

The Tripartite Relationship: When Harmony Dissolves to Dissonance

Introduction

The phrase “tripartite relationship” describes the harmonious teamwork of a liability insurer, its policyholder, and their common defense lawyer in the defense of a civil lawsuit, reminiscent of the comradery of the Three Musketeers: “All for one and one for all!” The policyholder serves as witness, the insurer serves as financier, and the lawyer serves as warrior for them both. One lawyer may ethically represent two clients whose interests are completely aligned. This team may work well when the liability insurer agrees at the outset that it will pay for everything - the cost of defense and any adverse judgment, except a modest deductible. The three “have a common interest in defeating or settling the third party’s claim. . . . The attorney has two clients. . . . The three parties form an entity - the defense team . . . with intramural relationships and reciprocal obligations and duties each to the other.”¹

But the harmony of the tripartite relationship exists only “absent a conflict of interest. . . . So long as the interests of the insurer and the insured coincide.”² If the interests of the insurer and the insured diverge, their harmony may yield to the dissonance of Biblical proportions: “No one can serve two masters. Either you will hate the one and love the other, or you will be devoted to the one and despise the other.”³ [W]hen coverage is disputed, the interests of the insured and the insurer are always divergent.”⁴ “[while] the usual tripartite relationship . . . is beneficial, . . . [a] different situation is presented, however, when some or all of the allegations in the complaint do not fall within the scope of coverage under the policy. . . . In such a case, . . . there may be little commonality of interest. . . . Although issues of coverage under the policy are not actually litigated in the third party suit, this does not detract from the force of these opposing interests as they operate on the attorney selected by the insurer, who has a dual agency status.”⁵ “The tranquility of this coalition is disturbed however, where disagreement arises between the members. Dissatisfaction may disrupt the harmony of the arrangement. [T]he attorney must withdrawn from further representation of the insured in all pending matters involving the insured. The situation has changed. Partners have become adversaries. The closely knit fabric of confidentiality is torn and shredded.”⁶

The pledge of Alexandre Dumas’ fictional characters would certainly be strained if Aramis was sleeping with Athos’ wife. Similarly, a liability insurer’s reservation of rights can and usually does transform “All for one and one for all” into a free-for-all. The triad may be friends, enemies, or both at the same time. The insurer still must fund the defense and perhaps pay a judgment or settlement. The common lawyer still wants to be a warrior and earn fees. But can the policyholder trust either to not stab him or her in the back? Will happy harmony dissolve into

¹ *Gafcon, Inc. v. Ponsor & Associates* (2002) 98 Cal.App.4th 1388, 1406,07 (*Gafcon*).

² *Id.* at 1406.

³ Matthew 6:24.

⁴ *San Diego Navy Fed. Credit Union v. Cumis Ins. Society, Inc.* (1984) 162 Cal.App.3d 358, 375 (*Cumis*).

⁵ *Id.* 364-65.

⁶ *American Mut. Liab. Ins. Co. v. Superior Court* (1974) 38 Cal.App.3d 579, 591-93 (ellipses omitted) (*American Mut.*)

discordant dissonance?

Three-In-One Relationship

The tripartite relationship consists of three binary relationships: 1) insurer-policyholder; 2) insurer-dependent counsel; and 3) policyholder-dependent counsel.

The Liability Insurer - Policyholder Relationship

A liability insurance policy is a contract of indemnity by which the insurer agrees to pay a lawyer to defend its policyholder against claims of civil liability and agrees to pay for an adverse judgment that satisfies all of the described terms of the policy. “Insurance is a contract whereby one undertakes to indemnify another against liability”⁷ even though the insurer is not a party to the lawsuit that may result in the judgment against the policyholder. Liability insurance is a regulated industry in which insurers owe fiduciary-like duties⁸ to the policyholder. The insurer-policyholder relationship is governed by the terms of the policy contract, insurance regulations, and law.⁹ Cases holding that “the judgment in the underlying action is conclusive as to the insurer’s liability hold only that if factual matters upon which the issue of coverage turns are expressly or impliedly determined in the prior action such determinations bind the insurer in the subsequent suit to enforce the provisions of the policy.”¹⁰ The doctrine of collateral estoppel generally binds an insurer to the outcome of a plaintiff’s lawsuit.¹¹

