Reexamining Conflicts of Interest: When Is Private Counsel Necessary?

Richard E. Nosky Jr.
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A characteristic of liability insurance policies\(^1\) is the obligation of the insurer to defend claims against the insured that come within the coverage of the policy.\(^2\) The liability insurer faces many formidable legal issues with respect to the duty to defend when a question concerning insurance coverage exists.\(^3\) In this situation, the duty of the insurer to defend will often turn on an issue of fact that is material to the third party's case against the insured.\(^4\) If the insurer wrongfully chooses not to defend the insured, the insurer may be subject to liability in excess of the policy limits.\(^5\) In addition, the liability insurer who breaches the duty to defend can be held liable to the insured for pain and suffering damages.\(^6\)

If the insurer chooses to defend, the action is tendered to the insurer's defense counsel, who then represents the insured.\(^7\) The tripartite relationship between the insurer, counsel, and the insured\(^8\) has created sensitive problems with respect to coverage issues.\(^9\) For example, since intentional conduct is often excluded under a liability

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1. **Cal. Ins. Code §108** provides: “Liability insurance includes...insurance against loss resulting from liability for injury, fatal or nonfatal, suffered by any natural person, or resulting from liability for damage to property, or property interests of others ....”

2. See R. Keeton, **Basic Text on Insurance Law** §7.6, at 462-89 (1971) (explaining the duty of the liability insurer to defend). A liability insurance policy ordinarily contains provisions that require the company to defend any suit against an insured alleging bodily injury or property damage within the scope of the insuring agreements, even if the suit is groundless, false, or fraudulent. *Id.* at 462.


policy, a finding that the insured intentionally assaulted the third party excludes coverage. This situation benefits the insurer at the expense of the insured by relieving liability under the policy.10

Out of concern that a coverage issue might influence the conduct of defense counsel in the original third party suit because of the financial interests of the insurer, several California courts have implied that the insured has the right to select independent counsel when a coverage issue exists.11 This right was expressly recognized by the California Court of Appeal for the Fourth District in San Diego Navy Federal Credit Union v. Cumis Insurance Society.12 The Cumis court held that when a coverage issue exists, the insured is entitled to private counsel at the expense of the insurer.13

The Cumis decision has had an adverse effect on the much troubled liability insurance industry.14 With a substantial percentage of premium dollars already spent on defense, insurers are having difficulty asserting legitimate coverage defenses because the cost of doing so is too high.15 Increasing litigation costs not only inhibit insurers from protecting their own interests, but also pose a detriment to the public.16 Rising defense costs often compel the insurer to extend coverage because asserting a coverage position adverse to the insured is too expensive.17 At face value, this situation might seem just because more

10. See Keeton, supra note 2, §5.4(b) at 291. The central idea of insurance is that coverage is extended for fortuitous losses only. Id. Consequently, coverage for intentionally caused harm has been denied under liability insurance policy provisions including the phrase "caused by accident" in the basic definition of coverage. Id. at 293. See also Cal. Ins. Code §533; Ford Motor Co. v. Home Ins. Co., 116 Cal. App. 3d 374, 382, 172 Cal. Rptr. 59, 64 (1981).


13. Id. at 375, 208 Cal. Rptr. at 506.

14. Insurers paid out from $135 to $160 for every $100 of premium income taken in 1984. Andresky, A World Without Insurance?, FORBES, July 15, 1985, at 40, 43. To avoid this loss, the liability carrier is forced to either raise rates or leave the business. The result to the consumer is often sharply reduced coverage at a vastly higher cost. Id. at 42-43. A major factor contributing to the financial woes of liability insurers is the growing number of huge personal injury awards. Unanticipated liabilities have also appeared such as exposure to asbestos and leaking toxic waste dumps. Insurance: Now It's a Risky Business, NEWSWEEK, Nov. 4, 1985, at 48, 49.

15. See infra notes 88-119 and accompanying text (explaining cost-related problems associated with the right to private counsel).


people receive coverage. As a result, however, many people and entities are not able to obtain liability insurance because the costs of obtaining the insurance are too high.18

This comment will explore the duty to defend19 and situations giving rise to conflicts of interest.20 Next, the impact of the Cumis21 decision on liability carriers will be discussed.22 Finally, this comment will determine whether independent counsel is necessary in all situations presenting potential diversity of interests. This comment will conclude that actual adversity should be the standard to trigger the right to private counsel because a reduction in the use of private counsel will lower costs for both insurer and insured without sacrificing the interests of either.23

THE DUTY TO DEFEND

Most liability policies provide that an insurance carrier has both the right and the duty to defend the insured.24 The insurer retains

18. The problem of soaring insurance costs has been felt in many areas of society, but particularly where risks of litigation are great. Cities and municipalities must curb services and boost taxes, or go without liability coverage altogether. Insurance Shock: Premiums Up, Coverage Down, Time, Sept. 16, 1985, at 55. Doctors, such as obstetricians plagued by wrongful birth claims, are switching to less risky specialties because malpractice premiums run as high as $72,000 a year. Id. Lawyer malpractice rates have increased 900 percent since 1984, with many firms having to finance the annual premium. Liability Insurance Crisis in Full Bloom, 29 Res Gestae 22 (1985). Liability to third parties has made accountants vulnerable to extremely high premiums. Andressky, supra note 14, at 40. The rise in product-liability lawsuits, notably in the case of the Dalkon Shield, has ballooned insurance costs for manufacturers. Insurance Shock: Premiums Up, Coverage Down, Time, Sept. 16, 1985, at 55, 56. Toxic pollution insurance is almost impossible to obtain since the Union Carbide disaster in Bhopal. Id. Liquor stores have been denied coverage because they sometimes have been found liable for death and injury caused by drunken customers. Id. The recent string of large-scale air disasters has produced huge premium increases for the airline industry. Id. The huge increase in public awareness about child abuse has made day care centers virtually uninsurable. Day Care Becomes High Risk, Time, June 3, 1985, at 62. New companies are experiencing difficulty assembling boards of directors because of the hardship involved in obtaining directors' and officers' insurance. Insurance: Now It's a Risky Business, Newsweek, Nov. 4, 1985, at 48, 49.
19. See infra notes 24-52 and accompanying text.
20. See infra notes 53-67 and accompanying text.
21. See infra notes 68-137 and accompanying text.
22. See infra notes 138-186 and accompanying text.
23. See infra notes 187-189 and accompanying text.
24. A. Windt, INSURANCE CLAIMS AND DISPUTES, §4.30 at 101 (1982). A typical duty to defend clause reads:

...the company shall have the right and the duty to defend any suit against the insured seeking damages on account of such bodily injury or property damage,...and may make such investigation and settlement of any claim or suit as it deems expedient, but the company will not be obligated to pay any claim or judgment or to defend any suit after the applicable limit of the policy has been exhausted by payment of judgments or settlements.

