Practical Considerations and Common Issues Arising in Claims Resolution

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INTRODUCTION

This article highlights many of the duties and rights that primary insurers, excess insurers, and insureds have when considering settlement of a lawsuit. It is not a 50-state survey of the issues, but does attempt to address the differing approaches that courts have taken to an issue, and also address the theoretical underpinnings for the various approaches.

Section I addresses the duties and rights of a primary insurer. As the primary insurer is the entity in control of settlement, most of the duties involving settlement fall on the primary insurer. Section I.A considers various tests that courts around the country have adopted to evaluate the primary insurer's duty to settle, whether the duty to settle obligates the primary insurer to initiate settlement negotiations, and whether the duty to settle requires the primary insurer to accept a demand in excess of the policy limits. Sections I.B, I.C, and I.D consider the rights that a primary insurer has in settlement. Sections I.B. and I.C. evaluate whether the primary insurer needs an insured's permission to settle within the policy limits, especially when the primary insurer settles for an amount that includes the insured's deductible. Section I.D evaluates whether the primary insurer can seek reimbursement from the insured for amounts the primary insurer paid to settle claims that were not covered. Sections I.E and I.F consider the rights a primary insurer has against other insurers. Section I.E evaluates the rights a primary insurer has to recover from other insurers providing the same level of coverage who refuse to contribute their fair share toward settlement. Section I.F evaluates whether the primary insurer can negotiate a settlement that includes excess limits without the consent of the excess insurer.

Section II addresses the duties and rights of an excess insurer. Section II.A considers whether the excess insurer ever has a duty to settle. Section II.B evaluates whether the excess insurer has a claim against a primary insurer for breach of the duty to settle. Section II.C analyzes whether the excess insurer has any claim for failure to settle again an insurer with a self-insure retention limit.

Section III addresses the rights of the insured at settlement. It evaluates whether an insured being defended under a reservation of rights can settle a case without the approval of its insurer while still preserving a claim for reimbursement against the insurer.

Section IV addresses a special scenario where the insurance policy gives the insured the right to object to settlement but only at their own peril. There is not much law addressing these types of provisions but we evaluate whether they are enforceable and how they are interpreted.

SECTION I
THE PRIMARY INSURER

A. The primary insurer's duty to settle.

"The 'duty to settle' refers to the insurer's obligation to settle claims against its insured within the applicable policy limits when proceeding to trial could result in a judgment in excess of the policy limits."[1] This duty applies when an insurer is defending an insured, even when the defense is provided under a reservation of rights. It does not apply when the insurer has denied coverage.

The duty to settle is not expressly stated in the CGL Policy. However, the CGL Policy gives the insurer the sole discretion to settle claims.[2] Further, the cooperation clause and no-action clause in the Policy act to prevent an insured from seeking recovery from an insurer, if the insured settles a case without the consent of the insurer.[3] Courts recognize that these provision give the insurer control of the settlement process and create an inherent conflict of interest between the insurer and the insured. On the one hand, the insurer has an interest in minimizing its payments. On the other hand, the insured has an interest in avoiding liability beyond the policy limits.[4] It is out of this recognized conflict of interest that courts have found that an insurer has a duty to settle.

Some courts hold that the duty to settle arises out of the control that the insurer exercises over the litigation process, and thus is a component of the insurer's duty to defend and indemnify.[5] For example in New York, the insurer's duty to settle "stems from the general principle that a covenant of good faith and fair dealing is implied in all contracts, including insurance policies, as well as a recognition of the control an insurer maintains over claims against an insured."[6]

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1 Leo P. Martinez, *The Restatement of the Law of Liability Insurance and the Duty to Settle*, 68 Rutgers U.L. Rev. 155, 156 (2015).

2 *See* ISO Commercial General Liability Coverage Form CG 00 01 04 13. The Insuring Agreement provides: "We may, at our discretion, investigate any 'occurrence' and settle any claim or 'suit' that may result."

3 *Id.* The cooperation clause provides: "No insured will, except at that insured's own cost, voluntarily make a payment, assume any obligation, or incur any expense, other than for first aid, without our consent." The no-action clause provides: "A person or organization may sue us to recover on an agreed settlement or on a final judgment against an insured…. An agreed settlement means a settlement and release of liability signed by us, the insured and the claimant or the claimant's legal representative."

4 *Pavia v. State Farm Mut. Auto. Ins. Co.*, 626 N.E.2d 24, 27 (N.Y. 1993).

5 *The Restatement of the Law*, 68 Rutgers U.L. Rev. at 161-62 (citing *Mesmer v. Md. Auto. Ins. Fund*, 725 A.2d 1053, 1060-64 (Md. 1999)).

6 *Smith v. Gen. Acc. Ins. Co.*, 91 N.Y.2d 648, 652–53, 697 N.E.2d 168 (1998); *see also N. Am. Van Lines, Inc. v. Lexington Ins. Co.*, 678 So. 2d 1325, 1330-31 (Fla. Dist. Ct. App. 1996) ("This obligation of good faith is implied in the contract because the insurer has taken over the entire defense of the matter and, in most contracts, the insured is prohibited from interfering in

Other courts hold the duty to settle is a tort-based duty that arises out of the insurer's fiduciary obligation to act in the "best interests of its insured in order to protect the insured from excess liability … [and to] refrain from acts that demonstrate greater concern for the insurer's monetary interest than the financial risk attendant to the insured's situation."[7]

Courts have formulated various tests to determine if an insurer has acted in bad faith in its settlement negotiations. "No state holds the insurance company strictly liable for the excess judgment when it rejects a settlement demand within the policy limits."[8] "Instead, the insurance company is liable only if its behavior in failing to settle departs from some norm by a margin a jury can fairly label 'negligent,' 'bad faith' (a standard purportedly more onerous than negligence), or some combination of the two."[9] A slight majority of jurisdictions have applied a "bad faith" standard, while some courts apply a "negligence" standard, and others a hybrid approach between a "bad faith" standard and a "negligence" standard. Ultimately, most courts focus on whether the insured rejected a "reasonable" settlement demand, but adopt different tests to define what is "reasonable."[10] The bad-faith standard of reasonableness is more insured friendly; the negligence standard is more insurer friendly.

