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Conflicts of interest involving the insurer, the defence lawyer and the insured

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Article abstract

La possibilité de conflits d'intérêt en assurance, voilà le sujet traité sous les aspects du Code civil et de la Common Law, par deux des avocats qui ont pris part à La journée du Droit des assurances sous les auspices du cabinet Ogilvy Renault, le 21 mai 1987. C'est avec plaisir que nous présentons les deux travaux, après avoir obtenu l'autorisation des auteurs et de leurs hôtes. Il y a là, croyons-nous, d'excellentes études sur un problème très sérieux, tant pour l'assureur que pour l'assuré.

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I – The Quebec Law, by Mr Mindy Paskell-Mede

Over the past few years, there have been a handful of Quebec cases discussing the insurer's duty to defend under Quebec Law and the problems encountered by the attorney appointed by the insurance company to act on behalf of the assured defendant. The purpose of this paper is to review these cases in an attempt to discover any judicial trends which can be gleaned from them and to suggest ways in which the cases may be reconciled with each other and with general principles of insurance law.

Before embarking on a discussion of the problems involved, we must situate ourselves with reference to article 2604 of the Civil Code (of public order by virtue of article 2500 C.C.) which imposes on a liability insurer the obligation to issue a *defence* policy rather than an *indemnity* policy :

> "Subject to other legislative provisions, the insurer is bound to take up the interest of any person entitled to the benefit of the insurance and assume his defence in any action brought against him."

As a result, the insurer is obliged to appoint a defence attorney to act on the assured's behalf and the assured, as is to be expected,

depends on that attorney for legal advice relating to every issue raised by the lawsuit. Although coverage issues *per se* are not necessarily raised in the lawsuit, certain allegations of fact might very well raise them. Moreover, since the defendant is obliged to file an appearance within 10 days of having been served with the writ and since it is often the case that notification of the service might not reach the insurer until much, if not all, of that delay has expired, there is, in practical terms, little time in which the insurance company can make an informed decision as to coverage before appointing a defence attorney.

Given the lack of time available to the insurer to investigate the facts which might have a bearing on coverage, to obtain legal advice, if necessary, and to reach a decision, the insurer often feels constrained to appoint defence counsel and take whatever procedural steps are necessary to protect the defence position before it can be certain that coverage is indeed available. The insurer must not only consider the obligations imposed by article 2604 of the Civil Code, but recognizes that, to the extent that there is entitlement to insurance coverage, its own interests dictate that the assured receive the best defence possible. In other words, providing the assured with a defence is a right as well as a duty.

Put briefly, conflicts of interest arise because although it is in both the assured's and the insurer's best interests that the defence position prevail in the underlying litigation, they are adversaries with regard to any contentious coverage issues. In some cases, the coverage issues arise out of facts which are not contested in the underlying litigation (such as, for example, breaches of policy conditions, such as late notification of the claim or non-disclosure of information to the insurer). At other times, the facts in dispute are the very points on which coverage issues will be joined (for example, when the plaintiff alleges behavior which would give rise to a justified denial of coverage either in virtue of an exclusion clause or an article of the Civil Code).

Decision to defend

Many of the problems which flow from this situation are evident. First, problems arise as soon as the insurer is notified of a claim which gives rise to doubt as to coverage. For example, the declara-

tion might allege facts which, if true, would relieve the insurer of its obligations, but the assured might deny those allegations.

On this point, the case of *Filion v. La Sécurité, Compagnie d'assurance générale* (1986), R.J.Q. 1449 (appeal pending) held that the insurer must take up the defence of the assured in any action instituted against it regardless of whether the allegations, if true, would bring the claim directly within the scope of an exclusion. In that case, the assured was accused of having committed a fraudulent act. This was not only within the scope of an exclusion, but, pursu-
332 ant to article 2563(2) of the Civil Code, the insurer would not be bound to indemnify the assured for fraud. Despite this, the Court held that the defence to the proceeding which would force the insurer to defend the assured based on the policy exclusion was not valid. We are of the view that of all the reasons given by the Court, its comment that the assured must be given the benefit of the doubt is the one most in tune with principles of civil law in general and insurance law in particular. Certainly, if the assured himself denies that he has committed fraud, one can see how, from his viewpoint, any result other than one which imposes an obligation on the insurance company to pay for the defence is unfair.

