INHOUSE DEFENDERS OF INSUREDS: SOME ETHICAL CONSIDERATIONS*

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I. INTRODUCTION

Insurance companies are professional defenders of lawsuits.[1] Insurers are not, however, selfless champions; rather, they are driven by profit.[2] Accordingly, most insurers will seek to defend insureds through methods that minimize expenses.[3] Traditionally, insurers have relied upon the presumed expertise of private law firms to defend insureds.[4] Recently, however, a trend toward the use of inhouse counsel to defend insureds has emerged.[5] Fueled by hopes of achieving greater efficiencies in litigation, the trend toward inhouse programs has shown signs of growth and permanence.[6]

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1. *See, e.g.*, State Farm Mut. Auto Ins. Co. v. Hollis, 554 So. 2d 387, 391 (Ala. 1989); Kooyman v. Farm Bureau Mut. Ins. Co., 315 N.W.2d 30, 33 (Iowa 1982); Rogers v. Government Employees Ins. Co., 598 So. 2d 670, 673 (La. Ct. App. 1992); Hartford Accident & Indem. Co. v. Foster, 528 So. 2d 255, 265 (Miss. 1988); Hamilton v. State Farm Mut. Auto. Ins. Co., 511 P.2d 1020, 1025 (Wash. Ct. App. 1973); 7C JOHN ALAN APPLEMAN & JEAN APPLEMAN, INSURANCE LAW AND PRACTICE § 4712, at 425 (Walter F. Berdal ed., 1979).

2. *See, e.g.*, Anne Colden, *Lack of Storms in 4th Quarter Aided Insurers*, WALL ST. J., Jan. 12, 1998, at B12C (stating that analysts predict "[e]arnings at property-casualty companies will be an average 10% higher than a year earlier"); Letter to the Editor, *Who Pays for Doctor Bills*, WALL ST. J., Dec. 20, 1988, at A15 ("Insurers should make a profit on the sale of their policies; they are businesses, not charities."); *see also* 44 C.J.S. *Insurance* § 108, at 233 (1993) ("In the absence of statutory regulation, the surplus or profits of a stock insurance company belong to the stockholders."); *Id.* § 119, at 258 (discussing the ownership of surplus in a mutual insurance company).

Some not-for-profit insurers do exist. *See, e.g.*, Robert A. Padgug et al., *Aids and Private Health Insurance: A Crisis of Risk Sharing*, 3 CORNELL J.L. & PUB. POL'Y 55, 60 (1993) (noting Empire Blue Cross & Blue Shield as an example). Nevertheless, the ability of not-for-profit insurers to compete is questionable. *See id.* at 71 ("The time when individual not-for-profit, socially-oriented insurers could play a unique role as 'insurers of last resort' is almost certainly at an end.").

3. *See supra* note 2 and accompanying text. "Profit" is defined as the amount by which revenues exceed expenses. ROBERT W. HAMILTON, FUNDAMENTALS OF MODERN BUSINESS § 7.4, at 155 (1989); *see also* 44 C.J.S. *Insurance* § 108, at 233 (1993) ("The surplus or so-called profit of a stock company is the sum remaining out of its gross income after deducting the reserve and the losses and expenses.").

Ironically, however, regulatory schemes may create incentives for insurers to maximize reported expenses. Michael Totty, *Farmers Insurance: What Are Its True Expenses?*, WALL ST. J., May 15, 1996, at T1 (discussing one insurer's response to Texas regulations).

4. *Cf.* Amy Stevens, *Lawyers and Clients*, WALL ST. J., Jan. 7, 1994, at B9 (discussing insurers' relations with law firms).

5. Alan Pell Crawford, *The Duty to Defend*, INS. REV., June 1, 1991, at 40 ("Insurers all across the country are beefing up their in-house staff counsel in response to spiraling legal costs and the deteriorating relationship between the carriers and law firms that represent them."); Ronald E. Mallen, *Defense by Salaried Counsel: A Bane or a Blessing?*, 61 DEF. COUNS. J. 518, 518 (1994) (concluding that the use of salaried counsel will continue to grow among insurance companies).

6. Mallen, *supra* note 5, at 518.

Like most innovations, the use of inhouse lawyers to defend insureds has not come without criticism.[7] Specifically, some have argued that inhouse defenders encounter a unique and powerful set of ethical pressures.[8] Further, it has been suggested that inhouse attorneys are particularly prone to yield to those pressures.[9]

This Note discusses some of the issues surrounding the use of inhouse lawyers to defend insureds. First, the benefits of these arrangements will be canvassed. Second, the potential costs will be explored, with a particular focus on ethical issues. Finally, some conclusions will be offered.

II. BENEFITS: "SKILL, DEXTERITY, AND JUDGMENT"

Adam Smith[10] observed that "[t]he greatest improvement in the productive powers of labour, and the greater part of the skill, dexterity, and judgment with which it is any where directed, or applied, seem to have been the effects of the division of labour."[11] The benefits of the "division of labour" occur in "every . . . art and manufacture,"[12] from the "trifling" work of pin-makers[13] to the presumably less trifling work of "philosophers and men of speculation":

> In the progress of society, philosophy or speculation becomes, like every other employment, the principal or sole trade and occupation of a particular class of citizens. Like every other employment too, it is subdivided into a great number of different branches, each of which affords occupation to a peculiar tribe or class of philosophers; and the subdivision of employment in philosophy, as well as in every other business, improves dexterity, and

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7. John F. Larkin, *Ethical Considerations for Attorneys Acting as Insurance Defense Counsel*, *in* 12TH ANNUAL INSURANCE, EXCESS AND REINSURANCE COVERAGE DISPUTES, at 381, 417-18 (PLI Litig. & Admin. Practice Course Handbook Series No. 518, 1995).

8. *See* Grace M. Giesel, *The Ethics or Employment Dilemma of In-House Counsel*, 5 GEO. J. LEGAL ETHICS 535, 536 (1992).

9. Larkin, *supra* note 7, at 418 (noting that critics have raised questions about the loyalty of staff attorneys).

10. Adam Smith (1723-90) was a Scottish philosopher. *See* George J. Stigler, *Preface, 1976* to ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS at xiii, xiv (Edwin Cannon ed., 1976) (1776). Smith's ideas are said to have led to the growth of modern capitalism. E.D. HIRSH, JR. ET AL., THE DICTIONARY OF CULTURAL LITERACY 454 (2d ed. 1993).

11. ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 7 (Edwin Cannon ed., 1976) (1776) (footnote omitted); *see also* Geoffrey C. Hazard, Jr., *"Practice" in Law and Other Professions*, 39 ARIZ. L. REV. 387, 390 (1997) (describing Smith's theory of specialization as "axiomatic").

12. SMITH, *supra* note 11, at 9.

13. *Id.* at 8-9.

> saves time. Each individual becomes more expert in his own peculiar branch, more work is done upon the whole, and the quantity of science is considerably increased by it.[14]

Smith's observations about "philosophers and men of speculation" are equally applicable to lawyers.[15] Accordingly, insurers—as professional defenders of lawsuits—take advantage of specialization by lawyers.[16] By maintaining their own legal departments, insurers reap the benefits of specialization on more than one front; the inhouse litigator becomes a cognoscente of insurance law that is intimately familiar with the particular workings of one insurer's business.[17] Additionally, the use of inhouse litigators cuts out the

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14. *Id.* at 14. *But see* FRIEDRICH NIETZSCHE, BEYOND GOOD AND EVIL 131 (R.J. Hollingdale trans., Penguin Books 1990) (1973). Nietzsche states:

> The compas and tower-building of the sciences has grown enormous, and therewith the probability . . . that the philosopher will become weary while still no more than a learner, or that he will let himself be stopped somewhere and "specialize": so that he will never reach his proper height, the height from which he can survey, look around and *look down.*

Id.

15. *See, e.g.*, Duggins II v. Guardianship of Washington, 632 So. 2d 420, 426 (Miss. 1994) (observing that ours is an "age of specialization of attorneys"); Christopher T. Cunniffe, *The Case for the Alternative Third-Year Program*, 61 ALB. L. REV. 85, 106 (1997) ("If true generalist lawyers ever did dominate the legal profession, it is clear that they are fast becoming 'a vanishing species.'") (quoting MARY ANN GLENDON, A NATION UNDER LAWYERS 29 (1994)); Hazard, *supra* note 11, at 396 ("Specialization of knowledge and technique has so many benefits for society as a whole that it is an irreversible process, at least short of an atomic or astrophysical catastrophe that returns us all to being cavepeople."); Diane P. Wood, *Generalist Judges in a Specialized World*, 50 SMU L. REV. 1755, 1766 (1997) (observing that specialization can enhance efficiency).

16. Crawford, *supra* note 5, at 40; Mallen, *supra* note 5, at 518. As Larkin observes:

> The most obvious benefit to [the use of inhouse counsel by insurers] is the significant savings to be had. Insurers cite several other reasons to justify their actions:
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> (1) The use of salaried counsel promotes [a more] efficient claims handling process because insurers can train counsel in specific coverage lines;
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> (2) Specialized expertise enhances the quality of the representation the insured will receive; and
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> (3) There are beneficial economic returns of scale that come from repeated handling of similar claims.

Larkin, *supra* note 7, at 416-17.

17. For example, an inhouse attorney would presumably become familiar with the underwriting procedures of the insurer, and thus, have a natural advantage in litigating misrepresentation issues. *See, e.g.*, Keefe v. John Hancock Prop. & Cas. Ins. Co., No. 9429, 1997 WL 733843, at *2 (Mass. App. Div. Nov. 17, 1997) ("A 'material' misrepresentation is one which would naturally influence the judgment of an underwriter in making the contract at all, or in estimating the degree and character of the risk, or in fixing the rate of the premium.")

middleman—the outside law firm—and thus, enhances the insurer's savings.[18] Accordingly, it may be safe to predict that "[s]taff counsel operations are not a mere economic fad, but a permanent reality."[19]

III. DRAWBACKS

A. *Overview: The Costs of Lunch*

Paul Carrington correctly observed that, in all human affairs, "there is no free lunch."[20] Accordingly, substantial costs may be associated with the use of inhouse lawyers to defend insureds.[21] For example, the opinion has been expressed that salaried counsel are not "as capable or as dedicated as outside counsel."[22] These allegations are apparently based on the assumption that corporate counsel are not paid as well as lawyers in private firms.[23]

Regardless of their basis, these ad hominem allegations are patently questionable. Assuming arguendo that private-practice attorneys are paid more than their inhouse counterparts,[24] that assumption does not require the conclusion that inhouse counsel are inferior. Certainly it is plausible that, *ceritus paribus*,[25] the better-qualified lawyers will be found in the higher-

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(quoting Employers' Liab. Assurance Corp. v. Vella, 321 N.E.2d 910, 913 (Mass. 1975)) (internal quotations omitted); Feldman v. Friedman, 661 N.Y.S.2d 9, 10 (App. Div. 1997) ("A court, in finding a material misrepresentation as a matter of law, generally relies upon two categories of evidence, an affidavit from the insurer's underwriter and the insurer's underwriting manual."). Similarly, the inhouse counsel would have an advantage in defending charges of postclaims underwriting. *See, e.g.*, Gulf Guar. Life Ins. Co. v. Duett, 671 So. 2d 1305, 1310 (Miss. 1996) (stating that postclaims underwriting is "an act of bad faith which warrants imposition of punitive damages, the amount of which is within the province of the jury to determine").

18. Mallen, *supra* note 5, at 518; *see also* Stevens, *supra* note 4, at B9 (discussing the conflicts between insurers and law firms over rates); *see also* Kristi Vaughn, *Insurers Overbilled in Massive Scam*, INS. REV., July 1, 1990, at 10 ("The alleged scam was made possible by a state law that requires insurers in certain situations to pay for a policyholders' [sic] legal defense, yet allows the policyholder to choose the lawyer.").

19. Mallen, *supra* note 5, at 519.

20. Paul D. Carrington, *ADR and Future Adjudication: A Primer on Dispute Resolution*, 15 REV. LITIG. 485, 486 (1996).

21. *See* Mallen, *supra* note 5, at 518 ("Not everyone perceives the development of staff counsel operations to be beneficial.").

22. *Id.* at 522.

23. *Id.*

24. *See* Bradford W. Hildebrandt, *Inside and Outside Counsel*, N.Y. L.J., Apr. 9, 1991, at 4 ("Law departments generally have lower hourly rates than law firms, chiefly because they pay their lawyers less, particularly at senior levels.").

25. *Ceritus paribus* means "other things constant." JAMES D. GWARTNEY ET AL., ESSENTIALS OF ECONOMICS 12 (1982). As Gwarntney and his colleagues point out,

paying jobs,[26] which law firms offer. The dynamics of the legal market, however, demonstrate the limitations of *ceritus paribus*:

> [T]he pool of highly qualified, talented attorneys seeking in-house positions has increased substantially. Many of the best and brightest attorneys have become disillusioned with private practice and see the in-house legal department as a place where they can enjoy an improved lifestyle and various opportunities for career growth and involve themselves in wide-ranging, cutting-edge legal issues while gaining exposure to non-legal business issues.[27]

Thus, it is incorrect to assume that law firms necessarily have better attorneys. Further, the skill with which inside lawyers serve their employer—the insurance company—may surpass that displayed by outside lawyers.[28] Therefore, allegations regarding the talent and skill of inhouse attorneys should be disregarded.

A second group of concerns may, however, carry greater validity. These concerns focus on the special ethical *positions* in which the inhouse defender of insureds may be found.[29] These positional concerns can be divided into two categories. First, there are ethical issues that are apparently endemic to the use of inhouse counsel by insurers to defend insureds.[30] Second, there are issues that appear to arise more from the particular way in which such practices are conducted.[31] These two categories will be discussed in turn.

"Unfortunately for the economic researcher, we live in a dynamic world" where "[o]ther things seldom remain constant." *Id.*

26. Smith argues that "[e]qual quantities of labour . . . may be said to be of equal value to the laborer." SMITH, *supra* note 11, at 37 (footnote omitted). In a given day's work, "he must always lay down the same portion of his ease, his liberty, and his happiness" regardless of what he is paid. *Id.* So, "[f]rom a regard to his own interest," the worker seeks to exchange "his ease, his liberty, and his happiness" for the maximum pay available. *Id.* at 18, 37. Conversely, an employer, acting "[f]rom a regard to his own interest," would be expected to exchange the best pay for the labor of the best candidate. Thus, those candidates that are most qualified can be expected to seek out the highest-paying jobs and to be selected over their less-qualified competitors.

27. Vivki Abeles & Peter Goldfeder, *Corporate Counsel Are Gaining Responsibility*, N.Y. L.J., Mar. 4, 1991, at 49.

28. *See supra* Part II.

29. *But see* Leo J. Jordan & Hilde E. Kahn, *Ethical Issues Relating to Staff Counsel Representation of Insureds*, 30 TORT & INS. L.J. 25, 34 (1994) ("The use of staff counsel to represent insureds presents no unique ethical problems.").

30. *See infra* Part III.B.

31. *See infra* Part III.C.

B. *Arguably Endemic Ethical Problems*

1. *Aiding the Unauthorized Practice of Law by a Nonlawyer*

Two related ethical problems have been argued to be endemic to the use of inhouse attorneys to defend insureds.[32] Both arise from the unusual circumstances under which such an attorney practices his profession: He is an employee of a corporation that is not a law firm, and yet he represents clients other than his employer.

