

Coverage

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by Charles Silver & Michael Sean Quinn

"Kids say the darnedest things," was Art Linkletter's famous phrase. He might have added, "Adults say the darnedest things, too." Especially when the topic is lawyers. Errors abound in public discussions of lawyering and civil justice. Politicians seeking votes have incentives to distort the truth, so we expect all sorts of falsehoods from them.¹ We also expect lay persons to make innocent mistakes. Being unschooled in our profession, they naturally misunderstand our roles and our obligations. One reason why we have professional responsibility law is to protect the laity from suffering because of their ignorance of the practice of law.

One expects both rectitude and sophistication from lawyers who talk about lawyering. Alas, the world is endlessly disappointing. Lawyers serving as judges, as members of state bar advisory committees, as representatives of the American Bar Association, and as reporters on and industry liaisons to the American Law Institute's project on the law governing lawyers have made assertions about the professional responsibilities of insurance defense lawyers which are completely false and that reflect deep misunderstanding of the issues. Because these lawyers hold prestigious positions, their mistakes are not to be ignored. Already, some of these errors are being recited as propositions of law. If they work their way deeply into the fabric of the law, they


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Dispelling Nonsense

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will be difficult to isolate and extract. Worse, they will render the law increasingly irrational over time. Mistakes about defense lawyers' professional responsibilities will infect and endanger cognate areas of law, including insurance law governing an insurance company's right to control the defense of the insured, evidence law governing the attorney-client privilege, and bad faith law governing a company's liability for defense counsel's mistakes.² Issues lying at the intersections of all these bodies of law regularly arise when defense lawyers' professional responsibilities are questioned.

The errors to which we refer, all of which were made within the last two years, rest on a shared misunderstanding about attorney-client relationships. The errors all occurred because the commentators thought *they* were entitled to determine, once and for all, whether an attorney-client relationship exists between defense counsel and an insurance company. On reflection, it is abundantly clear that *they* had no standing to make that determination. The law in every jurisdiction is that attorney-client relationships are consensual.³ Such relationships arise when a client asks a lawyer to serve as an agent for the provision of legal services, and the lawyer agrees. Whether an attorney-client relationship exists, turns on facts. The crucial fact is the parties' shared intention, as expressed in an agreement or course of dealing, to create a relationship in which they stand as attorney and client. If commentators remain mindful that parties, not commentators, determine whether attorney-client relationships exist, they will better understand defense lawyers' professional obligations.

 Professor Charles Silver, Cecil D. Redford Professor, University of Texas School of Law, is Co-Reporter on a Special Project on the Professional Responsibilities of Insurance Defense Lawyers sponsored by the International Association of Defense Counsel (IADC) and the Defense Research Institute (DRI). He has received funding from these organizations for related work and gratefully acknowledges their support. The views expressed in this article have not been approved by the IADC or the DRI and cannot be attributed to the organizations or their members, past, present, or future. Michael Sean Quinn is a visiting professor at the University of Texas School of Law. He is a former partner in the Dallas office of the law firm of Zelle & Larson, where he regularly handled insurance bad faith cases.

The mistakes we will take up appear in diverse places: a column in the *ABA Journal*; an advisory opinion issued by the California State bar; two cases from different Texas courts of appeals; an article in *Texas Lawyer*; and a decision of the Supreme Court of Tennessee. The diversity of the outlets indicates that we are dealing with the tip of an iceberg. Misunderstandings about defense lawyers' professional responsibilities undoubtedly exist nationwide. It is important to set the record straight.

Part I: Going the Wrong Way Down a 'Three-Way Street'

The professional responsibilities of insurance defense lawyers have received a fair amount of attention lately in the legal press. For example, "Three-Way Street," a column by Joanne Pitulla, appeared in the August 1995 issue of the *ABA Journal*.⁴ Pitulla is assistant ethics counsel in the ABA Center for Professional Responsibility, and her column usually is a source of reliable information about professional responsibility law. However, in this particular instance she makes remarkable and in-supportable claims about the tripartite relationship involving an insurance company, defense counsel, and an insured.

Pitulla's first mistake was giving the wrong answer to the question, Whom does defense counsel represent? "The majority view," she wrote, "is that the insured is the sole client even though the insurer retains the lawyer and foots the bill. . . . Most courts hold that the lawyer owes contractual or fiduciary duties to the insurer but not the duties of lawyer to client." That is not, and has never been, the majority rule. As William T. Barker, one of the leading lawyer-commentators on insurance issues, observes, "[t]he overwhelming consensus of the jurisdictions that have addressed the issue is that '(i)nsurance defense counsel routinely and necessarily represent two clients: insurer and insured.'"⁵ A recent report of the Professionalism Committee of the Tort and Insurance Practice Section of the American Bar Association agrees with Barker on the point.⁶ Apparently, Pitulla formed a mistaken impression after reading *Atlanta International Insurance Co. v. Bell*, a Michigan Supreme Court decision she discussed in her column that denied the existence of an attorney-client relationship between the lawyer and the carrier. *Bell* is "an anomaly in American law," as the authors of the leading treatise on legal malpractice point out.⁷ Most jurisdictions that have decided cases embrace

what we will call the two-clients view, according to which insurance defense counsel routinely represents both the company and the insured.⁸

The two-clients view also rests on a far firmer analytical foundation than the minority one-client approach. Under prevailing law, the right to defend provided for in the insurance contract entitles the company to control the defense of the liability suit, absent a conflict of interest sufficient to deprive the company of that right.⁹ The company makes all litigation calls a defendant ordinarily makes. It hires and fires defense counsel, manages the process of discovery, and decides litigation strategy. As Barker points out, "[t]he usual liability policy language grants the insurer whatever right the insured would otherwise have to direct counsel in the conduct of the litigation."¹⁰ However, to control defense counsel effectively an insurance company must be a co-client. As a co-client, it has every right to instruct the lawyer who represents it in the conduct of the joint representation. As a non-client, a company could not effectively control defense counsel because the law of professional responsibility greatly restricts the extent to which a lawyer may take instruction from a third-party payor.¹¹ Obviously, by definition and well-established law, third-party payors are never clients. Because attorney-client relationships are contractual, it makes sense that a company, when retaining defense counsel, would make itself a co-client and thereby put itself in a position to exercise its contractual right to defend the lawsuit against the insured. Otherwise, a company would be unable to protect its financial stake in the litigation. In the majority of all cases where liability insurance is involved, the insured-defendant is fully covered for the loss. In all such cases, as a matter of practical economics, only the insurance company has any exposure.

Another misstatement is Pitulla's assertion that defense counsel must represent the insured's interest as if the insured hired counsel directly. While insurer and insured share common interests, they may diverge at any point—over settlement, for example. Insurance "defense counsel must act in the best interests of the insured even if this compels opposing the insurer regarding procedure or strategy."¹²

The first and third sentences quoted are misleading or false. Defense counsel does not and should not act as an insured's personal counsel would. For one thing, defense counsel does and should take instruction from the company, not the insured. For another, defense counsel (usually) does not and

never should advocate the insured's interests when a conflict arises between the company and the insured. It is black letter law that a lawyer who jointly represents two clients cannot subordinate the interests of one client to those of another, without obtaining the informed consent of (at least) the client who stands to be harmed.¹³ It follows that a lawyer who represents both a company and an insured cannot take a side in a dispute between the two, without express authorization from at least the client who stands to be harmed.

