



## Checkmate: Challenging Coblentz Consent Judgments — Judgments That Are Executable Only Against the Defendant’s Insurer

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### Introduction

This article discusses insurers’ defenses to claimants’ attempts to enforce consent judgments against them after the insureds, which have had their liability insurance claims and requests for a defense denied, settle the claimants’ lawsuits against them by admitting liability to the claimants, consenting to judgments against themselves for a sum certain, and assigning their insurance policy rights to the claimants.<sup>2</sup> In exchange for these concessions, the claimants give the insureds a covenant not to collect the consent judgments from the insureds, but rather to execute the consent judgments against the insurers.

In some jurisdictions, courts call this type of settlement agreement a Coblentz Agreement, based on the decision in *Coblentz v Am. Sur. Co. of New York*, 416 F.2d 1059 (5th Cir. 1969). See, e.g., *Capital Assurance Co. v Margolis*, 726 So. 2d 376, 377 n.1 (Fla. 3rd DCA 1999). In some other jurisdictions, courts refer to it as a Damron Agreement, based on the decision in *Damron v Sledge*, 460 P.2d 997 (Ariz. 1969), or a Miller-Shugart Agreement based on the decision in *Miller v Shugart*, 316 N.W.2d 729 (Minn. 1982). See, e.g., *Safeway Ins. Co. v Guerrero*, 106 P.3d 1020, 1022 n.1 (Ariz. 2005) (*en banc*) (“Guerrero”), and *Wangler v Lerol*, 670 N.W.2d 830, 837-38 (N.D. 2003), respectively. In other jurisdictions, courts may refer to it by a different name.<sup>3</sup>

Although courts use different terminology to identify this type of settlement agreement (hereinafter referred to as a “Coblentz Agreement” or “Coblentz Consent Judgment”), the insureds’ and the claimants’ goal remains the same: shift all or part of the loss from the insureds to their insurers after the insurers have denied the insureds’ claims and have refused to defend the insureds. Insurers’ defenses vary from state to state, but fall into several general categories, which are discussed herein.

### Consent Judgments, Assignments, and Covenants Not to Execute

Commercial liability insurance policies often obligate the insurer to defend all lawsuits brought against the insured if the complaint alleges an act that the policy potentially covers, even though the allegations may be groundless.<sup>4</sup> This coverage feature is sometimes referred to as litigation insurance. Policies that provide it, however, do not obligate the insurer to defend a lawsuit when the policy does not even potentially cover any of the alleged acts. See, e.g., *Maneikis v. St. Paul Ins. Co. of Illinois*, 655 F.2d 818, 823 (7th Cir. 1981) (stating that “[i]f the policy did not afford even potential coverage at the time of denial, then the insurer’s refusal to defend was not actionable ...”) (“Maneikis”).

Typically, when a third party files a lawsuit against an insured, the insured will notify

### Abstract

*This article discusses “insurer set-up agreements” in which claimants and insureds attempt to force insurers to pay claims without genuine litigation as to the merits of the plaintiff’s claim. Specifically, in such agreements, the insured shifts its liability to its insurer by (1) admitting liability; (2) consenting to a judgment against itself for a (usually arbitrary and/or inflated) sum certain; (3) assigning all rights under its insurance policy to the claimant; and (4) in return, receiving from the claimant a covenant not to collect from the insured, but rather against the insurer. After a discussion of the requirements of such agreements, this article focuses on the legal defenses available to insurers who find themselves “set up.” The defenses vary from state to state.*

Key Words:

Coblentz, Miller-Shugart, Set-up

its liability insurer about the lawsuit and request that the insurer provide a defense and indemnification. The insurer will analyze the claim and make a coverage decision about whether or not the policy covers or potentially covers any of the acts alleged in the complaint. Afterward, the insurer will notify the insured about its coverage decision.

When the liability insurer believes that its policy does not cover the claim, the insurer has several options. “The insurer can (1) seek a declaratory judgment regarding whether its policy obligates it to provide a defense to the insured in the underlying lawsuit; (2) offer to defend the insured under a reservation of rights (which the insured may or may not accept); or (3) [deny the claim and] refuse either to defend or to seek a declaratory judgment at the insurer’s peril that it might later be found to have breached its duty to defend.” *Id.* at 821; *see also Pekin Ins. Co. v Allstate Ins. Co.*, 768 N.E.2d 211, 214 (Ill. App. Ct. 2002); *Red Giant Oil Co. v Lawlor*, 528 N.W.2d 524, 532 (Iowa 1995) (“*Red Giant Oil*”).

If the insurer denies a claim that the insured and the plaintiff believe is covered or potentially covered, the insured and the plaintiff sometimes agree to settle the lawsuit in an attempt to shift all or part of the loss from the insured to the insurer.<sup>5</sup> To do so, the insured and the plaintiff enter into a *Coblenz* Agreement. Then, as the assignee of the insured’s policy rights, the plaintiff seeks payment of the consent judgment from the insurer. *See, e.g., Cont’l Cas. Co. v Hempel*, 4 Fed. Appx. 703, 716 (10th Cir. 2001) (applying New Mexico law) (“*Hempel*”) (citing Schmidt, *The Bad Faith Setup*, 29 Tort & Ins. L.J. at 719-20).

Usually, a person or an entity that is not a party to a settlement agreement cannot be bound by its terms. *See e.g., Ahern v Odyssey re (London) Ltd.*, 788 So. 2d 369, 371-72 (Fla. 4th DCA 2001). An exception to this rule applies when an insurer incorrectly refuses to provide a defense to the insured. In that situation, a settlement between the insured and the injured party usually establishes the insured’s liability, and the insurer generally cannot relitigate the liability issue later. *Id.* at 372.

Courts in various jurisdictions have acknowledged that the amount of the settlement in cases involving consent judgments and covenants not to execute against the insured are suspect because the insured has nothing to lose given that it will never be obligated to pay the consent judgment. *See, e.g., Steil v Florida Physicians’ Ins. Reciprocal*, 448 So. 2d 589, 592 (Fla. 2d DCA 1984) (“*Steil*”); *Red Oaks Condo. Owners Assoc. v Sundquist Holdings, Inc.*, 116 P.3d 404, 407 (Wash. Ct. App. 2005) (“*Red Oaks*”); *Hempel*, 4 Fed. Appx. at 717. In the *Hempel* case, the court explained:

[These settlements] have “the high potential for fraud or collusion” because “[w]ith no personal exposure the insured has no incentive to contest liability or damages” and “the insured’s best interests are served by agreeing to damages in any amount as long as the agreement requires that the insured will not be personally responsible for those damages.”

*Id.* (quoting *Pruyn v Agricultural Ins. Co.*, 42 Cal. Rptr. 2d 295, 305 (Cal. Ct. App. 1995); *see also Steil*, 448 So. 2d at 592 (“The real concern in this type of case is that the settlement between the claimant and the insured may not actually represent an arm’s length determination of the worth of the plaintiff’s claim.”)).

## Challenging the Enforcement of Coblenz Consent Judgments

Although an insured that has entered into a *Coblenz* Agreement has admitted liability for the injuries that the plaintiff in the underlying tort case alleged and has agreed to the amount of damages in that case, the insurer may have various defenses to the claimant’s attempt to enforce the consent judgment against it.<sup>6</sup> This section discusses those potential defenses.

