Notes

Are Gallagher Covenants Unethical?: An Analysis Under the Code of Professional Responsibility

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A defendant in civil litigation can settle an alleged claim against him by a variety of means. Traditionally, a defendant can employ a release,[1] a covenant not to sue,[2] or a covenant not to execute.[3] A defendant can also enter into what has been termed a "Gallagher covenant."[4] A Gallagher

1. By a release a plaintiff surrenders his cause of action against a defendant, either gratuitously or for consideration. Under the common law, a release of one joint defendant released all. However, this rule was abrogated in Adams v. Dion, 109 Ariz. 308, 310, 509 P.2d 201, 203 (1973), wherein the court adopted the position of the RESTATEMENT (SECOND) OF TORTS § 885 (Tent. Draft No. 16, 1970). In *Adams* the court summarized the rule of the Restatement as follows: "[A release] does not discharge other joint tortfeasors unless such was the intent of the parties, or unless the amount paid for the release was full compensation." 109 Ariz. at 309, 509 P.2d at 202. *See also* W. PROSSER, HANDBOOK OF THE LAW OF TORTS § 49, at 301-02 (4th ed. 1971).

2. A covenant not to sue provides that the plaintiff will not sue the particular defendant entering into the covenant, but has no effect on any other wrongdoer. Fagerberg v. Phoenix Flour Mills Co., 50 Ariz. 227, 234-35, 71 P.2d 1022, 1025-26 (1937); W. PROSSER, *supra* note 1, at 303. In Arizona, a plaintiff is allowed to exercise a great deal of control over the composition of an action; he may elect to sue only one of several potentially liable defendants, and, if that defendant has no right to indemnity from a third person, may prevent a defendant from bringing in any other persons through a third-party complaint under ARIZ. R. CIV. P. 14. *See* Chrysler Corp. v. McCarthy, 14 Ariz. App. 536, 538, 484 P.2d 1065, 1067 (1971).

3. The covenant not to execute obligates the plaintiff, generally for some consideration, not to execute a judgment obtained against the agreeing defendant. *See* Riexinger v. Ashton Co., 9 Ariz. App. 406, 408-09, 453 P.2d 235, 237-38 (1969). The consideration for a covenant not to execute can be applied by a non-covenanting defendant to reduce the plaintiff's recovery, however. *Id.* at 407-08, 453 P.2d at 236-37.

4. Mustang Equip., Inc. v. Welch, 115 Ariz. 206, 208, 564 P.2d 895, 897 (1977); *see, e.g.*, City of Tucson v. Gallagher, 108 Ariz. 140, 142, 493 P.2d 1197, 1199 (1972); Hemet Dodge v. Gryder, 23 Ariz. App. 523, 529, 534 P.2d 454, 460 (1975); City of Glendale v. Bradshaw, 16 Ariz. App. 348, 355, 493 P.2d 515, 522, *aff'd on rehearing*, 16 Ariz. App. 483, 494 P.2d 383 (1972). The name Gallagher covenant is derived from *City of Tucson v. Gallagher*.

The development of settlement covenants can be attributed in large part to the common law rule that the release of one joint tortfeasor released all. Fagerberg v. Phoenix Flour Mills Co.,

covenant is a device currently being used in Arizona which guarantees a plaintiff recovery from at least one defendant regardless of the determination of liability at trial.[5] Under a typical Gallagher agreement, if liability is established at trial, the covenanting defendant can reduce the monetary guarantee by any sums the plaintiff can collect from non-convenanting defendants.[6] Thus, for example, a defendant may agree to pay the plaintiff $10,000 as consideration for the covenant. This sum will be paid even in the event of a defense verdict; but, in exchange for this guarantee, the plaintiff will promise to execute first against any other defendant found liable at trial.

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50 Ariz. 227, 234,71 P.2d 1022, 1025 (1937); *see* W. PROSSER, *supra* note 1, at 301-03; Note, *Settlement Devices With Joint Tortfeasors*, 25 U. FLA. L. REV. 762, 769 (1973). In *Fagerberg*, the Arizona Supreme Court held that a covenant not to sue did not release all joint tortfeasors. 50 Ariz. at 235, 71 P.2d at 1026. This distinction may no longer be important, however, as the common law rule was abrogated in Adams v. Dion, 109 Ariz. 308, 509 P.2d 201 (1973). *See* discussion note 1 *supra*. *See also* "Release of a Joint Tortfeasor," 16 ARIZ. L. REV. 489, 642 (1974).

The historical controversy over the procedural effects of the various settlement devices arose in part from the concept of "joint tortfeasors." At common law, this concept included only those individuals who operated in concert to produce the plaintiff's harm. W. PROSSER, *supra* note 1, § 46, at 291. Thus, the plaintiff had to allege and prove a common scheme or design which tied together all of the defendants. *See id.* Joint tortfeasors were considered mutual agents, where the liability of each defendant was dependent upon the liability of the others. *Id.* From this presumption, it was natural to hold that the release of one tortfeasor released all. Under modern liberalized rules of joinder, however, where there is no prerequisite of a common scheme or design, the common law rule of release loses its viability. Defendants may be joined even if they did not act in concert to cause the harm to the plaintiff. ARIZ. R. CIV. P. 20; *see* W. PROSSER, *supra* note 1, at 300-01. Nevertheless, the release is still distinguishable from a covenant not to sue or execute. The release extinguishes the plaintiff's claim against a defendant. *See* Reese v. Cradit, 12 Ariz. App. 233, 237, 469 P.2d 467, 471 (1970). The covenant, on the other hand, does not extinguish, but modifies the right of the plaintiff. Thus, in a Gallagher covenant, the plaintiff may bargain to retain certain rights against a defendant, such as a conditional right to execute. *See, e.g.*, City of Tucson v. Gallagher, 108 Ariz. 140, 142, 493 P.2d 1197, 1199 (1972); Sequoia Mfg. Co. v. Halec Const. Co., 117 Ariz. 11, 22, 570 P.2d 782, 793 (Ct. App. 1977); Hemet Dodge v. Gryder, 23 Ariz. App. 523, 529, 534 P.2d 454, 460 (1975). For a discussion of the characteristics of and the differences between releases, covenants not to sue, and covenants not to execute, see Bolton v. Ziegler, 111 F. Supp. 516 (N.D. Iowa 1953); Pellett v. Sonotone Corp., 26 Cal. 2d 705, 160 P.2d 783 (1945); Weems v. Freeman, 234 Ga. 575, 216 S.E.2d 774 (1975); Scott v. Krueger, 151 Ind. App. 479, 280 N.E.2d 336 (1973).

5. *See* City of Tucson v. Gallagher, 108 Ariz. 140, 142, 493 P.2d 1197, 1199 (1972); Grillo v. Burke's Paint Co., 275 Ore. 421, 424-25, 551 P.2d 449, 452 (1976). A typical Gallagher covenant was summarized in Hemet Dodge v. Gryder, 23 Ariz. App. 523, 534 P.2d 454 (1975):

> The substance of the agreement was that in the event of trial resulting in a verdict and final judgment, plaintiff would execute upon that judgment in a pre-determined manner, depending upon the amount of the verdict and against whom it was rendered. Execution on the judgment was to be as follows:
>
> 1. In the event of a defense verdict in favor of all defendants, defendant Looke would pay the sum of $50,000 to plaintiff.
> 2. In the event of a verdict against the defendant Looke alone, regardless of the amount of that judgment, defendant would pay to the plaintiff the sum of $50,000.
> 3. In the event of a judgment against the defendants Hemet Dodge and Chrysler Motor Company, or either of them, plaintiff would execute as follows:
>
> (a) In the event the judgment was less than $50,000, plaintiff would execute against the defendants Chrysler or Hemet for the amount of the judgment and against Looke for the balance;
>
> (b) In the event the judgment was in excess of $50,000, plaintiff would execute entirely against the defendants Hemet and/or Chrysler.

Id. at 529, 534 P.2d at 460.

6. *See* City of Tucson v. Gallagher, 108 Ariz. 140, 142, 493 P.2d 1197, 1199 (1972). *See also* Sequoia Mfg. Co. v. Halec Const. Co., 117 Ariz. 11, 21-22, 570 P.2d 782, 792-93 (Ct. App. 1977); Hemet Dodge v. Gryder, 23 Ariz. App. 523, 529, 534 P.2d 454, 460 (1975); City of Glendale v. Bradshaw, 16 Ariz. App. 348, 355, 493 P.2d 515, 522, *aff'd on rehearing* 16 Ariz. App. 483, 494 P.2d 383 (1972).

Moreover, covenanting defendants are not dismissed from the trial; rather, they participate as if no agreement had been made.[7]

Arizona law collaterally supports Gallagher covenants. First, no contribution is allowed between joint tortfeasors under present Arizona law.[8] Contribution would allow a joint and severally liable defendant who has paid a judgment in full to collect from the nonpaying defendants their pro rata shares.[9] Where states allow contribution, a Gallagher covenant cannot shield a defendant from contributing.[10] Further, under Arizona law, the plaintiff is free to execute inequitably among all or some of his judgment debtors.[11] Thus, the plaintiff may choose to go after one defendant or all in any proportion he wishes. Of course, a judgment debtor will receive credit for any amount received by the plaintiff from another tortfeasor, in order to prevent double recovery.[12]

Outside Arizona, Gallagher-type agreements are known as "Mary Carter" agreements, a name derived from the seminal case of *Booth v. Mary Carter Paint Company*.[13] In *Mary Carter*, the covenant set a maxi-

7. 108 Ariz. at 142, 493 P.2d at 1199.

8. DePinto v. Landoe, 411 F.2d 297, 300 (9th Cir. 1969); United States v. Arizona, 214 F.2d 389, 392 (9th Cir. 1954); State Farm Mut. Ins. Co. v. Factory Mut. Ins. Co., 22 Ariz. App. 199, 201, 526 P.2d 406, 408 (1974); Pinal County v. Adams, 13 Ariz. App. 571, 573, 479 P.2d 718, 720 (1971).

9. Brown v. Brown, 58 Ariz. 333, 336-37, 119 P.2d 938, 939-40 (1942).

10. *See* Alder v. Garcia, 324 F.2d 483, 485 (10th Cir. 1963) (holding that enforcement of a Gallagher-like covenant would be contrary to the public policy of New Mexico as expressed by the enactment of the UNIFORM CONTRIBUTION AMONG JOINT TORTFEASORS ACT); Note, *The Mary Carter Agreement—Solving the Problem of Collusive Settlements in Joint Tort Actions*, 47 S. CAL. L. REV. 1393 (1974).

Of course, even in Arizona, although there is no right to contribution, there are certain cases in which a defendant is entitled to indemnity, in which case a Gallagher covenant would be frivolous. Arizona allows indemnity only in narrow circumstances. A specific contractual agreement for indemnity will be enforced where the party seeking the indemnity has not itself been negligent. Stroud v. Dorr-Oliver, Inc., 112 Ariz. 403, 407-08, 542 P.2d 1102, 1106-07 (1975); Royal Properties, Inc. v. Arizona Title Ins. & Trust Co., 13 Ariz. App. 376, 377-78, 476 P.2d 897, 899-900 (1971). In addition, indemnity may be allowed where the negligence of the party seeking indemnification is "passive" and that of the indemnitor is "active." Allison Steel Mfg. Co. v. Superior Court, 20 Ariz. App. 185, 189, 511 P.2d 198, 202 (1973). The theory of active and passive negligence is set forth in Busy Bee Buffet, Inc. v. Ferrell, 82 Ariz. 192, 310 P.2d 817 (1957). The court held that where one individual has been held vicariously liable because of its legal relationship to another tortfeasor it may seek indemnity, but only if its negligence was passive. *Id.* at 198-99, 310 P.2d at 821. Thus, where the party seeking indemnity is negligent, but to a lesser degree than the other tortfeasor, his negligence will preclude any right of indemnity. *Id.* at 199, 310 P.2d at 821.