Keeton, supra note 2, at 658.
exclusive control over litigation involving the insured to permit orderly disbursement of monies accumulated from premiums.\textsuperscript{25} False claims are also minimized because the carrier is involved in the details of the litigation.\textsuperscript{26} Ultimately, however, the insurer is interested in controlling lawsuits against the insured because the insurer may be liable for losses suffered by the insured.\textsuperscript{27}

In California, the duty to defend is not coextensive with the duty to indemnify\textsuperscript{28} the insured. Often, the duty to defend will arise when no duty to indemnify exists. The landmark case of \textit{Gray v. Zurich Insurance Company}\textsuperscript{29} defined the duty to defend in California by holding that the insurance carrier is obligated to defend an action if the claim alleged is \textit{potentially} within the coverage of the insurance policy.\textsuperscript{30}

\textit{Gray} involved an action by an insured against his insurance carrier for failure to defend an assault complaint.\textsuperscript{31} The initial suit arose out of a fight between Gray, the defendant, and Jones, the plaintiff.\textsuperscript{32} Jones filed a complaint alleging that Gray intentionally assaulted him.\textsuperscript{33} Gray, stating that he acted in self-defense, asked the insurance carrier to defend.\textsuperscript{34} The carrier refused, stating that the complaint alleged an intentional tort, which was excluded from coverage.\textsuperscript{35} The court in \textit{Gray} found that the carrier had attempted to avoid the policy by employing unclear policy language for the intentional acts exclusion.\textsuperscript{36} Invoking the reasonable expectation rule, the court said that the carrier should have defended since Jones' allegations of intentional injuries could potentially be decided under a negligence theory and thus be within policy coverage.\textsuperscript{37}

\textsuperscript{25} 7C J. APPLEMAN, INSURANCE LAW AND PRACTICE §4681, at 2 (1980).
\textsuperscript{26} \textit{Id.}
\textsuperscript{27} King, Zeavin, & Snyder, \textit{The Insurer's Duty to Defend}, 6 CIV. LITIGATION REP. 173, 178 (California Continuing Education of the Bar) (1984).
\textsuperscript{28} The basic aspect of the principle of indemnity is the transfer of loss from an insured to an insurer by means of an obligation upon the insurer to confer an offsetting benefit. KEETON, \textit{ supra} note 2, §3.1(a) at 88. The value of the benefit (the policy proceeds) shall not exceed the loss because reimbursement is the ultimate goal of indemnity. \textit{Id.} This does not imply, however, that the benefit be no less than the loss. \textit{Id.}
\textsuperscript{29} 65 Cal.2d 263, 54 Cal. Rptr. 104, 419 P.2d 168 (1966).
\textsuperscript{30} \textit{Id.} at 275, 54 Cal. Rptr. 112, 419 P.2d 176.
\textsuperscript{31} \textit{Id.} at 266, 54 Cal. Rptr. 105, 419 P.2d at 169.
\textsuperscript{32} \textit{Id.} at 267, 54 Cal. Rptr. 106, 419 P.2d at 170.
\textsuperscript{33} \textit{Id.}
\textsuperscript{34} \textit{Id.}
\textsuperscript{35} \textit{Id.}
\textsuperscript{36} \textit{Id.} at 268, 54 Cal. Rptr. 107, 419 P.2d at 171.
\textsuperscript{37} \textit{Id.} at 275-76, 54 Cal. Rptr. at 112, 419 P.2d at 176.
The general rule, overruled in Gray, was that the specific allegations of the complaint determine the duty to defend.\(^{38}\) Considering the likely overstatement in the complaint and the liberality of modern pleading rules, the Gray court feared the third party being the "arbiter" of insurance coverage.\(^{39}\) Further, the court reasoned that since no one can determine at the outset of trial whether the third party suit falls within coverage, that issue will not be resolved until after adjudication of the third party suit.\(^{40}\) Thus, if an insurer finds the injury caused by the insured has the potential to fall within coverage, the insurer is obliged to defend even if the complaint contains allegations to the contrary.\(^{41}\)

Since the duty to defend is a contractually imposed duty,\(^{42}\) the fulfillment of that duty must be in good faith because of the covenant of good faith and fair dealing implied in every contract.\(^{43}\) This covenant requires that each contracting party shall not do anything to injure the right of the other party to receive the benefits of the contractual agreement.\(^{44}\) In the insurance context, the covenant of good faith means that the insurer must give the interests of insurer and insured equal consideration.\(^{45}\)

Consequences of breaching the duty to defend are often severe.\(^{46}\) A wrongful refusal to defend by the insurer may in itself result in

\(^{39}\) Gray, 65 Cal.2d at 276, 54 Cal. Rptr. at 112, 419 P.2d at 176.
\(^{40}\) Id. at 271-72, 54 Cal. Rptr. at 109, 419 P.2d at 173.
\(^{42}\) KEETON, supra note 2, §7.6(a) at 462.
\(^{46}\) See generally KEETON, supra note 2, §7.6(c) at 484-89 (discussion of wrongful failure to defend).
a finding of bad faith against the insurer, or may remove the insurer from the settlement process, thus setting the stage for a finding of bad faith. The insurer that refuses to defend a claim, does so at its own risk and becomes liable for all resulting damage to the insured. The insurer can be liable to the insured for the amount of the judgment in excess of the policy limits, as well as attorneys’ fees. Damages for pain and suffering, economic loss, and punitive damages are also available to the insured under the appropriate factual circumstances.

CONFLICTS OF INTEREST

Since the carrier may be required to defend an action for which it might not be held liable, many courts and commentators have

50. Gray, 65 Cal. 2d at 280, 419 P.2d at 179, 54 Cal. Rptr. at 115. The insurer who wrongfully refuses to defend is generally liable on the judgment against the insured even when that judgment exceeds the policy limits. In holding that the insurer who wrongfully refuses to defend is generally liable on the judgment against the insured, the Gray court applied the contract theory of recovery used in Tomerlin v. Canadian Indemnity Co., 61 Cal. 2d 638, 394 P.2d 571, 39 Cal. Rptr. 731 (1964). A wrongful refusal to defend constitutes a breach of the insurance contract. Gray, 65 Cal. 2d at 280, 54 Cal. Rptr. at 115, 419 P.2d at 179.
51. Brandt v. Standard Ins. Co., 37 Cal. 3d 813, 819, 693 P.2d 796, 800, 210 Cal. Rptr. 211, 215 (1985). Only those fees that are incurred in the course of attempting to obtain policy benefits are recoverable. Id. Fees attributable to obtaining any portion of the plaintiff’s award that exceeds the amount due under the policy are not recoverable. Id.
52. The courts have held that under the appropriate factual circumstances, an insurer who breaches the duty to defend may be held liable for pain and emotional distress caused to the insured. State Farm Mut. Auto Ins. Co. v. Allstate Ins. Co., 9 Cal. App. 3d 508, 528, 88 Cal. Rptr. 246, 258 (1970). New ground was broken in this area by the decision in Crisci v. Security Ins. Co., 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967). The court in Crisci stated that the general rule of damages in tort is that the injured party may recover for all detriment incurred whether it could have been anticipated or not. Id. at 433-34, 426 P.2d at 179, 58 Cal. Rptr. at 19. The right to recover for mental suffering is included when it constitutes an aggravation of damages. Id. Although the case did not include a claim for physical injuries, the court believed the property damage involved apart from the mental distress was substantial, thereby reducing the risk of a fictitious claim. Id. Loss of earnings and other economic losses are also recoverable since they naturally flow from the act of bad faith. See id. California courts have also held that punitive damages may be awarded in appropriate cases. See e.g. Egan v. Mutual of Omaha Ins. Co., 24 Cal. 3d 809, 820, 598 P.2d 452, 457, 157 Cal. Rptr. 482, 487 (1979); Richardson v. Employers Liab. Assur. Corp., 25 Cal. App. 3d 232, 244-46, 102 Cal. Rptr. 547, 555-57 (1972). Some form of conscious wrongdoing is required for an award of punitive damages. CAL. CIV. CODE §3294(a) provides: “...where the defendant has been guilty of oppression, fraud, or malice, the plaintiff, in addition to actual damages, may recover damages for the sake of example and by way of punishing the defendant.”
53. If the plaintiff in the underlying suit alleges both covered and non-covered conduct,
feared a less than competent defense by retained counsel of the insurer.54 Typically, in tort actions, the injured party will claim that the injuries were either intentionally or negligently inflicted.55 The liability policy will not usually cover intentional torts.56 Thus, the interest of the insurer would be served by a finding that the insured engaged in intentional conduct.57 This result, however, leaves the insured without coverage and the plaintiff uncompensated if the insured is insolvent.58 Because the insurer pays the fees of the defense counsel, many fear that defense counsel could slant efforts in favor of the insurer.59

