MEALEY'S™ LITIGATION REPORT
# Insurance Bad Faith

## Challenging Consent Judgments As Unreasonable Or Tainted By Bad Faith

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# Commentary

## Challenging Consent Judgments As Unreasonable Or Tainted By Bad Faith

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### I. Introduction

Generally, if an insurance company refuses to defend its insured against a claim, the insured may protect himself by entering into a stipulated agreement with the claimant and holding the insurance company responsible for paying the claimant the agreed-to amount. But, such agreements are inevitably entered into in an environment of moral hazard wherein the insured, in seeking to extricate himself from personal liability, is asked to write a check that will be cashed from his insurance company's account. This environment creates a very real risk of "collusion between the claimants and insured [] allowing them to bootstrap their damages with the ingenious assistance of counsel."[1] When the insured or the claimant succumb to this temptation and seek to cash this check, the insurance company will not be forced to pay if the Consent Judgment was unreasonable or was tainted by bad faith, fraud, collusion, or an absence of any effort to minimize liability.

### II. For Example

Mr. Insured and Ms. Claimant are in a car accident, and Ms. Claimant breaks one of her ribs. Ms. Claimant sues Mr. Insured for her bodily injuries. Mr. Insured's car insurance has Bodily Injury liability limits of $50,000. Accordingly, Mr. Insured notifies his liability Insurer of Ms. Claimant's lawsuit and requests a defense under his car insurance policy. Insurer investigates and finds a number of viable defenses that could either totally negate liability (the accident may have been entirely Ms. Claimant's fault) or seriously reduce the settlement value of the case (had Ms. Claimant been wearing her seatbelt, she would not have been injured). Insurer also determines that the claim falls within a policy exclusion, and that would mean that Insurer would not need to provide representation for or indemnify Mr. Insured against Ms. Claimant's lawsuit. Because it believes that the accident falls outside the scope of coverage, Insurer denies coverage and does not defend Mr. Insured.

Without Insurer's defense, Mr. Insured and Ms. Claimant enter into a Consent Judgment for $20 million, where Mr. Insured accepts liability for the accident and assigns all his rights against Insurer to Ms. Claimant in exchange for Ms. Claimant entering a covenant not to execute against Insured. In other words, Ms. Claimant agrees that the $20 million Judgment can only be recovered from Insurer—Mr. Insured is off the hook. So, Ms. Claimant sues Insurer to enforce the Judgment. Insurer asserts its defense that the claim was subject to the policy exclusion, but the court disagrees and determines that the claim was covered under Mr. Insured's policy with Insurer.

Now what? Does Ms. Claimant go pick-up her $20 million check from Insurer? Does Insurer really have to pay $20 million for a claim that could not have been worth a fraction of that?

The answer: No, not yet. There is still generally one more step: proving the Consent Judgment is reasonable

and lacks bad faith, fraud, or collusion. But, who has to prove what? And, how can they prove (or disprove) it?

## III. What is a Consent Judgment?

The above example is just one of the many ways in which an insured would be allowed to enter into a "Consent Judgment" or "Stipulated Judgment."[2] The rules and laws governing the enforceability of these types of Consent Judgments vary greatly from one jurisdiction to another.[3] Most courts have found that when an insurer wrongfully refuses to cover or defend its insured and the insured is forced to defend himself against the claimant's suit, then the insured may enter into a Consent Judgment with the claimant, and, that Judgment will likely be enforceable against the insurer.[4]

In most instances, like the above example, a Consent Judgment will contain, at minimum: (1) a stipulated judgment against the insured establishing liability and identifying a specific amount of damages; (2) a covenant for the claimant not to execute the stipulated judgment against the insured (meaning the insured has no obligation for the judgment amount and the claimant may only enforce it against the insurance company); (3) and an assignment of the insured's rights under the policy to the claimant.

