Alone In The Ditch—Settling Without The Carrier

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I. Coverage and Settlement

The courts have long-struggled with settlements by insureds with underlying claimants where the carrier has (a) wrongfully refused to defend the insured, (b) wrongfully denied the existence of a duty to indemnify, and/or (c) breached its duty to settle by rejecting a reasonable settlement offered by the underlying claimant. Insureds and claimants have used a number of approaches to settling without the carrier in these circumstances. A few of the more common examples is set forth below:

(1) Settling before trial of the underlying suit for an agreed amount with the source of funding being limited to an action against the liability insurer brought by either the insured or by the claimant after an assignment of the insured's rights against the carrier;

(2) The entry of an agreed judgment, without a trial, with an amount set by the parties, an agreement that the sole funding source would be an action against the liability insurer (usually with a covenant not to execute on any other assets), and an assignment of rights of the insured against the insurer;

(3) The entry of judgment after trial of the underlying suit has determined the (a) bases of liability and (b) the amount owed, joined with an assignment and a covenant limiting execution to the rights against the carrier;

(4) A settlement after trial or after the entry of a judgment after trial including some form of assignment and limitation of execution.

Because of the peculiarities of damages law in this area of insurance, some claimants will refuse to limit execution and will simply agree to seek satisfaction first from the carrier.

The courts have generally allowed insureds to have some form of settlement approach that allows them to be extricated from a situation where the carrier has wrongfully refused to defend or settle. The courts have struggled with carrier concerns as to whether the (a) amount of the settlement is reasonable, and (b) whether the liability or damages have been distorted or manipulated. The courts have also explored other solutions to the difficult situation where coverage is being contested by the carrier, but the issues of coverage cannot be finally determined until after trial or resolution of the underlying case.

This paper will focus on the Texas experience with these issues. The Texas Supreme Court currently has before it a case before it which again raises these scenarios and concerns and presents the opportunity for reconsideration of the appropriate solution/s. Finally, we will review some of the approaches taken by other jurisdictions in dealing with these issues.

II. The Texas Experience

A. Groundwork—The Danger

1. Damages Law

In Texas, the existence of a ***judgment*** against the insured is a critical element of establishing damages against an insurer. It is evidence of the damages. The fact that an insured did not, had not and would not ever actually pay the judgment has never been a defense to the damages claim. Texas rejected the so-called "pre-payment" approach as a condition of finding damages against the carrier because liability policies impose liability on the carrier based on a settlement or judgment against the insured, not on actual payment. *Hernandez v. Great American Insurance Co. of N.Y.,* 464 S.W.2d 91 (Tex. 1971). Liability policies are different from indemnity policies, which in fact require payment to establish harm.

The Texas Supreme Court adopted the "judgment rule." Under that rule, the Court held that the mere entry and existence of a judgment against the insured is

"some evidence" that the insured was exposed to the entire amount of the judgment and thus satisfaction of the judgment was required to extinguish that harm. *Hernandez v. Great American Insurance Co. of N.Y.,* 464 S.W.2d 91 (Tex.1971); *accord Montfort v. Jeter,* 567 S.W.2d 498 (Tex.1978). "Under the judgment rule of *Hernandez* and *Montfort*, when there is an existing adverse judgment offered into evidence in a suit against the tortfeasor who caused that judgment to be entered, the existing judgment is some evidence of actual damages, whether it is paid or unpaid. The basis of the judgment rule is that when there is a judgment against a person, his credit is affected, a lien attaches to his land, and his nonexempt property is constantly subject to sudden execution and sale." *Woods v. William M. Mercer,* 717 S.W.2d 391, 399 (Tex. App.—Texarkana 1986), *aff'd on related grounds,* 769 S.W.2d 515 (Tex. 1988).

Some Texas courts have held that the underlying judgment proved damages *against a liability insurer* in the amount of the judgment as a matter of law. *See, e.g., YMCA of Metro. Fort Worth v. Commercial Standard Ins. Co.,* 552 S.W.2d 497 (Tex. Civ. App.—Fort Worth 1977, writ ref'd n.r.e.); *see also Ridgway v. Gulf Life Ins. Co.,* 578 F.2d 1026 (5th Cir.1978); *Allstate Ins. Co. v. Kelly,* 680 S.W.2d 595 (Tex. App.—Tyler 1984, no writ); *Ranger Ins. Co. v. Rogers,* 530 S.W.2d 162 (Tex. Civ. App.—Austin 1975, writ ref'd n.r.e.). The Texas Supreme Court appeared to endorse so-called "Sweetheart" deals and the concept of damages in the amount of the judgment as a matter of law in its initial opinion in *American Physicians Ins. Exchange v. Garcia*, 36 TEX. SUP. CT. J. 406 (Dec. 31. 1996). The Court subsequently vacated this opinion and issued a new opinion, leaving the issue open.

2. Binding Effect Of Judgment—Liability and Amount/Reasonableness

Carriers were barred in Texas from making collateral attacks on the judgment against the insured, even if the judgment was entered after a non-adversarial proceeding or an agreed judgment. *Employers Cas. Co. v. Block*, 744 S.W.2d 940, 943 (Tex. 1988). Thus, the carriers raised concern about the fact that there were simply no

limits on the amount of damages that could be agreed upon by the claimant and the insured, at least in the context of an agreed judgment.

In *Block,* 744 S.W.2d at 943, the Supreme Court held that an agreed judgment was binding on a carrier in terms of the fact and quantum of liability. The Court reasoned:

> [W]e agree with the court of appeals' conclusion that Employers Casualty was barred from collaterally attacking the agreed judgment by litigating the reasonableness of the damages recited therein, *Ranger Insurance Co. v. Rogers,* 530 S.W.2d 162 (Tex. Civ. App.—Austin 1975, writ ref'd n.r.e.), and *St. Paul Insurance Co. v. Rahn,* 641 S.W.2d 276 (Tex. App.—Corpus Christi 1982, no writ) . . . .

Id. at 943. The Court relied on the decision of the court of appeals in *Hargis v. Maryland American General Ins. Co.,* 567 S.W.2d 923 (Tex. Civ. App.—Eastland 1978, writ ref'd n.r.e.):

> The court in *Hargis* held that the question of liability and of coverage are separate and distinct, and that the prior judgments establishing liability were not binding on Maryland as to the issue of coverage. *Hargis*, 567 S.W.2d at 927. Although *Hargis* dealt with *judgments resulting from litigation*, it is apparent that the reasoning of the court applies as much, if not more, to *agreed judgments*.

Id. Thus, the Court concluded that the "question of liability," and hence the fact of it and the amount of liability, were in fact determined by either a litigated or agreed judgment and ***could not be collaterally attacked by the carrier.*** *Id.*[1] What remained

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[1] The *Block* Court explained: "A collateral attack is an attempt to avoid the effect of a judgment in a proceeding brought for some other purpose." *Ranger Insurance Co. v. Rogers,* 530 S.W.2d 162, 167 (Tex. Civ. App.—Austin 1975, writ ref'd n.r.e.). Collateral estoppel refers to issue preclusion because it bars relitigation of any ultimate issue of fact actually litigated and essential to the judgment in the prior

unanswered by the courts was whether a judgment, agreed or otherwise, procured as a result of so-called collusion was admissible as evidence of the fact of liability and damages and the reasonableness of those damages.

3. Contractual Anti-Assignment Clauses

"[A]n insurer who first 'wrongfully refuses to defend' an insured is precluded from insisting on the insured's compliance with other policy conditions." *Quorum Health Res., L.L.C. v. Maverick Cnty. Hosp. Dist.,* 308 F.3d 451, 468 (5th Cir.2002); *Enserch v. Shand Morahan & Co., Inc.,* 952 F.2d 1485, 1496 n. 17 (5th Cir.1992) (applying Texas law); *Employers Cas. Co. v. Block*, 744 S.W.2d 940, 943 (Tex.1988); *Gulf Ins. Co. v. Parker Prods., Inc.,* 498 S.W.2d 676, 679 (Tex. 1973).*St. Paul Ins. Co. v. Rahn,* 641 S.W.2d 276, 278 (Tex. App.—Corpus Christi 1982, no writ); *see also OneBeacon Ins. Co. v. Welch*, No. CIV.A. H-11-3061, 2014 WL 2931933, at *10 (S.D. Tex. June 30, 2014). This includes the no-action clause of the policy. In *Gulf, supra,* the carrier wrongfully refused to defend and denying coverage. The insured then unilaterally settled the claim against it. The court reasoned and concluded:

> The insurance company may ordinarily insist upon compliance with this condition [no action] for its own protection, but it may not do so after it is given the opportunity to defend the suit or to agree to the settlement and refuses to do either on the erroneous ground that it has no responsibility under the policy. *See Womack v. Allstate Insurance Company,* 156 Tex. 467, 296 S.W.2d 233 (1956).

Id. (some citations omitted).

"Anti-assignment clauses that interfere with the operation of a statute are not enforceable. *Choi v. Century Surety Co.,* 2010 WL 3825405, *4 (S. D. Tex. Sept. 27, 2010); *see also Tex. Dev. Co. v. Exxon Mobil Corp.,* 119 S.W.3d 875, 880 (Tex. App.—

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suit. *Bonniwell v. Beech Aircraft Corp.,* 663 S.W.2d 816, 818 (Tex. 1984). Insofar as the coverage issue is concerned, both of these doctrines are inapplicable in the present case." *Id.*

Eastland 2003, no pet.) (citing *Reef v. Mills Novelty Co.,* 126 Tex. 380, 89 S.W.2d 210, 211 (1936)).

Anti-assignment clauses are inconsistent with and interfere with the federal Bankruptcy Code. *See* 11 U.S.C. §541(c)(1)(A), §1123(a)(5)(B). The Bankruptcy Code pre-empts the application of the anti-assignment clause in liability insurance policies to transfers to a trust under a Chapter 11 bankruptcy plan. *In re Federal-Mogul Global Inc.*, 684 F.3d 355, 377-78 (3d Cir. 2012) (§1123); *In re Thorpe Insulation Co.*, 671 F.3d 1011, 1026 (9th Cir. 2012) (§541); *In re Thorpe Insulation Co.*, 677 F.3d 869, 889 (9th Cir. 2012) (Congress expressly pre-empted liability insurance anti-assignment clauses through §541; even without that section, anti-assignment clauses impliedly pre-empted); *In re Combustion Eng'g, Inc.*, 391 F.3d 190, 219 n. 27 (3d Cir. 2004) (§§541, 1123); *In re W. R. Grace & Co.*, 475 B.R. 34, 197-99 (D. Del. 2012), *aff'd*, 729 F.3d 332 (3d Cir. 2013) (§1123).

