Settling the Contested Coverage Case: Is Insurer Consent Necessary?

By

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CHAPTER 4 Settling Without Insurer’s Consent

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Before considering circumstances that may justify depriving the insurer of control over settlement, one must consider all policy provisions relevant to the settlement question and must understand how and why these provisions operate in the usual situation where no question arises as to the existence and adequacy of coverage. Only then can one properly analyze how various insurer breaches or coverage disputes may affect the right of control.

Standard liability policies specify the types of liability insured against and provide that the insurer has the right and duty to defend against suits asserting such liabilities. The insured is prohibited from settling except at the insured’s own expense. Once the claim is resolved by a litigated judgment or a settlement agreed to by the insurer, the claimant has the right to payment of any covered claim, subject to the policy limit. (See § 3.02 above.)

In considering the effect of these provisions, we begin by assuming that no coverage question exists for the claim against the insured, that the claim clearly lies within policy limits, that the insurer is providing (or offering) an adequate defense, and that the insurer is not breaching any duties to the insured related to settlement of the case.

An insured usually cannot recover under his contract if he violates the terms of his policy by failing to preserve an opportunity for his insurer to defend or to compromise a claim. ¹ This result is appropriate because such policy provisions “give the insurer the opportunity to contest

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Missouri:

New York:

See, e.g.:

Mississippi:
Jones v. Southern Mar. & Aviation Underwriters, Inc., 888 F.2d 358, 361-62 (5th Cir. 1989);

Texas:
liability, to participate in settlement negotiations and to have input as to the value of the claim.”2 The restrictions also protect the insurer against collusion between an insured and a claimant.3

“It is pretty evident that if the insurer entrusted the matter of making settlements to its numerous policy holders, its existence would be precarious. We are all apt to be generous when it comes to spending the money of others. So long as the law countenances and to some extent encourages insurance of this character, the right of making voluntary settlements must, almost as a matter of necessity, rest with the insurer rather than with the insured. An insurance company could hardly be expected to do business on any other basis, because it furnishes the only safeguard available against the payment of excessive damages.”4

Apart from unconcern for the insurer’s pocketbook, there are other reasons insurers fear allowing insureds to settle. First, because insurance companies are in the business of handling liability claims, they may be better qualified than insureds to evaluate and to settle claims. Second, insureds may be motivated to overpay by considerations extrinsic to the legal obligation insured against: contrition for their involvement in the injury, desire to compensate an injured friend or relative, or the hope of promoting some other relationship with the claimant.

An example of the latter problem arose in Coil Anodizers, Inc. v. Wolverine Insurance Co.5 There the insured, Coil Anodizers, was in the business of anodizing aluminum, a method of treating sheet metal to apply a finish. Its customer, Prime Metals, sold the treated metal to Avion Coach Corporation for incorporation into trailers and motor coaches. Due to a defect in a chemical used in the treatment process, some Avion vehicles yellowed upon exposure to sunlight. Avion demanded replacement metal and Prime notified the insured that Prime would hold it responsible. When notified of the claim, the insurer, Wolverine, denied any duty to indemnify and, no suit having been filed, had no occasion to consider defending. Coil Anodizers then settled with Prime and sought reimbursement from the insurer. The court held Wolverine not liable.

2 Michigan:

3 E.g.:

Michigan:

Maryland:
American Auto. Ins. Co. v. Fidelity & Cas. Co., 152 A. 523, 527 (Md. 1930);

New Jersey:


Because the duty of defense had not yet arisen, the court found no breach by Wolverine that excused Coil Anodizers obligation to adhere to the settlement restrictions. Finding that violation of those restraints precluded any obligation of the insurer to pay, the court reasoned:

[D]efendant has bargained for the contractual right to contest the liability of its insured instead of having its money given away by an agreement to which it was not a party . . . . In this case, plaintiff’s interest in retaining the goodwill of its customers may have led it to settle, believing the claim to be insured, for a larger amount than defendant may have been able to obtain had defendant conducted the negotiations.

The insurance policy agreed to indemnify against certain liabilities. While the parties disputed whether this was one of those liabilities, no question existed that the insurer did not agree to indemnify for loss of goodwill resulting from either liability causing events or from normal delays in adjusting claims for such liabilities. Preservation of insurer control was essential to preserve contractual limits on the insured risk. (But it has been held that the insured might have a claim for loss of goodwill resulting from improper delays in adjustment.)

The same conclusion was reached in Charter Oak Fire Insurance Co. v. Color Converting Industries Co., Color Converting Industries, the insured had settled for $200,000 a product liability claim by its customer, American National Can Company. Travelers Insurance

8 See:

District of Columbia:

9 Similar problems were presented in:

California:

Michigan:

Texas:

California:
In Finkelstein v. 20th Century Ins. Co., 11 Cal. App. 4th 926 (1992), the insured’s decision to supplement the insurer’s settlement offer was based in part on remorse.
Company (and/or its affiliate Charter Oak) had declined to approve the settlement without cost information American declined to provide (on the ground that it was proprietary). American demanded that the claim be settled or it would stop doing business with Color Converting, which paid the settlement and sued Travelers. In an opinion by Chief Judge Posner, the Seventh Circuit held that the voluntary payments clause barred any duty to pay. While there is a duty to protect the insured from the risk of excess judgments, that risk was not implicated here.11 “The only risk Travelers was creating was the risk that Color Converting might lose a customer. That is not a risk which Travelers agreed to insure.”12 And there was good reason not to construe the insurance to cover such a risk:

Such insurance would be foolhardy to write, at least without an enormous premium. Products liability is (with the rare exception of a product the injures a bystander) liability for harm to a customer. Sellers of products do not want to harm their customers. If they do so by accident, as happened here, they are eager to make amends, especially if they can do so at no cost to themselves, or at least at no cost greater than the possible increase in insurance premiums that impends whenever an insurer has to pay a claim. They do not want to anger valued customers—and American Can appears to have been Color Converting’s most valued customer—by questioning the accuracy or honesty of the claim, or by trying to shift fault to the customer, or by failing to pay the claim promptly. If the insurance company has an implied duty to cooperate with its insured to the extent necessary to avoid offending powerful customers, the opening for collusive and exaggerated claims of products liability will be immense.13

For all the reasons stated in this section, insurance policy settlement restrictions should be enforced strictly, absent clear grounds for excusing compliance:

[T]he assured has no just cause for complaint if he be held to the substantial performance of duties thus freely undertaken. They are of the very essence of the contract … . Without these protective provisions, the insurer would be at the mercy of dishonest and culpably indifferent policy holders, for thereby it would run the risk of impoverishment to the detriment of honest claimants. Neither the public nor private interest is served by laxity in this regard.14

Other courts generally agree that no showing of prejudice is necessary or hold that

11 45 F.3d at 1173.
12 45 F.3d at 1173.
13 45 F.3d at 1173-74. (emphasis original).
14

New Jersey:
Kindervater, 120 N.J.L. at 376–80 (no showing of prejudice required to avoid coverage for insured’s settlement).
prejudice is inherent in a violation.15 (But see § 4.05[2] below.)

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§ 4.05 Effect of a Coverage Question

[1] Relation Between Control of Defense and Control of Settlements

There is nothing new or controversial in the notion that breach of the insurer’s policy duties may result in loss of its right to control all settlements it will be expected to bear. (See §§ 4.03–4.04 above,) However, some courts have proposed a relatively new and highly controversial idea. These courts assert that even the existence of a coverage question (unaccompanied by any breach) sometimes allows an insured to settle without the insurer’s consent.1

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Missouri:

Massachusetts:

Minnesota:
Buysse v. Baumann-Furrie Co., 448 N.W.2d 865, 874 (Minn. 1989) (prejudice inherent);

Contra:

New Jersey:

Texas:
Ideal Mut. Ins. Co. v. Myers, 789 F.2d 1196, 1201–02 (5th Cir. 1986) (Texas law);

Solvents Recovery is of doubtful validity, because it is at odds with both Kindervater (a supreme court case) and New Jersey’s recognition that loss of control, as to conduct of the defense, is inherently prejudicial. Merchants Indem. Corp. v. Eggleston, 179 A.2d 505, 511 (N.J. 1962). See William T. Barker, Defense Without Reserving Rights: When May Insurer Deny Coverage?, 56 DEF. COUN. J. 58, 62–63 (1989).

1 E.g.:

Virgin Islands:
Cay Divers, Inc. v. Raven, 812 F.2d 866, 869–71 (3d Cir. 1987);

Arizona:
United Servs. Auto. Ass’n v. Morris, 154 Ariz. 113, 116–17 (Sup. Ct. 1987);

Kansas:
Many of these cases start from certain propositions about control of the defense (as opposed to control of settlement). As we have already noted, an insurer must defend if any claims asserted would fall within its duty of indemnification if established. (See §§ 3.02[1]–[2] above.) Perforce, this means that insurers must often defend cases in which some or most asserted liabilities would not fall within the duty to indemnify.

So that the insured will not be misled into unknowingly relinquishing control of the defense of non-covered claims, an insurer wishing to limit its obligation to indemnify some or all of the claims it is defending must give the insured notice (known as a “reservation of rights”) which specifies claims it views as clearly or potentially outside the policy’s coverage. (See § 3.03[1] above.) If the insurer fails to reserve rights in a timely manner, it may be estopped to deny indemnification for non-covered claims. (See § 3.03[1] above.) If the insurer reserves its rights to deny indemnification, it is sometimes required to relinquish control of the defense (i.e. the right to direct counsel and to make strategic and tactical decisions about conduct of the litigation) to the insured. (See § 3.05[2] above.) All jurisdictions require the insurer to do this when the coverage issues overlap with issues in the underlying action such that the insurer could litigate the underlying case in a manner which benefits its coverage defense. (See § 3.05[2][a]) Some jurisdictions even say that an insurer must relinquish control of the defense whenever it reserves rights. (See § 3.05[2][b] above.)