However, a host of other problems might arise subsequently as the evidence on the issue of fraud unfolds. It might very well be that the Court in the case of *Commission scolaire Grande-Hermine v. Équipement Turbide Ltée*, J.E. 86-967 had these other problems in mind when it disagreed with the interpretation of article 2604 of the Civil Code given by the *Filion* case, stating quite clearly that the obligation to defend is owed only to those assureds who are actually covered and who meet the terms and conditions of the policy, rather than all of those who are named as assureds. Therefore, held the Court, an insurer is relieved of its obligation to defend when it has *prima facie* proof that the terms or conditions of the policy had been breached.

A similar approach was taken in the case of *Madill v. Joncas*, J.E. 85-1002, in which an insurer was permitted to refuse to defend the assured because the latter did not give timely notice of the loss

and did not cooperate in the insurer's investigation of the facts. The Court held as follows :

> "Article 2604 of the Civil Code does not apply in this situation since by refusing to cooperate, the assured lost its rights to the insurance. Indeed, the insurer, upon the refusal of the assured to cooperate, has reason to assume that this refusal is definitive and that the assured would not even be present at the trial. In consequence, it would be illusory for the insurer to appear to contest. It would be unnecessarily costly for the insurer to do so since, in so doing, it would incur costs and risk appearing to have renounced its rights to deny coverage in the eyes of the assured and third parties". (our translation)

In sum, then, these cases seem to lead to the conclusion that although it is possible for an insurer to refuse to defend an assured because no coverage is available, it is very difficult to know on what facts such a decision can legitimately be based. Obviously, the decision is more easily reached if it results from facts which are not contested in the underlying litigation. However, there remains the possibility that the facts giving rise to the coverage issues, although not contentious in the underlying litigation, are indeed contentious as between the assured and the insurer and the assured might once again be of the view that he is being unjustly denied a defence. The situation becomes even more complex, however, when the very facts in dispute in the litigation give rise to a coverage issue. In all these circumstances, the risk the insurer runs by not providing the assured with a defence is that the judgment will go by default and there will be liability on the assured (which might eventually be determined to be the responsibility of the insurer) which might have been avoided with an adequate defence.

From a practical viewpoint, then, the insurer must make a very quick decision to whether it wishes to take up the defence, having in mind many different considerations. If it refuses to defend and as a result the assured is financially incapable of defending itself properly, the insurer has missed an opportunity to reduce the amount of damages for which it might be liable. If, on the other hand, it grants the assured a defence and it is ultimately determined that it was under no obligation to do so, the assured might be unable to reimburse the insurer for those costs. Indeed, there is no definitive authority which states that the insurer would be entitled to reimbursement of

these costs from the assured, although we are satisfied that this is the only logical result.

Discovery of new facts

On the assumption that a decision has been made by the insurance company to provide the assured with a defence, an attorney is appointed who necessarily has an allegiance both to the assured, for whom he is attorney of record, and the insurer, who is paying his fees and who is likely a longstanding client.

334 It is likely the case that the insurer's original decision was based on an assessment that coverage was available. However, after the appearance is filed, further information might come to light which causes the insurer to change its mind. As indicated in the *Commission scolaire de Grande-Hermine* judgment, the insurer may appear to have renounced its rights to invoke these grounds by having taken up the assured's defence. To prevent this, insurance companies developed the practice of having their assureds sign non-waiver agreements or explicitly reserving their rights to deny coverage at a later date. Indeed, these options were suggested by the Court of Appeal in the case of *Stevenson v. Brique Champlain Ltée* (1943), B.R. 196.

However, in 1984, the Quebec Court of Appeal created doubt as to the efficacy of such protective measures in the case of *The Citadel General Assurance Company v. Wolofsky* (1984), C.A. 377. In that case, the insurer's attorney filed an appearance immediately upon learning of the suit taken against the assured. Soon afterwards, the attorney and a representative of the insurer met with representatives of the assured to discuss the facts giving rise to the claim. At that meeting, a non-waiver agreement was signed. Apparently, it was during the course of that meeting that the attorneys discovered that the notification given to the insurers had been late. As a result, they ceased to represent the assured and the assured eventually took warranty proceedings against the insurer. Problems arose when the same firm of attorneys appeared on behalf of the insurance company to defend the warranty proceedings.

Of interest in the decision is that the Court of Appeal upheld the trial judgment without commenting on one of the holdings of the trial judge, namely, that the insurance company could not make use of the information obtained at the meeting which gave rise to the

denial of coverage. We are satisfied that there is no juridical theory on which such a holding could be based. Indeed, the opposite result was achieved in the subsequent Court of Appeal decision in *Société d'assurance des Caisses Populaires v. Hains*, J.E. 86-1015 in which Mr. Justice McCarthy, who was in dissent on the substance of the coverage issues raised, addressed the issue of estoppel and held that the insurer had not waived its rights to deny coverage simply by filing an appearance on the assured's behalf.

