Caught in Violations of Law and Ethics, Insurers and Their Lawyers Favor Settlement

An Editorial

Prologue
"I didn't do it!" (Bart Simpson)

DutytoDefend.com usually focuses on the cold, sterile, obscure law of a liability insurer's duty to defend, but this musing shifts to amateur psychology to try to explain why liability insurance companies and their lawyers who don't obey the law and get caught *always* promptly pay to settle at no cost to the policyholder.

Liability insurance is a contract that makes two primary promises in a qualifying civil lawsuit: 1) *pay* a judgment entered against us policyholders, known as the duty to indemnify; and 2) *pay* a lawyer to manage the lawsuit, known as the duty to defend. Surprisingly to some of us, a standard policy makes no promise to settle even though settlement is the most common and welcome outcome. We pay premiums year after year, in return for which we get nothing to eat, wear, or use. Instead, we get the peace of mind that we will be protected if the need arises.

So when a lawsuit is actually filed against us, we are entitled to ask one simple question: "Will you, the insurer, pay the entire amount of any judgment, less my deductible?" There are only three possible answers: "Yes", "No", and "Maybe". If the answer is an unqualified "Yes" in writing, we have nothing to worry about. "Yes" means that the responsible insurer is going to keep the promises it made and our peace of mind was justified. If the answer is anything less than an unqualified "Yes", then we should do something to protect ourselves so that a sheriff will not appear at our door to seize everything it took a lifetime to build.

If the insurer says "No", we can encourage it to change its answer to "Maybe". We start by understanding the duty to defend is broader than the duty to indemnify in scope and timing. Scope: The insurer must pay a judgment only if all of the complex policy language is satisfied, while the insurer must defend any lawsuit that merely "seeks" damages that are "potentially" covered for indemnity. Timing: The duty to defend starts when an injured plaintiff makes a claim and ends when the lawsuit is over, while the duty to indemnify signs starts and ends by signing a check at the very end of the lawsuit. Thus, most of the action happens in the duty to defend phase. It is relatively easy to "trigger" the duty to defend, and there are many proper ways to change the insurer's answer from "No" to "Maybe".

If the insurer says "Maybe", we should expect some fireworks. "Maybe" creates conflicts of interest which usually result from a "reservation of rights". Typically, a reservation of rights says that the insurer will defend us, but may not indemnify us. Such a conditional denial creates great uncertainty and divides us in at least three ways: 1) each wants the other to pay; 2) each should want to control the defense; and 3) each should want to select, direct, and command the undivided loyalty of their lawyer. Control of the defense often includes the power to guide the lawsuit to a conclusion that is covered or not, benefitting the insurer or the policyholder, but not both. Insurers regularly select, direct, and demand loyalty from a pre-approved "panel" of lawyers, here called **de**pendent counsel. In contrast, sometimes we policyholders may choose **in**dependent counsel who is loyal only to us, but is paid for by the insurer.

Choosing the lawyer to conduct the defense is a big deal and is often bitterly contested when the insurer says "Maybe". With "Maybe", we policyholders often get to control the defense. A leading case lays down the law: "Canons of Ethics impose upon lawyers hired by the insurer an

obligation to explain to the insured and the insurer the full implications of joint representation in situations where the insurer has reserved its rights to deny coverage. If the insured does not give an informed consent, counsel must cease to represent both. Moreover, divergent interests brought about by the insurer's reservation of rights [require that] the insurer must pay the reasonable cost for hiring independent counsel by the insured. The insurer may not compel the insured to surrender control of the litigation."

Honoring the Biblical prohibition against serving two masters, lawyers' Canons of Ethics require that before starting work, s/he must analyze potential conflicts, make written disclosure of this analysis, and obtain the clients' informed written consent to conflicted representation. Analyzing potential conflicts of interest is hard work and the lawyer's conclusions are often suspect because the analysis impacts selfish interests. If the lawyer says that there *is a conflict*, s/he usually has to quit, earn no fees, and require the insurer to pay independent counsel instead - a bad thing for them. If the lawyer says that there is *no conflict*, the insurer and dependent counsel both benefit - a good thing for them. As a result, some dependent counsel give conflict of interest analysis short shrift, are reluctant to put anything in writing, and give false information to us, which s/he refuses to support in writing.

If an insurer says "Maybe" and insists that dependent counsel control the defense without ethical compliance, policyholders may push back. Policyholders may expressly withhold consent and authority to be represented by ethically conflicted dependent counsel until s/he responds to a "Coverage Questionnaire" and an "Ethical Compliance Questionnaire": both are downloadable at DutytoDefend.com for free. Doing so ripens the issues of coverage and ethical compliance at virtually no cost. Genuine answers will illuminate the status of coverage and conflicts. Empty responses will force the insurer and dependent counsel to choose among three options: 1) Obey the law; 2) Disobey the law; or 3) Settle the plaintiff's lawsuit *at no cost to the policyholder*.

1. Obeying the law is bad for business. The insurer may not easily control independent counsel's higher hourly rate, the vigor of the defense effort, the quantity of hours billed, nor inhibit the lawyer from tilting the lawsuit to a covered outcome. Incurring these higher costs means raising premiums, which in turn makes it difficult to compete against other insurers who avoid such extra costs. Dependent counsel risks having to quit, losing billable hours in each case farmed out to independent counsel, and angering each affected insurer - possibly resulting in the loss of future business from many insurers which could spell financial ruin. Obeying the law presents an *existential threat* to the insurer and its lawyers.

2. Disobeying the law is also bad for business. Insurers that hire unethical counsel, refuse to pay for ethical counsel, and improperly seize control of the defense risk the wrath of the Department of Insurance and civil liability, the recoverable damages for which may include all costs of defense, the cost of settlement or judgment, attorneys fees to sue the insurer, emotional distress, and punitive damages. Dependent counsel risks State Bar discipline, disbarment, shame, and civil liability. Like obeying the law, disobeying it is an equally distasteful *existential threat*.

3. The insurer may unilaterally and promptly settle with the plaintiff at no cost to us, thereby achieving peace to all discord. In one stroke, the lawsuit goes away, the coverage challenge ends, and dependent counsel's ethical problems become moot. Moreover, settlement is easy because it does not require the policyholder's consent or participation. While the insurer fully funding a settlement is unpleasant for it, settlement is the core of its business and *is not* an existential threat. One might reasonably think that the behavior of insurers and dependent counsel, like all human behavior would fall somewhere on the spectrum of a bell shaped curve, but it does not. In the editor's experience, sending Questionnaires *always* produces prompt and generous settlements at little cost, on one occasion in as little as eight days.