Three Recent Cases Tell Insurers, Denying Coverage or Reserving Rights are Indistinguishable When the Insured Settles With or Without Consent

Pennsylvania

Babcock & Wilcox v American Nuclear Insurers, et al

The PA Superior court's holding in Babcock and Wilcox v American Nuclear changes the rules for carriers and is a roadmap for an insured when a Reservation of Rights is issued.

American Nuclear Insurers provided coverage at the Apollo and Parks nuclear fuel processing facilities initially owned by Babcock and Wilcox at the time of the suit. Five individuals and three class representatives filed suit alleging bodily injury and property damage as a result of exposure to radioactive emissions. Known as the "Hall" case, it later grew to a class of over 300 plaintiffs. The defendants denied the allegations of liability and damages.

A "test" case of eight plaintiffs went to a verdict of $33.7 MIL against Babcock and Wilcox and its predecessor, Atlantic Richfield Company (ARCO), plus $2.8 MIL against only Babcock and Wilcox. A new trial was granted based on evidentiary issues. Coverage disputes soon arose.

American Nuclear filed a declaratory judgment action seeking a ruling on if American Nuclear was required to provide ARCO with separate counsel and alleging bad faith and breach of contract against Babcock and Wilcox. Babcock and Wilcox counter-sued for bad faith and similar declaratory relief.

While the DJ's were proceeding and over the objections of American Nuclear, counsel for Babcock and Wilcox settled the Hall case for $80 MIL, an amount less than the $360 MIL in available coverage.

In the jury trial on coverage, the judge applied the following standard: "…there was no principled distinction between a case in which an insurer provides a defense subject to a reservation of rights, the circumstances before the trial court, and a case where the insurer denies both defense and coverage." The court's analysis concluded American Nuclear would be required to reimburse Babcock and Wilcox as long as the settlement was "fair, reasonable and noncollusive". The court used this standard of review:

"[W]hen the insurance company has denied coverage and a defense, case law (using principles of waiver, estoppel, and implied obligations of good faith and fair dealing) allows the insured who has entered into a fair and reasonable settlement over the opposition of the insurance company to obtain reimbursement from the insurance company (assuming there is coverage).

The reason for this outcome is that the insurance company should not be making settlement decisions on behalf of the insured [while repudiating its obligations to defend and indemnify] where the insured may be liable for the verdict entered in the underlying case.

This is equally true where the insurance company is providing a defense under a reservation of rights. The insurance company should not be the sole decision maker where there is a possibility that only the insured's interests will be affected by the outcome of the underlying litigation.

When a defense is being provided under a reservation of rights, the interests of the insurance company, with respect to settlement of the underlying litigation, conflict with the interests of the insured. Because the insured may be responsible for paying any verdict, in most instances it desires to cap potential liability through a settlement at the lowest amount it can achieve. However, the insurance company is likely to reject a settlement offer that is fair and reasonable because by accepting the offer, it would be giving up its claim that there is no coverage.

The more that the company will deny the insured's request to agree to what appears to be a very reasonable settlement offer because (unless the parties otherwise agree) the only way for the insurance company to challenge coverage is by having the underlying case proceed to trial.[4] Also, where a verdict in the underlying case is very unfavorable to the insured, the likelihood increases that the insurance company will vigorously litigate coverage issues. Thus, there is not much difference between the interests 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. . . .

A ruling that an insured may enter into a reasonable settlement offer made in good faith and without collusion recognizes both the interests of the insurance company and the insured. It allows the insurance company to continue to make decisions as to settlement (including the right to reject reasonable settlement offers) by withdrawing the right to challenge coverage. However, if the insurance company wants to preserve the option of questioning coverage, it cannot prevent the insured from protecting its interests in capping liability through a settlement that is fair and reasonable."

