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Insurance Settlement Dilemma: The Policyholder's Right to Settle When Insured and Insurer Disagree

TUESDAY, MAY 10, 2022

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Insurance Settlement Dilemma: The Policyholder's Right to Settle When Insured and Insurer Disagree

Peter S. Selvin, Esq
Ervin Cohen & Jessup LLP

May 10, 2022

Overview

I. The General Rule

II. Consequences If Insurer Declines Coverage

III. Settlement Issues When Insurer Defends Under A Reservation of Rights

IV. What Happens When The Insured refuses To Consent To A Settlement That The Insurer Is Willing to Accept?

V. What Happens When The Insurer Rejects A Settlement That The Insured Wants To Accept?

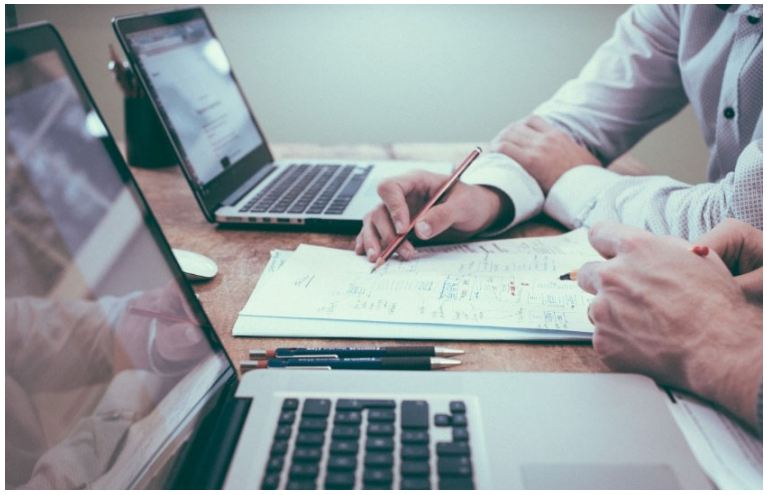
VI. Disputes About The Funding of a Settlement

I. General Rule

The general rule is that a carrier, even under a reservation of rights, has the ability to control settlement. The insured is ordinarily not entitled to unilaterally conclude a settlement with the claimant without breaching the "no voluntary payments" provision of the policy. (*Sargent v. Johnson*, 551 F.2d 221 (8th Cir. 1977).)

II. Consequences If Insurer Declines Coverage

If carrier declines coverage, this releases the insured from the duty of cooperation. *Eigner v. Worthington*, 57 Cal. App. 4th 188, 196 (1997) ("When an insurer wrongfully refuses to defend, the insured is relieved of his or her obligation to allow the insurer to manage the litigation and may proceed in whatever manner is deemed appropriate"). *Appleman on Insurance*, §24.06 [4].

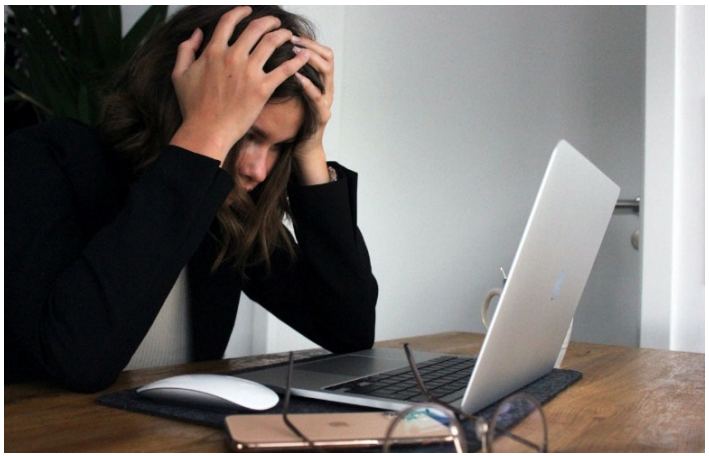


II. Consequences If Insurer Declines Coverage (cont'd)

An insured whose carrier does not provide a defense is free to settle with the claimant, without notice to or consent by its carrier. (*National Steel Corp. v. Golden Eagle Ins. Co.*, 121 F.3d 496 (9th Cir. 1997)) If it is later determined that the carrier improperly denied coverage for the claim, then it will be exposed to a potential bad faith claim.