On a factual level, one of the major differences between these two cases is that in the *Hains* decision the Court found that the assured had been warned from the outset in a clear and precise manner that insurance coverage was in doubt. Perhaps, then, one lesson to be drawn is that insurers who wish to reserve rights to deny coverage later should do so with specific reference to the coverage concerns which they have. Unfortunately, this is not always realistic since the insurance company itself might not know what issues will arise until after the appearance has been filed.

We are somewhat concerned that none of these judgments discuss clearly the role of the assured's obligation to make full disclosure of all relevant facts to the insurer. In other words, the assured is duty-bound to tell the insurer the entire truth, even if that truth would jeopardize his coverage. Indeed, it is precisely because each party to the contract is obliged to act in the interests of the other that the joint attorney finds himself with severe difficulties.

The second difficulty raised when an attorney appointed by an insurance company discovers a previously unsuspected coverage problem was also discussed in the *Wolofsky* judgment. The problem is that of the professional secret. Indeed, the focus of the Court of Appeal judgment in *Wolofsky* was with regard to the professional secret and the appropriate exchange of information which might take place between the assured and the insurer through the conduit of their common attorney. The Court held that when an insurance company has an obligation to defend an assured, that obligation includes any right attendant on the solicitor-client relationship. Among those rights is the right to a professional secret and therefore the attorney was not at liberty to disclose to the insurers facts which might give rise to a denial of coverage. Although we have no quarrel with the characterization of the relationship between the attorney

and the assured as being one of a solicitor-client nature, we question the application of the rule of professional secrecy in this matter.

First, it appears from the judgment that the meeting in question at which the facts giving rise to the denial were discovered was attended by an adjuster. Since the adjuster was the insurer's representative, we are of the view that there never was a *secret* to be protected.

Second, and of more difficulty, is the problem of whether there is a deemed waiver of the professional secret in the circumstances.
336 Normally, when two individuals retain the same attorney to defend a common interest (such as codefendants to a lawsuit), one might assume that each waives the professional secret with regard to the other. In other words, there appears to be no difficulty in having that common attorney share information as between his clients. Of course, that attorney is under an obligation to refuse the mandates if he perceives a conflict of interest and he must cease acting as soon as an unforeseen conflict arises. However, this does not resolve the issue of what must be done with the information obtained in a good faith execution of a mandate prior to the recognition of the conflict and which information itself gave rise to the conflict. Are both clients entitled to that information on the assumption that the original deemed waiver of the professional secret as between the two parties is still in place ? Obviously, the attorney is placed in an impossible position. He cannot divulge the information learned from the assured to the insurer without jeopardizing the assured's position and he cannot refrain from divulging that information without jeopardizing the insurer's position.

We are of the view that the attorney can advise both clients that he has found himself in a conflict of interest as a result of information learned in the course of his joint mandate which has prevented him from continuing to act for either party. Both the assured and the insurer should seek new counsel and presumably the insurer will mount a further investigation before making up its mind whether to continue to defend the assured. Unfortunately, the insurer is caught in a position where litigation is ongoing and it does not know why a coverage problem has arisen and therefore might not be able intelligently to reserve its rights or mount an investigation.

Once again, the insurer might be entitled to argue that as a result of the assured's obligation to act in good faith and make full disclosure to the insurer, it can ask the assured point-blankly the very questions which would uncover the information learned by the attorney, and the assured would be obliged to respond truthfully.

Litigation on the merits

A third set of difficulties arises even when both the assured and the insurer agree from the outset that there are coverage problems and, moreover, agree on the nature and scope of these problems. For example, it might very well be the case that coverage depends on a specific determination of fact (for example, whether a series of acts of the assured are sufficiently related to count as one occurrence, the time and place of the commission of negligence in a situation in which the assured denies that any negligence at all was committed, whether the assured's intent amounts to fraud, etc.). Sometimes, a single legal issue can be both favourable and unfavourable to the assured depending on whether one is approaching the matter from the viewpoint of his liability or from the viewpoint of the availability of coverage. In these circumstances, an attorney acting as defence counsel appointed by the insurer is in a conflict situation if he owes any allegiance at all to the insurer. That attorney will present evidence to the Court and argue for specific characterizations of the evidence. He cannot do so without jeopardizing the rights of one of his clients.

