules, and other components of the procedural system on product costs, product innovation, corporate entrepreneurship, and insurance rates. See, e.g., 141 CONG. REC. H2749, H2752-57 (daily ed. Mar. 7, 1995) (statements of Reps. Fields, Oxley, Bliley, Harman and Tauzin) (arguing in support of the Securities Litigation Reform Act in part on the ground that frivolous lawsuits are stifling entrepreneurship and economic growth); 141 CONG. REC. H2663, H2667 (daily ed. Mar. 6, 1995) (statement of Rep. Goodlatte) (arguing in favor of the Attorney Accountability Act of 1995 on the ground that nuisance suits brought to extort payments from insurance companies are driving up insurance rates); 141 CONG. REC. H1961, H1961 (daily ed. Feb. 21, 1995) (statement of Rep. Christensen) (discussing the draw on competitiveness and productivity inflicted by frivolous litigation and multimillion-dollar damage awards); 141 CONG. REC. H1961, H1963 (daily ed. Feb. 21, 1995) (statement of Rep. Bryant) (contending that businesses throughout the country "have to deal with ever-increasing insur-

posals pending in state legislatures contain similar provisions.²⁴

In this Article, we will examine in great detail one set of issues on the boundary between procedure and insurance. Actually, the issues we will discuss lie at the intersection of three fields: civil procedure, insurance, and professional responsibility/agency law. The focus of our attention will be the rules that govern the conduct of insurance defense lawyers—the lawyers insurance companies hire to defend lawsuits against their insureds.²⁵ Insurance

ance premiums which are driven up" by excessively large jury awards).

Some comments are unsupported by empirical evidence and seem greatly exaggerated. *See, e.g.*, 141 CONG. REC. H2731, H2731 (daily ed. Mar. 7, 1995) (statement of Rep. Chabot) (contending, without cited authority, that "[f]rivolous lawsuits cost Americans \$300 billion in higher prices and in lost wages"). A great many others offer the now-famous anecdotes that constitute the conventional wisdom that out-of-control juries, plaintiffs' lawyers, and abusive litigation have driven insurance costs sky-high. *See, e.g., id.* (citing the example of a man who, after attempting suicide by jumping in front of a subway train, recovered \$1.2 million in damages from New York City, and the example of a woman who spilled coffee on herself and recovered millions in punitive damages from McDonald's); 141 CONG. REC. H2735, H2738 (daily ed. Mar. 7, 1995) (statement of Rep. Goodlatte) (claiming that "the first 87,000 boxes of Girl Scout cookies . . . [sold] goes to raise the \$120,000 to pay their liability insurance," and that "Little Leaguers . . . are in favor[] of legal reforms . . . because of the fact that they face greater and greater exposure to lawsuits[] and the loss of insurance"); 141 CONG. REC. H2655, H2655 (daily ed. Mar. 6, 1995) (statement of Rep. Norwood) (stating that "our legal system is out of control, and [the problem] goes far deeper than million dollar cups of coffee"); 141 CONG. REC. H1961, H1961 (daily ed. Feb. 21, 1995) (statement of Rep. Christensen) (asserting that "the Girl Scouts of Illinois have to sell over a million cookies just to pay their liability insurance premiums"); 141 CONG. REC. H1961, H1961 (daily ed. Feb. 21, 1995) (statement of Rep. Christensen) (describing incident in which two men who were injured by an exposed electrical wire after illegally entering a naval base successfully sued the United States); 141 CONG. REC. H1896, H1896 (daily ed. Feb. 16, 1995) (statement of Rep. Christensen) (citing a variety of lawsuits stemming from injuries sustained by players and onlookers at Little League baseball games).

Procedural reforms offered to correct these perceived problems include a "loser-pays" rule, restrictions on expert witness testimony, amendments to the offer-of-judgment rule, elimination of joint-and-several liability, limitations on punitive damages, elimination of the collateral source rule, encouragement of alternative dispute resolution, elimination of implied private rights of action under federal statutes, and increased severity of sanctions for frivolous litigation and discovery abuse. *See, e.g.*, 141 CONG. REC. H2655, H2655 (daily ed. Mar. 6, 1995) (statement of Rep. Norwood) (describing components of the Republican legal reform package); 141 CONG. REC. H2663, H2663-64 (daily ed. Mar. 6, 1995) (statement of Rep. Moorhead) (describing proposals in the Attorney Accountability Act of 1995); 141 CONG. REC. S1964, S1964-68 (daily ed. Feb. 1, 1995) (reprinting text of the proposed Lawsuit Reform Act of 1995, S. 300, 104th Cong., 1st Sess. (1995)).

24. For example, legislation pending in Texas would cap punitive damages, narrow choice of venue, abolish joint-and-several liability, and limit pain-and-suffering damages in medical malpractice cases. *Highlights of Tort Legislation*, AUSTIN AM.-STATESMAN, Jan. 29, 1995, at B3.

25. Hereinafter, the word "company" will refer to the primary insurance carrier, the

defense lawyers are integral parts of the engine that drives civil litigation, and the rules that govern their conduct are both extraordinarily vague and often wrong. The rules fail to provide clear and defensible answers to the most basic questions, such as whether an attorney-client relationship exists between the insurance company and the lawyer retained to handle the lawsuit against the insured. Consequently, the rules are almost entirely unhelpful when more complicated questions arise. The obvious danger is that insurance defense lawyers will act improperly, even when they attempt to adhere to the law. The less obvious danger is that the procedural system, broadly understood as encompassing all the rules and forces that influence the progress of litigation, will work less well than it should, driving up insurance costs and distorting insurance contracts. Although we will focus on the microstructure of insurance litigation, our work also has important macroeconomic implications for the procedural system and for the business of insurance.

Our aim, then, is to clarify, explain, and help rationalize the rules that govern defense counsel's responsibilities. We hope to help defense lawyers act appropriately and to stimulate a desirable evolution and clarification of the positive law. For several reasons, we have chosen to limit this part of our project to cases in which the existence of insurance coverage is clear and the amount of coverage is clearly sufficient to cover the insured's exposure to liability. This full coverage situation is the most common one to confront defense counsel. To be sure, full coverage cases rarely present the most intractable ethical dilemmas. Nevertheless, serious uncertainties have arisen in full coverage cases concerning counsel's relationships with and duties to the company and the insured. These uncertainties have concerned the correct way for counsel to handle communications with the company and the insured, as well as how counsel should act when the company and the insured have conflicting desires concerning settlement, discovery, investigation, and other litigation decisions.

A good reason to focus initially on full coverage cases is that the professional responsibility problems that arise in them are both more basic and more tractable than those that arise when there is

phrase "defense counsel" will refer to the lawyer retained to defend the liability suit against the insured, and the word "insured" will refer to the policyholder who is covered by a standard commercial or comprehensive general liability insurance contract.

a coverage dispute or the threat of excess liability. Moreover, discussions of lawyers' duties in matters where coverage is disputed or incomplete often implicitly assume answers to the questions that full coverage cases present. For example, before one can decide how a defense lawyer should act when a coverage dispute causes the interests of the lawyer's two clients to conflict, one must establish that the lawyer participates in attorney-client relationships with both the company and the insured. To be certain that there are, in fact, two clients, one must understand how and why a joint representation came to be, and one must appreciate the scope, objectives, and allocation of authority within the joint representation. All these basic questions arise in the full coverage cases, and they can be examined more readily there because the overlay of inadequate or disputed coverage is not present. We therefore begin the process of constructing a general account of defense counsel's duties in the tripartite relationship—the relationship involving the company, the insured, and defense counsel—by clarifying, explaining, and rationalizing the duties lawyers have in cases where full coverage is clear.

The account of defense counsel's professional responsibilities in full coverage cases provided here rests on our understanding of how liability insurance works. We set out and defend that understanding in Part I: Working Hypotheses About Liability Insurance. In later parts, we address several basic issues: (1) Who does defense counsel represent? (2) What is the scope of the representations that defense counsel undertakes? And (3) What duties are defense counsel subject to when acting on matters within the defined scope? We attempt to answer these questions systematically, grounding our answers in the structure of the tripartite relationship and in the purposes the structure exists to serve.

I. WORKING HYPOTHESES ABOUT LIABILITY INSURANCE

Insureds buy liability insurance in the United States to protect against two related but distinct risks of financial loss: the risk of paying the costs of defending a lawsuit and the risk of having to pay money to a plaintiff as a result of a lawsuit. The vast majority of liability insurance policies cover both risks, obligating the insurance company to defend lawsuits against the insured, to pay the costs of defense, and to indemnify the insured for judgments and settlements up to a specified limit. Similarly, the vast majority of policies give the insurance company the right to defend the case,

and require the cooperation of the insured in the company's defense of any suits.²⁶ For the last century, these common insurance arrangements have permitted the company to select counsel to defend an action, to supervise counsel's litigation and settlement strategy, and to settle claims within policy limits at the company's discretion.²⁷

There are good economic reasons why both the company and the insured might desire to allocate control over the defense of potential lawsuits to the company. When a loss is fully covered, both parties expect the company to have the predominant financial interest in the outcome of litigation. They expect the company to have a greater incentive than the insured to defend the suit vigorously. Moreover, as a repeat litigant the company is more likely to have substantial judgment and experience in defending claims and managing lawyers. Because of the combined effect of the company's financial incentives and experience, claims costs should be kept lower if the company controls the defense, with a resultant lowering of the cost of liability insurance to all insureds.²⁸

26. Two of the most common forms of liability insurance coverage are found in homeowners and automobile package policies. The standard Personal Auto Policy, promulgated by the Insurance Services Office (ISO), entitles the company to control the defense of liability suits in Part A, Paragraph A, and requires the insured to cooperate in Part E, Paragraphs A-D. See ROBERT E. KEETON & ALAN I. WIDISS, *INSURANCE LAW: A GUIDE TO FUNDAMENTAL PRINCIPLES, LEGAL DOCTRINES AND COMMERCIAL PRACTICES* 1121-30 (student ed. 1988) (reprinting 1985 ISO Personal Auto Policy). The ISO Homeowners 4 Contents Broad Form (ed. 4-84) entitles the company to control the defense in Section II—Liability Coverages, Coverage E, and requires the insured to cooperate under Section II—Conditions, Paragraph 3. See *id.* at 1133-47 (reprinting Homeowners 4 Contents Broad Form (ed. 4-84)).

27. The working hypotheses advanced in this Part and the views on professional responsibility advanced later in this Article are tailored to the Commercial General Liability Coverage Form [hereinafter CGL Policy]. See INSURANCE SERVICES OFFICE, INC., *SAMPLE COMMERCIAL GENERAL LIABILITY POLICY* (1984), reprinted in Kenneth S. Abraham, *INSURANCE LAW AND REGULATION: CASES AND MATERIALS* 439-48 (1990). The CGL Policy has a particular structure: it requires the company to indemnify the insured for covered losses; it both requires and entitles the company to defend the insured against lawsuits alleging covered claims; it authorizes the company to investigate and settle claims at its discretion without the insured's consent; and it requires the insured to assist the company in the performance of the investigation, defense, and settlement functions. *Id.* at 440. When insurance coverage is governed by a policy other than the CGL Policy, the working hypotheses and the views on professional responsibility advocated here may not apply.

28. For a more detailed development of this reasoning, see *Wisconsin Zinc Co. v. Fidelity & Deposit Co. of Maryland*, 155 N.W. 1081, 1085 (Wis. 1916), overruled by *Hilker v. Western Auto. Ins. Co.*, 231 N.W. 257 (Wis. 1930), and Barker, *Settling, supra* note 4, at 342-45.

The foregoing assumes that, at the time the company and insured execute the typical liability insurance contract, the insured is primarily concerned with the monetary costs of future lawsuits. The policy transfers this financial risk to the company. The company, in turn, can be expected to direct the defense of a particular lawsuit against the insured in a way that minimizes claims costs—usually, by minimizing the amount paid out in judgments, settlements, and litigation expenses. Although it is hazardous to guess at the expectations of the insured and company at the time of contracting, these expectations seem both most common and most reasonable.

Problems arise when the threat of an unknown future claim ripens into a specific lawsuit. When a grocery store buys liability insurance from an insurance carrier, the store may indeed expect that the company will control the defense of any future claims, and it may desire that the company minimize claims costs on all future lawsuits so that premiums can be kept low. But when a customer sues the grocery store for negligence, the specific circumstances of the suit may lead the store and the company to disagree about the handling of the suit. Disagreements may arise for at least four reasons.

First, the company and the insured may disagree about the defense of the lawsuit because the insured no longer bears a risk of paying a judgment or settlement (which is covered by insurance), but does bear other risks related to the lawsuit. These risks include all the manifold side effects of civil litigation. The insured may be concerned about publicity, about its reputation, about a personal or business relationship with the injured plaintiff, or about collateral effects of the lawsuit on other lawsuits and parties.²⁹ The insured may want the plaintiff to recover as much as possible, perhaps because the plaintiff is related to the insured or because the insured feels compassion or responsibility to the plaintiff.³⁰ By removing the insured's obligation to pay the judgment or settlement, the policy permits and often encourages the plaintiff to think primarily about these side effects of the lawsuit. And in

29. *See, e.g.,* *Charter Oak Fire Ins. Co. v. Color Converting Indus. Co.*, 45 F.3d 1170, 1175-77 (7th Cir. 1995) (holding that a company has no duty to treat an insured's key customer specially to protect the insured's business relationship).

30. *See, e.g.,* *State Farm Mut. Auto. Ins. Co. v. K.A.W.*, 575 So. 2d 630, 631-34 (Fla. 1991).

thinking about these side effects, the insured may prefer a defense strategy different than that employed by the company that will pay the judgment.

Second, the company and the insured may disagree about the defense of the lawsuit because the company will bear the costs of the defense and the insured will not. Most often, this fundamental difference will mean that the insured will prefer a more expensive defense effort, particularly where a more expensive effort will benefit the insured. Thus, the insured may value vindication at trial, despite the possibility of a small pretrial settlement, in order to restore a reputation tarnished by a lawsuit.³¹

Third, the company and the insured may disagree about the defense of the lawsuit because the company has an additional stake in the outcome beyond the amount paid to defend or settle it. The company may be anxious to defeat a particular plaintiff's lawyer, to obtain a particular precedent that can benefit it in other cases, or simply to employ a particular defense counsel who has a relationship or tie to the company. The insured, who does not share these concerns, may dissent from defense policies that are driven by them.

Finally, the company and the insured may disagree simply because each can take strategic advantage of the additional stake in the lawsuit possessed by the other. If one party knows that the other values a particular outcome highly (for example, if the company knows that the insured wants to avoid trial at any price because of the fear of reputational consequences), there is room to coerce the other party into bearing a larger fraction of the expense of the lawsuit than called for by the insurance contract (for example, by requesting the insured to contribute to a settlement within policy limits).³²

Unfortunately, it is defense counsel who often must sort out these disagreements between the company and the insured in particular lawsuits. Generally, the disagreements arise after counsel has been retained by the insurance company (usually without a

31. See, e.g., *Eklund v. Safeco Ins. Co. of Am.*, 579 P.2d 1185, 1186-87 (Colo. Ct. App. 1978) (involving insured's objection to settlement because insured was convinced that his son was not liable).

32. This behavior by insurance companies, common early in this century, is now considered a *per se* breach of the insurer's duties to the insured in almost every state. See Syverud, *The Duty to Settle*, *supra* note 3, at 1153-57.

formal written retainer agreement) to defend the case. Counsel communicates with the insured and the company, and in the course of the defense, is called upon to make decisions about how to handle the litigation. In doing so, counsel often discovers that he is uncertain about the identity of client, the scope of the representation, or the objectives that counsel should seek in the suit.

One simple solution to problems in which counsel perceives a potential conflict of interest between the insured and the company is to require separate counsel for each routinely, with the company paying for both lawyers to represent zealously their separate clients' interests. This solution, while admirably removing most ethical dilemmas for defense counsel, imposes significant costs on insureds and insurance companies. A proliferation of lawyers on the defense side substantially increases the expense of lawsuits, and this in turn is reflected in liability insurance premiums. Insureds and companies may well prefer to waive separate counsel except in particular situations, or to provide in advance (in the insurance contract) that separate counsel will be at the expense of the insured rather than the insurer.

If one decides not to require separate counsel routinely, the remaining option is to consider conflicts case by case. One must ask defense counsel to assess his professional obligations in potential and actual conflict situations, and one must supply principles, guidelines, and rules that will help counsel decide when a joint representation can proceed and how it should be conducted. It is difficult to craft appropriate principles, guidelines, and rules, however, because insurance law and the law of professional responsibility often seem to be at war. For example, the insurance contract and the prevailing insurance law may give the insurance company the right to control the settlement and the right to accept any settlement within policy limits without the insured's consent. Professional responsibility law may declare that the insured is a client, and that, consequently, the lawyer may not accept any settlement without the insured's consent. The task of a rulemaker is to determine the proper relationship between the two bodies of law and to give defense counsel concrete instruction on how to proceed. To these tasks we now turn.

II. THE SOURCES OF THE TRIPARTITE RELATIONSHIP

Figure 1 identifies the first and most basic component of the tripartite relationship: the liability contract. As explained in Part I, the liability contract allocates rights and responsibilities between the company and the insured. Speaking generally, it entitles the company to control the defense and settlement of covered claims, and it requires the insured to assist the company in the performance of its contractual obligations.

FIGURE 1

THE INSURANCE RELATIONSHIP

Insured Policyholder	< Liability Contract >	Insurance Company
Duty to cooperate with investigation		Duty to indemnify
Duty to cooperate with defense		Duty to defend
Duty to refrain from settling except at own expense		Right to defend
		Discretion to investigate claims
		Discretion to settle claims

The liability contract creates a dyadic relationship: Only the company and the insured are parties to the liability contract. Consequently, the liability contract (directly) governs only the relationship between the company and the insured. The liability contract does not (directly) bind defense counsel or affect defense counsel's professional obligations because defense counsel is a stranger to that agreement.³³ Counsel's relationships with the company and the insured spring into existence when counsel agrees to handle a representation at the company's request. Only when counsel enters a retainer agreement with the company does a tripartite relationship appear.

33. See, e.g., *Scribner v. AIU Ins. Co.*, 647 A.2d 48, 51 (Conn. Super. Ct. 1994) (refusing to subject attorney hired by insurance company to duty of good faith and fair dealing because the attorney was not a party to the contract of insurance).

Figure 2 depicts the tripartite relationship that emerges when a company retains defense counsel to handle a suit against an insured. The figure shows that the relationship between the company and the insured continues to be governed by the liability contract, and that a second agreement, a retainer agreement, creates and governs the relationships defense counsel has with the company and the insured.

FIGURE 2

THE TRIPARTITE RELATIONSHIP

Figure 2 answers an important question. Does the tripartite relationship arise out of the insurance contract alone? No, although some authorities mistakenly assert otherwise. Only a bilateral relationship exists prior to the time a lawyer is retained. The tripartite relationship requires a liability contract and a retainer agreement.

It is crucially important to distinguish the retainer agreement from the liability contract. Only the retainer agreement directly regulates defense counsel's professional relationships with the company and the insured. The retainer agreement determines the nature of those relationships, including whether they are attorney-client relationships or relationships of some other kind. The retainer agreement also fixes the scope and content of those relationships. It defines the participants' contractual rights and obligations within the tripartite relationship, including the scope of defense counsel's representations of the company and the insured.³⁴ Be-

34. See RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 28 cmt. f (Tentative Draft No. 5, 1992) ("Contracts may . . . create or define the duties the lawyer owes the client . . . [and] may specify the services the lawyer is being retained to pro-

cause most of the duties a lawyer can owe a client are mutable—that is, are capable of being created and altered by agreement—the retainer agreement is of overwhelming importance in deciding what defense counsel's responsibilities are to be.

Having identified the retainer agreement and briefly explained its function, the natural next step is to ask what its content is. We make a start at answering that question in Part III.

III. THE RELATIONSHIP BETWEEN THE LIABILITY CONTRACT AND THE RETAINER AGREEMENT

Although the liability contract and the retainer agreement are distinct agreements, they do not exist in isolation from each other. The retainer agreement comes to exist because the liability contract binds the company to the insured, and an important purpose of the retainer agreement is to satisfy the company's duties to the insured. Because the retainer agreement is negotiated in the shadow of the liability contract, it is reasonable and natural that the content of the latter should inform the content of the former. In other words, the liability contract should "bleed" into the retainer agreement.

There are at least two reasons for thinking that a good deal of bleeding will ordinarily take place. First, as mentioned, when retaining defense counsel, the company will desire to fulfill its contractual obligations to the insured. It may have this concern for reputational reasons, because it wishes to avoid liability for bad faith breach of the liability contract, or for other reasons. To achieve this goal, the retainer agreement must require defense counsel to serve the insured as fully as the liability contract requires. Second, the company will want to protect its financial stake in the claim asserted against the insured. This may even be the company's primary goal.³⁵ The company can best accomplish this objective by structuring the retainer agreement in a manner that permits it to exercise all the rights and powers it holds under the liability contract. For example, the company will use the retainer agreement to confer upon itself exclusive authority to instruct

vide, the services the lawyer is not obliged to provide, and the goals of the representation.").

35. The legitimacy of the company's desire to protect its financial interest has often been recognized. *See, e.g.*, California State Bar Standing Committee on Professional Responsibility and Conduct, Formal Op. 1987-91 (1987).

counsel on the defense of the suit and the settlement of the claim, to reserve the right to dismiss counsel, and to approve expenses and fees.³⁶ The liability contract assigns the company these powers because doing so enables the company to minimize claim-related costs, as explained in Part I.³⁷ By designing an agency relationship that permits the company to exercise its powers fully, a company acts in a manner that effectuates the aims the liability contract is designed to serve.

The fact that the retainer agreement mirrors the liability contract does not imply that defense counsel must study the liability contract to learn about his professional obligations. Defense counsel may often find it advisable to have a copy of the liability contract on file,³⁸ but in principle defense counsel need not consult

36. Insurance companies often use outside counsel guidelines to structure their relationships with defense lawyers. See, e.g., AETNA LIFE & CASUALTY, AETNA GUIDE FOR OUTSIDE COUNSEL (on file with authors); COREGIS, COREGIS LITIGATION HANDLING GUIDELINES FOR ASSIGNED COUNSEL (on file with authors). The purpose of such guidelines is to coordinate the expectations of the company and defense counsel, so that the company can better monitor counsel's conduct, communicate with counsel, and control costs. See Sally Field, Address, *Legal and Ethical Aspects of Outside Counsel Guidelines: The Professional Liability Carrier's Perspective*, in THE ETHICAL AND MALPRACTICE ASPECTS OF OUTSIDE COUNSEL GUIDELINES 5 (1994). We express no opinion as to whether outside counsel guidelines form part of defense counsel's contract with the company.

37. The law is clear that, absent certain conflicts of interest, the company possesses exclusive and plenary control of the defense. 7C JOHN A. APPLEMAN, INSURANCE LAW AND PRACTICE § 4681, at 2 (Walter F. Berdal ed., 1979) (stating the longstanding doctrine that "the insurer has exclusive control over litigation against the insured, and the [insured] is required to surrender all control over the conduct of the defense"); KEETON & WIDISS, *supra* note 26, § 9.1(b), at 988 (stating that "[i]n many situations, such provisions [giving the company the right to defend] are interpreted to mean that the insurer is entitled to exercise exclusive control over the litigation," and observing that exclusive control "has been viewed as appropriate in order for the insurer to protect its financial interest in the matter"); Barker, *Right to Control*, *supra* note 4 (considering the circumstances in which conflicts-of-interests deprive insurers of the right of control).

At least one commentator argues that the law should entitle the insured to control the defense. John K. Morris, *Conflicts of Interest in Defending Under Liability Insurance Policies: A Proposed Solution*, 1981 UTAH L. REV. 457, 465-66. We disagree with Morris for reasons explained at length in Silver, *Insurance Defense Counsel*, *supra* note 3, at 1592-98.

38. For example, defense counsel may want to advise the insured to obtain separate counsel to handle coverage issues or excess liability issues. To do that, counsel must have information about coverages and policy limits, and counsel may need copies of any reservation of rights letters that have been sent as well. To avoid confusion, we emphasize that we are not saying that defense counsel has a duty to advise the insured to obtain separate counsel for coverage and excess liability issues. In this Article, only counsel's obligations in full-coverage cases are discussed.

the liability contract at all. The retainer agreement is a complete agreement that exists apart from the liability contract and that can be looked to directly. As long as defense counsel knows the terms on which he was retained by the company, counsel can answer questions about his responsibilities.

It is perfectly legitimate for a company to structure its relationship with defense counsel in the manner described. In other words, a company can properly establish a joint agency in which it, as a co-principal along with the insured, can exercise all the rights and powers it holds pursuant to a liability contract. We hold this view because clients can structure relationships with lawyers as they like, within limits that must be discussed.

IV. DOES DEFENSE COUNSEL REPRESENT THE COMPANY OR THE INSURED?

Before addressing limits on the flexibility of attorney-client relationships, it is appropriate to determine whether the relationships defense lawyers have with insurance companies and insureds are in fact attorney-client relationships. To this point, we have assumed, but have not shown, that an insurance company and an insured are co-principals of an attorney who is their joint agent. In other words, we have assumed that the agreement under which defense counsel is retained creates two attorney-client relationships: one with the company and one with the insured.

This is a controversial assumption. Currently, a debate is raging over the number of clients that defense counsel represents: one (the insured) or two (the company and the insured).³⁹ Most jurisdictions endorse the "two clients" view. A smaller number hold that defense counsel represents only the insured. However, the minority view is gaining adherents and recently acquired influential support. In tentative drafts of *The Restatement of The Law Governing Lawyers*, the American Law Institute backed the "one

39. Authorities endorsing both views are cited in Silver, *Insurance Defense Counsel*, *supra* note 3, at 1584-89. For more recent evidence of the continuing controversy see Richard Connelly, *Professor Swims Against Tide On Insurance Defense Question*, TEX. LAW., June 19, 1995, at 1 (quoting diverse views on the company's status); Joanne Pitulla, *Three-Way Street: Discord Between Insurers and Insureds Puts Defense Lawyers on Perilous Path*, 81 A.B.A. J. 102, 102 (1995) (asserting that the majority rule is that the company is not a client); California State Bar Comm. on Professional Responsibility, Formal Op. 1995-139 (1995) (stating that "[c]learly, the insurer is denominated a 'client' by case law, though one with limited rights").

client" view.⁴⁰ Because judges often rely on tentative *Restatement* provisions when making law, the number of jurisdictions embracing the "one client" view is likely to grow.⁴¹

One of the authors of this Article recently addressed the "one client/two clients" controversy at length.⁴² He contends that defense counsel has as many clients as the participants decide counsel should represent.⁴³ Defense counsel has one client if and when the retainer agreement provides that counsel shall represent only the insured; defense counsel has two clients if and when the retainer agreement requires counsel to represent the company as well. Because attorney-client relationships arise consensually, whether defense counsel has one client or two depends upon the agreement that counsel enters into when retained.