III. Settlement Issues When Insurer Defends Under a Reservation of Rights

In cases involving both covered and non-covered claims, a carrier's duty to settle does not extend to the non-covered portions of the injured party's claim. (*Camelot by the Bay Condo: Owners' Assn, Inc. a Scottsdale Ins. Co.*, 27 Cal. App. 4th 33 (1994)). The "reasonableness" of the carrier's settlement offer is measured by the insured's potential exposure in respect to the noncovered claims *(Zieman Mfg. Co. v. St. Paul Fire & Marine Ins. Co.*, 724 F.2d 1343 (9th Cir. 1983).



III. Settlement Issues When Insurer Defends Under a Reservation of Rights (cont'd)

Difficult questions often arise when an insurer defending under a reservation of rights offers a settlement amount to the claimant that its insured deems inadequate. This conflict may be particularly acute if the policy has "burning limits" where defense costs reduce the amount of coverage available to pay a settlement or judgment. In such an instance, the insured has a strong economic incentive to have the carrier settle with the claimant early in the litigation.

III. Settlement Issues When Insurer Defends Under a Reservation of Rights (cont'd)

Though the existence of such a conflict may require that the insured be represented in the litigation by so-called *Cumis* counsel (codified in Cal. Civ. Code § 2860), the carrier need not relinquish control over settlement even in these circumstances. (*See Rose v. Royal Ins. Co.*, 2 Cal. App. 4th 709 (1991)) An insured may therefore be motivated to settle on its own with the claimant, without its carrier's participation.

III. Settlement Issues When Insurer Defends Under a Reservation of Rights (cont'd)

But this course can be a risky choice if the insured wishes to later seek reimbursement from its carrier. Because the insured's breach of the policy's no-voluntary-payments provision will usually lead to a loss of coverage, it must establish in any subsequent bad faith lawsuit that the carrier committed an antecedent breach by failing to satisfy its duty to settle. *(Gribaldo, Jacobs, Jones & Assoc. v. Agrippina Versicherunges A, G*, 3 Cal. 3d 434 (197); *Hyatt Corp. v. Occidental Fire & Cas. Co.*, 801 S.W.2d 382 (1990))

III. Settlement Issues When Insurer Defends Under a Reservation of Rights (cont'd)

The insured will argue that the carrier's breach of its duty to settle excused its own compliance with the policy's no-voluntary-payments provision.

Thus, some courts hold that when the insurer has refused, either negligently or in bad faith, to effect a reasonable settlement, the insured may make a settlement on its own initiative, then sue the insurer to recover the amount expended, notwithstanding the policy provision that no action be against the insurer. (Couch On Insurance 3, § 293:13 at pp. 203-70)

IV. What Happens When The Insured refuses To Consent To A Settlement That The Insurer Is Willing to Accept?

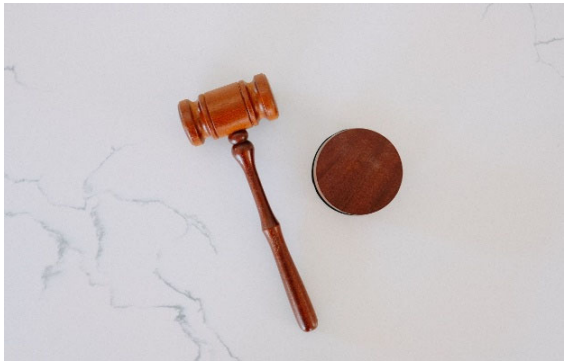
The consequences of an insured's refusal to consent to a settlement that the insurer wants to accept.