A number of the cases simply assume or assert that transferring the right to control litigation to the insured necessarily entails transfer of the right to settle at the insurer’s expense.2

Minnesota:
Miller v. Shugart, 316 N.W.2d 729, 733–35 (Minn. 1982);

Washington:

Wyoming:

Cases of freeing the insured to settle are said by some to be an “emerging trend.” Bernard A. Kahn & Ronald H. Nemciss, Unauthorized Settlement Agreements in a Reservation of Rights Context, 34 TORT & INS. L.J. 799, 800 (1999).

But see:

Texas:
Motiva Enterprises, LLC v. St. Paul Fire & Marine Insurance Co, 445 F.3d 381, 385–86 (5th Cir. 2006) (enforcing settlement restrictions despite coverage question and suggesting that prior Texas authority to the contrary has been overruled).

2

Texas:

Florida:
This assumption is clearly wrong, and the reasons for transferring control of the defense do not apply to control of settlement. The basis for shifting the right to select counsel and/or to control the defense derives from the significance of those rights to the conduct of the underlying litigation. The New Jersey Supreme Court explained that loss of these rights is a basis for finding prejudice sufficient to support an estoppel:

Control of the defense is vitally connected with the obligation to pay the judgment. Carriers contract for control ... success, absolute or relative, may depend on skill in investigation, in negotiations for settlement, and in conduct of the lawsuit. Just as a carrier would hardly agree to pay a judgment after defense by the insured, so it cannot expect the insured to pay for a judgment when it controlled the litigation. A carrier may be more confident of its handling of claims, but an insured may, with equal conviction prefer the individualized attention of his own counsel as against the services furnished by an insurer in the mass handling of litigation. Personal counsel may seize opportunities to settle which might be ignored or overlooked by a carrier to which the case is just one of a great number. Moreover, whatever his estimate of lawyers in general, a man usually has faith in “my lawyer.” This intangible is a valuable right.

Nor does a claim of prejudice resulting from losing control of the defense require the insured to show that the insurer mishandled the defense with some demonstrable prejudice to the insured in terms of the ultimate prospects in the litigation. Rather, [prejudice] turns on the insured’s relinquishment of the right to control its own defense. This appears to recognize that innumerable strategic and tactical decisions shape the defense of a lawsuit. In many cases, these decisions involve no clear right or wrong answers but only choices among various mixes of advantages or disadvantages, dependent on unknowable future developments. The right to control these choices is itself a valuable right. If the insurer’s

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Illinois:

But see:

Missouri:

decisions made during its exercise of control are significant and irreversible, in the sense that they materially limit the insured’s options in future conduct of the litigation, then prejudice may be found.4

Ultimately, control of the defense is indivisible. The parties may consult, but someone must resolve disputes between them. Yet the manner in which the defense is conducted necessarily affects the interests of both. As already noted, all jurisdictions deprive the insurer of contractual control of the defense where control could be misused to disadvantage an insured in its coverage dispute with the insurer, rather than being exercised solely for the mutual benefit of both parties. Some jurisdictions find it unfair for the insured to lose the right to shape the defense if any possibility exists that the insurer will not be obliged to indemnify. In either event, the justification depends entirely upon the unique and indivisible nature of the right to control the defense.

The right to control settlement decisions does not share these unique characteristics. To begin with, it does not involve complex decisions selecting among multiple, perhaps equally reasonable, unique and different approaches. The decision to pay or not pay a given amount of money in settlement is a yes/no decision and it is either reasonable or not.

The right to control settlement moreover, is divisible, in a way which respects the nature of an insurance policy. A number of such risks are accepted, some of which inevitably involve losses. However, such losses are spread over all the risks assumed so as to enable the insurer to accept each risk at a slight fraction of its possible liability. The insurance policy defines the risks transferred from the insured to the insurer in return for payment by the insured of a specified premium.5

Risks outside the coverage of the policy remain with the insured, as do the portions of covered risks that exceed policy limits. Thus, any suit partially within coverage and partially without involves risks to each party. But unlike conduct of the defense, where the fates of insurer and insured are inextricably intertwined, each party can act independently to settle its own portion of the risk. The policy does not forbid the insured to settle, but only requires that any settlement be made at the insured’s own expense. Insofar as the risk being settled is one which remained with the insured, the insured is the appropriate one to pay for its elimination.

To be sure, this analysis does not apply fully to claims within coverage but involving excess exposure. This is because the insurer is required to pay the full settlement value (up to the policy limits) even though part of the settlement value is attributable to the excess exposure. (See § 2.03[1] above.) But that problem has been adequately addressed by requiring the insurer to exercise its power to settle in good faith or to be held liable for any excess judgment. (See § 2.03[2] above.)

The insured’s ability to settle non-covered exposure may vary, as a practical matter,

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according to the nature of the coverage question. Sometimes it relates to the nature of the liability asserted: e.g. (1) fraud (not covered) vs. negligence (covered) or (2) damage to the insured's own work product (not covered) as opposed to the work of others incorporated into a larger whole (covered). In such cases, plaintiffs can value the different parts of the claim and settle them separately. This is also largely true where the coverage issue (e.g., permissive use of a vehicle) is factually intertwined with the underlying claim, even if theoretically independent. Plaintiff may be less able to value (and therefore to settle separately) issues totally unrelated to the underlying claim (such as validity of a cancellation or a claim for rescission based on alleged application misrepresentations). This practical problem arises from insuring some risks and not others, and does not alter the fact that uninsured risks remain with the insured, so it is the insured which should pay to eliminate them.

There are cases that appear to suggest that the insured is not free to settle excess or noncovered exposure without the insurer's consent. Thus, in *Merritt v. Reserve Insurance Co.*, 2 it was said that

Nor can the liability of the assured be divided into separate segments, about which the carrier and the assured may make their separate evaluations and go their separate ways. Patently, the carrier cannot settle its share of the assured's liability and turn the assured adrift, exposed to a suit for excess liability financed by the carrier's settlement. Nor can the assured settle the claim for excess liability and abandon the carrier to defend a suit financed by the assured's settlement. For better or worse, like a married couple, assured and carrier must make the best of each other. 3

It is certainly true that an insured who has settled a claim for excess liability cannot "abandon the carrier to defend [the] suit." The insured must continue to cooperate in the defense. But nothing in standard insurance policy language (or in any implied duty) restricts the freedom of the insured to purchase a covenant not to execute, even if the effect is to finance the plaintiff's suit for the amount covered by the policy.

In any event, no reason exists why the right to control settlement must be in the same hands as the right to control the defense. There are policies (directors and officers insurance, for example) which indemnify against liability and defense costs yet leave control of the defense with the insured. Some such policies nevertheless reserve to the insurer control of settlements for which it will be liable (though sometimes qualifying the consent requirement by promising not to unreasonably withhold consent). Just as the settlement restrictions in these policies are (and should be) enforced, 6 so should the settlement restrictions in policies when the insured has been granted the ability to control the defense by operation of law rather than by policy language.

Allowing insureds to settle claims whenever there is a coverage issue is not in the collective interest of the insurance-buying public. If the insured is allowed to settle the entire

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3 34Cal. App. 3d at 871.
6 A case enforcing the settlement restrictions in such a context is *Central Bank v. St. Paul Fire & Marine Ins. Co.*, 929 F.2d 431 (8th Cir. 1991) (Missouri law).
claim whenever the insurer has reserved its rights, the insurer will be deprived of the ability to bargain for lower settlements by forcing cases to trial if the claimants will not settle. For every claim, there is an expected verdict value (though the parties may disagree on what that is), and around that value, there is a range of reasonableness (reflecting both the uncertainty of any expectation and disagreements about what should be expected). One would expect that the alternative of having to try the case to result in bargained settlements generally near the middle of the range of reasonableness.

But if the insured is allowed to settle, the settlement amounts will be higher. Putting aside fraud and collusion, the insured has no incentive at all to minimize any payment assigned to the insurer and every incentive to agree to any amount that will resolve the case without payment (or with a minimum payment) by the insured. So, the insured can be expected to agree to almost anything the plaintiff proposes that the insurer should be required to pay.

The only incentive that the plaintiff has to limit that amount is the fear that the court may find the agreement unreasonable. Trial courts tend to be favorably disposed toward settlements that have removed cases from their trial dockets and to compensation of injured parties at the expense of insurance companies, so they generally tend to see a broad range of settlements as reasonable. A plaintiff can be expected to select a figure that is near the upper end of the range of reasonableness, perhaps with some margin of safety to guard against disapproval of the settlement. Moreover, that figure will be set in light of the plaintiff’s knowledge of the judge’s views of reasonableness. The result will be to deprive insurers of the ability to bargain for a settlement based on what they see as an expected verdict value by forcing the case to trial if the plaintiff will not agree to such a settlement. What will be substituted will be settlements at the upper end of a possibly elastic range of reasonableness. (Insurers believe that, where the law allows insureds to settle, the amounts permitted considerably exceed expected verdict values.) Consequently, permitting insureds to settle the covered portions of the claims against them would increase insurance costs.

The only benefit from that increase would be to (at least partially) protect the policyholders who are permitted to settle against liability for the uninsured portions of the claims against them. Because a contrary rule would still permit policyholders to settle uninsured exposures at their own expense, the result is simply to transfer some or all of the cost of doing so settling noncovered claims from the policyholders who incur such exposures to their insurers and, thereby, to the risk pool.