4. Covenant—Release Or Not?

In Texas and other jurisdictions, a covenant not to execute is treated under general contract law as a release. *Woods v. William M. Mercer,* 717 S.W.2d 791 (Tex. App.—Texarkana 1986), *aff'd on related grounds,* 769 S.W.2d 515 (Tex. 1988). The courts have reasoned that if a covenant is breached, treatment of it as a release prevents any recovery. This avoids the "circuity of action" presented by requiring a suit showing damages from the breach.

Apparently as a result of public policy concerns, the discharging or release aspect of a covenant not to execute is ignored in certain liability insurance contexts. In *Woods,* the court explained:

> Normally, a covenant not to execute is treated as discharging a judgment so that there are no damages caused by the judgment. *Panhandle Gravel Co. v. Wilson,* 248 S.W.2d 779 (Tex. Civ. App.-Amarillo 1952, writ ref'd n.r.e.); RESTATEMENT (SECOND) OF CONTRACTS § 285(2), comment a (1981). Ordinarily, however, a covenant not to execute will not obviate the

existence of damages when there is proof that an *insured was forced to assign his rights against the insurer or other responsible parties to obtain that covenant*.

717 S.W.2d at 398.

The timing of the covenant is important. Pre-judgment covenants or releases would appear to prevent any subsequent judgment from actually imposing a "legal obligation to pay" as required by the insuring agreement. *Empire Indem. Ins. Co. v. N/S Corp.,* 571 Fed. Appx. 344, 347 (5th Cir. 2014)(discussing *U.S. Fire Ins. Co. v. Lay,* 577 F.2d 421, 423 (7th Cir.1978)). Strangely, the court in *Woods* expressly held that "the agreement contained in the covenant not to execute was reached prior to the actual date of the execution of the covenant and, in fact, was entered into informally before judgment was rendered in federal court." *Woods, supra,* at 399. It should be noted that the claim in *Woods* was *not* against an insurer, but instead it was against an insurance agent which allegedly failed to procure professional liability insurance for the insured nurse anesthetist in that case. The court concluded that in this setting Texas law did not support a finding of damages as a matter of law in the amount of the judgment. *Id.* Instead, the question of damages presented a fact issue.

4. Inability To Resolve Coverage Disputes When Demand Within Policy Limits Was Made

At the time of the initial *Garcia* opinion, carriers had no ability to determine the duty to indemnify prior to trial of the underlying suit. The courts considered an indemnity coverage action premature because the insured might not even be found liable. Texas had also not recognized that insurers could settle and seek reimbursement from the insured if coverage was later found not to exist. Thus, pre-trial, insurers had to make an educated, unilateral determination regarding coverage,

and if they were wrong, the existence of a good faith defense to coverage, albeit a wrong one, did not excuse a failure to settle within policy limits.

B. *Gandy*—A Most Peculiar Set of Facts

Many considered the decision in *State Farm Fire & Cas. v. Gandy*, 925 S.W.2d 696, 714 (Tex. 1996), to presage the death of any form of "sweetheart" deal involving an assignment and/or agreed judgment. As subsequent decisions have revealed, it is a decision limited to its very peculiar facts and circumstances.

In *Gandy*, the insured was alleged to have molested his own step-daughter. The insurer importantly:

(a) Did not wrongfully refuse to defend,

(b) Did not wrongfully deny coverage,

(c) Did not dictate the choice of counsel and provided a defense through independent counsel.

(d) Sought and eventually obtained a declaratory judgment that there was in fact no duty to defend or indemnify owed by the insurer.

(e) Was not notified of the settlement and did not consent to the settlement.

Moreover, liability in *Gandy* ***was not predicated on a wrongful failure to settle***. Instead, the allegation was that the insured somehow did not know that he could change counsel after he had initially selected counsel himself, and thus he allowed incompetent counsel the insured himself selected to continue in the case, resulting in the imposition of judicial sanctions in the underlying suit. In short, the suit against the carrier alleged that if the insured had had competent counsel, he would have been exonerated or liability would have been substantially less. The case was akin to a legal malpractice claim for an incompetent defense.

Insurance policies provide a battery of potential contractual defenses to a unilateral settlement entered by the insured or the use of an agreed judgment:

(a) The requirement of a "legal obligation to pay" as damages by the insuring agreement.

(b) The no-action clause, barring any action against the carrier in the absence of a settlement consented to by the insured or a judgment after an "actual trial."

(c) The anti-assignment clause, barring assignment of claims against the carrier absent consent of the carrier.

None of these defenses was actually at issue in *Gandy* because the action was based on negligence and statutory theories and because the court found that there was in fact ***no contractual duty to defend or indemnify*** **owed under the policy.** Contract defenses were not relevant to such claims.

After so-called discovery abuse by the insured's independent counsel, of which the carrier was not informed by the insured or his lawyer, the insured replaced his previously selected counsel. Again, no notice was given to the carrier. New counsel entered into an agreed judgment for in excess of $6 million dollars, $2 million of which involved punitive damages. The judgment itself included numerous false recitals intended to make it look as though there was some form of adversarial proceeding leading to the judgment. The insurer was provided no opportunity to object to the judgment.

The controlling holding in *Gandy* was that the assignment in that case was invalid. The Court expressly limited its holding:

> Balancing the *various considerations we have mentioned*, we hold that a defendant's *assignment* of his claims against his insurer to a plaintiff is *invalid if*

(1) it is made *prior to an adjudication* of plaintiff's claim against defendant in a *fully adversarial trial*,

(2) defendant's insurer has tendered a defense, and

(3) either

(a) defendant's insurer has accepted coverage, or

(b) defendant's insurer has made a good faith effort to adjudicate coverage issues prior to the adjudication of plaintiff's claim.

Id. at 714.[2]

The *Gandy* Court overruled the holding in *Block, supra*, that a challenge to the amount of an agreed judgment was an improper "collateral attack" on the judgment. The Court stated:

> In no event, however, is a judgment for plaintiff against defendant, rendered without a fully adversarial trial, binding on defendant's insurer by plaintiff as defendant's assignee.

Id. The *Gandy* court expressly disapproved of language in its own opinion in *Block* and that of the Fifth Circuit in *United States Aviation Underwriters, Inc. v. Olympia Wings*, 896 F.2d 949, 954 (5th Cir. 1990), to the contrary. The Court's statement that under no circumstances would a judgment entered without a fully adversarial proceeding be binding upon the carrier was, according to subsequent decisions, obiter dictum.

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[2] The Court observed: "The settlement arrangement we have examined has three elements: [1] an assignment [to the plaintiff] of a defendant insured's claims against his insurer, [2] a covenant by the plaintiff to limit recovery from the defendant personally, and [3] a judgment for plaintiff against defendant." *Id.* at 715.

In any event, the reference to a judgment resulting from a fully adversarial proceeding appears to involve the issue of when and/or whether the judgment can be used as evidence of damages. The Court did not directly address whether "collusion" was a defense to an agreed judgment or a judgment without a full trial. The Court also did not address whether a covenant not to execute agreed to prior to the entry of judgment was in reality a release, thus negating the existence of damages and effectively throwing the baby out with the bath-water. In fact, the covenant in *Gandy* was a covenant to limit execution to the insurance policy and related extra-contractual rights.

C. The *Gandy* Court of Appeals Focuses On Damages Rule

The central complaint of the Court of Appeals in *Gandy* was the rule that the judgment in the underlying suit sets damages as a matter of law, even where there is an agreed judgment with a covenant not to execute. As the court explained, and as quoted by the Supreme Court in *Gandy*, the central distortion of the litigation process was the notion that damages were actually being suffered in the face of an agreed judgment from which the insured was fully protected:

> The amount of the judgment in a case like this, where a covenant not to execute is given contemporaneously with and as a part of a settlement and agreed judgment, cannot constitute damage to the judgment debtor. Allowing an assignee of the named judgment debtor in such a case to collect all or part of the judgment amount ***perpetrates a fraud on the court***, because it ***bases the recovery on an untruth***, i.e., that the judgment debtor may have to pay the judgment. *See Whatley v. City of Dallas,* 758 S.W.2d 301 (Tex. App.—Dallas 1988, writ denied); *Garcia v. American Physicians Ins. Exch.,* 812 S.W.2d 25 (Tex. App.—San Antonio 1991) (Peeples, J. dissenting), *rev'd,* 876 S.W.2d 842 (Tex. 1994). Such a result should be against public policy, because it allows, as here, parties to take a ***sham judgment*** [n.5] [The judgment is a sham because it is not what it is represented to be. It cannot be collected from the judgment

> debtor, and that was the parties' intention when the judgment was taken.] by agreement, without any trial or evidence concerning the merits, and then collect all or a part of that judgment from a third party. Allowing recovery in such a case encourages fraud and collusion and corrupts the judicial process by basing the recovery on a fiction . . . But the fact remains that the courts are being used to perpetrate and fund an untruth—that Pearce was damaged by the bare amount of the judgment. [n.6] [Prohibiting this type of arrangement would not inhibit settlements. The insurance company would still have an incentive to settle because it would face potential liability for damage to credit, reputation, property, and for mental anguish. Allowing recovery for the amount of the judgment is not necessary to encourage insurance companies to give careful consideration to the interests of their insureds.]
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> . . . .
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> To the extent that our Supreme Court would hold that the bare amount of the judgment constitutes damage in a case like this, we believe it is wrong, and we urge it to correct the matter when it has the opportunity. Until it does so, however, we defer to what we believe is the stated law and hold that the judgment here is some evidence of damage to Pearce, even though the judgment can never be collected from him, and is sufficient evidence to support the jury's finding.

Gandy, 925 S.W.2d at 705.

The court of appeals failed to recognize that the insured was in fact contributing to payment or satisfaction of the judgment. The insured was assigning valuable contractual rights to the claimant. The insurance policy and related extra-contractual rights unquestionably had value. The court also ignored the fact that a judgment debtor such as the claimant has the right to sue up to the policy limits without the necessity of an assignment.

The court of appeals complained about the unfairness of three judicially created rules: (1) damages were set by the underlying judgment as a matter of law, (b) the insured was damaged by the judgment and thus prepayment of the judgment was not required, and (c) a covenant not to execute would not be treated as a release as a matter of public policy in order to aid the insured left in the ditch by its insurer. The insured and the claimant in *Gandy* can hardly be said to have engaged in fraud and collusion, distorting the judicial process, by following then existing law. In fact, it was a set of rules endorsed in *Garcia* by the Supreme Court in its initial opinion.

