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Conflicting Interests Of Attorney Representing Both Insured And Insurer

*Fidelity Casualty Co. of N. Y. v. McConnaughy*¹

In the case under discussion (see facts *supra* — previous note) the insured was held to have breached the cooperation clause of his automobile liability insurance policy. He argued in defense that because of alleged unethical conduct on the part of the attorney who was hired by the insurance company to represent him, this breach should be inoperative and the insurer should be estopped from asserting it. Briefly, the conduct alleged was the following: Fidelity's attorney, while representing the insured in a tort action, learned that the insured had procured two witnesses to testify falsely in his behalf. Without disclosing this knowledge or its significance to the defendant, the attorneys interrogated him and proceeded to take his deposition in such a manner that he finally admitted his deceit. The additional information placed the attorney's employer, the insurer, in a position to disclaim liability under the policy, which it did nine days later.

The Maryland Court of Appeals, Judge Hammond, stated that the attorneys had erred in continuing to represent the insured after having gained information concerning the possible breach of cooperation clause in his policy.² The Court reasoned that while it is customary for insurance policies to contain clauses whereby the insured is required to relinquish the control over the defense of any claims to the insurer and attorneys of its choosing, and that such advanced consent on the part of the insured negates the improper relationship created by such dual representation, where in the course of dual representation, actual conflict between the interests of the two parties develops, the lawyer must elect either to represent one of the clients only, or withdraw from the case entirely.³ However, the Court, while admonishing the attorneys involved, held that the insurer did not thereby waive its right to disclaim liability for non-cooperation or become estopped to do so.

“We are not persuaded that because the [insurer] verified its belief that there had been a breach of the policy provisions by Butler, through lawyers who continued to represent *it and the insured* at a time when their

¹ 228 Md. 1, 179 A. 2d 117 (1962).

² *Id.*, 12.

³ *Id.*, 10.

interests were not parallel, it lost whatever rights it would have had."⁴

The purpose of this note is to discuss (1) the ethical problem an attorney faces in insurance cases where such a conflict of interest occurs, and (2) the consequences which may be imposed on the insurance company which he represents.⁵

The standard policy of automobile insurance requires the following duties of the insurance company:

- a. That it shall defend any suit against the insured alleging injury and claiming damage.
- b. That it shall pay any judgment rendered against the insured covered by the policy.
- c. That it shall pay all expenses incurred by it and all tax costs and interest accrued after entry of the judgment.

The standard policy of automobile insurance requires the following duties of the insured:

- a. To give the insurance company prompt notice of the accident, claim or suit.
- b. To give assistance and cooperation in opposing such suit or claim.
- c. To subrogate the insurance company for any amount paid by it to the insured.

It is readily apparent from an analysis of their respective rights and duties that a community of interest exists between the company and the insured as a result of the insurance contract in regard to any actions brought by a third party against the insured within the scope of the policy limitations. In commenting upon this relationship the American Bar Association said: "The essential point of ethics involved is that the lawyer so employed shall represent the insured as his client with undivided fidelity as required by Canon 6 of the Code of Professional Ethics."⁶

⁴ *Id.*, 12. (Emphasis added).

⁵ This note restricts itself to the insurance area. See the following for comprehensive analysis of related areas:

"Validity and effect of divorce as affected by representation of both parties by same attorney." 16 A.L.R. 427 (1922); "Propriety and effect of attorney representing interest adverse to that of former client." 51 A.L.R. 1307 (1927) *supp.* 126 A.L.R. 1271 (1940); "Attorney's representation of parties adversely interested as affecting judgment or estoppel in respect thereof." 154 A.L.R. 501 (1944).

⁶ AMERICAN BAR ASSOCIATION, OPINIONS OF THE COMMITTEE ON PROFESSIONAL ETHICS AND GRIEVANCES, Opinion No. 282 — "Conflicting Interest — Lawyer for Insurance Company representing insured." May 27, 1950 at p. 591.