Upon assumption of the defense of the insured, the insurer is estopped from later denying coverage if rights under the policy are not reserved.60 In California, because the duty to defend is invoked by the mere existence of potential liability,61 the carrier can accept the defense of an action brought against the insured while reserving the right to contest indemnification issues by using a reservation of

the insurer must defend because the possibility of liability exists. See Gray, 65 Cal.2d at 275, 419 P.2d at 176, 54 Cal. Rptr. at 112. If the noncovered conduct is proven, the insurer has defended without ultimate liability. Id.


55. The complainant in the third party action drafts the complaint in the broadest terms available. Gray, 65 Cal.2d at 276, 54 Cal. Rptr. at 112, 419 P.2d at 176.

56. Keeton, supra note 2, §5.4(b) at 291.

57. Morris, supra note 3, at 485.

58. Id. See generally Keeton, supra note 2, §7.7(a); Morris, supra note 3, at 466-493 (descriptions of other sources of conflict).

59. See Purdy v. Pacific Automobile Ins. Co., 157 Cal. App. 3d 59, 76, 203 Cal. Rptr. 524, 530 (1984); “The ‘triangular’ aspect of the representation afforded by the insurer’s lawyers is described as a coalition for a common purpose, a favorable disposition of the claim, with the attorney owing duties to two clients. As a practical matter, however, there has been recognition that, in reality, the insurer’s attorneys may have closer ties to the insurer and a more compelling interest in protecting the insurer’s position, whether or not it coincides with what is best for the insured.” Id. The Purdy court and others fail to emphasize that the conflict of interest problem is reciprocal. Conceivably, independent counsel can slant the defense so as to establish coverage to the detriment of the insurer in a coverage dispute. See Browne, supra note 16, at 24.

60. Tomerlin v. Canadian Indem. Co., 61 Cal. 2d 638, 647, 394 P.2d 571, 587, 39 Cal. Rptr. 731, 737 (1964). Withdrawal of the reservation of rights letter is in effect a promise by the insurer to pay any judgment rendered. See id. In California, the theory that an insurer waives the right to contest coverage by defending the suit is based upon the doctrine of estoppel. The insured must show that the insurer either intentionally relinquished a known right or acted in a manner that caused the insured to reasonably believe the insurer had relinquished the right, and that the insured relied upon the conduct of the carrier to the detriment of the insured. Val’s Painting & Drywall, Inc. v. Allstate Ins. Co., 53 Cal. App. 3d 576, 587, 126 Cal. Rptr. 267, 273 (1976).

61. Gray, 65 Cal. 2d at 276, 419 P.2d at 176, 54 Cal. Rptr. at 112.
rights agreement. The reservation of rights by the insurer accents the potential of a less than competent defense by the carrier.

In response, the courts have required the insurer to use due care and good faith in the defense of the insured. Although defense counsel has the duty to act with complete fidelity to the insured, apprehension exists over the longstanding ties between defense counsel and insurer. Believing that these ties could influence conduct in the case, several California courts have suggested strongly that a coverage issue presents a conflict sufficient to allow the insured the absolute right to private counsel.

SAN DIEGO NAVY FEDERAL CREDIT UNION v. CUMIS INSURANCE SOCIETY

In Cumis, the insured was sued for wrongful discharge. In addition to $750,000 in compensatory damages, the plaintiff sought $6.5 million in punitive damages, which are not subject to insurance coverage in California for public policy reasons. The insurer believed

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62. A typical reservation of rights letter reads:
This company will provide a defense for you as per the terms of the insurance policy, but this company does not waive any of its rights under the terms, conditions, and provisions of the insurance policy. Therefore, if a judgment is entered against you for damages that are not covered under the policy, this company will not be responsible for the judgment.

G. COUCH ON INSURANCE, §51.78 at 565-66 (2d Rev. ed. 1982). See generally Comment, Reservation of Rights Notices and Nonwaiver Agreements, 12 PAC. L.J. 763 (1981); Comment, supra note 3 at 745-6. One court has held that the insurer must have the approval of the insured to retain a reservation of rights. Cumis, 162 Cal. App. 3d at 375, 208 Cal. Rptr. at 506. This rationale seems unwarranted since a reservation letter is not a bilateral contract, but a unilateral notice sent by the insurer to the insured informing the insured of the intent of the insurer to maintain control over the defense and of the belief that the insurer has no obligation to indemnify the insured. Val's Painting & Drywall, Inc. v. Allstate Ins. Co., 53 Cal. App. 3d 576, 586, 126 Cal. Rptr. 267, 272 (1975). See Note, Liability Insurance Policy Defenses and the Duty to Defend, 68 HARV. L. REV. 1436, 1446-7 (1955). Several jurisdictions hold that the assumption of the defense by the insurer when the insured has refused to sign a reservation letter is not a waiver of the right of the insurer to bring a declaratory action to determine coverage. See, e.g., Great Southwest Fire Ins. Co. v. H.V. Corp., 658 P.2d 337, 340 (Hawaii 1983); Sussex Mut. Ins. Co. v. Hala Cleaners, 380 A.2d 693, 697 (N.J. 1977); Boode v. Allied Mut. Ins. Co. 458 P.2d 653, 659 (Wyo. 1969).

63. Comment, supra note 3, at 745-6.


65. See Mallen, supra note 7, at 246-48.


68. Cumis, 162 Cal. App. 3d at 361, 208 Cal. Rptr. at 496.

69. Id.

70. CAL. CIV. CODE §3294; CAL. INS. CODE §§250, 533; City Products Corp. v. Globe
that the alleged breach of the employment contract by the defendant employer was exempted from coverage under the policy.71 When the conflict of interest issue was raised initially, defense counsel concluded that no conflict existed.72 Consequently, the insurer refused to pay for independent counsel and defended the action under reservation with standard defense counsel.73

In sweeping language, the California appellate court held that when the action against the insured presents claims that might not be covered under the policy, the insured has the right to select independent counsel at the expense of the insurer.74 In short, a conflict of interest triggers the absolute right of the insured to private counsel.75 The court rejected the argument of the insurer that the duty to defend was met when counsel was retained at the expense of the insurer.76

The insurer, contending that Gray v. Zurich Ins.77 controlled, reasoned that no conflict existed because a carrier is bound ethically and legally to protect the interest of the insured.78 The court in Cumis responded by stating that “the dictum in Gray flies in the face of the reality of insurance defense work.”79 Since the attorney of the insurer has closer ties to the insurer, the Cumis court was concerned that the attorney would have a more compelling interest in protecting the position of the insurer.80

The insurer countered with the Gray reasoning that the coverage issue is not litigated in the third-party suit.81 Further, if a reservation of rights letter had been issued, the carrier would not be bound by

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Indemnity, 88 Cal. App. 3d 31, 42, 151 Cal. Rptr. 494, 500-01 (1979). The prime objective of this policy is punishment of wrongdoers. Countervailing interests favoring compensation of victims may prompt coverage for compensatory damages awarded for precisely the same conduct. Keaton, supra note 2, §5.3(3) at 288.