These difficulties are compounded if the trial judge does not deem it necessary to render an opinion on the disputed fact because he can render a decision on the liability issues without reference to it. Similar difficulties arise if the underlying litigation is settled for reasons unrelated to the parties' assessment of those factual disputes. The insurer might never find out whether it indeed owed a duty to defend or was ultimately entitled to deny coverage. Where the amount at stake is sufficiently great, the insurer might choose to retain two independent attorneys : one to take up the defence interests without regard to coverage issues and one to oversee the litigation and advise the insurer with regard to insurance problems.

Settlement

Finally, even when it is clear from the outset that there are no contentious coverage issues and that the interests of the assured and the insurer converge with regard to the carriage of the defence, it might be difficult for the two to arrive at a common accord with regard to settlement, particularly when an offer is made at an amount close to the deductible or close to the limits of the policy.

Let us assume, for example, that the assured has a policy with a deductible of $5,000 and the case would cost $20,000 to defend. Any
338 offer less than $10,000 might be attractive to the insurer but the assured might not want to settle the claim, satisfied of his own innocence. Similar problems might arise at the opposite end of the spectrum. An assured might be sued for an amount well in excess of the policy limits. The insurer, who believes that there is a defence to the action on the merits, would not be tempted by an offer to settle which approached or exceeded the limits of the policy, since it risks nothing more by going to trial and hoping for a judgment in the assured's favour. The assured, on the other hand, would prefer to see the matter settled at the policy limits, even if this were, indeed, more than what the case was worth, simply to avoid running the risk of an adverse judgment which would exceed the limits.

In our view, the same solution applies to both difficulties. The parties must try, as much as possible, to arrive at an assessment of the settlement value of the case without regard to their individual economic interest. In other words, both must look at the claim and the offer of settlement as if they were solely on the risk and make a decision accordingly. Unfortunately, although this is theoretically sound, it is not unusual for two persons to disagree as to an appropriate settlement value and both will look to the defence attorney for recommendations.

Summary

In conclusion, we are of the view that defence counsel appointed by insurers must take as many precautions as possible to avoid conflicts of interest. However, not all conflicts are avoidable and there will inevitably be instances in which attorneys will have to withdraw from files, at a disadvantage both to the assured and the insurer. Both the assured and insurer must recognize that the attorney

owes a duty to the other and must make every effort to discuss as openly as possible the difficulties which might arise and come to an amicable solution on those issues. If either of the parties to the insurance contract is of the view that its rights would be compromised by sharing counsel with the other, independent counsel should be retained, since this is the only way of ensuring that the defence interests are being adequately protected without jeopardizing either party's position on coverage.

II – The Common Law, by M[r] Steven Stieber

Can two masters be served ?

Section 214(b) of the Insurance Act, R.S.O. 1980, c. 218 provides that every contract of auto-liability insurance shall include a term that "the insurer shall. . . defend in the name and on behalf of the insured. . . any civil action. . . brought against the insured". In the course of fulfilling the contractual obligation to the insured, the insurer will retain a lawyer. Is that lawyer's client the insurance company which has retained him or is it the insured who is the defendant in the lawsuit, or are both his clients ?

Traditionally, the insurer has held the view that counsel retained by it to defend the insured has undivided loyalty to and owes duties to no one else other than the insurer. Why should this be otherwise considering that the Insurance Counsel is engaged and paid by the insurer ? There is usually a long standing relationship with the insurer who, as in the past will continue to send business in the future. On the other hand, counsel's relationship with the insured is usually transitory and limited to the defence of the specific lawsuit.

From the insurer's perspective, counsel is expected to investigate all issues relating to coverage and if at any time facts come to light which might result in a denial of coverage, counsel is expected to immediately report these matters to the insurer. Furthermore, counsel is expected to report only to the insurer who will provide any instructions relating to the proper conduct of the lawsuit.

Although the American position has been quite clear for some time, the position in Canada has recently become firmly established in cases decided by the Ontario Supreme Court as well as the British Columbia Court of Appeal. These authorities clearly indicate that not only is the insurer your client, but so is the insured. Counsel ap-

pears as the solicitor of record for the insured and the action is defended in his name notwithstanding that the insurer pays the bills. The relationship with the insured is that of solicitor and client and defence counsel owes to the insured the same duty of good faith as if he had been personally retained and paid by the insured.