The suggestion that Canon 6 should be rigidly adhered to in this type of situation has been followed by an increasing number of courts dealing with this question. The Maryland Court of Appeals approaches the problem by quoting the pertinent language of Canon 6:

"It is unprofessional to represent conflicting interests, except by express consent of all concerned given after a full disclosure of the facts. Within the meaning of this canon, a lawyer represents conflicting interests when, in behalf of one client, it is his duty to contend for that which duty to another client requires him to oppose."⁷

While the wording of this canon clearly appears applicable to the factual situation under discussion, it has only been in recent years that the courts have examined an attorney's conduct in this light. As a result of an increasing awareness on the part of the courts to the practical significance which such a relationship creates, a growing number of decisions have stressed the language of Canon 6.⁸ In the words of a recent New York case,⁹ which is quoted with approval by the Maryland court:¹⁰

"The court may not close its eyes to the obvious. The prime interest of these attorneys is the insurance company, in whose behalf they may defend cases year after year. Where the interests of the carrier and the client run parallel with each other, the attorneys undoubtedly will exert their best efforts to protect the interests of their client, since in so doing, they will also be protecting the interests of their real principal. But where, as in this case, the interests are adverse one to the other, then the attorneys may not 'assist the lost traveler along the road and at the same time prepare a trap into which he will ultimately fall.'"¹¹

By placing an emphasis on Canon 6, the courts have determined that the test of the attorney's conduct will be judged

⁷ *Supra*, n. 1, 9. See Canon 6 of the AMERICAN BAR ASSOCIATION, CANONS OF PROFESSIONAL ETHICS: CANONS OF JUDICIAL ETHICS (1948) 5. This was adopted by the Maryland State Bar Association on June 25, 1948, (see Vol. 53 of the Transactions of the Maryland State Bar Association, p. 198). See also the Baltimore City Bar Association Charter and Bylaws, Code of Professional Ethics and Judicial Ethics, issued in September, 1959.

⁸ *E.g.*, Allstate Insurance Company v. Keller, 17 Ill. App. 2d 44, 149 N.E. 2d 482 (1958); Schwartz v. Sar Corporation, 19 Misc. 2d 660, 195 N.Y.S. 2d 496 (1959); Van Dyke v. White, 55 Wash. 2d 601, 349 P. 2d 430 (1960).

⁹ Schwartz v. Sar Corporation, *Ibid.*

¹⁰ *Supra*, n. 1, 11.

¹¹ Schwartz v. Sar Corporation, *supra*, n. 8, 503.

solely by the existence of a potential conflict between his clients, and the attorney's motives or intentions of honesty are irrelevant. The present state of the law is succinctly stated by the Maryland Court of Appeals:

"We have no doubt whatever that the lawyers who represented Butler and the insurance company were activated by honest, high and worthy motives and intent in taking their client Butler's deposition, but this is not the test for determining compliance with the Canons of Professional Ethics when a lawyer is confronted with the necessity of choosing between conflicting interests. The standards of the Canons require undeviating fidelity of the lawyer to his client and no exception can be tolerated."¹²

There are two other canons, both of which are mentioned by the Maryland Court, which are applicable to the lawyer's conduct in this situation. Canon 37¹³ provides that it is the duty of a lawyer to preserve his client's confidences, which duty outlasts the lawyer's employment.¹⁴ This canon, as amended in 1937, elaborates upon the provision of the original 1908 Canon 6, which stated the lawyer's "obligation to represent the client with undivided fidelity and not to divulge his secrets or confidences. . . ." "The reason for the rule lies in the fact that it is essential to the administration of justice that there should be perfect freedom of consultation by client with attorney without any apprehension of a compelled disclosure by the attorney to the detriment of the client."¹⁵

¹² *Supra*, n. 1, 12, See Van Dyke v. White, *supra*, n. 8, 437.

"The high professional standing of the attorneys employed by the respondent to represent White at the trial of the negligence action justifies the assumption that in so doing their motives and intent were honest, but this is not the test for determining a lawyer's conduct when confronted with the necessity of choosing between conflicting interests. The standards of the legal profession require undeviating fidelity of the lawyer to his client. No exception can be tolerated."

¹³ AMERICAN BAR ASSOCIATION, CANONS OF PROFESSIONAL ETHICS, *op. cit. supra*, n. 7, 21.

¹⁴ The privilege of nondisclosure of the client's communication to his lawyer, embodied in Canon 37, has long been part of the common law. *Winters v. Winters*, 102 Ia. 53, 71 N.W. 184, 185 (1897). Also see 8 WIGMORE (3d ed. 1961) § 2292. During the 16th cen. when the rule first appeared, it was apparently based on a consideration for the oath and honor of the lawyer, rather than for the purpose of quieting the fears of a client, 8 WIGMORE (3d ed. 1961) § 2290. Later and in more modern times it has been deemed to rest on the principle that it was important to promote freedom of consultation between legal advisers and their clients.

