RESOLVING DISPUTES BETWEEN INSURER AND INSURED IN LIABILITY CASES

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Peter S. Selvin

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Conflicts between an insured and defense counsel appointed by the insurer often lead to disputes about whether the insured is entitled to counsel of its choosing. *See Simonyan v. Nationwide Insurance of America,* 78 Cal.App.5th 889, 2022 WL153894 (2022). More broadly, where a liability carrier has assumed its insured's defense under a reservation of rights, there may be a variety of conflicts between those parties that arise when there are settlement discussions to resolve the underlying liability case. These conflicts include:

- The insurer wants to settle in order to end its exposure for defense costs and the insured wants to continue to fight for business or reputational reasons.
- Where the policy has "burning limits" – i.e., defense costs reduce the amount of coverage available to pay a settlement or judgment – the insured has an incentive to have the carrier settle with the claimant early in the litigation.
- When coverage may be nullified if so-called "conduct exclusions" (typically found in D & O policies) may be supported by findings in the underlying case if it goes to trial, the insurer has a disincentive to settle. This is because carrier cannot litigate those "conduct exclusions" in a coverage suit if the underlying liability case is settled.

The question then arises: what tools does the insured have to compel its insurer to accept a settlement that it wishes to accept?

Independent Counsel. Under Civ. Code § 2860 an insurer is required to fund independent counsel for its insured when a conflict of interest arises between the parties. Such a conflict is deemed to arise when "an insurer reserves it rights on a given issue and the outcome of that coverage issue can be controlled by counsel first retained by the insurer for the defense of the claim". § 2860(b).

This option, however, has limitations. While independent counsel may more effectively advocate for settlement than the counsel selected by the insurance company, the insurer, even where it is defending under a reservation of rights,

retains control of settlement. *See, e.g., Rose v. Royal Ins. Co.,* 2 Cal.App.4th 709 (1991).

Policy Limits Demand. If the insured faces the prospect of a judgment in excess of policy limits, the insurer has an obligation to accept a reasonable settlement demand within policy limits. *See Comuale v. Traders & Gen Ins. Co.,* 50 Cal. 2d 654, 660 (1958). If the insurer spurns such a settlement opportunity, and the insured is later hit with a judgment in excess of policy limits, then the insurer may be liable for amounts above its policy limits. *See Johansen v. Cal. State Auto Assn. Inter-Ins. Bureau,* 15 Cal. 3d (1975). But importantly, this outcome is only available if the insured is able to demonstrate that the claim was covered from an indemnity point of view. *DeWitt v. Monterey Ins. Co.,* 204 Cal.App.4th 233 (2012).

Nevertheless, because of this potential exposure, a liability insurer may be incentivized to contribute more toward a settlement than it otherwise would. This is a key leverage point that the insured's counsel can utilize in the course of settlement discussions.

The Insurer's Duty To Accept A Reasonable Settlement. In considering whether to accept the claimant's settlement demand, an insurer has an implied duty of good faith that requires it to consider the interests of its insured on at least an equal level with its own. This duty requires it to evaluate settlement proposals as though it alone carried the entire risk of loss. *Diamond Heights Homeowners Ass'n v. Nat'l Am. Ins. Co.,* 227 Cal. App. 3d 563, 581 (1991).

In this regard, the pendency of a coverage dispute with its insured is not to affect, much less lessen, the insurer's duty to act in good faith with respect to the settlement of a potentially covered claim. In fact, in California an insurer may not consider its own coverage defenses in evaluating the reasonableness of a potential settlement. *Johansen, supra,* at p. 16. Indeed, "the existence of a coverage dispute, however meritorious the insurer's position, is simply not a proper consideration in deciding whether to accept an offer to settle the claim against the insured". *Archdale v. American International Specialty Lines,* 154 Cal.App.4th 449, 464-65 (2007).

This duty of good faith is important because an antecedent breach by the insurer of that duty relieves the insured of its obligation to secure the insurer's consent before settling with the claimant. *Jamestown Builders v. General Star Indem. Co.,* 77 Cal.App.4th 341, 348 (1999) ("The no-voluntary-payments provision is superseded by an insurer's antecedent breach of its coverage obligation. And the burden of proof shifts to the insurer to show that the settlement was not reasonable or was the product of fraud or collusion").

In such a case, the insured will argue that the carrier's breach of its duty to settle excused its own compliance with the policy's no-voluntary-payments provision. Indeed, some courts hold that when the insurer has refused, either negligently or in bad faith, to effect a reasonable settlement, the insured may make a settlement on its own initiative, then sue the insurer to recover the amount expended, notwithstanding the policy provision that no action may be filed against the insurer unless the insured has complied with all policy terms. *Couch On Insurance* 3rd, § 293:13 at pp. 203-10.

