TOOLS OF THE TRADE: POTENTIAL CONFLICT IN THE TRIPARTE RELATIONSHIP

By Hal Chase Jr.

When an insurer ("carrier") accepts a request for defense, this normally creates a dual attorney-client relationship between the carrier, defense counsel, and the insured defendant (hereafter, "the client"). In that relationship, defense counsel owes a professional duty of care to both carrier and client, who are bound by the insurance contract and duties of good faith. This inter-dependent association is sometimes referred to as the "tripartite relationship" and is the cornerstone of most defenses in civil litigation (at least where the defendant has insurance).

Problems rarely emerge in this relationship. However, trouble may brew when the interests of the client and carrier diverge. This usually involves situations that concern coverage. It is important to remember that usually the party who is least informed about coverage disputes is the client. The client's first line of defense must be defense counsel, who owes duties to both sides but has a primary duty to the client. (*See Glacier Gen. Assurance Co. v. Sup. Ct.* (1979) 95 Cal.App.3d 836, 839-841.)

Not every instance of friction between the parties in this relationship allows legal redress or a duty of disclosure. However, if a coverage problem does emerge, it is the primary responsibility of conscientious defense counsel to immediately alert the insured in writing. (See Cal. DR 3-310). It is important that defense counsel provide notice of conflict promptly because coverage problems may bar defense counsel from joint representation of carrier and insured. To address this issue, the law provides that when a conflict of interest arises that is serious enough to ethically prevent defense counsel from joint representation, then the client is entitled to be advised of such conflict and of his or her right to consult and hire independent counsel. The client cannot actually have been deemed to waive any potential conflict until he or she receives written notice of the conflict from defense counsel and is given the opportunity to consult independent counsel.

Any waiver of the conflict by the client must be in writing. If the client does not waive the conflict, then the carrier must pay for independent representation sometimes called "Cumis counsel." (See California Civil Code § 2860; *San Diego Navy Fed. Credit Union v. Cumis Ins. Society, Inc.* (1984) 162 Cal.App.3d 358, 364.)

When can such a conflict occur? While conflicts in the tripartite relationship are rare, the factual situations where they may arise are varied. The conflict must be "significant, not merely theoretical, actual, not merely potential." (*Dynamic Concepts, Inc. v. Truck Ins. Exch*. (1998) 61 Cal. App.4th 999, 1007.) Conflicts cannot occur when there is a denial of coverage because, rightly or wrongly, the carrier has determined that no coverage exists and, while that may open it up to a bad faith lawsuit, the very fact of denial means no defense will be provided. Allegations in litigation that the plaintiff claims punitive damages against the client also do not necessarily create a conflict because exemplary damages cannot, by law, be covered claims under any policy. (See Ins. Code §544.) Also, a conflict does not necessarily exist solely because an insured is sued for an amount that is in excess of the policy.

One instance where the right to independent counsel may be triggered is when an insurer reserves the right to deny coverage on a specific basis, and the manner of the defense might control the outcome of that disputed coverage question. (Civ. Code §2860(b).) Another instance occurs where the conduct of the defense is likely to affect the client's coverage with the carrier. Conflicts between carrier, defense counsel and client that warrant advising the client of conflict and requiring appointment of an independent counsel may occur in several situations.

The following examples may raise red flags and certainly deserve careful examination:

(1) An insured is sued and tenders the complaint to the carrier. The carrier responds with a reservation of rights but does not refuse to defend. The insured client may be entitled to independent counsel paid for by the carrier to conduct the litigation defense. (Civ. Code §2860.)

(2) An insured is sued and the carrier reserves its right to deny coverage on a specific basis and the outcome of that disputed coverage question may be controlled by the man-

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ner in which defense counsel conducts the defense in the underlying civil litigation. (Civ. Code §2860(b).) Whether such a conflict may be present depends on whether the carrier is likely to deny a client's claim and to what extent defense counsel's conduct of this litigation might control such a claim. This problem can occur when a carrier provides a defense (the duty to defend is greater than the duty to indemnify), but where a reasonable defense position may result in a denial of coverage.

(3)The carrier has a duty to provide coverage to different insureds in the same litigation and the insureds have conflicting claims against each other. (*O'Morrow v. Borad* (1947) 27 Cal.2d 794, 800.) For example, is there a potential for conflict when an insured passenger in a vehicle collision sues the insured driver, claiming negligence, and both the driver and passenger are also pursuing uninsured motorist claims (which requires the insured to not be at fault in order to recover)? Arguably, the carrier may be inclined to deny the UM claims (the first-party case), asserting the insured driver caused the collision; while defense counsel may assert that the suing passenger is at fault and the driver client (in the legal action, or "third-party case".) Defense counsel's aggressive defense in the third party case may provide the carrier with ammunition to deny the UM claim, or potentially negate or reduce them under claims of comparative fault.

(4) What about a situation where a client has limited coverage in litigation involving very large claims? Professionals often have cannibal or "defense-within-limits" liability policies where defense cost are paid out of the policy limits, thereby reducing coverage. I was involved in one lawsuit where the client, an engineer with low policy limits in massive construction defect case, kept telling defense counsel to settle. Defense counsel and the carrier ignored him, spent the small limits on a useless defense, and once the funds were exhausted, the carrier refused any further defense, leaving the engineer to make his own way. Defense counsel never advised of any conflict (its' fees were exhausting the policy, depleting the very funds that would be necessary to settle the claims and the insured desperately wanted a settlement). What occurred? The carrier was only too happy to be rid of this small professional. Defense counsel obtained an order allowing it to withdraw from the litigation. The carrier failed to file a declaratory relief action to obtain an order that coverage was no longer present. Once the carrier withdrew, the client was free to make any reasonable deal with his adversary, the cross complainant in the action. [Check out *Samson v. Transamerica Insurance Co*. (1981) 30 Cal.3d 220, 243 ("A good faith belief in non-coverage is not relevant to a determination of the reasonableness of a settlement offer.").] The engineer and his private counsel negotiated an assignment of rights against the carrier; judgment against the engineer was entered; the cross-complainant assignee, with the engineer tagging along, sued the carrier for bad faith in the amount of the judgment against the engineer (and punitive damages). The engineer sued defense counsel for malpractice. The carrier settled the bad faith suit for seven figures and defense counsel did likewise, after jury found the firm guilty of malpractice, oppression, fraud and malice.

Many problems involving potential conflict may be nipped in the bud if defense counsel simply stays alert to emerging problems in the relationship. There is a strong temptation to continue to take the fee and not upset the relationship with the carrier, but defense counsel's primary duty is always to protect the interest of the client-insured. If and when defense counsel becomes aware of any serious potential conflict, DR 3-310 should be scrupulously followed. For my money, the best approach is to always be on the lookout for potential coverage disputes that may emerge in the litigation, especially when they may be influenced by the conduct of the defense.

By and large, coverage should never be an issue in the relationship between client and defense counsel. When such issues come up and they will invariably from time to time defense counsel should examine the matter carefully and, if the potential for conflict is present, promptly advise both the client and the insurer in writing.

Chase is an associate at Vasquez Estrada & Conway LLP. He has practiced civil litigation in the Bay Area for 34 years. This series of articles Tools of the Trade is intended to benefit the general civil practitioner by discussing certain issues and areas of law that may not be well understood, but which most lawyers will invariably face at least once in their career. Chase's caveat is that these articles are informational only and any interested practitioner should do his or her own research. The law is always in flux, subject to continual change and reinterpretation by statute and courts. He can be reached at (415) 453-0555 or at hchase@vandelaw.com.