D. The Backdrop of *Garcia I*—Public Policy In Favor Of Assignment/Covenant Arrangements

In the original opinion in *Garcia*, which has been completely erased from any published source, the court, as described by the dissenting opinions in *Garcia*, expressly held that "that an injured plaintiff, as the assignee of the insured, is not precluded from recovering damages from the insurer by the existence of a covenant between the plaintiff and the insured to seek relief only from the insurer." (Hightower, J.). The dissent provides a very solid explanation of the public policy behind the damages and covenant rules:

> Insurance companies will at times inappropriately refuse to settle a case, thereby exposing their insureds to liability in excess of policy limits. *See* Kent Syverud, *The Duty to Settle,* 76 VA.L.REV. 1113, 1120 n. 15 & 1126 (1990). *See also* Bob Roberts, *Agreements Between Claimants and Insureds After Misconduct By Insurers,* STATE BAR OF TEXAS—SUING, DEFENDING AND NEGOTIATING WITH INSURANCE COMPANIES B–24–26 (1991) (hereinafter Roberts). To remedy this problem, many states, including Texas, allow an insured to assign any claim against the insurer in exchange for a covenant not to execute. *See Foremost County Mut. Ins. Co. v. Home Indem. Co.,* 897 F.2d 754, 759–60 (5th Cir.1990); *Young Men's Christian Ass'n (YMCA) v. Standard Ins. Co.,* 552 S.W.2d 497, 504–05 (Tex.Civ.App.—Fort Worth 1977), *writ ref'd n.r.e. per curiam,* 563

S.W.2d 246 (Tex.1978); Reagan M. Brown, *Defending Against the Sweetheart Deal,* STATE BAR OF TEXAS—SUING, DEFENDING AND NEGOTIATING WITH INSURANCE COMPANIES I–18 (1991) (hereinafter Brown); *Ranger v. Superior Coach Sales and Service of Arizona,* 110 Ariz. 188, 516 P.2d 324, 327 (1974); *Ivy v. Pacific Automobile Ins. Co.,* 156 Cal.App.2d 652, 320 P.2d 140, 147 (1958).

The use of a covenant not to execute provides insurers with a strong incentive to give due consideration to the interests of its insureds. *See YMCA,* 552 S.W.2d at 504–05; *Rawlings v. Apodaca,* 151 Ariz. 149, 726 P.2d 565, 575–76 (1986). The necessity of such covenants is particularly apparent when an insurer has ***refused to provide a defense***:

> In such a situation, the *YMCA* rule is needed to protect the insured adequately. Where the insurer refuses to tender a defense, the insured often can protect himself only with a covenant not to execute. Without such a covenant, the insured either would have to pay the plaintiffs enough to settle their claim or would have to incur defense costs himself, even though the insurer is contractually responsible for payment of such costs. *Were a covenant not to execute to absolve the insurer of liability, plaintiffs would have no incentive to enter into such a covenant.*

Foremost County Mut. Ins. Co., 897 F.2d at 759 (citations omitted). Without the availability of such a covenant, there may be nothing to deter an insurer from failing to give due regard to its insured's interests. *See YMCA,* 552 S.W.2d at 504–05; *Foremost County Mut. Ins. Co.,* 897 F.2d at 760.

Garcia II, supra, at 867-68 (emphasis added) Quoting *Samson v. Transamerica*

Insurance Co., 30 Cal.3d 220, 178 Cal. Rptr. 343, 636 P.2d 32 (1981), the dissent in *Garcia* recognized "When the insurer 'exposes its policyholder to the sharp thrust of personal liability' by breaching its obligations, the insured 'need not indulge in financial masochism . . . "[B]y executing the assignment, he attempt[ed] only to shield himself from the danger to which the company.... exposed him." In short, the dissent noted that ***deterrence*** was yet another public policy in favor of the use of assignment/covenants. The dissent observed that "[i]f there were no recovery for the excess judgment, there would be more of an incentive for breach of the contract than its performance . . . Pretrial covenants not to execute should be encouraged as a matter of *public policy favoring settlements and minimizing the insured's potential damages. See Rainbo Baking Co. v. Stafford*, 787 S.W.2d 41, 42 (Tex.1990). Public policy considerations are better served by allowing an injured claimant to collect from the party who engaged in false, misleading and deceptive acts and caused those damages—the insurance company—rather than the victim of those acts—the insured." *Garcia II, supra,* at 868-69 (emphasis added). The dissent noted a large number of other jurisdictions permitted the use of assignment/covenant arrangements based on the idea that when an insurer has "'refused to defend its insured, it is in no position to argue that the steps the insured took to protect himself should inure to the insurer's benefit.'" *Id.* (quoting *Greer v. Northwestern Nat'l Ins. Co.,* 109 Wash.2d 191, 743 P.2d 1244, 1251 (1987)).

E. *Gandy*—Rationale For Anti-Assignment

Instead of focusing on the "distorting" damages rule and the corollary that a covenant is not a release, the Supreme Court in *Gandy* turned to assignability, picking up the complaint of the court of appeals that the distorting effect of the damages/covenant rule was inconsistent with the Supreme Court's rejection of Mary Carter agreements because they "skew the trial process, mislead the jury, promote unethical collusion among nominal adversaries, and create the likelihood that a less culpable defendant will be hit with the full judgment." *Elbaor v. Smith*, 845 S.W.2d 240 (Tex.1992).

The court recognized that it had rejected alienation of legal malpractice actions because of the "reversal of roles" sometimes caused by such transfers. 925 S.W.2d. at 708. The Court also noted its decision in *Elboar* regarding the distorting effect of Mary Carter agreements. Both situations also increased litigation rather than ending it. The Court also emphasized that the jury would be confused where the claimant was standing in the shoes of the defendant/insured in the insurance litigation. *Id.* at 710-11.

A number of the distortions found by the *Gandy* Court are convoluted and unfounded:

1. **The *Gandy* assigment caused a proliferation of litigation rather than ending it.**

    a. A carrier breaching its contract and failing to act reasonably can should be sued in a separate action. Because of justiciability concerns, it is almost always after resolution of the underlying suit.

    b. Unless the insured abandoned its legal rights against the carrier, there was always going to be a second suit against the carrier, at the very least for the policy limits.

2. **"Without the assignment and covenant not to execute, the agreed judgment would never have been rendered." It was a sham and distorted the litigation.**

    a. The parties entered into an agreement sanctioned by Texas law and sought damages as a matter of law based on prior decisions allowing such a damage fiction in order to provide protection to insureds left in the ditch by their carrier.

    b. Julie Gandy argued her father was liable in the tort suit, but she argued as an assignee that he would have been found

innocent or less culpable if he had a proper defense. This situation involved what was in effect a legal malpractice claim, not a claim for the failure to settle a covered claim.

3. *Gandy* Agreements Alter the Natural Incentives of Insureds To Claims

a. Once the insurer fails to handle the claim properly and/or wrongfully denies a defense or indemnity, the insured rightfully wants to settle and place the liability on the insurer which acted improperly.

b. The carrier forced the insured into this situation, and it has no right to complain.

4. The Settlement Did Not Resolve The Parties' Disputes

a. The insurance dispute could not be settled earlier.

b. Absent a carrier acknowledging coverage, the insured and the claimant have no ability to settle their claims without a subsequent insurance case being brought.

Strangely, the Court recognized that some insureds need to have the ability to assign rights with a covenant, depending on the circumstances. Those circumstances form the framework of the Court's non-assignability ruling. The damages/covenant fiction will be entertained and the assignment held valid if the carrier did not attempt to resolve coverage issues early in the case. It will not be entertained if the carrier is in fact providing a defense. And/or the carrier has accepted coverage.

Finally, the Court recognized its decision was narrow:

As we have said, we do not address whether an assignment is invalid when any element of the rule is lacking, such as when an insurer has not tendered a defense of its insured. Adjudication of an insurer's obligations

> before determination of the defendant insured's liability to the plaintiff removes the justification for a settlement like the one in this case in most instances.

925 S.W.2d at 719.

E. Narrowing of *Gandy*—Wrongful Denial Of Coverage—Pure Settlement Without Judgment

1. *Evanston Ins. v. Atofina*

In *Evanston Insurance Co. v. ATOFINA Petrochemicals, Inc.,* 256 S.W.3d 660 (Tex. 2008), the Court narrowed the scope of *Gandy*. *Atofina* was presented to the lower courts as a summary judgment case. Evanston urged that Atofina was barred from recovery alternatively because it failed to at least create a fact issue as to whether the settlement agreement it had entered into was *reasonable*. The Supreme Court held that where the insurance carrier has ***wrongfully denied coverage***, it is estopped from urging the settlement was *unreasonable*. *Id.* at 671-72.[3] The Court certainly suggests that other breaches, such as a wrongful refusal to defend, would have a similar impact.

The *Atofina* Court resurrected *Employers Casualty Co. v. Block*, 744 S.W.2d 940 (Tex. 1988), which was clearly overruled by Gandy. The Court ignored the fact that *Block* involved the issue of whether a carrier could collaterally attack an agreed judgment entered into by the insured. *Atofina* involved a reasonableness attack on a settlement with no agreed judgment required as part of that settlement. The Court sidestepped the fact that the law regarding the sanctity and need to avoid collateral attacks on judgments does not apply to determining the recoverability of a settlement agreement that is not formalized into a judgment. *Id.* at 673-74.

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[3] *Block* involved a failure to defend by a primary carrier. It did not involve an excess carrier, as did *Atofina*. An excess carrier has no duty to defend. After *Atofina*, the simple fact is that excess carriers certainly should not prematurely deny coverage.

The Court by implication is would appear to be suggesting that even an agreed judgment may be entered and not subject to attack if a carrier is wrong about coverage. The Court noted numerous decisions had interpreted *Block* as binding a carrier who wrongfully denied a defense from challenging (a) the fact of liability and (b) the reasonableness of the amount. *Id.* at 671 n.58 (citing *W. Alliance Ins. Co. v. N. Ins. Co. of N.Y.,* 176 F.3d 825, 830 (5th Cir.1999) (citing *Block*, 744 S.W.2d at 943) ("If an insurer breaches the duty to defend, it may not contest a determination that its insured was liable in the underlying settlement or verdict (or the amount of either)."); *Enserch Corp. v. Shand Morahan & Co.,* 952 F.2d 1485, 1495-96 (5th Cir.1992) ("Texas law denies insurers like these a collateral attack on the settlement itself . . . . Recent opinions of both this Court and the Texas Supreme Court have confirmed that, unlike a request for allocation, an attempt to contest the reasonableness of a *consent judgment* entered into between the insured and an injured third party is unavailable to an insurer who has wrongfully breached its duty to defend.")(emphasis added)). The Court's decision potentially presages a new age of settlements with assignments that can once again bind a carrier to an agreed judgment.

