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Coordinating **In-House Counsel** And **Insurance Risk Management**: Best Practices

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Most companies would never enter into a complex $50 million transaction without the deal being vetted by counsel. Yet, that is precisely what many do every day when they entrust their assets and their very survival to insurance policies that are never seen by their attorneys.

Likewise, insurance claims are often pursued without the benefit of counsel's evaluation of the company's contractual rights or advice on how to pursue coverage in a way that will protect its interests if a negotiated solution cannot be reached. In-house counsel have an important role to play both when insurance is obtained and when claims are pursued.

Counsel's Role

While obtaining coverage is primarily the responsibility of risk management, there are two important tasks that benefit from the input of counsel. First, counsel can help to ensure complete disclosure in insurance applications. Second, important policy provisions should be analyzed by counsel with an eye toward the particular risks faced by the company and counsel's preferences for dispute resolution.

Counsel should help ensure full and complete disclosure of information for insurance applications.

It is important to ensure complete disclosure in insurance applications because material omissions can result in rescission of the insurance policy. Applications for insurance policies typically require disclosure of known claims, losses and risk exposures. The required information may include property losses, workers compensation claims, third-party claims and lawsuits, and occurrences and circumstances which might give rise to a loss or claims, such as accidents, threatened claims or government investigations. Often, in-house counsel are particularly knowledgeable about those items, and may be able to identify omissions in the disclosures prepared by risk management.

Counsel should analyze insurance policies before coverage is bound.

Before coverage is bound, counsel should analyze the contracts being offered with the company's major liability and loss exposures in mind. Insurance policies for businesses are typically complex, lengthy contracts written in arcane language, with many exclusions that take away much of the coverage that is otherwise afforded. Many of the key provisions found in standard form policies have been interpreted by the courts, and are best understood in light of that case law.

An attorney's review of the company's insurance policies is not as daunting a task as it might first appear, at least after going through the exercise once. Most policies consist largely of standard forms, many of which remain largely unchanged from year to year. The insurance broker can

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be asked to identify all changes in coverage, which can ease counsel's task. Moreover, excess policies often "follow form" to primary policies. So, reviewing higher layer policies in a tower of insurance is typically far less involved than gaining an understanding of primary policies. However, care must be taken to ensure, if possible, that excess policies do not have less advantageous terms, and that if they do, any policies at higher levels do not follow form to them.

The grants of coverage and exclusions that are most important vary from industry to industry, and company to company. They should be apparent to in-house counsel who are familiar with the types of claims that have been asserted against the company and the assets which need protection. The most difficult thing is determining what those provisions mean and whether they provide or exclude important protection. Counsel may not know whether better alternatives are available to the coverage afforded by a policy, but they can identify potential problems for risk management to address.

Counsel should carefully review insurance policies for choice-of-law and arbitration clauses, which can have a material impact upon the scope of coverage provided and the resolution of claims.

Many commercial insurance policies contain problematic choice-of-law provisions. The insurance companies' favorite choice is New York law, which is worse for policyholders than the laws of most other states in certain respects. For example, under New York law, in most instances there is no cause of action available to corporations for insurer bad faith.

Some clauses not only designate the law of a state that is preferred by the insurer, but also go further and modify the rules of evidence and of insurance policy interpretation to be applied under that state's law. In particular, often such clauses take away from policyholders the valuable advantages they receive under legal rules of insurance policy interpretation, such as the resolution of ambiguities in favor of coverage. These provisions should be removed from policies if at all possible.

The policyholder may be able to control the method of dispute resolution by focusing on that issue at the time coverage is procured. This issue is often ignored by risk managers and brokers, who focus their attention upon terms and pricing. While it might not be advisable to let dispute resolution provisions be the "tail wagging the dog," counsel should carefully weigh the advantages and disadvantages of litigation vs. arbitration, and review any arbitration provision in policies under consideration.

As a general rule, policyholders receive at least two potential benefits from resolving their coverage disputes through litigation instead of arbitration. First, all courts in the U.S. apply rules of insurance policy interpretation which are favorable in some respects to policyholders as the party which did not draft the contract. Most notably, insurance policy coverage granting provisions are to be construed broadly while exclusions are to be viewed narrowly, and ambiguities are to be resolved in favor of coverage. These rules are applied in some arbitrations, but their use is specifically prohibited under certain arbitration clauses, and in general arbitrators are granted broad latitude under the law to depart from a strict application of legal precedent. Second, litigation affords a policyholder the opportunity to present its case to a jury. While that is not necessarily an advantage, insurance companies are generally held in low esteem by jurors, according to jury selection consultants. For this reason, the prospect of a jury trial may provide the policyholder with leverage in settlement negotiations.

A number of characteristics of arbitration could be beneficial to either side, or both, depending upon the circumstances. For example, it is often said that arbitration is faster and less expensive than litigation. In the world of insurance coverage disputes, that statement may or may not be correct. First, arbitrations can be expensive because arbitrators of insurance disputes are often retired judges or English barristers, who charge high hourly or daily rates. In some instances those costs are offset by savings achieved through streamlined proceedings. However, discovery is allowed in many arbitrations, so there may be little or no savings on attorneys' fees. The cost of an arbitration can also vary dramatically in a proceeding in which the loser pays the prevailing parties reasonable fees and expenses, such as in a London arbitration. Second, the arbitration of a complex coverage dispute can easily take a full year or longer. Nonetheless, arbitration is faster than litigating in many, but not all, courts. Also, appeal from an arbitration award is usually not a realistic option, which may help to bring finality to the dispute sooner than would be the case in a litigation. Arbitrations are often confidential proceedings, which may afford benefits to policyholders and insurers alike.

