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Insurance 101: The Right to Settle: When Policyholders and Insurance Companies Disagree

Diana Shafter Gliedman– December 1, 2017

Deciding whether to settle or fight a lawsuit is a serious and sensitive endeavor. Defendants to a lawsuit must analyze the financial, legal, emotional, and business costs involved with battling it out in a public forum. For some litigants, protecting their privacy, avoiding risk, and reducing the stress of litigation is worth the price of settlement (even if they believe they are in the right); for others, the chance to publicly refute a false allegation is worth the price of a fight.

What many parties to litigation do not recognize, however, is that most liability insurance policies do not simply maintain that the insurance company will pay for the defense; they also provide the insurance company with the right, under certain circumstances, to control aspects of the defense of the underlying action, including whether and when to settle. For that reason, whether the policyholder wants to settle a complex case and simply be done with it, or is determined to reject settlement and fight a baseless claim to the bitter end, it is crucial that the covered party know its rights and the rights of its insurance company.

Consent to Settle May Not Be "Unreasonably Withheld"
Many standard commercial general liability provisions state that a policyholder may not enter into a settlement without an insurance company's consent, stipulating that "[n]o Claims Expenses shall be incurred or settlements made, contractual obligations assumed or liability admitted with respect to any Claim without the Insurer's written consent, which shall not be unreasonably withheld." Other policies do away with the reasonableness requirement altogether, simply stating that "[n]o 'insured' will, except at that insured's own cost, voluntarily make a payment . . . or incur any expense, other than for first aid, without our written consent." Some insurance policies even purport to limit a policyholder's ability to bring legal action against the insurance company seeking reimbursement for a settlement unless the settlement has been approved. For example, certain CGL policies contain a variation of the following condition: "Legal Action Against Us: You will have no right of action against us under this policy unless all of its terms have been fully complied with; and the amount that you seek to recover has been determined by settlement with our consent or by final judgment against an insured."

At first reading, these provisions seem to suggest that if an insurance company refuses to settle an underlying case, the policyholder is entirely without recourse. This is not the case. Based on the language of these provisions, it is clear that in most cases, the policyholder must seek the insurance company's consent before entering into a settlement with a plaintiff. Courts, however, generally do not permit an insurance company arbitrarily to withhold consent to a reasonable settlement.[1]

Such was the case in the oft-cited *Traders & General Insurance Co. v. Rudco Oil & Gas Co*.[2] In that seminal case, Traders agreed to defend Rudco in any lawsuits filed against it. After an incident involving Rudco and various injured parties, Rudco settled with the parties and sought consent and indemnification from Traders. Traders refused and Rudco sought relief from the court. Finding for Rudco, the court reasoned:

> [The insurance company's] obligation to defend and to pay is primary and paramount; consequently, its right to control the litigation is first and paramount. . . . But, the rights of the insurer in these circumstances are not absolute, they are subject to moderation by the rule of right and justice. *Exclusive authority to act does not necessarily mean the right to act arbitrarily.*

[W]here the insured is clearly liable and the insurer refuses to make a settlement, thus protecting the insured from a possible judgment for damages in excess of the amount of the insurance, the refusal must be made in good faith and upon reasonable grounds for the belief that the amount required to effect a settlement is excessive.[3]

Many courts have found this to be the rule of law even if the policy does not expressly state that consent will not be withheld unreasonably, because every policy contains an inherent, if unstated, duty of good faith and fair dealing:

> Under liability or indemnity policies in which the insurer assumes the duty of defending or settling suits against the insured, this obligation is one requiring due care and a strict performance in utmost good faith. In such case, the insurer owes the duty to exercise reasonable care in conducting the defense, and is liable for damages resulting to the insured by reason of its negligence in performing such duty. . . . *It is generally agreed that under policy provisions giving the insurer the right to defend and settle claims against the insured, the insurer may be held liable to the insured for any damage to the insured ensuing where the insurer acts with bad faith toward the insured and improperly refuses or fails to compromise the claim involved*. Moreover, there is authority to the effect that this liability of the insurer to the insured also obtains if the insurer negligently fails to settle a claim against the insured.[4]

Not All Refusals Are "Unreasonable"

While many courts hold that policyholders should not be bound by capricious or unreasonable refusals to settle, this does not negate the language of the "consent to settle" provision or the obligations it imposes. Indeed, in *Vincent Soybean & Grain Co. v. Lloyd's Underwriters of London*,[5] the court made it clear that an insurance company's refusal to authorize a settlement does not, in and of itself, constitute bad faith, even if the policyholder keeps the insurance company fully informed and involved in settlement discussions:

> Lloyd's was not guilty of bad faith as defined in Snowden. It did not unreasonably delay or refuse to take action after notice of the claim—Parr promptly investigated the claim by requesting documents and exchanging letters with Vincent, by speaking with Vincent's owner and insurance agent, and by seeking independent advice regarding the reasonableness of Eubanks's damage claim. Nor did Lloyd's refuse to defend. It accepted defense of the claim and never withdrew from the case. Some three months after notifying Lloyd's of the claim, Vincent wrote Parr, asserting that if Lloyd's did not take "all reasonable efforts" to settle the Eubanks claim within thirty days, Vincent "will no longer consider itself bound by [the cooperation clause.]" Vincent argues that Lloyd's acted in bad faith when it failed to comply with this demand. We disagree. Lloyd's never refused to settle. It simply refused to relinquish control of the settlement process. That was not bad faith; it was part of Lloyd's right to control defense of a claim it had agreed to defend.[6]

Some states make compliance with a consent-to-settle provision a condition precedent to recovery under the policy, and breach of that provision may result in forfeiture of coverage. For example, under New Jersey law, "an insured cannot take any meaningful steps toward an early settlement of the claim without risking loss of coverage."[7] However, "[w]hile the right to control settlements reserved to insurers is an important and significant provision of the policy contract, it is a right which an insurer forfeits when it violates its own contractual obligation to the insured"—for example, by unreasonably delaying the investigation or handling of a covered claim or by otherwise breaching the implied duty of good faith and fair dealing inherent in all insurance policies.[8] Thus, in New Jersey, to demonstrate that a policyholder is entitled to coverage notwithstanding a settlement entered into without the insurance company's consent, the policyholder must show that (1) the insurance company materially breached its policy, (2) the underlying settlement was reasonable, and (3) the underlying settlement was entered into in good faith.

The Failure to Settle and Excess Judgments

If an insurance company is given the opportunity to settle within policy limits but fails to do so, it may be held liable for a subsequent judgment, even if that judgment exceeds the policy's limits. In particular, as explained by the court in Pavia v. State Farm *Mutual Automobile Insurance Co.*,[9] the insurance company will be held responsible for satisfying an excess verdict if (a) it lost the opportunity to settle the case for within the policy limits when it was highly probable there would be an excess verdict and (b) the insurer acted in "gross disregard" of the insured's interests. The justification for this ruling is clear: Where an insurance company exercises control over the defense and settlement of claims against its policyholder, it must act in the policyholder's best interest and act to avoid liability beyond the policy's limits. It is simply not permissible to "roll the dice" and hope for a positive verdict, where there is the likelihood of a verdict above policy limits. If the insurance company takes such a stance and risks an adverse judgment—acting with "gross disregard" of the policyholder's interest—it will be liable for the entirety of the adverse judgment, even if it exceeds policy limits.

In some jurisdictions, this is the rule even if the excess judgment includes uncovered damages, such as punitive damages. For example, the Eighth Circuit rejected an insurer's argument that it could not be liable for punitive damages because the automobile liability policy at issue excluded those damages.[10] The court's reasoning is instructive:

> Next, we take up AAA's argument that, because its policy excluded the recovery of punitive damages, the district court erred in allowing the jury award to stand. We disagree. We acknowledge that the policy excluded coverage for punitive damages, yet we hold that Carpenter is entitled to be made whole, which necessarily requires her to recover the amount of the punitive damages awarded to the Whites and Giles in the underlying state court action. Those damages are part of the consequential damages flowing from AAA's alleged bad faith and negligence in handling Carpenter's insurance claims.[11]

In California, however, an insurance company is not required to consider punitive damages exposure in evaluating a potential settlement. For example, in *Zieman Manufacturing Co. v. St. Paul Fire & Marine Insurance Co.*, the Ninth Circuit, applying California law, held that an insurance company had "no absolute duty to settle [a] claim merely because [the policyholder] risked a punitive damage award."[12] Rather, the court indicated that if an insurance company conscientiously evaluates a case involving potential punitive damages and seeks to achieve a reasonable settlement based on that evaluation, it will not be held liable if there is an eventual jury verdict that exceeds policy limits. According to the court, "[t]he proposition that an insurer must settle, at any figure demanded within the policy limits, an action in which punitive damages are sought is nothing short of absurd."[13]

When the Policyholder Wants to Fight

While the cases discussed above address the respective rights of the policyholder and insurance company when the policyholder wants to settle, sometimes the situation is reversed. An insurance company may wish to resolve a case quickly and cheaply, while the defendant policyholder may believe a settlement could have an adverse reputational effect or embolden other litigants.

