Stipulated Judgments

The Assignment of the Insured's Rights

By Jude Francois

Analyzing an effective weapon used by the insured to coerce settlement.

Historically, the insured and the insurer have joined forces to defend suits brought by a tort claimant. In some instances, however, the insured and the tort claimant have joined forces to fight the insurer. This is normally the case where the insured is potentially faced with a verdict that may expose its personal assets. More precisely, this situation typically arises where the insurer decides not to defend the insured at all or where it provides a defense under a reservation of rights. Even when the insurer decides to defend the suit unconditionally, there may come a time when the insurer does not want to settle the suit for the policy limits. At that point, the insured may believe that its personal assets may be exposed if the lawsuit proceeds to trial.

When the insured realizes that its personal assets may be exposed because the insurer has refused to settle for the policy limits, has declined to provide a defense, or has provided a defense under a reservation of rights, it oftentimes seeks to join forces with the tort claimant by entering into a stipulated judgment coupled with a covenant not to execute the judgment against the insured's personal assets. Simultaneously, the insured normally assigns some or all of its rights that it may have against the insurer to the tort claimant for claims sounding either in tort or in contract.

The above stipulated judgments are commonly referred to either as "Miller-Shugart Agreements" or "Morris Agreements." They are named after *Miller v. Shugart*, 316 N.W.2d 729 (Minn. 1982) and *United Service Auto. Ass'n v. Morris*, 741 P.2d 246 (Ariz. 1987), the two leading cases in this area. In addition, they have also been referred to as "Damron Agreements," named after the third influential decision in this area. *See Damron v. Sledge*, 460 P.2d 997 (Ariz. 1969).

The offer to enter into a stipulated judgment is an attractive proposal from the perspective of a tort claimant because the insurer is usually seen as the deep pocket. In some instances, the tort claimant is relieved of the sometimes onerous task of establishing the liability of the insured after entering into such an agreement. Even if the parties decide not to enter into such an agreement, the threat that the insured is considering such an agreement might force an insurer into settling the underlying lawsuit.

This article analyzes how the courts have reacted to stipulated judgments entered into by the insured without the consent of

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the insurer. It also discusses some of the defenses available to the insurer.

Discussion

The liability insurance policy imposes certain obligations on both the insured and the insurer whenever the insured makes a claim under the policy. These obligations seek to protect both the interests of the insurer and the insured who are parties to the insurance contract. The insurer rightfully wants to pay out only those claims that fall within the coverage grant of the policy as the parties agreed. The insured's interest is to protect itself from unknown risks that may result in its liability in an amount greater than what it can afford to pay. 22 Eric Mills Holmes, Holmes' Appleman On Insurance 2d §136.1, at 3, 8–10 (2003) (hereinafter "Appleman"). To that end, the policy mandates that the insurer should 1) provide a defense for the insured; 2) indemnify the insured whenever appropriate against any judgment within the policy limits; 3) deal fairly and in good faith with the insured; and 4) accept a reasonable settlement made by a tort claimant in order to shield the insured.

As for the insured, its primary duty in the event that a claim is made is to cooperate with the insurer in its investigation of the claims brought by the tort claimant. *Id.* §138.2, at 222–23. "The purpose of the cooperation clause is not only to obviate the risk of collusive conduct between the insured and the injured party, but also to restrain the insured from voluntary action materially prejudicial to the insurer's ability to defend claims made under the policy." *Id.* at 223. Additionally, the insured is generally not permitted to settle the lawsuit independently without the consent of the insurer so that the insurer does not end up insuring a risk that it never intended.

When the Insurer Refuses to Provide a Defense at All

In a Miller-Shugart Agreement, the insured agrees with the tort claimant that judgment may be entered against it, after the insurer has denied all coverage, in return for the tort claimant releasing the insured from any personal liability. The courts are receptive to the argument that an insured can take steps to protect its personal assets from being exposed by entering into a stipulated judgment after the insurer has refused to defend the lawsuit. *See id.* §143.3, at 557 (discussing the effect of the wrongful refusal to defend on coverage). An example of such a situation is *Black v. Goodwin, Loomis & Britton, Inc.*, 681 A.2d 293, 302 (1996).

