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Duty of Attorney Appointed by Liability Insurance Company

Jerry Brodsky*

THIS ARTICLE EXAMINES the right of a liability insurer to control the defense of its insured, the duty owed to him in defending or settling an action brought against him, and liability for negligence in defending the suit. Special attention is given to the conflict of interests which may confront an attorney retained by an insurance company to defend an action brought against a policyholder.

Right to Control the Defense

Generally, a liability insurer has exclusive control over the defense of claims against the insured, and the policyholder must relinquish control of the defense,¹ as provided for in the contract of insurance. Ordinarily, the insurer is an independent contractor,² however, the modern rule is that the insurer becomes the agent of the insured.³ Most policies provide that, if any damage suit be brought against the insured, immediate notice shall be given the insurer, so that it can defend or settle the suit. During these legal proceedings, the policyholder is prohibited from settling the claim independently or in any way interfering with the carrier's negotiations, except with consent of the carrier.⁴

However, a conflict of interests may arise between insurer and insured and, in such a situation, the insured should not be required to act against his own interests, so long as his actions are not illegal or unfair.⁵ Thus, where the insurer lacks an economic motive for adequate defense of its insured, or when the insurer and insured have other conflicting interests, the insurer may not compel the policyholder to surrender control of the

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¹ 7A Appleman, *Insurance Law and Practice*, Sec. 4681 et seq. (rev. ed. 1962).

² *Ibid.*; see, *Attleboro Mfg. Co. v. Frankfort Marine, Acci. and P. G. Ins. Co.*, 240 F. 573 (C. C. A. Mass. 1917).

³ Appleman, *op. cit. supra* n. 1; see, *Hilker v. Western Automobile Ins Co.*, 204 Wis. 1, 231 N. W. 257 (1930).

⁴ *Connolly v. Bolster*, 187 Mass. 266, 72 N. E. 981 (1905).

⁵ Appleman, *op. cit. supra* n. 1.

litigation.⁶ Also, where any conflict exists and the insurer is obligated to furnish the insured with an attorney, the counsel appointed should not be associated with the attorney representing the insurance company.⁷ Some cases have held that clauses in insurance contracts which require the insured to allow the insurer's attorney to defend the claims insured against constitute consent in advance by the insured to dual representation. However, the better view is that where a conflict develops between the interests of the insured and those of the insurer, the insurer's attorney must either withdraw entirely from the case or continue to represent only one of the clients.⁸

Situations may arise where the insured may refuse the attorney furnished him by his insurance carrier, even though such refusal ordinarily would result in a breach of the insurance contract, thereby relieving the insurer of its responsibility to appoint counsel to defend the action.⁹ It must be remembered that the principal in the action, the insured, has the right to approve any compromise, settlement, discontinuance or other disposition thereof.¹⁰

Sometimes both the insurer and the insured will participate in the defense of a suit brought against the policyholder, each being represented by independent counsel. This situation arises quite frequently where there are multiple grounds for liability asserted, for some of which the insurer is liable, and for some of which the insured is liable because they are not covered by his policy. In such case, neither party has the right, without fault by the other party, to exclude the other from participating in the defense.¹¹ Where it is uncertain whether a claim asserted against an insured may or may not come within the scope of the policy coverage, the insurer must undertake and continue the defense

⁶ *Tomerlin v. Canadian Indemnity Co.*, 39 Cal. Rptr. 731, 394 P. 2d 571 (1964).

⁷ *Appleman, op. cit. supra* n. 1; see, *Hammett v. McIntyre*, 114 Cal. App. 2d 148, 249 P. 2d 885 (1952).

⁸ *Fidelity and Cas. Co. of N. Y. v. McConnaughy*, 228 Md. 1, 179 A. 2d 117 (1962).

⁹ *Reynolds v. Maramorosch*, 208 Misc. 626, 144 N. Y. S. 2d 900 (1955); *Ross v. Stricker*, 85 Ohio App. 56, 88 N. E. 2d 80 (1949).

¹⁰ *Reynolds v. Maramorosch, supra* n. 9; *Succession of Vlaho*, 140 So. 2d 226 (C. A. P., La. 1962).

¹¹ *Krutsinger v. Illinois Cas. Co.*, 10 Ill. 2d 518, 141 N. E. 2d 16 (1957); *Fidelity and Cas. Co. of N. Y. v. Stewart Dry Goods Co.*, 208 Ky. 429, 271 S. W. 444 (1925).

until it becomes certain that the claim is not covered by the policy, at which time the insurer may deny any obligation to defend the policyholder.¹²

Where the litigation involves a collision between two vehicles, the operators of each of which are insured by the same insurance company, may the company, through counsel of its choice, defend either or both of the operators?¹³ In *O'Morrow v. Borad*,¹⁴ the California Supreme Court held that it is contrary to public policy for one person, the insurance company, to control both sides of litigation, and therefore the assureds were excused from compliance with the cooperation clauses of their policies.¹⁵ This release of the contractual obligation to cooperate justifies the insured's refusal to permit the insurer to make any defense and to permit counsel appointed by the insurer to defend the action.¹⁶ It is evident that in these situations the conflict of interest between the assured and the carrier is serious. It is to the insurer's benefit to see that neither party recovers against the other. Each of the assured parties may believe that he has a right to an impartial jury determination.¹⁷ If the insurer can compel the insured, under a cooperation clause, to furnish it with information helping to defeat his own action, and control the conduct of the litigation, it would be manifestly unfair and in violation of public policy.¹⁸

It is submitted that the rationale and rule of the *O'Morrow* case should not be followed. The insurance company should be permitted to select separate counsel for each insured and to re-

¹² *Upper Columbia River Towing Co. v. Maryland Cas. Co.*, 313 F. 2d 702 (9th Cir. 1963); *Lee v. Aetna Cas. and Surety Co.*, 178 F. 2d 750 (2d Cir. 1949); *Firco, Inc. v. Fireman's Fund Ins. Co.*, 173 Cal. App. 2d 524, 343 P. 2d 311 (1959); *Cadwallader v. New Amsterdam Cas. Co.*, 396 Pa. 582, 152 A. 2d 484 (1959); *University Club v. American Mut. Liability Ins. Co.*, 124 Pa. Super. 480, 189 A. 534 (1937).

