INSURANCE LAW

Will Your Settlement Be Paid by the Insurance Company?

by Richard A. Huver, Column Editor

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You just settled your client's lawsuit on the eve of trial. You assume the case is over, right? Did you ever wonder whether there was a chance the defendant's insurance company would refuse to pay the settlement you just negotiated with the defense attorney? Would you be able to collect if the defendant's insurance company claimed it had no duty to pay because the policy language did not require indemnification of the settlement?

A recent case out of California's Third District Court of Appeal stirred up some debate within the legal community regarding its ramifications on the obligations of an insurance company to pay a settlement. It should be noted at the outset the opinion is one in a long line of cases involving Aerojet-General Corporation and its seemingly never-ending environmental contamination problems. Aerojet has been responsible for several California decisions addressing insurance coverage issues -- all in the context of administrative environmental clean-up orders and lawsuits.

However, the question addressed by the court in the case of *Aerojet-General Corp. v. Commercial Union Ins. Co.* (2007) 155 Cal.App.4th 132 was broad enough to create concern regarding how far-reaching the decision would be: "whether settlement costs negotiated *within* the context of a court suit are 'damages' [within the meaning of an excess insurer's policy]." *Id.* at 143 (emphasis in original).

A quick overview of the "history" of the California decisions addressing these environmental claims and lawsuits is necessary. The story begins in 1998 when the California Supreme Court decided *Foster-Gardner, Inc. v. National Union Fire Ins. Co.* (1998) 18 Cal.4th 857, a case which arose from a series of administrative orders directing Foster-Gardner to clean up environmentally contaminated property. The claims were tendered to various insurers who denied coverage contending they had no duty to defend against a claim -- only a lawsuit. The Supreme Court agreed, holding the phrase "suit seeking damages" literally required that a lawsuit be filed before the insurer was obligated to defend its insured. Because the administrative orders clearly were not lawsuits, the insurers owed no duty to defend Foster-Gardner. *Id.* at 878-888.

The *Foster-Gardner* decision was followed three years later by *Certain Underwriters at Lloyd's of London v. Superior Court* (2001) 24 Cal.4th 945 ("*Powerine I*") wherein the Supreme Court held the duty to indemnify an insured was limited to money "damages" ordered by a court. There, the insured sought indemnity coverage for clean up costs paid pursuant to various administrative orders

-- again without any lawsuits having been filed. The Supreme Court concluded if there was no duty to defend against the administrative orders, there surely was no duty to indemnify, in part because the duty to defend is much broader than the duty to indemnify. However, the Supreme Court went further and held the phrase "pay all sums that the insured becomes legally obligated to pay as damages" only required payment of damages that were awarded or ordered by a court incident to a lawsuit. *Id.* at 961-962.

As respects excess insurers (as opposed to primary insurers), the California Supreme Court previously interpreted policy provisions in two separate cases to determine when and under what circumstances an excess carrier was obligated to indemnify its insured. Each case had an impact on the *Aerojet-General* opinion. In the first case, *Powerine Oil Co., Inc. v. Superior Court* (2005) 37 Cal.4th 377 ("*Powerine II"*), the Court held the specific policy language at issue required indemnification of sums which were agreed to via settlement without a lawsuit. The policy provision in *Powerine II* required indemnification: "**...for damages, direct or consequential and expenses, all as more fully defined by the term 'ultimate net loss'... ."**

"Ultimate net loss" was defined as the amount the insured was obligated to pay:
"...either through adjudication, compromise, and shall also include ...* expenses *... for litigation, settlement, adjustment and investigation of claims and suits... ." *Id.* at 395-396 (italics in original).

Conversely, in *County of San Diego v. Ace Property & Casualty Ins. Co.* (2005) 37 Cal.4th 406, the court held the excess carrier's policy language did not trigger any indemnity obligations to pay the costs of settling third party claims for environmental harm which were negotiated outside the context of litigation. The policy provision at issue here only required the insurer to indemnify the insured for:
... "all sums which the insured is obligated to pay by reason of liability imposed by law or assumed under contract or agreement," arising from "damages" caused by personal injuries or the destruction or loss of use of tangible property.
Id. at 411.

