By Mark L. Austrian and Elissa O. Tomanda

Settling Contribution Claims Without Jeopardizing Your Insurance Coverage

In an all too familiar scenario, a company seeks contribution from a third party for an environmental cleanup, but its insurer "tentatively" denies coverage pending a court resolution and refuses to pay for the cleanup or the third-party litigation. The policyholder is forced to advance cleanup costs and finance its contribution action without the insurer's help. Following an extensive period of litigation, the third party agrees to settle and pay for a portion of the cleanup in exchange for a general release. Meanwhile, the insurer—who has not participated in this lawsuit—asserts rights under a "consent to settle" clause to block the settlement simply by claiming it is unreasonably low and may harm its subrogation rights. What's a policyholder to do?

The courts have held that a denial of coverage constitutes a waiver of a "consent to settle" provision. *See*, *e.g.*, *Sexton v. Cont'l Cas. Co.*, 816 P.2d 1135, 1137 (Okla. 1991). The law is less clear when an insurer "tentatively" denies coverage and refuses to pay for third-party litigation pending a court resolution. That refusal forces a policyholder to face painful dilemmas: (1) continue to prosecute the contribution action; (2) try to get the insurer to agree to provide coverage; or (3) settle with the third party, spend additional money in an insurance coverage action, defend the settlement on the merits, and risk forfeiture of coverage if it loses. In the meantime, the carrier is not forced to spend a penny or to participate in the litigation or settlement negotiations. It can simply wait until the insured runs low on money and patience, force a favorable settlement in the coverage litigation, and then reap the benefits of the insured's efforts against the third party in a subrogation action.

This was a policyholder's dilemma in a recent environmental coverage case, *Riggins, Inc. v. Hartford Ins. Co.*, No. CUM-L-151-01 (N.J. Super. Ct. Law Div. Oct. 3, 2008), in which the carriers tentatively denied coverage and sought to derail a third-party settlement. However, the *Riggins* court took a unique approach to finally bring the six-year-old coverage and contribution cases to a fair conclusion. It held that Riggins' insurers could not both deny that their policies apply and also assert their right under those policies to consent to a settlement. To avoid risk to the insurers that the settlement was collusive or patently unreasonable, the court required Riggins to provide the carriers with notice of the settlement and give the insurers the option of nullifying the settlement by paying Riggins the settlement amount and taking over the third-party proceedings. The court ruled that if the insurers refused to take over the proceedings, they would be barred from challenging the reasonableness of the settlement. Not surprising, the insurers elected not to take over the third-party action, and the insurance coverage case was settled as well.

This article examines the approach taken in *Riggins* and provides practical advice for policyholders seeking to enforce their rights against recalcitrant insurers. It first provides background on consent to settle and subrogation provisions, their purpose, and application. The next section addresses the order in *Riggins* and how it expands prior case law. Finally, the article provides some practical pointers that policyholders should follow to protect their insurance assets when insurers refuse to consent to a proposed settlement.

Commercial General Liability Policies and Consent to Settle and Subrogation Clauses

Every business owner knows that Commercial General Liability (CGL) insurance is a vital asset when a company is involved in litigation, as it applies broadly to cover defense fees and pay court judgments and settlements. In some instances, a CGL policy also will cover a policyholder's third-party contribution action. *See*, *e.g.*, *TIG Ins. Co. v. Nobel Learning Cmtys., Inc.*, No. Civ. A 01-4708, 2002 WL 1340332, at *14 (E.D. Pa. 2002) (duty to defend extends to pursuit of counterclaims); *Louisville and Jefferson Cty. Metropolitan Sewer Distr. v. Travelers Ins. Co.*, 753 F.2d 533, 540 (6th Cir. 1985) (where insurer wrongfully refuses to pursue other liable parties, policyholder entitled to recover costs of doing it on its own). Because potential coverage is very broad, CGL policies contain consent to settle and subrogation clauses to protect insurers. Those clauses, which appear in other insurance policies as well, allow an insurer to block a settlement when a policyholder cannot demonstrate that it is reasonable.

Consent to Settle and Subrogation: Protection for the Insurer

A consent to settle requirement, a standard provision in CGL policies, is often incorporated through the following, or similar, language:

> No insured will, except at that insured's own cost, voluntarily make a payment, assume any obligation, or incur any expense, other than for first aid, without our consent.

