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FEATURE STORY

Can Settling a Claim Destroy Insurance? Consent to Settle Clauses—A Trap for the Unwary

By William G. Passannante and David Kochman

Settling a liability claim requires serious consideration and often extensive negotiation. On the eve of such a settlement insurance companies have been advancing arguments regarding so-called "consent to settle" and "cooperation" clauses that leave policyholders in a quandary: (1) settle and face insurance company arguments about losing insurance coverage; or (2) refuse to settle and agree with your insurance company (which is contesting coverage) and thereby face the risk of proceeding as a defendant in a lawsuit. This Catch-22 is a tactic being used more commonly by insurance companies.

Leveraging the Policy's "Cooperation Clause" While Contesting Coverage

Similar to an unscrupulous business partner whose participation is both contingent and wholly self-interested, insurance companies improperly regularly leverage a policy's "cooperation clause" to require their consent for any settlement, even while they contest coverage pursuant to a reservation of rights. Courts have recognized the imbalance. When an insurance company contests coverage and can still rely on a consent to settle provision, "the insured risks financial catastrophe if they are held liable, while the insurer may save itself by litigating both issues—the insured's liability and the coverage defense—and winning either." *United Servs. Automobile Ass'n v. Morris*, 741 P.2d 246, 251 (Ariz. 1986).

Correspondingly, courts across the nation have adopted the rule that a policyholder, being defended subject to a reservation of rights, may reasonably settle claims without breaching the cooperation clause. Unfortunately, not every court has eliminated the insurance company's "double bite at escaping liability."

Settling Claims Without Breaching the "Cooperation Clause"

This scenario arose in a matter before the United States Court of Appeals for the Fifth Circuit in *Motiva Enterprises, LLC, v. St. Paul Fire and Marine Insurance Company and National Union Fire Insurance Company of Pittsburgh, Pennsylvania*, No. 05-20139 (February 6, 2006). The authors were counsel to United Policyholders which filed an *amicus curiae* brief in the case.

The *Motiva Enterprises* case stemmed from a \$16.5 million settlement reached between Motiva Enterprises, LLC, and a civil plaintiff for injuries sustained in a July 2001 sulfuric acid storage tank explosion at a Delaware refinery which killed one employee and injured several others. As the Court explained, National Union Fire Insurance Company, an excess insurance company, at first conditionally disclaimed coverage on the ground

that the underlying insurance policies had not been exhausted, and reserved its right to supplement its disclaimer in the future. While National Union subsequently withdrew its disclaimer of coverage, two days before a scheduled mediation of one of these claims, National Union tendered its offer to defend the policyholder subject to a reservation of rights to deny coverage. At the mediation, while National Union was present the only settlement demand it received was for \$40 million. The mediation continued without National Union present and ultimately Motiva agreed to pay \$16.5 million to resolve the claim.

Motiva's policy contained a settlement-without-consent exclusion which purported to require National Union's consent for any settlement. National Union did not argue prejudice or manifest unreasonableness of the settlement amount Motiva agreed to, but instead, refused to fund the settlement on the grounds that its consent had not been obtained. While the *Motiva Enterprises* court held that the trial court did not err in finding that Motiva breached the cooperation clause by virtue of the settlement, the court found, pursuant to the Texas law that an insurance company must demonstrate "actual, concrete" prejudice in order to avoid liability on the basis of a settlement-without-consent exclusion. Recently, in a separate decision, however, the same *Motiva Enterprises* court held that National Union did in fact suffer sufficient prejudice as a matter of law and has no obligation to reimburse Motiva for the settlement.

Conclusion

Allowing policyholders to settle claims without breaching a policy's cooperation clause is the proper rule. As policyholders approach settlement of liability claims, however, neutralizing improper Catch-22 claim approaches by insurance companies has become a necessary part of the settlement ritual. 📄

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