"On occasion, the insurer will want to consummate a settlement of insured litigation, but the insured will object to the settlement. This may happen when the insured believes that aggressively defending a case may discourage potential plaintiffs from filing similar lawsuits. In such situations, the insurer should consider creating a written record to support its argument that if the underlying lawsuit is tried to a verdict larger than the settlement offer rejected by the policyholder, the insurer's liability is capped in the amount of settlement demand rejected by the insured." *Appleman*, supra, at §24.10

V. What Happens When The Insurer Rejects A Settlement That The Insured Wants To Accept?

- **An insurer is obligated to consent to a reasonable settlement of underlying litigation [AstenJohnson, Inc. v. Colombia Cas Co., 562 F.3d 213, 230 (3d Cir. 2009)].**

- **Once an insurer breaches the duty to deal in good faith with respect to settlement, the insured may make a reasonable settlement and then seek reimbursement from the insurer [*see, e.g., Diamond Heights*, 227 Cal. App. 3d at 581]. A breach of the insurer's implied duty to deal in a good faith on settlement issues, like breach of any express provision of a policy such as the duty to defend, results in the insurer forfeiting its rights to enforce such policy provisions, including a no-action clause or cooperation clause, which may have given the insurer the rights to be involved in settlement of the underlying claim [*see Fireman's Fraud Ins, Co.*, 367 A.2d at 869 (stating that the insured can act prudently and settle rather than being required to wait for trial, which the court equated to being "required to wait until after the storm before seeking refuge" (citing Traders & General Ins. Co. v. Rudco Oil & Gas Co., 129 F. 2d 621, 627 (10th Cir. 1942))]. Appleman, § 24.19 [2]**



VI. Disputes About the Funding of a Settlement

A carrier therefore does not breach its duties to its insured by requesting that the insured contribute a settlement when there is a bona fide dispute about the extent of the carrier's obligations. (Croskey, et al., California Practice Guide: Insurance Litigation (Rutter Group) §12.449 at p. 12B-65.

VI. Disputes About the Funding of a Settlement (cont'd)

But by suggesting that it is insured contribute to an overall settlement, it is walking the razor's edge. On the one hand, from the perspective of the insurer, the reasonableness of any settlement offer made by the claimant will be measured against the magnitude of the covered, as opposed to noncovered, claims. On the other hand, any effort by the carrier to "coerce" the insured to contribute to a settlement might be invoked later by the insured as evidence of the carrier's bad faith. (*See J.B. Aguerre, Inc. v. American Guar. & Liab. Ins. Co.*, 59 Cal. App. 4th 6 (1997).)

VI. Disputes About the Funding of a Settlement (cont'd)

An insured pressured by its carrier to partially fund a settlement has an important resource. According to the California Supreme Court, when faced with the insurer's unreasonable refusal to pay settlement demand within policy limits, "the insured may recover the amount of payment from the insurer in an action for bad faith failure to settle." (*Hamilton v. Maryland Cas. Co.*, 27 Cal. 4th 718 at 731 (2002))

THANK YOU!

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Questions to ask

- Is policy a duty to defend policy, or reimbursement policy?
- Does policy say anything about consent to a settlement?
- Is there an allocation provision? What does it say?
- Is there a risk of an excess judgment?
- Are there covered and uncovered claims or damages? If so, is there a clear delineation between covered and uncovered claim and damages?
- Has the insurer denied coverage?
- Is the insurer defending under a reservation of rights? What does it say?
- What are the prospects for liability and damages?
- What state law applies?

What law applies?

- Most policies do not have choice of law clauses.
- Insurance policies are contracts, so choice of law rules for contracts generally applies.
- But, if bad faith is a tort under state law, tort rules may apply.
- Special rules for insurance policies.
  - Restatement (Second) Conflict of Laws § 193: "the principal location of the insured risk during the term of the policy."
  - Policies that insure risks in multiple states: Uniform contract interpretation approach v. site specific approach.