In England, the Court of Appeal has found insurance counsel to be in breach of their duty to the insured by virtue of their admission of negligence contained in a statement of defence. In *Groom v. Crocker* (1938) 2 All E.R. 394, the court held that the insurance
340 policy entitled the insurers to nominate a solicitor to act in their conduct of the proceedings, to have control of the proceedings and to decide upon the proper tactics to pursue in the conduct of the action "provided that they did so in what they considered *bona fide* to be the common interest of themselves and their insured". However, the insurers were not entitled to allow their judgment as to the best tactics to pursue to be influenced by their desire to obtain for themselves some advantage altogether outside the litigation in question, with which the insured had no concern. It was held that the solicitor had not acted *bona fide* in the common interests of their insurers and the insured and was liable for nominal damages.

In a recent Supreme Court case of *Paupst v. Henry*, 3 C.C.L.T. 1, it was held that a solicitor had no right to accept service of a writ of summons or to enter an appearance on behalf of an insured without first obtaining his instructions to do so. Instructions from the insurer were insufficient. It was held that the solicitor appointed by the insurer has a duty to the insured to protect his rights which was totally independant of their duty to the insurer.

Mr. Justice Catzman in a case in the Ontario Supreme Court of *Pelky v. Hudson Bay*, 35 O.R. (2d) 97, took an interesting approach to the issue of the relationship between the insured and counsel.

In this case, the claim was in excess of policy limits but an offer to settle was made within the policy limits. The lawyer retained by the insurer failed to communicate a settlement proposal received to the insured for its instructions. In finding for the plaintiff his Lordship said the following :

> "While I have found that, at the material time, a solicitor/client relationship existed between Erickson and the plaintiffs, I apprehend that the result would be the same even in the absence of

such a finding for, in all of the circumstances, Erickson placed himself, in my view, in "a sufficient relationship of proximity" that he incurred a duty of care to the plaintiffs and, in failing to see (and, according to the evidence obtain) instructions to settle the actions at the policy limits, he was in breach of such duty.

It was not necessary to consider whether an insurance company owed a duty to settle within its policy limits. In this case, liability could be imposed for the failure to submit the settlement offer for consideration. The evidence established that both the plaintiffs and R. would have accepted the settlement offer, had it been tendered". *341*

In the usual insurance action, wherein the claim is within the insurance limits and there are no grounds for denying coverage, the pecuniary interest at stake is that of the insurer – not the insured. In such cases, the insured has virtually no interest in the outcome of the proceedings because he knows the insurer will indemnify him in any event of the result.

When a conflict of interests between the clients arise, counsel is obliged to promptly inform both the insurer and the insured of the nature and the extent of the conflicting interests and either withdraw from both relationships or under certain circumstances, continue to represent one of the clients. However, he cannot continue to represent both clients without the informed consent of each client and only if competent representation of each interest is still possible. Under either option, if the solicitor continues to represent the insured, he owes the insured the same professional obligations that would exist had he been personally retained by the insured.

There are many situations where this conflict is not that readily apparent and the distinction between a mere diversity of interest which does not amount to a conflict and actual diversity is blurred. In my view, the test for identifying conflicting interests is objective ; the lawyer's honesty, good faith or motives are legally irrelevant.

Legal representation by one counsel is usually harmonious and equally beneficial to both the insurer and the insured. There are certain situations where it is obvious that a conflict exists requiring separate counsel for each. Where the claim exceeds the policy limits, a clear conflict may arise where a settlement offer is received within

the policy limits. Coverage problems arising during the course of an action may place counsel in a position of conflict.

I would like to explore three areas of what may be a diversity of interest or actual conflict and how these situations can be dealt with :

1. insured requests copies of your counsel's reporting letters and/or does not want counsel even to write to the insurer ;
2. situations involving coverage ;
3. settlement of claims.

I – Insured requests copies of your counsel's reporting letters and/or does not want counsel even to write to insurer

As between defence counsel's two clients, there is no confidentiality as to communications directed towards the defence of the action. It is suggested that by having a common solicitor, parties effectively waive their normal solicitor client privilege. The Law Society of Upper Canada in its Rules of Professional Conduct which govern all Ontario lawyers provides that :

> "Before the lawyer accepts employment for more than one client in a matter or transaction, the lawyer must advise the clients concerned that he has been asked to act for both or all of them, that no information received in connection with the matter from one can be treated as confidential so far as any of the others are concerned, and that if a conflict develops which cannot be resolved, he cannot continue to act for both or all of them, and may have to withdraw completely".

It would thus appear that one consequence of characterizing both insurer and the insured as clients of the solicitor would be to remove the solicitor-client privilege as between the clients. Therefore, the insured must recognize that counsel has two clients to serve and each is entitled to receive communications and reports emanating from his office.