Manuscript Provisions

Many insurance policies contain both standard forms and "manuscript" provisions drafted for a particular policyholder. The involvement of counsel in the negotiation of "manuscript" policy provisions can be important for two reasons. First, care must be taken to ensure that such provisions clearly reflect the agreement of the parties, because if a dispute arises over their meaning, the policyholder may not be entitled to application of contra proferentum, or the reasonable expectations doctrine, which are based upon the premise that the insurer who provides the contract wording must be held accountable for any ambiguity. Second, the participation of counsel in the company's evaluation and drafting of such provisions might provide attorney-client privilege or attorney work product protection against disclosure of internal communications in a coverage action over the meaning of a manuscript provision.

Evaluation, Pursuit of Claims

Large and complex insurance claims almost inevitably involve issues of contract interpretation and other matters for which the policyholder requires legal expertise. Perhaps the simplest way to explain this need is to point out that the insurance company to which a large or complex claim has been submitted will always seek the advice of counsel in formulating its coverage determination. Policyholders need advice of counsel to evaluate their contractual rights and to assist with the prosecution of their important claims to ensure that full recoveries are achieved from insurers which have large claims departments and legal representation to protect their interests.

Counsel should evaluate coverage for any important claim.

A coverage opinion from counsel should be obtained whenever an insurer asserts, or it appears from the policy, that coverage is not or may not be provided for an important claim. The application of insurance policy provisions to a particular claim is often unclear, and the meaning of numerous standard form clauses have been interpreted differently by the courts of different states. Therefore, determining which state's law applies and researching applicable case law can be important to a coverage analysis. Moreover, whether an exclusion applies to a claim may depend upon a determination of the proximate cause of a loss, injury or damage. These are legal issues which are best addressed by counsel. Risk managers often look to their brokers to opine on coverage. However, while brokers often have a productive role to play in the handling of the claim, they generally are not trained in insurance policy interpretation.

Counsel should be part of a multidisciplinary team for the pursuit of large claims.

In-house counsel should be part of the policyholder's team for pursuing any claim involving coverage issues or the possibility of coverage litigation or arbitration. A policyholder may find itself at a distinct disadvantage when pursuing a coverage claim unless it assembles a team with the necessary skills to match those available to the insurance company. Typically, the insurance company has a large claim department with specialists in handling particular types of claims who have access to coverage counsel, accountants, engineers and every other type of expertise which may bear upon coverage for a loss. Many policyholders have similar expertise residing in various departments within the company, which should be brought together to prepare and pursue the claim. Also, outside expertise may be needed, such as outside accounting and loss adjusting expertise for loss calculation and negotiating with the insurer's loss adjuster. If a claim is particularly large or complex, it may be advisable to retain outside counsel to evaluate coverage and provide advice as the claims handling process develops. This is particularly advisable when the insurance company has raised exclusions as a possible basis for a denial of coverage or has asserted other policy-based defenses to payment.

Ensure Prompt Notice

Most insurance policies require prompt notice of claims, suits, accidents and occurrences, and coverage can be forfeited if notice is late, particularly if the insurance company has been prejudiced. While New York law is now less draconian than it used to be in instances of late notice, the relaxed standard does not apply to all policies, and in any event, in some cases courts have found that prejudice has occurred very quickly after claims or accidents, such as where important evidence has been destroyed or settlements have been reached prior to notice. So, procedures must be established between the law department, risk management and other departments to ensure that all events which must be reported to the insurance companies are promptly communicated for all policies which may be implicated.

Coverage Positions

The assistance of counsel is often needed to obtain a clear understanding of the insurers' coverage position because so-called reservation of rights letters often provide no meaningful information. Those letters typically lack any meaningful statement of facts relating to the claim and simply quote various insurance policy provisions as providing possible grounds for a denial, without explaining why they may be applicable. They also typically conclude with a blanket statement that the insurer reserves all of its rights to deny coverage on any ground whatsoever. This type of letter is a self-serving effort to satisfy the insurer's obligation to promptly articulate the grounds upon which coverage may be denied, but it is deliberately vague in order not to limit the insurer's options as its evaluation of the claim proceeds. Policyholders need a clear and specific statement of any possible grounds for denial so they can provide additional information and assess their coverage. Counsel are often best equipped to demand meaningful coverage positions from insurers.

Choice-of-Law, Forum Selection

Insurance policies are interpreted under state law, and with respect to a surprising wide range of issues, standard form provisions are given different meanings from state to state. That creates a powerful incentive for both sides in a coverage dispute to engage in forum shopping, and to race to the courthouse of a preferred venue at the first indication that a claim will not be resolved amicably. Therefore, policyholder counsel must focus on choice-of-laws and choice of forum before a dispute arises over a claim, and prepare to file suit quickly in the appropriate forum which best suits the client's interests.

A policyholder may assume that as the aggrieved party it has the sole discretion to initiate a coverage action, and therefore to select the forum. However, insurance companies frequently bring preemptive declaratory judgment actions in the forum that best serves their strategic objectives. When this happens, a policyholder may file a competing suit in another jurisdiction, and argue that as the aggrieved party it is the "natural plaintiff" and therefore its choice of forum should be given priority. When deciding which of two competing actions should go forward, courts consider a number of factors, but many give significant weight to which case was commenced first. Therefore, the policyholder must consider the possibility that if a coverage claim is not resolved amicably, it may find itself in a race to the courthouse against its insurers.

Conclusion

Insurance policies are important contracts which require the attention of counsel when they are entered into, and when claims are pursued. In-house counsel can help to ensure that the coverage purchased meets the company's needs, and that the protection paid for is not lost in the pursuit of a recovery.