“[T]he insurer’s duty to defend entails the rendering of a service, viz., the mounting and funding of a defense in order to avoid or at least minimize liability.”¹² “An indemnity against liability embraces the costs of defense incurred [by the policyholder] in good faith. The [insurer] is bound to defend actions brought against [the policyholder], but [the policyholder] has the right to conduct such defenses, if he chooses to do so. If the [insurer] neglects to defend the

⁷ Ins. Code § 22 (ellipses omitted). “Upon an indemnity against liability, the [policyholder] is entitled to recover [from the insurer] upon becoming liable [to a third party plaintiff]. (Civ. Code § 2778(1) (ellipses omitted).)

⁸ “[W]hile these ‘special’ duties are akin to, and often resemble, duties which are also owed by fiduciaries, the fiduciary-like duties arise because of the unique nature of the insurance contract, not because the insurer is a fiduciary.” (*Vu v. Prudential Prop. & Cas. Ins. Co.* (2001) 26 Cal.4th 1142, 1151.)

⁹ “[T]he Unfair Insurance Practices Act defin[es] practices which constitute unfair or deceptive practices [and] grants the [Insurance] Commissioner rule making power. [The] authority the Legislature conferred here appears to be quite broad. The Commissioner has authority to craft regulations to administer the statutory bar on untrue, deceptive, or misleading statements.” (*Assn. of Calif. Ins. Cos v. Jones* (2017) 2 Cal.5th 376, 386-91 (ellipses omitted).)

¹⁰ *Hogan v. Midland National Ins. Co.* (1970) 3 Cal.3d 553, 565 (citations omitted).

¹¹ “[A] party will be collaterally estopped from relitigating an issue.[T]he court must balance the rights of the party to be estopped against the need to promote judicial economy by minimizing repetitive litigation, to prevent inconsistent judgments which undermine the integrity of the judicial system, or to protect against vexatious litigation.” (*Clemmer v. Hartford Ins. Co.* (1978) 22 Cal.3d 865, 884 (ellipsis omitted).)

¹² *Buss v. Superior Court* (1997) 16 Cal.4th 35, 46 (citations and ellipsis omitted). “The duty promised is to render, or fund, the service of providing a defense on the promisee’s behalf - a duty that necessarily arises as soon as such claims are made against the promisee, and may continue until they have been resolved.” (*Crawford v Weather Shield Mfg., Inc.* (2008) 44 Cal. 4th 541, 553 (ellipses omitted).)

[policyholder], a recovery against the [policyholder] suffered by him in good faith, is conclusive in his favor against the [insurer].”¹³

Liability Insurer - Dependent Counsel Relationship

The relationship between a liability insurance company and a “panel” of pre-approved lawyers it regularly hires is governed by contract, but not by the policy. Generally, insurers agree to send a large volume of business to dependent counsel, who in turn agree to charge lesser hourly rates and to submit to certain level of control by the insurer.

The succinct phrase “**dependent counsel**” describes the counterpart to “**independent counsel**.” Independent counsel is selected and directed by the policyholder and “there is no attorney-client relationship between Cumis counsel and the insurer.”¹⁴

Dependent counsel is hired by and paid by the insurer which is a “client” of dependent counsel. This unique relationship is well recognized in case law. “As a practical matter . . . in reality, the insurer’s attorneys may have closer ties with the insurer and a more compelling interest in protecting the insurer’s position, whether or not it coincides with what is best for the insured”¹⁵ “[i]nsurance companies hire relatively few lawyers and concentrate their business. A lawyer who does not look out for the Carrier’s best interest might soon find himself out of work”¹⁶ and “defense counsel and the insurer frequently have a longstanding, if not collegial, relationship”.¹⁷ “In California, an attorney may usually, under minimum standards of professional ethics, represent dual interests as long as full consent and full disclosure occur.”¹⁸ “[The] courts have acknowledged the existence of an attorney-client relationship between an insurer and the counsel it hires to represent the insured.”¹⁹ “Common logic dictates that counsel for [the insurer] would be inclined to bend his efforts, however unconsciously, toward establishing that any recovery by [the plaintiff] would be grounded on the theory of [the plaintiff’s] claim which was not covered by the policy.”²⁰ “[W]e simply cannot ignore the practical reality that the insurer may seek to exercise *actual* control over its retained attorneys in this context. [I]t would be imprudent for this Court to hold that attorneys are independent contractors vis-à-vis insurers, but then to ignore the practical realities of that relationship when it