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**A Covenant Not to Execute Against the Insured Releases the Insured and the Insurer from Liability to Pay a Coblentz Consent Judgment in at Least One State When the Policy Only Requires the Insurer to Pay Claims That the Insured Is “Legally Obligated to Pay as Damages”**

Under North Carolina law, an insurer has no obligation to pay a consent judgment if (1) the plaintiff in the underlying action has executed a covenant not to execute the judgment against the insured, and (2) the insuring agreement in the liability policy states that the insurer will pay on behalf of the insured all sums which the insured shall become “legally obligated to pay as damages.” See e.g., *Lida Mfg. Co. v United States Fire Ins. Co.*, 448 S.E.2d 854, 856 (N.C. Ct. App. 1994) (“*Lida*”); *Terrell v Lawyers Mut. Liab. Ins. Co. of North Carolina*, 507 S.E.2d 923, 927 (N.C. Ct. App. 1998). Formerly, a few other states, such as Oregon, had taken the same position, but it appears that those states have changed their law in this respect. See, e.g., *Walthers v Travelers Cas. & Sur. Co.*, Case No. CV-98-805-ST, 1999 WL 793939 at \*7 (D. Or. Sept. 16, 1999) (finding that an Oregon statute, Or. Rev. Stat. Ann. § 31.825 (West 2007) (formerly Or. Rev. Stat. Ann. § 17.100 (West 2003)), overruled an Oregon Supreme Court *en banc* decision that held that an insurer was not obligated to pay a consent judgment when the claimant had agreed not to execute the consent judgment against the insured).

In *Lida*, the Court of Appeals of North Carolina framed the issue:

The issue presented is whether the settlement agreement, which contains a covenant not to execute a confession of judgment against [the insured], precludes plaintiffs from recovering payment under the [insurer’s] general policy and under the [insurer’s] umbrella policy which provide coverage only if [the insured] is “legally obligated to pay” damages.

*Lida*, 448 S.E.2d at 856.

The court concluded that, “when an insurance policy contains language such as ‘legally obligated to pay,’ an insurer has no obligation to an injured party where the insured is protected by a covenant not to execute.” *Id.* at 857 (citing, among other cases, *Huffman v Peerless Ins. Co.*, 193 S.E.2d 773, 774 (N.C. Ct. App.), *cert. denied*, 195 S.E.2d 689 (N.C. 1973) and *Stubblefield v St. Paul Fire & Marine Ins. Co.*, 517 P.2d 262 (Or. 1973), *overruled by* Or. Rev. Stat. Ann. § 31.825 (West 2007) (formerly Or. Rev. Stat. Ann. § 17.100 (West 2003))). The court reasoned that [the plaintiff] “cannot ‘reduce [its] right to damage to judgment’ because of the covenant not to execute, and [the insured] is therefore not ‘legally obligated to pay’ [the plaintiff] for any damages ... based on negligence or breach of contract.” *Lida*, 448 S.E.2d at 857.

In North Carolina, insurers have a solid defense against suits seeking to enforce *Coblentz* Agreements if their policies’ insuring agreement contains the language “legally obligated to pay” or its equivalent. Also, notwithstanding the fact that courts in some states have abandoned the position that North Carolina continues to follow, other states that have not yet addressed this issue may conclude, in a case of first impression, that North Carolina’s view of the law is the better reasoned view. Therefore, an insurer’s counsel in an action to enforce a *Coblentz* Consent Judgment should carefully review the law of the states whose law potentially might govern the issue to determine whether the insurer has a “release of liability” defense in any of those states. The insurer’s counsel also should scrutinize all of the settlement documentation to determine whether, in addition to the typical covenant not to execute, any of those documents include an express release of liability that provides an independent basis for precluding recovery from the insurer.

**Some States Require an Insurer to Prove That There Is No Possibility of Coverage in the Underlying Action to Prevent a Claimant from Enforcing a Coblantz Consent Judgment, Assuming That the Amount of the Consent Judgment Is Reasonable and the Consent Judgment Is Not Tainted By Fraud, Collusion, or Some Other Form of Bad Faith**

Under the law of some states, such as Illinois, if the insurer refused to defend the insured and the insured entered into a *Coblantz* Agreement, the insurer must prove that there is no possibility of coverage for the acts alleged in the underlying suit to avoid becoming liable to pay the plaintiff the amount of the consent judgment, assuming the amount of the consent judgment is reasonable and the *Coblantz* Agreement is not tainted by bad faith. See, e.g., *Guillen v Potomac Ins. Co. of Illinois*, 751 N.E.2d 104, 114-15 (Ill. App. Ct. 2001) (“*Guillen I*”), *aff’d and modified* by 785 N.E.2d 1 (Ill. 2003) (“*Guillen II*”); *Maneikis*, 655 F.2d at 822 (applying Illinois law). Only “if the policy did not afford even potential coverage at the time of denial, [is] the insurer’s refusal to defend not actionable ...” *Maneikis*, 655 F.2d at 823; *Kim v State Farm Fire & Cas. Co.*, 728 N.E.2d 530, 536-37 (Ill. App. Ct. 2000) (“*Kim*”).

In *Guillen I*, former tenants of an apartment building brought a negligence suit against their former landlords, seeking damages for the alleged lead paint poisoning of their minor daughter. The landlords’ insurer denied the claim based on a lead hazard exclusion in the commercial general liability policy at issue, refused to defend the insureds, and did not file a declaratory judgment action to confirm that its policy did not provide coverage for the claim. The insureds and the plaintiffs settled the suit, entering into a *Coblantz* Agreement that included a \$600,000 consent judgment executable solely against the insureds’ insurer.

The claimants — the former tenants — brought suit against the insurer. The claimants alleged that the lead hazard exclusion did not apply because the insurer did not give proper notice of a policy change to the insureds. The claimants further contended that the insurer was estopped from raising any policy defenses, given that it refused to defend the insureds and did not seek a declaratory judgment that its policy did not cover the insureds’ claim. The insurer denied the improper notice and duty to defend allegations. The insurer also contended that it had no duty to indemnify because the insureds had no legal obligation to pay damages given that no judgment existed against the insureds and that the insureds had not paid any money to the claimants pursuant to the *Coblantz* Agreement.

The trial court ruled that the insurer had failed to give proper notice of the policy change and, therefore, was estopped from raising any policy defenses because it had breached its duty to defend. The trial court, however, granted summary judgment in favor of the insurer on the ground that the insureds were not legally obligated to pay the \$600,000 consent judgment.

The Illinois Supreme Court affirmed the trial court’s estoppel ruling, but reversed the trial court’s summary judgment ruling in favor of the insurer, holding that an insurer is liable for the amount of the settlement even though the insured has not yet paid it. *Guillen II*, 751 N.E.2d at 116. With respect to estoppel, the Illinois Supreme Court noted the well-established rule that “[i]f the facts alleged in the underlying complaint fall within or potentially within the coverage of the policy, the insurer’s duty to defend is triggered.” *Id.* at 127. Continuing, the Court observed that, under Illinois law:

If an insurer takes the position that the complaint is not covered by the language contained in the policy, it must defend the suit under a reservation of rights or seek a declaratory judgment that there is no coverage. If the insurer fails to take either of these steps, it will be estopped from asserting any policy defenses to coverage.