California applies the bad-faith standard for the duty to settle. It requires the insurers to "give the interests of the insured at least as much consideration as it gives to its own interests."[11] "In determining whether an insurer has given consideration to the interests of the insured, the test is whether a prudent insurer without policy limits would have accepted the settlement offer."[12] Further, "when 'there is great risk of a recovery beyond the policy limits so that the most reasonable manner of disposing of the claim is a settlement which can be made within those limits, a consideration in good faith of the insured's interest requires the insurer to settle the claim.' "[13]

In contrast, the question for court's applying the "negligence" standard "is not whether a reasonable insurer might have settled the case within the policy limits, but rather whether *no* reasonable insurer would have failed to settle the case within the policy limits."[14] Thus, the insured must "prove that the plaintiff in the underlying action would have settled the

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any manner with the litigation and settlement. As such, the insurer must exercise reasonable diligence in that regard…. This duty of good faith is the foundation of the cooperation clauses that are contained in most insurance policies.").

7 *The Restatement of the Law,* 68 Rutgers U.L. Rev. at 162 (quoting *Medical Malpractice Joint Underwriting Association of Rhode Island v. Rhode Island Insurers' Insolvency Fund,* 703 A.2d 1097, 1102 (R.I. 1997)).

8 Kent D. Syverud, *The Duty to Settle*, 76 Va. L. Rev. 1113, 1122 (1990).

9 *Id.*

10 *Id.* at 1123.

11 *Crisci v. Sec. Ins. Co. of New Haven, Conn.*, 426 P.2d 173, 176 (Cal. 1967).

12 *Id.*

13 *Id.* (quotation omitted).

14 *Hartford Cas. Ins. Co. v. N.H. Ins. Co.*, 628 N.E.2d 14, 18 (Mass. 1994) (emphasis added).

claim within the policy limits and that, assuming the insurer's unlimited exposure[,] … no reasonable insurer would have refused the settlement offer or would have refused to respond to the offer."[15] New York is known for its application of the "negligence" standard to determine bad faith. Under New York's test, an insurer "cannot be compelled to concede liability and settle a questionable claim … simply because an opportunity to do so is presented. Rather, the plaintiff in a bad-faith action must show that the insured lost an actual opportunity to settle the ... claim at a time when all serious doubts about the insured's liability were removed."[16]

Texas has its own formulation of the duty to settle, known as the "Stowers doctrine." This doctrine requires an insurer to exercise "that degree of care and diligence which an ordinarily prudent person would exercise in the management of his own business; and if an ordinarily prudent person, in the exercise of ordinary care, as viewed from the standpoint of the assured, would have settled the case, and failed or refused to do so, then the agent, which in this case is the indemnity company, should respond in damages."[17]

Wisconsin applies a "hybrid" approach of bad faith and negligence standards. "To show a claim for bad faith, a plaintiff must show the absence of a reasonable basis for denying benefits of the policy and the defendant's knowledge or reckless disregard of the lack of a reasonable basis for denying the claim."[18] Thus, "[a]n insurer will have committed the tort of bad faith only when it has denied a claim without a reasonable basis for doing so, that is, when the claim is not fairly debatable."[19]

In West Virginia, where the insurer fails to settle within the policy limits when there is an opportunity to do so, the insurer will be found to have acted in bad faith unless it can "prove by clear and convincing evidence that it attempted in good faith to negotiate a settlement, that any failure to enter into a settlement where the opportunity to do so existed was based on reasonable and substantial grounds, and that it accorded the interests and rights of the insured at least as great a respect as its own."[20]

The majority rule in the United States is that an insurer that unreasonably rejects a settlement demand that is within the policy limits is liable for any excess judgment against the insured.[21] Further, most courts have allowed insureds to recover other damages also caused by the insured's bad faith, including damages for economic loss, emotional distress damages, and punitive damages.[22] Recovery of this broad range of damages is grounded in the idea that the

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15 *Id.*

16 *Pavia*, 626 N.E.2d at 28 (internal quotations omitted).

17 *G.A. Stowers Furniture Co. v. Am. Indem. Co.*, 15 S.W.2d 544, 547 (Tex. Comm'n App. 1929).

18 *Anderson v. Continental Ins. Co.,* 271 N.W.2d 368 (Wis. 1978).

19 *Mowry v. Badger State Mut. Cas. Co.*, 385 N.W.2d 171, 180 (Wis. 1986).

20 *Shamblin v. Nationwide Mut. Ins. Co.*, 396 S.E.2d 766, 776 (W. Va. 1990).

21 *The Restatement of the Law,* 68 Rutgers U.L. Rev. at 183.

22 *See, e.g., Fletcher v. W. Nat'l Life Ins. Co.,* 89 Cal. Rptr. 78, 94 (Cal. Ct. App. 1970).

policy limits only apply to limit the insurer's exposure when the insurer meets its contractual obligations.[23] When an insurer breaches its duty, the contractual limits do not apply.

