

Workshop M3

Monday, October 29, 9:00 a.m.–noon and 1:30–4:30 p.m.

PROTECTING YOUR COVERAGE RIGHTS AFTER A CLAIM

Presented by



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Most contractors expect to be on the same “team” as their insurance company in responding to a liability claim. In reality, insurance companies sometimes have to balance competing interests, and policyholders are often confused by the results. In this session, learn more about reservation of rights letters and the defense of claims, two issues that most policyholders do not consider until they are in the middle of a complicated and stressful claim.

- Examines the purpose of a reservation of rights letter and outlines an effective, factual approach for responding and even using it to your advantage.
- Identifies potential conflicts of interest in construction claims, when independent counsel is appropriate, and how such a defense is coordinated.
- Outlines the role of the insurance agent or broker in responding to these issues.

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David A. Shaneyfelt
Senior Counsel
Wood & Bender LLP

Mr. Shaneyfelt is one of the presenters for Workshop M3, "Protecting Your Coverage Rights after a Claim" on Monday. He is Senior Counsel at Wood & Bender LLP, one of the nation's leading law firms specializing in insurance policy enforcement. He is a former trial attorney with the U.S. Department of Justice in Washington, D.C., with extensive background in complex civil litigation.

Mr. Shaneyfelt has represented numerous private and public entities in coverage disputes against insurers and joint powers agencies. He recently won a binding arbitration hearing against the London and Bermuda reinsurance markets on a significant coverage dispute involving the 2003 California wildfires. He also represents two major California municipalities in separate challenges regarding policy benefits, one of which arises under comprehensive litigation involving a city's affordable housing program, which he also defends. He prevailed against the insurers of another California municipality in a coverage matter before the court of appeal.

At the Department of Justice, Mr. Shaneyfelt assisted in implementing the federal civilian drug testing program covering more than 1 million employees throughout the federal workforce, including at the FBI, DEA, Bureau of Prisons, Secret Service, and Treasury Department. He also assisted in the successful defense to the numerous Constitutional challenges brought against that program. He also handled litigation involving the wind-up of lengthy Title VII class action suits against both the Department of Agriculture and the Small Business Administration.

He left Washington, D.C., to engage in private practice in Chicago, where he was involved in a wide array of complex state and federal litigation, including employment law, and at the trial and appellate levels. In 1997, he joined his alma mater, Thomas Aquinas College, where he worked as in-house counsel.

He has practiced before the Northern District of California, Western District of Washington, Southern District of Mississippi, District of Hawaii, Northern District of Illinois, Central District of Illinois, Ninth Circuit Court of Appeal, Seventh Circuit Court of Appeal, U.S. Supreme Court. He is a member of three state bars: California, Illinois, and Oregon (as an inactive member).

Mr. Shaneyfelt obtained his B.A. from Thomas Aquinas College in 1981, and his J.D. from Willamette College of Law in 1984, where he was Associate Editor of the *Law Review*.

David E. Wood
Principal
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Mr. Wood is one of the presenters for Workshop M3, "Protecting Your Coverage Rights after a Claim" on Monday. He cofounded Wood & Bender LLP, one of the country's leading law firms specializing in insurance policy enforcement. With 2 decades of experience in the insurance industry, Mr. Wood devotes his practice to evaluating and enforcing business insurance claims and handling litigation aimed at accessing insurance coverage.

In matters throughout California and the nation, Mr. Wood represents public and private companies enforcing their claims under professional errors and omissions, directors and officers liability, special risk and general liability policies, and fidelity bonds. The policyholders Mr. Wood typically represents include *Fortune 1000* corporations and corporate directors and officers, with special emphasis on contractors' errors and omissions, design professional errors and omissions, contractor and subcontractor additional insured disputes, and construction risks in general. Representative clients include Turner Construction in the United States and Aecon Group, Inc., in Canada.

His admissions include California; U.S. District Courts for the Northern, Eastern, Central, and Southern Districts of California; and the U.S. Court of Appeals for the Ninth Circuit.