*Id.* Given the insurer's refusal to defend and the potential for coverage, the court held that the insurer had a legal obligation to indemnify the claimant. *Id.*<sup>7</sup>

In Illinois and in states with similar laws, one way that an insurer can avoid liability for payment of a Coblentz Consent Judgment after the insurer has refused to defend an insured and has not obtained a declaratory judgment that its policy does not provide coverage is to prove in the consent judgment enforcement action that the insurer was correct when it denied the claim and refused to defend the insured because there was no possibility that the policy covered the submitted claim.

For example, in the *Kim* case, the insurer denied the insured's environmental damage claim, which was based on two lawsuits that the insured's landlord brought against the insured for damages arising from the insured's release of a chemical called tetrachloroethane or perc into the soil beneath the insured's store. *Kim*, 728 N.E.2d at 531-32. The insurer based its denial of the claim on the pollution exclusions in the business liability and property damage sections of the policy at issue. The insured brought suit against the insurer, contending, among other things, that the insurer was estopped from raising the exclusions as a coverage defense because the insurer had refused to provide a defense and had not brought a declaratory judgment action seeking a declaration that its policy did not trigger the insurer's duty to defend. *Id.* at 536.

The court in the *Kim* case ruled that the two pollution exclusions precluded coverage for the insured's claim and, therefore, the insurer had no duty to defend and was not estopped from raising coverage defenses. *Id.* at 536. The court explained:

To determine an insured's duty to defend, the court compares the allegations of the underlying complaint to the policy language. If the allegations fall potentially within the coverage, the insurer has a duty to defend the insured against the underlying complaint. The failure to defend the suit or seek a declaratory judgment as to coverage estops the insurer from raising any policy defenses should its decision regarding coverage turn out to be wrong.

... [The insurer] did not breach its duty to defend, as a comparison of the allegations in the underlying complaint to the policy language reveals that no potential for coverage existed under the terms of the policy. Therefore, [the insurer] is not estopped from raising the exclusions as a coverage defense and the circuit court did not err in granting judgment on the pleadings for [the insurer].

*Id.* at 536-37.

Assuming *arguendo* that the insured in the *Kim* case had settled with the plaintiff and had entered into a Coblentz Agreement (which it didn't), the plaintiff would not have been able to enforce a consent judgment against *Kim*'s insurer because the policy did not provide even potential coverage for the environmental damage liability claim. This result underscores the importance of experienced coverage counsel's careful analysis of the terms and conditions of the insurance policy and the allegations in the complaint.

### **In Some States a Claimant Cannot Enforce a Consent Judgment Entered into Pursuant to a Coblentz Agreement Unless the Policy Actually Covers the Insured's Claim**

Some states do not agree that a claimant can enforce a consent judgment arising from a Coblentz Agreement against an insurer merely by establishing that the liability policy at issue potentially covered one or more of the allegations that the claimant made against the insured in the underlying tort case. In those states, which include Florida, Pennsylvania, and Maine, insurers can prevent claimants from enforcing such consent judgments by showing that the policy at issue did not cover the allegations asserted. See, e.g., *Steil*, 448 So. 2d at 592 ("as a condition precedent to any recovery against

the carrier, [the claimant] will have to prove that her claim against [the insured] was within the coverage of the policy”); *Keystone Spray Equip., Inc. v Regis Ins. Co.*, 767 A.2d 572, 576 (Pa. Super. Ct. 2001) (“when an insurer wrongfully declines to defend an insured, the insured may enter a reasonable settlement agreement and subsequently seek indemnification from the insurer to the extent that there is *actual coverage* for the claim”) (emphasis added); *Patrons Oxford Ins. Co. v Harris*, 905 A.2d 819, 827 (Me. 2006) (“damages are binding on the insurer only if the insured or the claimant can show reasonableness of the amount and can establish coverage”) (“*Harris*”). See also *Quorum Health Res., L.L.C. v Maverick County Hosp. Dist.*, 308 F.3d 451, 468 (5th Cir. 2002) (“Even if an insurer wrongfully refuses to defend, it still has the right to assert the policy defense of noncoverage and will only be liable to indemnify the insured up to the policy limits.”) (applying Texas law).

In *Taylor v Safeco Ins. Co.*, 361 So. 2d 743, 746 (Fla. 1st DCA 1978) (“*Taylor*”), a Florida appeals court opined that the insurer would not be liable to the claimant for a \$1 million consent judgment entered into between the claimant and the defendant in the underlying wrongful death case if the claimant could not prove that the defendant was an insured under the automobile liability policy at issue. *Id.* at 746. The basis for the court’s ruling was the requirement, under Florida law, that the claimant must prove that the policy at issue provides coverage for the claim settled with a *Coblenz* Agreement. *Id.*

The defendant in the underlying wrongful death case was driving a third party’s car when it collided with another car. The accident caused the death of the defendant’s brother, who was a passenger in the car driven by the defendant. The brother, rather than the owner of the car, had allowed the defendant to drive the car. As a result, it was not clear whether the defendant was an insured under the car owner’s automobile liability policy.

The car owner’s insurer initially provided a defense for the defendant under a reservation of rights, but later withdrew its defense after a trial court ruled that the defendant was not an insured. The decedent’s widow, who was the plaintiff in the underlying case, appealed this coverage ruling. The *Taylor* court observed that “the claimant’s notice of appeal put [the insurer] on notice that its potential liability might yet be restored.” *Id.* at 745. The insurer, consequently, re-tendered its offer to provide a defense under a reservation of rights. The defendant, however, rejected the offer and entered into a *Coblenz* Agreement with his brother’s widow, agreeing to a \$730,000 consent judgment executable solely against the car owner’s insurer. The *Taylor* court ruled that the defendant had the right to reject the insurer’s offer and to effect a reasonable settlement because the insurer sought to reserve its rights to deny the claim. *Id.* at 746.

The widow then sought to enforce the consent judgment against the car owner’s insurer. The *Taylor* court ruled, however, that the widow could not enforce it against the insurer unless she prevailed on the threshold coverage issue of whether the defendant in the underlying case was an insured. *Id.* If she could not prove that the defendant was an insured, the court stated that the insurer would not have to pay the consent judgment. *Id.*

Insurers clearly have a better opportunity to challenge *Coblenz* Consent Judgments in states in which the claimant must prove that actual coverage exists under the policy at issue than they do in states in which the claimant must prove only that an act alleged in the complaint potentially is covered. In states that require proof of actual coverage, an insurer’s counsel can prevent an insurer from having to pay the consent judgment if counsel can prove that the insurer was right when it concluded that the policy did not provide any coverage, even if the insurer was wrong when it concluded that it had no duty to defend.

