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# "DANCING ON THE HEAD OF A PIN"

## I. INTRODUCTION

Insurance defense counsel is placed in a difficult position every time a new case is referred for the defense of an inured. The desire to provide excellent customer service according to the insurer defense guidelines must be balanced with the need to protect the rights of the client (insured). The tripartite relationship between insured, insurer and defense counsel is like dancing on the head of a pin. One misstep and the delicate balance can result in losing a client that could potentially provide the attorney's firm with a significant amount of revenue, or it exposes the insured to an excess judgment or other unintended negative consequences. Insurers, defense counsel and the insureds must always be cognicent of their relationship and the role it plays in defense of a claim. Understanding of the nature of this relationship and the challenges it presents impacts the rights and interests of all parties involved.

The tripartite relationship is formed as soon as the matter is assigned to defense counsel and the insured acknowledges and agrees to the representation. In many instances, this is the first time defense counsel is representing the insured, in addition to the insurer. It is presumed that defense counsel has been selected because of the insurer's knowledge of the attorney's expertise, decision-making processes, and work habits. It is also presumed that defense counsel has a reasonable understanding of the insurer's claims handling philosophy and procedures.

The ultimate obligation of the defense attorney is to determine the needs of both the insured and hopefully end up with a result that is in the best interests of all concerned.

## II. CASE STUDY

Examining the events of a recent case involving the tripartite relationship will be helpful in illustrating the different interests between the insured, insurer and defense counsel that arise throughout the representation. This case was tried to a verdict. Counsel danced their way through and fell many times.

**a. Facts**

This case arose out of a three-vehicle accident that occurred on August 8, 2006. The plaintiff alleged that at the time of the accident, she was stopped at a traffic light on Centerville Road in any town, USA. The plaintiff alleged that she was rear-ended by a motor vehicle operated by co-defendant, Craig Cringle, which was in turn rear-ended by the vehicle operated by co-defendant, Kerry B. Ferry. On August 8, 2006, Client provided Ms. Ferry the "loaner vehicle" while her car was being serviced. Car Owner owned the motor vehicle operated by Ms. Ferry. Car Owner leased the subject vehicle to Client for use in its Loaner Fleet. Plaintiff then brought suit against Kerry Ferry, Car Owner, Craig Cringle, Client, Car Company and co-defendant for medical damages, loss of society for her daughter and pain and suffering.

The insurance coverage in place at the time of the accident was as follows:

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| Priority Insurance | $50,000.00 |
| Craig Cringle | $50,000.00 |
| Secondary Insurance | $2,000,000.00 |
| Third Insurance | $3,000,000.00 |
| Umbrella Insurance | $15,000,000.00 |

It also appeared that there were several layers of Umbrella Coverage maintained through Third Insurance in excess of $50,000,000.00. Priority's coverage was first, followed by Secondary, Third Insurance and then finally Umbrella policy, if necessary.

**b. The Representation**

Priority Insurance and **Secondary insurance assigned defense counsel.**

As the case progressed, settlement negotiations occurred between all parties involved. Settlement talks ultimately failed, and the case was assigned for trial. However, prior to trial, the Plaintiff made a $2 Million Dollar policy limits demand to counsel for Car Owner and Car Company. The demand was rejected. Did the insurer fail in its fiduciary duty to seriously consider a plaintiff's reasonable offer to settle within the policy limits? If an insurer fails to settle, does it do so at its own peril? In the present case, the Plaintiff was willing to accept $2 million dollars, which was less than the combined policy limits of at least $2.05 million dollars. What was counsel's recommendation? Secondary Insurance ultimately rejected Plaintiff settle demand and the case proceeded to trial.