For this reason, it is perilous and inappropriate to adhere to either the "one client" or the "two clients" view. Both views are prescriptive. They posit that a lawyer represents a particular number of clients (one or two) without considering the agreement subject to which counsel was retained. Because it is up to lawyers and their principals to determine the nature of the relationships that exist between them, there is no reason to think that defense counsel must have one client or two clients in every case. A company may wish to name itself as a client along with its insured because it has an economic stake in a representation, because it wishes to control the defense and settlement of claims, because it can more easily and effectively monitor defense counsel than can its insured, and because it may desire the right to sue counsel for malpractice in the event of misconduct. Still, the decision to become a client is a company's to make, and in certain cases a company may prefer to be a third-party payor.⁴⁴

40. The authors have frequently corresponded with the Reporters working on the *Restatement*. As a result of this exchange, the Reporters appear to have abandoned the "one client" view in favor of the position that whether defense counsel has one client or two is determined by agreement of the parties to the retainer agreement. Letter from Thomas D. Morgan to Charles Silver (Nov. 4, 1994) (on file with authors).

41. Twenty-three different courts have cited the proposed *Restatement* 57 times since 1988, and all but two of the opinions cited the proposed *Restatement* with approval. Susan R. Martyn, Citations to the *Restatement* (Third), *The Law Governing Lawyers*, Tentative Draft 1-13 (1988-1994) (unpublished manuscript on file with authors).

42. Silver, *Insurance Defense Counsel*, *supra* note 3.

43. *Id.* at 1627. This point is correctly explained in *American Mutual Liability Insurance Co. v. Superior Court*, 113 Cal. Rptr. 561, 570 (Cal. Ct. App. 1974).

44. For example, when a conflict of interest with the insured prevents a company from controlling the defense of a suit, a company may show its good faith in respecting

The view endorsed here, the view that a retainer agreement determines how many clients defense counsel represents, follows from the universally accepted principle that an attorney-client relationship, like an agency relationship, arises by agreement: "The relationship is created by an undertaking to perform a particular professional legal service for the client."⁴⁵ A defense lawyer who undertakes to represent both a company and an insured has two clients and is a fiduciary with respect to both parties. A defense lawyer who undertakes to represent only an insured has one client and is a fiduciary with respect to only the insured. Such a lawyer may and clearly does participate in a different kind of relationship with the company that is underwriting the defense, but that relationship too must be considered on its own terms and in light of the parties' agreement.

FIGURE 3

HOW MANY CLIENTS?

		Insured	
		Non-Client	Client
Company	Non-Client	A	B Independent Counsel
	Client	C Company Counsel	D Defense Counsel

the rights of its insured by naming itself as a third-party payor.

45. 2 RONALD E. MALLIN & JEFFREY M. SMITH, *LEGAL MALPRACTICE* § 8.2, at 404 (3d ed. 1989); *see also* RESTATEMENT (SECOND) OF AGENCY § 15 (1958) (stating that "[a]n agency relation exists only if there has been a manifestation by the principal to the agent that the agent may act on his account, and consent by the agent so to act"); RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 26 (Tentative Draft No. 5, 1992) (positing that "[a] relationship of client and lawyer arises when . . . [a] person manifests to a lawyer the person's intent that the lawyer provide legal services for the person[] and . . . [t]he lawyer manifests to the person consent to do so").

The four-fold table in Figure 3 describes the possibilities concerning the number of clients defense counsel represents. Cell A represents the situation prior to the time defense counsel is retained. At that time, neither the company nor the insured is a client and defense counsel has no obligation to provide legal services to anyone. The retainer agreement moves the status quo from Cell A to one of the other cells by denominating the company and/or the insured as clients.

Cell B captures the situation when the insured is the only client defense counsel is asked to serve. A retainer agreement might obligate counsel to represent only the insured when a conflict of interests deprives the company of the right to control the defense of the liability suit or when, for some other reason, the company wishes to take a backseat to the insured.⁴⁶ When only the insured is a client, counsel's duty of loyalty runs solely to the insured and the company holds the lesser title of third-party payor. The company may receive reports from defense counsel, may limit the scope of the lawyer's activities on behalf of the insured, may discharge the lawyer, and may exercise other administrative powers. But the company's authority to instruct defense counsel is greatly restricted when the company is a third-party payor because, in this situation, defense counsel must act primarily for the benefit of the insured.⁴⁷ It is because defense counsel is not the company's agent⁴⁸ that the title "independent counsel" is often ap-

46. For a thoughtful presentation and analysis of the law on this topic, see Barker, *Right to Control*, *supra* note 4. See also APPLEMAN, *supra* note 37, § 4681, at 12 (observing that the company can waive the right to control the defense).

47. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.8(f)(2) (1994) (permitting third-party payor arrangements only when "there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship"); see also RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 215 (Tentative Draft No. 4, 1991) (permitting third-party payor arrangements only when the lawyer obtains the client's informed consent, and permitting the payor to influence the lawyer's professional judgment "only if the influence is reasonable in scope and character and the client expressly consents . . . before the lawyer undertakes the representation").

48. See RESTATEMENT (SECOND) OF AGENCY § 1 (1958) (defining "agency" as "the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act"); *Id.* § 13 cmt. a (1958) (defining obligation of a fiduciary to act primarily for a principal's benefit); RESTATEMENT (SECOND) OF AGENCY § 14N cmt. b (1958) (observing that "[a] person who contracts [with another], but who is not acting as a fiduciary for the other, is a non-agent contractor"). Because a fiduciary duty of loyalty runs only from a lawyer to a client, defense counsel is not an agent of an insurance company that is a third-party payor. See Richard L. Neumeier, *Serving Two Masters*:

plied to a lawyer who represents only the insured.

The participants wind up in Cell C when the company hires counsel solely for its own benefit in connection with the liability claim. In this situation, the company is the lawyer's only client. The insured is neither a client nor a third-party payor, but is instead a stranger to whom no contractual or fiduciary duties are owed.⁴⁹ The lawyer is therefore properly called company counsel or monitoring counsel, not defense counsel, because the lawyer advises the company on, but does not personally conduct, the defense of the liability suit. Company counsel may serve as settlement counsel and may become directly involved in the liability suit in that capacity. When assigned responsibility for settlement, company counsel will advise the company on settlement and handle negotiations.⁵⁰ Even then, however, no attorney-client relationship will exist between company counsel and the insured.

In a full coverage case, a company that hires counsel for itself will usually hire a second lawyer to defend the liability suit against the insured.⁵¹ In theory, the company could assign that task to independent counsel. In practice, the company will prefer to assign that responsibility to a lawyer who represents the company as well as the insured. The company will not be satisfied with the status of third-party payor because it can control defense counsel more effectively and better protect its economic stake in the litigation when it is a client. First, a client's authority to instruct a lawyer on matters within the scope of the representation is clear; a third-party payor's authority is not. Second, a client is the beneficiary of a fiduciary duty that requires a lawyer to act in ways that make the client better off. No fiduciary duty runs in favor of a third-party payor. Third, a dissatisfied client can sue a lawyer for malpractice. A third-party payor may have contract claims against a lawyer, but a judge may be reluctant to allow a payor to state a

Problems Facing Insurance Defense Counsel and Some Proposed Solutions, MASS L. REV., June 1992, at 66, 70 (discussing counsel's duties to insurance company that is third-party payor).

49. See 2 MALLIN & SMITH, *supra* note 45, § 23.10, at 387 (observing that "[a]n attorney who represents an insurer concerning coverage owes no duty to the insured").

50. We discuss the possibility of dividing responsibility for defense and settlement among different lawyers in Part VI.

51. Exceptions might occur when the company wishes to settle a claim immediately and when the company, expecting to pay the judgment in full, allows a default judgment to be taken against the insured. In both cases, the company may have no occasion to engage counsel to handle the defense of the insured.

malpractice claim, especially when the client's interests differ from the payor's. Fourth, any action a third-party payor may be able to bring against a lawyer may be subject to other defenses that do not apply to malpractice actions waged by clients or may be defeated by showing that the client ordered, approved, or ratified the challenged conduct. Fifth, as a client, a company can gain the benefit of evidentiary privileges for its communications with a lawyer and its insured, can require the lawyer to keep all communications confidential, and can enjoy other protections the law of agency and professional responsibility confer upon clients. By and large, these protections are unavailable to third-party payors. For these reasons at least, the insurance company that retains defense counsel will prefer to denominate itself a client when it has a choice. Because the option of becoming a client is always available in full coverage situations and because the company's right and desire to control the defense in full coverage situations is clear, we will hereafter assume that the retainer agreement creates a fiduciary relationship between the company and the lawyer.

Of course, even when the company names itself as a client, the lawyer chosen to handle the defense must also represent the insured. The insured must be a client because a lawyer cannot ordinarily speak in court on behalf of a person the lawyer does not represent. Usually, a lawyer can appear only on behalf of a client. The existence of an attorney-client relationship between defense counsel and the insured is therefore a predicate for the defense of the liability suit.⁵² There are also other reasons for identifying the insured as a client. Chief among these is the desire to secure the protection of evidentiary privileges for communications with the insured. These safeguards help the lawyer and the company investigate, defend, and evaluate the liability claim. Naming the insured as a client also limits the opposing parties' access to the insured because the anti-contact rule then applies.⁵³ Final-

52. See A.B.A., ANNOTATED MODEL RULES OF PROFESSIONAL CONDUCT 269-70 (2d ed. 1992) (citing cases requiring discharged attorneys to refrain from further involvement in former clients' cases); *In re Greenlee*, 658 P.2d 1, 2 (Wash. 1983) (upholding the imposition of discipline on a lawyer who continued as attorney of record after being discharged by the client); *Employers Casualty Co. v. Tilley*, 496 S.W.2d 552, 558 (Tex. 1973) (stating that defense counsel "becomes the attorney of record and the legal representative of the insured").

53. The anti-contact rule, MODEL RULES OF PROFESSIONAL CONDUCT Rule 4.2 (1994), states: "In representing a client, a lawyer shall not communicate about the subject of the representation with a party the lawyer knows to be represented by another lawyer

ly, in many states, the company may have to name the insured as a client in order to meet its contractual duty to defend the insured. For all these reasons, we conclude that, in the mill run of full-coverage cases, the retainer agreement normally will obligate defense counsel to represent the insured.

When a retainer agreement identifies both the company and the insured as clients, the tripartite relationship falls into Cell D. This is the state of affairs that ordinarily obtains in insurance defense representations. Most jurisdictions agree on this point.⁵⁴ The majority rule is that defense counsel has two clients, not one. Still, it is important to emphasize that the retainer agreement determines whether a representation falls into Cell B, Cell C, or Cell D. Even the jurisdictions that make up the majority have failed to appreciate this point.⁵⁵ It is up to the lawyer and the company that retains the lawyer to decide whether the lawyer will represent only the company, only the insured, or both. Their agreement settles the matter, and once they agree, judges should respect their decision. Because attorney-client relationships are consensual, judges (and other sources of professional responsibility and agency law) should refrain from substituting their own judgments about the tripartite relationship for the parties' decision to structure the relationship a particular way in a particular case.

An implication of the view that defense counsel ordinarily has two clients is that both the company and the insured are entitled to sue for malpractice when counsel violates the duty of care. We therefore reject the rule announced in cases like *Atlanta International Insurance Co. v. Bell*⁵⁶ that only the insured can have a direct malpractice claim. By agreement, a lawyer can serve two

in the matter, unless the lawyer has the consent of the other lawyer or is authorized by law to do so."

54. See 2 MALLIN & SMITH, *supra* note 45 § 23.2, at 364 (stating that "[i]nsurance defense counsel routinely and necessarily represent two clients" and citing cases); Neumeier, *supra* note 48, at 69-70 (stating that the "majority rule" is that "the law firm is [an] attorney for the insured as well as the insurer" (*quoting* *Imperiali v. Pica*, 338 Mass. 494, 499 (1959))); ABA, TORT & INS. PRAC. SEC. PROFESSIONALISM COMM., COMMENTS 9 (Jan. 30, 1995) (observing that "[m]ost courts . . . have concluded that when an insurer assumes control of the defense . . . the lawyer has two clients").

55. For example, none of the cases cited by the sources in the preceding footnote discuss the role of retainer agreements in determining the number of clients that defense counsel represents.

56. 475 N.W.2d 294, 296-97 (Mich. 1991) (holding that defense counsel's only client is the insured).

masters,⁵⁷ and a defense lawyer who has two masters owes performance to both that satisfies the standard of care. When defense counsel breaches this obligation, both clients are entitled to sue.

V. WHEN DOES DEFENSE COUNSEL'S REPRESENTATION OF THE COMPANY AND THE INSURED BEGIN?

Identifying how and when defense counsel acquires the insurance company as a client raises no special problems. An attorney acquires a company as a client when the company solicits legal services from the attorney and the attorney agrees to provide them; an attorney-client relationship springs into existence the moment agreement is reached. One can answer questions that may arise about the manner or the moment of defense counsel's retention by the company by using the same sort of evidence one would consider when studying an ordinary attorney-client relationship.⁵⁸

It is more problematic to determine when defense counsel acquires the insured as a client because the company retains counsel, not the insured. One must therefore consider whether an attorney-client relationship between defense counsel and the insured springs into existence when the lawyer is retained or at a later time, such as when the insured ratifies the company's selection.⁵⁹

An example will help demonstrate the importance of settling the time at which the insured becomes a client. Suppose that a lawyer, having been retained by the company to represent the insured, appears in court on behalf of the insured without meeting or contacting the insured. Did the attorney act properly by appearing? Ordinarily, an attorney may speak in court only on behalf of a client. If an attorney-client relationship with the insured commenced when the lawyer was retained, then the lawyer did nothing wrong. Conversely, if no attorney-client relationship yet existed because the insured had not consented to the choice of defense

57. See *supra* notes 39-43 and accompanying text.

58. For a discussion of the relevant evidence and examples, see RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 26 cmt. c, e (Tentative Draft No. 5, 1992).

59. The question posed in the text often arises in other contexts. See AMERICAN COLLEGE OF TRUST AND ESTATE COUNSEL, COMMENTARIES ON THE MODEL RULES OF PROFESSIONAL CONDUCT 60 (1993) [hereinafter ACTEC COMMENTARIES] (discussing how a lawyer should act when a father asks the lawyer to prepare a trust for a daughter who will soon attain her majority).

counsel, then the attorney was wrong to purport to represent the insured in court.

The prevailing and long-standing doctrine is that an attorney-client relationship arises between the lawyer and the insured when the company retains the lawyer at the insured's request. An early case applying this doctrine is *Countryman v. Breen*,⁶⁰ a routine automobile accident case in which the lawyer retained to defend the insured negotiated a \$3,500 settlement with the plaintiffs and announced the settlement in open court. Subsequently, the company's check was dishonored because the company became insolvent. The plaintiffs then applied to the court for entry of judgment against the insured on the settlement agreement.

In an attempt to stave off judgment, the insured argued that he should not be bound to the settlement because "in reality" the defense lawyers represented the company, not him.⁶¹ Speaking for the Supreme Court of Jefferson County of New York, Justice Smith observed that the insured's contention, if accepted, would work "a revolution" in the court's well-established settlement practices.⁶² Justice Smith then examined the terms of the liability policy pursuant to which defense counsel was retained and concluded that a revolution was not required. He wrote that

[b]y the clear terms of [the] policy the defendant had given power to the insurer to undertake the defense of these actions, which of course involved the employment of counsel; he actually delivered the pleadings and the process over to the insurance company with the knowledge and expectation that it would defend the actions and, to the amount of coverage, protect him against loss. So that in fact as well as in name, by reason of his swearing to the answers, and by reason of the contract of insurance itself, [the lawyers] were actually his attorneys He was at liberty, at the risk of course of forfeiting his rights under the policy of insurance, to discharge his counsel. Any limitation of his freedom in this respect was of his own creation.⁶³

In Justice Smith's view, the insured consented to representation by asking the company to provide a defense, which foreseeably in-

60. 263 N.Y.S. 603 (N.Y. Sup. Ct. 1933), *rev'd*, 271 N.Y.S. 744 (N.Y. App. Div. 1934), *aff'd*, 198 N.E. 536 (N.Y. 1935).

61. *Id.* at 605.

62. *Id.* at 606.

63. *Id.* at 607-08.

cluded hiring a lawyer who would operate subject to the company's control.⁶⁴

Formal Opinion 282, issued by the American Bar Association in 1950, reached the same conclusion on the same grounds. The opinion holds that "[a]n attorney may accept employment from an insurance company to represent the company's insureds within the limits of the policy without the request or approval of the insured."⁶⁵ In support of this holding, the committee argued that

"[c]onsent and approval" to represent the insured are clearly implied when the insured complies with his reciprocal duty under the insurance contract by forwarding the court process to the insurance company. If the insured does not desire to avail himself of the company's obligation to defend the suit including counsel, together with payment of any judgment and costs, he is at complete liberty to renounce his rights under the insurance contract and employ independent counsel at his own expense.⁶⁶

By asking the company to provide a defense in a context where the company has the power and the duty to retain a lawyer cou-

64. The decision in *Countryman* was reversed by the Appellate Division, and the appellate court's decision was affirmed by the New York Court of Appeals. *Countryman v. Breen*, 198 N.E. 536 (N.Y. 1935). The ground for reversal was that the attorneys had no authority to commit the insured on settlement and that the insured did not agree to pay the settlement amount himself.

The reversal does not impeach the argument of the lower court that the insured consented to representation by demanding a defense. It establishes at most that defense counsel had no authority to bind the insured to a settlement agreement. That conclusion can be justified in two ways. First, the scope of defense counsel's representation of the insured was limited to the defense of the liability suit. Because the scope of the retention excluded activities relating to settlement, counsel had no express or apparent authority to bind the insured. For a discussion of relevant issues, see Keeton, *Reciprocal Claims*, *supra* note 1, at 30-34. Second, an implied condition of the settlement agreement may have been that the agreement would be enforceable only against the company. That would be so if the parties to the agreement expected that only the company would pay.

It is worth noting that in *Countryman* defense counsel could bind the company to a settlement agreement because the company authorized the lawyer to handle settlement negotiations. Counsel could also bind the insured on litigation matters because such matters fell within the scope of the representation of the insured. See *Buchanan v. Buchanan*, 160 Cal. Rptr. 577, 582 (Cal. Ct. App. 1979) (observing that defense counsel has authority to bind the insured, without the insured's consent, in procedural matters arising during the action). The conclusion is only that defense counsel had no authority to enter into a settlement the insured would be obliged to pay. We discuss the scope of counsel's representation of the company and the insured at greater length in Part VI.

65. ABA Comm. on Professional Ethics and Grievances, Formal Op. 282 (1950) [hereinafter Formal Opinion 282].

66. *Id.*

pled with a financial interest in the exercise of its authority, the insured, according to Formal Opinion 282, agrees to be represented by the lawyer the company selects.

The view expressed in *Countryman* and Formal Opinion 282 meshes nicely with the liability contract and with the cases construing the company's right to defend. The liability contract gives the company the right to defend. Under prevailing caselaw, that right entitles the company to make every litigation decision that a person defending a lawsuit would ordinarily make, including the decision to retain defense counsel.⁶⁷ However, the right to defend does not entitle the company to foist counsel upon the insured. The company must wait for the insured to request a defense.⁶⁸ The act of presenting a demand is therefore reasonably read as completing the insured's consent to representation by counsel the company selects.

Many judicial opinions, treatises, and other authorities endorse the doctrine espoused in *Countryman* and Formal Opinion 282.⁶⁹ Some authorities endorse the slightly different view that the insured consents by purchasing liability insurance.⁷⁰ Although this

67. APPLEMAN, *supra* note 37, § 4681, at 2; KEETON & WIDISS, *supra* note 26, at 988.

68. Cf. APPLEMAN, *supra* note 37, § 4682, at 24 (observing that a policy condition for the defense obligation is that the insured request "that the insurer undertake the defense").

69. See, e.g., *id.* § 4681, at 2; 14 GEORGE J. COUCH, COUCH ON INSURANCE 2d § 51:103 (Ronald A. Anderson ed., rev. ed. 1984); *Moritz v. Medical Protective Co.*, of Ft. Wayne, Ind., 428 F. Supp. 865, 871-72 (W.D. Wis. 1977) (stating that "when the insured elects to tender to the insurer the defense of a claim against him or her, he or she consents to having the insurer choose the lawyer who is to defend the claim" and citing Formal Opinion 282); *Petition of Preferred Accident Ins. Co. of N.Y.*, 78 N.Y.S.2d 674, 675 (N.Y. App. Div. 1948) (stating that insureds, by delivering summonses to insurance carriers and demanding a defense, impliedly authorized the carriers to obtain lawyers for them to act as counsel of record in the litigations); see also Oregon Formal Ethics Opinion 1991-121 (1991) (citing Formal Opinion 282 with approval, but reasoning along different lines); *Central Cab Co. v. Clarke*, 270 A.2d 662, 665 (Md. 1970) (upholding the trial court's determination that an attorney-client relationship arose when the company sent defense counsel the insured's file, even though the company and the lawyer had yet to agree on the fee); *Mitchum v. Hudgens*, 533 So. 2d 194, 202 (Ala. 1988) (holding that defense counsel who settles at the company's direction without the insured's consent bears no malpractice liability to the insured "because the insured, by contracting away the right to require such consent, has thereby impliedly consented to the settlement of claims against him, within policy limits, by appointed counsel at the direction of the insurer").

70. Statements to this effect can be found in *Fidelity & Casualty Co. of N.Y. v. McConnaughy*, 179 A.2d 117, 121 (Md. 1962) ("The customary clause in insurance poli-

approach also responds to the need to find the insured's consent somewhere,⁷¹ we prefer the doctrine expressed in *Countryman* and Formal Opinion 282 for the reason just explained. It seems wrong to assert that the insured's consent is complete when the liability contract is signed because further action by the insured is required before the company can appoint defense counsel. The better view, in our judgment, is that the insured consents by performing the last act needed to perfect the company's right to select counsel for the insured.

Although we endorse the doctrine espoused in *Countryman* and Formal Opinion 282, we also recognize that the argument given in support of the doctrine is too weak to show that the insured consents to *joint* representation by demanding a defense. Further argument is needed to show that the insured agrees to become the company's co-client.⁷² Moreover, not everyone agrees that the insured in fact consents to joint representation. Some commentators, focusing on matters where the interests of the company and the insured conflict, suggest that the insured consents only to representation by an attorney whose loyalties run exclusively to the insured.⁷³

It is our judgment that an insured who demands a defense thereby consents both to representation by company-selected counsel and to joint representation because of the context in which the demand is presented. The company is entitled to control the defense. The company expects to take the helm and can defend the liability suit effectively only if it is a co-client.⁷⁴ In contrast, the

cies requiring the insured to permit the insurer's lawyer to defend claims . . . is consent in advance . . . to such dual representation."). Similar statements can also be found in at least three other cases: *Houston Gen. Ins. Co. v Superior Court*, 166 Cal. Rptr. 904, 908 (Cal. Ct. App. 1980); *Lysick v. Walcom*, 65 Cal. Rptr. 406, 413 (Cal. Ct. App. 1968); and *Krohe v. Goldman*, 4 N.Y.S.2d 851, 856 (N.Y. Mun. Ct. 1938).

71. On the requirement of client consent, see 2 MALLEN & SMITH, *supra* note 45, § 8.2, at 104-05.

72. The cases fail to observe the need for a separate argument. See, e.g., *Brohawn v. Transamerica Ins. Co.*, 347 A.2d 842, 852 (Md. 1975) (stating, without elaboration, that the provision of the insurance contract authorizing the company to select defense counsel constitutes the insured's implied consent to dual representation); *Fidelity & Casualty Co. of N.Y. v. McCoimughy*, 179 A.2d 117, 121 (Md. 1962) (same).

73. 2 ROBERT H. JERRY II, *UNDERSTANDING INSURANCE LAW*, § 114[b], at 603 (1987).

74. See William T. Barker, *ALI Draft Questions Insurer's Right to Control Defense*, reprinted in 60 DEF. COUNS. J. 611, 611 (1993) (stating that "[b]ecause lawyers cannot allow third parties who pay clients' legal fees to influence the representation," the

insured has no right of control, and, in a full coverage case, has no reasonable expectation of asserting control (and perhaps no actual expectation as well). In these circumstances, it is proper to conclude that the insured, by demanding a defense, impliedly agrees to allow the company to become a co-client.⁷⁵ To conclude otherwise would hold that an action not contemplated by the liability contract—that is, some further act conveying the insured's permission to allow the company to become a co-client—is a precondition for the company's exercise of the powers the liability contract conveys.

Because the insured authorizes the company to control the defense of the liability suit, it is tempting to conclude, as some authorities have, that the company acts as the insured's agent when handling the defense.⁷⁶ We think the conclusion is erroneous, and we therefore emphasize that nothing we have written suggests that the company is the insured's agent. We agree that the company is entitled to control the defense, but we deny that, when exercising the right to defend, the company acts an agent for the insured.

We hold this view for two related reasons. First, as a matter of positive law, the company neither owes the insured a fiduciary

company's ability to control the defense "is highly dependent on the premise that the insurer . . . is a client"); see also Barker, *Right and Duty to Defend*, *supra* note 4, at 210-11; James M. Fischer, *Should Advice of Counsel Constitute a Defense for Insurer Bad Faith?*, 72 TEX. L. REV. 1447, 1481 n.132 (1994) ("treating the insurer as a client permits the insurer to control the defense").

75. Implying consent in the circumstances described is consistent with basic contract law. See RESTATEMENT (SECOND) OF CONTRACTS § 204 (1979) ("When the parties [to a] contract have not agreed with respect to a term which is essential to a determination of their rights and duties, a term which is reasonable in the circumstances is supplied by the court."); see also *Kirk La Shelle Co. v. Paul Armstrong Co.*, 188 N.E. 163, 167 (N.Y. 1933) (stating that "in every contract there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract").

