



Legal Beat

By MICHAEL SEAN QUINN

Agents in the Claims Process

In any service industry, speed in responding to customer requests, customer satisfaction with performance (both in the short run and in the long), and accuracy in statements made are all terribly important. The three are not, however, always in harmony. Thus, for example, policyholders want to hear that there is coverage, or that there is probably coverage, when it is quite possible that there isn't or where the matter is quite uncertain.

Further, policyholders are frequently at sea about coverage. They do not want to pay for legal advice on the subject. Often, attorneys representing policyholders across-the-board don't know very much about insurance, and the policyholder doesn't know who specializes in such matters. It seems quite appropriate to many policyholders that their insurance agents should know what is covered and what is not. After all, in some sense, they sold the stuff.

Moreover, some large insurance brokerage houses tout the fact that they have claims departments. Sometimes, these departments are staffed by very experienced claims people.

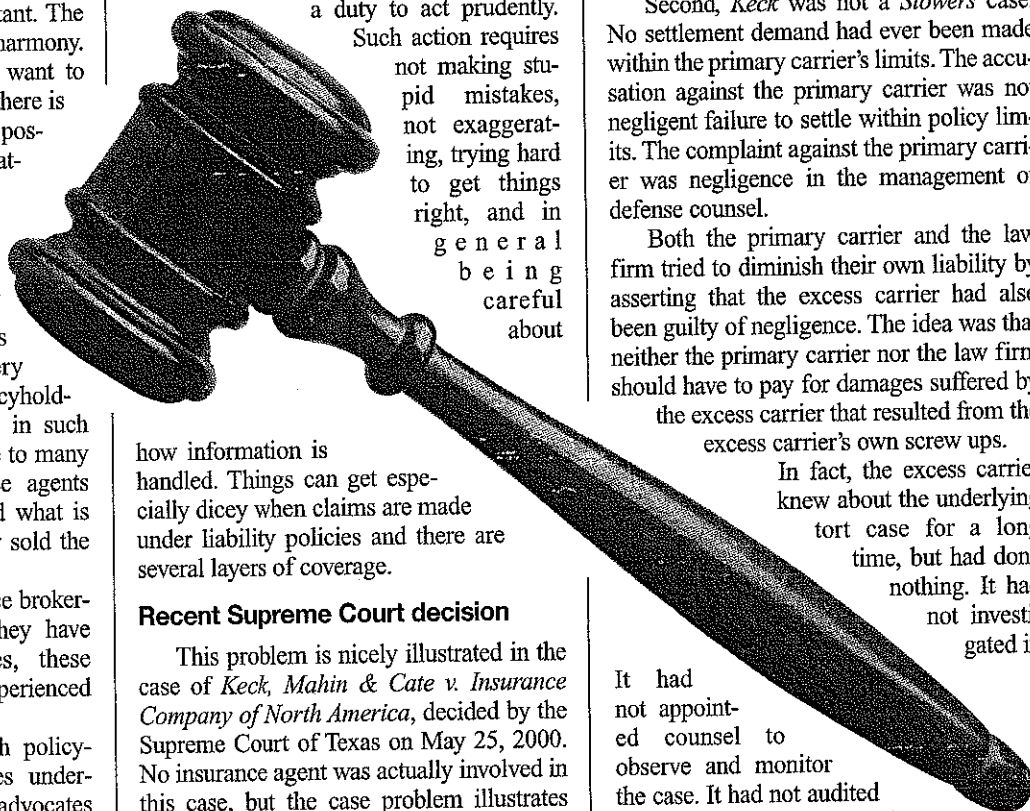
Finally, to some degree, both policyholders and insurance companies understand that agents are likely to be advocates for the interests of policyholders. Often this means that agents argue for coverage. Of course, agents tend to take a moderate approach to this advocacy, as they should, and they tend to shuttle back and forth between policyholders and insurance companies, trying to create a dialogue.

This posture is appropriate for an insurance intermediary. In addition, agents bring a global, but also blended, business point of view thinking about a claim, which an insurance company's claims department may lack. Sometimes agents have more feel for business context than policy text. Sometimes agents need to smooth ruffled feathers. Sometimes policyholders ask agents to help get a stubborn adjuster replaced. Occasionally, this needs to be done.