In *Black*, White, Wheeler and Company, hereinafter "White," was a framing contractor that obtained a commercial liability policy from Maryland Casualty Company, hereinafter "Maryland," for the total amount of $500,000. *Id.* at 295. White's employee, while the policy was in effect, fell through an uncovered chimney shaft while working. The employee died the next day. *Id.* The decedent's estate brought a wrongful death suit against White, and White tendered a request for a defense from Maryland. Maryland, however, declined to defend the lawsuit. *Id.* at 299.

Subsequently, White entered into a stipulation in settlement of the wrongful death action in the amount of $500,000, including interest for damages stemming from the decedent's death. *Id.* at 296. In addition, White assigned to the decedent's estate its rights against Maryland for its refusal to defend and to provide coverage for the underlying wrongful death suit. In return, the decedent's estate agreed to seek satisfaction of the judgment only against Maryland and thereby released White "from further liability regarding the payment and satisfaction of this judgment." *Id.* In accordance with the parties' agreement, the trial court entered judgment.

Following the stipulated judgment, the decedent's estate brought suit against Maryland for, among other things, breach of contract, negligence and bad faith. *Id.* at 296–97. As a special defense, Maryland asserted that "plaintiff's agreement not to seek satisfaction of the stipulated judgment against White created 'no enforceable rights [in the plaintiff] to the assignment or judgment' and that 'the assignment and judgment are void and against public policy as they were obtained by collusion' between the plaintiff and White." *Id.* at 297. A jury returned a verdict for the plaintiff on all counts.

On appeal, Maryland argued principally that the stipulated judgment entered into between White and the tort claimant is contrary to public policy because it would promote fraud or collusion between the insured and the tort claimant. *Id.* at 298. It argued further that by providing a release to White, the tort claimant could not recover from Maryland because White had no obligation that would require Maryland to indemnify it. *Id.* at 299.

The court rejected Maryland's argument that the covenant not to sue executed by the tort claimant released it also from liability because the insured was not "legally obligated" to pay the judgment. *Id.* at 299–300. The court reasoned that Maryland's argument was flawed because the policy in question was plainly "one of liability rather than indemnity." *Id.* at 300.

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The court also rebuffed Maryland's argument, based upon public policy grounds, noting that "[u]nder the majority view, when an insurer breaches its contractual duty to defend and, as a result, improperly leaves its insured to fend for itself, the insurer will not be heard to complain when the insured enters into a settlement agreement 'so long as the insured acts in good faith, and without fraud.'" *Id.* 299. (citing 7 C J. & J. Appleman, Insurance Law and Practice (1979) §4690, at 229.) However, the settlement entered into by the insured must be reasonable. *Id.*

While the court recognized that there was a possibility for fraud and collusion between the tort claimant and the insured, its solution was to permit the insurer to challenge the judgment on the ground that it was not properly obtained. *Id.* As the court indicated, our system is equipped with traditional tests of credibility, testimony under oath, and cross-examination that are more than adequate to provide protection against fraudulent claims. *Id.* Accordingly, the court declined to find that the stipulated judgment was void as against public policy. *See also Sledge*, 460 P.2d at

998 (holding that an insured is permitted to enter into an independent settlement when the insurer refuses to defend the lawsuit.); *Polaroid Corp. v. Travelers Indem. Co.*, 610 N.E.2d 912 (1993) (settlement entered into by insured following insurer's refusal to provide a defense may be assumed to be reasonable.)

If the assignment serves as a complete release of the insured, the insurer may be released as well.