76. See, e.g., *Ranger County Mut. Ins. Co. v. Guin*, 723 S.W.2d 656, 659 (Tex. 1987) (stating that when the company undertook the defense, it became the insured's agent for purposes of investigation, defense, trial, and settlement). The controversy over the company's status is described in APPLEMAN, *supra* note 37, § 4681, at 6-7 (stating (1) that the early rule was that a company exercising the right to defend was "in the position of an independent contractor," (2) that the "modern rule is that . . . the insurer becomes the agent of the insured," and (3) that the modern rule is "unrealistic and the subject of much mischief" and has been reversed by statute in some states) (citations omitted). For reasons set out in the text, we prefer the nonagent, independent contractor rule.

duty nor is subject to the insured's control when performing defense-related functions.⁷⁷ In a full coverage case, the company can select the lawyer it wants and, within broad limits, it can conduct the defense as it sees fit. It need not pick the lawyer the insured wants or the lawyer who the insured might think best. It need not change lawyers at the insured's request. And it need not put the insured's interests ahead of its own.⁷⁸ The hallmarks of agency—fiduciary duty and control—are missing from the relationship between the company and the insured.⁷⁹

Second, speaking normatively, it would be inappropriate to hold the company to a fiduciary duty or a duty of obedience when controlling the defense. Imposing either duty would require the company to sacrifice its interests in favor of the insured's interests.⁸⁰ A decision to impose either duty must therefore reflect a belief that the company may not legitimately put its own interest in minimizing the economic cost of a claim ahead of whatever other interest the insured may have. Such a belief is unwarranted. It is antithetical to the business of insurance which, as explained in

77. See, e.g., *Gillikin v. Ohio Farmers Indem. Co.*, 118 S.E.2d 605, 606 (N.C. 1961) (stating that a liability insurer is not a fiduciary to its insured); *Chavez v. Chenoweth*, 553 P.2d 703, 710 (N.M. Ct. App. 1976) ("Something more than the fact of the insurance relationship is required before a fiduciary relationship results."); see also *Barker, Fiduciary*, *supra* note 4, at 7-14 (arguing against the application of fiduciary standards to insurance companies in first-party contexts).

78. *APPLEMAN, supra* note 37, § 4681, at 4 ("[W]here there is a conflict of interests, the insurer may exercise the right to defend for its own advantage, even though a different course would have been preferable from the standpoint of the insured.").

79. *Keeton, Reciprocal Claims, supra* note 1, at 33-34 (stating that "the company and its representatives should not be regarded as agents of the insured even with respect to settlement of the claim against the insured or with respect to defense since the insured lacks that power of direction and right of control which a principal has over an agent"); see also *KEETON & WIDISS, supra* note 26, § 7.5(c), at 807-08 (discussing erroneous use of agency and fiduciary principles in certain settlement and defense contexts); *RESTATEMENT (SECOND) OF AGENCY* § 2(3) (1959) (defining an independent contractor as "a person who contracts with another to do something for him but who is not controlled by the other nor subject to the other's right to control with respect to his physical conduct in the performance of the undertaking," and observing that an independent contractor "may or may not be an agent"); *id.* § 14N cmt. b (stating that "a person who contracts . . . [with another], but who is not acting as a fiduciary for the other, is a non-agent contractor").

80. *Wisconsin Zinc Co. v. Fidelity & Deposit Co. of Md.*, 155 N.W. 1081, 1086-87 (Wis. 1916) (rejecting contention that insurance company controlling defense and settlement acted as insured's agent because holding otherwise would subject the company to a "duty . . . to use its best efforts to further the interests of the [insured]" and "to disregard its own interest" whenever its interest conflicted with the insured's), *overruled by Hilker v. Western Auto. Ins. Co.*, 231 N.W. 257 (Wis. 1930).

Part I, operates on the premise that the company can minimize the cost of handling claims.⁸¹ It is also inconsistent with the structure of the liability contract. The contract places both control of the defense and responsibility for claim-related costs in the company's hands because this arrangement best serves the economic interest the company and the insured have in common at the time the contract is made.⁸² Rather than encourage appropriate use of the company's contractual powers, imposing a fiduciary duty or a duty of obedience upon the company would be like tossing a monkeywrench into the works.

A better view is that an insurance company acts as a nonagent, independent contractor when performing defense functions. The cases originally accorded the company this status.⁸³ Moreover, the conclusion that the company is a nonagent, independent contractor fits both the law governing the right to defend and the economics of insurance. It reflects the fact that the company is generally free to conduct the defense as it wishes, even when the insured would prefer that it act otherwise.⁸⁴ It also recognizes that the alignment of control and financial responsibility gives the company incentives to minimize claims-related costs. All things considered, it is normatively better to treat the company as a nonagent, independent contractor than as an agent of the insured.⁸⁵

81. GEORGE E. REJDA, *PRINCIPLES OF RISK MANAGEMENT AND INSURANCE* 605 (4th ed. 1992) (stating that a soundly-run company will avoid paying excessive amounts on claims).

82. See *Hilker*, 231 N.W. at 259 (suggesting that insured's disavowal of the right to control the defense may be seen as part of the consideration paid for coverage).

83. See, e.g., *Wisconsin Zinc Co.*, 155 N.W. at 1081 (rejecting the contention that the company, having assumed control of the defense and settlement functions, acted as the insured's agent), *overruled by Hilker*, 231 N.W. at 257 (establishing agency rule).

84. The company may even permit entry of a default judgment that the company must then pay. APPLEMAN, *supra* note 37, § 4681, at 10 (observing that "an insurer is not required to defend a suit if it chooses to let a judgment be secured by default and then pay such judgment").

85. The shift to the agency doctrine is explained partly by the desire of the courts to find a basis for holding the company liable to the insured for defense counsel's misdeeds. See, e.g., *Ranger County Mut. Ins. Co. v Guin*, 723 S.W.2d 656, 659-60 (Tex. 1987) (deeming the company the insured's agent and the attorney the insured's sub-agent, so that the agent would be liable to the insured for the sub-agent's wrongdoing). Given that the insured has a direct action against defense counsel for malpractice and another against the insurance company for breach of contract, it is hard to see the need for the agency approach.

Our denial that the company is the insured's agent should not affect the extent to which communications within the tripartite relationship are or may be subject to the attorney-client privilege.⁸⁶ Under evidence law, it matters not whether the company bears a fiduciary duty to the insured.⁸⁷ The availability of the privilege turns on whether the company is a "representative" with authority to obtain legal services for the insured and to act for the insured on the basis of legal advice. Because the company clearly possesses such authority, it qualifies as a representative whether or not it owes a fiduciary duty to the insured.

VI. THE SCOPE OF DEFENSE COUNSEL'S REPRESENTATION OF THE COMPANY AND THE INSURED

Thus far, we have shown that whether defense counsel has one client or two depends on the retainer agreement, that in full coverage cases defense counsel ordinarily has two clients, and that relationships with both clients arise at the time the company retains counsel for the insured. With these matters settled, it is possible to discuss the duties defense counsel owes each client.

A discussion of duties must first address the scope of defense counsel's representation of the company and the insured. It is clear that a lawyer has no duty to provide services outside the scope of the representation of a client.⁸⁸ As the leading treatise

86. The argument of this paragraph relies heavily on analysis found in 24 CHARLES A. WRIGHT & KENNETH W. GRAHAM, *FEDERAL PRACTICE AND PROCEDURE: FEDERAL RULES OF EVIDENCE* § 5474, at 112, § 5482, at 264, § 5483, at 279, § 5505, at 548 (1986) (exploring the expansive attorney-client privilege by way of agency). The opinion by Presiding Justice Richardson in *American Mutual Liability Insurance Co. v Superior Court*, 113 Cal. Rptr. 561 (Ct. App. 1974), contains a thoughtful discussion of the availability of attorney-client privilege protection for communications among the insured, the company, and defense counsel after the tripartite relationship is formed.

87. See *In re Bieter Co.*, 16 F.3d 929, 939-40 (8th Cir. 1994) (holding that defendant did not waive protection of attorney-client privilege by revealing information to third-party who was an independent contractor of the defendant); *McCaugherty v. Siffermann*, 132 F.R.D. 234, 238-39 (N.D. Cal. 1990) (applying the attorney-client privilege to communications between two independent consultants hired by the client and the client's lawyers); see also John E. Sexton, *A Post-Upjohn Consideration of the Corporate Attorney-Client Privilege*, 57 N.Y.U. L. REV. 443, 498 (1982) (contending that it is sometimes appropriate to extend the attorney-client privilege to information-givers who are independent contractors, not company employees).

88. See *RESTATEMENT OF THE LAW GOVERNING LAWYERS* § 72 cmt. d (Council Draft No. 7, 1994) (stating that "[t]he lawyer is not liable for failing to act beyond [the] scope" of a representation). A lawyer and a client can agree that the lawyer will handle all of the client's legal needs. In practice, however, scope definitions usually are consider-

on legal malpractice states, "[t]he liability of the attorney depends upon whether a duty was breached which was justifiably within the scope of the employment."⁸⁹ We will consider the scope of defense counsel's representation of each client in this section, and we will examine counsel's particular duties to each client in Part VII.

A. The Retainer Agreement Defines the Scope of the Representations

The scope of a representation determines which of the client's interests the lawyer must protect and zealously represent.⁹⁰ Just as it is clear that a lawyer has no duty to act for a client on a matter that falls outside the scope of a representation, so it is apparent that lawyers and clients are generally free to define the scope and objectives of a representation as they wish. The *Model Rules of Professional Conduct* recognize that

[t]he objectives or scope of services provided by a lawyer may be limited by agreement with the client or by the terms under which the lawyer's services are made available to the client. For example, a retainer may be for a specifically defined purpose.⁹¹

The view is echoed in the tentative *Restatement of the Law Governing Lawyers*, which states simply that "a lawyer and an adequately informed client may agree to limit the scope or objectives of the representation."⁹² Other authorities also endorse this view.⁹³

ably less broad. For example, an agreement obligating a lawyer to help a client on a tax matter will not subject the lawyer to a duty to advise the client on a patent application. If the client wants the lawyer to handle the latter task, it must be separately agreed that the lawyer will tackle that job.

89. 2 MALLEN & SMITH, *supra* note 45, § 8.2, at 407.

90. Barker, *Defense Attorneys*, *supra* note 4, at 142.

91. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.2 cmt. (1994); *see also* MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.2(c) ("A lawyer may limit the objectives of the representation if the client consents after consultation."). The Comment to Model Rule 1.2 offers a relevant yet possibly odd example of a scope limitation. It states that "[w]hen a lawyer has been retained by an insurer to represent an insured, the representation may be limited to matters related to the insurance coverage." The example is odd because coverage counsel ordinarily represents only the company. Coverage counsel does not ordinarily represent the insured.

92. RESTATEMENT OF THE LAW GOVERNING LAWYERS § 30(1) (Tentative Draft No. 5, 1992)

93. *See, e.g.*, A.B.A., ANNOTATED MODEL RULES OF PROFESSIONAL CONDUCT 37 (2d ed. 1992) (citing cases upholding scope limitations); 2 MALLEN & SMITH, *supra* note

Insurance representations are no exception to the rule allowing parties to regulate contractually the scope of a representation. For example, the cases recognize that defense counsel "may be generally employed for all purposes related to the claim or he may be engaged only for the court representation."⁹⁴ Because the parties control the scope definition, in theory the contours of defense counsel's representation of the company and the insured can have any imaginable shape. In practice, however, only certain definitions are likely to find their way into retainer agreements for reasons we will explain shortly. These eligible definitions reflect the allocation of rights and responsibilities provided for in the liability contract between the company and the insured.

Before discussing the eligible definitions, it is important to establish three background points. First, it is better to speak of scope agreements or definitions than of scope limitations or restrictions, although one more often encounters the latter terms. A representation has no scope until the parties agree on what the scope shall be. Talk of limitations and restrictions obscures this point by suggesting that agreement is needed only when parties wish to limit the scope of the lawyer's undertaking in some way. The suggestion is mistaken. Agreement is needed whether the scope is to be unusually narrow, unusually broad, or somewhere in between.

Second, when a lawyer represents Client A and Client B on the same matter, the scope of the representation of Client A can differ from the scope of the representation of Client B, absent a fatal conflict of interests. The possibility of tailoring the scope definition to each client exists because the definition is governed by agreement. The parties' agreement that the lawyer shall provide a broader range of services for one client than for the other is sufficient to create different scope definitions.

The relevant implication of the point just made is that the scope of defense counsel's representation of the company can differ from the scope of counsel's undertaking on behalf of the insured. This difference arises when the retainer agreement obli-

45, § 8.2, at 408 (citing caselaw allowing parties to limit the scope of the representation by agreement); Barker, *Defense Attorneys*, *supra* note 4, at 142 (stating that "the scope of the representation . . . is a matter of agreement between [the] attorney and [the] client(s)").

94. *American Mut. Liab. Ins. Co. v. Superior Court*, 113 Cal. Rptr. 561, 570 (Cal. Ct. App. 1974).

gates defense counsel to provide the company a broader or a narrower range of services than the insured. Naturally, the retainer agreement may also entitle each client to the same range of services the other is to receive.

Third, when it is unclear whether or not a client was due a particular service from a lawyer, a court will often give the client the benefit of the doubt.⁹⁵ For example, in a case where a dispute arose as to whether the scope of defense counsel's representation of the insured included services relating to settlement, the court put the burden on the lawyer of clarifying the matter. It also decided that because the lawyer had left the matter unclear, the insured was entitled to believe that settlement issues fell within the scope of the lawyer's undertaking.⁹⁶ To be safe, defense counsel should see that each client understands the range and nature of the services counsel is to provide for that client. Defense counsel also should be careful to operate within limits once they are set. By performing services not required by the original scope agreement, defense counsel may reform that agreement. Such a reform can cause confusion over counsel's responsibilities and can increase counsel's malpractice exposure.

Scope definitions employed in insurance defense retainer agreements are like other scope definitions in many respects. For example, in all manner of representations, a function of the retainer agreement is to make clear that the lawyer is obligated to serve the client in only the particular lawsuit(s) agreed to be defended.⁹⁷ Counsel will have no obligation to handle other matters, including other litigation that may arise out of the same conduct or that may involve the same company or the same insured. Retainer agreements employed in insurance representations also serve this function. Usually, they identify the lawsuits defense counsel is

95. See, e.g., RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 29A(2) (Tentative Draft No. 5, 1992) (stating that "[a] tribunal should construe a contract between client and lawyer as a reasonable person in the circumstances of the client would have construed it").

96. *Lysick v. Walcom*, 65 Cal. Rptr. 406, 416 (Cal. Ct. App. 1968) (finding that defense lawyer was obligated to represent insured's interests in settlement, despite any scope restriction that may otherwise have freed the lawyer from this obligation, because the lawyer "did not advise or make it clear to the [insured] that he was representing only the insurance company in the advisability of settlement").

97. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 28 cmt. c (Tentative Draft No. 5, 1992) (stating that "[t]he lawyer's duties are, with some exceptions, limited to matters covered by the representation").

engaged to handle, and the company and the insured usually will understand that other counsel must be retained for other cases. Occasionally, there is confusion on the subject, the cause of which is often a misunderstanding on the part of the insured. For example, the insured may believe that counsel hired to defend a civil suit will also represent the insured in a related criminal action or will advise the insured on other matters not related to the defense of the liability claim. Upon learning that either client expects services outside the scope of the retention, a lawyer fails to correct the misunderstanding at his peril. To avoid liability, defense counsel should explain that he is not handling the matter and should advise the client to retain a lawyer.⁹⁸

In contexts where there is an identified risk of misunderstanding, defense counsel may want to explain the scope of the representation to both clients without waiting for a sign that either client is confused. For example, suppose that two related lawsuits, *A* and *B*, are pending against the insured, that the company retains defense counsel to handle only lawsuit *A*, and that counsel knows of the existence of lawsuit *B*. In this situation, it would be prudent for defense counsel to inform the insured that he has been retained to handle only lawsuit *A* and that the insured may wish to retain separate counsel to defend lawsuit *B*. A brief disclosure letter to the insured, with a copy to the company as well, can protect defense counsel from the possibility that a court presiding over a malpractice action will find that either the company or the insured reasonably expected the lawyer to handle lawsuit *B*.⁹⁹

Historically, perhaps the most controversial issue relating to the scope of defense counsel's representation of the two clients is whether counsel must provide either client coverage advice. It would be inappropriate to address that issue here because the subject matter of this Article is limited to cases in which coverage is both clear and clearly sufficient in light of the insured's possible

98. See 2 MALLEN & SMITH, *supra* note 45, § 8.2, at 408 (cautioning that "[a]lthough the attorney need not represent or counsel the client concerning such matters [outside the scope of the undertaking], the client should be informed of the need for legal assistance and that the attorney will not be providing such services"); see also *Daugherty v. Runner*, 581 S.W.2d 12 (Ky. Ct. App. 1978) (requiring attorney to attend to circumstances indicating that the client may have legal problems or remedies that fall outside the scope of the undertaking).

99. We do not mean to imply that defense counsel has an obligation to send a disclosure letter to either the company or the insured. The recommendation to send a letter is purely a prudential one.

loss. Even so, we note our tentative view that defense counsel has no duty to serve as coverage counsel for either the company or the insured and should refrain from providing coverage advice to either client.

B. The Scope of Defense Counsel's Representation of the Insurance Company

It is up to the company and the lawyer to decide what the scope of the lawyer's representation of the company will be. They can decide that the lawyer will represent all of the company's interests that stand to be affected by the liability suit against the insured, or they can decide that the lawyer will be responsible for protecting only a subset of those interests. For example, they can assign the lawyer responsibility for defending the liability action through trial but not for handling the appeal. Or they can agree that the lawyer will handle discovery and settlement, but that new counsel will be brought in if the case must be tried. In principle, the company and defense counsel can carve up the scope of the representation in innumerable ways.

Of particular interest is whether the scope of defense counsel's representation of the company must include matters relating to settlement of the claim asserted against the insured. In our judgment, the answer is no. We do not deny that the company can assign defense counsel responsibility for settlement. In fact, we believe that insurance companies usually do assign defense counsel that responsibility and that they usually expect defense lawyers to participate in the settlement process in a significant way.¹⁰⁰ However, the company need not give defense counsel that responsibility; the company can handle settlement negotiations in-house. It can also assign responsibility for settlement to outside counsel who represents the company but not the insured. Whether defense counsel will handle settlement issues is up to the company and the lawyer to decide.¹⁰¹

100. For a discussion of the role defense counsel ordinarily plays in settling cases, see G. Michael Bourgeois, *What the Lawyer-Malpractice Insurer Expects of Defense Counsel*, THE BRIEF, Winter 1994, at 16, 46.

101. See COREGIS, *supra* note 36, at 5 (providing that "[s]ettlement negotiations are to be handled and directed by the claim associate whenever possible," but also observing that "there may be cases which require that defense counsel handle negotiations directly" when authorized and supervised by the claim associate).

The retainer agreement also can require defense counsel to provide some services relating to settlement but not others. For example, the company will often (perhaps always) want defense counsel to estimate the value of the liability suit, to suggest a dollar range of reasonable settlement demands, and to opine on the lowest offer a claimant is likely to accept.¹⁰² Because defense counsel has access to all sorts of information bearing on these matters, it makes sense for the company to request counsel's help. However, even when defense counsel is given these responsibilities, the company may decide that settlement negotiations will be handled by somebody else. Defense counsel can handle some settlement responsibilities without handling all.

The company may have good reasons for assigning settlement responsibilities to someone other than defense counsel. The standard liability contract gives the company control of the settlement decision. The company has the right to settle without the insured's consent and even without consulting the insured. That is a valuable right, and the company may reasonably wish to retain full control of it by establishing up front that defense counsel, who also represents the insured, will participate in settlement to only a limited extent. In this way, the company can avoid the risk that defense counsel's duties to the insured will in any way dilute the company's contractual right to decide whether, when, and at what price settlement shall occur.

A second reason that may appeal to the company is the desire to save money. An insurance company can often minimize the administrative expense of settling a claim by leaving the insured out of the loop. It can use a claims adjuster or company counsel, including a lawyer who works in-house, to settle a lawsuit quickly and without any fuss. Like a claims adjuster, a lawyer who represents only the company can effect settlement without even meeting the insured. This efficient conduct might be impeded if settlement had to be effected via a defense lawyer who also represented the insured. The lawyer might feel obligated to confer with the insured before settling, if only to inform the insured that settlement would occur. This sense of obligation would drive up administrative costs

102. *Bourgeois*, *supra* note 100, at 46. *COREGIS*, *supra* note 36, at 2, requires defense counsel to assess "the expected damages at issue, the settlement value, the last demand from plaintiff and Coregis's last offer," even though they also put control of settlement negotiations in the claim associate's hands.

by consuming lawyers' time, by delaying settlement, and, in some cases, by revealing settlement conflicts between the company and the insured that would require counsel to withdraw.¹⁰³

Another reason for carving up settlement responsibilities is to take advantage of the skills different lawyers possess. Some lawyers are trial specialists. Others are great at carrying out discovery and writing motions and briefs. Still others are settlement artists.¹⁰⁴ When the stakes in the liability suit are sufficiently high, the company may find it economically rational to retain specialists to handle particular tasks. The company can do so if it can retain defense counsel on terms that exclude some or all settlement matters from the scope of the undertaking.

Defense counsel also may prefer to restrict the representation of the company to the defense of the liability action against the insured. Many malpractice claims against defense lawyers concern settlement-related conduct.¹⁰⁵ Malpractice litigation is especially likely when there is a disagreement over settlement between the company and the insured. The easiest way for a defense lawyer to avoid this sort of exposure is to obtain an agreement that responsibility for settlement will rest with someone else. Excluding settlement from the scope of the representation of the company is an effective way to deal with potential conflicts of interest between the company and the insured.¹⁰⁶

When all is said and done, however, the usual and efficient course in full coverage cases is to assign defense counsel plenary (but not exclusive)¹⁰⁷ responsibility for protecting the company's

103. See, e.g., Florida State Bar Comm. on Professional Ethics, Op. 86-6 (1987) (stating that attorney who represents both a company and an insured doctor accused of medical malpractice may not "participate on behalf of the insurer in settlement negotiations with the plaintiff" if the doctor opposes settlement).

104. See Jonathan M. Hyman, *Trial Advocacy and Methods of Negotiation: Can Good Trial Advocates Be Wise Negotiators?*, 34 UCLA L. REV. 863, 866 (1987) (discussing tendency of trial lawyers' ideology of advocacy to inhibit settlements).

105. Eric Mills Holmes, *A Conflicts-of-Interest Roadmap for Insurance Defense Counsel: Walking an Ethical Tightrope Without a Net*, 26 WILLAMETTE L. REV. 1, 75 (1989).

106. At least one advisory opinion recommends the strategy suggested in the text. Florida State Bar Comm. on Professional Ethics, Op. 86-6 (1987). The possibility of employing the strategy was also recognized in *Lysick v. Walcom*, 65 Cal. Rptr. 406, 415-16 (Cal. Ct. App. 1968).

107. Defense lawyers complain that insurance companies too often effect settlements behind their backs via other agents. Although we hardly recommend a strategy of excluding defense counsel from settlement negotiations, we see a need to point out that a

manifold interests in the liability suit. The liability contract entitles the company to control the investigation, defense, and settlement of the lawsuit against the insured. The widespread practice of involving defense counsel in all three activities strongly suggests that a single agent can efficiently handle them all. As a general matter, it is entirely permissible to employ a scope definition that gives defense counsel comprehensive responsibility for handling the company's affairs, and it is easy to understand why broad definitions are often used. Still, there may be times when it is wise to exclude some of the company's interests from the scope of defense counsel's undertaking. In these instances, narrower definitions can properly be employed.

C. The Scope of Defense Counsel's Representation of the Insured

Points made in the preceding section bear on the scope of defense counsel's representation of the insured. In principle, the company and defense counsel can consensually set any definition they like. They can agree that defense counsel will advocate all the interests the insured has in the liability suit or only some. In practice, however, certain definitions are more likely than others to be employed.

Before discussing the eligible definitions, it is worth reiterating a fundamental point. The scope of the lawyer's representation of the company may differ from the scope of the lawyer's representation of the insured. Therefore, our conclusion in Section VI(B) that defense counsel ordinarily represents the company on all matters relating to the investigation, defense, and settlement of the liability suit does not establish that defense counsel's undertaking on behalf of the insured is equally broad. The latter representation may be broad or narrow in scope, depending on the agreement that is reached.

It is particularly important to see that defense counsel can be responsible for advancing the company's interests in settlement without bearing the same responsibility to the insured. Instead, counsel may represent the company and the insured in the defense of the liability claim and the company alone in settlement. Although some commentators disagree that defense counsel's rela-

company is free to work for settlement via any agent it wants. Unless the retainer agreement provides that defense counsel is to be the company's sole agent for settlement, the company can properly effect settlement via someone else.

tionships with the two clients can properly be structured this way, the point here is that the consensual nature of attorney-client relationships gives the parties to the retainer agreement the freedom to do what they want.¹⁰⁸ Whether the parties should exclude responsibility for settlement issues from the scope of the representation of the insured must be considered on its own.

When thinking about the desirability of excluding settlement responsibilities, it is helpful to begin by recalling that a scope limitation frees a lawyer from having to provide services of a particular kind. In this context, the services in question are those that would further any interests the insured may have in the settlement of the liability claim. They include advising the insured about settlement values or strategies, conferring with the insured about collateral effects settlement could have on the insured, serving as a conduit for settlement offers made by or directed to the insured (as contrasted with offers made by or directed to the company), drafting settlement documents for the insured, and making binding settlement commitments on behalf of the insured. Of particular interest is the service of advocating the insured's position on settlement to the company. If settlement responsibility is excluded, defense counsel has no duty to provide that service to the

108. Judge Keeton was the first to observe that defense counsel may represent only the company on settlement. See Keeton, *Liability Insurance*, *supra* note 1, at 1168-71; see also Barker, *Defense Attorneys*, *supra* note 4, at 142-43 (arguing that the duty to advocate the insured's interests in settlement can and should be excluded from the scope of the representation of the insured). The connection between Keeton's observation and retainer agreements is more fully explained in Silver, *Insurance Defense Counsel*, *supra* note 3, at 1617-20.

Criticisms of Keeton's suggestion can be found in ROBERT H. JERRY II, *UNDERSTANDING INSURANCE LAW* 614 (1987) and in John K. Morris, *Conflicts of Interest in Defending Under Liability Insurance Policies: A Proposed Solution*, 1981 UTAH L. REV. 457, 470-71. Jerry argues that "the Keeton suggestion gives the insurer an immunity from the insured's claims that the duty to settle was breached, and does nothing to enhance the quality of the defense provided by the insurer." 2 JERRY, *supra*. We think this criticism is misguided. The company cannot immunize itself from a duty to settle liability by rigging the scope of defense counsel's representation of the insured. The only effect of excluding settlement from the scope definition is to deny the insured a malpractice claim against defense counsel arising out of the lawyer's settlement conduct. Keeton states as much. See Keeton, *Liability Insurance*, *supra* note 1, at 1169. Moreover, an agreement to exclude settlement responsibilities from the scope of counsel's representation of the insured can neither enhance nor diminish the quality of the defense the insurer provides. The exclusion only frees defense counsel from having to provide settlement-related services for the insured. It neither frees counsel from having to advocate the insured's interests in minimizing the loss to the liability claimant nor diminishes the quality of the defense-related services counsel must provide.

insured. Certainly, the insured may retain separate counsel for that purpose at the insured's own expense. The point is only that defense counsel would have no duty to provide that service for the insured.¹⁰⁹ Counsel's only duty, the only duty for breach of which the insured would be able to assert a malpractice claim, would be to defend the insured in the liability case.

