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Conflicts and Defense Lawyers: From Triangles to Tetrahedrons

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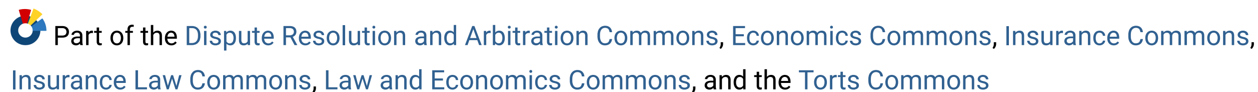
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LIABILITY INSURANCE CONFLICTS AND DEFENSE LAWYERS: FROM TRIANGLES TO TETRAHEDRONS

*Tom Baker**

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* Copyright 1997 Tom Baker, Connecticut Mutual Professor and Director, Insurance Law Center, University of Connecticut School of Law. This article was written at the Hebrew University of Jerusalem during a research leave provided by the University of Miami School of Law. Thank you to both institutions for their support and to James Fischer, Robert Jerry and Stephen Pepper for comments on an earlier draft.

INTRODUCTION

> *One problem in thinking through the lawyer's responsibilities in triangular relationships is that the relationship may not be continuously triangular. . . . Conceptualizing both the 'relevant others' as clients, and the lawyer as engaged in multiple representation, seems entirely natural when the triangular relationship is in its normal state. The question is whether there are reasons for refusing to conceptualize it in this way.*
>
> –*Geoffrey Hazard*[1]

The conflicts of interest that can arise when liability insurance companies control the defense and settlement of claims filed against their insureds have long concerned members of the tort defense bar,[2] as well as specialists in the fields of insurance[3] and professional responsibility.[4] I approach these conflicts from an insurance perspective, and I begin with the following observation: Whatever else can be said about the relationship between a defense lawyer, an insurance company and an insured, that relationship exists only because the company issued the insured a liability insurance policy. Most liability insurance policies assign the company the "duty" and "right" to defend the insured whenever the insured requests a defense against a defined set of claims. Ordinarily, the company fulfills that duty and exercises that right by retaining a lawyer to defend the insured. In that situation, the scope of the lawyer's representation of the insured will include all that is encompassed within the company's duty to defend.

This article explores the scope of the defense lawyer's representation of the insured by thinking about the lawyer as the means for fulfilling the company's duty to defend. A basic—and I think new—insight is that the conflicts of interest that draw our attention to the insurance defense lawyer arise out of an incomplete transfer from insured to company of what I will call "claim risk." I focus on the incomplete transfer of claim risk because

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1. Geoffrey C. Hazard, Jr., *Triangular Lawyer Relationships: An Exploratory Analysis*, 1 GEO. J. LEGAL ETHICS 15, 35-38 (1987).

2. *See, e.g.*, Brooke Wunnicke, *The Eternal Triangle: Standards of Ethical Representation By the Insurance Defense Lawyer*, FOR THE DEF., Feb. 1989, at 7.

3. *See, e.g.*, Robert E. Keeton, *Liability Insurance and Responsibility for Settlement*, 67 HARV. L. REV. 1136 (1954).

4. *See, e.g.*, CHARLES W. WOLFRAM, MODERN LEGAL ETHICS 38, 42 (1986).

it tests the company's duty to defend. When the company bears all the important claim risk, we hardly need to think about the company's duty to defend, because the company has every incentive to attend to the defense. In that situation, the interesting issues concern the company's *right* to defend and what the insured must do to cooperate in that defense. It is only when the company's incentive begins to wane that the duty to defend becomes interesting.

A second basic insight concerns the importance of looking beyond the familiar triangle of the lawyer, the insured and the company when analyzing liability insurance conflicts. The triangle is a useful metaphor, but it leaves out a crucial participant: the plaintiff who brings the liability claim. A relationship between a defense lawyer, an insurance company and an insured exists only in relation to—that is, in a relationship with—a plaintiff. For that reason, we cannot understand the dynamics of the professional responsibility triangle without also considering the plaintiff.

Accordingly, when thinking about insurance defense lawyers I prefer to picture the liability insurance relationship, not as a simple triangle, but rather as the set of triangles that exists between four points—a tetrahedron. When looking at any particular face of a tetrahedron, it can appear to be a simple triangle, just as when looking at any one aspect of the liability insurance relationship, it can appear to involve only three parties. But, there is always the "hidden" fourth party, whose relationship with these three parties will affect their relationships with each other.

Figure 1 on the following the following page depicts one view of the liability insurance tetrahedron. As figure 1 reflects, the professional responsibility triangle is not the only interesting face of the tetrahedron. There is also the jury triangle, composed of the three parties that a jury deciding the liability claim would see: the lawyer, the insured, and the plaintiff. There is the settlement triangle, composed of the three parties who, ordinarily, negotiate toward settlement of the claim: the lawyer, the company, and the plaintiff.[5] And there is a final, very interesting triangle composed of the plaintiff, the insured and the company that I will have a great deal to say about. Each of these faces of the liability insurance tetrahedron can seem to form a three way relationship. As with the

5. *See* Charles Silver & Kent D. Syverud, *The Professional Responsibilities of Insurance Defense Lawyers*, 45 DUKE L.J. 255, 293-96 (1996) (on "ordinary" case).

professional responsibility triangle, our understanding of these relationships can be deepened by considering the fourth party.[6]

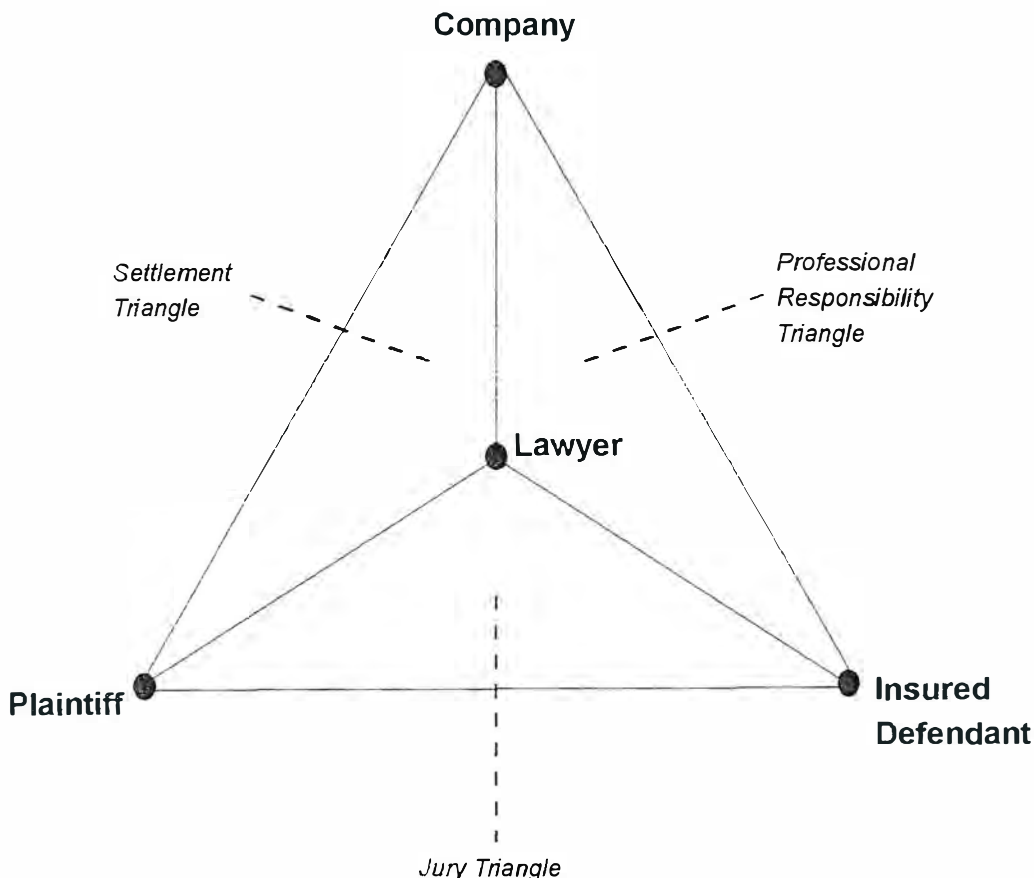

FIGURE 1

Part I of this article introduces this tetrahedron framework. Part II then explores the framework in the context of three sets of hypothetical cases involving the incomplete transfer of claim risk: one set in which the risk is shared because of dollar limits on the insurance coverage; a second set in which the risk is shared because of uncertainty about insurance coverage for the case; and a third set in which the risk is shared because the plaintiff has the potential to cause the insured a kind of harm that is not covered by

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6. In all of this I readily acknowledge that I have collapsed the plaintiff and the plaintiff's lawyer into a single unit, even though these two parties do not always have identical interests. It is my working hypothesis that, at least as respects the professional responsibilities of insurance defense lawyers, nothing of analytical importance is lost as a result.

the insurance policy. My goal is to use the tetrahedron framework to explore the conflicts in these cases and also to use these cases to explore whether that framework is a useful analytical tool.

Part III then addresses the role of the defense lawyer in fulfilling the company's duty to defend in shared claim risk situations. I begin with the conclusions reached by Professor Charles Silver and Dean Kent Syverud in their recent analysis of the professional responsibilities of insurance defense lawyers in full coverage cases[7] and then extend those conclusions to encompass the shared claim risk situations presented in my hypothetical cases. For reasons that will be explained, I agree on insurance law grounds with their conclusion that the insurance company is entitled to limit the scope of the defense lawyer's representation of the insured to minimizing what I will call the "judgment risk"[8] at issue in the claim.

Where I disagree with Silver and Syverud is with respect to the company's responsibility for what I will call the "non-judgment risk" faced by the insured. I locate this responsibility in the company's good faith obligation to give equal consideration to the interests of the insured, and I conclude that this obligation requires the company to retain the defense lawyer to give primary consideration to the interests of the insured in conflict situations when "equal consideration" is an impossibility. Thus, I ground what is sometimes called the primary client rule,[9] not in professional responsibility law, but rather in insurance law.

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7. *See* Silver & Syverud, *supra* note 5.

8. *See* Silver & Syverud, *supra* note 5, at 296-301. Silver and Syverud do not use the claim risk framework, but I think they would agree with this characterization. "Judgment risk" is the risk of having to pay all or part of a judgment entered in a claim. "Non-judgment risk" is every other kind of claim risk; it includes the risk that the claim is not covered (which I will call "coverage risk"), the risk that the company will not settle the claim (which I will call "settlement risk"), and the risk of consequences other than judgments, such as reputational harm (which I will call "other non-judgment risk"). Non-judgment risk also includes defense costs, but because the company is conducting the defense in the cases explored in this paper, defense costs are not part of the insured's non-judgment risk in these cases.

9. *See* Silver & Syverud, *supra* note 5, at 335 (criticizing the primary client rule and proposing an alternative, non-subordination rule).

I. A FRAMEWORK FOR ANALYZING INSURANCE DEFENSE CONFLICTS: SHARED CLAIM RISK AND THE LIABILITY INSURANCE TETRAHEDRON

Under the prevailing norms of insurance practice, the company's obligations to the insured are analyzed within the framework of contract law, as that law has been developed in the context of standard form insurance policies.[10] Within that framework, the point of departure is the insurance policy. Whatever else the company's obligations may be, those obligations include what was promised in the form contract the company chose to use.

With respect to the company's obligation to defend, most liability insurance policies provide little more than the following:

> We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. We will have the right and duty to defend any "suit" seeking those damages. We may at our discretion investigate any "occurrence" and settle any claim or "suit" that may result.[11]

In addition, these standard form policies contain provisions requiring the insured to cooperate with the company and prohibiting the insured from settling an insured claim without the company's consent.[12] These provisions constitute the whole of the language in the typical insurance policy directly relating to defense obligations.[13]

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10. *See* Tom Baker, *Constructing the Insurance Relationship: Claims Stories, Sales Stories and Insurance Contract Damages*, 72 TEX. L. REV. 1395 (1994).

11. ISO CGL 1986. The wording in the standard automobile and homeowners' insurance policies is essentially the same.

12. "You and any other involved insured must . . . [c]ooperate with us in the investigation, settlement or defense of the claim or "suit" . . . No insureds will, except at their own cost, voluntarily make a payment, assume any obligation, or incur any expense, other than for first aid, without our consent." *Id.*

13. The remainder of the policy principally addresses limits on the company's duty to indemnify and claiming conditions. Because the "duty to defend" applies only to suits seeking damages for which the company would be obligated to indemnify the insured, these other provisions do relate indirectly to the duty to defend.

