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Client Alert

Insurance Recovery

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Taking the Right Steps To Navigate the Consent To Settle Provision in an Insurance Policy and Maintaining the Right to Coverage Even After a Stumble

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Insurers often try to withhold, or at least minimize, coverage by taking the position that a policyholder has failed to keep the insurer sufficiently informed throughout the defense of an underlying matter or has failed to secure the insurer's consent before settling a claim. Policyholders find themselves in this predicament when they overlook the "cooperation" and "consent to settle" provisions within their policies at the outset of a claim and remember their insurance rights on the eve of mediation or trial.

Capitalizing on this common pitfall, some insurers have managed to escape their coverage obligations–even where they were uninvolved and seemingly disinterested in the status of the underlying matter and suffered no harm or prejudice when the claim was resolved through settlement. As is often the case, understanding the legal standards that apply to enforcement of the consent to settle and cooperation provisions and how choice of law will be determined may mean the difference between claim covered and claim denied.

A recent decision rendered in the U.S. District Court for the District of New Jersey drives these points home. In *Formosa Plastics Corp. v. Ace American Insurance Company*, after the insurer agreed to, and did, defend a claim asserted against the policyholder for a period of two years, the policyholder notified the insurer of its retention of a second law firm to focus solely on settlement of the underlying matter. Within a week of the policyholder's retaining its settlement counsel, the underlying action was settled–without advance notice to the insurer. The policyholder did not seek or obtain consent from the insurer prior to settlement, which led the insurer to deny coverage for the second law firm's defense costs, the entire settlement amount, and any costs that followed.

First, due to a conflict of law, the court addressed whether New Jersey or Texas law applied to the interpretation of the consent to settle provision. Under New Jersey law, insurers are permitted to rely solely on a lack of consent for a settlement even absent any harm or prejudice. Conversely, Texas law requires a showing of **actual prejudice** (not theoretical or speculative) to the insurer before the insurer may disclaim coverage based on a consent to settle provision. In *Formosa*, the court decided that Texas law applied, notwithstanding that the case had been filed in New Jersey, because Texas had the "most significant relationship" to the matter, which ultimately addressed whether coverage existed for a polluted site in Texas. Weighing several factors, the court found that Texas' governmental interest in having its laws apply to the dispute were most compelling and outweighed New Jersey's interests.

Next, on the merits of the coverage defense, the insurer took the position that the policyholder's failure to seek its consent resulted in actual prejudice and, therefore, under Texas law, barred coverage under the terms and conditions of the policy. The court rejected the insurer's arguments regarding the existence of prejudice, finding that there was a genuine dispute of material fact as to whether any prejudice resulted from the policyholder's failure to seek the insurer's consent to settle. The court further found genuine issues of material fact as to whether other policy conditions were breached (such as the cooperation, defense, and reporting conditions) and whether the settlement was covered and/or resulted from collusion.

The court's opinion reinforces a few practical considerations policyholders should keep in mind–regardless of applicable state law:

1. Have a comprehensive understanding of consent to settle and related provisions

While insurance policies often contain language requiring an insurer's consent to settle and conditioning coverage on the policyholder's cooperation, it is important to understand exactly what conditions are contained in the policy, with special attention to any qualifying language.

As the *Formosa* case demonstrates, even where a policyholder's decision to settle an underlying matter is justified and its insurer suffers no harm, some courts may find that the policy was breached and allow an insurer to escape its coverage obligations, while other courts will hold insurers to a higher standard. The best way to avoid this outcome is for policyholders to keep their insurers regularly and reasonably informed as claims are defended. However, when policyholders stumble during the course of the defense, they must carefully review the consent to settle provision and potentially applicable law before moving forward with claim resolution. Moreover, not all consent to settle provisions are created equal. For example, some may put limits on the insurer's ability to withhold consent for a settlement that will help a policyholder rebut the insurer's efforts to block coverage for a resolved claim. Given the importance of these policy terms and the intricacies of legal standards, policyholders will often benefit from consulting with experienced coverage counsel to ensure a comprehensive understanding of the specific conditions of the policy and to avoid giving the insurer a cheap "out."

2. Implement operational structures to ensure compliance

Beyond a genuine understanding of consent to settle and related provisions, it is equally important to implement operational structures to ensure reasonable compliance with these provisions. Keeping the insurer up to date on developments as they occur in the defense of the case, informing the insurer of the settlement process in real time, and seeking insurer consent for any settlement positions taken are all vital to rebutting any assertion by an insurer that the policy was breached or, depending on applicable law, that the insurer was prejudiced.

Additionally, while an insurer's disinterest or lack of involvement does not absolve the policyholder of its obligations, it may be considered by a court. In *Formosa*, the court found it compelling that the insurer chose not to be involved, declined to be an active participant in the defense, failed to ask questions or seek information on a regular basis, did not regularly communicate with defense counsel, and never substantively responded to defense counsel's updates or settlement positions. These facts, alongside the policyholder's established record of communication with the insurer, bolstered the policyholder's position that the insurer was not prejudiced and supported a finding that a genuine issue of material fact existed–requiring the court to deny the insurer's motion for summary judgment.

3. Be cognizant of applicable law

The interpretation and application of policy provisions differ vastly from state to state and should be a primary consideration when contemplating any action against an insurer. For example, the application of Texas law over New Jersey law in *Formosa* worked to the policyholder's advantage due to the insurer being subject to a higher burden of proof before it could avoid its coverage obligation for the settlement.

Policyholders should look to see whether their policies contain choice-of-law provisions and consult experienced coverage counsel to determine the impact of applicable law. As evidenced by *Formosa*, it is important that policyholders advocate for the law that will maximize the availability of coverage.

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