

## **SHOULD YOU TRUST YOUR LIABILITY INSURER OR ITS LAWYERS?**

### **Overview**

A liability insurance policy promises to defend you, the policyholder, against civil damage claims asserted by injured plaintiffs by hiring lawyers to do the actual work of defending you. Usually, the insurer accepts full coverage and promptly agrees that it will fund any settlement or judgment, so that you need pay nothing but a modest deductible. But if the insurer may deny coverage, it must warn you by a reservation of rights letter, so that you know to protect yourself from the reserving insurer and its lawyers. Sometimes a reserving insurer must pay for independent counsel, loyal only to you, who may defend you against the claimant and protect you from your insurer and its lawyers, known as “panel counsel”.

### **The Purpose Of Liability Insurance**

Hoping you will never need it, most of you buy liability insurance for the peace of mind that comes from confidence that if you get sued, you can rely upon your insurer and its lawyers to protect you from financial ruin.

### **A Sample Claim**

Imagine you have the green light when you collide with and kill another driver and you get sued. There are only two possible outcomes of the lawsuit - you were either: innocent or negligent. If you were innocent, then the plaintiff will lose and you and your liability insurer will win. If you were negligent, then your insurer will lose and you and the plaintiff will win. You win both ways, financially.

But suppose the lawsuit alleges that the other driver was your spouse’s lover whom you murdered in a jealous rage! Now, a third possible outcome is that you are a felon. If a jury later says that you are, your insurer will win and you will lose. Your peace of mind and freedom from fear of financial ruin is shattered.

### **There Are Two Primary Policy Promises**

Standard liability policies make only two primary promises - the promise to fund a settlement or judgment, creating the duty to indemnify, and the promise to defend claims made against you, creating the duty to defend. Most policies grant to the insurer the right to choose the lawyer to defend you. Almost all of the work gets done by conducting the defense. If the insurer must indemnify you, it merely cuts a check at the very end.

These duties have different timing requirements. Logically, the duty to defend matures immediately upon a plaintiff making a claim. The insurer must defend if there is any *possibility* that the lawsuit may result in a judgment that is covered for indemnity. The insurer must indemnify only if a judgment satisfies all of the complicated language of the lengthy policy contract. Thus, the duty to defend is broader than the duty to indemnify. The duty to defend, starts sooner, lasts longer, and has a hair trigger.

### **The Promise To Defend Must Be Delegated To Lawyers**

While the policy promises that the insurer will defend you, it cannot, itself, keep this promise because it is not licensed to practice law. Thus, the insurer must hire a competent, ethical lawyer to do the actual work of defending you. The lawyer’s duties to you are generally governed by Canons of Ethics that describe the fiduciary relationship which create lawyers’ duties of undivided loyalty (no conflicts of interest), disclosure (teach you what you need to know), and confidentiality (keep your secrets). Also, panel counsel may not generally accept payment from a reserving insurer because of the potentially corrupting influence of filthy lucre.

### **The Harmonious Tripartite Relationship**

The insurer (as financier), the policyholder (as witness), and their shared lawyer (as

warrior) usually form a harmonious defense team, known as the tripartite relationship, which is devoted to defeating or minimizing the plaintiff's claim, thereby reducing the insurer's outlay. The liability insurers develop symbiotic relationships with very few pre-approved lawyers panel counsel, who earn most of their income from insurers. Panel counsel defend the interests the insurers to spend as little as possible and also represent you as a defendant in the lawsuit, in which you must pay only the deductible.

### **Reservation Of Rights**

Frequently, a plaintiff's lawsuit seeks different kinds of damages that are either: 1) clearly covered; 2) clearly not covered; and 3) possibly covered depending on how the case comes out. If an insurer does not simply concede full coverage from the outset, it must promptly warn you, so that you can protect yourself from your own insurer and its lawyers. Known as a reservation of rights letter, this warning typically says that the insurer will pay to defend you, but that it may not fund a settlement or judgment, and defers a final decision to an uncertain future.

### **The Dissonant Tripartite Relationship**

A reservation of rights always creates a conflict of interest between the reserving insurer and the policyholder because each wants the other to pay. Thus, the other members of the tripartite relationship may be allies or enemies, changing harmony to dissonance! Because panel counsel rely almost exclusively on insurers for their livelihood, they may be tempted to protect the insurer's interests at your expense.

### **Two Closely Related Conflicts Of Interest Are Causally Connected**

"No one can serve two masters." (Matthew 6:24.) The assertion of a reservation of rights creates two closely related species of conflicts of interest: 1) you versus the insurer; and 2) you versus panel counsel. Each species of conflict is governed by different bodies of law. The insurer's policy promises are governed by contract law. Panel counsel's duties to you are governed by Rules of Professional Conduct. Despite developing dissonance among the defense team, the insurer must still keep its promise to pay for an ethical lawyer to defend you.

If panel counsel is ethically disqualified, then the insurer must keep its promise to defend by paying for a lawyer selected and directed by, and loyal only to you, the policyholder. Thus, panel counsel's ethical disqualification causes the reserving insurer's duty to pay for independent counsel, the only ethical choice. Also, the different bodies of law governing insurers and lawyers merge. Panel counsel's ethical inability to represent you triggers the reserving insurer's duty to pay for your choice of independent counsel. The reserving insurer's contractual duty to pay for independent counsel matures because panel counsel is ethically disqualified.

### **The Required Analysis**

Complicating matters, not all reservations of rights necessarily disqualify panel counsel. For example, if the insurer denies coverage because the policyholder paid no premium, the resulting coverage dispute will have nothing to do with the plaintiff's claim. The disqualification test is whether panel counsel "can control" the outcome of any coverage challenge by the manner in which your defense is conducted. Panel counsel may ethically accept your representation if the lawyer cannot control any coverage issue. But if panel counsel can control any coverage issue, the lawyer must either get your informed written consent or quit.

Determining whether panel counsel can control any reserved coverage challenge requires careful analysis of facts and law. Both panel counsel and the reserving insurer must do this analysis. You have no such obligation.

### **Should You Trust A Reserving Insurer Or Its Panel Counsel?**

An old adage says: "Trust everyone. But always cut the cards." If you opt to trust a reserving insurer and its lawyers, consider getting their assurances of fidelity in writing.