### c. Conclusion

This case is effectively illustrates the tripartite relationship between the insured, insurer and defense counsel because it shows the potential conflicts of interests that can arise in catastrophic loss cases. The interests of all the parties involved were not the same throughout the course of the lawsuit. Unfortunately, throughout the trial and defense of the case, counsel for Car Company, Car Owner and Secondary Insurance made determinations as to settlement of this matter, contrary to the interests of my client, in order to take the course of action that they thought was in their best interests. They had every opportunity prior to trial to resolve the case below the policy limits and refused to do so. In spite of all efforts to resolve the case, Secondary Insurance controlled settlement negotiations and made the final decision to risk a judgment in excess of the policy limits and tried the case. It was in Client's interest to settle the case below the policy limits in order to avoid excess damages. Because the insurer controlled the entire process, the only other alternative Client had would have been to pay the claim and proceed against Secondary Insurance for indemnification, which was not an option at any time throughout the case. In my opinion, it was in the best interest of all defendants for Secondary Insurance to resolve this case prior to trial when the Plaintiff made their settlement demand within the underlying limits prior to trial and then again after trial when the jury awarded damages less than the policy limits before judgment entered. This was ultimately Secondary Insurance's course of action.

## III. WHAT DOES THE RULE SAY?

We all think we know the rules, but when was the last time they were reviewed? Although each jurisdiction has specific rules governing the relationship between counsel and the client, it is fair to say that all jurisdictions have rules similar to the American Law Institute Restatement of The Law Governing Lawyers and the American Bar Association Rules of Professional Conduct. The Restatement offers the following guidelines:

*"(1) A lawyer may not represent a client under circumstances in which someone other than the client will wholly or partly compensate the lawyer for the representation, unless the client consents under the limitations and conditions provided in Section 202 [provision concerning the nature of informed consent to conflicts of interest], with knowledge of the circumstances and conditions of the payment.*
*(2) A lawyer's professional conduct on behalf of a client may be directed by someone other than the client when:*
*(a) The direction is reasonable in scope and character, such as by reflecting obligations borne by the person directing the lawyer; and*
*(b) The client consents to the direction under the limitations and conditions provided in Section 202." (Restatement of The Law Governing Lawyers, Section 215)*

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*"A lawyer might be designated by an insurer to represent the insured under a liability insurance policy in which the insurer undertakes to indemnify the insured and to provide a defense . . . certain practices of designated insurance defense counsel have become customary and, in any event, involve primarily standardized protection afforded by a regulated entity in recurring situations. Thus, a particular practice permissible for counsel*

*representing an insured may not be permissible under this Section for a lawyer in non-insurance arrangements with significantly different characteristics.*

There is no dispute that a lawyer assigned to defend an insured has a client- lawyer relationship with the insured. However, some states have recognized that an insurer can be found to be a client of the lawyer under limited circumstances, which requires more than the fact that the insurer assigns counsel for the insured. The Restatement provides some direction as to whether an attorney-client relationship also exists between the attorney and the insurer under Section 26. It provides in pertinent part:

*(Restatement, Section 215, comment f.)*

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*"A relationship of client and lawyer arises when a person manifests to a lawyer the person's intent that the lawyer provide legal services for the person . . . and either*

*(a) the lawyer manifests to the person consent to do so; or*

*(b) the lawyer fails to manifest consent to do so, and the lawyer knows or reasonably should know that the person reasonably relies on the lawyer to provide the services." (Restatement, Section 26(1).)*

The ABA Rules offer the following similar guidelines:

*"A lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer's responsibilities to another client or to a third person, or by the lawyer's own interests, unless:*

*(1) The lawyer reasonably believes the representation will not be adversely affected; and*

*(2) The client consents after consultation. When representation of multiple clients in a single matter is undertaken, the consultation shall include explanation of the implications of the common representation and the advantages and risks involved." (ABA Rules of Professional Conduct, Rule 1.7(b).)*

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*"A lawyer may be paid from a source other than the client, if the client is informed of that fact and consents and the arrangement does not compromise the lawyer's duty of loyalty to the client . . . for example, when an insurer and its insured have conflicting interests in a matter arising from a liability insurance agreement, and the insurer is required to provide special counsel for the insured, the arrangement should assure the special counsel's professional independence." (ABA Rules, Rule 1.7, comment 10.)*