Discussing an excess liability situation where the insured's money was on the line, William T. Barker argues that responsibility for settlement should be excluded from defense counsel's undertaking on behalf of the insured.¹¹⁰ He reasons that including responsibility for settlement compromises defense counsel's professional responsibilities in two ways. It puts counsel in the position of representing two clients whose interests on settlement conflict, and it requires counsel to advise the company to accept unreasonable settlement demands when that would free the insured from the risk of litigation, even though by giving such advice counsel would wrongly subordinate the company's interests to the insured's. To avoid these problems, Barker recommends excluding settlement from the scope of counsel's representation of the insured.¹¹¹

The conflict that concerned Barker cannot arise in full-coverage cases. Because the policy limits are adequate to cover the insured's exposure in such cases, the insured's money is not on the line. That is why, in full-coverage cases, the settlement-related interests of the company and the insured usually align. Even so, their interests can diverge. For example, an insured concerned about additional stakes may wish to accept a settlement demand that a company, concerned about the liability alone, would reject. The easiest way to avoid these conflicts is by following Barker's recommendation: Exclude settlement-related services from the scope of defense counsel's representation of the insured, even though exclusion is not required.

It remains for us to consider the particular services defense counsel must provide the insured when settlement responsibilities are excluded. Barker believes that, even when the retainer agree-

109. Our analysis follows that of Barker, *Defense Attorneys*, *supra* note 4, at 142-43. Barker is responding to the conflicting views advanced in STEPHEN S. ASHLEY, *DEFENSE ATTORNEYS AND POLICY LIMITS SETTLEMENT OFFERS, BAD FAITH LAW REPORT* 165 (1988).

110. Barker, *Defense Attorneys*, *supra* note 4, at 143.

111. *Id.*

ment limits the scope of the undertaking to the defense of the liability suit, defense counsel should "advise the insured on . . . the pros and cons of any particular settlement position, and *all other matters regarding [the insured's] interests in possible settlement.*"¹¹² If read literally, the italicized language could require defense counsel to advise the insured to the company's detriment. For example, counsel might have to explain that the insured could benefit by settling with the liability claimant and suing the company for bad faith. Counsel might even have to explain how a bad faith failure to settle a case can best be set up. If read as Barker suggests, a settlement exclusion would be insufficient to cure all settlement-related conflicts that may arise.

We think that an exclusion of responsibilities relating to settlement means what it says: that defense counsel has no duty to advise or act for the insured on settlement, period. Counsel must inform the insured of developments relating to settlement, including settlement demands received from other parties, because the insured is entitled to that information.¹¹³ Counsel also must tell the insured about the scope restriction and explain that the insured may need to hire separate counsel to handle settlement issues.¹¹⁴ But, in our judgment, counsel need not and should not otherwise advise the insured. When responsibility for settlement is excluded from the scope of the relationship with the insured, it is not defense counsel's job to tell the insured how the insured may be affected by settlement developments or by settlement on particular terms.

Other reasons for excluding settlement from the scope of defense counsel's representation of the insured are suggested by several points made in Section VI(B). By excluding settlement responsibilities and properly informing the insured of the restriction, the company can preserve its ability to exercise its contractual right to make settlement decisions and thereby more fully realize the economic value of that right. The company also can reduce the likelihood that defense counsel will have to withdraw as a

112. *Id.*

113. We discuss the duty to communicate with the insured in Section IX(B).

114. We agree with Barker on this point. See Barker, *Defense Attorneys*, *supra* note 4, at 142 (stating that "the insured must be fully informed of the limits of the representation and of the reasons why personal counsel on this subject might be desirable"); see also *Lysick v. Walcom*, 65 Cal. Rptr. 406, 416 (Cal. Ct. App. 1968) (refusing to enforce a scope restriction relating to settlement that was not disclosed to the insured).

result of a settlement dispute. That can save the company money and time as well. An exclusion also reduces defense counsel's malpractice exposure by making it clear that counsel is responsible to only one master—the company—on settlement questions.

The suggestion that defense counsel should not represent the insured on settlement is far less novel than it may seem. The belief that at least some settlement responsibilities traditionally are excluded appears to have been the conventional wisdom for years. Recall the case of *Countryman v. Breen*, in which the claimants sought to enforce a settlement against the insured after the insurance company went belly-up.¹¹⁵ Although Justice Smith would have bound the insured to the settlement, his judgment was reversed on appeal. The appellate division found that defense counsel had no authority to bind the insured to a settlement without the insured's express consent. That makes sense if the attorneys' relationship with the insured was limited to defending the liability suit since, in that event, they had no authority to settle for the insured. They could bind the company because the scope of their relationship with the company included defense and settlement as well. However, they had no authority to commit money belonging to the insured. Nor could the company instruct them to enter into an agreement on behalf of the insured. The insurance contract authorized the company to settle only at its own expense. On settlement, at any rate, the insured was right in claiming that "in reality" the attorneys represented the company, not him.¹¹⁶

Insofar as we can tell, both insurance law and the law of professional responsibility permit the use of retainer agreements that exclude settlement from the scope of defense counsel's representation of the insured. Insurance law burdens the company with two relevant duties: a duty to defend the insured and a duty to behave reasonably in settlement. The first duty requires the company to provide a lawyer to defend the insured. The second duty requires the company to consider the insured's interests along with its own when exercising its settlement discretion. Neither duty requires the company to provide a lawyer whose job is to serve the insured on settlement.¹¹⁷ The law of professional responsibility

115. See text following note 60.

116. Other cases discussing the insured's liability for settlements entered into by defense counsel are collected in Keeton, *Reciprocal Claims*, *supra* note 1, at 30 n.7. Keeton generally endorses the view expressed here.

117. Judge Keeton made this point many years ago. Robert E. Keeton, *Liability In-*

also permits defense counsel to exclude settlement from the scope of the representation of an insured, as a Florida advisory opinion recently recognized.¹¹⁸ The opinion distinguished a situation in which defense counsel did represent the insured on settlement from a situation in which counsel did not do so. When discussing the latter situation, the opinion observed that defense counsel could continue to defend both the company and the insured in the liability action even though a conflict of interests precluded counsel from serving either client in settlement. Thus, the opinion both recognized that services relating to settlement can be excluded from the scope of defense counsel's representation of an insured and endorsed exclusion as a means of dealing with settlement conflicts.

In keeping with the views just expressed, we encourage insurance companies and defense lawyers to limit the scope of defense counsel's relationship with the insured to the defense of the liability claim. However, for reasons given in Section VI(B), we do not recommend limiting defense counsel's relationship with the company in this way. Instead, we think it advisable, in the ordinary full coverage case, to agree that counsel will represent the company on all matters relating to the investigation, defense, and settlement of the lawsuit against the insured. Our recommendation is described in Figure 4, which indicates the scope of defense counsel's suggested relationship with both clients.

Insurance and Responsibility for Settlement, 67 HARV. L. REV. 1136, 1169 (1954) (arguing that the "insured has a right to require company to give consideration to his interests where they conflict with those of company regarding settlement, but not a right to require that the attorney-client relationship, between himself and the attorney employed by company, extend to this matter of settlement") (emphasis deleted); *see also* Lysick v. Walcom, 65 Cal. Rptr. 406, 415-16 (Cal. Ct. App. 1968) (discussing Keeton's views with approval).

118. Florida State Bar Comm. on Professional Ethics, Op. 86-6 (1987).

FIGURE 4

THE SCOPE OF DEFENSE COUNSEL'S RELATIONSHIPS
WITH THE COMPANY AND THE INSURED

	Investigation and Defense of Liability Suit	Settlement of Claim(s) Against the Insured
Company	Included	Included
Insured	Included	Excluded

There is a caveat: When drafts of this Article were presented to various audiences and distributed for comments, the suggestion that defense counsel should exclude services relating to settlement from the scope of the representation of the insured provoked considerable controversy and dissent.¹¹⁹ Some readers disputed the possibility of dividing the settlement and defense functions. Others questioned the practicability or the permissibility of the division in view of the fact that, in noninsurance contexts, lawyers usually handle both defense and settlement for clients. Although we believe that the scope restriction is possible, practicable, and permissible, we recognize that not all lawyers, insureds, and insurance companies agree with us. We therefore encourage those who disagree explicitly to include both defense and settlement of the liability claim within the scope of defense counsel's representation of the insured. It is better to clarify the scope of defense counsel's representation of the insured than to tolerate ambiguity on the subject, even if one would make the scope broader than we believe it should be. However, broadening the scope of the insured's representation affects defense counsel's obligations mainly by increasing the range of services counsel must provide the insured. It

119. As mentioned, some commentators also question the approach we recommend. See 2 JERRY, *supra* note 108; Morris, *supra* note 108.

also increases the probability that the existence of a conflict of interests will require defense counsel to withdraw. Still, just as it is permissible to limit the scope of an insurance defense representation in the manner we recommend, it is permissible to do otherwise. By arguing in favor of a restriction on the scope of the representation of the insured, we do not mean to suggest that it would be improper under any body of law for an insurance company and a defense lawyer to agree that the representation of the insured is to include both settlement and defense.¹²⁰

VII. DEFENSE COUNSEL'S DUTIES TO THE COMPANY AND THE INSURED

Having fixed the scope of defense counsel's undertakings on behalf of the company and the insured, we should identify the duties counsel owes each client when delivering the services counsel is obligated to provide. The matter of identifying defense counsel's duties is tricky for several reasons. First, a brief statement of counsel's duties, like that contained in section 28 of the tentative *Restatement of the Law Governing Lawyers*, is probably too general to be of much use to a lawyer who is unsure how to act in a particular situation.¹²¹ Second, to catalogue defense counsel's duties extensively would require a treatise on the order of the *Restatement (Second) of the Law of Agency*, a two-volume work. Third, even a lengthy account of defense counsel's duties

120. Both the scope definition we recommend and the broader definition free defense counsel from any obligation to handle any affirmative claims the insured may have against other parties to a litigation. See *Goldberg v. American Home Assurance Co.*, 439 N.Y.S.2d 2, 4 (N.Y. App. Div., 1981) (dictum). It is important that the insured understand this limitation on the range of services defense counsel will provide.

121. Section 28 states:

To the extent consistent with the lawyer's legal duties and subject to the other provisions of this Restatement, a lawyer must:

- (1) In matters covered by the representation, act in a manner reasonably calculated to advance a client's lawful objectives, as defined by the client after disclosure and consultation;
- (2) Act in the matter with reasonable competence and diligence;
- (3) Safeguard the client's confidences and property, avoid impermissible conflicting interests, deal honestly with the client, and not employ adversely to the client powers arising from the client-lawyer relationship; and
- (4) Fulfill any valid contractual obligation to the client.

RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 28 (Tentative Draft No. 5, 1992).

could only list default duties rather than actual duties because most of the duties a lawyer can owe a client can be changed or waived with a client's informed consent. Therefore, even an extensive list could never provide definitive guidance. A lawyer must always consider the content of a retainer agreement when deciding how to act.

We have attempted to strike an appropriate compromise between the uselessly broad and the unmanageably narrow. In the sections to follow, we will offer and defend a general way of thinking about defense counsel's duties to the company and the insured, and we will consider in detail some of defense counsel's most important duties. The combination of approaches will resolve some important problems that all defense lawyers face and will help defense lawyers think about other problems not specifically addressed.

A. Understanding Defense Counsel's Duties in General

The content of the liability contract informs the content of the agreement by which defense counsel is retained. When retaining defense counsel, an insurance company establishes a joint agency, naming itself and its insured as co-principals, by means of which it can exercise the rights and powers it holds under the liability contract, and can fulfill its contractual obligations to the insured as well. The allocation of rights, powers, and responsibilities between the co-principals follows the allocation of the same quantities in the insurance agreement. For example, the retainer agreement will ordinarily provide that the company is responsible for defense counsel's fees (in the first instance, at least), that the company can instruct counsel on the defense and settlement of the liability claim, and that the insured must refrain from telling defense counsel how to act.

Insurance law, as embodied in a retainer agreement, will therefore often determine defense counsel's duties—often, but not always. A retainer agreement cannot fix all lawyerly duties. Other bodies of law, mainly agency law and professional responsibility law, foster duties that may supplement, modify, or supplant those arising under a retainer agreement.¹²² For example, even when a retainer agreement requires defense counsel to follow a company's

122. We discuss other bodies of law in Sections VII(B) & (C).

instructions, counsel cannot honor a request to suborn perjury, to destroy evidence, to advance a frivolous position, or to harass a witness. Defense counsel is constrained from doing so by other laws that trump the contract by which counsel was retained.

The difficulty is in figuring out when the retainer agreement governs defense counsel's obligations and when some other body of law applies. When thinking about the matter, it is helpful to categorize the possibilities.

1. Only the retainer agreement governs a lawyer's conduct because no other body of law generates a relevant obligation. For example, suppose the retainer agreement limits the scope of the representation to the defense of a given suit. If no other body of law requires a broader or narrower scope definition, then the retainer agreement is the only source of a relevant obligation, and it alone determines the lawyer's professional obligations.
2. Another body of law, B, requires the lawyer to act in ways that are consistent with, but not required by, the retainer agreement. For example, suppose the retainer agreement requires defense counsel to honor the company's request to depose an expert, and that professional responsibility law (body of law B) requires defense counsel to observe certain rules of decorum and procedure when doing so. Because defense counsel can both follow the company's instruction to take the deposition and do so in a manner that is decorous and appropriate, counsel can satisfy the requirements of both bodies of law at the same time.
3. Another body of law, B, ordinarily requires the lawyer to act otherwise than as the retainer agreement requires; but the duty arising under B is mutable and has been changed by agreement, so that the lawyer can properly act as the retainer agreement requires. For example, suppose the retainer agreement requires the lawyer to follow the company's instruction to impeach the insured's testimony on the stand, and that agency law (body of law B) prohibits the lawyer from doing so without the insured's consent. The duty arising under agency law being mutable, the lawyer can act as the retainer agreement requires with the insured's consent.
4. Another body of law, B, requires the lawyer to act otherwise than as the retainer agreement requires, and the duty arising under B either cannot be changed or has not been changed, so

that the lawyer cannot properly act as the retainer agreement requires. For example, suppose the retainer agreement requires the lawyer to follow the company's instruction to urge a particular argument upon the court, but a rule of civil procedure (body of law B) prohibits the lawyer from doing so because the argument is not well-grounded in fact or law. The lawyer must decline to act as the company directs.¹²³

Clearly, conflicts falling into Category 4 pose the greatest difficulties for defense lawyers. However, before one can be certain that a situation falls into Category 4 rather than Category 3, one must understand that some duties lawyers ordinarily incur are mutable: They can be altered, amended, or waived with a client's informed consent. Sections VII(B) and (C) discuss the mutability of duties arising under agency law and the law of professional responsibility, respectively.

B. *Lawyers' Duties Arising Under Agency Law are Mutable*

A lawyer is first and foremost an agent. A principal can generally structure a relationship with an agent along any lines the principal chooses, with the agent's consent. As section 376 of the *Restatement (Second) of Agency* observes, "[t]he existence and extent of the duties of the agent to the principal are determined by the terms of the agreement between the parties."¹²⁴ This holds true whether an agent represents two principals or only one. Joint principals have as much freedom as sole principals¹²⁵ to

123. These categories are not exhaustive. A fifth category exists in which body of law B generates a duty to perform an act and the retainer agreement says nothing on the subject. For example, a state law may require a lawyer to pay a professional occupation tax. The retainer agreement does not bear on that subject. We omit this category because, insofar as we can tell, it raises no particular problems for defense counsel.

124. The full text of § 376 states:

The existence and extent of the duties of the agent to the principal are determined by the terms of the agreement between the parties, interpreted in light of the circumstances under which it is made, except to the extent that fraud, duress, illegality, or the incapacity of one or both of the parties to the agreement modifies it or deprives it of legal effect.

RESTATEMENT (SECOND) OF AGENCY § 376 (1958).

125. See RESTATEMENT (SECOND) OF AGENCY § 20 cmt. f (1958) ("a number of persons, such as the members of a partnership, may act jointly in the authorization of an agent."). Although an agent of joint principals may ordinarily act only with respect to the principals' joint interest, joint principals can consensually eliminate even that constraint. See RESTATEMENT (SECOND) OF AGENCY § 41(1) (1958) ("Unless otherwise agreed, authority given by two or more principals jointly includes only authority to act for their

fashion agency relationships as they want.¹²⁶

Because agency relationships are flexible and subject to agreement, it is perilous to posit categorically—that is, without reference to the understanding of the parties—that an agent owes or does not owe a principal a duty of a particular kind. Agency law permits a principal and an agent to alter, amend, or waive virtually every duty an agent ordinarily incurs by default, including the duty of loyalty.¹²⁷ Because agents' duties are mutable, an insurance company can structure a relationship with an agent—in this case, a defense lawyer—in a manner that permits the company to exercise fully the powers it holds under the liability contract and that relegates the insured to a subordinate role. The insured must consent to the creation of the agency by demanding a defense under an insurance policy with suitable terms, and must refrain from exercising the inherent authority of a principal to instruct the agent during the representation. But assuming an appropriate insurance policy and appropriate conduct by the insured, agency law permits the company to retain the lawyer on terms that further the purposes the liability contract exists to serve.

C. Lawyers' Duties Arising Under the Law of Professional Responsibility may be Mutable or Immutable

The law of professional responsibility derives in part from agency law but also differs from agency law in important respects.¹²⁸ One difference is that only some duties imposed by the law of professional responsibility can be altered, amended, or

joint account.”).

126. See Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1, 7–18, 71–72 (1990) (describing contractual nature of corporations, and arguing, in the corporate context, that the fundamentally contractual nature of fiduciary duties implies that contracting parties should be free to waive those duties if they desire).

127. RESTATEMENT (SECOND) OF AGENCY § 376 cmt. a (1958) (The duties “stated in Sections 387–398 as duties of loyalty” are “applicable to the normal case, in which the parties have not made a different agreement. Since the parties can make what agreements they please . . . the rules stated in [those sections] are . . . dependent upon the nonexistence of an agreement to the contrary.”).

128. See RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS 1, ch. 8, Introductory Note (Tentative Draft No. 4, 1991) (explaining that the general prohibition on concurrent representation of clients with conflicting interests “is derived in part from the law of agency”).

waived with a client's informed consent. Other duties are immutable: They cannot be changed or waived.

The duty of confidentiality is an example of a mutable duty. Rule 1.6 of the *Model Rules of Professional Conduct* states that "[a] lawyer shall not reveal information relating to representation of a client unless the client consents after consultation, except for disclosures that are impliedly authorized in order to carry out the representation" Because a client can free a lawyer from the duty of confidentiality, one cannot confidently assert that a lawyer who represents an insured would breach the duty of confidentiality by giving an insurance company information received from the insured. If the insured has expressly or impliedly authorized the lawyer to disclose the information, there would be no violation.¹²⁹

The duty to refrain from concurrently representing opposing parties to the same litigation is an example of an immutable lawyerly duty. Rule 1.7 of the *Model Rules of Professional Conduct* forbids a lawyer from representing clients whose interests are directly adverse. A lawyer who undertakes such a concurrent representation violates the rule, even if both clients consent.

Sometimes, the decision to make a duty immutable reflects a paternalistic desire to protect clients from mistakenly acting against their own interests. More often, the desire is to protect the public, including third parties and courts, by discouraging unwanted conduct. Immutable duties that protect public interests arise under disciplinary codes for lawyers, rules of practice in the courts, state statutes, and other laws. They include the duty of candor to the tribunal,¹³⁰ the duty to practice law only in jurisdictions where one is licensed or admitted *pro hac vice*,¹³¹ the duty to disclose a client's intent to commit a crime that threatens another with serious bodily injury or death,¹³² and the duty to refrain from assist-

129. This comports with the position taken in the *Restatement (Third) of The Law Governing Lawyers*. See RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 30 (Tentative Draft No. 5, 1992) (generally permitting waiver of default duties subject to informed client consent and reasonable terms); see also *id.* § 38 (permitting disclosure of confidential information to tribunal when an attorney reserves the authority to do); *id.* § 202 (Tentative Draft No. 3, 1990) (permitting waiver of most conflicts with informed client consent).

130. MODEL RULES OF PROFESSIONAL CONDUCT Rule 3.3(a) (1994) (obligating lawyers to act honestly and forthrightly in judicial proceedings).

131. CHARLES W. WOLFRAM, MODERN LEGAL ETHICS 865-74 (1986) (discussing requirements for practicing law in multiple jurisdictions).

132. Nine states have disciplinary rules of this kind. See THOMAS D. MORGAN &

ing a client with an ongoing fraud.¹³³ Whether the decision to make a duty immutable reflects a public interest or a paternalistic one, the important point is that parties have no power to change or waive such duties by agreement. A lawyer must respect an immutable duty, no matter what a retainer agreement may say.

D. The Impact of Mutable and Immutable Duties on the Structure of the Tripartite Relationship

In general, mutable lawyerly duties, whether arising under agency law or the law of professional responsibility, pose no obstacle to the creation of a joint agency in which rights, powers, and responsibilities are allocated along the lines set out in a liability contract. That is so because a retainer agreement can provide that all mutable lawyerly duties are to be as a liability contract requires. By and large, judges, advisory committees, and commentators on professional responsibility have failed to appreciate this fact. The conventional wisdom is that "the relationship [between defense counsel and the insured] is the same as if the attorney were hired and paid directly by the insured."¹³⁴ Surely, the conventional wisdom is incorrect. The relationship between a defense lawyer and an insured differs from an ordinary attorney-client relationship in many ways, the most obvious being that retainer agreement requires the insured to refrain from instructing the lawyer on the defense or settlement of the liability claim. The conventional wisdom ignores the fact that many lawyerly duties are mutable and that liability contracts bleed into retainer agreements. As a result, it wrongly characterizes the relationship between defense counsel and the insured in ordinary attorney-client terms.

RONALD D. ROTUNDA, SELECTED STANDARDS ON PROFESSIONAL RESPONSIBILITY 132-38 (1995) (including state-by-state table of confidentiality rules).

133. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.2(d) (1994) (barring a lawyer from assisting a client in the commission of a fraud).

134. *Lieberman v. Employers Ins. of Wausau*, 419 A.2d 417, 424 (N.J. 1980) (quoting RONALD E. MALLIN & VICTOR B. LEVIT, *LEGAL MALPRACTICE* § 262, at 353 (1977)); see also *Rogers v. Robson, Masters, Ryan, Brumund & Beloin*, 392 N.E.2d 1365, 1371 (Ill. App. Ct. 1979), *aff'd*, 407 N.E.2d 47 (Ill. 1980), (asserting that "[t]he fact that the attorney also represents the insurer in no way alters his obligations or responsibilities to the insured"); Francis M. Hanna, *When Medical Malpractice Becomes Legal Malpractice: Some of the Dangers Inherent in Representing Professional Malpractice Defendants*, 12 MISS. C. L. REV. 73, 77 (1991).

Of course, the fact that a duty is mutable does not by itself establish that the duty was actually altered, amended, or waived. It shows only that the parties have the power to change the duty if they wish. To show that a mutable duty was changed, one must identify the portion of the insurance contract that requires alteration of the duty from its default form and one must show that the insured expressly or impliedly consented to the change by demanding a defense under the policy or by some other means.

In theory, immutable lawyerly duties can prevent a company and an insured from allocating rights, powers, and responsibilities in the tripartite relationship along the lines laid out in the liability contract. Because immutable duties cannot be changed, they may prevent a party from exercising a right or power it holds under the liability contract. For example, the Commercial General Liability policy entitles the company to settle claims without the insured's consent.¹³⁵ Having acquired this authority, it is natural to assume that the company will want to be able to instruct the lawyer unilaterally when it wishes to settle a claim. Can the company do that? Can it hire defense counsel on terms that entitle it to instruct the lawyer to settle without consulting the insured and perhaps even against the wishes of the insured? The answer turns on the duty to confer with each client prior to settlement and whether the duty to respect each client's wishes on settlement are mutable or immutable. Few authorities discuss the possibility of waiving, altering, or amending these duties, but at least some suggest that the duties cannot be waived.¹³⁶ If that is so, then the company cannot use defense counsel as a means of exercising its

135. "We will have the right and duty to defend any 'suit' seeking those damages. But . . . (2) [w]e may investigate and settle any claim or 'suit' at our discretion" 1986 *Commercial General Liability Coverage Form*, reprinted in DONALD S. MALECKI & ARTHUR L. FLITNER, *COMMERCIAL GENERAL LIABILITY: CLAIMS MADE AND OCCURRENCE FORMS* 155, 157 (3d ed. 1990).

136. See, e.g., *Rogers*, 392 N.E.2d at 1365 (requiring defense counsel to inform the insured of settlement offers and finding improper counsel's decision to effect settlement without the consent of the insured); *Lieberman*, 419 A.2d at 424 (stating that lawyer who ignored insured's wish to litigate rather than settle "breached the duty he owed to his client"). Neither *Rogers* nor *Lieberman* explicitly addressed the possibility that an insured's right to participate in the settlement decision can be limited or waived by a retainer agreement. But cf. *Hayes v. Eagle-Picher Indus., Inc.* 513 F.2d 892 (10th Cir. 1975) (refusing to enforce the prior agreement of a plaintiff in a group litigation setting to be bound by majority vote of all group members and requiring attorney to respect individual plaintiff's direction not to settle even though a majority of the group voted to settle).

control of settlement. In other words, the lawyer cannot act on an instruction to settle without consulting the insured and perhaps without obtaining the insured's consent. The company still could settle unilaterally. It could order an in-house claims person to effect settlement, or it could effect settlement by means of a lawyer who represented the company alone. But the law of professional responsibility would prevent the company from exercising its power over settlement via an attorney who also represented the insured.

The general position endorsed in this Article is that the retainer agreement should provide that all mutable duties arising under agency law or the law of professional responsibility have the content required by the liability contract. For example, consider the duty to obey reasonable instructions. The duty exists under both bodies of law and appears to be mutable with a principal's consent.¹³⁷ Because the standard liability insurance contract and the cases construing it give the company exclusive and plenary authority to control the defense of claims, our position is that defense counsel can look solely to the company for instructions concerning the defense. The retainer agreement pursuant to which defense counsel operates requires the insured to refrain from instructing counsel on defense-related matters and entitles the company to exercise plenary control.

VIII. THE DUTY OF LOYALTY

The duty of loyalty requires an agent, including a lawyer, to act solely for the benefit of a principal or client in matters falling within the scope of the agent's undertaking.¹³⁸ The statement that an agent is a principal's fiduciary means that an agent is subject to the duty just described. The duty of loyalty forbids an

137. See RESTATEMENT (SECOND) OF AGENCY § 385 (1958); MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.2(a) (1994).

