

The Legal Intelligencer

THE OLDEST LAW JOURNAL IN THE UNITED STATES 1843-2014

TUESDAY, AUGUST 26, 2014

An **ALM** Publication



The Future of Settlement Without Consent in Pa.

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Special to the Legal

A “consent to settle” clause is a common feature of liability insurance policies. The clause provides that an insurer is not responsible to pay a claim that the insured settles without the insurer’s consent.

This prohibition seems straightforward. However, given the sometimes conflicting interests of the insured and insurer where the insurer is defending under a reservation of rights or where the value of the claim exceeds the policy limits, application of this seemingly straightforward term can prove difficult.

It has been long established under Pennsylvania law that where an insurer wrongfully denies coverage to its insured, the insured is free to settle claims against it and obtain reimbursement from the insurer in spite of the insurance policy’s consent to settle provision. The courts reason that where the insurer breaches the insurance policy by refusing to defend, it excuses the insured’s compliance with the policy terms. Accordingly, where the insurer wrongfully refuses to defend, the insured is free to settle claims and obtain reimbursement from the insurer even though the settlement was never approved, or



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was actively objected to, by the insurer, as in *Alfiero v. Berks Mutual Leasing*, 500 A.2d 169 (Pa. Super. 1985)

But until recently, Pennsylvania cases provided little direct guidance as to the outcome where an insured settles a claim without the insurer’s permission while the insurer is providing a defense under a reservation of rights to deny coverage at a later date. In this situation, the insurer’s right to control the defense and settlement conflicts with the insured’s desire to protect itself by settling the claim. The Superior Court filled this gap in the case law with its panel decision in *Babcock &*

Wilcox v. American Nuclear Insurers, 76 A.3d 1 (Pa. Super. 2013), which was decided last July.

Babcock involved insurance coverage for two nuclear fuel processing facilities owned first by ARCO and later by Babcock & Wilcox. In 1994, B&W and ARCO were sued by five individuals and three purported class representatives in federal court alleging that they had sustained bodily injury and property damage caused by radioactive emissions from the facilities. Their liability insurer, American Nuclear Insurers (ANI) provided a defense to the lawsuits under a reservation of rights.

Counsel retained by the insureds negotiated a settlement of the claims for \$80 million over ANI’s objection. The insureds then sought reimbursement of the settlement from ANI, which had denied coverage based on the policies’ consent-to-settlement clauses. The issue before the court was the standard to be applied in determining whether the insureds were entitled to reimbursement.

B&W argued that it should be able to settle without the insurer’s consent and without forfeiting its right to coverage as long as the settlement was reasonable and entered into in good faith, the standard that applies when an insured settles a claim

after the insurer has wrongfully denied coverage, per *Alfiero*. Citing the Supreme Court's seminal "excess bad faith" decision, *Cowden v. Aetna Casualty and Surety*, 134 A.2d 233 (Pa. 1957), ANI advocated a standard that would have required the insureds to show by clear and convincing evidence that ANI had acted in bad faith in refusing to agree to the settlement.

Finding no applicable precedent under Pennsylvania law, the Superior Court looked to cases from other jurisdictions for guidance, ultimately adopting the approach set forth by the Florida Court of Appeals in *Taylor v. Safeco Insurance*, 361 So.2d 743 (Fla. Ct. App. 1978).

Relying on *Taylor*, the Superior Court held that an insured's ability to settle without the insurer's consent depends on whether the insured has accepted the insurer's offer of a defense. If the insured accepts the defense, it remains unqualifiedly bound to the terms of the consent-to-settlement provision of the underlying policy and the insurer retains full control of the litigation—including the decision to settle—consistent with the policy's terms, per *Babcock*.

Alternatively, the insured may decline the insurer's tender of a qualified defense and furnish its own defense at its own expense. If the insured chooses this option, it retains full control of the defense and may settle the underlying claim without the insurer's authorization. If coverage is found, the insured can recover the defense costs and the cost of settlement from the insurer, as long as the defense costs and settlement are fair, reasonable and noncollusive.