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*"A lawyer shall not accept compensation for representing a client from one other than the client unless:*

*(1) The client consents after consultation;*

*(2) There is no interference with the lawyer's independence of professional judgment or with the lawyer-client relationship; and*

*(3) Information relating to representation of a client is protected as required by Rule 1.6." (ABA Rules, Rule 1.8(f).)*

In most jurisdictions, the law requires defense counsel hired by an insurance company to fulfill attorney-client obligations to the insurance company and the insured. It is this "dual client" concept that is the foundation of the tripartite relationship and the source of the many practical and ethical dilemmas that arise when the interests of the lawyer's two clients diverge.

In most cases compliance with the rules is easy. However, in cases that involve insureds with large self-insured retentions, insureds that are publically traded corporations, or situations where the policy limits are insufficient to cover the damages at issue, compliance with the rules can be challenging. The insured and the insurer have more to lose, and the pressure upon defense counsel to avoid or minimize the loss is correspondingly greater. The insurer's interest in conserving defense costs and preserving as much of its indemnity limits as possible may be in conflict with the insured's interest in keeping any judgment or settlement within the policy limits and avoiding an excess verdict.

When deductibles, self- insured retentions, policy limits, aggregate limits, and umbrella coverage is likely to be reached or exceeded; the interests of the parties may diverge. This happens especially when a judgment will have a far-reaching impact.

Although the ethical rules apply to small and large cases alike, the potential conflicts that may only be theoretical in cases with low damages more often become reality when a large loss is at issue.

## IV. WHO ARE YOU REPRESENTING?

It is important to understand the issues that can arise within the tripartite relationship, especially in cases that involve catastrophic losses, because the need for an appropriate response is imperative. The effect of one misstep in a catastrophic loss case can be devastating, for both the attorneys and the parties. As such, the assigned counsel's conduct is scrutinized at each and every step of the case. "Monday morning quarterbacks" wait on the sidelines to review the actions of assigned counsel. Emotions run high on all sides. The nature of the amount of damages at risk magnifies the disparate interests between the insurer and the insured. The pressure for a prompt and proper resolution of perceived conflicts in these cases can be intense.

Accordingly, in catastrophic loss cases, it is crucial for assigned counsel to be proactive in identifying potential conflicts and be prepared to deal with the conflicts that cannot be avoided.

### a. "Do not expose me to an excess judgment!"

A potential conflict can arise where there is a reasonable likelihood that a judgment will exceed the indemnity limits of the insured's policy.

The perception of a catastrophic loss can influence the approach of an insurer in several ways. A verdict potential at or near the policy limits may compel the insurer to be particularly aggressive in its efforts to save some of its limits. On the other hand, a verdict potential that clearly exceeds the policy limits may lead the insurer to believe that its limits will be lost no

matter what manner of defense is raised, so it will discourage elaborate defense strategies or tactics that will only raise the cost of the defense. From another perspective, a verdict potential clearly in excess of the policy limits may induce the insurer to be particularly interested in settling quickly, since the only savings it can realize are those associated with the cost of defense. Or, if the insurer views the claim as being marginally defensible, that may induce the insurer to try the case, based on the limited possibility that a defense will be obtained.

For the insured, the perception of a verdict potential in excess of the policy limits means something quite different. Since the insurer pays for the defense, the insured has no interest in conserving defense expense. To the contrary, the insured normally wants a five star defense waged on its behalf, particularly in a case with a large potential for damages. Nor does the insured have any interest in conserving the indemnity limits of the policy. Most insureds are primarily interested in only one thing: avoiding personal liability. As a result, it is in the clear financial interest of the insured for the insurer to settle the case, so long as the settlement falls within the indemnity limits of the policy.