Taken together, these standard form provisions mean that (in the ordinary case) the insurance company selects the lawyer who will represent the insured, directs that lawyer's handling of the case, and controls the investigation, negotiation and settlement of the case.[14] Indeed, an insured who interferes with the insurance company's right to defend or discretion to settle risks losing insurance for that case.[15] These provisions also mean, however, that the company has both a "duty to defend" and—although this is not explicitly stated in the policy—a "duty to settle."[16] Thus, the insurance contract clearly contemplates the defense and settlement of the insurance claim as the prerogative of the company, but it also grants the insured a right to a defense and, in the appropriate circumstance, to a settlement of the claim. If these latter rights are to have any meaning, they must—and do—set some limits on the insurance company's right to defend and settle.

A. Shared Claim Risk

In every case, the interests of the company and the insured diverge to the following degree: absent reputational or some unusual concern of the insured, she would prefer a company-funded settlement over further litigation, no matter how unreasonable the plaintiff's demand; and, if there is no settlement, the insured would prefer the company to spend more on defense. This is an example of what economists call ex post moral hazard: because the insurance company is paying for the settlement and defense, the insured's incentives regarding the consequences of an allegedly harmful event differ from what they would be if there were no insurance.[17]

The insurance contract provisions granting the company control over defense and settlement address that incentive problem. A rational *prospective* insured would prefer a liability insurance contract giving the

14. *See* Silver & Syverud, *supra* note 5, at 265. This typical practice was also confirmed to me in a series of interviews of South Florida personal injury lawyers. For a description of these interviews, see Tom Baker, *Transforming Punishment Into Compensation: In the Shadow of Punitive Damages*, 1998 WIS. L. REV. (forthcoming Spring 1998).

15. *See, e.g.*, Steen v. Underwriters at Lloyd's, 442, N.W.2d 158 (Minn. Ct. App. 1989).

16. *See generally* Kent D. Syverud, *The Duty to Settle*, 76 VA. L. REV. 1113 (1990) (explaining the company's duty to make reasonable efforts to settle a case within the policy limits in order to protect the insured from a judgment in excess of the policy limit).

17. *See generally* Tom Baker, *On the Genealogy of Moral Hazard*, 75 TEX. L. REV. 237, 269-70 (1996) (describing ex ante and ex post moral hazard).

company some such control, just as a rational prospective insured would prefer a health insurance policy with a deductible or copayment provision and some degree of oversight of the medical treatment.[18] Otherwise, the insured would demand at the point of claim a level of defense that she would not be willing to pay for at the time of purchasing the policy.[19]

Indeed, from an insured's perspective, a liability insurance policy that shifts the control over the defense and settlement of the claim to the company is much less threatening than a health insurance policy that shifts control over health treatment. In the ordinary liability case, the defendant's primary (and often exclusive) concern is avoiding or minimizing the cost of an adverse judgment. That concern easily can be transferred to an insurance company by a contract that makes the company liable for paying the judgment. In contrast, the "health" that is the primary concern of someone who buys health insurance cannot so easily be transferred by contract.

As this suggests, insurance company control presents difficult problems when the insurance contract does not transfer to the company all the important risk affected by that control. That is necessarily the case in health insurance; no contract can ever transfer all the important risk affected by control over health treatment. That is not necessarily the case in liability insurance; liability insurance can come much closer to transferring all the important risk affected by the company's control over the claim. Yes, there are deductibles, and there can be difficulties associated with being a defendant that are not eliminated by liability insurance. But, those deductibles and difficulties usually are relatively insignificant, as least as compared to the risk of paying a judgment.[20]

I call the risk that can be affected by the company's control over the claim the "claim risk." Claim risk is the risk associated with a claim once an event that may give rise to the claim has occurred. It includes all the possible consequences of a claim, such as defense costs, payment to the plaintiff, and loss of good will or reputational harm.

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18. For an analysis of the insurance/control nexus, see Tom Baker, Torts, Insurance and Social Control in the Age of Managed Care (unpublished manuscript on file with author).

19. *See* Baker, *supra* note 17, at 268.

20. Where the deductible is very high, as is increasingly the case in the major corporate liability context, the insurance agreements do not transfer control over defense and settlement to the company. This paper does not address that context. It is concerned solely with traditional liability insurance policies that transfer control to the company.

An insurance contract does not (and cannot) transfer all the important risk of an injury-causing activity, but it can (and sometimes even does) transfer all the important claim risk. For example, in the automobile context the risk of driving includes the risk of harm to the insured driver. That is a risk that not even the most generous insurance policy can transfer completely to an insurance company, because money simply cannot fully compensate an insured for injury to his or her body. But, by agreeing to cover all the costs of defense and to pay any liability claims, an automobile liability insurance policy can transfer essentially all the important *claim risk* associated with driving.[21]

Of course, the fact that the liability insurance company can bear essentially all the important claim risk does not mean that it always does so. The insured can retain significant claim risk for at least three reasons: dollar limits on the amount of coverage provided by the insurance policy, uncertainty over insurance coverage for the claim, and the potential for the plaintiff to cause the insured a significant kind of harm that is not covered by the insurance policy, such as reputational harm or, in some states, punitive damages.[22] In these shared claim risk situations, the company's control over defense and settlement can provide the opportunity to shift claim risk to the insured. Thus, unlike the paradigm liability insurance defense situation—where the ex post moral hazard we worry about is that of the insured—shared claim risk cases present a dual moral hazard problem.[23]

B. The Liability Insurance Tetrahedron

In teaching and thinking about insurance, I find it helpful to use geometric figures. The triangle below represents the liability insurance relationship when the company faces all the important claim risk in the case, which is understood to be the usual case.[24] In this situation, we can think of the interests of the company and the insured as having merged.

21. The possible exception is the risk of future premium increases under an experience-rated insurance policy.

22. *See* Tom Baker, *Reconsidering Insurance for Punitive Damages*, 1998 WIS. L. REV. (forthcoming Spring 1998).

23. *See* Baker, *supra* note 17, at 274 n.181 (collecting dual moral hazard literature).

24. *See* Silver & Syverud, *supra* note 5, at 263.

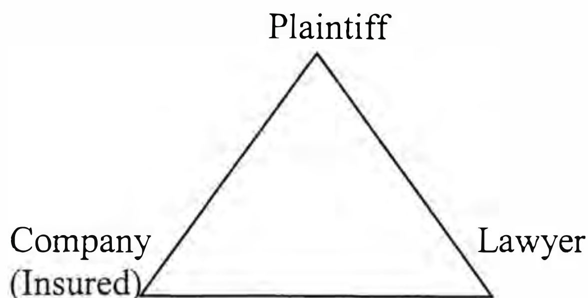

FIGURE 2

In this relationship, we usually think of the company and the insurance defense lawyer allied against the plaintiff; thus, some readers may resist thinking of this relationship as triangular. Yet, as any insurance defense lawyer or insurance adjuster can attest, the relationship between the company and the lawyer can involve conflict even in a case in which the company bears all the claim risk.[25]

The conflict principally revolves around defense fees. The company has an interest in reducing defense costs that is not shared by the lawyer. The plaintiff can use that interest to obtain a settlement that reflects, not only the risk of an adverse judgment, but also the costs of defense. Thus, this relationship presents an opportunity for the company and plaintiff to benefit at the "expense" of the lawyer.

There is also a potential community of interest between the plaintiff and the defense lawyer. Both plaintiff and lawyer have an interest in the continued existence of a claim: the lawyer to bill the file,[26] and the plaintiff to keep alive the possibility of payment. In the normal situation, we expect this potential community of interest to be overwhelmed by the lawyer's interest in proving her or his worth to the company by dispatching

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25. *See, e.g.*, Anonymous, *What Many of Us Really Think but are Afraid to Say*, FOR THE DEF., July 1993, at 2 ("From an economic standpoint, your law firm's interests are not necessarily the same as the insurance carriers. Where a case can be settled to eliminate your bill, they are going to do it."); Donald W. Rees & Robert F. Hall, *Communicating with the Insurer Consumer*, FOR THE DEF., Sept. 1994, at 4.

26. This interest assumes an hourly fee arrangement. Paying lawyers on a capitation or flat fee basis changes the incentives present in the relationship. This paper focuses exclusively on the incentive associated with hourly fees and does not address different fee arrangements or the incentives associated with those arrangements.

the claim. Nevertheless, this potential alliance appears to have resulted in fraud on the company.[27]

When the insured and the company share claim risk, the picture is more complicated. Instead of three relevant parties with potentially conflicting interests, there are four: the company, the insured, the defense lawyer and the plaintiff. The figure below shows the triangle from above "opened up" to reflect the conflict between the company and insured that results from the shared claim risk.

27. *See* Peter Carbonara, *Fleecing Insurance Companies, California-Style*, AM. LAW., Apr. 1990, at 52 (describing alleged fraud by a group of lawyers known as "the Alliance"); Alfred G. Haggerty, *Fireman's Fund, Allstate Settle with Three RICO Suit Lawyers*, NAT'L UNDERWRITER, Nov. 5, 1990, at 4 (reporting settlement by three alleged members of the alliance). This example involves independent counsel selected by the insured pursuant to California's Cumis statute. CAL. CIV. CODE § 2860 (West 1993). The conflict between lawyer and company is less acute when the company chooses the defense lawyer, but it does not go away. *See* Anonymous, *supra* note 25, and Rees & Hall, *supra* note 25.

Insured Defendant

Insured Defendant

Plaintiff

Plaintiff's Choice Triangle

Jury Triangle

Settlement Triangle

Company

Lawyer

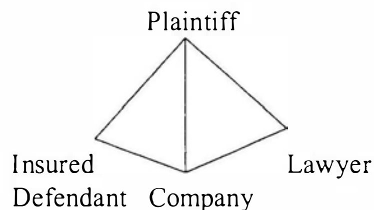
Professional Responsibility Triangle

Insured Defendant

FIGURE 3

If we plot the relationships between these four in three dimensions, the geometric figure that results is a tetrahedron—which I think of as a three dimensional triangle (and which I visualize by thinking of a pyramid with a triangular base).[28] Appendix A shows the liability insurance tetrahedron in

28. The following picture is a three-dimensional representation of the liability insurance tetrahedron:



a form that can be copied, enlarged, and then cut out and assembled into a three dimensional tetrahedron for individual use.

Each of the four faces of the tetrahedron represents a facet of the liability insurance relationship. The "professional responsibility triangle" represents the relationship between the company, the lawyer, and the insured. The "jury triangle" represents the relationship between the three parties that a jury deciding a liability claim would see: the insured, the plaintiff and the defense lawyer. The "settlement triangle" represents the relationship between the three parties that, ordinarily, are directly involved in the settlement of the case: the company, the plaintiff, and the defense lawyer.[29] And the "plaintiff's choice triangle" represents the relationship between the company, the plaintiff and the insured. Each of these components of this relationship is characterized by the kinds of tensions that I began to explore in discussing the company-lawyer-plaintiff triangle above.

II. EXPLORING THE LIABILITY INSURANCE TETRAHEDRON THROUGH PATTERN CONFLICT CASES

The liability insurance paradigm—in which the company controls the defense and settlement of claims using a single lawyer who represents both the company and the insured—is based on the assumption that in most cases the interests of the company and the insured do not fundamentally conflict. In other words, the liability insurance paradigm is based on an assumption that the company bears all the important claim risk. Liability insurance contracts are theoretically capable of transferring all the important claim risk from the insured to the insurance company. The degree to which existing liability insurance contracts approach this goal is an empirical question to which we do not have a rigorous answer. It is clear, however, that liability insurance contracts do not always transfer all the important claim risk faced by insureds. While we cannot say what percentage of actually filed insurance claims involve shared claim risk, we can identify with some confidence the patterns of these cases according to the reasons underlying the sharing of claim risk.

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29. *See* Silver & Syverud, *supra* note 5, at 295 (stating that the defense lawyer will usually be retained to represent the company at settlement); *see also*, Keeton, *supra* note 3, at 1168-71 (arguing that defense counsel may represent the company and not the insured for settlement purposes).

There are at least three such reasons: (1) the dollar limits of the insurance policy are less than the potential damages at issue in the claim; (2) substantive limits on the coverage provided by the insurance policy make the company's obligation to pay all or part of the claim doubtful or uncertain; and (3) the plaintiff has the potential to cause the defendant a kind of harm that is not covered by the insurance policy. The analysis that follows explores three sets of hypothetical cases that illustrate these patterns, using the framework developed in Part I.

A. Shared Claim Risk Resulting from Dollar Limits

In the first set of pattern cases, the insured and the company share the claim risk because of dollar limits on the coverage provided by the liability insurance policy.

