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Insurance Consent to Settle Hammer Clauses: Dangers for Insureds and Exposure for Insurers

WEDNESDAY, APRIL 29, 2020

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Today's faculty features:

Robert Blumberg, Attorney, **Deutsch Blumberg & Caballero**, Miami

Sara Perkins Jones, Attorney, **Anderson & Kreiger**, Boston

Steven P. Wright, Partner, **K&L Gates**, Boston

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Consent-to-Settle Clauses

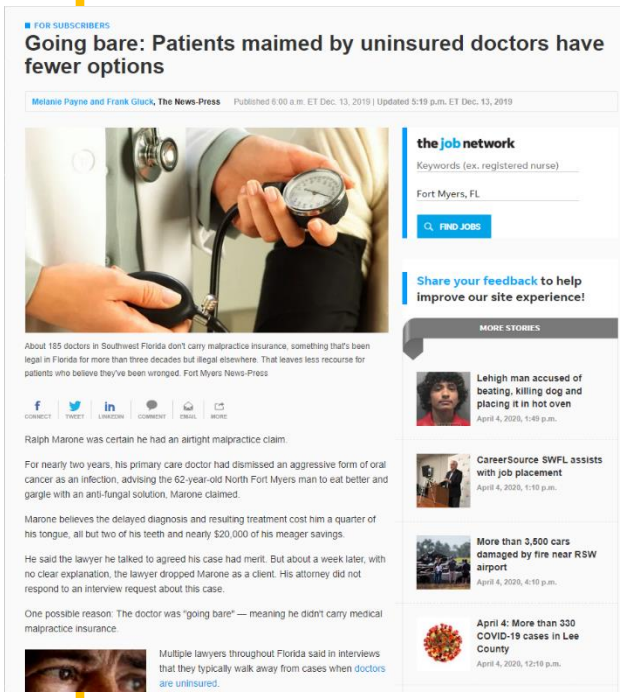
Varieties and Considerations

Consent Provisions

Insurer "shall have the right and duty to defend any suit against the insured, and may make such investigation and settlement of any claim or suit as it **deems expedient**."

- Most commonly found in professional liability policies
  - "Control over settlement is particularly important to professionals, as settlement of malpractice claims directly implicates their reputational interests. "Insured professionals are often more likely than other insured entities to resist settlement of underlying claims [because] settlement of an underlying claim may adversely affect the professional's reputation or might actually encourage future lawsuits against the professional."
    - *Rawan v. Continental Casualty*, 483 Mass 654, 665 (2019)
- Concerns about reputation, but also about attracting more claims

The “Florida Problem”



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Going bare: Patients maimed by uninsured doctors have fewer options

Melanie Payne and Frank Gluck, The News-Press Published 6:00 a.m. ET Dec. 13, 2019 | Updated 5:19 p.m. ET Dec. 13, 2019

About 185 doctors in Southwest Florida don't carry malpractice insurance, something that's been legal in Florida for more than three decades but illegal elsewhere. That leaves less recourse for patients who believe they've been wronged. Fort Myers News-Press

Ralph Marone was certain he had an airtight malpractice claim.

For nearly two years, his primary care doctor had dismissed an aggressive form of oral cancer as an infection, advising the 62-year-old North Fort Myers man to eat better and gargle with an anti-fungal solution, Marone claimed.

Marone believes the delayed diagnosis and resulting treatment cost him a quarter of his tongue, all but two of his teeth and nearly $20,000 of his meager savings.

He said the lawyer he talked to agreed his case had merit. But about a week later, with no clear explanation, the lawyer dropped Marone as a client. His attorney did not respond to an interview request about this case.

One possible reason: The doctor was "going bare" — meaning he didn't carry medical malpractice insurance.

Multiple lawyers throughout Florida said in interviews that they typically walk away from cases when doctors are uninsured.

the job network

Keywords (ex. registered nurse)

Fort Myers, FL

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April 4, 2020, 4:10 p.m.

April 4: More than 330 COVID-19 cases in Lee County

April 4, 2020, 12:10 p.m.