The Superior Court applied the holdings of v. Safeco Insurance Company, 361 So.2d 743 (Fla. Ct. App. 1978), in support of the lower court's decision. The Taylor court held "[j]ust as the insurer is not required to abandon its contest of a duty to pay as a condition of fulfilling an assumed or admitted duty to defend, the insured is not required to abandon control of his own defense as the price of preserving his claim, disputed by the insurer, that the insurer pay any judgment."

These rulings effectively allow the insured to reject the qualified defense and retain their own attorney. The insured then moves to settle the case for a reasonable amount and then seek reimbursement from the carrier for indemnity costs and legal cost. Of course, the carrier could

argue that the loss was not covered or that the settlement was not reasonable. Not easy to do when the court approves the settlement or issues rulings on coverage. Plus, the discovery can be targeted to support the insured's claim for coverage.

One unanswered question is does the insurer have an obligation to advise the insured of the option to reject the defense when the insurer issues an ROR letter? It is a long standing practice of carriers to advise the insured of their option to obtain an attorney at the insured's own expense to protect the insured against uninsured exposures. It may seem logical that if the Babcock ruling stands, such an obligation would be placed on the insurer. Notice of this option on every ROR letter now would certainly "stir the pot" and raise many questions. However, failing to notify the insured now, puts the carrier at risk of an unfavorable judicial review.

Another question is when the defense counsel appointed by the carrier becomes aware of a reservation of rights issued by the carrier is defense counsel obligated to advise the client of their rights under these rulings?

In a majority of cases, this is a non-starter. Most insureds do not have the means to pay for a defense and a settlement in the hopes of recovery against the carrier. However, sophisticated and well-funded insureds will have more to consider when the carrier provides a qualified defense under an ROR.

PA Supreme Court review has been sought but not yet granted.

Missouri

Columbia Casualty Company v Hiar Holdings, LLC

The Missouri Supreme Court has taken this concept a step further. In Columbia Casualty Company v Hiar Holdings, LLC, No SC93026, the insurer initially refused a defense of a class action suit on the basis that the claims were not covered. The plaintiff offered to settle within the $2Mil policy limit and Hiar again tendered the case to Columbia Casualty. Columbia stood by their disclaimer and refused to participate in any settlement discussions.

Hiar defended the case and ultimately settled for $5MIL. The trial court determined the settlement was fair and reasonable and not the product of collusion. Importantly, the trial court also held that "property damage" and "advertising injury" coverage was triggered under the Columbia policy. When interest was added in, the total amount of damages rose to $8.4MIL.

Hiar assigned its rights to the class. The class brought a garnishment action against Columbia seeking the full amount of damages.

Ultimately, the Missouri Supreme Court held the carrier's wrongful refusal to defend Hiar placed the carrier in line for all damages flowing from the breach of its duty. Columbia's argument that its maximum obligation was for the $2MIL policy limit failed to persuade the court. The court wrote:

"Because Columbia wrongly denied coverage and even a defense under a reservation of rights, and also refused to engage in settlement negotiations, Columbia should not avoid liability for the settlement judgment entered in this case. Columbia cannot benefit from its wrongful refusal to assume control of the proceedings. As such, the trial court did not err in determining Columbia's liability for the class's settlement."

The Missouri Supreme Court has granted re-argument on this case.

New York

K2 Investment Group, LLC v American Guarantee and Liability Insurance Company

In New York in June of 2103 the New York Court of Appeals handed down their ruling in K2Investment Group, LLC v. American Guarantee and Liability Insurance Company. In the underlying coverage action, the trial court ruled on summary judgment that the carrier breached its duty to defend and was therefore required to indemnify regardless of any exclusionary language in the policy. The Appellate Division affirmed with one dissent which gave leave for an appeal to the Court of Appeals. The Court of Appeals held that when the carrier breaches its duty to defend, it loses the right to rely on policy exclusions to later deny coverage.

Summary

The pattern in these rulings is that a carrier cannot place an insured in an untenable position, by denying coverage or providing a qualified defense, without risking the consequences. In short, if the carrier is wrong, they'd better get the check book ready.

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