SUPREME COURT OF ARIZONA

MICHAEL McREYNOLDS, an Arizona resident, Plaintiff/Appellant, v. AMERICAN COMMERCE INSURANCE COMPANY, a foreign corporation, Defendant/Appellee.	)	Supreme Court No. CV-10-0288-PR Court of Appeals No. 1 CA-CV 09-0017 Maricopa County Superior Court No. CV2007-005060 Hon. Edward O. Burke

AMICUS CURIAE BRIEF ON BEHALF OF UNITED POLICYHOLDERS

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THE COURT OF APPEALS' OPINION

The *McReynolds* opinion holds that when faced with multiple claims that exceed or will probably exceed the policy limits, an insurer may follow any one of three alternatives: (1) invite the claimants "to participate jointly in efforts to reach agreement as to the disposition of the available funds"; (2) attempt "to settle claims within the policy limits as they were presented"; or (3) "promptly and in good faith" commence interpleader proceedings and pay "its policy limits into court." *McReynolds v. American Commerce Ins. Co.*, 225 Ariz. 125, 130 ¶ 19, 235 P.3d 278, 283 (App. 2010) (quoting *Farmers Ins. Exch. v. Schropp*, 567 P.2d 1359, 1367 (Kan. 1977)).

An insurer following the third alternative has "a safe harbor . . . against a bad faith claim for failure to properly manage the policy limits (or give equal con–sideration to settlement offers) when multiple claimants are involved and the ex–pected claims" exceed the policy limits. *Id.* at 131 ¶ 26, 235 P.3d at 284.

The court did not explain what "good faith" means in this context. The "safe harbor" against bad-faith claims means that the insurer's responsibility to its in–sured is capped at policy limits, no matter how much damage may have been caused the insured by the insurer's mismanagement of its duties.

ISSUE

When faced with multiple claims exceeding the policy limits, does an insurer's implied contractual duty of equal consideration include an obligation to manage the limits in such a manner as to protect its insured by minimizing the insured's personal liability? Can such a contractual duty be satisfied by filing a prompt interpleader and continuing to defend the insured?

WHY THIS COURT SHOULD TAKE REVIEW

Given the above issue, the court should grant review for a number of reasons:

1. *McReynolds* is the first Arizona opinion specifically dealing with an insurer's duties and an insured's rights when there are multiple claimants and the claims exceed or probably exceed policy limits.

2. The problems of insurers and the rights of insureds in such multiple-claim situations are issues of major statewide importance. Hundreds of accidents occur on Arizona's streets and highways every day of every week, and in many of those cases, injuries are inflicted on several victims so that the insured tortfeasor is faced with multiple claims. Given the minimal $15,000/$30,000 required limits, there will often be multiple claims exceeding policy limits.

3. The language in *McReynolds* states an absolute, bright-line rule granting insurers immunity from bad-faith claims even though the prompt filing of an interpleader action may, in some cases, be quite harmful to the insured; thus, the bright-line, safe-harbor rule of *McReynolds* will often be contrary to the well-established Arizona rules that an insurer owes its insured the duty of acting reasonably to protect its insured and giving the insured equal consideration with the insurer. *See Zilisch v. State Farm Mut. Auto. Ins. Co.*, 196 Ariz. 234, 995 P.2d 276 (2000); *Fulton v. Woodford*, 26 Ariz.App. 17, 545 P.2d 979 (1976).

4. The Court of Appeals laid down a bright-line rule applicable to all multiple-claim factual situations, even though in many situations that rule would not protect the insured, would not provide the insured with a release, and would leave the insured personally liable to one or more claimants.

5. While it is certainly true that insurers are at risk in attempting to perform their duties without the safe harbor given to them by the Court of Appeals' opinion, insurers get paid for that risk by accepting premiums, while the insured pays premiums to be freed from such risks. The opinion ignores the risk to an insured whose insurer fails to manage the available insurance funds in a reasonable manner, leaving the insured personally liable to the most seriously injured claimant.

6. The safe-harbor rule adopted by the Court of Appeals is a matter previously not settled in Arizona insurance law and is a minority rule frowned on by many commentators and cases.

