Blue Ridge Settlement Reimbursement

Introduction

A liability insurer may settle a plaintiff's lawsuit on behalf of and over the objection of its policyholder and then sue the policyholder for reimbursement of the amount of the settlement attributable to non-covered liability in order to avoid "unjust enrichment."[1] The insurer must satisfy four prerequisites to perfect a settlement reimbursement claim.

The *Blue Ridge* Rule

"[A]n insurer may be reimbursed for a reasonable settlement payment made over the objection of its insureds. [T]he prerequisites for seeking reimbursement for noncovered claims included in a reasonable settlement payment [are]: (1) a timely and express reservation of rights; (2) an express notification to the insureds of the insurer's intent to accept a proposed settlement offer; (3) an express offer to the insureds that they may assume their own defense when the insurer and insureds disagree whether to accept the proposed settlement"[2]; and (4) the settlement must be reasonable.

Implicit Issue

In a concurring opinion, Justice Mosk, joined by Justice Werdegar wrote "separately to address an issue raised only implicitly by this case. [T]he insured has basically two options when it disagrees with an insurer about whether to settle a case for which the insurer claims noncoverage: (1) to accept the settlement anyway, including the insurer's reservation of rights that may make the insured liable; or (2) to assume its own defense, however financially burdensome that may be. A third option, that would neither place the insurer in a 'Catch-22' position nor place an undue burden on the insured is to allow the insured to refuse settlement and still retain the insurance defense, but, consistent with that refusal, waive any right to sue the insurance company for bad faith failure to refuse a settlement. This third option would not allow a windfall for the insured, but it would permit the insured the discretion of refusing a settlement it considers unfair and for which it may ultimately be financially responsible. Indeed, the insurer offered this option in the present case. This option is in harmony with the principle that the insured should truly consent to a settlement in such a situation. Without this option, the insured is forced to choose between accepting an unfair settlement for which it may be liable and having to pay its own legal expenses up front."[3]

Rationale

"[W]ere we to conclude insureds could refuse to assume their own defense, insisting an insurer settle a lawsuit or risk a bad faith action, but at the same time refuse to agree the insurer

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[1] ""The insurer therefore has a right of reimbursement that is implied in law. [U]nder the law of restitution such a right runs against the person who benefits from 'unjust enrichment' and in favor of the person who suffers loss thereby. The 'enrichment' of the insured by the insurer through the insurer's bearing of unbargained-for costs is inconsistent with the insurer's freedom under the policy and therefore must be deemed 'unjust.'" (*Blue Ridge Ins. Co. v. Jacobsen* (2001) 25 Cal.4th 489, 501 (ellipses omitted) (*Blue Ridge*).)

[2] *Id*. at 493, 502.

[3] *Id*. at 506-07 (citations, and ellipses omitted.)

could seek reimbursement should the claim not be covered, the resulting Catch-22 would force insurers to indemnify noncovered claims. If an insurer could not unilaterally reserve its right to later assert noncoverage of any settled claim, it would have no practical avenue of recourse other than to settle and forgo reimbursement. An insured's mere objection to a reservation of right would create coverage contrary to the parties' agreement in the insurance policy and violate basic notions of fairness. [T]he insurer only has a duty to indemnify the insured for covered claims, and no duty to pay for noncovered claims because the insured did not pay premiums for such coverage. Hence, if the insurer satisfies the prerequisites noted above, it should be deemed to have an implied-in-law right of reimbursement to avoid the insureds' unjust enrichment [to avoid] what would in fact be a windfall. [I]t encourages insurers to defend and settle cases for which insurance coverage is uncertain. In so doing, it transfers from the injured party to the insurer the risk that the insured may not be financially able to pay the injured party's damages."[4]

Four Prerequisites to Perfect a Settlement Reimbursement Claim

"[T]he prerequisites for seeking reimbursement for noncovered claims included in a reasonable settlement payment [are]: (1) a timely and express reservation of rights; (2) an express notification to the insureds of the insurer's intent to accept a proposed settlement offer; and (3) an express offer to the insureds that they may assume their own defense when the insurer and insureds disagree whether to accept the proposed settlement."[5] In addition the settlement must be reasonable.[6]

A Reasonable Settlement Is in the Ball Park

The law favors settlement,[7] especially when it is "the most reasonable manner of disposing of the claim."[8] Code of Civ. Proc. § 877.6 establishes a procedure by which trial court may satisfy due process of law to determine whether settlements are made in "good faith" and settlements are likely to be found to be reasonable if it is not "so far 'out of the ballpark' . . . as to be inconsistent with the equitable objectives of" the good faith settlement statute.[9] While the *Blue Ridge* opinion did not assess the reasonableness of the insurer's settlement, the means by which courts will assess the reasonableness of an insurer's settlement that perfects a reimbursement claim will likely be consistent with these principles.

Any determination whether a settlement is reasonable is highly judgmental and includes an

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[4] *Id.* at 502-03 (citations, quotation marks, and ellipses omitted.)

[5] *Id* at 502.

[6] *Ibid*.

[7] *Potter v. Pacific Coast Lumber Co.* (1951) 37 Cal.2d 592, 602; *Critz v. Farmers Ins. Group* (1964) 230 Cal.App.2d 788, 800.