1. The Low Limits Case

> *An individual insured with a $100,000 limit liability insurance policy cut off a stranger's foot with a lawn mower. The stranger filed suit seeking $1 million and then offered to settle the case for $100,000.*

In the Low Limits Case, the insured bears significant claim risk because the potential damages exceed the limits of the insurance policy. This case presents a well known conflict of interest: in the absence of some insurance law intervention, the company has only its subsequent defense costs to lose when it turns down a policy-limits settlement offer. Courts have described this situation as presenting the company with the opportunity to "gamble with the insured's money."[30]

Courts have attempted to resolve this conflict by requiring the insurance company to act "as if" there were no insurance limits when evaluating a settlement proposal.[31] This duty means that the company has a duty to accept a reasonable settlement offer within the policy limits, and

30. *See, e.g.*, Twin City Fire Ins. Co. v. County Mut. Fire Ins. Co., 23 F.3d 1175, 1179 (7th Cir. 1994); *see also* Murphy v. Allstate Ins. Co., 132 Cal. Rptr. 424, 426 (1976) ("the duty to settle is implied in law to protect the insured from exposure to liability in excess of coverage as a result of the insurer's gamble—on which only the insured might lose").

31. *See* Syverud, *supra* note 16, at 1122-26 (describing competing standards for evaluating whether company should be held liable for failure to settle a claim). The company may also have the duty to offer the policy limits to settle the appropriate case. *See* Coleman v. Holecek, 542 F.2d 532, 537 (10th Cir. 1976) ("the duty to settle does not hinge on the existence of a settlement offer from the plaintiff").

if the company breaches that duty, it will be liable for the full amount of any subsequent judgment in the case against the insured.[32] This duty to settle increases the company's incentive to settle a case and, thus, reduces the risk of an uninsured excess judgment. It does not, however, eliminate that risk. There remains the possibility that the company will not settle a case within policy limits and that a jury will conclude that the company made every reasonable effort to do so.

Thus, notwithstanding the insurance law "solution" to the conflict of interest, the company and the insured still share the claim risk in a low limits case. Moreover, when the value of the case exceeds the policy limits, the company lacks the usual incentive to defend the case at a level that is proportional to the damages at stake. Indeed, once it becomes reasonably clear that the company will have to pay the full limits of the policy in the case, the company's indemnity obligation provides little financial incentive to defend the case.

These residual conflicts between the company and the insured have consequences within each facet of the liability insurance tetrahedron. In the context of the plaintiff's choice triangle (company-plaintiff-insured), the conflict has the potential to weaken the usual alliance between the company and insured and to create an alliance between plaintiff and insured in favor of a settlement. The insured wants the case to settle to avoid the risk of an uncovered judgement; the plaintiff would like a quick resolution of the case, preferably at a premium.[33]

In the context of the professional responsibility triangle (company-insured-lawyer), the conflict gives the company an incentive to manage the defense in a way that shifts more of the claim risk to the insured. This can happen in at least two ways. First, the company can use its control over the liability case to strengthen its position in any subsequent failure to settle case. For example, the company could direct the defense lawyer not to arrive at an opinion regarding the value of the case or not to create any documents stating possible verdicts in the case, or the company could instruct the defense lawyer to minimize the value of the case in documents

32. *See* Syverud, *supra* note 16, at 1120-21.

33. In light of the rule that the company will be liable for excess verdicts when it has the opportunity to obtain a reasonable settlement within the limits, the conflict between the company and the insured is most acute in situations in which a within-limits settlement demand is not clearly reasonable. A rational plaintiff would use that conflict as a pressure point to obtain a settlement at the high end of what is reasonable.

about the case.[34] Such directions would make it more difficult for the insured to prevail in a subsequent failure to settle case. By inhibiting the defense lawyer's ability to communicate her perspective on the case to the relevant decision makers in the company, such directions may also reduce the probability that the company settles the case.

Second, the company can shift risk to the insured by shirking in the defense of the case. This seems most likely to occur in a case in which the value of the case clearly exceeds the limits of the policy and there is no opportunity to settle within limits. But, even when there is an opportunity to settle (as in the Low Limits case), a company that turns down that opportunity is only contingently liable for all the damages at stake and thus has less incentive to defend the case at the level proportional to those damages than would a solvent, uninsured defendant.

The lawyer's interests in this conflict may at first appear contradictory. On the one hand, the lawyer's interests clearly lie with the insured in favor of a strong defense and against company shirking. On the other hand, the lawyer's interests lie with the company in favor of litigation and against settlement. Of course, it is quite possible for the lawyer to satisfy both these interests: opposing settlement and insisting on a thorough defense of the liability claim.[35]

The conflict between the company and insured also has a potential spillover effect in the jury triangle (insured-lawyer-plaintiff), where it has the potential to create an alliance between the insured and the plaintiff against the lawyer. Both the insured and the plaintiff want the case to settle. The more the lawyer is seen as resisting settlement and siding "with" the company "against" the insured, the stronger the plaintiff-insured alliance. For this reason, plaintiffs' lawyers sometimes prepare demand letters aimed as much at the insured as the lawyer or company.[36] One goal of such letters is to induce the insured to retain personal counsel who may,

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34. In an interview conducted under a condition of anonymity for another project, a defense lawyer reported that he was instructed by an insurance company not to make a written assessment of likely damages or settlement numbers in cases he handles for them, in order to make it more difficult for insureds to prevail in failure to settle cases. Interview with Insurance Defense Lawyer (name confidential), in Miami, Fla. (May 17, 1996). For a description of the interviews, *see generally* Baker, *supra* note 14.

35. This is an example of a situation where an alternative fee arrangement could create a different incentive. Were the law firm paid a flat fee to handle a given percentage of the company's litigated cases, the firm would not have a fee-based incentive to oppose a settlement in a particular case.

36. *See* Baker, *supra* note 14.

in effect, work with the plaintiff to pressure the lawyer and the company to settle the claim.[37] If the company does not settle the case and a large judgment results, the insured and the plaintiff may then ally against the lawyer in a much more concrete fashion: the insured settles with the plaintiff, assigns to the plaintiff the insured's rights against the lawyer and the company, and then assists the plaintiff in a failure to settle suit against the company. Lurking in the background is a potential malpractice claim against the lawyer.

Considering the jury and professional responsibility triangles simultaneously, we can see how tensions in one facet of the liability insurance relationship can affect another. An important concern with respect to the professional responsibility triangle is that the lawyer's long-term economic dependence on the company gives the lawyer an incentive to favor the company against the insured. This concern plays out in the jury triangle as the wedge the plaintiff uses to attempt to split the lawyer and the insured. At the same time, however, the ability of the plaintiff and the insured to ally against the lawyer in the jury triangle may play out in the professional responsibility triangle by giving the lawyer an incentive not to favor the company over the insured. In the event of a large, uncovered excess verdict, the lawyer is a potential deep pocket target. This personal risk may lead the lawyer to bond more tightly with the insured, and, by extension, even the plaintiff.

The conflict between company and insured also has contradictory potential in the settlement triangle (plaintiff, lawyer, company), assuming, of course, that the lawyer handles the settlement on behalf of the company. Provided that the settlement offer is not clearly reasonable, it is in the interest of both the lawyer and the company to resist settlement: the company to avoid paying more than it is legally obligated to pay, and the lawyer to continue receiving fees for the defense of the case. Two factors mitigate against this alliance between lawyer and company, however. The personal risk of the lawyer described above may lead the lawyer to favor settlement when the company would not. Moreover, to the extent that the resolution of the conflict in the professional responsibility triangle results in a more expensive defense, the company's incentive to settle will closer approach that of the plaintiff's, thus increasing the community of interest

37. *Id.*

between company and plaintiff "against" the lawyer in favor of avoiding defense costs.[38]

2. The Multiple Victim Case

An insured with an automobile liability insurance policy with a $300,000 per accident limit caused a multiple car accident. Three family members seriously injured in one of the cars filed suit before any of the other victims. The three immediately offer to settle for $300,000.

This case is a variation on a low limits case. I use this case to correct any misimpression that it is always the insured who pushes to settle a low limits case. It would be in the company's interest to exhaust the policy limits by settling and thereby save the costs of continuing to defend the insured. The insured would like to keep the company-paid defense until all the cases arising out of the accident are resolved.

In both this case and the Low Limits Case just considered, the conflict between the company and the insured arises from the lack of adequate insurance. In the Multiple Victim Case, however, the company is the one motivated to settle, not the insured. This difference has consequences within each aspect of the liability insurance relationship.

Consider first the plaintiff's choice triangle. As in the Low Limits Case, the conflict between the insured and the company threatens the usual bond between the company and the insured. This time, however, the potential alliance is between these first three plaintiffs and the company. Now the reason for calling this the "plaintiff's choice" triangle becomes clear. A conflict between the company and the insured provides a plaintiff with a potential ally where, before, there were two opponents. In the Low Limits Case the potential ally was the insured. Here, the potential ally is the company.

Whether the plaintiff chooses an alliance in any particular case and, if so, with whom, depends on the situation. Consider first the Low Limits Case. If the insured has significant, collectible assets, a rational plaintiff would have little interest in an alliance with the insured against the company to promote a within-limits settlement—unless either the

38. This will be especially true when the insured has little or no personal assets, because the lack of assets does not relieve the company of the duty to settle, but it dramatically reduces the plaintiff's interest in an excess judgment. *See* Steele v. Hartford Fire Ins. Co., 788 F.2d 441, 446-48 (7th Cir. 1986) (Posner, J.).

plaintiff's case on liability is weak or the damages are unlikely to exceed the policy limits.[39] If the insured does not have significant collectible assets, however, a rational plaintiff would have great interest in an alliance with the insured in favor of settlement,[40] regardless of the strength of the case or the size of the damages in relation to the policy limits.

The Multiple Victim Case presents the plaintiff with a similar choice. If the insured has significant, collectible assets, a rational plaintiff would have no interest in an alliance with the company to promote a quick settlement—unless, once again, either the plaintiff's case on liability is weak or the damages are unlikely to exceed the policy limits. But, if the insured does not have significant, collectible assets, a rational plaintiff would have great interest in an alliance in favor of settlement (this time, of course, with the company), regardless of the strength of the case or the size of the damages in relation to the policy limits.

Courts' treatment of settlements in multiple victim cases reflects the dynamics of this "plaintiff's choice." The black letter standard remains what Keeton called the "more rustic rule, 'first come, first served'"[41]—meaning that the company may settle individual claims in a manner that leaves less insurance money for later claimants.[42] Nevertheless, that rule has been qualified over time to protect both the insured and other claimants from opportunistic plaintiffs and companies. When the insured has assets, it is the insured who needs protection from a colluding plaintiff and company; the duty of good faith provides that insured some protection.[43] When the insured does not have assets, it is the other victims who need protection; the mandatory allocation of the available insurance to all victims required in some jurisdictions provides those victims some

39. In either of those two cases, the plaintiff may believe that an alliance with the insured against the company would make it possible to obtain a more generous settlement than would be possible if there were no insurance.

40. The alliance would seem to be the strongest in cases in which the insured defendant has some assets (and thus some interest in avoiding an excess verdict), but not enough to justify great effort on the part of the plaintiff.

41. *See* Robert E. Keeton, *Preferential Settlement of Liability Insurance Claims*, 70 HARV. L. REV. 27, 38 (1956).

42. *See, e.g.*, Allstate Ins. Co. v. Evans, 409 S.E.2d 273, 274 (Ga. Ct. App. 1991).

43. While the contours of "bad faith" in this context are far from settled, a decision in Massachusetts suggestd that settling quickly with one claimant and leaving the insured to defend remaining cases on its own would constitute bad faith. *See* Voccio v. Reliance Ins. Co., 703 F.2d 1, 3-4 (1st Cir. 1983) (dicta that insurance company could be liable if a settlement with one plaintiff caused an excess verdict by another).

protection.[44] As in the Low Limits case, then, insurance law resists the detrimental consequences of opportunistic behavior by the company. Nevertheless, insurance law does not (and cannot) eliminate the conflict between the companies and insureds that results from there being too little insurance.

Consider next the professional responsibility triangle (company-lawyer-insured). The conflict in the Multiple Victim Case has at least the potential to strengthen the bond between the insured and the lawyer. Both the lawyer and the insured have an interest in the company continuing to pay to defend the case, an interest which conflicts with the company's interest in terminating its involvement in the claim. This common interest may not overcome the lawyer's economic dependence on the company, but it provides an incentive to manage that dependent relationship in a way that keeps this case alive (for example, by bringing to the company's attention the case law indicating that there is some risk to a company that pursues a settle and exit strategy).

From analyzing just these two pattern conflict cases we can see that the lawyer's position in the professional responsibility triangle is similar in some ways to the plaintiff's position in the plaintiff's choice triangle. The conflict between the company and the insured provides the lawyer with a potential opponent, where before there were two allies. Thus, we might call the professional responsibility triangle the "lawyer's choice triangle" and anticipate that the lawyer's choice, like the plaintiff's, would depend on the lawyer's interest in the situation. "Lawyer's choice" is not, however, a comfortable way of thinking about this situation. Indeed, one of the goals of insurance and professional responsibility law in this situation is precisely to dictate the "choice" that the lawyer must make and to structure the liability insurance relationship in such a way that the lawyer does not have an unobserved opportunity to make a contrary choice.