The first contention is that the inhouse attorneys are aiding a nonlawyer—the insurer—in the practice of law. Aiding the unauthorized practice of law is verboten by both the Model Code of Professional Responsibility (Model Code)[33] and the Model Rules of Professional Conduct (Model Rules).[34] In spite of that, the definition of "the practice of law" is neither set out by the ethical codes[35] nor uniform from jurisdiction to jurisdiction.[36] Most jurisdictions have rejected the contention that the use of salaried lawyers to defend insureds amounts to the unauthorized practice of law.[37] At least one state has, however, taken a contrary position.[38] In *Gardner v. North Carolina State Bar*,[39] the Supreme Court of North Carolina held that "a licensed attorney who is a full-time employee of an insurance company [may not] ethically represent one of the company's insureds as counsel of

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32. Of course, this discussion does not presume to provide an exhaustive coverage of all possible ethical issues.

33. MODEL CODE OF PROFESSIONAL RESPONSIBILITY Canon 3 (1980) ("A lawyer should assist in preventing the unauthorized practice of law."). This principle is codified in negative form: "A lawyer shall not aid a non-lawyer in the unauthorized practice of law." *Id.* at DR 3-101(A). Some moderately helpful guidance is added in the Ethical Considerations. *See id.* at EC 3-1 to EC 3-9.

34. MODEL RULES OF PROFESSIONAL CONDUCT Rule 5.5(b) (1995) ("A lawyer shall not: . . . assist a person who is not a member of the bar in the performance of activity that constitutes the unauthorized practice of law.").

35. *See* MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 3-5 ("It is neither necessary nor desirable to attempt the formulation of a single, specific definition of what constitutes the practice of law.").

36. MODEL RULES OF PROFESSIONAL CONDUCT Rule 5.5 cmt.

37. *See* Mallen, *supra* note 5, at 519 & n.5 (collecting cases); Jordan & Kahn, *supra* note 29, at 27 & n.8 (collecting cases).

38. Mallen, *supra* note 5, at 519-20; *see also* Feliberty v. Damon, 527 N.E.2d 261, 265 (N.Y. 1988) (stating that, because of rules regarding the unlicensed practice of law, "the insurer necessarily must rely on independent counsel to conduct the litigation").

39. Gardner v. North Carolina State Bar, 341 S.E.2d 517 (N.C. 1986).

record . . . ."[40] In support of its holding, the North Carolina court distinguished the views of other states on the basis of statutory differences.[41] Thus, while the majority rule can be stated comfortably, it must be accompanied with a caveat: Local statutes may hold hidden landmines.[42]

2. *Fee Splitting*

A second contention is that inhouse defenders of insureds split fees with nonlawyers. In other words, the insurance company—a nonlawyer—divides the premium paid by the insured with the lawyer when it pays the lawyer's salary. Both the Model Code[43] and Model Rules[44] prohibit the splitting of legal fees between a lawyer and a nonlawyer. As the Model Code explains, "[because] a lawyer should not aid or encourage a layman to practice law, [a lawyer] should not practice law in association with a layman or otherwise share legal fees with a layman."[45] The Model Rules provide a different rationale for the "traditional limitations" on sharing fees: "These limitations are to protect the lawyer's professional independence of judgment."[46]

According to one observer, "The case law [on fee splitting] allows a corporation to obtain reimbursement from a third party for legal services, but not beyond that cost."[47] Thus, an insurer could obtain "reimbursement" from an insured for legal services, but not beyond the cost of those legal services. Unfortunately, such a standard carries considerable ambiguity. First, is an insured's premium—which is often paid prospectively and may not be spent on defending the paying insured—a "reimbursement"?[48] Second, what is the "cost" of legal services if they are provided?[49] Does the "cost"

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40. *Id.* at 518. *See generally* William Kinsland Edwards, Note, *The Unauthorized Practice of Law by Corporations: North Carolina Holds the Line*, 65 N.C. L. REV. 1422 (1987) (discussing the *Gardner* decision).

41. Gardner v. North Carolina State Bar, 341 S.E.2d at 522.

42. An excellent—if somewhat dated—starting point for research is JUSTINE FISHER & DOROTHY H. LACHMANN, UNAUTHORIZED PRACTICE HANDBOOK (1972), which compiles statutes, cases, and commentary.

43. MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 3-5, EC 3-8, DR 3-102 (1980).

44. MODEL RULES OF PROFESSIONAL CONDUCT Rule 5.4(a) (1995) ("A lawyer or law firm shall not share legal fees with a nonlawyer . . . ."). Like DR 3-102 of the Model Code, Rule 5.4 provides some exceptions to the basic prohibition that are not relevant to this discussion. *Compare* MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 3-102, *with* MODEL RULES OF PROFESSIONAL CONDUCT Rule 5.4.

45. MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 3-8.

46. MODEL RULES OF PROFESSIONAL CONDUCT Rule 5.4 cmt.

47. Mallen, *supra* note 5, at 521.

48. *Cf.* Donald Arthur Winslow, *A Note on Retrospectively Rated Insurance and Federal Income Taxation*, 79 KY. L.J. 195, 195 (1990) ("When contracting for a typical insurance policy, the insured normally knows the amount that must be paid to the insurance company regardless of the amount of the losses experienced under the policy.").

49. *See generally* CHARLES T. HORNGREN & GEORGE FOSTER, COST ACCOUNTING: A MANAGERIAL EMPHASIS (7th ed. 1991) (exploring the complexities of the concept of cost).

include only the attorneys' salaries, or should the liquid in the legal department's photocopier be considered as well?[50] May a portion of the insurer's indirect costs—such as the electric bill—be included in the "cost" of defense?[51] May an insurer include some measure of *profit* in the "cost" of an insured's defense?[52] In short, an entire article—in a law review or perhaps an accounting journal—could be devoted to the issue of what constitutes fee splitting between an insurer and its attorneys. This Note, however, can only introduce the issue.

C. *Other Ethical Issues Regarding Use of Inhouse Counsel by Insurer*

In addition to the ethical problems introduced above, a second group of issues may arise. These problems appear to depend less on the inherent nature of the attorney's position as both employee of the insurer and defender of insureds. Instead, the significance of these problems will depend on the particularities of the employment and representation.

One assumption of this Note is that these ethical problems arise in part from the confusion as to the proper objects of the attorney's duties. Restated, one important issue is: Who are the attorney's clients? Before addressing that question, however, it may be useful to review the rules and circumstances that make the identity of "clients" so important.

1. *The Attorney-Client Relationship: The Essential Duties*

The lawyer's first duty is to his client.[53] Some have suggested that his *only* duty is to his client: As Lord Brougham stated in his oft-quoted[54] speech:

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50. *See id.* at 456 (providing the paper and liquids used in the photocopier as an example of a direct cost of a law firm's photocopying area); *see also* Hildebrandt, *supra* note 24, at 4 ("The hourly rate for inside and outside counsel depends on most of the same types of costs. These include time worked; lawyer and staff compensation and benefits; and overhead items such as space, computers, office supplies, and library resources.").

51. *See* HORNGREN & FOSTER, *supra* note 49, at 456 (providing the electricity used to run the photocopiers as an example of an indirect cost of a law firm's photocopying area).

52. *See supra* notes 1-3 and accompanying text.

53. *See, e.g.*, MODEL RULES OF PROFESSIONAL CONDUCT preamble (1995) ("*A lawyer is a representative of clients*, an officer of the legal system and a public citizen having special responsibility for the quality of justice.") (emphasis added).

54. For examples of legal scholars that have quoted Lord Brougham, see Teresa Stanton Collett, *The Promise and Peril of Multiple Representation*, 16 REV. LITIG. 567, 570 (1997); Nathan M. Crystal, *Limitations on Zealous Representation in an Adversarial System*, 32 WAKE FOREST L. REV. 671, 711 (1997); Thomas Ross, *Knowing No Other Duty: Privity, the Myth of Elitism, and the Transformation of the Legal Profession*, 32 WAKE FOREST L. REV. 819, 831 (1997); Irma S. Russell, *Cries and Whispers: Environmental Hazards, Model Rule 1.6, and the Attorney's Conflicting Duties to Clients and Others*, 72 WASH. L. REV. 409, 450 (1997).

> [A]n advocate, in the discharge of his duty, knows but one person in all the world, and that person is his client. To save that client by all means and expedients, and at all hazards and costs to other persons, and, amongst them, to himself, is his first and only duty; and in performing this duty he must not regard the alarm, the torments, the destruction which he may bring upon others. Separating the duty of a patriot from that of an advocate, he must go on reckless of consequences, though it should be his unhappy fate to involve his country in confusion.[55]

Lord Brougham presents a poetic, yet shocking view of the attorney's role: It approaches a religious devotion to the client.[56] Thankfully, perhaps, we find that the more rococo[57] rules of today do not appear to require the single-minded devotion that Lord Brougham describes.[58] Nonetheless, both the Model Code and the Model Rules demand that an advocate serve as a

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55. *See* Crystal, *supra* note 54, at 711 (quoting Lord Bougham) (internal quotations omitted). Professor Underwood has noted that "[t]his famous passage, 'wrenched out of its context,' is often cited in justification of the most extreme conduct by counsel." Richard H. Underwood, *Perjury: An Anthology*, 13 ARIZ. J. INT'L & COMP. L. 307, 326 (1996) (citing DAVID MELLINKOFF, THE CONSCIENCE OF A LAWYER (1973); RICHARD H. UNDERWOOD & WILLIAM FORTUNE, TRIAL ETHICS 54-55 (1988 & Supp. 1993)).

56. *Cf.* Genesis 22:1-2 (recounting God's command to Abraham to kill Isaac, Abraham's son).

57. *See* NIETZSCHE, *supra* note 14, at 80 (comparing the New Testament, "a species of rococo taste in every respect," with the Old Testament, "the book of divine justice").

58. *See, e.g.*, MODEL RULES OF PROFESSIONAL CONDUCT preamble ("While it is a lawyer's duty, when necessary, to challenge the rectitude of official action, it is also a lawyer's duty to uphold legal process."); MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 7-10 (1980) ("The duty of a lawyer to represent his client with zeal does not militate against his concurrent obligation to treat with consideration all persons involved in the legal process and to avoid the infliction of needless harm.").

As Gerald Uelman observed, "Today, there are many who argue that Lord Brougham was guilty of overstating the case." Gerald Uelman, *Lord Brougham's Bromide: Good Lawyers as Bad Citizens*, 30 LOY. L.A. L. REV. 119, 121 (1996). Uelman notes:

> Clearly, a lawyer has duties to others as well. A lawyer's duties to the court preclude the knowing presentation of perjured testimony and the intentional nondisclosure of controlling authority rejecting a legal position one is arguing. A California lawyer also has substantial duties imposed by the reciprocal discovery law to provide opposing counsel with evidence in advance of its presentation at trial.

Id. (citations omitted); *accord* State v. Whiteside, 272 N.W.2d 468, 470 (Iowa 1978). *But see* Uelman, *supra*, at 122 ("By being a good lawyer who zealously represents the interests of a client, the lawyer is being a good citizen who preserves the tenets of our adversary system of justice.").

loyal and able champion to the client.[59] For example, the lawyer must provide competent representation to a client.[60] Competent representation requires not only sheer ability, but also thorough treatment and ample preparation.[61] Also, the attorney must hold secret the confidences of his clients, even if revelation would benefit the attorney, another client, or a third party.[62] Additionally, the attorney is obliged to inform and advise each of his clients.[63] Further, the duty of loyalty requires the lawyer to serve his clients with independent judgment:[64] The attorney's zeal must not be compromised by obligations to third parties,[65] other clients,[66] or himself.[67]

2. *The Inhouse Attorney's Kampf*

The ethical problems of the insurance defense lawyer are often described in tripartite[68] or triangular terms.[69] There is, indeed, a bizarre love

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59. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.1; MODEL CODE OF PROFESSIONAL RESPONSIBILITY Canon 6.

60. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.1; MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 6-2, EC 6-5, DR 6-101.

61. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.1; MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 6-3.

62. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6; MODEL CODE OF PROFESSIONAL RESPONSIBILITY Canon 4, DR 4-101, EC 4-5.

63. MODEL RULES OF PROFESSIONAL CONDUCT preamble, Rule 1.2, 1.4, 2.1; MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 7-7, EC 7-8.

64. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.7; MODEL CODE OF PROFESSIONAL RESPONSIBILITY Canon 5.

65. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.7, 1.8 cmt. 4; MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 5-105, DR 5-107, EC 5-1, EC 5-17, EC 5-21 to 5-24.

66. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.7 & cmt. 4; MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 5-105, EC 5-1, EC 5-17, EC 5-19.

67. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.7 & cmt. 6; MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 5-1 to 5-8.

68. *See, e.g.*, Jill B. Berkeley, *Tripartite Ethics: Confidential Communications Among the Insured, the Insurer, and Defense Counsel*, BRIEF, Spring 1997, at 22 (discussing the possibility for conflicts of interest involving the defense lawyer, insured client, and the insurer); John H. Mathias, Jr., et al., *Tripartite Relationships and Reservation of Rights Letters: The Need for Independent Counsel*, *in* INSURANCE COVERAGE LITIGATION 1994, at 253, 253 (PLI Litig. & Admin. Practice Course Handbook Series No. 516, 1994) ("An uneasy alliance exists when insurance defense counsel is called on to serve two masters, the insurer and the policy holder, despite their often competing interests."); Irene A. Sullivan & Lloyd M. Eisenberg, *Identifying and Resolving Conflicts in the Tripartite Relationship*, *in* INSURANCE COVERAGE LITIGATION, at 281, 283-86 (PLI Litig. & Admin. Practice Course Handbook Series No. 516, 1994) (discussing the potential conflicts within the "tripartite relationship between insurer, insured, and defense counsel"); *see also* Nancy J. Moore, *Ethical Issues in Third-Party Payment: Beyond the Insurance Defense Paradigm*, 16 REV. LITIG. 585, 586 (1997) ("There are

triangle[70] between the insurer, the attorney, and the insured. In many cases, the interests of the three will be congruent.[71] For example, in the garden-variety automobile accident case, all three will be focused on avoiding a judgment of negligence against the insured.[72] In some cases, however, the interests of the three may diverge. As the once clear objectives of representation become questionable, the defense attorney may be placed in an ethical quandary. Specifically, the attorney may feel pressure to compromise one or more of his ethical duties.

a. *The Duty to Provide Competent Representation.* As mentioned above, competent representation requires not only sheer ability, but also thorough treatment and ample preparation.[73] Although some have questioned the ability of inhouse counsel as a class,[74] under the correct conditions, an inhouse attorney may demonstrate greater skill than his private practice counterparts.[75] Instead, legitimate concerns about competent representation

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numerous decisions and scholarly articles attempting to delineate the rights and responsibilities involved in the so-called 'tripartite relationship' between the insurer, the insured, and the lawyer retained by the insurer to defend an action brought against the insured.").