Mr. Wood holds the highest "AV" rating for professional skill and ethics conferred by *Martindale-Hubbell*. Chosen by 60,000 of his peers, and based on the independent research of *Law and Politics* magazine, he has been named one of the top 2007 Southern California lawyers. Mr. Wood is a long-time member of the American Bar Association Tort & Insurance Practice Section, Fidelity & Surety Committee, as well as the Directors and Officers Section.

Mr. Wood is frequently quoted in national media on significant insurance matters. He has been interviewed on insurance recovery issues on CNBC Television, Bloomberg Radio, *USA Today*, and *Forbes* and *Forbes.com*. He also is a frequent speaker on insurance policy enforcement matters before organizations like the Association of Corporate Counsel, the Society of Corporate Secretaries and Governance Professionals, Mealey's, International Risk Management Institute, and the Risk & Insurance Management Society.

Mr. Wood has published articles for trade and legal publications including *D&O Advisor*, *The John Liner Review*, *The National Law Journal*, *Risk Management Magazine*, *California Lawyer*, *San Francisco Recorder*, and *Risk & Insurance Magazine*.

Mr. Wood earned his J.D. from the University of California, Hastings College of Law in 1985, and an A.B., *cum laude*, from Williams College in 1979.



Protecting Your Coverage Rights After A Claim

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Part II: Coordinating A Defense Against Claims

Presented by: David A. Shaneyfelt, Senior Counsel, Wood & Bender LLP
 David E. Wood, Principal, Wood & Bender LLP





Part II: Coordinating A Defense Against Claims – Overview

- ❖ I. Independent Counsel
 - Why is it necessary?
 - What triggers right?
- ❖ II. State Law Approaches

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Part II: Coordinating A Defense Against Claims – Overview

- ❖ III. Application to the Construction Industry
 - Construction defect disputes
 - Contractor/Subcontractor disputes
 - Employment disputes
 - General tort liability
- ❖ IV. Appointment-Related Issues
 - Who gets to select counsel?
 - How is counsel paid?
 - How are disputes resolved?
 - How are disputes avoided?

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I. Independent Counsel

- ❖ Why is it necessary?
- ❖ What triggers the right?

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Understanding The Tripartite Relationship

- ❖ The Insurer
- ❖ The Policyholder
- ❖ The Appointed Attorney

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The Insurer

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The Insurer's Duties

- To the Policyholder: Payment of benefits

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The Policyholder

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The Policyholder's Duties

- To the Insurer: To cooperate in the defense

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The Appointed Attorney

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The Appointed Attorney's Duties

- To the Insurer: To honor panel counsel agreement
- To the policyholder: To represent the policyholder zealously

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Source of "Conflict"

- ❖ Relationship Is Governed By A Contract (Policy)
 - Some things are covered
 - Some things are not covered

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The Source of "Conflict"

The Insurer
Wants Less Coverage

The Policyholder
Wants More Coverage

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The Tripartite Relationship

The Insurer

The Policyholder

The Appointed Attorney

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An Inherent Problem

“No man can serve two masters.”

U.S. Fidelity & Guaranty Co. v. Louis A. Roser Co.,

585 F.2d 932, 938 n5 (8th Cir. 1978)

(quoting *Matthew 6:24*)

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Independent Counsel: Why Do You Need It?

- ❖ Can't you *trust* your appointed attorney to represent you?
- ❖ What would an independent counsel *do* that your appointed attorney would not do?
- ❖ Doesn't this increase defense costs *needlessly* (especially under a "burning limits" policy)?

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Independent Counsel: Why Do You Need It?

- ❖ Why Not Trust?
 - Trust is not the main concern
 - Main concern is case defense strategy:
 - ❖ Sometimes counsel must choose between two courses
 - ❖ One course helps one party to the exclusion of the other
 - Smaller concern is loyalty:
 - ❖ Faced with a choice, counsel has incentives to please insurer (Repeat business)
 - Independent Counsel eliminates these concerns

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Independent Counsel: Why Do You Need It?

❖ What Better Advice?

- Helps you isolate your interests from your insurance carrier's interests
- Helps you determine whether the proposed defense strategy really is in your interest
- May allow you to entreat panel counsel to desist from proposed defense strategy
- Will sharpen your overall defense strategy

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Independent Counsel: Why Do You Need It?

❖ Do Costs Increase?