Some authorities try to finesse this dispositive point by contending that the insured is the primary client whom defense counsel must favor in conflict situations. Statements to this effect that appear in decided cases are dicta, however, and the view itself is an insupportable deviation from nearly-universal norms of professional responsibility law.¹⁴ The notion of a "primary client" has no concrete meaning under professional responsibility law, which puts all co-clients on an equal footing absent an agreement that a particular co-client is to be preferred. Because "primary client" is a meaningless locution, its use should be discontinued.

Pitulla's remarks concerning settlement conflicts are perhaps the most alarming of her errors. Taken at face value, her words imply that defense counsel, when making settlement recommendations, must argue the position most beneficial to the insured whatever the merits of settling or the impact on the company may be. It is hard to imagine what led Pitulla to think defense counsel's job is to beat up the company at the company's expense for the benefit of the insured. In our experience, insurance companies retain defense lawyers to beat up liability claimants, not to beat up themselves, and to provide objective advice concerning settlement values and the merits of the surviving liability claims. How does Pitulla think insurance companies would react if they could not trust defense lawyers to provide unbiased advice? It is obvious to us that they would handle settlement issues in-house, which they have every right to do, removing defense counsel from the loop.¹⁵ It seems unlikely that this development would help insureds, and there is no obvious reason to encourage insurance companies to handle settlement via their own personnel.

The deeper point here is that the parties to the retainer agreement decide what tasks the lawyer will perform in the representation.¹⁶ Will the lawyer (or someone else) handle settlement? Will the lawyer (or someone else) conduct discovery? Will the

lawyer (or someone else) appear in court? Just as the parties to a retainer agreement decide who the lawyer's clients are to be, they also fix the scope of the lawyer's undertaking, thereby determining the range of services the lawyer must provide. This, again, is black letter professional responsibility law.¹⁷ It follows that the party retaining defense counsel determines whether defense counsel is to have any role in settlement and, if so, what that role is to be. In our experience, the party that hires defense counsel, the primary insurer, normally assigns counsel the task of providing accurate, unbiased settlement advice. It makes sense to employ defense counsel this way. Defense counsel will know the case, will have a reservoir of settlement experience, and will have a point of view that, to some extent at least, is independent of both the company and the insured.

But if they are non-clients, they must sit on the sidelines like other third-party payors (such as employers, parents, friends, or drug lords who hire lawyers to represent, respectively, employees, children, friends, or mules), and defense lawyers must follow only instructions received from insureds.

Pitulla is far from the only authority on professional responsibility law to have made incorrect statements about defense lawyers' obligations in the legal press. Not long ago, in an interview with *Texas Lawyer*, Geoffrey Hazard, the Director of the American Law Institute and the driving force behind the Institute's effort to restate the law governing lawyers, made several stunning remarks. He also treated the fundamental question, "Is or is not the company a client?," in an extraordinarily flip-pant way. Hazard's statements, as quoted in *Texas Lawyer*, appear in full below.

A lot of insurance companies want (the *Restatement* [of the *Law Governing Lawyers*]) to say that they are clients, too because if they're not treated as client, the law in some states says they can't sue for malpractice. But to me, that's a non sequitur—there are con-

tractual duties owed by the attorney to the insurance company, and if you [the lawyer] screwed up, why should you [the lawyer] be immune just because you [the insurance company are] not called a client? . . . [W]hat I'm telling them is that our analysis is based on the premise that there are duties owed by an attorney, and an insurance company can sue for malpractice even if they're not a client. And if there are states where the law would make that difficult to do, *then call them 'the other client' if you have to.*¹⁸

The italicized language is scandalous. Call the insurance company a client if need be to support a malpractice claim? Does not the connection run in the opposite direction? Determine if the company is a client and, if it is, let it sue for malpractice. Client status is acquired at the outset of a representation by mutual agreement. Even the ALI's *Restatement of the Law Governing Lawyers* agrees that is so. Section 26 of the *Restatement* provides as follows.

A relationship of client and lawyer arises when:

- (1) A person manifests to a lawyer the person's intent that the lawyer provide legal services for the person; and
- (2)(a) The lawyer manifests to the person consent to do so or (b) fails to manifest lack of consent to do so, when the lawyer knows or reasonably should know that the person reasonably relies on the lawyer to provide the services, or (c) a tribunal with power to do so appoints the lawyer to provide the services.¹⁹

Given the connection the *Restatement* draws between client status and the parties' agreement to establish an appropriate relationship, Prof. Hazard ought not peddle the nostrum that a judge can freely slap the label "client" on a non-client who wishes to assert a malpractice claim.

Furthermore, it is important to know whether a company is a client for other reasons. Insurance companies rarely sue defense lawyers for malpractice, but they instruct lawyers who are defending lawsuits every day. Are they entitled to tell defense counsel what to do? If they are clients, it is clear that they are. But if they are non-clients, they must sit on the sidelines like other third-party payors (such as employers, parents, friends, or drug lords who hire lawyers to represent, respectively, employees, children, friends, or mules), and defense law-

yers must follow only instructions received from insureds. Such an arrangement would make it exceedingly difficult for companies to administer cases and would greatly impair their ability to hold down defense costs. And what about the attorney-client privilege? Does control of that privilege rest (in part) in the company's hands? If the company is a non-client, then, under prevailing law, the insured can waive the attorney-client privilege without the company's consent.²⁰ Imagine the impact that would have in cases where insureds assign claimants the right to sue their insurance carriers for bad faith.

It is easy to see why insurance companies, lawyers, and insureds do not share Prof. Hazard's perception that the debate over the company's status is an "obscure and somewhat arcane controversy," to be treated cavalierly.²¹ Perhaps it overstates the case to say that insurance drives tort litigation, but it is surely true that insurance and tort litigation substantially interpenetrate. It is also true that liability insurers spend hundreds of millions of dollars every year defending lawsuits brought against their insureds. These same companies spend billions of dollars paying claims. The two classes of expenditures interact. From an economic point of view, it makes no sense to deny insurers control over their expenses and their risks. Law must accord with sound, sensible social practice.

In the real world, where insurance companies are battling liability claimants, defending most cases unreservedly, defending some cases under reservations of rights, struggling to obtain the cooperation of insureds, making close settlement calls, hiring, instructing, firing, and (occasionally) suing defense lawyers, defending bad faith claims, and fighting to contain costs, the issue Prof. Hazard treats so jocularly matters greatly. This is why the interested parties know how important it is to apply the label "client" correctly. What is difficult to understand is why Prof. Hazard thinks the issue matters so little. As the *Restatement of the Law Governing Lawyers* points out,

Many legal requirements turn on the distinction between clients, to whom lawyers owe many duties, and nonclients, to whom they owe few duties. *It is therefore vital to know when someone is a client, and when not.*²²

The divide between clients and non-clients is fundamental to professional responsibility law. Privity, to use the language of another day, is not dead. To the contrary, it lives and, in some juris-

dictions, it is even frisky. It is little short of amazing that a leading authority on professional responsibility and a collaborator on the *Restatement* should need reminding of that.

Part II: Stare Indecisis—What Is the Law of Texas Anyway?