As in the Low Limits Case, the conflict between the company and the insured in the Multiple Victim Case has spillover effects in the jury

44. *See, e.g.*, Holtzclaw v. Falco, Inc., 355 So. 2d 1279, 1288 (La. 1977) (interpreting direct action statute to prohibit company from exhausting an automobile insurance policy by settling with less than all the victims of an accident); Dorn v. Liberty Mut. Fire Ins. Co., 401 N.W.2d 662, 663 (Minn. 1987) (interpreting uninsured motorist statute to prohibit company from exhausting the policy by settling with less than all the victims of an accident); *see also* Miller v. Lambert, 464 S.E.2d 582 (W. Va. 1995). This goes some way toward achieving Keeton's preferred solution: a court-ordered allocation of policy proceeds according to the "relative settlement value of all claims." Keeton, *supra* note 41, at 52.

(plaintiff-lawyer-insured) and settlement (plaintiff-lawyer-company) triangles. In contrast to the Low Limits Case, however, the incentives strengthen the bond between insured and lawyer against the plaintiff in the jury triangle and weaken the bond between company and lawyer against the plaintiff in the settlement triangle. The result is that the lawyer in the Multiple Victim Case has more incentive to advocate for the insured at the settlement table than the lawyer in the Low Limits Case.[45] These spillover effects are further examples of the effect that the dynamics in one component of the liability insurance relationship can have on others. They also illustrate the important point that the self interest of the lawyer may mitigate the effect that the lawyer's long term economic dependence on the insurance company has on the lawyer's relationship with the insured. This may explain the relative paucity of published opinions in which insureds challenge a company's early settlement of a multiple victim case.[46]

B. Shared Claim Risk Resulting from Insurance Coverage Uncertainty

In the second set of pattern cases, the insured and the company share the claim risk because there is some uncertainty whether the potential damages are covered by the insurance policy.

1. The Misrepresentation Case

> *In investigating a serious, but otherwise routine "slip and fall" involving a repairman at the home of an insured with adequate liability insurance for the resulting claim, the company discovered that the insured had been conducting business at the home, despite having answered "no" to a question in the policy application regarding business at the home. The company undertook the defense of the insured, but reserved the right to contest its obligation to pay any judgment on misrepresentation grounds.*

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45. Once again, a lawyer whose fees are not based on the number of hours worked may have a different incentive.

46. None of the cases cited in Annotation, *Basis and Manner of Distribution Among Multiple Claimants of Proceeds of Liability Insurance Policy Inadequate to Pay Claims in Full*, 70 A.L.R. 2d 416 (1960), and in the supplements to that annotation through 1996, were brought by insureds to recover money paid to claimants. Instead, the cases all are brought by victims who were not fully compensated.

In the Misrepresentation Case, the insured and the company share the claim risk because of the uncertainty over insurance coverage for the claim. Here the interests of the company and the insured in the defense of the liability claim appear to be aligned: both the company and the insured would be better off if the repairman's claim went away; the limits of the policy exceed the damages claimed; and there is no obvious way that the company could use the control over the claim to improve its misrepresentation defense. Thus, the conflict between the insured and the company appears to concern only the coverage for the claim.

Nevertheless, the interests of the company and the insured do conflict in the defense and settlement of the liability claim, because the claim and the coverage defense intersect in the company's valuation of the claim. As a result of the coverage defense, a rational company will value the Misrepresentation Case at a discount. The stronger the company's misrepresentation defense, the larger the discount. The larger the discount, the less incentive the insurance company has to mount a vigorous defense or settle the liability case. Although the company and the insured share the risk of having to pay an actual judgment, the company, alone, controls the settlement process. Accordingly, as in the Low Limits Case, the company has an opportunity to "gamble with the insured's money."

In the Low Limits Case, the company would have none of its own money to lose if it refused to settle (ignoring for the moment both defense costs and the duty to settle). In the Misrepresentation Case, in contrast, the company does risk its own money. If the company is wrong about the value of the liability case and the coverage defense, it will have to pay a judgment in excess of the settlement amount. Using the gambling metaphor, then, we can say that a low limits case offers the company the opportunity to place a bet using only the insured's money, while a coverage defense case requires it to bet some of its own money, too.[47]

Nevertheless, a significant conflict of interest remains. Imagine that there is a 50% chance of a $100,000 verdict and 50% chance of a $0 verdict, so that we can say that the settlement value of the case is $50,000. If we also imagine that there is a 50% chance that the company will prevail in a coverage case, then the company should be willing to pay no

47. Factoring in defense costs reduces the differences between the two types of conflicts. The more significant the defense costs are to the overall cost of the claim, the more the conflict present in a low limits case approaches the conflict present in a coverage defense case like the Misrepresentation Case (i.e., in which there is no factual overlap between the liability claim and the coverage defense).

more than $25,000 to settle the case (ignoring defense and coverage litigation costs, which complicate the analysis without changing the point). As long as the insured has collectible assets, it would be irrational for the plaintiff to settle the case for that amount. Any resulting three-way settlement negotiation between the plaintiff, the insured and the company presents obvious opportunities for conflict between the company and the insured.

In practice, insureds appear not to contribute to settlements within policy limits, at least outside the realm of large scale corporate insurance coverage litigation (for example, mass products liability or environmental claims).[48] Yet, such cases do settle.[49] Does that mean that plaintiffs ignore defendants' other assets, that insurance companies ignore their coverage defenses, or that there is some other dynamic at work? Empirical research directed at answering these questions would help us better understand the role of liability insurance in tort law-in-action.

Even without such research, however, it is clear that at least one reason for the lack of contributions by insureds to within-limit settlements is the existence of cases holding that it is a breach of the company's duty of good faith to require the insured to pay a portion of a settlement within limits.[50] The apparent concern is that the company will use its lower risk aversion and greater experience at valuing claims to profit at the insured's expense. Playing the settlement and coverage numbers is the company's business, not the insured's. Indeed, the insured's aversion to having to play those numbers is one of the pillars of the liability insurance business.[51]

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48. *See* Syverud, *supra* note 16, at 1156. My interviews with personal injury lawyers corroborated Syverud's report. *See* Baker, *supra* note 14, for a description of the interviews. Not one of the lawyers reported having handled or heard of a personal injury case involving an individual or small business insured in which the insured had contributed to a "within limits" settlement. I am aware of insured contributions to "within limits" settlements in the large scale corporate coverage litigation context from my personal involvement in such cases. The details of the settlements cannot be provided because of confidentiality provisions in the settlement agreements.

49. All of the personal injury lawyers interviewed said that it was common practice for insurance companies in Florida to settle contested coverage cases. *See* Baker, *supra* note 14 (describing the interviews).

50. *See* Syverud, *supra* note 16, at 1153-57.

51. The presence of such settlements in the large corporate context is consistent with this explanation because, in that context, there is much less risk that a court will act in a paternalistic manner to protect the insured.

For present purposes, we need not decide whether this paternalistic prohibition is good or bad policy.[52] It is enough to realize that, as this prohibition reflects, a coverage defense changes the insurance relationship so that the insured and company become adversaries, not only with respect to coverage, but also with respect to the defense and settlement of the claim.

Structurally, the conflict in the Misrepresentation Case is more like the conflict in the Low Limits Case than the conflict in the Multiple Victim Case. The conflict in the Misrepresentation Case encourages an alliance between the insured and the plaintiff in favor of settlement, leaving the company out in the plaintiff's choice triangle and leaving the lawyer out in the jury triangle. Indeed, because the insurance limits are more than adequate for the claim, this alliance has the potential to exist even when there is a deep pocket defendant. In addition, the conflict encourages an alliance between the insured and the lawyer in the professional responsibility triangle opposing efforts by the company to shirk in the defense and maybe even, for the reasons explored below, in favor of settlement.

In the settlement triangle, the lawyer's interests would seem to run squarely with the company against the plaintiff (and, thus, against settlement unless the plaintiff is willing to reduce the settlement value of the case to reflect the coverage uncertainty). What may weaken the bond between company and lawyer, however, is the lawyer's risk aversion. If the claim results in a large, covered verdict, the lawyer may not receive the next file from the company. If the case results in an uncovered verdict, the lawyer may be on the receiving end of legal proceedings: at best a deposition notice in a failure to settle case against the company; at worst a complaint in a malpractice case.

A settlement ends the case on a less than disastrous note for all the people directly involved: the plaintiff, the defendant, the claims adjuster, and the lawyer. For this reason, some lawyers assert that contested coverage cases are more likely to settle than uncontested coverage

52. At least in the abstract, such settlements could be in the insured's interest, in effect providing the insured the opportunity to purchase insurance against the risk of losing the liability claim and the subsequent coverage case. *Cf.* Syverud, *supra* note 16, at 1157 (observing that contributions by insureds to within limits settlements can be understood in the context of a low limits case as insurance "against the risk of an excess judgment").

cases[53]—this notwithstanding my earlier observation that the settlement value of the case to the company would seem to be much lower than the settlement value of the case to the plaintiff. True or not,[54] this assertion suggests, once again, that the common assumption that it is in the lawyer's interest to align with the company against the insured may not always hold true.

2. The Separation Assault

> *Following a legal separation in an abusive marriage, the insured regularly stalked his wife. One evening, in a drunken rage, the insured shot his wife's boyfriend and then himself. Both survived. The boyfriend filed suit against the husband, who requested a defense from his homeowners' insurance company. The company agreed to defend the case, but reserved the right to contest its obligation to pay any judgment on the grounds that the husband intended the harm.*[55]

This case presents the same settlement and defense conflicts as the Misrepresentation Case, plus an additional conflict arising from the factual overlap between the liability and coverage aspects of the case. The company would benefit from a factual finding in the liability case that the insured shot the boyfriend with the intent sufficient to meet the standard for the company's intentional harm defense. For the insured, that finding would be a disaster, leading to both a large adverse judgment and the loss

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53. *See, e.g.*, Interview with Insurance Defense Lawyer (name confidential), in Miami, Fla. (May 1, 1996). For a description of the interviews, see Baker, *supra* note 14.

54. This is a question that is ripe for empirical testing. Unlike many such questions, it actually seems testable. Indeed, as long as a company's claim data base contains a field indicating whether a reservation of rights letter was sent and a field indicating whether the case settled before trial, running a simple cross tabulation would be easy.

55. This hypothetical is loosely modeled on State Farm Fire & Cas. Co. v. Wicka, 474 N.W.2d 324 (Minn. 1991). The court in *Wicka* affirmed a judgment against the insurance company, based on a jury finding that the assailant lacked the capacity to form the intent necessary to bring the case within the scope of the expected or intended exclusion. If we understand that exclusion to address the problem of moral hazard—changed behavior attributable to insurance—then a very high standard of intent in such separation assault coverage disputes is good policy, because it is highly unlikely that separation assaults are affected by insurance incentives.

of coverage.[56] Thus, this case differs structurally from the Misrepresentation Case because there is a potential community of interest between the plaintiff and the company: provided the insured has other collectible assets, both company and plaintiff gain by proving that the insured intended to harm the plaintiff.[57]

In the professional responsibility triangle, the insured and the lawyer share an interest in preventing the company from shirking in the defense, and the lawyer has a long term interest in assisting the company. In this sense, the Separation Assault is no different than the other pattern cases. But, the Separation Case is like the Low Limits Case (and unlike the Multiple Victim and Misrepresentation cases) in that it presents the lawyer with the opportunity to further both interests: receiving fees for a thorough defense of the liability claim while helping the company shift claim risk to the insured.

The Separation Assault case differs from the Low Limits Case, however, in terms of the pressure exerted by relationships outside the professional responsibility triangle. In the Low Limits Case, the potential alliance between the insured and plaintiff against the lawyer tempered the lawyer's interest in helping the company shift claim risk to the insured. Here, in contrast, if the plaintiff prefers an alliance with the company, the plaintiff will not pressure the lawyer to place the insured's interests ahead of the company's. Indeed, the logical extension of the lawyer's economic dependence on the company and the company's alliance with the plaintiff would be for the lawyer in effect to work with the plaintiff against the insured in the jury triangle.

Accordingly, the Separation Assault Case presents the strongest potential constellation of interests against the insured yet seen: two against one in the plaintiff's choice triangle, the professional responsibility triangle and even the jury triangle. And, in contrast to the prior cases, no one may be pressing for a settlement in the settlement triangle.

Thus, it is not surprising that many jurisdictions have adopted a shift in control strategy to assist the insured in this kind of case. In these

56. Even if the jurisdiction did not permit offensive collateral estoppel, the finding in the first case would affect the settlement value of the coverage case: the fact that one jury found that the insured intended the harm clearly would affect the lawyers' evaluation of whether a second jury would do so and thereby reduce the settlement value of the coverage claim.

