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Navigating Calif. Insurance Defense Settlements

Law360, New York (July 1, 2015, 10:57 AM ET) --

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During the 2012/2013 fiscal year, the vast majority of civil cases before California's Superior Courts — 88.97 percent — were disposed of before trial.[1] That year, the National Center for State Courts estimated the median cost for litigation from initiation through post-trial disposition to range from $43,000 for a "typical" automobile tort case to $122,000 for a "typical" malpractice suit.[2] Costs drive litigation outcomes, even for litigants whose defense and/or indemnity is covered by insurance.

But the prospect of settlement can be a delicate endeavor for insureds, particularly when their interests diverge from those of the insurer. The omnipresent priority of the insurance carrier is to minimize cost exposure. The priorities of the insured, however, can vary and are not always exclusively limited to exposure. The insured may prioritize vindication, the prosecution of cross-claims and/or other forms of nonmonetary resolution over the bottom-line cost of defense.

Insurance struggles in the settlement context more typically arise when an insurer refuses to agree to the proposed settlement. But insurance disputes can also arise where an insurer seeks to settle over the insured's objection. In these instances, settlement becomes a question of obligations and priorities. This article explores some of the parties' respective obligations and factors to consider when disputes arise between insureds and insurers during the settlement process.

Legal Obligations for the Parties to Consider in Settlement Discussions

Insurers' Legal Obligations

Most policies (though not all) give the insurer the right to control the defense and settle the action. This right is not unfettered and insurers must be mindful of the duty of good faith and fair dealing when considering whether to accept a settlement proposal. "There is an implied covenant of good faith and fair dealing in every contact that neither party will do anything which will injure the right of the other to receive the benefits of the agreement."[3] This implied covenant "requires the insurer to settle in an appropriate case although the express terms of the policy do not impose such a duty."[4] Failure to comply with this implied covenant may expose the insurer to liability beyond policy limits where

judgment is subsequently rendered against the insured in excess of policy limits.[5]

What factors, therefore, should an insurer consider when determining whether to accept a settlement and comply with the implied covenant of good faith and fair dealing?

- *Reasonableness.* Courts have explained that settlement demands are reasonable where the insurer knew or should have known at the time the settlement demand was made that the potential judgment would likely exceed the settlement demand if rejected.[6] Reasonableness must also be evaluated without regard to coverage defenses.[7] If the insurer maintains that not all claims are covered, it should reserve its right to seek reimbursement on noncovered claims and proceed with the defense.[8] Moreover, insurers should bear in mind that they have an affirmative duty to investigate claims with reasonable diligence and are "charged with constructive notice of facts that it might have learned if it had pursued the requisite investigation."[9]

- *Financial Interests.* The insurer must give the insured's financial interest at least as much consideration as its own interests, though insurers need not consider punitive exposure.[10] Courts have further explained that "[i]n deciding whether or not to compromise the claim, the insurer must conduct itself as though it were liable for the entire amount of the judgment."[11]

- *The Insured's Reasonable Expectations.* Insurers must also consider the reasonable expectations of the insured who purchased coverage. It is common knowledge that settlement is "one of the usual methods by which an insured receives protection under a liability policy," and it is reasonable for an insured who purchases a policy "to believe that a sum of money equal to the limits is available and will be used to avoid liability on his part with regard to any covered" incident.[12]

- *The Terms of the Offer.* While the terms of a settlement offer must be clear, an insurer has a duty to seek clarification of the terms and eliminate uncertainty if possible.[13] Additionally, an insurer may not accept a settlement offer on behalf of one claimant where doing so would leave the insured exposed to additional damages from another claimant.[14] Further, an insurer must give equal consideration to an additional insured as it would to the insured.

If, after taking these factors into consideration, an insurer rejects settlement, it does so at its peril. Even a position that is not entirely groundless will not shield an insurer from liability if it is found to be wrongful.[15]

The Insured's Legal Rights and Obligations

Whereas the insurer's obligations in the settlement context are grounded in tort and contract law, the insured's rights and obligations arise exclusively from contract principles based on the terms of the policy itself.[16] Most policies include the following provisions:

- *Duty to Cooperate.* Liability insurance policies typically require the insured to cooperate in the defense of the matter and to act in good faith.[17] Among other things, the insured must attend settlement conferences, timely provide claims information to the insurer and

sign settlement papers. An insured's failure to cooperate may excuse the insurer's performance if it is substantially prejudiced.

- *Settling Without Permission.* Insureds are generally prohibited from settling claims without involving the insurer. If the insurer has agreed to provide a defense, an insured who settles without the insurer's participation runs the likely risk of forfeiting reimbursement of the settlement.[18]

- *Settlement Approval.* Most policies provide the insurer with the right to settle claims in its discretion, though there are some policies (particularly professional errors and omissions) that require the insurer to first obtain the insured's consent to settle.[19] Settlement over the insured's consent may also be prohibited by statute in specific instances (for instance, under professional liability policies for dentists, veterinarians and licensed marriage and family therapists, among others).[20] Further, some policies, such as errors and omission policies, include a "Hammer Clause" which limits the insurer's liability to the amount of the settlement offer if the insured's consent is required and the insured refuses.[21]

Factors and Obligations to Consider Where the Insured Objects to the Settlement

Knowing each side's rights and obligations, what strategies should be employed where an insured seeks to prevent the insurer from accepting a settlement offer?

Know Your Policy and Rights

Not all policies give insurers primary control of settlement. Some policies, such as professional liability policies, provide the insured with the right to approve settlements.[22] If you are a insured and disagree with your insurer's decision to accept the settlement offer, do not assume that you are without recourse. Review the terms of your policy because you may have more control and rights over the decision to settle than you originally thought,and do not be afraid to assert these rights.