ARGUMENT

A. Introduction and summary to argument

Under most factual situations, the interpleader/safe-harbor alternative does nothing to protect the insured but instead may expose the insured to significant risk in multiple-claim situations. There is a long-established Arizona rule regarding the insurer's general duty in settling claims: The insurer must use reasonable care to protect its insured and at all times give its insured equal consideration.

But the court's language in *McReynolds* lays down an absolute, bright-line rule that in many situations protects only the insurer and not the insured. The proper rule, and one that would conform to existing Arizona law respecting the general obligation of insurers, is that the insurer must manage the available policy proceeds in a reasonable manner with the object of settling claims by protecting its insured as much as is reasonably possible. This will often mean using the available limits to satisfy the maximum liability facing the insured.

Whether the insurer has acted reasonably is usually a question of fact for the jury. *McReynolds*, however, holds that, as a matter of law, prompt, good-faith filing of an interpleader action (and continuing to defend) satisfies all of the insurer's obligations; it thus adopts a rule that often leaves the insured unprotected and thereby conflicts with Arizona's general law requiring the insurer to act reasonably to protect its insured.

B. The *McReynolds* rule conflicts with long-recognized principles of Arizona insurance law

Arizona law has long recognized the principle that a liability insurer must act reasonably to protect its insured. *Zilisch*, 196 Ariz. 234, 995 P.2d 276 (first-party case). In the context of settlement of third-party claims, this has led to the rule that the insurer must treat the insured with equal consideration, as if it were paying out of its own pocket. *Clearwater v. State Farm Mut. Auto. Ins. Co.*, 164 Ariz. 256, 792 P.d 719 (1990); *Fulton*, 26 Ariz.App. 17, 545 P.2d 979. Failure to do so constitutes bad faith.

The *McReynolds* opinion, however, gives interpleading insurers safe-harbor immunity from a bad-faith claim even if filing the interpleader action instead of settling with the most seriously injured victim was unreasonable under the circumstances.

Consider, for instance, a hypothetical case (actually not so hypothetical): A motorist with a 15/30 policy negligently collided with and injured nine bicyclists. Eight were not badly injured, did not require hospitalization, and received only minimal medical care. One unlucky victim had severe hip injuries that necessitated hospitalization and surgery, incurring in excess of $130,000 in medical expenses. He also had a substantial loss of income, pain and discomfort for a year, and may need a hip replacement in the future. This claimant offers to settle and release the insured for the $15,000 limit applicable to him, but the insurer, concerned about its ability to settle with other claimants for the remaining $15,000, promptly interpleads the entire $30,000 available insurance and continues to defend the insured. The other claimants eventually are happy to split "their" $15,000 share, but, as in *McReynolds*, the badly injured claimant goes forward to trial.

Filing the interpleader and depositing the $30,000 did not, of course, discharge the insured's tort liability, and a verdict would leave the insured liable for several hundred thousand dollars. Indeed, one of the shortcomings of the interpleader/safe-harbor immunity adopted by the Court of Appeals is that when the insurer interpleads competing tort claimants based on the inadequacy of policy limits to satisfy all claimants, neither the insurer nor the interpleader court may restrict the claimants' rights to sue the insured tortfeasor and obtain judgments that exceed the limits. *See Oak Cas. Ins. Co. v. Lechliter*, 524 S.E.2d 704 (W.Va. 1999).

Our experience tells us this was not a reasonable way for the insurer to protect its insured under the foregoing hypothetical facts. Many experts would testify that the insurer did not act reasonably and did not give the insured equal consideration.[1] But *McReynolds* holds that assuming it acted in good faith,[2] the interpleading insurer is not liable beyond the $30,000 policy limit, and the insured thus remains liable for the entire verdict.

But in our hypothetical, the insurer could have saved its insured from this liability simply by taking the claimant's offer of settlement/release for $15,000. Until *McReynolds*, insurers operated on the assumption that they had to manage the available limits in a reasonable manner so as to give their insured as much protection as possible. This, of course, conformed to the Arizona law of equal consideration, not to mention a rule of common sense. It also provided the insured the protection for which he paid – and the insurer accepted – a premium.