### **Coblentz Consent Judgments Usually Are Not Enforceable If the Amount of the Consent Judgment is Unreasonable or the Coblentz Agreement Is the Product of Fraud, Collusion or Some Other Form of Bad Faith**

As discussed on page 3 of this article, the law in at least one state is that a claimant cannot enforce a consent judgment against the insurer of an alleged tortfeasor when the consent judgment is coupled with a covenant not to execute the judgment against the insured. The rationale for this prohibition is that the claimant's covenant not to execute releases the insured's legal obligation to pay damages, and, therefore, also releases the insurer because the policy obligates the insurer to pay only those sums that the insured is legally obligated to pay as damages.

The Nebraska Supreme Court in *Metcalf v Hartford Acc. & Indem. Co.*, 126 N.W.2d 471, 476 (Neb. 1964) ("*Metcalf*"), rejected the foregoing principle. Moreover, the court ruled that, because the insurer wrongfully refused to defend the insured, the insurer was "in no position to attack the judgment in the absence of fraud collusion, or bad faith." *Id.* The court reasoned:

It is a well-settled principle that where a person is responsible over to another, either by operation of law or express contract, and he is duly notified of the pendency of the suit against the person to whom he is liable over, and full obligation is afforded him to defend the action, the judgment, if obtained without fraud or collusion, will be conclusive against him, whether he appeared or not.

*Id.*; see also *Coblentz*, 416 F.2d at 1062-63.

In the *Coblentz* case, the Fifth Circuit expressly followed the *Metcalf* decision. The *Coblentz* court held, that under Florida law, such agreements are enforceable "in the absence of fraud or collusion." *Coblentz*, 416 F.2d at 1063 (predicting how a Florida court would rule on this issue). Courts in the states that recognize the validity of *Coblentz* Agreements and that have addressed the enforceability of the consent judgments that they spawn appear to have universally held that a *Coblentz* Agreement that is the product of fraud or collusion is not enforceable.

These courts, however, have not adopted a uniform definition of "fraud" or "collusion." For example, in *Steil*, a Florida district court of appeal explained that "fraud" and "collusion" in the context of a *Coblentz* Agreement do not mean the same thing that they mean in other civil law contexts. The *Steil* court reasoned that, because of the nature of *Coblentz* Agreements, "the ordinary standard of collusion or fraud is inappropriate." *Steil*, 448 So. 2d at 592. The *Steil* court observed that, when the insured has to pay the judgment or when the case has been tried and a judgment entered in the case, one can assume that the amount of the settlement or judgment is fair. The court indicated, however, that one cannot have as much faith in the fairness of the amount of a consent judgment when a covenant not to execute against the insured exists:

[The insured] has little or nothing to lose because he will never be obligated to pay. As a consequence, the settlement of liability and damages may have very little relationship to the strength of the plaintiff's claim. Due to this problem, the ordinary standard of collusion or fraud is inappropriate. Thus, we hold that in a case such as this, a settlement may not be enforced against a carrier if it is unreasonable in amount or tainted by bad faith.

*Id.*

In contrast, a federal district court, applying Virginia law, defined fraud and collusion in a more traditional manner. *Spence-Parker v Maryland Ins. Group*, 937 F. Supp. 551, 560-61 (E.D. Va. 1996) ("*Spence-Parker*"). In a case involving a *Coblentz* Agreement, the *Spence-Parker* court stated that, under Virginia law, fraud is well-defined and includes fraud and constructive fraud. The court defined both varieties of fraud:

Actual fraud is intentional fraud, and its elements are: (i) a false representation, (ii) of a material fact, (iii) made intentionally and knowingly, (iv) with intent to mislead, (v) reliance by the misled party, and (vi) resulting injury to the party misled. Constructive fraud, in contrast, is “a breach of legal or equitable duty, which, irrespective of moral guilt ... the law declares fraudulent, because of its tendency to deceive others, to violate public or private confidence, or to injure public interests.” ... Thus, constructive fraud does not require scienter or intent to mislead; it can be established whether the representation is innocently or knowingly made.

*Id.* (citations omitted; alterations in original).

The *Spence-Parker* court also defined “collusion.” The court stated that “collusion is simply fraud accomplished by two or more persons. As such, it incorporates, but does not substantively expand the kind of conduct that constitutes actual or constructive fraud.” *Id.* at 561. See also *Harris*, 905 A.2d at 828 (defining collusion as “[a]n agreement to defraud another or to obtain something forbidden by law”).

In addition to “fraud” and “collusion,” courts in some states have held that the amount of a *Coblentz* Consent Judgment is not enforceable if the amount is “unreasonable” or is the product of “bad faith.” As discussed below, the definitions of these terms varies from state to state. Moreover, some courts appear to use the terms “fraud,” “collusion,” and “bad faith” interchangeably. The result is that it is difficult to draw bright lines that separate these concepts. See e.g., *Damron*, 460 P.2d at 1000 (“We cannot conceive of a case where there is collusion without bad faith.”); *Midwestern Indem. Co. v Laikan*, 119 F. Supp. 2d 831, 843 (S.D. Ind. 2000) (the issues of bad faith and collusion are closely related to the issue of the reasonableness of the settlement amount) (“*Laikan*”); *Cont’l Cas. Co. v Westerfield*, 961 F. Supp. 1502, 1505 (D.N.M. 1997) (“In evaluating the reasonableness of a settlement, the trier of fact may take into consideration ‘any evidence of bad faith, collusion, or fraud.’”), *aff’d*, *Cont’l Cas. Co. v Hempel*, 4 Fed. Appx. 703 (10th Cir. 2001).

Given the overlap between these legal concepts, an insurer’s counsel may not be able to isolate certain acts as purely evidence of collusion and other acts as purely evidence of bad faith, or fraud. Insurer’s counsel needs to recognize the interrelatedness of these legal conclusions and must determine which of them the state law at issue recognizes as a defense to the enforcement of a *Coblentz* Consent Judgment, how the applicable state law defines the available defenses, what the insurer’s and/or the claimant’s burden of proof is with respect to each available defense, and what evidence the insurer must produce to satisfy its burden of proof. The following two sections discuss cases that illustrate these defenses and identify factors that some courts have considered when determining whether the amount of the *Coblentz* Consent Judgment is unreasonable or whether the *Coblentz* Agreement is the product of fraud, collusion, or some other form of bad faith.

### ***In Most States, an Insurer Can Avoid Becoming Liable for a Coblentz Consent Judgment if the Insurer Can Establish that the Amount Is Unreasonable***

Most states that have addressed the validity of *Coblentz* Agreement have held that an insurer may challenge the enforceability of the consent judgment on the ground that the amount of the consent judgment is unreasonably high. See, e.g., *Hempel*, 4 Fed. Appx. at 715 (applying New Mexico law and ruling that the insured’s settlement must be reasonable to make an insurer that breached its duty to defend liable to pay it); *Red Giant Oil*, 528 N.W.2d at 535 (holding that the amount of a settlement must be reasonable and prudent); *Steil*, 448 So. 2d at 592 (“in a case such as this, a settlement may not be enforced against the carrier if it is unreasonable in amount ... ”); *Harris*, 905 A.2d at 829 (“if the claimant cannot show that the settlement and the amount of

damages or the settlement amount are reasonable, the claimant may recover only that portion which he proves to be reasonable”).