What if insurer denies coverage?

As a general rule, where the insurer declines to defend and denies indemnity, the insured is not required to establish actual liability to the claimant as long as the insured had "potential" liability and the settlement amount was reasonable in light of the magnitude of any potential recovery and the degree of probability of an adverse result.

– Bruner & O'Connor Construction Law § 11:189

Is there a possibility of an excess judgment?

- What is the standard?
  - Some states apply a negligence standard.
  - Other states require bad faith.
    - Standard for bad faith differs state by state.
  - *See generally*, 14A Couch on Ins. § 203:24.
- Are there prerequisites?
  - *E.g.*, "*Stowers*" demand. *G.A. Stowers Furniture Co. v. Am. Indem. Co.*, 15 S.W.2d 544, 548 (Tex. Comm'n App. 1929)

What if insurer provides defense under reservations of rights?

- Does state law allow insurer to recover fees and/or uncovered settlement?
- What did policyholder agree to in accepting defense under reservation of rights?

Can an insurer settle and seek reimbursement from its policyholder?

Blue Ridge Ins. Co. v. Jacobsen, 25 Cal. 4th 489, 22 P.3d 313 (Cal. 2001)

- Under California law, a qualified defense based upon a unilateral reservation of rights permits the insurer to settle a claim over the insured's objections and seek reimbursement for both the defense and settlement payments.
- Prerequisites:

  (1) a timely and express reservation of rights;

  (2) an express notification to the insureds of the insurer's intent to accept a proposed settlement offer; and

  (3) an express offer to the insureds that they may assume their own defense when the insurer and insureds disagree whether to accept the proposed settlement.

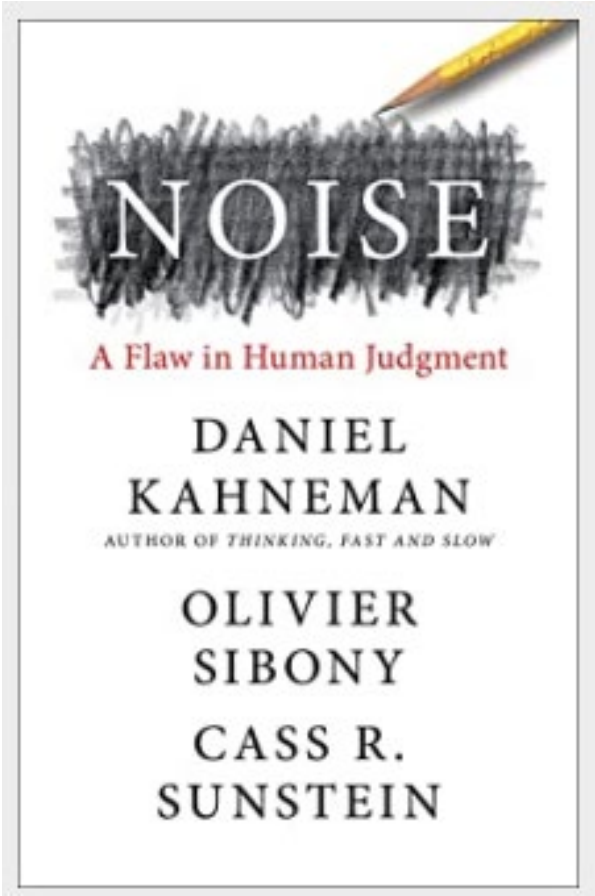
Can policyholder pay all or part of settlement within policy limits and seek recovery from insurer where insurer is defending?