138. RESTATEMENT (SECOND) OF AGENCY § 387 (1958) (stating general principle); *id.* § 23 (stating that although one whose interests are adverse to those of another can serve as the other's agent, "it is a breach of duty for him so to act without revealing the existence and extent of such adverse interests"); RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS ch. 8, Introductory Note (Tentative Draft No. 4, 1991) (stating that "[t]he prohibition against conflicts of interest reinforces the view of a lawyer as the loyal representative of a client's interest" and citing RESTATEMENT (SECOND) OF AGENCY § 23).

agent from putting the interests of the agent or a third party ahead of those of the principal the agent agreed to protect.¹³⁹

The duty of loyalty is fully inmutable under agency law¹⁴⁰ and inmutable within limits under professional responsibility law.¹⁴¹ The difference is clear when the *Restatement (Second) of Agency* and the *Model Rules of Professional Conduct* are compared. Under section 394 of the *Restatement*,¹⁴² an agent is entirely free to represent competing principals as long as the conflict is adequately disclosed.¹⁴³ By contrast, client consent is not always sufficient to waive a conflict of interests under the *Model Rules of Professional Conduct*. Model Rule 1.7 permits a lawyer to represent clients with opposing interests only when both clients consent and "the lawyer reasonably believes the representation [of one] client will not adversely affect the relationship with the other client." Because Model Rule 1.7 imposes a further condition, a lawyer may violate the rule by means of a representation that is permitted under agency law.

Although the general statement of the duty of loyalty is clear, it can be difficult to apply the duty in concrete settings, particularly when a lawyer concurrently represents multiple clients whose interests align imperfectly. Then the lawyer may find that courses of conduct likely to help one client are also likely to harm another. The general rule is that the lawyer may pursue such a course of conduct only with the informed consent of each client who is in danger of being harmed.¹⁴⁴

139. RESTATEMENT (SECOND) OF AGENCY § 13 cmt. a (1958).

140. The RESTATEMENT (SECOND) OF AGENCY § 387 (1958) sets out the general principle governing the duty of loyalty, stating that "[u]nless otherwise agreed, an agent is subject to a duty to his principal to act solely for the benefit of the principal in all matters connected with his agency." Subsequent *Restatement* provisions dealing with particular applications of the duty of loyalty contain the same proviso.

141. See *Developments in the Law: Conflicts of Interest*, 94 HARV. L. REV. 1244, 1305 (1981) (arguing on public interest grounds for limits on clients' power to waive conflicts).

142. Section 394 states: "Unless otherwise agreed, an agent is subject to a duty not to act or to agree to act during the period of his agency for persons whose interests conflict with those of the principal in matters in which the agent is employed." RESTATEMENT (SECOND) OF AGENCY § 394 (1958) (emphasis added).

143. See RESTATEMENT (SECOND) OF AGENCY § 394 cmt. b (1958).

144. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.7(a) (1994) ("A lawyer shall not represent a client if the representation of that client will be directly adverse to another client, unless: . . . (2) each client consents after consultation."); RESTATEMENT (SECOND) OF AGENCY §§ 389-94 (1958) (describing duties of agents who act adversely to their principals); RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 201 (Tentative Draft No. 4, 1991) (appearing to require the consent of all clients, including

The consent requirement has proven especially troublesome for insurance defense lawyers. As explained, defense lawyers are retained with the understanding that the company will instruct them and the insured will not. The arrangement works well until the company directs the lawyer to do something that may or does run contrary to the wishes or interests of the insured. At that point, the lawyer must decide (1) whether to confer with the insured before acting on the instruction, (2) how to advise the insured with respect to the instruction, and (3) what to do if the insured insists that the instruction not be obeyed.

In this Part, we will discuss an example involving the duty of loyalty and recommend how defense counsel can handle these three decisions. The example involves impeachment of the insured's dissembling testimony at trial against the wishes of the insured. However, before taking up this example, we will briefly discuss how the law governing current- and former-client conflicts of interest applies to a defense lawyer who wishes to sue a company or an insured at the behest of another client. We do so to make the point that defense lawyers are and should be subject to the same rules that other lawyers must follow.

A. A Prologue on Litigation Against Former and Current Clients

No jurisdiction permits a lawyer to sue a past client on a substantially related matter without the client's consent. Every jurisdiction save one also prohibits a lawyer from suing a current client whether or not the matters are related unless the client consents. Thus, a lawyer who presently represents Client A in Matter 1 cannot sue Client A in Matter 2 without Client A's informed consent, even if Matter 2 is unrelated to Matter 1.¹⁴⁵

If applied to insurance defense counsel, the former-client conflict rule would establish that a lawyer who previously represented Insurance Company A and Insured A in Matter 1 could not subsequently attack either Insurance Company A or Insured A

those who are not in danger of being harmed).

145. MODEL RULES OF PROFESSIONAL RESPONSIBILITY Rule 1.7(a) (1994). The lone exception to the general rule on concurrent conflicts prevails in Texas, which permits a lawyer to represent a client and to attack the client in an unrelated matter without the client's consent. Texas Disciplinary Rules of Professional Conduct Rule 1.06 (1993). However, even Texas forbids concurrent representation and opposition on related matters. *Hoggard v. Snodgrass*, 770 S.W.2d 577 (Tex. Ct. App. 1989).

in Matter 2 when Matter 2 is substantially related to Matter 1 without the informed consent of the relevant former client(s).¹⁴⁶ Similarly, the current-client conflict rule would imply that a lawyer who presently represents Insurance Company A and Insured A in Matter 1 cannot attack Insurance Company A or Insured A in Matter 2, whether or not the matters are related, unless the lawyer obtains the informed consent of the relevant current client(s).¹⁴⁷

By stating that the rules identified above limit defense lawyers' freedom to represent clients who are adverse to insurance companies and insureds, we do not mean to endorse the conflict of interest rules that now prevail. Arguably, the rules should be changed in ways that give defense lawyers greater discretion to oppose former or current clients. We take no position on that issue. We assert only that the existing conflict rules, the application of which turns on client identity, apply straightforwardly to in-

146. Several authorities take the position we endorse. *See, e.g.*, ABA Comm. on Ethics and Professional Responsibility, Informal Op. 822 (1965) (observing that defense counsel is the insured's attorney and applying ordinary conflict of interest rule to representation adverse to the insured); ABA Comm. on Ethics and Professional Responsibility, Informal Op. 949 (1966) (citing Informal Decision C-728 (1963) for the proposition that a lawyer who previously represented an insured in a liability suit "should not subsequently represent the company in an action against the insured . . . without full disclosure to and express consent by the insured"); HENRY S. DRINKER, *LEGAL ETHICS* 115 (same); ABA Comm. on Ethics and Professional Responsibility Informal Op. 977 (1967) (finding that the attorney who defends the insured on a counterclaim in an automobile accident case cannot represent the company in an arbitration proceeding initiated by the insured to determine the extent of the company's obligation to provide uninsured motorist coverage); *Insurance Co. of North Am. v. Westergren*, 794 S.W.2d 812 (Tex. Ct. App. 1990) (finding that the attorney who defended the insured in an action to recover adjusted premiums on a construction bond cannot later represent the insured on claim against the insurance company that defended the prior action); *Moritz v. Medical Protective Co.*, 428 F. Supp. 865, 870-76 (W.D. Wis. 1977) (finding defense counsel to be the common attorney of the company and the insured and applying ordinary conflict of interest principles when attorney subsequently defended the company in a lawsuit brought by the insured). *But cf.* ABA Comm. on Ethics and Professional Responsibility, Informal Op. 853 (1965) (deciding that an attorney who defended a company in a direct action brought by a claimant could not subsequently defend the company in a coverage action brought by the insured, even though the insured was represented by personal counsel in the direct action).

147. *McCourt Co., Inc. v. FPC Properties, Inc.*, 434 N.E.2d 1234 (Mass. 1982) (disqualifying a law firm that was defending the insured in four lawsuits from concurrently suing the insured in an unrelated matter). In *Gray v. Commercial Union Insurance Co.*, 468 A.2d 721 (N.J. Super. Ct. App. Div. 1983), the court disqualified a lawyer from litigating against an insurance company under both the former- and current-client conflict of interest rules. Although we do not mean to endorse the decision in *Gray*, the approach taken by the court is consistent with the recommendations made here.

insurance defense lawyers when both insurance companies and insureds are defense lawyers' clients. We see no reason to treat insurance defense lawyers differently from other lawyers with respect to the conflicts described.

Our opinion concerning the application of the existing conflict of interest rules to insurance defense lawyers diverges from that expressed by a Reporter for the *Restatement of the Law Governing Lawyers*. The Reporter's approach would permit a lawyer who represents Insurance Company A in Matter 1 to oppose Insurance Company A in Matter 2 without Insurance Company A's consent if Matter 1 and Matter 2 are unrelated.¹⁴⁸ There are two possible explanations for the recommended approach. First, the Reporter may dislike the nearly universal rule that a lawyer cannot concurrently represent Client A and oppose Client A in unrelated matters without Client A's informed consent. Second, the Reporter may like the rule but oppose its application to protect insurance companies on the ground that an insurance company is a third-party payor, not a client.¹⁴⁹

If the first explanation were the correct one, we would take no position on the recommended approach. It may or may not be that the rule governing concurrent conflicts of interests should be changed. However, the *Restatement of Law Governing Lawyers* unambiguously endorses the prevailing rule.¹⁵⁰ Thus, the Reporter's recommendation must rest on the belief that the insurance company is a third-party payor. We therefore disagree with the Reporter and think the proposed approach is unwise because we deny that insurance companies are necessarily, always, or even ordinarily third-party payors. As explained in Part IV, insurance companies can be and usually are co-clients of the lawyers they hire to defend their insureds. The Reporter's contrary belief is pure stipulation. When and because an insurance company is a

148. Letter from Thomas D. Morgan, Professor, Brigham Young Law School, to Charles Silver, Professor, University of Michigan Law School (Sept. 30, 1994) (on file with authors).

149. This appears to be the actual reason. See RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 215 (Tentative Draft No. 4, 1991) (describing insurance company as third-party payor).

150. See RESTATEMENT (THIRD) OF LAW GOVERNING LAWYERS § 209(2) (Tentative Draft No. 3, 1990) (providing that, "unless all affected clients consent," a lawyer may not "[r]epresent one client against another client currently represented by the lawyer, whether or not the matters are related.")

client, defense lawyers should have no greater freedom to oppose insurance companies than they have to oppose clients of other kinds. Absent a reason for treating insurance companies differently, they should be protected as fully as other clients are from suits by lawyers who presently represent them or represented them in the past.

B. *Why is it Wrong to Impeach the Insured?*

Consider the following example which, in various guises, is discussed in a sizable number of cases and scholarly works.¹⁵¹ The insured's spouse is injured in an automobile accident and sues the insured, who was driving the car. The insurance company retains defense counsel, who interviews the insured. The insured says, "I wasn't negligent. The accident wasn't my fault." At trial, however, the insured takes the stand and says, "I was negligent. The accident was my fault." Defense counsel then attempts to impeach the insured's testimony by cross-examining the insured, by introducing evidence of prior inconsistent statements, by suggesting that the insured is attempting to maximize the spouse's recovery, by asking whether the insured understands the penalty for perjury, etc.¹⁵²

The authorities largely agree that the lawyer's conduct is improper, although they do not always explain their reasons as fully or as persuasively as one might like.¹⁵³ Some appellate courts have even used defense counsel's successful impeachment of the insured as a reason for granting a defeated claimant a new trial!¹⁵⁴ The oddity of the remedy at least equals the oddity of the wrong. It is not obvious that defense counsel's breach of duty to

151. See, e.g., Holmes, *supra* note 105, at 34-35.

152. A recent case with similar facts is *Montanez v. Irizarry-Rodriguez*, 641 A.2d 1079 (N.J. Super. Ct. App. Div. 1994).

153. Neumeier, *supra* note 48, at 78 (observing that "[e]very jurisdiction which has addressed the issue, except Massachusetts, has held or stated that insurance defense counsel may not impeach the insured in cross-examination or in closing argument"); KEETON & WIDISS, *supra* note 26, at 819-20 (discussing a situation in which "the insurer decided to attack the character and motives" of the insured, and stating, without elaboration, that "[q]uite plainly, a defense attorney acceding to such a request and proceeding to question motivations and honesty of the insured would be acting improperly"); Holmes, *supra* note 105, at 36 (stating that "counsel should not accede to a request [from the company] to challenge the insured's motives or credibility").

154. *Montanez*, 641 A.2d at 1085; *Spadaro v. Palmisano*, 109 So. 2d 418, 421-22 (Fla. Dist. Ct. App. 1959).

the defendant entitles the plaintiff to any remedy, let alone a new trial. Nor it is obvious that the defendant suffers a legally cognizable harm when the defendant, after suffering impeachment, wins at trial. To conclude that the defendant is injured, one must embrace the belief that the defendant is better off being found negligent than being vindicated at trial. This belief seems quite alien to the law.¹⁵⁵

Of course, in the example described, everyone understands that the insured really is worse off winning at trial. When the insured loses, the insured's spouse wins. Because the company is picking up the tab, the insured also wins by losing; and the bigger the loss, the bigger the win. It is easy to see why the insured wants to lose and to lose badly. The combined force of affection and economic interest must be difficult for anyone to resist.

One must therefore consider whether defense counsel acts improperly by impeaching the insured when the insured attempts to help the claimant to recover. As a matter of insurance law, it is reasonable to contend that the insurance company has the power to instruct defense counsel to impeach the insured. The prevailing doctrine is that "where there is a conflict of interests, the insurer may exercise the right to defend for its own advantage, even though a different course would have been preferable from the standpoint of the insured."¹⁵⁶ The company's exclusive and plenary authority over the defense logically includes the power to instruct defense counsel to impeach the insured, and the insured's duty to cooperate plausibly requires the insured to submit to impeachment as well.¹⁵⁷ No more than the liability contract permits the insured to control or interfere with the defense in other ways does it allow the insured to decide whether or not defense counsel may proceed with impeachment.¹⁵⁸

155. See *Buchanan v. Buchanan*, 160 Cal. Rptr. 577, 583 (Cal. Ct. App. 1979) (The court stated that "[i]t is axiomatic that absent collusion, the best interests of this or any other defendant is the full dismissal of an action whenever possible." It also observed that when the insured collusively attempts to keep alive litigation that could be dismissed, "the necessary element of adversity between defendant and plaintiff [is] totally absent.").

156. APPLEMAN, *supra* note 37, § 4681, at 4.

157. The insured's duty to cooperate with and assist the company in defending the liability suit is imposed by language similar to the following: "The insured shall cooperate with the company in the conduct of suits and shall attend hearings and trials and assist in securing and giving evidence and obtaining the attendance of witnesses." By suggesting that the insured must submit to impeachment, we do not suggest that the insured must commit perjury at the company's request.

158. Imagine that the insured was to instruct defense counsel to refrain from calling

Assuming that insurance law does permit the company to request impeachment of the insured, we must determine whether any other body of law also bears on the permissibility of impeachment. At least one other body of law, the law governing civil trial practice, including evidence law, contains relevant rules. *Montanez v. Irizarry-Rodriguez*,¹⁵⁹ the most recent case on point, offers one view of how the law governing civil trial practice applies to impeachment. In that case, the New Jersey Court of Appeals concluded that defense counsel acted improperly by cross-examining the insured. The court of appeals endorsed the majority rule that "it is not at the hands of a party to an action, offering himself as a witness in his own behalf, to cause himself to be contradicted or his testimony neutralized, through prior, oral or written, inconsistent or contrary, statements made by him."¹⁶⁰ According to the court of appeals,

[t]he rule prohibiting impeachment of an insured by counsel assigned by the insurer is based upon the practical observation that the insured's impeachment is relevant only to an issue between the insured and the insurer, and has no bearing on the only issue in the case at hand, that is, whether the insured is liable to the plaintiff.¹⁶¹

When the company wishes to attack the insured, *Montanez* requires it to do so in a separate proceeding.

The stated rationale of the court of appeals is nonsense. By impeaching the insured, defense counsel attempts to demonstrate the incredibility of the insured's dissembling statements and, thereby, to convince the jury that other exculpatory evidence is more reliable than the insured's incriminating testimony. Impeachment can therefore relate to liability in a straightforward and perfectly ordinary way by undermining credibility. Impeachment can also be effective. In *Montanez*, the jury came back with a verdict for the defense. The connection between impeachment and liability is so obvious that one can only wonder how the court of appeals missed it in *Montanez*.¹⁶²

witnesses whose recollection of events differed from the insured's or who, as experts, were willing to testify that the insured's recollection must be flawed. Clearly, the insured has no authority to instruct defense counsel in this manner.

159. 641 A.2d 1079 (N.J. Super. Ct. App. Div. 1994).

160. *Id.* at 1083 (quoting *Crothers v. Caroselli*, 20 A.2d 77, 79 (N.J. 1941)).

161. *Id.* at 1083.

162. It is precisely because impeachment can be relevant to liability that the company

Other courts that have found it impermissible for defense counsel to impeach the insured have offered different reasons for so holding. There appear to be three prominent rationales. Some courts assert that it is bad civil practice to allow defense counsel to impeach an insured because a trial in which the defense attorney argues that the defendant is colluding with the plaintiff is a trial in which the jury is likely to become confused.¹⁶³ Others base the prohibition on agency law, which requires a lawyer to follow a client's directions. These cases hold that agency law prohibits a lawyer from impeaching an insured who does not wish to be impeached.¹⁶⁴ Still others conclude that defense counsel violates professional responsibility law by impeaching the insured.¹⁶⁵ The point of these cases is that when one client calls for another's impeachment, their interests are too adverse for them to share the same lawyer. Rather than impeach the insured, defense counsel must withdraw from the joint representation.

The fear of jury confusion seems farfetched. In disputes like *Montanez* that involve parties who are joined by familial, emotional, or other bonds, anyone can appreciate the defendant's desire to help the claimant and can understand the danger of collusion when the defendant is insured. Lawyers, judges, and insurance companies have understood the problem for the better

and defense counsel decide, as a predicate to impeachment, to tell the jury that the defendant is insured. Ordinarily, neither the company nor defense counsel wants the jury to focus on insurance. See Syverud, *Demand for Liability Insurance*, *supra* note 3, at 1652 n.84 and accompanying text. For impeachment to work, however, the existence of insurance must be revealed. Otherwise, jurors cannot be made to understand the insured's interest in maximizing the recovery for the claimant. The decision to go public about insurance reflects the hope that disdain for the insured's underhanded effort to help the claimant will discourage the jury from requiring the company to pay more than the merits entitle the claimant to collect. The strategy is candidly explained in defense counsel's closing argument to the jury quoted in *Pennix v. Winton*, 143 P.2d 940, 944-45 (Cal. Ct. App. 1943).

163. *Pennix*, 143 P.2d at 947; see also *Katz v. Ross*, 216 F.2d 880, 884 (3d Cir. 1954) (denying right to impeach because insurance company was not a party to the liability case); *Crothers v. Caroselli*, 20 A.2d 77, 78 (N.J. 1941) (same); *Newman v. Stocker*, 157 A. 761, 763 (Md. 1932) (same).

164. *Friedman v. Berkowitz*, 136 N.Y.S.2d 81, 82-83 (City Ct. Bronx County 1954).

165. *Spadaro v. Palmisano*, 109 So. 2d 418, 421 (Fla. Dist. Ct. App. 1959); *Pennix*, 143 P.2d at 946-47; see also *Gass v. Carducci*, 185 N.E.2d 285, 290-91 (Ill. App. Ct. 1962).

part of a century.¹⁶⁶ The issue is plain enough for jurors to grasp.

In this connection, it is worth noting that evidence law appears to permit a lawyer to impeach the adverse testimony of a party-witness whom the lawyer represents.¹⁶⁷ Thus, when a party-witness makes a dis-serving statement on the stand, the party's lawyer can attempt to repair the damage by eliciting further, contradictory testimony from the party and by undermining the party's credibility by all proper means. Although some jurisdictions sometimes regard a party's dis-serving testimony as a judicial ad-

166. In 1934, the Supreme Judicial Court of Massachusetts, citing numerous older cases, admonished that "[c]ourts must necessarily examine [cases involving automobile liability insurance] with care, to prevent fraudulent co-operation between a plaintiff and a nominal defendant at the expense of the insurer." *Horneman v. Brown*, 190 N.E. 735, 738 (Mass. 1934). See also *King v. Spencer*, 161 A. 103, 104-05 (Conn. 1932) (commenting on evidence supporting the trial judge's statement that the insured defendant testified "in an abnormal way possibly indicative of collusion in an action in which his sweetheart and her mother were suing him, and in which an insurance company was the real defendant in interest"); *Posner v. Nutkis*, 137 A. 716, 716 (N.J. 1927) (upholding trial judge's decision to allow the introduction of the insured-defendant's prior statement for the purpose of discrediting the defendant's direct testimony at trial, and observing that "[t]he defendant was clearly friendly to the plaintiff's side of the case (the reason for which it is not difficult to surmise)").

167. "The credibility of a witness may be attacked by any party, including the party calling the witness." FED. R. EVID. 607. The plain language of the rule appears to permit a party-witness to attack his own credibility. That reading comports with longstanding practice. See *Horneman*, 190 N.E. at 738 (finding that a Massachusetts statute permitting parties to impeach witness by prior inconsistent statements applied to party-witness and citing prior cases); *Posner*, 137 A. at 717 (holding that "[i]t was the right of counsel" who was surprised by the insured-defendant's dis-serving testimony "to offer in evidence the [prior] contradictory statements" of the insured for the purpose of impeachment).

Some courts have adopted a more restrictive view of evidence law and have denied defense counsel the option of impeaching the defendant. See, e.g., *Newman v. Stoker*, 157 A. 761, 763 (Md. 1932) (allowing only an opposing party to impeach a party-witness); *Katz v. Ross*, 216 F.2d 880, 884-85 (3d Cir. 1954) (same). In justification of this view, courts have argued that because an insurance company is not a party to the liability case, it is not entitled to impeach a defendant-witness, even if a party, including the defendant, would be so entitled. *Newman*, 157 A. at 763; *Katz*, 216 F.2d at 884. One difficulty with this view is that it fails to recognize that the defendant conferred upon the insurance company the right to make every litigation call the defendant has the power to make. If the defendant can order counsel to impeach his own testimony, the company, standing in the defendant's shoes, can request impeachment as well. A second shortcoming is that the position taken in *Newman* and *Katz* would deny the company the power to instruct defense counsel to impeach any witness. If only a party can impeach a witness and if an insurance company is not a party, then an insurance company cannot impeach any witness. It doesn't matter whether the witness is the defendant or not. The suggested reading of evidence law would therefore prevent the company from defeating the liability suit effectively by denying it the power to impeach witnesses called by either side.

mission that a party will not later be heard to contradict, preclusion is the exception and freedom of contradiction is the better rule.¹⁶⁸ Apparently, the fear of jury confusion has not led evidence law to prohibit defense counsel from impeaching a defendant.¹⁶⁹

In practice, lawyers often attack their clients' credibility with their clients' cooperation and assent. When a party-witness wants to be impeached because impeachment will make a favorable outcome more likely, the lawyer is free to attack the client's credibility with the client's blessing. Thus, when the insured wishes to defeat the liability claim, defense counsel can use the insured's prior inconsistent statements and the contrary testimony of other witnesses to suggest that the insured's disserving recollection of events is flawed. Then, it is plain to all that the lawyer's aim is to help the insured. The insured neither protests nor minds the attempt at correction, and impeachment can proceed without the lawyer having to treat the insured as a hostile witness.

Difficulties arise only when defense counsel proceeds with impeachment against the wishes of the insured. This suggests that the prohibition against impeaching the insured reflects a concern about disloyalty, not a fear of confusion or a belief that impeachment is irrelevant to liability. If loyalty is the issue, then the prohibition is properly seen as resting on beliefs about agents' and

168. See 2 KENNETH S. BROWN ET AL., MCCORMICK ON EVIDENCE § 258, at 153-56 (4th ed. 1992) (discussing party admissions and arguing against preclusion from contradiction). *McCormick* specifically argues for freedom of contradiction when a "defendant who is protected by liability insurance testifies to facts that will help the plaintiff to win." *Id.* at 155; see also *Christie v. Eager*, 26 A.2d 352 (Conn. 1942) (refusing to hold that insured-defendant made adverse judicial admission and allowing impeachment); *King v. Spencer*, 161 A. 103, 105 (Conn. 1932) (denying status of judicial admission to defendant's testimony that "if he had had good brakes and had applied them, he could have stopped in time to have avoided a collision," because the testimony expressed an opinion that could properly be contradicted by other evidence, and denying status of judicial admission to defendant's testimony that "he did not apply his brakes, and did not know why he failed to do so," because insurance company, not defendant, was the real party in interest). But cf. *Tennes v. Tennes*, 50 N.E.2d 132, 139 (Ill. App. Ct. 1943) (finding insured-defendant's testimony that he fell asleep while driving a judicial admission despite contrary testimony of other witnesses).

169. When only insurance law and the rules of civil trial practice are considered, impeachment of the insured falls into Category 2 of our four-fold typology. Insurance law allows the company to request impeachment, and the civil practice rules establish procedures through which impeachment may properly take place.

lawyers' professional responsibilities. As already stated, justifications of this nature have been offered in several cases.

Agency law and professional responsibility law contain many rules that bear on the permissibility of impeaching a client who wishes not to be impeached. The most directly relevant rule is that an attorney may not act contrary to a client's instruction, even when the instruction is unreasonable or is one the retainer agreement does not authorize the client to give.¹⁷⁰ This is not to say that defense counsel must obey an unreasonable or unauthorized instruction from the insured. By issuing such an instruction, the insured breaches the retainer agreement, and it is clear that "an agent has no duty to act contrary to the terms of the contract or agreement under which he is employed."¹⁷¹ The insured's conduct thus terminates the retention and frees the lawyer from any further duty to act.¹⁷² Having no duty to act, the proper course for the lawyer is to withdraw.¹⁷³

170.

Unless he is privileged to protect his own or another's interests, an agent is subject to a duty not to act in matters entrusted to him on account of the principal contrary to the directions of the principal, even though the terms of the employment prescribe that such directions shall not be given.

RESTATEMENT (SECOND) OF AGENCY § 385(2) (1957); *see also id.* cmt. d (stating that an agent's remedy, when a principal gives an instruction in breach of the contract by which the agent was retained, "is not to violate the principal's orders but to obtain such relief as is given for other breaches of contract."); *Olson v. Fraase*, 421 N.W.2d 820, 829-30 (N.D. 1988) (indicating that a lawyer must follow the client's specific instructions).

Other rules of agency law or professional responsibility law forbid a lawyer from sacrificing one client's interests for the benefit of another without the first client's informed consent, and from representing clients whose interests are fundamentally adverse, even if both clients consent. *See* RESTATEMENT (SECOND) OF AGENCY § 394 cmt. d (1957) ("Unless an attorney makes full disclosure to his client, it is improper for him, in court proceedings or otherwise, to act for two clients whose interests conflict.").