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A settlement is covered by insurance if the policyholder can demonstrate that it is reasonable in light of the potential liability, and the insurer is provided an opportunity to consent. Typically, an insurer cannot withhold consent unreasonably. The purpose of the consent to settle clause is to protect an insurer from unreasonable or fraudulent settlements. It is further meant to protect an insurer's right to subrogation. It is with these interests in mind that many courts have upheld and enforced consent to settle provisions. *See*, *e.g.*, *Vigilant Ins. Co. v. Bear Stearns Cos., Inc.*, 884 N.E.2d 1044 (N.Y. 2008) (enforcing consent to settle clause where policyholder informed insurer of settlement after it was signed).

A subrogation provision, also standard in CGL policies, often contains the following or similar language:

> In the event of any payment under this policy, the insurer shall be subrogated to all the insured's rights of recovery against any person or organization…. The insured shall do nothing after loss to prejudice such rights.

To the extent that an insurer pays a claim, most CGL policies subrogate the insurer to its policyholder's rights of recovery against third parties.

A subrogation provision prevents double recovery by the policyholder, once from the insurer and once from the liable third party. It also enables an insurer to recoup those amounts paid under the policy from the ultimately liable party, by placing the insurer in the shoes of its insured. Most subrogation provisions compel policyholders to protect the subrogation rights of the insurer. Because the right of subrogation is derivative, an insurer can claim only its policyholder's rights. As a result, an insured may not release a claim against a potentially responsible third party without first consulting its insurer.

Consent to Settle and Subrogation: Conflicts between Policyholders and Insurers

A policyholder's violation of the consent to settle or subrogation provision can permit the insurer to deny coverage. Because exclusionary clauses in insurance policies generally are disfavored, they are strictly construed against insurers, and it is the insurer's burden to prove that an exclusion applies. In a jurisdiction that strictly applies consent to settle provisions, such as New York, violations result in a complete bar to coverage. *See*, *e.g.*, *Vigilant Ins. Co.*, 884 N.E.2d 1044. In other jurisdictions, before an insurer can avoid coverage, it must also prove that its interests were prejudiced by a policyholder's failure to obtain consent. *See*, *e.g.*, *Nationwide Ins. Co. v. Schneider*, 906 A.2d 586, 592–92 (Pa. Super. Ct. 2006). Even when a court is inclined to hold that a policyholder's violation of a consent to settle clause does not bar coverage, in most jurisdictions an insurer may still challenge the reasonableness of a settlement. The amount of coverage might be reduced by the reasonable amount of the settlement. *See*, *e.g.*, *United Servs. Auto. Assoc. v. Morris*, 741 P.2d 246, 253 (Ariz. 1987) (policyholder seeking payment of settlement reached without consent has the burden of establishing reasonableness); *but see*, *e.g.*, *U.S. Auto Ass'n v. Hartford Ins. Co.*, 468 So. 2d 545 (Fla. App. 1985) (if insurer refuses defense, it cannot challenge reasonableness of settlement between policyholder and injured party). Given the unsettled state of the law, if a court finds that a settlement is unreasonable, the policyholder risks forfeiting all or some of its coverage.

Riggins favorably expands the law for policyholders by limiting an insurer's right to challenge the reasonableness of a settlement while continuing to tentatively deny coverage.

An insurer's ability to block a settlement under a consent to settle provision has in some circumstances led insurers to take advantage of their policyholders, while protecting themselves from liability, by forcing policyholders to go to trial. If a policyholder is held liable at trial or settles before trial, insurers have other opportunities to protect themselves from liability in an insurance coverage action by raising a long list of possible policy defenses. If a policyholder settles a contribution action against third parties, it again leaves an insurer with an opportunity to challenge coverage. If an insurer wins on just one front, it is free from liability. But in the meantime, a policyholder's options are much less attractive: settle without consent, potentially forfeiting coverage, or forgo settlement and proceed to trial, risking a verdict less favorable than that anticipated in a settlement, all while still risking a court finding that coverage does not apply. A policyholder must also bear the additional burden of paying its own attorneys' fees, which could be reduced by settling before trial.