When the Insurer Provides a Defense under a Reservation of Rights

The insured's personal assets are usually put at risk when an insurer defends an insured against a claim by a tort claimant, but reserves the right to dispute whether the claim is covered under the policy. While an insurer with a good faith policy defense has a right to dispute coverage, the insured is nevertheless placed in a "precarious position." *Morris*, 741 P.2d at 251; *see also* Appleman §136.7, at 49 (stating that, "if the insurer has reserved its right to deny coverage, the insurer cannot compel the insured to surrender control of the litigation"). Similarly, when it is being defended under a reservation of rights, the insured faces the possibility that any judgment, even one within policy limits, may not be covered by the policy. *Id.* Moreover, while the insurer is liable up to the policy limits, the insured's potential liability is limitless. Recognizing the potential for exposure, the *Morris* court permitted the insured to enter into such agreements with the tort claimant. *Id.*

More particularly, in *Morris*, the court attempted to find a balance that would protect both the insured and the insurer that rightfully defends, under a reservation of rights, where its indemnity obligations are unclear when suit is filed. To protect the insurer's rights, it held that the insured must provide timely notice to the insurer that it intends to enter into such an agreement. If the insurer, after receiving notice, decides to provide an unconditional defense, then the cooperation clause in the policy serves as a bar to such agreements. *Morris*, 741 P.2d at 252.

The *Morris* court also recognized the potential for collusion and fraud by allowing an insured to enter into a stipulated judgment coupled with a covenant not to sue because the insured in that context has little incentive to minimize the amount of the judgment. It resolved this conflict by holding that "neither the fact nor amount of liability to the claimant is binding on the insurer unless the insured or claimant can show that the settlement was reasonable and prudent." *Id.* at 253.

When the Insurer Does Provide a Defense

Even when the insurer decides to provide a defense, some courts have permitted the insured to assign its right to a tort claimant under some limited circumstances. *See*, *e.g.*, *Mello v. General Insurance Co.* 525 A.2d 1304 (R.I. 1987). In *Mello*, the injured party recovered an excess judgment of over $120,000. *Id.* at 1305. The insurer paid the policy limits of $100,000; however, it refused to pay the excess judgment. The insured, in turn, assigned its right to pursue the insurer to the tort claimant because of the insurer's alleged failure to settle within the policy limits. The insurer argued vehemently that the assignment was improper as a matter of law because an action for bad faith is personal to the insured and thus cannot be assigned. *Id.*

The court noted that as a general policy, it does not advocate the assignment to sue an insurance company for bad faith. It made, however, an exception for the situation where the insurer failed to accept multiple offers to settle within the policy limits. *Id.* at 1306. This is because the insured would then be required to institute a separate action against the insurer for bad faith because of its refusal to settle within the policy limits. Under such circumstances, the court held that "an insured may assign its bad-faith claim against its insurer to the injured claimant for the limited purpose of recovering the difference between the judgment received against the insured and the insurance-policy limits." *Id.*; *see also Consolidated American Insurance Co. v. Mike Soper Marine Services*, 951 F.2d. 186 (9th Cir. 1991).

The Insurer Is Not without Defenses to an Insured's Assignments of Its Claims to a Tort Claimant

Generally, insurers have raised numerous objections to stipulated judgments in which they have not given consent. Typically, they argue that these agreements are against public policy, that they constitute a violation of the cooperation clause of the insurance policy, the release of the insured by the tort claimant constitutes a release of the insurer, and that such agreements constitute a breach of the nonassignment clause of the policy. J. Harris, Note, *Judicial Approaches to Stipulated Judgments, Assignments of Rights, and Covenants Not to Execute in Insurance Litigation*, 47 Drake L. Rev. 853, 872–74 (1999). Insurers have argued further, when supported by the facts, the stipulated judgments were obtained through fraud and collusion. *Id.*

Notably, the courts are more likely to find that an assignment is invalid where:

> the insured's assignment of his or her claims against the insurer to the injured party is made prior to an adjudication of the injured party's claim against the insured in a fully adversarial trial, the insurer has tendered a defense, and either: the insurer has accepted coverage, or the insurer has made a good faith effort to adjudicate the coverage issues prior to the adjudication of the injured party's claim.

Appleman §142.1, at 488–89.