¹³ Casper, *The Defense of Automobile Collision Cases By Insurers In Pennsylvania*, 60 Dick. L. R. 171 (1956).

¹⁴ 27 Cal. 2d 794, 167 P. 2d 483, 163 A. L. R. 894 (1946).

¹⁵ In addition to the release, the insurer has been held liable not only for payment of any judgments obtained in the actions between the insureds, but also for the fees of the parties' individual attorneys, such fees being recoverable in place of the defense required by the contract. *Ibid*; Casper, *op. cit. supra* n. 13.

¹⁶ *Ibid*.

¹⁷ *Ibid*; Appleman, *op. cit. supra* n. 1.

¹⁸ *Ibid*; Keeton, *Liability Insurance and Responsibility For Settlement*, 67 Harv. L. R. 1136 (1953).

quire the cooperation of each of them.¹⁹ Of course the insurer must exercise the utmost good faith towards each policyholder in conducting the defense;²⁰ and, in view of the prospective conflict of interest in such a situation, it is incumbent upon the insurance company to inform its policyholders of its prospective adverse interest.²¹ Each insured would then be entitled, at his own and not at the insurer's expense, to retain his own counsel who would be required to cooperate with counsel selected by the insurer.²² This solution is a just and reasonable one. An insurer cannot conduct a defense arbitrarily or capriciously with impunity, the relationship of the insurer and the insured requiring the highest degree of good faith in the conduct of the defense.²³

As a matter of record, the attorney furnished by an insurer would be the insured's attorney. However, as a matter of fact, he would be the insurer's servant.²⁴ The right of the insurer to exclusively control the litigation against the insured is usually accompanied by a duty to defend the insured against all actions brought against him on the allegation of facts and circumstances which are covered by the policy even though such suits are groundless, false, or fraudulent.²⁵ This obligation is one requiring due care and utmost good faith.²⁶

¹⁹ Casper, *op. cit. supra* n. 13.

²⁰ *Ibid*; New York Consolidated R. Co. v. Mass. Bonding & Ins. Co., 193 App. Div. 438, 184 N. Y. S. 243 (1920); Perkoski v. Wilson, 371 Pa. 553, 92 A. 2d 189 (1952).

²¹ *Ibid*.

²² Casper, *op. cit. supra* n. 13.

²³ New York Consolidated R. Co. v. Mass. Bonding & Ins. Co., and Perkoski v. Wilson, *supra* n. 20; Weiner v. Targan, 100 Pa. Super. 278 (1930).

²⁴ Petition of Preferred Acc. Ins. Co. of N. Y., 273 App. Div. 993, 78 N. Y. S. 2d 674 (1948); Heller v. Alter, 143 Misc. 10, 255 N. Y. S. 627 (1932), *revd. on other gds.* 143 Misc. 783, 257 N. Y. S. 391 (1932).

²⁵ Sumner and Co. v. Phoenix Indem. Co., 177 Misc. 887, 32 N. Y. S. 2d 2 (1942); West Philadelphia Stockyard Co. v. Maryland Cas. Co., 100 Pa. Super. 459 (1930); Annot., 50 A. L. R. 2d 458 (1956); Annot., 29 A. Am. Jur. 562 (1960); 45 C. J. S. 1055 (1946).

²⁶ Moore v. U. S. Fidelity and Guaranty Co., 325 F. 2d 972 (10th Cir. 1963); Harbin v. Assurance Co. of America, 308 F. 2d 748 (10th Cir. 1962); Traders and General Ins. Co. v. Rudco Oil and Gas Co., 129 F. 2d 621, 142 A. L. R. 799 (10th Cir. 1942).

Duty Owed—Conflict of Interest

An insurer's duty to defend is not an absolute obligation to defend successfully. It is an obligation to contest the dispute to a final judgment,²⁷ regardless of the amount involved and whether or not it exceeds the insurer's liability,²⁸ and to protect the policyholder as well as itself against liability at all stages of the litigation.²⁹ Of course, a firm demand or claim may be made against an insured for an amount in excess of policy coverage and in such case, especially where the exposure may exceed policy coverage, it is the duty of the insurer to disclose to its insured its limited and perhaps adverse interest with respect to the extent of its liability under the policy. It is imperative that such disclosure be made in order that the insured may take steps to protect himself against the possible excess exposure by retaining personal counsel.³⁰ This problem will be discussed more fully below.

In conducting a defense, it is the duty of the insurer to act in good faith,³¹ and in a careful and prudent manner,³² giving to its insured its undivided support.³³ Although, as was stated above, it has been held that an insurer undertaking to defend an action against its insured is in the position of an independent contractor,³⁴ the better view is that it acts as an agent of the insured.³⁵ Thus, when a conflict of interest arises between the insurer as agent and the insured as principal, the insurer's conduct is sub-

²⁷ Appleman, *op. cit. supra* n. 1; *Utilities Ins. Co. v. Montgomery*, 134 Tex. 640, 138 S. W. 2d 1062 (1940), *rev. 117 S. W. 2d 486* (1938); see 45 C. J. S., *op. cit. supra* n. 25.