[8] "An insurer assesses whether a settlement offer is reasonable by determining whether accepting the offer is 'the most reasonable manner of disposing of the claim ....' (*Crisci v. Security Ins. Co.* (1967) 66 Cal.2d 425, 430 (*Crisci*).) (*Blue Ridge, supra*, 25 Cal.4th at 506.)

[9] *Tech-Bilt, Inc. v. Woodward-Clyde & Associates* (1985) 38 Cal.3d 488, 499-500 (*Tech-Bilt*) ("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.")

assessment of the policyholder's "potential liability."[10] In evaluation a settlement offer, the insurer may not consider the issue of coverage[11] and "must give the interests of the insured at least as much consideration as it gives to its own interests."[12]

Three Specified Policyholder Response Options

"[A]n insurer may be reimbursed for a reasonable settlement payment made over the objection of its insureds. [T]he insured has basically two options when it disagrees with an insurer about whether to settle a case for which the insurer claims noncoverage: (1) to accept the settlement anyway, including the insurer's reservation of rights that may make the insured liable; or (2) to assume its own defense, however financially burdensome that may be. A third option is to allow the insured to refuse settlement and still retain the insurance defense, but, consistent with that refusal, waive any right to sue the insurance company for bad faith failure to refuse a settlement."[13]

When an insurer reserves its rights, the policyholder is permitted to protect one's own interests. "Through reservation, the insurer gives the insured notice of how [the insurer] will, or at least may, proceed and thereby provides [the insured] an opportunity to take any steps that it may deem reasonable or necessary in response."[14]

Multiple Policyholders

1. All Inclusive Settlement

An insurer is not permitted to settle a suit on terms that include one policyholder while excluding another, unless the excluded policyholder(s) consent(s). The insurers duty to good faith to the first policyholder does not require it to violate that duty to the other policyholder(s). "[A]n insurer's duty [of good faith] extends to all of its insureds. Therefore, an insurer may, within the boundaries of good faith, reject a settlement offer that does not include a complete release of all of its insureds."[15]

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[10] In *Blue Ridge* "the issue of whether the settlement was reasonable, which includes a consideration of the [policyholders'] potential liability, is not before us." (*Id*. at 505.)

[11] "Moreover, the insurer may not consider the issue of coverage in determining whether the settlement is reasonable." (*Id*. at 502; see also, *Johansen v. California State Auto. Assn. Inter-Ins. Bureau* (1975) 15 Cal.3d 9, 12, 15, 16.)

[12] "[I]n determining whether to settle[,] the insurer must give the interests of the insured at least as much consideration as it gives to its own interests." (*Id*. at 506; see also, *Crisci, supra*, 66 Cal.2d at 429; *Cates Construction, Inc. v. Talbot Partners* (1999) 21 Cal.4th 28, 44.")

[13] See Article: *Blue Ridge Settlement Reimbursement.*

[14] *Blue Ridge, supra*, 25 Cal.4th at 501.

[15] *Strauss v. Farmers Ins. Exch.* (1994) 26 Cal.App.4th 1017, 1021 ("[A]cceptance of [a settlement] offer that left two of its insureds bereft of coverage would have breached [the insurer's] implied covenant of good faith and fair dealing." (*Id.* at 1022-21); see also, *Lehto v. Allstate Ins. Co.* (1994) 31 Cal.App.4th 60, 75 ("Were [the insurer] to accept plaintiff's . . . offer, it would have left one of its insureds bereft of coverage, an act of bad faith. (Citations.) [the insurer]'s failure to do so cannot itself be deemed to be bad faith.")

2. Each Policyholder Is Entitled to Separate Treatment

Standard liability policies include a "Separation of Insureds" provision that typically states: "[T]his insurance applies: . . . b. Separately to each insured against whom claim is made or 'suit' is brought." Such a clause "creates an ambiguity which must be construed in favor of coverage that a lay policyholder would reasonably expect. A lay insured would reasonably anticipate that, under a policy containing such a clause, each insured's coverage would be analyzed separately."[16] Thus, each of multiple policyholders should be treated separately as though each was the only policyholder, unaffected by the happenstance that others are also insured.

3. Allocation of Reimbursement Liability Among Policyholders Required

"It would be inequitable to require a party insured to reimburse the insurer the policy benefits it received and also all policy benefits that every other insured party received. The right to reimbursement may run against the person who benefits from unjust enrichment, but it should do so only to the extent the person actually benefits."[17]

Timing

The insurer need not give sufficient time for the policyholder to the insurer's offer to take back the defense. "[W]e hold the trial court erred by imposing an additional requirement, not authorized by the Supreme Court's opinion or rationale, that the insured have "sufficient" time to respond to the insurer's offer"[18]

Conflicts of Interest

"When an offer is made to settle a claim in excess of policy limits for an amount within policy limits, a genuine and immediate conflict of interest arises between carrier and assured. The normal legal remedy for conflicts in interest is separate representation for the conflicting interests."[19]

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[16] *Minkler v. Safeco Ins. Co. Of Amer.* (2010) 49 Cal.4th 315, 319 (ellipses omitted.)

[17] *LA Sound USA, Inc. v. St. Paul Fire & Marine Ins. Co.* (2007) 156 Cal.App.4th 1259, 1273 (*LA Sound*) (citations, quotation marks, and ellipses omitted).

[18] *American Modern Home Ins. Co. v. Fahmian* (2011) 194 Cal.App.4th 162, 164.

[19] *Merritt v. Reserve Ins. Co.* (1973) 34 Cal.App.3d 858, 870.