Another statement in the *Texas Lawyer* worth noting was Robert O'Malley's assertion that "Texas law clearly takes the view ... that [defense counsel's] sole duty is with and to the insured."²³ O'Malley is Vice Chairman and Loss Prevention Counsel of the Attorneys Liability Assurance Society. He is also a leading player in the politics surrounding the increasingly controversial *Restatement*, and he is the author of an article often cited in support of the one-client view.²⁴ His statements concerning a jurisdiction's law are worth considering and, in fact, two recent opinions out of two different Texas courts of appeals bear him out. The cases are *State Farm Lloyds Insurance Company v. Maldonado*²⁵ and *Bradt v. West*,²⁶ both decided last year. Can it be that Texas, our home jurisdiction, is a one-client state?

No, it cannot be. To the contrary, Texas jurisprudence assumes that a defense lawyer has two clients, the company and the insured. The leading Texas opinion is *Employers Casualty Company v. Tilley*.²⁷ Indeed, *Maldonado* and *West* purport to rely upon *Tilley* in reaching the one-client conclusion. The trouble is, both courts of appeals misread *Tilley*, which was expressly premised on the two-clients view. Texas adheres to the majority rule.

In *Maldonado*, the insured asserted that because his lawyer, whom State Farm Lloyds retained to defend him, recommended settlement of the liability claim, the insurance company was negligent in declining to settle. The court of appeals rejected this assertion, stating that it

overlooks the fundamental principle that [the lawyer's] client was [the insured,] not State Farm. [The lawyer] was State Farm's agent in the sense that negligence by him would have been imputed to State Farm in certain circumstances. But it does not follow that [the lawyer] was State Farm's agent in the sense that his opinions about settlement bound the company. On that issue [the lawyer] was acting for the insured. [The lawyer's] duty was to protect the insured's interests, and in pursuance of the duty he tried valiantly to settle the case. But in urging settlement he

was acting on behalf of the insured and not the insurer who hired him.²⁸

Although the court of appeals came to the right conclusion, almost every sentence in the passage quoted is completely wrong.

Consider the assertion that it is a fundamental principle of Texas law that the defense lawyer's sole client was the insured. In support of this statement, the court of appeals cited two Texas Supreme Court cases, *American Physicians Insurance Exchange v. Garcia*²⁹ and *Tilley*. Neither case endorsed the principle the court of appeals identified. In a footnote, *Garcia* stated that a particular lawyer did not represent a particular insurance company.³⁰ Putting aside the fact that a footnote is hardly the place to announce a fundamental principle of law³¹ and ignoring the fact that the footnote would be dictum if it did assert a proposition of law,³² in reality, the footnote contained a statement of fact specific to the particular case before the Supreme Court. The footnote did not set out any relevant proposition of law. The Supreme Court concluded that the attorney did not represent the carrier because the record showed plainly that the company told the lawyer he had no authority to speak for the company and that the lawyer understood the company to be a third-party payor.³³ If anything, the *Garcia* footnote presupposes the two-clients view by assuming that the lawyer would have been the company's attorney if the company had authorized him to act on its behalf. There is nothing, anywhere in *Garcia*, which suggests that the insurer could not have authorized the lawyer to speak for it. Clearly, the *Maldonado* court read the footnote incorrectly.

In addition to making a factual claim, the *Garcia* footnote also cites *Tilley* for the proposition that "an attorney retained by an insurer to defend the insured owes the insured a duty of unqualified loyalty."³⁴ This may sound like an endorsement of the one-client view, but it is actually a statement of black letter, multiple-client, professional responsibility law. Any lawyer who represents more than one client owes a duty of unqualified loyalty to each. As already mentioned, the duty forbids the lawyer from subordinating the interests of one client for the sake of another. The lawyer can pursue only courses of action which either make both clients better off or make one better off without harming the other. *Garcia's* reference to *Tilley* is thus entirely consistent with the two-clients view.

The tendency of commentators and judges to interpret statements concerning defense counsel's

duty of unqualified loyalty to the insured as requiring defense counsel to side with the insured in conflict situations reflects a misreading of the phrase "unqualified loyalty." A lawyer who represents a single client demonstrates unqualified loyalty to that client by advocating that client's interests exclusively. A lawyer who represents multiple clients demonstrates unqualified loyalty to each client by refraining from pursuing any course of action that is expected to make any client worse off. Under professional responsibility law, the content of the duty of unqualified loyalty a lawyer owes a client depends on whether the lawyer has multiple clients or only one.

Now turn to *Tilley* itself. There, the lawyer defended the insured for 18 months without revealing that he was also helping the company build a case for denying coverage on grounds of late notice. The Texas Supreme Court found this conduct inappropriate, reasoning that because the lawyer represented the insured, he owed the insured unqualified loyalty and could not work adversely to the insured without the insured's informed consent.³⁵ This holding is unexceptionable. To conclude as it did, the *Tilley* court did not need to, and did not in fact, deny that the insured's defense lawyer also represented the insurance company. No violation of a duty owed to the company was alleged. The court had simply to apply the rule that a lawyer who represents two clients cannot subordinate the interests of Client 1 to those of Client 2 without the informed consent of Client 1.

Tilley could not express more clearly the majority's belief that the lawyer had two clients. First, the majority explicitly analyzed the case under professional responsibility rules that apply to multiple-client representations.³⁶ Second, the *Tilley* majority relied extensively on the Guiding Principles promulgated by the National Conference of Lawyers and Liability Insurers of the American Bar Association.³⁷ The Guiding Principles endorse the two-clients view, identify the insurance company as the client in charge, and anticipate that defense counsel will zealously protect the company's financial interest in the liability suit.³⁸ Third, the majority rejected the position of Justice Johnson, who wrote separately that defense counsel's only client was the insured.³⁹ Fourth, the majority held the insurance company accountable for the lawyer's misconduct because the company controlled the lawyer.⁴⁰ Had the majority thought the company was a non-client, it would have had to deal with the problem, raised in Justice Johnson's concur-

rence, that Texas professional responsibility law prohibits a lawyer from taking instruction from a third-party payor.⁴¹ As it was, the majority saw no need to address this issue.

In reality, then, *Maldonado's* so-called "fundamental principle" is at odds with Texas law.⁴² Neither *Tilley* nor *Garcia* provides any basis at all for asserting that Texas is a one-client state. *Tilley* supports the contrary principle that normally defense counsel has two clients. *Garcia* says only that the lawyer did not represent the insurance company in that case and, by saying that, presupposes that the lawyer would have represented the company as well as the insured had he been authorized. Both cases comport with the real fundamental principle of Texas law, which is that private agreements, not courts, determine how many clients a lawyer is to represent.⁴³ When an insurance company and a lawyer agree that the lawyer is to represent both the company and the insured, the lawyer has two clients. When they agree that only the insured is to be represented, the lawyer has only one. The answer to the question, Whom does defense counsel represent?, is that simple.

The Houston Court of Appeals, which decided *Bradt v. West*,⁴⁴ also got the law wrong. In *West*, an obstreperous litigant sued opposing counsel for moving to hold him in contempt and at the same time sought recovery from the insurance carriers who retained the lawyers. The Houston court had nothing but contempt for this appeal, and said so by quoting the poet George Herbert, "the worst of law is that one suit breeds twenty."⁴⁵ Nevertheless, the court discoursed at length on the legal relationships obtaining among defense counsel, the insured, and the defending insurers:

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, the 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 cases, and the insured's interests that he represents. There is no attorney-client relationship between [defense counsel] and the [insurance] company [providing the defense].⁴⁶

Tilley is the only Texas case the court of appeals cited in support of this remarkable statement. We have already shown that *Tilley* is solidly and unambiguously a two-clients case. Hence, *West* flies in the face of authority from the Texas Supreme Court. Section 26 of the *Restatement*, quoted above, also makes mincemeat out of this language from *West*. According to § 26, a lawyer-client relationship exists if a lawyer and another person agree that the lawyer shall, and the lawyer in fact does, provide legal services to that person. No one with the slightest knowledge about litigation and its management has any doubt whatsoever that defense lawyers provide legal services to liability carriers acting for their insureds.

