Working with Insurance Claims and Adjusters & Ethical Considerations

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1. Introduction

Conflicts between the interests of insurers and insureds are inevitable. In the context of liability insurance, the insurer promises to defend the insured against claims that fall within coverage, and retains an attorney to represent the insured's interest as well as the insurer's common interest. This creates a fiduciary relationship with the insured, and requires zealous representation of the insured's interests. However, the attorney has two masters because the

attorney is retained and paid by the insurer, and the insurer generally expects that the attorney will not take any action that will prejudice the insurer. This relationship among the insurer, the insured, and the attorney is known as the tripartite relationship, and the attorney must proceed with caution.

2. Client Relationship

The key to representation of an insured is communication with the insured. As soon as you are retained to defend an insured, immediately contact the insured. Schedule a time to meet with the insured, preferably prior to the deadline for filing an Answer or other responsive pleading. Obviously, that is not always practical, as often you will receive the assignment a few days before the Answer deadline. During the initial meeting with the insured, explain the nature of the tripartite relationship and the potential for conflicts. It is imperative that the insured be made aware of the potential for conflicts. The goal is not to frighten the insured by explaining the endless number of contingencies that may develop that could create

a conflict, but the insured should at least have a general understanding of why there is a potential for a conflict of interest. The defense lawyer also should explain to the insured the nature of the duty to defend and the rights and responsibilities that are appurtenant thereto. Specifically, the insured should be advised that the insurer controls the defense of the case and determines whether to settle the case. As part of this contract between the insurer and the insured, the insured has a duty to cooperate with the insurer and not take any actions that will prejudice the insurer.

If the insured has a counterclaim, this must be addressed during the initial meeting. The defense lawyer needs to determine whether he is willing to prosecute the insured's counterclaim, which is outside the scope of his original representation, or whether the insured will need to retain independent counsel. There is no right or wrong way to approach this issue, but there are several things that need to be addressed between the insured and defense counsel, including: The fee arrangement for the counterclaim; how costs will be apportioned between the original claim and the counterclaim; who

controls what aspects of the case (insurer or insured); and if the insured needs to retain independent counsel, the role of that counsel in the lawsuit.

After the initial meeting, it is easy to forget to maintain communication with the insured. However, it is necessary that the attorney maintain a line of communication with the insured throughout the lawsuit. A good practice to avoid this problem is to simply carbon copy the insured on any correspondence that defense counsel sends to the insurer. This will ensure that the insured is as informed as the insurer. This also helps to insulate the attorney from a bar complaint or malpractice action in the event that the insured is not satisfied with the outcome of the case.

Another potential communication pitfall relates to the insured's discovery responses. The insured signs his or her interrogatory responses, attesting to their truthfulness. However, attorneys are often the ones who prepare the responses and the insured simply signs the signature page. If possible, get the insured involved in the process of preparing discovery responses. At the very minimum,

send the insured a draft of the proposed responses. Request that he review them and, if he is agreeable to the proposed responses, sign the signature page. Failure to obtain the insured's authority prior to filing discovery responses is an invitation for an ethics complaint.

The one and only mistake that the defense attorney must never make is failing to advise the insured of a settlement demand. As soon as a demand is received, the attorney should immediately send it to both the insurer and the insured. This communication should include not only the amount of the demand but, if the demand was made through a formal letter or demand package, the attorney should provide the actual communication from the plaintiff's lawyer. This communication should also advise both the insurer and the insured of the deadline to respond. The attorney may also invite the insured to contact the attorney if the insured wishes to discuss the demand.

Settlement demands can create a number of conflicts of interest. For example:

- The demand exceeds the policy limits.
- The value of the claim exceeds the policy limits, but the

demand is only made for the policy limits.

• The claim appears to be defensible, but the insured has low policy limits and is thus more likely to have personal exposure.

• The attorney and the insurer may disagree over the value of the claim and, as a result, disagree on how to respond to the settlement demand.

• The demand requires the insured to personally contribute to the settlement.

• The insurer fails to timely respond to the settlement demand.

• The settlement demand requires the insured to remain in the lawsuit and continue to participate, but will be personally insulated.

If it appears that an insured has excess exposure, he needs to be made aware of that fact immediately so that the proper steps can be taken to protect him. If possible, schedule an in-person meeting with the insured. Also, the attorney (or the insured's personal attorney) should send a "hammer letter", which is a letter to the insurer advising of the potential for an excess verdict and demanding that the insurer settle the claim within the insured's policy limits. (Often times, if the

attorney must send a hammer letter to the insurer, a good practice is to call the claims representative first and advise that such a letter is on the way. This ensures that the insured is protected, but also recognizes the ongoing business relationship that the attorney has with the insurer.)

3. Conflicts

There are a number of other conflicts that can arise during the representation of the insured, including:

(1) The insured is being defended pursuant to a Reservation of Rights:

• The Reservation of Rights letter is simply a letter notifying the insured that the insurer reserves the right to contest coverage despite the fact that it has undertaken the defense of the insured. This allows the insurer to avoid waiving any coverage defenses it may have or that may develop, while still ensuring that the insured is properly defended. However, this may diminish the insurer's willingness to settle the claims asserted against the insured. The insured also does not know whether and to what extent the insurer will indemnify him in

the event that a judgment is obtained against him.

