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Coverage Jeopardy! Test Your Skills on Some of the Most Challenging Coverage Scenarios

I. Steps To Be Taken Upon Receipt of Time-Limited Policy Limit Demand

Plaintiff's counsel are frequently issuing policy limits demands, some are issued prior to a suit being filed. In many instances, the purpose of the demand is an attempt by the claimant to create potential exposure for an indemnity obligation in excess of the policy's stated dollar limits. Thus, attention to deadlines and steps to be taken to avoid exposure beyond the policies' limits are necessary.

Upon receiving a time limit demand, it's important to review the demand thoroughly and determine what conditions are imposed on the insurer, and what scope of release is being offered. The scope of release may be particularly significant if the claim is or could be asserted against several different insureds. In order to develop an appropriate response, first review the information you have and determine what information you would need to answer the demand completely. After you have done a preliminary review of what information is still needed in order to respond to the demand, you should communicate, in writing, acknowledging you have received the demand and if appropriate, request additional time (perhaps 30 – 60 days) depending upon what additional information is needed and/or the complexity of the evaluation you need to undertake in order to respond. Furthermore, when acknowledging the demand, it is important to state what additional information you need in order to properly evaluate the demand with respect to the claim and advise why you need this additional information. If you are requesting additional time as well, it is also important to state why that additional time is needed. For example, are you planning to retain defense counsel or an expert to assess liability and damages? Is a site inspection necessary or helpful to properly evaluate the alleged damages? Do witnesses need to be contacted and interviewed?

While you are awaiting the requested additional information, you should advise the insured(s) of the demand and provide them with a copy of the demand. Here, you can also advise the insured you are awaiting further information from other sources but inquire if they have any further information or documentation that would further assist with the claim. Since you have already done a preliminary review of the claim, you may be able to alert the insured as to how you plan to respond, though that approach may not be appropriate in all policy limit demand scenarios. You will also want to determine what if any additional insurance is available to the

insured and advise the other insurers (primary and excess) of the demand in writing and provide them with a copy of the demand. When finalizing your response to the demand, determine whether affidavits are necessary (e.g. no other coverage or assets) and include them with your response.

If you are accepting a demand, you need to first and foremost assess the need for releases. Are you securing a release of all known and unknown claims? Are all insureds or potential insureds being released? Additionally, make sure to consider the potential of liens and other claims when crafting a release. In some insistences, if a claim involves bodily injury, there may be Medicare liens or health care liens that you will have to consider.

When determining if the demand should be rejected, you should consider such factors as, is there liability or potential liability exposure that does not warrant settling for policy limits; are damages unclear; and is there a reasonable basis to make a settlement offer for an amount less than the demand? Of note, if the demand is for damages which are not covered under the policy, you need to determine if there is a basis to seek contribution from the insured to resolve the action.

II. Handling Of Policy Limit Demand Regarding Claim Valued In Excess Of Limits Involving Covered And Non-Covered Damages

A problem insurers are faced with is that frequently they are confronted with high damage exposure claims which exceed the policy limits, but a large portion of the claim is not covered. When presented with this situation, an insurer should determine what steps should be taken where covered damages are within limits but the total damage exposure exceeds limits and there is a time limit demand within limits. One of the first steps you should consider is to advise the insured in writing of the coverage limitations and invite the insured to participate in discussions and offers. Be sure to set forth the coverage limitations to the insured in a way that the insured understands them. You will want to issue appropriate reservation of rights letters as well, after you determine whether the jurisdiction requires reservation of rights and/or partial disclaimer letters, to the injured party or others. Also, you will want to determine whether there are other statutory obligations. Generally, there are no obligations to make payments for non-covered claims. It is important; however, to assess which claims are covered and which claims are not covered. Once you have made the determination as to covered verses non-covered claims, you would follow the steps outlined above regarding responding to a time limit demand.