We can easily understand and forgive O'Malley's mischaracterization of the law of a particular state, even one as important as Texas. O'Malley, who is from Illinois, cannot be expected to analyze carefully every jurisdiction's caselaw. We strike this conciliatory note even though *Tilley* is a nationally renowned case. It is harder for us to understand our fellow Texans sitting on the Houston and San Antonio courts of appeals. *Tilley* is famous around these parts. Every defense lawyer we know knows it by name and is familiar with its holding. Some keep a copy of the opinion within arm's reach of their desks. *Tilley* is a two-clients case. Locals should more accurately state our law. Or, if their aim is to transform Texas law, they should refrain from doing so by sleight of hand.

Part III: The Supreme Court of Tennessee: Leading the Charge for Managed Legal Care

Texas judges are not the only ones who forget that attorney-client relationships arise by consent. Every justice on the Supreme Court of Tennessee suffered the same lapse earlier this year. The occasion for the bout of group amnesia was *In re Youngblood*,⁴⁷ where the Court considered whether professional responsibility law permits an insurance company to use staff attorneys to defend insureds in liability suits. In concluding "maybe," the Court said many doubtful things, the first of which was that "[t]he employment of an attorney by an insurer to represent the insured does not create the relationship of attorney-client between the insurer and the attorney."⁴⁸ It should be obvious by now that this is sheer and unwarranted stipulation. Such

an employment can and usually does create just that relationship. Attorney-client relationships are consensual, even in Tennessee.⁴⁹ Therefore, the parties to the retainer agreement determine whether the lawyer will represent the company as well as the insured.

Another unwarranted assertion in *Youngblood* is the statement that a lawyer representing an insured in a liability action owes the insured the same loyalty "whether the attorney is employed and paid by the [insured], is a salaried employee of the insurer, or is an independent contractor engaged by the insurer."⁵⁰ Surely the obligations of an insured's personal counsel differ from those of a defense lawyer hired by an insurer. Personal counsel represents only the insured, obeys only the insured, and protects only the insured. That is why personal counsel can, does, and should go to bat against the insurance company for the benefit of the insured. By contrast, carrier-hired defense counsel has two clients, takes instruction from the company, and must protect both clients. That is why defense counsel *cannot* permissibly beat up the company for the sake of the insured.

Most shocking of all was the Court's utter refusal to consider the economies when deciding whether to permit staff attorneys to defend insureds.

Petitioners defend the use of employee-attorneys as an efficient and economical means of accomplishing the insurers' obligations to defend their insureds. Petitioners explain that the specialization and institutionalization of the bar which . . . make the economy and efficiency possible, necessitates [sic] that the regulation of the profession must be founded on practical realities as they exist. If the import of petitioner's argument is that ethical considerations must be sacrificed for the sake of economy, that proposition is totally rejected. The loyalty and independent judgment required by the Code [of Professional Responsibility] are absolute. They are essential to the integrity and accountability of the profession and the legal system. If the cost of legal representation is burdensome, . . . the profession must look to reforms which do not threaten the foundation of the profession and the system of justice.⁵¹

To say that this view is otherworldly is to understate the matter. Clients often try to save money by hiring (relatively) inexpensive attorneys, by acting as co-clients of a single attorney, and by limiting the services attorneys are to provide. Professional

responsibility law allows attorneys to help clients who want to spend less.⁵² It permits lawyers to charge low prices, it rarely requires lawyers to provide more legal services than clients wish to buy, and it allows lawyers to represent co-clients. By insisting that insurance companies provide gold-plated attorneys to insureds, the Supreme Court of Tennessee made a pig's breakfast of professional responsibility law. The Court also undermined the integrity of insurance law. For the better part of a century, insurance companies have satisfied the duty to defend by providing lawyers who represent the company and the insured,⁵³ and they have done so in keeping with lawyers' professional norms.⁵⁴ Now, when a conventional defense lawyer is retained to handle a matter in Tennessee, the insurance company may breach the duty to defend and the lawyer may violate the duty of loyalty to the insured.

Even worse than the court's departure from long-standing doctrines is the extraordinary message the passage conveys. Send in the gold-plated lawyers, and hang the expense! Any price must be paid to preserve the foundation of client loyalty on which the profession and the system of justice rest! Can the justices fail to see that lawyers' professional freedom is more greatly threatened by spiraling legal costs than by joint-client insurance representations in which staff attorneys are employed?⁵⁵ Did word of the Republican Revolution not reach Tennessee, or did the justices think the Attorney Accountability Act and Common Sense Legal Reforms Act would not apply to their state? Did the justices sleep through the debate over national health care? Doctors nearly lost their professional independence, not because too many doctors served patients badly, but because doctors served patients too well. They emphasized quality of care regardless of cost. As a result, they narrowly escaped federal regulation, and they now seethe under the constraints of managed care.

It is far from fanciful to suggest that lawyers are next. Already, spiraling legal costs have greatly impaired policyholders' ability to buy insurance coverage for defense costs. Policyholders who once purchased unlimited defense cost insurance now obtain coverage tied to the policy limits, so that every dollar spent defending claims reduces the amount available for indemnification. Policyholders provide self-insured retentions that require them to bear defense costs up to established limits. Insurance companies serve as third-party administra-

tors who manage lawyers for insureds. Nationwide insurance companies bring increasing amounts of legal work in-house. They sponsor conferences and research programs aimed at dethroning the billable hour and developing cheaper, alternative methods of paying lawyers. They solicit bids from law firms on blocks of cases and concentrate their work among a smaller number of firms. They impose rigid billing requirements and hire accounting firms to audit lawyers' bills. They support the Republican agenda of civil justice reform.

Here is a simple truth. Cost control is not the enemy of substantial justice or client service. Cost control is an essential feature of responsible lawyering that must be taken into account by judges who announce standards with which lawyers must comply. Judicial demands for gold-plated lawyers are a dangerous threat to the continued professional independence of the bar. The days are long past (if there ever were such days) when insurance companies could afford to provide every insured a "Cadillac defense," no matter how small the claim or how meritorious the complaint. If judges make it difficult for lawyers to control costs themselves, others will be only too glad to subject lawyers to managed care.

Part IV: They're Still Doing Drugs in California. How Else Can Opinion 1995-139 Be Explained?

California Formal Opinion 1995-139 is supposed to shed light on some important duties defense lawyers have, including duties regarding information acquired from an insured that puts the insured's coverage in doubt. Unfortunately, the light has a psychedelic quality. Like the colored lights at a disco bar that freeze dancers in weird poses, the opinion creates a strange, distorted picture of the subject it purports to illuminate.