In re Farmers Texas Cty. Mut. Ins. Co., 621 S.W.3d 261, 268 (Tex. 2021)

- Insurer defended claim under policy with $500,000 limits and potential excess exposure.
- Plaintiff demanded $350,000; insurer agreed to pay only $250,000; policyholder paid the additional $100,000 and then brought claim against insurer.
- Court held that policyholder had no *Stowers* cause of action, because case was settled within policy limits, but that policyholder could pursue claim for breach of duty to indemnify.
- But, the court noted that it was ruling on a motion to dismiss and that, "we do not hold that insureds who settle third-party claims unilaterally—without the consent or participation of their insurers—are entitled to reimbursement under their policies."
- Court also noted that, "If a liability insurer disputes whether some claims asserted against its insured are covered, it may comply with its policy obligations by defending under a reservation of rights, and it may settle the entire suit and—with the insured's consent—reserve for separate litigation the question whether the insured should reimburse it for part of the settlement."

What are the policyholder's settlement options after an excess judgment?

- Many courts hold that a failure to settle claim is not ripe until after the judgment is final. *See, e.g., Spitz v. Starr Indem. & Liab. Co., Inc.*, No. 21 C 1044, 2021 WL 3929219, at *3 (N.D. Ill. Sept. 2, 2021) (collecting cases).
- Does insurer intend to fund appeal?
- What are the prospects for the appeal?
- Will the insurer pay for an appeal bond for the full amount of the judgment (including amount in excess of policy limits)?
- Can the insured afford a bond for the excess portion of the judgment?



Question: In a well-run insurance company, if you randomly selected two qualified underwriters or claims adjusters, how different would you expect their estimates for the same case to be?

Answer: By our measure, the median difference in underwriting was 55%, about five times as large as was expected by most people, including the company's executives.

For claims adjusters, the median ratio was 43%.

We stress that these results are medians: in half the pairs of cases, the difference between the two judgments was even larger.

Case evaluations are not equations; they are judgments

- *Surgery Ctr. at 900 N. Michigan Ave., LLC v. Am. Physicians Assurance Corp., Inc.*, 922 F.3d 778 (7th Cir. 2019).
  - Coverage limits of $1MM and pretrial demand for policy limits.
  - $5.17MM verdict against policyholder.
  - Policyholder brings claim against insurer based on failure to settle.
  - Policyholder's president agreed with insurer's strategy to take case to trial and not settle.
  - Trial court granted Rule 50 motion for insurer.
  - Affirmed: Because "a reasonable jury would not have a legally sufficient evidentiary basis" to find the duty to settle arose—i.e. that there was a reasonable probability of a finding of liability against Surgery Center—the district court properly granted judgment as a matter of law for APA.

Scenario 1

- Policy limits of $1MM.
- Exposure for excess judgment.
- Insurer denies coverage and refuses to defend.
- Policyholder wants to settle.
- What are the considerations and strategy moves?

Scenario 2

Possibility of excess judgment, but demand within policy limits. Insurer is defending under reservation of rights because of allegations of intentional conduct.

1. Does insurer have duty to pay demand within policy limits?
2. Can insurer ask policyholder to contribute to settlement and refuse to settle if policyholder does not contribute?
3. If insurer refuses to settle and case proceeds to an excess judgment, must insurer fund the judgment?

Scenario 3

- Policy limits of $1MM.
- Demand of $1.5MM.
- Disagreement as to whether verdict would exceed policy limits.
- Insurer is defending. No reservation of rights.
- Policyholder agrees to fund settlement above policy limits, but insurer refuses to pay its limits.
- Judgment is entered for $2MM.
- Who owes what? Why?