III. Reservations Of Rights and The Right To Independent Counsel

In some states whether an insured is entitled to have independent counsel funded by the insurer is an unresolved issue. For example, in Arkansas there is currently no published state court decision or statute, but some federal district courts have concluded that the state courts would hold that a reservation resulting in a conflict of interest would trigger a right to independent counsel. See, e.g., *Northland Ins. Co. v. Heck's Service Co., Inc.* (E.D.Ark. 1985) 620 F.Supp. 107; *Union Ins. Co. v. Knife Co.* (W.D. Ark. 1995) 902 F. Supp. 877; *Bituminous Cas. Corp. v. Zadeck Energy Group, Inc.* (W.D. Ark 2005) 416 F.Supp.2d 654.

In Colorado, there is currently no published state court decision or statute. The federal district courts have predicted that Colorado would adopt the approach that, in a conflict of interest situation, appointed defense counsel only has one client - the insured - and counsel is required by state professional ethics rules to not consider the insurer's interests in handling the insured's defense. See, e.g., *Essex Insurance Company v. Tyler* (D.Colo.2004) 309 F.Supp.2d 1270.

When the issue has been resolved by state courts, typically, one of three approaches has been adopted. The first approach is the "No Right To Independent Counsel" approach. In some states, the insurer can provide a defense by way of appointed defense counsel even where the insurer reserves its rights and this reservation results in a conflict of interest between insurer and insured. A reservation of rights under states which follow this approach never triggers a right to independent counsel.

The typical rationale for a state's adoption of this "no right to independent counsel" approach is: There is no "tripartite" relationship between insurer, insured and defense counsel retained by the insurer to defend the insured against third-party claims. Defense counsel appointed by the insurer has only one client – the insured – and does not also represent the interests of the insurer. It is the ethical duty of appointed defense counsel to not consider the interests of the insurer when handling the insured's defense. Counsel must only consider the interests of counsel's singular client, the insured.

Other states adopt the "Any reservation triggers a right to independent counsel" approach. The insured has a right to independent counsel whenever the defending insurer asserts, for whatever reason, that not all claims alleged in the suit are covered under the policy. The primary basis for adoption of this approach (as well as for the "only an actual conflict" triggers a right to independent counsel approach discussed below) is the particular state's recognition of a "tripartite" relationship between the insurer, the insured, and insurer-appointed defense counsel.

The "tripartite" relationship is the relationship between defense counsel, the insurer, and the insured that is created when counsel is hired by the insurer to defend a suit against the insured. Defense counsel has two clients, the insurer that hired counsel and the insured that counsel is obligated to defend, and the primary, overlapping, and common interest of defense counsel and counsel's two clients is the speedy and successful resolution of the suit against the insured. However, when the insurer reserves its rights on a coverage issue, defense counsel may be facing the ethical dilemma of two clients with opposing interests. The classic ethical dilemma situation is where the underlying complaint alleges mutually exclusive theories of recovery, one covered and one not, such as, in the case of standard "occurrence" (accident)-based Bodily Injury and Property Damage Liability Coverage, negligence (covered) and intentional tort (not covered). If the insurer reserves rights pursuant to the "occurrence" definition, the potential exists for appointed defense counsel to, through the way the defense is handled, steer the case towards a result that is either favorable on the coverage issue to the insurer or to the insured. In this situation, the reservation of rights results in an actual conflict of interest between insurer and insured.

However, in an "any reservation triggers a right to independent counsel" jurisdiction, it does not matter whether there is any reservation of rights that in fact results in an "actual conflict" of interest. If the insured reserves any right, regardless of whether or not this reservation results in any conflict of interest (potential or actual), the insured has a right to independent counsel.