1. Does the duty to settle obligate the primary insurer to initiate settlement negotiations?

Courts have reached varying conclusions on whether an insurer has a duty to initiate settlement discussions with a plaintiff. On the one hand, courts have recognized that requiring an insurer to make or solicit settlement offers when the claimant has given no indication of a desire to settle would essentially require the insurer to bid against itself. Such duty would put the insurer "at a negotiating disadvantage not imposed on any other litigant."[24] But courts also recognize that settlement is often in the best interest of the insured, especially when liability is clear and there is a strong possibility of an excess verdict. Therefore, many courts impose an affirmative duty on an insurer to solicit a settlement offer or initiate settlement demands when warranted under the circumstances.[25] Failure to do so may be considered a factor evaluating if an insurer has acted in bad faith.[26]

Texas law differs. In Texas, the insurer's duty of care in settling claims does not require the insurer to make or solicit settlement offers. [27]

2. Does the duty to settle require the primary insurer to accept a demand in excess of policy limits?

Courts consistently hold that insurers have a duty to communicate settlement demands to their insureds, and that failure to do so is evidence of bad faith. A special situation arises when the settlement demand is in excess of the policy limits. The majority of jurisdictions hold that insurers have a duty to communicate a settlement demand even when the settlement offer is in excess of the policy limits. If the insured or an excess insurer offers to contribute the excess

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[23] *The Restatement of the Law,* 68 Rutgers U.L. Rev. at 183-84.

[24] *Oda v. Highway Ins. Co.*, 194 N.E.2d 489, 499 (Ill. App. Ct. 1963).

[25] *Badillo v. Mid Century Ins. Co.*, 2005 OK 48, ¶ 33, *as corrected* (June 22, 2005) ("if an insured's liability is clear and the injuries of a claimant are so severe that a judgment in excess of policy limits is likely, the insurer has an affirmative duty to initiate settlement negotiations"); *Hopkins v. Liberty Mut. Ins. Co.*, 750 N.E.2d 943, 950 (Mass. 2001) (once an insured's liability has become reasonably clear, an insurer has a duty to make a fair offer to settle the claim); *Powell v. Prudential Prop. & Cas. Ins. Co.*, 584 So. 2d 12, 14 (Fla. Dist. Ct. App. 1991) (citing cases); *Commercial Union Ins. Co. v. Liberty Mut. Ins. Co.*, 393 N.W.2d 161, 165 (Mich. 1986) (holding evidence of bad faith can include "failure to solicit a settlement offer or initiate settlement negotiations when warranted under the circumstances"); *Rova Farms Resort v. Investors Ins. Co. of Am.*, 306 A.2d 77 (N.J. Ct. App. Div. 1973) (per curiam), *aff'd in part*, 65 N.J. 474 (1974).

[26] *See id.*

[27] *Am. Physicians Ins. Exch. v. Garcia,* 876 S.W.2d 842, 849 (Tex. 1994).

demand in order to reach settlement, the duty to settle will apply, even though the plaintiff's demand is in excess of the policy limits.[28]

In communicating a settlement demand that is in excess of the policy limits, insurers must strike a delicate balance in informing the insured of their right to contribute to the excess demand in order to reach a settlement.[29] The Second Circuit, applying New York law, has recognized the "need for a controlled arms-length discussion between the assured and the insurer about their respective interests in the settlement."[30] The court found "nothing per se improper in the bare mention by the insurer that contribution is possible" in order to settle the case.[31] But it recognized that claims of impropriety could arise if the insurer insists "upon a contribution as the price of settlement, particularly where the amount demanded is relatively high compared with what the insurer is willing to contribute."[32]

Texas law differs from the majority of jurisdictions. "A demand above policy limits, even though reasonable, does not trigger the *Stowers* duty to settle."[33] Texas courts have left open the possibility that the duty to settle may be triggered "if an insured provides notice of his or her willingness to accept a reasonable demand above the policy limits, and to fund the settlement, such that the insurer's share of the settlement would remain within the policy limits."[34]

B. Does the primary insurer need an insured's permission to settle within policy limits?

The standard CGL Policy gives the insurer sole discretion on whether to settle a case, providing: "We may, at our discretion, investigate any 'occurrence' and settle any claim or 'suit' that may result."[35] Courts have generally held that by purchasing a policy with this provision, the insured "agrees to accept the insurer's view concerning the point at which the benefits of settlement exceed the risk of continuing litigation. The alternative is to negotiate-and pay for-a policy with a consent provision."[36] Insurers are thus given wide discretion when settling a claim

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28 *Berglund v. State Farm Mut. Auto. Ins. Co.*, 121 F.3d 1225, 1228 (8th Cir. 1997) (citing cases) (holding that where "an insured is not judgment proof or an excess insurer exists, absence of an offer to settle within policy limits is not dispositive of the question of the primary insurer's bad faith. To hold otherwise would relieve [the insurer] of its obligation to negotiate settlement in good faith to protect its insured when settlement is impossible within its own limits, but possible because of other available funds."); *see also Gen. Acc. Fire & Life Assur. Corp. v. Am. Cas. Co. of Reading, Pa.*, 390 So. 2d 761, 765 (Fla. Dist. Ct. App. 1980) (citing cases).

29 *Redcross v. Aetna Cas. & Sur. Co.*, 688 N.Y.S.2d 817 (N.Y. App. Div. 1999).

30 *Brockstein v. Nationwide Mut. Ins. Co.*, 417 F.2d 703, 709 (2d Cir. 1969) (internal quotations omitted).

31 *Id.*

32 *Id.*

33 *Garcia*, 876 S.W.2d at 849 (Tex. 1994).

34 *Id.* at 849 n.13.