²⁸ *Pacific Indem. Co. v. McDonald*, 107 F. 2d 446, 131 A. L. R. 208 (9th Cir. 1939); see 45 C. J. S., *op. cit. supra* n. 25.

²⁹ *Abrams v. Factory Mut. Liability Ins. Co.*, 298 Mass. 141, 10 N. E. 2d 82 (1937); see 45 C. J. S., *op. cit. supra* n. 25.

³⁰ *Murach v. Mass. Bonding and Ins. Co.*, 339 Mass. 184, 158 N. E. 2d 338 (1959); *Hilker v. Western Automobile Ins. Co.*, *supra* n. 3; see 45 C. J. S., *op. cit. supra* n. 25.

³¹ *Weiner v. Targan*, *supra* n. 23; 45 C. J. S., *op. cit. supra* n. 25; *Annot.*, 21 A. L. R. 766 (1922); *Annot.*, 29 A. Am. Jur., *op. cit. supra* n. 25.

³² *Traders and General Ins. Co. v. Rudco Oil and Gas Co.*, *supra* n. 26; *Attleboro Mfg. Co. v. Frankfort Marine, Acci. and P. G. Ins. Co.*, 171 F. 495 (C. C. A. Tenn. 1909); *Murray v. Aetna Cas. and Sur. Co.*, 61 Wash. 2d 618, 379 P. 2d 731 (1963); see 45 C. J. S., *op. cit. supra* n. 25.

³³ *Shehee-Ford Wagon and Harness Co. v. Continental Cas. Co.*, 170 So. 249 (La. App. 1936); see 45 C. J. S., *op. cit. supra* n. 25.

³⁴ *Attleboro Mfg. Co. v. Frankfort Marine, Acci. and P. G. Ins. Co.*, *supra* n. 2; *Holmes v. Hughes*, 125 Cal. App. 190, 14 P. 2d 149 (1932); Appleman, *op. cit. supra* n. 1.

³⁵ *Traders and General Ins. Co. v. Rudco Oil and Gas Co.*, *supra* n. 26; *Hilker v. Western Automobile Ins. Co.*, *supra* n. 3; Appleman, *op. cit. supra* n. 1.

ject to closer scrutiny than that of the ordinary agent because of its adverse interest.³⁶

What facts must be considered by an insurer in determining its obligation to assume the defense of a suit brought against its insured by an injured party? The majority view is that if the allegations of the complaint state a cause of action within the coverage of the policy the insurance company must defend.³⁷ Such a rule advises the insurer at the beginning of the action that a duty to defend exists. Difficulty arises, however, when the allegations in the pleadings state facts which bring the injury within an exception in the policy, and these facts are in contradiction to the facts known or which could be known to the insurer which do bring the injury within the policy coverage.³⁸ Is the company's duty to defend to be determined by the allegations of the complaint alone, or by those facts not contained in the complaint which would ordinarily come under the umbrella of policy coverage? The effect of the so-called majority view is to allow the insurer to ignore the true facts which are not stated in the complaint but which are available to it and to rely solely upon the plaintiff's allegations when determining the existence of its duty to defend.³⁹ The rationale behind this rule seems to be that the company should not be obligated to defend a suit against its insured when the insurer would be under no obligation to pay the judgment if the plaintiff's allegations prevail.⁴⁰

Those jurisdictions which oppose the majority view argue that the insurance company is under a duty to investigate the facts, even where the complaint, on its face, indicates that the claim against the insured falls outside the policy coverage.⁴¹

³⁶ *Traders and General Ins. Co. v. Rudco Oil and Gas Co.*, *supra* n. 26; Annot., 29 A. Am. Jur., *op. cit. supra* n. 25.

³⁷ *Harbin v. Assurance Co. of America*, *supra* n. 26; *Lessack v. Metropolitan Cas. Ins. Co.*, 168 Ohio St. 153, 151 N. E. 2d 730 (1958); *Wilson v. Maryland Cas. Co.*, 377 Pa. 588, 105 A. 2d 304 (1954); *McMunn, Insurance—Duty To Defend—Alleged Facts Not Within Policy Coverage*, 65 W. Va. L. R. 175 (1962); *Gerding, Insurance—Duty To Defend—Conflict of Interests*, 3 Natural Resources J. 185 (1963); Annot., 50 A. L. R., *op. cit. supra* n. 25; Comment, 30 N. Y. U. L. R. 1019 (1955); Comment, 103 U. Pa. L. R. 445 (1954).

³⁸ *McMunn, op. cit. supra* n. 37.

³⁹ *Ibid.*

⁴⁰ *Ibid.*; *Lessack v. Metropolitan Cas. Ins. Co.*, *supra* n. 37; *Ocean Acci. and Guar. Corp. v. Washington Brick and Terra Cotta Corp.*, 148 Va. 829, 139 S. E. 517 (1927).

⁴¹ *McMunn, op. cit. supra* n. 37; *Appleman, op. cit. supra* n. 1; *State v. Bland*, 354 Mo. 622, 190 S. W. 2d (1945).

