FDCC Insights
DEFENSE LAWYERS. DEFENSE LEADERS.
A Journal for Defense and Corporate Counsel

JUNE 2017

PICKING UP THE TAB WHEN YOU WEREN'T INVITED TO DINNER: AN INSURED'S EFFORT TO COLLECT A CONSENT JUDGMENT TO THE SURPRISE OF THE INSURER

TOM BAZEMORE

I. Introduction

The obligation of an insurer to defend an insured is universally recognized as broader than an insurer's obligation to indemnify. Even so, insurers are frequently confronted with a claim or lawsuit that does not warrant coverage and no defense is provided. The coverage issues underlying such a decision are innumerable. As an example, a property insurer may deny coverage to its insured based upon a finding that the underlying claim did not arise during the coverage period. Similarly, an insurer may deny coverage under a general liability policy after concluding that the underlying accident arose from a set of facts that falls within the parameters of one of the policy's express exclusions. In either example, the decision to deny coverage and refuse to provide a defense removes the insurer from the "front row seat" in the litigation.

In the absence of a defense provided by the insurer, what remains is a strong motivation for the insured to strike a bargain that will eliminate the need to further defend the lawsuit and guarantee that the insured will never face any out-of-pocket expense. Oddly, the underlying claimant and the insured share a number of motivations in this situation: each seeks to end the litigation in the best possible financial position and to do so with certainty and finality. Frequently, the solution reached by the insured and the claimant is a consent judgment.

Entering a consent judgment ends the necessary expenditure of time and money demanded by the litigation; however, the effort to fund and satisfy the judgment begins. Where the insurer has denied coverage, it loses the opportunity to play a role in the negotiations leading up to the consent judgment. The insurer may be completely unaware of the facts, damages, evidence, and discussions that culminated in the consent judgment. In some cases, the insurer may learn of the consent judgment for the first time when it receives a lawsuit challenging the propriety of the insurer's decision to deny a defense. In these circumstances the insurer is playing "catch up" in its effort to better understand the underlying consent judgment. Critically, the consent judgment may ultimately bind the insurer to a large settlement that appears excessive. Understanding the nature of a consent judgment and the strategies and tools available to challenge it will equip the insurer to pursue steps which may prevent that outcome.

Consider a claim by a homeowner against a homeowners' association which is a relatively low exposure claim. The insurer for the homeowners' association may determine there is no

TOM BAZEMORE
Huie, Fernambucq & Stewart, LLP
Birmingham, AL
tbazemore@huielaw.com

Tom Bazemore is a partner in the Birmingham, Alabama office of Huie, Fernambucq & Stewart, LLP. Since joining Huie in 1996, Tom has successfully defended clients in various trial venues at both the state and federal levels and in both rural and urban court systems. He has tried cases to defense verdicts in Alabama, Louisiana, West Virginia, and Missouri. In the areas of fraud, bad faith, product liability defense, and insurance defense, Tom brings extensive litigation experience and a proven track record to the representative process. Tom frequently represents automobile manufacturers, insurers, insurance agents, and construction companies. Currently, Tom serves as Vice Chair of the Property Insurance Committee for the FDCC.

coverage and refuse to provide a defense. The homeowner and the insured homeowners' association then agree to a settlement and consent judgment in which the homeowners' association assigns all of the claims against its insurer to the homeowner. If the homeowner goes on to establish that the insurer owed a defense, the insurer may be obligated to satisfy a huge and disproportionate judgment. This article addresses some strategies for the insurer that is being asked to accept and pay the consent judgment.

When an insurer denies a defense and leaves the insured to defend on its own, the insurer may expose itself to significant financial liability if it is determined that the denial was improper.

II. The Basic Framework of the Consent Judgement

The consent judgment is a form of settlement between a plaintiff and a defendant-insured that is formally entered as a judgment by the court and that carries the same force and effect as if the dispute and accompanying issues had been litigated. 49 C.J.S. *Judgments* § 240 (2016). Agreements to enter the consent judgment carry varying names from jurisdiction to jurisdiction. *See Petro v. Travelers Cas. & Sur. Co. of Am.*, 54 F. Supp.3d 1295, 1302 (N.D. Fla. 2014) (Where a liability insurer denies coverage and wrongfully refuses to defend an insured against a claim, the law recognizes that the insured may enter into a fair consent judgment for liability with the adverse party and bind the insurer, if coverage exists, despite language in the policy that seemingly would prevent such a result. The Court referred to this type of agreement as a "Coblentz agreement."); *Corn Plus Co-Op v. Continental Cas. Co.*, 516 F.3d 674, n.2 (8th Cir. 2008) (noting that, in Minnesota, the agreement is known as a "Miller-Shugart" settlement); *Safeway Ins. Co. v. Guerrero*, 106 P.3d 1020, n.1 (Ariz. 2005) ("The term 'Morris agreement' is generally used to describe a settlement agreement in which an insured defendant admits to liability and assigns to a plaintiff his or her rights against the liability insurer, including any cause of action for bad faith, in exchange for a promise by the plaintiff not to execute the judgment against the insured."); *See also Quihuis v. State Farm Mut. Auto. Ins. Co.*, 748 F.3d 911, n.1 (9th Cir. 2014) (Under Arizona law, the court distinguished between a *Darmon* agreement (which refers to a settlement agreement between an insured and an injured party in circumstances where the insurer has declined to defend the suit against the insured) and a *Morris* agreement (which refers to a settlement agreement between an insured and an injured party where the insurer defends the suit against the insured under a reservation of rights)). Although the name of the agreement may vary, the agreements are almost universally characterized by several common features: (1) The plaintiff and the insured agree to the entry of a judgment against the insured; (2) the agreement and the litigants describe the judgment as reasonable; (3) the plaintiff releases the insured from his/her obligation to pay any part of the judgment making an express agreement that the plaintiff will never attempt to execute the judgment against the insured instead, looking solely to the insurer for satisfaction of the judgment; and (4) the insured assigns all rights or claims he/she may have against the insurer to the plaintiff. *See* Robert J. Franco & Amy C. Kavarik, *Insurance Bad Faith: Assignments, Consent Judgments and Covenants Not to Execute*, The Federation of Defense and Corporate Counsel, FDCC Quarterly (Winter 2001).