When agents get involved in claims, liability lurks. Agents have no legal duty to get involved in the claims part of customer service. They cannot be accused of any sort of malpractice if they do not get embroiled in

disputes. Often, however, claims-involvement is a business necessity for agents. In general, under the common law, if one gets involved in a process, one has a duty to act prudently.

Such action requires not making stupid mistakes, not exaggerating, trying hard to get things right, and in general being careful about



how information is handled. Things can get especially dicey when claims are made under liability policies and there are several layers of coverage.

Recent Supreme Court decision

This problem is nicely illustrated in the case of *Keck, Mahin & Cate v. Insurance Company of North America*, decided by the Supreme Court of Texas on May 25, 2000. No insurance agent was actually involved in this case, but the case problem illustrates difficulties for insurance intermediaries.

Somebody sued a business policyholder. Under the liability insurance contract at issue, the policyholder got to pick counsel. Apparently, defense counsel did a lousy job, and the primary carrier did not supervise counsel competently.

Before trial, the plaintiff offered to settle for \$3.6 million. After trial began, the primary carrier tendered the case to the excess carrier. The excess carrier, which knew little of the case, paid \$7 million to settle. In hindsight, everyone agreed the excess carrier paid too much. The excess carrier's explanation/excuse was that the hand-off from the primary carrier was late, so that it had no time to gather facts in a rationally paced manner.

Because the excess carrier thought it paid too much, it sued the *Keck* law firm for malpractice and sued the primary carrier for negligence in managing the defense, including negligence in supervising the lawyers.

Two legal principles need to be kept in mind. First, only clients can sue lawyers for malpractice, as a general rule. An exception to this rule arises when someone is subrogated to the interests of the client. An insurance company that pays off or settles a client's liability is subrogated to the interest of the client-policyholder. This means that the insurance company steps into the shoes (metaphorically) of the insured for almost all purposes. One excluded purpose is the collection of punitive and statutory treble damages.

Second, *Keck* was not a *Stowers* case. No settlement demand had ever been made within the primary carrier's limits. The accusation against the primary carrier was not negligent failure to settle within policy limits. The complaint against the primary carrier was negligence in the management of defense counsel.

Both the primary carrier and the law firm tried to diminish their own liability by asserting that the excess carrier had also been guilty of negligence. The idea was that neither the primary carrier nor the law firm should have to pay for damages suffered by the excess carrier that resulted from the excess carrier's own screw ups.

In fact, the excess carrier knew about the underlying tort case for a long time, but had done nothing. It had not investigated it.

It had not appointed counsel to observe and monitor the case. It had not audited the primary carrier's claims files. It had not audited the law firm's files. In the view of the primary carrier, the excess carrier had simply stuck its head in the sand.

The precise issue before the Supreme Court of Texas was whether the excess carrier and the law firm could introduce evidence to prove that the excess carrier had imprudently ignored the lawsuit at a time before the primary carrier had tendered the defense of the case to the excess carrier. (There was a second issue pertaining to the scope of a release affecting only the law firm. That topic is unrelated to insurance law and insurance adjustment practices.)

Tendering offers

The concept of tender is not one that has any special meaning in the insurance business. There is no great mystery about the term, however. It means, in the layered-liability carrier context, pretty much what it

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means everywhere else in the business world. It means offer.

Consider a primary carrier that has the legal obligation to manage and pay for the defense. When a primary carrier tenders to an excess carrier, it offers to the excess carrier the right to control defense and settlement, even though the primary carrier will continue to pay for the defense. In other words, the primary carrier offers to give the excess carrier discretion over spending the primary carrier's policy limits and a measure of control over spending the primary carrier's defense budget.

Sometimes primary carriers are irrationally loathe to tender defenses to excess carriers. For one thing, they hate to lose control over defense expenses. It seems inelegant, perhaps threateningly chaotic, for someone other than the company who has set up the defense reserve to be in control of that reserve. Often, line adjusters are fearful that excess carriers will not audit attorney bills carefully, since they are not paying them.

Primary carriers are also concerned that excess carriers will switch law firms and run legal bills up even higher. Finally, there is the "Guardian Mentality" that pervades the psyches of adjusters and insurers alike: "It's my money, and you can't have one dime of it to which you do not prove yourself entitled!" The "Guardian Mentality" can be a virtue, since it is useful in combating fraud

and natural exaggeration (both products of greed), but when it is carried to excess, or ossifies into stiff-necked rigidity, it becomes a vice, even a disease.