Likewise, if the assignment serves as a complete release of the insured, the insurer may be released as well because liability policies typically provide the insurer is only contractually obligated to pay the amounts that the insured becomes "legally obligated" to pay because of an incident or occurrence. *Id.* at 489. Some assignments, which have not reserved the tort claimant's rights to pursue the insurer, have been held to be invalid on the ground that a release of the insured also serves as a release of the insurer. *Id.* (citing *Fidelity & Casualty Co. v. Cope*, 462 So.2d 459, 461 (Fla. 1985) (when the injured party releases the insured from all liability prior to assignment of the insured's rights against the insurer, the release has the effect of extinguishing the insured's liability and, therefore, all of the insured's rights against the

insurer that are subject to assignment); *Freeman v. Schmidt Real Estate & Ins.*, 755 F.2d 135, 138 (8th Cir. 1985) ("an injured protected by a covenant not to execute has no compelling obligation to pay any sum to the injured party; thus, the insurance imposes no obligation on the insurer."); Harris, *supra*, at 858 (noting "most recent decisions concerning the use of this procedure do not even address the question of whether the provider is 'legally obligated to pay' under the terms of its policy").

However, the same cannot be said when the covenant not to execute explicitly preserves the right of the tort claimant to pursue the insurer. Under the latter circumstances, the courts have often held that the insurer is not released. Appleman §142.1, at 488–89. The latter result is based on the view that a covenant not to execute does not completely deprive the tort claimant of its right to execute on the judgment. Rather, it simply deprives the tort claimant of one of its avenues to recover on the judgment. *Id.*

Moreover, some insurers have successfully defended against the assignments of the insured's rights under the liability policy by arguing that the assignment is made prior to the entry of a judgment against the insured. *Id.* §142.1, at 486. More particularly, they argue that the "no-action" clause in the policy prohibits such suits until the satisfaction of certain preconditions such as obtaining a judgment against the insured. *Id.* §143.1 at 528. Other courts have permitted assignment of the insured's rights prior to the entry of judgment, but have held that the tort claimant's right is not ripe until judgment is entered. *Id.* §142.1, at 486.

The defenses that may be available to an insurer vary, depending on the jurisdiction. It is important, however, for an insurer to defend itself vigorously when its insured has entered into a stipulated judgment without its consent because such assignments may have implications for coverage. In some instances, the insurer may be precluded from contesting the facts stipulated to in the underlying suit relating to the insured's liability. *Id.* §143.2, at 542. Depending on the applicable jurisdiction, the insurer's only recourse may be to litigate whether there is coverage and whether the settlement entered into by the insured was reasonable and prudent. *Id.* §142.1, at 490. While the tort claimant must generally make an initial showing that the settlement/judgment was reasonable and prudent, the burden nevertheless shifts to the insurer to demonstrate that the stipulated judgment was the result of fraud and/or collusion. *Id.* §142.1, at 488.

Conclusion

The stipulated judgment tool is an effective weapon that the insured might attempt to use to coerce an uninformed insurer into settlement. An insurer that seeks protection from such a threat should carefully examine its policies and the law from the applicable jurisdiction to make the best use of the "no-action" clause, the cooperation clause found in most policies, and other available defenses.

The insurer, when faced with an un-consented assignment situation, should look for several issues that might become important: whether the assignment is made prior to an adjudication of the insured's claim in a fully adversarial trial; the type of defense that has been provided to the insured prior to the assignment; and its efforts to adjudicate the issues concerning coverage prior to adjudication of the tort-claimant's claim. An insurer that is providing a defense to the insured should move quickly to try to resolve any coverage issues to do away with the insured's ultimate argument that it was exposed to an excess verdict that it didn't have the means to pay.

Equally important, the insurer should document its good faith efforts to ensure that the insured's personal assets are not exposed by carefully considering good faith settlement offers. It should also communicate its reasons clearly as to why it chooses not to accept unreasonable offers to settle. Lastly, the insurer should be cautious in the manner that it participates and/or negotiates with the insured upon learning that the insured is contemplating whether to enter into a stipulated judgment with the tort claimant. This is necessary to avoid the insurer's actions being construed as consent to such agreements. FD