171. RESTATEMENT (SECOND) OF AGENCY § 385 cmt. d (1957). The instruction may be given in words or by conduct sufficient to put the attorney on notice that the insured does not wish to be impeached. *See id.* § 118 ("Authority terminates if the principal . . . manifests to the [agent] dissent to its continuance."); *id.* § 119 ("Authority created in any manner terminates when either party in any manner manifests to the other dissent to its continuance . . ."); *id.* § 119 cmt. b ("The principal may manifest his termination of consent by conduct which is inconsistent with its continuance . . .").

172. *Id.* § 385 cmt. d (describing "an agent who has no duty to continue to act" as "one whose principal has committed a serious breach of contract").

173. *See id.* § 385 cmt. a, illus. 2 (stating that a lawyer is "privileged to withdraw" when a client persists in asking the lawyer to act unethically). In some situations, a lawyer may even incur liability to the client by continuing to act for the client after termination. *See id.* § 386 ("Unless otherwise agreed, an agent is subject to a duty not to act as such after the termination of his authority."); RESTATEMENT (THIRD) OF THE LAW

By an entirely different route, then, we reach the same conclusion concerning the propriety of defense counsel's conduct in subjecting the insured to unwanted impeachment as the New Jersey Court of Appeals did in *Montanez*. Rather than proceed with impeachment against the manifest wishes of the insured, defense counsel should seek to withdraw. Withdrawal should not occur at the first sign of resistance, however. Before withdrawing, defense counsel should confer with the insured privately and discuss several matters:

Defense counsel should remind the insured of the obligation to testify truthfully and of the penalties that may apply against a person who knowingly violates that obligation.

Defense counsel should tell the insured that, by testifying falsely, the insured may forfeit insurance coverage by breaching the cooperation clause.

Defense counsel should tell the insured that counsel cannot help the insured present false testimony to the court and that counsel is obligated to take reasonable measures to correct false testimony that has already been given.

Defense counsel should remind the insured that the insurance company will be able to discover all information defense counsel possesses relating to the truthfulness of the insured's testimony in a subsequent coverage dispute between the company and the insured because there is no attorney-client privilege between former co-clients who become adverse.

Defense counsel should explain his reasons for thinking that the insured's testimony was untrue. For example, counsel should remind the insured of prior statements that conflict with the testimony given on the stand. Counsel should also ask whether the insured can explain the discrepancy between the testimony and the prior statements.

Defense counsel should explain that, in his judgment, the insured's testimony must be corrected or impeached if liability is successfully to be avoided or reduced.

Defense counsel should ask whether the insured is willing to correct the testimony or submit to impeachment.

If the insured is unwilling to follow either course, defense counsel should explain that the insured has no authority to control the defense of the liability claim, that defense counsel will

nonetheless refrain from impeaching the insured against the insured's wishes, but that defense counsel will have to withdraw if the insured persists in refusing.

If the insured still refuses to correct the prior testimony or to submit to impeachment, defense counsel should explain the likely consequences of withdrawal for the insured and the steps the lawyer will take to protect the insured's interests. The likely consequences include the loss of insurance coverage for liability and defense costs. The protective steps include requesting a trial recess so that the insured can retain new counsel to handle the defense.¹⁷⁴

In *Montanez*, the lawyer began to treat the insured as a hostile witness without taking any of the listed steps. That was improper because the lawyer disregarded the insured's desire not to be cross-examined and for the less obvious, but no less important, reason that the lawyer may have avoided the need for cross-examination and preserved the tripartite relationship by conferring privately with the insured.

The listed steps protect the insured and defense counsel from acting against their interests. In a case like *Montanez* where the insured's unexpected testimony catches defense counsel by surprise, the insured may not fully appreciate the consequences of testifying falsely and defense counsel may too hastily conclude that the insured lied. A conversation structured along the lines laid out above will often clarify matters and help both persons avoid mistakes. It may convince the insured to retract the prior testimony or to submit to impeachment, and it may enable defense counsel to avoid an unnecessary or ill-advised withdrawal.

We have taken a long route to the conclusion that defense counsel cannot impeach the insured without the insured's cooperation or assent. We could have shortened the trip by taking up agency law and professional responsibility law directly, but had we done so, valuable insights concerning the remedies for improper impeachment would have been lost. As mentioned, improper impeachment has led some courts to grant new trials to defeated claimants out of concern that, in the original trial, the jury became

174. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.16(d) (1994) (requiring a withdrawing lawyer to "take steps to the extent reasonably practicable to protect a client's interests, such as giving reasonable notice to the client [and] allowing time for employment of other counsel"); see also RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 45(1) (Tentative Draft No. 5, 1992).

confused when defense counsel attacked the defendant. Nothing we have stated should be read as endorsing that remedy. We believe that impeachment creates little risk of confusion and comports with evidence law. Nor does anything we have written suggest that improper impeachment entitles an insured to a contract remedy or a bad faith remedy from an insurance company. Rather, insurance law entitles the company to instruct defense counsel to impeach the insured; by exercising this power a company neither (necessarily) breaches the liability contract nor (necessarily) acts in bad faith. The remedy, assuming one should lie, is an action by the defendant against defense counsel for breach of the duty of loyalty to the insured. The propriety of even that remedy is questionable, however, because it is unclear that the insured is harmed when, as a result of defense counsel's disloyalty, the jury decides for the insured at trial. We leave that conundrum for another day.

We next consider what defense counsel should do if the court denies permission to withdraw and insists that counsel proceed with the trial. It is clear that a lawyer who is ordered by a judge to continue to act for a client must do so.¹⁷⁵ Therefore, defense counsel cannot withdraw.¹⁷⁶ What, then, should defense counsel do? Our recommendation is simple: Act as though the insured is the only client because, as a matter of fact, the insured is the only client defense counsel represents at this point.

We reach this conclusion in the following way. When the insured breaches the retainer agreement by insisting that defense counsel forgo impeachment, the tripartite relationship ends and defense counsel has no further duty to act for the insured. When the judge orders defense counsel to continue to act for the insured notwithstanding the breach, a new attorney-client relationship arises between defense counsel and the insured. However, the insurance company is not a co-principal in that representation because the trial can continue without it; the insured is the only

175. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.16(c) (1994); RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 44(4) (Tentative Draft No. 5, 1992).

176. Withdrawal may be permissible when the lawyer wishes to test the legality of the order to proceed. This is not a step to be taken lightly. "If the tribunal improperly requires representation, the usual remedy for the lawyer or client is to appeal the order at the proper time and obey it in the meantime." RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 43 cmt. c (Tentative Draft No. 5, 1992). "On disobedience to orders as a means of obtaining appellate review, see § 151, Comment e [Chapter 6]." *Id.*

necessary client. Therefore, defense counsel must do what the insured wants.

This analysis settles an important issue by establishing that defense counsel's duty of loyalty runs entirely in favor of the insured when the court denies permission to withdraw. However, it raises a second concern: whether the insurance company or the insured is liable for defense counsel's fees. In our opinion, this is a matter to be handled contractually. Nothing prohibits an insurance company from acting as a third-party payor in these circumstances. The company cannot control the representation of the insured because the two parties' interests are directly opposed; however, it can pay defense counsel's fees. Nor does anything prohibit the insured from paying. Defense counsel should therefore work out an arrangement in advance with the company and the insured for payment of fees in the event of court-ordered representation of the insured.

C. A Strategy for Handling Potential Conflicts: Confer with the Insured

Subjecting the insured to cross-examination as a hostile witness, as the lawyer did in *Montanez*, is possibly the most extreme act defense counsel can take against the insured's interests when defending the liability suit. Partly for that reason, we close to address impeachment first. It is an easy case, relatively speaking. There is widespread agreement that the conduct is improper, and the conduct involves a straightforward violation of the duty of obedience to the insured.

Defense counsel can readily apply the analysis of unwanted impeachment offered in Section VII(B) to other conflict situations in which the insured attempts to control defense counsel's actions. For example, the insured may instruct defense counsel to refrain from seeking dismissal of the liability suit on procedural grounds,¹⁷⁷ the insured may ask counsel not to file a motion for summary judgment,¹⁷⁸ the insured may request that counsel not

177. *Buchanan v. Buchanan*, 160 Cal. Rptr. 577 (Cal. Ct. App. 1979) (allowing attorney to obtain dismissal on service of process grounds despite insured-defendant's objection and attempt to waive defect); *Reynolds v. Maramorosch*, 144 N.Y.S.2d 900, 904-05 (N.Y. Sup. Ct. 1955) (denying a company's motion to dismiss, which raised the defense that the plaintiffs lacked the capacity to sue, based on the insured's desire to litigate the case on its merits).

178. *Schwartz v. Sar Corp.*, 195 N.Y.S.2d 496 (discussing attorney's summary judgment

move to disqualify claimant's counsel,¹⁷⁹ or the insured may direct counsel to admit liability or damages even though liability (or facts relating thereto) can properly be denied.¹⁸⁰ Each situation involves an attempt by the insured to control the defense of the liability suit. Therefore, each situation directly implicates defense counsel's duty of obedience to the insured, and each can be handled in the manner recommended for impeachment. Defense counsel should confer with the insured and inform the insured of the likely consequences of the insured's chosen course of action. If the insured persists in attempting to control the representation, defense counsel should withdraw.

Not all conflicts involve attempts by the insured to control the defense. Consider an example: In an initial client interview, defense counsel informs the insured that unless the lawsuit settles, the insured will probably be deposed and may also be called as a witness at trial. The insured tells defense counsel that he desperately wants to avoid having to testify, either in deposition or at trial. He is afraid that, if he testifies, his wife will learn that he was with another woman on the night in question and will seek a divorce.

Here the insured has not sought to control the defense of the liability suit. The insured expressed a desire not to testify, but he did not instruct counsel to do anything or to refrain from doing anything. He simply alerted defense counsel to a respect in which he could be adversely affected by the handling of the defense.

The example presents what is sometimes called a "potential conflict of interests." There is a conflict because there is a course of action that, if undertaken, could help the company while harming the insured. The conflict is potential, rather than actual, because the decision to act or not act need not now be made and may never have to be made.

motion sought against insured's objection), *rev'd on other grounds*, 195 N.Y.S.2d 819 (N.Y. App. Div. 1959).

179. *State Farm Mut. Auto. Ins. Co. v. K.A.W.*, 575 So. 2d 630 (Fla. 1991) (discussing attorney's motion for disqualification over insured's objection and despite insured's attempt to waive conflict of interests).

180. *See, e.g., Collins v. Coastline Constr.*, 820 F. Supp. 270, 273-74 (E.D. La. 1993) (declining to enter a proposed stipulated judgment between the insured and the claimant because it would deprive the insurer of its rights and defenses); *Friedman v. Berkowitz*, 136 N.Y.S.2d 81, 83 (City Ct. of Bronx County 1954) (holding the company liable on the basis of the insured's admission of liability, despite a strong possibility of collusion and doubts regarding actual liability).

In situations involving potential conflicts, defense counsel's professional responsibilities are governed by Rule 1.7(b) of the *Model Rules of Professional Conduct*, which states:

A lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer's responsibilities to another client . . . unless: (1) the lawyer reasonably believes the representation will not be adversely affected; and (2) the client consents after consultation. When representation of multiple clients in a single matter is undertaken, the consultation shall include explanation of the implications of the common representation and the advantages and risks involved.¹⁸¹

Rule 1.7(b) requires defense counsel to ask to a threshold question: Could counsel's responsibilities to the company materially limit the representation of the insured? If the answer is no, the inquiry stops and defense counsel can proceed with the joint representation. If the answer is yes, further analysis is required.

Because the example embodies a potential conflict, the answer to the threshold question is yes. Defense counsel's responsibility to the company is to defend the liability suit in a manner calculated to minimize the loss. That responsibility could require defense counsel to offer the insured for a deposition or to ask the insured to testify at trial. In either event, the insured's interest in preserving his marriage would be compromised.

An affirmative answer to the threshold question does not require defense counsel to withdraw, but does require defense counsel to take two further steps. Counsel must consider whether the insured could reasonably consent to the potentially conflicted representation.¹⁸² If the insured reasonably could consent, the insured's informed consent must actually be obtained. If either the insured could not reasonably consent or the insured refuses to consent, defense counsel must withdraw from the representation.

181. See 1 GEOFFREY C. HAZARD, JR. & W.W. HODES, *THE LAW OF LAWYERING* § 1.7:301, at 246 (2d ed. 1994) (Rule 1.7(a) applies where "adverse representation *will* take place, and where it will be *directly* adverse." Rule 1.7(b) applies "whenever representation of a client *may* be impaired or limited by the lawyer's responsibilities to others, and does not depend upon the existence of an actual adverse relationship, 'direct' or not.").

182. "[W]hen a disinterested lawyer would conclude that the client should not agree to the representation under the circumstances, the lawyer involved cannot properly ask for such agreement or provide representation on the basis of the client's consent." MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.7 cmt. (1994).

In this example, it is clear that the insured reasonably could consent to joint representation despite the potential conflict. The likelihood of testifying in deposition or at trial may be remote, and independent counsel may be no more able than defense counsel to protect the insured from the risk. The insured also may reasonably put off deciding whether to testify until a decision absolutely has to be made. Why take a position on a troublesome issue when one can wait and perhaps avoid having to decide? Defense counsel can therefore continue representing the insured as long as the insured, having been properly informed, consents.

The standard to which discussions with the insured must conform remains to be addressed. Authorities often pronounce that a client's decision to waive a conflict of interests must be fully and completely informed.¹⁸³ These statements cannot be taken literally. It is the rare decisionmaker who is fully or completely informed about anything. People routinely make decisions, including decisions of the utmost importance, on the basis of incomplete information about facts, alternatives, and risks. There is no reason to require full and complete information in this context when limited information suffices for others. We therefore prefer a standard, like that embodied in the *Model Rules of Professional Conduct* and the tentative *Restatement of the Law Governing Lawyers*, which requires only that clients be reasonably well-informed or adequately informed.¹⁸⁴ Defense counsel must make the insured "aware of the important respects in which the representation could have adverse effects on the interests" of the insured.¹⁸⁵ When this standard is met, defense counsel should be free of liability to the insured even when the insured, by waiving a conflict, makes a choice that turns out to be a poor one.

Adequately informing the insured in the above example would require defense counsel to explain the following:

183. See, e.g., WOLFRAM, *supra* note 131, at 343 (1986) (stating that "the client must consent after full disclosure" before a conflict is successfully waived).

184. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.7(a) (1994) (requiring client consent "after consultation" when counsel owes potentially conflicting duties to another client); *id.*, Terminology (defining "consultation" as "denot[ing] communication of information reasonably sufficient to permit the client to appreciate the significance of the matter in question"); RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 202 (Tentative Draft No. 4, 1991) ("Informed consent requires that the client have adequate information about the risks and advantages of such representation to that client.").

185. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 202 cmt. c (Tentative Draft No. 4, 1991).

Defense counsel understands the insured's concern.

The likelihood that the insured will have to testify is small (assuming it is) because of four possible reasons: the lawsuit may settle before a deposition is taken; depositions are sometimes not taken even when cases are tried; the insured may not be called as a witness; and neither a deposition nor a trial appearance is likely to be required for some time.

Defense counsel's duty of loyalty to the company requires counsel to defend the liability suit in the manner most likely to minimize the loss.

Defense counsel's duty of obedience to the insured forbids counsel from calling the insured as a witness without the insured's consent.

The lawsuit can proceed toward resolution without compromising either duty (assuming it can) by setting a late date for the insured's deposition, by focusing on other aspects of the liability suit, by moving to dismiss the liability suit on procedural grounds, etc.

The cost to the insured of waiving the conflict is that the insured must continue to bear the risk of being asked to testify, if needed to defend the liability suit effectively. The benefit to the insured is that the insured can continue to receive the services of defense counsel at the company's expense.

At some point, the insured may have to decide whether to testify. The insured will then face the tough choice of testifying and harming his marriage or not testifying and perhaps losing insurance coverage and a defense in the liability suit. In this event, defense counsel will tell the insured why the insured must be called.

If the insured refuses to testify when asked, defense counsel may have to withdraw.

Defense counsel cannot advise the insured whether or not to testify. Defense counsel can explain why the insured's testimony will help minimize the loss in the liability suit. But defense counsel is precluded from discussing other aspects of the decision, including aspects relating to coverage, by the scope of counsel's retention. Defense counsel can only alert the insured to the co-operation agreement and advise the insured to obtain advice from another lawyer if the insured is sufficiently concerned about the matter and can afford the expense.

This list is tailored to the example employed above. The list can be generalized to other potential-conflict situations by identifying its structural components. Thus, we derive the list that ap-

pears below. After learning of a potential conflict of interests between the company and the insured and deciding that the conflict can be waived, defense counsel should confer with the insured and take the following actions:

Explain the nature of the potential conflict.

Identify defense counsel's obligation to the company to defend the liability suit in a manner that will minimize the loss.

Identify defense counsel's duty to the insured not to act in disregard of the insured's express desires.

Explain that the joint representation can continue, despite the conflict, because the conflict is unlikely to prevent defense counsel from satisfying his obligations to the company or the insured.

Explain the costs and benefits to the insured of waiving the conflict.

Explain that a time may come when defense counsel's responsibilities to the company and the insured will actually conflict. When this happens the insured will have to decide whether to protect the identified interest or to compromise that interest and permit counsel to proceed with a defense that is calculated to minimize the loss on the liability claim.

Explain that defense counsel will respect the insured's decision, but may withdraw if the insured decides to do otherwise than as required to defend the liability claim effectively.

Explain that the decision facing the insured involves coverage questions or other questions (if it does) on which defense counsel cannot advise the insured but concerning which the insured may obtain advice from independent counsel retained and paid for by the insured.

By disclosing the listed information, defense counsel adequately informs the insured of the important respects in which a decision to waive a potential conflict of interests can adversely affect the insured.

D. The Duty to Investigate Potential Conflicts: Make Inquiries Upon Encountering "Conflict Clues"

The preceding paragraphs address defense counsel's professional responsibilities when counsel is aware that the insured may be harmed by an efficient and effective defense of the liability claim. It remains to consider what steps, if any, defense counsel must take to bring conflicts of interests to light. Must defense

counsel conduct a thorough investigation to learn whether the insured's interests and the company's interests conflict? Or may defense counsel assume that the representation is free of conflicts until learning otherwise?

As discussed below in Part IX, we believe that defense counsel must inform the company and the insured of major developments in the representation. Given that duty, we contend here that no routine duty to investigate potential conflicts of interests should be imposed. We would generally allow a lawyer who keeps a client adequately informed to rely on the client to speak up when the conduct of the defense threatens to harm the client. Only after a client expresses a concern would we require defense counsel to explore a possible conflict further. The disclosures listed in Section VIII(C) need be made only in unusual situations where the company or the insured indicates an interest, economic or otherwise, that can be compromised by an efficient defense.

We reach the conclusion just stated in part because the alternative of requiring defense counsel to look for possible conflicts in all cases would entail mostly wasted effort and expense. The vast majority of insurance defense representations are free of conflicts between the company and the insured. Typically, the company's only interest is to minimize the sum of defense costs and liability payments to the claimant, and the insured's only interest is to preserve insurance coverage for the loss. The company therefore wants an efficient defense, and the insured is happy to help the company achieve that goal. Routine investigations would most often establish that the joint representation of the company and the insured can safely proceed.

A further reason for opposing a routine duty to investigate is that a restricted duty will do most of the useful work with less wasted effort. Conflicted representations usually are marked by "conflict clues" that should alert a competent attorney to the possibility that a client has an unusual interest at stake. An obvious clue is an expression by the company or the insured of a special interest in the conduct of the defense. For example, the insured may display great concern for or extreme hostility toward the claimant. Such an expression should alert defense counsel to the possibility that the insured may want to help the claimant recover or that the insured may oppose settling with the claimant on any terms. In either event, defense counsel should confer with the insured after learning of the insured's interest in the liability suit.

Investigation may also be required when the company expresses an unusual interest. For example, suppose the company states a desire to allow a default judgment against the insured or wishes to wage all-out war in litigation when neither course of action seems warranted in light of the merits of the claim. Such statements, although hardly conclusive evidence in and of themselves, are clues that the company may have unusual interests at stake. Defense counsel should regard the discovery of such clues as a reason for investigating the company's interests further.

Conflict clues also come in other recognizable forms. Standard clues include coverage questions, especially those memorialized in reservation of rights letters and nonwaiver agreements; excess liability problems; insureds who are related to claimants by blood or marriage or who share with claimants other emotional, affinal, or financial bonds;¹⁸⁶ insureds who are defendants in criminal prosecutions; insureds alleged to have committed acts of intentional, willful, or malicious wrongdoing; insureds from whom punitive damages are sought; and insureds, especially doctors, sued for malpractice who, because they earn their livelihoods in regulated professions, may have reputational or other interests at stake. Clues like these, which are widely recognized signs of possible conflicts, come to defense counsel's attention in the ordinary course of the representation. No special investigation is needed to reveal them.¹⁸⁷ Therefore, rather than ask defense counsel to investigate routinely, we would require investigations only when defense counsel learns of information that would alert a reasonable defense lawyer to a possible conflict. Then defense counsel must inquire further to learn whether the joint representation can properly proceed.

186. See *Immer v. Risko*, 267 A.2d 481, 485 (N.J. 1970) ("In the family context, the danger of collusion is the greatest of all. Not only are the parties in a close personal relationship, but any recovery will inure to the benefit of the entire family and failure to recover will affect the entire family adversely.").

187. Reservation of rights letters and nonwaiver agreements may be an exception to this generalization. Apparently, insurance defense lawyers do not routinely receive copies of these documents. Although we hope to take up coverage disputes in a second article, we tentatively encourage defense lawyers to ask whether there is a coverage dispute whenever counsel has any reason to think that coverage is a subject of controversy between the company and the insured.

E. *Handling Actual Conflicts: Obtain an Informed Waiver from the Insured or Withdraw*

Montanez presented an actual conflict of interests. In that case, the lawyer subjected the insured to an unwanted cross-examination in an effort to impeach the insured's disserving testimony. An actual conflict is a potential conflict that has ripened: A potential conflict exists when a lawyer may have to advocate or pursue a course of action that helps one client but compromises an interest of another; an actual conflict exists when a lawyer must advocate or pursue such a course. In *Montanez*, the conflict clearly had ripened prior to the time the lawyer cross-examined the insured. The insured had no interest in minimizing the loss to the claimant. Therefore, the lawyer had either to pursue a course of action—cross-examination of the insured—that would help the company at the insured's expense or to forbear from treating the insured in a hostile manner, in which event the insured would be protected but the company's interest in an efficient defense would be lost.

The professional responsibilities of a lawyer who faces an actual conflict of interests are governed by Rule 1.7(a) of the *Model Rules of Professional Conduct*. Rule 1.7(a) states that "[a] lawyer shall not represent a client if the representation of that client will be directly adverse to another client, unless: (1) the lawyer reasonably believes the representation will not adversely affect the relationship with the other client; and (2) each client consents after consultation."

The situation in *Montanez* fits under this rule because the insurance company's interest in minimizing the loss to the claimant was directly adverse to the insured-defendant's interest in helping the claimant recover. Any step likely to reduce the loss would help the company but compromise the identified interest of the insured; any step likely to increase the loss would help the insured but compromise the identified interest of the company.

Under Rule 1.7(a), the lawyer in *Montanez* could not continue to represent both clients unless conditions (1) and (2) were met. Condition (2) requires informed client consent to continued representation. A lawyer can satisfy condition (2) by obtaining the consent of the company and the insured after adequately informing each client of the respects in which that client's interests may be diminished by the joint representation. Condition (1) imposes a paternalistic constraint on a client's ability to waive a conflict. A

lawyer can satisfy condition (1) by satisfying himself that both the company and the insured can reasonably waive the conflict. "[W]hen a disinterested lawyer would conclude that the client should not agree to the representation under the circumstances, the lawyer involved cannot properly ask for such agreement or provide representation on the basis of the client's consent."¹⁸⁸

In full-coverage cases involving actual conflicts, conditions (1) and (2) can usually be met. That is so even in seemingly extreme cases like *Montanez*. In that case, the insured faced the difficult choice of having to compromise one of two interests, both of which were dear. By assisting the defense, the insured would retain insurance coverage but could also reduce his wife's recovery or even deny her a recovery outright. By hindering the defense, the insured might increase his wife's recovery but might also forfeit coverage by breaching the cooperation clause. The insured could reasonably have selected the first option, even though he in fact chose the second. Not only could the insured reasonably have put his interest in preserving insurance coverage ahead of his interest in assisting his wife, he might even have decided that he could best help his wife by preserving coverage because money would then have been available to pay a judgment had she won. Because the insured could reasonably have selected the first option, defense counsel could properly have asked the insured to waive the conflict. Had the insured done so after being adequately informed of the risks, defense counsel could have continued with the joint representation and impeached the insured.

Of course, a client may refuse to issue a waiver even when a lawyer may reasonably request one. Thus, the insured in *Montanez* may have refused to submit to impeachment had counsel bothered to inquire. When the insured refuses to waive an actual conflict of interests, defense counsel cannot continue to represent the company and the insured at the same time. That is also the case when condition (1) of Rule 1.7 renders an actual conflict unwaivable. In both contexts, the question arises: Which client, if either, should defense counsel continue to represent?

Some authorities endorse what we call the Primary Client Rule (PCR).¹⁸⁹ PCR requires defense counsel to side with the

188. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.7 cmt. 5 (1994).

189. See, e.g., *Montanez v. Irizarry-Rodriguez*, 641 A.2d 1079, 1084 (N.J. Super. Ct. App. Div. 1994) ("[W]hen the interest of the insurer and the insured differ, the insurance

insured, the primary client, when there is an unwaived or unwaivable conflict between the company and the insured. Proponents of PCR assert that defense counsel must act against the interests of the insurance company when necessary to protect the insured.¹⁹⁰

We reject PCR. Before offering our reasons, we wish to observe that PCR has no analogue outside the area of insurance defense. Generally speaking, the law of professional responsibility does not distinguish between primary and secondary clients. It puts all clients on the same plane, absent an agreement explicitly allowing an attorney to prefer one client to another.¹⁹¹ The law rejects PCR even though joint representations commonly involve co-clients who possess unequal economic power or unequal sophistication. Estate planners frequently represent husbands and wives, but they are not required to favor the interests of either spouse. The conventional wisdom that husbands are often both wealthier and better able to deal with lawyers than wives has not spawned a primary client rule for lawyers who handle trusts and estates. Criminal defense lawyers often represent drug "bosses" and "mules," but they are not required to prefer either client to the other.¹⁹² Even though "bosses" pay fees and call the shots in representations where unsophisticated "mules" are vulnerable to

defense lawyer's ethical duty of undivided loyalty to the client is owed to the insured." (quoting Brooke Wunicke, *The Eternal Triangle: Standards of Ethical Representation by the Insurance Defense Lawyer*, in FOR THE DEFENSE, Feb. 1989, at 7, 9)).