- Yes, to some extent
- But it should save you far more in the long run

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Independent Counsel: Why Do You Need It?

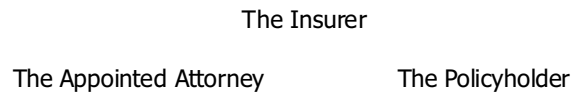
❖ Coverage Advice

- Carrier-appointed counsel cannot provide it
- Amounts to serving one "master" over the other
- Test: Ask appointed counsel whether you have coverage

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The Tripartite Relationship



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The Independent Counsel

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The Independent Counsel Relationship

Independent Counsel	Insurer
Appointed Attorney	Policyholder

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The Tripartite Relationship

- ❖ Note: Not all courts *call* this a “tripartite relationship”
 - Some believe only one relationship exists:
 - ❖ Between the appointed attorney and client
 - But even they will acknowledge need for independent counsel
 - ❖ A reality arising out of a contractual (coverage) relationship
 - Thus, whether it is called “tripartite” or not, result is same
 - ❖ Circumstances may trigger right to independent counsel

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Appointment of Independent Counsel

- ❖ Is it a right or an option?
- ❖ What triggers the right?

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Depends On A Conflict of Interest

- ❖ Distinguish between “actual” and “potential”
- ❖ In a few states, “potential” conflict will trigger right
- ❖ In most states, “actual” conflict will trigger right

“The conflict must be significant, not merely theoretical, actual, not merely potential”

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“Actual” Conflict: The *Cumis* (California) Approach

- ❖ Lots of litigation, lots of case development
- ❖ Courts in other states can’t help but noticing it
- ❖ Other states follow these decisions explicitly or implicitly
- ❖ The leading case:
 - *San Diego Federal Credit Union v. Cumis Ins. Society, Inc.* (1984)
- ❖ The statute:
 - California Civil Code 2860

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Actual Conflict of Interest

❖ General rule:

"Any time an attorney who represents both the carrier and its insured finds the attorney's representation of the one is rendered less effective by reason of the attorney's representation of the other, a conflict of interest sufficient to require independent counsel may be present"

"The conflict must be significant, not merely theoretical, actual, not merely potential"

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Actual Conflict of Interest

❖ Rationale:

Attorney's ethical obligations are compromised

Attorney must choose between one of two options

Option 1: Curtails policy benefits to insured
and contains costs of insurer

Option 2: Maximizes policy benefits to insured
and imposes costs on insurer

Either option benefits one and burdens the other

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Independent Counsel

- ❖ Even if you have a right to it, do you always need to assert it?
 - When case will settle for more than defense costs
 - When liability is substantial
- ❖ In short: In big dollar cases

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II. State Law Approaches

- ❖ Development is state-by-state, case-by-case
- ❖ No “majority vs. minority” positions
- ❖ Development is headed in same direction:
 - When you can show a direct conflict of interest between the insurer and the insured, you will likely establish a right to independent counsel
- ❖ States vary according to gradations of conflict
 - A few say potential conflict will trigger the right
 - Most say actual conflict will trigger the right
 - A few say actual conflict could trigger the right

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State Law Roundup: "Mere Reservation of Rights" Approach

- ❖ Third party files claim against you
- ❖ You tender the claim to your insurer
- ❖ Your insurer issues a "Reservation of Rights" letter
- ❖ That alone requires insurer to appoint independent counsel
 - (In Alaska, Mississippi, and isolated other cases)
- ❖ Rationale: Conflicts of interest are always potentially present

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State Law Roundup: "Mere Reservation of Rights" Approach



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State Law Roundup: Conflict of Interest Approach

- ❖ Insurer undertakes defense under a reservation of rights
- ❖ *And* an actual conflict of interest is shown to exist
 - Direct Authority
 - Developing Authority