However, some other states, such as Virginia, do not allow insurers who have breached their duty to defend to challenge the enforceability of consent judgments on that ground. *See, e.g., Liberty Mut. Ins. Co. v Eades*, 448 S.E.2d 631, 633 (Va. 1994) (“*Eades*”) (“[a] consent judgment entered upon a stipulation of the parties requires judicial action by the court and therefore is valid, has substantially the same effect as any other judgment, is conclusive of the matters adjudicated, and is not subject to collateral attack except upon jurisdictional grounds or for fraud or collusion . . . .”); *Spence-Parker*, 937 F. Supp. at 560 (applying Virginia law); *Himes v Safeway Ins. Co.*, 66 P.3d 74, 77 n.2 (Ariz. Ct. App. 2003) (citing the *Damron* case for the proposition that “[t]here are some Damron/Morris agreements under which an insurer has no right to contest damages on the basis of reasonableness, but only on the basis of fraud or collusion”) (“*Himes*”).

With regard to those states that recognize unreasonableness of the amount of a Coblenz Consent Judgment as a defense, some of them have expressly identified the factors that courts should consider when evaluating this defense. For example, Washington state courts consider the following evidence concerning the underlying case:

[T]he damages involved; the merits of the plaintiff’s liability theory; the merits of the defendant’s theory; the defendant’s relative faults; the risks and expenses of continued litigation; the defendant’s ability to pay; any evidence of bad faith, collusion, or fraud; the extent of the investigation and preparation of the case; and the interests of the parties not being released from liability.

*Red Oaks*, 116 P.3d at 407 (citations omitted); *see also Himes*, 66 P.3d at 85 (the Arizona court employed the same factors that the *Red Oaks* court listed with the exception of the defendant’s ability to pay).

Iowa courts have adopted the “reasonable and prudent person” test, which a Minnesota court articulated in the *Miller-Shugart* case. *Red Giant Oil*, 528 N.W.2d at 535. The Iowa Supreme Court in *Red Giant Oil* characterized it as an objective test that asks “what a reasonably prudent person in the position of the defendant [in the underlying case] would have settled for on the merits of the plaintiff’s claim.” *Id.* (quoting *Miller-Shugart*, 316 N.W.2d at 735). Courts in some other states have adopted this test. *See e.g., Hempel*, 4 Fed. Appx. at 717 (applying New Mexico law); *Guillen II*, 785 N.E.2d at 14 (applying Illinois law); *Rhodes v Chicago Ins. Co.*, 719 F.3d 116, 120 (5th Cir. 1983) (applying Texas law). The *Red Giant Oil* court explained that the test requires the fact finder to consider “the facts bearing on the liability and damage aspects of plaintiff’s claim, as well as the risks of going to trial.” *Red Giant Oil*, 528 N.W.2d at 535.

In another case in which the court did not use a pre-determined group of factors like those that Washington state courts apply, a New Jersey court of appeal affirmed a lower court’s conclusion that a \$4.15 million consent judgment in a sexual harassment and gender-related violence case was unreasonable on its face and collusive. *Fireman’s Fund Ins. Co. v Imbesi*, 826 A.2d 735, 751 (N.J. Super. Ct.) (“*Imbesi*”), *cert. denied*, 834 A.2d 406 (N.J. 2003). In *Imbesi*, a former employee sued two companies that formerly employed her and sued the companies’ principal owner, who also was her supervisor, for alleged acts that occurred during a 19-month period.

The plaintiff settled with the defendants and a group of their insurers for a \$1 million payment, a \$4.15 million consent judgment, and an assignment of the insured defendants’ rights to recover from two nonsettling insurers. The settling parties

agreed that the plaintiff would return some or all of the \$1 million payment if the plaintiff recovered specified amounts from the nonsettling insurers, both of which had denied coverage for the plaintiff's claims.

The lower court dismissed one of the nonsettling insurers and found that the other had a duty to defend and a duty to indemnify under an employer's liability policy. *Imbesi*, 826 A.2d at 747. The claimant sought to enforce the \$4.15 million consent judgment against the nonsettling insurer.

The court of appeal court agreed with the lower court's ruling that the amount of the consent judgment was unreasonable on its face and collusive for several reasons. First, the evidence presented in the case demonstrated that no New Jersey court had ever awarded that much money in a case based on sexual harassment and gender-related violence. Second, the settlement agreement categorized all of the damages as compensatory damages and none as punitive damages. Third, the claimant agreed to reimburse the settling insurers for part of their settlement payment if she recovered a certain amount from the nonsettling insurers. Fourth, the settlement agreement required the nonsettling insurer to pay a disproportionate share of the judgment — at least \$3.15 million, which was 76 percent of the settlement amount, and at most \$4.15 million, which was 100 percent of the settlement amount. The court found that this was unreasonable given that the nonsettling insurer provided coverage for only 5 of the 19 months that the alleged wrongful acts occurred.<sup>8</sup> *Id.* at 565-66. See also *Hempel*, 4 Fed. Appx. at 718-19 (finding a \$26.38 million consent judgment to be wildly out of proportion to other sources' valuation of the claim).

As these cases indicate, the law concerning the extent to which *Coblenz* Consent Judgments are subject to attack on unreasonableness grounds and the factors that courts consider when evaluating an insurer's challenge of the reasonableness of the amount of such consent judgments varies from state to state. When the amount of a consent judgment appears to be excessive and the governing state law permits insurers to contest the reasonableness of *Coblenz* consent judgments, insurers' counsel should gather evidence during discovery concerning the factors identified in the foregoing cases, organize the evidence to reveal the artificially high amount of the consent judgment, file dispositive motions based on that evidence, and, if necessary, focus the jury's attention throughout the trial on the evidence that demonstrates that a reasonable person who was spending his or her own money would have and could have negotiated a lower settlement amount.

***An Insurer Can Avoid Becoming Liable for a Coblenz Consent Judgment if the Insurer Can Establish that the Coblenz Agreement Is the Product of Fraud, Collusion, or Some Other Form of Bad Faith***

Fraud, collusion, and bad faith are legal principles that overlap to a great extent, which makes it difficult to differentiate between them. In the *Hempel* case, a federal court quoted a section from a law journal which reflects that fact and identifies the types of evidence of collusion and bad faith that insurers' counsel should look for when defending a *Coblenz* Consent Judgment enforcement action:

Any negotiated settlement involves cooperation to a degree. It becomes collusive when the purpose is to injure the interests of an absent or nonparticipating party, such as an insurer or nonsettling defendant. Among the indicators of bad faith and collusion are unreasonableness, misrepresentation, concealment, secretiveness, lack of serious negotiations on damages, attempts to affect the insurance coverage, profit to the insured, and attempts to harm the interest of the insurer. They have in common unfairness to the insurer, which is probably the bottom line in cases in which collusion is found.

*Hempel*, 4 Fed. Appx. at 717 (quoting Schmidt, *The Bad Faith Setup*, 29 Tort & Ins. L.J. at 721).