Many liability policies give the insurance company the right to make an investigation and settle a claim or suit if deemed expedient. If the policyholder does not want to settle the underlying suit, there may be consequences. For example, a typical liability policy containing a duty to defend may contain the following provision:

> The Insurer shall have the right to appoint counsel, investigate and conduct negotiations and, with the consent of the Insured, to enter into the settlement of any Claim that the Insurer deems appropriate. If the Insured refuses to consent to a settlement acceptable to the claimant in accordance with the Insurer's recommendations;
>
> (1) The Insured will thereafter be solely responsible for negotiating and defending such Claim at their own expense; and
>
> (2) Subject to the insurer's aggregate Limit of Liability . . . the Insurer's liability with respect of any such Claim will not exceed the amount for which such Claim could have been settled by the Insurer, including Defense Expenses incurred up to and until the time that the Insured refuses to consent to settlement.[14]

Other policies simply purport to give the insurance company the right to settle any claim or suit within the available limits of coverage. Some courts have found that this type of policy language gives the insurance company the right to a settle an action, even if the policyholder objects to the terms of the settlement. That was the case in *Western Polymer Technology, Inc. v. Reliance Insurance Co.*[15]In *Western Polymer*, a policyholder (Western) sued its liability insurance company (Reliance) for bad faith after Reliance settled an action brought against Western for breach of a sales contract and negligence.[16] Western's independent defense counsel believed the settlement was excessive and would hurt the company's reputation, but Reliance settled the matter over counsel's objection.[17]Western sued, but the Court of Appeal of California, First District, held that Reliance had the right to settle, noting that

> Western's policy gave Reliance the right to "make such investigation and settlement of any claim or suit as it deems expedient." This type of clause is not unusual in liability insurance policies. In general, the insurer is entitled to control settlement negotiations without interference from the insured. As a result, an insurer normally cannot be liable to the insured if the insurer does no more than settle a claim or suit within the policy's limits.[18]

The court did note, however, that there were "limits to the latitude afforded an insurer in effecting a settlement pursuant to" these types of policies, noting that an insurance company had a duty not to use its discretionary settlement authority in a way that it knew would injure the insured's rights.[19]For example, in *Barney v. Aetna Casualty & Surety Co.*, the California Court of Appeal held that an insurance company acted in bad faith by settling an automobile accident claim when the settlement terms foreclosed the policyholder's claims against another party for injuries arising from the accident.[20]

Policyholders also may argue that a divergence in litigation strategy gives rise to a conflict of interest that entitles the policyholder to select independent counsel. Some states hold that "[d]ivergent defense strategies and goals in the underlying action" can trigger the right to independent counsel and the right to control the defense and settlement of the underlying action.[21]

This point is well demonstrated by *69th Street and 2nd Avenue Garage Associates v. Ticor Title Guarantee Co*.[22] In *Ticor Title*, the plaintiff purchased a parking garage located in a building and purchased title insurance from the defendant title insurance company. Subsequently, the building sought to terminate the plaintiff's ownership in the garage. The plaintiff argued that a conflict of interest existed between the garage and its insurer, which entitled the garage to choose its own counsel: On the one hand, the garage had an interest not only in its title but also in its continuing business, the retention of its employees, and other matters, and thus wished to resolve the litigation quickly; on the other hand, the insurance company's sole interest was in the garage's title, with the likelihood that its exposure would be reduced by the reduction of the plaintiff's equity interests caused by a fall of property values. Thus, the insurance company had an economic incentive to proceed very slowly in the title termination case. The New York Appellate Division, First Department, agreed that a conflict existed, reversing the decision of the lower court and holding that

> [t]he motion court concluded . . . that no conflict of interest existed between the plaintiff and the title insurance company, both having the "same united controlling interest, i.e., to vigorously defend against the adverse title claim." This, of course, reflects misunderstanding of the law. . . . In practically all, if not in all cases, the insured and the insurer will have a common interest in defeating the claim made against the insured. *What changed the rights of the insurer and the insured in those cases were the conflicts arising from their divergent interests, in how they would prefer to go about defeating such claims*. The interests of Garage Associates and Ticor diverged seriously here, though each wished to defeat the claim of the cond-op. Ticor, having insured the title of a heavily mortgaged property, could proceed leisurely. Garage Associates needed a quicker resolution to keep open the possibility of refinancing, to retain customers and employees, and to stay in business. There was a crucial conflict of interests between them, and Garage Associates had the right to its own attorneys. [23]

Know Your Rights, Know Your Policy
Liability policies and the state laws interpreting them can differ greatly. It is crucial that defendants and defense attorneys fully understand the rights afforded—and obligations imposed—by a given liability policy as they contemplate the resolution of an action.