Until 2011, Florida did not permit “consent to settle” clauses in medical malpractice policies – and it does not require doctors to carry malpractice coverage.

Doctors’ groups fought to change the law to allow consent clauses, arguing that large numbers of doctors were going uninsured in order to avoid the risk of reputational damage from a large settlement.

Doctors are the only profession for which settlements and judgments must be reported to a National Databank.

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Consent Provisions

- Why not other liability policies?
  - Less demand where reputational interests are not implicated.
  - Compulsory insurance is standardized by insurance regulators – for example, Massachusetts does not permit consent clauses in Medical Malpractice policies, which are required of practicing physicians.
  - **The AWOL Insured**: *Gov't Employees Ins. Co. v. Gingold*, 249 Ga. 156, 157, 288 S.E.2d 557, 558 (1982)
  - Insured on auto policy disappeared, literally AWOL from the military
  - "It was understood by all parties concerned that any settlement would require the consent of the insured. We thus turn to a determinative question: was the insured capable of being located? If he was not, GEICO, of course, cannot be liable for any failure to reach a settlement."
- May also be found in:
  - Employment Liability policies
  - self-insurance or captive insurance policies, giving the Named Insured the power over settlement.
- Will not be implied, or required by public policy: *see Webb v. Witt,* 379 N.J. Super. 18 (App. Div. 2005).

Hammer Clauses

- Unreasonable insureds with consent clauses could force insurers to defend at trial, pay large judgments – how to mitigate?

"The insurer shall not settle any claim without the consent of the insured. If, however, the insured shall refuse to consent to any settlement recommended by the insurer and shall elect to contest the claim or continue any legal proceedings in connection with such claim, then the insurer's liability for the claim shall not exceed the amount for which the claim could have been settled plus claims expenses incurred up to the date of such refusal."

Hammer Clauses

- *Rawan v. Continental Casualty*, 483 Mass 654 (2019)
- Continental could "not settle any claim without the informed consent" of insured
- Consent-to-settle clause did not violate Massachusetts unfair settlement practices statute (c. 176D). While insurers in MA have a duty to third-party claimants to effectuate settlement when liability is "reasonably clear," it can satisfy that duty by making good-faith efforts to investigate the claim and encourage its insured to settle.
- "[W]e also reject the argument that only consent-to-settle clauses paired with hammer clauses are permissible. … The hammer clause also will diminish the incentive professionals have to purchase this voluntary insurance, which, as explained supra, serves a valuable purpose: it benefits third parties by providing deeper pockets for recovery."

Variations on the Hammer Clause

- “Extreme” Hammers – revoking defense, or refusing to cover any eventual judgment.
- Cost-sharing – 60/40 split of any amount over settlement offer.
- Arbitration as to whether refusal to settle is reasonable.

Reasonable vs. Unreasonable Refusal

Clauson v. New England Ins. Co., 254 F. 3d 331 (1St Cir. 2001)

The Company shall have the right to make any investigation it deems necessary and with the written consent of the insured, said consent not to be unreasonably withheld, any settlement of any claim covered by the terms of this policy. If the Insured shall refuse to consent to any settlement or compromise recommended by the Company and acceptable to the claimant, and elects to contest the claim, suit or proceeding, **then the Company's liability shall not exceed the amount for which the Company would have been liable for damages if the claim or suit or proceeding had been so settled** or compromised, when so recommended. The Company shall have **no liability for claims expenses accruing thereafter** and the Company shall have the right to withdraw from the further defense thereof by tendering control of said defense to the Insured.

- Trial court held that the insured's decision to reject settlement was reasonable.
- Insurer argued the second paragraph was not limited to unreasonable refusals of consent, the court disagreed. "Construing the policy in the manner suggested by NEIC would negate that [consent] right. The insured's refusal to consent to a settlement, however reasonable, would deprive the insured of the full indemnification protection for which he contracted. In addition, it would deprive the insured of the right to be defended by the insurer because the second sentence of the paragraph upon which NEIC relies would allow NEIC to withdraw from further defense."
  - However, the court declined to order the insurer to pay interest under RI's Rejected Settlements statute -- the insured, not the insurer, rejected the settlement offer.

