

Managing evolving risks through liability insurance

| BY SYED S. AHMAD

Liability risks for all kinds of businesses continue to evolve and increase. Recent examples include groups hacking into computer networks, natural disasters in the US and elsewhere, and the Madoff scandal, all resulting in billions of dollars in losses. Liability policies can provide an opportunity to manage the various exposures, perhaps during the risk management and litigation phase, or perhaps much earlier, during corporate restructuring transactions, for example. Although the specific claims and insurance policy language will determine the appropriate strategy, some considerations apply more globally and should be evaluated for most, if not all, risks.

First and foremost, although insurance policies are contracts between a business (the policyholder) and the insurer, in almost all jurisdictions they are governed by special rules of interpretation, favouring coverage. Nonetheless, specific policy provisions are of paramount importance because seemingly minor differences in contract terms can have a significant impact on managing insurance assets and recovery efforts. Moreover, insurers may rely on broader language available in the market to argue that a policy sold to their insured should be given a narrow interpretation. As such, at the time they purchase insurance, companies should canvass the market to ensure that they acquire the broadest language available.

After a loss, policyholders should identify all potentially relevant insurance assets and alternate sources of insurance recovery. Examples include coverage procured by a corporate predecessor or other affiliated companies as well as insurance purchased by third parties, such as suppliers, distributors, contractors, or retailers. Although such coverage may not readily appear to apply, in fact, the alternate insurance may be an important asset, depending on the precise corporate relationships between companies and the state of the law in the relevant jurisdictions, among other factors.

Another issue that typically arises relates to so-called 'trigger' and 'allocation' issues. Many losses involve allegations and circumstances spanning numerous years and, therefore, potentially implicating different policies as well as different kinds of coverages. To properly manage the insurance recovery efforts, companies need to be aware that their current policies may not be the only assets available to cover the loss and should take into account prior policies as well and evaluate which policies may maximise protection. For example, some policies may include a high deductible or self-insured retention (SIR), which may sug-

gest pursuing coverage from other sources. But if other insurance could apply to the loss, the deductible or SIR may be paid by another insurer, and the policyholder may be able to avoid making any deductible or SIR payment directly.

Moreover, policies with deductibles or SIRs may result in the policyholder and insurer having different obligations and duties. Typically, policies with deductibles will require the insurer to provide a defence of claims and litigation, and many policies with SIRs could require that the defence be handled by the policyholder directly. The distinction between deductibles and SIRs is also important for evaluating the impact of a policyholder's insolvency or bankruptcy. In general, even if the policyholder cannot pay a deductible, the insurer may need to pay for the entire loss and, separately, could try to recover the deductible from the policyholder. In contrast, certain policies may provide that a policyholder's SIR obligations are a condition precedent before the insurer is required to make any payment.

After considering the various issues related to which insurance may be available to manage a particular risk or exposure, the policyholder will need to provide notice to the insurers. Failure to provide timely and effective notice could negate coverage otherwise available. Furthermore, an insurer may need to be involved during settlement negotiations and, more likely than not, the more information provided to the insurer, the easier it should be to have the insurer meaningfully participate to resolve the matter on terms favourable to the policyholder. On the other hand, a business may have a desire to avoid notifying certain insurers based on the likelihood that particular insurance may not be necessary to resolve the claims and providing notice may have a negative impact on the relationship with the insurer and the future cost for purchasing insurance. To avoid obstacles in maximising the available insurance recovery, these considerations will need to be carefully evaluated based on the governing law and the specifics relating to the claim and policies.

Having received notice, a liability insurer will typically assign defence counsel or, alternatively, attempt to coordinate efforts with counsel already handling the claim. In such instances there may be potential conflicts of interest. Different jurisdictions provide different rules about the policyholder's and the insurer's competing interests in controlling the defence and strategy, all of which could have significant implications for the eventual resolution of the claim. The policyholder will need to ensure that its interests are protected, independent from the insurer's ►►



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objectives and desires. Furthermore, depending on the existence of a potential conflict of interest, there may be a risk that applicable privileges could be waived, resulting in possible disclosure of defence counsel's advice. As a result, any decision to share privileged and confidential information with the insurer will need to be determined based on potential conflicts of interest and by evaluating if additional steps need to be taken to preserve the privilege, such as the policyholder and the insurer entering into a 'Joint Defence' agreement.

The role of the defence counsel can be particularly important during settlement negotiations. In this context, an insurer typically has a heightened duty of good faith to protect the policyholder's interests. To maximise the chance to settle, when appropriate and provided it is in the policyholder's benefit to do so, defence counsel will need to realistically assess the claim and evaluate all of the risks and exposures. The insurer has an obligation when evaluating settlement to treat its insured's inter-

est as at least equal to its own.

The issues discussed above are only a sample of many considerations and challenges that a policyholder may face in dealing with potential insurance disputes. Given the variety of areas where there may be disagreements, the importance of the specific claims and policy language, as well as the differing laws that may govern any such disputes, the policyholder will need to be proactive in managing all facets of the relationship with the insurers. Although the business risks continue to evolve, insurance will remain a critical tool to manage those risks. And the issues discussed above demonstrate the importance of proper handling of insurance to minimise the risks and obstacles.

Syed S. Ahmad is counsel at Hunton & Williams LLP. He can be contacted at +1 (703) 714 7676 or by email: sahmad@hunton.com.

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