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## **“The Strategic, Moral and Ethical Dilemmas of Defending Clear Misconduct Claims”**

As a claim resolution professional or defense attorney involved in professional and general liability claims, there may be times when you are confronted with claims involving clear misconduct, credible allegations of fraud, intentional misconduct, or otherwise malicious and utterly indefensible behavior. When presented with these claims, you will immediately face potential coverage issues, regulatory and ethical concerns, and considerations with regard to the tripartite relationship, as well as moral concerns with regard to defending and protecting the individuals/entities alleged to have been involved from exposure. Managing these various issues and concerns can be a delicate balancing act, requiring a careful consideration of the issues presented on multiple levels, and creative litigation strategies. In this handout, we will explore the moral, ethical, and strategic considerations to be balanced in successfully handling the seemingly indefensible liability claims.

### **I. Identifying/Defining the ‘Indefensible’ Claim**

#### **When there is clear-cut, indisputable liability on the facts and law**

One of the most difficult circumstances presented to both insurance professionals and defense attorneys is what to do with a case that exhibits clear liability under both the facts and the law. This can be presented in many different ways. Often, there are unfavorable documents that evidence the “bad facts” at issue. Even more troublesome, there are times where the defendant has actually confessed liability. This can take many different forms: for example, an apology to the injured party, a revelation to a business partner or colleague or even in a formal proceeding (such as a disciplinary action against a professional).

#### **When the case is theoretically defensible, but there are big obstacles to surmount**

More complex circumstances can arise when the case is theoretically defensible under the facts or law, but there are other factors which make the case difficult to defend. This can occur in cases where one of the following may exist:

- The defendant's story simply does not add up due to inconsistencies in his/her own recitation of the facts or comparison of the story with other involved parties.
- The defendant has made prior sworn statements compromising, but not completely eviscerating, his/her defense position.
- The defendant or corporate representative is unlikable or presents badly.
- The defendant is unable to participate in the defense due to death, mental incompetence or inability to locate.
- The legal rationale on which the defense relies is tenuous at best.
- The defendant or a critical witness has engaged in outrageous conduct, even if tangential to the matter at hand.
- The defendant or the principal is under indictment or criminal investigation and will not attest to anything under oath.

Additionally, there are numerous other factors which can create obstacles in the defense. For example, high profile cases with negative publicity tend to be more difficult to defend. Unreasonable defendants who either push for settlement or want their day in court at any cost can create significant hurdles for professionals to overcome. In cases in which attorney's fees are recoverable, the plaintiff attorney may resist settlement given the prospect of a potential attorney's fee award that could dwarf the actual damages. This could them to make extreme demands that serve as a barrier to good faith settlement while they build up their fees. Cases where there is discoverable information which, when revealed, has the potential for exponentially increasing the value of the case can be problematic. Parallel criminal proceedings or investigations may interfere with the ability to mount a defense, or other circumstances may exist that render a defendant unable to defend themselves or participate in their defense. Finally, there are circumstances where seasoned insurance professionals and defense counsel can instinctually tell you that the case will be difficult to defend, even if one of these factors is not immediately apparent.

## **II. Issues, Obstacles, Ethical and Other Concerns**

### **Addressing coverage issues on the carrier side**

Claims professionals are most often the first party to evaluate a claim, even before defense counsel is involved. In many circumstances, there may be coverage or other unique issues that can potentially complicate the defense and strategy. A claims professional must carefully evaluate the impact of a reservation of rights on the defense and the potential resolution of the claim from the very onset of the report to the insurance company. In addition, the claims professional must also evaluate any actual or potential conflicts between insureds and determine whether multiple files or separate defense is warranted. Any issues of imputed liability/*respondeat superior* must be considered and addressed. In addition, the claims professional must also consider the impact of any coverage issues on the relationship with the insured and counsel, often in advance of making any preliminary decisions or investigation into the claim.

The claims professional must advise the insured of covered and non-covered claims and damages for allocation of defense costs purposes (when such allocation is permitted), as well as required contribution to settlement.

### **Addressing obstacles from defense counsel's point of view**

Even with cases which seem relatively simple from the outset, obstacles can arise that further complicate the defense of the matter as the case progresses. As just a few examples from among the multitude of possibilities, a witness' recollection can be found to be contradicted by a document uncovered from a comprehensive ESI capture, or some other unfavorable information is uncovered. A key defense witness has his/her employment terminated, and suddenly is not interested in cooperating. There is an adverse change in the law. Defense counsel must formulate a strategy to address these situations. Even doing so, there may be issues that defense counsel has no control over, like the Plaintiff presenting inflated settlement demands reflective of a desire to have his/her day in court. Plaintiffs may also seek non-monetary relief which is objectionable to the defendant. Co-defendants may become uncooperative if they have reached settlement independently or there is a feeling that the other parties are more at fault. Uncovered conduct, damages or ancillary proceedings can also complicate the defense. The defendants can also complicate matters by refusing to consent to settlements or, conversely, by insisting on "falling on the sword" to resolve the matter for all.

### **Addressing ethical concerns**

There are also many ethical concerns that need to be addressed by both insurance professionals and defense counsel. Unique issues are inherent in the tripartite relationship between the insured, insurance company and defense counsel when a claim is defended under an insurance policy, including confidentiality, the duty to advocate zealously on the part of the client and addressing any conflicts that may arise. Professionals must also be mindful of the duties respecting information obtained through the course of the defense: what can be used in settlement negotiations, what can be withheld, what duty does defense counsel have in reporting information that may impact coverage, and what claims can be appropriately made the subject of a dispositive motion? In addition, professionals may have to address the duties involved in representing a repulsive client or conduct.