It is improper to increase insurance costs merely to protect policyholders against the costs of paying noncovered claims, because the purchasers of insurance have no apparent reason to want to pay for such protection. Insurers make money by assuming risks in return for a premium. An exclusion from coverage (unless compelled by law or designed to segment the market between different types of policy) necessarily reflects a conclusion that there is no market demand to insure that risk sufficient to make offering broader coverage at an appropriate price would produce enough sales to make it worthwhile. Absent some reason to conclude that such a judgment is wrong, the presumption should be that policyholders do not want to buy coverage for that risk at the price that would be required. If policyholders do not want to purchase the coverage at the full price, they presumably do not want to have the price of the coverage they do want to purchase inflated by x% of that price to have some ancillary doctrine, such as a right to settle when the insurer reserves rights, protect them against the excluded risk in the x% of the cases where that ancillary doctrine would have that effect.

If the insurance is actually available but the particular policyholder failed to purchase it,
those who purchased some other type of insurance—and may have purchased insurance for the risk which has now befallen the policyholder—would have no reason to contribute to indemnifying the policyholder from the consequences of the policyholder’s own purchasing decision.

An Indiana federal court has enforced the settlement restrictions to deny coverage for a settlement by independent counsel, though without addressing that point specifically.7

[2] Need for Demonstrable Increased Costs Resulting From Insured’s Settlement

[a] Authorities Supporting Requirement of Prejudice

Settlement restrictions were not enforced in Roberts Oil Co. v. Transamerica Insurance Co. 8 Roberts was an environmental coverage case arising out of an underground gasoline leak at a gas station. The leak was discovered in January, 1985, and Roberts notified the authorities and its then-current CGL insurer, Federated. The insured’s management purportedly had no recollection of its prior carriers and no notice was provided to them until July, 1989, when Federated learned of their identities. In the interim, Roberts and Federated had agreed with the authorities to abate the pollution and had expended over $250,000 to do so and to negotiate the agreement.9 The prior CGL insurers obtained partial summary judgment that they were not liable for obligations voluntarily incurred by Roberts without their consent, without trial, and prior to notifying them. The New Mexico Supreme Court reversed, holding that settlement by the insured bars coverage only if prejudicial to the insurer’s rights and that factual issues regarding prejudice precluded summary judgment.10

The New Mexico Court adopted an unusually strong form of the reasonable expectations doctrine, under which no ancillary conditions to provision of the coverage defined in the policy would be enforceable unless “‘their application in a particular case advances the purpose for

References:
8 New Mexico:

Kansas:
Roberts was essentially followed in Cessna Aircraft Co. v. Hartford Acc. & Indem. Co., 900 F. Supp. 1489, 1517–18 (D. Kan. 1995); and both were followed in

Michigan:
9 After the other insurers were notified and suit filed, there were further negotiations in which they declined to participate, resulting in additional costs for a complete settlement. The total expenses for both defense and indemnity approximated $504,000, and at least $45,000 in post-notice expenses (and, probably, significant post-notice defense costs) were not dealt with in the partial summary judgment. 113 N.M. at 748–50.
which they were included in the policy.’”11 It concluded that this might be inappropriate in dealing with “truly bargained” contractual terms, but felt that enforcement of such terms, absent a need in the particular case “will probably frustrate ‘the consumer’s reasonable expectations that coverage will not be defeated on arbitrary procedural grounds.’”12

As the court viewed the issue, default by the insured in one of its undertakings would not excuse performance by the insurer unless the undertaking in question was “‘a material part of the agreed exchange.’”13 The agreed exchange was said to be the payment of premium in return for the promise of defense or indemnification should certain fortuitous events occur, and the voluntary payments provision was seen as immaterial to that exchange.14 While the policy language expressly conditioning the insurer’s obligations on compliance strengthened the case for enforcement, it could only create a rebuttable presumption of prejudice to the insurer.15

The *Estes* court improperly distinguished *Augat, Inc. v. Liberty Mutual Insurance Co.*16 which had sustained summary judgment for the insurer in an analogous situation, by speculating that the record there must have reflected (unstated) facts showing prejudice beyond dispute. It also reasoned that, under New Mexico evidentiary law, the presumption of prejudice, standing alone, would permit a jury to find for the insurer even if the insured introduced evidence that prejudice was lacking, but that the insurer would have the burden of persuasion.17

In *Lennar Corp. v. Markel American Insurance Co.*,18 the Texas Supreme Court also held that violation of the settlement restrictions did not preclude a right to indemnification absent prejudice. Lennar, a homebuilder, had entered into a remediation program to fix defects in homes constructed with an exterior insulation and finish system (“EIFS”), without awaiting claims by affected homeowners and without notifying its insurers or consulting them about the claims it was resolving. It then sought indemnification for the costs it had incurred. The court reasoned that one party’s breach of contract does not excuse performance by the other unless the breach is material,

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New Mexico:
113 N.M. at 750–52, quoting and following:

Alaska:

Arizona:
12 113 N.M. at 752, quoting *Estes*. That reasoning would support an argument that *Roberts* does not apply to manuscript policies, whose terms are bargained as opposed to adhesive.

13 113 N.M. at 753, quoting RESTATEMENT (SECOND) OF CONTRACTS § 229 (1979), and relying on *Aetna Cas. & Sur. Co. v. Murphy*, 206 Conn. 409 (1988), a late notice case.

14 113 N.M. at 753.

15 113 N.M. at 754.


17 833 P.2d at 232–34.

and that this depended upon “the extent to which the nonbreaching party will be deprived of the benefit that it could have reasonably anticipated from full performance.” It held that there was evidence sufficient for the jury to find that remediation costs would have been increased had Lennar not acted as it did. Lennar also relied on a policy provision (similar to the no-action clause) requiring that the amount of any loss be established by adjudication, arbitration, or a settlement to which the insurer had consented. But the court did not find this any more central to the policy than the voluntary payments provision, so it to required prejudice to bar coverage.

The Texas court did not take account of the fact that Lennar acted as it did, at least in part, to protect its customer goodwill, an interest not covered by the insurance. (See § 4.02, above.) Moreover, the materiality of a contractual condition ought to be judged, not purely by a hindsight estimate of the impact of a particular breach, but at least in part by the importance of the provision in structuring and pricing the bargain between the parties. And settlement restrictions are very important to the structuring and pricing of liability insurance policies.

The court also relied in part on uninsured/underinsured motorist cases, where the issue is whether the insurer’s subrogation rights have been prejudiced. That sort of assessment, looking primarily to whether the tortfeasor had nonexempt assets that subrogation might have reached, is a far more reliable and objective inquiry than a post hoc determination of whether an insurer would have been able to obtain a better result had the insured not settled.

Stresscon Corp. v. Travelers Property & Casualty Co. of America likewise relied on the notice-prejudice rule and uninsured/underinsured motorist cases. It also relied on Roberts.

[b] Authorities Rejecting Requirement That Prejudice Be Shown

The cases requiring prejudice largely do so on the basis of analogies to the requirement of prejudice with respect to late notice and non-cooperation. That analogy is inappropriate. Both produce total forfeiture of coverage while the settlement restrictions merely require the insured to bear obligations it voluntarily assumed, leaving coverage intact for parts of the case whose defense has not been foreclosed. As such, the restrictions are more like exclusions than the supposedly analogous conditions of timely notice and cooperation. Moreover, an important reason for the requirement of prejudice with respect to late notice and non-cooperation is that forfeitures based on those conditions would deprive the claimant of the benefit of the policy, without any fault of the claimant. Because the claimant is an express beneficiary of the duty to

19 413 S.W.3d at 754-55.
20 413 S.W.3d at 755-56.
21 413 S.W.3d at 756.
22 413 S.W.3d at 754-55.
26 This point was apparently overlooked by the court in Public Util. Dist. No. 1 v. International Ins. Co., 124 Wn. 2d 789, 803–06 (1994), which simply treated the late notice rule (addressing a potential forfeiture of all coverage) as an appropriate analogy for breach of the settlement restrictions. The oversight detracts from the persuasiveness of the case.
27 E.g., Harvey v. Johnson, 30 Ill. App. 3d 750, 754–56 (1975) (construing prejudice requirement in light of
indemnify (and given the policy of the law in favor of compensating those wrongfully injured), it is appropriate to protect the rights of the claimant against inconsequential failures on the part of the insured. But the claimant can protect against any loss of rights based on breach of the settlement restrictions by simply refraining from settlements not agreed to by the insurer. It is always possible to simply take the case to trial. A claimant who settles without insurer consent should be held to assume the risk that policy rights will be lost. (The Voluntary Payments Clause also finds application in cases where the insured pays defense costs before tendering the case to the insurer for defense. Most cases in that context, where the claimant’s interests are not implicated, hold that no showing of prejudice is necessary for the Voluntary Payments Clause to bar any obligation of the insurer to pay for defense payments voluntarily made by the insurer.)

For a number of reasons, the value of Roberts as precedent in other jurisdictions is exceedingly limited. Perhaps most fundamentally, the case relies on an extravagant version of the reasonable expectations doctrine rejected in all but a few jurisdictions. (Roberts has been

fact that “a contract of automobile insurance is a contract that protects … the public from hazards of financial distress to which they may become victims as a result of engaging in traffic upon our streets and highways”); ROBERT E. KEETON & ALLAN I. WIDISS, INSURANCE LAW § 7.3(b), at 783 (1988).

28 E.g.:

Texas:

New Jersey:

California:

But see:

Washington:


29 A few jurisdictions have rejected the doctrine and most apply it only as a means of resolving ambiguities or where the provision would eliminate the dominant purpose of the transaction.