Reasonable vs. Unreasonable Refusal

But see *Sec. Nat'l Ins. Co. v. City of Montebello*, 680 F. App'x 525, 526 (9th Cir. 2017)

> If plaintiff makes a "bona fide, good faith settlement demand ... the payment of which would result in the full and final disposition" of the lawsuit, and insured refuses to consent, the insurer can tender to the insured "an amount equal to the difference between [the insured's] retained limit, less incurred defense costs, and [the plaintiff's] settlement demand," and be discharged from liability.
>
> – Holding: hammer clause does not limit the insurer's right to invoke the clause to instances where the insured was unreasonable in rejecting an offer. "To hold otherwise would impermissibly rewrite the hammer clause to the policyholder's benefit."

Revoking Consent

- Insurers asked for consent well before negotiating settlements, then told policyholder that consent was irrevocable.
- Courts largely sided with policyholders:
  - Lieberman v. Employers Ins. of Wausau, 84 N.J. 325, 337, 419 A.2d 417, 423 (1980): Physician signed "consent form" at first meeting with insurer and defense counsel, but prior to trial sent a certified letter withdrawing his blanket consent.
  - Holding that "consent of the insured to authorize the insurer to effect a settlement is revocable in the absence of a contrary provision."

"Insureds' Remorse"

- *Am. Physicians Assur. Corp. v. Schmidt*, 187 S.W.3d 313, 315–16 (Ky. 2006)
  - Insured withheld consent to a settlement within $1,000,000 policy limits
  - After $1,200,000 verdict, insured paid its limits, and insured assigned its rights against insurer to the plaintiff
  - Insured testified at trial that he did not withhold his consent. But on cross he admitted:
    - That he wanted "his day in court" to "tell his story to a jury of twelve people" and "to be exonerated of any wrongdoing" "because he did nothing wrong;"
    - That he knew that his insurance limits were one million dollars, but regardless of whether his limits were $100,000.00 or five million dollars, he wanted to take the case to verdict and he did not want to settle;
    - That he had conversations with his lawyers regarding the potential for a verdict in excess of his policy limits and the fact that the exposure would be both personal and corporate;
    - That if insurer had settled the case without his consent, he would have sought legal counsel, and that he was concerned about any settlements being reported to the National Practitioners Data Bank.
- "An insurer acts in 'bad faith' with respect to a potential excess judgment against its insured only if it is afforded the opportunity to settle within the policy limits."

Thank You

Sara Perkins Jones

sjones@andersonkreiger.com

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Documentation Concerns and Suggested Actions for Insured, Insurers, and Third-Party Claimants

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Implications of Consent to Settle Provisions Pre-Settlement Offer

- Even where an insurer would ultimately need to obtain consent to settle a claim, courts have recognized that an insured must still abide by certain obligations
- McCollough v. Minn. Lawyers Mut. Ins. Co., 2013 WL 823411 (D. Mont. March 6, 2013)
  - Insurer breached duty to conduct reasonable investigation and good faith negotiation, even when insured ultimately rejected settlement offer
- Ins. Co. of N. Am. v. Med. Protective Co., 768 F.2d 315 (10th Cir. 1985)
  - The "consent [to settle] clause quoted above is immaterial to the question of whether [the insurer] acted in bad faith in pursuing settlement negotiations . . . . It is common practice for an insurer to conduct settlement negotiations in advance of obtaining the insured's final consent to the agreement.

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Pre-Settlement Offer Implications Cont'd

Rawan v. Cont'l Cas. Ins. Co., 483 Mass. 654 (2019)

- Even in the presence of a consent to settle clause, insurer must still abide by its obligation to effectuate settlement, including:
  - Conducting a thorough investigation of the facts
  - Carefully attempting to determine the value of the claim
  - Undertaking good faith efforts to convince the insured to settle for such an amount, and
  - Not engaging in misleading, improper, or extortionate conduct

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What to do when settlement is offered and a consent to settle provision applies:

- While the exact steps may vary by jurisdiction or the terms of the policy, generally, an insurer should:
  - Convey any settlement offer to the insured
  - Consider advising on the affects of a hammer clause if the insured refuses to settle
- An insured should:
  - Determine whether the hammer provision applies to any rejection of a settlement offer, or only bad faith rejections
  - Weigh the potential exposure over the proposed settlement amount
  - Weigh the reputational impact of a settlement

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Ill. State Bar Ass'n Mut. Ins. Co. v. Burkart, 2015 WL 5657857 (Ill. App. Ct. Sept. 24, 2015)

- In the underlying action, the insured, a lawyer, was sued by former clients for return of funds distributed to the lawyer under a later-reversed court order
  - Insurer accepted defense of the action, and then negotiated a settlement with the plaintiffs
  - The insurer requested the insured's consent to settle the claim against him, and warned that it would invoke the hammer clause and stop defending the insured if the offer was rejected
  - The insured declined consent to settle
- The insurer filed a declaratory judgment action, and the court determined that it had no duty to defend and that its liability was capped at the offered settlement amount

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Documentation Concerns

- In a dispute involving a consent to settle provision, documentation is important for insurers, insureds, and third party claimants.
- For insurers, it is important to document:
  - Relaying an offer for settlement to the insured
  - An insured's rejection of a settlement offer
  - An insurer's attempts to facilitate or effectuate settlement, BUT not placing the insured under duress to induce consent
- For insureds, it is important to document:
  - Rejection of a settlement offer
- For third-party claimants, it is important to document:
  - Offers to settle, particularly if within the policy limits
  - Requests that insurer relay settlement offer to insured
  - Any bad faith actions by the insurer during negotiations or claim investigation

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Documentation Concerns for Both Insureds and Insurers

- Both insureds and insurers have an interest in documenting the insured's reaction to a settlement offer.
- For an insured, documentation is key to:
  - Preserving a future claim against an insurer for settling over the insured's objection
- For an insurer, documentation is key to:
  - Ensure the effectiveness of a hammer clause at cutting off the insurer's liability for the proposed settlement amount if consent to settle is withheld
  - Shield the insurer from liability for settling a claim if the insured later claims it withheld consent to settle
    - Freedman v. United Nat'l Ins. Co., 2010 WL 11460005 (C.D. Cal. July 6, 2010): fact issue remained whether consent was freely given where insured stated "given what you . . . have done, no rational person in [the insured]'s position would have any choice other than to acquiesce to you and the insurance company's demand."

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Documentation Concerns for Insurers

- For an insurer, it may be equally important to document attempts to effectuate settlement of a claim by the insured
  - As noted in Rawan, McCollough, and Med. Protective Co., even where consent to settle is ultimately withheld, an insurer has obligations to investigation and engage in settlement negotiations, documentation of those efforts could be essential to defending against later claims against the insurer
- However, an insured's attempts to effectuate settlement and the manner of invoking a hammer clause can lead to a finding of duress
  - Freedman v. United Nat'l Ins. Co., 2010 WL 11460005 (C.D. Cal. July 6, 2010): fact issue remained as to whether insured was under duress to accept settlement offer where insurer invoked hammer clause and informed insured's counsel that the insurer would not pay any more legal fees, leading to insured's counsel halting all preparations for trial scheduled to begin 12 days later

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Documentation Concerns for Third-Party Claimants

- A third-party claimant should document all settlement negotiations with an insurer or questions from the insurer, because anything that suggests bad faith or a failure to investigate could allow the claimant to pursue a later claim against the insurer
- Similarly, documented settlement offers and requests that the insurer relay settlement offers to the insured can used to show:
  - Bad faith on the part of the insurer for not relaying offers
  - Reasonableness or unreasonableness on the part of the insured for withholding consent to settle, as that can affect the sources of recovery available

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Thank You

Steven P. Wright

steven.wright@klgates.com

HAMMER CLAUSES

Beau Blumberg, Esq.
Deutsch Blumberg & Caballero, P.A.
100 Biscayne Blvd. Suite 2802
Miami, FL 33132
bblumberg@deutschblumberg.com