• The insurer should take the following steps to ensure that its insured's interests are sufficiently represented: Thoroughly investigate the plaintiff's claim; retain competent defense counsel for the insured; fully inform the insured of all developments relevant to the coverage and the progress of the lawsuit; refrain from doing anything that would demonstrate a greater concern for the insurer's financial interest than the insured's.

(2) The attorney learns of information that could serve as a basis for defeating coverage.

• The insured may advise the attorney of information that could take the claim outside of coverage. For example, in a situation where the insured is being defended under the omnibus coverage of an automobile policy as a permissive user of a non-owned automobile, the attorney may learn from the insured that he actually stole the vehicle. This would make the insured a non-permissive user of the insured vehicle, and take the loss outside of the policy's coverage.

• The attorney cannot take any actions that will prejudice the

insured. The question, then, is whether the attorney should convey to the insurer the information that he has obtained. The attorney has several options: He can refuse to advise the insurer of the potentially prejudicial information; he can advise the insured that he has an obligation to gather and communicate to the insurer any information about the case, and request the insured's authority to communicate the potentially prejudicial information. However, if the insured does not consent, the attorney will likely have to withdraw from the case.

(3) A declaratory judgment action has been filed to resolve questions of coverage.

• The declaratory judgment action is a useful tool for the insurer because it allows the insurer to obtain Court-declaration of its coverage obligations. However, a declaratory judgment action presents a number of potential conflicts between insurer and insured. First and foremost, the primary goal of a declaratory judgment action is to avoid coverage. The insured, on the other hand, obviously wants a full defense and indemnification without any restrictions. This obviously creates a conflict of interest.

• Unless the insurer has already denied coverage outright, the insurer is defending the insured while simultaneously working to avoid defending the insured. Often, the insurer will set up a “Chinese wall” for the handling of these two lawsuits. One adjuster will oversee the defense of the insured, while a second adjuster will oversee the prosecution of the declaratory judgment action. In theory, the two files will be completely segregated, and the adjusters will have no contact about their respective files. However, usually at some point in the chain of authority, one supervisor will have oversight of both files.

• The defense attorney must clearly advise the insured of the limited scope of his representation. Generally, the defense attorney does not represent the insured in the declaratory judgment action. The insured should be advised to retain personal counsel or otherwise respond to the declaratory judgment action, but any assistance beyond that is likely outside the scope of the attorney’s representation.

• The insurer would not have filed the declaratory judgment if it did not have a reasonable expectation that all or at least a portion of

the claims fall outside the policy's coverage. As a result, the insurer may wish to limit its defense costs for the insured while the declaratory judgment action is being prosecuted. This puts the attorney in a precarious position, as the insurer controls the defense of the claim pursuant to the terms of the insurance contract.

(4) The liability policy affords coverage to multiple insureds who have been named as defendants in the same lawsuit, but who have conflicting interests.

• When there are multiple insureds named in a lawsuit, there exists a huge potential for conflicts of interest. This is most common when one insured has a defense that is detrimental to another insured (e.g., negligent entrustment claims).

• If such a conflict exists, the insurer should retain separate counsel for the insureds.

(5) The value of the claim exceeds the policy limits.

• The insured desires to avoid an excess judgment and thus has an incentive to settle the case within the policy limits, if possible. The insurer, on the other hand, will not be responsible for the excess

judgment, absent some type of bad faith. As a result, the insurer takes on less risk by continuing litigation.

• However, as a practical matter, insurers are very averse to any type of conduct that even hints of bad faith, and will generally take all necessary steps to secure a release for the insured within policy limits if the insured has exposure in excess of his policy limits.

(6) The insured refuses to cooperate in the defense of the claim.

• Some insureds, for whatever reason, refuse to participate in the defense of claims asserted against them. This may include refusing to respond to discovery, refusing to appear for depositions, or refusing to appear at trial. Such conduct can increase the insurer's exposure, as the insured is not assisting to refute the plaintiff's claims.

• Liability policies contain a "cooperation clause", and this type of conduct violates the "cooperation clause" so as to defeat coverage under the policy. However, the defense attorney should never point this out to the insurer. The defense attorney should report facts to the insurer, such as advising that the insured failed to appear for his

deposition. However, the defense attorney should never offer any advice on how such conduct impacts coverage.

• Practically speaking, the plaintiff's attorney may be reluctant to pursue a default judgment or other sanctions against the insured if he refuses to participate in the lawsuit. If he does so, the insurer will likely be able to demonstrate sufficient prejudice to avoid coverage under the "cooperation clause".

There are an endless number of conflicts that may develop, depending upon the specific facts of the case. When any type of conflict develops, the attorney's ultimate obligation rests with the insured. The attorney should never take any steps that will prejudice the insured. If the attorney finds himself in a position where his conduct will prejudice the insured, he should immediately withdraw and cannot represent either the insurer or the insured from that point forward.

4. Negotiation

There is no bright line rule for how to handle this issue. The defense

attorney is generally reluctant to allow opposing counsel to have any communications with anyone affiliated with the case except for the defense attorney himself. However, some adjusters prefer to handle cases in this fashion. A good practice is to discourage adjusters from negotiating with the plaintiff's attorney directly unless the adjuster is particularly experienced, or a supervising litigation attorney is handling the negotiations.

The plaintiff's attorney should exercise caution in having direct contact with the insurer once a defense attorney has been retained. Even if the adjuster contacts the plaintiff's attorney directly, the plaintiff's attorney should obtain written confirmation from defense counsel that he has permission to communication directly with the adjuster.