See:

Illinois:
followed in jurisdictions that do not accept New Mexico’s version of the reasonable expectations doctrine, but they might reconsider if this inconsistency were pointed out.) Second, it improperly denigrates the significance of the settlement restrictions. As we have seen, those restrictions are, and are widely recognized as being, fundamental to the insurer’s ability to control its exposure, and so to its willingness to insure and its setting of the premium. (See § 4.02 above.)

Even if prejudice is necessary, prejudice is inherent in the breach. The insurer has not simply contracted for the right to limit its liability to reasonable settlements. Instead, it has obtained the right to judge for itself whether to settle or to defend, subject to liability if it exercises that judgment in bad faith. The insurer may believe its settlement evaluations more reliable than after-the-fact review by a court, and deprivation of the right to control all settlements it is to indemnify destroys that interest. Moreover, the requirement of consent enables the insurer to insist upon a trial, at which a judge or jury would determine the actual value of the claim, rather than whether a settlement fell within some nebulous range of reasonableness. This ability can be used to bargain for a more favorable settlement than a plaintiff might be willing to make if not threatened with an actual trial. Thus, the Roberts analysis, like that based on tying control of settlement to control of the defense, is unsound.

Finally, Roberts involves and relies upon characteristics unique to environmental

Idaho: 

See JEFFREY E. THOMAS, THE NEW APPELMAN INSURANCE LAW § 5.05. Jurisdictions taking either of the foregoing views do not require that a generally reasonable and appropriate provision be individually defended as necessary on each specific set of facts to which it is applied. A substantial minority of jurisdictions have not decided whether or how the doctrine may apply.

Kansas: 

Michigan: 

Massachusetts: 
Augat, Inc. v. Liberty Mut. Ins. Co., 571 N.E.2d 357 360 (Mass. 1991);

Minnesota: 
Buysee v. Baumann-Furrie Co., 448 N.W.2d 865, 874 (Minn. 1989);

Missouri: 
Johnston v. Sweeney, 68 S.W.2d 398, 402 (Mo. 2002).

Wisconsin: 
West Bend Co. v. Chiappua Industrs., Inc., 112 F. Supp. 2d 816 (E.D. Wis. 2000), considered whether prejudice is necessary but decided that prejudice was evident where the insured had settled the claim before notifying the insurer. This suggests that prejudice is inherent in the breach, as does the court’s citation to Augat.
coverage cases, which makes it an even weaker precedent in other types of cases. On the undisputed facts, the insured was clearly subject to strict liability from the outset, so the only possible issue was whether the costs of remediation had been minimized. Because Roberts and Fidelity were actually paying those costs, with no assurance of reimbursement, they had every incentive to minimize them and there was not even a hint that they had failed to do so. On that basis, the court felt that there would have been no possibility that the insurer had been prejudiced by the lost opportunity to defend. Finally, there was, and Roberts relied upon, a strong public interest in prompt clean-up, without delay to identify and seek the consent of prior insurers whose identities were purportedly no longer known to the insured.

Even courts willing to take all of the other questionable steps necessary to Roberts should hesitate to apply the resulting rule where these sorts of unique factors are absent, as they are in almost all non-environmental cases and even in many environmental cases.


[a] Miller v. Shugart

In Miller v. Shugart, the insurer, Milbank, defended under a reservation of rights while prosecuting a declaratory judgment action on whether the driver of the insured car had permission

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32 A special rule regarding enforcement of settlement restrictions in environmental coverage cases is advocated in FIELDS & SWANSON, The Voluntary Payment Clause: The Insurers’ New Bogeyman, 5 ENVIR. CL. J. 57 (1992), also applauding Roberts.

Such a rule may have been implicitly adopted in

Minnesota:
SCSC Corp. v. Allied Mut. Ins. Co., 515 N.W.2d 588, 599 (Minn. Ct. App. 1994), which allowed an insured to recover amounts expended, without the insurer’s consent, in environmental clean-ups where no proceedings to compel such action had even been brought. The court relied on the existence of strict liability and the desirability of swift voluntary clean-ups and decreed a rule which would compel insureds to await formal proceedings and resist them. But it ignored the possibility of consulting the insurer before undertaking the expenses, to give it an opportunity to consider the respective costs of settlement and litigation (possibly followed by a clean-up grown more expensive for lack of attention). The insurer has contracted for the right to test any liability which it must indemnify unless it judges settlement to be a less expensive approach.

33 The claimed prejudice was solely to the insurer’s coverage investigation. As such, it was really more in the nature of a late notice claim, as to which consideration of prejudice is customary, rather than one based on violation of the settlement restrictions, where such consideration is highly unusual.

34 Roberts, 113 N.M. at 758 (admonishing trial court to “weigh the evidence [on prejudice] in light of the necessity for, and the public policy favoring, a prompt and effective response to an instance of environmental contamination.”). Some policyholder lawyers urge that, because insurers almost always deny or question coverage, their involvement is both unnecessary and prejudicial. FIELDS & SWANSON, The Voluntary Payment Clause: The Insurers’ New Bogeyman, 5 ENVIR. CL. J. 57, 85 (1992). But their argument is largely based on premises about control of the defense and its relation to control of settlement whose error was shown in § 4.05[1] above.


36 Miller v. Shugart, 316 N.W.2d 729 (Minn. 1982).
to use it. After prevailing in the trial court in the declaratory judgment action, the tort defendants made a nonrecourse settlement and then prevailed on the insurer’s appeal of the coverage issue. The issue then became one of whether breach of the settlement restrictions precluded enforcement against Milbank. The court began by recognizing that Milbank had not acted improperly by reserving its rights. But it did not feel that this necessarily left the insureds’ duty to cooperate and refrain from settlements totally unaffected, for the reservation of rights left the insureds potentially exposed to liability, and it was unlikely that the coverage issue could be resolved before the tort case was tried, so the insureds ought not to be denied the opportunity to settle. The court delineated their rights as follows:

While the defendant insureds have a duty to cooperate with the insurer, they also have a right to protect themselves against plaintiff’s claim. The attorneys hired by Milbank to represent them owe their allegiance to their clients, the insureds, to best represent their interests. If, as here, the insureds are offered a settlement that effectively relieves them of any personal liability, at a time when their insurance coverage is in doubt, surely it cannot be said that it is not in their best interest to accept the offer. Nor, do we think, can the insurer who is disputing coverage compel the insureds to forego a settlement which is in their best interest.

Moreover, the court found no indication that Milbank could avoid the settlement on the basis of fraud or collusion. To be sure, the settlement was twice the policy limit, but no one attempted to enforce the excess judgment against Milbank and, indeed, the absence of any personal liability of the insureds for the excess would preclude any bad-faith claim for that amount. Moreover, the insureds had waited until they prevailed in the trial court on coverage before settling and had given Milbank notice of what they were doing. (Though the court does not make the point, notice would also allow the insurer to withdraw its reservation of rights, thereby precluding a settlement without its consent.) Given the court’s holding that they had a right to settle without Milbank’s consent, the procedure followed posed no inherent problem.

This is not to say that Milbank’s position is enviable. As the trial court observed, it had “serious doubts about the propriety of the procedure whereby the insurer is placed in a ‘no-win’ situation as was done here.” If the insurer ignores the “invitation” to

37 316 N.W.2d at 733.
38 316 N.W.2d at 733.
39 316 N.W.2d at 733–34 (footnote omitted). See also S.G. v. St. Paul Fire & Marine Ins. Co., 460 N.W.2d 639 (Minn. Ct. App. 1990), in which the court upheld a settlement between an insured and claimants even when the insurer in S.G. indicated that it would defend under a reservation of rights. The insurer conditioned any potential defense upon filing a lawsuit, and the insured settled before such a filing took place to avoid the potential publicity. The court, applying Miller-Shugart reasoning, ruled that the insurer could protect itself. The court found that the insured did not fail to cooperate, that the insurer was not prejudiced by the terms of the settlement agreement, and that the settlement was not fraudulent or collusive.
40 Miller, 316 N.W.2d at 734.
41 This sort of advance notice is necessary under Miller, but unnecessary to enforce a settlement by the insured if the insurer breached its duty to defend. Brownsdale Corp. Ass’n v. Home Ins. Co., 473 N.W.2d 339, 340 (Minn. Ct. App. 1991).
participate in the settlement negotiations, it may run the risk of being required to pay, even within its policy limits, an inflated judgment. On the other hand, if the insurer decides to participate in the settlement discussions, ordinarily it can hardly do so meaningfully without abandoning its policy defense. Nevertheless, it seems to us, if a risk is to be borne, it is better to have the insurer who makes the decision to contest coverage bear the risk.42

But the court also found the mere absence of fraud and collusion insufficient to permit enforcement against the insurer in these circumstances. The stipulated judgment did not represent an adjudication on the merits, so it was not binding on Milbank, and in attempting to enforce the settlement it embodied,

the burden of proof is on the claimant, the plaintiff judgment creditor, to show that the settlement is reasonable and prudent. The test as to whether the settlement is reasonable and prudent is what a reasonably prudent person in the position of the defendant would have settled for on the merits of plaintiff’s claim. This involves a consideration of the facts bearing on the liability and damage aspects of plaintiff’s claim, as well as the risks of going to trial. This can be compared with the somewhat analogous situation in which a joint tortfeasor seeking consideration from a cotortfeasor must prove the settlement made was reasonable.43

Had the insurer breached its duty to defend, then the settlement would have been treated as presumptively valid, but that was not the situation presented.44 Because this was a one-car accident, with a substantial likelihood of liability, and in which the plaintiff passenger had suffered special damages (compensable by no-fault insurance) likely to exceed $35,000, the trial court had properly concluded that an enforceable judgment for the $50,000 policy limit was reasonable.