II – Situations involving coverage

Where the insured discloses to defence counsel facts or information which indicate a lack of coverage and the disclosure is made under circumstances indicating that the insured believes the disclosure will not be revealed to the insurance company but will be

treated as a confidential communication to the solicitor, then the disclosure should not be revealed to the insurer by counsel. In the same breath, neither should counsel discuss with the insured the legal significance of the disclosure nor the nature of the coverage question.

The insured is entitled to assume that his communications with counsel will be accorded the same treatment as his communications with his own personal solicitor. Accordingly, insurance counsel may not communicate to the insurer facts or information learned during the course of the solicitor/client relationship which are detrimental to the insured in the coverage dispute.

However, in my view, this prohibition upon non-disclosure does not apply where the facts giving rise to the denial have been learned by the insurer and their counsel in a non-confidential communication such as :

a) information independently learned from a witness ;

b) examination for discovery of the insured ;

c) examination for discovery of third party.

It has been suggested that perhaps this problem can be avoided in its entirety by writing to the insured and have him consent at the outset that nothing said by him is of a confidential nature and may be passed onto the insurer.

It is important to look at the stage to which the claim has advanced as to a large extent this will determine what should be done and the failure to do so may later prevent the making of a denial.

1. Initial stages of investigation by adjuster

The cases which I shall be referring to point out the importance of keeping in mind the following rules :

a) proceed with a non-waiver agreement or reservation of rights, whenever coverage problems are suspected ;

b) deny as soon as you become aware of a policy violation or any facts which might lead to a denial of coverage.

In the case of *Zed v. Barristers Society of New Brunswick*, 1 A.C.W.S. (3d) 285, the insured, following one and one-half years of investigation and negotiation on behalf of the insured, although

aware of a policy violation, purported to deny coverage. The Court held that in the circumstances, the insurer was estopped from denying coverage.

2. Retainer of counsel but prior to the filing of any legal proceedings on behalf of insured

It is necessary that you ensure that the insured understands that at this stage you are acting on behalf of the insurer. It may also be prudent to have the insured's own counsel present or at least invite him to attend any meetings with the insured at which facts may

be learned which may subsequently be relied upon to support a denial of coverage.

3. Following delivery of notice of intent

In a recent decision of the New Brunswick Court of Queen's Bench in *Rowe v. Mills*, 21 C.C.L.I. 112, the insured had failed to give notice of a snowmobiling accident, notwithstanding the condition in his C.G.L. policy. Counsel retained on behalf of the insurer filed a notice of intent to defend and the adjuster continued his investigation. It was held that the insurer was not allowed to investigate the facts surrounding the accident and at the same time conduct an investigation as to whether there existed proper grounds for repudiation of the contract. The proper course of action would have been for counsel to enter an appearance and then write to the insured advising of its investigation and the possible breach and reserving its rights in the interim. By not doing this, the insurer had waived its rights to repudiate.

4. During course of litigation

It is my view that during the course of litigation, all communications between the insured and the insurance counsel are confidential. If facts are learned at this phase which may lead to a denial of coverage, you must, in my view, either :

a) withdraw if feasible ;

b) continue to act for insured if facing trial.

Disclosure by counsel of these confidences can prejudice the insurer and may result in an estoppel if its coverage defence. *Parsons v. Continental National Am. Group* (Ariz. 1976).

Accordingly, as soon as the insurer has knowledge of a breach of condition, he must either repudiate the policy and refuse to continue to defend or proceed on the basis of a non-waiver or reservation of rights. If the insurer continues to defend, it may constitute a waiter of the right it might otherwise have had to deny liability.

The facts of *Western Canada Association and Guarandian Insurance Company v. Parrett*, 61 S.C.R. 595, demonstrates the need to adopt the appropriate and timely action. In this case, a young woman working at a mangle in the insured's laundry was injured by her fingers being drawn into the rollers. There was a condition in the policy requiring all machines to be provided with guards failing which there would be no liability upon the insurer for injuries due to such neglect. During the trial, insurer's counsel learned for the first time that the machine was unguarded. Notwithstanding this revelation, he continued with the defence down to judgment wherein damages were awarded to the employee.

In an action by the employer against its insurer, it was held that the insurer having assumed and continued the defence with knowledge of the fact that the machine was unguarded had waived any right to dispute liability under the policy for such breach of condition.

Mr. Justice Anglin said the following :

> "On becoming aware of the fact which it now alleges excluded the insurer's liability, it had an election to repudiate liability to it and decline further to carry on his defence or to accept such liability and continue the defence. Its action in continuing the defence would seem to be unequivocal and to import an election to undertake liability upon its policy".

