Expediency in Trying Times

Options for a Professional Lines Insurance Carrier Facing the Obdurate Policyholder

by J. Christopher Henschel

What can a professional lines insurance carrier do when a reasonable opportunity to settle presents in an underlying case, but the policyholder refuses under a Consent to Settlement Clause requiring the insurance carrier to obtain the consent of its policyholder before settling? Like almost everything in the world of law, the answer is "it depends." Here, what depends is how the insurance policy may afford consenting rights to the policyholder and settlement rights to the insurance carrier, and the extent to which those competing rights and interests interact with each other. This becomes a case specific, fact intensive inquiry, which turns entirely on the unique circumstances of each implicated matter. Ultimately, though, the insurance company will need to demonstrate that the policyholder's consent to the settlement was unreasonably withheld.

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The duty of good faith and fair dealing remains the paramount concern in any coverage dispute. However, an insurance carrier does not owe infinite deference to its policyholder. Consent to Settlement Clauses are colloquially referred to as "hammer clauses" or the more ominous "blackmail settlement clauses"[1] because they allow the insurance carrier to place a liability ceiling on a claim over the potential objections of the policyholder. Put another way, even if the policyholder refuses to consent to an otherwise reasonable settlement demand, the insurance carrier can limit its own indemnity exposure to the amount of the reasonable settlement demand, while the policyholder faces potential personal liability for any indemnity amounts ultimately in excess of the "refused" demand. Oftentimes, Consent to Settlement Clauses contain a "deems expedient" clause affording the insurance carrier control over settlement decisions. These two seemingly contradictory clauses guide the situation where the policyholder may refuse to settle over the recommendation of the insurance company.

An example Consent to Settlement Clause follows:

> Settlement of Claims. ***The Company shall have the right to make such investigation, negotiation or settlement of a covered Claim that it deems expedient***; provided, however, that the Company shall not settle any Claim ***without the consent of the Insured, which shall not be unreasonably withheld***. If the Company recommends a settlement and the Insured refuses to give written consent to such settlement as recommended by the Company, then the Company's liability shall not exceed the amount which the Company would have paid for Damages and Claim Expenses at the time the Claim could have been settled or compromised. (emphasis added).

New Jersey courts have interpreted "deems expedient" language in a variety of types of insurance policies to afford insurance companies nearly unfettered discretion in managing claims. Absent a policyholder consent provision, this would be the typical end of any analysis addressing whether the insurance carrier has the ability to settle a matter of its own volition.[2] The inclusion of the Consent to Settlement Clause in favor of the policyholder undercuts that power.

However, the additional conditions on the Consent to Settlement Clause allow the "deems expedient" clause to keep its teeth—requiring that the consent shall not be unreasonably withheld, and limiting the damages of the insurance company to the ceiling of the recommended and refused settlement. It is important to recall that most professional lines policies are "defense within limits" policies. This means that both indemnity and defense costs erode the limits of an implicated policy, as opposed to only indemnity payments as seen in other lines of coverage. This makes the potential liability cap even more potent, as continued litigation may result in even greater defense and indemnity erosion than the refused settlement.

Why Would a Policyholder Refuse a Reasonable Settlement?

In addition to professional lines, similar clauses can also be found in Errors & Omissions, Directors & Officers, and other related insurance products. Oftentimes, the cover provided by these products involve claims that implicate, among others, public perception or professional reputation. With specific regard to professional lines, a policyholder's personal interest in defending against, *e.g.*, malpractice claims may, in their mind, outweigh the litigation risk of continuing to defend a claim through verdict. For example, an alleged engineering error on a popular bridge could result in not only litigation, but also media scrutiny for the engineering company. The engineering company's alleged error may become the subject news reports, or the litigation itself may capture the public's attention. Even if the engineering company was ultimately not at fault, a significant amount of professional and reputational damage can occur if the case is settled after these publicizing events. Litigating through a defense verdict might be seen as the only way for the engineering company to recover its reputational damages.

This creates a difficult situation for

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To be sure, good faith and fair dealing are at the forefront of any analysis dealing with the objections of the policyholder to a course of action. Ultimately, the risk facing the insurance company is a declaratory judgment action from the policyholder over the reasonableness of the settlement and whether that settlement was in good faith becomes the focal point.

the relationship between the engineering company and the insurance company. The engineering company is concerned not only with the immediate exposure presented by the claim but also, understandably, the effect reputational harm can have future business. This can lead to emotional and biased evaluations of how the claim or litigation should proceed by the engineering company. Conversely, an insurance company will, in theory, evaluate the claim from a dispassionate and analytical approach. Under such circumstances, a settlement offer within or at limits may be tendered by the underlying plaintiff which the insurance company may recommend that the engineering company take, but which the engineering company refuses.

Notably, these Consent to Settlement Clauses are different from their cousins in the commercial general liability (CGL) context. Coverage disputes surrounding the consent to settle provisions in the CGL realm are frequently litigated, and often involve situations where the *policyholder* settles an underlying bodily injury or property damage claim without the prior authority of the insurance carrier. Such disputes revolve around the interpretation of policy terms and conditions involving, *inter alia*, obtaining the prior consent of the insurance carrier to settle, the extent of coverage available for voluntary payments by a policyholder, or even using settlement language that may impair the rights of the insurance carrier. Most of the time, CGL consent to settle issues revolve around the effect the settlement of a claim has on the insurance carrier. This hypothetical raises the opposite end of that question—what happens when the policyholder refuses to settle.