A New Jersey appellate court's opinion in a case concerning a Coblenz Agreement identifies the type of evidence that a claimant should provide to support the reasonableness of the amount of a consent judgment and that signals unreasonableness if the claimant does not produce it. *Pasha v Rosemount Memorial Park, Inc.*, 781 A.2d 1119 (N.J. Super. Ct. 2001) ("*Pasha*"), cert. denied, 791 A.2d 221 (N.J. 2002). In *Pasha*, the trial court and the court of appeal ruled that a consent judgment, which was part of a Coblenz Agreement, was unenforceable because it was the product of collusion and bad faith. The plaintiffs sued an insured who operated a cemetery, claiming damages for emotional distress. The plaintiffs alleged that the insured's employees mishandled the corpse of their mother and caused her casket to sink in three feet of rainwater that had accumulated in the grave before the insured's employees attempted to bury her. While the casket was submerged, water seeped into the casket and damaged the body. The insurer denied the insured's request for a defense. Later, the insured and the plaintiffs entered into a Coblenz Agreement.

Under the settlement agreement, the insured agreed to pay the plaintiffs \$30,000, consented to the entry of a \$500,000 consent judgment, and assigned its insurance policy rights to the plaintiffs. The parties, however, had an understanding that none of them would disclose the insured's \$30,000 payment to the plaintiffs or their agreement that the plaintiffs would return all or a portion of the \$30,000 payment to the insured if the plaintiffs recovered specified amounts of damages from the insurer. The plaintiffs agreed to a covenant not to execute against the insured.

The insurer moved to set aside the consent judgment on the ground that it was collusive. The trial court agreed, holding that the "settlement judgment was tainted by bad faith." *Id.* at 1121. The grounds for the trial court's ruling were: (1) the claimants did not present any medical or psychological reports supporting their claim for emotional stress damages; and (2) the insured was willing to enter into a publicly disclosed consent judgment against it for \$500,000, but insisted that the claimants conceal the facts that the insured paid \$30,000 to the claimants and that the claimants would return part or all of that amount depending upon their success in their action against the insurer.

The court of appeal affirmed the trial court's decision, ruling that the Coblenz Agreement did not bind the insurer. *Id.* at 1122. The court of appeal examined the certifications of the claimants' counsel and found that the certifications failed to describe: (1) the factors taken into consideration when settling the case; (2) the factors that usually would be considered in similar cases; or (3) the physical or psychological damages or injuries that the claimants allegedly suffered. *Id.* at 1223. The court also found that the opinions that the claimants' expert gave lacked sufficient detail and that the settling parties acted inappropriately in concealing the amount that the insured paid to the claimants and the agreement to return part or all of those funds. The court also concluded that the disparity between the amount that the insured paid and the total amount of the settlement was evidence of collusion and bad faith. *Id.* at 1224.

In support of its ruling and its criticism of the testimony that the claimants' expert witness provided, the court of appeal quoted a portion of the New Jersey Supreme Court's opinion in *Griggs v Bertram*, 443 A.2d 163 (N.J. 1982), which identified the information that a claimant's expert should provide in these types of cases:

An expert in the settlement of claims, such as an experienced claims adjuster, is necessary to explain the various factors which are taken into consideration in the settlement of a case of this kind. . . . For example, such expert testimony could render a

comparison of similar claims in the area, an analysis of how plaintiff's other injuries would have affected the settlement of his [claim], an opinion as to the value of plaintiff's ... injury in light of its projected severity when the case settled.

*Id.* at 1124.

The *Pasha* case illustrates how an insurer's defense counsel can successfully challenge a *Coblenz* Agreement by demonstrating that the consent judgment that the claimant is attempting to enforce is the product of collusion or bad faith. To make that showing, the *Pasha* opinion teaches that the insurer should challenge the claimant and the insured during discovery and, if necessary, at trial to explain, among other things, which factors each of them considered when agreeing to the amount of the consent judgment, how those factors justified the amount of the consent judgment, which jury verdicts in the relevant state support the amount of the consent judgment, and what other admissible evidence the claimant has to support its contention that the amount of the consent judgment is the result of good faith negotiations.

Another New Jersey case — *Imbesi* — also is instructive because, like the *Pasha* opinion, the *Imbesi* opinion demonstrates how an insurer can use the claimant's lack of supporting evidence and the testimony of the insurer's expert witness to prove the insurer's collusion and bad faith defense. In that emotional distress case, the court carefully explained why it found that the settlement agreement at issue was collusive and tainted by bad faith. Like the *Pasha* court, the *Imbesi* court first focused on the lack of evidence that the claimant produced to support her damages claim. The *Imbesi* court found that the claimant relied on the allegations in her complaint, the unsubstantiated opinions of two employment law attorneys, and the unsubstantiated statements of her attorney during settlement negotiation. The court noted that the claimant did not present any admissible evidence to support any of these assertions.

The court stated that, in contrast, the nonsettling insurer submitted an expert report from a former Chief Judge of a federal circuit court of appeals that identified the evidentiary holes in the claimant's case, surveyed all reported verdicts and settlements in similar cases in the forum state's courts, demonstrated that there never had been a comparable judgment in a similar case, and cited specific evidence that cast doubt on the truthfulness of the allegations against the business owner.

The court in *Imbesi* next focused on the insured's conduct. The court noted that the insured did not try to rebut the claimant's valuation of the case, but rather simply accepted the claimant's contention that a multi-million dollar judgment was reasonable. The insured did not take any discovery concerning the claims for which the claimant received the judgment. This included failing to have the claimant submit to an independent examination by a medical doctor or psychologist.

The *Imbesi* court also found that the terms of the settlement agreement evidenced collusion and bad faith. The settling parties' agreement to characterize all of the judgment as compensatory damages indicated to the court that the settling parties wanted to ensure that the whole judgment would be insured. The court noted that punitive damages generally are not insured or insurable and that, by characterizing all of the judgment as compensatory damages, the claimant would not have to look to the owner or any other party to collect any punitive damages. Another significant factor was the claimant's waiver of the right to collect anything more from the settling insurers or their insureds if the claimant was unable to recover from the nonsettling insurer. The court concluded that the waiver was strong evidence that the value of the claim really was the \$1 million that the settling insurers paid the claimant. The court reasoned that, if it were not, the claimant would not have agreed to the waiver.

The court concluded that the parties in the underlying case were primarily interested in disposing of that case and suing the insurers. The court cautioned that, to support the reasonableness and good faith of a *Coblentz* Agreement, courts expect detailed examinations of the potential for liability and damages and detailed discussions of the underlying facts and expert opinions. The claimant did not provide that class of evidence in the *Imbesi* case. As a result, the nonsettling insurer avoided having to pay an exorbitant amount of money to a claimant as a result of incorrectly denying her claim and refusing to provide a defense.