Also remember that your insurer may not obligate you to settle beyond policy limits. Such an act could constitute a breach of the implied covenant of good faith and fair dealing.[23] Know the limits of your policy and make sure your carrier is not entering into an agreement that will expose you beyond those limits. You have the right to object to such a settlement and may recover against the insurer if it accepts the settlement over your objection.

Further, an insurer may not enter into a settlement where doing so would extinguish its insured's affirmative claim(s) in a separate action.[24] An insurer has "a duty not to knowingly use its discretionary power under the policy to effect a settlement in a manner injurious of [the policyholder's] rights."[25] Doing so would violate the covenant of good faith and fair dealing by elevating the insurer's priorities over those of its insured.

Consider the Option of Assuming Your Own Defense and Filing a Bad Faith Action

If an insurer insists on accepting a settlement over an insured's objection, consider whether it is worth offering or accepting an offer to assume your own defense and the corresponding rights and obligations. This question should arise when an insurer agrees to settle for an amount that exposes the insured to monetary damages beyond the policy limits. Depending on the extent of the exposure, the insured may consider assuming its own defense or simply lodging its objections and immediately suing for bad faith if

appropriate.

The question of whether to assume your own defense and/or sue for bad faith may also arise where the insurer is agreeing to a settlement that waives an insured's rights, requires an insured to admit to liability that the insured disputes or obligates an insured to undertake an action that the insured objects to. Under these circumstances, an insured may want to seriously consider assuming its own rights to prevent irreparable harm and sue for bad faith.

Also remember that an insurer must offer the insured the opportunity to assume its own defense where the insurer intends to settle one or more claims that it asserts are not covered and later plans to seek reimbursement. If the insurer does not make this offer or the insured accepts the offer to assume its own defense but the insurer proceeds with the settlement regardless, the insurer waives its right to obtain reimbursement for indemnity paid even if it is ultimately determined that the claims are not covered.[26]

Finally, if an insured offers or agrees to assume its own defense under such circumstances, remember to do so under a reservation of rights that you are not waiving any rights under the policy.

Better understanding the insurer and insured's respective rights and obligations under various policies can help the parties position themselves to better achieve their objectives in the settlement context.

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[1] Judicial Council of California, 2014 Court Statistics Report at p. xv; see also Comunale v. Traders & General Insurance Co. (1958) 50 Cal.2d 654, 659 ("a large percentage of the claims covered by insurance are settled without litigation and this is one of the usual methods by which the insured receives protection.")

[2] Paula Hannaford-Agor & Nicole L. Waters, Estimating the Cost of Civil Litigation, National Center for State Courts, Court Statistics Project, Caseload Highlights, Vol 20, No. 1, Jan. 2013, at 7.

[3] Comunale, at p. 658; see also California Cas. Gen. Ins. Co. v. Sup. Ct. (1985) 173 Cal.App.3d 274, 283.

[4] Comunale, at p. 659.

[5] Johansen v. California State Automotive Association. Inter-Insurance Bureau (1975) 15 Cal.3d 9, 12; Comunale, at p. 659.

[6] 1-2300 CACI 2334; Comunale, at p. 659; Johansen, at p. 16; Isaacson v. California Insurance Guarantee Association. (1988) 44 Cal.3d 775, 793.

[7] Rappaport-Scott v. Interinsurance Exchange of the Automotive Club (2007) 146 Cal.App.4th 831, 836; Samson v. Transamerica Insurance Co. (1981) 30 Cal.3d 220, 243.

[8] Blue Ridge Insurance Co. v. Jacobsen (2001) 25 Cal.4th 489, 502; Buss v. Sup. Ct. (1997) 16 Cal.4th 35.

[9] KPFF Inc. v. California Union Insurance Co. (1997) 56 Cal.App.4th 963, 973.

[10] Comunale, at p. 659; Merritt v. Reserve Insurance Co. (1973) 34 Cal.App.3d 858, 874.

[11] Crisci v. Security Insurance Co. (1967) 66 Cal.2d 425, 429.

[12] Crisci, at p. 431.

[13] See e.g., Betts v. Allstate Insurance Co. (1984) 154 Cal.App.3d 688; Coe v. State Farm Mutual Automotive Insurance Co. (1977) 66 Cal.App.3d 981, 991-992.

[14] Coe, at p. 993-994.

[15] Johansen, at p. 15-16.

[16] Kransco v. American Empire Surplus Lines Insurance Co. (2000) 23 Cal. 4th 390, 402.

[17] Kransco, at p. 402-404.

[18] Hamilton v. Maryland Casualty Co. (2002) 27 Cal. 4th 718, 730.

[19] Robertson v. Chen (1996) 44 Cal.App.4th 1290, 1294.

[20] Bus. & Prof. Code, § 801; Health & Saf. Code § 1306.

[21] See e.g., Transit Casualty Co. v. Spink Corp. (1979) 94 Cal.App.3d 124, 129 (disapproved on other grounds in Commercial Union Assurance Cos. v. Safeway Stores Inc. (1980) 26 Cal.3d 912).

[22] Robertson v. Chen (1996) 44 Cal.App.4th 1290 at 1295, n.3.

[23] Coe, at p. 989.

[24] Barney v. Aetna Casualty & Surety Co. (1986) 185 Cal.App.3d 966, 978.

[25] Barney, at p. 978.

[26] Blue Ridge Insurance Co., at p. 489.