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[1] Such testimony was indeed available in *McReynolds*. Thomas A. Zlaket, a very experienced lawyer, was of the opinion that the insurer had not acted reasonably, had failed to protect its insured, had failed to give the insured equal consideration, and had committed bad faith. Plaintiff's Second Supplemental Disclosure Statement, attached as an exhibit to the deposition of Thomas A. Zlaket, Sept. 11, 2008. *See* Exhibit A. *See also McReynolds*, 225 Ariz. at 127 ¶ 9, 235 P.3d at 280.

[2] The court did not define what "good faith" means in this context, but given *McReynolds*' language, it obviously did not mean managing the limits so as to protect the insured to the maximum extent reasonably possible. *See* subsection E, *infra.*

It is true that in *some* of these cases, the insured has been able to satisfy his personal liability by assigning his rights to the victim in return for a covenant not to execute.[3] But after *McReynolds*, there will be no rights to assign because under the absolute language used by the Court of Appeals, interpleading insurers will all be in their safe harbor, immune from liability over the interpleaded limits, and some insureds will either have to pay the judgment themselves or, quite likely, seek protection from the bankruptcy court.

This result not only conflicts with basic Arizona insurance law but is very bad policy.

C. The duty to settle

There is really nothing unique about the problems an insurer faces when multiple claims probably exceed policy limits. An insurer's general duty under a liability insurance contract "is to settle a claim that has been brought against the insured when it is appropriate to do so." 1 ALLAN D. WINDT, INSURANCE CLAIMS AND DISPUTES: REPRESENTATION OF INSURANCE COMPANIES AND INSUREDS § 5:1 at 5-2 (5th ed. 2007). In determining what is an appropriate case, the insurer must consider the insured's interests and give those "at least as much consideration as it gives to its own interest." *Id.* (citing cases, including *Clearwater*, 164 Ariz. at 259-

[3] But not cases in which the insured has significant assets.

61, 792 P.2d at 722-24, and *City of Glendale v. Farmers Ins. Exch.*, 126 Ariz. 118, 120, 613 P.2d 278, 280 (1980)). The insurer "must treat the claim as if it alone might be liable for any verdict . . . and commit its policy limits accordingly." *Id.* at 5-6 (citing cases, including *Fulton*, 26 Ariz.App. at 21, 545 P.2d at 983).

These duties imposed on the insurer arise in part, of course, from the fact that the insured pays a premium to be protected from risks arising from liability claims and because, in most liability policies, control of the defense, and thus of settlement, is left entirely in the hands of the insurer. *Clearwater*, 164 Ariz. at 260, 792 P.2d at 723. Thus, the insured, unable to control the defense, has no right to direct the insurer how to apply the policy proceeds. 1 ALLAN D. WINDT, *supra* § 5.3 at 5-23 – 5-25 (citing cases).[4] But the fact that the insured cannot control the defense and thus cannot control settlement does not mean that the insurer may manage the question of settlement any way it wants, even in a multiple-claims situation.

Insurers faced with multiple claims are not caught between Scylla and Charybdis. While an interpleader may be a good-faith answer in a very few cases,

[4] Though the insurer's duty of acting reasonably certainly includes the obligation to consult with the insured on difficult issues, the opinion does not require such action as part of the safe-harbor alternative. According to American Commerce's response to the petition for review, American Commerce consulted with its insureds and followed their direction. Opposition to Petition for Review at 8-10. We have no way of knowing whether such consultation was timely, but none of these facts appear in the Court of Appeals' opinion; if mentioned and given appropriate importance, they might have obviated the entire problem.

managing the limits in such a manner as to discharge the known greater liability may be the only reasonable answer in most others.