However, this Minnesota rule does not extend to cases where the coverage dispute depends on the facts which determine the insured’s liability.45 In that context, a settlement reasonable in amount for the entire claim will necessarily include amounts related to the non-covered exposure, thereby improperly shifting that risk to the insurer.46 Nor does the rule reach cases where coverage is admitted, but the applicable limits are disputed on the basis of facts also involved in the underlying litigation.47 It appears that the Minnesota courts are considering

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42 Miller, 316 N.W.2d at 734.
43 316 N.W.2d at 735.
44 316 N.W.2d at 735.
46 442 N.W.2d at 161.
practical difficulties with settlement where the coverage-determining facts are unrelated to the liability-determining facts and limiting the rule to situations which present such difficulties. Additionally, though the Minnesota courts have not made this point, coverage issues not intertwined with the merits should be subject to resolution in a declaratory judgment action even while the tort suit is pending. So diligent prosecution of such an action might resolve the coverage question before any settlement decision needs to be made.

Where the claim settled is asserted against multiple defendants only some of whom are insured, an aggregate joint-and-several settlement, not allocated among the defendants is void and per se unreasonable, for there is no way to evaluate separately the prudence of the settlement as to each party. Similarly, where the lawsuit involves both covered claims and noncovered claims, a settlement that fails to allocate between those claims is per se unreasonable. However, where a reasonable *Miller-Shugart* settlement is reached with one allegedly joint tortfeasor (the insured), that settlement is not defeated if, at the trial against the remaining tortfeasor, the jury renders a verdict that the insured had no liability.

**[b] Morris v. USAA**

A rationale similar to *Miller v. Shugart* was adopted in *United Services Automobile Association v. Morris*. There, the suit against the insureds, Taylor and Waltz, alleged both an assault (uncovered) and negligence (covered) and the claim involved exposure beyond the $100,000 policy limit. Taylor and Waltz asserted that they acted in self-defense or defense of others. The insurer, USAA, defended under reservation of rights and Taylor and Waltz stipulated to a $100,000 nonrecourse judgment. The court posed the question as one of “whether an insurer may assert the policy’s cooperation clause to prevent insureds being defended under a reservation of rights from protecting themselves by settling.”

The court, like that in *Miller v. Shugart*, noted Taylor’s risk of catastrophic, noncovered liability and need to take protective action against that threat. Moreover, precluding settlement would give USAA two chances (the tort trial and the coverage case) to avoid liability, while never risking more than its policy limits. The court then analogized to cases denying the insurer control of the defense when a conflict of interest exists, and imposed a similar rule for control of

48 See Bob Useldinger & Sons, Inc. v. Haughsleben, 505 N.W.2d 323, 330 (Minn. 1993) (applying *Miller-Shugart* to coverage dispute based on insured’s alleged failure to maintain the required underlying insurance because, *inter alia*, coverage facts unrelated to liability facts); FDIC v. Gordiner, 783 F. Supp. 1181, 1189–90 (D. Minn. 1992) (suggesting that *Miller-Shugart* may be so limited) (dictum), *rev’d on other grounds*, FDIC v. Gordiner, 993 F.2d 155 (8th Cir.1993).
49 See State Farm Fire & Cas. Co. v. Gandy, 925 S.W.2d 696, 714 (Tex. 1996) (limiting insured’s right to settle, even in the presence of a coverage question, so long as the insurer has made a good faith effort to adjudicate the coverage issue before the tort claim is adjudicated).
50 Bob Useldinger & Sons, 505 N.W.2d at 331.
51 Corn Plus Coop. v. Cont’l Cas. Co., 516 F.3d 674, 681 (8th Cir. 2008).
54 154 Ariz. at 120.
55 154 Ariz. at 120.
Some courts have followed *Miller v. Shugart* or *Morris v. USAA*.57

In litigating coverage, the insurer is not bound by any facts stipulated between the insured and the claimant, even if those facts would be relevant to both coverage and liability.58

Because the purpose of the rule is to allow an insured to avoid the risk of excess or noncovered liability, it cannot be used by another insurer to try to shift some of its own liability to the insurer that has reserved its rights. That was one holding in *Leflet v. Redwood Fire & Casualty Insurance Co.*59 That was a construction defect class action against a developer, Hancock and its subcontractors. The subcontractors’ insurers were defending Hancock, subject to reservation of their respective rights not to indemnify matters not arising out of the insured subcontractors’ work. Hancock was also defended under reservation by direct insurers, who were primarily liable for anything not covered by the subcontractors’ insurers and provided excess coverage for anything that was covered by the subcontractors’ insurers. Hancock and the direct insurers entered into a purported *Morris* settlement, under which Hancock paid $375,000, agreed to enter into a consent judgment ultimately set at $8.475 million, and plaintiffs agreed to collect only from the subcontractors’ insurers. The court of appeals held that this did not qualify as a *Morris* settlement.60

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56 Arizona: 154 Ariz. at 120.

57 E.g.: *Midwestern Indemn. Co. v. Laikin*, 119 F. Supp. 2d 831, 842 (S.D. Ind. 2000) (predicting that Indiana would follow *Miller v. Shugart* and *USAA v. Morris*; arguably dictum, as *Midwestern* had not provided a defense, 119 F. Supp. 2d at 834); *Am. Family Mut. Ins. Co. v. C.M.A. Mort., Inc.*, 682 F. Supp. 2d 879, 890-94 (S.D. Ind. 2010) (concluding that, so long as the insurer was performing its contractual obligations, the insured was obliged to perform its, and was not free to settle; distinguishing *Laikin* and concluding that later Indiana authority undermined its conclusion); *Klepper v. ACE Am. Ins. Co.*, 999 N.E.2d 86, 95-97 (Ind. Ct. App. 2013) (agreeing with *C.M.A. Mort.*).


60 226 Ariz. 297, ¶¶ 1–12, 21.
The purpose of the agreement here was not to protect Hancock, but to favor the direct insurers and burden the subcontractors’ insurers, allowing the direct insurers to pay far less than their limits for a consent judgment that exceeded those limits twentyfold. Moreover, there was no question that each subcontractor’s insurer was appropriately reserving the right not to pay for damages not arising from that subcontractor’s work, and there had been no determination of either the existence or the amount of any such liability. The direct insurers did not face the types of risks that *Morris* allows an insured to protect against. The court reasoned that “[b]ecause *Morris* agreements are fraught with risk of abuse, a settlement that mimics *Morris* in form but does not find support in the legal and economic realities that gave rise to [Morris] is both unenforceable and offensive to the policy’s cooperation clause.”

[c] The Iowa-Pennsylvania Variation

Iowa declined to follow *Miller* and *Morris*, but did hold that, when the insurer defends under reservation and has refused a settlement demand that a reasonable and prudent insurer would have paid (considered without regard to the coverage issue), the insured is then free to stipulate to a judgment in the amount of that demand. “The insurer, if found to have coverage, will be liable for the insured’s settlement if the settlement is found to be fair and reasonable.” The court distinguished that standard from that applicable to liability for an excess judgment resulting from bad faith refusal to settle:

we do not impose a bad faith standard for failure to settle a case where the defense is provided under a reservation of rights. The bad faith standard is simply not appropriate here, where the issue is one of *contractual* liability as opposed to *extra-contractual* liability. We hold, therefore, that when an insurer provides a defense under a reservation of rights and rejects a fair and reasonable settlement demand that a reasonable and prudent insurer would pay, the insured is free to consummate the settlement on terms that protect the insured from any personal exposure.

Under Iowa law, an insurer is not subject to liability for an excess judgment resulting from failure to settle if it has a good faith question as to coverage. But, as to covered claims, if, but for the policy limits, the insurer would settle for an offered amount, it is obliged to do so (and pay toward settlement up to the policy limits). But the insurer is free to reject the offer if it would have rejected the same offer under policy limits covering the whole claim.

While *Kelly* is not entirely clear on exactly how its standard differs from the bad faith

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63 620 N.W.2d at 644.
64 620 N.W.2d at 645.
standard, it must at least free the insured to accept a settlement that the insurer was free to reject only because of coverage doubts, with the coverage question to be litigated later. On the other hand, it does not seem that the mere existence of coverage doubts should allow the insured to settle on a basis that a prudent insurer, liable for the full judgment, would have been free to reject. Thus, putting aside the question of partial coverage (which the Kelly court did not consider), the Kelly standard may differ from the bad faith standard only by putting aside any consideration of the coverage doubts.

The Pennsylvania Supreme Court, in Babcock & Wilcox Co. v. American Nuclear Insurers, followed the Iowa rule, apparently with some qualifications. The precise scope of the new rule is not entirely clear, so the case requires detailed consideration.

The Pennsylvania Supreme Court specifically rejected the rule that had been adopted by the superior court. In Babcock & Wilcox Co. v. American Nuclear Insurers, a divided panel of the Pennsylvania Superior Court adopted an unusual combination of minority rules. It held that an insured, offered a defense under reservation of rights, is free to reject that defense and defend itself. Moreover, an insured that does this would be free to settle without its insurer’s approval, and the insurer must pay if the claim settled is covered and the settlement reasonable. The supreme court granted review and reversed. Both parties “vehemently object[ed]” to the superior court’s holding that an insured had the right to reject a defense under reservation. They argued that Pennsylvania law was to the contrary and “most insureds would be unable to utilize the [superior court’s] approach as they would not have the funds to allow them to employ an independent defense after rejecting the insurer’s defense for which they had paid premiums to obtain.” The Supreme Court agreed and “reject[ed] the Superior Court’s holding as unworkable under Pennsylvania law.” It then turned to determining the proper rule regarding control of settlement where the insurer has reserved the right to deny coverage.