190. See JERRY, *supra* note 73, at 615 (contending that when advising the insured of developments relating to settlement, defense counsel must "sometimes act contrary to the insurer's interests"); Karon O. Bowdre, *Conflicts of Interest Between Insurer and Insured: Ethical Traps for the Unsuspecting Defense Counsel*, 17 AM. J. TRIAL ADVOC. 101, 112 (1993) (arguing that when a conflict arises, defense counsel "must recognize that his client now is the insured—not the insurance company"); Bruce L. Gelman, Note, *The Insurance Company or the Insured: Where Does Defense Counsel's Loyalty Really Lie?*, 70 U. DET. MERCY L. REV. 215, 221–23 (1992) (summarizing cases recognizing that defense counsel owes primary loyalty to the insured); Jason A. Reschly, Note, *Attorney Malpractice—Wrongful Settlement by the Insured's and Insurer's Joint Defense Attorney*, 45 MO. L. REV. 739, 743–44 (1980) (citing cases holding that defense counsel's loyalty must run primarily to the insured).

191. ABA/BNA LAWYERS' MANUAL ON PROFESSIONAL CONDUCT 51:301 (Supp. 1995) [hereinafter ABA/BNA MANUAL] (observing that a lawyer may represent two or more clients in the same case only "where the lawyer reasonably believes the multiple representation will not adversely affect any one of the clients").

192. The term "mules" is colloquially applied to persons at the bottom of a drug distribution hierarchy who carry illegal substances from place to place. Steven Goode, *Identity, Fees, and the Attorney-Client Privilege*, 59 GEO. WASH. L. REV. 307, 323 (1991).

exploitation, there is no primary client rule for members of the "white powder" bar. Employers and employees who are named as co-defendants often become co-clients of a single attorney as well. But a lawyer who represents an employer-employee pair has no duty to privilege the interests of the employee, even when the employer possesses a monopoly on control and economic power. To the contrary, in every example described, it would be improper for the lawyer to favor one client over the other, and it would be grossly improper for a lawyer to use the desire to protect one client as an excuse for knowingly and intentionally acting contrary to the other's interests or desires.¹⁹³

Outside the area of insurance defense, the norm is the No Subordination Rule (NSR), which forbids a lawyer from subordinating one client's interests to those of another without both clients' informed consent. Absent a waiver, a lawyer may advocate and pursue only courses of action that make both clients better off. When no available course of action satisfies NSR, the lawyer must withdraw and may not thereafter represent either client in the matter or in a dispute between the clients relating to the failed joint representation.

Many, and apparently most, authorities endorse the application of NSR to insurance defense representations.¹⁹⁴ PCR appears to be a minority view. Even so, PCR enjoys strong support.¹⁹⁵ It also exerts strong psychological pressure on insurance

193. ABA/BNA MANUAL, *supra* note 191, at 51:303. Many examples of improper favoritism are discussed in *id.*, ch. 51. See also ACTEC COMMENTARIES, *supra* note 59, at 47-54; Craig D. Gear, Note, *Conflicts of Interest: Simultaneous Representation*, 2 GEO. J. LEGAL ETHICS 103 (1988).

194. See, e.g., ALLAN D. WINDT, INSURANCE CLAIMS AND DISPUTES: REPRESENTATION OF INSURANCE COMPANIES AND INSURED § 4.17, at 168 (2d ed. 1988) (observing that "[t]he attorney should not . . . subordinate the interests of one [client] to those of the other"); *id.* n.140 (citing cases supporting NSR, the majority rule, and PCR, the minority rule); JERRY, *supra* note 73, at 602 (stating that under the "dual representation approach . . . it is a breach of the attorney's relationship with his client if he subordinates one client's interests to another's"). It is unclear whether Professor Jerry endorses NSR. He may prefer PCR instead. See *id.* at 616 (contending that "the best solution" in conflict situations "is for the attorney to give undivided loyalty to the insured," and arguing that "[i]f the insured wishes certain tactical choices to be made, ultimately it is the attorney's responsibility to his client to respect those choices").

195. See, e.g., MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 5-17 n.23 (1983) (stating that when a lawyer is hired by an insurance company, the lawyer's primary duty of loyalty is to the insured); ABA Comm. on Professional Ethics and Grievances, Formal Op. 282 (1950) (emphasizing that defense counsel must "represent the insured . . . with undivided fidelity"); Oregon Formal Op. No. 1991-121 (1991) (agreeing that defense

defense lawyers for manifold and subtle reasons. Having been reminded incessantly that they owe an undivided duty of loyalty to the insured, many defense lawyers now feel that they owe no loyalty to the company when the interests of the two clients conflict.¹⁹⁶ They feel that way even though duties of undivided loyalty to the company and the insured can coexist, as they do under NSR. PCR appeals to defense lawyers' sense of professionalism as well. It affirms that they must exercise independent judgment on behalf of insureds—that they are more than guns for insurance companies to hire and fire.¹⁹⁷ Lastly, PCR can give defense lawyers a normative basis for arguing their self-interest. When a company opts for a "Yugo defense" instead of a "Cadillac defense," a defense lawyer can invoke PCR in an effort to persuade the company to spend more. The duty to put the insured's interest in defeating the liability claim ahead of the company's interest in conserving defense costs harmonizes with the lawyer's self-interest in maximizing the fee to be earned from a case.¹⁹⁸

As stated, we reject PCR. We do so first because we think NSR adequately addresses the concerns that gave rise to PCR. The argument most often made for PCR is that it is needed to counterbalance economic factors, including the ability to pay fees and to offer future employment, that encourage defense lawyers to

counsel has two clients, but stating that defense counsel "must treat the insured as 'the primary client' whose protection must be the attorney's 'dominant' concern"; JERRY, *supra* note 73, at 603 (observing that "[m]ost courts have held that when dual representation is no longer feasible the attorney owes an absolute duty of loyalty to the insured"); 2 MALLEN & SMITH, *supra* note 45, § 23.3, at 365-66 (commenting that an attorney's "loyalty to the insured should even be paramount since that client's defense is the sole reason for the attorney's representation").

196. When presenting drafts of this report, we have been repeatedly struck by the extent to which defense lawyers, general counsel for insurance companies, and claims personnel have internalized PCR. Although we did not expect to have to do so when we undertook this project, a major part of our effort has been to convince company-related constituencies that defense lawyers can have duties of loyalty to insurance companies, not just to insureds.

197. See, e.g., Willis R. Tribler, *Coverage Disputes: Attorneys in the Middle*, 17 THE BRIEF 39, 39 (Summer 1988) (noting that "even though they [insurance defense lawyers] were hired by the insurance company, they represent the insured," and asserting that the principle that the company may not interfere with the lawyer's professional judgment when representing the insured "is universally accepted by reputable defense attorneys").

198. *Id.* (arguing that defense counsel's duty of loyalty to the insured requires counsel to insist that the company expend sufficient resources to investigate and evaluate the liability suit fully, but observing that the company's decision to cut costs "is of little or no concern in cases where there are sufficient limits and the insured is agreeable to the strategy proposed by the carrier").

put the company's interests ahead of the insured's and to deny the insured the loyalty that every client is due.¹⁹⁹ Although this argument raises a valid concern, the concern is too weak to justify PCR. The fear that defense counsel will abandon the insured justifies a rule forbidding counsel from acting to the detriment of the insured. It does not call for a rule requiring defense counsel to abandon the company when the interests of the company and the insured collide. The fear of disloyalty to the insured supports NSR, not PCR. Absent a reason for subordinating the interests of either client, defense counsel should hold their interests equally dear and should refrain from helping either at the other's expense.

In defense of PCR, one could argue that only a rule requiring defense counsel to bend over backward to help the insured can effectively offset the company's advantages. The idea here is that the insured needs an unusually strong legal force to counterbalance the unusually strong economic forces that bind the lawyer to the company. The hope is that the forces will cancel each other out and that the lawyer will then be free to give each client the loyalty it is due. The difficulty with this analysis is that it requires bad results in the cases. To maintain the balance, judges and disciplinary authorities must punish defense lawyers who give equal loyalty to the company and the insured, even though equal treatment is the goal. Given this requirement, only in the imagination can things work out right. In the real world, the law will evolve and, as time passes, it will require lawyers to favor insureds in ever more situations. Ultimately, the law will deny that defense counsel owes the company any loyalty, as the law in the State of Michigan now seemingly does.²⁰⁰ This evolution will undermine

199. See, e.g., *Bogard v. Employers Casualty Co.*, 210 Cal. Rptr. 578, 582-83 (Cal. Ct. App. 1985) (noting that defense lawyers have closer ties with insurance companies than insureds and have a corresponding interest in favoring the former); 1 HAZARD & HODES, *supra* note 181, § 1.7:304, at 250.2 (Supp. 1992) (noting that a lawyer representing both a company and an insured may fail to represent properly the insured because the company is a repeat player, whereas the insured probably is not); JERRY, *supra* note 73, at 602 (arguing that the "close economic and personal relationships" between defense counsel and insurers may de-emphasize the interest of the insured); John K. Morris, *Conflicts of Interest in Defending Under Liability Insurance Policies: A Proposed Solution*, 1981 UTAH L. REV. 457, 463 (1981) (arguing that attorneys have a "substantial incentive . . . to favor the interests of insurers over insureds").

200. This is the clear implication of *Atlanta International Insurance Co. v. Bell*, 475 N.W.2d 294, 297 (Mich. 1991), in which the Supreme Court of Michigan stated that the relationship between retained defense counsel and the insurance company is "less than" an attorney-client relationship. See also Connecticut Bar Assoc. Comm. on Professional

the company's ability to control the defense of the liability claim and to minimize costs. The law of professional responsibility will progressively replace the law of insurance because it will increasingly deny companies the opportunity to exercise the rights and powers that the liability contract conveys.

Thus, a fundamental reason for opposing PCR is that it allocates authority within the tripartite relationship in a manner that is at odds with the allocation provided for in the liability contract. PCR allows the insured to call the shots when the interests of the company and the insured conflict, even though the liability contract entitles the company to control the defense. For this reason, PCR appears to be inconsistent with other rules of professional responsibility and agency law. As explained in Part VII, both agency law and professional responsibility law provide that defense counsel's duty to act for the insured terminates when the insured issues an instruction that, under the retainer agreement, the insured has no authority to give. Defense counsel may not act contrary to such an instruction, but counsel need not obey the instruction either. Instead, the representation having ended, counsel must withdraw. PCR seems to be at odds with this mandate because it apparently requires defense counsel to do what the insured wants. It attaches no importance to the fact that the insured has no power to issue instructions.

A final reason for rejecting PCR is that NSR, properly applied, adequately handles the problems for which PCR was devised. The authorities that espouse PCR do so mainly in conflict settings where the lawyer worked adversely to the insured. For example, in *Employers Casualty Company v. Tilley*,²⁰¹ the defense lawyer helped the company build a case for a coverage denial without telling the insured. This conduct violated ordinary norms of agency law and professional responsibility law, both of which prohibit an attorney from acting adversely to one client at the request of another client without informing the client who stands to be harmed.²⁰² These norms embody NSR. To handle the problem in *Tilley*, enforcement of NSR would have sufficed.

Ethics, Informal Op. 92-7 (1992) (relegating the company to the status of third-party payor and characterizing the company's instructions to defense counsel as irrelevant).

201. 496 S.W.2d 552, 557 (Tex. 1973).

202. RESTATEMENT (SECOND) OF AGENCY § 391 (1957); MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.7(a) (1994).

By rejecting PCR, we do not mean to deny that defense counsel may sometimes owe loyalty to only the insured. Sometimes an insurance company cannot control the defense of the liability suit because a conflict between the company and the insured deprives the company of that right.²⁰³ When such a conflict exists, the company may retain defense counsel to represent only the insured as a client. The company is then a nonclient, third-party payor. Having only the insured for a client, the lawyer would owe loyalty solely to the insured. We do not need PCR to tell us that, however. When defense counsel has only the insured as a client, PCR is irrelevant because the need to distinguish between primary and secondary clients cannot arise.

IX. THE DUTY TO GIVE INFORMATION AND THE DUTY OF CONFIDENTIALITY

The duty of confidentiality in the tripartite relationship is addressed in numerous advisory opinions, law review articles, and guides for practicing lawyers. Because alleged violations of the duty have fostered many lawsuits, there is a large body of relevant judicial writings as well.²⁰⁴ However, almost all authorities and commentators discuss the duty to keep secrets in settings where, in one way or another, the existence of coverage is at stake. The main focus of attention is how defense counsel should handle information which, if made known to the company, could deprive the insured of coverage and a paid defense.²⁰⁵

203. See Barker, *Right to Control*, *supra* note 4, at 469.

204. For sources, see 2 MALLEN & SMITH, *supra* note 45, § 23.5.

205. See, e.g., Karon O. Bowdre, *Conflicts of Interest Between Insurer and Insured: Ethical Traps for the Unsuspecting Defense Counsel*, 17 AM. J. TRIAL ADVOC. 101 (1993) (discussing the duty of confidentiality solely with respect to information which, if communicated, could give rise to policy defenses). The preoccupation with coverage issues is reflected in the Guiding Principles that were proposed by the National Conference of Lawyers and Liability Insurers in 1969 and approved by the A.B.A. in 1972. Section VI of the Guiding Principles, which requires defense counsel to withhold certain facts and information from the company, applies only when the insured provides information "which indicate[s] to the attorney a lack of coverage." A.B.A. National Conference of Lawyers and Liability Insurers, *Guiding Principles: Lawyers and Insurers*, 20 FED'N OF INS. COUNS. Q. 93, 97-98 (Summer 1970).

American Mutual Liability Insurance Co. v. Superior Court, 113 Cal. Rptr. 561, 572 (Cal. Ct. App. 1974), appears to be the only case that considers how the duty of confidentiality applies to information not bearing on coverage. In that case, the court observed that defense counsel may send the company an evaluation of the insured while keeping the evaluation secret from the insured, and that defense counsel may withhold

As explained in the Introduction, coverage disputes fall outside the scope of this Article, which addresses lawyers' responsibilities in insurance representations where coverage is clear and sufficient to insulate the insured from loss. We will therefore sidestep the most difficult and interesting questions of confidentiality for the time being.²⁰⁶ Instead, we will offer a ground-level account of the duty of confidentiality in the tripartite relationship. The need for such an account is great. Although coverage disputes are the stuff of advisory opinions, law review articles, and reported cases, they arise in the minority of insurance defense representations. It is at least as important to clarify defense lawyers' duties in routine matters as it is to figure out what lawyers should do in the relatively small number representations where information bearing adversely on coverage comes their way. It may also be easier to figure out how lawyers should handle coverage-related information when their duties with respect to other information have been sorted out. An account of lawyers' duties in routine representations may set the stage for and help generate a better understanding of how lawyers should handle sensitive information in coverage disputes.

The discussion in this Part will take up the duty of confidentiality and the duty of communication. We address the duties in tandem because they are logically tied. A lawyer who is required to communicate certain information to one client cannot simultaneously have a duty to another client to keep the same information confidential. For example, if defense counsel has a duty to disclose certain information to the company, then, as a logical matter, defense counsel cannot owe the insured a duty to refrain from revealing the same information. Likewise, a determination that the duty of confidentiality to the insured requires counsel to withhold certain information forecloses the possibility that the duty to communicate with the company requires counsel to disclose.

from the company confidences imparted by the insured. Although the court's observations are dicta, commentators cite *American Mutual* as authority for the proposition that a duty of confidentiality can apply to information bearing no connection to coverage. See, e.g., 2 MALLEN & SMITH, *supra* note 45, § 23.5 (3d ed. 1989); Holmes, *supra* note 105, at 68.

206. We will also ignore the duty defense counsel undeniably has to keep confidential information secret from third-parties. Defense counsel may reveal confidences to third-parties only when other lawyers can permissibly do so—for example, when needed to carry out the representation.

The mutually exclusive and logically exhaustive possibilities that confront a defense lawyer who receives new information are as follows: Where "Client X" refers by turns to only the company or only the insured, the alternatives are that (1) the lawyer must communicate the information to Client X; (2) the lawyer must keep the information secret from Client X; and (3) the lawyer is neither obligated to disclose the information to Client X nor obligated to withhold the information from Client X. The truth of any proposition implies the falsity of the other two. Thus, when it is true that (2) the lawyer must keep information secret from the company, it must be false that (1) the lawyer has a duty to disclose the information to the company, and it must be false that (3) the lawyer may disclose the information to the company. When it is true that (1) the lawyer must communicate information to the insured, it is false that (2) the lawyer must withhold the information from the insured, and it is also false that (3) the lawyer may withhold the information from the insured.

The set of alternatives must be considered once for the company and a second time for the insured. That way, all possible combinations of duties are covered and inconsistent pairs of duties cannot be imposed. For example, suppose we decide that (1) the lawyer must inform the company of certain news. That decision neither forecloses any possibilities as to what defense counsel's duty to the insured may be nor prejudices the alternatives. Defense counsel may have to (1) inform the insured as well, (2) keep the information secret from the insured, or (3) exercise discretion and tell the insured or not, as counsel elects. Cycling through the alternatives separately for the company and the insured guarantees that nothing is missed and that defense counsel's responsibilities to each client are considered on the merits.

A. The Duty to Inform the Company and the Duty of Confidentiality to the Insured

When devising a ground-level account of defense counsel's responsibilities in full-coverage cases, it makes sense to begin by recalling relevant aspects of the allocation of authority in the liability contract. Under the contract, the insurance company controls the defense and settlement of claims and the insured suffers a duty to assist the company in the performance of the investigation, defense, and settlement functions. As explained in Part III, the

allocation of rights and responsibilities in the retainer agreement mirrors the allocation in the liability contract—the purpose of the retainer agreement being to create an agency by means of which the participants can exercise their respective rights and powers and discharge their respective obligations.

In keeping with the liability contract, the retainer agreement should assign defense counsel responsibility for investigating the liability suit.²⁰⁷ It also should free defense counsel to disclose to the company all information received from any source bearing materially on the defense or settlement of the liability suit. Any other arrangement would prevent the company from exercising the full extent of its contractual powers and would thereby jeopardize the company's ability to minimize the loss to the liability claimant. Having acquired the right to the insured's assistance and cooperation, the company would be especially unwilling to enter into an arrangement permitting defense counsel to withhold material information received from the insured. When defense counsel is retained, the expectation must be that counsel will help the company defend and settle the liability suit without qualification. That includes the expectation that defense counsel will tell the company everything it reasonably needs to know to make sensible defense and settlement decisions.

The preceding discussion enables one to divide the universe of information that defense counsel receives into two broad categories. The first category includes all information that is relevant in any way to a matter within the scope of the representation—that is, to the investigation, defense, or settlement of the liability suit. The second category includes all information that is not relevant to any such matter. With respect to relevant information, defense counsel's duty under the retainer agreement is to tell the company everything it would reasonably want to know when making investigation, defense, and settlement decisions.²⁰⁸ With respect to the second category, defense counsel has no duty to tell the company anything at all.

207. Defense counsel need not have sole responsibility for investigating (or for handling any other matter). The responsibility may be shared with other agents retained for the purpose, including company employees.

208. Some authorities distinguish between information defense counsel receives from the insured and information counsel receives from other sources. Holmes, *supra* note 105, at 64–68 (summarizing authorities). We draw no such distinction.

Our recommendation that counsel give the company everything in the way of relevant information that the company would reasonably want to know comports with black letter agency and professional responsibility law. Under the *Model Rules of Professional Conduct*, "[a] lawyer has an obligation to keep a client reasonably informed concerning matters undertaken on the client's behalf. This involves the positive duty to volunteer information and [to] give all information necessary for informed decision making."²⁰⁹ The common law imposes a similar duty on agents. Section 381 of the *Restatement (Second) of Agency* subjects a lawyer to "a duty to use reasonable efforts to give his principal information which is relevant to affairs entrusted to him and which, as the agent has notice, the principal would desire to have."²¹⁰ The common law of agency appears to be the source from which the duty of communication imposed by professional responsibility law was drawn.²¹¹

Because participants can consensually modify or clarify the duty to give information, a defense lawyer can often satisfy the duty to the company by adhering to terms set out in the company's guidelines for outside counsel. Such guidelines establish ground rules for communication between the company and the lawyer.²¹² Whether defense counsel must consult with the company more often or more extensively than the guidelines require turns on the understanding of the participants and on whether

209. A.B.A. ANNOTATED MODEL RULES OF PROFESSIONAL CONDUCT 54 (2d ed. 1992) (citing HAZARD & HODES, *supra* note 181, at 85); *see also* MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.4(b) (1994) (requiring a lawyer to "explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation"); RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 31 (Tentative Draft No. 5, 1992) (requiring an attorney to "keep a client reasonably informed about the status of a matter," to "consult with a client to a reasonable extent concerning decisions to be made by the lawyer," and, with respect to decision to be made by the client, to "explain [the] matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation").

210. RESTATEMENT (SECOND) OF AGENCY § 381 (1958).

211. *See* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 31 cmt. c (Tentative Draft No. 5, 1992) (citing RESTATEMENT (SECOND) OF AGENCY § 381); A.B.A. ANNOTATED MODEL RULES OF PROFESSIONAL CONDUCT 54 (2d ed. 1992) (citing RESTATEMENT (SECOND) OF AGENCY § 381).

212. *See* Field, *supra* note 36, at 10 (discussing relationship between outside counsel guidelines and ethical responsibilities); Edmund G. Farrell III, Outside Counsel Guidelines, Who Controls the Litigation: The Legal Malpractice and Ethical Dilemmas (undated, unpublished manuscript, on file with authors).

additional communications are needed to keep the company reasonably well informed. If the company and the lawyer agree to dispense with communications not required by the guidelines, defense counsel commits no impropriety by adhering to the guidelines. If the guidelines are not meant to exhaust the lawyer's duty to give information, supplemental communications should occur as reasonably needed. Apparently, the latter arrangement is the norm.²¹³

As explained previously, the existence of a duty to the company to communicate information precludes the possibility that a duty to the insured requires defense counsel to keep the same information confidential. Defense counsel's duty to communicate with the company therefore logically implies that defense counsel can have no duty to the insured to keep secret information relevant to the defense or settlement of the liability suit that the company would reasonably want to know. We thus adhere to the majority view that no duty of confidentiality within the tripartite relationship applies to relevant information received from the insured.²¹⁴

213. Field, *supra* note 36, at 10 (stating that outside counsel guidelines "are not intended to be, nor should they be treated as a substitute for good communication").

214. See, e.g., 2 MALLIN & SMITH, *supra* note 45, § 23.5, at 369 ("As between defense counsel's two clients, there is no confidentiality concerning communications intended to affect the common goal of the defensive effort."); Neumeier, *supra* note 48, at 75 (stating the general rule that "when an attorney has two clients with respect to a particular matter, the attorney cannot have any secrets between them as to that matter," and observing that the rule "applies to insurance defense counsel"). The view that counsel must share relevant information is the norm in noninsurance, multiple-client representations. See, e.g., ACTEC COMMENTARIES, *supra* note 59, at 37 (stating that the existence of a joint representation "usually implies that information will be shared by the clients with respect to the subject of the representation").

A corollary of the view that there is no expectation of confidentiality within the tripartite relationship is that the attorney-client privilege does not entitle the insured or the company to require defense counsel to keep relevant information secret from the other subsequent litigation between the two. Cf. PAUL RICE, ATTORNEY-CLIENT PRIVILEGE IN THE UNITED STATES § 9:3, at 9-8 (1993) ("When the joint clients . . . turn on one another and become adversaries . . . each participant can use the privileged communications against the others."); RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 125(2) (Tentative Draft No. 2, 1989) (providing that, unless explicitly agreed otherwise, communications in a coclient representation "are not privileged as between the coclients in subsequent litigation between them"); *Goldberg v. American Home Assurance Co.*, 80 A.D.2d 409, 413 (N.Y. App. Div. 1981) (stating that because defense counsel represented both the company and the insured, defense counsel, by disclosing to the company information received from the insured, did not violate the insured's attorney-client privilege); *Liberty Mutual Ins. Co. v. Engels*, 244 N.Y.S.2d 983 (N.Y. Sup. Ct. 1963), *aff'd*, 250 N.Y.S.2d 851 (N.Y. App. Div. 1964) (holding that when an attorney acts for two clients with a common interest, communications by either party to the attorney

It is important to understand why defense counsel can permissibly give the company relevant information received from the insured in a full-coverage case. This is a basic matter that has been neglected in the rush to sort out confidentiality issues arising in contexts where, by revealing information, defense counsel could put the insured's coverage at risk. However, the vast bulk of the information defense counsel receives from the insured (and other sources) concerns only liability, not coverage. Counsel's duties with respect to this information must also be explained.

Consider an example. In an initial interview, the insured tells defense counsel, "When the accident occurred, I was driving within the speed limit, the light was green, and I was sober." Can defense counsel give this information to the company and, if so, why? Although defense lawyers convey such information routinely, an affirmative answer is not self-evidently correct. The *Model Rules of Professional Conduct* permit a lawyer to reveal information relating to a representation only when the client expressly or impliedly authorizes disclosure.²¹⁵ Defense counsel can therefore inform the company only with the insured's approval, express or implied.

After talking with many defense lawyers, our impression is that few obtain the insured's express consent before making the company aware of the sort of information provided in the example. However, we do not conclude that defense lawyers act improperly by doing so. Defense lawyers need not seek the insured's express consent, in our opinion, because they have implied authority to give the company all information that is relevant to the defense or settlement of the liability suit, including relevant information received from the insured. When purchasing insurance, the insured authorizes the company to investigate, defend, and settle liability claims, and the insured further undertakes to help the company do its job. As previously explained, these promises "bleed into" the retainer agreement. Because the company needs access to relevant information to do its job correctly and because the insured has covenanted to assist the company, the retainer

are not necessarily privileged in a subsequent controversy between the clients).

215. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6(a) (1994) ("A lawyer shall not reveal information relating to representation of a client unless the client consents after consultation, except for disclosures that are impliedly authorized in order to carry out the representation.").

agreement establishes a baseline of open communication of relevant information received from any source, including the insured.²¹⁶

The view just expressed assumes that a retainer agreement can regulate the extent to which a lawyer who represents joint clients may share information. The assumption seems sound. Agency law conditions the general duty of confidentiality on the absence of a contrary agreement.²¹⁷ Because the duty of confidentiality imposed by the law of professional responsibility derives from agency law, it should be mutable by agreement as well.²¹⁸ Both the American College of Trusts and Estates Counsel and the ABA Special Probate and Trust Division Study Committee on Professional Responsibility concur with this assessment. Both organizations endorse the use of agreements to regulate information sharing by estate planning lawyers who handle multiple-client representations.²¹⁹ The recently-issued *Council Draft of the Restatement of the Law Governing Lawyers* adopts the same view. It endorses the use of agreements among co-clients to determine which information a lawyer must keep secret and which must be shared.²²⁰

By saying that the retainer agreement establishes a baseline of free communication, we do not imply that defense counsel auto-

216. See *Moritz v. Medical Protective Co.*, 428 F. Supp. 865 (W.D. Wis. 1977) (adopting the view similar to the one expressed here that a physician's obligation to disclose information to his insurer prevents the information from being considered confidential).