### **The Burden of Proof in Coblentz Consent Judgment Enforcement Actions Varies from State to State**

When considering how to defend against a claimant's attempts to enforce a *Coblentz* Consent Judgment against an insurer, the insurer's counsel must determine which party has the burden of proof with respect to the various issues in the enforcement action. All states do not use the same burden of proof standard in these actions. At present, states are divided into at least three camps: (1) those that do not require any showing of the reasonableness of the amount of the consent judgment and that place the burden of proof with respect to fraud, collusion, and bad faith on the insurer; (2) those that place the burden of proof of the reasonableness of the consent judgment on the claimant and place the burden of proof of fraud, collusion, or bad faith on the insurer; and (3) those that place the burden of making a *prima facie* case of reasonableness and good faith on the claimant and that shift the ultimate burden of persuasion on the issues of the unreasonableness of the amount of the consent judgment, fraud, collusion, and bad faith on the insurer if the claimant satisfies its initial burden of production. In addition to the variations concerning which party has the burden of proof on different issues, the weight of the burden of proof varies from state to state.

Virginia is a state that falls into the first camp and that requires the insurer to prove its fraud or collusion defense by more than a preponderance of the evidence. In *Spence-Parker*, a federal district court held that, under Virginia law, insurers that have breached their duty to defend cannot challenge the enforceability of a consent judgment on the ground that the amount of the consent judgment is unreasonable. *Spence-Parker*, 937 F. Supp. at 560. See also *Eades*, 448 S.E.2d at 632-33 (affirming the trial court's ruling that "the insurer was not permitted to challenge the reasonableness of the amount of the judgment, unless it could prove fraud or collusion"). Rather, in order to avoid liability for the *Coblentz* Consent Judgment, the *Spence-Parker* court ruled that the insurer had to "establish by *clear and convincing evidence* that the consent judgment was the product of 'fraud or collusion.'" *Id.* at 560 (emphasis added).

In contrast, some other states, like Iowa, split the burden of proof between the two parties in a *Coblentz* Consent Judgment enforcement action, requiring the claimant to prove some issues and requiring the insurer to prove others. In *Red Giant Oil*, the Iowa Supreme Court held that the claimant had the burden of proving by a preponderance of the evidence that the policy covered the claim asserted in the underlying case and that the amount of the settlement was reasonable and prudent. *Red Giant Oil*, 528 N.W.2d at 535. The court also held that the insurer had the burden of proving that the settlement was the product of fraud or collusion. *Id.* The *Red Giant Oil* case did not specify whether the insurer, like the claimant, had to satisfy its burden by a preponderance of the evidence. However, the court's silence on this issue suggests that the weight of the insurer's burden is the same as the weight of the claimant's burden.

Another group of states, like New Jersey and Florida, use a burden shifting scheme. See, e.g., *Pasha*, 781 A.2d at 1122-23; *Steil*, 448 So. 2d at 592. In the *Pasha* case, a New Jersey court of appeal applied New Jersey's rule that the claimant has the initial

burden of producing sufficient evidence to make a *prima facie* case that the amount of the consent judgment is reasonable and is not tainted by bad faith. If the claimant fails to make that showing, the insurer prevails. *Pasha*, 781 A.2d at 1122-23. However, if the claimant satisfies its initial burden of production, the ultimate burden of persuasion on these issues shifts to the insurer. *Id.* The court explained that New Jersey used this scheme because their courts concluded that claimants are in a better position than insurers to produce evidence concerning the settlement and that placing the initial burden of production on the claimants discourages collusive behavior by claimants and insureds. *Id.* at 1123. The court did not give any indication that the weight of the parties' burden was different from the typical preponderance of the evidence standard applied to most issues in civil trials.

Because the states have not adopted a uniform burden of proof standard or a uniform weight of the burden of proof that each party must bear in *Coblantz* Consent Judgment enforcement actions, insurers' chances of success in such actions, based on the same evidence, will vary from state to state. As a result, insurers' counsel must build into their analyses of the possibility of a successful outcome the relevant state's burden of proof standard and the weight of the burden that the relevant state makes each party bear. Only by including these factors in their analyses, along with the factors that the relevant state's courts consider when evaluating the previously discussed "release of liability," "no potential or actual coverage," "unreasonable amount," and "fraud, collusion and bad faith" defenses, can insurers' counsel make a credible forecast about what the possibility is of getting a favorable result in a *Coblantz* Consent Judgment enforcement action. Because of the number of variables involved in these cases, they are complex matters. They also often are high stakes matters because the insured and the claimant decide upon the amount of the consent judgment without the insurer's participation.

### **The Amount of Damages That an Insured May Recover After a *Coblantz* Agreement Has Been Found Invalid Is Not Well Settled**

There is no clear law as to what damages are available against an insurer after a *Coblantz* agreement is found to be invalid. One court has ruled that, if the settlement is unreasonable and collusive, then the insurer "would have no liability to pay any part of the insured's settlement, even if [the insurer] had absolutely and wrongfully refused to defend." *Taylor*, 361 So. 2d at 746 (emphasis added) (citing *Coblantz*, 416 F.2d at 1059 (finding no bad faith and enforcing judgment against insurer)); *Georgia So. & Florida Ry. Co. v United States Cas. Co.*, 102 S.E.2d 500 (1958) ("Georgia Southern"); *Fidelity & Cas. Co. of New York v Galt*, 196 F.2d 329 (5th Cir. 1952) ("*Galt*"); *Lawrence v Burke*, 431 P.2d 302 (Ariz. 1967) ("*Lawrence*").

However, the *Taylor* court did not enforce the all-or-nothing rule, but merely remanded for a determination of coverage and reasonableness, and the subsequent proceedings were not published. Further, only one of the cases relied upon by the *Taylor* court actually found that the *Coblantz* test is all-or-nothing, and that was not a Florida case. In *Galt*, the Fifth Circuit applied Mississippi law to reverse a judgment against insurer, finding there was no effort by the insured to minimize damages, the court held the insurer was not liable at all. In *Coblantz*, the court found that the consent judgment at issue to be legitimate; therefore, it did not determine an alternative. Likewise, in *Georgia Southern*, the court found the insured's settlement to be legitimate.

In *Lawrence*, the court did the opposite: it vacated the default judgment and remanded the case to the trial court for a determination of damages. The all-or-nothing approach was taken in *Continental Cas. Co. v Hemple*, 4 Fed. Appx. 703, 716 (10th Cir. 2001) (New Mexico law) ("in spite of the insured's authority to settle a claim after the

insurer has refused to provide a defense, “[a] settlement that is the product of fraud or collusion at the expense of a nonparticipating insurer would release that insurer from any obligation under the settlement”), citing *Rummel v Lexington Ins. Co.*, 945 P.2d 970, 984-85 (N.M. 1997) (remanding for determination of collusion); and *Imbesi*, 826 A.2d at 581 (after finding collusion, court ruled “[s]ummary judgment was appropriately entered in Harleysville’s favor and a plenary hearing [on reasonableness of amount] is unnecessary”).

In *Pozzi Window Co. v Auto-Owners Ins. Co.*, 429 F. Supp. 2d 1311 (11th Cir. 2006) (“*Pozzi*”), the magistrate judge found that a set-up agreement was for an unreasonable amount, and held a trial to determine what the reasonable amount was. However, this aspect of the case was mentioned in passing, cited no authority, and was not appealed. Nor did either side brief this issue — when called, Auto Owners’ attorney stated that she had conceded this issue. The *Laikin* Court recognized this approach hypothetically:

Even if there were evidence of unreasonableness, bad faith, or collusion, it is highly doubtful that such evidence would help Midwestern avoid all liability here. The undisputed evidence shows that the Cossell Group paid the Skaggs \$300,000 in cash. That amount would be reasonable under any theory here, and the Cossell Group assigned to the Skaggs their own right to seek indemnity from Midwestern for that amount. In addition, the result of a finding of unreasonableness or bad faith as to the settlement would probably be to set aside the settlement, leaving the underlying claims for trial on the merits.