Both the insured and the plaintiff enjoy significant advantages in reaching such an agreement. On one hand, the insured is absolved of any further financial liability arising from the claim. *Id.* On the other hand, the plaintiff may be able to position himself/herself with evidence supporting a claim for higher damages than might have otherwise been possible with constraints on the admissibility of evidence in court. *Id.* Furthermore, the plaintiff's likelihood of collecting on the judgment may now be far greater than it would have been against a judgment-proof defendant. *Id.*

III. The Effects of the Consent Judgement on the Insurer

When an insurer denies a defense and leaves the insured to defend on its own, the insurer may expose itself to significant financial liability if it is determined that the denial was improper. For example, in *Coblentz v. American Surety Co.*, 416 F.2d 1059 (5th Cir. 1969), the Fifth Circuit Court of Appeals noted:

> It is a well-settled principle that where a person is responsible over to another, either by operation of law or express contract, and he is duly notified of the pendency of the suit against the person to whom he is liable over, and full opportunity is afforded him to defend the action, the judgment, if obtained without fraud or collusion, will be conclusive against him, whether he appeared or not.

Id. at 1063 (internal citations omitted). It is important to remember, however, that the consent judgment alone does not automatically trigger liability for the insurer. For example, under Florida law, to recover in the subsequent action against an insurer, a plaintiff must prove: (1) that the insurer breached its duty to defend the insured in the initial lawsuit; (2) that the insurer had an obligation to cover the loss or indemnify the insured under the policy; and (3) that the settlement and consent judgment were made in good faith and are objectively

reasonable. *See Petro*, 54 F.Supp.3d at 1302. By successfully challenging any of these elements, the insurer can escape liability for the amount of the consent judgment.

IV. Challenges to the Consent Judgement

The insurer should defend against the enforcement of the consent judgment on all possible grounds. Challenging the consent judgment on the basis of the insurer's duty to defend and indemnify can present questions of fact. A more unique obstacle to challenging a consent judgment, however, is that it is particularly difficult to determine whether a settlement agreement is procured through fraud or collusion. *Sidman v. Travelers Cas. & Sur.*, 841 F.3d 1197, 1202 (11th Cir. 2016). The underlying litigants will, of course, contend that the judgment was the result of hard fought negotiation and representative of the liability and damages. Case law recognizes a presumption in favor of the judgments constructed by the Plaintiff and insured. For example, in *Sidman, supra.,* the Eleventh Circuit noted that when an insured negotiates a settlement for which he/she will be responsible, an independent fact-finder may generally assume that the settlement amount is reasonable. *Id.* (citing with approval *Steil v. Florida Physicians' Ins. Reciprocal*, 448 So.2d 589 (Fla.Dist.Ct.App. 1984)). However, when a settlement amount includes a covenant not to execute releasing the insured from personal liability and the plaintiff agrees to look to a third party for satisfaction of the judgment, the settlement amount may not be a "realistic valuation of the injured party's claim." *Id.*

A more unique obstacle to challenging a consent judgment, however, is that it is particularly difficult to determine whether a settlement agreement is procured through fraud or collusion.

The *Sidman* court drew on the decision of the Florida District Court of Appeal in *Steil v. Florida Physicians' Ins. Reciprocal, supra.,* to apply what it considered the proper framework for analyzing whether a consent judgment ("Coblentz Agreement") is enforceable. *Sidman*, 841 F.3d at 1203. In *Steil*, the Florida court crafted a standard of review based on the following considerations:

> …the court weighed the countervailing interests of (1) protecting insurers against settlement agreements that overstate their liability and (2) preserving incentives for insureds and injured parties to resolve claims when they can. The *Steil* court recognized the need to protect insurers when the injured party and the insured settled for an amount for which neither will be on the hook: the settlement "may not actually represent an arm's length determination of the worth of the plaintiff's claim." At the same time, *Steil* recognized that countervailing policy interests weigh in favor of enforcing [these] agreements against insurers. If an insured's mere lack of incentive to negotiate would render a[n] … agreement fraudulent or collusive, such agreements could rarely be enforced. As a result, insureds and injured parties would be discouraged from settling their claims even when they were able to reach agreement on the amount of the insured's liability. Instead, injured parties would have an incentive to insist either that an independent factfinder determine the amount of liability or that insureds pay out of their own pockets.