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[1] *See* Bogan v. Progressive Cas. Ins. Co., 521 N.E.2d 447, 452 (1988) ("[A]n insurer may not avoid coverage by unreasonably refusing to consent to a settlement. . . .").
[2] Traders & Gen. Ins. Co. v. Rudco Oil & Gas Co., 129 F.2d 621(10th Cir. 1942).
[3] Traders, 129 F.2d at 626–27 (emphasis added).
[4] Home Indem. Co. v. Snowden, 223 Ark. 64, 70 (1954) (emphasis added). *See also* Fisher v. USAA Cas. Ins. Co., 973 F.2d 1103, 1107 (3d Cir. 1992) ("Nor may an insurer, once presented with a demand for consent, unduly delay its decision regarding coverage."); In re State Farm Mut. Ins. Co. v. Del Pizzo, 185 A.D.2d 352 (N.Y. App. Div. 2d Dep't 1992) (insurer ignored insured's request for release from rights and causes of action flowing from an earlier auto accident and as a result was deemed to acquiesce as a matter of law to the release as well as waive its right to object to insured's settlement with third party).
[5] Vincent Soybean & Grain Co. v. Lloyd's Underwriters of London, 246 F.3d 1129 (8th Cir. 2001).
[6] Vincent Soybean & Grain Co., 246 F.3d at 1132. *See also* Vigilant Ins. Co. v. Bear Stearns Cos., Inc., 10 N.Y.3d 170 (2008).
[7] Griggs v. Bertram, 88 N.J. 347, 360 (1982). *See also* N.J. Eye Center, P.A. v. Princeton Ins. Co., 394 N.J. Super. 557, 571 (App. Div. 2007) (noting that a "consent to settle" provision constitutes a condition precedent, and stating, "based upon this analysis, we do not find it necessary to even consider whether the findings of the judge below, that the procedure adopted was not the product of bad faith or collusion and the damages were reasonable in amount, were supported by the record. In our judgment, that is simply immaterial because the purported settlement represented such a fundamental breach of the insured's obligation to [its insurance company].")
[8] Fireman's Fund Ins. Co. v. Sec. Ins. Co., 72 N.J. 63, 71–72, 77 (1976).
[9] Pavia v. State Farm Mut. Auto. Ins. Co., 82 N.Y.2d 445, 453 (1993). *See also* J & N Logging Co. v. Rockwood Ins. Co., 848 F.2d 1438, 1440 (8th Cir. 1988) (holding that "an insured may maintain an action where the insurer has been guilty of bad faith toward the insured in failing to settle the insured party's claim within policy limits" and that "an insurer who is guilty of the breach alleged may be 'liable for the entire judgment against the insured even if it exceeds the policy limits'. . . .").
[10] Carpenter v. Auto. Club Interinsurance Exch., 58 F.3d 1296 (8th Cir. 1995).
[11] Carpenter, 58 F.3d at 1302.
[12] Zieman Mfg. Co. v. St. Paul Fire & Marine Ins. Co., 724 F.2d 1343, 1345 (9th Cir. 1983).
[13] Zieman Manufacturing Co., 724 F.2d at 1345.
[14] *See, e.g.*, Form RSG 24 1001 0609.
[15] W. Polymer Tech., Inc. v. Reliance Ins. Co., 32 Cal. App. 4th 14 (1995).
[16] Western Polymer, 32 Cal. App. 4th at 18.
[17] Western Polymer, 32 Cal. App. 4th at 20.
[18] Western Polymer, 32 Cal. App. 4th at 24. *See also* Vintilla v. Safeco Ins. Co., 417 F. Supp. 2d 922, 925 (N.D. Ohio 2006) ("[T]he insurer's duty to defend its insured is generally held to include the right to settle rather than litigate claims.").

[19] Western Polymer, 32 Cal. App. 4th at 26–28.
[20] Barney v. Aetna Cas. & Sur. Co., 185 Cal. App. 3d 966 (1986).
[21] Bovis Lend Lease LMB, Inc. v. Virginia Sur. Ins. Co., 2008 N.Y. Misc. LEXIS 10522 (N.Y. Sup. Ct. 2008).
[22] 69th St. & 2nd Ave. Garage Assocs., L.P. v. Ticor Title Guarantee Co., 207 A.D.2d 225, 622 N.Y.S.2d 13 (1st Dep't 1995).
[23] Ticor Title, 207 A.D.2d at 227–28 (emphasis added). *See also* Emons Indus., Inc. v. Liberty Mut. Ins. Co., 749 F. Supp. 1289, 1298 (S.D.N.Y. 1990) (holding that where insurance company had "a strong interest in reducing the defense costs it must pay," while policyholder had an interest in "vigorously defending [the underlying] suits," a conflict of interest existed, entitling policyholder to choose independent counsel).