¹⁵ OPINIONS OF THE COMMITTEE ON PROFESSIONAL ETHICS AND GRIEVANCES, *op. cit. supra*, n. 6, Opinion 91, p. 202.

Canon 41 is also applicable, and presents the reverse side to the above mentioned rules,¹⁶ i.e., when and to whom an attorney may breach this duty of confidence:

"When a lawyer discovers that some fraud or deception has been practiced, which has unjustly imposed upon the court or a party, he should endeavor to rectify it; at first by advising his client, and if his client refuses to forgo the advantage thus unjustly gained, he should promptly inform the injured person or his counsel, so that they may take appropriate steps."¹⁷

The three canons taken together prescribe the principles by which a lawyer should be governed when he is faced with the problem under discussion. The New York Court of Appeals in a careful examination of the problem synthesized the rules as follows:

"The lawyer may not take up the cudgels of this insurance carrier, when its interests are diametrically opposed to the interests of the insured. . . . He is not required to participate in or to help in perpetrating a fraud, and if he is satisfied that his client is so conducting himself, it is his duty as an officer of the court to withdraw as counsel. He may not, however, take up the defense of the one upon whom the fraud is sought to be practiced, particularly where he has already received the confidence of his client."¹⁸

When a court determines that an attorney has breached his duty of professional ethics by simultaneously representing an insured and insurer whose interests conflict, the court must decide what if any penalty should be imposed against the insurance company because of the lawyer's conduct. It is important to remember that in most instances the insured's breach of the duty to cooperate would, if given full effect, avoid liability on the part of the insurer.¹⁹

The right of an insurance company to forfeit an insurance policy may be lost through the doctrine of waiver or

¹⁶ AMERICAN BAR ASSOCIATION, CANONS OF PROFESSIONAL ETHICS, *op. cit. supra*, n. 7, 22.

¹⁷ *Ibid.*

¹⁸ Schwartz v. Sar Corporation, *supra*, n. 8, 503.

¹⁹ The courts are divided as to the question of whether the burden of going forward with the evidence as to the non-fulfillment of the cooperation clause should be placed on the insured or the insurer. Practically, it makes little difference, for in any event it is a material part of the policy, and a breach of the provision by the insured, in a material respect (see *supra*, n. 18) constitutes a defense to liability on the policy by the insurer in the absence of waiver or estoppel. See Glen Falls Indemnity Co. v. Keliher, 88 N.H. 253, 187 A. 473, 475 (1936); 29A AM. JUR. 583, Insurance, § 1471.

estoppel.²⁰ While these principles have importance throughout the law,²¹ they take on added significance in the law of insurance. When applied to insurance they are frequently treated as synonymous, and as denoting similar concepts, or, in some instances, complementary concepts. In fact, however, there is a well recognized distinction between the two that is rigidly adhered to in the more carefully reasoned opinions.²² Waiver connotes a voluntary agreement, express or implied, to relinquish a known right.²³ Estoppel is not based upon contract, but rests instead on the principle, that where one party has by his representations or his conduct induced another party to a transaction to give him an advantage which would be against equity and good conscience for him to assert, he would not in a court of justice be permitted to avail himself of that advantage.²⁴ When a court recognizes a waiver it is carrying out the intention of the party who is waiving. On the other hand, when an estoppel is enforced the inequitable intent of the party estopped is defeated. It is possible that the same conduct may constitute both an implied waiver and an estoppel. Whether or not the equitable doctrine of estoppel applies depends upon the facts of each particular case.

The decisions which have considered the doctrines of waiver and estoppel as applied to the factual situation presented by the case being noted, are divided. In the principal case, the Maryland Court of Appeals did "not think that the insurance company . . . waived its right to disclaim liability . . . or became estopped to do so."²⁵ The Court's attitude was that the "insurer, through its own claim investigator, or through counsel who did not represent Butler, could have ascertained what Butler disclosed to his lawyers,"²⁶ if in fact it hadn't already become aware of

²⁰ *Commonwealth Casualty Co. v. Arrigo*, 160 Md. 595, 154 A. 136, 77 A.L.R. 1250 (1931). *Royal Ins. Co. v. Drury*, 150 Md. 211, 132 A. 635, 45 A.L.R. 582 (1926).

²¹ "In probably one-third to one-half of the law suits between insured and insurer involving the validity or unenforceability of the contract, it is claimed by the insured and denied by the insurer that the latter has waived a defense that it is now asserting." PATTERSON, *ESSENTIALS OF INSURANCE LAW* (1935) § 93, p. 418.