This view holds that the parties intended that the insurer should not be permitted to ignore the actual facts (known to it or which could be known to it from a reasonable investigation) thereby placing the burden on the insured to prove coverage already known to the insurer.⁴²

Some policies provide indemnity for damage suffered by one insured as the result of the negligence of an uninsured motorist. Such provisions allow the insured to recover from his own insurance company whatever damages he could have recovered from the uninsured motorist. In such cases, there is clearly a conflict of interest between the insurance company and its assured. The attorney for the insurance company has a dual role. He owes a duty to the insured to see that he recovers damages if he is free from negligence himself. On the other hand, he owes a duty to his principal, the insurance company, to determine whether or not the insured was negligent. If the insurer can show negligence on the part of its insured, the provision in the policy relating to indemnity for the negligence of the uninsured motorist would not apply to the benefit of the insured. In view of this conflict of interest, it would appear that the attorney for the insurance company should advise the insured to engage separate counsel.⁴³ This would be in accord with the Canons of Professional Ethics of the American Bar Association and of all other bar associations.⁴⁴ In observing the admonition of the Canon to avoid dual representation of conflicting interests, the attorney, at the inception of his undertaking, must have in mind not only the avoidance of a retainer which will obviously and presently involve a duty to contend for one client what his duty to the other presently requires him to oppose, but also the proba-

⁴² *Ibid*; Gerding, *op. cit. supra* n. 37; Hardware Mut. Cas. Co. v. Hilderbrandt, 119 F. 2d 291 (10th Cir. 1941); Loftin v. U. S. Fire Ins. Co., 106 Ga. App. 287, 127 S. E. 2d 53 (1962).

⁴³ American Employers Ins. Co. v. Goble Aircraft Specialties, 205 Misc. 1066, 131 N. Y. S. 2d 393 (1954); Notes A. B. A. J. 945 (Oct. 1964).

⁴⁴ Canon 6 of the Canons of Professional Ethics, provides in part:

It is the duty of a lawyer at the time of retainer to disclose to the client all the circumstances of his relations to the parties, and any interest in or connection with the controversy, which might influence the client in the selection of counsel.

It is unprofessional to represent conflicting interests, except by express consent of all concerned given after a full disclosure of the facts. Within the meaning of this canon, a lawyer represents conflicting interests when, in behalf of one client, it is his duty to contend for that which duty to another client requires him to oppose.

bility or possibility that such a situation may develop later.⁴⁵ The Canons make it clear that there are not two standards, one applying to counsel privately retained by a client, and the other to counsel paid by an insurance carrier.⁴⁶

The chief purpose of this rule of professional conduct relating to an attorney's acceptance of employment adverse to his client or former client is to protect the confidential relationship existing between attorney and client.⁴⁷ As was ably stated in *American Employers Ins. Co. v. Goble Aircraft Specialties*,⁴⁸ quoting from the case of *Loew v. Gillespie*:⁴⁹

The relation of attorney to client is a high trust. Not only may he do nothing adverse to his client, but he may accept no retainer to do anything which might be adverse to his client's interests. These principles must be regarded as the foundation of all the rules which the courts and the leaders of the legal profession have announced as fixing the proper relations of attorneys and clients. Public policy absolutely demands that these foundations be not weakened. The essential question in each case is whether or not the attorney has accepted a retainer which is in any manner in conflict with his obligation to some other client.⁵⁰

Whenever there is the possibility of an excess judgment, ethical problems are created for the attorney who represents the assured under the insurance policy. The insurance company attorney who accepts such employment must be very careful in his handling of the case. He must first ask himself: Whom do I represent? Do I represent the insured or do I represent the insurer? If I represent both, at what point must I cease to continue

⁴⁵ *Ibid.*

⁴⁶ *American Employers Ins. Co. v. Goble Aircraft Specialties*, *supra* n. 43; Canon 45 of the Canons of Professional Ethics, provides:

The canons of the American Bar Association apply to all branches of the legal profession; specialists in particular branches are not to be considered as exempt from the application of these principles.

⁴⁷ *Jacuzzi v. Jacuzzi Bros., Inc.*, 32 Cal. Rptr. 188, 218 Cal. App. 2d 24 (1963); Rules of Professional Conduct, Rule 5, West's Annot. Bus. and Prof. Code following Sec. 6076.

⁴⁸ *Supra* n. 43.

⁴⁹ 90 Misc. 616, 619, 153 N. Y. S. 830 (1915), *affd.* 173 App. Div. 889, 157 N. Y. S. 1133 (1916).

⁵⁰ See also, *McLure v. Donovan*, 82 Cal. App. 2d 664, 186 P. 2d 718 (1943); *Spadaro v. Palmisano*, 109 So. 2d 418 (Fla. C. A. 1959); *Crum v. Anchor Cas. Co.*, 264 Minn. 378, 119 N. W. 2d 703 (1963); *Newcomb v. Meiss*, 263 Minn. 315, 116 N. W. 2d 593 (1962); *Van Dyke v. White*, 55 Wash. 2d 601, 349 P. 2d 430 (1960); *Pacific Coast Cement Co. v. Metropolitan Cas. Ins. Co. of N. Y.*, 173 Wash. 534, 23 P. 2d 890 (1933).

to do so?⁵¹ It has been held in such situations, that after counsel has been retained by the insurer and has appeared for the insured in the action, the primary interest of the attorney is to represent the insured;⁵² his allegiance is to him and he may not represent any other interest that may be adverse.⁵³ The statement of principles with respect to the practice of law formulated by representatives of the American Bar Association and various insurance companies expressly provides:

4(b). The companies and their representatives, including attorneys, will inform the policyholder of the progress of any suit against the policyholder and its probable results. If any diversity of interest shall appear between the policyholder and the company, the policyholder shall be fully advised of the situation and invited to retain his own counsel . . .⁵⁴

If the attorney feels that the insured may suffer personal loss as a result of a course of conduct which he, as an attorney, is pursuing, full and complete information must be given to the assured.⁵⁵ Some of the cases have gone so far as to hold that if counsel has reason to believe that the discharge of his duties will produce a conflict of interest, it becomes incumbent upon him to terminate his relationship with the client whose interests would prevent counsel from devoting his entire energies in that client's behalf.⁵⁶ The insured, as a client, may presume from his attorney's silence on the matter that the attorney has no interest which will interfere with his devotion to the cause confided in him, and that the attorney has no interest which may betray his judgment or endanger his fidelity.⁵⁷

⁵¹ Appleman, *The Relation Of Trial Counsel To The Public*, 61 W. Va. L. R. 260 (1959).