The *Keck* case is almost a paradigm of a situation in which the primary carrier suffered from the "Guardian Mentality." Primary carriers should tender as soon as they are convinced that their policy limits will have to be paid. The fact that a primary carrier tenders a defense does not mean that it must stop auditing legal bills. It does not mean that the primary carrier has to stop insisting that attorneys charge only necessary and reasonable legal expenses. As a practical matter, a primary carrier may even be able to prevent a change of law firms if the firm's performance has been mostly error free and appropriately aggressive.

In the first transaction I handled since *Keck* came down, I represented a policyholder. The primary carrier tendered. The excess carrier did a strange thing. It purported to refuse the tender. What the excess carrier meant was that it refused to pick up the cudgels and manage the defense of the insured. At the same time, the excess carrier believed that it escaped liability under *Keck* by simply refusing to go forward.

I wrote the excess carrier and told it that it could refuse to take over the defense of the case, but under *Keck* it was on the hook. It couldn't refuse a tender, although it could refuse to manage the policyholder's defense.

A tender was an offer. Offers can be

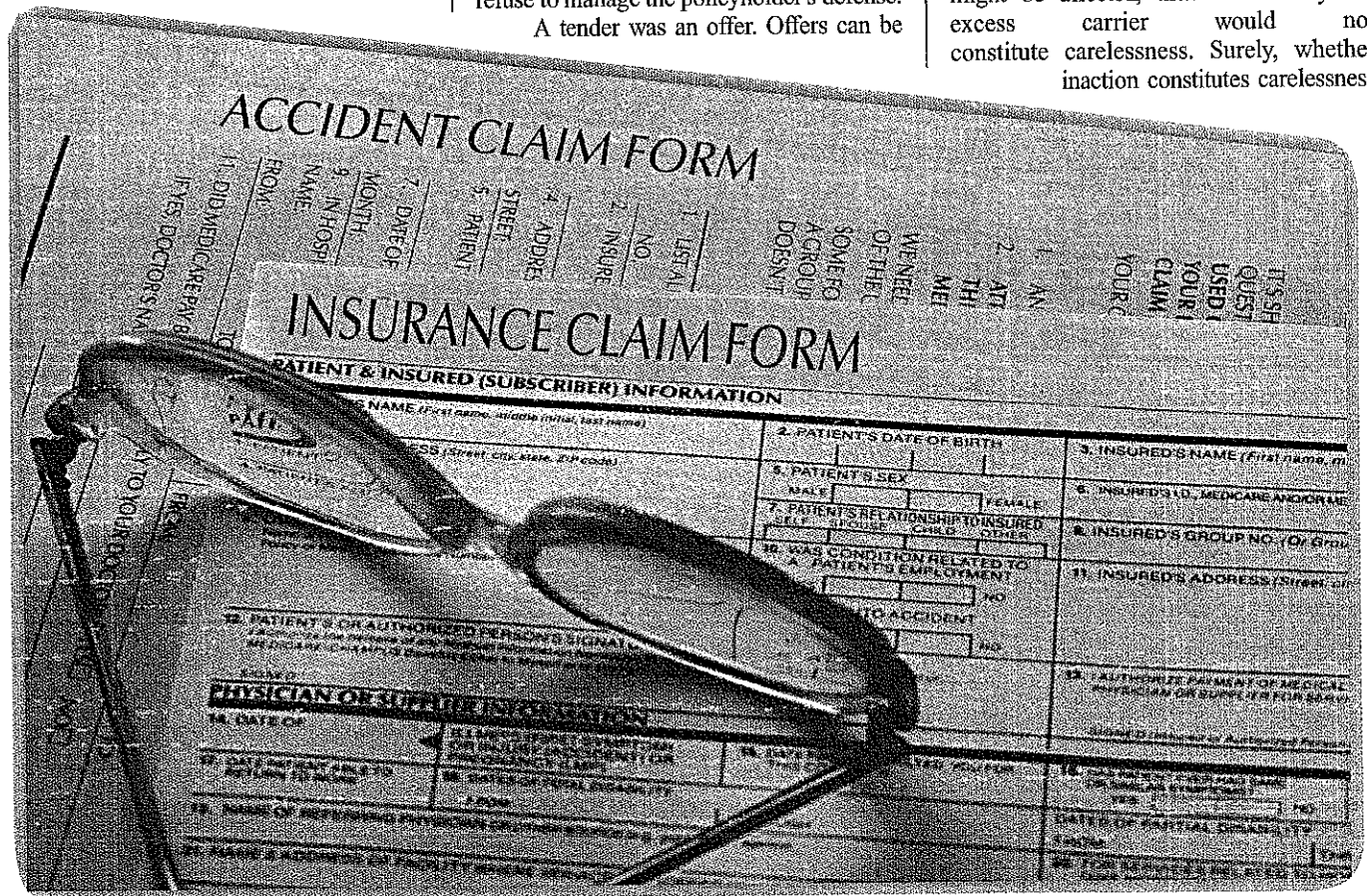
declined, rejected or countered. They cannot be erased by refusal. The primary carrier has tendered once it has made an offer. The fact that the excess carrier refused to accept the defense, does not mean that the primary carrier had not successfully tendered under *Keck*.

