

Insureds' options when their insurers refuse to settle: Massachusetts high court weighs in

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Liability insurance has been described as the fuel that drives the American tort system.

The aptness of this metaphor is nowhere more evident than in the willingness of plaintiffs to enter into settlements or uncontested judgments that insulate defendants from all personal liability in exchange for defendants' rights, both contractual and extra-contractual, against their liability insurers.

The sometimes-irresistible appeal of such no-personal-liability settlements is understandable in light of the dynamics of many civil lawsuits.

In many cases, a defendant's only significant executable asset is an insurance policy. Thus, neither side has anything to lose.

When the parties settle early and the plaintiff acquires the defendant's insurance rights, both the plaintiff and defendant avoid the burden, delay, expense and risk of a trial. Moreover, the defendant's liability insurer typically presents a far more inviting, less sympathetic target in a plaintiff's subsequent bad-faith suit as the defendant's assignee.

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In *Commerce Insurance Co. v. Szafarowicz*, 131 N.E.3d 782 (Mass. 2019), the Supreme Judicial Court of Massachusetts was not asked to enforce an assigned no-personal-liability stipulated judgment against the insured's liability carrier. Nonetheless, the court's opinion announced a rule for determining when such judgments are enforceable.

The court held that the insurer was obligated to pay post-judgment interest only on the amount of the stipulated judgment that was valid and enforceable.

In deciding how much of a \$7.7 million judgment was valid and thus subject to post-judgment interest, the court ruled a no-personal-liability stipulated judgment against an insured coupled with an assignment to the tort victim of the insured's insurance policy rights is enforceable against the insurer only if:

- The insurer is given notice of the settlement/assignment agreement and an opportunity to be heard by the court before judgment enters.
- The insurer contests the judgment.
- The insured, after a hearing, shows that the settlement amount is reasonable.

The court ruled that a proper reasonableness review must assess the reasonable compromise value of the claim in light of the ultimate goal of enforcing the judgment against the insurer and the risks of going to trial. This commentary examines the reasoning and implications of the court's decision.

BACKGROUND

Szafarowicz arose out of a verbal altercation in a bar between David Szafarowicz and the insured, Matthew Padovano. After they left the bar, a car driven by Matthew Padovano and owned by his father, Stephen Padovano, struck and killed Szafarowicz in the bar's parking lot.

Matthew Padovano pleaded guilty to voluntary manslaughter.

Commerce Insurance Co. insured the Padovano vehicle under a policy that provided \$20,000 in compulsory liability insurance for bodily injury to others and \$480,000 in optional liability insurance.

The optional coverage applied only to accidental bodily injury, while the compulsory coverage was not limited to accidental injury.

The Szafarowicz estate and the Padovanos, on one hand, and Commerce, on the other, therefore had conflicting interests with respect to the development of the evidence surrounding the collision in the parking lot. A finding that the collision was accidental would result in an additional \$480,000 in recovery from Commerce.

WRONGFUL-DEATH AND DECLARATORY RELIEF ACTIONS

When Szafarowicz's estate sued the Padovanos for wrongful death, Commerce acknowledged its duty to defend.

However, it reserved its right to refuse to indemnify the Padovanos beyond \$20,000 for damages arising from the wrongful-death action if it were determined that Szafarowicz's death was caused by Matthew Padovano's intentional act and was therefore not the result of an "accident" covered by the policy.

Commerce also brought a separate action seeking a declaratory judgment that it had no duty to indemnify under its policy's optional coverage provisions on the ground that Szafarowicz's death resulted from Matthew Padovano's intentional act and thus was not an "accident" within the meaning of its policy's insuring agreement.

COMMERCE SEEKS INTERVENTION AND STAY

The parties' conflicting views of the circumstances surrounding the fatal collision came into clear focus when Commerce sought to intervene in the wrongful-death action.

Relying on the summary of evidence proffered by the prosecutor at Matthew Padovano's plea hearing in the criminal proceeding, Commerce maintained that the altercation between Szafarowicz and Padovano escalated in the bar's parking lot.

The potential for a factual finding at trial that would undermine coverage, such as a finding regarding the nature of the insured defendant's conduct, will lower the reasonable settlement value of the claim.

Szafarowicz allegedly gestured at Padovano, who responded by aiming his car at Szafarowicz and accelerating, prosecutors said.

Commerce contrasted the prosecutor's version of events with the estate's description in the wrongful-death action. Characterizing the incident as accidental, the estate contended that Padovano was frightened by unknown people who came from the bar with knives. It maintained that Padovano did not see Szafarowicz when he ran over him.

Commerce argued that it should be permitted to intervene because neither the estate nor the Padovanos had any incentive to offer evidence tending to show that the incident was intentional. Although acknowledging that Commerce had reason to be concerned about "underlitigation" in the wrongful-death suit, the trial court denied the insurer's motion.

The court reasoned that intervention would "severely compromise[]" the Padovanos' ability to defend themselves and alert the jury to the possible existence of insurance coverage.