Some courts have long recognized the imbalance that an insurer's improper leveraging of consent to settle and subrogation provisions creates:

> If… the insurer denies liability for the asserted claims and refuses to defend… the assured is released from the covenant against settlement or interference and may assume control of the litigation… or effect a reasonable and prudent settlement of the claims, or suits, and thereafter assert his rights under the policy; in which event, his right to recover against the insurer is generally measured by the coverage under the policy and the reasonableness of the settlement.

Traders & Gen. Ins. Co. v. Rudco Oil & Gas Co., 129 F.2d 621, 626 (10th Cir. 1942).

These courts have permitted policyholders in certain circumstances to reach settlements without insurer consent and without holding that the policyholders violated subrogation provisions.

The Importance of *Riggins* and How It Expands the Law

Riggins, Inc. v. Hartford Fire Insurance Co.

While insurers in most actions are permitted to challenge the reasonableness of a settlement before coverage is applied, the *Riggins* court extended the law by barring

the insurers from challenging the settlement's reasonableness unless they agreed to pay the settlement amount to Riggins and take over the third-party action. The court thus gave the insured the right to reach what it considered a fair result, and the insurers were protected from an unreasonable settlement since they had the right to seek what they considered a reasonable amount at trial.

Background

Riggins operated a bulk-oil facility and gasoline service stations in New Jersey. It discovered and reported potential contamination to the New Jersey Department of Environmental Protection, which issued a Notice of Probable Violation (NOPV). Riggins believed that two other companies, ExxonMobil Corporation (Exxon) and Anchor Hocking Corporation (Anchor), had contributed to the contamination, and it sought funds from them to use toward cleanup costs. Riggins notified its insurers of the NOPV and requested that they cover the cleanup costs and bring a third-party contribution action against Anchor. Riggins' insurers took a tentative coverage position, neither clearly denying coverage nor taking any action toward actually providing coverage. Riggins therefore filed a declaratory judgment action to have the insurers' rights and responsibilities determined.

Riggins settled with some of its insurers, but three carriers, North River Insurance Company, Globe Indemnity Company, and Mission National Insurance Company, through the New Jersey Property-Liability Guaranty Association, continued to deny coverage. Without the assistance of its insurers, Riggins filed its own lawsuit against Exxon and Anchor, and it was consolidated, for discovery purposes only, with the coverage action. All parties participated in mediation, and the contribution action progressed toward trial. Little progress was made in the coverage action, however, and it languished for six years. Due to the expense of the third-party action and its insurers' tentative denials of coverage, Riggins entered into settlement negotiations with Anchor. When it became clear that Riggins could settle with Anchor for what it viewed as a satisfactory amount, Riggins sought its insurers' approval. After denying a contractual responsibility to Riggins under their policies, the insurers relied on those very same policies to withhold consent to settle, arguing that the settlement was unreasonable and would destroy their subrogation rights. They did this even though the proposed settlement would undoubtedly reduce their liability.

The insurers' self-serving desire to wait to see if Riggins could obtain more money from Anchor at trial than through the settlement put them in a win-win situation: if Riggins succeeded at trial, the insurers' liability would decrease, and if Riggins failed at trial, the insurers could still challenge their responsibilities in a coverage action, without paying a penny. In contrast, Riggins was left in a very frustrating situation. It was incurring high costs in the third-party contribution action but faced a complete denial of insurance coverage if it accepted the proposed settlement. But if it took the settlement off the table, it would incur far more in attorneys' fees trying the third-party action while still risking a denial of coverage.

Motion for Declaratory Relief

In an effort to save money and motivate its insurers to provide coverage, Riggins sought a court declaration that, by denying coverage and refusing to pay for the contribution action, the insurers forfeited their rights to subrogation and to control settlement, and that Riggins' settlement without consent would not affect its coverage. Riggins relied primarily on case law involving under- and uninsured motor vehicle coverage insurance (UIM), which found consent to settle provisions unenforceable on the ground that they frustrated a public policy interest in protecting innocent victims from financially irresponsible motorists. Specifically, Riggins relied on *Longworth v. Van Houten*, 223 N.J. Super. 174, 538 A.2d 414 (N.J. Super. Ct. App. Div. 1988), in which an insurer tried to force its policyholder to go to trial against an underinsured motorist by refusing to permit a settlement. In that case, the court held that an insurer that refuses to consent to a settlement and also refuses to take over the litigation or pay its policyholder, waives its right to control settlement and its right to subrogation.