That alternative is available. An insurer may choose to settle some claims, thus exhausting limits and excluding settlement of other claims, "provided this decision is reasonable and in keeping with its good faith duties to the insured." 14 COUCH ON INSURANCE § 203.29 at 203-48 (3d ed. Supp. 2008). Thus, the insurer must show that it investigated the claims, tried to settle as many as possible, "and minimized the magnitude of possible excess judgments against the insured by reasoned claim settlement." *Id.* at 203-49 (citing cases). If it reasonably determines that a particular claim posed a "greater risk" to its insured, it acts "reasonably and in good faith" when it settles that claim "to the exclusion of another." *Id.* (citing *General Sec. Nat'l Ins. Co. v. Marsh*, 303 F.Supp.2d 1321, 1325-26 (M.D. Fla. 2004)). Thus, the insurer's usual settlement duty of equal consideration applies to multiple claimants, just as it does to a single-claim case, and it may settle a portion of the multiple claims even though this exhausts the policy limits "so long as the distribution is in the insured's best interests." 22 APPLEMAN ON INSURANCE § 137.2 at 127 (2d ed. 2003).

D. *McReynolds* adopts a minority rule in declaring an absolute safe harbor for interpleading

The views expressed in COUCH and APPLEMAN are echoed in other authorities. A respected treatise discusses the three alternatives an insurer faces when presented with multiple claims that exceed policy limits and describes the interpleader "alternative [as one that] merely passes the buck from the insurer to the court and provides little protection for the insured." STEPHEN S. ASHLEY, BAD FAITH ACTIONS: LIABILITY AND DAMAGES § 4:19 at 4-67 (2d ed. 1997).

ASHLEY then discusses how to "resolve the problem of multiple claimants." *Id.* His solution is as follows:

> In principle, the insurer's duty in a multiple claimants case should be to use the policy limits to purchase for the insured release from as much liability as possible. The insurer must first investigate the claims and determine their individual expected costs, ignoring the policy limits. The insurer should then accept those settlement offers that provide the insured the maximum relief from liability for each settlement dollar paid.

Id.

Another respected commentator has this succinct statement of the proper rule to be applied:

> Unique problems are presented when the insured is being sued by more than one person and the policy limits are not sufficient to settle all the claims against the insured. Under those circumstances, the insurance company has a duty to manage the insurance proceeds in a manner reasonably calculated to protect the insured by

> minimizing total liability. As a result, depending on the facts, an insurer may be held liable either for settling or for not settling.

1 ALLAN D. WINDT, *supra* § 5.8 at 5-45 – 5-46 (citing cases, including *Brown v. United States Fidelity & Guar. Co.*, 314 F.2d 675 (2d Cir. 1963) (New York law)). This statement conforms exactly to general Arizona law on insurance: An insurer must act reasonably in protecting its insured and is liable for bad faith when it does not do so.

As WINDT indicates, this rule creates a dilemma for the insurer because it will "always confront the spectre of an excess judgment." *Id.* at 5-49. But the company confronts that same problem in handling negotiation and settlement of any single claim that may or may not exceed policy limits. Whenever the insurer is handling negotiation of such a claim, there will often be a question of fact whether the insurer gave its insured equal consideration. *McReynolds* gives no reason why a different rule should obtain when an insurer is confronted with two or three claims instead of one that might exceed policy limits.

Of course, there is a practical and pragmatic solution for the insurer. In multiple-claim situations, the insurer can try to get a global settlement with all claimants and, failing that, inform the insured of the problem and follow the insured's directions or, as WINDT suggests, even turn over the policy limits to the insured to distribute between the multiple claimants as the insured thinks will best satisfy the maximum amount of his or her potential liability. *Id.*

The basic duty, then, is to manage the available limits in a manner best calculated to protect the insured. If the insurer does that, it will not be liable for bad faith. The Court of Appeals' language, however, does not require the insurer to even attempt to protect the insured but leaves it free to protect itself no matter the consequences to the insured. The interpleader/safe-harbor immunity provides *no protection* to the insured. The interpleader court cannot make the claimant/defendants give up their right to trial to judgment. Ariz. Const. art. XVIII, § 6. Nor can it make them release the tortfeasor from liability. While *McReynolds* provides a safe harbor for insurers, it does so by depriving insureds of the contractual right to have their insurers act reasonably to protect them.