Courts have uniformly determined that for a Consent Judgment to be valid and binding against the insurer, the insured must be covered under the policy and the insurer must have wrongfully refused to defend or indemnify the insured based upon the facts known at the time the Consent Judgment was entered.[5] The remainder of this article presumes that these requirements have been met. But, the question whether a Consent Judgment is enforceable does not end with the insurer's failure to defend or indemnify its insured. The Consent Judgment may generally still be challenged for unreasonableness or bad faith.

## IV. The Last Step Before Enforcement: Who Steps First?

The purpose of this widely recognized basis for challenging a Consent Judgment is that, while an Insured may take certain steps to protect himself by entering the Judgment if his insurer wrongfully denies coverage and a defense, the insured does not have carte blanche over the insurer's checkbook. Accordingly, almost every jurisdiction requires that a Consent Judgment be reasonable and lack bad faith before the Judgment will be enforced against the insurer.[6]

There are three schools of thought on how the burden should shift: (1) the insurer carries the entire burden, (2) the claimant carries the initial burden and then it shifts to the insurer, or (3) the claimant must prove reasonableness and the insurer must prove bad faith, fraud, or collusion. Some jurisdictions have determined that the Consent Judgment itself is presumptive evidence of reasonableness and good faith. These jurisdictions—like Connecticut and Michigan—require that that the insurer rebut this presumption by establishing unreasonableness, bad faith, fraud, or collusion.[7] Other jurisdictions, such as Florida and Kansas, require that the claimant make a prima facie showing of reasonableness and lack of back faith and then shift the ultimate burden of proof to the insurer to prove that the Consent Judgment was either unreasonable or made in bad faith.[8] Some jurisdictions—such as Illinois and Kentucky—cut the burden in half, resting the burden to prove reasonableness upon the claimant and the burden to prove bad faith, fraud, or collusion upon the insurer.[9] In other jurisdictions, like Montana,[10] an insurer must first show fraud or collusion in order to contest the reasonableness of the Consent Judgment, or Virginia,[11] where an insurer may not contest a Consent Judgment absent fraud or collusion. And, some states have simply combined the question of unreasonableness and bad faith and place the burden upon the insurer.[12]

Thus, the insurance company must typically shoulder the ultimate burden of proof that the Consent Judgment was unreasonable or that it was fraudulent, collusive, or made in bad faith. But regardless of who must initially prove it, how can an insurance company ultimately prove that the Consent Judgment was unreasonable or made in bad faith?

## V. What is Unreasonable or in Bad Faith? The Proverbial Catch-22: Admitting Evidence to Prove Unreasonableness, Bad Faith, Fraud, or Collusion

### A. The Factors

Both objective and subjective factors are considered in determining, under the totality of the circumstances, whether the insured's decision conformed to the standard of a prudent uninsured and what a prudent person in the position of the insured would have settled for on the merits of the claimant's claim.[13]

In many jurisdictions, a Consent Judgment is not enforceable against an insurer if it is unreasonable or entered into in bad faith, fraudulently, collusively, or when the insured has no liability (or made no effort to minimize his liability).[14]

Alternatively, in other jurisdictions, like Washington, there are factors courts consider when determining whether a Consent Judgment is reasonable, which envelopes bad faith, fraud, and collusion:[15]

> [1] the releasing person's damages; [2] the merits of the releasing person's liability theory; [3] the merits of the released person's defense theory; [4] the released person's relative faults; [5] the risks and expenses of continued litigation; [6] the released person's ability to pay; [7] any evidence of bad faith, collusion, or fraud; [8] the extent of the releasing person's investigation and preparation of the case; and [9] the interests of the parties not being released.

In a recent case applying Florida law,[16] *see* § V.B., *infra*, a jurisdiction that divides the two questions, the court elucidated that "[a] determination of reasonableness of the settlement agreement is made in view of the degree of probability of the insured's success and the size of the possible recovery."[17] The factors used to determine "reasonableness" in Florida include: "[1] the extent of the defendant's liability, [2] the reasonableness of the damages amount in comparison with compensatory awards in other cases, and [3] the expense which have been required for the settling defendants to settle the suit." And, for the second question, the Court prefaced that "bad faith" does not necessarily require proof of fraud.[18] While fraud may prove bad faith, bad faith may also be demonstrated by evidence of a false claim or collusion[19] or an absence of any effort to minimize liability.[20]

As is clear from these factors, the insured's liability is a common thread that is weaved throughout the question of whether a Consent Judgment is enforceable in that it is neither unreasonable nor tainted by bad faith.