217. RESTATEMENT (SECOND) OF AGENCY § 395 (1958).

218. A.B.A., ANNOTATED MODEL RULES OF PROFESSIONAL CONDUCT 90-91 (2d ed. 1992) (identifying agency law as the source of the lawyerly duty of confidentiality); *accord*, RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 125(2) (Tentative Draft No. 2, 1989) (allowing co-clients to agree that communications within the representation will be subject to the attorney-client privilege in subsequent litigation between the co-clients).

219. ACTEC COMMENTARIES, *supra* note 59, at 37-39; Malcolm A. Moore & Anne K. Hilker, *Representing Both Spouses: The New Section Recommendations*, PROB. & PROP., July/August 1993, at 26, 29-31. It is also worth mentioning the presumption in evidence law that every joint client is privy to all relevant information counsel possesses, so that in a dispute between joint clients the attorney-client privilege does not apply. The presumption reflects a belief that joint clients consent to information sharing. See Holmes, *supra* note 105, at 66-67 (observing that cases and secondary authorities addressing the attorney-client privilege conclude that, as between the company and the insured, no privilege applies to communications with defense counsel because by accepting dual representation the company and the insured "each consent[ed] to the attorney disclosing their statements to the other client").

220. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 125 cmt. d (Council Draft No. 11, 1995) ("Co-clients may agree that the lawyer will not disclose certain confidential communications of one co-client to other co-clients.").

matically violates the duty to communicate by failing to give the company relevant information. Neither the baseline nor the duty to keep the company reasonably well-informed requires a lawyer to convey every scrap of relevant information the lawyer receives. Impropriety occurs only when defense counsel fails to communicate relevant information the company reasonably would want to know. The company may not want bits of information that, although relevant to defense or settlement in some way, are unimportant or bear on matters the company expects defense counsel to handle independently. For example, suppose that a deposition of a claimant's expert witness has been scheduled to take place at defense counsel's office, and that claimant's counsel calls and asks to change the location to the expert's office. Absent a reason for thinking the company would care about the venue, defense counsel can agree to the change without bothering the company about it. Counsel may think it advisable to inform the company later if, in counsel's opinion, the expert's unease is a sign that the expert will perform poorly at trial. The point is only that counsel need not communicate the information at the time the change is made because the information is then of little importance and because the company expects counsel to handle scheduling matters without consultation.

It is likewise true that the duty to keep the company reasonably well-informed entails no duty to give the company information that is irrelevant to the defense or settlement of the suit against the insured. For example, suppose the lawyer assigned to a slip-and-fall case learns that the insured, a grocery store owner, admires a particular artist. The information, which we can assume to have been communicated in casual conversation, has no bearing on the defense or settlement of the slip-and-fall case. The lawyer need not communicate it to the company for three reasons: the company has no interest in it; the company would probably prefer not to have it; and the lawyer has no duty to advise the company on matters beyond the scope of the representation.²²¹ There is

221. The company has no interest in the information because it can perform the defense and settlement functions effectively and efficiently without it. The company would prefer not to have the information because a conversation about the insured's tastes in art would be a waste of time. And a lawyer has no duty to advise a client on a matter beyond the scope of a representation because a lawyer's obligation to serve a client is contractual.

no reason to require defense counsel to give the company information that is irrelevant to the investigation, defense, and settlement of the liability suit.

B. The Duty to Inform the Insured and the Duty of Confidentiality to the Company

We have argued that defense counsel must be free to give the company relevant information received from any source that the company reasonably would want to have when making decisions about the investigation, defense, or settlement of a liability suit. Our conclusion logically entails that defense counsel can have no duty to the insured to keep secret information relevant to the investigation, defense, or settlement of the liability suit that the company would reasonably want to know. When defense counsel receives relevant information, counsel's duty is to disclose the information as needed to help the company make suitably informed decisions. That is so regardless of the source from which the information is acquired. We thus adhere to the majority view that no duty of confidentiality within the tripartite relationship applies to relevant information received from the insured.²²²

The preceding issue notwithstanding, several questions concerning the duty of confidentiality to the insured remain to be considered. Must defense counsel keep irrelevant information secret at the request of the insured? How should counsel respond to an instruction from the insured to withhold relevant information from the company? Should counsel honor the request and ignore the duty to disclose? Should counsel disclose the information despite the request? Should counsel follow some other course?

Questions also remain concerning the duty that defense counsel may have to inform the insured. Must defense counsel tell the insured about the duty to convey relevant information to the company? If so, what must counsel say? Must defense counsel educate the insured on other subjects as well? If so, which subjects, and to what standard must counsel's consultations with the insured comply?

For reasons explained in Part IX, a determination that defense counsel must convey certain information to the insured precludes the possibility that counsel can have a duty to the company to

222. See sources cited *supra* note 215.

keep the same information confidential. Thus, the duty of confidentiality to the company must also be explored. One must consider whether defense counsel owes any duty to the company to keep certain information secret from the insured, and, if so, what conduct the duty requires.

The liability insurance contract contains no provisions that directly bear on any right the insured may have either to receive information or to have irrelevant information withheld from the company. The reason for the omission is apparent. The relevant contractual provisions are those bearing on the investigation, defense, or settlement of liability claims. The purpose of these provisions is to create a structure that can minimize the cost of responding to such claims. The provisions can accomplish that purpose while saying little about the insured's right to receive information or to have irrelevant information kept confidential because these matters are likely to have little impact on the cost of handling claims. Because the contract can function well without addressing the identified rights of the insured, there has been little need to clarify what the insured's rights should be, and there has been little economic pressure to incorporate relevant provisions into the liability contract as well.

The preceding may seem to ignore the cost of communicating with the insured. To communicate, the company and defense counsel must expend time and other resources. These expenditures could be avoided, and the cost of handling claims reduced, by contractual provisions designed to eliminate the need for communication.

Although we do not deny that it is costly to communicate with the insured, it seems likely to us that the unique cost of communications intended solely to inform the insured is too small to justify specific contractual provisions like those mentioned above. We hold this opinion for two reasons. First, in cases that are seriously litigated to any significant extent, defense counsel must usually educate the insured in order to obtain information and assistance from the insured. Defense counsel will confer with the insured and seek the insured's assistance when investigating the events that gave rise to the liability suit, when responding to the complaint, when answering interrogatories, when preparing the insured for deposition, and when taking statements from other witnesses. On these occasions, counsel will find it helpful to tell the insured about the progress of the liability suit and to answer

any questions the insured may have about the investigation or the defense. The insured will then understand why particular information is needed, will cooperate more fully, and will perform better overall. Insurance company guidelines may require defense counsel to communicate even more information, so as to protect the company against allegations of misconduct or bad faith.²²³ Because defense counsel must often educate the insured to defend the liability suit successfully and to comply with company guidelines, the marginal cost of communications intended solely to provide information that would not otherwise be conveyed is likely to be small.

Second, insureds are unlikely to want more information than defense counsel finds it advantageous to supply because, in full-coverage cases, insureds have limited interests at stake. An insured who is fully protected from claim-related costs typically has two goals: to cooperate with the company and to keep the lawsuit from becoming a headache. An insured motivated by these goals will rely on defense counsel to decide when the insured's assistance is required, what the insured needs to know, and how the insured can cooperate effectively. The insured will otherwise be content to allow the lawsuit to proceed without his active involvement. Less often, an insured has but a single goal: to avoid involvement in the litigation entirely. An insured who is motivated in this fashion will probably want less information about the liability suit than defense counsel seeks to provide.²²⁴ Finally, there is the occasional insured who, despite being insulated from loss, wants to know everything about the liability suit and frequently presses defense counsel for news. All defense lawyers encounter this sort of client from time to time. A hypercooperative insured can consume an inefficiently large portion of defense counsel's

223. Field, *supra* note 36, at 10 (recommending, in professional liability cases, that the insured receive copies of all reports, bills, and important communications prepared by defense counsel, and that companies draft their outside counsel guidelines in ways that encourage defense counsel to consult with the insured and to gain the insured's acceptance of the strategy for resolving the claim).

224. When representing a resistant insured, defense counsel may have to bend over backward to secure the insured's cooperation. Counsel may be able to convince the insured to assist the defense by warning the insured that the insured may forfeit coverage by failing to cooperate. Although a client usually has no duty to communicate with a lawyer, *see* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 31 cmt. b (Tentative Draft No. 5, 1992), an insured is subject to such a duty. This is another respect in which insurance representations are unique.

time, but the problem appears to be too small to deal with via amendments to the liability contract. Relying on defense lawyers to handle such insureds in an ad hoc manner seems to suffice.

In sum, it makes sense that standard liability contracts contain no provisions creating or negating a duty to inform the insured. Such provisions can be dispensed with because, generally speaking, things work well without them. The same analysis explains why standard insurance contracts omit provisions addressing the insured's right to withhold irrelevant information from the company. Because the company can effectively investigate, defend, and settle liability suits without irrelevant information, duties concerning such information can safely be ignored.

Because the liability contract contains no provisions to the contrary, we conclude that the retainer agreement leaves intact the lawyer's default duty to give information to the insured. The default duty requires a lawyer to tell the insured everything the insured reasonably would want to know when making decisions concerning the representation.²²⁵ Because in a full-coverage case the insured makes few such decisions and has no economic stake in the conduct of the defense, the duty has limited implications. It requires little effort on the part of defense counsel that counsel would not otherwise expend.

The standard liability contract entitles the company to control the investigation and defense of the liability suit. Because the insured has no right to make decisions concerning these matters, defense counsel's duty to inform the insured about them is greatly reduced. Certainly, the duty entitles the insured to far less consultation than the company is due and to less information than a client in full control of a representation would receive. The fact that the insured bears no financial responsibility for defense costs or for any judgment that may be entered at the conclusion of the case further supports this claim. Why require frequent and exten-

225. See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.4(b) (1994) ("A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation."); RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 31(3) (Tentative Draft No. 5, 1992) (same); RESTATEMENT (SECOND) OF AGENCY § 381 (1958) (subjecting an agent to "a duty to use reasonable efforts to give his principal information which is relevant to affairs entrusted to him and which, as the agent has notice, the principal would desire to have"). Although often formulated as a separate duty, a particular application of the duty to communicate is the obligation to respond to a client's reasonable requests for information.

sive communications about matters of no economic interest to the insured? Because the insured would derive no value from most of the information that could be conveyed, it makes no sense to obligate defense counsel to convey it.

We conclude that, in full-coverage representations, the duty to communicate requires defense counsel only to keep the insured informed of major developments in the representation and of any particular actions that may be required of the insured. Appropriate subjects for conversation include a summary of important information learned in discovery, an estimate of the likely outcome at trial, and a description of the likely progress of a trial, including the possibility that the insured will be asked to testify. In the vast majority of representations, defense counsel will provide the information described, and probably other information as well, by means of conversations with the insured that occur in the ordinary course of investigating the liability suit and preparing a defense. No supplemental communications will be required. Only when defense counsel and the insured fail to meet for a considerable time may it be necessary for counsel to contact the insured and bring the insured up to date about intervening events. Even then the conversation can usually focus on the broad contours of the representation. Specifics need be mentioned only in response to questions from the insured.

In a full-coverage case, the insured's most important choice is probably the decision to accept or reject a defense at the company's expense. The insured makes that decision in the first instance by asking the company to respond to a complaint. Obviously, defense counsel cannot advise the insured on this subject. Defense counsel is retained after the insured initially demands a defense. However, the insured can revoke the demand for a defense at any time. The insured can dismiss the company and take control of the defense if the insured is willing to bear the expense.

Clearly, the insured cannot wisely decide whether to accept continued representation by the company without knowing how the company is handling the investigation and defense. The obvious source for the insured to look to for that information is the lawyer retained by the company to defend the insured. Although the lawyer can give information to the insured, and must do so upon reasonable request, the lawyer should not advise the insured whether to assume personal control of the defense. The scope definition eliminates any duty to advise the insured on this subject.

Counsel's duties to the insured concern matters relating to the investigation or defense of the liability claim, as explained in Part IV. Because the decision to assert personal control of the defense relates to neither subject, defense counsel has no duty to advise the insured about that decision.²²⁶ The matter is also one in which the company's and the insured's interests are likely to conflict. Defense counsel should advise the insured to consult separate counsel, retained and paid for by the insured, for assistance.

Still, the fact that the insured can dismiss the company and can do so wisely only if adequately informed has some implications for defense counsel. The scope of the representation permits defense counsel to tell the insured whatever the insured would reasonably want to know about the investigation or defense of the liability suit. It also allows counsel to answer relevant questions posed by the insured. Ordinarily, information given in the ordinary course of investigating and defending the liability suit is more than adequate to satisfy the insured's curiosity about the progress of the liability suit. However, in an unusual case where a competent lawyer would see that the insured might reasonably wish to discharge the company, more information should arguably be supplied. Defense counsel should alert the insured to the possibility of taking control of the representation (if the insured is not aware of the possibility already), should advise the insured to retain separate counsel for help with the decision, and should provide whatever information the insured needs to form an accurate and reasonably complete understanding of the conduct of the investigation and defense.

Like the duty to investigate conflicts of interest discussed in Section VIII(A), the heightened duty to communicate should apply only when defense counsel encounters "clues" that would alert a competent attorney to the possibility that the insured has special interests or needs. Recall the example in which the insured expressed a desire to avoid testifying because he feared that his wife would learn he was with another woman the night the accident occurred. Such a statement puts defense counsel on notice that the insured has a special interest in the conduct of the defense—an interest that may lead the insured to attempt to settle the matter

226. See, e.g., RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 72 cmt. d (Tentative Draft No. 7, 1994) (observing that a lawyer is not liable to a client for failing to assist the client with matters outside the defined scope of a representation).

quietly on his own. Or consider a situation in which the company proposes to defeat a claim against the insured, a fast-food operation that has franchises across the country, by arguing that the claim should be brought in a worker's compensation proceeding rather than a civil suit because the injured person is an employee. The insured may balk at this suggestion. The insured may have carefully structured its operations to ensure that people who work for it are independent contractors, not employees, and it may be more concerned about a statement to the contrary in a document submitted to a court than about the possibility of losing to the claimant.

When the insured displays a special interest in the handling of the defense or expresses reluctance to cooperate with the company or defense counsel, defense counsel should take the following steps. First, inform the insured of the option of discharging the attorney. Second, explain that defense counsel cannot advise the insured whether to take personal control of the defense. Third, encourage the insured to retain separate counsel. Fourth and finally, provide whatever information the insured reasonably needs to correctly understand the past and likely future progress of the investigation and defense.²²⁷

The basic duty to inform the insured of major developments in the representation and of specific actions required of the insured precludes the existence of any duty to the company to keep such information confidential. The heightened duty that applies when the insured has a special interest at stake precludes a duty of confidentiality to the company as well. We thus conclude that defense counsel has no duty to keep relevant information secret from either the company or the insured. Counsel's affirmative duty to inform the company imposes a greater burden than the duty to educate the insured because the company has larger economic interests at stake and because the company has far more decisions to make. As a general matter, however, neither client has a right to ask defense counsel to withhold relevant information from the other. Again, this is the majority view.²²⁸

227. The analysis of the heightened duty to communicate recalls the discussion of the duty to investigate in Section VIII(D). Both duties are conditioned on the presence of "clues" that should alert a competent lawyer to the possibility that one of the clients has unusual interests at stake in the representation.

228. See sources cited *supra* note 215.

The baseline of free communication establishes that the insured is entitled to know the content of all correspondence between defense counsel and the company. That may include some information the company and defense counsel would prefer not to reveal, such as the attorney's unflattering evaluation of the insured's likely credibility on the stand. Although defense counsel must disclose such information in response to an appropriate request from the insured, counsel need not volunteer the information when neither the basic duty to communicate nor the heightened duty requires disclosure. By itself, the fact that information is relevant to the investigation or defense of the liability suit does not imply that defense counsel must make the insured aware of it. The existence of a duty to disclose the information turns on whether the insured can understand the investigation and defense of the liability suit sufficiently well without it. If so, counsel can withhold the information. If not, counsel must supply it. Because defense counsel errs at his own risk, the safest course is always to disclose. A court will have little sympathy for a lawyer who, in deference to either the lawyer's or the company's interest in secrecy, withholds needed information from the insured.

In Section IX(A), we established that the duty to confer with the company does not require defense counsel to give the company irrelevant information received from the insured. It is equally true that the duty to educate the insured leaves counsel free to withhold any irrelevant information that representatives of the company happen to provide. That is so because defense counsel can inform the insured sufficiently by communicating only information that is relevant to the investigation or defense of the liability suit. The insured has no need for irrelevant information; therefore, defense counsel has no duty to convey it.

Whether defense counsel must keep irrelevant information supplied by one client secret from the other seems to us to depend on the circumstances surrounding the communication. If the circumstances indicate that the client, be it the company or the insured, expects the lawyer to maintain confidentiality, then the lawyer can and should respect that expectation. If the circumstances do not so suggest, the lawyer may disclose. The safest course is to presume that the communicating client always expects confidentiality and to obtain that client's permission before revealing irrelevant information to the other. The only risk defense counsel faces is the inadvertent disclosure of information that counsel

properly can and should keep secret. Defense counsel can always avoid that mistake by keeping irrelevant information to himself.

A further question is how defense counsel should act when either client communicates relevant information that the client wants the lawyer to withhold from the other. Usually, such information is supplied by the insured. We think the best way to deal with this problem is to avoid it by explaining that both clients are entitled to learn all relevant information defense counsel receives from any source. Defense counsel should tell the insured (and the company too, if there is reason to think that the company misunderstands the terms on which counsel was retained) that as a general matter there can be no secrets within the tripartite relationship. When either client imparts relevant information, it must do so with the understanding that defense counsel can share the information with the other client.

The safest course for defense counsel is to explain the baseline of free communication to both clients at the outset of the joint representation. In practice, it may often be acceptable and even wise to delay discussion until it is clear that the liability suit will not settle early on. Why focus the clients' attention on the uncomfortable and possibly alarming prospect of sharing sensitive information without proper cause? Why expend lawyer time in such conversations before it is reasonably clear that the representation will require substantial consultations with the company or the insured? It is sufficient to inform a client about the baseline before the client tells the lawyer relevant information expecting it to be kept confidential, even if the disclosure occurs after the representation has gone on for some time.

Having said that a lawyer can defer educating the clients, we must also observe that a lawyer does so at his peril. It is too late to have a conversation about the baseline after one of the clients has given the lawyer relevant information and asked that it be withheld from the other. Once the cat is out of the bag, it cannot be returned. Although the decision to defer discussion is subject to a reasonableness standard, a lawyer who fails to set a client straight in time should expect little sympathy from a finder of fact. With the aid of hindsight, it will usually appear that the lawyer should have educated the client about the baseline before the client spoke.

The baseline of free communication may discourage one or both of the clients from revealing sensitive information that is

relevant to the investigation or defense. Secrecy often occurs because the insured fears that the company will assert a policy defense if information is revealed. Secrecy can also have other causes. The insured may find certain facts embarrassing and may wish to conceal them. The insured may worry that the company will cancel coverage in the future or charge higher premiums if information is revealed. The insured may have stakes in other lawsuits or reputational interests that the insured is concerned to protect.

It is unfortunate that the baseline may inhibit the flow of information from the clients to defense counsel, but the problem is not of counsel's making and is one defense counsel need not attempt to redress (other than by encouraging the clients to disclose everything counsel needs to know). The problem arises because the retainer agreement, reflecting the company's decision to name itself as a client and the allocation of rights, powers, and responsibilities in the insurance contract, provides that secrets cannot be kept. Because the company controls the content of the retainer agreement, it could choose a different arrangement if it so desired. For example, the company could hire separate counsel for itself and the insured, or the company could authorize a single lawyer representing both clients to keep relevant information secret unless authorized by the communicating client to disclose.²²⁹ The decision to reject other arrangements reflects the company's assessment that a joint representation with a baseline of open communication best serves its needs. In effect, the company trades off fuller disclosure to defense counsel for fuller control of the investigation and defense. Given the company's demonstrated willingness to pay the price that the baseline of open communication entails, the possibility that the baseline will inhibit communications is not defense counsel's concern.

We come at last to the crucial question. What should defense counsel do when one client, after revealing relevant information, directs that it not be disclosed to the other? The first thing counsel should do is remind the client of the understanding that secrets cannot be kept within the tripartite relationship. The understanding will be explicit if counsel discussed the baseline with the client prior to the communication. Otherwise, it will be implicit, but it

229. This arrangement is sometimes used in estate planning representations. See ACTEC COMMENTARIES, *supra* note 59, at 38 (discussing separate representation of multiple clients with interests in related matters).

will provide the operational basis for the tripartite relationship even so. Counsel should then explore the possible implications of disclosure for the client to the extent counsel knows what the implications are and can discuss them within the scope of the representation of the client. The consequences of nondisclosure should then be discussed, and the case for disclosure should be weighed.

Often, the lawyer will be able to convince the communicating client to allow the lawyer to disclose the information. The communicating client is especially likely to assent when the law governing the attorney-client privilege is explained. In a dispute between former joint clients, the law entitles each client to discover all communications between the other client and the lawyer relating to the subject of the joint representation made prior to the existence of a conflict.²³⁰ When the communicating client understands that the other client cannot be denied access to the information, the communicating client may see the reason in freeing the lawyer from the confidentiality request.

A further consequence of nondisclosure is that defense counsel will have to withdraw from the representation, thereby signaling the other client that something is amiss. This too should be explained to the communicating client. By instructing defense counsel to keep a secret, the communicating client breaches the retainer agreement. Defense counsel has no duty to honor an unauthorized instruction from either client. Nor can counsel simply honor the request and continue the joint representation as though nothing had occurred. The breach terminates the joint agency, and a new tripartite relationship can be created only with the informed consent of both the company and the insured. Counsel cannot obtain that consent without disclosing the information at issue to the other client. Because disclosure is prohibited, counsel is effectively discharged and must withdraw.

If after all is said and done the communicating client still insists that the information be withheld, defense counsel may not ignore the client's wishes. Counsel must withdraw for the reasons already explained. The letter explaining defense counsel's action should state that counsel can no longer represent the clients jointly

230. 24 WRIGHT & GRAHAM, *supra* note 86, § 5505 (discussing inapplicability of attorney-client privilege when litigation breaks out between a formerly aligned company and insured).

because one of the clients issued an unauthorized instruction that counsel can neither act upon nor disclose.

Many authorities voice the concern that, by sending a letter like the one just described, defense counsel violates a fiduciary duty to the communicating client. Because such a letter must "tip off" the other client, the feeling is that the act of sending it is disloyal. We understand this concern, but the act is blameless even so. The occasion for sending the letter arises when and because the communicating client wants defense counsel to act in violation of the terms subject to which counsel was retained. The communicating client cannot reasonably expect that no adverse consequences will flow from a decision to breach the retainer agreement. The retainer agreement stands as it is, and given its content the communicating client must make a choice: Free defense counsel to disclose relevant information or insist that counsel keep the information under wraps. The communicating client may find both options unattractive, but that is not defense counsel's fault. It is a consequence of the communicating client's decision first to participate in the tripartite relationship and then to violate the terms. Defense counsel's only responsibility in this situation is to help the communicating client understand what lies ahead if permission to disclose is withheld.

CONCLUSION

Even in full coverage cases, the interests of insurance companies and their insureds often diverge, putting defense counsel in the difficult position of deciding what the law of professional responsibility requires. In this Article, we have offered a systematic way of thinking about those obligations—a way that builds upon basic principles of agency law, professional responsibility, and insurance law.

A key to sorting out the complex interactions between these bodies of law is the retainer agreement, which determines who defense counsel represents, the scope of the representation, and the duties owed the client or clients. We have also identified limits on the ability of the parties to alter the professional responsibilities of defense counsel through the retainer agreement. To a remarkable extent, those limits are less constraining than is currently assumed by many scholars, lawyers, and sources of professional responsibility law. Thus, for example, it is possible to structure the

retainer agreement so that defense counsel, although representing both the insurance company and the insured as clients, can take instructions on most matters from the company alone. Similarly, it is possible to limit the scope of the insured's legal representation so that it includes defense but not settlement of the lawsuit, leaving settlement to be handled by claims personnel of the company.

Because written retainer agreements are rarely employed by defense counsel in civil cases, these functions of retainer agreements have been misunderstood. Judicial opinions, treatises, and tentative drafts of the *Restatement of the Law Governing Lawyers* have mistakenly assumed that only default rules of professional responsibility and agency law govern defense counsel's obligations to the insured. We have argued, to the contrary, that the liability insurance contract bleeds into the retainer agreement, overriding or altering many of the default rules that govern in other contexts. If insurance defense counsel were to employ written retainer agreements as frequently as other lawyers do, we believe it would be clearer to everyone that and why default rules do not necessarily apply.

Some lawyers and legal scholars will resist our claim that defense counsel's representation of the insured can be constrained as severely as we suggest. They will insist that a liability insurance contract must be interpreted through professional responsibility law to provide the insured a "gold-plated attorney"—a lawyer who represents all of the insured's interests in the litigation, who operates subject only to the insured's control, who keeps information received from the insured confidential from the insurance company, and who subordinates the company's interests to the insured's even when, because there is full coverage, only the company has a direct monetary stake in the litigation. We find it profoundly troubling to use professional responsibility law in this manner. In all other contexts, people are free to buy less than a "gold-plated" attorney—to choose a lawyer who represents only some of their interests, who operates subject to the control of a co-client, who shares information with that co-client, and who pursues only courses of action beneficial to both clients.

Of course, requiring the provision of a "gold-plated" attorney with every liability insurance contract will benefit some insureds. But that benefit comes at price to all insureds who, when buying liability insurance, may prefer to pay for less expensive lawyering, just as consumers of health insurance increasingly choose cost

savings over unlimited expensive medical care. We believe that just as doctors should not have exclusive authority to define how much medical care consumers must buy, lawyers should not be able to employ professional responsibility law to control the amount of legal services insureds must buy.

When lawyers control the amount of legal services insureds must buy, it is predictable that there will be a tendency to set the requirements too high. Professional responsibility law will then distort insurance law, depriving companies of the ability to control the defense in efficient ways. This in turn could threaten the continued viability of traditional liability insurance arrangements as insureds and companies increasingly choose alternative and less expensive means to manage the risk of lawsuits. As we began this Article by pointing out the sometimes perverse incentives liability insurance creates in litigation, so we conclude by emphasizing that procedural rules, including the rules of professional responsibility governing defense counsel, can create perverse effects in liability insurance markets.