To support its position, the Court of Appeals relies on the Kansas cases, *Schropp* and *Club Exchange Corp. v. Searing*, 567 P.2d 1353 (Kan. 1977). These cases list the three alternatives an insurer may follow when faced with multiple claims, but neither addressed the question of the insurer's duty to manage the limits to best protect the insured. The question of bad-faith liability or failure to do so was not an issue in either case. *Schropp* merely lists interpleader among the alternatives that could be followed and affirms a verdict for bad faith. 567 P.2d at 1362-63. *Club Exchange* was not a bad-faith case at all. Acknowledging that the interpleader court cannot limit the claimant's rights to sue, the court assumed as a "practical matter" that "all claims will no doubt be resolved in the interpleader action." 567 P.2d at 1358. But as *McReynolds* illustrates, while that assumption

may be valid in some situations, it is not valid in others. The court also made it clear that it was not dealing with an insurer's duty to settle. *Id.* But the extent of the duty to settle was the precise issue before the *McReynolds* court.

E. The Court of Appeals meant to state an absolute rule of immunity

In *McReynolds*, the Court of Appeals limited the safe harbor/bad faith to situations in which the insurer "promptly and in *good faith* interpleads its policy limits." *McReynolds*, 225 Ariz. at 127 ¶ 10, 235 P.3d at 280 (emphasis added). The court did not explain what it meant by interpleading in good faith. If the court meant that the safe harbor was available only if the insurer tried but was unable to manage the limits in a reasonable manner that would minimize the insured's exposure, the opinion is ambiguous and incomplete. It will cause terrible problems because it is being read by insurance counsel as a bright-line immunity from bad-faith claims.

It is apparent, however, that the court's real meaning is that an insurer's duty to manage policy limits so as to minimize the insured's exposure is satisfied by the interpleader process: "To the extent" an insurer has "a duty to manage policy limits . . . , we consider it . . . to be part of the duty to equally consider settlement offers." *Id.* at 129 ¶ 18, 235 P.3d at 282. The court then concludes that the "favored" method of managing requires "certainty to insureds, insurers, and litigants short of submitting each case to a jury." *Id.* at 131 ¶ 26, 235 P.3d at 284.

It then states that the interpleader process "acts as a safe harbor . . . against a bad faith claim for failure to properly manage the policy limits." *Id.*

The rule therefore provides the insurer with immunity as a matter of law, regardless of the size and nature of the multiple claims asserted against potentially insufficient limits. It may provide "certainty," as the Court of Appeals says, but only to the insurer. *McReynolds*, 225 Ariz. at 131 ¶ 26, 235 P.3d at 284. The insurer gains immunity by interpleading, leaving the claimants to argue about dividing the funds or, if they wish, trying their cases to a jury. The interpleader court cannot force them to agree on allocation; nor can it prevent all or some from trying the case. *See* Ariz. Const. art. XVIII, § 6. The only certainty for the insured after the insurer has deposited the funds is that the limits are exhausted, settlement leverage is lost, no releases have been obtained, and personal liability remains.

American Commerce reads the opinion more or less the same way, concluding that so long as there are "valid competing claims," only "a refusal to pay policy limits could rise to a level of bad faith." Opposition at 8. Thus, the insurer's duty to its insured is satisfied when the insurer acts promptly, deposits the limits, and continues to defend. *Id.* It does not mention a duty to manage limits in a reasonable manner best calculated to protect the insured. The *McReynolds* opinion tells the insurer it does not have to do so.

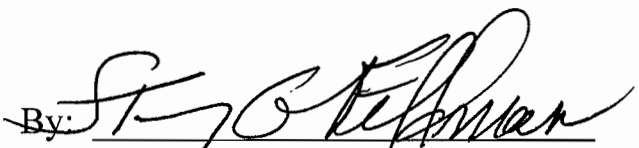
CONCLUSION

The insurer's duty in handling multiple claims should be the same as with any case in which claims may exceed policy limits: Manage the claims and limits reasonably and in accordance with the duty to maximize the protection owed the insured. In other words, with equal consideration.

We submit this court should grant review and either depublish the Court of Appeals' opinion or vacate it and remand to the trial court for further proceedings.

Dated this 20th day of October, 2010.

HARALSON, MILLER, PITT,
FELDMAN & McANALLY, P.L.C.