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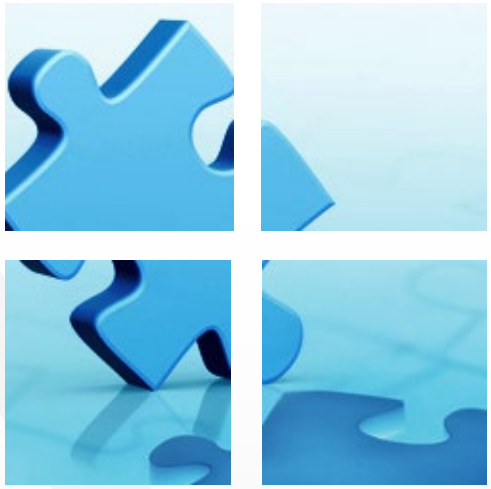

Strafford Publications Webinar

Live Webinar
May 10, 2022
1:00 pm – 2:30 pm

INSURANCE SETTLEMENT DILEMMA: THE POLICYHOLDER'S RIGHT TO SETTLE WHEN INSURED AND INSURER DISAGREE

Disclaimer

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THE POLICYHOLDER'S RIGHT TO SETTLE: POLICY LANGUAGE

- Many standard CGL policies state that a policyholder may not enter into a settlement without an insurance company's written consent, stipulating that:

> "[n]o Claims Expenses shall be incurred or settlements made, contractual obligations assumed or liability admitted with respect to any Claim without the Insurer's written consent, which shall not be unreasonably withheld."

THE POLICYHOLDER'S RIGHT TO SETTLE: POLICY LANGUAGE (CONT'D)

- Other policies do away with the reasonableness requirement altogether, stating that:

  "[n]o insured will, except at that insured's own cost, voluntarily make a payment . . . or incur any expense, other than for first aid, without our written consent.

  * * * * * *

  "Legal Action Against Us: You will have no right of action against us under this policy unless all of its terms have been fully complied with; and the amount that you seek to recover has been determined by settlement with our consent or by final judgment against an insured."

THE POLICYHOLDER'S RIGHT TO SETTLE: POLICY LANGUAGE (CONT'D)

How are these policy provisions interpreted?

How do Courts determine whether consent has been unreasonably withheld?

THE POLICYHOLDER'S RIGHT TO SETTLE: POLICY LANGUAGE (CONT'D)

It is imperative to ascertain which state's law governs the interpretation of the policy, as state law varies greatly with regards to the interpretation of consent to settle provisions.

THE POLICYHOLDER'S RIGHT TO SETTLE: POLICY LANGUAGE (CONT'D)

"Where the insured is clearly liable and the insurer refuses to make a settlement, thus protecting the insured from a possible judgment for damages in excess of the amount of the insurance, the refusal must be made in good faith and upon reasonable grounds for the belief that the amount required to effect a settlement is excessive." *Traders & General Ins. Co. v. Rudco Oil & Gas Co.*, 129 F.2d 621, 626-27 (10th Cir. 1942).

THE POLICYHOLDER'S RIGHT TO SETTLE: POLICY LANGUAGE (CONT'D)

"[A] presumption of prejudice should be applied when evaluating the effects of the breach of a consent-to-settle or other subrogation-related provision. As in breach of prompt-notice cases, we find that the burden of presenting evidence to show a lack of prejudice should be on the insured who has failed to comply with the terms of the policy." *Ferrando v. Auto-Owners Ins. Co.,* 98 Ohio St.3d 186 (Ohio 2002).

THE POLICYHOLDER'S RIGHT TO SETTLE: POLICY LANGUAGE (CONT'D)

"Under liability or indemnity policies in which the insurer assumes the duty of defending or settling suits against the insured, this obligation is one requiring due care and a strict performance in utmost good faith. In such case, the insurer owes the duty to exercise reasonable care in conducting the defense, and is liable for damages resulting to the insured by reason of its negligence in performing such duty . . . *It is generally agreed that under policy provisions giving the insurer the right to defend and settle claims against the insured, the insurer may be held liable to the insured for any damage to the insured ensuing where the insurer acts with bad faith toward the insured and improperly refuses or fails to compromise the claim involved*. *Home Indem. Co. v. Snowden*, 223 Ark. 64, 70 (1954) (emphasis added).