35 ISO Commercial General Liability Coverage Form CG 00 01 04 13.

36 *Hurvitz v. St. Paul Fire & Marine Ins. Co.*, 135 Cal. Rptr. 2d 703 (Cal. Ct. App. 2003).

even over the objection of an insured.[37] As described by the New Jersey Superior Court, the establishment of a claim of bad faith against an insurer for settling a case over the objection of the insured "requires proof that the insurer conspired to provide the claimant with monetary gain for reasons other than the potential validity of, or exposure to, the third party's claim."[38]

The insured's right to object to settlement often arises when a professional objects to the settlement of a claim, arguing that settlement will injure his or her reputation, increase the costs of insurance premiums, and/or result in the insured being unable to obtain insurance. Insurance policies in these contexts often include provisions that give the professional a right to object to settlement. But absent such a consent-to-settle clause, courts have enforced the insurer's right to settle over the objection of the insured.[39] Further, some courts hold an attorney cannot be liable for malpractice when negotiating a settlement at the direction of the insurer, when the insured has objected to the settlement, because the insured has contracted away the right to object to the settlement.[40] However, other courts have found that a malpractice claim can exist against an attorney who negotiates a settlement against the instructions of the insured.[41]

There are some exceptions to an insurer's general right to settle that allow an insured to bring a bad faith action against an insurer for its settlement over the insured's consent. The Florida Supreme Court has identified two situations where a bad-faith claim may still exist. First, where there are multiple parties to a lawsuit, an insurer cannot indiscriminately settle "one or more of the parties for the full policy limits, thus exposing the insured to an excess judgment from the remaining parties."[42] Second, an insurer may act "in bad faith and without regard to the insured's interests by settling a claim in a manner that bars the insured's counterclaim."[43] As to the second situation, the Court reasoned that it would not have been the intent of the parties, in giving the insurer the right to settle, for the insured to also give up his or right to a counterclaim.[44] While some courts have restricted the insurer from settling only existing

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[37] *See, e.g., Davenport v. St. Paul Fire & Marine Ins. Co.*, 978 F.2d 927, 932 (5th Cir. 1992) ("The consensus of the courts that have considered this question is that, absent a policy rider to the contrary, such settlement is the exclusive prerogative of the carrier.") (citing cases); *Doe v. S.C. Med. Malpractice Liab. Joint Underwriting Ass'n*, 557 S.E.2d 670, 675 (S.C. 2001) (citing cases).

[38] *Alan H. Frankel, D.M.D., P.A. v. St. Paul Fire & Marine Ins. Co.*, 759 A.2d 869, 873 (N.J. App. Div. 2000).

[39] *See e.g., Schuster v. South Broward Hospital Dist. Physicians' Professional Liability Ins. Trust*, 591 So.2d 174, 176 (Fla.1992); *see also Bleday v. Oum Group*, 645 A.2d 1358 (Pa. Super. 1994).

[40] *Mitchum v. Hudgens*, 533 So. 2d 194, 202 (Ala. 1988).

[41] *See e.g., Rogers v. Robson, Masters, Ryan, Brumund & Belom*, 392 N.E.2d 1365 (Il. App. Ct.1979), *aff'd*, 407 N.E.2d 47 (1980).

[42] *Shuster*, 591 So. 2d at 177.

[43] *Id.*

[44] *Id.*

counterclaims,[45] other courts have held it also applies to prevent an insurer from settling an insured's potential for recovery of a counterclaim.[46]

C. Does the primary insurer need an insured's permission to settle for an amount that includes the insured's deductible?

A majority of jurisdictions hold that an insurer's right to control settlement includes the right to settle for amounts that will require the insured to contribute its deductible, even if the insured does not consent to the settlement. This right is included within the insurer's contractual right to control the settlement negotiations. In other words, "when a liability policy contains a deductible clause along with a clause authorizing the 'unfettered right to settle,' … the 'insured has bargained away whatever rights might otherwise be created by what might be perceived as a conflict of interest between the insurer and insured.' "[47] "It would even be proper for the insurers to settle for a figure within the deductible, thus spending [the insured's] money without its consent and at no cost to themselves."[48] The insured can only avoid payment of its deductible by showing there has been some impropriety in the insured's settlement of the claim.[49]

A minority of jurisdictions hold that an insurer who settles over the objection of an insured cannot later seek to recover the deductible amount from the insured. They reason that the policy only requires the insured to pay a deductible for amounts the insured "shall become legally obligated to pay," and a negotiated settlement does not legally obligate the insured to pay anything.[50]

D. Can the primary insurer seek reimbursement from the insured for amounts the primary insurer paid to settle claims that were not covered?

If an insurer pays to settle claims against an insured, and some of the claims are covered and others are not, can an insurer seek to recover from the insured for the part of the settlement made to resolve uncovered claims? The answer is easy if the insurance policy expressly provides for such a right of reimbursement, or if the insured agrees to the settlement and agrees to reimburse the insurer if the insurer prevails on coverage. But courts have reached various

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45 *Caplan v. Fellheimer Eichen Braverman & Kaskey*, 68 F.3d 828, 838 (3d Cir. 1995).

46 *Barney v. Aetna Cas. & Sur. Co.*, 230 Cal. Rptr. 215 (Cal. Ct. App. 1986); *Rothtrock v. Ohio Farmers Ins. Co.*, 43 Cal. Rptr. 716 (Cal. Ct. App. 1965); *see also* Jon Epstein, Annotation, *Liability of insurer to insured for settling thirdparty claim within policy limits resulting in detriment to insured,* 18 A.L.R. 5th 474 § 2[a] (1994).

47 *Am. Home Assur. Co. v. Hermann's Warehouse Corp.*, 563 A.2d 444, 448 (N.J. 1989); *see also Am. Prot. Ins. Co. v. Airborne, Inc.*, 476 F. Supp. 2d 985, 990 (N.D. Ill. 2007) (citing cases).

48 *OrionInsurance Co. v. General Electric Co.,* 493 N.Y.S.2d 397, 401 (N.Y. Sup. Ct. 1985).

49 *Hermann's Warehouse Corp.*, 563 A.2d at 448.

50 *St. Paul Fire & Marine Insurance Co. v. Edge Memorial Hospital,* 584 So. 2d 1316, 1326-27 (Ala.1991); *National Service Industries, Inc. v. Hartford Accident & Indemnity Co.*, 661 F.2d 458, 462 (5th Cir. 1981) (applying Georgia law); *Employers' Surplus Line Ins. Co. v. City of Baton Rouge*, 362 So. 2d 561 (La. 1978).

conclusions when determining if the insurer has a right to reimbursement when the insured does not agree that it has any liability for the settlement.