¹³ Civ. Code § 2778(3)(4)(5) (ellipses omitted).

¹⁴ *Assurance Co. of America v. Haven* (1995) 32 Cal.App.4th 78, 90.

¹⁵ *Purdy v. Pacific Automobile Ins. Co.* (1984) 157 Cal.App.3d 59, 76.

¹⁶ *San Diego Navy Fed. Credit Union v. Cumis Ins. Society, Inc.* (1984) 162 Cal.App.3d 358, 364.

¹⁷ *Gulf Ins. Co. v. Berger, Kahn, Shafton, Moss, Figler, Simon & Gladstone* (2000) 79 Cal.App.4th 114, 131.

¹⁸ *Lysick v. Walcom* (1968) 258 Cal.App.2d 136, 147; See, also *Ishmael v. Millington* (1966) 241 Cal.App.2d 520, 528; *Industrial Indem. Co. v. Great American Ins. Co.* (1977) 73 Cal.App. 3d 529, 537.

¹⁹ *Unigard Ins. Group v. O’Flaherty & Belgium, supra*, 38 Cal.App.4th at p. 1236, 45 Cal.Rptr.2d 565 (*Unigard*). “The signed defense guidelines, with the negotiated hourly rate, and subsequent correspondence, along with the subsequent dealings between [dependent counsel] and [the insurer], reflected an agreement between them and an attorney-client relationship as a matter of law.” (*Gulf Ins. Co. v. Berger, Kahn, Shafton, Moss, Figler, Simon & Gladstone* (2000) 79 Cal.App.4th 114, 127 (*Berger, Kahn*)).

²⁰ *Howard v. Russell Stover Candies Inc.*, 649 F.2d 620, 625 (8th Cir. 1981) (Mo. law) (citations, quotation marks, and ellipses omitted).

causes injury.”²¹

Dependent Counsel - Policyholder Relationship

Law is also a regulated industry. Lawyers must be licenced to practice law and are governed by the express or implied terms of an employment contract, the State Bar Act, and Canons of Ethics, known as Rules of Professional Conduct. The attorney client relationship is sacrosanct in our American system of justice. The Constitutional guarantee of procedural due process is meaningless if lawyers cannot be trusted to fulfill their four primary duties to their clients: 1) the duty of undivided loyalty; 2) the duty of disclosure; 3) the duty of confidentiality; and 4) the duty of competent representation.²²

“One of the principal obligations which bind an attorney is that of fidelity, the maintaining inviolate the confidence reposed in him by those who employ him, and at every peril to himself to preserve the secrets of his client. This obligation is a very high and stringent one. It is also an attorney’s duty to protect his client in every possible way, and it is a violation of that duty for him to assume a position adverse or antagonistic to his client without the latter’s free and intelligent consent given after full knowledge of all the facts and circumstances. By virtue of this rule an attorney is precluded from assuming any relation which would prevent him from devoting his entire energies to his client’s interests. Nor does it matter that the intention and motives of the attorney are honest. The rule is designed not alone to prevent the dishonest practitioner from fraudulent conduct, but as well to preclude the honest practitioner from putting himself in a position where he may be required to choose between conflicting duties, or be led to an attempt to reconcile conflicting interests, rather than to enforce to their full extent the rights of the interest which he should alone represent.”²³

