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# A TALE OF TWO REFUSAL TO CONSENT TO SETTLEMENT CASES

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A pair of decisions this spring reached different results where an excess insurer failed or refused to consent to a settlement by the insured. In a Ninth Circuit Court of Appeals case, an excess insurer monitoring the underlying lawsuit was found liable after it refused to fund a settlement or to timely take over the defense. In a First Circuit case, the excess insurer was found not liable, not because it failed to consent to a reasonable settlement; but rather because of the structure of the underlying settlement.

In *Teleflex Med. Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, 851 F.3d 976 (9th Cir. 2017) (applying California law), the insured LMA (which merged with Teleflex) and competitor Ambu were distributors of laryngeal mask airway products. LMA was insured by Transportation ($1 million limit of liability) and National Union ($14 million limit). LMA sued Ambu for patent infringement related to certain masks. Ambu counterclaimed for trade disparagement and false advertising. The district court granted summary judgment to Ambu and against LMA on the patent claims, and denied summary judgment to LMA on Ambu's counterclaims.

Following this ruling, the parties held a two-day mediation in January, 2011. National Union did not attend, but received daily updates from LMA's counsel. Ambu and LMA agreed conditionally that Ambu would pay LMA $8.75 million for the patent claims; and LMA would pay Ambu $4.75 million for the disparagement claims.

The settlement was conditioned on the funding by Transportation and National Union. Transportation agreed, but National Union did not. Instead, National Union asked for an updated analysis of liability and damages from LMA's counsel, even though counsel previously provided pleadings, discovery, verbal reports, access to other information and a case report evaluating LMA's exposure on the counter claims at up to $10 million, excluding trebling of damages (a potential under the Lanham Act). Two months later, LMA's counsel provided the updated analysis, noting the $10 million exposure, substantial defense costs, and asserting that $4.75 million was a fair and reasonable settlement. LMA also advised National Union that it had three options: accept the settlement, reject the settlement and take over the defense, or reject the settlement, refuse to defend, and leave LMA the choice of pursuing reimbursement. Instead of a reply, National Union sent a list of further questions about the proposed settlement. LMA responded four days later and again advised National Union of its three options.

On April 7, 2011, National Union declined to consent to the settlement. On April 13 and 14, LMA again requested that National Union take up the defense, otherwise it would finalize the settlement. Having no response, LMA finalized the settlement on April 18. On April 21 National Union advised it would accept the defense and asked LMA's counsel if he could undo the settlement. LMA said that the executed settlement could not be undone, and National Union's belated acceptance of defense was little more than a manufactured defense to an anticipated bad faith claim.

LMA then sued National Union for breach of contract and bad faith for failing to either contribute toward the reasonable settlement of underlying lawsuit or takeover the defense. National Union unsuccessfully moved for summary judgment arguing that the "voluntary payments" and "no action" clauses precluded LMA's suit. The matter was tried and a jury found that National Union breached its contract and acted in bad faith. It awarded $3.75 million in contract damages, over $1.21 million in attorney's fees (available in California if bad faith is shown) andapproximately$1.1 million in prejudgment interest, for a total of just over $6 million. The court denied National Union's motions for new trial and for judgment. National Union appealed and the Ninth Circuit affirmed.

The Ninth Circuit relied on the California Court of Appeal's decision in *Diamond Heights Homeowners Association v. National American Ins. Co.*, 227 Cal. App. 3d 563, 227 Cal. Rptr. 906 (1991) as correctly predicting how the California Supreme Court would resolve the issue of whether and how an insured and primary insurer could settle for an amount invading the excess coverage, without the consent of the excess and without a trial. In *Diamond Heights*, the court identified three appropriate responses by an excess insurer presented with a proposed settlement of a covered claim that has been agreed to by the primary insurer and the insured. "The excess insurer must (1) approve the proposed settlement, (2) reject it and take over the defense, or (3) reject it, decline to take over the defense, and face a potential lawsuit by the insured seeking contribution toward the settlement." *Id*. at 580-81. These are the three options which the insured's counsel had laid out for National Union and National Union chose the last option