Babcock & Wilcox Company and B&W Nuclear Environmental Services (collectively, “B&W”) owned and operated two nuclear fuel processing facilities formerly owned and operated by Atlantic Richfield Co. (“ARCO”). Those facilities were insured by American Nuclear Insurers and Mutual Atomic Energy Liability Underwriters (collectively, “ANI”) under policies with limits ranging from $3 million per facility (in 1958) to $160 million (in 1979). In June, 1994, B&W and ARCO were sued in federal court in a purported class action (the “Hall Action”) by plaintiffs claiming bodily injury and property damage caused by radioactive emissions from the facilities. B&W and ARCO denied any releases exceeding those permitted by federal standards and denied that any of plaintiffs’ claimed damages were attributable to releases from the

68 The court’s opinion was joined by three justices, there were two dissenters on control of settlement, and two justices did not participate. 2015 Pa. LEXIS 1551, at *1, *50–51 (concurring and dissenting op.; agreeing with rejection of superior court’s holding, but disagreeing with majority’s holding that Babcock was entitled to recover for its unapproved settlement).
70 76 A.3d at 22.
facilities. Ultimately, the Hall Action had over 500 named plaintiffs. Originally, ANI reserved its rights on the grounds that “the policy did not cover damages that were not caused by nuclear energy hazard, damages in excess of the policy limits, and claims for injunctive relief and punitive damages.” None of the available opinions says much about how the defense was handled.

In 1998, the federal court tried eight test cases in a single jury trial, resulting in verdicts totalling $33.7 million against B&W and ARCO jointly and an additional $2.8 million against B&W alone. But the court granted a new trial based on evidentiary errors. At this point, coverage disputes arose as to the applicable limits of coverage and whether B&W and ARCO were each entitled to independent counsel.

Coverage litigation was brought and produced an initial determination that a manifestation trigger applied (making a limit of $160 million for each facility available) and that B&W and ARCO were each entitled to independent counsel; this was affirmed by the superior court without published opinion.

B&W then settled with the plaintiffs for $80 million; ANI disagreed with the settlement and B&W paid the full amount. B&W then sought to recover the full settlement amount from ANI. ANI argued that it had no liability because B&W had violated policy provisions requiring its consent for any of the settlement it would have to pay. B&W argued that if an insurer breaches its duty to consent to a reasonable settlement, the insured is then free to settle without forfeiting coverage. ANI responded that the insured would only be free to settle if it could show violation of the bad faith standard articulated in Cowden v. Aetna Casualty & Surety Co. According to ANI, this would require proof “by clear and convincing evidence that: (a) there was no real chance of a defense verdict in the Hall Action; (b) there was little possibility of a verdict or settlement within policy limits; (c) ANI’s decision to proceed to trial rather than settle was not based on their bona fide belief, predicated upon all of the circumstances of the case, that there was a good possibility of winning; and (d) ANI’s decision to litigate rather than settle was made dishonestly.”

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75 Babcock IV, 2015 Pa. LEXIS 1551, at *2. In 1999, this reservation was supplemented by one “based upon Insureds’ pressuring of Insurer to settle, which Insurer viewed, in connection with other actions, as a breach of Insureds’ duty to cooperate.” 2015 Pa. LEXIS 1551, at *3.


77 Babcock III, 76 A.3d at 4. That suggests that the defense at the first trial may have been by insurer-directed counsel.

78 76 A.3d at 4; Babcock I, 51 Pa. D. & C. 4th at 358–91.

79 76 A.3d at 3–4.


81 Babcock III, 76 A.3d at 5–6 (quoting ANI’s trial court brief).
Initially, the trial court agreed with ANI as to the applicable standard. On this basis, B&W faced a heavy burden, as the court observed that “it is very questionable whether the plaintiffs, represented by competent counsel, would have settled the case for $80 million if there was a realistic possibility that the verdict would exceed $320 million if the case proceeded to trial.”

After further proceedings, the trial court changed its mind on the standard, concluding that there was no principled distinction between an insurer that had provided a defense under reservation of rights and one where it had denied coverage entirely. Thus, the insured would be free to make a reasonable settlement unless the insurer withdrew its reservation. At trial, the jury found that the settlement was fair and reasonable. ANI waived all coverage defenses other than the requirement of consent to settle and judgment was entered for B&W for $80 million plus prejudgment interest of over $15 million.

The court noted that amici supporting ANI took the position that “a relatively small percentage of reservation[s] of rights actually create types of conflicts of interest that truly expose an insured to uninsured losses.” According to the amici, “most reservations of rights resolve during the course of the litigation and are merely a ‘reminder of the terms of the contract as applied to the facts in the lawsuit.’” In particular,

\( \text{Amici note that in a water damage case resulting from a ruptured water line, an insurer would likely issue a reservation of rights in regard to any claims for mold damage which would be subject to a mold exclusion, even though the bulk of the claims would be fully covered and no mold claims would likely be advanced by the plaintiff. It notes that the \textit{Morris} fair and reasonable standard fails to take into account the difference between this type of “soft” reservation of rights, which is unlikely to alter the} \text{.} \)

\[\text{76 A.3d at 6.} \]

\[\text{76 A.3d at 6 (quoting trial court). On the other hand, the superior court observed that} \]

\[\text{we credit at least the outlines of B&W’s concern that the eight test trial verdicts entered in 1998, which resulted in awards averaging approximately $4.5 million per plaintiff, extrapolated across 250 to 300 claimants certainly suggested the prospect of an aggregate verdict well in excess of the policy limits, and perhaps as high as $1 billion, exclusive of pre- or post-judgment interest and what would have been voluminous defense costs associated with the defense of litigation involving hundreds of plaintiffs.} \]

\[\text{76 A.3d at 21. Of course, plaintiffs’ counsel was more fully informed than the superior court could have been and apparently found such an extrapolation an unsatisfactory basis to value his clients’ claims, else there would have been no agreement to the $80 million settlement.} \]

\[\text{76 A.3d at 6–9.} \]

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interests of the parties, and a “hard” reservation of rights. With a “hard” reservation of rights, the insurer views the claims as possibly covered, requiring a defense, but ultimately unlikely to be covered by the policy, such as when intentional actions are also pled in negligence.\(^{87}\)

This distinction between “hard” and “soft” reservations may be significant in light of the following discussion. After reviewing *Morris*, the Pennsylvania court described as “somewhat problematic” *Morris*’s declaration that “‘the cooperation clause prohibition against settling without the insurer’s consent forbids an insured from settling only claims for which the insurer unconditionally assumes liability under the policy.’”\(^{88}\) It elaborated on its reservation about this point as follows:

This sentence broadly suggests that the insured can settle any claim for which the insurer defends subject to a reservation of rights. *We agree with Amici, however, that not all reservations of rights are equal. The mere fact that an insurer restates that it will not cover what the insurance policy does not cover, where it arguably might be part of the damages sought, does not automatically result in allowing the insured to settle the entire suit. Parties and courts may need to consider whether a particular reservation of rights justifies diverging from the contract’s cooperation clause, a question which is not squarely before this Court.*\(^{89}\)

After reviewing *Morris, Kelly*, and other cases addressing the issue the court declared that:

*we adopt a variation on the *Morris* fair and reasonable standard limited to those cases where an insured accepts a settlement offer after an insurer breaches its duty by refusing the fair and reasonable settlement while maintaining its reservation of rights and, thus, subjects an insured to potential responsibility for the judgment in a case where the policy is ultimately deemed to cover the relevant claims. Like our sister states, we observe that a determination of whether the settlement is fair and reasonable necessarily entails consideration of the terms of the settlement, the strength of the insured’s defense against the asserted claims, and whether there is any evidence of fraud or collusion on the part of the insured.*\(^{90}\)

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\(^{87}\) 2015 Pa. LEXIS 1551, at *27 n.13.


\(^{89}\) 2015 Pa. LEXIS 1551, at *38 n.15 (emphasis added).

The court recognized that this test “has attributes of the Cowden bad faith test.” But, like Kelly, it distinguished that test on the ground that bad faith subjects an insurer to liability in excess of its limits, while the test applied here only allows settlements within limits.

It then approved the approach taken in the trial court:
In this case, after an extensive trial where the jury was presented with voluminous evidence relating to the strength of the underlying action and the settlement offer, the jury determined that the settlement was “fair and reasonable from the perspective of a reasonably prudent person in the same position of [Insureds] and in light of the totality of the circumstances,” a standard which we adopt herein as the proper standard to apply in a reservation of rights case where an insured settles following the insurers’ refusal to consent to settlement.

The dissenters would have remanded for the trial court to apply the Cowden standard.

It is actually not clear how much the Babcock IV standard differs from the Cowden standard. Cowden sets forth the following rule:

there is no absolute duty on the insurer to settle a claim when a possible judgment against the insured may exceed the amount of the insurance coverage. The requirement is that the insurer consider in good faith the interest of the insured as a factor in coming to a decision as to whether to settle or litigate a claim against the insured. . . . The predominant majority rule is that the insurer must accord the interest of its insured the same faithful consideration it gives its own interest. Since it is obvious that the interest of one or the other party may be imperiled at the instant of decision, the fairest method of balancing the interests is for the insurer to treat the claim as if it were alone liable for the entire amount. But, that does not mean that the insurer is bound to submerge its own interest in order that the insured’s interest may be made paramount. It means that when there is little possibility of a verdict or settlement within the limits of the policy, the decision to expose the insured to personal pecuniary loss must be based on a bona fide belief by the insurer, predicated upon all of the circumstances of the case, that it has a good possibility of winning the suit. While it is the insurer’s right under the policy to make the decision as to whether a claim against the insured should be litigated or settled, it is not a right of the insurer to hazard the insured’s financial well-being. Good faith requires that the chance of a finding of nonliability be real and substantial and that the decision to litigate be made honestly.