Applying this principle to a contribution case, in Salt River Project Agricultural Improvement & Power Dist. v. City of Scottsdale, 24 Ariz. App. 254, 537 P.2d 982 (1975), the court narrowly interpreted *Busy Bee*, stating that a failure to act was not the equivalent of passive negligence. *Id.* at 255, 537 P.2d at 983. Thus, indemnity will be allowed only where the whole fault lies with one tortfeasor.

11. City of Tucson v. Gallagher, 108 Ariz. 140, 142-43, 493 P.2d 1197, 1199-1200 (1972); City of Glendale v. Bradshaw, 16 Ariz. App. 348, 356, 493 P.2d 515, 523, *aff'd on rehearing*, 16 Ariz. App. 483, 494 P.2d 383 (1972).

12. Egurrola v. Szychowski, 95 Ariz. 194, 198, 388 P.2d 242, 244 (1964); Fagerberg v. Phoenix Flour Mills Co., 50 Ariz. 227, 235, 71 P.2d 1022, 1026 (1937). This rule eschews unjust enrichment.

13. 202 So. 2d 8 (Fla. App. 1967). The typical Mary Carter agreement consists of three parts. First, it provides that the defendant remains a party to the action as long as desired by the plaintiff, or until the court dismisses him. *See id.* at 10. *See also* Weinstein v. National Car

mum liability for two of the defendants of $12,500, regardless of the outcome at trial.[14] If a verdict in favor of the plaintiff was in excess of $37,500, the plaintiff promised to execute against the nonagreeing defendants.[15] If liability against the nonagreeing defendant was less than $37,500, however, the agreeing defendants would make up the difference, up to $12,500.[16] Moreover, the settling defendants continued as parties at trial until the resolution of all questions of liability and damages.[17] The *Mary Carter* court held that the agreement did not constitute a release,[18] and denied an offset to the nonagreeing defendants.[19] The *Mary Carter* litigants did not raise, and the court did not explore, the ethical implications of the agreement, notwithstanding the fact that it was wholly undisclosed.[20] However, the Florida courts now allow both discovery of the agreement and its introduction into evidence if the nonagreeing defendant so desires.[21] Thus, any secrecy clause contained in the agreement is ineffective.[22]

Although the Gallagher covenants or Mary Carter agreements are frequently attacked on the basis of their ethical propriety, only Nevada, Wisconsin, and South Dakota condemn their use.[23] A vigorous condemna-

Rentals, 288 So. 2d 509, 510 (Fla. App. 1973): Arapage v. Odell, 114 N.H. 684, 685, 327 A.2d 717, 717 (1974). Second, the defendant guarantees the plaintiff a fixed sum regardless of the outcome of the trial. Booth v. Mary Carter Paint Co., 202 So. 2d 8, 10 (Fla. App. 1967). Finally, the plaintiff agrees to execute first against all other defendants. *Id.* All amounts collected will serve to reduce the amount which the covenanting defendant is obligated to pay. *Id.* In its original form, a Mary Carter agreement also contained a secrecy clause, requiring that the agreement not be revealed to anyone unless so ordered by the court. *Id.*

14. *Id.* Under the agreement, if the noncovenanting defendant was not financially responsible to the extent of $37,500, the covenanting defendants agreed to contribute the difference, not to exceed $12,500. *Id.*

15. *Id.*

16. *Id.*

17. *Id.*

18. *Id.* at 11.

19. *Id.*

20. *Id.* Thus, it appears that the court did not consider it necessary to have the covenant revealed, despite the provision allowing disclosure if ordered.

21. *See* Imperial Elevator Co. v. Cohen, 311 So. 2d 732, 734 (Fla. 1975); Ward v. Ochoa, 284 So. 2d 385, 387 (Fla. 1973); Weinstein v. National Car Rentals, 288 So. 2d 509 (Fla. App. 1974); Maule Indus., Inc. v. Rountree, 264 So. 2d 445, 448 (Fla. App. 1972). The reasons for requiring disclosure were discussed by one Florida appellate court:

> The search for the truth, in order to give justice to the litigants, is the primary duty of the courts. Secret agreements between plaintiffs and one or more of several multiple defendants can tend to mislead judges and juries, and border on collusion. To prevent such deception, we are compelled to hold that such agreements must be produced for examination before trial, when sought to be discovered under appropriate rules of procedure. If the agreement shows that the signing defendant will have his maximum liability reduced by increasing the liability of one or more co-defendants, such agreement should be admitted into evidence at trial upon the request of any other defendant who may stand to lose as a result of such agreement.

Ward v. Ochoa, 284 So. 2d 385, 387 (Fla. App. 1973). Recently, a Florida court stated: "The jury is entitled to be advised of such an agreement since it relates to the credibility and demeanor of the witnesses and their interest in the outcome of the case, as well as to conduct of counsel during the course of the trial." Imperial Elevator Co. v. Cohen, 311 So. 2d 732, 734 (Fla. App. 1975).

22. *See* Ward v. Ochoa, 284 So. 2d 385. 387 (Fla. App. 1973).

23. *See, e.g.*, Lum v. Stinnett, 87 Nev. 402, 410-11, 488 P.2d 347, 352 (1971); Degen v. Bayman, 86 S.D. 598, 607-08, 200 N.W.2d 134, 138-39 (1972); Trampe v. Wisconsin Tel. Co., 214 Wis. 210, 217-18, 252 N.W. 675, 678 (1934).

tion of the device was made in the Nevada case of *Lum v. Stinnett*.[24] The agreement in *Lum* coupled a promise to pay $20,000 by two defendants in a medical malpractice action with an agreement not to execute against the defendants in the event of a verdict in excess of $20,000.[25] In addition, the covenant stipulated that a motion for a directed verdict in favor of the agreeing defendants would be unopposed by the plaintiff.[26] The Nevada Supreme Court classified the agreement as champertous[27] and contrary to public policy,[28] on the ground that the agreement called for improper attorney conduct.[29] Concerning the requirement of actual adversity between litigating parties, the *Lum* court concluded that the agreeing defendants were "sham" adverse parties because their actual liability was predetermined.[30] Moreover, the *Lum* court reasoned that allowing covenanting defendants to continue as parties to the litigation was violative of the nonagreeing defendant's right to a fair trial.[31]

Despite the disapproval of some jurisdictions, the Mary Carter or Gallagher covenant has been upheld in Arizona,[32] California,[33] Oregon,[34] Illinois,[35] and Indiana.[36] The agreements themselves may take a variety of forms. While the general terms of the agreement are usually similar to those involved in the Mary Carter case,[37] including the guarantee and the covenant not to execute, innovations such as the loan receipt[38] have arisen, relegating

24. 87 Nev. 402, 488 P.2d 347 (1971).
25. *Id.* at 404-05, 488 P.2d at 348.
26. *Id.* at 404, 488 P.2d at 348.
27. *Id.* at 410, 488 P.2d at 352.
28. *Id.* at 408-09, 488 P.2d at 350-51.
29. *Id.* at 410-11, 488 P.2d at 352.
30. *Id.* at 412, 488 P.2d at 353.
31. *Id.* The Nevada court declared the agreement void and remanded the action for retrial with all parties situated as they were originally. *Id.*
32. Sequoia Mfg. Co. v. Halec Const. Co., 117 Ariz. 11, 24-25, 570 P.2d 782, 795-96 (Ct. App. 1977); City of Tucson v. Gallagher, 108 Ariz. 140, 142, 493 P.2d 1197, 1199 (1972).
33. Pease v. Beech Aircraft Corp., 38 Cal. App. 3d 450, 473-74, 113 Cal. Rptr. 416, 432 (1974); River Garden Farms, Inc. v. Superior Court, 26 Cal. App. 3d 986, 998, 103 Cal. Rptr. 498, 507 (1972).
34. Grillo v. Burke's Paint Co., 275 Ore. 421, 427, 551 P.2d 449, 453 (1976).
35. Reese v. Chicago, B. & Q.R.R., 55 Ill. 2d 356, 364, 303 N.E.2d 382, 386 (1973); Hitchcock Air Conditioning, Heating & Piping Co. v. Hazen, 43 Ill. App. 3d 483, 489, 357 N.E.2d 69, 73 (1976).
36. American Transp. Co. v. Central Ind. Ry., 255 Ind. 319, 323, 264 N.E.2d 64, 67 (1970); Scott v. Krueger, 151 Ind. App. 479, 515, 280 N.E.2d 336, 358 (1972); Northern Ind. Pub. Serv. Co., v. Otis, 145 Ind. App. 159, 176, 250 N.E.2d 378, 392 (1969).
37. *See* text & note 8, *supra*.
38. The loan receipt agreement resembles the Gallagher covenant because it contains a guarantee of some recovery to the plaintiff, *see* Cullen v. Atchison, T. & S.F. Ry., 211 Kan. 368, 370, 507 P.2d 353, 357 (1973), and sets a maximum limit on liability for the agreeing defendant, *id.* at 370-71, 507 P.2d at 357-58. However, the loan receipt provides for an advance to the plaintiff of the funds representing the consideration for the agreement, and normally contains a reduction clause, which is termed a "pay back" agreement. *Id.* at 371, 507 P.2d at 358. The reduction clause operates to decrease the liability of the agreeing defendant according to the amount that the plaintiff can collect from other defendants. For a discussion of loan receipts, see Scoby, *Loan Receipts and Guaranty Agreements*, 10 F. 1300, 1301-06 (1975); Thornton & Wick, *Loan Receipt Agreements: Are They Loans, Settlements, Wagering Contracts, or Unholy Alliances?*, 43 INS. COUNSEL J. 226 (1976). *See also* Reese v. Chicago B. & Q.R.R., 55 Ill. 2d 356, 303 N.E.2d 382 (1973); Northern Ind. Pub. Serv. Co. v. Otis, 145 Ind. App. 159, 250

the courts to a case by case analysis, and creating judicial reluctance to declare a broad condemnation of these agreements.[39]

This Note will examine the question whether Gallagher covenants are consistent with the Code of Professional Responsibility. The Gallagher covenant may arise in two distinct factual situations, with differing ethical consequences. In one instance, the agreement is between the plaintiff and an individual defendant, through the counsel for that defendant. In the second instance, the agreement is entered into under the supervision and direction of counsel for an insurance company, which is not a party, but which, under the terms of a standard liability policy, is required to represent an insured in any action covered by the policy.[40] As to these two situations, both Arizona law and opinions of the Arizona State Bar Committee on Rules of Professional Conduct[41] will be explored with an eye to ascertaining the established parameters of ethical conduct. Gallagher covenants which meet present

N.E.2d 378 (1969); Edwards v. Passarelli Bros. Auto. Serv., Inc., 8 Ohio St. 2d 6, 221 N.E.2d 708 (1966). For a discussion of Mary Carter agreements, see Freedman, *The Expected Demise of "Mary Carter": She Never Was Well!*, 1974 INS. L.J. 602 (1975); Lageson, *Guarantee and Loan Receipt Agreements in Multi-party Litigation*, 43 INS. COUNSEL J. 409 (1976); Michael, *"Mary Carter" Agreements in Illinois*, 64 ILL. B.J. 514 (1976); Note, *The Mary Carter Agreement—Solving the Problems of Collusive Settlements in Joint Tort Actions*, 47 S. CAL. L. REV. 1393 (1974); 23 DEFENSE L.J. 516 (1974); 28 U. MIAMI L. REV. 974, 978 (1974). For a recent analysis of the Gallagher covenant, *see* Note, *Gallagher Covenants, Mary Carter Agreements, and Loan Receipt Agreements: Unsettling Contributions to Conflict Resolution*, 1977 ARIZ. ST. L.J. 117 (1977).

39. Typifying this reticence is the statement of the Florida Supreme Court, in Maule Indus., Inc. v. Rountree, 264 So. 2d 445 (Fla. App. 1972):

> Obviously, the number of variations of the so-called "Mary Carter Agreement" is limited only by the ingenuity of counsel and the willingness of the parties to sign, and we therefore feel that we can neither condone nor condemn such agreements generically. We simply say that we do not find the agreement in this case to be void.

Id. at 447.

