FOR BIG-NUMBER SETTLEMENT NEGOTIATIONS, EXCESS INSURERS CANNOT TAKE A BACK SEAT

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It is an all-too-common dilemma for many companies. You've been hit with a lawsuit after a mistake or accident that has caused extensive damages. Facing an imminent jury trial and the very real risk of a verdict well into the millions, the company, its lawyers, and its primary insurance carrier all agree that the smart choice is to accept the plaintiff's latest settlement demand. But the excess insurance carrier—who is likely to foot the bulk of the bill—is dragging its feet, and will not consent to the settlement. This can be frustrating for companies seeking to put unfortunate accidents behind them and avoid the uncertainty of a jury trial.

An Excess Insurer's Veto

In a recent decision, the U.S. Court of Appeals for the Ninth Circuit concluded that an excess insurer's attempt to effectively veto a desired settlement can amount to bad faith. The court in *Teleflex Medical Incorporated v. National Union Fire Insurance Company of Pittsburgh PA*,[1] affirmed a jury verdict finding that AIG must pay $3.75 million in damages plus attorneys' fees to cover LMA North America, Inc.'s ("LMA") settlement with its competitor over allegedly disparaging advertisements that characterized a competitor's products as unsafe.

Background

In 2007, LMA (formerly known as Teleflex Medical) sued Ambu for patent infringement. In response, Ambu filed counterclaims against LMA for trade disparagement and false advertising. LMA had two general liability insurance policies covering disparagement claims: (1) a primary policy issued by Transcontinental Insurance Company (called "CNA") with a $1 million limit, and (2) an excess policy issued by AIG with a $14 million limit. CNA agreed that the counterclaims were covered under the CNA primary policy and agreed to defend LMA.

During the course of the disparagement lawsuit, LMA conducted an analysis of its potential liability and concluded that its potential exposure was up to $10 million, not including potential treble damages. After LMA negotiated a proposed settlement of $4.25 million, CNA, its primary insurer, agreed to fund up to its $1 million limit. AIG, however, declined to consent to the proposed settlement and did not offer to take up the defense if the settlement fell through.

With trial getting closer, LMA reiterated its request that AIG either consent to the settlement or agree to take up the defense. After waiting for three months without getting a response from AIG on how it was going to proceed, LMA finalized the $4.25 million settlement and promptly notified AIG. Thereafter, AIG advised LMA that it would now assume the defense of the disparagement lawsuit if LMA could "undo" the settlement. LMA responded that the settlement could not be undone, and sued AIG for breach of conduct and bad faith in handling the matter. After a trial in that insurance coverage lawsuit, the jury unanimously found for LMA and against AIG on both the breach of contract and bad faith claims, awarding $3.75 million in breach of contract damages and $1.22 million in attorneys' fees and costs.

The Ninth Circuit Gives Excess Insurers Their Marching Orders

In affirming the judgment, the Ninth Circuit held that under California's standard set forth in *Diamond Heights Homeowners Ass'n v. Nat'l Am. Ins. Co.*,[2] an excess insurer has three options when presented with a proposed settlement of a covered claim that has met the approval of the insured and the primary insurer: *The excess insurer must (1) approve the proposed settlement, (2) reject it and take over the defense, or (3) reject it, decline to take over the defense, and face a potential lawsuit by the insured seeking contribution toward the settlement.* Noting AIG's "foot-dragging," the court rejected AIG's argument that it could essentially veto the settlement under the AIG policy's "no action" and "no voluntary payments" clauses, concluding that such circumvention of *Diamond Heights*' three-option framework would impose unnecessary burdens on settling parties and their primary insurers.

The *Teleflex* decision illustrates the relative power dynamics in settlement discussions involving excess insurers. The court recognized that adopting the *Diamond Heights* framework "arguably gives the insured and primary insurers more than was bargained for" because it would seem to contradict commonly-used provisions requiring an excess insurer's consent prior to making a payment. But insurers, rather than policyholders, are best-positioned to assess and mitigate this risk. For example, excess insurers can adjust their rates to accommodate for the additional costs resulting from this rule. Moreover, the *Diamond Heights* framework is a natural extension of the longstanding principle that a primary insurer cannot unreasonably delay the processing of a claim or refuse to settle unreasonably based on "no action" and "no voluntary payments" clauses, and if it does, the insured can pursue a reasonable settlement and seek reimbursement even if the insurer did not consent. Finally, an important takeaway from *Teleflex* is that excess insurers should not only participate in reasonable settlement discussions, but should also do so promptly. If an excess carrier waits too long before it decides to either consent to the proposed settlement or undertake the defense, and the insured accepts the settlement offer in the meantime, then the excess carrier may be stuck with the settlement. Although many would agree that three months would seem to be far too long for a response, the Ninth Circuit also noted that the insurer in *Diamond Heights* had less than two weeks to consider that settlement.

Conclusion

The Ninth Circuit's affirmance of the *Diamond Heights* standard will likely give additional leverage to policyholders who are negotiating with excess carriers over large settlements. The decision stands to encourage those excess insurers to participate in such settlements—and do so promptly—in order to avoid bad faith liability, so long as those settlements are reasonable and not the product of fraud and collusion.

Notes

[1] No. 14-56366 (9th Cir. Mar. 21, 2017).

[2] 227 Cal. App. 3d 563 (1991).

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