⁵² *Jackson v. Trapier*, 42 Misc. 2d 139, 247 N. Y. S. 2d 315 (1964); *Reynolds v. Maramorosch*, *supra* n. 9; *Johnston*, *Family Law*, 31 N. Y. U. L. R. 368, 380 (1956).

⁵³ *Ibid.*; cf., *Imperiali v. Pica*, 338 Mass. 494, 156 N. E. 2d 44 (1959); *Helm v. Inter-Ins. Exchange For Auto. Club of Mo.*, 354 Mo. 935, 192 S. W. 2d 417, 167 A. L. R. 238 (1946); see, 7 C. J. S. 823 (1937).

⁵⁴ Appleman, *op. cit. supra* n. 51; *Keeton, op. cit. supra* n. 18; *Anderson v. Eaton*, 211 Cal. 113; 293 P. 788 (1930); *Allstate Ins. Co. v. Keller*, 17 Ill. App. 2d 44, 149 N. E. 2d 482 (1958); *Hunter v. Troup*, 315 Ill. 293, 146 N. E. 321 (1924); *Anderson and Ireland Co. v. Md. Cas. Co.*, 123 Md. 67, 90 A. 780 (1914).

⁵⁵ *Ibid.*

⁵⁶ *Hammett v. McIntyre*, *supra* n. 7; *Allstate Ins. Co. v. Keller*, *supra* n. 54; Appleman, *op. cit. supra* n. 51.

⁵⁷ *Allstate Ins. Co. v. Keller*, *supra* n. 54; *Hunter v. Troup*, *supra* n. 54.

If an attorney appointed by the carrier represents the insured and has acted in such a manner as to constitute a breach of the ethical duties which he owes to the insured, then he may be subject to disbarment proceedings and he may be exposed to personal liability for loss resulting to the insured during the course of the representation.⁵⁸ Of course, if there is no ethical breach, but a question of judgment involved, the attorney representing the insured may not be so endangered;⁵⁹ however, in each situation, it must be evident that the attorney acted in the best interests of the insured as well as in the best interests of the insurer.⁶⁰

The attorney appointed by an insurer to defend its insured is not required to participate in, or aid in, the perpetration of a fraud. If the attorney has knowledge that the insured is perpetrating a fraud upon the insurance company through collusion with the plaintiff in the action, it is counsel's duty, as an officer of the court, to withdraw from further proceedings in the action in order that the insured may retain other counsel.⁶¹

The defense attorney engaged in defending a personal injury action should insist upon a full and efficiently conducted investigation; keep abreast of developments of a medico-legal nature;⁶² have some knowledge of anatomy, cell, tissue and organ functions; the spine and its injuries and degenerative diseases;⁶³ in order to evaluate a claim for reserve or settlement purposes,⁶⁴ and make proper recommendation as to settlement or refusal thereof.⁶⁵ Finally, defense counsel must at all times exercise the utmost good faith and fidelity toward the client.⁶⁶

⁵⁸ Appleman, *op. cit. supra* n. 51; see 7 C. J. S. 823 (1937).

⁵⁹ *Ibid.*

⁶⁰ *Id.*

⁶¹ *Pennix v. Winton*, 61 Cal. App. 2d 761, 143 P. 2d 940 (1943); *Spadaro v. Palmisano*, *supra* n. 50; *Schwartz v. Sar Corp.*, 19 Misc. 2d 660, 195 N. Y. S. 2d 496 (1959); *Keeton, op. cit. supra* n. 18.

⁶² 1 Defense L. J. 23 (1957).

⁶³ *Ibid* at 79.

⁶⁴ 9 *Id.* at 380 (1961).

⁶⁵ *Id.*

⁶⁶ 1 *id.* at 79 (1957); Appleman, *op. cit. supra* n. 51.

Settlement of Suits

Liability insurance policies ordinarily reserve to the insurer the decision whether the claimant's offer of compromise will be accepted.⁶⁷ A conflict of interest may arise between the insured and the insurer where the amount sought is in excess of the policy coverage and an offer is made by the injured claimant to compromise the claim for an amount within the limit of the coverage.⁶⁸ The insurer may insist that it has the sole and exclusive right to control the litigation and may refuse to accept the offer. On the other hand, if the insured is aware of the offer, he may insist that the insurer accept it, or take steps to negotiate for a settlement as to his excess exposure.⁶⁹ What must the insurer do, what steps must he take, and whose interests must he serve? Can the insurer become liable to the policyholder if it fails to settle and later the insured is faced with a judgment in excess of the policy limits?⁷⁰

The general rule is that a liability insurer is required to exercise good faith in protecting the interest of its insured where an offer is made to compromise a claim against the latter within the policy limits.⁷¹ In some jurisdictions, however, the insurer may be held liable for the amount of a recovery against the insured in excess of the policy limits, not because of the insurer's lack of good faith, but because of negligence in rejecting the offer.⁷²

⁶⁷ *Baker v. Northwestern Nat. Cas. Co.*, 22 Wis. 2d 77, 125 N. W. 2d 370 (1963); *Hilker v. Western Automobile Ins. Co.*, *supra* n. 3; Annot., 6 Am. Jur., Proofs of Facts 415 (1960); Annot., 5 A Am. Jur. 115 (1956); Annot., 40 A. L. R. 168 (1926).