40. The typical liability insurance policy contains a provision for representation substantially as follows:

> With respect to such insurance as is afforded by this policy for bodily injury liability and for property damage liability, the company shall:
> (a) defend any suit against the insured alleging such injury, sickness, disease or destruction and seeking damages on account thereof, even if such suit is groundless, false or fraudulent; but the company may make such investigation, negotiation and settlement of any claim or suit as it deems expedient.

Automobile Liability and Damage Form, *cited in* R. KEETON, BASIC INSURANCE LAW 634 app. (1960).

41. The Opinions of the Arizona State Bar Committee are based on the Arizona version of the Code of Professional Responsibility. The Code was adopted by the Arizona Supreme Court and became effective November 1, 1970. Ariz. Sup. Ct. R. 29 (a) (current version at ARIZ. SUP. CT. R. 29(a) (1973 & Supp. 1977-1978)). Prior to the adoption of the Code, the rules whereby attorney conduct was evaluated were embodied in the Canons of Professional Ethics, ABA CANONS OF PROFESSIONAL ETHICS (1908). *See* Statement of Jurisdictional Policies, Committee Rules of Procedure, 9 ARIZ. B.J., Winter, 1973-74, at 6.

The Code of Professional Responsibility is made up of three parts: the Canons, the Ethical Considerations, and the Disciplinary Rules. A violation of a Disciplinary Rule will support disciplinary action against an attorney. ABA CODE OF PROFESSIONAL RESPONSIBILITY, *Preamble* (1976). Disciplinary action may affect both the lawyer's professional status and the disposition of the particular litigation. For example, the client's suit can be dismissed. *Cf.* Damron v. Sledge, 105 Ariz. 151, 155, 460 P.2d 997, 1001 (1969) (indicating that the court could dismiss a suit where counsel had behaved in a collusive manner).

In Arizona, the State Bar Committee has the power to determine questions regarding the standards of proper professional conduct. ARIZ. REV. STAT. ANN. § 32-237(2) (1970); ARIZ. SUP. CT. R. 27(d).

ethical standards will then be measured against the ethical norms of champerty, a lawyer's duty to the adversary system of justice, the problem of conflicting interests, and the appearance of impropriety. From this scrutiny, conclusions as to the propriety of Gallagher covenants in Arizona can be drawn.

THE ARIZONA COURTS AND GALLAGHER COVENANTS

The phrase "Gallagher covenant" is coined from *City of Tucson v. Gallagher*.[42] However, the development of the use of such covenants in Arizona begins with *Damron v. Sledge*.[43] In *Damron*, the plaintiffs sought to recover for personal injuries sustained due to defendant Sledge's alleged negligent operation of a motor vehicle owned by defendant Polk.[44] Sledge procured his own counsel when both Sledge's and Polk's liability insurers refused to defend him.[45] Sledge's attorney then entered into a convenant not to execute with the plaintiffs,[46] in exchange for which Sledge assigned his rights against the two insurance companies to the plaintiffs.[47] On the day before trial, the plaintiffs moved to dismiss Polk from the action, and sought to take a default judgment against Sledge,[48] thus enabling plaintiff to proceed directly against the insurance company of the owner of the vehicle under the assignment.[49] The trial court viewed this action as collusive, and dismissed plaintiffs' complaint.[50] On appeal, however, the Arizona Supreme Court upheld the agreement against the charge of collusion.[51] In so holding, the *Damron* court established a precedent that would give impetus to the trend toward using Gallagher covenants in Arizona, and made their legality less questionable. In *Damron*, the court reasoned that collusion is dependent upon a showing of bad faith on the part of the parties or counsel.[52] Moreover, bad faith must be manifested by definite evidence in the record of a collusive undertaking, such as perjured testimony:

> There is no question but that the trial court has inherent power to dismiss a case which is collusive. Before doing so, however, it must hold a hearing and *take evidence* which will prove or disprove the presence of such collusion. It cannot be held that as a matter of law collusion exists simply because a defendant chooses not to defend when he can escape all liability by such an

42. 108 Ariz. 140, 493 P.2d 1197 (1972).
43. 105 Ariz. 151, 460 P.2d 997 (1969), *noted in* "Duty to Defend," 12 ARIZ. L. REV. 89, 213 (1970).
44. 105 Ariz. at 152, 460 P.2d at 998.
45. *Id.*
46. *Id.* The agreement in *Damron* was a pure covenant not to execute and not a Gallagher covenant. *See* discussion note 3 *supra*.
47. 105 Ariz. at 153, 460 P.2d at 999.
48. *Id.* at 154, 460 P.2d at 1000.
49. *Id.* at 153, 460 P.2d at 999.
50. *Id.* at 154, 460 P.2d at 1000.
51. *Id.*
52. *Id.*

> agreement, and must take large financial risks by defending. If, at a hearing, where testimony comes from *sworn witnesses* rather than from arguments of the attorneys, it appears that the defendant instead of defaulting agrees to perjure himself and testify falsely to statements that are untrue, and that plaintiff is a party to the agreement, or if some other definite evidence of collusion is adduced by proper testimony, a dismissal of the entire action may be justified.[53]

The court then held that the record reflected an absence of bad faith, partly because the agreement had been fully disclosed to the trial court.[54] Nondisclosure by the attorney for Sledge of his intended trial tactics to the other parties was insufficient to support a charge of collusion.[55]

Of course, the *Damron* agreement clearly is distinguishable from a Gallagher covenant. In *Damron*, the defendant neither guaranteed the plaintiff a flat sum, nor did he act as an adverse party through a jury trial. Under the circumstances presented in *Damron*, a test which calls for definite evidence of collusion in the record is established.[56] This test of collusion may be inappropriate, however, when a defendant is subject to more subtle conflicts of interest. Nonetheless, the *Damron* test was applied to a Gallagher covenant, without analysis, by an Arizona court of appeals in *City of Glendale v. Bradshaw*.[57] Plaintiff, a passenger in an automobile, suffered injury due to the alleged negligence of the driver, Fandrey, and the City of Glendale.[58] Before trial, Fandrey's insurance company covenanted with the plaintiff to limit Fandrey's liability to $50,000 regardless of the jury verdict.[59] Moreover, if liability was also assessed against the City of Glendale, or against the City alone, the plaintiff agreed to execute solely against the City of Glendale and its insurance carrier.[60] On appeal from a judgment against both defendants, the City of Glendale charged that the Bradshaw-Fandrey covenant was collusive.[61] This charge was based on an alleged failure of Fandrey's counsel to fully cross-examine the plaintiff's witnesses.[62] Relying on the reasoning and holding of *Damron*, however, the court of appeals upheld the covenant as noncollusive.[63]

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53. *Id.* at 155, 460 P.2d at 1001 (emphasis in original).
54. *Id.* at 154, 460 P.2d at 1000.
55. *See id.*
56. For a view that the actual bad faith test should have not been applied, see "Duty to Defend," 12 ARIZ. L. REV. 89, 213 (1970).
57. 16 Ariz. App. 348, 356, 493 P.2d 515, 523, *aff'd on rehearing*, 16 Ariz. App. 483, 494 P.2d 383 (1972).
58. *Id.* at 350, 493 P.2d at 517.
59. *Id.* at 355, 493 P.2d at 522.
60. *Id.*
61. *Id.* at 356, 493 P.2d at 523.
62. *Id.*
63. *Id.* The Arizona court of appeals in *Bradshaw* apparently read *Damron* for the proposition that a defendant is free to defend in any manner he chooses. *Id.* Whether the court interpreted *Damron* as giving a defendant the absolute right to limit his cross-examination of

The *Bradshaw* court distinguished an earlier State Bar Committee opinion, 70-18,[64] which held that a settlement agreement between the plaintiff and less than all of the defendants, which included a clause requiring that the agreement be kept secret from both the nonagreeing party and the court constituted a violation of the lawyer's ethical obligations, embodied at that time in the Canons of Ethics.[65] Because the agreement constituted a settlement and was to be kept secret, the Committee indicated that such an agreement was violative of the Canons which required candor on the part of attorneys to facilitate the judicial process.[66] The Committee felt that the requirement that the agreeing defendants stay in the action was inconsistent with the purported purpose of the agreement as a settlement.[67] In *Bradshaw*, however, the agreement was not kept secret, and this fact was noted by the court.[68]

Whatever doubt existed as to the ethical propriety of Gallagher covenants after *Bradshaw*[69] disappeared in *City of Tucson v. Gallagher*.[70] In *Gallagher*, the plaintiff, a passenger in an automobile, was injured when the driver turned into a deceptively marked dirt road. The plaintiff alleged negligence against the driver of the automobile and the City of Tucson.[71] A pretrial agreement between the plaintiff and the driver was in the form of what has since been referred to as a Gallagher covenant. The driver's liability insurer offered to pay the $10,000 policy limit to the plaintiff notwithstanding the outcome of the trial; the plaintiff agreed to either take

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plaintiff's witnesses, or merely intended to bolster its observation that there was no showing of actual collusion is unclear.

64. ARIZ. ETHICS OP. 70-18 (1970).

65. *Id.* at 2-3; *see* ABA CANONS OF PROFESSIONAL ETHICS (1908). The Code of Professional Responsibility replaced the Canons of Ethics in 1970, and became effective in Arizona on November 1, 1970. ARIZ. SUP. CT. R. 29(a).

66. ARIZ. ETHICS OP. 70-18, at 4 (1970); *see* ABA CANONS OF PROFESSIONAL ETHICS No. 22 (1908), which provided:

> The conduct of the lawyer before the Court and with other lawyers should be characterized by candor and fairness.
>
> . . . .
>
> It is unprofessional and dishonorable to deal other than candidly with the facts in taking the statements of witnesses, in drawing affidavits and other documents, and in the presentation of causes.

In addition, Canon 30 declared:

> The lawyer must decline to conduct a civil cause or to make a defense when convinced that it is intended merely to harrass or to injure the opposite party or to work oppression or wrong. But otherwise it is his right, and, having accepted retainer, it becomes his duty to insist upon the judgment of the Court as to the legal merits of his client's claim. His appearance in Court should be deemed equivalent to an assertion on his honor that in his opinion his client's case is one proper for judicial determination.

67. ARIZ. ETHICS OP. 70-18, at 4 (1970).

68. 16 Ariz. App. at 355, 493 P.2d at 522.

69. The *Bradshaw* court expressed some reservations: "[W]e recognize some merit in . . . [defendant's collusion] argument and [we] do not voice our unqualified approval of the agreement . . . ." *Id.* at 356, 493 P.2d at 523.

70. 108 Ariz. 140, 493 P.2d 1197 (1972). After *Gallagher* was announced by the Arizona Supreme Court, the *Bradshaw* court, on rehearing, stated: "We find in the case now under consideration that there is an absence of showing of unethical conduct as well as an absence of collusion or perjury." 16 Ariz. App. at 484, 494 P.2d at 384.

71. 108 Ariz. at 141-42, 493 P.2d at 1198-99.

the $10,000 and release the driver, or to retain the driver as a codefendant in the action.[72] The plaintiff could choose between these alternatives at any time.[73] However, if a judgment was taken against the City for more than $10,000, the plaintiff would make no attempt to execute against the driver.[74] The nonagreeing defendant challenged the pretrial covenant as a breach of ethics, but the contention was soundly rejected by the court:

> The city's principal arguments are directed against the pretrial agreement. It is contended that the contract constitutes a breach of ethics. This appeal is not concerned with the ethics of counsel. Even if it were, there is no showing that the agreement was unethical. *See* Damron v. Sledge . . . . No collusion or perjury is alleged or proved in the instant case.[75]

Although the Arizona Supreme Court's cursory analysis, concluding that all ethical issues are determined by a test of actual collusion, is, at best, unpersuasive, the court did scrutinize the defendant's additional charge that the City was denied a fair trial. The City alleged that the covenant took "away from the driver all motivation to defend vigorously, since he could not lose, and could only gain, by helping plaintiff get a large verdict against the city."[76] The court held, however, that the mere existence of the agreement, without more, was insufficient to show prejudice.[77] The court reasoned that no actual change in position had been reflected in the trial tactics of the entering defendant and his counsel.[78] The court reasoned that with or without the covenant, the tactics and motive of the entering defendant would be the same; in either case, he would put forth a defense that primary fault lay with the nonagreeing defendant.[79] The supreme court did state that the covenant could suggest a motive for the defendant to exaggerate his testimony to enhance the plaintiff's damages.[80] However, no evidence of exaggeration was found upon the court's independent examination of the trial record.[81]

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72. *Id.* at 142, 493 P.2d at 1199.
73. *Id.*
74. *Id.*
75. *Id.*
76. *Id.*
77. *Id.* at 142-43, 493 P.2d at 1199-1200.
78. *Id.*
79. *Id.*
80. *Id.*
81. *Id.* at 143, 493 P.2d at 1200.

