YOU DID… WHAT!

Looking at post-breach settlements under the light of a torch passed to third-party claimants

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[William Ford (Moderator) Collins Ford, LLP

Wendy Feng Covington & Burling, LLP

Jean Lawler Lawler ADR Services

Ellen Van Mier Thompson Coe

AMERICAN COLLEGE OF COVERAGE COUNSEL

THE *GRAY* RULE

If the insurer wrongfully fails to defend it will be liable for the amount of a judgment against its insured whenever the trial in the underlying action involved a theory of recovery within the coverage of the policy and it was not clear whether the jury's verdict was based upon that theory.

(*Gray v. Zurich Insurance Company*, 65 Cal. 2d 263 (1966) (*Gray*).)

THE *ISAACSON* RULE

[I]f an insurer wrongfully fails to provide coverage or a defense, and the insured then settles the claim, the insured is given the benefit of an evidentiary presumption. In a later action against the insurer for reimbursement based on a breach of its contractual duty to defend the action, a reasonable settlement made by the insured to terminate the underlying claim against him may be used as presumptive evidence of the insured's liability on the underlying claim, and the amount of such liability.

Isaacson v. California Ins. Guarantee Assn., 44 Cal. 3d 775, 791–92 (1988) (quoting *Clark v. Bellefonte Ins. Co.*, 113 Cal.App.3d 326, 335 (1980) (additional citations omitted).

THE *HOGAN/GEDDES* RULE

One consequence of an insurer's failure to defend is that it may be bound in a subsequent suit to enforce the policy (on in a direct action under Insurance Code, § 11580), by the express or implied resolution in the underlying action of the factual matters upon which coverage turns. Thus, where the issues upon which coverage depends are not raised or necessarily adjudicated in the underlying action, then the insurer is free to litigate those issues in the subsequent action and present any defenses not inconsistent with the judgment against its insured.

(*Hogan v. Midland National Ins. Co.*, 3 Cal. 3d 553 at 564-565 (1970); *Geddes & Smith, Inc. v. St. Paul Mercury Indemnity Co.*, 51 Cal. 2d 558, 561-562 (1959); *see, Pruyn v. Agriculture Ins. Co.,* 36 Cal. App. 4th 500 at 514, n. 15.)

DUE PROCESS

But, . . . What about procedural Due Process?

- **Where the insured enters into a post-breach settlement, the insurer always has the right to contest whether the deal was reasonable and non-collusive. The availability of this defense guarantees fairness and due process.**

- **"A nonparty insurer must be given a fair opportunity to litigate the question of whether the settlement was unreasonable or was the product of fraud or collusion between a settling insured and the claimant."**

(*Pruyn v. Agricultural Ins. Co.*, 36 Cal. App. 4th 500, 527 (1995).)

ESTOPPEL

Under the estoppel rule, "an insurer will be precluded from denying coverage after it has unjustifiably refused to defend."

(Allan D. Windt, *Insurance Claims and Disputes: Representation of Insurance Companies and Insured* §4:37 (2015); see, Stanley C. Nardoni, *Estoppel for Insurers who Breach Their Duty to Defend: Answering Critics*, 50 J. Marshall Law Rev. 53 (2016)

In May of 2019, the Restatement of the Law of Liability Insurance (RLLI) passed. One section, §19, styled "Consequences of Breach of the Duty to Defend," reads as follows: "An insurer that breaches the duty to defend a legal action forfeits the right to assert any control over the defense or settlement of the action."

BIG PICTURE

- **DUTY defend**
- **BREACH of duty to defend**
- **RIGHT to settle, reasonably and without fraud or collusion**
- **In later suit for reimbursement of the post-breach settlement, the Settlement gives rise to PRESUMPTIONS: (a) liability and (b) amount of liability**
- **DUE PROCESS served because Insurer has the right to litigate whether post-breach settlement was reasonable or non-collusive.**

BIG PICTURE (CONT'D)

- **PUBLIC POLICIES are important:**

(a) ENCOURAGE PERFORMANCE AND DISCOURAGE BREACH:

- **The presumptions only arise in cases of breach of the duty to defend or denials of coverage--thus, their purpose is to provide a disincentive for breach--if the insured had to prove "coverage" the presumptions would be rendered pointless.**

(b) CONSERVE JUDICIAL RESOURCES:

- **By breaching the defense obligation, insurer "rejected chance to contest liability, it cannot reach back for due process to void a deal the insured has entered to eliminate personal liability."** (*Hamilton v. Maryland Cas. Co.*, 27 Cal. 4th 718, 728 (2002).)

"Where such a breach has occurred, there is an obvious need, as a matter of policy, to permit the insured to protect his or her position by settling the third party's claim, so long as the settlement is in fact reasonable. The unacceptable alternative would be to compel the insured, following the insurer's breach, invariably to force the dispute to trial and thus to incur unnecessary expenditure of the insured's own money and of the state's overtaxed judicial resources." (*Xebec Dev. Partners, Ltd. v. National Union Fire Ins.*, 12 Cal. App. 4th 501, 549 (1993).