⁶⁸ *Ibid.*

⁶⁹ *Appleman, op. cit. supra* n. 51; *Braidwood, Settlement—The Insurer's Dilemma*, 3 Alberta L. R. 250 (1964).

⁷⁰ *Ibid.*

⁷¹ *Klingman v. National Indem. Co.*, 317 F. 2d 850 (7th Cir. 1963); *Tully v. Travelers Ins. Co.*, 118 F. Supp. 568 (N. D. Fla. 1954); *Ohio Cas. Ins. Co. v. Gordon*, 95 F. 2d 605 (10th Cir. 1938); *Palmer v. Financial Indem. Co.*, 215 Cal. App. 2d 419, 30 Cal. Rptr. 204 (1963); *Auto Mut. Indem. Co. v. Shaw*, 134 Fla. 815, 184 So. 852 (1938); *Rudisill v. Nationwide Ins. Co.*, 76 York 133 (Pa. Com. Pl. 1962); *Baker v. Northwestern Nat. Cas. Co.*, *supra* n. 67; *Hilker v. Western Automobile Ins. Co.*, *supra* n. 67; *Braidwood, op. cit. supra* n. 69; Annot., 6 Am. Jur., Proof of Facts, *op. cit. supra* n. 67; Annot., 5 A Am. Jur., *op. cit. supra* n. 67; Annot., 40 A. L. R., *op. cit. supra* n. 67.

⁷² *Tully v. Travelers Ins. Co.*, *supra* n. 71; *Anderson v. Southern Surety Co.*, 107 Kan. 375, 191 P. 583 (1920); Annot., 6 Am. Jur., Proof of Facts, *op. cit. supra* n. 67; Annot., 5 A Am. Jur., *op. cit. supra* n. 67; Annot., 40 A. L. R., *op. cit. supra* n. 67.

Once the good faith rule or the negligence rule is considered, a second problem arises as to how much consideration the insurer may give to its own interests as opposed to the interests of the insured. Generally, the insurer is required to give as much weight to the policyholder's interests as it gives to its own.⁷³

The decision to try or settle a case is likely to be the joint decision of a responsible claims representative or officer of the insurance company and the attorney who is duly authorized to make the settlement.⁷⁴ In addition, where by the terms of the policy, the insurer is given the right to control the settlement of any claims within the coverage of the policy, the relationship of principal and agent is created between the insured and the insurer, and the insurer's duty as agent is of a fiduciary nature, subject to the strictest scrutiny.⁷⁵ When counsel is appointed by the insurer he assumes the same duties which the insurance company owes to the insured, and is therefore in the position of representing clients with conflicting interests.⁷⁶ It is improper for the attorney to communicate with the insured on the subject of settlement without first advising his principal, the insurance company, and obtaining its consent to communication of the offer to the insured.⁷⁷

Where the attorney appointed by the insurer has a duty regarding the settlement decision, the standard for defining that duty is more severe than that applied in favor of the policyholder against the insurance company.⁷⁸ The standard for judging the insurer's conduct is sometimes stated in terms of the ordinarily prudent person concerned with the management of his own affairs.⁷⁹ However, an ordinarily prudent person would be less fa-

⁷³ *Ballard v. Citizens Cas. Co. of N. Y.*, 196 F. 2d 96 (7th Cir. 1952); *Kelley v. British Commercial Ins. Co.*, 34 Cal. Rptr. 564 (Cal. App. 1963); *Braidwood, op. cit. supra* n. 69; *Keeton, op. cit. supra* n. 18.

⁷⁴ *Griffith v. Frankfort General Ins. Co.*, 34 N. D. 540, 159 N. W. 19 (1916); *Cunningham, Liability Beyond Policy Limits*, 25 Tenn. L. R. 432 (1957); *Keeton, op. cit. supra* n. 18.

⁷⁵ *Bostrom v. Seguros Tepeyac*, 225 F. Supp. 222 (N. D. Tex. 1963); *Fidelity and Cas. Ins. Co. of N. Y. v. Robb*, 267 F. 2d 473 (5th Cir. 1959).

⁷⁶ *Cunningham, op. cit. supra* n. 74; *Keeton, op. cit. supra* n. 18.

⁷⁷ *Ibid*; Annot., 6 Am. Jur., Proof of Facts, *op. cit. supra* n. 67; Annot., 5 A Am. Jur., *op. cit. supra* n. 67; Annot., 40 A. L. R., *op. cit. supra* n. 67; Canon 6 of the Canons of Professional Ethics, *op. cit. supra* n. 44; *Perkoski v. Wilson, supra* n. 20.

⁷⁸ *Keeton, op. cit. supra* n. 18.

⁷⁹ *Ibid*; *Dumas v. Hartford Acc. and Indem. Co.*, 56 A. 2d 57 (N. H. 1947); *G. A. Stowers Furniture Co. v. American Indem. Co.*, 15 S. W. 2d 544 (Tex.