In California, does defense counsel have one client or two? According to Opinion 1995-139, the answer is one-and-a-half. "Clearly," the opinion begins, the "insurer is denominated a 'client' by case law. . . and is substantially affected by the insured's matter. But," it continues, "while [the] insurer is indeed a client in some respects--the ongoing relationship with the [attorney], the payment of fees, etc.—it is a client whose rights under case law are clearly limited."⁵⁶ Limited how?, one naturally asks. According to the opinion, an insurance

company *stops being a client* when a conflict arises and is denied any right of access to information communicated to the lawyer by the insured.⁵⁷ "[I]f an insured reveals matters to the attorney in confidence, and these matters are not intended to be heard by the insurer, the attorney may not reveal them to the insurer, regardless of the relationship between them."⁵⁸

Clearly, Opinion 1995-139 forbids a defense lawyer from communicating to a company confidential information received from an insured. That expressly includes information that might lead to a coverage denial.⁵⁹ Does it include anything else? The opinion does not say, but its broad language imposes no obvious limit on the insured's power to limit the information defense counsel can convey. In an automobile accident case, can a married insured insist that defense counsel keep secret the fact that his mistress was a passenger in the car? Can the insured require defense counsel to hide the fact that the insured-driver is a diabetic whose blood sugar may have been low? Suppose the insured's spouse apparently suffered a back injury in the wreck? If the insured lets slip that the spouse had a preexisting condition, must defense counsel keep that information confidential as well? Even though these bits of information relate to liability and damages rather than coverage, the opinion's unqualified language entitles the insured to insist they not be revealed.⁶⁰

Opinion 1995-139 gets professional responsibility law wrong in several respects. First, absent an express agreement so providing, a representation does not end when a conflict occurs. A representation ends when a lawyer completes an assignment, when a client discharges an attorney, when an attorney withdraws, etc.⁶¹ This comports with the contractual nature of attorney-client relationships. "Just as consent is usually a prerequisite to creating the relationship, the end of mutual consent usually ends the relationship."⁶² Termination works the same way in tripartite relationships. A defense lawyer acquires two clients by agreement and continues to have two clients until the representation ends by one of the recognized means. Thus, an insurance company remains a client until the company discharges the lawyer, the lawyer withdraws, or the representation is completed. The emergence of a conflict of interest never converts a client into a non-client, unless a retainer agreement provides otherwise. The error regarding the means of termination completely undermines the Opinion's assertion that the emergence of a conflict automatically converts a two-client representation into a one-client

ent matter where defense counsel represents only the insured.

Second, Opinion 1995-139 errs by contending that, once (and assuming) the company ceases to be a client, defense counsel can automatically continue to act for the insured. The prevailing rule is that when a lawyer representing co-clients "cannot adequately represent the interests of each party, ... the lawyer must withdraw and may not thereafter represent one party against another on the same matter."⁶³ Only the informed consent of the former client can cure the disability. Model Rule 1.9 expressly requires the consent of a former client before a lawyer may represent "in the same ... matter" another client whose interests are materially adverse to those of the former client.⁶⁴ Similarly, California Professional Responsibility Rule 3-310(E) requires the former client to consent if the lawyer wishes to "accept employment adverse to the ... former client where, by reason of the representation of the ... former client, the [lawyer] has obtained confidential information material to the employment."⁶⁵

Lawyers might like to be able to handle co-client conflicts by dropping one client and continuing to represent the other, but life is not so easy for them. Except in rare cases, a lawyer who would drop a client "like a hot potato" must obtain that client's consent before opposing that client in the same matter on behalf of someone else.⁶⁶ Lacking consent, the lawyer must withdraw from both representations.

Third, and most importantly, Opinion 1995-139 errs in stating that, absent a prior agreement allowing defense counsel to keep secrets, defense counsel must withhold, or even properly can withhold, information relevant to liability or damages that also bears on coverage. As a rule, no co-client can ask a joint agent to withhold from another co-client information relating to the subject matter of a representation. That is one reason why the attorney-client privilege does not apply in disputes between former co-clients who have fallen out.⁶⁷ Co-clients cannot reasonably expect relevant information to be kept confidential from other co-clients.⁶⁸ Exceptions are recognized mainly when a prior agreement permits the joint agent to keep secrets.⁶⁹

Although few relevant cases have been decided,⁷⁰ application of the no-secrets rule to insurance defense representations makes sense when the information at issue bears on the defense, investigation, or settlement of the liability suit against the in-

sured.⁷¹ The insurance contract assigns the company responsibility for defending, investigating, and settling claims. To help the company conduct these activities, the contract also obligates the insured to cooperate by providing relevant information, securing witnesses, testifying, etc.⁷² It is therefore reasonable to infer that the company retains defense counsel with the understanding that counsel will tell the company everything it reasonably needs to know to make informed defense, investigation, and settlement decisions, including pertinent information received from the insured.⁷³ No agreement to keep secret information relevant to these activities can or should be read into the tripartite relationship.

By requiring defense counsel to withhold relevant information, Opinion 1995-139 makes hash of the structure of the liability insurance contract. The opinion prevents a company from exercising its contractual rights by denying the company access to information held by its agent. The opinion thus uses professional responsibility law to rewrite insurance law. It usurps the role of California's insurance regulators, whose job it is to set the terms on which insurance can be sold in that state.

Although Opinion 1995-139 suggests otherwise, California case authority does not *require* defense counsel to keep relevant information secret at the request of the insured. The only California case Opinion 1995-139 cites in support of the secrecy rule is *American Mutual Liability Ins. Co. v. Superior Court*.⁷⁴ This is a remarkable use of precedent.⁷⁵ *American Mutual* generally endorses the view that, because the company is a co-client, defense counsel must pass on to the company all information pertinent to the investigation, defense, or settlement of the liability suit.⁷⁶ The opinion does *not* hold that defense counsel must keep information secret at the request of the insured. It merely recognizes the *possibility* that secrets may be kept.

[I]t may well be that in the full discharge of his obligation to his client-insurer, the attorney may communicate to the insurer objective evaluations of his client-insured, which are for the consideration only of the client-insurer in permitting it to discharge its duties to the insured under the insurance contract. Similarly there may be confidences indulged by the insured to the attorney which in turn are not intended for the insurer.⁷⁷

It would mock legal reasoning to characterize the last sentence quoted, an obvious dictum, as a

holding that requires defense lawyers to keep secrets. Yet that is what Opinion 1995-139 does. The Opinion cites *American Mutual* for the proposition that "if an insured reveals matters to the attorney in confidence, and these matters are not intended to be heard by the insurer, the attorney *may not* reveal them to the insurer."⁷⁸ This is spin-doctoring, not lawyering.

The authors of Opinion 1995-139 should have analyzed the problem of secrecy in the tripartite relationship by starting with the general rule against confidentiality in multiple-client representations. They might then have asked whether a good reason exists for departing from that rule in insurance defense cases. That is the route we have taken. It leads us to conclude that, in the tripartite relationship, there is a baseline of open communication of information bearing on the investigation, defense, or settlement of liability claims. This is not to deny that an insured can insist on secrecy, and when an insured does insist, a lawyer who has the insured as a client must obey. An agent cannot disobey a direct instruction from a principal, even if the instruction is one the principal has no authority to give.⁷⁹ But obedience comes at a price: the loss of the agent's services by the principal. An instruction issued in violation of a retainer agreement frees an agent from the duty of continuing service.⁸⁰ In the tripartite relationship, an unauthorized instruction by the insured to keep information secret breaches the retainer agreement, terminating the agency relationship between the defense lawyer and the insured.