As the possibility for a verdict potential in excess of the policy limits increases, the polarization of the competing interests between the insured and the insurer increases as well. It is only until a settlement demand is made within the policy limits that the potential conflict of interests between the insured and the insurer dissipates. If a settlement offer is made within the policy limits, the interest of the client is paramount to the interest of the insurance company. After consulting with the client, counsel has a legal duty to carefully protect the interests of the insured by advising the insurance carrier of that duty.

The nature of the conflict that arises from potential excess verdict exposure is such that it requires continuous reexamination and reevaluation by counsel. As discovery proceeds, the defense assessment of the value of the case can often change in ways that will affect the competing interests of the parties and the representation owed by counsel. The presentation of a demand within the policy limits may immediately actualize dormant conflicts. In addition, during the course of negotiations, the balance of competing interests between insured and insurer may change abruptly. Counsel must remain ever mindful of her dual role and the sometimes competing interests of her/ her clients. This issue does not rest until the case has been finally concluded.

**b. "I don't care if punitive damages are not covered, you have to defend me!"**

Punitive damages are designed to punish the insured for egregious conduct. Many policies expressly exclude coverage for punitive damages and many jurisdictions prohibit coverage for punitive damage claims.

The insured, of course, is primarily interested in vigorously defending against the punitive damages claim because of their potentially high personal exposure. While many insureds will retain personal counsel, most often, the defense of the covered damages claims is consistent with the defense of the uncovered punitive damages claim (e.g., where the defendant denies that she was negligent or willful and wanton, or denies that her conduct was a proximate cause of the injury).

When an insurer owes or undertakes the duty to defend its insured in a suit seeking both insured and uninsurable damages, it has the duty to conduct settlement negotiations in good faith as part of that defense. This includes warning the insured of any potential exposure to him and apprising him of settlement opportunities within a reasonable time after they are presented. The insurer's obligation to exercise good faith in the defense and negotiation of the case does not entirely eliminate the occurrence of conflicts for defense counsel, but it helps. Where actual conflicts arise as to the approach to the defense (e.g., where the insured resists admitting liability when the insurer wishes to admit liability), it may be beyond the ken of the defense counsel to either resolve the conflict or continue defense representation.

Thus, again, the analysis of potential conflicts and the assessment of counsel's proper response should be an ongoing process throughout the life of the file.

**c. "It is my money, pay the claim!"**

Another scenario in which a conflict may arise is the situation where the insured has a substantial deductible or self-insured retention, by first allocating dollar risk to the insured rather than the insurer. When this occurs, the usual interests of the insured and insurer are initially reversed. Depending upon the perceived exposure in the case, the insured may initially resist settlement where there is a substantial deductible or self-insured retention in place, because she has the primary obligation to fund settlements. On the other hand, the insurer may be very interested in settling, precisely because it is the insured's money that will fund the settlement. The insured may more readily recognize that a prompt settlement is in its best interest simply because there is no realistic likelihood of preserving the deductible or self-insured retention by the time the case concludes.

The insured/insurer dynamics may revert to the scenario in which there is no deductible or self-insured retention on the policy if and when the insured realizes that its deductible or self-insured retention will be consumed regardless of the case's outcome. Until then, the insured's interest focuses on conserving the deductible or self-insured retention by avoiding a judgment in excess of the policy limits. Since the interests of the insured and insurer are largely measured by the parties' perceptions of the value of the case, counsel must have a keen sensitivity to potential conflicts throughout the lifetime of the file, because those perceptions can easily change.

**d. "Do I have plenty of coverage to settle the case? I don't care how much coverage I have I want a trial! I did nothing wrong!"**

The analysis of conflicts typically involves an examination of the insured's and the insurer's divergent economic interests. Insureds sometimes resist settlement, even when it would seem to be in their clear financial interest. Sometimes this resistance is based on principle (The insured says, "Don't pay anything, because I didn't do anything wrong."). Other times, the resistance is based in the insured's interest in maintaining her reputation (The insured tells her attorney, "A settlement would have disastrous consequences for my personal reputation or my professional reputation in the business community").

