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Insurers Could Face Inflated Settlements Under Pa. Ruling

By **Matt Fair**

Law360, Philadelphia (July 22, 2015, 7:02 PM ET) -- Insurers may be left holding the tab for inflated settlements in Pennsylvania after its Supreme Court ruled Tuesday that Babcock & Wilcox Co. was entitled to coverage for $80 million in deals it reached to end radiation exposure claims without the permission of its carrier, attorneys told Law360.

While insurance policies typically include language requiring cooperation between insureds and their carriers, the court's **3-2 ruling** concluded that policyholders could unilaterally ink settlements to end claims being defended by insurers under a reservation of rights to later disclaim coverage, so long as they could prove the deals were fair and reasonable.

Robert Cosgrove, managing partner of Wade Clark Mulcahy's office in Philadelphia, said the court's decision effectively rendered such clauses meaningless and could lead to insurers being forced to pay settlements over claims they believed were either worth less money or could be defeated entirely.

"I think this decision is a whopper," he said. "If you're an insurer and the insured settles out around you, then you might be left holding the bag."

The Supreme Court's decision upended a ruling that would have required B&W and Atlantic Richfield Co. to show that their insurers had acted in bad faith by refusing to consent to the $80 million settlement deals they struck with a group of plaintiffs who claimed they'd suffered injury and property damage after exposure to radiation from a southwestern Pennsylvania facility.

"If an insurer breaches its duty to settle while defending subject to a reservation of rights and the insured accepts a reasonable settlement offer, the insured need only demonstrate that the insurer breached its duty by failing to consent to a settlement that is fair, reasonable and noncollusive," the court said in an opinion penned by Justice Max Baer.

The dispute centered largely on what standard courts should apply when faced with a settlement that violates a policy's so-called consent to settle clause, which requires an insurer's blessing to move forward with a deal.

By allowing policyholders to show merely that they'd struck a fair and reasonable settlement, Cozen O'Connor attorney Richard Bennett said, the court's ruling largely rendered such cooperation clauses meaningless.

"I think it gives the insured far more latitude to violate these clauses than is appropriate," he said.

Bennett added that the fair-and-reasonable standard accepted by the Supreme Court could lead to settlement amounts out of line with what an insurer thinks a case is worth.

"It's not a particularly difficult test, I don't think," he said. "You can always find some amount of money, even for a totally frivolous claim, that the claimant will accept, and the test articulated here says that if an insurer has reserved their rights, then they can't object to that or refuse to pay it as long as it's reasonable."

Under the standard articulated by the state's Superior Court in a **July 2013 ruling** in the case, policyholders would have to show that an insurer acted in bad faith by declining to endorse the settlements.

Jones Day partner Peter Laun told Law360 that the bad faith standard endorsed by the Superior Court was too high for policyholders to have to meet.

"A bad faith standard is a very high standard," he said. "It would basically require the policyholder to prove that the insurer acted contumaciously or abandoned the policyholder. I think that's way too high a standard. If a settlement is proven to be reasonable and covered, the insurer should be liable."

He added that policyholders should not be forced to face the prospect of both an adverse judgment and a move by their insurer to disclaim coverage after providing a defense under a reservation of rights.

"A policyholder may deny that it should be held liable in the underlying case but want to settle due to the risk of liability," he said. "If the insurer withholds settlement consent, effectively preventing the policyholder from settling, and it is then held liable and the insurer declines to pay the judgment, the consequences can be catastrophic. In my view, the insured should have the right to settle in those circumstances because the insurer isn't standing behind it and agreeing to pay the judgment resulting from its decision not to settle."

The Superior Court's ruling in the case voided a decision by Judge R. Stanton Wettick Jr. in Allegheny County, who held a two-week jury trial aimed at determining whether the settlements that B&W and Arco reached in the case were fair and reasonable.

The opinion handed down Tuesday reinstated Judge Wettick's decision in the dispute.

Cosgrove said the standard accepted by the Supreme Court required only that settlements be considered in context of the damages being asserted in the underlying case and the liability faced by an insured.

He said settlement negotiations traditionally also included discussion of any potential coverage issues, including whether any claims fall outside the scope of the pertinent insurance policy.

By allowing insureds to reach unilateral settlements, Cosgrove said, such coverage concerns were taken out of the equation.

"Fair and reasonable only talks about, given the damages and liability, whether this number was fair and reasonable," Cosgrove said. "Now the third leg of that stool has been taken out, and I think that's going to increase case value."

According to Bennett, the prospect of policyholders entering unilateral settlements would spur

insurers to launch declaratory judgment actions aimed at disclaiming coverage much earlier in the process.

He said that insurers may also be less likely to agree in the first place to provide a defense under a reservation of rights.

"If they have coverage concerns, what insurers have typically done in the past is to reserve their rights and nonetheless provide the insured with a defense," Bennett said. "I think to some extent this is discouraging insurance companies from providing that defense, and encouraging them to file a declaratory judgments instead to put the coverage issue front and center while leaving the insured to defend himself."

Attorneys for policyholders, however, said they believed that the Supreme Court's ruling properly balanced the interests of both insurers and insureds.

Traci Rea, an attorney with Reed Smith LLP who helped draft an amicus brief in the case on behalf of the nonprofit United Policyholders, said insurers still had the ability to pursue declaratory judgment actions to avoid the cost of any settlements they believed should not be subject to coverage.

"It's a good balancing rule that protects both sides," she said. "It preserves the insurer's right to contest the coverage situation so that if the settlement doesn't fit within the policy, then they're not on the hook for it."

Laun, meanwhile, shrugged off concerns that insurers could face outsized settlements given the fact that courts would review the fairness and reasonableness of any payment.

"The court is going to look hard at the underlying case and make some assessment as to whether the insured bore some risk and at what level," he said. "For example, if an insured was virtually certain to be found not liable for anything, but it settles a case for the full amount claimed, that's probably not going to pass muster as a reasonable settlement."

B&W is represented by Thomas M. Reiter of K&L Gates LLP. Arco is represented by James A. Dattilo of Dattilo Law Offices PC.

American Nuclear Insurers and Mutual Atomic Energy Liability Underwriters are represented by Jon G. Hogue and John E. Murray Jr. of Murray Hogue & Lannis and Andrew S. Amer of Simpson Thacher & Bartlett LLP.

United Policyholders is represented by James C. Martin, John N. Ellison, Jay M. Levin and Traci S. Rea of Reed Smith LLP.

The case is the Babcock & Wilcox Co. et al. v. American Nuclear Insurers, case number 2 WAP 2014, in the Supreme Court of the State of Pennsylvania.

-- Additional reporting by Joe Van Acker. Editing by Jeremy Barker and Edrienne Su.