Note the following discussion by the Court as to the conduct of Evanston that it found critical in invoking the protections of *Block*:

> On multiple occasions before the settlement, Evanston explicitly rejected Atofina's claim for coverage under the policy. Evanston first denied Atofina's request for coverage by letter, and then consistently asserted the same in its pleadings throughout the coverage suit. Even if this conduct does not amount to an anticipatory breach of the contract, which it very well might, *see Murray v. Crest Constr., Inc.,* 900 S.W.2d 342, 344 (Tex. 1995); *Johnson & Higgins of Tex., Inc. v. Kenneco Energy, Inc.,* 962 S.W.2d 507, 515 (Tex. 1998), this kind of explicit, unqualified rejection of coverage surely operates to trigger the equitable principles in Block.

Id. at 672 n. 60.

Importantly, the *Atofina* Court observed:

> [N]either the difference in policy claims nor the absence of a judgment memorializing the parties' settlement disrupts the *Block* principles here because *Block's* rule is not derived from the nature of the violated policy term or the formality of agreed judgments. The cases barring insurers' challenges rest on principles of estoppel and waiver; what is most important in this context is *notice to the insurer and an opportunity to participate in the settlement discussions*.

Id. (emphasis added). This was a critical missing element in *Gandy,* where the insured failed to inform the carrier or numerous developments in the litigation and failed to involve the carrier or notify it of the settlement offer/s and discussion.

The inability to attack the reasonableness of the insured's settlement is particularly stinging for carriers. In *Excess Underwriters at Lloyds, London v. Frank's Casing Crew & Rental Tools, Inc., supra,* the Court held that reasonableness concerns with respect to a carriers settling and seeking reimbursement were so substantial that no cause of action for reimbursement would be recognized. The message is that this Court does not appear to like litigation about reasonableness.

In *Atofina,* the Court noted that some cases had found that a carrier wrongfully denying coverage was also *estopped to assert policy defenses*. The Court admitted that this was not the situation presented in the case before it. Nevertheless, the Court certainly seems to give it importance in dismissing the distinction that a difference in the type of coverage, excess versus primary, should result in *Block* not applying. But, in a footnote, the Court held that even a carrier wrongfully denying coverage or a defense ***could still contest coverage***.

> The denial does not bar Evanston from challenging coverage. *See Utica Nat'l Ins. Co. of Tex. v. Am. Indem. Co.,* 141 S.W.3d 198, 203 (Tex. 2004) ("Even if a liability insurer breaches its duty to defend, the party seeking

> indemnity still bears the burden to prove coverage if the insurer contests it."); *Block,* 744 S.W.2d at 943–44.

Id. n. 74.

The *Atofina* Court sidesteps the fact that Block was obviously overruled by Gandy. The Court recognized that *Gandy* held:

> "In no event, however, is a judgment for plaintiff against defendant, rendered without a fully adversarial trial, binding on defendant's insurer or admissible as evidence of damages in an action against defendant's insurer by plaintiff as defendant's assignee. We disapprove the contrary suggestion in dicta in *Employers Casualty Company v. Block,* 744 S.W.2d 940, 943 (Tex. 1988), and *United States Aviation Underwriters, Inc. v. Olympia Wings, Inc.,* 896 F.2d 949, 954 (5th Cir. 1990)."

Id. (quoting Gandy, supra). The Court concludes that *Gandy* only overruled *Block* to the extent the next case at issue involves precisely the factual and legal situation presented in *Gandy.* Undoubtedly, *Gandy* has been narrowed.

Gandy was initially recognized as having two distinct holdings. The first dealt with assignability. It depended on a list of factors, which were not found to be exclusive or always mandatory, and evidence of distortion. The second holding of Gandy involved the evisceration of *Block*. It was seemingly not dependent on proof of the factors or anything similar to them. In limiting *Gandy,* the *Atofina* Court observed:

> *Gandy* does not disrupt the application of Block to this case for two reasons. First, this case does not fall within *Gandy's* holding. *Gandy's* holding was explicit and narrow, ***applying only to a specific set of assignments with special attributes. By its own terms, Gandy's invalidation applies only to cases that present its five unique elements***. Here, *Gandy's* key factual predicate is missing: ATOFINA made

no assignment of its claim against Evanston; ATOFINA sued Evanston directly.

Id. (emphasis added.) The Court added:

> *Gandy's* rationale does not require disapproving *Block* in this setting. ***Gandy's reason for invalidating assignments was simple: Those assignments made evaluating the merits of a plaintiff's claim difficult by prolonging disputes and distorting trial litigation motives.*** But not all cases implicate *Gandy's* concerns. "We should not invalidate a settlement that is free from this difficulty [of fairly evaluating a plaintiff's claims] simply because it is structured like one that is not."
>
> Barring Evanston's challenge here does not implicate *Gandy's* concerns. ***Preventing insurers from litigating the reasonableness of a settlement does not extend disputes***; by definition, it shortens them. ***Nor is there a risk of distorting litigation or settlement motives here.*** ATOFINA settled without knowing whether or not it would be covered by the policy, ***leaving in place its motive to minimize the settlement amount in case it became solely responsible for payment.***

Id. (emphasis added).

2. *Lennar v. Markel Ins.*—Unilateral Settlements By The Insured

In *Lennar Corp. v. Markel American Ins. Co.,* 413 S.W.3d 750, 751 (Tex. 2013), the insured homebuilder determined that homes built with an exterior insulation and finish system ("EIFS") were suffering serious water damage that worsens over time. The insured "undertook to remove the product from all the homes it had built and replace it with conventional stucco." "The homebuilder's insurers refused to cooperate with this remediation program, preferring instead to wait until homeowners sued, and denied coverage of the costs." *Id.* The insurers all denied coverage. All of the underlying claims eventually settled, with only three ever getting to litigation. *Id.*

The Court held that legal liability sufficient to invoke coverage under the insuring agreement and Loss Establishment Clause can be established by a unilateral settlement to which the insurer has not consented, so long as the settlement did not prejudice the insurer. The policy obligated Markel to pay Lennar's "'ultimate net loss'—defined as 'the total amount of [property] damages for which [Lennar] is legally liable'—and states that such loss 'may be established by adjudication, arbitration, or a compromise settlement to which we have previously agreed in writing.'" *Id.* at 756. The policy also included a condition barring settlement without consent, and it also included similar language in the insuring agreement. *Id.* at 751. The Court also reasoned that repeating the consent requirement in the insuring agreement did not mean that the absence of consent was a material breach that obviated the need to show prejudice. *Id.* at 756.

The Court rejected arguments that Lennar prejudiced the insurer as a matter of law by actively "soliciting claims which might otherwise never have been brought contacting of potential claimants rather than waiting for them to assert a claim somehow prejudiced the insurer." *Id.* at 755-56. Strategic use of the Court's ruling could assist policyholders with a new tool to encourage carriers to participate and initiate settlement. While carriers in Texas have traditionally not had a tort duty to initiate settlement, the decision in Lennar strongly suggests that is they take a wait and see approach, the insured can take preemptive action, solve the impasse and send the bill back to the carrier.

Critics of the decision in Lennar fear that the Court has set the stage for policyholders to exclude liability insurers from settlement discussions. As noted, the Court has previously emphasized that carriers who are given the opportunity to participate in settlement and refuse to do so will suffer. *Evanston, supra.* The Court in *Lennar* clearly desired to reward responsible corporate insureds seeking to limit and solve problems, noting that "Lennar's responsible efforts to correct defects in its home construction did not absolve [the liability insurer] of responsibility for the costs under its liability policy." *Id.* at *6.

F. *Yorkshire v. Seger*—The Saga—Denial Of Defense And Coverage

Litigation over a variety of issues involving *Gandy* and so-called sweetheart deals have been played out over a long period of time in *Yorkshire Ins. Co., Ltd. v. Seger,* 407 S.W.3d 435 (Tex. App.—Amarillo 2013, review granted March 13, 2015). The court of appeals addressed the *Atofina* reading of *Gandy*, and reasoned:

> Relying on *ATOFINA,* the Segers contend that, because Insurers did not provide Diatom a defense and denied coverage, Insurers are barred from challenging the reasonableness of the underlying judgment. However, we conclude that the arrangement between Diatom and the Segers does not meet *ATOFINA*'s exception to *Gandy.* First, because the Segers are asserting their *Stowers* claims as assignee of Diatom, "*Gandy*'s key factual predicate" is present. *Id.* at 673; *see Gandy,* 925 S.W.2d at 713. Second, the agreement between Diatom and the Segers implicates both of *Gandy*'s concerns. The very point of the assignment was to prolong the litigation. Before the underlying judgment ***441** was obtained, Diatom was judgment-proof and each of the individual principals of Diatom had been nonsuited. *See Transp. Ins. Co. v. Heiman,* No. 05–95–00482–CV, 1999 WL 239917, at *9–10, 1999 Tex.App. LEXIS 3083, at *27–28 (Tex.App.-Dallas Apr. 26, 1999, no pet.) (it is the insured's insulation from any personal liability, such as from a covenant not to execute, that makes these sorts of arrangements "so highly suspect."). Thus, the Segers obtained an assignment of Diatom's *Stowers* claims specifically for the purpose of initiating another suit against the CGL insurers. *See First Gen. Realty Corp. v. Md. Cas. Co.,* 981 S.W.2d 495, 499 (Tex.App.-Austin 1998, pet. denied).

Id. at 439-40. The court added:

> Likewise, the assignment distorted the litigation. Because neither Diatom nor its principals had any financial exposure in the underlying trial, unlike

> ATOFINA, Diatom had no incentive to contest its liability or to attempt to limit the assessment of damages after it was found liable. *See ATOFINA*, 256 S.W.3d at 674 (*ATOFINA* "settled without knowing whether or not it would be covered by the policy, leaving in place its motive to minimize the settlement amount in case it became solely responsible for payment."); *see also First Gen. Realty Corp.*, 981 S.W.2d at 500. Further, as assignee of Diatom's claims against Insurers, the Segers, in their *Stowers* action, are forced to take the position that they would not have recovered more than policy limits against Diatom if Insurers had only provided Diatom a defense. In the underlying action against Diatom, the Segers sought and obtained a judgment awarding them a combined $15,000,000 in actual damages. However, as assignee of Diatom, in the present action, the Segers are forced to argue that they would have recovered no more than the $500,000 CGL policy limits had Insurers provided Diatom a defense. In fact, the Segers argued to the trial court in their *Stowers* action that admission of the amount of damages recovered by them in the underlying proceeding would be "completely prejudicial."