²² VANCE, *INSURANCE* (3d ed. 1951) 475 and cases listed in n. 17 therein. Note also that Vance considers that the majority of the courts treat the concepts as synonymous (cases listed in n. 21 to p. 475).

²³ *McFarland v. Farm Bureau Mutual Auto. Ins. Co.*, 201 Md. 241, 93 A. 2d 551 (1952); *Royal Ins. Co. v. Drury*, *supra*, n. 20.

²⁴ See *Gould v. Transamerican*, 224 Md. 285, 294-297, 167 A. 2d 905 (1961) for definition and distinction between waiver and estoppel.

²⁵ *Fidelity Casualty Co. of N.Y. v. McConnaughy*, 228 Md. 1, 12, 179 A. 2d 117 (1962).

²⁶ *Ibid.*

Butler's fraud in taking the deposition of the witness whom Butler had procured to testify falsely in his behalf.

The conclusion of the Court of Appeals is contrary to the majority of decisions which have dealt with the issue. In the leading case of *Allstate Ins. Co. v. Keller*,²⁷ an opposite result was reached. There the insured had breached the cooperation clause of his policy by falsely stating that he and not his girl friend had been driving at the time of the accident. Approximately nine months later the insured gave a correct version of the accident to the insurer. Thereafter, the insurer's attorneys took the deposition of the insured who repeated the correct version of the accident. At the trial of the case the attorney who had been employed by the insurer admitted that he had taken the insured's deposition for the purpose of subsequently using it against him. The Court held that because of the conduct of the attorney the insurance company had waived the breach of the cooperation clause.²⁸

The applicability of waiver or estoppel being imposed against an insurance company due to unethical conduct on the part of its attorneys has also been carefully examined by the New York courts — the most recent case being

²⁷ 117 Ill. App. 2d 44, 149 N.E. 2d 482 (1958). The Maryland Court cited this case with approval for the proposition that the attorneys acted unethically.

²⁸ The Allstate case lists three analogous cases as authority for their decision, the first two of which are also cited by the Maryland Court. In *Helm v. Inter-Insurance Exchange for Auto. Club*, 354 Mo. 935, 192 S.W. 2d 417, 167 A.L.R. 238 (1946), the attorneys learned during *voir dire* that the insured was only fifteen and thus not covered by the policy which was limited to those sixteen years and older. During recess this information was confirmed and the attorneys withdrew from the case. On appeal, the Missouri Supreme Court quoted Canon 6 and upheld the trial court's ruling that under the circumstances granting leave to the lawyer to withdraw was the proper action. In *Hammett v. McIntyre*, 114 Cal. App. 2d 148, 249 P. 2d 885 (1952), an attorney hired by an insurance carrier represented both the insured automobile owner and a driver of the owner's automobile. The liability policy contained provisions extending coverage only to persons operating an automobile with the named insured's consent. Thus, when an answer was filed on behalf of insured that the automobile in question was driven without his consent, and the driver denied this allegation, it was held that the driver, due to the conflict of interest on the part of the lawyer representing him, had been deprived of a fair trial essential to due process. In *Reynolds v. Maramorosch*, 208 Misc. 626, 144 N.Y.S. 2d 900 (1955) an action based upon negligence in an automobile accident was brought by two unemancipated infants against their father. The attorneys, who were furnished by the insurance company to the father, without getting authorization from the father, filed a motion to dismiss the suit on the grounds that unemancipated infants in New York may not maintain an action for ordinary negligence against their parents. The company's motion to dismiss was held not to be properly before the court, because of an affidavit filed by the father that denied the attorneys the authority to file such a motion. The court held that this affidavit created a conflict of interest for the attorney, and thus placed him under a disability.

Schwartz v. Sar Corporation.²⁹ There, an attorney hired by the insurer became suspicious of possible collusion between the insured, who was the defendant and driver in an automobile accident case, and the injured plaintiff, who was his uncle. After a personal investigation the lawyer issued an affidavit charging his own client, the insured, with attempting to commit a felony, attempted larceny, perjury, and conspiracy with the plaintiff to defraud. The Court held that regardless of the truth or falsity of these charges the insurance company had, by continuing with the defense of the insured through an attorney who was obviously working against the insured's best interests, committed an act which "undoubtedly amounts to a waiver of a later claim of non-liability."³⁰