What Happens After the Policyholder Refuses to Consent to a Settlement?

Unlike the CGL consent provisions, the professional lines Consent to Settlement Clause is infrequently litigated. However, the New Jersey Supreme Court has recognized that "there may be situations where it would plainly be unreasonable or in bad faith for the insured to withhold his consent or to attempt to withdraw it."[3] In *Lieberman v. Employers Ins. Co. of Wausau*, the Supreme Court addressed whether the policyholder could revoke its prior consent to a settlement. The insurance company settled the underlying claim despite the subject revocation, and the policyholder sued the insurance company. The Supreme Court explained that in order to recover from the insurance company, the policyholder must be able demonstrate actual damages as a result of the insurance company's settlement over the policyholder's objections including, in particular, that it would have obtained a defense verdict at trial.

To be sure, good faith and fair dealing are at the forefront of any analysis dealing with the objections of the policyholder to a course of action. Ultimately, the risk facing the insurance company is a declaratory judgment action from the policyholder over the reasonableness of the settlement and whether that settlement was in good faith becomes the focal point. However, there is another option for the insurance company. In the event that the insured unreasonably withholds consent to settle, the insurance company can also exercise its further rights to limit liability to the sum total of the offered settlement.

The Deems Expedient and Consent to Settlement Clauses in Action

As a hypothetical, our engineering company was involved on a project for a bridge spanning a major waterway and connecting two states. Very public allegations arise that the engineering company committed significant errors, and a litigation ensues. At the beginning of the litigation, the engineering company receives a $15 million settlement demand. After discovery exchanges, it is revealed that a different company may bear some or all of the responsibility. However, it remains unclear whether the engineering company will be found liable at trial.

The engineering company has a $10 million defense within limits professional lines policy containing the full above referenced Consent to Settlement Clause. Approximately $1 million has been spent on claims expenses already. The underlying plaintiff revises its demand in light of the existence of the potential liability of the second company, seeking $7 million. The insurance company recommends the settlement, but the engineering company believes it has been wrongfully sued and wants to continue the litigation in order to fully

blame the second company for the underlying issues. Therefore, the engineering company refuses to consent to the settlement.

The insurance company now has two choices. It can, pursuant to the "deems expedient" clause, attempt to settle with the underlying plaintiff as demanded. This could result in litigation with the engineering company policyholder, who may seek a declaratory judgment that the $7 million settlement was unreasonable and executed in bad faith. Alternatively, the insurance company can inform the engineering company that it is exercising the ceiling provisions of the clause, and attempt to cap its own exposure at $7 million if the engineering company desires to continue with the litigation. This puts the engineering company in the position of knowing that its total defense and indemnity coverage available under the policy has been limited, and the engineering company will face any additional potential liabilities alone. This can place immense pressure on a policyholder to accept the settlement if it is truly reasonable—recognizing that a reasonable settlement may not provide the desired public perception outcome the engineering company desires.

However, even under the "capped" situation, the policyholder may still choose to engage in a subsequent declaratory judgment action with the insurer. In particular, the policyholder may argue that the settlement demand was unreasonable, and therefore the policyholder should have been entitled to additional limits under the policy. Hypothetically, the engineering company may ultimately spend more money than the demand obtaining a defense verdict and seek to recover that difference from the insurance company. Although the question of whether the consent to settle was unreasonably withheld is not definitively determined by a subsequent defense verdict, the insurance company could still face potential exposure in the way of bad faith and extra-contractual claims in a later declaratory judgment action.

Ultimately, principles of good faith and dispassionate evaluations of whether a settlement demand is reasonable should govern any decisions to execute rights under a Consent to Settlement Clause by an insurance company. Although relatively rare, disputes between insurance companies and policyholders over whether to settle can arise, and present a difficult decision tree of options and outcomes. Insurance companies should evaluate each situation on a case-by-case basis, keeping the principles of good faith and fair dealing at the forefront. ⚖

Endnotes

1. irmi.com/term/insurance-definitions/consent-to-settlement-clause#:~:text=Consent%20to%20Settlement%20Clause%20%E2%80%94%20a,claim%20for%20a%20specific%20amount.
2. *Am. Home Assur. Co. v. Hermann's Warehouse Corp.,* 117 N.J. 1 (1989) (addressing whether an insurance company can settle a claim and demand a deductible under a CGL Policy over the objections of the insured and holding "if, as here, the deductible provision is accompanied by another provision giving the carrier the unfettered right to settle as it 'deems expedient,' the insured has bargained away whatever rights might otherwise be created by what might be perceived as a conflict between insurer and insured."). *See also Travelers Ins. Co. v. Hitchner*, 160 A.2d. 521 (N.J. Super. 1960).
3. *Lieberman v. Employers Ins. Co. of Wausau*, 84 N.J. 325, 337 (1980).