On the one hand, Cowden appears to adopt the widely used disregard-the-limits standard. (See § 2.03[2][d], above.) But that is followed with language that can be read to suggest that a good possibility of a defense verdict is enough to allow the insurer to refrain from settling, without being exposed to liability for bad faith, seemingly without any consideration of the magnitude of the judgment that would result if liability were found. Still, the paragraph should be read as a consistent whole, rather than allowing the latter language to override the former. And, if Cowden is seen as calling for application of an unmodified disregard-the-limits standard, that would be very close to the Babcock IV standard. (ANI relied heavily on the latter portion of the Cowden paragraph, beginning with “little possibility of a verdict or settlement within the limits of the policy,” and regarded it as setting a significantly higher bar for insureds seeking to settle without consent. The court at least assumes that this might be correct, were the Cowden standard deemed applicable.)

Because ANI waived all of its other coverage defenses, the Babcock IV court could treat the case as if ANI had had coverage doubts it was entitled to litigate but that the liability settled upon had been fully covered. The court expressly declined to address situations where there were coverage issues as to part of the claim. But even Miller v. Shugart requires that any settlement be fairly allocated between covered and noncovered claims. (See § 4.05[3][a], above.) The same should be true in Pennsylvania and Iowa.

[d] This Approach, Like Others That Free Insureds To Settle, Is Flawed

The Miller-Shugart/Morris line of cases has been expressly rejected elsewhere. Other cases implicitly reject this theory by summarily holding that a reservation of rights does not, without some breach, free the insured to settle without the insurer’s consent. Even where accepted, the rule has not been extended to cases where there is no coverage question but there is exposure that may exceed policy limits.

95 Colorado: Old Republic Insurance Co. v. Ross, 180 P.3d 427, 433–34 (Colo. 2008);

Iowa: Kelly v. Iowa Mutual Insurance Co., 620 N.W.2d 637, 642 (Iowa 2000);

Texas: State Farm Fire & Casualty Co. v. Gandy, 925 S.W.2d 696, 714 (Tex. 1996) (except, perhaps, where the insurer has failed to make a good faith effort to obtain adjudication of the coverage issue).

96 E.g.:


Miller v. Shugart, USAA v. Morris, and the cases following them disregard the ability of the insured to settle separately regarding his uninsured exposure. (See § 4.05[1], above.) In addition, Morris totally disregards the danger of shifting the cost of uninsured liability to the insurer. Both are wrongly decided and should not be followed by other courts.

At least one commentator, Stephen Ashley, disagrees with both Miller/Morris and the contrary position advanced here.98 As to Miller and Morris, he finds the reasoning flawed because each court assumed that the insured was free to disregard contractual duties whenever that was in the insured’s interest.99 But he does not find the insured’s ability to settle only the uninsured portion of the risk adequate to solve the insured’s dilemma, because it will be too difficult in most cases to determine what portion of the liability might not be covered, to value that separately from the rest of the case, and to structure a separate settlement.100

In fact, there is not the slightest difficulty conceptualizing a settlement of the sort proposed: the insured need only pay the plaintiff a negotiated amount for a covenant not to execute on any assets other than the insurance policy. This leaves the plaintiff free to prosecute, and the insurer to defend, the action, with any resulting judgment collectible from the insurance proceeds. If both the coverage dispute and the tort claim are evaluated properly, the amount paid by the insured to settle his own exposure and the value of the remaining claim against the insurer will equal the tort claim’s settlement value, with insurer and insured each bearing the portion of the risk appropriate to its prospects of success in the coverage dispute.

To be sure, as previously acknowledged, (see § 4.05[1], above) the plaintiff may have difficulty evaluating the coverage issue if that issue is distinct from the liability facts, and this difficulty may diminish any interest in a settlement of the sort just described. If coverage is found to exist, the plaintiff may recover fully against the insurer and also keep the amount paid by the insured. But this excessive recovery only compensates for the risk of a deficient recovery if coverage does not exist. And, while the insured may wind up paying unnecessarily if coverage is found, that is simply the result of the decision to buy peace rather than risking larger non-covered liability. Thus, there is no inequity in any of these results. And difficulty in evaluating the coverage issue does not excuse the insured from paying to eliminate uninsured risks.

Mr. Ashley argues that such reasoning “must come as cold comfort to an insured who loses an opportunity to reach a reasonable settlement of a potentially covered claim because the insurer will neither consent to settlement nor take a position on the coverage issue.”101 On the

Wyoming:

98 Stephen S. Ashley, Reservation of Rights and Control of Settlement, 8 BAD FAITH L. REP. 77 (1992). Ashley was responding to William T. Barker, Control of the Defense and Control of Settlement—Need They Go Together, 8 BAD FAITH L. REP. 59 (1992), and William T. Barker, Coverage Disputes and Control of Settlement, 8 BAD FAITH L. REP. 82 (1992). Morris (as well as, implicitly, other cases of this type), is criticized in Benjamin A. Kahn & Ronald Nemirow, Unauthorized Settlement Agreements in a Reservation of Rights Context, 34 TORT & INS. L.J. 799, 812 & 817 (1999).

99 8 BAD FAITH L. REP. at 79.
100 8 BAD FAITH L. REP. at 80.
101 8 BAD FAITH L. REP. at 80.
other hand, he resists a rule which would permit the plaintiff and the insured to settle when the insurer has not yet had a fair opportunity to consider and to take a position on coverage. Thus, he argues that the insurer should be required to promptly take a coverage position, with a denial freeing the insured to settle and a confirmation removing the risk of noncovered exposure.

But, unless either the relevant facts and law are undisputed or the insurer can obtain a final adjudication of coverage before the settlement is reached (an assumption which would eliminate any occasion for a Miller-Shugart/Morris settlement) the insurer would be forced to bind itself to a position on coverage at a time of inherent uncertainty. Under these circumstances, if the insurer affirms coverage, it will have to pay even if no coverage existed; if it denies coverage, then Mr. Ashley would deprive it of the contractual right to control settlements it must pay.

Refusal to take a definitive coverage position where unavoidable uncertainty exists neither breaches the policy nor constitutes an unfair claim practice. Thus, such a refusal is no reason to force the insurer to a choice of forfeitures, rather than allowing it to preserve all of its rights pending full and final adjudication. As already shown, allowing such preservation is fully consistent with the allocation of insured and uninsured risks made when the policy was purchased.

Sargent v. Johnson illustrates the dangers of allowing an insured to settle, absent any breach by the insurer, simply because of a coverage dispute. There, the Eighth Circuit, applying Minnesota law prior to Miller v. Shugart, held that the insured’s settlement voided coverage.

The facts involved were extremely complex. The problem arose out of an underlying action postured as follows:

Sargent, while employed on a construction project in Minneapolis, Minnesota, sustained severe and permanently disabling injuries on July 14, 1969, when he fell from an upper floor into the basement of the building under construction. No person witnessed the incident. Sargent brought an action to recover for his injuries against a subcontractor on the job, Axel H. Ohman, Inc. (Ohman), and Roger T. Johnson (Johnson), architect on the project, alleging that the subcontractor’s employees removed coverings from an elevator shaft in the building and that the architect had been negligent in enforcing safety standards in building construction. These defendants joined Haglin, general contractor (Sargent’s employer), as a third-party defendant seeking contribution or indemnity against Haglin for Haglin’s failure to provide a safe place of work for its employee. Defendants, subcontractor Ohman and architect Johnson, could not join employer Haglin as a defendant to Sargent’s suit because under Minnesota law an employer covered by the workmen’s compensation statute is immune from

102 8 BAD FAITH L. REP. at 80–81.
103 8 BAD FAITH L. REP. at 81 (footnotes omitted).
104 Sargent v. Johnson, 551 F.2d 221 (8th Cir. 1977) (Minnesota law).
suit by an employee injured on the job. Defendants Johnson and Ohman and third-party defendant Haglin asserted various cross-claims against one another for contribution or indemnity.\footnote{551 F.2d at 223 (citation omitted).}

Haglin had a workers compensation and employer’s liability policy with Liberty Mutual Insurance Company (“Liberty”). The employer’s liability coverage was subject to a $100,000 limit of liability. Haglin also had a $500,000 comprehensive general liability policy which excluded coverage for claims arising out of injuries to Haglin’s employees, but had a contractual liability provision which might have afforded coverage for architect Johnson’s contractual indemnity claims against Haglin. However, the latter provision excluded coverage for any obligation to the architect for liabilities arising out of his professional duties, including inspection and supervision. Haglin, in a fourth-party action against Liberty, contended that Liberty had negligently failed to recommend an increase in the employers liability limit of $500,000, had breached a contractual duty to provide $500,000 in coverage for such claim, and should be estopped to deny $500,000 in coverage for them.\footnote{551 F.2d at 226 n.7.} Finally, Haglin claimed that Liberty should be deemed to have issued a $2,000,000 umbrella policy which he claimed it had negligently failed to recommend. (No further details are given regarding that hypothetical policy.)