However, remember that when the insured enters into the Consent Agreement he admits liability for the claim. Accordingly, when a liability insurer wrongfully breaches its duty to defend, it cannot typically contest a Consent Judgment entered against its insured by subsequently raising defenses to the underlying tort claim that were available but were not asserted by the insured. Thus, cases involving Consent Judgments generally hold that an insurer may not assert the defenses which could have been asserted in the underlying tort action.[21]

But, an insurance company has the right to challenge a Consent Judgment to determine whether it was unreasonable or made in bad faith. If an insurance company is barred from asserting any of the tort defenses, could it possibly show that the Consent Judgment was unreasonable or tainted by bad faith?

### B. Case Study in Florida: *Mid-Continent Casualty Company v. American Pride Building Company*[22] and *Bond Safeguard Insurance Company v. National Union Fire Insurance Company of Pittsburgh*[23]

Last year in *American Pride*, a federal case applying Florida law found the following jury instruction proper: "Do you find the consent judgment entered into by [Insured] was reasonable in amount and not tainted by bad faith, fraud, collusion, or without any effort to minimize liability?"[24] The jury answered "no."[25] But, the court did not offer any guidance as to what evidence was actually presented to the jury to support its finding that the Consent Judgment[26] was unreasonable or tainted by bad faith, fraud, or collusion, or was reached without any effort to minimize liability.[27]

Recently, another federal court applying Florida law picked up where *American Pride* had left off. In *Bond Safeguard*, the court resolved whether the Consent Judgment was reasonable and entered without bad faith, noting the "plethora of evidence indicating that enforcement of the [Consent Judgment] in this case would be contrary to Florida law."[28]

The court reached this conclusion based upon four facts.[29] The first was that the Consent Judgment gave the insured a benefit in addition to the conclusion of the underlying case.[30] Evidence regarding the terms of the consent agreement and judgment were admissible and supported this finding as the agreement included a provision that would give the insured's trustee a ten percent portion of the claimant's recovery.[31] Second, the court determined that some aspects of the settlement were subject to negotiation, but neither the

insured nor the claimant endeavored to minimize the amount of the Consent Judgment.[32] The court considered various deposition testimony that the amount of the Judgment had been supplied by the claimant, the amount was vaguely described as the "loss to date," and the insured's attorney had a very limited role in negotiating the Consent Judgment.[33]

Third, the court found that the insured had viable defenses, but the Consent Judgment had been entered without even taking them into account.[34] Lastly, the court noted that the claimant had previously offered to settle with the insured for a "fraction of the Judgment" and had indeed settled with two other defendants for a fraction of the Judgment.[35] In making these determinations, the court reviewed the record evidence, including deposition testimony and from the underlying documents filed with the court.

Because the insured received additional benefits, negotiations were limited or nonexistent, viable defenses existed but were never asserted, and the claimant had previously offered to settle with the insured, the court found the evidence "compelling" that the Consent Judgment was reached by collusion or an absence of effort to minimize liability.[36] Therfore, despite the fact that defenses from the underlying tort action are inadmissible as a defense against enforceability, based on this case, it appears that there should be no issue discovering and admitting evidence of liability and damages from the underlying tort action. Indeed, the court specifically considered evidence of Consent Judgment negotiations (or lack thereof), including liability defenses, damages, and previous offers to settle.[37]

Accordingly, while liability defenses that were not raised in the underlying tort litigation are inadmissible as a defense to the enforcement of a Consent Agreement, the facts underlying those defenses should be presented to the jury as evidence that the Consent Judgment was for an unreasonableness amount or was tainted by bad faith, fraud, collusion, or an absence of any effort to minimize liability.