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miliar with settlement negotiations and values than would an ordinarily prudent attorney, and it is arguable that the standard for judging the attorney's conduct should be defined in terms of an attorney specializing in personal injury litigation.⁸⁰

The attorney must give a bona fide opinion to his principal, the insurance carrier, based on all of the liability factors of the case, whether to compromise and settle, or to defend.⁸¹ If the insurer, or its appointed attorney, does not exercise good faith in protecting the interest of the insured, where an offer is made to compromise the claim within the policy limits, the insurer may be held liable to its insured for all damages set in the verdict, even though above the policy limits, because of its failure to exercise good faith in protecting the interest of the insured.⁸² If the offer, which has been rejected by the insurer on the advice of appointed counsel, had been fully and fairly considered in the light of all relevant evidence, and the rejection was based on an honest belief that the insured had a strong defense or that the verdict could be kept within the policy limits, the fact that this judgment is later proved mistaken does not amount to a lack of good faith.⁸³ Bad faith may be shown by the fact that the evidence as to liability and damage was strongly against the insured so that there was no fair or reasonable prospect of escaping liability or holding the recovery within the limits of the policy.⁸⁴ Bad faith may also be predicated on the failure of the insurer to properly investigate the claim, thus rendering it unable to intelligently assess the probabilities of recovery against the in-

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Comm. App. 1929); cf., *Wilson v. Aetna Cas. and Surety Co.*, 145 Me. 370, 76 A. 2d 111 (1950); *Hilker v. Western Automobile Ins. Co.*, *supra* n. 3.

⁸⁰ *Baker v. Northwestern Nat. Cas. Co.*, *supra* n. 67; *Hilker v. Western Automobile Ins. Co.*, *supra* n. 3; *Keeton*, *op. cit. supra* n. 18.

⁸¹ *Baker v. Northwestern Nat. Cas. Co.*, *supra* n. 67; *Hilker v. Western Automobile Ins. Co.*, *supra* n. 3; Annot., 6 Am. Jur., *Proof of Facts*, *op. cit. supra* n. 67; Annot., 5 A. Am. Jur., *op. cit. supra* n. 67; Annot., 40 A. L. R., *op. cit. supra* n. 67.

⁸² *Ibid.*; *Christian v. Preferred Acci. Ins. Co.*, 89 F. Supp. 888 (N. D. Cal. 1950); *Best Building Co. v. Employers' Liab. Assur. Corp.*, 247 N. Y. 451, 160 N. E. 911 (1928); *Braidwood*, *op. cit. supra* n. 69.

⁸³ *General Cas. Co. of Wis. v. Whipple*, 328 F. 2d 353 (7th Cir. 1964); Annot., 6 Am. Jur., *Proof of Facts*, *op. cit. supra* n. 67; Annot., 5 A. Am. Jur., *op. cit. supra* n. 67; Annot., 40 A. L. R., *op. cit. supra* n. 67.

⁸⁴ *Palmer v. Financial Indem. Co.*, *supra* n. 71; *Kelley v. British Commercial Ins. Co.*, *supra* n. 73; *Brunswick Realty Co. v. Frankfort Ins. Co.*, 99 Misc. 639, 166 N. Y. S. 36 (1917).

sured.⁸⁵ An insurer's rejection of the advice of its own attorneys to settle a case is evidence of bad faith in failing to compromise a claim against the insured.⁸⁶

Difficulties are compounded in this area of settlement when there are assertive multiple claimants, with whom the insurer makes settlements, and subsequently discovers other later claims, the total of which would exceed the policy limits. Should the insurer, in such a situation, be liable in excess of the policy limits?⁸⁷ Generally, the courts have encouraged settlements, which prevent unnecessary litigation and the congestion of court lists and eliminate many of the problems in actions.⁸⁸ It has been held that an insurer, which has settled in good faith and without negligence with some of the claimants in an action against the insured, is liable to subsequent claimants only for the amount by which its maximum liability under the policy exceeds the amounts of the settlements previously made, such excess to be paid to the subsequent claimants pro rata to the amounts of their judgments.⁸⁹

Another difficulty may arise in this area of settlement where the attorney for the insurer advises his principal, the insurance company, to settle with the party claiming against the insured, and the insurer does so settle with the claimant. The settlement may be held to constitute a bar to the insured's tort action against the person receiving the settlement. In this situation, the attorney may have prejudiced and harmed his own client, the insured.⁹⁰ However, the courts which have considered the question are agreed that a liability insurer's settlement of a claim against its insured, made without the insured's consent or despite his protests of nonliability, and not thereafter ratified by him, will not ordinarily bar an action by the insured against the person

⁸⁵ *Jessen v. O'Daniel*, 210 F. Supp. 317 (D. Mont. 1962); *Sowder v. Lawrence*, 129 Kan. 135, 281 P. 921 (1929); *Johnson v. Hardware Mut. Cas. Co.*, 108 Vt. 269, 187 A. 788 (1936).

⁸⁶ *Royal Transit v. Central Surety and Ins. Corp.*, 168 F. 2d 345 (7th Cir. 1948), cert. den. 335 U. S. 844, 69 S. Ct. 68, 93 L. Ed. 395 (1948); *Olympia Fields Country Club v. Bankers Indem. Ins. Co.*, 325 Ill. App. 649, 60 N. E. 2d 896 (1945).

⁸⁷ *Braidwood*, *op. cit. supra* n. 69; see also *Keeton*, *op. cit. supra* n. 18.

⁸⁸ *Bennett v. Conrady*, 180 Kan. 485, 305 P. 2d 823 (1957).

⁸⁹ *Ibid.*; *Alford Textile Ins. Co.*, 248 N. C. 224, 103 S. E. 2d 8 (1958); *Braidwood*, *op. cit. supra* n. 69; *Keeton*, *op. cit. supra* n. 18.