By: 

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CERTIFICATE OF COMPLIANCE

Pursuant to Rule 14(b), Arizona Rules of Civil Procedure, I certify that this brief has been prepared using proportionately-spaced type of 14 points, is double-spaced using Times New Roman font, and contains 4,055 words.

Dated this 20th day of October, 2010.

Sherry Van Camp
Secretary to Stanley G. Feldman

CERTIFICATE OF SERVICE

I certify that the original and seven copies of the foregoing Brief of Amicus Curiae were sent via FedEx on October 20th, 2010, to:

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EXHIBIT A

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IN THE SUPERIOR COURT OF THE STATE OF ARIZONA

IN AND FOR THE COUNTY OF MARICOPA

MICHAEL McREYNOLDS, Plaintiff, vs. AMERICAN COMMERCE INSURANCE CO., a foreign corporation; Defendant.	Case No.: CV2007-005060 **PLAINTIFF'S SECOND SUPPLEMENTAL DISCLOSURE STATEMENT** (Assigned to the Honorable Edward O. Burke)

Pursuant to Rule 26.1, Ariz. R. Civ. P., Plaintiff hereby supplements his Initial Disclosure Statement in this matter, as follows:

VI. THE NAMES AND ADDRESSES OF EACH PERSON WHOM THE DISCLOSING PARTY EXPECTS TO CALL AS AN EXPERT WITNESS AT TRIAL, THE SUBSTANCE OF THE OPINIONS, FACTUAL BASIS THEREFORE, AND QUALIFICATIONS.

1. Thomas A. Zlaket, Esq., 310 S. Williams Blvd., Suite 170, Tucson, Arizona 85711.

Mr. Zlaket is an attorney and former justice and chief Justice of the Arizona Supreme Court. His curriculum vitae is attached hereto as **Exhibit A.**

It is expected that Mr. Zlaket will opine as follows:

The Defendant ACIC breached the duty of equal consideration when it failed to accept the offer of judgment. In doing so, the carrier placed its insureds in a significantly worse position than if the offer had been accepted. That is Mr. Zlaket's bottom-line opinion. There are certainly other inappropriate acts and/or omissions on the part of the insurer that support and/or contribute to this ultimate conclusion. They are set forth in the following analysis.

On August 29, 2004, Plaintiff Michael McReynolds was injured in an automobile accident as a direct and proximate result of the negligence of Tanya Raineri. He was taken to Flagstaff Medical Center, and incurred medical bills. At the time of the accident, American Commerce Insurance Co. ("ACIC") insured Tanya Raineri for liability arising out of her negligence while operating a motor vehicle, up to the limits of $25,000 per person and $50,000 per occurrence. The Plaintiff made a settlement demand on the Defendant ACIC for policy limits, which was conditionally accepted with the proviso that the Flagstaff Medical Center, as a lienholder, would also be named as a payee on the settlement check. This counter-offer was rejected by the Plaintiff, who then proceeded to file a lawsuit.

At the inception of the underlying action, the Plaintiff filed an offer of judgment for $25,000.00. As stated above, the applicable policy limits on the ACIC policy were $25,000.00, and the carrier was aware of Flagstaff Medical Center's timely-filed lien in the approximate amount of $46,000.00. ACIC was also aware that the Plaintiff, Michael McReynolds had suffered quite serious injuries and that their insured driver, Tanya Raineri, was solely at fault for the accident. Finally, the Defendant ACIC either

was or should have been aware that this was a case in which its insured was exposed to a liability judgment that would quite likely exceed the policy limits by hundreds of thousands of dollars.

Flagstaff Medical Center had perfected its lien pursuant to A.R.S. 33-931, *et seq.* These statutes, and the cases discussing them, are self-explanatory. In perfecting the lien, Flagstaff Medical Center became a potential claimant against any judgment or settlement in the action brought by Plaintiff against ACIC's insured.

The Defendant ACIC realized that it had 60 days in which to accept or reject the offer of judgment. Before responding, Defendant ACIC requested from Chandler Travis, the attorney it had previously hired to defend and protect the insureds, an opinion as to whether it was required to "protect the lien." In Mr. Zlaket's opinion, this was not the proper inquiry at all. Instead, the question should have been whether it was in the insureds' best interests to reject the offer of judgment.