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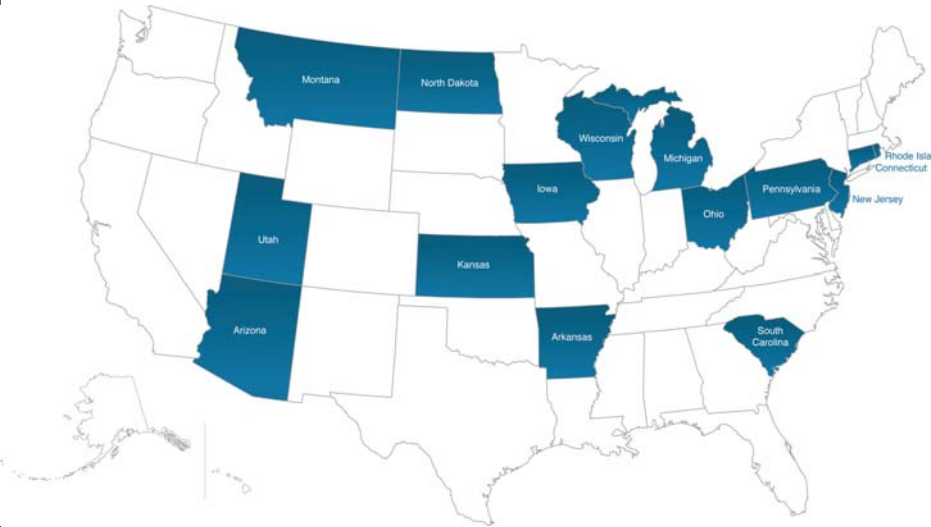
State Law Roundup: Conflict of Interest Approach



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State Law Roundup: Conflict of Interest Approach (Developing Authority)




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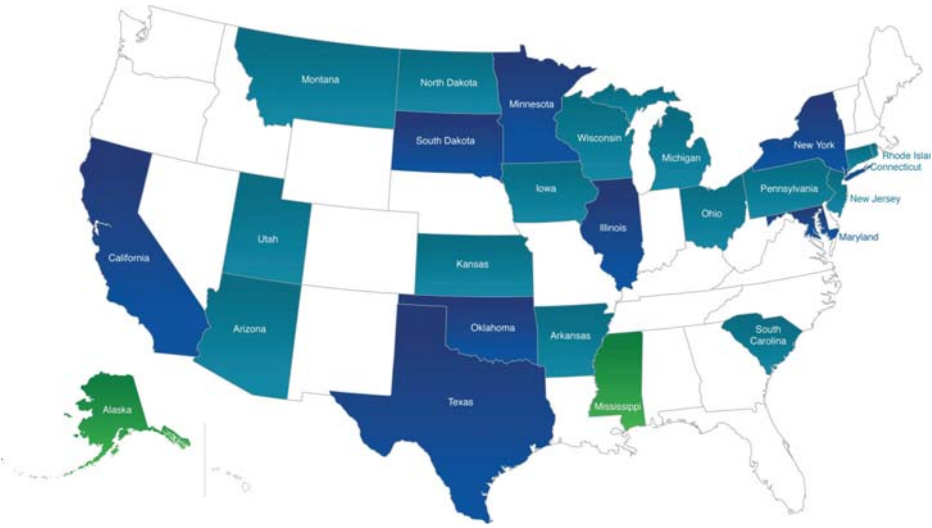
State Law Roundup: States Following *Cumis* Approach

- ❖ Half the states (25) follow this approach
 - Directly or Indirectly
- ❖ They recognize a *right* to independent counsel, when a conflict of interest is shown to exist


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State Law Roundup: Conflict of Interest Approach (Combined)



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State Law Roundup: States Following *Cumis* Approach

- ❖ The other states?
 - Most have no decisions (16)

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State Law Roundup: No Decisions