57. If the insured lacks significant collectible assets, the likely alliance is between insured and plaintiff, with the result that the interests would more nearly match those in the Misrepresentation Case.

jurisdictions, when a company raises a coverage defense that turns on issues that are relevant to the liability claim, the company gives up the right to defend the insured.[58] Of course, this means the insured now controls the defense at the company's expense, raising the ex post moral hazard problem that motivated the insurance contract provisions assigning control to the insurance company. Perhaps as a result, insurance law seems to tolerate the company placing some limits on the defense, such as requiring the insured's lawyer to accept payment at the company's usual rate and that the lawyer be experienced in defending civil claims.[59]

If the shift in control is only partial, so that the company retains control over settlement of the claim, a significant settlement conflict remains. As with the defense conflict just discussed, this settlement conflict is more acute than the corresponding conflict in the Misrepresentation Case. Keeping the liability case "alive" in the Separation Assault Case benefits the company in a way that keeping the liability case alive in the Misrepresentation Case does not. As long as the Separation Assault liability case continues, there remains the chance that the plaintiff will reveal or prove facts helpful to the company's coverage defense. Once the plaintiff settles with the insured, however, the plaintiff is no longer adverse to the insured and, thus, will be less helpful to the company's position against the insured. As a result, the company has less incentive in the Separation Case to reach a settlement with the insured and the plaintiff that resolves at least the liability aspects of the case. By contrast, in the Misrepresentation Case, if the parties can agree on the value of the liability claim, it may be in both the company's and the plaintiff's interest to settle that claim and then litigate the real issue: whether there is insurance coverage for the claim.

3. The Softball Case

The company hired a lawyer to defend what seemed to be a routine negligence claim filed by a spectator injured at a high school softball game. During informal interviews, two potential witnesses told the defense lawyer that the insured had deliberately thrown her bat at the plaintiff, who had been heckling the insured. The lawyer talked to

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58. *See, e.g.*, CAL. CIV. CODE § 2860 (West 1993); Thornton v. Paul, 384 N.E.2d 335 (Ill. 1978). *See generally* William T. Barker, *The Right and Duty to Defend: Conflicts of Interest and Insurer Control of the Defense*, 1992 A.B.A. SEC. OF TORTS & INS. PRAC. 195.

59. *See, e.g.*, CAL. CIV. CODE § 2860(c) (West 1993).

> *the insured, who denied the story. When the lawyer next talked to the two potential witnesses, they said they had since spoken to the plaintiff's lawyer, who told them that the plaintiff would prefer to treat the incident as an accident and that they would not be needed as witnesses in the case.*

The Softball Case is a latent Separation Assault Case. The immediate conflict between the insured and the company lies in the use of the information from the potential witnesses. The insured would prefer that the company never learn about these witnesses.[60] The company would prefer to have the information in order to determine whether to make any additional investigation and, eventually, whether to raise a coverage defense.

Here, the plaintiff's lawyer's statement to the witnesses (that the plaintiff prefers to treat the case as an accident) strongly suggests that the plaintiff has chosen an implicit alliance with the insured.[61] Either the insured lacks collectible assets or the plaintiff has decided that it will be easier to obtain a settlement from the company than it would from the insured. As a result, the interests in this case line up much like the interests in the Misrepresentation Case: the plaintiff and the insured allied against the company in the plaintiff's choice triangle and against the lawyer in the jury triangle, with the goal of creating pressure for settlement.

The difference is that, as in the Separation Assault, the company has an enhanced incentive to enlist the lawyer in an alliance against the insured and, thus, a correspondingly greater interest in preventing the lawyer from allying with the insured and the plaintiff. At the same time, however, the lawyer has a significant interest in withholding the information, at least in jurisdictions that adopt the shift in control strategy described above. Providing the information increases the likelihood that the Softball case will become a Separation Assault case, with the likely result that the insurance defense lawyer will lose the file (to an "independent" lawyer

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60. The insured has this preference whether or not she "in fact" intended the harm. Thus, the conflict does not depend on a fraudulent intent on the part of the insured.

61. For a nuanced discussion of the "underlitigation" strategy that follows from such an alliance, see Ellen S. Pryor, *The Stories We Tell: Intentional Harm and the Quest for Insurance Funding*, 75 TEX. L. REV. 1721 (1997).

selected by the insured).[62] Once again, the self-interest of the lawyer may mitigate the presumed tendency of the lawyer to favor the interests of the company over the insured.

C. *Shared claim risk from uncovered harm*

In the third set of pattern conflict cases, the company and the insured share the claim risk because the insured faces a kind of harm that is not covered by the insurance policy. In the Food Poisoning Case that harm is damage to the insured's reputation. In the Punitive Damages Case that harm is punitive damages in a jurisdiction in which such damages are uninsurable.

1. The Food Poisoning Case

> *An insured restaurant faces a food poisoning claim. The company's claims manager believes that the plaintiff's case is weak on causation grounds. The restaurant owner believes that litigation of the case would cause negative publicity that would decrease sales. The plaintiff offers a pre-suit settlement of the claim for an amount that is greater than what the claims manager reasonably believes to be the present value of the expected judgment in the case (adjusted for the plaintiff's probability of success) but less than what the restaurant owner reasonably believes to be the sum of that present value plus the reputational harm the plaintiff can cause the restaurant.*

In the Food Poisoning Case, the insured bears claim risk because there is more at stake than a potential judgment. This case is the reverse of the often discussed malpractice settlement conflict.[63] In malpractice cases, insureds sometimes oppose settlement because of reputational concerns.[64] Here, in contrast, the insured prefers settlement because of reputational concerns. The conflict between the company and the insured arises from the nature of the risk transferred by the liability insurance contract. The contract obligates the company "to pay those sums that the insured

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62. *See supra* note 58 and accompanying text.

63. *See, e.g.*, Note, *An Insurer's Right to Settle Versus Its Duty to Defend Nonmeritorious Medical Malpractice Claims*, 16 J. LEGAL MED. 545 (1995).

64. *See, e.g.*, Shuster v. South Broward Hosp. Dist. Physicians' Prof'l Liab. Ins. Trust, 570 So. 2d 1362 (Fla. Dist. Ct. App. 1990), *aff'd*, 591 So. 2d 174 (Fla. 1992).

becomes legally obligated to pay as damages"[65]; it does not obligate the company to compensate the insured for damaged reputation.

The conflict in the Food Poisoning Case is similar to the conflicts in the preceding cases. Because the company and the insured share the claim risk, the company has less incentive to defend and settle the case than would a defendant without insurance. Indeed, if we analogize the reputational harm at risk in the Food Poisoning Case to a judgment in excess of the insurance policy limits, the interests in this case line up much like the interests in the Low Limits Case. For example, the plaintiff and insured would be allied in favor of settlement against the company in the plaintiff's choice triangle and against the lawyer in the jury triangle.

There is, however, an important difference between the two cases. In the Low Limits Case, the duty to settle requires the company to evaluate the settlement offer as if it bore all the claim risk. In the Food Poisoning Case, in contrast, the duty to settle does not require the company to evaluate the settlement offer as if it bore all the claim risk. Requiring the company to do so would have the effect of eliminating the "as damages" limit and indemnifying the insured for reputational harm.

I do not mean to suggest that the company has no obligation to consider the consequences that its actions may have for the insured, but simply to observe that whatever obligation the company does have, it cannot be required to pay a settlement that takes into account the full reputational harm faced by the insured. Thus, there almost inevitably will be a gap in such a case between what the settlement value of the case would be for a solvent, uninsured defendant and what the settlement value of the case would be to a liability insurance carrier. As a result, if the plaintiff demands a large settlement premium that is based on its ability to damage the insured's reputation (and, providing the insured has assets, what rational plaintiff would not?), the company effectively would be relieved of the obligation to settle the case.

Another difference between the Food Poisoning Case and the Low Limits Case relates to the nature of the claim risk borne by the insured. The claim risk borne by the insured in the Low Limits Case is a risk that the company willingly would have borne had a higher premium been paid. What is at stake in the conflict between the company and the insured,

65. *See supra* note 58 and accompanying text.

therefore, is simply the amount of a given type of risk that is transferred at a given price.[66]

In the Food Poisoning Case, in contrast, the claim risk borne by the insured is not a risk for which coverage is openly available on the insurance market. There is no "lost profits" endorsement available for purchase in the liability insurance market. Thus, adjusting the incentives in this case could shift to the company a different kind of risk than is typically understood to be transferred by liability insurance. Accordingly, what is potentially at stake in the conflict between company and insured in the Food Poisoning case is the nature of the risk against which liability insurance protection will be available.[67]

In this situation, neither the company's indemnity obligations nor its duty to settle would give the company an incentive to reduce the claim risk faced by the insured. Indeed, if there is a realistic possibility that the risk of reputational harm could lead the insured to decide to take over the case and abandon coverage, the company has an incentive to increase that risk. This creates a potential community of interest between the plaintiff and the company. Although neither the company nor the plaintiff can directly benefit from the reputational harm, each can benefit from the insured's desire to avoid that consequence. The plaintiff increases the settlement price, and the company avoids having to defend and pay the claim.

Like the Multiple Victim Case and the Separation Assault Case, then, the Food Poisoning Case presents an opportunity for a tacit alliance between the company and the plaintiff. Whether the plaintiff chooses that alliance will, of course, depend on such circumstances as the amount of collectible assets held by the insured, the relationship between the value of the likely judgment and the reputational harm in the case, and so forth.

The interests of the lawyer may provide some counterbalance to this tacit alliance. It is in the lawyer's interest that the company reject an early settlement offer, but that the insured not be so threatened that it takes over the case from the company and replaces the lawyer.[68] Thus, it is in the lawyer's interest to manage the case so as to minimize the non-judgment risk faced by the insured.

66. This is also true of the Misrepresentation Case: the disclosure of the business at home most likely would not have caused the company to reject the application, although it may have increased the premium.

67. This is also true of the Separation Assault Case and the Punitive Damages Case: coverage is not generally openly available for intentional harm or in some jurisdictions for punitive damages. *See* Baker, *supra* note 22.

68. Once again, this incentive assumes an hourly fee arrangement.

2. The Punitive Damages Case

After leaving a bar at closing, an insured driver drove through a red light and hit a pedestrian in a crosswalk. The driver stopped, backed up, drove around the victim (now lying badly injured in the street), and proceeded to an after hours club, where he was later arrested and charged with driving while intoxicated and leaving the scene of an accident. The victim survived to bring a compensatory and punitive damages claim. Punitive damages are not insurable in the jurisdiction.

On these facts, the victim has a clear right to compensatory damages and a strong claim for punitive damages.[69] The insured bears claim risk because the company is not required to pay a punitive damages verdict. The conflict between the insured and the company concerns the level of defense effort to devote to the case as well as the allocation of any settlement or verdict to these two categories of damages.[70]

From the plaintiff's perspective this case is a combination of the Separation Assault and Softball cases on the one hand and the Low Limits Case on the other. If the insured does not have significant, collectible assets, then the plaintiff has no financial interest in obtaining a punitive damages judgment (just as the plaintiff in the Softball Case appeared to have no financial interest in proving intentional harm). Indeed, because plaintiffs' lawyers commonly believe that a large punitive damages verdict is likely to be accompanied by a smaller compensatory damages verdict than would be the case in the absence of the punitive damages verdict, the plaintiff in a drunk driving case without a "deep pocket" defendant is

69. Florida personal injury lawyers characterized a driving while intoxicated claim as a good punitive damages case, particularly if the insured left the scene. *See, e.g.*, Interview with Insurance Defense Lawyer (name confidential), in Miami, Fla. (May 17, 1996), quoted in Baker, *supra* note 14.

70. *See* Nandorf v. CNA Ins. Co., 479 N.E.2d 988 (Ill. 1985) (holding that because of the conflict between the insured and the company in a case involving a small claim for compensatory damages and a large claim for punitive damages, the insured is entitled to an independent counsel at the company's expense); *but see* Douglas R. Richmond, *Lost in the Eternal Triangle of Insurance Defense Ethics*, 9 GEO. J. LEGAL ETHICS 476, 501 (1996) (asserting that a claim for uninsurable punitive damages does not create a conflict—without considering the settlement point made in the text above or the conflict addressed in *Nandorf*).

likely to request little or no punitive damages from the jury.[71] Similarly, if the insured has no substantial assets, the plaintiff is likely to handle the Punitive Damages Case like the Low Limits Case: offering to settle the case within policy limits and then pursuing a failure to settle case in the event of a punitive damages verdict.[72]

If the defendant has substantial other assets, however, the plaintiff's litigation strategy will be quite different. In that event, the interests of the plaintiff and the company may align, much as in the Separation Assault case. If the company's limits are high enough, the best strategy for reducing the company's liability and increasing the plaintiff's recovery may well be to contain the compensatory damages by boosting the punitive damages claim.[73] Thus, provided the insured has assets, the Punitive Damages Case presents the same constellation of interests against the plaintiff as the Separation Assault Case: two against one in the plaintiff's choice triangle, the professional responsibility triangle and even the jury triangle, with no one pushing for settlement in the settlement triangle. And, in contrast to the Separation Assault Case, the insured's claim for

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71. *See* Baker, *supra* note 14. It is worth noting this ability to transform punitive into compensatory damages means that a settlement premium based on the plaintiff's ability to obtain a punitive damages award differs from a settlement premium based on the plaintiff's ability to damage the insured's reputation because the ability to harm the defendant's reputation cannot be used to increase a compensatory damages judgment, whereas the plaintiff's ability to obtain punitive damages can. *See id.* Thus, a settlement premium demanded because of the plaintiff's ability to inflict an uninsured punitive damages judgment should not necessarily relieve the company of the duty to settle the case. *Cf.* Lira v. Shelter Ins. Co., 913 P.2d 514 (Colo. 1996) (majority and dissent review case law on duty to settle a punitive damages claim).