69. *See, e.g.*, Robert E. O'Malley, *Ethics Principles for the Insurer, the Insured, and Defense Counsel: The Eternal Triangle Reformed*, 66 TUL. L. REV. 511, 511-12 (1991) (arguing that the insured should be deemed the defense attorney's only client in every case); Douglas R. Richmond, *Lost in the Eternal Triangle of Insurance Defense Ethics*, 9 GEO. J. LEGAL ETHICS 475, 475 (1996) (comparing the "'eternal triangle' of insurance defense" with the Atlantic Ocean's Bermuda Triangle).

70. This phrase is respectfully borrowed from NEW ORDER, *Bizarre Love Triangle*, *on* BROTHERHOOD (WEA/Warner Brothers 1986).

71. *See, e.g*, Jordan & Kahn, *supra* note 29, at 32 ("An insurance company's defense of an insured while it reserves the right to sue to dispute coverage does not in itself create a conflict of interest."); Jeffrey P. Donohue, Note, *Developing Issues Under the Massachusetts 'Physician Profile' Act*, 23 AM. J.L. & MED. 115, 147 & n.324 (1997) ("In most situations, an insurer and its insured 'have the same or at least compatible interests in regard to the possible responses to . . . claim.'") (citing ROBERT E. KEETON & ALAN I. WIDISS, INSURANCE LAW: A GUIDE TO FUNDAMENTAL PRINCIPLES, LEGAL DOCTRINES, AND COMMERCIAL PRACTICES § 7.6(a)(1), at 808 (1988)).

72. *See* Larkin, *supra* note 7, at 387 ("Initially, there is no theoretical problem for defense counsel with the insurer's dominant role in formulating defense strategy. Both insurer and insured are united in their desire to escape liability for the alleged injury under the third-party claim.").

73. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.1 (1995); MODEL CODE OF PROFESSIONAL RESPONSIBILITY Canon 6, EC 6-1 to 6-3 (1980).

74. *See* Mallen, *supra* note 5, at 518.

75. *See supra* Part II. It should be noted, however, that specialization itself may raise the standard of required competence. *See* Charlotte Moses Fischman & Jeffrey Davis, *The Lawyer as Civil Defendant: Recent Developments in the Law of Legal Malpractice*, *in* LEGAL ETHICS 1990: WHAT EVERY LAWYER NEEDS TO KNOW, at 609, 617 (PLI Litig. & Admin. Practice Course Handbook Series No. 403, 1990) ("The modern trend is to require an attorney who accepts work

are raised by the requirements of thorough treatment and ample preparation.[76] The case of *Kooyman v. Farm Bureau Mutual Insurance Co.*[77] illustrates one context in which such problems may arise. In *Kooyman*, the insured passed a line of cars stopped behind a school bus, which had its warning lights blinking, and struck a child.[78] The injured child was left a paraplegic.[79] Farm Bureau appointed attorneys to defend the insured.[80] Estimates of the jury's verdict ranged from $500,000 to $1,200,000.[81] In felicitous understatement, Justice Larson wrote that "[t]he potential for a very large verdict was apparent."[82] Under the policy, however, the insurer's duty to indemnify was limited to $25,000.[83] Thus, the liability limits were "gone."[84] From the insurer's point of view, each additional dollar spent on the insured's defense was wasted: The *insurer* had no hope of decreasing *its* short-term liability.[85]

Unfortunately, the attorneys whom Farm Bureau had hired to defend the insured pursued the insurer's short-term interests: First, although the attorneys attended depositions arranged by other attorneys, they made no arrangements for their own.[86] Second, "[w]hen requested . . . to contribute to the deposition of a urologist, [the] attorneys refused . . . despite the fact the urologist's testimony was critical on the issue of prognosis."[87] Third, when the other defendants settled during trial, Farm Bureau's attorney moved for a continuance and a mistrial.[88] As the court noted, "a jury could infer that Farm Bureau had been relying upon the lawyers for the other defendants and that the delay was requested in order for its attorneys' preparation to handle the laboring oar suddenly handed to them."[89] Further, a lack of preparation was evidenced when the attorneys "apparently not having adequately interviewed two of its witnesses in advance, inadvertently elicited very damaging testimony from them at trial."[90]

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in a 'specialized' area (e.g., securities, tax, real estate, etc.) to possess the skill and knowledge of attorneys who practice in that area.").

76. *See supra* notes 63-64.

77. Kooyman v. Farm Bureau Mut. Ins. Co., 315 N.W.2d 30 (Iowa 1982).

78. *Id.* at 34.

79. *Id.*

80. *See id.* at 33-34.

81. *Id.* at 34.

82. *Id.* It should be noted, however, that the school and the bus driver were defendants as well. *Id.* at 32. Still, even their combined liability did not match that of the insured. *Id.*

83. *Id.* at 34.

84. *Id.*

85. *Id.*

86. *Id.* at 35.

87. *Id.*

88. *Id.*

89. *Id.*

90. *Id.*

Kooyman was a bad faith action against the insurer; the court did not specifically address the ethical failures of the attorneys.[91] Nevertheless, *Kooyman* remains a telling example of the pressures an inhouse attorney can face. Simply put, when "thorough treatment and ample preparation" of a case cannot decrease the insurer's short-term liability,[92] it may appear to the inhouse attorney—and those to whom he reports—that competent representation is no longer an efficient use of the insurer's resources.[93]

b. *The Duty to Advise.* Sir Francis Bacon is credited with the now-cliched observation that knowledge is power.[94] Attorneys are expected to share the power of knowledge by informing the client "promptly whenever he has any information to give which it is important the client should receive."[95] Despite this requirement, an insurer may exert pressure on the attorney to *withhold* important information from the insured. Thus, the situation will be ripe for conflict. For example, if a settlement offer near policy limits is communicated to the attorney, the insurer may have an interest in burying it.[96] If the insured learns of the offer, he or she will have an incentive to invoke the insurer's duty to settle the case.[97] Thus, the attorney's

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91. *See id.*

92. *But see id.*

93. *See* David B. Wilkins & G. Mitu Gulati, *Why Are There So Few Black Lawyers in Corporate Law Firms? An Institutional Analysis*, 84 CAL. L. REV. 493, 580 (1996) ("Litigation is a very costly way for corporations to resolve their problems. Not surprisingly, corporate general counsel look for ways to reduce these expenses.").

94. *See* HIRSH ET AL., *supra* note 10, at 52 (attributing the phrase "knowledge is power" to Sir Francis Bacon); Scott D. Gilbert & Eric Dodson Greenberg, *Information Sharing Between Policyholders and Insurers: Pitfalls and Protections*, *in* LITIGATING THE COVERAGE CLAIM II: PRETRIAL PROCEDURES AND STRATEGIES FOR INSURERS, INSUREDS, AND THEIR COUNSEL 1, 3 (Tort & Ins. Practice Section ABA 1993) (describing the observation that knowledge is power as "now-cliched").

95. Baker v. Humphrey, 101 U.S. 494, 500 (1879); *see also* Mann v. Mann, 273 N.E.2d 40, 45 (Ill. App. Ct. 1971); Rice v. Perl, 320 N.W.2d 407, 410 (Minn. 1982); Penelope Potter Palumbo, Note, *Balancing Competing Discovery Interests in the Context of the Attorney-Client Relationship: A Trilemma*, 56 S. CAL. L. REV. 1115, 1129 (1983).

96. William T. Barker succinctly describes this problem:

> The insurer's control of settlement within limits creates a possibility of abuse when the insured has exposure beyond the limits. Faced with a settlement opportunity at or near the limits, the insurer may have little or nothing to lose by taking the case to trial and hoping for a defense verdict or a lower damage award. The risk in such cases lies almost entirely on the insured or excess insurer, which must pay any above limits judgment. In short, the insurer may have the opportunity to take a gamble in which any winnings belong to it and any losses fall exclusively or primarily on others.

William T. Barker, *Combining Insurance and Self Insurance: Issues for Handling Claims*, 61 DEF. COUNS. J. 352, 357-58 (1994).

97. *See generally* Seth J. Chandler, *Reconsidering the Duty to Settle*, 42 DRAKE L. REV. 741 (1993) (discussing the insurer's duty to settle in terms of discrete game theory).

position is not unlike that of the victim of a "fork":[98] He must choose which interest to protect, and which to disregard.

c. *The Duty of Confidentiality.* A lawyer's interest in communicating information to the insurer may arise from a variety of sources. First, as described above, if the insurer is a client, then the attorney is duty-bound to inform the insurer "promptly whenever he has any information to give which it is important the client should receive."[99] Second, even in the absence of an attorney-client relationship, principles of agency may require disclosure of important information to the employer-insurer.[100] Third, even an outside attorney may wish to protect his relationship with the insurer; consequently, he may feel inclined to disclose helpful information to the insurer.[101]

Regardless of its source, an impetus to disclose may conflict with the attorney's duty of confidentiality[102] to the insured. The risk of conflict is particularly acute in situations where coverage is at issue.[103] For example, in *Parsons v. Continental National American Group*,[104] a fourteen-year-old boy named Michael brutally assaulted three female neighbors.[105] Michael's parents were insured by Continental National American Group (CNA).[106] The policy with CNA had an exclusion for intentional acts.[107] CNA appointed counsel to defend Michael in a suit brought by the three victims.[108] CNA's defense was apparently predicated on the assumption that Michael was psychologically impaired and that the assault did not fall within the

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98. In chess, a "fork" is "an attack on two different pieces by the same man." WILLIAM R. HARTSTON, CHESS 40 (1985). In many cases, a fork leaves the victim with a choice of losses, such as losing either the King or the Rook. *See id.* at 40-41. If the King and Rook are forked, "the King must move, leaving the other piece to be captured." *Id.* at 41.

99. *See supra* note 95 and accompanying text.

100. *Cf. In re* Yagman, No. 91-O-03890, 1997 WL 817721, *5 (Cal. Bar Ct. Dec. 31, 1997) ("At common law a fiduciary owes his beneficiary a duty of full and frank disclosure of all relevant information relating to affairs of the relationship.").

101. *Compare* Giesel, *supra* note 8, at 536 (downplaying the economic importance of any single client to outside counsel), *with* Angus J. Goetz, Jr., *Conflicts: Insurance Company Defense of Third-Party Claims*, 74 MICH. B.J. 174, 174 (1995) (observing that both inhouse and outside counsel "may feel the need to curry favor with the insurer's management representatives").

102. *See* MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6 (1995); MODEL CODE OF PROFESSIONAL RESPONSIBILITY Canon 4, DR 4-101, EC 4-5 (1980).

103. *Cf.* Jordan & Kahn, *supra* note 29, at 30 ("When an insurance company employs staff counsel to defend insureds in cases in which (1) there is no question of coverage and (2) the claim is within the insured's policy limits, it is highly unlikely that the interests of the insurance company and the insured will diverge.").

104. Parsons v. Continental Nat'l Am. Group, 550 P.2d 94 (Ariz. 1976).

105. *Id.* at 95.

106. *Id.* at 96.

107. *Id.* at 97.

108. *Id.* at 96.

intentional acts exclusion.[109] During the investigation, the appointed lawyer obtained confidential information regarding the Michael's psychological state.[110] That information suggested that Michael was "fully aware of his acts and that he knew what he was doing was wrong."[111] The appointed attorney revealed this information to CNA.[112] CNA then sent a letter to Michael's parents, informing them that CNA would continue the defense while reserving its rights to deny coverage at a later date.[113] The letter also stated that the attack might be found to be an intentional act, and that the policy specifically excludes liability for bodily injury caused by an intentional act.[114]

Following trial, judgment was entered against Michael for $50,000.[115] The victims then garnished CNA, but CNA successfully resisted on the basis of the intentional acts exclusion.[116] On appeal, the victims argued that CNA had waived the intentional acts exclusion by taking advantage of the fiduciary relationship between the attorney and the boy.[117] The Arizona Supreme Court agreed.[118] Most of the court's opinion, however, was devoted to the unethical behavior of the attorney whom CNA had appointed. As the court pointed out, "'The standards of the legal profession require undeviating fidelity of the lawyer to his client.'"[119] And, "[w]here an attorney is representing the insured in a personal injury suit, and, at the same time advising the insurer on the question of liability under the policy it is difficult to see how that attorney could give individual loyalty to the insured-client."[120] Thus, the Arizona court stated that "[t]he attorney in the instant case should have notified CNA that he could no longer represent them when he obtained any information (as a result of his attorney-client relationship with Michael) that could possibly be detrimental to Michael's interests under the coverage of the policy."[121]

d. *The Duty of Independence.* It appears that failures to fulfill the duties of candor, confidentiality, and competence are often symptoms of an underlying disease; namely, conflicts of interest.[122] It is important to note,

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109. *Id.*
110. *Id.*
111. *Id.*
112. *Id.*
113. *Id.*
114. *Id.*
115. *Id.* at 97.
116. *Id.*
117. *Id.* The victims also argued that CNA should be estopped from denying coverage. *Id.*
118. *Id.*
119. *Id.* at 98 (quoting Van Dyke v. White, 349 P.2d 430, 437 (Wash. 1960)).
120. *Id.*
121. *Id.*
122. See *supra* Part III.C.2.a for a discussion of the possible conflict between the insurer's desire to save costs of litigation and the attorney's duty to provide competent defense to the insured; see *supra* Part III.C.2.b for a discussion of the possible conflict between the insurer's desire to not pay near-limits settlements and the attorney's duty to advise the insured

however, that the manifestation of such symptoms is not necessary for a diagnosis of the disease. Attorneys may be prohibited from representing conflicting interests *even when the overt symptoms described above have not yet manifested.*[123] Therefore, it may be fruitful to look toward some of the causes of conflict.

It must be remembered that, in the usual case, the interests of the insured and the insurer are substantially common.[124] Thus, no conflict of interest is presented. Nonetheless, a number of situations may give rise to differing interests between the insurer and the insured.[125] Thus, as his clients enter the realm of conflicting interests, the attorney may follow. The number and complexity of the possible conflicts between the insurer and insured are too great to allow an exhaustive exploration here.[126] Several recurrent manifestations of conflict do, however, merit discussion here.[127]

i. *Defense Under a Reservation of Rights.* Most liability policies include two separate but related duties: the duty to defend and the duty to indemnify.[128] The duty to indemnify is triggered by the establishment of

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of settlement offers; see *supra* Part III.C.2.c for a discussion of the possible conflict between the insurer's desire to obtain information that would justify denial of coverage and the attorney's duty to maintain the insured's confidences.

123. *See* MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.7 (1995); *see also* MODEL CODE OF PROFESSIONAL RESPONSIBILITY Canon 5, DR 5-101, DR 5-105, EC 5-1, EC 5-2, EC 5-14 (1980).

124. Sharon K. Hall, Note, *Confusion Over Conflicts of Interest: Is There a Bright Line for Insurance Defense Counsel?*, 41 DRAKE L. REV. 731, 733 (1992) ("Because the interests of the insurer and insured may be harmonious, this dual representation is often beneficial.").

125. *See* Atlanta Int'l Ins. Co. v. Bell, 475 N.W.2d 294, 297 (Mich. 1991) (noting that "courts and commentators recognize universally that the tripartite relationship between insured, insurer, and defense counsel contains rife possibility of conflict"); Hall, *supra* note 124, at 733 ("Conflicts of interest are essentially built into dual representation.").