Knowledge of the scope of the appellate power in Arizona is helpful to understand the rulings on the ethical propriety of the Gallagher covenant. In general, the appellate court is bound by the record of the trial court. Polk v. Koerner, 111 Ariz. 493, 494, 533 P.2d 660, 661 (1975); Chenoweth v. Earhart, 14 Ariz. 278, 280, 127 P. 748, 749-50 (1912). Therefore, judicial review looks only to the record to evaluate the outcome below. City of Tucson v. Ruelas, 19 Ariz. App. 530, 531, 508 P.2d 1174, 1175 (1973); *see* ARIZ. R. CIV. P. 75(h). The appellate court is not, of course, bound by the trial court's conclusions of law. Polk v. Koerner, 111 Ariz. 493, 495, 533 P.2d 660, 662 (1975). In addition, the appellate court may interpret an instrument independently from the determination of the trial court. *Id.* However, the conduct of counsel is not subject to consideration if the evidence showing such conduct does not appear in the record. Collins v. Dilcher, 104 Ariz. 221, 223, 450 P.2d 679, 681 (1969).

After *Bradshaw* and *Gallagher*, the Arizona State Bar Committee again examined the ethical propriety of Gallagher covenants, this time under the newly adopted Code of Professional Responsibility, in Opinion 72-26.[82] The submitted facts concerned an agreement whereby defendant's insurance carrier stipulated to pay $50,000 to plaintiff regardless of the trial verdict, provided the plaintiff would execute solely against the codefendants in the event of a judgment against all defendants.[83] Opinion 70-18[84] was distinguishable, as the covenant was not secret.[85] Unlike the courts in *Bradshaw* and *Gallagher*, the Committee gave detailed scrutiny to the problems of conflict of interest. Where a Gallagher covenant has been executed, the Committee candidly recognized that the insured defendant may have interests different from those of the insurance company in the outcome of the trial: Although the defendant's interest is to be exonerated completely from liability, the insurance carrier may be satisfied with a judgment against all defendants and may have no pecuniary interest in the exoneration of the insured defendant.[86] The Committee stated:

> The question submitted does make crystal clear the difficult position of a lawyer representing two clients—an insured and an insurer—and the ethical considerations under Canon 5 point out the primary duty of the lawyer to explain to the insured the reasons for the trial procedure adopted by the lawyer, and the necessity to obtain the approval by the insured of the attorney's conduct of the case.[87]

The Committee concluded that the possible conflict of interest did not fatally taint all Gallagher agreements. Instead, full disclosure and informed consent of the client were found to be adequate assurances of ethical propriety. After obtaining the consent of the insured, which vitiates the conflict of interest, it was assumed by the Committee that the defendant's attorney would "prepare and conduct the trial, to the best of his ability, in the interests of [the] defendant."[88] Opinion 72-26 did not explore legal principles to test this assumption.[89] Presumably, the tests applied in *Dam-*

82. ARIZ. ETHICS OP. 72-26 (1972).
83. *Id.* at 1.
84. ARIZ. ETHICS OP. 70-18 (1970). See text & notes 64-67 *supra*.
85. ARIZ. ETHICS OP. 72-26, at 1 (1972).
86. The benefit to the insurance company arises from the existence of a solvent codefendant. To the extent that a codefendant may not be able to fully satisfy a judgment, the insurance company retains a pecuniary interest in its insured's exoneration. Where the policy limits for the insured are high and the solvency of the codefendant is questionable, the carrier may have an interest in its insured's exoneration equal to that of the insured, depending on the terms of the particular Gallagher covenant involved.
87. ARIZ. ETHICS OP. 72-26, at 3 (1972).
88. *Id.* at 5.
89. *See id.* at 3.

ron and *Gallagher*, requiring actual evidence of collusion, are the measure of conduct to be applied in Arizona.[90]

Recently, the Arizona Supreme Court held, in *Mustang Equipment, Inc. v. Welch*,[91] that, as a matter of public policy, all Gallagher-type agreements should be disclosed to all parties and the court, either prior to trial or, if entered during trial, as soon as possible after they are made.[92] The basis of the action in *Mustang Equipment* was again an automobile accident. Plaintiff Welch was injured when his vehicle was rear-ended by a truck owned by Mountain States Telephone & Telegraph Company, being driven by its employee.[93] The telephone company entered into an agreement with the plaintiff which the court classified as a Gallagher agreement, despite its differences in terms and conditions from the covenants previously examined by the Arizona courts.[94] The court investigated the actual effect of the existence of the covenant on the trial strategy of the agreeing defendant and concluded, as in *Gallagher*, that the motives and trial tactics would not change because of the covenant.[95] The court was not faced, however, with allegations of fraud or collusion or the conduct of a less than vigorous defense by the agreeing defendant.[96] Nonetheless, the court went beyond the *Gallagher* and *Damron* cases and looked at the effect the covenant might have had on the nonagreeing defendant. Relying on the policy of encouraging settlement, the court concluded that the nonagreeing defendant should have had the opportunity to evaluate the propriety of settlement with the plaintiff in light of the existence of the covenant.[97] Arguably, the examination of the effect of the covenant on the nonagreeing defendant was brought about solely because of the secret nature of the covenant; and where a Gallagher covenant is not concealed, prejudice to the nonagreeing defendant will be determined under the *Damron* collusion test. Under this reasoning, the *Mustang Equipment* case can be seen to stand solely for the proposition that the covenants may not be secret. However, the willingness of the court to take a broader role in supervising the use of Gallagher covenants is significant.

90. In Hemet Dodge v. Gryder, 23 Ariz. App. 523, 534 P.2d 454 (1975), the court of appeals upheld the agreement involved therein without discussion, on the basis of the prior Arizona decisions. *Id.* at 530, 534 P.2d at 461. The court did recognize, however, that the agreements had been condemned by other courts as bordering on collusion and misleading to the trier of fact. *Id.* at 529-30, 534 P.2d at 460-61.

91. 115 Ariz. 206, 564 P.2d 895 (1977).

92. *Id.* at 211, 564 P.2d at 900.

93. *Id.* at 207, 564 P.2d at 896.

94. *Id.* at 209, 564 P.2d at 898. The agreement consisted of a letter between attorneys, providing the plaintiff's attorney with the name of a potential defendant and an agreement by the covenanting defendant to pursue its defense by attempting to place primary liability on the new defendant. The plaintiff's obligations were to file an amended complaint naming the new defendant, and, upon a verdict against both defendants, to execute solely against the new defendant. *Id.* at 208, 564 P.2d at 897.

95. *Id.* at 210, 564 P.2d at 899.

96. *Id.*

97. *Id.* at 211, 564 P.2d at 900.

The most recent decision concerning the Gallagher covenant was made by the Court of appeals in *Sequoia Manufacturing Co. v. Halec Construction Co.*[98] Plaintiff, an employee of Halec Construction, was seriously injured by the failure of a roll-over protection structure attached to a tractor he was operating.[99] During the trial, plaintiff and defendant Maricopa Tractor Company entered into a loan receipt agreement,[100] providing that the insurance carrier for Maricopa would pay the plaintiff the sum of $2,500 monthly, with the total amount to be paid not to exceed the policy limit of $500,000.[101] In exchange for these payments, the plaintiff promised to execute first against the nonagreeing defendants, with the agreeing defendant to make up any amount necessary to bring the total award up to the policy limit.[102] The court of appeals cited *Mustang Equipment* for the proposition that the agreement must have been disclosed at the earliest possible opportunity, finding that this requisite had been satisfied.[103] The second issue which confronted the court was whether the nonagreeing defendant should have been allowed to present the agreement to the jury.[104] The court stated that admission into evidence or proper instruction of a jury would be beneficial in certain circumstances and for limited purposes. The limited purposes were not outlined, but the court did indicate that the presence of a reduction clause[105] would create a situation where admission of the covenant "would not only be permissible but probably obligatory if requested by the nonagreeing party."[106]

The court then proceeded to examine the question of actual incentive on the part of the agreeing defendant, Maricopa, to increase the plaintiff's verdict. An analysis of the evidence presented led the court to conclude that no such incentive existed and that the agreement did not encourage fraud or collusion or change the trial strategy of the agreeing defendant.[107] The charge of fraud and collusion regarding the manner in which Maricopa conducted its case led the court to examine the factors which prompted the creation of the covenant. The court ultimately deferred to the discretion of the trial court, which "was aware of all the possibilities inherent in the existence of the agreement and was fully prepared to impose sanctions, if necessary, to prevent injustice, up to and including admitting the agreement into evidence."[108]

98. 117 Ariz. 11, 570 P.2d 782 (Ct. App. 1977).
99. *Id.* at 15, 570 P.2d at 786.
100. *Id.* at 16, 570 P.2d at 787.
101. *Id.* at 21-22, 570 P.2d at 792-93.
102. *Id.* at 22, 570 P.2d at 793.
103. *Id.* at 23, 570 P.2d at 794.
104. *Id.*
105. *Id.*
106. *Id.*
107. *Id.* at 24, 570 P.2d at 795.
108. *Id.*

Thus, at this point, although the Arizona courts have recognized that Gallagher and similar covenants present clear problems, no direct resolution of these problems has been attempted. In light of the unsettled history of such agreements in Arizona, culminating with *Sequoia Manufacturing*, an investigation of the ethical problems seems unavoidable.

THE ETHICAL PROPRIETY OF GALLAGHER COVENANTS

Through *Damron* and its progeny, the Arizona courts and the State Bar Committee have begun to set down ethical boundaries for the use of Gallagher covenants. First, the covenant must not be secret; thus, the secrecy clause which was found in the original Mary Carter agreement is unethical in Arizona.[109] Second, there must be no direct evidence in the record of collusion between the plaintiff and defendant to foist a large verdict on the codefendants.[110] Third, the tacit understandings involved in *Lum v. Stinnett*[111] for a passive role by the agreeing defendant's counsel are ethical violations in Arizona.[112] Moreover, defense counsel must present a true adversary position.[113] Finally, if an insurance carrier participates in the formation of a Gallagher covenant, the informed consent of its insured must be obtained.[114] Whether these precepts should be polestars of ethical analysis, however, requires a closer scrutiny than the Arizona courts have taken to date. For this reason, the concepts of champerty, collusion, conflicts of interest, and the duties of the attorney under the Code of Professional Responsibility must be explored.

Champerty

The doctrine of champerty arises from the common law,[115] and is a species of maintenance.[116] Maintenance occurs where a third party interferes in a lawsuit which in no way belongs to him. This influence may consist of either assisting or maintaining a party to the suit, monetarily or otherwise, to prosecute the claim.[117] Champerty consists of an agreement with an intermeddler who undertakes to maintain or support the lawsuit of another in

109. Mustang Equip., Inc. v. Welch, 115 Ariz. 206, 211, 564 P.2d 895, 900 (1977); ARIZ. ETHICS OP. 70-18 (1970); *see* text & notes 64-67 *supra*.

110. City of Tucson v. Gallagher, 108 Ariz. 140, 143, 493 P.2d 1197, 1200 (1972); *see* text & notes 71-81 *supra*.

111. 87 Nev. 402, 488 P.2d 347 (1971); see text & notes 24-31 *supra*.

112. *Id.* at 409-10, 488 P.2d at 351-52; ARIZ. ETHICS OP. 70-18, at 4 (1970).