## **III. Strategic considerations and options**

### **Maneuver case to early settlement**

Defense counsel and insurance professionals can employ numerous strategies in order to address claims that seem indefensible at the onset of the litigation. Often, early settlement may be an option if the plaintiff's demand is relatively reasonable and the defendant is amenable to the options presented. This is often less complicated when there are no non-monetary demands, no counterclaims or fee disputes or no potentially

uncovered claims. There are policy provisions that may apply such as a reduction in a deductible or retention.

**Also, when the insured's consent to settle is required by the policy, securing that consent is a significant consideration.**

### **Defense Options**

In the event that the case is unable to be settled, there are numerous other strategies available to mitigate or obviate the damages related to a seemingly indefensible claim. Some of the strategies which are often successful are:

- Consider options for counter-attack: are there counterclaims available to offset exposure or provide leverage in settlement negotiations?
- Aggressively defend, even though liability may be unavoidable
- Take the case through to final adjudication, as that may in fact result in a more favorable outcome than may otherwise be the case

### **Technical Legal Defenses**

Professionals can also consider technical legal defenses in order to address exposure or liability. Issues which do not rely on actual liability or credibility can sometimes be used as leverage in a claim, or, perhaps, to even defeat it. These include traditional legal defenses such as jurisdiction, standing to sue, failure to join indispensable parties, statute of limitations, causation, ratification or unclean hands or failure to comply with pre-suit requirements. Attacking damages can also be a good strategy. Following are some specific considerations:

#### Jurisdiction

- Does the defendant have sufficient contacts with the forum state?
- Is the case a candidate for removal to federal court to achieve a more favorable venue?
- Was service proper (particularly as this may impact statute of limitations defenses)?

#### Proper Parties

- Does the plaintiff have standing to sue? For example,
  - A claim by a trust must be brought by the trustee, not the beneficiaries
  - A decedent's claim must be brought by the estate executor or administrator, not the heirs
  - A claim by a party plaintiff absolved of liabilities through bankruptcy may belong to the trustee in bankruptcy, not that party plaintiff
  - Claims of children are assertable by their legal guardian, not simply any family member

- Corporate entities generally must be in good standing to enjoy the privilege of using state courts (such as being current with corporate tax obligations)
- Is there failure to join indispensable parties, such as others who have a claim to disputed assets?
- Is the plaintiff legally incompetent? If so the court may need to appoint a guardian ad litem

### Statute of Limitations

While the statute generally starts to run from the date the claim should have been discovered, in some circumstances it may actually begin to run at the time of the negligent act leading giving rise to the claim, regardless of when the injury or damage was discovered. Some claims are subject to an absolute time limit from the date of the transaction regardless when a claim may be discovered, such as statutory and FINRA arbitration claims.

- When the claim should have been discovered may be a triable issue of fact
- Look for evidence of early discovery, such as a complaint letter

### Causation

Some claims essentially require “but for” causation, which may allow for absolute defense, even in cases of clear negligence. For example, an insurance broker fails to place requested coverage, but the uncovered claim would have fallen outside of the claims made policy period in any event, or a lawyer misses the statute of limitation on the filing of what was a legally deficient claim in any event.

### Ratification

The plaintiff’s ratification of the defendant’s actions may completely defeat their claim. For example, a registered representative places an unauthorized trade. The client sees the trade on their activity statement but says nothing because the stock has increased in value. Later, when the stock drops and the client complains that the trade was not authorized, they will be deemed to have ratified the trade.

### Unclean Hands

Generally, a plaintiff who actively participates in wrongful conduct will not be rewarded. For example, when a client actively conspires with their insurance agent to submit a fraudulent insurance application will not be able to recover from the agent when the carrier discovers the fraud and denies a subsequent claim because of that fraud. In other instances, courts may not allow certain damages.

### Damages Unavailable to the Plaintiff

Some of the damages being claimed by a plaintiff may not be recoverable under the law, such as the case in New York, where recovery of lost profits arising from a fraudulent scheme that did not proceed as planned are barred. Claims for loss of reputation outside of a claim for defamation are generally not recoverable, or claims for emotional distress arising from property damage or economic loss are typically barred in most jurisdictions.

Failure to Comply with Pre-Suit Requirements may also defeat all or a portion of a claim. For example, claims under consumer protection statutes may require a pre-suit demand letter, or in order to pursue a professional negligence claim in some jurisdictions, the plaintiff must obtain a certificate of merit from a qualified expert.

### **Attacking Damages**

Even in the most egregious cases of liability, the damages claimed may not have any real bearing to those that are actually sustained, provable or recoverable. In fact, controlling the damage picture may be one of the most promising defenses available to an “indefensible” claim.

- Invest in a good damages expert early on
- Look to parse concrete from speculative damages
- Identify mitigating factors (such as expenses, taxes, etc., that would have otherwise been incurred).

### **IV. Conclusion**

In the end, it is critical to identify the “indefensible” case as early as possible in order to conduct the necessary investigation and evaluation. The insurance professional and defense counsel should consider all available means of attack in order to successfully defend and ultimately resolve the case. Executing a well-thought out strategy can sometimes produce unexpected results, and will at minimum provide a roadmap to ultimate resolution of the claim.