126. For example, the complex problems of subrogation will not be discussed here. *See, e.g.*, George W. Nowell, *Subrogation: Selected Bars, Waivers and Pitfalls*, 7 U.S.F. MAR. L.J. 421, 427 (1995) ("An insurer is subrogated to all of the rights and remedies of the insured upon payment.").

127. *See infra* notes 128-65 and accompanying text.

128. *See* APPLEMAN & APPLEMAN, *supra* note 1, § 4684, at 80; Douglas R. Richmond & Darren S. Black, *Expanding Liability Coverage: Insured Contracts and Additional Insureds*, 44 DRAKE L. REV. 781, 792 (1996) (citing State Farm Fire & Cas. Co. v. Richardson, 37 Cal. Rptr. 2d 824, 828-29 (Ct. App. 1995); Clinton v. Aetna Life & Sur. Co., 594 A.2d 1046, 1048 (Conn. Super. Ct. 1991); City of Idaho Falls v. Home Indem. Co., 888 P.2d 383, 387 (Idaho 1995); Vaughn v. Commonwealth Edison Co., 632 N.E.2d 44, 45 (Ill. App. Ct. 1994); A.Y. McDonald Indus. v. Insurance Co. of N. Am., 475 N.W.2d 607, 627 (Iowa 1991); Allied Mut. Ins. Co. v. State Farm Mut. Ins. Co., 502 N.W.2d 484, 487 (Neb. 1993); Nationwide Mut. Ins. Co. v. Tate, 438 S.E.2d 266, 268 (S.C. Ct. App. 1993); Weyerhauser v. Aetna Cas. & Sur. Co., 874 P.2d 142, 148 (Wash. 1994)).

liability within the scope of the policy's coverage.[129] The duty to defend is broader:[130] It is triggered by a complaint that alleges facts which, if established, would support liability.[131] Additionally, the duties of indemnity and defense differ in timing. The duty to defend may be triggered at the outset of a suit against an insured, while the duty to indemnify may not arise until settlement is reached or judgment is entered.[132] Thus, in some situations the duty to defend is triggered before the duty to indemnify is clear. If an insurer silently accepts the duty to defend, that acceptance is generally seen as an acknowledgment of coverage.[133] The insurer, however, may wish to accept the duty to defend at times when coverage is uncertain.[134] In those situations,

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129. APPLEMAN & APPLEMAN, *supra* note 1, § 4684, at 83.

130. Richmond & Black, *supra* note 128, at 792 (citing Haskel, Inc. v. Superior Court, 39 Cal. Rptr. 2d 520, 525 (Ct. App. 1995); Hecla Mining Co. v. New Hampshire Ins. Co., 811 P.2d 1083, 1089 (Colo. 1991); Irvine v. Prudential Prop. & Cas. Ins. Co., 630 So. 2d 579, 580 (Fla. Dist. Ct. App. 1993); Commerce & Indus. Ins. Co. v. Bank of Haw., 832 P.2d 733, 735 (Haw. 1992); Yount v. Maisano, 627 So. 2d 148, 153 (La. 1993); Auto Owners Ins. Co. v. City of Clare, 521 N.W.2d 480, 487 (Mich. 1994); Brown v. Lumbermens Mut. Cas. Co., 390 S.E.2d 150, 153 (N.C. 1990); Select Design, Ltd. v. Union Mut. Fire Ins. Co., 674 A.2d 798, 800 (Vt. 1996); Carstensen v. Chrisland Corp., 442 S.E.2d 660, 666 (Va. 1994)).

131. APPLEMAN & APPLEMAN, *supra* note 1, § 4684, at 71-72 ("[W]henever a complaint alleges facts which, if proven, would bring about liability under the policy, there is a duty to defend, even if liability would be impossible."); *see* Coulter v. Cigna Prop. & Cas. Co., 934 F. Supp. 1101, 1113 (N.D. Iowa 1996) (citing Yegge v. Integrity Mut. Ins. Co., 534 N.W.2d 100, 102 (Iowa 1995); Essex Ins. Co. v. Fieldhouse, Inc., 506 N.W.2d 772, 774 (Iowa 1993); Weber v. IMT Ins. Co. 462 N.W.2d 283, 285 (Iowa 1990); First Newton Nat'l Bank v. General Cas. Co., 426 N.W.2d 618, 623 (Iowa 1988); Kartidg Pak Co. v. Travelers Indem. Co. 425 N.W.2d 687, 688 (Iowa Ct. App. 1988)).

132. APPLEMAN & APPLEMAN, *supra* note 1, § 4684, at 85 ("The duty to defend is determined at the time suit is brought and not at the conclusion of litigation.").

133. *Id.* § 4692, at 297 ("[W]here an insurer accepts the defense of a case with knowledge of potential non-liability, without a reservation of rights, it becomes obligated to continue to defend and also waives its right to deny coverage."); *see also* Richmond & Black, *supra* note 128, at 815 ("Depending on the facts and circumstances, an insurer that defends without reserving its rights may later be estopped to deny coverage, or may be deemed to have waived its right to contest coverage.").

134. Kenneth S. Abraham, *The Natural History of the Insurer's Liability for Bad Faith*, 72 TEX. L. REV. 1295, 1307 (1994). Abraham explains that:

> In virtually all jurisdictions, an insurer subject to the duty to defend (including almost any primary automobile, commercial general liability, or malpractice liability insurer) must defend any claims against its insured alleging liability that potentially falls within the terms of coverage, even if the claim is groundless, false, or fraudulent. The question is not whether the claim against the insured is valid but whether the claim would be covered if it were valid. As the courts put it in seemingly endless repetition, the duty to defend is broader than the duty to indemnify. *To comply with the duty to defend without prejudicing their coverage defenses, insurers with such potential defenses typically defend their policyholders under a "reservation*

many states allow an insurer to defend under a reservation of rights.[135] As the name implies, a reservation of rights allows the insurer to defend while reserving its right to deny the duties of defense and coverage at a later time.[136]

At least one ethical problem may arise from an insurer's continuing ability to challenge coverage.[137] If the insured's attorney has allegiance to an insurer who is not intractably committed to coverage, the attorney may be

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> *of rights" that reserves to them the right to contest coverage at a later time if the suit against the policyholder they are defending is successful.*

Id. (emphasis added).

135. *But see* Abraham, *supra* note 134, at 1308 ("A reservation of rights issued without any reasonable basis would still trigger bad faith liability.").

Although the term "reservation of rights" is used here, it should be noted that three distinct options may exist: a reservation of rights letter, a nonwaiver agreement, or an action for declaratory judgment as to coverage. Each option may have the effect of allowing the insurer an opportunity to deny the duties of coverage and/or defense. APPLEMAN & APPLEMAN, *supra* note 1, § 4694, at 346. The insurer's choice among the three will depend upon issues of strategy and local law. *See* KENNETH S. ABRAHAM, INSURANCE LAW & REGULATION 581 (2d ed. 1995) ("In some jurisdictions the presentation of a unilateral Reservation of Rights is sufficient to avoid waiver or estoppel; in others, the insurer must obtain the insured's consent to continued representation, through a Non-Waiver Agreement, in order to achieve this protection."). In *Coulter v. Cignia Property & Casualty Co.*, the court observed that:

> If the totality of facts fail to disclose potential coverage, an insurer might proceed in two ways: it could initiate a declaratory judgment action against its insured, or it might elect to do nothing, running the risk, of course, that its insured will seek indemnity if coverage is established at trial.

Coulter v. Cignia Prop. & Cas. Co., 934 F. Supp. at 1113 (citing McAndrews v. Farm Bureau Mut. Ins. Co., 349 N.W.2d 117, 119 (Iowa 1984)).

136. APPLEMAN & APPLEMAN, *supra* note 1, § 4694, at 336-43.

> It is almost uniformly held that if an insurer conducts an investigation or defense under a non-waiver agreement or a notice of reservation of its rights, it will not thereby be estopped to set up any policy defenses that may be available to it. It has been held that the filing of a declaratory judgment action while providing the insured with a defense to a claim against him has the same effect as serving the insured with a reservation of rights.

Id. at 336-43; *see also* Lee v. Aetna Cas. & Sur. Co., 178 F.2d 750, 753 (2d Cir. 1949) (Hand, J.) ("[I]f the plaintiff's complaint against the insured alleged facts which would have supported a recovery covered by the policy, it was the duty of the defendant to undertake the defense, until it could confine the claim to a recovery that the policy did not cover."); Central Bearings Co. v. Wolverine Ins. Co., 179 N.W.2d 443, 445 (Iowa 1970) ("[D]efendant's duty to defend does not in all cases and under all circumstances depend solely on the terms of the policy and the allegations in the petition filed against the insured."). Professor Abraham has observed that the issue of whether an insurer may withdraw the defense under appropriate circumstances "is said to have been settled at least since Judge Learned Hand's decision in *Lee*." ABRAHAM, *supra* note 135, at 581.

137. APPLEMAN & APPLEMAN, *supra* note 1, § 4694, at 336-66.

confronted by perverse incentives. For example, as discussed above, he may feel pressured to reveal the insured's confidential information[138] to the insurer. If the attorney discovers that the insured was acting criminally in his alleged wrongdoing, that information would be quite helpful to the insurer who could deny coverage on the basis of a criminal activity exclusion.[139] Thus, when coverage issues remain viable—such as when an insurer reserves its rights to dispute coverage—courts have viewed insurer-appointed counsel with some suspicion.[140]

ii. *Defense of Alternate Claims, One with Coverage and the Other Without.* Insurance contracts deal with aleatory events.[141] Accordingly, policy language often disclaims coverage for intentional harms caused by the insured.[142] This disclaimer may be provided through a specific exclusion, a statement defining the scope of coverage, or both.[143] Further, even in the absence of explicit contractual expression, "nonfortuity defenses are implicit within the insurance contract."[144] Additionally, even when contractual lan-

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138. *See supra* Part III.C.2.c.

139. *See, e.g.*, Princeton Ins. Co., v. Chunmuang, 698 A.2d 9, 19 (N.J. 1997) (holding that "public policy is not offended by enforcement of an exclusion in a medical malpractice policy of liability for injury caused by a criminal act"). For a discussion of the coverage of intentional acts, see *infra* notes 141-46 and accompanying text.

140. *See* Wendy Y. Watanabe, *The Title Insurer's Duty to Defend and Right to Initiate Actions on Behalf of its Insured, in* TITLE INSURANCE: HANDLING CRITICAL ISSUES FACING BUYERS, SELLERS AND LENDERS, at 383, 395 (PLI Real Estate Practice Course Handbook Series No. 423, 1997) ("In California, the right to independent counsel has been established by judicial decision and statute and independent counsel is often referred to as '*Cumis*' counsel."). *But see id.* at 397 ("The *Cumis* decision has not been interpreted as automatically entitling an insured to independent counsel whenever an insurer has reserved rights regarding coverage.").

141. The Restatement of Contracts defines "aleatory":

> An aleatory contract is one in which at least one party is under a duty that is conditional on the occurrence of an event that, so far as the parties to the contract are aware, is dependent on chance. Its occurrence may be within the control of third persons or beyond the control of any person. The event may have already occurred, as long as that fact is unknown to the parties. It may be the failure of something to happen as well as its happening. Common examples are contracts of insurance and suretyship, as well as gambling contracts.

RESTATEMENT (SECOND) OF CONTRACTS § 379 cmt. a (1979).

142. John D. Boyle & Michael R. O'Malley, *Insurance Coverage for Punitive Damages and Intentional Conduct in Massachusetts*, 25 NEW ENG. L. REV. 827, 830 (1991) (discussing standard policy forms).

143. *Id.; see also* ABRAHAM, *supra* note 135, at 507 (citing Honeycomb Sys., Inc. v. Admiral Ins. Co., 567 F. Supp. 1400 (D. Maine 1983)). Abraham notes that "it is hornbook law that the insured bears the burden of proving that a loss falls within the terms of the Insuring Agreement, but that the insurer bears the burden of proving that an exclusion applies." *Id.*

144. M. Elizabeth Medaglia et al., *The Status of Certain Nonfortuity Defenses in Casualty Insurance Coverage*, 30 TORT & INS. L.J. 943, 966 (1996).

guage appears to dictate coverage for intentional harms, public policy often bars enforcement.[145] Therefore, it is likely that, where the only claims against an insured arise from intentional acts, neither the duty of defense nor the duty to indemnify will be triggered.[146]

The plaintiff may, however, plead both intentional and nonintentional torts as alternative theories.[147] For example, where the plaintiff is injured by a gunshot from a weapon held by the insured, the plaintiff may plead both negligence and assault. Depending on the facts, the insured's liability under *a* theory may be clear. The insurer's duty to indemnify, however, will turn on

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145. *Compare* Sean W. Gallagher, Note, *The Public Policy Exclusion and Insurance for Intentional Employment Discrimination*, 92 MICH. L. REV. 1256, 1258 (1994) ("[C]ourts often refuse to enforce, on public policy grounds, insurance policies that cover *intentional* employment discrimination."), *with* Ward S. Connolly, Note, *Sexual Abuser Insurance in Alaska: A Note on* St. Paul Fire & Marine Insurance Co. v. F.H.; K.W., 13 ALASKA L. REV. 265, 282 (1996) (noting that "several states have found that allowing insurance for intentional acts, sometimes even sexual misconduct, does not violate public policy"); State Farm Fire & Cas. Co. v. Tringali, 686 F.2d 821, 824 (9th Cir. 1982) ("We are persuaded that the adoption of a compulsory scheme of automobile liability insurance very strongly suggests a legislative intent that there be no exclusion of intentional acts of the insured.").

146. *See, e.g.*, Doe v. Liberty Mut. Ins. Co., 667 N.E.2d 1149, 1152 (Mass. 1996) ("A negligence claim which is premised on the same acts which are contended to be the basis of an intentional sexual misconduct claim is not legally supportable. There is no duty to defend in these circumstances.") (citations omitted); *see also supra* notes 141-45 and accompanying text. *See generally* BARRY R. OSTRAGER AND THOMAS R. NEWMAN, HANDBOOK ON INSURANCE COVERAGE DISPUTES § 8.02 (1995) (discussing the fortuity doctrine in insurance); James L. Rigelhaupt, Annotation, *Construction and Application of Provision of Liability Insurance Policy Expressly Excluding Injuries Intended or Expected by Insured*, 31 A.L.R. 4th 957 (1981) (collecting cases).