71. Cumis, 162 Cal. App. 3d at 362, 208 Cal Rptr. at 496.
72. Id. at 363, 208 Cal. Rptr. at 497.
73. Id.
74. Id. at 375, 208 Cal. Rptr. at 506. Apparently the Cumis rationale does not apply when the coverage defense does not involve facts in the tort action. An example of such a defense would be a claim that the policy was void for nonpayment of premiums. Berg, supra note 17, at 14. One case has limited the holding of Cumis to the facts of the case decided, “notwithstanding the use of overly broad language by the court....” McGee v. Superior Court, 176 Cal. App. 3d 221, 226, 221 Cal. Rptr. 421, 423 (1985).
75. Cumis, 162 Cal. App. 3d 375, 208 Cal. Rptr. at 506.
76. Id. at 367, 208 Cal. Rptr. at 500.
78. Cumis, 162 Cal. App. 3d at 368, 208 Cal. Rptr. at 501. See Gray, 65 Cal.2d at 279, 54 Cal. Rptr. at 114, 419 P.2d at 178, n.18.
79. Cumis, 162 Cal. App. 3d at 368, 208 Cal. Rptr. at 498 (quoting the trial court).
81. Id. at 368, 208 Cal Rptr. at 501. The only question litigated is the liability of the insured. Gray, 65 Cal. 2d at 279, 54 Cal. Rptr. at 114, 419 P.2d at 178.
the judgment in the third-party suit.\textsuperscript{82} Thus, the interests of the insurer and insured are identical in the primary suit since the insurer could raise the coverage defense later.\textsuperscript{83} The \textit{Cumis} court rejected the reasoning of the insurer by assuming that defense counsel might not try to minimize the liability of the insured.\textsuperscript{84} The court conceded that issues of coverage under the policy are not actually litigated in the third-party suit,\textsuperscript{85} but reasoned that this point did not detract from the force of the opposing interests operating on the attorney selected by the insurer.\textsuperscript{86}

PROBLEMS PRESENTED BY THE RIGHT TO INDEPENDENT COUNSEL

The right of the insured to select independent counsel has been detrimental to several facets of the liability insurance industry.\textsuperscript{87} Often, insurers cannot raise coverage defenses because doing so is not cost-effective.\textsuperscript{88} The dramatic sway in control of the defense given to the insured has contributed to spiraling costs for both carriers and those buying liability policies.\textsuperscript{89} These problems and others presented by the \textit{Cumis} decision accentuate the need for a new solution to the conflicts of interest dilemma.

\begin{enumerate}
\item \textsuperscript{82} \textit{Cumis}, 162 Cal. App. 3d at 367, 208 Cal. Rptr. at 500. If the injured party prevails, that party or the insured will assert the claim against the insurer. Then, the insurer can assert the coverage defense. \textit{Gray}, 65 Cal. 2d at 279, 54 Cal. Rptr. at 114, 419 P.2d at 178. See CAL. INS. CODE \S 11580(b)(2) which provides in pertinent part: "whenever judgment is secured against the insured...in an action based upon bodily injury, death, or property damage, then an action may be brought against the insurer on the policy and subject to its terms and limitations, by such judgment creditor to recover on the judgment." \textit{Id.}
\item \textsuperscript{83} \textit{See Gray}, 65 Cal. 2d at 279, 54 Cal. Rptr. at 114, 419 P.2d at 178. The insurer and the insured both seek to avoid, or at least minimize the judgment. \textit{Id.}
\item \textsuperscript{84} \textit{Cumis}, 162 Cal. App. 3d at 363-64, 368, 208 Cal. Rptr. at 497-98, 501. The court stated \textit{Gray} was not controlling because the question of whether the scope of the duty to defend includes payment for independent counsel was not addressed in that case. \textit{Id.} at 368, 208 Cal. Rptr. at 501.
\item \textsuperscript{85} \textit{Id.} at 364, 208 Cal. Rptr. at 498.
\item \textsuperscript{86} \textit{Id.} The court emphasized the dual agency status of the attorney retained by the insurer and rejected the idea that the insured consents to this status by contracting with the insurer. \textit{Id.} at 365, 208 Cal. Rptr. at 498. Any consent by the insured was deemed waived by the court when the insured hired independent counsel. \textit{See Lysick v. Walcom}, 258 Cal. App. 2d 136, 146, 65 Cal. Rptr. 496, 503 (1968). The insured may waive or otherwise forego the right to independent counsel. \textit{McGee v. Superior Court}, 176 Cal. App. 3d 221, 227, 221 Cal. Rptr. 421, 424 (1985). The right to independent counsel was expressly stated by the \textit{Cumis} court to be a right belonging to the insured, not the adversary of the insured. \textit{Id.} at 228.
\item \textsuperscript{87} \textit{Berg, supra} note 17, at 13-14.
\item \textsuperscript{88} \textit{Id.}
\item \textsuperscript{89} \textit{Id.} Large judgment awards, expanded liability theories, and the joint and several liability rule are other contributing factors. \textit{See generally} Comment, \textit{Extending MICRA Liability Limitations To All Negligence Actions: The Case For Tort Reform}, 17 PAC. L.J. 553, 553-57 (1986) (for a detailed discussion of this dilemma). \textit{See also supra} notes 14-18 and accompanying text (for a general discussion of the insurance crisis).
\end{enumerate}
A. Defense Costs and Handling of Claims

The cost of defending an action often exceeds the potential recovery. This situation coerces the carrier to settle, even if the case has little merit. Currently, even though punitive damage claims are not subject to coverage, claims for punitive damages are often included by plaintiffs to create a conflict of interest and force the insurer to pay for private counsel. The inclusion of non-covered claims in the pleadings can put pressure on the insurer to settle. Defense costs can increase at an astonishing rate, and the ability of the insurer to restrain these costs may be limited due to the threat of a bad faith action by the insured. Failing to respond in timely fashion to demands or inquiries of the insured is the most common way for the insurer to provide a factual basis for a bad faith claim. This type of behavior is easily recognized by a jury, and is difficult, if not impossible, to justify. Thus, the insurer and retained counsel must take all steps necessary to respond to these demands or face additional costs resulting from bad faith litigation.

Cumis mandates that the insurer pay the reasonable costs of hiring independent counsel incurred by the insured. The costs considered reasonable for the insurer often differ from those considered reasonable for independent counsel. Private rates may be higher in comparison

90. Berg, supra note 17, at 13-14.
91. Id.
93. See Berg, supra note 17, at 14. Punitive damages do not create a coverage issue since they are not subject to coverage. An award of punitive damages still benefits the insurer while hurting the insured because of this coverage exemption. Hence, the interests of insurer and insured are in conflict. See supra notes 53-67 and accompanying text (for a discussion of conflicts of interest).
94. See Berg, supra note 17, at 14.
95. The rate of increase can rise geometrically in a situation with multiple defendants, since each will be entitled to private counsel. For instance, in an action with five defendants, the insurer might have to pay $100,000 with a standard defense counsel. After each defendant secures private counsel, costs can jump to $500,000 and beyond. Id.
96. Even when the insurer assumes the defense and ultimately settles the third party claim for an amount within the policy limits, a possibility for tort liability exists on the basis of bad faith of the insurer in conduct of the defense. See Shernoff, Gage & Levine, Insurance_bad Faith Litigation, §3.25(2) (1984). Most courts that have been called on to define bad faith have usually done so in terms of the reasonableness or unreasonableness of the action of the carrier. Thus, insurers are required to act reasonably to carry out the agreed purpose of the contract. LePley, Bad Faith Updated: Definitions and Defenses, 21 Trial 46-47 (1985).
97. Ashley, Counsel's Role in Avoiding Bad Faith Exposure, Bad Faith Insurance Litigation (California Continuing Education of the Bar) 73, 77-78 (1985).
98. Id.
99. Id.
100. Cumis, 162 Cal. App. 3d at 375, 208 Cal. Rptr. at 506.
101. Berg, supra note 17, at 15; Browne, supra note 16, at 25-26. Since insurers are not
since standard defense counsel are accustomed to handling insurance defense cases and can therefore charge lower fees. Further, the amount of business generated by the insurer for standard counsel allows the demand of lower rates. The defense bar is to a certain extent dependent on the insurance industry for continued business, constraining law firms to keep legal fees as low as possible to obtain that business. Independent counsel of the insured is under no such constraint.