National Union's efforts to distinguish *Diamond Heights* were unavailing. It first argued that *Diamond Heights* was not an accurate predictor of California law because it had been effectively overruled in *Waller v. Truck Ins. Exch*., 11 Cal.4th 1, 44 Cal. Rptr. 2nd 370, 900 P. 2nd 619 (1995). *Waller* was a waiver case and held that insurer did not waive a coverage defense when it failed to disclose the defense in the denial letter. The Ninth Circuit disagreed finding *Waller* and *Diamond Heights* reconcilable because unlike a policy exclusion, the court opined that the "no action" and "no voluntary payment" clauses do not create absolute rights to veto settlements.

National Union then tried to distinguish *Diamond Heights* on the facts, which the Ninth Circuit rejected. National Union also attacked the reasonableness of the settlement because liability remained uncertain at the time of settlement. The court noted: "the fact that discovery had not been completed in this case was relevant to the reasonableness of the settlement but did not render the rule inapplicable. Here, the jury found the settlement to be reasonable. Indeed, there may be good reasons to settle mid-discovery, such as the risk of disclosing damaging documents, rather than on the eve of trial." *Teleflex, supra*, 851 F.3d at 986.

Finally, National Union argued that LMA acted in self-interest, since it was receiving a substantial payment from Ambu. That certainly seems like a good argument when one looks at the settlement. Ambu had obtained summary judgment, yet it was agreeing to pay a substantial amount of money to LMA to settle. But this issue to the Ninth Circuit found was resolved by the jury finding that the settlement was reasonable and not the product of collusion.

Three thousand miles away on the other coast, the First Circuit also reviewed a decision concerning an excess insurer and its settlement obligations. In *Salvati v. American Ins. Co.*, 855 F.3d 40 (1st Cir. 2017) (applying Massachusetts law), Gerardo Salvati died while doing maintenance work at the Lovejoy Wharf building. While he was standing on a ladder, examining the brick facade of the building, brickwork came

loose and hit him causing him to fall to his death. The building had been in a state of disrepair for years, and the owners knew that the building's brickwork needed repair.

Gerardo Salvati's wife, Lucia ("Salvati"), individually and as executrix of her husband's estate, sued the owners of the building and Easton (Gerardo Salvati's supervisor at the time and the person holding the ladder when the accident occurred) for wrongful death and loss of consortium (the "Insureds"). The Insured shared a primary insurance policy with Western World Insurance ($1 million limit) and an excess policy with the American Insurance Company ("AIC") ($9 million limit).

AIC advised the Insureds that it would not defend or indemnify them. At mediation, Salvati made a settlement demand for an amount in excess of the primary limit, but within the AIC limit. Although AIC had denied coverage, a representative and an attorney from AIC attended the mediation. The parties did not settle at the mediation. Salvati sent a demand letter to AIC seeking payment under the Excess Policy. AIC once again denied coverage.

Salvati and the Insureds finally settled for $6 million. The Settlement Agreement provided for payment of $6 million to Salvati; released Western World and the Insureds from any further liability in exchange for tendering the full $1 million of the Western World primary policy; and assigned all of the insureds' rights against AIC to Salvati, allowing her to seek recovery of the remaining $5 million from the excess policy. The Agreement stipulated that the settlement was not contingent on the ultimate availability of the excess coverage and the insureds did not represent that excess coverage was necessarily available. The insureds also expressly disclaimed wrongdoing in the Agreement.

Pursuant to Massachusetts law, which requires court approval of settlements of cases in which workers' compensation benefits have been paid under Mass. Gen. Lawsch.152,§15, the Superior Court approved the Settlement Agreement, and the case was dismissed with prejudice. Salvati, as the assignee of the insureds, then sued AIC for breach of contract, declaratory relief, and related counts.

