Best's Insurance Law Podcast

Attorney Gives Primer on Insurers' Reservation of Rights - Episode #102

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Announcer: Welcome to the Insurance Law Podcast, brought to you by Best's Directory of Recommended Insurance Attorneys.

John Czuba: Welcome to the Insurance Law Podcast, the podcast about timely and important legal issues affecting the insurance industry. I'm John Czuba, Managing Editor of *Best's Directory of Recommended Insurance Attorneys*. We're pleased to have with us today attorney Charlie Lemley from the law firm of Wiley Rein, LLP, in Washington DC. Charlie's practice is primarily focused on professional liability coverage and malpractice litigation in federal and state courts.

He has significant experience in litigation, arbitration, and mediation of disputes. In addition to insurance coverage, he has represented clients in commercial aviation and regulatory disputes. Charlie, we're very pleased to have you with us today.

Charlie Lemley: Thank you. Good morning, John.

John: Today's topic is factors insurers should consider in deciding whether to offer independent counsel, when defending an insured under a reservation of rights. Charlie, why do courts or legislators sometimes require insurers to provide independent counsel?

Charlie: Generally, where an insurance company has the duty to defend its policyholder, they share the common goal of minimizing the policyholder's exposure to liability. The insurance company has the same interest as the policyholder in making sure that the lawsuit is adequately defended, and the policyholder can trust the insurance company to select counsel and control the defense.

The equation changes somewhat when the insurance company provides a defense while reserving the right to deny coverage on certain grounds, especially where the defense of the policyholder might affect whether the policyholder is ultimately entitled to coverage for any judgment against it, there is perceived to be a divergence of the interests of the insurer and its policyholder.

John: Charlie, can you give us an example of a case in which a defense under reservation of rights would result in a divergence of interest?

Charlie: Yes, the classic case would be where a policyholder is sued for running a red light and causing injury to a pedestrian. If the lawsuit just alleged negligence, then the insurance company likely would defend the case without a reservation of rights, and the insurance company and the policyholder would share the same interest, which would be the policyholder being found not to have acted negligently.

If the insured pedestrian alleged alternatively that the driver was either negligent or that she intentionally ran a red light in order to harm the pedestrian, the insurance company likely would reserve the right to deny coverage, if the court ultimately found that the driver acted intentionally.

Under those circumstances, the insurance company arguably has an interest that's not shared with the policyholder because the insurance company would benefit just as much from a finding of intentional conduct, as it would from a verdict in favor of the policyholder.

Since defense counsel arguably could influence the outcome of the litigation through their tactical and strategic decisions, the policyholder probably would want some protection from the possibility that the defense counsel would steer the defense toward a finding of intentional conduct.

John: Charlie, what are the different approaches courts and legislators take to protect insurer's in auto or defense situations?

Charlie: There are really four approaches to this issue. Some states like Washington and Hawaii impose heightened obligations on insurers to hire competent defense counsel to ensure that defense counsel answers only to the policyholder, to keep the policyholder informed, and to avoid taking actions that would undermine the policyholder to the benefit of the insurer.

Other states like Massachusetts effectively impose a per se rule that if the insurance company offers a defense under reservation of rights, the insurance company must permit the policyholder to select independent counsel at the insurance company's expense.

Florida law, by statute, requires that the insurance company appoint counsel that's mutually agreeable to the policyholder. In many states like California, the insurance company must provide independent counsel, but only for certain types of reservations of rights, generally those where the outcome of the coverage issue could be controlled by the defense of the policyholder, but the earlier example of the driver running the red light.

John: What can an insurer do to protect itself if it does not want to pay for an independent counsel for the insured?

Charlie: First, it can waive the rights that it's reserving. In the red light scenario, the insurance company might decide that the chances of a finding of intentional conduct are so low that it's not worth the cost of paying independent counsel just to reserve the right to deny coverage on that ground. The insurance company could file a declaratory judgment action and provide independent counsel only until it's able to obtain a ruling that there is no coverage.

In some states, the insurance company can reserve the right to recover from the policyholder any amounts that it pays for the defense, if it ultimately prevails on the coverage action, but the possibilities vary greatly from state to state. It's really important to look carefully at the applicable law.

John: What dangers do insurers face if they do not implement the appropriate safeguards when defending against a reservation of rights?

Charlie: This is an area that can be fraught with peril for insurers. First, in certain circumstances, the insurance company might lose all of its coverage defenses including the ones that it was concerned enough to reserve if it doesn't provide counsel when it should. Courts in New York and elsewhere found that an insurance company can be estopped from denying coverage where it fails to provide independent counsel when it should have.

Second, the insurance company conceivably might be found to have acted in bad faith by not appointing independent counsel and therefore to have exposed itself to liability in excess of its policy limits. The insurance company might also be subjected to statutory, administrative, or regulatory sanctions in states where heightened duties are imposed by law.

John: What should insurers do to protect themselves from these dangers, Charlie?

Charlie: First, pay attention to the law of the appropriate jurisdiction, don't make assumptions. Just because you didn't need to appoint independent counsel for a policyholder in one state doesn't mean you won't have to do so for a policyholder in another state under the same circumstances.

Second, think through the potential coverage defenses that you might want to assert and determine whether they might require you to provide independent counsel or otherwise impose some kind of heightened obligations on you.

If so, then make a rational decision, "Is the reservation of rights worth the cost?" If you decide that it is, then you can determine whether steps could be taken to preserve your right to recover the amount you pay for the defense, if your coverage position ultimately turns out in your favor.

It's important to reassess the coverage position at various points throughout the life of a lengthy claim so that if the discovery proves that the coverage defense won't apply, you can decide whether to withdraw the reservation of rights and attempt to assume control of the defense at that point.

John: Charlie, thanks very much for joining us today.

Charlie: Thank you very much, have a good day.

John: That was Charlie Lemley from the law firm of Wiley Rein, LLP, in Washington DC. Special thanks to our producer, Brian Cohen. Thank you all for joining us for the Insurance Law Podcast. To subscribe to this audio program, visit podcast.insuranceattorneysearch.com or go to online directory such as iTunes or Google or Yahoo's podcast directory.

If you have any suggestions for a future topic regarding an insurance law case or issue, please email us at lawpodcast@ambest.com. I'm John Czuba, and now this message.

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