



Policyholder obtains coverage for \$80 million settlement reached without insurer's consent

The Supreme Court of Pennsylvania held that an insurer must pay for a policyholder's reasonable settlement if the insurer defends the policyholder under a reservation of rights, even if the insurer does not consent to the settlement.

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The Supreme Court of Pennsylvania held that an insurer must pay for a policyholder's reasonable settlement if the insurer defends the policyholder under a reservation of rights, even if the insurer does not consent to the settlement. *Babcock & Wilcox Company v. Am. Nuclear Insurers*, 2015 WL 4430352 (Pa. July 21, 2015). This important decision confirms that an insurer defending under a reservation of rights forfeits the right to withhold consent for reasonable and fair settlements.

Background

Plaintiffs commenced an underlying class action against Babcock & Wilcox Company (B&W) and Atlantic Richfield Company (ARCO) claiming emissions from nuclear facilities caused bodily injury and property damage. B&W and ARCO requested coverage from their insurers, American Nuclear Insurers and Mutual Atomic Energy Liability Underwriters (collectively, the "insurers"). The insurers agreed to defend B&W and ARCO under a reservation of rights to later deny coverage.

The insurance policy required the insureds to obtain the insurers' consent before settling any action. Such clauses are standard in many policies. Recognizing this requirement, B&W and ARCO sought their insurers' consent to various settlement offers. The insurers repeatedly refused to provide consent. Consequently, in order to protect themselves, B&W and ARCO settled the suit for \$80 million, an amount significantly less than the \$320 million limits of coverage.

Contending that the insureds had breached the consent to settlement clause and thereby forfeited coverage under the policy, the insurers refused to pay any amount toward the settlement. The Pennsylvania Supreme Court granted review to resolve the question of whether, where the insurer has defended the suit subject to a reservation of rights, an insured can obtain coverage when it settles a lawsuit without the insurer's consent.

The Pennsylvania Supreme Court's Decision

The Pennsylvania Supreme Court rejected the insurers' defense and held that where an insured is defended under a reservation of rights and settles claims without the insurer's consent, the insured does not forfeit coverage so long as the settlement is fair and reasonable. Consequently, a consent to settlement clause will not bar coverage where the insured accepts a fair and

reasonable settlement without the insurer's consent while the insurer is defending under a reservation of rights.

The court began its analysis by observing that the interests of insurers and insureds generally align when the insurer has accepted coverage for defense and indemnity. Under that circumstance, the insurer is obligated to pay not only for defense, but for indemnity as well, and thus generally has the same interest as the insured with respect to whether a settlement should be accepted.

But this is not the case where there is a reservation of rights. In that circumstance, the insurer has not accepted its obligation to pay for any judgment against the insured and therefore has a conflict of interest with its insured regarding whether a claim should be defended or settled. For example, an insured might prefer to cap its potential liability at an amount within the available coverage limits, while the insurer, believing that it may have no obligation to make any indemnity payments, might be prepared to take the case to trial if projected defense costs are sufficiently lower than a settlement demand. There is thus an inherent conflict of interest between an insurer defending under a reservation of rights and an insured evaluating whether to accept a settlement demand.

Notwithstanding this conflict, the court recognized an insurer's duty of good faith creates a duty to settle when faced with a fair and reasonable settlement demand, even where it has issued a reservation of rights. The court therefore ruled that where an insurer is defending under a reservation of rights, an insured does not forfeit coverage where it accepts a reasonable and fair settlement offer that the insurer refuses to accept. By reserving its rights, the insurer has created a conflict with its insured and as a result forfeits its right to control settlement decisions.

The court also found that the determination of whether a settlement is "fair and reasonable" should include "consideration of the terms of the settlement, the strength of the insured's defense against the asserted claims, and whether there is any evidence of fraud or collusion on the part of the insured." In this case, the jury had concluded after an extensive trial that the settlement was "fair and reasonable from the perspective of a reasonably prudent person in the same position of [the policyholders] and in light of the totality of the circumstances." Accordingly, the Pennsylvania Supreme Court affirmed the judgment of the trial court, finding that the insurers must reimburse B&W and ARCO for the \$80 million settlement.

Implications

The decision resolves an issue that arises frequently between insurers and insureds. Policyholders often find themselves preferring to settle a case while their insurance companies, defending the case under a reservation of rights, prefer to continue to litigate, hoping to address coverage issues at a later date. In that situation, insurers consistently attempt to control the defense and settlement in a manner often at odds with their policyholders' interests, and commonly rely on consent to settlement clauses.

Babcock & Wilcox shows that consent to settlement provisions do not give insurers authority to deny fair and reasonable settlement offers where the insurer has created a conflict with its policyholder by reserving the right to disclaim coverage. Under the Pennsylvania Supreme Court's reasoning, if an insurer is defending under a reservation of rights, it forfeits the right to withhold consent from reasonable and fair settlements. In other words, when faced with a fair and reasonable settlement demand in a reservation of rights case, an insurer must either abandon its coverage defense and pay the demand or lose its right to control settlement.

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