LOS ANGELES
Daily Journal
www.dailyjournal.com
WEDNESDAY, MAY 3, 2107

PERSPECTIVE

'Fettering' insurers' right to settle cases against insureds

By Pamela M. Woods

Liability insurance policies often provide that, when an insurer is defending claims against an insured, the insurer may settle claims "as it deems expedient" or at its discretion. Many insurers take the position that such a "deems expedient" or "discretionary" provision gives the insurer the unfettered right to settle claims against the insured, even when the insured is unaware of the settlement or is aware of a potential settlement and objects to it. Indeed, insurers often take the position that they have an absolute right to settle cases even when the insurer is defending the insured under a reservation of rights.

For obvious reasons, this position is problematic for insureds. If the insurers have the absolute and unfettered right to settle cases against their insureds, they very well may do so based on what is best for the insurer, not what is best for the insured. The insurer would be able to enter into settlements that are damaging to the insured, both with respect to any ongoing lawsuit and with respect to the insured's rights outside of the lawsuit. In addition, the insurer would be able to do so without even telling the insured. However, particularly when an insurer is defending under a reservation of rights, there are several reasons why the insurer should not have the absolute authority to settle a claim.

First, several California cases state that when the insurer is defending the insured under a reservation of rights, and provides and pays for *Cumis* counsel, the insured, not the insurer, controls the defense of the underlying action. *Hartford Cas. Ins. Co. v. J.R. Marketing, L.L.C.*, 61 Cal. 4th 988, 1011 (2015) ("'*Cumis* counsel represents the insured independently of the insurer,' and its attorney-client relationship exists with the insured, not the insurer. Thus, when it comes to defending the third party action, the insured retains ultimate decision-making authority." (citations omitted)); *Long v. Century Indem. Co.*, 163 Cal. App. 4th 1460, 1470 (2008) (when there is a conflict of interest between the insurer and the insured, "the insurer is required to provide its insured with independent counsel of the insured's choosing 'who represents the insured, not the insurer; and the insured may thereafter control the defense of the case"); *Assurance Co. of Am. v. Haven*, 32 Cal. App. 4th 78, 87 (1995) ("An important corollary of the *Cumis* doctrine is that if the insured is entitled to *Cumis* counsel, the insured is entitled to control the defense of the case."). An absolute unfettered right of an insurer to settle a claim as to which it has reserved its rights is inconsistent with these holdings that the insured, and not the insurer, controls the defense of such cases.

Second, such a position is inconsistent with California Civil Code Section 2860. Section 2860 applies when "provisions of a policy of insurance impose a duty to defend upon an insurer and a conflict of interest arises which creates a duty on the part of the insurer to provide independent counsel." Section 2860(f) provides that "[w]here the insured selects independent counsel pursuant to the provisions of this section, *both the counsel provided by the insurer and independent counsel selected by the insured shall be allowed to participate in all aspects of the litigation.*" (emphasis added). This language is directly contrary to an insurer's claim that its right to settle a case as to which it has reserved rights is absolute and that it has no obligation to involve the insured and its independent counsel in settlement discussions. As the court stated in *Novak v. Low, Ball & Lynch*, 77 Cal. App. 4th 278, 284 (1999), "[t] he section 2860 equilibrium is shattered when counsel provided by the insurer shuts the independent counsel out of the [settlement] process."

> Insurers often take the position that they have an absolute right to settle cases even when the insurer is defending the insured under a reservation of rights.

Third, in a series of cases, California courts recognize that even when a policy contains a "deems expedient" clause or allows for settlement in the insurer's discretion, the insurer must act in good faith in exercising that discretion.

In *Barney v. Aetna Casualty & Surety Co.*, 185 Cal. App. 3d 966 (1986), the court found that an insured had a bad faith claim against its insurer when the insurer settled an underlying lawsuit against the insured claim with prejudice, which barred insured's claim again underlying plaintiff. The insured alleged that the insurer knew of the potential claim against the underlying plaintiff and made the settlement without knowledge or consent of insured to save the insurer the costs of litigation. The court noted that although the policy provided that the insurer "may make such investigation and settlement of any claim or suit as it deems expedient," when "a contract confers on one party a discretionary power affecting the rights of the other, a duty is imposed to exercise that discretion in good faith and in accordance with fair dealing." (citations omitted) The court stated that "the derogation of [the insured's] collateral right to counterclaim against [the underlying plaintiff] deprived her of the policy's benefits as surely as if [the insurer] unreasonably had refused to indemnify, defend or settle at all."

Other courts have reached similar conclusions. *See, e.g., Security Officers Serv., Inc. v. State Comp. Ins. Fund*, 17 Cal. App. 4th 887, 894- 95 (1993) (the "'covenant of good faith finds particular application in situations where one party is invested with a discretionary power affecting the rights of another.' Thus 'the insurer, when determining whether to settle a claim, must give at least as much consideration to the welfare of its insured as it gives to its own interests.'"); *Rothtrock v. Ohio Farmers Ins. Co.*, 233 Cal. App. 2d 616, 623 (1965) (insurer may not, without the knowledge or consent of the client, "compromise with impunity that litigation for reasons foreign to the client's substantial rights or best interests"); *Ivy v. Pac. Auto. Ins. Co.*, 156 Cal. App. 2d 652, 659-61 (1958) (the insurer violated the duty it owed to the insured when, without investigating the facts or informing the insured, the insurer made stipulations that were damaging to the insured's defense of the underlying claim, and agreed to a judgment in excess of the policy limits solely to save money).

However, courts in some cases have found that insurers did not act in bad faith in entering into settlements over their insureds' objections. For example, in *Western Polymer Technology, Inc. v. Reliance Insurance Co.*, 32 Cal. App. 4th 14 (1995), the court found that the insurer did not breach the duty of good faith and fair dealing by entering into settlements which the insured claimed harmed the insured's reputation in its industry and might prejudice the insured's counterclaims against the underlying plaintiffs. The court recognized that "there are limits to the latitude afforded insurers in effecting settlements pursuant to 'deems expedient' clauses" and that there were "circumstances under which an insurer could be liable for bad faith when settling a claim against the insured within policy limits." However, the court found that the insured's "slender claims of impaired interests differ in kind and character from the actionable injuries recognized in *Rothrock, Barney* and *Security Officers Service*."

In sum, particularly when an insurer is defending an insured under a reservation of rights, the insured and its independent counsel should make clear to the insurer that the insurer may not enter into any settlement negotiations with the claimant without the participation of the independent counsel. Further, in any such negotiations, independent counsel should advise the insurer of any interests of the insured that might be compromised by any settlement terms and remind the insurer of its obligation to act in good faith in entering into any settlement.


WOODS

Pamela M. Woods *is a partner in Liner LLP's Insurance Recovery Group. She represents insureds in complex insurance coverage matters.*