B. Expertise of Private Counsel

Insurers also lack any method of screening the qualifications of independent counsel. The carrier not only has a duty to defend but also a right. Private counsel might not always adequately protect this right due to lack of experience or expertise in the area of defense. Skilled in particular areas of advocacy, standard defense counsel are generally better prepared than the average attorney to defend the insured effectively. Further, insurers have experience in selecting attorneys, which is particularly important in complex litigation. An uninformed choice by the insured may result in higher judgments and settlements. Consequently, the insured may be denied the opportunity to the most effective defense available, which ultimately is why the right to private counsel is provided.

thought to be impoverished, a "reasonable" fee is likely to be higher than that ordinarily charged by the retained counsel of the insurer. Browne, supra note 16, at 25.

102. Berg, supra note 17, at 15. An increased cost can result from want of skill and experience. Independent counsel may need more time to perform work that an experienced counsel could perform with greater dispatch as a matter of routine. Browne, supra note 16, at 26.

103. See Mallen, supra note 7, at 245.
105. Id.

106. The lay insured will often make a poor choice of counsel. Id. This is often due to concern over legal expenses. See Fager, Insured's Right to Independent Counsel in Conflicts of Interest Situations, 48 Ins. Couns. J. 160, 161 (1981).
110. Morris, supra note 3, at 477.
111. Id., at 466.
112. See Spindle v. Chubb/Pacific Indemnity Group, 89 Cal. App. 3d 706, 712, 152 Cal. Rptr. 776, 780 (1979). Conflict occurs when representation of one client by standard defense counsel is rendered less effective by representation of the other. Id. The Cumis court applied the reciprocal reasoning that dual representation is rendered less effective when conflict occurs. Cumis, 162 Cal. App. 3d at 365, 208 Cal. Rptr. at 498.
C. Settlement Information

As with defense counsel retained by the insurer, the independent counsel has an obligation not to disclose information that would adversely affect the client in the dispute over coverage. The insurer, however, has an obligation to settle cases in which liability becomes reasonably clear. Because private counsel often will not disclose all facts necessary for the evaluation of liability and damages, the insurer may not be able to make a proper decision as to settlement. Thus, the carrier often must make such decisions based upon inadequate information. Refusal to settle can bring about the possibility of a bad faith action. Counsel retained by the insurer can keep the carrier informed as to the prospects of liability without prejudice to the insured, thus allowing the insurer to make prudent settlement decisions.

The inherent problems of conflicts of interest in liability insurance have been outlined above. Since the problem has been resolved against the insurer, two approaches to minimize losses are presented. The first is long term, involving prospective changes in the insurance policy.

113. The attorney can never advise the insurer as to coverage issues between insurer and insured. This would violate Canon 5 of the Model Code of Professional Responsibility which states, "A Lawyer Should Exercise Professional Judgment on Behalf of a Client." MODEL CODE OF PROFESSIONAL RESPONSIBILITY Canon 5 (1979). The attorney is also obligated to respect the confidence of the client and to not disclose to the carrier any facts that might vitiate coverage. Any such disclosure would be clear violation of Canon 4 of the Code of Professional Responsibility which states, "A Lawyer Should Preserve the Confidence and Secrets of a Client." Id. Canon 4. See Welthers, The Coverage Role of Defense Counsel, 48 INS. Couns. J. 156 (1981).

114. CAL. INS. CODE §790.03(h)(5). See Royal Globe Ins. Co. v. Superior Court, 23 Cal. 3d 880, 884, 592 P.2d 329, 332, 153 Cal. Rptr. 842, 845 (holding that a third party claimant may sue an insurer for violating Insurance Code §790.03(h)(5)).


116. Id.

117. The California Supreme Court has stated that the test whether an insurer has acted in bad faith in refusing a settlement offer is "whether a prudent insurer without policy limits would have accepted the offer." Crisci v. Security Ins. Co., 66 Cal. 2d 425, 429, 426 P.2d 173, 175, 58 Cal. Rptr. 13, 15 (1967). But see Johansen v. California State Automobile Assoc. Inter-Insurance Bureau, 15 Cal. 3d 9, 538 P.2d 744, 123 Cal. Rptr. 288 (1975). The only permissible consideration in evaluating the reasonableness of the settlement offer is whether the ultimate judgment is likely to exceed the amount of the settlement offer. Id. at 16, 538 P.2d at 748, 123 Cal. Rptr. at 292. The size of the judgment recovered exceeding the policy limits furnishes an inference that the value of the claim is the equivalent of the amount of the judgment and that acceptance of an offer within those limits was the most reasonable method of dealing with the claim. Id. at 17, 538 P.2d at 749, 123 Cal. Rptr. at 293. See also Allen, Insurance Bad Faith Law: The Need for Legislative Intervention, 13 PAC. L.J. 833 (1982); Note, Insurer's Liability for Refusal to Settle: Beyond Strict Liability, 50 S. CAL. L. REV. 751 (1977); Kelly, The Workable Sanction and Solution in Excess Liability Cases: Strict Liability for Insurance Carriers, 10 U.S.F. L. REV. 159 (1975).

The second is short term, involving the coverage position asserted by the insurer.

**Minimizing Losses Of The Insurer**

Changes in the liability insurance policy are one way to alleviate the problems of the conflict of interest situation.\(^{119}\) Changing the terms of the insurance policy may, however, prove to be unpredictable in practice, and may expose the carrier to even higher costs. Further, these long term changes can only be implemented in the future and will not affect the present losses of insurers.

**A. Elimination of the Duty to Defend**

Since the duty to defend is contractual,\(^{120}\) the simple elimination of the clause from the insurance policy is an option. The obligation of the insurer would be limited to paying losses.\(^{121}\) Exorbitant costs of private counsel would be avoided.\(^{122}\) Elimination of the duty to defend, however, would leave the insurer vulnerable. The insured may not be able to defend the claim effectively, resulting in the carrier having to pay unduly large judgments.\(^{123}\) Moreover, in California, a statutory duty to defend arises when the policy is silent.\(^{124}\) Unless the policy clearly and expressly excludes a duty to defend, California courts will imply the duty.\(^{125}\) Elimination of the duty to defend, even if feasible, does not necessarily eliminate the duty to settle.\(^{126}\) Lack of participation in the defense leaves the carrier vulnerable to bad faith claims because of the difficulty of ascertaining when liability becomes reasonably clear.\(^{127}\)

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120. Keeton, supra note 2, §7.6(a) at 462.
121. Berg, supra note 17, at 16.
122. Id.
124. Cal. Civ. Code §2778(3)-(5). These code sections provide that indemnity against liability embraces the costs of defense against claims brought against the insured. Id. Hence, if the parties are under a contract of indemnity, a statutory duty arises requiring the insurer to defend the insured.
126. Since the duty to settle is statutory, a court may be persuaded on public policy grounds not to allow an insurer to disclaim the duty to settle. See Berg, supra note 17, at 16.