Id. at 440.

The court of appeals next turned to the "adversarial trial" requirement of *Gandy.* Applying the *Atofina* approach, the court concluded the assignment was valid:

> In the present case, (1) the Segers obtained their assignment of Diatom's claims against Insurers after the underlying proceeding, (2) Insurers refused to tender a defense of Diatom, and (3) Insurers neither accepted coverage nor made a good faith effort to adjudicate coverage prior to the adjudication of the Segers' claims. Thus, under *Gandy*, Diatom's assignment of its claims against Insurers to the Segers is valid.

Id. at 441. The court held that the underlying judgment may not be used as evidence of damages whenever it is rendered without a fully adversarial trial. Of course, if this is what *Gandy* intended, then why would there be a need for the anti-assignment rule?

The court reasoned that "any evidence of pre-trial collusion between Diatom and the Segers would only be relevant to the validity of the post-judgment assignment of Diatom's claims against Insurers. *See Gandy*, 925 S.W.2d at 714. The determination of the reliability of the underlying judgment's assessment of damages depends entirely on the extent of Diatom's participation in the underlying proceeding. *See Gandy*, 925 S.W.2d at 713–14; *Seger I,* 279 S.W.3d at 772 n. 25." *Id.* at 443 n. 7.

The court characterized the "trial" as follows:

> The record reflects that Diatom was not represented by counsel, did not announce ready at the start of trial, made no opening or closing statements, offered no evidence, and did not cross-examine any of the Segers' witnesses.
>
> . . . .
>
> The record reflects that the Segers offered a significant amount of evidence during the underlying proceeding, however, it is noteworthy that the only evidence of actual damages offered during this proceeding was that Randall's death cost his estate $570,278 as the value of his expected future earnings, and that funeral expenses were $4,881.76. There was no evidence offered that would support awards of $7,500,000 to both Roy Seger and Shirley Hoskins. However, because Diatom was not acting as an adversary, this lack of evidentiary support for the trial court's award of actual damages was not challenged during the trial, by post-judgment motion, or on appeal. Further, this lack of evidentiary support for the trial court's award of damages in the underlying case evinces that the value of the Segers' claims against Diatom were not

> "fairly determined" by that proceeding.6 See Gandy, 925 S.W.2d at 713–14 (a settlement or judgment that follows an adversarial trial "fairly determine[s]" the value of the plaintiff's claims).

Id. at 442. The court added: "[T]he 'fully adversarial trial' determination is a legal one, as a mixed question of law and fact, the trial court's factual determinations underlying its legal conclusion must be properly supported by the record. *See Remington Arms Co. v. Luna*, 966 S.W.2d 641, 643 (Tex. App.—San Antonio 1998)." *Id.* at 443 n. 4. Thus, the court concluded that the judgment could not be admitted into evidence as proof of damages, and no other proof was provided.

III. The Georgia Approach

A. The Bedrock Principle—An Insurer That Fails to Provide a Defense "Does So At Its Peril"

The Supreme Court of Georgia has held: "An insurer that refuses to indemnify or defend based upon a belief that a claim against its insured is excluded from a policy's scope of coverage "[does] so at its peril, and if the insurer guesses wrong, it must bear the consequences, legal or otherwise, of its breach of contract." *S. Guar. Ins. Co. v. Dowse*, 278 Ga. 674, 676, 605 S.E.2d 27, 29 (2004) (quoting 49 A.L.R.2d 694 at (I)(2b)). One of these "consequences" is that the insurer can no longer enforce consent and cooperation conditions in the policy. This rule is predicated on the finding that "[t]hese provisions enable insurers to control the course of litigation concerning such claims, and also serve to prevent potential fraud, collusion and bad faith on the part of insureds," but that an insurer also "has a correlative duty to defend its insured against all claims covered under a policy, even those that are groundless, false, or fraudulent." *Dowse*, 278 Ga. at 676. Thus, under Georgia law, the duty to defend and duty to obtain consent to settle are inextricably intertwined.

Pursuant to these principles, "an insurer that denies coverage and refuses to defend an action against its insured, when it could have done so with a reservation of its rights as to coverage, 'waives the provisions of the policy against a settlement by the insured and becomes bound to pay the amount of any settlement [within a policy's limits] made in good faith[,] plus expenses and attorneys' fees.'" *Id.* Put another way, an insurer that abandons its policyholder on the side of the road is responsible for the full fare paid by the policyholder to get home safely.

1. "Sweetheart Deals" Under *Dowse*—Substance Over Form

In *Dowse*, the claimants in the underlying action released the policyholder from all liability for damages in exchange for an assignment of the policyholder's right to pursue a claim against the insurer. *See id.*, at 675. "Because the settlement agreement release[d] Cutter, Inc. [the policyholder] of any obligation to pay damages, SGIC [the insurer] argue[d] that it, too, [was] relieved of that obligation." *Id.* The Supreme Court of Georgia rejected this argument and held:

> The settlement agreement provides that the Dowses [the claimants in the underlying action] would not seek to recover or collect from Cutter, individually, or from Cutter, Inc., "except [the Dowses] may seek to recover any funds available to [Cutter, Sr., and Cutter, Inc.,] as indemnity under [SGIC's insurance policy] .... it being the express intent of all parties hereto to enter into an agreement providing [the Dowses] shall limit their recovery to whatever [they] may recover under the [SGIC policy] ... whether as assignee of the benefits of this policy or as judgment creditor of [the insureds]." Thus, it is clear that the Dowses specifically reserved their claims against Cutter, Inc., to the extent that coverage is provided under the SGIC policy. Accordingly, there has not been a full and complete release of Cutter, Inc., as claimed by SGIC, and its argument to the contrary fails.

Id.

In so holding, the Supreme Court of Georgia affirmed the opinion of the Georgia Court of Appeals, which relied on precedent from other jurisdictions holding "that an insurer may be liable to an injured party when the insured before judgment is protected by an agreement not to execute, basing their holdings . . . on the right of the insured to protect itself from the bad faith conduct of its insurer." *Dowse v. S. Guar. Ins. Co.*, 263 Ga. App. 435, 439, 588 S.E.2d 234, 237 (2003), *aff'd*, 278 Ga. 674, 605 S.E.2d 27 (2004) (citing *Metcalf v. Hartford Accident &c. Co.*, 176 Neb. 468, 126 N.W.2d 471 (1964); *Coblentz v. American Surety Co. of New York,* 416 F.2d 1059 (5th Cir. 1969)). Importantly, the Georgia Court of Appeals distinguished its holding from an "alternative line of reasoning in holding that a covenant not to enforce against a party does not release that party's insurance carrier" because a "covenant not to execute is simply a contract, not a release, so that the underlying tort liability remains and a breach of contract action lies if an injured party seeks to execute on its judgment." *Id.* at 441. Thus, while the court implied that the same result would be reached under this "alternative" approach based on the distinction between contract and tort rights, it also affirmed that in Georgia substance rules over form. The insurer will not avoid the "consequences" of breaching its duty to defend simply because the "sweetheart deal" is structured a certain way. *See id.* at 438 (finding "distinction between a covenant not to execute and a covenant not to sue" is "a distinction without a difference").

Indeed, the Georgia Court of Appeals' decision was predicated on three fundamental "policy considerations":

1) ***Enforcing the Intention of the Settling Parties***. As the court explained, "holding that SGIC is not released from its obligations under the policy by the Dowses' settlement agreement with Cutter, Inc. forwards the important goal of enforcing the intentions of the parties to the agreement. . . In this case, our holding enforces the parties clear intention that SGIC not be released."

2) ***Ensuring the Availability of Insurance for Tort Victims***: The court also noted that its holding "advances the strong public policy favoring the availability to injured persons of the liability insurance of those whose negligence is the cause of their plight. Cutter, Inc. secured insurance and paid premiums to cover instances of liability such as the one damaging the Dowses, both Cutter, Inc. and the Dowses are entitled to the protection of that insurance coverage, and SGIC should not be permitted to refuse to supply it."

3) ***Encouraging Settlements***. Finally, the court held that Georgia courts have "long recognized that it is sound public policy to encourage parties to engage in settlement negotiations to the end that litigation may be avoided."

Id. at 442 (internal citations omitted).

2. Other Consequences—Waiver of Defenses

The Supreme Court of Georgia subsequently reaffirmed *Dowse* in *Owners Ins. Co. v. Smith Mech. Contractors, Inc.*, 285 Ga. 807, 683 S.E.2d 599 (2009). In *Smith Mechanical*, the Georgia Supreme Court held there was a waiver of the provisions of the insurance policy against settling without the insurer's consent when there is a denial of coverage and refusal to defend. In that case, the court went on to hold that the insurer's decision not to defend its policyholder estopped the insurer from re-litigating the merits of the underlying disputes and, consequently, from arguing that the policyholder's settlement was a "voluntary payment." *Id.* Similarly, in *Hoover v. Maxum Indem. Co.*, the Supreme Court of Georgia reaffirmed that an insurer that "den[ies] coverage and refuse[s] to defend" faces consequences, including the waiver of coverage defenses not asserted with its initial coverage denial. 291 Ga. 402, 405, 730 S.E.2d 413, 416 (2012).

Moreover, several Georgia Court of Appeals have relied on *Dowse* to hold insurers responsible for the "consequences" of its refusal to defend its policyholder. *See, e.g., Occidental Fire & Cas. of N. Carolina v. Goodman*, 339 Ga. App. 427, 431, 793 S.E.2d 606, 610 (2016) ("In this case, rather than defend the action with a reservation of rights as to coverage, [the insurer] simply denied coverage and refused the request to provide a defense to the lawsuit based on its incorrect belief that the claim against [the policyholder] was not covered by the policy. Under these circumstances, [the insurer] ***must bear the consequences*** of its decision not to defend the suit and must pay for its breach of the contract.") (emphasis added); *McGregor v. Columbia Mat. Ins. Co.,* 298 Ga.App. 491, 494, 680 S.E.2d 559, 562 (2009) ("Georgia law is clear that by refusing to defend its insured in litigation, an insurer ***loses all opportunity to contest the negligence of the insured or the injured person's right to recover***, and exposes itself to a charge of and penalty for breach of contract.") (internal citations omitted) (emphasis added); *Yeomans & Assocs. Agency, Inc. v. Bowen Tree Surgeons, Inc.*, 274 Ga. App. 738, 747, 618 S.E.2d 673, 681 (2005) ("Under these circumstances, [the insurer] is ***estopped from arguing that the plaintiffs violated the insurance policy by settling a claim without [the insurer's] consent***, when it was [the insurer] who breached the policy and left [the policyholder] unprotected in the [underlying] suit.")(emphasis added).

