Presented:
2014 Insurance Law Institute

November 13-14, 2014
Dallas, TX

The Bermuda Triangle in Texas: How to Navigate the Tripartite Relationship

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I.
THE UNHOLY ALLIANCE[1]

It has been described as the "unholy alliance." No, this is not a reference to a musical duet about humility by Taylor Swift and Kanye West at this year's Grammys.[2] Instead, the "unholy alliance" refers to the so-called tripartite relationship between an insurance company, its insured, and the defense counsel that is hired by the carrier to defend the insured. In this context, three is most definitely a crowd.

The genesis for the tripartite relationship stems from one sentence found in the standard commercial general liability ("CGL") policy: the insurer "will have the right and duty to defend the insured against any 'suit' seeking those damages."[3] Similar language is found in other types of policies providing for a duty to defend. The amount of ink spilled in courts across this nation dealing with the ethical issues surrounding this innocuous-sounding provision is staggering. So what is all the fuss about this single sentence?

A. Ethical Concerns In The Tripartite Relationship

As recognized by the Supreme Court of Texas, "[t]here is no question, of course, that conflicts arise in the tripartite insurer—insured—defense attorney relationship."[4] Insurers contend that their ability to control the defense and appoint panel counsel to defend the insured saves the policy holder money, and thus, keeps premium rates low for everyone. The insured counters that keeping costs down at the expense of quality can have a detrimental impact to the defense of the insured. Who is correct?

1. The Carrier's Point of View – The Noble Insurance Company With The Power Of The Purse

When an insurance contract gives the insurer the right to control the defense, the insurance company has the "power of the purse" over defense counsel hired to defend the insured. In the classic tripartite scenario, it is the insurance company that chooses defense counsel, and the insurance company is also the one who pays the defense bills. In support

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[1]The author would like to give a special thanks to Jamie Strickler for her invaluable help in editing this paper. She has lived up to her nickname of the "Sticklerrr." In addition, the paper was greatly aided by the editing assistance of Benjamin Motal, an associate at Sedgwick, LLP, and one of the finest coverage lawyers in Texas.

[2] For those of you over the age of 45 who may be confused by this reference, please imagine a duet between Madonna and Elton John. For those over the age of 65, please disregard.

[3] This duty to defend language sharply contrast with the language in policies that do not include a defense obligation. For example, some policies contain language that "it shall be the duty of the Insureds and not the duty of the Underwriter to defend Claims against the Insureds." Policies which traditionally do not impose an obligation to defend are most commonly found in malpractice and professional liability insurance. Rather than provide a defense up front, these policies typically reimburse an insured for the defense costs incurred by the insured after a judgment or settlement. Unlike the standard CGL policy, such defense cost reimbursement policies place the onus on the insured to select and manage its defense counsel.

[4] *Unauthorized Practice of Law Comm. v. Am. Home Assur. Co., Inc.*, 261 S.W.3d 24, 39-40 (Tex. 2008).

of this arrangement, carriers often point out the fact that insureds purchase insurance to avoid the headaches involved with selecting and managing counsel. They justifiably rely on insurance companies' vast expertise in managing litigation and superior ability to negotiate rates. This experience handling litigation allows insurers to more efficiently handle the defense than the inexperienced insured, which benefits both insureds and insurers.

Furthermore, the point of insurance is to shift the financial risk of a loss to the insurer, which necessarily includes the costs of defense. Thus, the chief concern regarding the cost of defense rightfully falls to the insurer. The insured is little more than a disinterested party regarding these defense costs.

Finally, by keeping defense costs low in the aggregate, insurance premiums are reduced for all insureds. If insurers are forced to pay more in defense costs, these increased costs will be passed along to the insurance-buying public. The higher cost of insurance would likely prevent some prospective buyers of insurance from entering the insurance market altogether, or result in insureds obtaining a lesser amount of insurance. As liability insurance, particularly mandatory forms of insurance such as automobile liability insurance, is recognized as a social good, uncontained defense costs could potentially harm the general public.

2. The Insured's Point Of View – The Devil Is In The Details

The insured does not reflexively dispute stated rationales provided by the insurers. After all, most insureds do not have the time, interest, or experience in managing litigation. Where a claim is fully covered and the insured's only concern is that the claim is settled by the insurer, little attention is given to how the insurer handles the defense. Moreover, keeping costs down ultimately benefits insureds when renewal time comes up - the insured's loss history used to calculate renewal rates is greatly aided by containing runaway defense costs.

The insured's chief concern is the practical effects of the insurers' race to drive down defense costs. Cutting costs to the bone have detrimentally impacted insureds. Unqualified counsel are sometimes appointed because they are cheaper. Even worse, competent defense counsel are not allowed to fully deploy their recommended strategies due to budget constraints and billing guidelines.

This singular focus on costs results in less-than-stellar results for the insured. By way of example, defenses that exist go unasserted or undeveloped due to the insurer's budget constraints. As a result, cases that should not settle are settled, and cases settle for far more than the claim is worth.

For some insureds, like businesses, precedent is more important than a particular case. A single precedent can upend a successful business model that took decades to create and mold. With insurers only caring about the bottom line, the precedent and business of the insured hardly matter.

Title search: The Bermuda Triangle in Texas: How to Navigate the Tripartite Relationship

Also available as part of the eCourse
Insurance Law Ethics: Challenges and Best Practices; The Tripartite Relationship; plus What Clients Want

First appeared as part of the conference materials for the
19th Annual Insurance Law Institute session
"The Bermuda Triangle in Texas: How to Navigate the Tripartite Relationship"