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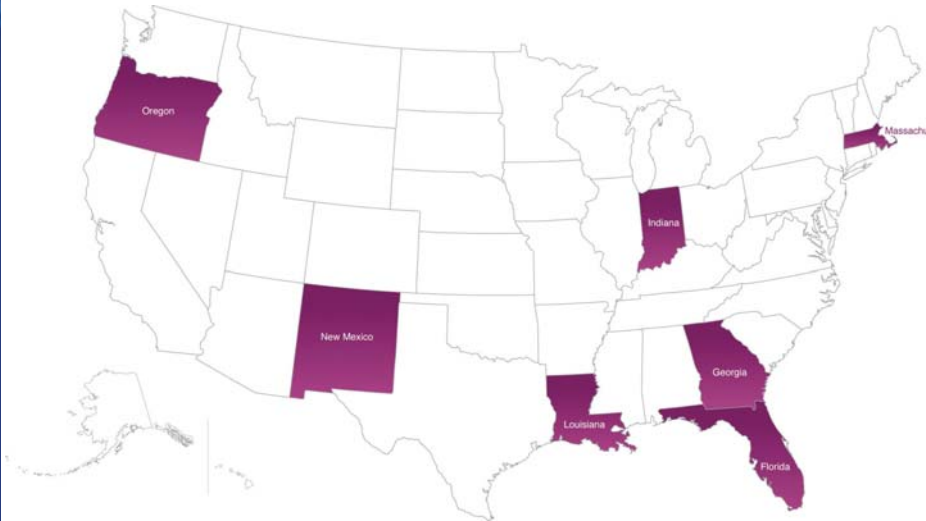
State Law Roundup: States Where Independent Counsel Is Possible

- ❖ "Right" to independent counsel may not be automatic
- ❖ Depends on kind of conflict between insurer and insured
- ❖ One option: carrier seeks declaratory judgment on coverage
- ❖ Another option: independent counsel, if conflict is unavoidable
- ❖ These states are not opposed to *Cumis* approach
 - They arose through unique fact contexts

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State Law Roundup: States Where Independent Counsel Is Possible



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State Law Roundup: States With "Enhanced Duty of Good Faith"

- ❖ In contrast to the AK, MS approach
 - The "shifty attorney" approach
- ❖ "Enhanced duty of good faith" approach
 - The "loyal attorney" approach
- ❖ The gist: Courts trust that attorneys will honor their professional responsibilities to represent the insured they have been hired (by the carrier) to represent
- ❖ When a conflict of interest arises, the attorney is presumed to be looking out for the insured's interests exclusively
 - And not the insurer's interests at all

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State Law Roundup: States With "Enhanced Duty of Good Faith"

- ❖ But what if attorney does not represent insured's interests?
- ❖ The attorney will have breached an "enhanced duty of good faith" to the client-insured
- ❖ Do you get an independent counsel?
 - No
 - You get a cause of action against the attorney
- ❖ Problem: You must wait until case is over to pursue relief

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State Law Roundup: States With "Enhanced Duty of Good Faith"

- ❖ Difficulty of enforcement
 - Hard to mount claim after the fact
 - Challenges the vast resources of an insurer
 - Requires highly specialized counsel to identify the breach
 - Attorney and insurer will collaborate against you
 - Remedies might not make challenge worth fight

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State Law Roundup: States With "Enhanced Duty of Good Faith"



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State Law Roundup: Nationwide Comparison



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Independent Counsel: Who Selects?

- ❖ Unclear
 - Few cases address this issue
- ❖ Pro-Carrier
 - If carrier pays, carrier gets to appoint
- ❖ Pro-Insured
 - The existence of the carrier-attorney relationship is what independent counsel is aiming to redress

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Independent Counsel: Who Selects?

- ❖ Under California law:
 - (1) An insurer can declare under a policy that it gets to choose
 - Insurers will try to write that into their policies
 - The matter is negotiable(Talk with your broker about it)
 - (2) If you pick your own counsel, your insurer can require your counsel to
 - Have five years of experience in subject matter of suit
 - Carry own errors and omissions insurance
- Rationale: If insurer will be paying for a second lawyer, it should be allowed to insist on paying for competence

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III. Application To Construction Industry

REVIEW

- ❖ The last thing you want: non-covered exposure
- ❖ Powerful tool to prevent this: independent counsel
- ❖ Independent counsel's job: to ensure that losses are covered wherever possible
- ❖ Independent counsel is a right, not a gift
- ❖ Available only where there is:
 - A qualifying conflict, **and**
 - A duty to defend

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Identifying A Qualifying Conflict

- ❖ Could carrier-appointed counsel, in theory, affect an underlying coverage dispute between the carrier and its insured?
- ❖ Examples:
 - Settlements in excess of policy limits
 - Steering case toward non-covered claims

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Construction Defects (Non-Covered Losses)

- ❖ Owner sues Contractor for construction defects
 - Windows installed incorrectly
 - Water enters, damaging floors
 - When installed, floors given wrong finish
- ❖ Losses:
 - Covered: CD (window installation) causing property damage (water damage)
 - Not covered: poor workmanship (wrong finish on floors)
- ❖ Conflict?