One Georgia court has applied the *Dowse* rule where the insurer did not have duty to defend under the policy and held the insurer's attempt to rescind the directors and officers liability policy at issue precluded the insurer from subsequently challenging the allocation of the settlement payment. *Exec. Risk Indem., Inc. v. AFC Enterprises, Inc.*, 510 F. Supp. 2d 1308, 1333 (N.D. Ga. 2007), *aff'd*, 279 F. App'x 793 (11th Cir. 2008) ("[The insurer] had the opportunity to protect the interests of its insureds and its own interests. It chose instead to stand by its rescission of the Policy. It cannot now insist that its insureds should have, in some fashion suitable to [the insurer], allocated the settlement they reached to comply with an insurance policy [the Insurer] has insisted does not exist.")

Thus, the *Dowse* holding and bedrock principle upon which it is based—*i.e.*, that an insurer that abandons its policyholder "does so at its peril"—has not only been reaffirmed, but has been expanded by subsequent decisions to impose additional consequences beyond the waiver of the right to contest a settlement.

B. Exception for Bad Faith or Collusive Settlements

Under the *Dowse* holding and its progeny, the only means for an insurer to challenge a settlement made after refusing to provide a defense is to prove the settlement was entered into in bad faith. *See, Dowse,* 278 Ga. at 676; *see also Lee v. Universal Underwriters Ins. Co.*, No. 1:12-CV-3540-CAP, 2014 WL 11858159, at *3 (N.D. Ga. June 25, 2014), aff'd, 642 F. App'x 969 (11th Cir. 2016) ("Under Georgia law, [the insurer] may challenge the underlying consent judgment only by establishing that it was not made in good faith.") The burden of proving such bad faith conduct is on the insurer. *See AFC Enterprises, Inc.*, 510 F. Supp. 2d at 1332 ("[The insurer offered no evidence at trial that [policyholder's] settlement of the Underlying Actions was collusive or in bad faith."). However, the insurer may not need to show additional evidence of collusion if the settlement amount is grossly excessive. *See Georgia Southern & c. R. Co. v. U.S. Cas. Co.*, 97 Ga.App. 242, (1958); ("Where an insurer refuses to defend an action against an insured on the ground that the policy does not require it to do so under the policy coverage, the insurer is bound by a settlement of the action made by the insured in good faith, and may not question the reasonableness of the amount if the settlement otherwise was in good faith, ***unless the excessiveness of the amount alone is sufficient to show bad faith***.")

IV. Other Jurisdictions

A. Florida and The *Coblentz* Agreement

1. Mary Carter Agreements

The term "Mary Carter" agreement is derived from the name of one of the earliest cases involving such an agreement, *Booth v. Mary Carter Paint Company*, 202

So. 2d 8 (Fla. 2d DCA 1967). Four features characterize Mary Carter agreements: (1) the settling defendant and the plaintiff usually agree to keep the agreement secret; (2) the settling defendant remains a party to the litigation and agrees to aid the plaintiff's recovery; (3) the settling defendant guarantees the plaintiff a minimum recovery, and in return, the plaintiff agrees not to enforce a judgment against the settling defendant; and (4) the settling defendant gains a financial interest in the plaintiff's recovery.

The argument in favor of Mary Carter agreements: they promote settlement . . . but with only one of the defendants. The arguments against Mary Carter Agreements:

> Settling parties may cooperate during the discovery process; cooperate during voir dire and share their strategic peremptory challenges; coordinate courtroom strategy, support each other's motions, vigorously challenge the non-settling defendant's motions; and persuade the jury to render a judgment that serves the settling parties' interests. Additionally, it can increase the likelihood of post-trial attacks on verdicts alleged to have been unfairly obtained as a result of such agreements. Bottom line, they prevent fair trials, and obscure the search for the truth.

Florida attempted to ameliorate the inherent unfairness of Mary Carter Agreements. In 1973, Florida held the Agreement must be disclosed and admitted into evidence. Even admitting the agreement into evidence, however, can be a double-edged sword to the extent that it conveys a message to the jury that at least one of the defendants felt that the plaintiff's claim was meritorious. *Ward v. Ochoa,* 284 so. 2d 385 (Fla. 1973) *abrogated by Dosdourian v. Carsten*, 624 So. 2d 241 (Fla. 1993).

In 1993, the Florida Supreme Court held that it would no longer recognize Mary Carter agreements between plaintiff and one of multiple defendants, including any agreement which requires the settling defendant to remain in the litigation, regardless of whether there is a specified financial incentive to do so. The court noted that Mary

Carter Agreements were invalid for (1) encouraging an unfair trial, (2) promoting unethical practices by attorneys, (3) adding to litigation and appeals to the Florida courts, and (4) undermining the integrity of the judicial system. *Dosdourian v. Carsten*, 624 So. 2d 241 (Fla. 1993).

2. Policyholder Settlements

Policyholder settlements without involvement of the carrier have been drawn into the world of Mary Carter agreements, as Gandy shows. The majority of jurisdictions permit a policyholder to enter into a stipulated judgment with the underlying claimant, under certain circumstances, without the consent of the insurer in exchange for an agreement that the underlying claimant will not execute the judgment against the policyholder. There are important limitations, though, in every jurisdiction.

3. *Coblentz* Agreement:

Coblentz v. American Surety Co. of New York, 416 F. 2d 1059 (5th Cir. 1969) coined the term "Coblentz Agreement." As a general matter, one who is not a party to a settlement agreement cannot be bound by its terms. An exception to this rule occurs when an insurer refuses to defend its insured. Absent fraud or collusion, a liability insurance carrier will be bound to the settlement agreement between the insured and the claimant if the insurance carrier wrongfully refused to defend its insured. Florida courts have extended the reasoning of *Coblentz* to allow agreements by the insured to a judgment *in excess of the policy limits* against an insured who wrongfully refuses to defend and acts in bad faith. *Perera v. U.S. Fid. and Guaranty Co.,* 35 So.3d 893, 900 (Fla.2010).

As in most jurisdictions, under Florida law, "when an insurer unequivocally denies coverage that actually exists, the insurer has breached the contract and therefore cannot rely on a contractual provision prohibiting the insured from settling the claim without its consent." *U.S. Fire Ins. Co. v. Mikes*, 576 F.Supp.2d 1303 (M.D. Fla. 2007). "Likewise, when an insurer improperly fails or refuses to defend an insured's

claim, the insurer has breached the insurance contract and an insured is entitled to enter into a reasonable settlement even though the policy purports to avoid liability for a settlement made without the insurer's consent." *Id.* (citing *Gallagher v. Dupont*, 918 So.2d 342 (Fla. Dist. Ct. App. 2005) and *Steil v. Fla. Physicians' Ins. Reciprocal*, 448 So.2d 589, 591 (Fla.Dist.Ct.App.1984)).

The recent decision in *Bioscience West, Inc. v. Gulfstream Property and Cas. Ins. Co.,* 2016 WL 455723, --- So.3d --- (Fla. 2d Dist. Ct. App. 2016), the court held that the policy in that case barred assignment of the entire policy without consent of the carrier, but it did not bar assignment of benefits derived from the policy. The policy stated: "Assignment. Assignment of this policy will not be valid unless we give our written consent." *Id.* at *2. The court also held:

> A review of the "loss-payment" provision provides support for our interpretation that the "Assignment" provision of the insurance policy was not intended to apply to assignments of benefits derived from the policy but instead to assignments of the entire policy. See *Cespedes*, 161 So.3d at 584 (noting construction of an insurance contract as a whole). Specifically, an examination of the loss-payment provision demonstrates that Gulfstream contemplated the need to pay third parties who were "legally entitled" as follows: "[Gulfstream] will pay you unless some other person ... is legally entitled to receive payment." (Emphasis added). In sum, Gulfstream anticipated the need to pay those "legally entitled to receive payment" under the policy, which, pursuant to Ms. Gattus's "Assignment of Insurance Benefits" agreement with Bioscience, entitled Bioscience to receive any payments due under the policy.

Id. Importantly, the court also held that anti-assignment clauses do not apply to assignments made *after* a loss:

> Even if an insurance policy contained a specific, articulate provision precluding an insured's post-loss assignments of benefits without the

> insurer's consent, Florida case law yields deep-rooted support for the conclusion that post-loss assignments do *not* require an insurer's consent.[1] *See One Call Prop. Servs. Inc.,* 165 So.3d at 755 ("Even when an insurance policy contains a provision barring assignment of the policy, an insured may assign a post-loss claim."). Nearly 100 years ago, the Florida Supreme Court recognized that provisions in an insurance policy requiring consent to assignment of that policy do not apply to assignments after a loss. *W. Fla. Grocery Co. v. Teutonia Fire Ins. Co.,* 77 So. 209, 210–11 (Fla.1917) ("The policy was assigned after loss, and it is a well-settled rule that the provision in a policy relative to the consent of the insurer to the transfer of an interest therein does not apply to an assignment after loss."). This principle was reaffirmed in 1998, when our supreme court explained that "an insured may assign insurance proceeds to a third party after a loss, even without the consent of the insurer." *Lexington Ins. Co. v. Simkins Indus., Inc.,* 704 So.2d 1384, 1386 n. 3. (Fla.1998).

Id. at *4.

In Florida, a party seeking coverage under a *Coblentz* agreement must prove: (1) coverage; (2) a wrongful refusal to defend; and (3) that the settlement was objectively reasonably and made in good faith. There are two prongs to the coverage element:

- the facts alleged in the underlying complaint must state a claim that fealls within the coverage of the policy (i.e., that the insurer had a duty to defend); and
- notwithstanding the allegations in the underlying complaint or stipulated facts in the consent judgment, the plaintiff's underlying claims must actually come

within the coverage of the policy (i.e., on the merits, the insurer has a contractual duty to indemnify).

How the duty to indemnify is determined is a narrow enquiry, based on what liabilities were settled and why. Again, a claimant seeking coverage must not only prove a wrongful refusal to defend but also that the claim was ultimately within the policy's coverage. *Steil v. Florida Physicians Ins. Reciprocal,* 448 so. 2d 589, 592 (Fla. 2d DCA 1984).

A covenant not to execute given in connection with a consent judgment does not affect the insurer's responsibility under the policy or release it from liability. *Shook v. Allstate Ins. Co.*, 498 So. 2d 498 (Fla. 4th DCA 1984).