In approaching this question, a reasonable insurer would have performed an analysis of the damages, and immediately realized that the value of the lien was much less than the potential exposure faced by the insureds if forced to trial on the tort liability claim. In addition, a reasonable insurer would have discerned that forcing the matter to trial would not have reduced or limited any responsible party's exposure to Flagstaff Medical Center's lien rights, and/or the insureds' liability exposure to a judgment in favor of the Plaintiff; but accepting the offer of judgment would have severely restricted or eliminated exposure to both.

Finally, a reasonable insurer would have disclosed all available analysis and information, including the likely value of the claim, to the insureds, giving them a chance to intelligently participate in a fully informed decision to accept or reject the offer of judgment. It appears instead that the Defendant ACIC either failed to fully analyze the situation in the best interests of its insureds, or simply decided to act in what

it perceived to be its own best interests. Either way, it inexplicably chose to ignore a much larger risk in order to "protect" against the smaller risk.

Although Tanya Raineri, through her mother, was given some information in this regard, it appears that she was not really provided an opportunity to make a fully informed choice concerning the offer of judgment. Neither she nor her mother was sophisticated in the workings of the justice system. They understandably relied on the lawyers provided for them by their carrier. However, neither the Defendant ACIC nor the lawyer, Chandler Travis, ever discussed or advised them concerning the clear advantages of accepting the offer of judgment, *i.e.* how it would have limited the insureds' exposure to a much greater threat.

The Defendant ACIC, through Chandler Travis, not only gave the insureds a limited amount of information before asking if they would agree to reject the offer, but also never really told them that it actually controlled the decision. In truth, it was ACIC that chose to reject the offer of judgment for $25,000.00. It had and exercised control of the litigation. The likely motive for its refusal to accept the offer of judgment was that the lienholder, Flagstaff Medical Center, would still have had a potential claim to which ACIC would be exposed.

There is simply no evidence the insured, Tanya Ranieri, was ever advised that by accepting the offer of judgment, her total excess exposure would be capped at $25,000.00, and that it would thereafter likely be possible to negotiate settlement for a lesser amount (or perhaps even nothing) with Flagstaff Medical Center. She also was obviously never told that her excess exposure on the McReynolds claim was hundreds of thousands of dollars more than the foregoing amount.

Thus, she was in no position to make a reasoned decision even if she had truly been given authority to do so. It is beyond comprehension that any fully informed, rational insured would have elected to reject an offer of judgment under such

circumstances. It is also beyond comprehension that the lawyer hired by the insurer, whose obligations of independence, loyalty and fidelity were to the insureds, did not advise them in no uncertain terms, even in writing if necessary, that they should demand acceptance of the offer of judgment by the insurer.

One reason the Raineris were not informed of the true extent of their exposure appears to have been that nobody fairly evaluated the claim during the pendency of the offer of judgment. Because the Raineris thought they would be protected the entire time, and could not appreciate the magnitude of the risk, they obviously went along with whatever was told to them.

At the time of the offer, the lien represented only a contingent threat to the insureds. This was never communicated to them. It was also very possible that the lien would never actually be collected from the insureds, or that it could be significantly compromised. This is something that was apparently never contemplated by either ACIC or the attorney it hired to defend the Raineris, Chandler Travis. In any event, ACIC made a conscious decision to expose its insureds to the very real threat of a large judgment in favor of Mr. McReynolds, because of the much smaller, contingent threat posed by the lien. The decision made no sense at all.

Once ACIC, who controlled the litigation, had the chance to severely limit exposure, not only to itself but more importantly to its insureds, it was obligated to do so or risk the consequences of its actions. *Parking Concepts, Inc. v. Tenney*, 207 Ariz. 19, 24-5 83 P.3d 19, 24-5 (2004) is instructive in this regard. *See also, Ansonia Ltd. Partnership v. Public Service Mutual Insurance Co.,* 257 A.2d 84 (N.Y. 1999) (Even in the face of coverage questions, an insurer, faced with the possibility that its insured will be exposed to damages well in excess of what the insurer may be required to pay, must consider consequences to the insured before deciding to reject a policy limits offer).