In the case of *Cadeddu v. Mount Royal Assurance Co.*, 1929 B.C.R. 110, the insured provided a statutory declaration to a third party adjuster practically admitting liability in breach of a condition of the policy. Insurance counsel learned of the statement upon the examination for discovery, but continued with the action through trial and judgment.

Mr. Justice McDonald set out the appropriate action required in the circumstances :

> "However, once the breach came to the knowledge of the appellant, it had to take a stand. The solicitor by continuing to defend after knowledge could only do so on the assumption that the policy was valid and subsisting. It was a representation by acts that the appellant would assume any judgment obtained within the limits of the policy. The solicitor's right to act at all only arose on the basis that the claim was within the policy unless there was an additional retainer from the respondent to act for him also.
> 346 Election may be by words or acts. The words were equivocal carrying a proviso but the action or conduct was unequivocal. If he had repudiated liability electing to stand on the breach of conditions, the respondent would naturally reconsider his position. He might seek a settlement knowing that he was in jeopardy and succeed in doing so for a less amount than the judgment finally obtained, or at all events, save further costs. What took place was in effect an agreement by conduct with the acquiescence of the respondent that the appellant would assume liability. I do not of course criticize the solicitor. He was possibly in doubt as to whether or not there was a breach and did not like to leave respondent to his own resources and was further influenced by the fact that he might succeed in defending the action in any event. But we are dealing with legal implications".

By reason of the action of the appellant in continuing to defend, the insured changed his position to his detriment. Therefore, the insured was estopped from relying on the condition.

III – Settlement of claims

Section 207 provides that every contract of insurance shall include a term that :

> "The insured shall not. . . interfere in any negotiations for settlement or in any legal proceedings".

In *Beacon Insurance Co. v. Langdale* (1939) Eng. C.A., the policy contained the usual clause giving the insurer conduct and control of the proceedings. The insurer settled without the express sanction of the insured but also against his view of what was reasonable. It was held that the insurance company had behaved with complete propriety.

Assume that immediately upon being retained to act on behalf of an insured, you receive instructions from the insurer to attempt to negotiate settlement and instructions from the insured that in no circumstances are you to discuss settlement with opposing counsel. Insured has $100,000 deductible and feels that there is no liability upon him. The insured is advised that pursuant to his policy of insurance the insurer may settle any claim or suit at its discretion. Whose instructions are to be followed ?

Promoting settlements are in the public interest. It is the lawyer's duty under our rules of professional conduct to advise and encourage clients to compromise or settle an action whenever it is reasonably possible. Accordingly, the first step would be an attempt by counsel to encourage his client to settle. Where these efforts are unsuccessful, it is my view that counsel having received conflicting instructions may not follow those received from the insurer to the prejudice of the insured. Even though the insurer pursuant to the insurance policy could not have been held liable for making the settlement, the lawyer may be in breach of his fiduciary obligations to one of his clients, namely the insured, by failing to follow his instructions.

The case of *Rogers v. Robson et al*, 74 Ill. App. 3d 467, 81 Ill. 2d 201, a decision of the Illinois Supreme Court illustrates the extent to which counsel may find himself in a difficult situation.

On February 4, 1972, the plaintiff sued Dr. Rogers alleging negligence in his care and treatment. Dr. Rogers' insurance carrier, Employer's Fire Insurance Company, retained the law firm of Robson Masters to represent Dr. Rogers in the medical malpractice action. While the action was ongoing, Dr. Rogers informed the law firm that he would not consent to any offer of settlement. Nevertheless, there was a clause in the insurance policy which granted Employer's the authority to settle without the consent of the insured. As the claim against Dr. Rogers involved about $400,000, Robson thought he was doing a great job by settling the medical malpractice action for $1,250. Unfortunately, Dr. Rogers was not informed in advance of the settlement nor was his consent obtained.

Dr. Rogers filed suit in 1977 alleging that he was damaged by the wrongful settlement which was effected without his express permission or knowledge. In an appeal to the Illinois Appellate Court

and thereafter, to the Supreme Court, it was held that the settlement of the medical malpractice suit by the lawyer without the insured's consent constituted a breach of the solicitor/client relationship. The insurer had the contractual right to settle the lawsuit without the consent of the insured and Robson argued that he was merely assisting the insurer in the implementation of the settlement. However, it was held that this did not relieve Robson of his obligations to his client, the insured, to provide full and frank disclosure of all material facts and circumstances.