In approaching this issue, it is helpful to first consider if a jurisdiction allows the insurer to consider its coverage defenses in determining its duty to settle. In other words, is an insurer's good-faith belief that there is no coverage a defense to a claim that the insured failed to settle a claim within policy limits? Courts that allow an insurer to consider coverage are more likely to hold than an insurer cannot seek reimbursement from an insured than courts that do not allow an insurer to consider coverage defenses in determining their duty to settle.

Courts that hold that an insurer cannot consider coverage in determining its duty to settle leave the insurer between a rock and a hard place: "If an insurer waived its coverage position simply by settling a claim for the insured, the insurer would be forced either to refuse to settle and face a bad faith claim, or to settle the lawsuit and lose its coverage defenses."[51] In contrast, "[p]ermitting an insurer to make a reservation of rights not only protects against unjust enrichment of the insured" but also "provides for the settlement of cases when coverage is uncertain, and thus ensures compensation of the injured party by placing 'the risk that the insured may not be financially able to pay the injured party's damages' on the insurer."[52]

Other jurisdictions hold that an insurer can consider coverage in determining its duty to settle. For example, the Wisconsin Supreme Court has concluded: "[I]t is not bad faith for an insurer to refuse to settle an insured's claim within policy limits when the question of policy coverage is fairly debatable and when the grounds for the refusal, if determined in the insurer's favor, would wholly defeat the indemnity responsibility of the insurer to the insured."[53] These jurisdictions are more likely to hold that an insurer does not have a right to reimbursement, because the insurer is not required to settle.[54]

The majority of courts allow an insurer to seek reimbursement from their insured.[55] These courts have formulated various requirements that must first be met before an insurer can seek such reimbursement. Most notably, California's *Blue Ridge* standard allows an insurer to seek reimbursement if there is: "(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

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[51] *Phillips & Assocs., P.C. v. Navigators Ins. Co.*, 764 F. Supp. 2d 1174, 1176 (D. Ariz. 2011) (citing *Blue Ridge Ins. Co. v. Jacobsen*, 22 P.3d 313, 321 (Cal. 2001)).

[52] *Id.*

[53] *Mowry v. Badger State Mut. Cas. Co.*, 385 N.W.2d 171, 180-81 (Wis. 1986); *see also Snodgrass v State Farm Mut. Auto. Ins. Co.*, 804 P.2d 1012 (Kan. Ct. App. 1991) (holding an insurer who legitimately believes that there is no coverage under its policy has no duty to initiate settlement negotiations).

[54] *See e.g., Eskridge v. Educator & Exec. Insurers, Inc.*, 677 S.W.2d 887, 889 (Ky. 1984) (citing cases).

[55] *Travelers Prop. Cas. Co. of Am. v. Hillerich & Bradsby Co.*, 598 F.3d 257, 265-66 (6th Cir. 2010) (citing cases).

insureds disagree whether to accept the proposed settlement."[56] The Sixth Circuit, applying Kentucky law, has formulated the test as allowing an insurer to seek reimbursement when "(1) the insurer has timely asserted a reservation of rights; (2) the insurer has notified the insured of its intent to seek reimbursement; and (3) the insured has meaningful control of the defense and negotiation process." The court held the insured had exercised "meaningful control" when the insured asked insurer to authorize settlement and refused to contribute it own funds, the insured demanded insurer settle the litigation and threatened to sue for bad faith if it did not, and the insured's chosen defense counsel handled the litigation and settlement negotiations.[57]

A minority of jurisdictions do not allow an insurer to seek reimbursement from its insured unless such right is expressly provided for in the insurance policy. In these jurisdictions, an insurer that settles a claim without agreement from its insured to reimburse the insurer if the claims are not covered is a volunteer and is not entitled to reimbursement from the insured.[58]

Texas law continues to evolve on whether an insurer can seek reimbursement from an insured. Under the *Stowers* doctrine, an insurer can consider coverage when determining its duty to settle; an insurer only has a duty to settle if there is a demand to settle for an amount within the policy limits – and the claims are covered. Thus, a 2002 opinion from the Texas Supreme Court concluded that an insurer could not seek reimbursement from its insured for settlement of non-covered claims unless the insured expressly agreed to the settlement and to the insurer's right to seek reimbursement.[59] However, in a 2008 opinion the Court concluded that a right to reimbursement exists: (1) when an insured has demanded that its insurer accept a settlement offer that is within policy limits, or (2) when an insured expressly agrees that the settlement offer should be accepted. In the case, the court recognized the insured had approved the settlement, and concluded that the insured's demand that the insurer settle precluded the insured from then taking the "inconsistent position" that the settlement offer was unreasonable, or too financially burdensome.[60]

E. Can an insurer recover from other insurers providing the same level of coverage who refuse to contribute their fair share toward settlement?

If an insurer pays more than its fare share to settle a claim, the majority of courts recognize the first insurer has an equitable cause of action for contribution against the non-

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[56] *Blue Ridge*, 22 P.3d at 320.

[57] *Hillerich*, 598 F.3d at 268.

[58] *United States Fidelity & Guarantee Co. v. United States Sports Specialty Ass'n*, 270 P.3d 464 (Utah 2012); *Mt. Airy Ins. Co. v. Doe Law Firm*, 668 So. 2d 534 (Ala. 1995); *Scottsdale Ins. Co. v. Alabama Mun. Ins. Co.*, No. 2:11-CV-0668-MEF, 2012 WL 4477656, at *5 (M.D. Ala. Sept. 28, 2012).

[59] *Texas Ass'n of Counties County Gov't Risk Mgmt. Pool v. Matagorda County,* 52 S.W.3d 128 (Tex. 2000).