The Defendant ACIC chose to place its insured in harm's way to save itself the threat of a contingent exposure, while it held total and complete control of the litigation. This action breached the duty of equal consideration and ultimately caused Tanya Raineri to be subjected to a trial and a judgment of more than $469,000.00, when the carrier could and should have limited the potential exposure to $25,000.00.

ACIC also acted wrongly when failed to recognize the conflict of interest that arose when it chose to reject the offer of judgment. Once this rejection occurred, ACIC was in a materially different position with respect to its insureds, and should not have asked guidance from the very lawyer it hired to represent them.

The case of *Paradigm Ins. Co. v. Langerman Law Offices, P.A.*200 Ariz. 146, 24 P.3d 593(2001) is instructive on this issue. A conflict of interest exists if there is a *substantial risk* that the lawyer's representation of the client would be materially and adversely affected by the lawyer's own interests or *by the lawyer's duties to another current client,* a former client, *or a third person. Id, citing* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS.

In cases like this, where an excess judgment is inevitable, the conflict is constant and apparent. The lawyer hired to represent the insureds, Chandler Travis, was required to give his undivided allegiance to those clients. ACIC only made things worse by asking for legal advice from Mr. Travis, who should have declined to give an opinion. Both the carrier and Mr. Travis seem to have overlooked or ignored that an opinion might not have been in the insureds' best interests. In fact, it clearly was not.

ACIC asked for a legal opinion on the applicability of certain lien statutes, A.R.S. § 33-931, *et seq*. The legal opinion should have come from independent counsel who had no contact with the insureds. In any event, the resulting opinion lacked any crucial analysis of the differing duties and risks as between the insureds and ACIC.

ACIC also acted wrongly when it chose to interplead the funds it held. This money, $25,000.00 was the only thing the insured had with which to negotiate a release, and the Defendant ACIC was willing to give it away to relieve itself of any burden. This certainly did not protect the Plaintiff. The lien holder, Flagstaff Medical Center, was not required to relinquish its lien because of the interpleader action, just as the Plaintiff's claim against the Raineris would not be extinguished by interpleading the funds. It was wrong-headed to file the interpleader and release the funds, because it left the insureds without any leverage, and they were still forced to go to trial.

In filing the interpleader, it was also wrong for the Defendant ACIC to use the same attorney it had hired to defend its insureds. Counsel representing ACIC should not have been asked to advise the company and/or to file the interpleader, and the insurer should have known this. The lawyer also apparently failed to realize both the conflict and the fact that he exceeded his role when he filed the interpleader. He later acknowledged all of this in correspondence to ACIC, however by then it was too late.

Additionally, the Defendant ACIC acted in its own interest by hiring for its insureds an "independent counsel" who then kept in contact with the carrier, and communicated with its appointed counsel, Ralph Hunsaker. Again, the *Paradigm* case makes it quite clear that merely because the insurer pays for the attorney does not mean the insurer is a client. The undivided allegiance of the "independent counsel" should have been only to the insureds, but ACIC apparently expected more.

In this case all attorneys communicating with the Raineris had some real or perceived allegiance to ACIC, and thus were not truly independent. Robert Kozak admitted that he perceived an attorney client relationship with ACIC, which could not be true if he were the insureds' independent counsel. This failure to allow the Raineris to receive truly independent advice of counsel was arguably a way to retain control of all aspects of the litigation.

Finally, attorneys Chandler Travis and Robert Kozak inexplicably refused to honor the insured's request to produce documents even after she waived her right to claim attorney-client communication and work product privileges. They had no right or obligation to withhold documents from her. That they did so on instruction and advice of ACIC and/or its attorneys implies that the insureds' instructions were secondary to those of ACIC. Because the duty of good faith and fair dealing is a non-delegable duty, ACIC is ultimately responsible for this conduct as well. This is simply more evidence that implicates the actions of ACIC in this case.

DATED this 27th day of June, 2008.

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