“It is a well accepted and oft repeated principle that the attorney retained by the insurance company for the purpose of defending the insured under the insurance policy owes the same duties to the insured as if the insured had hired the attorney him or herself.”²⁴ “However, whether in the insurer-insured context or otherwise, the attorney who undertakes to represent parties with divergent interests owes the ‘highest duty’ to each to make a ‘full disclosure of all facts and circumstances which are necessary to enable the parties to make a fully informed decision regarding the subject matter of litigation, including the areas of potential conflict and the possibility and desirability of seeking independent legal advice.’”²⁵

Generally, lawyers may not represent clients with conflicting interests. Rules of Professional Conduct, Rule 1.7(a) provides: “a lawyer shall not represent a client if the representation involves a concurrent conflict of interest”.²⁶ However, a “lawyer may represent a client if the representation does not involve the assertion of a claim by one client against another client.”²⁷

²¹ *Givens v. Mullikin ex rel. Estate of McElwaney*, 75 S.W.3d 383, 395 (Tenn. 2002) (citations, quotation marks, and ellipses omitted).

²² See, *Compendium of Attorney Duties* at DutytoDefend.com.

²³ *Anderson v. Eaton* (1930) 211 Cal. 113, 116 (citations omitted.)

²⁴ *Bogard v. Employers Casualty Co.* (1985) 164 Cal.App.3d 602, 609.

²⁵ *Betts v. Allstate Ins. Co.* (1984) 154 Cal.App.3d 688, 716; see, also, *Klemm v. Superior Court*, *supra*, 75 Cal.App.3d at p. 901; *American Mut.*, *supra*, 38 Cal.App.3d 590; *Lysick*, *supra*, 258 Cal.App.2d at 147-149.

²⁶ ABA Model Rule 1.7(a) (ellipsis omitted).

²⁷ ABA Model Rule 1.7(b) (ellipses omitted). Dependent counsel may not ethically represent dual clients with conflicting interests until potential conflicts of interest have been

These ethical rules are designed to prevent the lawyer from doing harm. “The primary purpose of this prophylactic rule [1.7] is to prevent situations in which an attorney might compromise his or her representation of the client.”²⁸ “[T]he purpose of a [lawyer] disqualification order must be prophylactic, not punitive.”²⁹

In the attorney-client relationship it is the lawyer, not the client, who bears the burden of resolving potential conflicts of interest. Rule 1.7 prohibits a lawyer from representing dual clients with conflicting interests unless the lawyer: 1) analyzes potential conflicts of interest; 2) makes written disclosure to the policyholder; and 3) if an actual conflict of interest exists, obtains both clients’ informed written consent.

“Conflicts [of interest] come in all shapes and sizes”.³⁰ Proper conflict analysis “must therefore consider whether a conflict of interest exists and not simply look for a reservation of rights.”³¹ “Some of the circumstances that may create a conflict of interest requiring the insurer to provide independent counsel include: (1) where the insurer reserves its rights on a given issue and the outcome of that coverage issue can be controlled by the insurer’s retained counsel; (2) where the insurer insures both the plaintiff and the defendant; (3) where the insurer has filed suit against the insured, whether or not the suit is related to the lawsuit the insurer is obligated to defend; (4) where the insurer pursues settlement in excess of policy limits without the insured’s consent and leaving the insured exposed to claims by third parties; and (5) any other situation where an attorney who represents the interests of both the insurer and the insured finds that his or her ‘representation of the one is rendered less effective by reason of his [or her] representation of the other.’”³² Neither the insurer nor dependent counsel may not give conflict analysis short shrift. “[I]t was simply wishful thinking by [dependent counsel] when he [or she summarily denied the existence of any conflicts of interest].”³³

As the beneficiary in a fiduciary relationship, the policyholder has no corresponding duty to anyone to analyze conflicts of interest.

Both dependent counsel and the insurer share the duty to advise the policyholder of conflicts of interest and the right to independent counsel.

“The conflict situation [places] a duty squarely on the attorney for the insurer to withdraw from representation or make full disclosure to both clients in the event of a conflict between them, or risk exposure to liability for harm resulting from his failure so to act, as well as to a charge of professional misconduct.”³⁴ “Canons of Ethics impose upon lawyers hired by the insurer an obligation to explain to the insured and the insurer the full implications of joint

analyzed and dependent counsel “has communicated and explained (i) the relevant circumstances and (ii) the material risks, including any actual and reasonably foreseeable adverse consequences of the proposed course of conduct” and “each affected client gives informed consent, confirmed in writing.” (Cal. Rule 1.0.1(e).)