## VI. Conclusion

Even though the underlying facts regarding damages and liability are inadmissible as a defense to the enforcement of a Consent Judgment, they should still be admitted when establishing that a Consent Judgment is (or is not) unreasonable or tainted by bad faith, fraud, collusion, or absence of any effort to minimize liability. And, because the Rules of Evidence authorize the court to restrict how the evidence would be utilized and presented to the jury, the Rules of Evidence should be used to ensure that evidence of liability or damages is admitted and considered only in considering reasonableness and lack of bad faith. This would also prohibit the parties from re-litigating the underlying tort claim. Based on the recent cases out of Florida, evidence of liability and damages from the underlying tort action should be both discoverable and admissible when an insurer contests a Consent Judgment so long as the proper foundation is laid.

A Consent Judgment is meant to be a way for an insured to reasonably protect himself from personal liability if his insurer wrongfully refuses to defend or indemnify him. In this way, Consent Judgments encourage insurers to defend and indemnify their insureds. At the same time, the insured and claimant are forced to enter into a reasonable Consent Judgment made in good faith because a Consent Judgment that is unreasonable or tainted by bad faith will not be enforced. The only way for the courts and juries to balance these competing interests and protect the insured from personal liability and the insurer from enforcement of bad faith or unreasonable Judgments is to allow the parties to introduce evidence—documents, testimony, affidavits, experts—tending to show whether the Consent Judgment was reasonable or was tainted by bad faith, fraud, collusion, or an absence of any effort to minimize liability.

## Endnotes

1. Smith v. State Farm Mut. Auto. Ins. Co., 7 Cal. Rptr.2d 131, 138 (Ct. App. 1992) (quoting Doser v. Middlesex Mut. Ins. Co., 162 Cal. Rptr. 115, 120-121 (Ct. App. 1980)).

2. These type of agreements largely spawned from the Nebraska Supreme Court's decision in Metcalf v. Hartford Acc. & Indem. Co., 176 Neb. 468, 476, 126 N.W.2d 471, 476 (Neb. 1964) (citing Fullerton v. U.S. Cas. Co., 184 Iowa 219, 167 N.W. 700, 705 (Iowa 1918); Griggs v. Bertram, 88 N.J. 347, 364, 443 A.2d 163, 171-72 (1982). Consent Judgments go by many different names. For example, in Arizona, these type of Consent Judgments are known as *Damron*

Agreements or *Morris* agreements. Damron v. Sledge, 460 P.2d 997 (Ariz. 1969); USAA v. Morris, 741 P.2d 246 (Ariz. 1987). In Missouri, they are called "065 Agreements" based upon Missouri Statute. § 537.065, Mo. Stat. In Minnesota and North Dakota these type of agreements are known as *Miller-Shugart* Agreements based upon the case of *Miller v. Shugart*, 316 N.W.2d 729 (Minn. 1982). Florida refers to these type of Consent Judgments as *Coblentz* Agreements based upon the Fifth Circuit Court of Appeals decision. Coblentz v. Am. Sur. Co. of New York, 416 F.2d 1059 (5th Cir. 1969) (applying Florida law). In Colorado, these type of agreements are referred to as *Basher* Agreements. Northland Ins. Co. v. Bashor, 177 Colo. 463, 494 P.2d 1292 (Colo. 1972). Other states, like Washington, simply refer to these as "Covenant Judgments." Bird v. Best Plumbing Grp., LLC, 766, 287 P.3d 551, 556 (Wash. 2012)).

3. Because the rules, restrictions, and enforceability regarding Consent Judgments are jurisdiction-specific, it is important to look up the specific rules for the state where the Consent Judgment is entered and attempted to be enforced.