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B. Limits on Defense Costs

Another option would be for the insurance policy to limit what the insurer will pay in defense costs. When the limit is reached, however, the problems of questionable defense by the insured and vulnerability to bad faith actions again are involved.128 The carrier could also modify the policy limit to include the cost of defense. As defense costs rise, the obligation to indemnify decreases. The insured would be forced to control defense costs, thus minimizing the risk of an economically coerced settlement.129

California law on the correlation between the duty to defend and the duty to indemnify is unclear.130 Whether the duty to defend would terminate by including defense costs within the policy limits is questionable, because Gray suggested that the duty to defend is broader than the duty to indemnify131 and a split of authority exists in California as to whether the duty to defend terminates upon exhaustion of the policy limits.132 If a court construes the duty to defend as independent of the duty to indemnify, including defense costs within the policy limits achieves little.133

C. A Short Term Strategy for the Insurer

Even if the policy modifications suggested were viable, their effect could only be prospective. Thus, any savings accruing to the insurer could only be realized in the long run. Claims arising under existing policies must be considered. If the carrier is faced with a possible conflict, expenses can sometimes be minimized by withdrawing the reservation of rights letter. This procedure eliminates any possible con-

129. Id.
130. See Comment, Termination of the Duty to Defend: Did the California Supreme Court Send the Wrong Signal?, 17 PAC. L.J. 283, 296-300 (1985).
131. Gray, 65 Cal.2d at 275, 54 Cal. Rptr. at 112, 419 P.2d at 176. This belief is apparently based on the fact that an insurer must sometimes defend when no duty to indemnify exists. Also, the insurer may have to defend groundless suits, but is only required to compensate the insured for actual losses under the policy. See Comment, supra note 130, at 301.
conflict, because the insurer has in effect promised to pay any judgment rendered.\textsuperscript{134} Thus, no private counsel would be necessary.

In certain instances, this alternative may be cost-effective. If the potential exposure to non-covered claims is small compared to the savings in defense costs, withdrawal of the reservation letter will save the insurer money. Further, the threat of enormous defense costs is avoided, allowing the insurer to litigate more cases fully. Ultimately, this alternative may result in lower settlements because plaintiffs would not be able to economically coerce insurers as easily.\textsuperscript{135} By regularly following this procedure, however, the insurer has in effect forfeited the right to assert coverage defenses.\textsuperscript{136} Insurers have no duty to sacrifice their own interests when those interests conflict with the interests of the insured.\textsuperscript{137}

The balance struck by California courts with regard to conflicts of interest weighs heavily against insurers. The detriment incurred by insurers through the mandatory use of private counsel and the lack of a viable method for insurers to minimize their losses have been diagrammed. Obviously, this detriment is passed on to insureds through higher premiums. A new balance is necessary to protect the interests of insurance carriers adequately while serving the public as well.

**RE-EXAMINING CONFLICTS OF INTEREST**

Granting an absolute right to private counsel whenever a conflict exists\textsuperscript{138} is an inappropriate solution to the conflicts of interest problem. The real inquiry should be the effect of the use of counsel retained by the insured on the ultimate resolution of the coverage issue.\textsuperscript{139} A conflict of interest inheres in every coverage dispute.\textsuperscript{140} The insurer seeks to minimize loss payments and the insured seeks indem-


\textsuperscript{135} See Berg, supra note 17, at 17.

\textsuperscript{136} See Keeton, supra note 118, at 1170.

\textsuperscript{137} Id.

\textsuperscript{138} See Cumis, 162 Cal. App. 3d at 375, 208 Cal. Rptr. at 506. A conflict arises whenever the insurer takes the view that a coverage issue is present. Id. at 369, 208 Cal. Rptr. at 501. When a conflict exists, the insured may have control of the defense. Id. at 375, 208 Cal. Rptr. at 506.

\textsuperscript{139} See Clemmons v. Travelers Ins. Co., 430 N.E.2d 1104, 1109 (Ill. 1981) (holding nothing that the insurer could do in the underlying suit would affect the later dispute over policy coverage).

\textsuperscript{140} "A conflict of interest exists when the attorney, or any person represented by the attorney, has interests adverse in any way to the advice or course of action that should be available to the present client. A conflict exists when this tension exists even if the attorney eventually takes the course of action most beneficial to the present client." Aronson, Conflict of Interest, 52 Wash. L. Rev. 807, 809 (1977). See generally H. DRINKER, LEGAL ETHICS, at 104-18 (1953).
These irreconcilable interests trigger the right to private counsel every time a coverage dispute exists if the insurer chooses to defend under reservation. Mere diversity of interests should not trigger the right to private counsel. Actual adversity should be the standard to trigger the right. If counsel retained by the insurer is not in a position to further the interests of the insurer, considerably less reason exists for allowing the insured to select private counsel since little chance of prejudice to the insured exists with respect to coverage. Allowing the carrier to retain the attorney selection function facilitates lower defense costs for the carrier and lower insurance costs for the insured. The appropriate standard in the selection of counsel is influenced by the conduct of retained counsel and the standard of loyalty.

A. Preventing Coverage Harm to the Insured

The attorney has an obligation not to disclose information voluntarily that is adverse to the client, regardless of the source. This means defense counsel of the insurer cannot represent the insurer in a declaratory action against the insured, nor advise the insurer regarding coverage issues. In the context of a coverage dispute, an abuse of the attorney-client relationship resulting in denial of coverage to the insured should constitute a waiver of any policy defense. Disciplinary measures and malpractice liability are possibilities to deter the attorney from abusing the attorney-client relationship. The attorney also may be liable for conspiracy to commit an unfair claims

141. The insurer can reduce costs by concentrating on eliminating or reducing the liability of the insured to third parties, or direct attention to coverage exclusions or limitations in the policy of the insured. The result, reduced payments, is the same in either case. Only the person affected differs. Morris, supra note 3, at 460.
142. Cumis, 162 Cal. App. 3d at 369, 208 Cal. Rptr. at 505.
147. Employers Casualty Co. v. Tilley, 496 S.W.2d 552, 561 (Texas 1973).
148. See id.; Parsons v. Continental National American Group, 550 P.2d 94, 99 (Ariz. 1976). Use of the confidential relationship to gather information so as to deny coverage is so contrary to public policy that the insurer is estopped from disclaiming liability even when the defense was conducted subject to a reservation of rights. Id.
150. See generally Mallen & Levitt, Legal Malpractice §§7-8 (West 1977) (discussing risks of abusing the attorney-client relationship).
Thus, defense counsel retained by the insurer must ensure that the information related to coverage issues obtained as a result of the privileged relationship with the insured is not disclosed to the insurer.  

Conflicts of interest pose many ethical problems for attorneys engaged in the tripartite insurance defense relationship. California courts reason that an attorney retained by the carrier is engaged in a dual representation of insurer and insured, which requires the attorney to exercise a high duty of care to both clients. This standard promotes conflicts, because defense attorneys are forced to make decisions in the underlying litigation that may harm one of the interests they are supposed to promote.