113. ARIZ. ETHICS OP. 72-26 (1972); *see* text & notes 82-89 *supra*.

114. *See* ARIZ. ETHICS OP. 72-26 (1972).

115. Richfield Oil Corp. v. LaPrade, 56 Ariz. 100, 104, 105 P.2d 1115, 1117 (1940); Coopers & Lybrand v. Levitt, 52 App. Div. 2d 493, 497, 384 N.Y.S.2d 804, 807 (1976).

116. Schnabel v. Taft Broadcasting Co., 525 S.W.2d 819, 823 (Mo. App. 1975); Coopers & Lybrand v. Levitt, 52 App. Div. 2d 493, 497, 384 N.Y.S.2d 804, 807 (1976); *see In re* Ratner, 194 Kan. 362, 374, 399 P.2d 865, 874 (1965).

117. *In re* Ratner, 194 Kan. 362, 374, 399 P.2d 865, 874 (1965); Schnabel v. Taft Broadcasting Co., 525 S.W.2d 819, 823 (Mo. App. 1975); Lum v. Stinnett, 87 Nev. 402, 408, 488 P.2d 347, 350 (1971).

exchange for a part of the proceeds of the judgment.[118] The policy behind the discouragement of champertous contracts is to prevent harassment, strife, and discord;[119] a champertous contract is one with "the tendency or purpose to stir up and foment litigation, multiply contentions, or unsettle the peace and quiet of a community, or set one neighbor against another, or give one litigant advantage over another."[120]

The use of the Gallagher covenant presents the possibility of champerty on several levels. The agreeing defendant may be said to have purchased an interest in the outcome of the litigation, since the reduction clause will work to his benefit.[121] In addition, his liability has been settled with regard to the plaintiff, and it may, therefore, be argued that he no longer has an interest in the suit, other than proving the nonsettling defendants' liability. On another level, the insurance company may also be engaging in champertous conduct. The company is not directly a party to the action, yet its payment of funds to the plaintiff aids in the continuation of the cause of action. Where insurance is involved, the carrier would have an interest in seeing the reduction clause operate to reduce its own liability. In any event, the plaintiff will have a tactical advantage, where a Gallagher covenant is entered into, in having the agreeing defendant held in the action.

Champerty and maintenance have been held not to exist in Arizona as independent causes of action for damages. In *Strahan v. Haynes*,[122] the court was faced with a challenge to an assignment of a purchaser's rights in a real estate contract.[123] The defendant-seller failed to comply with the terms of the agreement and the plaintiff-assignee brought suit to specifically enforce the agreement. The defendant demurred to the complaint on the ground that the assignment of the chose in action was champertous.[124] The court summarily disposed of this argument, stating: "This doctrine has been practically discarded both in England, the country of its origin, and in the United States. There may be a very few states in which it is still in force but

118. Richfield Oil Corp. v. LaPrade, 56 Ariz. 100, 104, 105 P.2d 1115, 1117 (1940) (holding that an attorney's contingent fee contract was not champertous and did not create an interest sufficient to justify holding the attorneys liable for security for costs); Schnabel v. Taft Broadcasting Co., 525 S.W.2d 819, 823-24 (Mo. App. 1975) (holding that cause of action for champerty did not exist in Missouri; remedies lay under actions for abuse of process, malicious prosecution, and wrongful initiation of litigation); Lum v. Stinnett, 87 Nev. 402, 408, 488 P.2d 347, 350 (1971) (holding that a Gallagher-type covenant entered through insurance counsel was champertous); Coopers & Lybrand v. Levitt, 52 App. Div. 2d 493, 497-98, 384 N.Y.S.2d 804, 807 (1976) (holding assignment of claim against plaintiff to corporation was not champertous); Groce v. Fidelity Gen. Ins. Co., 252 Ore. 296, 304, 448 P.2d 554, 558 (1968) (attacking assignment of insured's claim against insurer for failure to settle).

119. Poloron Prods., Inc. v. Lybrand Ross Bros. & Montgomery, 534 F.2d 1012, 1016 (2d Cir. 1976) (quoting Fairchild Hiller Corp. v. McDonnell Douglas Corp., 28 N.Y.2d 325, 329, 270 N.E.2d 691, 693, 321 N.Y.S.2d 857, 860 (1971)).

120. Fordson Coal Co. v. Garrard, 277 Ky. 218, 226-27, 125 S.W.2d 977, 981 (1939).

121. *See* text & notes 5, 8 *supra*.

122. 33 Ariz. 128, 134, 262 P. 995, 997 (1928).

123. *Id.* at 132, 262 P. at 996-97.

124. *Id.* at 133, 262 P. at 997.

we think that Arizona is not one of them."[125] *Strahan* would appear to preclude the effectiveness of any allegation of champerty; however, the holding might be limited to the facts of that case. The case can be interpreted as holding that an assignment of a chose in action is not, by itself, champertous. Such a holding would be consistent with the policies of the common law prohibition on champerty and maintenance. Rather than being a device to foment litigation, an assignment of this type is merely a transfer of one's property to another person, who then becomes the real party in interest. In fact, some jurisdictions that would uphold the assignment made in the *Strahan* case recognize the doctrines of champerty and maintenance when their policies come into play.[126]

It is possible, then, that *Strahan* holds only that champerty and maintenance are not applicable to the assignment of a chose in action for the sale of real estate.[127] However, even if *Strahan* is taken literally, the doctrines may apply in Arizona by statute. Two separate statutes proscribe acts which constituted common law champerty. In Section 13-261 of the Arizona Revised Statutes Annotated,[128] the crime of "barratry" is outlined. This statute, which is directed at the same judicial policies as the common law doctrines, prohibits activity intended to stir up litigation in which a party has no interest, and applies both to the general public and to attorneys. In addition, the statutes governing the conduct of attorneys contain a proscription on maintaining an action on the basis of corrupt motive, passion, or interest.[129]

That the prohibition of champerty outlived *Strahan* is shown by the

125. *Id.* at 133-34, 262 P. at 997.

126. *See* Haines v. Phillips Petroleum Co., 58 F. Supp. 777, 780 (W.D. Okla. 1945); Oil, Inc. v. Martin, 381 Ill. 11, 19, 44 N.E.2d 596, 600 (1942).

127. The *Strahan* court cited Gurule v. Duran, 20 N.M. 348, 149 P. 302 (1915), as the basis for its holding. 33 Ariz. at 134, 262 P. at 997. The *Gurule* case would also fit into the more traditional analysis.

128. ARIZ. REV. STAT. ANN. § 13-261 (1956) provides:

A. A person is guilty of barratry who:

1. Wilfully instigates, maintains, prosecutes or encourages bringing an action or presentation of a claim in which such person has no interest, for his own profit, or with the intent to distress or harass defendant or the person in the action to whom the claim is presented.

2. Wilfully brings or prosecutes a false action of his own for his own profit, or with intent to distress or harass defendant therein.

B. An attorney at law or other person is guilty of barratry who:

1. Seeks or obtains employment in the action to prosecute or defend it by means of personal solicitation of such employment, or by procuring another to solicit for him employment in such cases.

2. By himself or another, seeks to obtain the employment mentioned in paragraph 1 of this subsection by giving, loaning or promising to give, directly or indirectly, to the person from whom the employment is sought money or other thing of value.

It should be noted that in order for a person to be penalized under the statute, three instances of barratry must have occurred. *Id.* § 13-261(D).

129. In describing the duties of an attorney at law, *id.* § 32-263(7) (1956) provides that it is the duty of the lawyer "[n]ot to encourage either the commencement or continuation of an action or proceedings from any corrupt motive of passion or interest, and never to reject for any consideration personal to himself the cause of the defenseless or oppressed."

court's language in *Richfield Oil Corp. v. LaPrade*.[130] In *LaPrade*, the Arizona Supreme Court considered the argument that a contingent fee contract between an attorney and his client was champertous.[131] The case involved a motion by the defendant for an order requiring the plaintiff to give security for costs.[132] When the plaintiff successfully demonstrated his inability to do so, the defendant attempted to have plaintiff's attorneys account for the security.[133] The defendant argued that because the attorneys would be compensated from the proceeds of the judgment, they had a sufficient interest in the case to be charged with security for costs.[134] The court found the argument untenable, stating:

> The attorneys who take a case on the ordinary contingent fee basis are not parties to the action, nor could they be made parties plaintiff thereto, for while they are "interested" in the *result* of the action, they have no "interest" in the *right of action* itself. The client under such circumstances may settle, compromise or release his claim on such terms as he desires without the consent of the attorneys, or even in defiance of their wishes. . . . To say that under such circumstances they have an "interest," in a legal sense, in the cause of action is not true.[135]

Having found that the attorneys had no interest in the right of action, the *LaPrade* court then faced the issue of whether the contingent fee agreement was champertous: "Under the common law, where a person without interest in another's suit undertook to carry it on at his own expense . . . in consideration of receiving . . . a part of the proceeds of the litigation, the agreement was champertous and void. . . ."[136] Although technically falling within the definition of champerty, the court held that the modern view was to relax the rule and allow contingent fee arrangements, due to the competing policy of assuring access to the judicial system.[137]

LaPrade sets forth the Arizona test for determining whether an individual has a sufficient interest in the action to withstand a charge of champerty. Where the individual can be made a party to the action, his interest is not champertous.[138] However, if the interest of the individual inheres only in the result of the action and not in the right of action itself, a

130. 56 Ariz. 100, 105 P.2d 1115 (1940).
131. *Id.* at 102, 105 P.2d at 1116.
132. *Id.*
133. *Id.*
134. *Id.*
135. *Id.* at 105, 105 P.2d at 1118 (emphasis in original).
136. *Id.* at 104, 105 P.2d at 1117.
137. *Id.* The court went on the say that the attorneys could have been held liable for the security for costs if they had, in addition to the contingent fee contract, obtained an assignment of all or part of the cause of action. *Id.* at 105-06, 105 P.2d at 1118. The existence of an assignment would have permitted the attorneys to become parties in the action, but would also have shielded the attorneys from falling within the traditional definition of champerty. *Id.*
138. *Id.* at 105-06, 105 P.2d at 1118; *see* Kenrich Corp. v. Miller, 256 F. Supp. 15, 17-18 (E.D. Pa. 1966), *aff'd*, 377 F.2d 312 (3d Cir. 1967).

charge of champerty will lie, unless the presence of a public policy requires a specific exception.

The interest which is created by a Gallagher covenant in favor of the settling defendant falls within the definition found in *LaPrade*, and would not seem to bring any contravening public policies into play. The agreement creates a fund from which the plaintiff can realize his litigation costs. As consideration, the defendant can reduce his contractual indebtedness by proceeds from a judgment collected by the plaintiff from a codefendant. Clearly, the interest of the defendant entering the agreement is solely in the outcome of the litigation, and not in the cause of action itself. He stands to gain only from the proper result, and does not have a validly assigned interest in the cause itself which could be invoked to make him a party. A Gallagher covenant would thus seem to constitute champerty.

In *Lum v. Stinnett*,[139] the Supreme Court of Nevada held that an insurance company entering a Gallagher-type agreement on behalf of its insured did not have a sufficient interest in the plaintiff's action to avoid the champerty argument. The court classified such insurance companies as "strangers to the claims" of the plaintiff.[140] In *Cullen v. Atchison, Topeka & Santa Fe Railway*,[141] a case involving a loan receipt agreement, however, a contrary result was reached. The reasoning of the Kansas court in *Cullen*, however, was conclusory and offered little analytical insight into the problem. One reason for this is that the noncovenanting defendant raised the issue of champerty for the first time on appeal.[142] In addition, this issue was coupled with a charge that the loan receipt agreement constituted an illegal assignment of a tort claim.[143] In striking both challenges, the court simply stated:

> We might well decline to consider the champerty and maintenance issue because it was not raised nor presented to the trial court; however, we see nothing in the agreement complained of rendering it subject to [the champerty] doctrine nor did it constitute an illegal assignment of a tort claim inasmuch as State Farm did have at least a possible interest in any wrongful death action brought by the guardian.[144]

Lum represents the only American appellate decision that has given serious attention to the application of the champerty doctrine to the Gal-

139. 87 Nev. 402, 488 P.2d 347 (1971).
140. *Id.* at 407, 488 P.2d at 350.
141. 211 Kan. 368, 507 P.2d 353 (1973). *Cullen* arose from an automobile-train collision. The loan receipt agreement was entered into by the insurance company for the driver of the automobile and the survivors of his passenger. *Id.* at 370, 507 P.2d at 357. The agreement contained the usual pay-back provision, a guarantee to the plaintiff, and a conditional covenant not to execute against the agreeing defendant. *Id.* at 370-71, 507 P.2d at 357-58.
142. *Id.* at 374, 507 P.2d at 360.
143. *Id.*
144. *Id.* The court did not explain from where the insurance company's interest arose.

lagher-type covenant. Future decisions should look to this case for guidance and strike down such agreements as champertous. In Arizona, the doctrine of champerty is manifested by statute and case law, and can be applied to the use of Gallagher covenants. In addition, where an attorney is involved in the execution of such an agreement, the Code of Professional Responsibility raises other problems.