The most recent analysis of the problem, excluding the instant case, was in 1960 by the Washington Supreme Court in the case of *Van Dyke v. White*.³¹ In finding a waiver of the insured's breach of the cooperation clause because the insurer had continued the defense of the assured in spite of

²⁹ 19 Misc. 2d 660, 195 N.Y.S. 2d 496 (1959). The Schwartz opinion relied heavily on *American Employers Ins. Co. v. Goble Aircraft Sp.*, 205 Misc. 1066, 131 N.Y.S. 2d 393 (1954). There an attorney paid by a casualty company, undertook the defense of a policyholder, and in doing so attempted to save the company money by not bringing in all possible witnesses expert and lay, who could help his client. The Court held that the lawyer's first duty was to his client and that every effort should be made in his behalf, even if this increased the cost to the insurer beyond the limit of the policy coverage. The Goble case in turn relied on *Loew v. Gillespie*, 90 Misc. 616, 153 N.Y.S. 830 (1915).

³⁰ *Schwartz v. Sar Corporation*, *supra*, n. 29, 504.

³¹ 55 Wash. 2d 601, 349 P. 2d 430 (1960). The Van Dyke case makes a reference to a factor which frequently has a controlling influence on a court's decision as to the applicability of the doctrines of waiver or estoppel, i.e., the absence (as in the Van Dyke case) or presence, of an assertion of a reservation of rights on the part of the insurance company. Where an insurance company, usually through its attorney who is representing the insured, notifies the insured that its continued control of the defense of his action is only an exercise of its rights under the policy and is not a waiver of any of its defenses against the insured, the courts will not raise a waiver or estoppel. Thus, if an insured breaches the cooperation clause of an automobile liability policy, and thereafter the insurer and the insured expressly agree that a continuation in the defense of the suit by the insurer shall not be construed as a waiver of the insurer's right to deny liability under the policy, the act of the insurer is not a waiver of the breach of the cooperation clause of the policy. *Hardware Mutual Casualty Co. v. Mitnick*, 180 Md. 604, 26 A. 2d 393 (1942). As to the proper form required for an insurer to reserve its rights to contest liability under a policy, there is almost no statutory law and very few cases on point. There is nothing "which requires such notice on the part of an insurer, . . . to be in the form of a non-waiver agreement, or in any particular form. All that seems to be required is notice to the insured that the insurer will defend under a reservation of its rights." *Van Dyke v. White*, *supra*, 434, (emphasis added) quoting *Associated Indemnity Corp. v. Wachsmith*, 2 Wash. 2d 679, 99 P. 2d 420, 426, 127 A.L.R. 531 (1940) which held that notice to the lawyer of the insured was not sufficient to prevent a waiver.

the insured's refusal to attend trial, the Washington Court also states that "there is another compelling reason why respondent waived its defense of non-cooperation. . . ."³² When the defendant left the state and failed to appear for trial his attorney had the choice of asking for a continuance or proceeding with the defense of the case without the insured and he chose the latter. "Obviously this choice was to improve its own position in any future attempt to enforce liability under the policy. At this point, whom did the attorney, employed by respondent [the insurer] to defend the action, represent, the policyholder . . . or the respondent?"³³ In answering its own question, the Court concluded that he was in fact primarily representing the insurer.³⁴

The majority of the courts favor imposing a waiver or estoppel on the insurance company when an attorney who it has employed breaches the principle embodied in Canon 6 of the Code of Professional Ethics. This approach should have great success in curtailing the present day abuses which exist in this area, and it is hoped the courts of Maryland will restrict the instant decision to its exact facts. The Court of Appeals left the door open to this by its favorable recognition of the cases elsewhere and its decision of the instant case on its peculiar facts.

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³² Van Dyke v. White, 55 Wash. 2d 601, 349 P. 2d 430, 435 (1960).

³³ *Id.*, 436.

³⁴ The dissent in Van Dyke decided the case on the issue of whether the injured party who has recovered a judgment against the insured, can assert the rights of the assured. While the Van Dyke dissent answered this in the negative, the majority and, it is submitted, better rule allows the injured party the identical rights against the insurance company as the insured. Thus, if the policyholder has breached the cooperation clause of his policy, the injured party cannot recover from the insurer of the policy; however, if the insurer has waived or become estopped to assert this breach against the policyholder, it is also denied the right to assert the breach against the injured party. The issue raised by the Van Dyke dissent is rarely considered by the courts as applied to the area under discussion. See 29A AM. JUR. 605, Insurance, § 1496 for support of the majority approach.