147. *See* James E. Berger, Note, *Liability Insurers Get a Fair Deal:* Easley v. American Family Mutual Insurance Co., 59 MO. L. REV. 209, 233 (1994) ("To get around the specific intent rule, many plaintiffs will try to plead recklessness or negligence to render the intentional acts exclusion inapplicable.") (citing Nathan Z. Cyperstein, *Coverage for Intentionally Caused Unintended Consequences*, FOR THE DEFENSE, Feb. 1993 at 18, 19). An alternate method of "underlitigating" the claim is to plead only negligence. *See* Ellen S. Pryor, *The Stories We Tell: Intentional Harm and the Quest for Insurance Funding*, 75 TEX. L. REV. 1721, 1722 (1997) (discussing "the plaintiff's choice to plead and prove negligence rather than or in addition to intentional tort theories when, absent insurance considerations, the plaintiff would either frame the case solely as an intentional tort claim or emphasize the intentional tort claim"). Some courts have limited the availability of "underlitigating" strategies by declaring certain acts, including sexual abuse, to be inherently intentional and thus inconsistent with recovery under a negligence theory. *See* David S. Florig, *Insurance Coverage for Sexual Abuse or Molestation*, 30 TORT & INS. L.J. 699, 699-700 (1995) ("Most courts refuse coverage to the insured perpetrator of abuse when the perpetrator is an adult and the victim is a minor. In such cases the nearly unanimous rule is that the intent to injure is inferred as a matter of law from the act of abuse itself (the inferred intent rule).").

which of the two theories of liability is established.[148] Accordingly, if the insurance company has power over the defending attorney, then he may feel pressure to develop facts that support an intentional tort theory—a theory for which there is no coverage.[149] If the attorney yields to that pressure, the insured may suffer both exposure to enhanced liability[150] and abandonment with neither defense nor indemnity.[151] Thus, the attorney may once again face that old chessplayer's dilemma, the "fork": He must sacrifice either the King or the Rook.[152] In those situations, the respective identities of the King and Rook become particularly important.

iii. *Defense of Claims for Damages in Excess of Policy Limits.* The possibility for conflict in excess liability cases is clear. As *Kooyman* illustrates,[153] the insurer may not have the insured's interests at heart. Once the policy limits are "gone," the insurer is no longer negotiating with its own money.[154] The insurer may then experience moral hazard, the erosion of one's concern for risks that one no longer bears.[155] Accordingly, the insurer may question the wisdom of providing a rigorous defense for the insured.[156] Consequentially, the appointed attorney may feel compelled to reduce the intensity of the insured's defense.[157] In other words, the appointed attorney may experience a conflict of interest.

iv. *An Insured's Claims Against the Insurer.* The duty of good faith and fair dealing is implied in all insurance contracts.[158] This umbrella duty

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148. *See supra* notes 141-46 and accompanying text.

149. *See supra* notes 141-46 and accompanying text.

150. *See, e.g.*, Douglas Lee Hertlein, Comment, *Intentional Torts by Employers in Ohio, the General Assembly's Solution: Ohio Revised Code Section 4121.80*, 56 U. CIN. L. REV. 247, 254 (1987) ("In almost all jurisdictions, comparative negligence cannot be used to reduce the amount of damages awarded for an intentional tort.").

151. *See supra* notes 141-47 and accompanying text.

152. *See supra* note 98 and accompanying text.

153. *See* Kooyman v. Farm Bureau Mut. Ins. Co., 315 N.W.2d 30, 34-35 (Iowa 1982); *see also supra* notes 73-93 and accompanying text.

154. *See supra* notes 77-85 and accompanying text.

155. *Cf.* Tom Baker, *On the Genealogy of Moral Hazard*, 75 TEX. L. REV. 237, 238-39 (1996) ("In the economics literature and in the law and policy debate that draws upon this literature, 'moral hazard' refers to the tendency for insurance against loss to reduce incentives to prevent or minimize the cost of loss.").

156. *See supra* notes 73-93 and accompanying text.

157. *See supra* notes 73-93 and accompanying text.

158. Johnny C. Parker, *The Development of First-Party Extracontractual Insurance Litigation in Oklahoma: An Analytical Examination*, 31 TULSA L.J. 57, 65 (1995) ("Every contract of insurance contains an obligation to act in good faith in the performance of the duties expressly set out in the contract. Each insurance contract also contains the implied duty of good faith and fair dealing.") (footnotes omitted). As Douglas R. Richmond observes,

> It is not surprising that courts troubled by insurers' claims practices formulated a tort duty of good faith and fair dealing. Insureds purchase their policies for peace of mind and security, rather than for financial gain. Insurance policies are thus more personal than commercial. An insurer and its

imposes a number of specific duties upon insurers.[159] For example, when an insurer defends an insured, a duty arises to advise the insured of possibilities for settlement.[160] Similarly, the insurer has a "duty to inform [the insured] of the expected consequences of [the] failure to settle."[161] When insurers fail to fulfill these duties, a claim for bad faith may arise in favor of the insured.[162] An insured's interests may be well served by pursuing such a claim; both compensatory and punitive damages may be available.[163] Thus, yet another potential area of conflict appears for the attorney that owes loyalties to both the insurer and the insured. Certainly it would seem impermissible for such an attorney to actually bring a bad-faith claim against the insurer on behalf of the insured.[164] It is readily argued, however, that that same attorney would

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> insured, unlike parties to other contracts, may be thought to share a special relationship. This special relationship arises out of the parties' perceived unequal bargaining power and the nature of insurance policies, which potentially allow unscrupulous insurers to exploit their insureds' misfortunes when resolving or settling claims.

Douglas R. Richmond, *An Overview of Insurance Bad Faith Law and Litigation*, 25 SETON HALL L. REV. 74, 78 (1994) (footnotes omitted); *see also* Nicola W. Palmieri, *Good Faith Disclosures Required During Precontractual Negotiations*, 24 SETON HALL L. REV. 70, 87 & n.54 (1993) ("Presently, courts in the vast majority of American jurisdictions agree that a general obligation of good faith and fair dealing is implied in every contract.").

159. *See, e.g.*, Alan I. Widiss, *Obligating Insurers to Inform Insureds About the Existence of Rights and Duties Regarding Coverage for Losses*, 1 CONN. INS. L.J. 67, 77 (1995) ("In many states, judicial decisions hold that the duty of good faith and fair dealing obligates insurers to inform insureds about rights and duties regarding coverages in a variety of circumstances.").

160. Kooyman v. Farm Bureau Mut. Ins. Co., 315 N.W.2d 30, 36 (Iowa 1982).

161. *Id.*

162. *See* Bates v. Allied Mut. Ins. Co., 467 N.W.2d 255, 258 (Iowa 1991) ("The law currently provides that an insured may sue an insurer for bad faith while a third party may not.") (citing Dolan v. Aid Ins. Co., 431 N.W.2d 790 (Iowa 1988); Long v. McAllister, 319 N.W.2d 256 (Iowa 1982); Kooyman v. Farm Bureau Mut. Ins. Co., 315 N.W.2d 30 (Iowa 1982)).

163. Richmond notes:

> In the last decade there has been a marked increase in disputes and tension between insurers and their policyholders. The heightened adversarial relationship between insurance carriers and their insureds is evidenced by juries' willingness to return financially overwhelming verdicts. In 1993, for example, California juries returned $425,600,000 and $89,320,000 verdicts against insurers in bad faith cases. In another 1993 case, a Texas jury assessed compensatory damages of $2,170,000 and punitive damages of $100,000,000 against an insurer that denied a $20,000 underinsured motorist claim. While not all large verdicts survive appeal, there can be no doubt that insurance bad faith litigation has become a high stakes field.

Richmond, *supra* note 158, at 75.

have a duty to inform the insured of the potential claim against the insurer.[165] Fulfillment of that duty may have harsh consequences, especially if the insurer happens to be *the* employer of the attorney. In such cases, the attorney may feel torn: His bonds of duty may pull in one direction while the insurer's purse strings pull in another.

D. *Transition*

All of the problems discussed in this section have at least one commonality: they all arise from a confusion of loyalties.[166] An attorney who does not know to whom his highest loyalty should be given—who his client is—is bound to drift into ethical trouble.[167] Thus, in hopes of adding a candle to the path toward ethical practice, the next sections of this Note discuss the candidates for clienthood.[168] The discussion will focus on the attorney who is employed by an insurer and who defends insureds in the course of that employment. Therefore, one hypothetical insured will be assumed to be *a* client. The relationship of the inhouse defender to his employer—the insurer—is less susceptible to assumption and thus will be explored.[169] Further, two other plausible candidates for clienthood—the additional insured and the insurer's agent—will be discussed.[170] But first, this Note examines the criteria by which candidates for clienthood should be judged: the essential attributes of the attorney-client relationship.[171]

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164. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.7 (1995); MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 5-105 (1980).

165. *See supra* Part III.C.2.b.

166. *See supra* Part III.C.

167. *But see* Nancy J. Moore, *Expanding Duties of Attorneys to "Non-Clients": Reconceptualizing the Attorney-Client Relationship in Entity Representation and Other Inherently Ambiguous Situations*, 45 S.C. L. REV. 659, 659-60 (1994) ("Recently, courts have expanded duties owed by attorneys to third-party non-clients.").

168. As Professor Silver has noted, "Clearly, the time is right to think seriously about the number of clients that defense counsel represents and about the obligations each client is due." Charles Silver, *Does Insurance Defense Counsel Represent the Company or the Insured?*, 72 TEX. L. REV. 1583, 1589 (1994).

169. *See infra* Part IV.B.

170. See *infra* Part IV.C. for a discussion of multiple insureds and *infra* Part IV.D for a discussion of agents.

171. *See infra* Part IV.A.

IV. DETERMINING THE EXISTENCE OF AN ATTORNEY-CLIENT RELATIONSHIP: GENERIC PRINCIPLES AND THEIR APPLICATIONS

A. *Generic Principles of the Attorney-Client Relationship*

The ABA's model statutes on professional responsibility say much about clients,[172] but they offer little guidance on how to identify one. Rather, the attorney-client relationship is left largely to external "principles of substantive law."[173] Not surprisingly, jurisdictions vary as to what principles constitute the appropriate "substantive law."[174] For example, the Iowa Supreme Court has stated that

> Under Iowa law three elements must be shown to establish an attorney-client relationship: (1) the person claiming a breach of the relationship has sought the advice or the assistance of the attorney; (2) the advice or assistance pertain to a matter within the attorney's competence; and (3) the attorney expressly or impliedly agreed to give or actually gave desired advice or assistance.[175]

By contrast, New York has expressed a more narrow view of the formation process: "[T]o establish an attorney-client relationship there must be an explicit undertaking to perform a specific task."[176] Despite differences such as these, many jurisdictions appear to agree on the fundamental bases of the attorney-client relationship.[177] Thus, some generalizations can be offered:

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172. *See generally* MODEL RULES OF PROFESSIONAL CONDUCT (1995); MODEL CODE OF PROFESSIONAL RESPONSIBILITY (1980).

173. MODEL RULES OF PROFESSIONAL CONDUCT scope ("[P]rinciples of substantive law external to these Rules determine whether a client-attorney relationship exists.").

174. *See* Ronald I. Friedman, *The Creation of the Attorney-Client Relationship: An Emerging View*, 22 CAL. W. L. REV. 209, 212 (1986).

175. Whalen v. Connelly, 545 N.W.2d 284, 295 (Iowa 1996); *see also* Kurtzenbach v. TeKippe, 260 N.W.2d 53, 56 (Iowa 1977) ("In appropriate cases the third element may be established by proof of detrimental reliance, when the person seeking legal services reasonably relies on the attorney to provide them and the attorney, aware of such reliance, does nothing to negate it.").

176. Volpe v. Canfield, 654 N.Y.S.2d 160, 162 (App. Div. 1997); *see also* Sucese v. Kirsch, 606 N.Y.S.2d 60, 62 (App. Div. 1993) ("It is fundamental that an explicit undertaking to perform a specific task is required to establish an attorney-client relationship."). *But see* Solondz v. Barash, 639 N.Y.S.2d 561, 564 (App. Div. 1996) ("It is true that an attorney-client relationship may arise by words and actions of the parties.").

177. For example, several courts have expressed substantial agreement with the test expounded by the Iowa court in *Whalen*. *Compare* Whalen v. Connelly, 545 N.W.2d at 295, *with In re* Anonymous, 655 N.E.2d 67, 70 (Ind. 1995) (endorsing a standard similar to the test set forth in *Whalen*), Fanaras Enters., Inc. v. Doane, 666 N.E.2d 1003, 1006 (Mass. 1996) (same), DeVaux v. American Home Assurance Co., 444 N.E.2d 355, 357 (Mass. 1983) (same),

(1) An attorney-client relationship, generally, is a matter for the trier of fact to determine;[178] (2) The attorney-client relationship is contractual;[179] (3) An

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Macomb County Taxpayers Ass'n v. L'anse Creuse Pub. Sch., 564 N.W.2d 457, 462 (Mich. 1997) (same), Richardson v. Griffiths, 560 N.W.2d 430, 435 (Neb. 1997) (same), McVaney v. Baird, Holm, McEachen, Pedersen, Hamann & Strasheim, 466 N.W.2d 499, 506 (Neb. 1991) (same), Todd v. State, 931 P.2d 721, 725 (Nev. 1997) (same), State v. Gordon, 692 A.2d 505, 506 (N.H. 1997) (same), Herbert v. Haytaian, 678 A.2d 1183, 1188 (N.J. Super. Ct. App. Div. 1996) (same), Saylor v. Nichols, No. 87-08-067, 1988 WL 32992, at *2 (Ohio Ct. App. Mar. 28, 1988) (same), and Keegan v. First Bank, 519 N.W.2d 607, 611 (S.D. 1994) (same); *see also* Cost v. Cost, 677 A.2d 1250, 1254 (Pa. Super. Ct. 1996) (adding a fourth element: "[i]t is reasonable for the putative client to believe the attorney was representing him").

178. *See, e.g.*, Pembroke State Bank v. Warnell, 461 S.E.2d 231, 235 (Ga. Ct. App. 1995), *rev'd in part*, 471 S.E.2d 187 (Ga. 1996); Warner v. Stewart, 930 P.2d 1030, 1035 (Idaho 1997); Barre v. St. Martin, 636 So. 2d 1061, 1063 (La. Ct. App. 1994); Fraidin v. Weitzman, 611 A.2d 1046, 1058 (Md. Ct. Spec. App. 1992); *In re* Stern, 682 N.E.2d 867, 871 (Mass. 1997); Admiral Merchants Motor Freight, Inc. v. O'Conner & Hannan, 494 N.W.2d 261, 265 (Minn. 1992); McCabe v. Arcidy, 635 A.2d 446, 449 (N.H. 1993); Keegan v. First Bank, 519 N.W.2d at 611; Bohn v. Cody, 832 P.2d 71, 74-75 (Wash. 1992); State v. White, 907 P.2d 310, 312 (Wash. Ct. App. 1995); State v. Bedell, 446 S.E.2d 906, 910 (W. Va. 1994); Marten Transp. Ltd. v. Hartford Specialty Co., 509 N.W.2d 106, 108 (Wis. Ct. App. 1993); Meyer v. Mulligan, 889 P.2d 509, 514 (Wyo. 1995).

179. *See, e.g.*, *In re* Chicago Flood Litig., 682 N.E.2d 421, 425 (Ill. App. Ct. 1997); Somuah v. Flachs, 702 A.2d 788, 793 (Md. Ct. Spec. App. 1997); World Resources, Ltd. v. Utterback, 943 S.W.2d 269, 270 (Mo. Ct. App. 1997); Plunkett & Cooney, P.C., v. Capitol Bancorp Ltd., 536 N.W.2d 886, 889 (Mich. Ct. App. 1995); C.K. Indus. v. C.M. Indus., 623 N.Y.S.2d 410, 411 (App. Div. 1995); State v. Green, 936 P.2d 947, 952 (Ok. 1997); Keegan v. First Bank, 519 N.W.2d at 611; Alexander v. Inman, 903 S.W.2d 686, 694 (Tenn. Ct. App. 1995); *see also* 7A C.J.S. *Attorney-Client* § 169, at 249 (1980). *But see In re* Ryan, 670 A.2d 375, 379-80 (D.C. App. 1996) ("[E]thical responsibilities exist independently of contractual rights and duties."); Aflac, Inc. v. Williams, 444 S.E.2d 314, 316 (Ga. 1994) ("[F]orc[ing] all attorney-client agreements into the conventional status of commercial contracts ignores the special fiduciary relationship created when an attorney represents a client."); Johnson v. Amethyst Corp., 463 S.E.2d 397, 400 (N.C. Ct. App. 1995) (applying the law of agency to the attorney-client relationship).