Canon 7: A Lawyer's Duty to the Adversary System of Justice

The American trial process is based on an adversary system for the determination of the legal and factual issues.[145] The adversary system posits that vigorous presentation of each side of the controversy affords the best opportunity for the trier of fact or the judge to properly resolve the issues actually in dispute.[146] Canon 7 of the Code of Professional Responsibility outlines the attorney's duty with regard to the adversary system.[147] The Ethical Considerations under Canon 7 are premised on the notion that the system functions best where full adversity between the parties to the controversy exists,[148] calling upon both lawyers and the courts to ensure that

145. *See* Frankel, *The Search for Truth: An Umpireal View*, 123 U. PA. L. REV. 1031, 1036 (1975); Freedman, *Judge Frankel's Search for Truth*, 123 U. PA. L. REV. 1060, 1065 (1975); Thode, *The Ethical Standards for the Advocate*, 39 TEX. L. REV. 575, 586 (1961); Uviller, *The Advocate, the Truth, and Judicial Hackles: A Reaction to Judge Frankel's Idea*, 123 U. PA. L. REV. 1067, 1067 (1975); ABA JOINT CONF. ON PROFESSIONAL RESPONSIBILITY, *Professional Responsibility: Report of the Joint Conference*, 44 A.B.A.J. 1159, 1160-61 (1958).

146. *See* M. FREEDMAN, LAWYERS' ETHICS IN AN ADVERSARY SYSTEM 9-26 (1975). *See generally* L. PATTERSON & E. CHEATHAM, THE PROFESSION OF LAW 111 (1971).

147. ABA CODE OF PROFESSIONAL RESPONSIBILITY, CANON NO. 7 (1976) states the general standard of conduct: "A Lawyer Should Represent a Client Zealously Within the Bounds of the Law." The Disciplinary Rules [DR] under Canon 7, of course, provide specific guidelines for such behavior. The overriding spirit of Canon 7 is that, while the lawyer should act as a vigorous advocate for his client, he should also not lose sight of the goal of the fair administration of justice. *See id.*, EC 7-39.

A Gallagher covenant may be seen to violate Canon 7 if it misleads the trier of fact. The obfuscation of the true position of the agreeing defendant works to undermine a full and impartial determination of the issues, violating the spirit, if not the letter, of Canon 7. Several judicial decisions have illustrated the reach of this Canon. In State v. Turner, 217 Kan. 574, 577, 538 P.2d 966, 970 (1975), facing a charge that an attorney had used improper and abusive language toward the opposing counsel, the court stated: "Suffice it to say that Canon 7 does not countenance unrestrained zeal on the part of an advocate; his ardent zeal, commendable in itself, is to be exercised within the bounds of the law." Similarly, in State v. Martindale, 215 Kan. 667, 672, 527 P.2d 703, 707 (1974) the court elaborated on this theme:

> Simply stated, courts must be able to rely on what lawyers say—what they represent as to the facts or the law. Courts must also be able to rely upon what lawyers do not say, for silence, when there is a duty to speak, may mislead the court and prejudice the administration of justice in the same way as a misleading, expressed statement.

See generally State v. Kruchten, 101 Ariz. 186, 191, 417 P.2d 510, 515, *cert. denied*, 385 U.S. 1043 (1966) ("The duty of an attorney to a client, whether in a private or criminal proceeding, is subordinate to his responsibility for the due and proper administration of justice. In case of conflict, the former must yield to the latter."); Barriero v. State Bar, 2 Cal. 3d 912, 926, 471 P.2d 992, 1001, 88 Cal. Rptr. 192, 201 (1970) ("It is the duty of an attorney to employ, for the purpose of maintaining the causes confided to him such means only as are consistent with truth, and never to seek to mislead the judge or any judicial officer by an artifice or false statement of law or fact.").

148. ABA CODE OF PROFESSIONAL RESPONSIBILITY, EC 7-20 (1976) provides:

> In order to function properly, our adjudicative process requires an informed, impartial tribunal capable of administering justice promptly and efficiently according

the adversary sytem is utilized to reach a fair and well-reasoned result for the litigants.[149] Thus, truly adverse parties promote the ability of the court and the jury to arrive at the truth and correctly adjudicate the legal rights involved.[150]

The Gallagher covenant undermines the proper functioning of the adversary system by its effect on the actual adversity of the plaintiff and the agreeing defendant. Gallagher covenants are frequently charged as collusive.[151] Collusion exists where an action is brought or maintained between parties who appear to be on opposite sides, but in fact, are cooperating in the action.[152] Where there is a Gallagher covenant between an individual defendant and the plaintiff, all adversity between that defendant and the plaintiff is removed. The defendant's interest is in providing an opportunity for the reduction agreement to accrue to his benefit. Where the insurance company negotiates the covenant, some adversity may still reside in the individual defendant; he may wish to be exonerated personally from all liability. Although the defense verdict will not affect the liability of the insurance company for the funds promised, such a verdict may result in the defendant's continued insurability by the company, since he was determined to be without fault in the transaction.

A lack of adversity between the parties works to the advantage of the plaintiff procedurally. Whereas the plaintiff and the agreeing defendant have

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to procedures that command public confidence and respect. Not only must there be competent, adverse presentation of evidence and issues, but a tribunal must be aided by rules appropriate to an effective and dignified process. The procedures under which tribunals operate in our adversary system have been prescribed largely by legislative enactments, court rules and decisions, and administrative rules. Through the years certain concepts of proper professional conduct have become rules of law applicable to the adversary adjudicative process. Many of these concepts are the bases for standards of professional conduct set forth in the Disciplinary Rules.

149. *Id.*, EC 7-39 states:

In the final analysis, proper functioning of the adversary system depends upon cooperation between lawyers and tribunals in utilizing procedures which will preserve the impartiality of tribunals and make their decisional processes prompt and just, without impinging upon the obligation of lawyers to represent their clients zealously within the framework of the law.

150. *Id.*, EC 7-23 provides:

The complexity of the law often makes it difficult for a tribunal to be fully informed unless the pertinent law is presented by the lawyers in the cause. A tribunal that is fully informed on the applicable law is better able to make a fair and accurate determination of the matter before it. The adversary system contemplates that each lawyer will present and argue the existing law in the light most favorable to his client. . . .

151. *See, e.g.*, City of Glendale v. Bradshaw, 16 Ariz. App. 348, 356, 493 P.2d 515, 523, *aff'd on rehearing*, 16 Ariz. App. 483, 494 P.2d 383 (1972); River Garden Farms, Inc. v. Superior Court, 26 Cal. App. 3d 986, 995, 103 Cal. Rptr. 498, 505 (1972); Ward v. Ochoa, 284 So. 2d 385, 387 (Fla. 1972); Degen v. Bayman, 86 S.D. 598, 608, 200 N.W.2d 134, 139 (1972).

152. River Garden Farms, Inc. v. Superior Court, 26 Cal. App. 3d 986, 996, 103 Cal. Rptr. 498, 505 (1972); *see* Elias v. Erwin, 129 Cal. App. 2d 313, 319, 276 P.2d 848, 852 (Ct. App. 1954). The reason for discouraging collusive actions is the doctrine that judicial power will be invoked only on strict necessity. Rescue Army v. Municipal Court, 331 U.S. 549, 569 (1947). Under this doctrine, the judicial system has imposed a limitation on its decisionmaking powers by entertaining only litigation which involves a real controversy. *See* Damron v. Sledge, 105 Ariz. 151, 155, 460 P.2d 997, 1001 (1969). *See generally* Elias v. Erwin, 129 Cal. App. 2d 313, 319, 276 P.2d 848, 852 (Ct. App. 1954).

the common goal of establishing the liability of all defendants, the plaintiff may still treat the agreeing defendant as an adverse party. One example of the tactical advantage this gives the plaintiff is that he may freely ask leading questions during cross-examination of the settling defendant.[153] Thus, unless the court qualifies the codefendant as adverse, the plaintiff will be granted the advantage of leading the settling defendant, while the nonsettling defendant will not be able to take the same liberties.[154]

Where collusion tacitly exists, the agreement may operate to mislead the jury.[155] Although the covenant operates to present the appearance of adversity between the plaintiff and agreeing defendant to the jury, all parties are cast in a false light to the detriment of the nonagreeing defendant. Of course, in Arizona, the finding of the ethical propriety of Gallagher covenants is bottomed on disclosure to all parties and the assumption that a convenanting attorney will fully and vigorously try the case.[156] The question arises, however, whether even full disclosure and the assumption of vigor will ensure the adversity necessary to make the judicial process effective. Since it is clear that the existence of the covenant alone creates a motivation to enhance the liability of codefendants, it would seem more logical to apply a presumption that the case will not be vigorously tried. Where the existence of a Gallagher covenant is revealed to the court, the trial judge should be required to scrutinize closely the activities of the attorneys during the trial.

It is doubtful that the problems created by Gallagher covenants under the strictures of Canon 7 are resolved by disclosure and the mere presumption of adversity currently mandated in Arizona. Although Canon 7 attempts to discourage half-hearted advocacy as well as clearly collusive actions, the application of *Damron v. Sledge*[157] requires definite evidence of a collusive undertaking. Since the attorney may feign actual adversity during the trial and exercise his professional judgment at numerous points,[158] proof that the attorney has failed to meet this standard is virtually impossible. The latitude traditionally allowed for trial tactics clearly militates against a finding of collusion. Attorneys are permitted a large measure of discretion in mapping and carrying out trial strategy, as demonstrated by the traditional tests of

153. *See* ARIZ. R. EVID. 611(c) (reprinted at 1977 Ariz. Legis. Serv. 885) (limiting the use of leading questions to an adverse party, hostile witness or a witness identified with the adverse party).

154. Daniel v. Penrod Drilling Co., 393 F. Supp. 1056, 1060 (E.D. La. 1975); Pellett v. Sonotone Corp., 26 Cal. 2d 705, 713, 160 P.2d 783, 788 (1945); Lum v. Stinnett, 87 Nev. 402, 411, 488 P.2d 347, 352 (1971); Degen v. Bayman, 86 S.D. 598, 608, 200 N.W.2d 134, 139 (1972).

155. Ward v. Ochoa, 284 So. 2d 385, 387 (Fla. 1974). *See also* Daniel v. Penrod Drilling Co., 393 F. Supp. 1056, 1060-61 (E.D. La. 1975); Trampe v. Wisconsin Tel. Co., 214 Wis. 210, 218, 252 N.W. 675, 678 (1934).

156. ARIZ. ETHICS OP. 72-26, at 5 (1972); *see* text & notes 82-89 *supra*.

157. 105 Ariz. 151, 460 P.2d 997 (1969); *see* text & notes 33-39 *supra*.