4. *See, e.g.*, Old Republic Ins. Co. v. Ross, 180 P.3d 427 (Colo. 2008); Ayers v. C & D Gen. Contractors, 269 F. Supp. 2d 911 (W.D. Ky. 2003). Some courts allow an insured to enter into a Consent Judgment when the insurer is defending the insured under a reservation of rights. *See, e.g.*, Morris, n.2 supra; Patrons Oxford Ins. Co. v. Harris, 2006 ME 72, 905 A.2d 819 (Maine 2006); Miller, n.2 supra; Ins. Co. of North America v. Spangler, 881 F. Supp. 539 (D. Wyo. 1995). *See also* Kelly v. Iowa Mut. Ins. Co., 620 N.W.2d 637 (Iowa 2000) (permitting insured to enter into Consent Judgment when insurer was defending under a reservation or rights and rejected a reasonable settlement offer within the policy limits). And, some courts prohibit an insured from entering into a Consent Judgment when the insurer is providing the insured with a defense unless the insurer agrees to the judgment. *See, e.g.*, Wright v. Fireman's Fund Ins. Companies, 11 Cal. App. 4th 998, 14 Cal. Rptr. 2d 588 (Cal. App. 1992); Romstadt v. Allstate Ins. Co., 844 F. Supp. 361 (N.D. Ohio 1994) *aff'd*, 59 F.3d 608 (6th Cir. 1995) (applying Ohio law).

5. *See* Nelson v. Am. Home Assur. Co., 824 F. Supp. 2d 909 (D. Minn. 2011) *aff'd*, 702 F.3d 1038 (8th Cir. 2012) (applying Minnesota law).

6. The most widely recognized basis for challenging a Consent Judgment is the existence of bad faith, fraud, or collusion between the Claimant and Insured when they entered into the Judgment. This is typically accompanied with or preceded by a determination of the reasonableness of the Consent Judgment. *See, e.g.*, Associated Wholesale Grocers, Inc. v. Americold Corp., 261 Kan. 806, 934 P.2d 65 (Kan. 1997); Detroit Edison Co. v. Michigan Mut. Ins. Co., 102 Mich. App. 136, 301 N.W.2d 832 (Mich. App. 1981); *but see* Mora v. Phoenix Indem. Ins. Co., 196 Ariz. 315, 996 P.2d 116 (Ariz. Ct. App. 1999). In some jurisdictions, such as Texas and Montana, the court is even statutorily required to hold a "reasonableness hearing" for a Consent Judgment. *See, e.g.*, State Farm Fire & Cas. Co. v. Gandy, 925 S.W.2d 696 (Tex. 1996); Tidyman's Mgmt. Servs. Inc. v. Davis, 376 Mont. 80, 330 P.3d 1139 (Mont. 2014).

7. *See, e.g.*, Missionaries of Co. of Mary v. Aetna Cas. & Sur. Co., 155 Conn. 104, 230 A.2d 21 (Conn. 1967); Detroit Edison Co. v. Michigan Mut. Ins. *Co.*, 102 Mich. App. 136, 301 N.W.2d 832 (Mich. App. 1981).

8. *See, e.g.*, Steil v. Florida Physicians' Ins. Reciprocal, 448 So. 2d 589 (Fla. 2d DCA 1984); Associated Wholesale Grocers, Inc. v. Americold Corp., 261 Kan. 806, 934 P.2d 65 (Kan. 1997).

9. *See, e.g.*, Guillen ex rel. Guillen v. Potomac Ins. Co. of Illinois, 203 Ill. 2d 141, 785 N.E.2d 1 (2003); Ayers v. C & D Gen. Contractors, 269 F. Supp. 2d 911 (W.D. Ky. 2003).

10. *See, e.g.*, Nielsen v. TIG Ins. Co., 442 F. Supp. 2d 972 (D. Mont. 2006).

11. *See, e.g.*, Liberty Mut. Ins. Co. v. Eades, 248 Va. 285, 448 S.E.2d 631 (Va. 1994).

12. *See, e.g.*, Bird v. Best Plumbing Group, LLC, 287 P.3d 551, 556 (Wash. 2012); § 4.22.060, Wash. Code.

