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Know Your Rights: Policyholders' Defense And Settlement Rights

November 4, 2014 | | Claims, Policyholder Protection

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In *Piedmont Office Realty Trust v. XL Specialty Ins. Co.*, No. 14-11987 (11th Cir. Oct. 21, 2014), the United States Court of Appeals for the Eleventh Circuit certified questions to the Supreme Court of Georgia regarding the extent to which an insurance company was bound by a settlement to which it refused to consent. This case represents one of an increasing number of disputes between policyholders and their insurance companies over the defense and settlement of underlying lawsuits. Having lost the battle to narrow the scope of their defense and settlement obligations in many states, insurance companies appear to have opened a new front: attempting to reduce the cost of their defense and settlement obligations. This may take the form of refusing to consent to settlement, thus forcing the policyholder to pay and attempt to recover from the insurance company; or it may take the form of forcing policyholders to deal with attorneys with whom they are not familiar and/or to accept a defense at rates that are well below market. Many insurance policies give the insurance company the "right and duty to defend" the policyholder against lawsuits and other claims made against the policyholder. On its face, this may appear to be a valuable benefit; but it can create problems for a policyholder when its insurer's decisions with regard to defense and settlement do not align with the policyholder's interests. Businesses and individual policyholders should consider whether control of the defense and settlement of lawsuits and other claims against them is a right they want; and, if so, they should consider purchasing insurance that gives them that right, or at least negotiating the right to use their preferred lawyers for any such lawsuits or claims. Business and individual policyholders also should be aware that there are circumstances where an insurance company does not have the right to control its policyholder's defense, even where the insurance policy purports to give the insurance company that right. Whether an insurance company has the right to control the defense of a lawsuit or other claim is generally determined by whether its interests and the policyholder's interests are at least theoretically aligned. If the insurance company reserves its right to deny coverage, those interests may not align. In those circumstances, the policyholder may have a right to independent counsel to be paid by, but not controlled by, the insurance company. This is an important protection; and, for this reason, businesses and individuals should evaluate any reservation of rights by their insurance companies. With respect to settlement, insurance policies that give an insurer the right and duty to defend also generally give the insurer "the right to make such

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investigation, negotiation and settlement of any claim as [the insurance company] deem[s] expedient." In some cases, policyholders may be able to negotiate consent rights with respect to settlement; but in many instances, the insurance policy language will not grant the policyholder any express rights with respect to settlement. Nevertheless, courts have held that an insurance company's rights with respect to settlement of a lawsuit or other claim against its policyholder are not absolute. In addition to the right to independent counsel, most jurisdictions impose a duty of good faith on an insurance company towards its policyholders. Any decisions the insurance company makes in the defense and settlement of a lawsuit or other claim against one of its policyholders must be consistent with this duty of good faith. Precisely what this duty requires will differ depending on the circumstances of each particular case. Courts have held that the duty of good faith generally mandates that an insurance company must view the situation as if there were no policy limits applicable to the claim give equal consideration to the financial exposure of the insured. An insurance company may be liable for a judgment in excess of its policy limits where it was negligent in handling the defense, or where it acted in bad faith. Businesses and individual policyholders should be diligent in holding their insurance companies to this standard. A policyholder's failure to monitor its insurance company's defense of a lawsuit or claim, or to question when its insurance company makes defense or settlement decisions with which the policyholder may not agree – or which may expose the policyholder to uninsured liability – may make it difficult for the policyholder to challenge those decisions later, in the event of an adverse judgment.