These decisions served as the basis for the *Aerojet-General Corp. v. Commercial Union Ins. Co.* opinion, in which the Supreme Court denied review. Aerojet was sued by various water agencies for contaminating groundwater in the San Gabriel Valley. Aerojet tendered the lawsuits to numerous primary and excess insurers. None of the excess insurers accepted tender of the defense or indemnity. Ultimately, the lawsuits were settled directly between Aerojet and the water entities for a total of $175 million, a sum which exceeded the total insurance coverage available from all its primary and excess policies.

With slight variations, each of the excess policies contained indemnification language requiring payment for: "...all sums which the Assured shall become legally obligated to pay, or by final judgment be adjudged to pay, to any person or persons as damages... ." *Id.* at 137.

In addition to the indemnity provision, the policies also contained "attachment of liability clauses" which stated the excess insurers were not liable for any indemnification until either the primary insurers admitted liability or the insured was held liable by a final judgment which exceeded the

underlying coverage limits and those limits had been exhausted. Finally, each policy contained a "no voluntary payments" clause which required the insurer's settlement consent. *Id.* at 138.

Aerojet demanded payment under its policies, but none of the excess insurers (four in total) agreed to contribute to the $175 million settlement. Aerojet filed suit for breach of contract and declaratory relief. On the eve of trial, the trial court granted summary judgment in favor of the insurers, holding they were not required to contribute toward the settlement.

Under *Powerine* ... the language in the policies at issue providing for payment of sums Aerojet becomes legally obligated to pay as damages is limited to sums Aerojet was ordered to pay by the court. The monies paid in settlement do not meet this definition.

Id. at 135-136.

On appeal, the Third District framed the issue to be decided as follows: "whether settlement costs negotiated *within* the context of a court suit are 'damages.'" Relying on the Supreme Court's decisions and the policy provisions referenced *infra*, the Third District held the settlement costs agreed to by Aerojet -- even though within the context of a lawsuit -- were not "damages" as defined by the policy's provisions because they were not ordered by a court. *Id.* at 143-144.

One would think the *Aerojet-General Corp.* decision would be narrowly construed to apply to the specific indemnity policy provisions at issue and to excess carriers in particular. (The indemnity obligations of an excess carrier differ from those of a primary insurer and are not addressed in this article.) Moreover, the unique facts of the case -- the excess insurers had refused to defend or indemnify Aerojet during the course of the litigation and thus had not participated in nor consented to the settlements reached between the parties -- would seem to further confine the breadth of the holding.

Nevertheless, the *Aerojet-General General* decision led to several articles concerning its affect on garden-variety settlements, including an article in the *Daily Journal* titled "Insurance Companies Could Be Off The Hook For Settlements." Other articles discussed whether the *Aerojet* decision would allow insurance companies to refuse to pay settlements based on policy provisions even though they were obligated to defend against the lawsuit.

Consider these articles in the context of a typical automobile insurance policy provision (this one issued by USAA) and you might understand why the sounding of alarm bells:

We will pay compensatory damages for **BI** or **PD** for which any **covered person** becomes legally liable because of an auto accident. **We** will settled or defend, as **we** consider appropriate, any claim or suit asking for these damages. **Our** duty to settle or defend ends when our limit of liability for these coverages has been paid or tendered. **We** have no duty to defend any suit or settle any claim for **BI** or **PD** not covered under this policy.

The words "becomes legally liable" in the USAA auto policy are similar to the words "shall become legally obligated to pay" which appeared in the Aerojet policies. Could USAA refuse to pay a settlement which was agreed to by all parties -- even though in the context of a lawsuit -- because it was not "ordered by a court?"

There probably is no need to panic because, in most settlements, there is either direct or implied consent of the insurer to settle the case and agreement on the amount of the settlement. In many mediations, the adjuster is present and usually signs the settlement agreement. The unique facts of *Aerojet-General Corp*. most likely confine the scope of its holding. However, you will definitely want to dot your "i's" and cross your "t's" in any settlements you reach to make sure there is written consent by or on behalf of the insurance company to assure that you and your client are paid.