Minnesota recognizes both a "contract" theory of attorney-client relations and a "tort" theory. Admiral Merchants Motor Freight, Inc. v. O'Conner & Hannan, 494 N.W.2d at 265-66; *In re* Disciplinary Action Against Perry, 494 N.W.2d 290, 294-95 (Minn. 1992). "Under this [tort] theory, an attorney-client relationship is created whenever an individual seeks and receives legal advice from an attorney in circumstances in which a reasonable person would rely on such advice." Admiral Merchants Motor Freight, Inc. v. O'Connor & Hannan, 494 N.W.2d at 265-66 (citing Togstad v. Vesely, Otto, Miller & Keefe, 291 N.W.2d 686, 692-93 (Minn. 1980)). Other courts have recognized reliance-based theories as well. *See, e.g.*, State v. Green, 936 P.2d 947, 956 (Ok. 1997). Further, some states have recognized the reasonable expectations of the putative client as a basis for finding an attorney-client relationship. *See, e.g.*, Kidney Ass'n v. Ferguson, 843 P.2d 442, 448 (Or. 1992) ("The existence of a lawyer-client relationship primarily is determined by the reasonable expectation of the client that the lawyer will perform legal work in the client's behalf."). Additionally, at

attorney-client relationship can be implied from the conduct of the parties and need not be expressed;[180] (4) An attorney-client relationship can be created without formality;[181] (5) The attorney-client relationship requires the consent of both the attorney and client;[182] (6) The attorney-client relationship is not dependent on the payment of a fee.[183]

From these six principles—and Iowa's well-accepted three-part analysis—a picture begins to emerge: An attorney-client relationship can, of course, be created through the traditional mechanism of formal, mutual assent.[184] In addition, the contractual relationship may arise from rather

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least one court has stated a more extreme view that "[t]he existence of an attorney-client relationship turns largely on the client's subjective belief that it exists." Barnett v. Sethi, 608 So. 2d 1011, 1014 (La. Ct. App. 1992) (citing Louisiana State Bar Ass'n v. Bosworth, 481 So. 2d 567, 571 (La. 1986)). *But see* Bohn v. Cody, 832 P.2d 71, 74-75 (Wash. 1992) ("The client's subjective belief, however, does not control the issue unless it is reasonably formed based on the attending circumstances, including the attorney's words or actions.").

180. *See, e.g.*, Johnson v. Superior Court, 45 Cal. Rptr. 2d 312, 320 (Ct. App. 1995); *In re* Kinney, 670 N.E.2d 1294, 1297 (Ind. 1996); *In re* Anonymous, 655 N.E.2d at 70; *In re* Stern, 682 N.E.2d at 871; Williams v. Ely, 668 N.E.2d 799, 805 (Mass. 1996); Macomb County Taxpayers Ass'n v. L'anse Creuse Pub. Sch., 564 N.W.2d at 462; Todd v. State, 931 P.2d at 725; State v. Green, 936 P.2d at 952; *In re* Hassenstab, 934 P.2d 1110, 1114 (Or. 1996); Cost v. Cost, 677 A.2d at 1254; Keegan v. First Bank, 519 N.W.2d at 611; Daves v. Commission For Lawyer Discipline, 952 S.W.2d 573, 577 (Tex. App. 1997); Wright v. Gundersen, 956 S.W.2d 43, 48 (Tex. App. 1996); State v. White, 907 P.2d 310, 312 (Wash. Ct. App. 1995); State v. Bedell, 446 S.E.2d 906, 910 (W. Va. 1994); Carstensen v. Chrisland Corp., 442 S.E.2d 660, 668 (Va. 1994).

181. *See, e.g., In re* Ryan, 670 A.2d 375, 379-80 (D.C. 1996); *In re* Anonymous, 655 N.E.2d at 70; Larochelle v. Hodson, 690 A.2d 986, 989 (Me. 1997); Fraidin v. Weitzman, 611 A.2d at 1058-59; Macomb County Taxpayers Ass'n v. L'anse Creuse Pub. Sch., 564 N.W.2d at 462; Todd v. State, 931 P.2d at 725; Williams v. Waldman, 836 P.2d 614, 618 (Nev. 1992); Herbert v. Haytaian, 678 A.2d at 1188; C.K. Indus. v. C.M. Indus., 623 N.Y.S.2d at 411-12; *In re* Hassenstab, 934 P.2d at 1114; Keegan v. First Bank, 519 N.W.2d at 611. *But see* Friedman, *supra* note 174, at 214 (stating that the Alabama court "apparently envisioned no circumstances in which the [attorney-client] relationship could be created informally") (citing State Bar v. Jones, 281 So. 2d 267, 273 (Ala. 1973)).

182. *See, e.g., In re* Chicago Flood Litig., 682 N.E.2d at 425; *In re* Kinney, 670 N.E.2d at 1297; *In re* Anonymous, 655 N.E.2d at 70; Donahue v. Shughart, Thomson & Kilroy, P.C., 900 S.W.2d 624, 626 (Mo. 1995); Herbert v. Haytaian, 678 A.2d at 1188.

183. *See, e.g., In re* Ryan, 670 A.2d at 379-80; Florida Bar v. King, 664 So. 2d 925, 927 (Fla. 1995); *In re* Anonymous, 655 N.E.2d at 70; Larochelle v. Hodson, 690 A.2d at 989; Macomb County Taxpayers Ass'n v. L'anse Creuse Pub. Sch., 564 N.W.2d at 462; Todd v. State, 931 P.2d at 725; Herbert v. Haytaian, 678 A.2d at 1188; Lillback v. Metropolitan Life Ins. Co., 640 N.E.2d 250, 256 (Ohio Ct. App. 1994); State v. Green, 936 P.2d at 952; Keegan v. First Bank, 519 N.W.2d at 611; State v. Bedell, 446 S.E.2d at 910; *see also* Friedman, *supra* note 174, at 212 n.15 (citing a collection of appropriate cases).

184. *See supra* notes 175-83 and accompanying text.

informal dealings.[185] At least three caveats must be added, however, to complete the picture. First, despite the existence of broadly-accepted principles, "'[w]hat constitutes an attorney-client relationship [remains] a rather elusive concept.'"[186] This elusivity is complicated by the fact that "different jurisdictions have varying requirements applicable in more or less formal ways."[187] Thus, for real-world problems—as opposed to mere law review conjectures—pithy aphorisms cannot substitute for fact- and jurisdiction-specific research.[188]

A second caveat—actually an example of the first—is that some courts treat confidentiality in special ways.[189] The Kentucky Supreme Court recently expressed the importance of confidentiality:

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185. *See supra* notes 180-81, 183 and accompanying text. The Oregon case of *In re Conduct of Hassenstab* is instructive. *In re* Conduct of Hassenstab, 934 P.2d 1110 (Or. 1997). In *Hassenstab*:

> [The attorney had] represented [a] woman . . . on two criminal matters and a probation violation in 1988 and 1989. In 1991, that woman contacted the [attorney] about a potential personal injury action. The [attorney] suggested that they go to lunch to discuss her case. After meeting at his office, the [attorney] drove the woman to a public park and asked her to masturbate him. She did so. She then asked the [attorney] about the merits of her case. He stated that it would be a difficult case to prove and also discussed his fee. The woman later retained the [attorney] to represent her in that matter.

Id. at 1113-14.

In a later disciplinary proceeding, the attorney contended that the masturbation incident did not occur during the course of an attorney-client relationship. *Id.* at 1114. The Supreme Court of Oregon disagreed:

> That woman testified that she met with the accused because he was a lawyer and that she thought of him as her lawyer during their meeting. Additionally, their meeting was scheduled to discuss her personal injury case, which was discussed after the sexual encounter. In the light of those circumstances, we find that the incident occurred during the course of a lawyer-client relationship.

Id.

186. Friedman, *supra* note 174, at 212 (quoting Folly Farms I, Inc. v. Bar of Md., 387 A.2d 248, 254 (Md. 1978)).

187. *Id.*

188. See *supra* note 178 for an illustration of the differences among various jurisdictions.

189. *See, e.g.*, State v. Bedell, 446 S.E.2d 906, 910-11 (W. Va. 1994). The Model Rules state:

> Most of the duties flowing from the client-lawyer relationship attach only after the client has requested the lawyer to render legal services and the lawyer has agreed to do so. But, there are some duties, such as that of confidentiality under Rule 1.6, that may attach when the lawyer agrees to consider whether a client-lawyer relationship shall be established. Whether a client-lawyer relationship exists for any specific purpose can depend on the circumstances and may be a question of fact.

> *Consultation with a lawyer may ripen into a lawyer/client relationship that precludes the lawyer from later undertaking a representation adverse to the individual who consulted him.* The lawyer/client relationship can arise not only by contract but also from the conduct of the parties. Courts have found that the relationship is created as a result of the client's reasonable belief or expectation that the lawyer is undertaking the representation. Such a belief is based on the conduct of the parties. *The key element in making such a determination is whether confidential information has been disclosed to the lawyer.*[190]

The special treatment of confidentiality may originate more in the law of evidence than in the core doctrines of professional responsibility.[191] Regardless, lawyers should be leery of the inadvertent formation of an attorney-client relationship through the divulgence of confidential information by potential clients.

One final warning is that, despite appearances, the attorney-client relationship is not a monolith. Rather, the duties commonly associated with the attorney-client relationship—such as confidentiality, competence, candor, and independence—may not always attach simultaneously.[192] For example, if Litigant *X* discusses a potential suit with Attorney *A*, but instead hires Attorney *B*, Attorney *A* may owe a duty of confidentiality to Litigant *X*. Attorney *A* probably will not, however, owe a duty of competence in pursuing the claim. Attorney *B*, however, will owe duties of confidence *and* competence to Litigant *X*.

The manifold nature of attorney-client relationships is mentioned but not fully explored here for two reasons. First, a complete discussion is beyond the scope of this Note. Second, the precise distinctions among the ethical obligations owed to various "clients" may have minimal importance. This Note assumes that the full range of ethical duties are owed by the inhouse defender of one hypothetical insured.[193] Further, as has been discussed, those duties may conflict with duties owed to others.[194] As long as it is true that (1) all attorney-client duties are owed to the insured; (2) some ethical duties are owed to people other than the insured; and (3) the duties

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MODEL RULES OF PROFESSIONAL CONDUCT scope (1995).

190. Lovell v. Winchester, 941 S.W.2d 466, 468 (Ky. 1997) (emphasis added).

191. *See, e.g.*, Landis v. Hunt, 610 N.E.2d 554, 558 (Ohio Ct. App. 1992) ("An essential element as to whether an attorney-client relationship has been formed is the determination that the relationship invoked such trust and confidence in the attorney that the communication became privileged and, thus, the information exchanged was so confidential as to invoke an attorney-client privilege.").

192. *See* MODEL RULES OF PROFESSIONAL CONDUCT scope.

193. *See supra* Part III.C.

194. *See supra* Part III.C.

owed to the insured may or will conflict with duties owed to others,[195] it may not be important to fully describe the duties owed to those "others."

A series of examples may help to clarify this point. In everyday terms, consider a hypothetical married man. If he has a mistress, he need not actually propose to his mistress for a conflict of interest to evolve. In fact, the particulars of his relationship with the mistress—insert favorite headline—may not matter *to his wife* once the threshold discovery of infidelity is made.

Consider also the illustration above where Attorney *A* owes a duty of confidentiality to Litigant *X*.[196] If that duty of confidentiality impairs Attorney *A*'s ability or willingness to exercise his duty of candor to another client — Litigant *Y*—the fact that Attorney *A* does not owe other duties to Litigant *X* may not matter.

Similarly, if an attorney's consultation with an insurance agent (1) yields information that would be helpful to another client's case and (2) invokes the attorney's duty of confidentiality, the fact that no other duties are invoked toward the agent may be *ethically irrelevant*. The attorney is stuck between his duty of confidentiality to the agent and his duty of candor to the other client.

With these principles in mind, some of the potential clients of the inhouse defender of insureds will now be addressed.

B. *Application: Relationship with Insurer*

Few would disagree with Professor Jonas' observations that

> It is axiomatic that a corporation is a distinct, discrete legal entity that exists separate and apart from its officers, agents, directors, and shareholders. It is almost equally axiomatic that a lawyer who is retained to represent a corporation owes his allegiance solely to that legal entity, and not to the corporation's officers, directors, and shareholders.[197]

Certainly the law of professional responsibility is in accord with Jonas' statements. As the Model Code explains, "a lawyer employed by a corporation or similar entity . . . should be vigilant to safeguard the fidelity of the lawyer to his employer, free from outside influences."[198] The Model Rules agree: "*A lawyer employed or retained by an organization represents the organization* through its duly authorized constituents."[199] Further, if the corporation's

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195. *See supra* Part III.C.

196. *See supra* note 192 and accompanying text.

197. Ralph Jonas, *Who is the Client? The Corporate Lawyer's Dilemma*, 39 HASTINGS L.J. 617, 617 (1988) (citing MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13; MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 5-18 (1980)); *see also* MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13 cmt. ("An organizational client is a legal entity, but it cannot act except through its officers, directors, employees, shareholders and other constituents.").

198. MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 5-13.

199. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(a) (emphasis added).

lawyers are to represent a "constituent" personally, that representation must be accompanied by either the consent of the organization or freedom from conflict.[200]

From these rules, it seems that a third axiom can be added to Jonas' observations; namely, an insurance company—clearly an "organization" if not a "corporation"—is a client of the lawyers that it employs. Restated, this third proposition is that, by definition, an attorney-client relationship exists between an insurer and its salaried lawyers. Interestingly, this third proposition has not been universally accepted. For example, in *Bradt & Brodt, P.C. v. West*,[201] the Texas Court of Appeals stated:

> There is no attorney-client relationship between an insurer and an attorney hired by the insurer just to provide a defense to one of the insurer's insureds. Even though such an attorney is typically selected by the insurer, paid by the insurer, and periodically reports to the insurer about the progress of the case against the insured, these facts do not mean that the insurer is the client. *In the context of insurance, the client is the insured.* It is the insured to whom the attorney owes his allegiance in such a case, and the insured's interests that he represents. There was no attorney-client relationship between the attorney-appellees and the insurance company-appellees.[202]

Further, Texas is not the solitary defender of the one-client view. Michigan's Supreme Court has expressly held that the relationship between the insurer and the retained defense counsel is "less than a client-attorney relationship."[203] Also, New York's highest court has stated that "the paramount interest independent counsel represents is that of the insured, not the insurer."[204] Further, these cases may not be the "the most potent authorit[ies] to back the 'one-client' view."[205]

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200. *Id.* Rule 1.13(e).

201. Bradt & Brodt, P.C. v. West, 892 S.W.2d 56 (Tex. Ct. App. 1994).

202. *Id.* at 77 (emphasis added).