13. *See Guillen*, n.9, *supra*; *Miller*, n.2, *supra*.

14. *See, e.g.*, Fireman's Fund Ins. Co. v. Sec. Ins. Co. of Hartford, 72 N.J. 63, 71, 367 A.2d 864 (N.J. 1976); Taylor v. Safeco Ins. Co., 361 So. 2d 743 (Fla. 1st DCA1978). However, there appears to be a very small minority of jurisdiction that have permitted

the "redetermination" of damages if a Consent Judgment is found to be unreasonable in amount, but made in good faith. Alton M. Johnson Co. v. M.A.I. Co., 463 N.W.2d 277 (Minn. 1990); *but see* Mid–Continent Cas. Co. v. Am. Pride Bldg. Co., *LLC*, 534 F. App'x 926, 927-28 (11th Cir. 2013) (specifically rejecting this approach).

15. *See* Besel v. Viking Ins. Co. of Wisconsin, 49 P.3d 887, 891 (Wash. 2002).

16. Bond Safeguard Ins. Co. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa., No. 6:13-CV-561-ORL, 2014 WL 5325728 (M.D. Fla. Oct. 20, 2014).

17. *Id.* at *9.

18. *Id.* (citing *Steil*, 448 So. 2d at 592).

19. *Id.* (citing Chomat v. Northern Ins. Co. of N.Y., 919 So. 2d 535, 538 (Fla. 3d DCA 2006)).

20. *Id.* (citing Am. Pride Bldg. Co., LLC, 534 F. App'x at 928 and *Taylor*, 361 So. 2d at 746).

21. *See, e.g.*, Fireman's Fund Ins. Co. v. Imbesi, 361 N.J. Super. 539, 826 A.2d 735 (N.J. App. Div. 2003); Wright v. Hartford Underwriters Ins. Co., 823 So. 2d 241 (Fla. 4th DCA 2002).

22. Mid–Continent Cas. Co. v. Am. Pride Bldg. Co., *LLC*, 534 F. App'x 926, 927-28 (11th Cir. 2013).

23. Bond Safeguard Ins. Co. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa., 2014 WL 5325728, at *8-9 (M.D. Fla. Oct. 20, 2014).

24. *Am. Pride Bldg. Co.*, 534 F. App'x at 927-28.

25. *Id.*

26. In Florida, this type of Consent Judgment is called a *Coblentz* agreement, *see* n.1, *supra*. *Id.*

27. *Id.* at 928.

28. *Bond Safeguard Ins. Co.*, 2014 WL 5325728, at *8-9.

29. *Id.* at *9.

30. *Id.*

31. *Id.*

32. *Id.*

33. *Id.*

34. *Id.*

35. *Id.*

36. *Id.*

37. *Id.* This makes good sense too. Evidence that is properly admissible for one purpose should not be automatically excluded merely because it is inadmissible for another or the jury may erroneously apply it or consider it useful for another purpose. *See* Lubbock Feed Lots, Inc. v. Iowa Beef Processors, Inc., 630 F.2d 250 (5th Cir. 1980); Gindin v. Baron, 16 N.J. Super. 1, 7-8, 83 A.2d 790, 793-94 (N.J. App. Div. 1951); Dolan v. Newark Iron & Metal Co., 18 N.J. Super. 450, 456-57, 87 A.2d 444, 446-47 (App. Div. 1952); Johnson v. Malnati, 110 N.J. Super. 277, 281-82, 265 A.2d 394, 396 (App. Div. 1970). As the United States Supreme Court has stated, "there is no rule of evidence which provides that testimony admissible for one purpose and inadmissible under one theory is thereby rendered inadmissible; quite the contrary is the case." United States v. Abel, 469 U.S. 45, 56, 105 S. Ct. 465, 471 (1984). The Federal Rules of Evidence also specifically include a rule that evidence inadmissible for one purpose may be admitted for a different purpose. Fed. R. Evid. 105. *See* § 90.107, Fla. Stat.; W. Va. R. Evid. 105. ■

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