158. *See* text & note 82-89 *supra*.

legal malpractice.[159] For example, in *Lynn v. Lynn*,[160] an attorney for a party to a divorce action was charged with malpractice, negligence, and incompetence in his presentation of the case, motions, and post trial affidavits.[161] However, the court of appeals in Washington refused to find malpractice based on the attorney's trial technique, stating:

> Attorneys frequently differ on trial tactics, and obviously the substitute attorney did not agree with the trial attorney on the matter in which the trial was conducted. A difference of opinion on trial tactics, however, does not constitute either negligence or incompetence. The test of skill and competence of counsel is: After considering the entire record, was the complaining party afforded a fair trial?[162]

A lawyer is held only to a general negligence standard which requires him to act with the level of competence possessed by a reasonably prudent lawyer in the community.[163] Where a question of the attorney's judgment is concerned, the standard of care is necessarily flexible.[164] The test of good faith is employed in Arizona in such instances.[165] Similarly, where questions of law are involved, as long as the highest court in the jurisdiction has not ruled definitively on the matter, the good faith of the attorney will protect him.[166]

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159. In State v. Haley, 87 Ariz. 29, 347 P.2d 692 (1959), the incompetency of trial counsel was asserted on appeal of a criminal conviction. The court characterized the attorney's discretion as follows:

> Thus, an attorney in the trial court is accorded a wide breadth of discretion in making or omitting to make objections as in his judgment the exigencies of the case require. And it is of fundamental importance that the client be bound by the exercise of his attorney's discretion in these matters, otherwise a disposition of such cause may never become final.

Id. at 33, 347 P.2d at 694.

160. 4 Wash. App. 171, 480 P.2d 789 (1971).

161. *Id.* at 173-74, 480 P.2d at 791.

162. *Id.* at 175, 480 P.2d at 792; *see* Bollinger v. Nuss, 202 Kan. 326, 449 P.2d 502 (1969) (discussing a charge of bad faith during settlement negotiations, the court stated:

> An attorney must be given considerable leeway in trying a lawsuit, and ordinarily the matter of trial strategy must be left in his hands rather than in the hands of his client. Especially where the evidence negativing liability is weak, as apparently it was here, the admission of liability may tend to work psychologically in favor of the defense in relation to the amount of recovery.

Id. at 340, 449 P.2d at 513).

163. *See* Neel v. Magana, Olney, Levy, Cathcart & Gelfand, 6 Cal. 3d 176, 180, 491 P.2d 421, 422-23, 98 Cal. Rptr. 837, 838-39 (1971). *See also* Martin v. Burns, 102 Ariz. 341, 343, 429 P.2d 660, 662 (1967); Sarti v. Udall, 91 Ariz. 24, 26, 369 P.2d 92, 93 (1962).

164. Budd v. Nixen, 6 Cal. 3d 195, 200, 491 P.2d 433, 436, 98 Cal. Rptr. 849, 852 (1971); *see also* Martin v. Burns, 102 Ariz. 341, 343, 429 P.2d 660, 662 (1967); Sarti v. Udall, 91 Ariz. 24, 26, 369 P.2d 92, 93 (1962).

165. The good faith test is well established in Arizona in determining professional liability for errors of judgment. *See* Sarti v. Udall, 91 Ariz. 24, 26, 369 P.2d 92, 93 (1962). In Martin v. Burns, 102 Ariz. 341, 429 P.2d 660 (1967), the Arizona Supreme Court stated that an attorney will not be held liable in a malpractice action:

> while acting in good faith and in a belief that his conduct is for the benefit of his client, for a mere error of judgment or for a mistake in a point of law that has not been settled by the highest court of the jurisdiction and upon which reasonable lawyers may differ.

Id. at 343, 429 P.2d at 662.

166. Martin v. Burns, 102 Ariz. 341, 343, 429 P.2d 660, 662 (1967).

Where a Gallagher covenant is present, although the conduct of the attorney in handling the trial may not itself suggest collusion, proof of which is required under *Damron*, there is no way to ascertain whether discretionary actions are undertaken in the interest of a full adversary hearing.[167] Clearly, both the case law regarding the use of Gallagher covenants and the law concerning the permissible trial strategy make a finding of collusion virtually impossible. Under such circumstances, it would be entirely appropriate for the Arizona courts to presume Gallagher covenants violate Canon 7, rather than risk unascertainable ethical violations.[168] In *Mustang Equipment, Inc. v. Welch*,[169] the Arizona Supreme Court indicated that it might begin to give closer scrutiny to Gallagher covenants, by looking beyond the record into the policy favoring settlement. Although there was no evidence that the existence of the covenant changed any aspect of the trial, the court still investigated the impact of the covenant on other aspects of the case, holding:

> Thus, while the parties' failure to disclose the agreement apparently did not affect any litigant's course of conduct at trial itself, we cannot say that counsel for Mustang would not have pursued a settlement more actively than it actually did had it known of the agreement. Accordingly, we think it the better policy to require candid disclosure of all Gallagher-type agreements to the court and to all parties before trial or, if entered into during the course of the trial, at the earliest possible opportunity.
>
> Finally, we think this is a matter of public policy. While we recognized that under the particular fact situation of this case there was neither fraud, collusion nor unethical conduct involved, we cannot condone secret agreements between a plaintiff and defendant which, by their very secretiveness, may tend to encour-

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167. One further impediment still exists. In addition to a showing of collusion, the injured defendant must prove that the collusive undertaking had a substantial effect on the outcome of the trial. *See, e.g.*, Daniel v. Penrod Drilling Co., 393 F. Supp. 1056, 1059-61 (E.D. La. 1975); City of Tucson v. Gallagher, 108 Ariz. 140, 142-43, 493 P.2d 1197, 1199-1200 (1972); River Garden Farms v. Superior Court, 26 Cal. App. 3d 986, 1002, 103 Cal. Rptr. 498, 510 (1972); Ponderosa Timber & Clearing Co. v. Emrich, 86 Nev. 625, 627-28, 472 P.2d 358, 360 (1970). The effect of the behavior of the opposition counsel on the outcome of the trial involves an essentially subjective test, difficult of proof. As with the legal malpractice test, the injured defendant will often be placed in the impossible position of having to determine the inner workings of the trier of fact, especially difficult in light of the restrictions placed on communications with jurors. *See* ABA CODE OF PROFESSIONAL RESPONSIBILITY, DR 7-108, EC 7-29, EC 7-30, EC 7-31 (1976).

168. *Cf.* T.C. Theatre Corp. v. Warner Bros. Pictures, Inc., 113 F. Supp. 265, 268-69 (S.D.N.Y. 1953). In that case, the court assumed that confidential information was passed to an attorney who now was suing a former client, stating:

> The Court will assume that during the course of the former representation confidences were disclosed to the attorney bearing on the subject matter of the representation. It will not inquire into the nature and extent. Only in this manner can the lawyer's duty of absolute fidelity be enforced and the spirit of the rule relating to privileged communications be maintained.

Id.

169. 115 Ariz. 206, 564 P.2d 895 (1977); *see* text & notes 91-97 *supra*.

age wrongdoing and which, at the least, may tend to lessen the public's confidence in our adversary system.[170]

Canon 9: The Appearance of Impropriety

The Code of Professional Responsibility raises an additional ethical problem for the attorney using a Gallagher covenant, even if such covenant falls outside a strict reading of Canon 7. In Canon 9 of the Code, the lawyer is urged to avoid any "appearance of impropriety."[171] Although there is no Disciplinary Rule under Canon 9 which applies to the formation and use of the Gallagher covenant, the Ethical Considerations exhort the attorney not to distort the public confidence through behavior which will be perceived by the public as improper.[172] Public perception, in part, is the bedrock of Canon 9. However, the application of Canon 9 to actual cases demonstrates confusion as to its role in attorney discipline.

In *In re Ethics Opinion No. 74-28*,[173] the Arizona Supreme Court examined the role of Canon 9 in governing the conduct of an attorney serving on a city's council. The court held that public perception embodied in Canon 9 imposed limitations on the attorney's practice of law while employed as a councilman. First, the court ruled that Canon 9 prohibits appearances of members of the councilman's law firm before various municipal bodies.[174] Second, the participation of the councilman in matters before the council was limited where a member of his firm or a client of the firm was involved.[175] The majority of the court felt that to allow the attorney-councilman or his firm to participate in such official actions would create at least the appearance of impropriety in the public eye. However, the concurring judges felt that although the particular limitations of the majority opinion were justified, Canon 9 should be limited to only those situations where an actual ethical violation existed.[176] This represents an extremely narrow reading of Canon 9. Limiting the reach of this Canon to cases of actual impropriety would make it superfluous to the other provisions of the Code. Further, such an interpretation would be inconsistent with the inclusion of the term "appearance of impropriety."[177] It is the interest of the

170. 115 Ariz. at 211, 564 P.2d at 900.
171. ABA CODE OF PROFESSIONAL RESPONSIBILITY, CANON NO. 9 (1976).
172. *Id.*, EC 9-1, EC 9-2, EC 9-6.
173. 111 Ariz. 519, 533 P.2d 1154 (1975), *noted in* "The Arizona Supreme Court and the Appearance of Impropriety," 18 ARIZ. L. REV. 585, 772 (1976).
174. 111 Ariz. at 521, 533 P.2d at 1156.
175. *Id.* at 520-21, 533 P.2d at 1155-56.
176. *Id.* at 522, 533 P.2d at 1157 (Cameron, Lockwood, JJ., concurring).
177. General Motors Corp. v. City of New York, 501 F.2d 639, 649 (2d Cir. 1974) (disqualifying an attorney from representing a new client in a matter in which he had substantial responsibility while in government service, and stating:

> Accordingly, without in the least even intimating that [the attorney] was improperly influenced while in Government service, or that he is guilty of any actual impropriety in agreeing to represent the City here, we must act with scrupulous care to avoid any

public in the fair administration of justice that the lawyer must always keep in mind.[178]

Perception of impropriety in the use of the Gallagher covenant obviously exists among various members of the public. Surely, the nonagreeing defendant perceives the Gallagher covenant as a trick used to impede the fair trial of the cause. The number of challenges made against the covenants based on allegations of a denial of a fair trial would indicate this. Moreover, the public can generally be expected to view the covenants as unfair. Where the public is aware that the agreeing defendant has settled the extent of his liability while remaining in the trial for the sole purpose of reducing that liability at the expense of the nonagreeing defendants, it cannot help but perceive unfairness. In addition, since the plaintiff is the recipient of procedural advantages under the rules of evidence,[179] and the jury is not made aware of the bias of the agreeing defendant, there is certainly a reasonable argument that an appearance of impropriety results. Finally, an absence of the vigor required for the proper defense of an action would impress the public as improper. The goal of Canon 9 is to ensure that the public confidence in the judicial system will not be undermined. If the use of the covenant creates an appearance of impropriety, it should be declared to be against public policy and prohibited. An additional ethical restriction remains to be considered in regard to the use of Gallagher-type agreements.

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appearance of impropriety lest it taint both the public and private segments of the legal profession.

Id.)

178. *See* ABA CODE OF PROFESSIONAL RESPONSIBILITY, DR 1-102(A)(5) (1976). In State v. Kruchten, 101 Ariz. 186, 417 P.2d 510, *cert. denied*, 385 U.S. 1043 (1966), the court stated: "The duty of an attorney to a client whether in a private or criminal proceding, is subordinate to his responsibility for the due and proper administration of justice. In case of conflict, the former must yield to the latter." *Id.* at 191, 417 P.2d at 515. The court emphasized that among the purposes of regulating attorney conduct are protection of the public, the profession, and the administration of justice. *In re* Tribble, 94 Ariz. 129, 131, 382 P.2d 237, 238 (1963) (quoting *In re* Richey, 76 Ariz. 152, 154, 261 P.2d 673, 674 (1953)).