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Construction Defects (Non-Covered Losses . . . With a Twist)

- ❖ Owner sues Contractor for construction defects
 - Windows installed incorrectly
 - Water enters, damaging floors
 - *Metal staircases installed backward*
- ❖ Losses:
 - Covered: CD (window installation) causing property damage (water damage)
 - Not covered: poor workmanship (*installing staircases backward*)
- ❖ Conflict?

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Construction Defects (Rejection Of Within-Limits Demand)

- ❖ Contractor has liability exposure in excess of policy's \$10 million limits
- ❖ Claimant demands \$9 million to settle
- ❖ Conflict?

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Construction Defects (Rejection Of Within-Limits Demand . . . With A Twist)

- ❖ Contractor's punitive damages risk: > \$10M policy limits
- ❖ Compensatory damages risk: < \$10M policy limits
- ❖ Claimant demands \$9 million to settle
- ❖ Conflict?

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Contractor/Subcontractor Disputes

- ❖ Subcontractor sues Contractor for defamation

- ❖ Contractor policy covers libel and slander (unless insured intended to cause harm)

- ❖ Conflict?

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Contractor/Subcontractor Disputes (With A Twist)

- ❖ Subcontractor sues Contractor for defamation and for unpaid A/R
- ❖ Contractor policy covers libel and slander (unless insured intended to cause harm)
- ❖ Contractor tells insurer: "I didn't mean any harm"
- ❖ Panel counsel prepares a motion for summary judgment on the defamation claim
 - Contractor: "Why are you doing that?"
 - Attorney: "Because you meant no harm"
- ❖ Conflict?

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Employment Claims

- ❖ Contractor is sued by a female employee for failure to pay overtime:
 - Non-exempt employee (wage/hour)
 - Men given overtime more often than women (discrimination)

- ❖ EPLI policy excludes wage/hour claims
 - Policy has duty to defend

- ❖ Conflict?

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General Tort Claims

- ❖ Driver sues Contractor for causing her injuries when her car struck a barrier, rendering her a quadriplegic

- ❖ Claimant alleges that Contractor used sand-filled barrels rather than concrete to save money, seeks punitive damages based on intentional acts

- ❖ Conflict?

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IV. Independent Counsel's Attorney's Fees: Standard For Payment

- ❖ Panel counsel rates
 - Legal specialty?
 - Geographic area?

- ❖ Fair Market Value

- ❖ Where independent counsel rates are limited by statute or case law, should the insured pay the difference?

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IV. Independent Counsel's Attorney's Fees: Means of Resolving Disputes

- ❖ Litigation with insurer
 - Timetable
 - Magnitude of problem

- ❖ Arbitrate with insurer
 - Required by statute in CA

- ❖ Most common dispute: whether fees are reasonable
 - Gives insurer substantial bargaining power

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Conclusion: Negotiating Terms

- ❖ Up front: Independent counsel panel endorsed to policy?

- ❖ When suit filed:
 - Hourly rates and selection of counsel
 - Billing guidelines

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Conclusion: Pitfalls

- ❖ Carriers sometimes try to avoid providing independent counsel
 - “We are not reserving rights, we are denying coverage for the excluded losses if they ever happen . . . ?
 - Allocation provisions in duty to defend policies!
 - Sometimes they give up and simply waive reservation of rights

- ❖ Decreasing carrier emphasis on adjuster training

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Conclusion: Resolving Conflicts

- ❖ Before arbitrating or litigating:
 - Meet in person with adjuster (help the learning curve)
 - Bring in underwriter and broker
 - Ask the insurer to assign coverage counsel

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Conclusion: Best Practices

- ❖ Evaluate Early:
 - Are you entitled to, and do you need, independent counsel here?
- ❖ Make the Request to Your Carrier Early
- ❖ If Carrier Denies Request Claiming No Conflict, Underscore Conflict:
 - Request detailed interim liability evaluation in form aimed at showing conflict
 - Ask panel counsel in writing to protect against liability for non-covered losses
 - Ask panel counsel to furnish proof of E&O limits

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