While some liability policies expressly require the consent of the insured before the insurer may settle a claim, most do not. Rather, most liability policies grant the insurer exclusive control over the defense and the settlement of claims, within the carrier's discretion. Under such policies, the insurer is authorized to settle a claim, even over the objection of the insured. The insurer, wishing to limit its defense and indemnity exposure, may insist that counsel seize the opportunity to settle the claim. At the same time, the insured, wishing to preserve principle or reputation, may insist that the opportunity to settle be ignored, demanding that the case be tried for vindication. It is important for the defense counsel to remember that even where the policy clearly allocates the control over settlements to the insurer, the insured still has a choice. As the party to the suit, it is always the insured's decision whether to settle or proceed to trial. Choosing to proceed to trial when the insurer wishes to settle may jeopardize the insured's insurance coverage, but this is a choice to be made by the insured nonetheless.

Defense counsel plays a critical role in advising the insured and the insurer of their options regarding settlement. By carefully explaining the practical importance of taking advantage of an opportunity to settle, counsel is also in the best position to reconcile the potential conflicts that may divide the insured and insurer. Particularly in high stakes cases, where the insured's personal financial exposure may be great, counsel can be instrumental in shepherding the case to a negotiated resolution using the insurer's money to settle a case. However, if the insured sticks to his guns and demands that the case not be settled, counsel may face an irresolvable conflict of interests. When one of the counsel's clients tells her to settle the case, and the other client tells counsel not to settle the case, and these positions cannot be reconciled, counsel has no choice but to withdraw. Handling these potential conflicts requires counsel to carefully monitor the attitudes of the insured and insurer throughout the litigation and to identify any potential conflicts when they arise.

**e. "How much is this going to cost?"**

Pursuant to the terms of most insurance policies the right to control the defense is allocated to the insurer. Assigned counsel has a duty to zealously and skillfully defend the insured in the underlying litigation. Balancing the interest of the insurer with the interest of the insured may become a challenge for counsel when the insurer refuses to pay for experts, investigators, testing etc.

Counsel must remember that it is the insured's decision based upon counsel's recommendation that controls. If an insurer refuses to pay for an expense, the file must be documented and the insured must be advised of the refusal and be given an opportunity to pay the cost associated with the recommended course of action. Assigned counsel must not do anything to favor either until the potential conflict can be resolved by mutual agreement.

These conflicts are particularly difficult in catastrophic loss cases because they can pit the insurer's efforts to conserve defense expense against the defense attorney's judgment. In a serious case, the insurer may face tremendous defense expense, whereas containing those expenses is a high priority for the insurer. However, from the insured's perspective, a large loss or a catastrophic case is exactly the kind of case where defense costs mount at an alarming rate.

To avoid surprise, assigned counsel must assess the case immediately upon receiving the assignment and advise the insurer of all anticipated expenses.

## V. RECOMENDATONS

Counsel must keep in mind that the client's objective is paramount. Communicating early and often will assist all parties, defense counsel, the insured and the insurer in determining what activities are needed to achieve the client's desired objective, whether that is contesting liability or mitigating damages. Counsel must determine what is the best outcome for the insured and NEVER forget that the insured's interest must come first including responding to settlement demands over the insurers comfort level but within the policy limits. Some questions counsel should always consider:

- Is early resolution in the best interest of the client?
- What is needed to achieve early resolution?
- Is liability at issue?
- If liability is not at issue, what are the damages?
- What will be the impact of a trial on the insured?
    - Excess exposure?
    - Damage to reputation and brand?
    - Time and/or resources required to defend?

Communication and early agreement regarding defense strategy will result in the delicate balance needed to complete the task without falling off the head of the pin into the abyss of bad faith and malpractice.

Remember, the rules, guidelines and information provided above is not binding nor is it exhaustive. It is ALWAYS best practice to follow the rules and procedures in the jurisdiction in which defense counsel practices.