²⁸ *Santa Clara County Counsel Attorneys Assn. v. Woodside* (1994) 7 Cal.4th 525, 546.

²⁹ *Gregori v. Bank of America* (1989) 207 Cal. App. 3d 291, 308-309.

³⁰ *Manfredi & Levine v. Superior Court (Barles)* (1998) 66 Cal.App.4th 1128, 1134.

³¹ *State Farm Mut. Auto. Ins. Co. v. Hansen* (2015) 131 Nev. Adv. Op. 74.

³² *James 3 Corp. v. Truck Ins. Exchange* (2001) 91 Cal.App.4th 1093, 1101 (citations omitted).

³³ *Industrial Indem., supra*, 73 Cal. App. 3d at 535.

³⁴ *Purdy, supra*, 167 Cal.App.3d at 77 (ellipsis omitted.)

representation in situations where the insurer has reserved its rights to deny coverage.”³⁵ “In short, an attorney representing two parties with divergent interests must disclose all facts and circumstances which, in the judgment of a lawyer of ordinary skill and capacity, are necessary to enable his client to make free and intelligent decisions regarding the subject matter of the representation”³⁶

The policyholder’s right to have independent counsel paid for by the insurer is a policy benefit. “Every insurer shall disclose to a [policyholder] all benefits that might reasonably be payable and cooperate with and assist the insured in determining the extent of the insurer’s additional liability.”³⁷ “Moreover, attorneys may be liable for participation in tortious acts with their clients, and such liability may rest on a conspiracy. By parity of reasoning, an insurer may be held liable for participation in tortious acts with attorneys it hires on behalf of its insured. Conspiratorial conduct on the part of insurers to avoid the contractual liability they undertake is not countenanced in California.”³⁸ “It seems doubtful that the conflict of interest can be avoided merely by the insurer’s instructing defense counsel to ignore coverage defenses. Insureds are likely to contend that defense counsel will make litigation decisions with the insurer’s interests in mind even if instructed by the insurer not to do so (after all, the insurer is paying counsel’s bills, etc.). Also, this holding requires ‘hindsight evaluation’ as to the adequacy of defense counsel’s representation.”³⁹

³⁵ *Cumis, supra* 162 Cal.App.3d at 375.

³⁶ *Ishmael, supra*, 241 Cal.App.2d at 528. The attorney has “an independent ethical obligation to disclose the conflict to [the clients] and either obtain written waivers of the conflict or withdraw.” (*Berger, Kahn, supra*, 79 Cal.App.4th at, 132.) Dependent counsel “owed a duty to plaintiffs, under Civil Code, section 2860, to disclose potential conflicts of interest between [the insurer] and [the policyholders].” (*Canton Poultry & Deli, Inc. v. Stockwell, Harris, Widom & Woolverton* (2003) 109 Cal App 4th 1219, 1224.) “Where an attorney represents two clients with divergent or conflicting interests in the same subject matter, the Lucas rule demands that the attorney must disclose all facts and circumstances which, in the judgment of a lawyer of ordinary skill and capacity, are necessary to enable his client to make free and intelligent decisions regarding the subject matter of the representation. Accordingly, when an attorney attempts dual relationship without making the full disclosure required of him, he is civilly liable to the client who suffers loss caused by lack of disclosure. (*Lysick, supra*, 258 Cal.App.2d at 147-48 (citations omitted).)

³⁷ Cal. Code. Regs. § 2695.4(a) (ellipses omitted).

³⁸ *Barney v. Aetna Cas. & Sur. Co.* (1986) 185 Cal.App.3d 966, 982 (citation, quotation marks, and ellipses omitted).

³⁹ Croskey et al., *Cal. Prac. Guide: Insurance Litigation* (The Rutter Group 2020) ¶ 7:788.