Bad Faith: The Noxious Fumes of Legal Malpractice Cases

BY KAREN STROMEYER

"A[n ordinary [legal malpractice] case can turn into a cause célèbre when divergent interests regarding insurance coverage in lawsuits arise," according to Richard Hoffman, of Duane Morris LLP in San Francisco and coverage counsel to insurers.

Hoffman and fellow speakers at the Fall 2015 National Legal Malpractice Conference explored the most common circumstances where disputes in professional liability coverage arise during and after litigation, the players involved and their respective perspectives, expectations and goals.

Hoffman moderated the discussion, which also featured Ernest Martin Jr. of Haynes and Boone LLP in Dallas, providing the perspective of coverage counsel for the policyholder, and Todd Hampton, vice president of claims for Monitor Liability Managers and Berkley Select in Chicago.

The panel agreed that circumstances that tend to lead to an internal dispute between the insured and the insurer arise when:

- Liability is questionable;
- Damages are high;
- The policy limits are not enough to cover the exposure to the insured;
- There are uncovered damages;
- The case is very expensive to defend and there are eroding policy limits, meaning that defense costs are deducted from the amount available to pay claims; and
- The judgment exceeds the policy limits.

Martin explained that when law firms purchase insurance, they often view it as “lawsuit protection.” Therefore, he said, policyholder counsel can get involved at any point in the life of the claim as soon as there is the possibility of an excess judgment or uncovered claims.

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Martin said the goal of policyholder counsel is to get the case completely resolved with carrier dollars, with no contribution at all by the policyholder. In bad faith evaluations, he said, most jurisdictions look to who is in control of the case to trigger the insurer’s obligations. He said that is why, when there is excess exposure, he sends a letter to the insurance carrier demanding they settle within the policy limits so that it is clear the insurer is in control of the case.

But the tradeoff to that approach, Hampton said, is a large loss on the claim history of the insured, and potentially corresponding premium increases.

Plaintiff’s Counsel: Friend and Foe

While the plaintiff’s counsel is the “enemy” to the insurance company and defense counsel, according to Martin, the attorney willing to go after the insurer for bad faith refusal to acknowledge coverage is the plaintiff’s counsel’s best friend.

Martin explained that this is because they both are on the side of working to get the insurance company to pay to resolve the claim. He said this is a fine line to tread, however, as the policyholder’s counsel cannot collude in any way with plaintiff’s counsel—for example, by advising plaintiff’s counsel to focus only on the covered claims.

Defense Counsel: Be Loyal and Frank

Martin said during litigation he tries to educate defense counsel and will try to keep them from walking into hidden danger or exposure for the insured. He said in his experience some defense counsel are open to this, while others insist on staying largely ignorant of coverage issues.

As the policyholder’s counsel, Martin stated, he expects defense counsel to be loyal to their client—the insured. Hampton said from the insurer’s prospective the carrier is looking to defense counsel to provide an accurate view of the exposures and risks.

All three panelists agreed that accurate predictions regarding the cost to defend the claim are key to evaluating the claim because most professional liability policies have eroding limits. They said care must be taken to investigate immediately and try to get an accurate picture of the defense cost exposure, and, if it is large, take advantage of any opportunity to settle early.
Insurers: Target and Arrow

According to Hampton, liability insurers seek to do right by their insureds without capitulating to what might be unreasonable and unjustifiable demands. He said from the insurer’s prospective “red flags” are most often raised by claims that have small policy limits with large exposure that could exceed the limits, and uncovered damages.

Not with an eye toward a potential bad faith claim, he said; rather, these red flags just mean that the claim may be “tricky” to resolve. In these instances, Hampton said he often will reach out to plaintiff’s counsel to try to resolve the claim in the early stages.

When there is a legitimate risk of exposure for uncovered claims, Hampton stated he also may have a frank discussion with the insured about going into its own pocket, as the insurance company only has the obligation to resolve covered claims. Additionally, he said, insurers are very aware that on the worst day they are only on the hook for the compensatory damages—not punitive damages.

Coverage Counsel: A Second Pair of Eyes

If the threat of bad faith is raised while the litigation is ongoing, the insurer will often engage coverage/monitoring counsel. The primary role of coverage counsel during the litigation is to assist in creating a road map to successful resolution, Hampton said.

In this goal, he said, coverage counsel is often aligned with policyholder’s counsel, as they both have the goal of resolving the case within the limits. Coverage counsel ensures that the insurer has an independent evaluation, in addition to that being provided by defense counsel, that the carrier evaluates all aspects of the case, and to assist in coming up with creative alternatives for resolution of the claim, Hampton said. They also watch out for potential “traps” and setups for the insurance company to make sure the insurer doesn’t accidentally walk into a bad-faith claim, he said.

If there is an excess judgment, coverage counsel doesn’t try to justify what occurred, Hoffman said. Rather, they just try to find a good resolution for the insurer. To that end they talk to the claims professional to understand why they did what they did.

Martin said if the excess judgment is appealable, another key consideration is who will be posting the security bond required for an appeal. He said most insureds don’t understand that, under most policies, the insurer is only required to pay the premium on the bond.

Conclusion

The specter of uncovered claims and excess judgments can create dilemmas as to how and, more crucially, what is a reasonable settlement for a claim. However, all of the panelists agreed that all parties involved are on the same side, seeking to resolve claims for the insured within the policy limits.