WHEN POLICYHOLDER WANTS TO SETTLE: ESTABLISHING THE REASONABLENESS OF SETTLEMENT

- Some states review the reasonableness of the proposed settlement from the perspective of the Insured . . . .

  "In considering the reasonableness of a proposed settlement amount, an insurance company must take into "consideration all the factors bearing upon the advisability of a settlement for the insured."
  Haugh v. All State Ins. Co., 322 F. 3d 227, 238 (3d Cir. 2003).

WHEN POLICYHOLDER WANTS TO SETTLE: ESTABLISHING THE REASONABLENESS OF SETTLEMENT (CONT'D)

Factors which may be considered when considering the value of a settlement may include the reputational harm and potential loss of goodwill that can result from a failure to settle. *See Landow v. Medical Ins. Exch*., 892 F. Supp. 239, 241 (D. Nev. 1995) ("in determining whether to settle, the insurer has a duty to consider injury to the insured, such as emotional distress and injury to business goodwill that proximately flow from the failure to settle"); *Bodenhamer v. Superior Court*, 192 Cal. App. 3d 1472, 1478-1479 (1987) ("An express term of the liability contract is to pay claims of third parties where the insured is liable. An implied promise is to process the claims in a manner which will not injure the insured, which in this case includes injury to the business."); *Tan Jay Internat. v. Canadian Indem. Co.,* 198 Cal. App. 3d 695, 704 (1988) (allowing bad faith award based on damage to policyholder's reputation because of insurance company's failure to settle); *United States Fire Ins. Co. v. Button Transp*., Inc., 2006 Cal. App. Unpub. LEXIS 3472, at *59 (Apr. 26, 2006) (allowing bad faith award based on policyholder's loss of goodwill because of insurance company's failure to settle); *Rawan v. Continental Cas. Co.,* 483 Mass. 664, 685, 670-71 (Mass. 2019) (noting that a valuable purpose of liability insurance is the protection of the policyholder's reputation and goodwill, and affirming the insurance company's contractual obligations even where the policyholder acts unreasonably in connection with settlement negotiations in order to protect its reputation).

WHEN POLICYHOLDER WANTS TO SETTLE: ESTABLISHING THE REASONABLENESS OF SETTLEMENT (CONT'D)

BUT SEE:

Apollo Ed. v. Nat. Union Fire Ins. Co., 250 Ariz. 408, 409-10 (2021):

"We hold that under a policy without a contractual duty to defend, the objective reasonableness of the insurer's decision to withhold consent is assessed from the perspective of the insurer, not the insured. The insurer must independently assess and value the claim, giving fair consideration to the settlement offer, but need not approve a settlement simply because the insured believes it is reasonable."

WHEN POLICYHOLDER WANTS TO SETTLE: ESTABLISHING THE REASONABLENESS OF SETTLEMENT (CONT'D)

Apollo Ed. v. Nat. Union Fire Ins. Co., 250 Ariz. 408, 415 (2021):

"The company may not refuse to pay the settlement simply because the settlement amount is at or near the policy limits. Rather, the insurer must fairly value the claim. The insurer may, however, discount considerations that matter only or mainly to the insured—for example, the insured's financial status, public image, and policy limits—in entering into settlement negotiations. The insurer may also choose not to consent to the settlement if it exceeds the insurer's reasonable determination of the value of the claim, including the merits of plaintiff's theory of liability, defenses to the claim, and any comparative fault. In turn, the court should sustain the insurer's determination if, under the totality of the circumstances, it protects the insured's benefit of the bargain, so that the insurer is not refusing, without justification, to pay a valid claim."

PRACTICE TIPS:

- When possible, the policyholder should:
  - Keep its insurance companies informed and updated with regards to the underlying litigation;
  - Provide information regarding settlement demands and negotiations.