AIC moved to dismiss. The district court granted this motion, holding that the amended complaint failed to state a claim for breach of contract and declaratory judgment. The court reasoned that AIC's duty to indemnify could only be triggered when the insureds became legally obligated to pay Salvati. Here, however, the insureds had not incurred such an obligation "because the Underlying Action was dismissed with prejudice and no judgment entered against the Insureds." The court noted that "AIC was not a party to the underlying settlement and thus never agreed or became contractually bound to pay the $5 million." Salvati appealed. AIC agreed in its policy to "pay on behalf of any Insured those sums in excess of the Primary Insurance that any Insured becomes legally obligated to pay as damages." Salvati argued that AIC's duty to indemnify the insureds was triggered when the insured assigned the Settlement Agreement, and that AIC breached by failing to do so.

AIC responded that it had no duty to indemnify under the Settlement Agreement because only a judgment can "legally obligate" a party to pay "damages." The district court agreed with AIC and held that "there was never any legal determination of liability" because "no judgment entered against" the Insureds, and thus AIC has no duty to indemnify the Insureds for the $5 million in excess of Western World's payment.

The First Circuit affirmed, although on different grounds. The court disagreed with AIC that the term "damages" required a court judgment finding various policy provisions supported the conclusion that the

policy provides indemnity coverage for settlements. For instance, the definition of "suit" included alternative dispute resolution proceedings in which damages are claimed. Secondly, the AIC policy could be triggered by a settlement which reduces or exhausts underlying policy limits. Thirdly, the policy provided AIC with the authority to settle a "claim" or "suit." The First Circuit looked at the various policy provisions to conclude the policy provided coverage for "damages" claimed or paid by way of settlement when not accompanied by a judgment.

AIC next contended that even if the insureds became "legally obligated to pay ... damages" through a settlement, that the Settlement Agreement did not trigger a duty to indemnify because it did not legally obligate the insureds to pay anything beyond the $1 million primary limit. The Settlement Agreement created a settlement in the amount of $6 million, but only required payment from Western World for $1 million. The remaining value was attributed to the assignment to Salvati of the insureds' rights against AIC. In return, the plaintiff released the insureds and Western World from liability and dismissed the lawsuit. AIC argued that the release of the insureds from liability and the parties' agreement to dismiss the suit means that the insureds are not "legally obligated to pay" the remaining $5 million. Therefore, the Agreement did not trigger AIC's indemnification obligation and it did not breach its policy by refusing to indemnify the insureds.

The court noted that Salvati did not respond to this argument in her briefs or explain how the Settlement Agreement imposed on the insureds a legal obligation to pay the $5 million to trigger the Excess Policy. Salvati merely asserted that, because the primary policy was exhausted and $5 million of the $6 million settlement amount remains unpaid, AIC must pay that remaining amount. Instead, Salvati analyzed the obligations of excess insurers generally and acknowledged that a primary insurer must exhaust the full limits of its coverage before an excess insurer can be required to contribute to a compromise settlement or judgment. She pointed out that Western World had exhausted its policy limits. She argued that AIC's duty to indemnify must be determined by the basis for the settlement. She asserted that "the entire settlement was made in compensation for the acts of the [Insureds]," and that those acts were covered by the excess policy. And she argued that the settlement was made in good faith and in reasonable anticipation of liability.

Nonetheless, the court found that the Settlement Agreement did not create a "legal [ ] obligat[ion]" to pay the $5 million. The court noted that a settlement structured differently could have met the requirements of the Excess Policy by creating a "legal obligation" on the part of the insureds, while achieving the parties' apparent goal of shielding the insureds from direct exposure to liability. The court offered two examples where a settlement created a legal obligation without direct exposure to the insured. First, the court noted that the parties could have entered into a settlement agreement and an agreement for judgment contemporaneously with an assignment of claims and a *conditional release* of the defendants (contingent on their cooperation with the plaintiffs' future lawsuit). See *Campione v. Wilson*, 422 Mass. 185, 661 N.E.2d 658, 660-62 (1996). Under this example, the insured remains legally obligated to pay the judgment, but it is protected from liability because the plaintiff contractually agreed to pursue the insurer only. As such, the insured's liability is not extinguished by the settlement under this scenario. The First Circuit conceded this is a technical difference, but legally significant given the plain language of the policy.

Two consent to settle cases, two different outcomes.

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