[60] *Excess Underwriters at Lloyd's London, et al. v. Frank's Casing Crew & Rental Tools, Inc.*, 246 S.W.3d 42, 48–50 (Tex. 2008).

paying insurer. "The doctrine of equitable contribution arises when two (or more) separate insurance companies have the same obligation to cover the same claim."[61]

Texas is a notable exception. In a 2007 opinion, the Texas Supreme Court held that an insured who has been fully indemnified by one insurer has no right to recover additional pro rata portions of the settlement from another insurer, even if that other insurer was required to contribute. Therefore, as the insured had no cause of action against an insurer that did not contribute, the contributing insurer would have no right of equitable contribution either.[62] Since the 2010 opinion, Texas state and federal courts have attempted to limit the case. The Southern District of Texas has limited the ruling "to situations where the insurers (1) were co-primary insurers, (2) did not dispute that both covered the loss, and (3) were subject to pro rata clauses."[63] The Fifth Circuit has noted the ruling "does not bar contractual subrogation when an insurer has denied coverage." Thus, in Texas, the rights of one insurer to recover against another insurer who fails to contribute their share at settlement are still evolving.

F. Can the primary insurer negotiate a settlement that includes excess limits without the consent of the excess insurer?

Excess policies most often require the insured to obtain the consent of the excess carrier before consenting to a settlement of a claim in an amount which invades excess coverage. They most often also contain a no-action clause that prevents an insured from suing an excess carrier to recover for amounts the insured paid without the consent of the excess carrier. However, just as courts have recognized that the primary carrier has an interest in not settling a case, the excess carrier also has an interest in not settling, because it does not pay the defense costs of taking the case through trial. Recognizing this conflict of interest, the California Court of Appeals has aptly held: "Consistent with its good faith duty, the excess insurer does not have the absolute right to veto arbitrarily a reasonable settlement and force the primary insurer to proceed to trial, bearing the full costs of defense."[64]

The California Court of Appeals case in *Diamond Heights* represents the seminal case on the rights of a primary carrier and an insured to reach a reasonable settlement of a claim in an amount which invades excess coverage when the excess carrier has not given consent to the settlement. It holds that a primary carrier can reach such a settlement if two conditions are met: (1) the primary carrier is offering its policy limits; and (2) in advance of the settlement being finalized, the primary carrier gives the excess carrier notice of the settlement and demands that

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61 *State ex rel. Owners Ins. Co. v. McGraw*, 760 S.E.2d 590, 603 (W.V. 2014) (citing cases); *Nat'l Cas. Co. v. Great Sw. Fire Ins. Co.*, 833 P.2d 741, 747–48 (Colo. 1992) (citing cases); *Home Ins. Co. v. Cincinnati Ins. Co.*, 821 N.E.2d 269, 276 (Ill. 2004).

62 *Mid-Continent Insurance Co. v. Liberty Mutual Insurance Co.*, 236 S.W.3d 765 (Tex. 2007).

63 Employers Ins. Co. v. Penn-Am. Ins. Co., 705 F. Supp. 2d 696 (S.D. Tex. 2010).

64 *Diamond Heights Homeowners Assn. v. Nat'l Am. Ins. Co.*, 277 Cal. Rptr. 906, 916 (Cal. Ct. App. 1991).

the excess carrier either approves the settlement or accept the defense of the action.[65] While the court recognized that its holding would conflict with the consent and no-action clauses in the policy, it held an excess insurer could waive its rights under that clause "if it rejects a reasonable settlement and at the same time fails to offer to undertake the defense."

SECTION II
THE EXCESS INSURER

A. The excess insurer's duty to settle.

"[T]he accepted practice in the insurance industry is that the excess carrier has no duty to step in and settle a case where the primary carrier refuses to contribute its policy limits to the settlement."[66] However, an excess carrier has the same duty as the primary carrier to act in good faith when considering settlement proposals that implicate excess insurance.[67]

In *SRM, Inc. v. Great American Insurance Company*, the Tenth Circuit found no case law to support the insured's argument that its excess carrier was responsible for settlement of a claim in excess of the excess insurance limits, thus requiring an insured to contribute personal funds to the settlement.[68] The insured argued that if the excess carrier had investigated the claims and initiated settlement negotiations by tendering its policy limits earlier in the litigation, the case would have settled within the limits of the excess policy.[69] While the Court noted case law that required an "excess carrier to act reasonably when evaluating a plaintiff's settlement offer or a settlement agreement negotiated by the primary insurer," it found no case law to "suggest that an excess insurer must investigate, initiate settlement negotiations, or proactively tender its policy limits in the face of an unambiguous policy to the contrary and absent any settlement demand from the plaintiffs or proposed settlement agreement from the primary insurer."[70]

B. The excess insurer's claims against the primary insurer for breach of the duty to settle.

A majority of jurisdictions hold that an excess insurer has a claim for equitable subrogation against the primary insurer that acts in bad faith in failing to accept a settlement within its policy limits. Under the doctrine of equitable subrogation, "[s]ince the insured would have been able to recover from the primary carrier for a judgment in excess of policy limits caused by the carrier's wrongful refusal to settle, the excess carrier, who discharged the insured's liability as a result of this tort, stands in the shoes of the insured and should be permitted to assert

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65 *Id.*; *see also N. Am. Van Lines, Inc. v. Lexington Ins. Co.*, 678 So. 2d 1325, 1331 (Fla. Dist. Ct. App. 1996) (applying analysis of *Diamond Heights* to claim by an insured with a large deductible against an excess insurer).

66 *U.S. Fire Ins. Co. v. Nationwide Mut. Ins. Co.*, 735 F. Supp. 1320, 1330 (E.D.N.C. 1990).

67 *Diamond Heights*, 277 Cal. Rptr. at 914.

68 *SRM, Inc. v. Great American Insurance Company*, 798 F.3d 1322, 1327-29 (10th Cir. 2015).

69 *Id.* at 1325.