203. Atlanta Int'l Ins. Co. v. Bell, 475 N.W.2d 294, 297 (Mich. 1991). *See generally* Goetz, *supra* note 101 (discussing Michigan law).

204. Feliberty v. Damon, 527 N.E.2d 261, 265 (N.Y. 1988) (stating that, because of rules regarding the unlicensed practice of law, "the insurer necessarily must rely on independent counsel to conduct the litigation").

205. Silver, *supra* note 168, at 1588 (discussing RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 215 (Tentative Draft No. 4, 1991)). Professor Silver has compiled a useful bibliography of authorities that discuss the one-client view. *See id.* at 1588 n.22 (citing Karon O. Bowdre, *Conflicts of Interest Between Insurer and Insured: Ethical Traps for Unsuspecting Defense Counsel*, 17 AM. J. TRIAL ADVOC. 101, 111 (1993); John K. Morris, *Conflicts of Interest in Defending Under Liability Insurance Policies: A Proposed Solution*, 1981 UTAH L. REV. 457, 465-66; O'Malley, *supra* note 69, at 512; Debra A. Winiarski, *Walking the Fine Line: A Defense Counsel's Perspective*, 28 TORT & INS. L.J. 596, 597 (1993)).

Thus, it is not clear whether—as a matter of law—the insurer is a client of the attorney that defends the insureds.[206] Further, because many courts utilize a fact-based inquiry in determining whether an insurer is a client,[207] the persuasive power of strict 'one-client' views may be limited. Instead, the particulars of the relationship between the attorney and the insurer will determine the outcome. Accordingly, it is difficult to discern a rule that is both *a priori* and universal.

Fortunately, the determination of whether an attorney-client relationship exists between an inhouse attorney and the insurer may not be necessary. This is because the employer could represent a dangerous competitor for an attorney's loyalties *regardless of whether that employer is technically a client.* Certainly, any attorney that is hired by a major insurer would be disinclined to lose that insurer's patronage.[208] But, as Professor Giesel has pointed out:

> In-house attorneys have a very different calculus: if ethical conduct results in loss of the client, in-house counsel becomes unemployed. Loss of the attorney's one and only client reduces profitability to zero. Exalted statements that most in-house counsel possess such high ethical standards that economic pressure cannot sway them, no matter how great, are, unfortunately, suspect. . . . In-house attorneys are not second-class attorneys or less ethical attorneys. The economic pressure on in-house attorneys as a class, however, does create an atmosphere in which those attorneys may subordinate standards of responsibility more often.[209]

Therefore, regardless of whether an attorney-client relationship is formed between the inhouse attorney and his employer, the attorney must be

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206. *Compare supra* notes 201-05 and accompanying text, *with* Karon O. Bowdre, *Conflicts of Interest Between Insurer and Insured: Ethical Traps for the Unsuspecting Defense Counsel*, 17 AM. J. TRIAL ADVOC. 101, 109 & n.35 (1993) ("The prevailing rule among the jurisdictions is that, absent a conflict of interest, the defense attorney hired by the insurer represents *both* the insurer and the insured.") (citing Mitchum v. Hudgens, 533 So. 2d 194, 198 (Ala. 1988), Bogard v. Employer's Cas. Co., 210 Cal. Rptr. 578, 582 (Ct. App. 1985); Nandorf Inc. v. CNA Ins. Cos., 479 N.E.2d 988, 991 (Ill. App. Ct. 1985), Gray v. Commercial Union Ins. Co., 468 A.2d 721, 725 (N.J. Super. Ct. App. Div. 1983), Lieberman v. Employers Ins., 419 A.2d 417, 424 (N.J. 1980), Oregon State Bar Ass'n Bd. of Governors, Formal Op. No. 1991-121 (1991), *and* John K. Morris, *Conflicts of Interest in Defending Under Liability Insurance Polices: A Proposed Solution*, 1981 UTAH L. REV. 457, 461 n.15).

207. See *supra* notes 178 and 180 and accompanying text for cases that endorse a fact-based inquiry.

208. Giesel, *supra* note 8, at 536; *see also* O'Malley, *supra* note 69, at 515 ("Even the most optimistic view of human nature requires us to realize that an attorney employed by an insurance company will slant his efforts, perhaps unconsciously, in the interests of *his real client*—the one who is paying his fee and from whom he hopes to receive future business—the insurance company.") (quoting United States Fidelity & Guar. Co. v. Louis A. Roset Co., 585 F.2d 932, 938 n.5 (8th Cir. 1978)) (emphasis added).

209. Giesel, *supra* note 8, at 536-37.

vigilant to protect his independence when representing insureds. For the inhouse attorney, the insurer is not just another third-party payer of legal expenses.[210] Rather, as a monopsony, an insurer holds the power to inflict financial ischemia on its employees.[211] And, beyond the fear of termination, "employees typically strive to achieve a more rewarding relationship with their employers."[212] Thus, the influence of the insurer on its salaried lawyers—with or without an attorney-client relationship—should not be underestimated.

C. *Application: Relationships with Multiple Insureds*

A single event may burden an insurer with the duty to defend both a primary insured and additional insureds.[213] In addressing its duty, an insurer may appoint the same attorney to defend all potentially-liable insureds.[214] Efficiency would appear to recommend such a strategy. For example, the costs of investigation would not have to be duplicated.

Even if the attorney is not specifically commanded to represent additional insureds, ethical duties may still arise in favor of additional insureds.[215] Such duties would seem a likely consequence of an investigation process in which confidential information was disclosed.[216] Thus, it would not

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210. *See* MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 5-23 (1980) ("A person or organization that pays or furnishes lawyers to represent others possesses a potential power to exert strong pressures against the independent judgment of those lawyers.").

211. Richard A. Epstein notes:

> The contract at will is thus thought to be particularly unwise because it invites the exercise of arbitrary power by persons with a dominant economic position against individuals whose mobility is said to be limited by the structure of labor markets. The absence of viable alternative employment opportunities is thought to leave employees vulnerable to coercion and exploitation.

Richard A. Epstein, *In Defense of the Contract At Will*, 51 U. CHI. L. REV. 947, 949 (1984); *see* Giesel, *supra* note 8, at 591-96 (arguing that society should offer protections for inhouse counsel who face the ethics v. employment dilemma). *But see* Epstein, *supra*, at 952 (pointing out that critics of the contract at will do not take into account the nonlegal means of preserving long-term employment relationships and ignore the greater imperfections that are created under alternative legal rules).

212. Patterson v. McLean Credit Union, 491 U.S. 164, 221 (1989) (Stevens, J., concurring in part and dissenting in part); *see also* Goetz, *supra* note 101, at 174 ("In-house counsel seek to promote personal advancements and emoluments of employment.").

213. Richmond & Black, *supra* note 128, at 807.

214. *See* Paul M. Vance & Cindy T. Matherne, *Legal Ethics: Defense Counsel's Responsibilities to Insured and Insurer*, 6 U.S.F. MAR. L.J. 157, 177 (1993).

215. *See supra* notes 178-96 and accompanying text.

216. *See supra* notes 189-96 and accompanying text.

be surprising for an attorney—by design or by accident—to become beholden to multiple insureds in some regard.

Regardless of their genesis, attorney-client relations with multiple insureds can bring defense counsel into the waters of conflict.[217] Certainly, there will be situations where all parties involved will share a single goal, such as the defeat of a third-party claim.[218] The interests of an additional insured will often diverge, however, from those of both the insurer[219] and the other insureds.[220] The case of *Millers Mutual Insurance Ass'n v. Shell Oil Company*[221] is instructive in this regard. Shell leased land to Dunn.[222] As lessee, Dunn agreed to maintain insurance satisfactory to Shell.[223] Millers issued an insurance policy to Dunn, naming Shell as an additional insured and providing Shell all the benefits of coverage afforded to Dunn.[224]

In 1993, two plaintiffs brought an underlying negligence action against Dunn and Shell.[225] Both Dunn and Shell tendered the defense of the case to Millers.[226] Millers agreed to defend both Dunn and Shell in accordance with the provisions in the insurance policy.[227] In February 1995, Millers settled the claims as to Dunn for the policy limit.[228] In March 1995, Millers terminated its defense of Shell in the underlying suit.[229] Millers then filed a declaratory judgment action seeking a declaration that its duty to defend Shell as an additional insured on the policy ceased with its settlement solely on behalf of Dunn.[230] Shell filed a counterclaim, seeking a declaration that Millers had an obligation to continue to defend Shell in the underlying suit.[231]

The trial court entered judgment in favor of Millers on its declaratory judgment action, and found in favor of Millers on Shell's counterclaim.[232] Shell appealed, contending that there must be a complete settlement or judg-

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217. *See* Richmond & Black, *supra* note 128, at 813-15; Vance & Matherne, *supra* note 214, at 177.

218. Larkin, *supra* note 7, at 410.

219. *See* Richmond & Black, *supra* note 128, at 799 (noting that "additional insureds are plagued by coverage problems"). *See generally* David D. Thamann, *Adding Insureds to CGL Form Can Lead to Trouble*, NAT'L UNDERWRITER PROP. & CASUALTY-RISK & BEN. MGMT., Jan. 13, 1997, at 13 (discussing potential problems between insurers and additional insureds).

220. Larkin, *supra* note 7, at 410.

221. Millers Mut. Ins. Ass'n v. Shell Oil Co., 959 S.W.2d 864 (Mo. Ct. App. 1997).

222. *Id.* at 865.

223. *Id.*

224. *Id.*

225. *Id.*

226. *Id.* at 866.

227. *Id.*

228. *Id.* (emphasis added).

229. *Id.*

230. *Id.*

231. *Id.*

232. *Id.*

ment in the underlying action to terminate the duty to defend.[233] The Missouri Court of Appeals explained that "[a] settlement offer given to only one insured that would exhaust coverage under the liability limit of the policy creates a dilemma for the insurer."[234] Nevertheless, "[a]n insurer should not be precluded from accepting a reasonable settlement offer for fewer than all insureds."[235] Thus, the court observed that "Millers, faced with a difficult choice, should not be obligated to defend an additional insured after paying its limits in a reasonable settlement for the named insured."[236] Accordingly, the court affirmed.

The *Millers Mutual* case is less important, however, for its holding than for the dynamics that it illustrates.[237] In the beginning, both Shell and Dunn shared a single goal: Defeat of the third-party negligence claim.[238] As the litigation progressed, however, the insurer was forced to choose between the interests of Dunn and Shell.[239] When Dunn was favored over Shell, Shell's interests diverged from those of Dunn and conflicted with those of Millers. For purposes of this Note, the lesson is clear: When an inhouse defender of insureds also owes duties to one or more additional insureds, the potential for ethical conflict is high.

D. *Application: Relationships with Insurance Agents*

The Model Rules suggest that a corporate lawyer must exercise caution when dealing with the corporation's "constituents":

> There are times when the organization's interest may be or become adverse to those of one or more of its constituents. In such circumstances the lawyer should advise any constituent, whose interests he finds adverse to that of the organization of the conflict or potential conflict of interest, that the lawyer cannot represent such constituent, and that such person may wish to

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233. *Id.* at 869.

234. *Id.* at 870.

235. *Id.* (citing Bohn v. Sentry Ins. Co., 681 F. Supp. 357, 365 (E.D. La. 1988), *aff'd* 868 F.2d 1269 (5th Cir. 1989); Underwriters Guarantee Ins. Co. v. Nationwide Mut. Fire Ins. Co., 578 So. 2d 34, 35 (Fla. Dist. Ct. App. 1991); Country Mut. Ins. Co. v. Anderson, 628 N.E.2d 499, 503-04 (Ill. App. Ct. 1993); Pekin Ins. Co. v. Home Ins. Co., 479 N.E.2d 1078, 1081 (Ill. App. Ct. 1985); Anglo-Am. Ins. Co. v. Molin, 670 A.2d 194, 198 (Pa. Commw. Ct. 1995)).

236. *Id.*

237. This Note makes no claim that *Millers* represents a majority approach or even the law of Missouri. *See* Underwriters Guar. Ins. Co. v. Nationwide Mut. Fire Ins. Co., 578 So. 2d 34 (Fla. Dist. Ct. App. 1991) (holding that an insurer was not obligated by its contract to continue defending additional an insured after payment of policy limits in settlement for named insured).

238. Millers Mut. Ins. Ass'n v. Shell Oil Co., 959 S.W.2d at 865.

239. *Id.* at 866.

> obtain independent representation. Care must be taken to assure that the individual understands that, when there is such adversity of interest, the lawyer for the organization cannot provide legal representation for that constituent individual, and that discussions between the lawyer for the organization and the individual may not be privileged.[240]

Thus, the Model Rules suggest that constituents be given "*Miranda* warnings."[241] This suggested prophylactic is apparently designed for the corporation's benefit.[242] If a corporation's attorney unintentionally becomes the lawyer for one of the corporation's constituents, a number of problems can arise.[243] For example, the lawyer that represents both corporation and constituent could not pursue the corporation's claims against the constituent.[244] Further, ethical contagion may occur: The dual representation by one lawyer may "vicariously taint" other lawyers in the same office.[245] And, more basically, if the attorney represents both the corporation and a constituent, the attorney's loyalties to the corporation may be eroded.[246]

In the context of insurance, the problem of constituent representation appears particularly troublesome when corporate attorneys have contact with insurance agents. First, there are numerous opportunities for inadvertent creation of an attorney-client relationship with an agent.[247] Second, where an attorney-client relationship is formed, the likelihood of conflict is substantial.[248]

1. *The Seeds of Trouble: Opportunities for Inadvertent Representation of Agents*

The actions of the agent may have an important—if not determinative—impact on the insurer's liability. For example, the Iowa Supreme Court has said that "[o]ur cases have uniformly held that a soliciting agent's knowledge and material declarations at the time an application for insurance is obtained are binding on the company and may serve as a basis for reformation."[249]

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240. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13 cmt. (1995).

241. *See* STEPHEN GILLERS, REGULATION OF LAWYERS: PROBLEMS OF LAW AND ETHICS 501 (4th ed. 1995) (using term "*Miranda* warnings" in context of corporate lawyers' contacts with other employees).

242. *See* Kathryn Tate, *Lawyer Ethics and the Corporate Employee: Is the Employee Owed More Protection than the Model Rules Provide?*, 23 IND. L. REV. 1, 13 (1990) ("One key deficiency is that Model Rule 1.13 does not require that employees be given an early warning about the corporate attorney's role.").

243. GILLERS, *supra* note 241, at 501.

244. *Id.*

245. *Id.*

246. *Id.*

247. *See infra* section IV.D.1.

248. *See infra* section IV.D.2.