A standard of undivided loyalty to the insured is ethically and contractually mandated. This standard is consistent with the ethical obligations attorneys owe to clients. Further, the phrase "duty to defend" does not merit anything less than a full defense just as if the insured were paying the fees. The troublesome allegiance to two clients is thereby eliminated, giving a clearer direction to the defense attorney.

Many cases assume that upon discovery of a policy defense during representation, the defense counsel can withdraw from the case without harming the insured. This way of dealing with the problem actually operates as a warning to the insurer to look for a coverage defense. The undivided loyalty standard can circumvent this thorny problem. Because defense counsel cannot reveal any information that may be detrimental to the insured in any subsequent action, no dilemma arises of whether to continue defending a suit that the insurer may have no obligation to defend.

152. Mallen, supra note 7 at 247.
154. The court in Lysick v. Walcom stated that the attorney owes a high duty of care to both clients. 258 Cal. App. 2d at 146, 65 Cal. Rptr. at 413. The court added, however, that the insured expects the same services from the attorney as if retained by the insured personally. Id. Since the attorney would owe no loyalty to the insurer if retained by the insured, the standards are seemingly inconsistent.
155. One commentator has outlined the standard of undivided loyalty in detail. See Morris, supra note 3.
157. See Allen, Some Conflicts of Interest Problems in Insurance Litigation, 37 INS. COUNS. J. 512, 514.
158. See Morris, supra note 3, at 478-84. See also Siebert Oxidermo, Inc. v. Shields, 430 N.E.2d 401 (Ind. 1982).

Without considering the respected reputation of the attorney involved, we point out that
Settlement information provided to the insurer by retained counsel does not detract from the strict standard of loyalty to the insured. Such information can be provided without prejudice to the insured because only the prospects of liability to the injured third party are involved. Promoting settlement is unquestionably in the best interests of the insured. Further, public policy is advanced since the encouragement of settlements reduces court congestion and delay.159

Two practical considerations present problems. First, since defense counsel lacks full knowledge of the intricacies of the coverage dispute, the effect of any communication upon the coverage litigation may not be known. Awareness of potential coverage problems and defenses can help the attorney assess the potential impact of disclosures. A division of the two phases of the litigation by the insurer can also minimize this problem. One attorney can handle defense and settlement, another can handle coverage.160 Separate files are maintained and communication between the two attorneys is limited.161 To isolate the two phases further, separate law firms can be used for each phase.

Second, information relevant to the coverage issue might be needed by the insurer to evaluate the underlying suit and formulate a settlement position. In California, settlement decisions should be made without regard to the merits of the coverage dispute.162 The insurer often must settle with the belief that no coverage exists or face liability for any excess judgment.163 The insurer, however, may recover the amount of the settlement from the insured if coverage is denied later.164

Id. at 403.

159. See Kelly, supra note 117, at 171.


161. In Goldberg, steps were taken to assure independence and confidentiality between the separate phases of the litigation. Each maintained a separate file and was cautioned not to communicate the contents of that file with the respective counterparts. Id.

162. CAL. INS. CODE §790.03(b)(5).


No reason exists to fear conflicts of interest if defense counsel lacks the opportunity to prejudice the insured with respect to coverage. Thus, the pivotal inquiry is the effect of the role of counsel retained by insurer upon resolution of insurance coverage. If the factual determinations made in the tort action are not binding on the insurer or insured with respect to factual coverage defenses, nothing is gained by manipulating the defense one way or the other. The insurer, in fact, will be as interested in winning the tort suit as the insured, since a judgment for the insured will automatically eliminate the coverage controversy and save the insurer money. Judicially enforced ethical considerations and a well-defined standard of loyalty can help prevent harm to the insured in a subsequent coverage dispute. If findings in the underlying suit have no effect on the coverage action, the insurer lacks the opportunity to harm the insured in that action. To explore this point, the doctrine of collateral estoppel must be examined.

B. Collateral Estoppel of Coverage Issues

Collateral estoppel bars a party from litigating an issue that has previously been litigated fairly.165 Three factors must be present to apply the doctrine. First, a final judgment on the merits must exist.166 Second, the issue decided in the prior adjudication must be identical with the one presented in the current action.167 Lastly, the party against whom the plea is asserted must have been a party or in privity with a party to the prior adjudication.168

The first factor, a final judgment on the merits, is easily satisfied in the third-party suit. The other two factors, however, are not satisfied, which indicates that the judgment in the underlying suit will bind neither insurer nor insured. This analysis considerably weakens the argument that defense counsel, by influencing the court to find that the acts of the insured were exempted from coverage, could favor the interests of the insurer.

165. See generally Scott, Collateral Estoppel by Judgment, 56 Harv. L. Rev. 1 (1942). The interests of the state and of the parties require the putting of an end to controversies. If an issue is actually litigated and determined, that issue cannot be litigated again between the parties even though the issue arises in an action based upon a different claim. Id. at 1-2.
167. Id.
168. Id.
1. **Identity of Issues**

As to the second factor, identity of issues, a finding on the basis for the adjudication must be available.\(^{169}\) Findings of fact from the judge in a bench trial, or special interrogatories to a jury can serve this function.\(^{170}\) The underlying suits are usually tried before juries, however, and special interrogatories are seldom used.\(^{171}\) In fact, defense counsel avoid using special interrogatories, in order to protect the interests of the insured.\(^{172}\) Further, if the issues are somewhat different in the two actions, collateral estoppel cannot be applied.\(^{173}\) For instance, the intentional injury situation involves the state of mind of the defendant, but specific intent to harm the plaintiff is not an element of a prima facie case unless punitive damages are sought.\(^{174}\) Intent in tort actions merely involves whether the defendant desires to cause the consequences of the act.\(^{175}\) In a coverage dispute, intent constitutes a desire to harm the plaintiff.\(^{176}\) Because coverage exists for the unintended result of intentional acts, the act and the harm must be intentional for coverage exemption.\(^{177}\) Consequently, a finding in the underlying suit that the insured intended the act, such as an assault, should not bind anyone in the coverage suit because the issues are clearly not identical.\(^{178}\)

\(^{169}\) The burden of proof rests upon the party who relies on the judgment as an estoppel as to a particular matter to show that the matter was litigated, and that the matter was determined by the judgment. Scott, *supra* note 165, at 10.

\(^{170}\) *Id.*

\(^{171}\) *Mallen, supra* note 7, at 259.

\(^{172}\) Such procedures should not be used without full disclosure and informed consent of the insured. *Id.* This situation also applies to private counsel. *Id.*

\(^{173}\) The issues must be *identical.* *Bernhard,* 19 Cal.2d at 813, 122 P.2d at 895.

\(^{174}\) *See* Burd v. Sussex Mutual Ins. Co., 267 A.2d 7, 12 (N.J. 1970). A claimant who charges intentional injury may recover even though intent to injure is not proved. *Id.* If the determination of an issue is not essential to the judgment, the judgment cannot be given a conclusive effect. *Wright, Law of Federal Courts §100a,* at 682 (1983).

\(^{175}\) *Restatement (Second) of Torts §8A (1965). See Prosser, Law of Torts §8,* at 31 (1971). Tort liability is not concerned with hostile intent, or a desire to do any harm. Bringing about a result which invades the interests of another is the focus. *Id.*

\(^{176}\) 11 *Couch on Insurance* §44:289, at 449 (1982). The coverage issue is often framed in terms of an occurrence which includes an accident that results in an injury neither expected nor intended from the standpoint of the insured. *See Morris, supra* note 3, at 491. These terms have been construed to include only acts performed with a preconceived design to inflict injury. Walters v. American Ins. Co., 185 Cal. App. 2d 776, 783, 8 Cal. Rptr. 665, 670 (1960).