70 *Id.* at 1327-29.

all claims against the primary carrier which the insured himself could have asserted."[71] Recognizing that the excess insurer has a right of equitable subrogation promotes the "fair and reasonable settlement of lawsuits by discouraging primary [insurers] from 'gambling' with the excess [insurer's] money when potential judgments approach the primary insurer's policy limits."[72] It also applies "to prevent an unfair distribution of losses among primary and excess insurers" and to prevent the need for increased premiums by excess insurers.[73]

Alabama and Idaho hold that the excess insurer cannot recover from the primary insurer.[74]

Most courts have declined to recognize a direct right of reimbursement by an excess insurer against the primary insurer. Insurers would prefer such a direct right, because it is not "subject to any defenses assertable against an insured, including the refusal to settle and the failure to cooperate."[75] But courts have held the doctrine of equitable contribution to provide the excess insurer with a sufficient means of seeking reimbursement from the primary insurer, while also noting that "there is no contractual relationship between primary and excess insurers" that would give rise to a direct right of reimbursement.[76]

One note of caution, the assistance and cooperation clauses in an excess insurance policy generally give the excess carrier a right to associate with the insured in the underlying litigation. While this does not create any duty for the excess carrier to defend the insured, or to initiate settlement, it may estop the excess carrier from filing a bad faith claim against the primary carrier for failure to settle if the excess carrier was part of that decision.[77] But simply hiring counsel to monitor the case would not preclude an excess carrier from asserting a bad faith claim against the primary carrier.[78]

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[71] *Commercial Union Assurance Companies v. Safeway Stores, Inc.*, 610 P.2d 1038, 1041 (Cal. 1980); *see also Nat'l Sur. Corp. v. Hartford Cas. Ins. Co.*, 493 F.3d 752, 756 & n.2 (6th Cir. 2007) (Kentucky law) (citing cases).

[72] *Commercial Union Ins. Co. v. Medical Protective Co.*, 393 N.W.2d 479, 483 (Mich. 1986).

[73] *Hartford Accident & Indem. Co. v. Aetna Cas. & Sur. Co.*, 792 P.2d 749, 754 (Ariz. 1990).

[74] *See Fed. Ins. Co. v. Travelers Cas. & Sur. Co.*, 843 So.2d 140, 145-46 (Ala. 2002) (holding that a "bad-faith-failure-to-settle claim does not exist where the insured is subject to no personal loss from a final judgment"); *Stonewall Surplus Lines Ins. Co. v. Farmers Ins. Co. of Idaho*, 971 P.2d 1142, 1148-49 (Idaho 1998) (holding the primary insurer's fiduciary responsibility to settle only applied to its insured and did not extend to the excess insurer).

[75] *Am. Centennial Ins. Co. v. Canal Ins. Co.*, 843 S.W.2d 480, 483 (Tex. 1992).

[76] *See e.g., Scottsdale Ins. Co. v. Addison Ins. Co.*, 448 S.W.3d 818, 833 (Mo. 2014); *Twin City Fire Ins. Co. v. Country Mut. Ins. Co.*, 23 F.3d 1175, 1178 (7th Cir. 1994) (Illinois law).

[77] *Commercial Union Ins. Co. v. Medical Protective Co.*, 393 N.W.2d 479, 483 (Mich. 1986).

[78] *Certain Underwriters of Lloyd's v. General Accident Ins. Co. of Am.*, 699 F. Supp. 732, 741 (S.D. Ind. 1988).

C. The excess insurer does not have a claim again an insured with a self-insured retention limit for failure to settle.

An insured has no duty to settle within the amount of a self-insured retention limit unless there is an express provision in the policy directing it to do so. Courts reason that policyholders are not to be treated as primary insurers, and have no duty "to put the excess carrier's financial interests on at least an equal footing with [their] own."[79] Further, "[p]olicyholders pay premiums to excess carriers in order to have protection against the risks of litigation (which risks include that of guessing wrong in settlement negotiations); primary carriers do not, and therefore must be careful as to how they balance their own interests with the competing interests of the excess carriers in any given claim instance."[80]

<u>SECTION III</u>
THE INSURED

If the insurer denies coverage and refuses to defend an insured, courts around the country uniformly conclude that the insured can enter into a stipulated judgment that is enforceable against the insurer. A different situation occurs when the insurer is defending under a reservation of rights. The insured has not breached its duty to defend when it provides a defense under a reservation of rights. Therefore the "cooperation" clause and the "no action" clause of the policy are still enforceable. However, the insured is left in a precarious position because they face the possibility of a jury verdict that may not be covered and/or a verdict in excess of their policy limits.[81] Courts have various ways of addressing whether an insured can enter a stipulated judgment that will bind an insurer which is defending under a reservation of rights.

Many jurisdictions do not allow an insured to settle a case without the consent of an insurer unless the insurer first breaches the duty to settle. These jurisdictions require the insured to first demonstrate that the insurer acted in bad faith in refusing to settle before an insurer can be required to pay the settlement.[82] For example, Colorado allows pretrial stipulated judgments if they are the insured's "only viable recourse against an insurer that has acted in bad faith."[83]

Other jurisdictions allow an insured to bind the insurer to a settlement (providing the settlement is fair, reasonable, and non-collusive) if the insurer first "rejects a fair and reasonable

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79 *Royal Surplus Lines Ins. Co. v. Coachmen Indus., Inc.*, No. 3:01CV301J-HTS, 2002 WL 32894915, at *10–11 (M.D. Fla. Sept. 17, 2002); *see also Commercial Union Assurance Co. v. Safeway Stores Inc.*, 610 P.2d 1038 (Cal. 1980); *Int'l Ins. Co. v. Dresser Indus., Inc.*, 841 S.W.2d 437, 444 (Tex. App. 1992), *writ denied* (Jan. 20, 1993).

80 *Employers Mut. Cas. Co. v. Key Pharm., Inc.*, 871 F. Supp. 657, 665 (S.D.N.Y. 1994), *amended*, 886 F. Supp. 360 (S.D.N.Y. 1995), and *aff'd sub nom. Employers Mut. Cas. Co. v. Key Pharm.*, 75 F.3d 815 (2d Cir. 1996).