PRACTICE TIPS (CONT'D)

- Establish frequent communication with defense counsel;
- Inform insurance companies of mediations or settlement conferences;
- Request settlement authority in **writing**;
- Explain liability, damages analyses, potential cost of litigation– demonstrate the reasonableness of settlement; and
- Carefully review appropriate state's law regarding interpretation of consent to settle provisions and how reasonableness of settlement is established.

QUESTIONS?

THANK YOU.

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Insurance Settlement Dilemma: The Policyholder's Right to Settle When Insured and Insurer Disagree

Scott F. Bertschi

May 10, 2022

Scenario One

Insured wants to settle, but the Insurer doesn’t

Scenario One – Insured wants to settle

Motivators

- Insured is concerned about excess exposure
- Insured is concerned about non-covered exposure
  - *e.g*. lack of coverage for punitive damages or intentional acts
- Insured is concerned about non-monetary issues
  - *e.g.* loss of goodwill, bad publicity

Scenario One – Insured wants to settle

Policy language

- Cooperation/consent to settle clause
  - “In no event will the insured admit or assume any liability, enter into any settlement agreement, stipulate to any judgment, incur any defense costs, or otherwise assume any obligation with respect to any claim that is covered in whole or in part by this policy without our prior written consent.”
- No action clause
  - “No action will be taken against us unless, as a condition precedent thereto, there has been full compliance with all the terms of this policy, and until our obligation to pay has been finally determined by an adjudication against you or by a written agreement between you, the clamant, and us.”
- No assignment/legal obligation to pay language

Scenario One – Insured wants to settle

The law

- Insurance company disclaims a defense
  - General rule is that insured is free to settle
  - Compare rules for enforcement of *Coblentz* judgment – consent judgment and assignment of rights in exchange for consent not to execute; *see Coblentz v. American Surety Co.*, 416 F.2d 1059 (5th Cir. 1969)

Scenario One – Insured wants to settle

The law

- Insurance company defends under a reservation of rights
  - A few states permit insured to settle; *see United Servs. Auto. Ass'n v. Morris*, 154 Ariz. 113, 121 (1987)
  - Some states require a showing of prejudice to disclaim on consent to settle/no action clause
  - Majority enforce consent to settle
  - Insured still has recourse to bad faith law

Scenario One – Insured wants to settle

The law

- Insurance company defends without a reservation
  - Insured’s only recourse is bad faith failure to settle
  - Does insurance protect insured’s non-monetary interests?

Scenario Two

Insurer wants to settle, but the Insured doesn’t

Scenario Two – Insurer wants to settle

Motivators

- Insured is concerned about payment of a retention or deductible
  - High SIR or fronting policy
  - Only additional insured liable
- Insured is concerned about reputation or copycat claims
  - Reporting to medical malpractice database
- Insured wants to defend out of spite

Scenario Two – Insurer wants to settle

Policy language

- Consent to settle provision
  - “We have to right to settle any claim with your consent, which will not be unreasonably withheld.”
- So-called “hammer” clause
  - “In the even we recommend a settlement and you refuse to consent to that settlement recommendation, our liability for that claim will be limited to the amount in excess of the Retention which we would have contributed to the settlement had you consented to that settlement and the defense costs covered under the policy and incurred before the date of your refusal to settle.”
- Implied covenant of good faith and fair dealing

Scenario Two – Insurer wants to settle

The law

- Bad faith settlement – can the insurer be held liable for settling a claim?
  - *Shuster v. S. Broward Hosp. Dist. Physicians' Liab. Ins. Trust*, 591 So.2d 174 (Fla. 1992) ("a cause of action for breach of a good faith duty owing to the insured will not lie for failure to defend or investigate a claim when the insurer has settled the claim for an amount within the limits of the insurance policy.")
- Settlement subject to a reservation of rights
  - *Blue Ridge Ins. Co. v. Jacobsen*, 25 Cal.4th 489 (2001)
- Reverse bad faith – does the insured have an obligation to consent to settle?

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