Id. at 1202-03 (internal citations omitted). Aware of this reality, the *Steil* court determined that consent judgments of this nature could not be reviewed under "the ordinary standard of collusion or fraud." *Id.* at 1203 (quoting *Steil*, 448 So.2d at 592). Instead, *Steil* found that courts must look to evidence of unreasonableness and bad faith of the negotiating parties, and assigned the "initial burden of producing 'evidence sufficient to make a prima facie showing of reasonableness and lack of bad faith [on the party seeking to enforce the agreement], even though the ultimate burden of proof will rest upon the [insurer.]'" *Id.* Applying this "sufficient evidence" standard of review, the *Sidman* court ultimately cited evidence that the insured "agree[d] to any fee so long as the [plaintiffs] would enforce the judgment only against [the insurer]" and that the parties entered into a side agreement in which the insured agreed to pay the plaintiffs up to a certain amount depending on their success in enforcing the settlement agreement and collecting from the insurer was sufficient for a finding of bad faith.

With this example in mind, and although a court may place an initial burden of proof on the party seeking to enforce the consent judgment to show that it is reasonable and was made in good faith, insurers and their counsel must be aware of the framework that governs their challenge.

V. Strategies for the Insurer Facing the Effort to Enforce a Consent Judgement

The challenge to the consent judgment should begin with a recognition that a consent judgment in which the insured could be responsible for payment is distinct from one in which the settlement agreement permits collection solely against the insurer and absolves the insured of liability. A judgment that is the result of a trial on the merits or one that the insured actually pays can be assumed to be realistic. However, a consent judgment coupled with an agreement not to execute against the insured is more suspect than one produced by the adversarial process. Thus, the courts have looked to evidence of bad faith or an unreasonable settlement in scrutinizing the consent judgment that is only to be visited on the insurer. As indicated above, the Court in *Steil* places the initial burden of producing evidence sufficient to make a prima facie showing of reasonableness and lack of bad faith on the party seeking to enforce the consent judgment although the ultimate burden nonetheless rests on the insurer. *Id.*

Ultimately the consent judgment is enforceable against the insurer only when it is rendered "without collision or fraud." The insurer's knowledge of the terms of the settlement in advance of the agreement will not, in most jurisdictions, prevent the insurer from later challenging the settlement.

The insurer tasked with an attack on a consent judgment has a number of opportunities to establish the nature of the agreement as unreasonable. Because the effort comes long after the negotiation and contrary to the interests of both parties to the consent judgment, the insurer has a difficult task.

To establish an unreasonable or bad faith settlement, there are several areas which should be explored. First, establishing the testimony of parties to the agreement and the terms that were negotiated is paramount. It is possible that the terms are not as simple as those that were reduced to writing in the Settlement Agreement. In *Sidman,* the insured offered to "stipulate to whatever number you want" with respect to the plaintiffs' claim for attorneys' fees so long as there was no effort to execute against the insured. As the Court noted: "A reasonable party would not be indifferent to the amount of a judgment entered against it were its own money on the line." *Sidman*, 841 F.3d at 1203. Further, any agreement that allows the underlying plaintiff to share in any recovery with the insured is arguably collusive and in bad faith. *Chomat v. Northern Ins. Co*., 919 So.2d 535, 538 (Fla.Dist.Ct.App. 2006).

Establishing the "unreasonableness" of a judgment can be challenging in cases involving catastrophic injury. It seems difficult, for example, to argue that a settlement in a case involving a claim of wrongful death was unreasonable. However, the liability facts cannot be ignored. If there was a clear statute of limitations defense or some other obvious challenge to liability, one would expect something less than a "full value" settlement. Comparisons to the liability or settlement agreements of other defendants in the same or similar litigation can also be helpful in characterizing the amount of the consent judgment as unreasonable.

Finally, the efforts of the insured in defending the case should be carefully analyzed. The complete or substantial absence of a defense followed by a large consent judgment may implicate a "rollover" by the insured. Similarly, a case involving serious injuries which would typically require the identification and deposition of multiple experts and witnesses with no significant discovery or depositions points to a "lay down." The insurer should access the entire file of the lawyer defending the insured (including billing records and correspondence) because these records can yield important information that reflects on an allegedly hard-fought and arms-length negotiation. Records establishing that an insured settled for ten million dollars during a brief phone call can help to establish that a settlement was collusive and unreasonable.

The insurer tasked with an attack on a consent judgment has a number of opportunities to establish the nature of the agreement as unreasonable. Because the effort comes long after the negotiation and contrary to the interests of both parties to the consent judgment, the insurer has a difficult task. By carefully and extensively scrutinizing these agreements the insurer may be able to avoid the unfortunate possibility of being bound by the agreement.