Insurer needs to have breached the insurance policy before the insured may enter into assignment agreement. If an insurance company breaches its contractual duty to defend, the insured can take control of the case, settle it, and then sue the insurance company for damages it incurred in settling the action. *MCO Environmental Inc. v. Agricultural Excess & Surplus Ins. Co.*, 689 So. 2d 1114 (Fla. 3d DCA 1997)

In *Zurich American Insurance Company v. Frankel Enterprises*, 2008 WL 2787704 (11th Cir. 2008), the insurer agreed to provide defense under reservation of rights. The insured never rejected the assigned defense counsel and never rejected the defense offered by Zurich. Zurich never withdrew its defense of the case, even after reserving its rights. The insured settled with the claimant, consented to a judgment against it, and assigned its rights against Zurich to the claimant. Zurich did not authorize or consent to the settlement. The court upheld the trial court's order granting summary judgment in favor of the Insurer. The trial court noted that an insurer is not bound by an unauthorized settlement unless: the insurer refuses to defend, not merely denies coverage; or if the insurer defends under a reservation of rights, and the ***insured rejects the defense***. *Zurich American Insurance Company v. Frankel Enterprises*, 2008 WL 2787704 (C.A. 11 July 18, 2008). This is a very touchy subject, wed as it is to reservation of rights law, such as the existence of true conflicts

between the insured and insurer, when can a defense be rejected once accepted, consent to settle and no voluntary assumption clauses.

In , the court explained:

> When a defense is offered under a reservation of rights, the insured has a right to reject the conditional defense, retain control over the defense, and effect a reasonable settlement, despite a contract term forbidding settlement without the insurer's consent and thus without releasing the insurer's obligation to pay for covered losses. *See Taylor v. Safeco Ins. Co.*, 361 So.2d 743, 744, 746 (Fla. 1st DCA 1978) (insured rejected the defense at the outset of the case); see also *W. Heritage Ins. Co. v. Montana*, 8:13cv1116, 2014 WL 3057393, at *5 (M.D. Fla. July 7, 2014) (citing *Taylor,* 361 So.2d at 746). "However, the insured must actually reject the conditional defense to be entitled to take control of the defense." *Montana*, 30 F.Supp.3d at 1372, 2014 WL 3057393, at *5 (citing *Aguero v. First Am. Ins. Co.*, 927 So.2d 894, 898 (Fla. 3d DCA 2005)).

Id. The court also noted that even if the insured accepts the defense initially and thus does not "reject" the conditional defense, circumstances may change, allowing the insured to unilaterally settle:

> Florida law also provides that an insured who does not reject a conditional defense at the outset may nonetheless ***subsequently reject*** it "if the insurer changes the terms of the defense in a material way." *Am. Pride,* 601 F.3d at 1150 (internal marks omitted) (finding a question of fact on this issue where, although the insured had accepted the conditional defense for over a year before rejecting it, there was evidence that the insurance company had changed the conditions of the defense by seeking attorney's fees and costs).

Id. (emphasis added).

The initial burden of making a prima facie showing of reasonableness and lack of bad faith rests with the claimant. Once that initial burden is met, the burden of pleading and persuasion regarding unreasonableness, bad faith or collusion shifts to the Insurer. The ordinary standard of collusion or fraud is inappropriate. *Steil v. Florida Physicians Ins. Reciprocal,* 448 so. 2d 589 (Fla. 2d DCA 1984). All agreements are collusive by definition. True fraud must be proven.

The Florida test as to whether a settlement of a claim against an insured is reasonable and prudent is what a reasonably prudent individual in the position of the insurance carrier would have settled for on the merits of the claimant's claim. *Wrangen v. Pennsylvania Lumbermans Mut. Ins. Co.*, 593 F. Supp. 2d 1273 (S.D. Fla. 2008). Florida courts consider *objective factors* (the extent of the claimant's injuries) and *subjective factors* (the degree of certainty of the tortfeasor's subjection to liability, risks of going to trial, chances that the jury verdict might exceed the settlement offer, etc.). Insurance carrier can only challenge a settlement if the parties settled in bad faith, fraudulently, collusively or without any effort to minimize the insured's liability. *U.S. Auto Ass'n v. Hartford Ins. Co.*, 468 So. 2d 545 (Fla. 5th DCA 1985).

The stipulated judgment between the insured and the claimant may affix damages at a larger figure than the case's actual value. *Florida Physicians Ins. v. Reciprocal c. Avila, M.D.*, 473 So. 2d 756 (Fla. 4th DCA 1985). Similarly, a settlement is sufficient to satisfy the policy requirement that there be a legal obligation to pay as damages*. U.S. Fire Ins. Co. v. Mikes*, 576 F.Supp.2d 1303 (M.D. Fla. 2007).

If the insured is completely released from liability *before* it assigns any rights to the claimant, then the Consent Judgment cannot be binding on the insurer. *Fidelity & Cas. Co. v. Cope*, 462 So.2d 459, 461 (Fla. 1985) (the release has the effect of extinguishing the insured's liability, and therefore, all of the insured's rights against the insurer that subject to assignment). In Florida, the Supreme Court distinguished its earlier decision in *Cope* and held that the courts must look to the intent of the parties, and if the settlement between plaintiff and the insured was intended to continue liability rather than end it, it would be treated as a covenant not to execute,

rather than a release. *Rosen v. Florida Ins. Guar. Ass'n*, 802 So.2d 291, 297-298 (Fla. 2001)(Agreement that plaintiff would accept consent judgment against defendant, but the judgment "would never be recorded, would create no liens and could not be executed," was a covenant not to execute, not a release). In 2008, the court reaffirmed this rule, allowing it to be used in a case involving assignment of claims against an insurance agent for failure to procure insurance and breach of fiduciary duty. *Wachovia Ins. Services, Inc. v. Toomey,* 994 So.2d 980 (Fla. 2008).

B. Arizona and *Damron* and *Morris* Agreements

"A Damron agreement is one initiated when an insurer ***refuses to defend*** a policyholder in a lawsuit. Faced with the risk of personal liability, the policyholder/defendant settles the case for a specific amount and assigns to the plaintiff whatever claims the policyholder has against the insurer for failing to defend the lawsuit. In consideration, the plaintiff enters a covenant not to execute against the policyholder. *Damron v. Sledge*, 105 Ariz. 151, 460 P.2d 997 (1969)." *Cunningham v. Goettl Air Conditioning, Inc.,* 194 Ariz. 242, 246, 980 P.2d 495, 499 (1997). Such agreements are intended to allow the insured to protect itself from personal liability when the insurance company has left the insured "high and dry." *Id.* as explained by one court:

> In a *Damron* agreement, a policyholder may settle with a claimant only if the insurer first has breached a contractual duty to the policyholder. 105 Ariz. 151, 460 P.2d 997; *see Arizona Property and Casualty Ins. Guar. Fund v. Helme,* 153 Ariz. 129, 735 P.2d 451 (1987); *State Farm Mutual Auto. Ins. Co. v. Paynter,* 122 Ariz. 198, 200-01, 593 P.2d 948, 950-51 (App.1979). On the other hand, if an insurer performs its contractual obligation to defend the policyholder against any claim potentially covered by the policy, the policyholder must cooperate and aid the insurer in the defense. *United Services Auto. Ass'n v. Morris,* 154 Ariz. 113, 117, 741 P.2d 246, 250 (1987) . . . In this context, a policyholder defended by its insurer under a "reservation of rights"2 can enter a

> *Damron* agreement without breaching the policy's cooperation clause if the agreement is "made fairly, with notice to the insurer, and without fraud or collusion on the insurer."

460 P.2d at 999 (some citations omitted).

The Arizona Supreme Court, in *Safeway Ins. Co., Inc. v. Guerrero*, 210 Ariz. 5, 106 P.3d 1020 (2005)(en banc), noted that in circumstances involving wrongful conduct by the insurer other than denial of a defense, so-called *Morris* agreements are used. The court explained:

> The term "*Morris* agreement" is generally used to describe a settlement agreement in which an insured defendant [a] admits to liability and [b] assigns to a plaintiff his or her rights against the liability insurer, including any cause of action for bad faith, [c] in exchange for a promise by the plaintiff *not to execute* the judgment against the insured. *See United Servs. Auto. Ass'n v. Morris,* 154 Ariz. 113, 741 P.2d 246 (1987). Such an agreement can be prompted by a number of circumstances. *See, e.g., id.* at 115, 741 P.2d at 248 (involving an agreement entered into *after reservation of rights* by insurer); *Ariz. Prop. & Cas. Ins. Guar. Fund v. Helme,* 153 Ariz. 129, 735 P.2d 451 (1987) (involving an agreement entered into after alleged ***anticipatory breach of insurer's duty to indemnify***); *Miel v. State Farm Mut. Aut. Ins. Co.,* 185 Ariz. 104, 912 P.2d 1333 (App.1995) (involving an agreement entered into after alleged ***bad faith failure to settle*** by insurer). An agreement with these same characteristics entered in response to an insurer's ***refusal to defend*** the insured is generally referred to as a *Damron* agreement. *See Damron v. Sledge,* 105 Ariz. 151, 460 P.2d 997 (1969). We recognize that the cases sometimes use the terms "*Morris* agreement" and "*Damron* agreement" interchangeably. *See Himes v. Safeway,* 205 Ariz. 31, 34 n. 2 ¶ 1, 66 P.3d 74, 77 (App.2003). We refer to the agreement at issue in this case as a "*Morris* agreement" because it does not involve a refusal to defend.

Id. at n. 1. The court found that a bad faith refusal to settle would permit such an agreement to be entered without it violating the cooperation clause. *Id.* But, in the case before it, there was a finding that the carrier did not mishandle the claim.

C. California

In *Critz v. Farmers Ins. Group,* 230 Cal.App.2d 788, 41 Cal.Rptr. 401 (App.1965), the California Supreme Court held:

> When the insurer breaches its obligation of good faith settlement, it exposes its policyholder to the ***sharp thrust of personal liability***. At that point, there is an acute change in the relationship between policyholder and insurer. The change does not or should not affect the policyholder's obligation to appear as defendant to testify to the truth. He need not indulge in financial masochism, however. Whatever may be his obligation to the carrier, it does not demand that he bare his breast to the continued danger of personal liability. By executing the assignment, he attempts only to shield himself from the danger to which the company has exposed him.

Id. at 153, 460 P.2d at 999.