The court errs

I believe the *Keck* case was wrongly decided, however. The premise Chief Justice Phillips used in saying that the excess carrier was not to be found in the risk of negligence was that the excess carrier did not have a duty to anyone to do anything to defend the case until the primary carrier had tendered.

But this is really irrelevant. The question was whether the excess carrier had been prudent in looking after its own interests. A driver on the highway can be negligent if he does something stupid vis-a-vis his own interests, even if he doesn't violate any duty he owes another.

Surely the Supreme Court is not saying that an excess insurer is not expected to look after its own interests. Of course, an inactive excess carrier may not be careless in looking after its own interests. For example, if the excess carrier did not know that its interests were at stake, then inaction would be entirely rational. Further, if an excess carrier knew that there was a lawsuit but had received no information to the effect that its interests might be affected, then inaction by the excess carrier would not constitute carelessness. Surely, whether inaction constitutes carelessness



should not be determined by some "shining star" event such as tender. Whether an excess carrier is careless would depend on particular facts and particular circumstances. (The one judge who wrote separately, Justice Nathan Hecht, seems to have understood this.)

Moreover, *Keck* has limited significance. Most excess carriers, once they are warned that the plaintiff's damages may exceed the policy limits of the primary carrier, get involved to some degree. The *Keck* case does not address liability that might result from a voluntary undertaking. If I get involved in trying to straighten a problem

out, and my involvement is pursued negligently, I may have liability, even if I had no obligation to get involved in the first place.

Why agents should care

In *Keck* no agents were involved. The case involved an important theme, however, which is of concern to insurance agents. That theme is the passage of time, and how things can get really fouled up as time goes by.

One could imagine the helpful involvement of an agent in *Keck*. Indeed, if an agent had been involved, the whole process might have started sooner and evolved in a more

businesslike way. Agents should consider seeing to it that excess carriers are put on notice in a timely manner. Agents should discuss such notifications with policyholders. Agents should review with policyholders the consequences of putting an excess carrier on notice. Agents might wish to make sure that excess carriers receive thorough periodic reports as to what's going on in the underlying case. Agents might even consider staying in touch with claims people who are excess carriers to let them know about particularly bad facts.

In the transaction I just handled the agent has been extremely helpful in managing the rapid and smooth flow of information. Isn't this what being an intermediary is all about? ■

Quinn is an Austin shareholder in the law firm of Sheinfeld, Maley & Kay. He is mostly involved in litigation problems involving insurance coverage. Many of the problems upon which he works involve conduct of lawyers. He testifies from time to time on insurance related issues and on issues pertaining to the conduct of lawyers.

Yates Announces Departure from IIAA

Independent Insurance Agents of America (IIAA) CEO for Industry and State Relations Jeffrey M. Yates announced that he is resigning and will be leaving the association this fall to pursue other opportunities and *Jeffrey M. Yates* lifelong ambitions.



Yates will leave the association staff following IIAA's 105th Annual Convention & InfoXchange, which will be held Oct. 29-Nov. 1 in Orlando.

"This August I will reach 25 years of service to the Big 'I', and I have decided that now is an appropriate time for me to complete my tenure as an IIAA employee," said Yates of his decision.

"The staff management of the association is in excellent hands, and it is time for me to spend much more time with my family and on other interests that I have. "I will continue my current position at the association through the Orlando convention to assist in the transition and to have the opportunity to personally thank the members of the organization, many of whom I consider close friends, for their support and friendship over the last 25 years," says Yates. ■



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