BI BUSINESS INSURANCE

Breaking through misconceptions on defense rules when litigating claims

Business Insurance
August 1, 2019
By Lynda A. Bennett

Recently, we have seen an uptick in coverage disputes with insurers that are centered on the insurer's defense obligation. Many policyholders do not understand their rights with respect to the selection of defense counsel, the hourly rates charged by defense counsel, whether insurer litigation management guidelines are enforceable, and the scope of available defense coverage for a "mixed" claim. This article addresses some of the common misconceptions held by policyholders and provides practical tips about how to engage with insurers on these issues.

Myth 1: The insurer always gets to select defense counsel

Many policyholders mistakenly believe that if a claim is covered by an insurance policy, then the insurer has the exclusive right to choose the lawyers who will defend the case. However, that is not always true.

As a preliminary matter, only certain types of policies contain a "panel counsel" provision that expressly and contractually gives the insurer the right to choose counsel.

When a policy does not contain an express panel counsel provision, selection of counsel is a point that can, and should, be negotiated with the insurer. Moreover, even when a panel counsel provision exists in the policy, insurers may agree to approve the use of nonpanel counsel when policyholders agree to certain parameters with respect to the handling of the defense.

In addition, when an insurer agrees to provide a defense subject to a reservation of rights – whether or not there is a panel counsel provision in play – courts have determined that the policyholder has the legal right to select conflict-free and independent counsel. In fact, some jurisdictions have established a policyholder's right to independent counsel by statute.

Policyholders also should be aware that they can avoid the selection of counsel dispute at the policy placement stage by requesting an endorsement to preapprove law firms to serve as defense counsel. However, this approach may come with some unexpected negative consequences if the policyholder needs the option of choosing different defense counsel depending on the nature of the claim asserted.

Myth 2: The insurer has the unilateral right to impose panel counsel rates

In circumstances where the insurer has denied coverage or has reserved rights and nonpanel counsel is defending the claim, another common area of dispute involves whether the insurer can take the position that it will reimburse defense costs only at the rates that the insurer pays its panel counsel. While there is not extensive case law on this issue, courts generally reject the notion that insurers can establish a bright-line rule based on the volume discount rates that they have negotiated with their lawyers. Instead, courts seek to determine the prevailing market rate that is charged by capable counsel in the geographic area where the matter is pending while considering the level of complexities and magnitude of risk exposures faced in the underlying action.

The policyholder can, and should, work closely with experienced coverage counsel and their brokers to develop the data points needed to challenge panel rates and secure reimbursement at reasonable rate structures.

Myth 3: The insurer can impose litigation management guidelines on defense counsel

Once the horse trading on selection of defense counsel has ended, policyholders and their counsel next must confront the insurer's attempt to unilaterally impose litigation management guidelines that place material restrictions on what the insurer will agree to pay for and what will not be reimbursed to defend the case. Oftentimes, the guidelines are not a provision of the insurance policy that was purchased and were not agreed to by the policyholder. Nevertheless, the insurer contends the guidelines now govern the defense.

While the general idea behind the guidelines is a laudable one — that is, to put mechanisms in place to control litigation costs and expenses — the reality is that the guidelines are often draconian in nature and can be particularly unworkable in the context of a large, complex litigation.

Policyholders should understand that the guidelines can, and should, be challenged with insurers. Indeed, some courts have determined that insurer litigation management guidelines are unenforceable because they are not agreed-upon terms of the policy and they impede a lawyer's ability to zealously defend his or her client. Other jurisdictions have issued ethics opinions warning defense lawyers against following the guidelines to the extent that doing so would impede the lawyer's professional judgment.

In many instances, policyholders and insurers can work together to develop a collaborative and agreed-upon approach to defend the case, and the guidelines can be customized to address the specifics of the underlying action. Clear, open and regular communications about these issues are the key to successfully managing them.

Myth 4: The insurer can do simple math to reduce its defense

obligation for a 'mixed' claim Another issue that regularly arises with respect to the scope of the insurer's defense obligation relates to a "mixed" claim. Think of the all-too-common "everything and the kitchen sink" complaint that includes 12 different legal causes of action and is asserted against a laundry list of defendants.

Some of the legal causes of action and some of the defendants are potentially covered by the insurance policy, while other causes of action and defendants are not. And even though the complaint is a "mishmash," what is really driving the legal dispute is the potentially covered claim or claims asserted against the potentially covered policyholder or policyholders.

Oftentimes, the insurer attempts to artificially reduce its defense obligation by engaging "simple" math; for example, since only four of the 12 counts are potentially covered, the insurer will agree to pay one-third of the defense costs. However, that is not how the insurer's defense obligation is established, nor is that how allocation law works. As a preliminary matter, the insurer's duty to defend is broader than its duty to indemnify. Nearly every jurisdiction across the country recognizes that if there is one potentially covered claim alleged in the complaint, then the insurer has an obligation to defend the entire action.

Moreover, many courts have held that if defense costs do "double duty" — that is, provide a benefit for both the covered and uncovered claims/defendants — then the insurer must pay those defense costs.

In other words, "simple math" does not rule when a mixed claim is presented. A careful analysis of the facts and circumstances of the underlying action is required, and policyholders must be armed with the appropriate legal authority to reject the insurer's attempt to artificially minimize its defense coverage obligation by tallying the covered and uncovered counts/defendants.

Conclusion

Defense coverage is a critical aspect of any company's risk management program.

However, buying insurance policies and making claims are not enough to ensure that the company will be fully, fairly and immediately defended by its insurer when a complaint is served. In order to navigate these murky waters, policyholders are well served to engage experienced coverage counsel to negotiate these critical issues early on so that the policyholder and its insurers can then collaboratively focus on the task at hand — defending and resolving the underlying action.

Lynda A. Bennett is the chair of Lowenstein Sandler LLP's insurance recovery practice. She has represented policyholders in complex insurance coverage disputes for the past 25 years. She can be contacted at lbennett@lowenstein.com.

Article link: https://www.businessinsurance.com/article/20190801/ISSUE0401/912329894/Business-Insurance-Perspective-Breaking-through-misconceptions-on-claims-defense