Finally, the contention that an insurance company is a half-client is a strained one that finds little support in professional responsibility law and that is increasingly at odds with California cases. Professional responsibility law has generally resisted the efforts of scholars like Prof. Hazard to create a category of quasi-clients,⁸¹ and in September, 1995, the California Court of Appeal for the Second District took a big step in the direction of recognizing that an insurance company is a client in full. In *Unigard Insurance Group v. O'Flaherty & Belgum*,⁸² the court allowed an insurance company to assert a malpractice action against counsel retained to defend its insured. The Second District concluded that where the insurer hires counsel to defend its insured and does not raise or reserve any coverage dispute, and where there is otherwise no actual or apparent conflict of interest between the insurer and the insured that would preclude an at-

torney from representing both, the attorney has a dual attorney-client relationship with both insurer and insured.⁸³

We would put the matter more simply: When a retainer agreement provides that a lawyer shall have two clients, the lawyer has two clients. We are nonetheless delighted that *Unigard* rejected the one-and-a-half-clients view.

Conclusion

Our fundamental point is that in the insurance defense situation, it is for the significant players to decide who defense counsel represents. It is not for courts or other sources of professional responsibility law to mandate this arrangement, and no one arrangement is required by any deeply embedded, true proposition of law. Indeed, it is profoundly consistent with the structure of professional responsibility law that the company, the insured, and the lawyer should agree to the terms of their relationship. After all, attorney-client relationships are usually initiated and structured by contract.

Along with this bedrock point we make another. As an empirical matter, in the majority of cases insurance carriers, insureds, and defense lawyers actually agree to a dual representation, so that defense counsel represents both the insurer and the insured. In general, they do this by performance or course of dealing rather than by explicit arrangement. All lawyers know, however, that contracts are often based upon acts. So it is here. The actual conduct of most insurance defense representations, in which lawyers routinely take instructions from insurers and otherwise treat insurers as clients, demonstrates the parties' understanding that the lawyer has two clients and that the insurer is in charge.

This nearly universal arrangement makes perfect practical sense. Insurers run lawsuits for their own benefit and for the benefit of their insureds. Mostly, insureds are delighted that they do. In the majority of representations, insureds and carriers both benefit by minimizing the loss associated with the liability claim. Trying to make insurance defense counsel the lawyer for only the insured threatens to impair this efficient working arrangement. It is difficult to see how an insurer can lawfully manage a case for its insured unless it is a co-client. Nobody--but nobody--who has thought about the matter carefully would ever wish to deny insureds access to the experience insurers have amassed in defeating bogus claims and limiting exaggerated ones.

What probably motivates proponents of the one-client view is the fear that an insurance company and a defense lawyer will conspire against an insured. That is what happened in *Tilley*, where the defense lawyer helped the insurance company build a late-notice case for denying coverage to the insured. Although the possibility of collusion is clear, *Tilley* shows that the two-clients rule protects insureds from such misconduct. It prohibits defense lawyers from subordinating their interests to those of insurers. Of course, the rule also prohibits defense lawyers from preferring insureds, and this flip-side of the rule can have adverse consequences for insureds, especially those who want defense lawyers to keep secrets. The two-clients rule is hard on such insureds, but hardship occurs only because these insureds entered into liability insurance contracts requiring them to cooperate in the defense, investigation, and settlement of claims. Defense lawyers retained pursuant to the terms of those liability contracts properly operate on a ba-

sis of full disclosure to the company of information received from any source that bears on the claim-handling functions a company is to perform.

Other difficulties remain to be considered. Sometimes an insurer mismanages a lawsuit. Occasionally, a legitimate claim against an insured exceeds the policy limits of the primary carrier and, in a fraction of these cases, there is no excess insurer perched on top. These situations are the stuff of which dramatic state supreme court opinions are made. Thankfully, they are relatively rare. Because of their infrequency, the central law of the routine insurance defense paradigm should not be built upon them. *Ad horrendum* arguments make for wonderful law school classes and stump speeches, but they seldom provide a proper foundation for common law rules. Besides, each of the problems we have just described has a safe and helpful solution within the majority, two-clients view. Presenting those solutions is work to be done another day. ■

NOTES

1. For an excellent critique of lawyer-bashing by politicians, see Marc Galanter, *News From Nowhere: The Debased Debate on Civil Justice*, 71 *Denver University Law Review* 77 (1993).

2. Hereafter, the word "company" will refer to a primary liability insurance carrier.

3. See, e.g., ABA/BNA *Lawyer's Manual on Professional Conduct* §31:101 (Supp. 1995); *Restatement (Third) of the Law Governing Lawyers* §26 (Tentative Draft No. 5, 1992).

4. Joanne Pitulla, *Three-Way Street: Discord between Insurers and Insureds Puts Defense Lawyers on Perilous Path*, ABA *Journal* 102 (Aug. 1995).

5. William T. Barker, *Insurer Liability for Defense Counsel's Blunders*, *Bad Faith Law Report* 73, 76 (May 1993) (quoting Ronald A. Mallen & Jeffrey M. Smith, *Legal Malpractice* § 23.3 (3d ed. 1989)). *Home Indemnity Co. v. Lane Powell Moss & Miller*, 43 F.3d 1322 (9th Cir. 1995) and *Unigard Insurance Group v. O'Flaherty & Belgum*, 1995 WL 576675 (Ct. of App., 2nd Dist. 1995), the two most recent decisions of which we are aware, also conclude that defense counsel has two clients.

6. Tort and Insurance Practice Section, Professionalism Committee, *Comments [on the Restatement (Third) of the Law Governing Lawyers]* 9 (Jan. 30, 1995) (typescript on file with the authors) (observing that "[m]ost

courts . . . have concluded that when an insurer assumes control of the defense . . . the lawyer has two clients").

7. Ronald A. Mallen & Jeffrey M. Smith, *Legal Malpractice* § 23.3 (3d ed. Supp. 1993). One of us has already criticized the Bell opinion elsewhere. See Charles Silver, *Does Insurance Defense Counsel Represent the Company or the Insured?*, 72 *Texas Law Review* 1583, 1609-1610 (1994). We direct readers interested in a fuller discussion to that source.

8. Barker, *Insurer Liability for Defense Counsel's Blunders*, *supra*, reviews the cases and explains the logic that has persuaded most courts to adopt the two-clients view.

9. Many insurance contracts, including homeowners policies and commercial liability policies, cover defense costs as well as judgments and settlements. These contracts usually vest the company with the right and duty to defend lawsuits asserting covered claims, and with discretion to investigate and settle claims as well. The defense-related language both entitles and requires the company to provide defense counsel and to control the defense, absent a conflict of interest sufficient to divest the company of control. The investigation- and settlement-related language entitles the company to exercise reasonable judgment in these areas, and expose the company to liability for improperly handling claims.