81 *United Servs. Auto. Ass'n v. Morris*, 741 P.2d 246, 251 (Ariz. 1987).

82 *Vincent Soybean & Grain Co., Inc. v. Lloyd's Underwriters of London*, 246 F.3d 1129 (8th Cir. 2001) (applying Arkansas law); *Nunn v. Mid-Century Ins. Co.*, 244 P.3d 116, 120 (Colo. 2010); *Besel v. Viking Ins. Co. of Wisconsin*, 49 P.3d 887, 892 (Wash. 2002); *Pruyn v. Agric. Ins. Co.*, 42 Cal. Rptr. 2d 295 (Cal. Ct. App. 1995).

83 *Nunn*, 244 P.3d at 120.

settlement demand that a reasonable and prudent insurer would pay."[84] If coverage is later found to apply, the insurer will be liable for the insured's settlement up to policy limits.[85] Under this line of cases, the insured does not have to establish the insured acted in bad faith in refusing a settlement offer, "the insured need only demonstrate that the insurer breached its duty by failing to consent to a settlement that is fair, reasonable, and non-collusive."[86] The bad-faith standard does not apply where the settlement is within the policy limits, thus making the "issue is one of *contractual* liability as opposed to *extra-contractual* liability."[87]

Still other jurisdictions, such as Florida, hold that an insurer who offers to defend under a reservation of rights retains control over the litigation. If the insured does not want to accept a defense under a reservation of rights, it is free to select its own counsel, control the litigation, and enter into a reasonable settlement that it seeks to have enforced against the insurer. But if the insured accepts the defense under a reservation of rights, the insured cannot settle a case without the insurer's consent. The insured may still bring has a bad faith claim against the insurer if the insurer fails to settle in good faith and exposes the insured to liability in excess of the policy limits.[88]

Finally, some jurisdictions allow an insured to stipulate to a judgment being entered against them to be collected only against the insurer.[89] Often, as a prerequisite to entering into such a stipulated judgment, the insurer must first be given notice of the proposed stipulated judgment and an opportunity to withdraw its reservation of rights to avoid the judgment being entered.[90] If the insurer does not withdraw its reservation of rights, and coverage is found to exist, an insurer may then be liable for the judgment amount so long as it is found to be fair reasonable, and non-collusive.[91]

<u>SECTION IV</u>
HAMMER CLAUSES

There is yet another scenario that often arises in the context of settlements covered under liability policies, although usually in management or professional liability policies and not typically in CGLs. This scenario is in place when the insurance policy gives the insured the right

[84] *Kelly v. Iowa Mut. Ins. Co.*, 620 N.W.2d 637 (Iowa 2000).
[85] *Id.* at 644-45 n. 6.
[86] *Babcock & Wilcox Co. v. Am. Nuclear Insurers*, 635 Pa. 1, 29, 131 A.3d 445, 462 (2015).
[87] *Kelly*, 620 N.W.2d at 645 (emphasis added).
[88] *Cont'l Cas. Co. v. City of Jacksonville*, 550 F. Supp. 2d 1312, 1343-44 (M.D. Fla. 2007), *aff'd*, 283 F. App'x 686 (11th Cir. 2008); *see also Mercado v. Allstate Ins. Co.*, 340 F.3d 824 (9th Cir. 2003) (applying California law and holding an insured cannot settle without the consent of the insurer).
[89] *Morris*, 741 P.2d at 46; *Miller v. Shugart*, 316 N.W.2d 729 (Minn. 1982); *Patrons Oxford Ins. Co. v. Harris*, 905 A.2d 819, 828 (Me. 2006); *Ins. Co. of N. Am. v. Spangler*, 881 F. Supp. 539 (D. Wyo. 1995).
[90] *See e.g., Miller*, 316 N.W.2d 729.
[91] *Id.*

to object to a settlement but also then contains what is known as a "hammer clause."[92] Hammer clauses are negotiated terms in the insurance contract that are intended to provide ground rules when an insurer and an insured do not agree on whether to settle or go to trial.

Hammer clauses can take a couple forms but generally provide that if the insured withholds its consent to a settlement the insurer deems expedient, the insurer's liability will not exceed the amount for which the insurer could have settled. In these clauses, the insurer is also typically given the right to withdraw from further defense of the suit and may tender control back to the insured.[93] Given the harsh practical effects of these clauses, an uninformed insured might not expect them to be used or even be aware they are present in their policy.

There are not many cases that address hammer clauses but those that do apply the general rules of interpretation applied to insurance contracts.[94] And to the extent the provisions are clear and unambiguous, courts have enforced them.

Because they are enforceable, policyholders may want to have the "hammer" clause deleted, but should also recognize many carriers are not inclined to give up their hammer. As a middle-ground some insurers will agree to modify the language to apply only when the insured "unreasonably" withholds consent. Courts have applied the reasonableness test so it is an option with legal precedent.[95] Another option sometimes available to insureds to soften the blow is to insert a co-insurance provision which requires the insured to only be responsible for a percentage of the loss above the amount the insurer could have settled for. In any case, insureds and insurers should understand that what is agreed to at placement of the policy, if it is unambiguous, is what will control should the two not agree on a settlement in a claims situation.

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92 *See Transit Casualty Co. v. Spink Corp.*, 156 Cal. Rptr. 360 (Cal. App. 1979); *Commercial Union Assurance Cos.*, 610 P.2d 1038 (Cal. 1980); and *Security Insurance Co. of Hartford v. Schipporeit*, 69 F.3d 1377 (7th Cir. 1995).

93 *See e.g., Clauson v. New England Ins. Co.,* 254 F.3d 331 (1st Cir. 2001).

94 *See id.*; *see also Freedman v. United National Ins. Co.*, 2011 WL 781919 (C.D. Cal. 2011).

95 *See id.*