119 F. Supp. 2d at 851, n. 9 (finding that determination of whether consent judgment was reasonable is too “complex” for a jury and must be tried by a judge).

Significantly, in *Pozzi*, the jury specifically found that the consent judgment was an unreasonable amount, but that it was not a product of collusion. *Id.* at 1315. Therefore, based on all the foregoing authority discussed in this section, it seems logical to conclude that a finding of unreasonableness *without* collusion gives the claimant a second chance to establish its damages, but a finding of unreasonableness *and* collusion results in a zero recovery. However, no court has specifically made this distinction.

A third approach was taken in *Alton M. Johnson Co. v M.A.I. Co.*, 463 N.W.2d 277, 279 (Minn. 1990) in the context of a *Miller-Shugart* judgment. The court discussed the impact of a decision that a settlement agreement was unreasonable:

Underlying the insurer’s argument that an unreasonable settlement should completely defeat the judgment creditor’s claim is the realization that such settlements are not made at arms’ length. As we noted in *Miller v Shugart*, the exposed insured has no incentive to drive a hard bargain; to avoid personal liability, the insured has no compunction to agreeing that judgment may be entered against him for the policy limits, even if the claim is worth much less than the policy limits, if it is worth anything.

Three possible alternatives that might be taken if a *Miller-Shugart* release is found to be unreasonable are: (1) dismiss the action against the insurer; (2) let the trial court decide what lesser award of damages is reasonable and, therefore, collectible against the insurer; or (3) hold the settlement unenforceable and reinstate for trial the plaintiff’s tort claim against the defendant insured. We adopt the middle ground proposed by the third alternative.

*Id.* at 279-81. See also *State Farm Fire and Cas. Co. v Gandy*, 925 S.W.2d 696 (Tex. 1996) (holding that if a set-up agreement fails a test similar to *Coblenz*, then the assignment of the insured’s rights is simply invalid and the consent judgment was not binding). This third approach has not been mentioned by courts in some states and was found to be inconsistent with the majority of jurisdictions, the Restatement of Judgments, and Indiana law in *Laikin*.

## Conclusion

When a third party and the insured enter into a *Coblentz* Agreement to settle the third party's lawsuit against the insured, the insured and the third party decide the amount of the judgment without the participation of the insurer and with the intent that the third party will execute the judgment solely against the insured's insurer. Because the insured will not have to pay the judgment, the amount may be artificially high. Insurers may challenge the enforcement of *Coblentz* Agreements in several ways. State law, however, determines which defenses are available to insurers, what the burdens of proof are, and which party must satisfy the burden of proof with respect to particular issues. It is incumbent upon the insurer's counsel to understand the available defenses and the applicable burdens of proof and to gather the evidence necessary to prove the insurer's case if sufficient evidence exists. Only by doing so can the insurer's counsel protect insurers from becoming liable for some judgments that far exceed the actual value of the claim.

## Endnotes

1. The purpose of this paper is to discuss insurance law issues. The views and opinions contained in this paper are not intended to be legal advice and should not be considered as such. Further, the views and opinions expressed in this paper are solely those of the authors, not the views of McKenna Long & Aldridge LLP or its clients.
2. A federal district court applying Florida law opined that an insurer is not bound by a stipulated settlement between the insured and the claimant unless: (1) the insurer refuses to defend; or (2) the insurer defends under a reservation of rights and the insured rejects that defense. *Zurich Am. Ins. Co. v Frankel Enters., Inc.*, 509 F. Supp. 2d 1303, 1310 (S.D. Fla. 2007). The *Frankel* court stated that, when the insurer is providing a defense, the insured is not free to independently enter into a stipulated settlement agreement with the claimant. *Id.* In Florida, and in other states that follow this rule, insurers that have not refused to defend the insured can assert this defense to a stipulated judgment entered into by the insured and the claimant without the insurer's consent. *See also Mut. of Enumclaw Ins. Co. v T&G Constr., Inc.*, 137 Was. App. 1055, 2007 WL 959894 at \*3 (Wash. Ct. App. April 2, 2007), holding that, under Washington law, a court's determination that a stipulated settlement agreement between the insured and the claimant is reasonable does not bind an insurer that defended the insured under a reservation of rights but did not consent to the settlement and ruling that the insurer had the right to contest coverage and its alleged obligation to indemnify the insured.
3. Note that some courts use the term *Morris* Agreements to refer to similar settlement agreements entered into in response to: (1) an insurer's reservation of rights; (2) an alleged anticipatory breach of the insurer's duty to indemnify; and (3) an alleged bad faith failure to settle by the insurer. *See, e.g., Guerrero*, 106 P.3d at 1022 n.1 (citing *United Servs. Auto Ass'n. v Morris*, 741 P.2d 246 (Ariz. 1987)). An analysis of *Morris* Agreements is beyond the scope of this article.
4. Note that in some states, the insurer may be obliged to consider information beyond the allegations contained in the complaint when the insurer makes its coverage decision. *See, e.g., LaRotunda v Royal Globe Ins. Co.*, 408 N.E.2d 928, 934 (Ill. App. Ct. 1980) (stating that the results of the insurer's investigation may be considered as unpleaded facts known to the insurer when evaluating whether the insurer had a duty to defend).
5. "[Liability] [i]nsurance policies normally reserve to the insurer exclusive rights to control the defense and settlement of covered claims against the insured and require the insured to cooperate in the defense and settlement of such claims and not settle without the consent of the insurer. Violation of these policy provisions can void the policy . . . However, despite these policy provisions, the law of most jurisdictions gives an insured the right, in certain limited circumstances, to settle claims without the insurer's consent." Stephen R. Schmidt, *The Bad Faith Setup*, 29 Tort & Ins. L.J. 705, 723 (ABA 1994).
6. As previously noted, if the insurer incorrectly denied its duty to defend, the insurer generally is not entitled to raise any defense that the insured could have raised to the plaintiff's claims in the underlying suit. *See e.g., Gallagher v Dupont*, 918 So. 2d 342, 347 (Fla. 5th DCA 2005); *Moore v State Farm Mut. Auto. Ins. Co.*, 397 S.E.2d 127 (Ga. Ct. App. 1990) ("Failure of motorist's liability carrier to defend motorist in action brought by bicyclist who was struck by insured's car did not constitute

waiver of liability carrier's right to deny coverage; failure to defend only constituted waiver of opportunity to contest insured's negligence.").

7. Although the Court in *Guillen II* ruled against the insurer on these two issues, the court remanded the case to the trial court for a determination of the reasonableness of the settlement amount because it exceeded the policy limits. The reasonableness issue is discussed below.
8. The *Imbesi* court also concluded that the *Coblenz* Agreement was collusive and was tainted by bad faith. These aspects of the case are discussed in the next section of this article.