72. *See* Baker, *supra* note 14 (reporting that defense lawyers analogized punitive damages cases to low limits cases for duty-to-settle purposes).

73. This strategy seems most likely to be fruitful in jurisdictions in which the duty to settle does not obligate the company to protect the insured from a punitive damages verdict. *See, e.g., Lira*, 913 P.2d at 516 ("[a]n insurer who has not contracted to insure against its insured's liability for punitive damges has no duty to settle the compensatory part of the claim to minimize the insured's exposure to punitive damages"). In such a jurisdiction, a company that has rejected a policy limits settlement offer would have great incentive to have the jury release its anger on the punitive damages line on the verdict form, not the compensatory damages line. Other jurisdictions appear to require the company to provide at least some protection against a punitive damages verdict. *See* Magnum Foods, Inc. v. Continental Cas. Co., 36 F.3d 1491, 1506 (10th Cir 1994) ("the good faith duty thus requires cooperative efforts by [company] with [insured] throughout to handle and settle the entire case"). In my view, the former approach wrongly ignores the fact that punitive damages can be "transformed" into compensatory damages. *See* Baker, *supra* note 14.

control over the insurance defense lawyer is quite weak. Indeed, California's "Cumis" statute explicitly states that a claim for punitive damages does not entitle the insured to a company-funded independent defense lawyer.[74]

III. THE DUTY TO DEFEND WHOM AGAINST WHAT?

As the preceding discussion has illustrated, triangularity is a multifaceted feature of the liability insurance relationship. Typically, courts and professional responsibility specialists worry about that triangularity because the insurance defense lawyer's financial interests are so closely tied to the company that the lawyer seems destined to become the company's instrument for shifting risk to the insured.[75] Factoring the plaintiff into the relationship complicates that worry. On the one hand, the concern that the lawyer will sacrifice the insured is increased by potential alliances between plaintiff and company, as illustrated most clearly by the Separation Assault Case and the Punitive Damages Case and also, potentially, by the Multiple Victim Case and the Food Poisoning Case. On the other hand, the potential alliance between plaintiff and insured raises concerns about the lawyer shifting risk to the company, as seems likely in the Softball Case and at least possible in the Low Limits Case and the Misrepresentation Case.

Complicating the question "who is taking advantage of whom" does not change the existence of the conflict between the company and the insured, nor the need to decide the scope of representation that the duty to defend requires. Insurance law plainly does not require the company to engage a lawyer to represent all the interests of the insured potentially at issue in a claim. For example, the company would not be required to retain a lawyer to defend the insured in a criminal proceeding arising out of the Separation Assault, even though the outcome could have obvious relevance both to the value of, and insurance for, the claim.[76] Nor, in either the

74. *See* CAL. CIV. CODE § 2860 (West 1993). In *Nandorf*, 479 N.E.2d at 988, the Illinois court permitted the insured to hire independent counsel at the company's expense, but the facts in that case were quite exceptional. In the underlying claim at issue in *Nandorf*, only nominal compensatory damages were sought, with the result that the whole case was really about punitive damages. In that special case, the court held that the company cannot be counted upon to provide a defense that is adequate to the risk at stake.

75. *See, e.g.*, CHI of Alaska v. Employers Reinsurance Corp., 844 P.2d 1113, 1116 (Alaska 1993) and sources cited therein.

76. *See* Silver & Syverud, *supra* note 5, at 292.

Separation Assault Case or the Misrepresentation Case would the company be required to engage a lawyer to represent the insured in any related insurance coverage litigation.[77] The challenge is to define the scope of the defense lawyer's representation of the insured in a manner that provides meaningful guidance to the real people who navigate through the liability insurance tetrahedron.

A. A Judgment Risk Approach to the Duty to Defend

In "The Professional Responsibilities of Insurance Defense Lawyers," Professor Charles Silver and Dean Kent Syverud considered the scope of the insurance defense lawyer's representation of the insured in the context of what they call the full coverage case.[78] By a "full coverage" case they mean a case in which the limits of the insurance policy exceed the damages sought by the plaintiff and in which the company has no present basis for expressing any doubt about the obligation to indemnify the insured against those damages.[79] In such a case, they conclude that the duty to defend obligates the company to retain a lawyer to conduct a defense that minimizes the size and probability of a plaintiff's judgment in the case and, consistent with that primary goal, minimizes the costs of defense.[80] Thus, with respect to the insured—who does not bear the costs of defense—the scope of the lawyer's representation is the minimization of the size and probability of a judgment in favor of the plaintiff. For this reason, I refer to Silver and Svyerud's approach as a "judgment risk" approach to the duty to defend.

In the paragraphs that follow, I use the pattern cases and the concept of claim risk and its components to extend this judgment risk approach beyond the full coverage situations Silver and Syverud considered. This extension is possible because the company and the insured can share the claim risk even in a "full coverage" case of the sort that Silver and Syverud

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77. If the insured is successful in that insurance coverage litigation, the company may well have to pay the insured's legal fees, but the insured bears those fees in the first instance. *See* Baker, *supra* note 10 at 1424.

78. *See* Silver & Syverud, *supra* note 5.

79. *See id.* at 263.

80. The most direct statement Silver and Syverud make on this point is that the company has a duty "to provide a lawyer to defend the insured." *Id.* at 300-01. Nowhere do they succinctly define what they mean by "defend the insured," but a careful reading of their analysis leads me to the judgment risk description. *See, e.g.*, *id.* at 329-31 (discussing scope of lawyer's representation in a case in which there is a conflict between the insured's reputational interest and the company's interest in minimizing the cost of the claim).

addressed. This risk sharing can occur for one of two reasons: either the claim has consequences for the insured beyond a potential plaintiff's judgment (as in the Food Poisoning Case) or there is the potential for the company later to learn of circumstances that would lead it to express uncertainty about its obligation to pay the claim (as in the Softball case). These two types of cases—both of which Silver and Syverud considered—present all the essential elements of shared claim risk that occur in the other pattern cases.

Indeed, the Softball Case presents most of these elements. These elements can be illustrated by thinking of the insured's claim risk in the Softball Case as the product of the following six factors:

> (1) the probability that the company learns of information suggesting that the insured intended the harm,
> (2) the probability that this information would lead the company to reserve its right to litigate coverage for the claim,
> (3) the probability that the company would not settle the claim,
> (4) the probability of a plaintiff's verdict should the company not settle,
> (5) the probability that the insured would lose a subsequent coverage case, and
> (6) the dollar amount of the likely plaintiff's verdict in the liability case.

The "judgment risk" portion of this equation is the product of factors (4) and (6): the probability of a plaintiff's verdict multiplied by the likely dollar amount of that verdict.

The portion of that judgment risk borne by the insured is a function of the remaining factors in the equation. Factors (1), (2), and (5) are all part of what I refer to as the "coverage risk" component of the claim risk, and factor (3) is what I call the "settlement risk" component. In Silver and Syverud's analysis, both of these components lie outside the scope of the defense lawyer's representation of the insured.[81] Thus, we might say that,

81. *See* Silver & Syverud, *supra* note 5, at 343-48 (stating that the lawyer has an obligation to turn over all information relevant to the defense of the case, even if harmful to the insured's coverage case), at 296-99 (stating that the company is not required to retain the lawyer to represent the insured with respect to settlement), and at 293 (stating their

under a judgment risk approach to the duty to defend, the lawyer represents the insured for the purpose of minimizing the total judgment risk in the case, but not for the purpose of reducing the insured's share of that risk.

Silver and Syverud did not directly address limited coverage cases. Nevertheless, the claim risk faced by insureds in limited coverage cases is essentially the same as the claim risk presented in a latent limited coverage case like the Softball Case.

In the Separation Assault Case and the Misrepresentation Case, the insured's claim risk is the product of factors (3) through (6) from the Softball Case above: the judgment risk (factors (4) and (6)), the settlement risk (factor (3)), and the risk that a court will determine that the claim is not covered (factor (5)). In the Low Limits Case and the Punitive Damages Case, the insured's claim risk is the product of four similar factors:

> (a) the probability that the company will not settle the case,
> (b) the probability of an excess or punitive damages verdict if the company does not settle,
> (c) the probability of losing a subsequent failure to settle case, and
> (d) the size of the excess or punitive damages verdict that the insured would have to pay as a result.

Factors (b) and (d) from this list are part of the judgment risk; factor (a) is the same as the settlement risk present in the preceding cases; and factor (c) is a form of coverage risk. As in the Softball Case, the judgment

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"preliminary conclusion" that the lawyer does not represent the insured with respect to coverage and should not provide coverage advice).

As Silver & Syverud are careful to make clear, deciding that these factors lie outside the scope of the defense lawyer's representation would not mean that the lawyer would have no professional responsibilities with respect to those factors. For example, if the insured directed the defense lawyer not to supply the information in the Softball Case to the company, Silver & Syverud would agree that the lawyer could not do so. Under the canons of professional responsibility, a lawyer has a duty of loyalty to the client that precludes disobeying instructions. The proper course for the lawyer under Silver & Syverud's approach would be to inform the insured that the lawyer's duty of loyalty to the company requires the lawyer to provide the information to the company, unless the insured instructs the lawyer to the contrary, and that, if the insured did instruct the lawyer to the contrary, the duty of loyalty to the company would require the lawyer to withdraw from the case. *See id.* at 359-61.

risk approach would assign the lawyer to represent the insured with respect to the judgment risk, but not the settlement or coverage risk.

In the Food Poisoning Case (and in the analogous case addressed by Silver and Syverud[82]), the damages sought by the plaintiff are well within the limits of the policy, and there is no doubt that the claim is covered by the policy. As a result, the insured does not bear any judgment risk. All the risk the insured bears is non-judgment risk, and under a judgment risk approach to the duty to defend, the company would have no obligation to retain the defense lawyer to represent the insured with respect to that risk.[83]

Looking at these pattern cases together, we can see that the judgment risk approach to the duty to defend leaves the insured on its own with respect to three kinds of claim risk: settlement risk, coverage risk, and a catch-all category I call "non-judgment risk" that is illustrated by the reputational risk in the Food Poisoning case.

If we understand the company's duty to defend as derived from the duty to indemnify,[84] then excluding both the coverage risk and the other non-judgment risk from the scope of the lawyer's representation makes good intuitive sense. (I will address settlement risk in a separate section below.) The duty to defend does not encompass coverage risk because, by definition, the company has no duty to indemnify a non-covered claim. Similarly, the duty to defend does not encompass non-judgment risk because the insurance policy limits the company's indemnity obligation to "pay those sums the insured is legally obligated to pay as damages," which does not include collateral harm to the insured (as opposed to a third party) resulting from a claim. Thus, the duty to defend is broader than the duty to indemnify, but the duty to defend is broader only in the sense that the

82. In Silver & Syverud's hypothetical the insured is concerned that litigation of the case would reveal his marital infidelity. *See id.* at 327.

83. *See id.* at 327-31.

84. This is the way standard liability insurance policies define the duty. *See supra* note 11 ("We will pay those sums that the insured is legally obligated to pay as damages . . . We will have the right and duty to defend any suit seeking those damages."). It is also the way that courts describe the duty to defend. *See, e.g.*, Burd v. Sussex Mut. Ins. Co., 267 A.2d 7 (N.J. 1970) ("[t]he sense of the covenant is to defend claims which the carrier would be required to pay if the claimant prevailed in the action. . . . The obligation to defend 'groundless, false or fraudulent' claims does not mean that the carrier will defend claims which would be beyond the covenant to pay if the carrier prevailed"); Gray v. Zurich, 419 P.2d 168, 176 (Cal. 1966) ("[a]n insurer, therefore, bears a duty to defend its insured whenever it ascertains facts which give rise to the potential of liability [i.e., an obligation to indemnify the insured] under the policy").

company must defend the case as if there were no doubt about coverage, unless and until non-coverage is conclusively proven.[85]

B. Defense Lawyers and Settlement Risk

As I have just described, excluding coverage risk and other non-judgement risk from the scope of the defense lawyer's representation of the insured can be justified by reference to limits on the duty to indemnify and the derivative nature of the duty to defend. That justification cannot be used to exclude settlement risk from the scope of representation. Indeed, the company's duty to settle exists precisely because the company's duty to indemnify is limited. If the company's duty to indemnify were unlimited, the insured would face no risk from the company's failure to settle and, thus, there would be no need for a duty to settle. Accordingly, limits on the duty to indemnify provide no logical basis for concluding that settlement lies outside the scope of the duty to indemnify or its derivative, the duty to defend.