10. *Barker, Insurer Liability for Defense Counsel's Blunders*, *supra*, at 74.
11. *Model Rules of Professional Conduct*, Rule 1.8(f) (1995) (permitting third-party payor arrangements only when "there is no interference with the lawyer's independence of professional judgment"); *Restatement (Third) of the Law Governing Lawyers* §215 (Tentative Draft No. 4, April 10, 1991) (permitting a third-party payor to materially influence a lawyer's professional judgment "only if the influence is reasonable in scope and character and the client expressly consents to the possible influence before the lawyer undertakes the representation"); *Id.* at Cmt. c ("In general, unless the third person who is paying the lawyer bears substantially all of the consequences of the result in litigation, the third person may not direct or restrict the lawyer's decisions");
12. *Pitulla, Three-Way Street*, *supra* at 102.
13. See *ABA/BNA Lawyers' Manual on Professional Conduct* 51:309 (Supp. 1995) ("when a course of action would be beneficial to the client insured, but would be detrimental to the insurer that employs or pays the lawyer . . . the lawyer may not continue with the dual representation," unless both clients consent).
14. See *Charles Silver and Kent D. Syverud, The Professional Responsibilities of Insurance Defense Lawyers*, *Duke Law Journal* (forthcoming November 1995).
15. Commentators contend that in excess liability cases where there is a considerable prospect that a judgment against the insured will exceed the policy limits, defense counsel should be excluded from settlement issues, other than by providing objective assessments of the likely outcome at trial. In such cases, a defense lawyer who recommends against settlement within the policy limits exposes the insured to a personal financial loss, a position the insured is unlikely to relish. See *William T. Barker, Defense Attorneys and Policy Limits Settlement Offers: Another View*, *Bad Faith Law Report* 141, 142-43 (Sept. 1990); *Silver & Syverud, The Professional Responsibilities of Insurance Defense Lawyers*, *supra*.
16. Clearly, the insurance company and the defense lawyer are parties to the retainer agreement. The insured authorizes the company to retain counsel for the insured by demanding a defense under the policy. Whether the insured, by virtue of having authorized the company to retain counsel, also becomes a party to the retainer agreement we do not say. See *Silver & Syverud, The Professional Responsibilities of Insurance Defense Lawyers*, *supra*, for an argument that it is proper to infer the insured's consent to joint representation from the act of demanding a defense.
17. *Restatement of the Law Governing Lawyers* §30 (Tentative Draft No. 5, March 16, 1992) (stating that "a lawyer and an adequately informed client may agree to limit the scope or objectives of the representation" when listed requirements are met). See also *Restatement of the Law Governing Lawyers* § 125, Cmt. d (Tentative Draft No. 2, April 7, 1989) (observing that "a lawyer representing five claimants against a common defendant may represent them as co-client only with respect to the issue of liability and not with respect to separate issues of the damages or separate affirmative defenses that apply to each of them").
18. *Richard Connelly, Professor Swims Against Tide On Insurance Defense Question*, *Texas Lawyer*, June 19, 1995.
19. *Restatement of the Law Governing Lawyers* § 26 (Tentative Draft No. 5, March 16, 1992); see also *Id.*, Cmt. b (emphasizing the importance of obtaining the consent of both the lawyer and the client).
20. In multiple-client representations, there can be no waiver of the attorney-client privilege without the consent of all clients. *Restatement of the Law Governing Lawyers* § 125 (Tentative Draft No. 2, April 7, 1989) (stating that, when "two or more persons are jointly represented by the same lawyer in a matter, . . . any co-client may assert the privilege" and prevent revelation of protected communications to third-parties); see also *Id.*, Cmt. d (stating that the co-client rule does not apply if the second person is not a co-client of the same attorney, even though the second person is cooperating with the client).
21. *Connelly, Professor Swims Against Tide On Insurance Defense Question*, *supra*.
22. *Restatement of the Law Governing Lawyers*, Chapter 2, Topic 1, Introductory Note, (Tentative Draft No. 5, March 16, 1992).
23. *Connelly, Professor Swims Against Tide On Insurance Defense Question*, *supra*.
24. *Robert E. O'Malley, Ethics Principles for the Insurer, the Insured, and Defense Counsel: The Eternal Triangle Reformed*, 66 *Tulane Law Review* 511 (1991).
25. 1994 WL 723670 (Tex. App.--San Antonio 1994).
26. 892 S.W.2d 56 (Tex. App.--Houston [1st Dist.] 1994).
27. 496 S.W.2d 552 (Tex. 1973).
28. *Maldonado*, 1994 WL 723670 at *4 (citations omitted).
29. 876 S.W.2d 842 (Tex. 1994).
30. *Garcia*, 876 S.W.2d at 844 n.6.

31. We say this knowing that some readers will immediately ask "What about footnote four"? See J.M. Balkin, *The Footnote*, 83 *Northwestern University Law Review* 275 (1988). There are exceptions to every rule.

32. The court resolved the case on the ground that an offer to settle within policy limits is a condition for a duty-to-settle violation, and that no duty-to-settle violation occurred because no such offer was received. Garcia, 876 S.W.2d at 855 ("APIE never had an opportunity to settle for \$500,000[, its policy limits]. Therefore, it cannot be held liable for not settling.").

33. The evidence was a letter from Ross Crossland, the attorney representing Dr. Garcia, to Pat Maloney, the lawyer representing the plaintiffs, stating that Crossland had "been advised by representatives of [APIE] that [he did] not in any manner represent their interests." *Id.* When Crossland wrote the letter, he knew APIE had already denied coverage of the claims against Dr. Garcia. Crossland's denial of an attorney-client relationship therefore rings true, even though the company continued paying his bills after the coverage denial.

34. *Id.*

35. See Tilley, 496 S.W.2d at 558 (stating that the attorney "owe[d] the insured the same type of unqualified loyalty as if he had been originally employed by the insured," and that when a conflict of interest arose between the company and the insured, "the attorney owe[d] a duty to the insured to immediately advise him of the conflict").

36. The majority invoked Canon 5 of the Texas Code of Professional Responsibility which, as the opinion points out, dealt "specifically with conduct of a lawyer representing multiple clients with conflicting or potentially conflicting interests" and which specifically listed "[r]epresentation of 'an insurer and his insured' . . . among typically recurring situations involving potentially differing interests." Tilley, 496 S.W.2d at 558 (emphasis added) (citing Code of Professional Responsibility, Canon 5, Art. 320a-1 V.A.T.S. (1971 pocket part)). The majority also relied upon Ethical Consideration 5-16, which stated that

[i]n those instances in which a lawyer is justified in representing two or more clients having differing interests, it is nevertheless essential that each client be given the opportunity to evaluate his need for representation free of any potential conflict and to obtain other counsel if he desires. Thus before a lawyer may represent multiple clients, he should explain fully to each client the implications of the common representation and should accept or continue employment only if the

clients consent. If there are present other circumstances that might cause any of the multiple clients to question the undivided loyalty of the lawyer, he should also advise all of the clients of those circumstances.

Code of Professional Responsibility, EC 5-16, Art. 320a-1 V.A.T.S. (1971 pocket part) (emphasis added).

37. The text of the Guiding Principles can be found at 20 *Federation of Insurance Counsel Journal* 95 et seq. (1970).

38. The Guiding Principles, *supra* note 37, at 95, open with the following General Statement: Under a policy providing liability insurance, the company has a direct financial interest in any claim presented against its insured which the company may be obligated to defend or pay, and in any suit on such claim, whether or not the company is named as a party. The company has the right to have counsel of its own choice to defend this interest. So long as no conflict of interests exists, that counsel also represents the insured. If and when representation of the company by its attorney conflicts with the interest of the insured, the company and its attorney are under a duty to inform the insured of such conflict and to invite him to retain his own counsel at his own expense.

39. See 496 S.W.2d at 562-563 (concurring opinion of Justice Johnson) (contending that it is more appropriate to regard the attorney as having "a single client, the insured").