\(^{177}\) 11 *Couch on Insurance* §44:289, at 449 (1982).

\(^{178}\) The concept of intentionally caused loss does not extend to all damages awarded under the theory of intentional tort. Even though the theory of judgment is intentional tort, the harm for which damages are awarded may be accidental from the point of view of defendant and victim. In these cases, the principal reasons for disallowing insurance against intentionally caused loss are inapplicable. *Keeton, supra* note 2, §5.4(b) at 293. *See also* F. JAMES & G. HAZARD, *Civil Procedure* §11.18 (2d ed. 1977).
2. Fair Opportunity to Litigate

At first glance, the third requirement seems easily satisfied—the insured is the defendant and the insurer is in privity with the insured by virtue of the insurance contract. Further scrutiny reveals that this is not the case. The due process clause of the United States Constitution mandates that a person must have had a full and fair opportunity to litigate an issue to be barred from relitigating the issue.

The insurance policy prevents the insurer from realizing the opportunity to fully and fairly litigate the underlying suit. The duty to defend provision in the policy requires the insurer to advance the interests of the insured while defending the original suit. This situation forces sacrifice of the interests of the insurer when no such duty exists. An analogous situation applies to insureds. By surrendering control of the defense to the carrier, the insured may have been deprived of the opportunity to fully and fairly litigate coverage issues.

Additional authority supports the conclusion that the outcome of the original suit will not bind either the carrier or the insured. Section 58 of the Second Restatement of Judgments provides that the insurer is only precluded from relitigating issues determined in the action against the insured if no conflict of interest existed. A similar


180. Allen v. McCurry, 449 U.S. 90, 95 (1980); Blonder-Tongue Lab., Inc. v. Univ. of Illinois Found., 402 U.S. 314, 328-29 (1971). The insurer has never had a chance to present its own evidence and arguments. See Blonder-Tongue, 402 U.S. at 329. The plaintiff must be permitted to demonstrate that a fair opportunity procedurally, substantively, and evidentially to pursue the claim did not exist. Id. at 333. See Comment, supra note 3, at 740.

181. J. APPLEMAN, supra note 25, §46.87 at 179.

182. The carrier has no duty to sacrifice its own interests when they conflict with those of the insured. Keeton, supra note 118, at 1170.

183. See Outboard Marine Corp. v. Liberty Mutual Ins. Co., 536 F.2d 730, 735 (7th Cir. 1976).


185. RESTATEMENT (SECOND) OF JUDGMENTS §58 (1982) states:

(1) When an indemnitor has an obligation to indemnify an indemnitee (such as an insured) against liability to third persons and also to provide the indemnitee with a defense of actions involving claims that might be within the scope of the indemnity obligation, and an action is brought against the indemnitee involving such a claim and the indemnitee is given reasonable notice of the action and an opportunity to assume its defense, a judgment for the injured person has the following effects on the indemnitor in a subsequent action by the indemnitee for indemnification:

(a) The indemnitor is estopped from disputing the existence and extent of the indemnitee's liability to the injured person; and

(b) The indemnitor is precluded from relitigating those issues determined in the action against the indemnitee as to which there was no conflict of interest between the indemnitor and indemnitee (emphasis added).

Section 58 recognizes that a party is not precluded from contesting issues determined in an action
position is taken with respect to insureds. Because control of the
defense has been surrendered to the insurer, the underlying suit should
have no binding effect on the insured.\textsuperscript{186}

If no harm to the insured relating to coverage exists, no need for
independent counsel exists. The safeguards of professional responsibility
and collateral estoppel can provide enough protection for the insured.
Specific guidelines, however, are necessary for insurers to follow.

A Specific Standard For Insurers

If the carrier seeks to retain the right to control the defense of
the insured, a certain standard of conduct must be met. The insurer
must defend the insured in good faith,\textsuperscript{187} and that requires nothing
less than the selection of an attorney who will represent the insured
alone, to the exclusion of the coverage interests of the insurer.\textsuperscript{188} If
this standard is not met, the insurer breaches the covenant of good
faith and fair dealing\textsuperscript{189} and should also lose the right to select the
defense attorney for the insured. Once this right is lost, the insurer
must reimburse the insured for the costs of obtaining independent
counsel as well as other defense costs.

This standard will not prejudice the insured. First, no clear reason
exists to assume that attorneys retained by the insurer will not follow
the clear guidelines of professional conduct. Since the insured is, in
effect, the sole client of the defense counsel, the same ethical obliga-
tions owed to other clients are owed to insureds. In addition, little

\textsuperscript{186.} \textit{Restatement (Second) of Judgments} \textsection 39 \textit{comment f} (1982) provides:
As between the party surrendering control and the person assuming control, there may
be subsequent controversy over whether the person assuming control adequately
represented the interest of the party surrendering control. In an action concerning that
controversy, the party who surrendered control is not bound
by the determinations made
against him in the original action because, by hypothesis, he did not have the opportunity
that a party ordinarily has to present proofs and argument on the issues in question.

\textsuperscript{187.} \textit{See, e.g.,} Comunale v. Traders & General Ins. Co., 50 Cal.2d 654, 658, 328 P.2d 198,
16 (1967).

\textsuperscript{188.} Once insurers select the attorneys, the reasonable expectations of the insureds require that
the attorneys conduct themselves in the same manner as if the insureds were paying the fees. \textit{See}
Gray, 65 Cal.2d at 271-72, 54 Cal. Rptr. at 109-10, 419 P.2d at 173-74.

\textsuperscript{189.} By breaching this standard, the insurer has injured the right of the insured to receive the
benefits of the insurance contract. I Witkin, \textit{Summary of California Law} (8th ed. 1973) \textit{Con-
tracts}, \textsection 576, at 493.
motivation exists for standard defense counsel to prejudice the coverage prospects of the insured because any finding in the underlying suit should not have any binding effect on the insured.

With the advent of the Cumis decision, insurers are faced with a no win situation. If they defend without a reservation of rights, the coverage defense is lost. If they assert the reservation of rights, control of the defense is lost. Adherence to strict guidelines of professional responsibility and collateral estoppel will ease the one-sided aspect of this situation, while still promoting the interests of the insured.

CONCLUSION

The tripartite relationship between defense counsel, insurer, and insured poses unique problems to which no complete solution exists. If a question as to coverage exists, many fear a less than competent defense of the insured by the defense counsel. The courts have responded by granting the insured the right to private counsel in the event of a conflict. This solution has proved to be detrimental to insurers and insureds alike. Skyrocketing defense costs stemming from the Cumis decision force insurers to forego legitimate coverage defenses and often coerce settlement. These costs are inevitably passed on to insureds through increased premiums, making affordable liability insurance increasingly difficult to obtain. Policy modifications are not the answer, thus another compromise must be reached.

The fear of the tripartite relationship is based upon the assumption that conflicts of interest will influence the conduct of defense counsel. If counsel retained by the insurer lacks the opportunity to favor the interests of the insurer, this rationale is considerably weakened. This comment has shown that the outcome of the underlying suit should not bind either party, leaving defense counsel with no incentive to prejudice the insured. In addition, adherence to well defined ethical considerations minimizes actual harm to the insured concerning coverage. Thus, allowing the insurer to retain the attorney selection function most effectively fulfills the duty to defend while providing lower costs to everyone.

Richard E. Nosky, Jr.