Moreover, it is historical happenstance that the duty to settle evolved out of the duty to indemnify. The duty to settle can also be seen as an extension of the duty to defend. After all, what better way is there to minimize the judgment risk than to settle the case? Furthermore, because settlements are also a means of avoiding defense costs, it is not hard to erode the defense - settlement distinction.[86]

This does not mean, however, that the scope of the defense lawyer's representation of the insured should include settlement. In the ordinary

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85. There is a useful symmetry between the proposition that the duty to defend requires the company to defend the claim "as if there were full coverage" for any resulting judgment and the proposition that the duty to settle requires the company to evaluate settlements "as if there were no limits" on the dollar amount of coverage. Both propositions simplify, in a helpful way, some of the complexities of the liability insurance relationship. Both, at least in theory, help contain the conflict between company and insured. And both are likely in fact to provide significant protection to the insured, because both also benefit another party to the liability insurance relationship. The plaintiff stands to benefit from the duty to settle and, for that reason, has an incentive to construct its case in a manner that protects the insured's right to a settlement within limits. The defense lawyer stands to benefit from the requirement that the company defend the case "as if" it were fully covered and, thus, has an incentive to defend the case in that manner.

86. This may explain why there are, at least to my knowledge, no liability insurance policies that provide only defense coverage. For an argument that there should be such liability insurance defense-only policies, see Alan Widiss, *Abrogating the Right and Duty of Liability Insurers to Defend Their Insureds: The Case for Separating the Obligation to Indemnify from the Defense of Insureds*, 51 OHIO L.J. 917 (1990).

case it is the company that controls settlement and, therefore, an insured wishing to settle a case must convince the company to do so.[87] As a result, including settlement in the scope of the lawyer's representation of the insured is problematic from the perspective of preserving the "triangular relationship [between insured, lawyer and company] in its normal state."[88] If the defense lawyer represents the insured with respect to settlement, the defense lawyer would become the insured's advocate to the company. In that setting, it is very difficult to think of the insured and the company on an equal footing in a "normal" triangular relationship. Instead, the insured would be the lawyer's "friend" and the company, the lawyer's "enemy".[89]

Thus, one reason to exclude settlement from the scope of the defense lawyer's representation of the insured is to minimize the frequency of overt conflicts in the professional responsibility triangle. Indeed, because an insured almost always would prefer a settlement, even when the insured bears essentially no claim risk, including settlement within the scope of representation of the insured would seem to make client conflicts the usual, rather than the exceptional, lot of the insurance defense lawyer.

Ultimately, however, this reason is unsatisfactory because the lawyer's responsibilities in the face of the conflict can easily be addressed by directing the lawyer to privilege one or the other client in settlement conflict situations. Indeed, in practice this appears to be exactly what happens. Insurance defense lawyers typically represent the company, and not the insured, with respect to settlement.[90] Including settlement in the scope of the lawyer's representation of the insured would simply reverse that situation, so that the insurance defense lawyer would represent the insured, not the company, with respect to settlement. In that event, we can expect a rational insurance company either to retain a second lawyer to

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87. The qualification in this sentence reflects the fact that in disputed coverage situations insurance law may permit the insureds to settle directly with claimants and then litigate coverage with the company. *See, e.g.*, Thornton v. Paul, 384 N.E.2d 335 (Ill. 1978).

88. Hazard, *supra* note 1, at 38.

89. *See id.* at 21 (citing Charles Fried, *The Lawyer as Friend: The Moral Foundations of the Lawyer-Client Relationship*, 85 YALE L.J. 1060 (1976)).

90. *See* Silver & Syverud, *supra* note 5, at 295. *Cf.* Keeton, *supra* note 3, at 1168-71 (arguing that this arrangement is proper). The defense lawyers interviewed in connection with my punitive damages study, *see* Baker, *supra* note 14, confirmed this practice. The exception to the general rule occurs not when the insurance defense lawyer represents the insured with respect to settlement, but rather when the lawyer does not handle settlement for either client— because an adjuster or company counsel (who does not represent the insured for any purpose) is handling the settlement.

handle the settlement or to expand the duties of the claims adjuster to include settlement. Both seem likely to increase the company's cost of handling claims. The question is whether this extra cost would be so clearly outweighed by benefits to insureds that legal intervention to change the current practice appears justified.

For defendants with significant assets to protect, including settlement within the scope of the insurance defense lawyer's representation of the insured would seem to provide very little benefit. For the reasons explored in Part II, a defendant with significant assets to protect in a shared claim risk situation is unlikely to conclude that a lawyer selected and controlled by the company would be sufficiently loyal to serve as the insured's sole representative for settlement purposes. As the liability insurance tetrahedron makes clear, in a shared claim risk situation there are simply too many opportunities for the interests of the company and the plaintiff to intersect for a wise insured with assets to protect not to seek personal counsel. Once the insured retains personal counsel, there is little need for the insurance defense counsel to serve as the insured's settlement advocate.

Defendants with few or no assets to protect have little need for settlement representation and, thus, little reason to pay extra to obtain it.[91] Indeed, it is the plaintiff, not the judgment proof (or near-judgment proof) defendant who bears the real settlement risk.[92] For defendants without significant assets, the best protection against all aspects of the claim risk is the plaintiff's interest in constructing the case so that the company will settle as favorably as possible.

The "unsophisticated" insured with personal assets to protect presents the most difficult case, because that insured may not easily appreciate the need to obtain independent advice about settlement. In my view, obligating the lawyer to make sure that that insured in fact comes to appreciate that need[93] provides better protection than a rule that requires

91. Perhaps the most persuasive evidence that most individual insureds feel little need to pay extra for less settlement risk is the prevalence of low limit insurance policies.

92. *See, e.g.,* Steele v. Hartford Fire Ins. Co., 788 F.2d 441 (7th Cir. 1986) (Posner, J.).

93. Silver and Syverud ground that obligation in professional responsibility law. *See* Silver & Syverud, *supra* note 5 at, 311-13 (grounding obligation to inform client in the duty of loyalty). I would also ground it in insurance law. *See, e.g.,* Myers v. Ambassador Ins. Co., 508 A.2d 684 (Vt. 1986) (obligating insurance company to advise insured of the existence of a conflict of interest so the insured can determine whether to retain personal counsel); *see also* Steele v. The Hartford Ins. Co., 788 F.2d 441 (7th Cir. 1986) (illustrating

the lawyer to act on the insured's behalf against the lawyer's interests.[94] Fulfilling that obligation is likely to require the lawyer to provide the insured much of the same information that a lawyer representing the insured for settlement purposes would provide, but with the additional disclosure that the lawyer is prohibited from undertaking that representation because of the conflict between the company and the lawyer.

Moreover, all insureds benefit from the common practice of the company using the insurance defense lawyer to handle the settlement on behalf of the company. Under the duty of good faith and fair dealing, the company has the obligation to consider the interests of the insured in all aspects of the claim, including settlement. This obligation is implemented not by an abstract entity, but rather by real people who have limited access to information and competing demands on their time. Of all the people available to handle settlement on behalf of the company, the insurance defense lawyer is the person most likely to know and understand the situation of the insured and, therefore, best able to take into account the insured's interests. If insurance or professional responsibility law were to obligate the insurance defense lawyer to represent the insured for purposes of settlement, the real people to whom companies will assign settlement responsibilities will be company counsels and adjusters. Neither company counsel nor an adjuster will know and understand the insured's situation as well as the insurance defense lawyer. Thus, the higher liability insurance premiums that would likely result from requiring the lawyer to represent the insured for purposes of settlement seem unlikely in practice to purchase additional protection for insureds.

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the extent of measures insurance defense lawyers are expected to undertake to ensure that individual insureds understand the nature of conflicts of interest).

94. The "lawyer's interests" I am referring to here are not simply the interest in obtaining more fees from avoiding a settlement, but also the interest in obtaining additional business from the company by favoring the company over the insured in the context of settlement. The clearest examples of cases in which the conflict between company and insured would make it difficult for the lawyer to be the insured's loyal settlement advocate are those in which the interests of the company and the plaintiff potentially overlap: the Separation Assault, Food Poisoning, and Punitive Damages cases. Even in cases in which the interests of company and plaintiff do not overlap, however (the Low Limits, Misrepresentation, and Softball cases), there are many scenarios in which resisting settlement would be in the company's interest.

C. Conflicts in the Judgement Risk Approach

The judgment risk approach holds out the potential for preserving the triangular relationship between the lawyer, the insured and the company in its normal state. The judgment risk approach would do this, not by eliminating the conflict between the company and the insured, but rather by removing the lawyer from the middle of that conflict and thereby eliminating the lawyer's choice between company and insured.

In the Misrepresentation Case, and only in that case, the judgment risk approach realizes most of that goal. In the Misrepresentation Case, the conflict between the company and the insured relates only to the coverage for the claim and the related effect that uncertainty over coverage has on the company's commitment to the defense and settlement of the claim. By making clear that the scope of the lawyer's representation of the insured includes neither coverage nor settlement risk, the judgment risk approach takes the lawyer out of the middle of those two conflicts.

The lawyer does remain in the middle of the conflict over the amount of effort to devote to the defense of the case, but the judgment risk approach contains that conflict by reducing the company's ability to shirk in the defense. The judgment risk approach charges the company—and by extension the lawyer—with the responsibility of defending the claim as if there were no coverage dispute.[95] Opposing company efforts to shirk in the defense is in the lawyer's self-interest, and, because the lawyer's participation in such shirking would be grounds for a malpractice claim, the judgment risk approach empowers the lawyer to resist company efforts to shirk.

In all the other pattern conflict cases, the judgment risk approach leaves the lawyer firmly embedded in the conflict between company and insured. In each of these other cases, the company has an opportunity to manage the defense lawyer's representation of the insured in a way that shifts claim risk to the insured. In the Low Limits Case, the company can manage the defense so as to make it more difficult for the insured to later

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95. A court surely would imply in the retainer agreement between the company, lawyer and insured those requirements from the liability insurance contract that benefit the insured. The company has actual notice of such requirements, the lawyer has constructive notice, and the insured has a reasonable expectation that a retainer agreement formed in an effort to fulfill the requirements of the liability insurance contract will not reduce the insured's rights under that contract.

prove that the case could have been settled within the policy limits. In the Multiple Victim Case, the company can direct the lawyer to represent the insured only with respect to the first claim, pay that claim and terminate the representation. In the Separation Assault Case and the Softball Case, the company can use the defense to gather information helpful to the coverage case and, absent a shift in control, even to shape the outcome of the liability case to its benefit.[96] In the Food Poisoning Case, the company can instruct the lawyer to handle the case in a manner that exacerbates the potential reputational harm, thus increasing the likelihood that the insured settles at its own expense to avoid that harm. And in the Punitive Damages Case, the company can instruct the lawyer to handle the case in a manner that exacerbates the risk of punitive damages.

All this is review from Part II above. The significant point here is that the judgment risk approach to the duty to defend does not eliminate the "lawyer's choice" in these other pattern cases. Thus, unless the law constrains that choice, it seems likely to be governed solely by the interests I explored using the metaphor of the liability insurance tetrahedron.

Silver and Syverud unapologetically would constrain that choice in favor of obligating the lawyer to protect the company's interest in minimizing the judgment risk. Thus, in the Softball Case they would obligate the lawyer to inform the company of the information that may threaten the insured's coverage.[97] And in the Food Poisoning Case they would obligate the lawyer to withdraw from the case once there is a concrete action that implicates the conflict, unless the insured agrees to sacrifice its reputational interest in favor of reducing the company's claim risk.[98] By extension, they would require the lawyer to follow the company's instructions regarding the handling of the insured's defense in the Low Limits, Multiple Victim, Separation Assault and Punitive

96. For example, if the plaintiff includes both a negligence and an intentional tort count in the complaint, the company could manage the defense in a way that made if more likely that the liability case would result in an outcome that would be more helpful to the company in avoiding coverage. The company could do this by, for example, instructing the defense lawyer to request a special verdict form rather than a general verdict form. This could assist the company in avoid coverage because a special verdict form would ask the jury to consider the negligence and intentional tort counts separately. If the jury finds the defendent liable under the intentional tort, the company may not have to pay the claim (depending on the collateral estoppel rules of the jurisdiction and the particular facts of the case). If the jury answers a general verdict, there will be no finding of intent.