The majority approach is that only a reservation that results in an "actual conflict" of interest triggers a right to independent counsel. In the majority of states that have addressed the right to independent counsel issue, either by case law or statute, the insurer must offer independent counsel paid for by the insurer only where the insurer has reserved one or more rights that result in an "actual conflict" of interest between the insurer and insured. States that have clearly adopted the "actual conflict" approach include: Alaska, California, Illinois, Kansas, Louisiana, Maryland, Minnesota, Missouri, Nevada, New Hampshire, New York, North Dakota, Ohio, Oklahoma, Oklahoma, Pennsylvania, Rhode Island, and Texas.

A court in a state that has adopted the "actual conflict" of interest approach regarding the right to independent counsel looks to the facts of the particular case to decide whether a particular reservation of rights results in an "actual conflict." The question to answer is, generally: Does this reservation result in a situation where appointed defense counsel could (would be in a position to) control the outcome of the coverage issue by the way he or she handles the insured's defense (e.g., through discovery, jury instructions and special verdicts)? The impact of each reservation of rights must be evaluated independently. It only takes one reservation of rights which results in an "actual conflict" for the insured to have a right to independent counsel

IV. Determining Reasonable Attorney Fee Rates For Payment of Independent Counsel

When the insured's right to independent counsel is triggered, there is often disagreement between the insurer and insured as to what rates should be paid. Determining a reasonable attorney fee rate may vary by state. In some states (for example, Alaska and California) the rate is tied to the rates paid to panel counsel, see e.g., Cal. Civ. Code §2860 and Alaska Stat. §21.89.100(d)). Other states reject panel rates as unreasonable since they are often tied to a volume discount, see e.g. *Northern Sec. Ins. Co. v. R.H. Realty Trust*, 941 N.E.2d 688 (Mass. Ct. App. 2011).

Rates may be determined by factors set out in ABA Model Rule 1.5(a). Those factors include: 1) time and labor required; 2) novelty and difficulty of issues; 3) skill required; 4) loss of other employment in taking the case; (5) customary fee; 6) whether the fee is fixed or contingent; 7) time limitations imposed by client or circumstances; 8) amount involved and result obtained; 9) counsel's experience, reputation and ability; 10) case undesirability; 11) nature and length of relationship with the clients; and 12) awards in similar cases. *Kolupar v. Wilde Pontiac Cadillac, Inc.*, 2004 WI 112, § 28, fn. 5 (These fees and costs… are reasonable and necessary based on the quality of work, and the experience of the attorney involved).

In some instances, the policy itself may have language addressing conditions or limits on payment for independent defense counsel. However, those policy provisions may or may not be enforceable or compatible with particular state's laws.

Lastly, in some states the insurer may engage in negotiations with the insured to reach an agreement as to the rates paid to independent counsel.

V. "Privileged and Protected" – What Does This Mean?

The presentation will include discussions into what it means when someone says "privileged and protected"; attorney client privilege; work product privilege; when these privileges don't apply; and how these privileges are created and how they are lost.

VI. Use Of Mediation To Resolve Coverage Disputes

Often times, unresolved coverage issues hamper an insurer's ability to settle an underlying action. Some strategies may be employed to work through coverage issues so they do not present a road block for settlement of claims. In pre-suit matters, the parties may elect to mediate the liability and coverage issues in order to achieve early resolution. After suit is filed, it may be necessary to schedule a coverage mediation separate from the underlying action. In some instances, retaining a mediator who is not engaged in the underlying action may be beneficial in order to avoid conflicts among insurers which could taint the underlying action. Oftentimes, it may be appropriate to engage the same mediator who is handling the underlying action to serve as a coverage mediator. Consider providing a coverage mediation brief in advance of the mediation but be sensitive to liability issues which may impact the insured. In some instances, the coverage issues cannot be resolved until after the underlying action is resolved through settlement or trial. When that occurs, it's important to document the terms of the agreement reached, if insurers elect to "pay & chase" (meaning rights are reserved), attention should be paid to what rights are being released in an underlying settlement so there are no surprises that the release impairs subrogation or other equitable rights otherwise available to the insurer. If rights are being reserved to pursue the insured for recovery – check jurisdictional rules as they differ among the states.