348 The majority found that when Robson became aware that settlement was imminent, knowing that the insurance company desired to settle, and knowing Dr. Rogers had expressed unwillingness to cooperate in such a result, a conflict of interest arose which made it improper for Robson to continue to represent both Dr. Rogers and the Employer's Insurance without full disclosure. By continuing to represent both the insured and the insurer without disclosure, Robson had breached his ethical obligations to Dr. Rogers and was liable for any loss suffered because of the failure to disclose. The rational supporting such a conclusion was that the failure to inform Dr. Rogers of the proposed settlement foreclosed any alternatives otherwise available to the doctor. He could have consented to continued representation by Robson at the expense of the insurer with the likelihood that the case would be settled without his consent pursuant to the insurance policy. On the other hand, he could have released the insurance company from its obligations under the policy and defended the suit using his own attorney, bearing the risk of an adverse judgment. As a result of the failure of Robson to inform Dr. Rogers of these two alternatives, Dr. Rogers suffered damages consisting of :

1. deprivation of an opportunity to pursue successfully a malicious prosecution action against the plaintiff for bringing the medical malpractice action ;
2. loss of direct and referred surgical patients ;
3. increased professional liability insurance premiums resulting from the medical malpractice action ; and
4. additional legal fees in pursuing the action against Robson.

Ironically, defence counsel was in no way relieved of his solicitor/client obligation to the insured by the fact that he was merely as-

sisting the insurer in implementing its contractual right to settle without the consent of the insured. The mere fact that the insured instructed counsel not to settle imposed on counsel an obligation which, in some measure, overrode his ability to take and follow instructions from the insurer. Even though the insurer probably could not have been held liable for making the settlement, the lawyer who implemented the settlement on its behalf was held to be in breach of his fiduciary obligations to the insured.

Practical guidelines

The following guidelines are suggested in an effort to meet the desires of the insurer and at the same time enable counsel to deal with the conflict of interest position he may find himself in.

1. Defence counsel has an affirmative duty to create settlement opportunities during the course of the action and especially at the pre-trial, these opportunities must be explored.
2. In negociating a settlement, defence counsel must act in good faith.
3. Defence counsel must keep the insured promptly and fully informed concerning all settlement offers and demands that are received and his opinion concerning them.
4. Counsel must recognize when he is faced with a conflict of interest situation.
5. Both the insured and the insurer should be advised of the nature and extent of the conflicting interest and the insured should be invited to retain his own counsel (hopefully at his own expense) to represent his separate interests. Counsel must promptly and fully explain to each client the conflict, its adverse consequences, and any limitation imposed upon his representation to enable each to make a free and intelligent decision regarding the conflict.
6. If both the insurer and the insured agree to the same counsel continuing to act for both, and counsel believes that he can adequately represent the interests of each, then his retainer may be continued. However, he may not continue to act on behalf of both the insured and the insurer where the action on behalf of one client may adversely affect his representation of the other.

Conclusion

It is suggested that the creation of this tripartite relationship as between the insurer, the insured and counsel, creates the potential for situations of conflict. The insured recognizes that since he did not elect and appoint you, nor is he paying your fees, that you are basically the "insurance company's lawyer". Notwithstanding this degree of acceptance, lawyers should not be misled, but must understand that by assuming the defence of an action on behalf of an insured, the solicitor/client relationship is thereby created. Greater
350 difficulty may be encountered in convincing your client, the insurers that once coverage under the policy has been assumed, you may not be able to advise them if you learn of a breach during the course of the lawsuit. In fact, if you do report to the insurer a breach of the policy, the insurer may be estopped from denying coverage based upon facts disclosed by counsel.

It is suggested that a better understanding of this relationship and establishing guidelines to deal with situations of conflict will result in fewer situations of conflict and where they do arise their resolution can be easily achieved.

Le centenaire de l'Union Suisse

L'Union Suisse fête, en 1987, le centenaire de sa fondation. Son président, M. Buckhart Gantenbein, note ceci comme entrée en matière d'une très intéressante brochure consacrée au groupe :

> « Si nous nous arrêtons un instant, aujourd'hui, pour voir où nous en sommes, ce n'est pas pour faire orgueilleusement une rétrospective de nos succès, mais pour constater en toute dignité et humilité que notre Compagnie est saine au point de vue financier et technique et que nous disposons d'une direction, d'un personnel et d'agents dévoués et compétents ; cela nous laisse augurer de l'avenir avec optimisme et courage ».

L'Union Suisse, c'est le groupe de La Fédération au Canada. À la compagnie-mère et à sa société canadienne, nous offrons nos félicitations.