Liberty defended Haglin unconditionally under the $100,000 employer’s liability coverage and, subject to a reservation of rights, under the $500,000 contractual liability coverage for Johnson’s claim for contractual indemnity. The district court, on what the Eighth Circuit characterized as “tenuous” grounds,\footnote{551 F.2d at 224.} directed a verdict against Johnson, Ohman, and Haglin on the issues of negligence and causation. A jury fixed Sargent’s damages at $1,600,000 and apportioned fault as follows:

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<td>Haglin</td>
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The district court then denied any claims for indemnity between Haglin and Ohman and found Johnson entitled to indemnity equally from both Haglin and Ohman. Accordingly, it entered judgment against Ohman for 11/14 of the verdict and against Johnson for 3/14, subject to Johnson’s rights to indemnity. Post-trial motions postponed finality of the judgment for appeal, and execution was stayed. The Eighth Circuit noted “substantial authority” for Haglin’s claim that
any obligation of Haglin to indemnify Johnson would fall on Ohman pursuant to an indemnity provision in Ohman’s contract.\textsuperscript{108} The propriety of the directed verdicts was also challenged. Although the court heard argument of the post-trial motions in November, 1973, it never decided them. Instead, on July 30, 1974, the district court wrote to all counsel announcing its belief that recent decisions of the Minnesota Supreme Court probably would now allow Ohman to obtain contribution from Haglin.\textsuperscript{109} The court also announced its belief that probably only Haglin would be obliged to indemnify Johnson (ignoring Haglin’s claimed contractual indemnity from Ohman for any indemnity obligation it might have to Johnson). The court said that both questions would require certification to the Minnesota Supreme Court, but implored the parties to make another settlement attempt before the court had to write an extensive memorandum certifying them.

On August 19, 1974, personal counsel for Haglin wrote to Liberty pointing out that Haglin now faced a judgment for at least $800,000, and perhaps the full $1,600,000, plus interest. He demanded that Liberty affirm coverage of $2.5 million. If it failed to do so, he proposed to waive the $100,000 in admitted coverage, discharge counsel retained by Liberty to defend Haglin, and then pursue other remedies or settlements advantageous to Haglin. On August 26, 1974, Liberty refused to affirm $2.5 million in coverage. However, it never refused a settlement offer of any or all claims against Haglin.

On or before August 26, Haglin, Ohman, and Sargent reached a settlement, under which the $1,600,000 judgment would be permitted to stand, Ohman would contribute $900,000 toward its payment, and the balance would be enforceable only against Liberty (pursuant to an assignment of Haglin’s rights). On August 27, the district court permitted Haglin to discharge counsel retained by Liberty upon waiver of the $100,000 in admitted coverage. The settlement came to light on September 3 as a result of worker’s compensation proceedings.

Subsequently, the district court approved entry of a judgment (including accrued interest and costs) of $1,766,556.72. It then considered the fourth-party action against Liberty and found that, because Haglin had more coverage than Liberty admitted (though not determining how much coverage), the consent judgment was binding on it to whatever extent it did have coverage.

The Eighth Circuit reversed, finding that settlement without Liberty’s consent voided the coverage. It began by finding that Liberty had not, at the time of the settlement, breached any duty to Haglin. The duty to defend was being fully performed. No duty to pay or settle had yet arisen because there was no final judgment, there was no settlement approved by Liberty, and Liberty had not refused any offer to settle. The cases relied upon to support the settlement were all distinguished because the insurers had either refused a defense or disclaimed coverage.

The Eighth Circuit recognized that the duty of good faith required fair treatment of other contracting parties. But, after noting that the settlement breached the terms of the policy, it concluded that the duty of good faith had been breached by Haglin, not Liberty:

Counsel for the insured did not enter into a bargain to settle its

\textsuperscript{108} Sargent, 551 F.2d at 224–25.
\textsuperscript{109} 551 F.2d at 226–27. The Eighth Circuit found that none of the cases cited by the district court “in any way support the court’s ‘belief’ that contribution would lie in favor of Ohman against Haglin.” 551 F.2d at 227.
liability claims for a fair price, but entered into a questionable collaboration by which the parties maneuvered through terms of a settlement agreement to impose an uncompromised full balance of a judgment upon the insurer, while the insured incurred no real detriment. In light of the questionable validity of the judgment on its face, and the substantial sum obtained outright by Sargent from Ohman, this seems particularly unreasonable. This kind of bargain represents the antithesis of mutual respect for rights.

Haglin’s breach of insurance policy provisions and its failure to deal with Liberty in good faith, effectively severed the insured-insurer relationship. Thus, Haglin’s settlement arrangement could not bind Liberty under any of its written policies with Haglin or under any unwritten policy which might be determined to arise from the same insured-insurer relationship, regardless of the amount of coverage afforded under such policies.\(^{110}\)

_Sargent_ is an extreme case. The settlement involved was clearly unreasonable and the attempt to prevent Liberty from fairly contesting the existence and amount of Haglin’s liability verged on fraud. Undoubtedly courts following _Miller v. Shugart_ and _USAA v. Morris_ would respond that this problem can be handled by requiring a showing of reasonableness. But any such requirement only limits the amount that the insured and the plaintiff can “get away” with, without eliminating the incentives to inflate settlements to offset the contingencies involved in enforcement. Absent any breach, the insurer should be entitled to the protection of the contractual terms entitling it to contest liability unless it consents to a settlement.


The American Law Institute Principles of the Law of Liability Insurance endorses a variant of the Minnesota-Arizona rule:

Unless otherwise stated in a policy issued to a large commercial policyholder, when an insurer has reserved the right to contest coverage for a claim, the insured may settle the claim without the consent of the insurer and without violating the duty to cooperate or other restrictions on the insured’s settlement rights contained in the policy, provided the following requirements are met:

(a) The insurer is given the opportunity to participate in the settlement process;

(b) The insurer declines to withdraw its reservation of rights after receiving prior notice of the proposed settlement;

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\(^{110}\) 551 F.2d at 232.
(c) A reasonable person that bore the sole financial responsibility for the full amount of
the potential judgment and the costs of defending the claim would have accepted the
settlement; and

(d) If the settlement includes payments for damages that are not covered by the liability
insurance policy, the portion of the settlement allocated to the insured component of the
claim is reasonable.\textsuperscript{111}

This seems to provide the insurer more of an opportunity to participate in the settlement
process than the Minnesota-Arizona rule, though it is unclear that this would have practical
significance. The insurer is given a right to withdraw its reservation and thereby preclude a
settlement, but that right is also implicit in the Minnesota-Arizona rule. (See § 4.05[1], above.)
The primary difference from the Minnesota-Arizona rule is that, under the Principles rule,

If a court determines that the settlement between the insured and
the claimant is not reasonable or that the portion allocated to the
insurer is not consistent with the terms of the policy, the insurer
is excused from its defense, settlement, and indemnity
obligations to the insured. This rule more strongly discourages
collusive or otherwise unreasonable settlements than the rule that
applies to settlements in cases in which the insurer has breached
the duty to defend. In such cases, the insurer is obligated to pay
the reasonable portion of an unreasonable settlement. By
contrast, an insurer that is fulfilling the duty to defend by
defending under a reservation of rights has no obligation to pay
any portion of an unreasonable settlement entered into without
its consent.\textsuperscript{112}

This is an improvement on the Minnesota-Arizona rule, but it is still flawed in the same
way that rule is.

The rationale for the rule stated by the Principles is that:

This rule allows insureds to manage the risk of personal liability
from the trial of a claim. The reasonableness and allocation
requirements protect the insurer from fraud or collusion between
the insured and the claimant.

The effect of the rule is to give an insurer that is disputing

\textsuperscript{111} PRINCIPLES OF THE LAW OF LIABILITY INSURANCE § 28(3) (Tent. Dr. No. 2 Mar. 28, 2014). The
American Law Institute has converted this project into one to produce a Restatement of the Law of
Liability Insurance, and the previously approved Principles are being revised to comport with the differing
standards applicable to Restatements. As yet, no draft Restatement has been approved by the Annual
Meeting of the ALI, so no draft represents the policy of the ALI. However, a Council Draft was approved
by the ALI Council in October and will be presented to the Annual Meeting in May. The quoted language
was essentially carried forward into that draft, with only stylistic changes.

\textsuperscript{112} PRINCIPLES, § 28 cmt. e. The quoted language was essentially carried forward into the Council Draft of
the Restatement, with only stylistic changes.
coverage for a claim the choice between (a) accepting the coverage obligation and retaining control of the defense and settlement of the claim or (b) preserving the right to contest coverage and conceding some control of the case to the insured. The rule encourages insurers to drop weak coverage defenses in order to maintain control of the underlying claim, because it is primarily the insurer’s money at stake in the underlying litigation when a coverage defense is weak. The rule encourages insurers with strong coverage defenses to grant control over settlement to the insured. Insured control over settlement in such cases is appropriate: because of the strong coverage defense, it is primarily the insured’s money at stake.\textsuperscript{113}

But this ignores the fact that control of settlement is divisible, so that the insured is always free to settle any noncovered exposure at the insured’s own expense. (See § 4.05\textsuperscript{[1]}, above.) Thus, without disturbing insurer control over covered settlements, the insured is always free to “manage the risk of personal liability.” Proceeding based on divisible control results in each party paying for the portion of the liability risk that the policy allocated to it, while the rule stated by the Principles is likely to shift some of the settlement cost attributable to the noncovered exposure from the insured to the insurer (and, thereby, to other members of the risk pool who may not share the noncovered risk).

For reasons previously stated (see § 4.05\textsuperscript{[1]}, above), the insurer’s ability to obtain post-settlement review of the reasonableness of the settlement is not an adequate substitute for an insurer’s ability to settle only for amounts it finds acceptable. Precisely because doubts on that issue would be called in favor of the insured, the insured is adequately protected by the ability to bring a claim for failure to settle if a covered judgment in excess of policy limits results or to assign that claim to the claimant, in return for a covenant not to execute.

No reason is given for encouraging insurers to drop weak coverage defenses. Even weak defenses sometimes succeed, and pressuring insurers to drop them would necessarily inflate premium costs for members of the insurance pool who do not share the noncovered risks to which those defenses pertain. The divided control of settlement allowed by standard policy language obviates any justification for denying enforcement to the standard settlement restrictions merely because there is a coverage issue.

\textsuperscript{113} PRINCIPLES, Sec. 28, cmt. e. The quoted language was essentially carried forward into the Council Draft of the Restatement, with only stylistic changes.