Another treatise summarizes this principle as follows: “Once an insurer breaches the duty to deal in good faith with respect to settlement, the insured may make a reasonable settlement and then seek reimbursement from the insurer (*see, e.g., Diamond Heights,* 227 Cal.App.3d at 581). A breach of the insurer's implied duty to deal in a good faith on settlement issues, like breach of any express provision of a policy such as the duty to defend, results in the insurer forfeiting its rights to enforce such policy provisions, including a no-action clause or cooperation clause, which may have given the insurer the rights to be involved in settlement of the underlying claim [*see Fireman's Fraud Ins,* Co., 367 A.2d at 869 (stating that the insured can act prudently and settle rather than being required to wait for trial, which the court equated to being "required to wait until after the storm before seeking refuge" (citing *Traders & General Ins. Co, v. Rudco Oil & Gas Co.,* 129 F. 2d 621, 627 (10th Cir. 1942))].” 2 *Appleman Insurance Law*, 2021 edition, § 24.19 [2].

But this course is not without risk if the insured settles with the claimant without the insurer’s participation or consent. Because the insured's breach of the policy’s consent or no-voluntary-payments provision will usually lead to a loss of coverage, the insured must establish in any subsequent bad faith lawsuit that the carrier committed an antecedent breach by failing to satisfy its duty to settle.

Convince The Carrier To Front The Settlement Payment, Subject To A Right Of Reimbursement. The California Supreme Court in *Blue Ridge vs. Jacobsen,* 25 Cal. 4th 489 (2001) held that where a liability insurer funds a settlement of a claim involving both covered and uncovered claims, it may seek reimbursement from its insured in a subsequent lawsuit as to settlement amounts allocable to the non-covered claims.

The pathway outlined in *Blue Ridge* has advantages for both the insurer and the insured. As to the insurer, fronting the settlement payment subject to the right of reimbursement presumably insulates it from a subsequent bad faith suit relating to its duty to settle. As to the insured, the *Blue Ridge* decision enhances the likelihood that its liability insurer will resolve the underlying claim. This is because it gives the insurer the right to recoup those portions of its payment relating to uncovered claims.

In *Blue Ridge*, the Court conditioned the insurer’s right to pursue recovery of the settlement payment from its insured on a timely and express reservation of rights, an express notification to the insured that the insurer intended to accept the claimant’s settlement offer, and an express offer to the insured that it may assume its own defense arising from the parties’ dispute about whether to accept the settlement offer.

As noted above, from the carrier’s standpoint, this scenario has the advantage of presumably insulating it from potential bad faith claims that could be asserted by its insured if the underlying lawsuit went to trial and an excess judgment were rendered. But such protection comes at a cost: the insurer bears the economic risk that its insured may be incapable of reimbursing it for the settlement payment that the insurer has advanced. However, this serves the societal interest of transferring the risk of nonpayment from the insured party to the insurer. *Blue Ridge, supra,* at 503.

Seek A Stay Of The Insurer’s Declaratory Relief Action. It is not unusual for an insurer defending under a reservation to rights to bring a declaratory relief action seeking a determination that there is no coverage for the underlying claim. As suits for declaratory relief are entitled to a trial preference (C.C.P. § 1062.3), an insurer may

be reluctant to settle the claim in the hopes that it will get a judicial determination that there is no coverage before the underlying liability case goes to trial.

An insured can even the playing field by seeking a stay of the insurer's declaratory relief action pending the outcome of the underlying liability suit, especially where there are overlapping issues as between the liability and coverage suits. *United Enterprises, Inc. v. Superior Court,* 183 Cal.App.4th 1004 (2010). The theory behind this principle is that the insured is not obliged to fight a "two-front war". *Haskell, Inc. v. Superior Court,* 33 Cal.App.4th 963 (1995).

Getting the insurer's declaratory relief case stayed improves the insured's bargaining power with its insurer. This is because absent the prospect of a quick determination of non-coverage, the insurer faces the likelihood that it will have to continue to fund its insured's defense until the conclusion of the liability suit. In these circumstances, the insurer may become more flexible when it comes to settling the underlying case.

These are some of the strategies that an insured can utilize to bring its liability insurer to the table and resolve an underlying liability case.

Editor's Note: The following article provides important information about the insured's rights when dealing with the insurance carrier in connection with the selection of legal representation and possible settlement of covered or partially covered claims. Employers with employment practices liability insurance (EPLI) are often caught in the situations described in the article without knowing their rights, often to their detriment. We therefore hope that this article, written by Peter Selvin, partner and Chair of the Firm's Insurance Coverage and Recovery Department, will serve to shed light on these issues and assist employers in obtaining the most beneficial results.