The Supreme Court granted B&W's petition for allowance of appeal in January. The question that will be considered is whether an insured forfeits its right to insurance coverage by settling a covered claim without its insurer's consent, where the insurer is defending subject to a reservation of rights to disclaim coverage, the settlement is at arm's length, is fair and is reasonable, and the insurer has failed to offer any amounts in settlement. Briefs were filed in March and the Supreme Court's decision is pending.

The Superior Court's decision in *Babcock* answers some question and raises others.

The decision puts to rest the question of whether an insured has a right to independent counsel where the insurer defends under a reservation.

Insureds sometimes claim that when an insurer offers a defense under a reservation of rights it creates a conflict of interest that allows the insured to hire counsel of its choosing, but at the insurer's expense, as in *Eckman v. Erie Insurance Exchange*, 21 A.3d 1203, 1207 (Pa. Super. 2011). Under *Babcock*, an insured that accepts a defense under a reservation of rights cedes control of the defense to the insurer, and this would logically include selection of counsel. *Babcock* suggests that where the insured believes that the reservation creates an irresolvable conflict with regard to the conduct of the defense, the insured's recourse would be to reject the defense and recover the cost of defense in addition to indemnity if coverage is later found. However, there do not seem to be any circumstance under which an insured could compel an insurer to pay for counsel selected by the insured prospectively.

Similarly, it also seems clear that an insured cannot reject a defense offered without reservation, defend the case itself and later seek reimbursement of defense costs or payment of a settlement or award from the insurer. One of the primary concerns motivating the *Babcock* decision was the possibility that an insurer defending under a reservation might be able to skew the evidence developed in the underlying case so as to affect the insurer's obligation to provide coverage. Where the insurer has accepted coverage without reservation, this potential conflict does not exist and there is therefore no reason to permit the insured to reject the insurer's defense and thus interfere with the insurer's right to control defense and settlement.

What is not entirely clear is whether an insured can settle a case without the insurer's consent where the insurer is defending without reservation and a disagreement develops with respect to whether a settlement demand within policy limits should be accepted. *Babcock* suggests that the answer is no.

If an insured's acceptance of a defense with reservation prohibits the insured from settling without the insurer's consent, an insured's acceptance of a defense without reservation surely has the same result. Where a verdict in excess of policy limits occurs in that circumstance, the insured's recourse is to file an action for bad-faith failure to

settle under *Cowden*.

Finally, it is interesting to note that *Babcock* does not refer to the prejudice standard so often applied to policy conditions. Like the policy's cooperation clause and notice requirement, the consent-to-settle clause is a policy condition. Where an insured breaches other policy conditions, such as the cooperation clause or the notice requirement, the insurer is not relieved of its coverage obligation unless the insurer was prejudiced as a result of the breach, as in *Brakeman v. Potomac Insurance*, 472 Pa. 66, 371 A.2d 193 (1977), and *Forest City Grant Liberty Associates v. Genro II*, 438 Pa. Super. 553, 559, 652 A.2d 948, 951 (1995). The courts have reasoned that the purpose of the notice and cooperation clauses is to ensure that the insurer has a full and fair opportunity to investigate and defend claims for which it will be called upon to pay indemnity. Where violation of the condition has not affected the insurer's ability to investigate or defend, forfeiture of coverage does not serve the purpose of the provisions. The consent-to-settlement provision is aimed at preventing the insurer from having to pay damages greater than those for which the insured is legally liable and therefore one could argue that a reasonable settlement that approximates the damages the insured would have had to pay anyway presents the same "no harm, no foul" scenario.

The consent-to-settle clause continues to be a complicated issue for an insurer. While cases like *Babcock* offer some answers to insurers in Pennsylvania, the issues will continue to evolve and change, especially once the appeal is heard by the Supreme Court. •