to act in their respective best interests even in the presence of a conflict between them.

At present, Canadian law does not provide clear answers or policy directives to insurers or defence lawyers about their obligations when a coverage issue arises in a liability claim against the insured. Until guidance is provided by the judiciary or regulators of the legal profession, insurers, insureds and defence lawyers will have to continue to protect their own interests without violating their ever increasingly muddled obligations to one another.

A recent and dramatic example of the pitfalls of the tripartite relationship can be found in the case of *Fellowes, McNeil v. Kansa General International Insurance Company Ltd.*[61] One of the issues raised in that case was whether a defence lawyer, appointed by a liability insurer pursuant to its contractual duty to defend an insured but not yet on the record, had an obligation to alert the insurer to the possibility of successfully denying coverage on the basis of information received from the insured. Both the trial judge and the Ontario Court of Appeal in that case held that a defence law firm should alert the excess insurer to a coverage defence by virtue of its "unfettered duty" to the insurer. This conclusion may be viewed as having turned on the particular facts of the case:[62] the opinions rendered by the Superior Court and the Court of Appeal did not address the developing principles and law concerning the tripartite relationship. The Supreme Court of Canada granted Fellowes McNeil's application for leave to appeal; however, the case settled before the appeal was heard. The legal profession and the insurance industry will therefore have to wait until another case that raises this issue comes along to obtain a level of guidance that is sorely needed.

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61. (2000), 22 C.C.L.I. (3d) 1, 138 O.A.C. 28 (C.A.), leave to appeal to the Supreme Court of Canada granted [2001] S.C.C.A. No. 543 (QL).

62. Ontario Court of Appeal decision, *ibid.*, at p. 23, para. 62. Madam Justice Weiler stated:

> As I have indicated, on his examination for discovery, McNeil admitted that Fellowes, McNeil ". . . was retained to protect Kansa's interests, as opposed to the insured's interests up and until [it] undertook the defence of the insured." McNeil's admission prevents him from asserting that he had a legal duty to Little at that time. McNeil's admission supports the trial judge's conclusion that, at the time McNeil read Little's examination for discovery, *he should have realized that it raised an issue of coverage and, given his unfettered duty to the insurer, should have reported this to Kansa.*
>
> (Emphasis added.)

Insurers understandably wish to retain control of the defence of their insureds. It is the insurers who bear the ultimate financial responsibility for indemnifying the insured. It is important for insurers to be able to retain lawyers whom they know and in whom they can repose their trust and confidence.

The debate over the tripartite relationship is only engaged when a problem arises. In the vast majority of cases, the defence lawyer defends the insured acting on instructions and directions from the insurer. Unless there are limits issues, the insured is barely involved in the process other than as a witness. The defence lawyer respects the insurer's billing guidelines and reporting requirements. Information gathered by the defence lawyer in the course of defending the insured is freely passed on to the insurer. The insured does not know about these things and has no need to care.

It is when a problem arises — a lack of insurance or a coverage issue, or perhaps (and more controversially) a directive from the insurer that may restrict the defence lawyer's ability to provide optimal service to the insured — that the delicacy of the tripartite relationship is exposed. It is in these situations that the courts will, if the trend of the American cases is indicative, put the interests of the insured first. Conflicts of interest inherent in the tripartite relationship will be resolved in favour of the insured. This is consistent, in our view, with the principles of utmost good faith. Good faith requires the insurer to afford its insureds an adequate defence. The insurer, in retaining counsel to defend an insured, is acting as the agent of the insured pursuant to the authority provided by the insurance contract. The defence lawyer is the embodiment of the insurer's discharge of its obligation to defend. If the interests of the insurer and the insured conflict, the insured's interests must prevail.

From the perspective of defence lawyers, they undoubtedly regard the insurance companies as their "clients" in the general sense. These lawyers may devote time and resources to cultivating the insurers' business and maintaining their relationships with them. But when the lawyer is retained to defend an insured, it can be seen that it is for the mutual protection of the insurer, the insured and the defence lawyer that only one solicitor-client relationship be recognized — that which is between defence counsel and the insured. This is so even if the defence lawyer is an employee of the insurer. The trend of the American cases, which we believe will spill over into other parts of the common law world, is to resolve conflicts that

arise in the context of the tripartite relationship by holding that the ultimate client is the insured, and that lawyers' ethical obligations to their clients trump the provisions of the contract between the insurer and the insured. To the extent that the insurer is made privy to the lawyer-client relationship that exists between the defence lawyer and the insured, it is because the insured has agreed through the insurance contract that the insurer should be able to receive otherwise privileged information and, indeed, to act as the insured's agent for the purpose of giving instructions to the lawyer. This actual or implied right of the insurer is qualified to the extent that it cannot conflict with the lawyer's professional obligations to his or her client, the insured.

7. Conclusion

There remains a superficial attraction to the "two client" theory, which is still accepted by many courts, often supported by priority rules in the event that conflicts of interest arise. However, in our view, the ethical problems for the defence lawyer and the exposure of the insurer to allegations of bad faith increase where there is doubt about to which client complete allegiance is owed.

While the conflicts of interest inherent in the tripartite relationship can never be entirely eradicated, it is submitted that a "one client" approach goes a long way towards providing the players in the tripartite relationship with a clearer understanding of their roles and responsibilities. Each of the participants also benefits in important ways. The insurer is shielded from allegations of bad faith arising from its selection and direction of defence counsel. The defence lawyer is insulated from the sort of allegations that Kansa made against Fellowes McNeil. The insured receives an unequivocal defence from the lawyers appointed to provide that defence.

Appendix A

Rules Regulating the Florida Bar — Rule 4-1.8(j)

STATEMENT OF INSURED CLIENT'S RIGHTS

An insurance company has selected a lawyer to defend a lawsuit or claim against you. This Statement of Insured Client's Rights is being given to you to assure that you are aware of your rights