40. See Tilley, 496 S.W.2d at 561 (observing that "it [was] undisputed that the work of the [defense] lawyer on the coverage issue . . . was not on his own initiative or merely incidental to his defense of [the insured]; it was at the instance and request of [the insurance company] for its benefit against [the insured]").

41. See *Id.* at 563 (concurring opinion of Justice Johnson) (pointing out that "the Ethical Considerations under Canon 5 [made] it clear that situations where the cost of legal services are borne by a third party are ethically proper only so long as control remains in the client and the responsibility of the lawyer is solely to the client") (emphasis added).

42. Of course, one should not go overboard in the opposite direction. As far as we can tell, no Texas court has ever decided whether a primary insurance carrier can sue defense counsel for malpractice. One authority cites *Fireman's Fund American Insurance Co. v. Patterson & Lamberty Inc.*, 528 S.W.2d 67 (Ct. of App.-Tyler 1975), for the proposition that Texas permits company-initiated malpractice suits. See Mallen & Smith, *Legal Malpractice*, *supra*, §23.09 at 151-152

n.3.5. *The case does not stand for that proposition. The malpractice at issue in Fireman's Fund occurred when the lawyer was acting as subrogation counsel for the company, not as defense counsel.*

43. 7 Tex. Jur. 3d, Attorneys At Law § 48 (Supp. 1995) ("The relationship of attorney and client is one of agent and principal. Thus, the relationship in its general features is governed by the same rules that apply to other agencies.").

44. 892 S.W.2d 56 (Tex. App.--Houston [1st Dist.] 1994).

45. *Id.* at 60.

46. *Id.* at 77 (citations omitted).

47. 895 S.W.2d 322 (Tenn. 1995).

48. *Id.* at 328.

49. *In re Ellis*, 822 S.W.2d 602 (Ct. of App. 1991) (stating that an attorney-client relationship is based on a contract, so that rules generally applicable to contract formation apply to contracts for legal representation); *Broyles v. Califano*, 495 F.Supp. 4, X (D. Tenn. 1979) (observing that no person has a right to appear as another's attorney without the other's authority).

50. *In re Youngblood*, 895 S.W.2d at 328.

51. *Id.* at 329 (internal quotation marks omitted).

52. See, e.g., Restatement of the Law Governing Lawyers § 30 (Tentative Draft No. 5, March 16, 1992) (allowing restrictions on the scope of a lawyer's representation of a client and recognizing that such restrictions help meet clients' economic needs).

53. See, e.g., *Countryman v. Breen*, 263 N.Y.S. 603 (Sup. Ct. 1933), reversed on other grounds, 198 N.E. 536 (N.Y. 1935) (rejecting insured's claim that defense lawyers were really the company's attorneys, not his).

54. See, e.g., A.B.A. Committee on Professional Ethics and Grievances, *Formal Opinion 282* (1950) (recognizing that defense lawyer has two clients, the company and the insured, whose interests usually align).

55. Robert E Litan and Steven C. Salop, *More Value for the Legal Dollar: A New Look At Attorney-Clients Fees and Relationships*, in Section of Litigation, American Bar Association, *Value Billing and Gaining a Competitive Advantage in the Legal Marketplace* (1992) (observing that "since 1977 total revenues of the legal services industry have risen at an annual growth rate of 12 percent, even more rapidly than health services output and at a substantially higher rate than output for the economy as a whole"). The Aetna Life & Casualty Company sponsored Litan and Salop's research as

part of a larger project aimed at developing innovative methods of reducing defense costs.

56. California Ethics Opinion 1995-139, 1995 WL 255397 at *1.

57. Opinion 1995-139, *supra*, at *2 ("when [] a conflict manifests itself, case law resolves any potential conflict ... by mandating a resolution in favor of the represented insured and against the non-represented, non-party insurer"; and *4 n.6 ("at the point at which a conflict develops, the insurer is no longer a client in the usual sense").

58. Opinion 1995-139, *supra* note 56, at *2.

59. *Id.*

60. "The attorney is obligated at all times to protect the insured/client and may not act in any way which prevents devoting his entire energies to his client's interest." *Id.* at *1 (internal quotations omitted).

61. Section 43 of the Restatement (Third) of the Law Governing Lawyers §43 (Tentative Draft No. 5, March 16, 1992), titled "Termination of Lawyer's Authority," summarizes the ways of ending lawyer-client relationships: (1) [A] lawyer's actual authority to represent a client ends when :

(a) The client discharges the lawyer;

(b) The client dies;

(c) The lawyer withdraws;

(d) The lawyer dies or becomes physically or mentally incapable ... or is disbarred or suspended ...

(e) The representation ends as provided by agreement or because the lawyer has completed the contemplated circumstances.

62. *Id.* at Cmt. b.

63. ABA/BNA Lawyers' Manual on Professional Conduct 51:301 (Supp. 1995).

64. Model Rules of Professional Conduct, Rule 1.9(a) (1995).

65. California Rules of Professional Conduct, Rule 3-310(E) (1995). See also *Alchemy II, Inc. v. Yes! Entertainment Corp.*, 844 F.Supp. 560 (C.D. Cal. 1994) (explaining consent requirement); *In re Marriage of Zimmerman*, 20 Cal.Rptr. 132 (Ct. of App., 1st Dist., 1993) (same).

66. ABA/BNA Lawyers' Manual on Professional Conduct 51:303 (Supp. 1995) ("Where a lawyer is prohibited from representing multiple parties, ... the conflict may not be eliminated by dropping one client in favor

the client to make informed decisions regarding the subject concerning which the attorney represents the client"). See also *Betts*, *supra*, 201 Cal.Rptr. at 545 (observing that a defense lawyer who represents a company and an insured owes each client a duty of full disclosure of all facts and circumstances needed to enable that client to make decisions regarding the subject matter of the litigation).

77. *American Mutual*, 113 Cal. Rptr. at 572.

78. *Opinion 1995-139*, *supra*, at *2 (citing *American Mutual*) (emphasis added).

79. *Restatement (Second) of Agency* § 385(2) (1958).

80. *Id.* at §385, Cmt. d (observing that "an agent has no duty to act contrary to the terms of the contract or agreement under which he is employed," and describing as "an agent who has no duty to continue to act" as "one whose principal has committed a serious breach of contract"). For a fuller discussion, see *Silver & Syverud*, *supra*.

81. Compare *Geoffrey C. Hazard, Triangular Lawyer Relationships: An Exploratory Analysis*, 1 *Georgetown Journal of Legal Ethics* 15, 38 (1987) (arguing that a lawyer who represents a trust fiduciary owes duties to trust beneficiaries, who are the lawyer's quasi-clients), with *ABA Formal Opinion 94-380* (1994) (determining that trust beneficiaries are not clients of a lawyer who represents a trust fiduciary, so that the lawyer owes no more duties to the beneficiaries than are owed to other third parties). For arguments for recognizing quasi-clients, see also *Nancy J. Moore, Expanding Duties of Attorneys to "Non-Clients": Reconceptualizing the Attorney-Client Relationship in Entity Representation and Other Inherently Ambiguous Situations*, 45 *South Carolina Law Review* 659 (1994); *John Leubsdorf, Pluralizing the Client-Lawyer Relationship*, 77 *Cornell Law Review* 825 (1992).

82. 1995 WL 576675 (Ct. of App., 2nd Dist. 1995).

83. *Id.* at *3.