249. Johnson v. United Investors Life Ins. Co., 263 N.W.2d 770, 772 (Iowa 1978) (citing Quinn v. Mutual Benefit Health & Accident Ass'n, 55 N.W.2d 546, 550-51 (Iowa

Thus, an inhouse insurance attorney—whether he is acting for the insurer or the insured—may have occasion to interview the agent.[250] One purpose of such an interview is obvious: To find out what exactly was said to and by the agent.[251] If, however, during that interview—or through subsequent conduct—the agent reveals confidential information to the attorney, then the attorney may be obliged to hold that information secret.[252] Similarly, if the attorney provides some legal advice to the agent, the agent may form reasonable beliefs that would support a finding of an attorney-client relationship.[253] As with most cases, the facts of the interaction would control.[254]

It must also be remembered that insurance agents themselves are subject to liability in many forms.[255] Accordingly, agents may seek out the services of the insurer's inhouse attorney. If that attorney provides the agent with legal advice, an attorney-client relationship may be created despite the absence of a formal retainer.[256]

2. *The Fruition of Conflict: Adversity Between Insurers, Insureds, and Agents*

Little imagination is required to conceive of opportunities for conflict between an insurer and its agents. For example, in the case of *Magnusson v. Public Entity National Company-Midwest*,[257] an independent insurance agent brought suit against an insurer for breach of contract and fraudulent misrepresentation after the insurer gave its bid on public entity insurance to

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1952); Lankhorst v. Union Fire Ins. Co., 20 N.W.2d 14 (Iowa 1945); Mortenson v. Hawkeye Cas. Co., 12 N.W.2d 823 (Iowa 1944); Green v. Phoenix Ins. Co., 253 N.W. 36 (Iowa 1934); Smith v. National Fire Ins. Co., 207 N.W. 334 (Iowa 1926); Fitchner v. Fidelity Mut. Fire Ass'n, 72 N.W. 530 (Iowa 1897)).

250. *Cf.* Tate, *supra* note 242, at 13-14 ("Once a corporation learns that it is being investigated for possible violations of the law, it will hire counsel, or possibly use its in-house counsel, to conduct an internal investigation to ascertain if there has indeed been any corporate illegality.").

251. *See id.* at 13 ("When there is corporate misconduct, employees will have information about or will have been involved in that misconduct."). One alternative purpose of an interview might be to evaluate the strengths and weaknesses of the agent as a potential witness. *See* Arthur H. Aufses, III, *Total Preparation of the Deposition Witness*, *in* TAKING AND DEFENDING DEPOSITIONS IN COMMERCIAL CASES 1996, at 7, 14 (PLI Litig. & Admin. Practice Course Handbook Series No. 556, 1996).

252. *See supra* notes 189-96 and accompanying text.

253. *See supra* notes 178-83 and accompanying text.

254. *See supra* notes and 178 and 180accompanying text.

255. *See infra* notes 261-65 and accompanying text.

256. *See supra* notes 175, 178, 180-81 and 183 and accompanying text.

257. Magnusson Agency v. Public Entity Nat. Co.-Midwest, 560 N.W.2d 20 (Iowa 1997).

another agent.[258] Conversely, in *Commercial Insurance Company v. Apgar*,[259] the insurer brought an action for wrongful and fraudulent conversion of insurance premiums paid by insureds to the agents but not remitted to the insurer.[260] Thus, an attorney that has attorney-client relations with both an insurer and one of its agents may represent two directly adverse parties.

Similarly, conflict may arise between an insured and an insurance agent. As Jeffrey Lipman and Greg Noble have observed, the common law provides consumers with a broad arsenal for use against the errant insurance agent.[261] Included in that arsenal are the weapons of professional negligence,[262] breach of contract,[263] negligent misrepresentation,[264] and breach of fiduciary duty.[265] So, not unlike the attorney who represents both the insurer and an agent,[266] an attorney who owes ethical duties to both an insured and an agent may be drawn into conflict.[267]

E. *Summary*

The bizarre love triangle may have more than three sides.[268] The insurer's inhouse attorney may find himself in attorney-client relationships with not one, but many insureds.[269] Further, duties will always be owed to the insurer,[270] and duties may come to be owed to an agent.[271] And, as the list of potentially adverse clients grows, so too does the probability of ethical difficulty for the attorney.[272]

V. CONCLUSION

In many regards, the increasing use of inhouse counsel by insurers should be viewed as beneficial to society.[273] It is conceivable that the savings

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258. *Id.* at 24.

259. Commercial Ins. Co. v. Apgar, 267 A.2d 559 (N.J. Super. Ct. Law Div. 1970).

260. *Id.* at 561.

261. Jeffrey Lipman & Greg Noble, *Agent-Broker Negligence Actions: Pitfalls for Insurance Providers and Ammunition for Consumers*, 44 DRAKE L. REV. 835, 845-48 (1996) (examining the causes of action available to consumers).

262. *Id.* at 845-46.

263. *Id.* at 846-47.

264. *Id.* at 847-48.

265. *Id.* at 848.

266. *See supra* notes 257-60 and accompanying text.

267. For an illustration of this problem, see *supra* note 196 and accompanying text.

268. See *supra* notes 68-70 and accompanying text for a discussion of the triangular view of the insurance defense counsel's ethical problems.

269. *See supra* Part IV.C.

270. *See supra* Part IV.B.

271. *See supra* Part IV.D.1.

272. *See supra* Parts III to IV.

273. *See generally* Jordan & Kahn, *supra* note 29 (arguing that insurance company staff counsel programs can be consistent with the ethical rules). *Cf.* Cunniffe, *supra* note 15, at 107

allowed by such efficient use of legal personnel could be passed along[274] to insureds, thus benefiting a large number of Americans.[275] Further, even if premium levels remain stable, insurers' savings can enhance solvency thus, benefiting our insurance-dependent society.[276] Such benefits would be consistent with Adam Smith's observation that "it is the great multiplication of the productions of all the different arts, in consequence of the division of labour, which occasions, in a well-governed society, that universal opulence which extends itself to the lowest ranks of the people."[277] It must, however, be remembered that Smith's sanguine prediction was qualified: The "universal" benefits of specialization are enjoyed only in "a well-governed society."[278] And, in the United States, it is axiomatic that ethical conduct by lawyers is a *sine qua non* to good government:

> *The continued existence of a free and democratic society depends upon recognition of the concept that justice is based on the rule of law grounded in respect for the dignity of the individual and his capacity through reason for enlightened self-government.* Law so grounded in respect for the dignity of the individual and his capacity through reason for enlightened self-government. Law so grounded makes justice possible, for only through

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("The decline of the generalist lawyer . . . [and] the profession's shift toward greater specialization and diversification should largely be embraced.").

274. *See* Cunniffe, *supra* note 15, at 108 ("The efficiency savings that business enterprises achieve by employing legal specialists can be passed along to the general population in the form of lower overall prices for thousands of goods and services."). Given the assumption that most insurers act on the basis of economic and legal forces rather than altruistic impulse, such "passing along" of savings would most likely occur through price competition, regulation, or a combination of the two. *See* ABRAHAM, *supra* note 135, at 101 (describing types of rate regulation ranging from state prescription of rates to open competition).

275. For example, all but fifteen percent of Americans have health insurance throughout the year. *See* Carney Tom, *Survey says fewer Iowans uninsured; some skeptical*, DES MOINES REG., Jan. 17, 1998, at 6M (citing federal Census Bureau statistics).

276. Abraham notes:

> State departments of insurance traditionally have considered assuring the solvency of companies selling insurance in their jurisdictions to be their first mission. Insurance is unlike most tangible products, because the insured receives only the insurer's promise to pay in the event that the insured suffers a future loss. That promise to pay is valuable only so long as the insurer making the promise is financially capable of performing it when an insured loss actually occurs.

ABRAHAM, *supra* note 135, at 99; *see also* Amy M. Samberg, Note, *Drop Down Liability of Excess Insurers for Insolvent Primary Carriers: The Search for Uniformity in Judicial Interpretation of Excess Insurance Policies*, 33 ARIZ. L. REV. 239, 239 & n.1 (1991) (documenting an increase in significant insurer insolvencies).

277. SMITH, *supra* note 11, at 15.

278. *Id.*

> such law does the dignity of the individual attain respect and protection. Without it, individual rights become subject to unrestrained power, respect for law is destroyed, and rational self-government is impossible.
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> *Lawyers, as guardians of the law, play a vital role in the preservation of society.* The fulfillment of this role requires an understanding by lawyers of their relationship with and function in our legal system. *A consequent obligation of lawyers is to maintain the highest standards of ethical conduct.*[279]

Thus, the use of inhouse counsel to defend insureds can only be of real benefit to society if the lawyers involved "maintain the highest standards of ethical conduct."[280] Surely, in an ultimate sense, a lawyer's conduct is his own responsibility.[281] The insurer that employs that lawyer, however, can do much to support or sabotage the ethical efforts of that lawyer.[282] Perhaps the

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279. MODEL CODE OF PROFESSIONAL RESPONSIBILITY preamble (1980) (emphasis added); *see also* Perl v. St. Paul Fire & Marine Ins. Co., 345 N.W.2d 209, 215 (Minn. 1984) ("The professional conduct of attorneys has always been a matter of prime public policy concern to this court.").

280. MODEL CODE OF PROFESSIONAL RESPONSIBILITY preamble. Professor Silver has emphasized another perspective:

> It is also important to be open to the suggestion that occasionally the law of professional responsibility should give way. Liability insurance is greatly desired by insureds, judging from the amount of insurance purchased every year. The impressive level of demand should chasten anyone who may wish to propose professional responsibility rules that would make it more difficult or more expensive for insureds to obtain coverage. Insureds can be harmed both by lawyers who forsake their interests and by laws that cause premiums to rise. When private market ordering generates a practice, like the joint representation of companies and insureds, that is both widespread and firmly entrenched, the practice is probably beneficial. The benefit is worth keeping in mind when considering professional responsibility rule that would change the practice, make it more expensive, or bring it to an end.

Silver, *supra* note 168, at 1627-28.

281. *But see* Mallen, *supra* note 5, at 525 ("Those who manage or supervise lawyers in a staff counsel operation should be cognizant that they likely have ethical and civil responsibility for the subordinate lawyers and staff to assure the ethical integrity of the office.").

282. Of course, those who offer academic criticism or advise should always remember the distance between the classroom and the board room. As Henry Kissinger observed about the analagous gap between the ivory tower and the real world of politics:

> Intellectuals analyze the operations of international systems; statesmen build them. And there is a vast difference between the perspective of an analyst and that of a statesman. The analyst can choose which problem he wishes to study, whereas the statesman's problems are imposed on him. The analyst can allot whatever time is necessary to come to a clear conclu-

insurer's first act of support is to acknowledge that, although the use of inhouse attorneys can enhance profitability, it is not a panacea.[283]

Certainly, there will be situations in which the use of inhouse counsel to defend insureds would carry minimal risk. For example, if coverage is both undisputed and sufficient to cover liability, inhouse lawyers may be excellent candidates to represent an insured.[284] The truth of this assertion is particularly clear when neither an insurance agent nor multiple insureds is involved in the case.[285]

More often, however, the use of inhouse counsel to defend insureds will be counterindicated. In those cases, prudence dictates that alternate means of representing insureds be explored: If the potential for ethical conflict is ignored, a panoply of dangers awaits. If the inhouse lawyer is led into patently unethical behavior, then he may perish at the hands of an angry insured[286] or an ethics committee.[287] And, regardless of the lawyer's

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> sion; the overwelming challenge to the statesman is the pressure of time. The analyst runs no risk. If his conclusions prove wrong, he can write another treatise. The statesman is permitted only one guess; his mistakes are irretrievable.

HENRY KISSINGER, DIPLOMACY 27 (1994).

283. One solution to the efficiency versus ethics dilemma is the use of an appropriate mix of inhouse and outhouse counsel to defend insureds. *See* Jeffrey R. Parsons, *Litigation Management: In-House Counsel and Outside Counsel—Who's in Charge?*, *in* LITIGATION MANAGEMENT SUPERCOURSE: TECHNIQUES FOR IN-HOUSE AND OUTSIDE COUNSEL, at 219, 219 (PLI Corp. Law Practice Course Handbook Series No. 684, 1990) ("Successful management of a corporation's litigation is best acheived when inhouse and outhouse counsel function as an effective team."). Parson's concept of "teamwork," however, may not avoid all of the ethical problems discussed here, particularly if inhouse counsel's responsibilities include "defining the corporation's general litigation policies and communicating them to outside counsel." *Id.*

284. Jordan & Kahn, *supra* note 29, at 30 ("When an insurance company employs staff counsel to defend insureds in cases in which (1) there is no question of coverage and (2) the claim is within the insured's policy limits, it is highly unlikely that the interests of the insurance company and the insured will diverge."); Hall, *supra* note 124, at 733 ("Because the interests of the insurer and insured may be harmonious, this dual representation is often beneficial.").

285. *See supra* Parts IV.C to IV.D.

286. The Iowa Supreme Court has recently iterated the elements of legal malpractice:

> To establish a prima facie claim for legal malpractice the plaintiff must introduce substantial evidence of the following elements: (1) the existence of an attorney-client relationship between the defendant and plaintiff giving rise to a duty; (2) the attorney, by either an act or a failure to act, breached that duty; (3) this breach proximately caused injury to the plaintiff; and (4) the plaintiff sustained actual injury, loss, or damage. When the alleged malpractice involves the handling of a lawsuit the plaintiff must establish the third element by proving that, but for the lawyer's negligence, the underlying suit would have been successful.

individual fate, the specter of bad-faith liability haunts those insurers that do not adequately fulfill their duty to defend insureds.[288] Finally, it should be remembered that if our insurers do not choose to facilitate ethical practice by their employees, then the people may alter our insurers' freedom to choose.[289]

David N. May

Huber v. Watson, 568 N.W.2d 787, 790 (Iowa 1997) (citations omitted). *See generally* John E. Theuman, Annotation, *Measure and Elements of Damages Recoverable for Attorney's Negligence in Preparing or Conducting Litigation—Twentieth Century Cases*, 90 A.L.R. 4th 1033, 1045 (1992) (noting the amount the client would have recovered in the former action but for the attorney's negligence is a proper measure of damages).

287. *See, e.g.*, Iowa Supreme Court Bd. of Prof'l Ethics and Conduct v. Ronwin, 557 N.W.2d 515, 522 (Iowa), *cert. denied*, 117 S. Ct. 1845 (1997) ("In determining appropriate discipline, we must consider the attorney's fitness to continue in the practice of law, the deterrence of others from similar conduct, and assurances to the public that the court will maintain the ethics of the profession.") (citation omitted).

288. *See generally* Milton Roberts, Annotation, *Insurer's Tort Liability for Consequential or Punitive Damages for Wrongful Failure or Refusal to Defend Insured*, 20 A.L.R. 4th 23 (1981) (collecting cases).

289. The power of the people to change the rules under which insurers must operate is apparent. *See, e.g.*, U.S. CONST. amend. X ("The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."); IOWA CONST. art. 1, § 2 ("All political power is inherent in the people. Government is instituted for the protection, security, and benefit of the people, and they have the right, at all times, to alter or reform the same, whenever the public good may require it."); THE DECLARATION OF INDEPENDENCE para. 2 (U.S. 1776) (stating that "whenever any Form of Government becomes destructive . . . it is the Right of the People to alter or to abolish it, and to institute new Government"); THE FEDERALIST NO. 49, at 313 (Alexander Hamilton) (Clinton Rossiter ed., 1961) (noting that "the people are the only legitimate fountain of power"). California's Proposition 103 and the regulations which followed provide an alarming example. *See* Stephen Kreider Yoder, *California Unveils Insurer Rules Setting $2.5 Billion Refund and Cap on Profits*, WALL ST. J., Aug. 16, 1991, at A8.