In Daniel v. Penrod Drilling Co., 393 F. Supp. 1056 (E.D. La. 1975), the court examined an agreement made during trial to dismiss a codefendant in a tort action at the end of trial, in exchange for an agreement by the codefendant "'not to maintain an aggressive, destructive posture vis-a-vis plaintiff's case, its witnesses, etc.'" *Id.* at 1058. The agreement was immediately made known to the court and the other defendants. *Id.* Regarding the conduct of the entering attorney, the court stated that the lawyer's duty to the proper administration of justice precludes the use of such an agreement. *Id.* at 1059-61. *See also* People v. Radinsky, 176 Colo. 357, 359, 490 P.2d 951, 952 (1971) (fraudulent activity by attorney in using assignment for the benefit of creditors, in suspending the attorney the court stated: "The foundation of the legal profession is honor. If acts of the type that the respondent has committed are not promptly and severely punished, the public will not have reason to trust lawyers that maintain the high standard of our profession."); State Savings & Loan Ass'n v. Corey, 53 Haw. 132, 146, 488 P.2d 703, 712, *cert. denied*, 406 U.S. 920 (1971) (fraudulent activity by attorney in negotiating mortgage, court admonished this behavior even though outside the scope of his attorney/client relation, stating: ". . . [A]n attorney, as an officer of the court, owes a special duty to the public, his client and the bar to keep his conduct beyond reproach . . . .").

179. *See* text & note 153 *supra*.

Canon 5: The Problem of Conflicting Interests

Canon 5 of the Code of Professional Responsibility was designed to ensure that a lawyer is able to exercise his professional judgment on behalf of a client free from any adverse influences.[180] Such adverse influences include his own interests, financial or personal, interests of other clients, or interests of third persons.[181] Both the Ethical Considerations and the Disciplinary Rules under Canon 5 outline what constitutes an adverse influence upon the lawyer's independent judgment.[182]

The participation of the insurance company and its counsel in the adversarial process creates a serious ethical impediment to the use of a Gallagher covenant. An attorney representing an insured on behalf of an insurance carrier is faced with a potential conflict of interest between the duty owed to the insured and the duty owed to the insurance company.[183] The individual insured desires to be exonerated from liability at trial so that he may remain insurable and maintain or improve his reputation in the community. This interest of the insured is unchanged by the existence of the Gallagher covenant. The insurer, before the covenant is signed, also seeks exoneration of the insured, for its own financial reasons. However, once the Gallagher agreement is made, this identity of interests is substantially weakened. Under the typical Gallagher covenant, the insurer no longer has a pecuniary interest in total exoneration of the insured, since a defense verdict will not excuse its liability. Instead, the insurance carrier has an interest in seeking a large plaintiff's verdict against all defendants, as this is the mechanism by which its liability can be reduced or eliminated. Canon 5 specifically recognizes the interests of the insurer and the insured as potentially differing,[184] requiring the attorney to weigh carefully the potential for impairment of his judgment in favor of one client over the other, and to resolve all doubts against dual representation.[185] However, the provisions of

180. ABA CODE OF PROFESSIONAL RESPONSIBILITY, EC 5-1 (1976).
181. *Id.*
182. *See, e.g., id.*, EC 5-1, EC 5-2, EC 5-13, DR 5-101, DR 5-105 and DR 5-107.
183. *Id.* EC 5-17 (1975) provides:

> Typically recurring situations involving potentially differing interests are those in which a lawyer is asked to represent co-defendants in a criminal case, co-plaintiffs in a personal injury case, an insured and his insurer, and beneficiaries of the estate of a decedent. Whether a lawyer can fairly and adequately protect the interests of multiple clients in these and similar situations depends upon an analysis of each case. In certain circumstances, there may exist little chance of the judgment of the lawyer being adversely affected by the slight possibility that the interests will become actually differing; in other circumstances, the chance of adverse effect upon his judgment is not unlikely.

See also ARIZ. ETHICS OP. 75-4, at 3 (1975) (discussing the ethical implications of employment of house counsel by an insurance carrier, while upholding the practice).
184. ABA CODE OF PROFESSIONAL RESPONSIBILITY, EC 5-17 (1976).
185. *Id.*, DR 5-105, EC 5-15. EC 5-15 provides:

> If a lawyer is requested to undertake or to continue representation of multiple clients having potentially differing interests, he must weigh carefully the possibility that his judgment may be impaired or his loyalty divided if he accepts or continues the employment. He should resolve all doubts against the propriety of the representation.

Canon 5 do not expressly prevent dual representation. A lawyer may undertake dual representation where he has fully disclosed the potentially differing interests to the clients and where it is obvious that each client can be adequately represented.[186] Under Canon 5, a lawyer is permitted, in certain limited situations, to represent the potentially differing interests of the insured and the carrier in negotiating and using the Gallagher covenant, if he fully discloses his ties with the insurer, how these might affect his judgment, and the implications of the covenant to the insured.[187] However, the attorney must be certain that adequate representation is possible under the circumstances.

If both the insurance company and the defendant are viewed as clients of the attorney, the conflict of interest is not potential, but present and intractable once a Gallagher covenant is entered into. The interest of the insurance company is in escaping payment in accordance with the terms of the covenant; the interest of the insured is in being found faultless in the transaction. Such interests clearly conflict and would seem to be outside the provisions of Canon 5 which allow dual representation. One solution to the problem of representing actually conflicting interests between the insurance company and the insured may be found, however, by redefining the relationship between the attorney and the insurance company.[188] A modification of the traditional attorney-client relationship can be made with respect to the insurance company, in order to enable the attorney to properly serve the insured.

The duties of the attorney representing an insured under an insurance policy reservation of rights clause were addressed by the Arizona Supreme

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A lawyer should never represent in litigation multiple clients with differing interests; and there are few situations in which he would be justified in representing in litigation multiple clients with potentially differing interests.

186. In the situations covered by DR 5-105(A) and (B), a lawyer may represent multiple clients if it is obvious that he can adequately represent the interest of each and if each consents to the representation after full disclosure of the possible effect of such representation on the exercise of his independent professional judgment on behalf of each.

Id., DR 5-105(C).

187. ARIZ. ETHICS OP. 72-26, at 5 (1972); *see* ABA CODE OF PROFESSIONAL RESPONSIBILITY, DR 5-105, EC 5-16. EC 5-16 provides:

> In those instances in which a lawyer is justified in representing two or more clients having differing interests, it is nevertheless essential that each client be given the opportunity to evaluate his need for representation free of any potential conflict and to obtain other counsel if he so desires. Thus before a lawyer may represent multiple clients, he should explain fully to each client the implications of the common representation and should accept or continue employment only if the clients consent. If there are present other circumstances that might cause any of the multiple clients to question the undivided loyalty of the lawyer, he should so advise all of the clients of those circumstances.

Id.

188. For a detailed discussion of the relationship and an argument for its redefinition, *see* "Duties of the Insurance Company-Retained Counsel: To the Insurer and the Insured," 18 ARIZ. L. REV. 585, 757 (1977).

Court in *Parsons v. Continental National American Group*.[189] In *Parsons*, the insurance company attorney, representing a child against allegations of negligently injuring the plaintiff, learned during his investigation of the case that there was evidence indicating the act was intentional, a potential policy defense. The attorney passed along this confidential information to the carrier, despite the fact that it had been obtained directly from the insured. The carrier then attempted to use this information to deny coverage.[190] The Arizona Supreme Court held that such behavior was clearly unethical and violated the right of the insured to undivided fidelity from his attorney.[191] Relying on opinions from both the American Bar Association Ethics Committee and the Arizona State Bar Committee on Rules of Professional Conduct,[192] the court held that the loyalty of the attorney must lie first and foremost with the insured.[193]

Applying *Parsons* to the Gallagher covenant problem, it is clear that an attorney cannot represent the insurance company in negotiating, drafting, or executing a Gallagher covenant, because to do so conflicts with the insured's interest in exoneration at trial. The relationship of the insured's attorney to the insurance company must necessarily be less than a client-attorney relationship. For example, if the relationship between the insurer and the attorney is redefined as one of agency, a workable solution appears. The relationship can be based on the theory of superior and inferior principals.[194] Under this theory, the duties owed to each principal are permitted to differ. Thus, the greater duty would be allowed to lie with the insured, while the insurer would also function as a principal, but of a lesser nature. The attorney would be permitted to represent both parties only insofar as their interests coincided, with his loyalty shifting to the insured in case of potential conflicts. With reference to the Gallagher covenant, the insurance company could then act independently from the insured in its negotiations with the plaintiff and the insured, retaining separate counsel for the purpose of negotiating the agreement. Indeed, the participation of separate counsel for the insured and the insurer with respect to Gallagher covenant negotiations may be the only solution to vitiate conflicting interests under Canon 5.[195]

However, if the *Parsons* decision is applied literally, the lawyer may be seen as having one client only—the insured. Under this reasoning,

189. 113 Ariz. 223, 550 P.2d 94 (1976), *noted in* "Duties of the Insurance Company-Retained Counsel: To the Insurer and the Insured," *supra* note 188.
190. 113 Ariz. at 225-26, 550 P.2d at 96-97.
191. *Id.* at 227, 550 P.2d at 98.
192. *Id.* at 226-27, 550 P.2d at 97-98 (*citing* ABA COMM. ON PROFESSIONAL ETHICS, INFORMAL OP. NO. 949 (1966); ARIZ. ETHICS OP. 282 (1969); ARIZ. ETHICS OP. 261 (1968)).
193. 113 Ariz. at 227, 550 P.2d at 98.
194. *See* "Duties of the Insurance Company-Retained Counsel: To the Insurer and the Insured," *supra* note 188, at 766-68.
195. ABA CODE OF PROFESSIONAL RESPONSIBILITY, DR 5-105 (1976).

adverse influences exerted by the insurance company would be violative of a mandatory provision of Canon 5 which prohibits an attorney from allowing a nonclient to affect his personal judgment on behalf of his client.[196] Compliance with this provision should also limit the activities of the insured's attorney in the use of a Gallagher covenant. Whereas, with the client's consent after full disclosure, the attorney may be paid by the insurance company, he may not allow the company to "direct or regulate his professional judgment."[197] The problem encountered by the attorney representing the insured when the insurer has entered a Gallagher covenant is avoiding the influence of the insurer on his professional judgment. It is a fact of life that insurance company-retained counsel is unlikely to do anything which would jeopardize his relationship with the carrier. Therefore, once he learns of the existence of an agreement, it is inevitable that his judgment will be affected by the insurer, the party that pays his fee. Tactical decisions at trial may be made with the insurer's, rather than the insured's, interests in mind. For this reason, the Gallagher covenant appears to violate mandatory provisions of Canon 5.

CONCLUSION

Until the Arizona courts grasp the initiative and rule that the Gallagher covenant embraces unethical behavior, an attorney may continue to make use of this device. However, the attorney should not overlook the condemnation of the covenant in other jurisdictions and the issues of champerty, collusion, and conflict of interests which inhere in the Gallagher covenant. Since the covenant by its very nature tends to obscure the true position of the settling defendant and may be supported wholly by an otherwise disinterested insurer, it both misleads the trier of fact and perverts the operation of the adversary system. Under Canon 7, such an undermining of the adversary process should not be permitted. The public has a right to expect that the judicial system will function fairly for all litigants. Further, since the covenants obviously provide an advantage to one side, public confidence cannot be fostered as mandated in Canon 9. Moreover, the conflicts of interest which the covenants create when an insurance company enters the picture cannot easily be remedied.

The attorney's duty to the administration of justice alone should charge him not to use the device. A federal district court in Louisiana recently expressed disdain for Gallagher-type covenants:

> Courts are not merely arenas where games of counsel's skill are played. Even in football we do not tolerate point shaving. It is

196. "A lawyer shall not permit a person who recommends, employs, or pays him to render legal services for another to direct or regulate his professional judgment in rendering such legal services." *Id.*, DR 5-107(B).

197. *Id.*

> perhaps because the trial is adversary that each side is expected to give its best, without secret equivocation. Counsel have a duty to seek ultimate truth in a system where the lawyer's duty is primarily to represent his client. But even if the lawyer has no duty to disclose the whole truth, he does have a duty not to deceive the trier of fact, an obligation not to hide the real facts behind a facade.[198]

The lawyer's obligation not to violate the Code of Professional Responsibility exists independently of the court's rulings on the validity of the Gallagher covenants, and that obligation should prohibit the use of the covenant despite the apparent reluctance of the Arizona courts to address the ethical issues which the Gallagher covenants present.

198. Daniel v. Penrod Drilling Co., 393 F. Supp. 1056, 1060-61 (E.D. La. 1975).