⁹⁰ *Annot.*, 6 Am. Jur., *Proof of Facts*, *op. cit. supra* n. 67; *Annot.*, 5 A Am. Jur., *op. cit. supra* n. 67; *Annot.*, 40 A. L. R., *op. cit. supra* n. 67.

receiving the settlement, on a claim arising out of the same set of facts.⁹¹

Negligence in Defense of Suits

Where an insurer assumes the defense of a suit against the insured it owes the duty to exercise not only good faith, but also ordinary care and reasonable diligence in conducting such defense and is liable in tort for the excess over the coverage of the policy of a judgment recovered by an injured person against the insured by reason of the insurer's negligence in performing such duty.⁹² As was stated above, the insurer is bound to exercise that degree of care which a man of ordinary prudence would exercise in the management of his own affairs. Failure to meet this standard will result in liability to the insured for the excess of the judgment over the policy limits, irrespective of any fraud or bad faith.⁹³ In such case the insurer's liability is not confined to the monetary limits of the policy, and, while having some relation to the policy, is not a contractual right growing out of the policy, but a tort liability for violation of a duty owed to the insured.⁹⁴ The duty sued upon by the insured arises, not upon the bringing of the suit against the insured, but out of the act of the insurer in undertaking the defense, whether obligated to do so by the policy or not.⁹⁵

Circumstantial evidence may be used to establish the bad faith of an insurer. The insurer's negligence in investigation, in

⁹¹ *Isaacson v. Boswell*, 18 N. J. Super. 95, 86 A. 2d 695 (1952); *Barron v. Smith*, 33 Erie Co. L. J. 1541 (Pa. 1949); Annot., 32 A. L. R. 2d 937 (1953).

⁹² *Ballard v. Ocean Acci. and Guarantee Co.*, 86 F. 2d 449 (7th Cir. 1936); *Attleboro Mfg. Co. v. Frankfort Marine, Acci. and P. G. Ins. Co.*, *supra* n. 32; *Schwartz v. Sar Corp.*, *supra* n. 61; *American Employers Ins. Co. v. Goble Aircraft Specialties*, *supra* n. 43; *Ross v. Stricker*, *supra* n. 9; *J. Spang Baking Co. v. Trinity Universal Ins. Co.*, 45 Ohio L. Abs. 577, 68 N. E. 2d 122 (1946); *Appleman, op. cit. supra* n. 1; Annot., 29 A. Am. Jur., *op. cit. supra* n. 25; 45 C. J. S., *op. cit. supra* n. 25; Annot., 131 A. L. R. 1499 at 1510 (1941).

⁹³ *Ballard v. Ocean Acci. and Guarantee Co.*, *supra* n. 102; *Attleboro Mfg. Co. v. Frankfort Marine, Acci. and P. G. Ins. Co.*, *supra* n. 32; *Hilker v. Western Automobile Ins. Co.*, *supra* n. 3; *Stilwell v. Parsons*, 51 Del. 342, 145 A. 2d 397 (1958); *Appleman, op. cit. supra* n. 1; Annot., 131 A. L. R., *op. cit. supra* n. 102.

⁹⁴ *Chittick v. State Farm Mut. Auto. Ins. Co.*, 170 F. Supp. 276 (D. Del. 1958); *Duncan v. Lumberman's Mut. Cas. Co.*, 91 N. H. 349, 23 A. 2d 325 (1941); *Stilwell v. Parsons*, *supra* n. 103; *Southern Fire and Cas. Co. v. Norris*, 35 Tenn. App. 657, 250 S. W. 2d 785 (1952).

⁹⁵ *Attleboro Mfg. Co. v. Frankfort Marine, Acci. and P. G. Ins. Co.*, *supra* n. 32; Annot., 131 A. L. R., *op. cit. supra* n. 102.

failing to prepare a defense properly, in failing to produce available evidence, in failing to keep the insured advised, are all suggestive of indifference to the trust imposed by the policy and the representation which, in turn, may raise an inference of bad faith.⁹⁶ However, where the insurer asserts a defense in good faith, a reasonable doubt existing as to its validity, while a negligent failure to use proper care in the preparation of the case would constitute a breach of contract giving rise to a tort liability for breach of duty, the insurer is not liable beyond the limits of the policy.⁹⁷ The fact that the insurer was unsuccessful in the trial of the case is not sufficient by itself to show that the defense of the action brought against the insured was not made in good faith.⁹⁸ However, the fact that personal counsel appears for the insured, as well as company employed counsel, does not excuse the insurer for the errors of the attorney employed by it.⁹⁹ In Appleman's opinion,¹⁰⁰ these rules do not clearly state the responsibility devolving upon an insurer under modern conditions. He states:

It has more than the duty of the care of an ordinary man unskilled in litigation; it must exercise more than mere good faith. It is a professional which advertises by all media of mass communication its skill in the investigation, settlement, and litigation of liability cases. It then becomes chargeable with a greater duty—even as the brain surgeon must exercise greater knowledge, judgment, and skill in a brain operation than would a general practitioner of medicine. It must use skill diligently and adequately to investigate a case, it must use skill in negotiation, it must select skilled trial counsel—not the lowest priced member of the bar—and that individual, so selected by it, may bind the insurer by his derelictions.¹⁰¹

⁹⁶ *Ibid.*; *Southern Fire and Cas. Co. v. Norris*, *supra* n. 104; *Hilker v. Western Automobile Ins. Co.*, *supra* n. 3.

⁹⁷ *State Farm Mut. Auto. Ins. Co. v. Skaggs*, 251 F. 2d 356 (10th Cir. 1957); *Appleman*, *op. cit. supra* n. 1.

⁹⁸ *Ballard v. Citizens Cas. Co. of N. Y.*, *supra* n. 73.

⁹⁹ *Ibid.*; *Appleman*, *op. cit. supra* n. 1.

¹⁰⁰ *Appleman*, *op. cit. supra* n. 1.

¹⁰¹ *Dempsey, Excess Liability*, 19 *Insur. Counsel J.* 44 at 58 (1952); *Cunningham*, *op. cit. supra* n. 74; *Keeton*, *op. cit. supra* n. 18.