NEWS & ARTICLES

OFFER TO DEFEND UNDER ROR COULD GIVE INSURED CONTROL OF SETTLEMENT

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On July 10, 2013, the Superior Court of Pennsylvania issued a ruling that examined law from across the country regarding whether the insured or insurer controls settlement after the insurer defends under a reservation of rights. The Court ruled that Pennsylvania will join the states that give the insured the option of whether to accept the insurer's defense under a reservation of rights. If the insured accepts such a defense, then the insurer can control settlement decisions. If the insured rejects a qualified defense, then the insured must be granted independent counsel who can then enter any reasonable settlement without the insurer's consent.

In *Babcok & Wilcox et. al. v. American Nuclear Insurers, et al.* , (Case No. 525 WDA 2012), the insured was faced with hundreds of bodily injury and property damage claims arising from radioactive emissions at two nuclear fuel processing plants. The insurers agreed to defend the matters, paying over $40 million in defense costs under reservations of rights. After a round of coverage litigation, the insured was entitled to select independent counsel to defend itself. The insured's independent counsel then settled hundreds of claims for $80 million, over the insurer's objections. The insurer claimed that it need not cover the settlements because the insured had breached the consent to settlement clauses in the policies, even though the settlement was within the $320 million policy limit.

The insurer argued that it should not be forced to pay the $80 million settlement because the insurance policy unambiguously affords the insurer the right to control settlement and to exclude coverage for unauthorized payments. The insurer also argued that, based upon Pennsylvania precedent, coverage for the settlement should be barred because the insured ignored the insurer's bona fide belief that there were legitimate and reasonable defenses to liability and because the insurer's desire to litigate was made honestly.

The Superior Court of Pennsylvania considered three approaches as to how defending under a reservation of rights may impact an insurer's right to control the settlement:

Approach 1: An insurer who defends a case under a reservation of rights retains its right to control the defense and settlement. In other words, the insurer retains full authority under the consent to settle provision. *Vincent Soybean & Grain Co., Inc. v. Lloyd's Underwriters of London*, 246 F.3d 1129 (8th Cir. 2001)(Arkansas law). The Pennsylvania Superior Court rejected this approach because it failed to recognize that an insurer who defends under a reservation of rights may very well have different interests than the insured in terms of settling a claim expeditiously within the policy limits, so it is not appropriate for the insurer to retain complete settlement control when it defends under a reservation of rights.

Approach 2: An insurer who defends under a reservation of rights is bound by any reasonable settlement within policy limits reached by the insured. The insurer loses the right to rely upon the consent to settle provision. The trial court had adopted this view, explaining "There is not much difference between the interest of the insured where coverage has been denied and the interests of the insured where the insurance company is providing a defense under a reservation of rights." So, under Approach 2, a defense under a reservation of rights is essentially treated like a denial for purposes of turning settlement control over to the insured.

States adopting Approach 2 include: Arizona, *United Servs. Auto. Ass'n v. Morris*, 741 P.2d 246(Ariz. 1987); Iowa, *Kelly v. Iowa Mut. Ins. Co.*, 620 N.W.2d 637 (Iowa 2000); Maine, *Patrons Oxford Ins. Co. v. Harris*, 905 A.2d 819 (Me. 2006); and Washington, *Martin v. Johnson*, 170 P.3d 1198 (Wash. Ct. App. 2007). The Pennsylvania Superior Court rejected this approach because it contravened fundamental principles of contract law by robbing the insurer of access to the consent to settle provision, even when the insurer had not breached its insurance obligations.

Approach 3: When an insurer offers to defend under a reservation of rights, the insured can choose to: 1) accept the defense, in which case the insurer has exclusive control over defense and settlement, including the consent to settle provision, or 2) reject the insurer's qualified defense and then retain its own counsel and control its own defense at the insured's expense. Under this option, if the insured settles a case within the policy limits, then the insurer is bound by that settlement, as long as it is deemed fair, reasonable and non-collusive. This "Approach 3" was derived from the Florida case, *Taylor v. Safeco Ins. Co.,* 361 SO.2d 743 (Fla.Ct.App. 1978), as well as a line of Missouri cases applying the *Taylor* approach.

The court found that the third approach is what will govern in Pennsylvania. The party controlling the defense—whether it be insured or insurer—is the party that retains the unqualified prerogative to proceed in settlement negotiations the way that it determines is best. In this case, the Court remanded the matter for the trial court to determine: 1) Did the insured reject the defense under a reservation of rights? 2) If the insured did not reject the defense, then the insurer was free to have refused to settle, as long as the insurer's position was one of good faith.

Please do not hesitate to contact us should you have questions on this case or any other issues regarding the challenges and impact of reserving rights.

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