Mediation: Coverage Lawyer as Captain of the Settlement

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MEDICATION: COVERAGE LAWYER AS CAPTAIN OF THE SETTLEMENT

As coverage lawyers, we are often asked to participate in mediation of the underlying matters in which an insurer or insurers will be the responsible party. Too often, this involvement comes late in the game and too close to the mediation to be effective. This session will explore the benefits of engaging a coverage
lawyer as part of the plaintiff or defense team to initiate the strategy for getting the underlying case settled with the maximum utilization of insurance assets or the lowest cost.

I. Introduction of Panel

A. Policyholder Coverage Lawyer
B. Insurer Coverage Lawyer
C. Policyholder/Claimant Representative/Mediator
D. Insurer Representatives

II. Hypotheticals

A. Bodily Injury Catastrophic Loss where multiple excess insurers provide coverage in layers. Primary has not been exhausted. Coverage for punitive damages has been denied. First excess insurer denies that it has a duty to defend after exhaustion of the primary layer. Over 15 claims have been made: one death case; two seriously injured plaintiffs; others are combination of lesser personal injuries, property damage and subro cases. Total demand exceeds limits of all insurance by multiple of five.

1. Who sets the stage? Examples: general counsel gets reservation of rights letter; defense counsel gets discovery requests from plaintiff’s counsel to discover extent of insured’s corporate assets; primary insurer tries to settle smaller claims in order to exhaust primary limits.

2. Timing of mediation - Not too soon; not too late. Examples: Plaintiffs make their separate demands, but higher level excess insurers’ assigned monitoring counsel have not completed reviews; primary defense counsel has pursued liability defense and not adequately worked up damages profiles.

3. Alliances among the players – strange bedfellows. Examples: Policyholder counsel must work with plaintiff lawyers to make demands that will pressure lower level excess insurers to tender their limits; Defense counsel must coordinate “dog and pony” show for all insurer representatives to get a consensus on the settlement range for each case; lower level excess insurers must work with policyholder counsel to eliminate risk of bad faith for their clients.

4. Pre-Mediation Preparation. Examples: Conferences with all defendants and their insurers to discuss settlement values (with or without mediator) and allocations for offers; set realistic deadlines for excess insurers to indicate their authority; have primary layer and lower level excess money offered to plaintiffs before mediation.

5. What role should the coverage issues play? Settlement within limits would eliminate potential for uncovered punitive damages or excess compensatory damages; punitive damages proof will drive up compensatory damages; defendant has uncollectible assets and cannot fund defense if primary policy is exhausted.
B. Professional Liability Wrongful Death suit where Hospital is sued for conduct of Neurology resident and attending physician. Hospital has large SIR and has apologized to plaintiff’s family; excess insurer has hired monitoring counsel that has seriously undervalued case.

1. **What are the Conflicts?** Examples: Neurology department has relationship with the patient and wants to settle; Hospital Risk Management office responsible for monitoring exhaustion of the SIR; Hospital General Counsel retains Defense Counsel, whose fees do not apply against SIR; excess insurer retains participating defense counsel.

2. **Whom should the Plaintiff Attorney Trust?** Examples: Should plaintiff make a demand; does that indicate a weakness in resolve to try the case; is the defense counsel hired by the Hospital giving the Risk Manager realistic appraisal or trying to be a hero? Is the excess insurer’s participating counsel prepared to try the case?

3. **What are the pressure points?** SIR must be tendered before excess will consider participating in settlement; policyholder has the drain of funding defense through trial; hammer clause on policyholder; excess liability above limits of insurance; can Hospital admit value of case exceeds insurance limits?

C. Directors’ & Officers’ Claim–Clinical Trials for New Drug

Shareholder class action lawsuit filed against public pharmaceutical company, Size 0, Inc. its, CEO, CFO and three board members, arising from the company’s failure to obtain FDA approval for its new diet drug. The complaint alleges defendants engaged in a scheme to inflate the market price of Size 0 securities and to defraud shareholder class members by making misrepresentations and non-disclosures of material facts regarding the prospects for FDA approval of Size 0’s drug for the treatment of obesity. The Securities and Exchange Commission (SEC) also conducted an investigation and filed an enforcement action against the company, CEO and CFO. A motion to dismiss the shareholder class action is pending.

