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Pennsylvania High Court Expands Circumstances Under Which Insureds May Settle Underlying Claims Without Insurer Consent

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Liability policies often contain a "cooperation clause" pursuant to which an insurer who has agreed to defend an insured from an underlying lawsuit purports to have the right to approve any settlement to be entered into by the insured. A recent decision by the Pennsylvania Supreme Court, however, has expanded the circumstances under which an insured may settle underlying claims without insurer consent in situations where the insurer has reserved its rights and refuses to consent to a non-collusive, objectively reasonable settlement under policy limits.

In *The Babcock & Wilcox Company et al. v. American Nuclear Insurers et al.*, the Pennsylvania Supreme Court granted review to determine whether "an insured forfeits insurance coverage by settling a tort claim without the consent of its insurer, when the insurer defends the insured subject to a reservation of rights, asserting that the claims may not be covered by the policy." The *Babcock* case involved a claim for insurance coverage for a class action lawsuit alleging bodily injury and property damage caused by emissions from nuclear facilities owned by insureds. Although the insurer had agreed to defend the lawsuit subject to a reservation of rights, during the course of the litigation the insurer refused consent to any settlement offers presented to it due to its conclusion that the case had a strong likelihood of a defense verdict given the lack of medical and scientific support for the plaintiffs' claims. After presenting the settlement offers to the insurer and being denied consent, the insureds settled with the class action plaintiffs for substantially less than the applicable policy limits. The insurer thereafter refused to reimburse the insureds for any such settlements, citing a standard consent to settlement clause (*i.e.*, cooperation clause) in the policy.

In proceedings before the Pennsylvania Supreme Court, the insureds argued that the insurer should reimburse the insureds for the settlement so long as coverage applies and the settlement is fair, reasonable and entered in good faith. Conversely, the insurer argued that the obligation to pay the settlement could only be imposed on the insurer if it acted in bad faith in refusing to settle. The Pennsylvania Supreme Court determined that "if an insurer breaches its duty to settle while defending subject to a reservation of rights and the insured accepts a reasonable settlement offer, the insured need only demonstrate that the insurer breached its duty by failing to consent to a settlement that is fair, reasonable, and non-collusive, as described above, rather than demonstrating bad faith by the insurer, as the damages sought are subject to the policy limits to which the insurer originally contracted." The court went on to note that "a determination of whether the settlement is fair

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and reasonable necessarily entails consideration of the terms of the settlement, the strength of the insured's defense against the asserted claims, and whether there is any evidence of fraud or collusion on the part of the insured."

In many jurisdictions, if an insurer has not denied coverage, and the insured settles without insurer consent, insureds should be prepared for fervent arguments against coverage by the insurer. The *Babcock* case, however, may provide an argument for changing existing law in such jurisdictions to allow insureds to consent to a non-collusive, objectively reasonable settlement under policy limits when an insurer has reserved rights and unreasonably refused to consent to a settlement.