In response, the insurers attempted to distinguish these UIM cases by arguing that they are inapplicable to environmental coverage claims. The insurers also argued that Riggins had not met its burden to show that settlement was reasonable. Moreover, the insurers sought a declaration from the court that they would have the rights to challenge the reasonableness of settlements and to offset what they might eventually owe Riggins against settlement amounts.

The Court's Order and Its Effect on Insurance Coverage Law

The court granted Riggins' motion and denied the insurers' requests. The court declared that the insurers were barred from disapproving the settlement and from using it later as a defense to deny coverage. Further, it declared that the insurers had no right to challenge the reasonableness of the settlement, although they did have the option of paying Riggins the proposed settlement amount and taking over the third-party action, which would effectively give Riggins the monetary benefit of the settlement.

Riggins favorably expands the law for policyholders by limiting an insurer's right to challenge the reasonableness of a settlement while continuing to tentatively deny coverage, something few, if any, other courts have done. An insurer simply must decide whether it will provide or deny coverage. The *Riggins* order was issued without an opinion, but it appears that the court relied on public policy interests and also balanced the equities. Thus, the court justifiably could have relied on legal authority balancing the rights of the parties consistent with the state's public interest in: (1) cleaning up pollution in a timely manner, an interest analogous to that of protecting drivers from uninsured motorists; (2) encouraging recalcitrant insurers to fulfill their responsibilities; and (3) reducing the costs of litigation by encouraging settlements.

Legal Authority Supporting the *Riggins* Order

As discussed above, many courts have upheld and enforced consent to settle requirements. In certain circumstances, however, courts have permitted policyholders to settle with other parties without

their insurers' consent without jeopardizing their coverage.

Public Policy Interests

Courts in some jurisdictions have found that consent to settle clauses are unenforceable as contravening public policy. These courts find that the clauses violate public policy because they enable insurers that provide UIM coverage to refuse to take over policyholders' litigation against underinsured motorists, refuse to provide timely insurance benefits to policyholders, and, at the same time, prevent policyholders from settling on their own with underinsured motorists, frustrating the purpose of UIM insurance coverage, which is mandated by statute in some states. Some courts hold that consent to settle provisions further violate public policy because they impair an insured's right to manage and dispose of his or her claim and also frustrate the legislative design to decrease litigation and encourage prompt settlement. For a discussion of these public policy interests, *see*, for example, *Longworth*, 538 A.2d at 420. The *Riggins* court was likely persuaded by this body of law and may have determined that the same policies should apply to environmental cleanups.

The courts of other states, including Maryland, Massachusetts, and Illinois, have upheld and enforced consent to settle requirements in UIM policies. Other states, including Connecticut and Florida, have applied the same rules to UIM coverage that they apply to CGL coverage.

Unreasonable Insurers

Numerous courts have recognized that when an insurer acts unreasonably or in bad faith toward its policyholder, a consent to settle clause is not enforceable because an insured should not be "required to wait until after the storm before seeking refuge." *Traders & Gen. Ins. Co.*, 129 F.2d at 627. Courts have forced insurers to pay a settlement amount or the amount lost at trial, even when a final amount is more than anticipated during settlement negotiations, and sometimes, even when it exceeds a policy's limits.

When a policyholder's potential liability is within its policy limits, a proposed settlement is also within those limits, and if the insurer has agreed to defend and pay judgments but refuses its consent to settle, it is typically in the policyholder's best interests to forgo settlement and proceed to a trial. If the policyholder suffers a judgment that exceeds its policy limits, it can seek payment of that amount. *See*, *e.g.*, *Fireman's Fund Ins. Co. v. Security Ins. Co. of Hartford*, 367 A.2d 864, 870–71 (N.J. 1976) (relying on *Traders & Gen. Ins. Co.*, 129 F.2d 621). This benefits a policyholder when it assumed trial risks that it would not otherwise have assumed but for its insurer's refusal to consent to a settlement. On the other hand, if a policyholder's liability is likely to exceed its policy limits and a proposed settlement is in excess of those limits, an insured need not await a trial outcome, even if its insurer is defending the case. *See*, *e.g.*, *Traders & Gen. Ins. Co.*, 129 F.2d at 627. Rather, an insured can make a reasonable settlement in excess of its policy's limits and recover an amount up to the policy limits.