Specifically, it is alleged that Size 0 defendants knew the FDA had serious concerns about not only the drug’s life threatening side effects, but also about the methodology of the company’s clinical studies, yet defendants announced promising results from the drug trials and that FDA approval could be expected. The stock price continued to rise in anticipation of the drug receiving FDA approval.

During the class period, the CEO and CFO defendants sold over 50% of their Size 0 stock realizing millions of dollars from the sale. On March 28, 2012, at the close of trading, Size 0 announced that the FDA’s decision regarding approval of its diet drug would be delayed until the latter half of 2012. The next day, the share price of Size 0 stock declined 60% in a single day of trading.

Weeks later, Size 0 shareholders and the investing public learned that two people in the study had died and that the failure to follow test protocols during the Phase III trials of the drug made it highly unlikely the FDA would grant approval based on the data submitted.
Insurance Program

Size 0 maintains a $20 million Directors and Officers (D&O) Liability Insurance program with $1 million retention for securities claims. The D&O coverage consists of four $5 million policies provided by Insurer W (primary); Insurer X (first excess); Insurer Y (second excess) and Insurer Z (third excess).

Public company D&O policies are indemnity policies and do not impose a duty to defend upon the D&O carriers.

1. **What are the conflicts?** Examples: The defendant board members had no knowledge of the breach of testing protocols and did not participate in preparation of the press releases. Conflicts exist between defendant officers who knew of problems and sold their shares versus the “innocent” defendant directors. Separate counsel may be needed for different defendants.

Additionally, the company, CEO and CFO are fighting on two fronts: defending both the securities class action and the SEC enforcement action. The company can reach a settlement with the SEC but a settlement with the CEO and CFO is more problematic. As part of any settlement with the individuals, the SEC seeks a lifetime bar order prohibiting the CEO and CFO from ever working as an officer of a public company.

In addition to the competing interests of the separate defendants, the interests of the carriers are not aligned. There is the pressure of the excess carriers on the carriers below them to settle the case beneath the higher policy layers.

There are also strategic considerations as to which lawsuits should be settled first if a global resolution is not possible.

2. **What are the pressure points?** Multiple defense firms are eroding policy limits. This is the only drug Size 0 has in its pipeline. The future of the company is at stake. If the company can get the securities class action behind it, Size 0 may be able to raise sufficient funds to conduct another drug trial, with strict compliance with testing protocols thus correcting the deficiencies of the earlier trials. The two deaths involved individuals with pre-existing conditions that caused their deaths and were unrelated to the diet drug.

There remains the possibility of obtaining FDA approval of the diet drug. Size 0’s goal is to settle the securities class action within policy limits as soon as possible so it can proceed to another round of clinical trials. Defense counsel paints the worst-case scenario to carriers to maximize settlement authority. Carriers assert policy conduct exclusions for fraud and personal profit or advantage. The CEO and CFO do not want the D&O coverage exhausted by the settlement of the securities class action since they need to fund the continuing defense of the SEC enforcement action.

Settling the securities class action sooner rather than later will cut off the erosion of policy limits by defense costs and preserve some of the limits for the defense of the CEO and CFO in the SEC enforcement action. The company may make
a contribution of shares of stock to the settlement since it may be willing to agree to a higher settlement amount to resolve the lawsuit quickly.

3. **What role do the coverage issues play?** Conduct based exclusions are in play but generally require 'final adjudication,' e.g., a determination of fraud in a legal proceeding to trigger the exclusion. Such determination could occur in the SEC action. The carriers may seek a contribution from the company, CEO or CFO to any settlement in light of the potential policy exclusions. The carriers may negotiate a reduced amount of policy limits available for settlement due to the coverage issues.

III. **Legal Issues**

A. Exhaustion by payment
B. Bad Faith Failure to Settle
C. Allocation
D. Indemnity

IV. **Strategy Issues**

A. Timing and pre-mediation preparation
B. Alliances with Plaintiff or Defendant
C. Alliance with the Defense Lawyer
D. Demands within policy limits
E. Role of the Mediator