That's word because you know
You can't touch this (oh-oh oh oh-oh-oh)
You can't touch this (oh-oh oh oh-oh-oh)
Break it down
(Oh-oh-oh-oh-oh-oh-oh-oh-oh oh-oh)
(Oh-oh-oh-oh-oh-oh-oh-oh-oh oh-oh)
Stop Hammer time

-MC Hammer

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FACTORS WHICH FAVOR INSURERS

WITHDRAW OF DEFENSE

- The insurer is also typically given the right to withdraw from further defense of the suit and may tender control back to the insured. *Clauson v. New England Ins. Co.*, 254 F.3d 331 (1st Cir. 2001).
  - Was a derivative action after having obtained judgment against the insured alone to proceed on that judgment in a separate action against the insured.
  - Policy "If the Insured shall refuse to consent to any settlement or compromise recommended by the Company and acceptable to the claimant, and elects to contest the claim, suit or proceeding, then the Company's liability shall not exceed the amount for which the Company would have been liable for damages if the claim or suit or proceeding had been so settled or compromised, when so recommended. The Company shall have no liability for claims expenses accruing thereafter and the Company shall have the right to withdraw from the further defense thereof by tendering control of said defense to the Insured."

REFUSAL TO COVER JUDGMENT

- Depending on the type of hammer clause and the wording the insured might be able to limit its liability for all or part of the judgment.
- This can save a lot of money for the insurer.
- Types of Hammers:
  - "Auger" 100% of any defense costs and settlement exceeding first proposed settlement is entirely insured's responsibility
  - "Mallet" 70-75% of final cost exceeding first proposal to settle is carrier's responsibility.
  - "Sledgehammer" 50% of final cost exceeding first proposal to settle is carrier's responsibility
  - "Soft Hammer" if the insured accepts a hammer clause and the litigation ultimately settles for less than the first proposed settlement insured retained the "underage"

MONEY

"See I'm a tell you like Wu told me
Cash rules everything around me
Singin' dollar dollar bill y'all"- Wyclef Jean

- Charge higher premiums
- Impose higher deductibles
- When the insured is able to withdraw from the defense of a claim
- Settlements

LITIGATION

- There are not many cases that address hammer clauses but those that do apply the general rules of interpretation applied to insurance contracts. *Freedman v. United National Ins. Co.*, 2011 WL 781919 (C.D. Cal. 2011). And to the extent the provisions are clear and unambiguous, courts have enforced them.
- Finding Plaintiff's attorney's who want to handle bad faith litigation with regards to hammer clauses can be challenging to the insured. Insureds, even professionals, such as doctors or architects still have much more limited funds to litigate a claim.

LITIGATION

- Litigation over what the "reasonableness" of an offer to settle a claim can be expensive and time consuming for the insured.

FACTORS WHICH FAVOR INSUREDS

REPUTATION & CONTROL

- Settlements can be reported by the press
- Outcome reported to national data bank
- Outcome reported to state data bank
- Targeted by Plaintiff's attorneys
- Future clients/ revenues
- Might cause additional lawsuits to be filed against the insured.

MONEY

- Premiums may go up if settle
- Deductibles may go up if settle
- Coverage may not be renewed if settle
- Coverage may not be available or difficult to obtain if settle
- Money - control

LICENSURES & FUTURE EMPLOYMENT

- Licensure might be suspended.
  - Penalized

- Future employers- could know about past settlement

MULTIPLE INSUREDS

- Factors that favor the insurer's right to settle in good faith up to policy limits, even if such settlement leaves another insured without coverage. These factors include:
  - Whether, in the jurisdiction in question, the insurer has a duty to accept a reasonable settlement offer;
  - Whether, during the settlement process, the insured has made a good faith effort to settle all claims against all insureds within policy limits;
  - Whether the insurer has disclosed its settlement strategy, so that the various insured may act to protect their interests;
  - Whether the insurer has a filed an interpleader or declaratory relief action.

POSSIBLE MIDDLE GROUND

- Cost- sharing of settlement
  - The various types of hammers.
- Insured and insurer negotiations
- Arbitration

QUESTIONS?