Coverage counsel can assist in analyzing policy language and can clarify how specific language might be interpreted by a court in a particular jurisdiction given certain facts.

Riggins had litigated against the third parties and its insurers for six years, while its insurers took no action to assist Riggins with its continually increasing costs and never moved beyond a tentative coverage position to either clearly agree to or deny coverage. This unreasonable behavior likely convinced the court that the insurers should not, in all fairness, be able to enforce the consent to settle clause against Riggins.

Reducing Litigation and Encouraging Settlements

Many courts have expressed an interest in reducing litigation costs and in encouraging settlements, as noted in a line of cases. *See U.S. v. Rohm & Haas Co.*, 721 F. Supp. 666, 686–87 (D.N.J. 1989) (discussing Congress' intent to encourage settlement of government environmental enforcement actions); *Thompson v. Commercial Union Ins. Co. of N.Y.*, 250 So. 2d 259, 263 (Fla. 1971) (in an auto accident case, the court stated that it is the "settled public policy of this state to encourage and favor compromise and settlement of controversies"). The *Riggins* court was likely persuaded by this rationale as well, especially given that the litigation between Riggins and the third parties had been ongoing for six years.

How Policyholders Can Protect Themselves When an Insurer Denies Consent to Settle

As the above discussion demonstrates, a consent to settle clause can wreak havoc on a policyholder that is denied the opportunity to settle its liability. Should your company find itself in Riggins' shoes, the following practical advice may help you to protect your insurance assets:

1. Familiarize yourself with your company's insurance policies and read the policies from cover to cover to determine if coverage likely will be available. Assume there is coverage unless something proves otherwise, and remember the following rules of construction:
   - Words in a policy are given their plain meaning, not technical meaning known only to insurers.
   - Words easily susceptible to more than one meaning are ambiguous and must be construed in a policyholder's favor.
   - Policies are interpreted so that every word has a meaning and there is no surplusage.

   Coverage counsel can assist in analyzing policy language and can clarify how specific language might be interpreted by a court in a particular jurisdiction given certain facts.
2. Remember that if coverage is denied, you should not assume that the insurer is correct or that a court would agree with its reasoning. Instead, you should consult with an attorney experienced in representing policyholders in insurance disputes. Insurers routinely deny their

policyholders' claims, but with the help of experienced attorneys, policyholders have convinced courts time and again to find that coverage does indeed apply.

3. Keep your insurers informed of the status and progress of liability and contribution actions. Provide copies of briefs, motions, court orders, and other decisions to them.
4. Advise your insurers immediately if you enter into settlement negotiations and request consent to reach a settlement within a certain dollar range. If consent is withheld and you decide to continue with settlement negotiations nonetheless, continue to advise your insurers of the status of those negotiations. Provide your insurers with the following information: the amounts offered; the risks involved in going to trial, including legal issues, projected defense costs, and potential liability; the likelihood of success; and the benefits of a settlement.
5. If you reach satisfactory settlement terms, seek approval from your insurers again, and explain why the settlement is beneficial.
6. If your insurers withhold consent, talk to counsel about the following options:
   - Accepting the settlement terms without consent, if you and your counsel are satisfied that the settlement is reasonable given the circumstances, and especially if liability is likely to exceed policy limits.
   - Consider forgoing the settlement and advancing to trial, especially if liability is likely to be within the policy limits. But warn your insurers that you believe that the proposed settlement is reasonable and that, should you suffer a verdict for a less favorable amount, you will seek coverage of the difference. If you suffer such a verdict, seek coverage.
   - Consider seeking an order allowing settlement without insurer consent and expressly forbidding insurer defenses on the grounds of violation of consent to settle or subrogation provisions. If this order is granted, you may need to await the expiration of the time for appeal, or you may even need to litigate the issue on appeal, to ensure it is safe to settle.
7. If you settle with a third party for contribution without your insurer's consent, keep in mind that the third party may seek additional protection and insist that you provide a complete release or indemnify it for future claims that may be brought by your insurers.