97. *See* Silver & Syverud, *supra* note 5, at 343-48.

98. *See id.* at 328.

Damages cases, even when those instructions would further the company's interests against the insured in a later failure to settle or coverage case.[99]

This does not mean that Silver and Syverud would obligate the lawyer *in fact* to carry out such instructions. Under the norms of professional responsibility they describe, the lawyer would have a duty of loyalty to the insured that would require the lawyer to explain the existence of a conflict and to obey contrary instructions of the insured. In the face of such contrary instructions, the lawyer would not be obligated *in fact* to carry out either the instruction of the company or the instruction of the insured, but rather would be obligated to withdraw from the case.[100] If the insured continued to issue the same instructions to the replacement defense lawyer, that lawyer would also be required to withdraw, as would the next lawyer, and so on. The result would be that the insured would not receive a defense.[101] Thus, Silver and Syverud would allow the company to condition the provision of a defense on the insured agreeing to allow the defense lawyer to favor the company's interests over the insured's.

Nevertheless, I do not read Silver and Syverud as saying that the company can "do no wrong" in the handling of these cases. Indeed, I have no doubt that they would condemn a company that crudely profited at the insured's expense. Their approach simply takes away from the lawyer the need to decide whether the lawyer is obligated to honor any particular instruction from the company and leaves the policing of the company's conduct to a subsequent bad faith suit between the company and the insured.

This approach has the great benefit of simplicity and predictability. It gives the defense lawyer a clear objective: reducing the judgment risk. It prohibits the lawyer from allying with either the insured or the plaintiff

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99. I should be clear that they do not reach these issues and, thus, may disagree. It is possible that they would conclude in the Separation Assault Case that, in jurisdictions where there is no shift in control, the conflict between the insured and the company is so acute that, as a matter of professional responsibility law, the lawyer may not represent both company and insured. Once the lawyer represents only the insured, the duty of loyalty upon which they base the lawyer's obligation to provide the information to the company would no longer apply.

100. *See* Silver & Syverud, *supra* note 5, at 359.

101. If the instruction relates to information (as in a Softball-type case), a particular conflict may be resolved in a contrary manner, because the new lawyer may not receive that information. For example, if the first defense lawyer withdraws in the Softball case, the second lawyer may not learn about the first lawyer's conversations with the potential witnesses.

against the company. It reduces the likelihood that the insured will place mistaken trust in the lawyer and the company. And, provided the lawyer fully discloses the limited scope of the representation, it encourages the insured to retain a separate lawyer whose loyalty will be unconflicted. While this approach may seem to disadvantage an insured without substantial assets, that insured will receive at least some protection from the plaintiff, who has the greatest interest in structuring the case to maximize the company's claim risk.

D. Leavening the Judgement Risk Approach

From an insurance law perspective, however, Silver and Syverud's approach (at least as I have understood and extended it) goes too far in limiting the duty to defend. The core problem is that their approach obligates the person most immediately in charge of the defense—the defense lawyer—to harm the insured, either by providing harmful information to the company or by defending the case in a manner intended to advantage the company over the insured in a subsequent or pending dispute. Granted, this will only happen in a limited set of circumstances, and in some of those circumstance the insured may even "deserve" the harm. Indeed, in many cases the insured will either have chosen to buy an insurance policy with an absurdly low limit[102] or will have committed a serious wrong.

Nevertheless, insurance law requires insurance companies to give "equal consideration" to the interests of insureds in handling liability claims.[103] Thus, even though the source of the shared claim risk may be

102. My current favorite examples are obstetricians and cardiac surgeons with $250,000 malpractice policies (a common practice in South Florida). I doubt many of these doctors have liability limits this low in their automobile or homeowners' insurance policies.

103. *See, e.g.*, Coleman v. Holecek, 542 F.2d 532, 537 (10th Cir. 1976) (explaining the equal consideration principle in the duty to settle context in which it originated). As the Coleman court recognized, the equal consideration principle applies when the company has control over decisions in which there is a conflict between company and insured. As that broad description of the principle suggests, it applies to the duty to defend as well. *See, e.g.*, Bennett v. Conrady, 305 P.2d 823 (Kan. 1957) ("[b]ecause of possible conflicts of interest between an insurance company and its insured in the defense or settlement of claims against the insured there is a mutual fiduciary relationship whereby each owes the other the duty to exercise reasonable care in conducting such defense or settlement"). Indeed, the Washington Supreme Court has stated that the company's duty goes beyond equal consideration when defending a case under a reservation of rights. *See* Tank v. Public Employees Mut. Ins. Co., 715 P.2d 1133, 1137 (Wash. 1986) ("the potential conflict of

the insured's negligence in purchasing insurance (the Low Limits and Multiple Victim cases), or a strong likelihood that the insured acted with sufficient culpability to satisfy either the intentional harm exclusion or the standard for punitive damages (the Separation Assault, Softball and Punitive Damages Cases), the company nevertheless may not manage the defense of the claim in a way that exploits the risk faced by the insured to reduce the risk faced by the company.

Retaining a defense lawyer on terms that require the lawyer to betray the insured when the company so requests is unlikely to be seen as consistent with the equal consideration principle. As I have explored elsewhere, betrayal is a potent theme in insurance law discourse that insureds have often used to constrain insurance company behavior.[104] The fact that, under norms of professional responsibility law, the lawyer may not be obligated in fact to carry out those instructions if the insured objects,[105] does not insulate the company from the insured's complaint. It will remain the case that the insured will be required to choose between betrayal and a defense.

That choice is hardly consistent with the insurance law vision of the insurance company as the insured's protector.[106] Indeed, it takes very little imagination to see that the Silver and Syverud approach would transform the lawyer in the Softball case from the insured's shield into the company's sword. That is how I see it, and, while I acknowledge that shields and swords, like triangles and tetrahedrons, are only metaphors and that there may be other ways of understanding that situation, I predict this is also how judges will see it.

Thus, although I conclude with Silver and Syverud that a company can fulfill its duty to defend by retaining a lawyer to minimize the judgment risk associated with the claim (and therefore that a company has no

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interests between an insurer and insured inherent in this type of defense mandates an even higher standard").

104. *See* Baker, *supra* note 10, at 1395-96, 1418-20, 1423.

105. *See* Silver & Syverud, *supra* note 5, at 351.

106. *See* Baker, *supra* note 10, at 1403-07, 1419-20. A recent print advertisement for a new form of directors and officers liability insurance portrays this vision in striking terms. The advertisement consists of a large photo of a pair of well worn business shoes, over the caption: "The First D&O Coverage With "Duty To Defend" For Public Companies. It Puts Carriers Where They Belong." BUS. INS., Jan. 13, 1997, at 40; NAT'L UNDERWRITER PROP. & CAS./RISK & BENEFITS MGMT. ED., May 19, 1997, at 22. A company that hires a defense lawyer on terms that require the lawyer to betray the insured is hardly standing in the shoes of the insured.

obligation to retain a lawyer to represent the insured with respect to coverage, settlement or other non-judgment risk), I also conclude that the duty to defend requires the company to retain the lawyer to represent the insured first in a conflict situation. This "primary client" rule arises from the company's duty of good faith, as expressed by the equal consideration principle and by cases requiring the insurance company to give up control over the defense when the conflict between the company and the insured is severe.

Because the duty to defend is implied (whether "in fact" or "in law") in the retainer agreement, the lawyer is so obligated whether the company explicitly instructs the lawyer or not.[107] For example, the lawyer should not provide information to the company that increases the uncertainty of insurance coverage for the claim, the lawyer should not conduct the defense in a manner that unnecessarily harms the reputation of the insured,[108] and the lawyer should not refrain from providing his or her best judgment about the value of the liability case to the company and the insured.

Like the duty to evaluate settlement possibilities as if there were no dollar limits in the insurance policy, and like the duty to defend as if there were no doubts about coverage for the claim, the duty to retain the lawyer to represent the insured first in a conflict situation should provide real protection to insureds because that duty benefits other participants in the liability insurance relationship. The duty to represent the insured first in a conflict situation benefits the defense lawyer by reducing the likelihood of the lawyer being conflicted out of a case and by clarifying the lawyer's obligations in a way that reduces the likelihood that the insured will feel betrayed by the lawyer. The duty also benefits the plaintiff by providing a

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107. Silver & Syverud conclude that under established norms of professional responsibility the liability insurance contract "bleeds into" the retainer agreement. *See* Silver & Syverud, *supra* note 5, at 271. I agree, though I would like to register a small contracts teacher's complaint. Contracts do not "bleed" into one another. Instead, terms from one contract are, in the appropriate circumstance, implied (in fact or in law) into another because of a course of dealing, trade practice or other appropriate reason.

108. I recognize the failure of analytical imagination that requires the use of the word "unnecessarily" in this situation. The harm that this standard is seeking to prevent is that of the company exploiting the insured's vulnerability in order to spend less money on a claim than it would if the insured did not have that vulnerability. The lawyer presented with an instruction from the company that has the potential to cause significant harm to the insured's reputation (or other non-judgment stake) is best served by drawing that potential to the attention of the insured, so that the insured will retain independent counsel to negotiate with the company over the direction of the defense.

potential avenue for relief in the event of a verdict in excess of the policy limits or outside the policy. In other words, the obligation to regard the insured as the primary client is an obligation lawyers likely will fulfill, both because it is in their long term interest to do so and because plaintiffs (more accurately, plaintiffs' lawyers) are in a position to discover and act upon breaches of that obligation that result in harm to insureds.

It is important to emphasize, however, that the practical effect of my "primary client" approach would differ only slightly from that of the "non-subordination" approach of Silver and Syverud. In a limited set of conflict situations, a primary client rule would require the lawyer to ignore an insurance company instruction, where a non-subordination rule would require the lawyer to ask the insured to waive the conflict and to withdraw if the insured refuses. Regardless which of us turns out to be "right" (in the sense of best predicting what courts will decide), the most significant service the defense lawyer provides an insured in conflict situations is one that we seem to agree about. That service consists of a direct statement that a conflict exists, a clear explanation of the decisions that the insured needs to make as a result of the conflict, and forceful advice that the insured retain a personal lawyer to assist in making those decisions. This advice matters most in connection with settlement, where personal counsel can advise the insured whether to limit the potential loss by first settling the case and then disputing coverage.

CONCLUSION

In concluding, I want to emphasize that this article reflects a positive, not a normative, analysis of the duty to defend. I have described the liability insurance relationship and insurance law as I see them. As the liability insurance tetrahedron helps to demonstrate, there are tradeoffs in any definition of the scope of the duty to defend. It is my judgment that the equal consideration principle of insurance law requires the company to provide the insured a space in the relationship with the insurance defense lawyer in which the insured's interests are primary. But I am not prepared to claim that granting the insured that space will always make the world a better place.

If we intend to ground tort law in deterrence—and much of the recent academic writing and many judicial opinions assert that is the case—then we should be concerned that insureds can and will use that space to cooperate tacitly with plaintiffs and induce companies to pay claims that, from a pure deterrence perspective, companies perhaps should not pay. My view, however, is that liability insurance law is no more distinct from

tort law than "law" is distinct from "practice," and that this application of insurance law's equal consideration principle is only one of many legal phenomena that demonstrate that tort law-in-action is not grounded primarily in deterrence.

Indeed, working through the liability insurance tetrahedron provides further evidence that victim compensation is at least as important to tort law-in-action as deterrance. In each of the pattern cases that presented a real "plaintiff's choice" (which is to say, all but the Misrepresentation Case), that choice turned in part on the ability-to-pay of the insured. When the insured has no assets, the liability insurance relationship presents the plaintiff with the opportunity to ally tacitly with the insured against the company and, in effect, to expand the insurance available for the claim. But, where the insured has assets, the liability insurance relationship presents the plaintiff with the opportunity to ally tacitly with the company against the insured and, in effect, to narrow the insurance available for the claim.

Thus, in part because of liability insurance, tort law-in-action constitutes a sliding scale system of deterrence at least partially attuned to the defendant's ability to pay. The greater the wealth of the defendant, the more tort law-in-action serves a deterrence function. The less the wealth of the defendant, the more deterrence gives way to compensation. I am reserving my normative judgment about that for a better understanding of the world than that provided by current tort and insurance theory.

APPENDIX
CONSTRUCTING THE INSURANCE LIABILITY TETRAHEDRON

1. Copy and enlarge the insurance liability tetrahedron below.
2. Fold dotted lines and Flaps A, B & C down.
3. Tape Flap A under the *Settlement Triangle.*
4. Tape Flap B under the *Jury Triangle.*
5. Tape Flap C under *Plaintiff's Choice Triangle.*