In 1981 the California Supreme Court held that "an insured breaches no duty to the insurance company when he assigns his rights against the company to the injured plaintiffs in return for a covenant not to execute." *Samson v. Transamerica Ins. Co.*, 30 Cal.3d 220, 178 Cal.Rptr. 343, 356, 636 P.2d 32, 45 (1981). In *Isaacson v. California Ins. Guarantee Assn.*, 44 Cal.3d 775, 244 Cal.Rptr. 655, 750 P.2d 297 (1988), the Supreme Court acknowledged the rule that if an insurance company "'erroneously denies coverage and/or improperly refuses to defend the insured' in violation of its contractual duties, 'the insured is entitled to make a reasonable settlement of the claim in good faith and may then maintain an action against the insurer to recover the amount of the settlement.'" *Id.* at 791, 244 Cal.Rptr. 655, 750 P.2d 297, quoting

Clark v. Bellefonte Ins. Co., 113 Cal.App.3d 326, 335, 169 Cal.Rptr. 832 (1980)). The court added that where the insurer *wrongfully refuses to defend* and the insured settles, the insured is entitled, in later litigation, to the following *evidentiary presumption*: "In a later action against the insurer for reimbursement based on a breach of its contractual duty to defend the action, a reasonable settlement made by the insured to terminate the underlying claim against him may be used as presumptive evidence of the insured's liability on the underlying claim, and the amount of such liability." *Isaacson, supra,* at 791, 244 Cal.Rptr. 655, 750 P.2d 297.

Isaacson did not consider whether a settlement or stipulated judgment containing a covenant not to execute would raise a presumption of the insured's liability and the amount of such liability. That issue was addressed in *Pruyn v. Agricultural Insurance Co.,* 36 Cal. App.4th 500, 42 Cal. Rptr.2d 295 (1995), in which the court observed:

> [C]ourts focus on whether the facts have been adjudicated independently in a process that does not create the potential for abuse, fraud or collusion . . . To be sure, a stipulated or consent judgment which is coupled with a covenant not to execute against the insured brings with it a high potential for fraud or collusion . . . An insurer which has wrongfully abandoned its insured should not be heard to complain or allowed to relitigate the trial court's judgment merely because the default or uncontested proceedings followed, and were related to, an agreement between the insured and the claimant.

Id. at 304. The court added:

> We . . . hold that when, as plaintiff alleges happened here, a liability insurer ***wrongfully denies coverage or refuses to provide a defense,*** then the insured is free to negotiate the best possible settlement consistent with his or her interests, including a stipulated judgment accompanied by a covenant not to execute. Such a settlement will raise an ***evidentiary presumption*** in favor of the insured (or the insured's

> assignee) with respect to [a] the existence and [b] amount of the insured's liability. The effect of such presumption is to *shift the burden of proof* to the insurer to prove that the settlement was [a] unreasonable or [b] the product of fraud or collusion. If the insurer is unable to meet that burden of proof then the stipulated judgment will be binding on the insurer and the policy provision proscribing a direct action against an insurer except upon a judgment against the insured after an "actual trial" will not bar enforcement of the judgment.

Id. 42 Cal.Rptr.2d at 299. The court explained that the presumption required the insured

> to establish . . . [that] (1) the insurer wrongfully failed or refused to provide coverage or a defense, (2) the insured thereafter entered into a settlement of the litigation which was (3) reasonable in the sense that it reflected an informed and good faith effort by the insured to resolve the claim . . . .
>
> The insured can satisfy its prima facie burden of showing that the settlement was reasonable by presenting . . .evidence which would support a determination of good faith . . . "Good faith" . . . requires "the trial court to inquire, among other things, whether the amount of the settlement is within the reasonable range of the settling tortfeasor's proportional share of comparative liability for the plaintiff's injuries . . . . [A] number of factors [must] be taken into account including a rough approximation of plaintiffs' total recovery and the settlor's proportionate liability, the amount paid in settlement, the allocation of settlement proceeds among plaintiffs, and a recognition that a settlor should pay less in settlement than he would if he were found liable after a trial. Other relevant considerations include the financial conditions and insurance policy limits of settling defendants, as well as the existence of collusion, fraud, or tortious conduct aimed to injure the interests of

nonsettling defendants."

Id. at 312 (quoting *Tech–Bilt, Inc. v. Woodward–Clyde & Assocs.,* 38 Cal.3d 488, 213 Cal. Rptr. 256, 698 P.2d 159, 170 (1985)). The court in *Pruyn* concluded that the risk of collusion and inflation of claims was acceptable given that "the presumption only arises in those cases where the insurer has breached the underlying insurance contract " and that "[i]n no other way can the courts give any ***meaningful protection to an insured who is abandoned by a liability insurer*** wrongfully denying coverage or refusing a defense and at the same time provide to the insurer some measure of procedural due process in order to protect against the consequences of a fraudulent or collusive settlement." *Id.* at 530, 42 Cal.Rptr.2d 295 (emphasis added).

In *Fluor Corp. v. Superior Court*, 61 Cal.4th 1175, 191 Cal.Rptr.3d 498, 354 P.3d 302 (2015), the California Supreme Court addressed whether California Insurance Code section 520 prevented enforcement of a consent to assignment or anti-assignment clause in a liability policy. Prior to the adoption of this provision, the court had held in *Henkel Corp. v. Hartford Accident & Indemnity Co.* 29 Cal.4th 934, 129 Cal.Rptr.2d 828, 62 P.3d 69 (2003), that a "consent-to-assignment clause was enforceable and precluded the insured's transfer of the right to invoke coverage without the insurer's consent even after the coverage-triggering event . . . had already occurred." 354 P.3d at 303. Section 520 provides: "An agreement not to transfer the claim of the insured against the insurer ***after a loss has happened***, is void if made before the loss except as otherwise provided in Article 2 of Chapter 1 of Part 2 of Division 2 of this code." *Id.* (emphasis added).

The *Fluor* court concluded that a "loss has happened" for liability insurance purposes when the claimant is injured, not when a judgment against the insured for those damages has been entered. The court resoned and held:

> [W]e conclude that the phrase "after a loss has happened" in section 520 should be interpreted as referring to a loss sustained by a third party that is covered by the insured's policy, and for which the insured *may be liable*. We conclude that the statutory phrase *does not contemplate that*

> *there need have been a money judgment or approved settlement* before such a claim concerning that loss may be assigned without the insurer's consent. Only this interpretation of the statute's language barring veto of assignment by an insurer honors the clear intent demonstrated by the history of section 520 to avoid any "unjust" or "grossly oppressive" enforcement of a consent-to-assignment clause.

Id. at 329. The court added: "In light of the relevant language and history of section 520, we conclude the statute applies to third party liability insurance, and that, properly construed in light of its relevant language and history, section 520 bars an insurer from refusing to honor an insured's assignment of policy coverage regarding injuries that predate the assignment." *Id.* at 315.

D. Minnesota—*Miller Shugart* Agreements

In Minnesota, the courts have adopted and enforced so-called "Miller-Shugart" agreement. *Chalmers v. Kanawyer*, 544 N.W.2d 795 (Minn. Ct. App. 1996). Minnesota refers to assignment/covenant agreements as nonexecution or "by-pass" agreements. Under Minnesota law, such agreements are not per se fraudulent or collusive. Following *Critz, supra,* the courts recognize that as a matter of fairness an insured "deserted" by his insurer is entitled to enter an agreement that allows it to personal liability and avoid litigation expense. *Miller v. Shugart,* 316 N.W.2d 729 (Minn. 1982).[4]

In *Miller,* the court reasoned:

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[4] In *Buysse v. Baumann–Furrie & Co.*, 481 N.W.2d 27, 29 (Minn.1992), the court observed:

> In an authentic Miller–Shugart settlement, the insurer has denied all coverage, and the abandoned insured, left on its own, agrees with the plaintiffs that judgment in a certain sum may be entered against it in return for the plaintiffs releasing the insured from any personal liability.

Buysse v. Baumann–Furrie & Co., 481 N.W.2d 27, 29 (Minn.1992).

> [The insurer] says there has never been a trial on the merits, that the purported judgment, insofar as it is concerned, is still an "unliquidated tort claim," and that, consequently, the sum due plaintiff is not "due absolutely," and so garnishment does not lie. Minn. Stat. § 571.43 (1980). [The insurer] overlooks, however, that as between plaintiff and the defendants the tort claim has been liquidated and reduced to a judgment. So long as this has occurred, the basis for garnishment exists.
>
> What [the insurer] is really saying is that the judgment does not liquidate the claim because it obligates the defendants to pay nothing. While it is true that defendants need not pay anything, it is also true that the judgment effectively liquidates defendants' personal liability. We hold, therefore, that plaintiff may seek to collect on that judgment in a garnishment proceeding against the insurer.

Id. at 732. The court refused to find a breach of cooperation as a result of the agreement:

> What we have, then, is a question of how should the respective rights and duties of the parties to an insurance contract be enforced during the time period that application of the insurance contract itself is being questioned. Viewed in this context, Milbank's position, really, is that it has a superior right to have the coverage question resolved before the plaintiff's personal injury action is disposed of either by trial or settlement. It is unlikely plaintiff could have forced defendants to trial before the coverage issue was decided. Put this way, the question becomes: Did the insureds breach their duty to cooperate by not waiting to settle until after the policy coverage had been decided? In our view, the insureds did not have to wait and, therefore, did not breach their duty to cooperate.

. . . .

> While the defendant insureds have a duty to cooperate with the insurer, they also have ***a right to protect themselves*** against plaintiff's claim. The attorneys hired by Milbank to represent them owe their allegiance to their clients, the insureds, to best represent their interests. If, as here, the insureds are offered a settlement that effectively relieves them of any personal liability, at a time when their insurance coverage is in doubt, surely it cannot be said that it is not in their best interest to accept the offer. ***Nor, do we think, can the insurer who is disputing coverage compel the insureds to forego a settlement which is in their best interests.***

Id. at 733-34 (emphasis added).

Minnesota also appears to base the rule first on a wrongful denial of coverage, which then permits the insured to agree to the entry of a judgment against him in a reasonable amount and limit the source of payment to the insurance policy and carrier. This type of agreement may also be enforceable where the carrier has not denied a defense, but it has been put on notice of the settlement situation and circumstances. *Insurance Co. of North America v. Spangler,* 881 F. Supp. 539, 545 (D. Wyo. 1995); *Brownsdale Co-op. Ass'n v. Home Ins. Co.,* 473 N.W.2d 339 (Minn. Ct. App. 1991);*The Rivers v. Richard Schwartz/Neil Weber, Inc.,* 459 N.W.2d 166 (Minn. Ct. App. 1990). The insurer is given the opportunity to show that the judgment is not conclusive as to it and this does not bind it. *Economy Fire & Cas. Co. v. Iverson*, 426 N.W.2d 195 (Minn. Ct. App. 1988), *judgment aff'd in part, rev'd in part on other grounds,* 445 N.W.2d 824 (Minn. 1989) (overruled on other grounds by, *American Standard Ins. Co. v. Le,* 551 N.W.2d 923 (Minn. 1996)).