After the denial of its motion to intervene, Commerce moved to stay the wrongful-death trial until after the question of insurance coverage was resolved in the declaratory judgment action.

Another judge denied the motion.

SETTLEMENT WITHOUT INSURER'S CONSENT

Shortly before the wrongful-death trial was scheduled to begin, the estate and the Padovanos agreed to settle the wrongful-death suit. Under the settlement agreements, Matthew Padovano agreed that he "grossly negligently" caused Szafarowicz's injuries, and Stephen Padovano admitted liability for negligent entrustment of the vehicle.

The parties agreed that damages would be determined in a jury-waived proceeding. *The estate agreed that it would not seek to collect or enforce any judgment against the Padovanos beyond the amount payable under their insurance policy*, and the Padovanos agreed both to assign to the estate all their rights with respect to insurance coverage and to cooperate with the estate in litigation related to insurance coverage.

The trial court overruled Commerce's objections to the settlement and conducted a hearing to assess the estate's damages.

Following the hearing, the court entered judgment for the estate in the amount of nearly \$7.7 million (damages of \$5.5 million plus \$2.2 million in prejudgment interest).

LIMIT ON POST-JUDGMENT INTEREST SOUGHT

In an attempt to stop the accrual of post-judgment interest on the wrongful-death judgment during the pendency of the declaratory judgment action and its appeal from the wrongful-death judgment, Commerce sought the court's permission to deposit with the court — or, in the alternative, to deposit in an interest-bearing account — the policy limit of its optional bodily injury coverage (\$480,000), plus already accrued post-judgment interest.

By doing so, Commerce hoped to avail itself of a policy provision that terminated the obligation to pay post-judgment interest that accrues "after we have offered to pay up to the limits you selected."

Given the size of the judgment in the wrongful-death action, the stakes in the dispute over post-judgment interest were significantly higher than in the declaratory judgment action. Recall that the estate agreed to limit its recovery in the wrongful-death action to the amount payable under the insurance policy.

So, the most Commerce could be compelled to pay under its contractual duty to indemnify was \$480,000, the limit of the policy's optional coverage.

However, Commerce's contractual duty to pay post-judgment interest was based on its duty to defend, not its duty to indemnify.

The policy obligated Commerce to pay post-judgment interest "in any suit we defend," and Commerce acknowledged that it had a duty to defend the estate's wrongful-death suit.

Thus, even if Commerce were to prevail in the declaratory judgment action, eliminating its duty to indemnify altogether, it still faced liability for post-judgment interest. That liability was significant: Accruing at the 12% annual rate established by statute, interest on the wrongful-death judgment amounted to more than \$920,000 per year from the date of the judgment.

The court noted that the interest policy provision, which is set by state law, has been revised so that under current auto policies the insurer is only required to pay post-judgment interest on an amount of a judgment up to the policy limit. But that revision did not apply to Commerce in this case.

Relying on *Davis v. Allstate Insurance Co.*, 747 N.E.2d 141 (Mass. 2001), the trial court denied Commerce's motion to deposit the optional policy limits, thereby leaving the insurer exposed to liability for post-judgment interest on an award it had no contractual obligation to pay if it prevailed in the declaratory relief action.

In *Davis*, the Massachusetts high court held that to stop the accrual of post-judgment interest, the insurer must make an unconditional offer of payment of the full policy limit plus the accrued post-judgment interest.

Here, the offer of payment of the optional bodily injury coverage limit was conditional because Commerce expected its \$480,000 deposit to be returned if it prevailed in the declaratory judgment action.

COMMERCE PREVAILS IN DECLARATORY JUDGMENT ACTION

Following a bench trial in Commerce's declaratory relief action, the judge ruled that Commerce had no duty to indemnify the Padovanos for any claims arising from the optional bodily injury coverage of its automobile policy.

Matthew Padovano "decided to hit the accelerator of the vehicle knowing to a substantial certainty that the vehicle would strike" Szafarowicz, and therefore Szafarowicz's "injuries and death did not arise out of an accident under the policy," the judge said.

As a result of that declaratory judgment, Commerce has no obligation to pay any amount of the \$7.7 million judgment

in the wrongful-death action beyond the \$20,000 it already paid under its compulsory bodily injury coverage.

Neither the estate nor the Padovanos appealed the ruling in the declaratory relief action. Consequently, the issue of whether Commerce had any obligation to pay the judgment in the wrongful-death action was not before the court. The reasonableness of the judgment was, however, relevant to other issues before the court.

ISSUES ON APPEAL AND HOLDINGS

Despite prevailing in the declaratory relief action, Commerce still had an obligation to pay post-judgment interest on the judgment in the wrongful-death action.

Commerce therefore sought appellate review of the scope of its obligation to pay post-judgment interest and of the trial court's previous denial of its motions to intervene in, or stay, the wrongful-death action.

Recognizing the importance of the issues raised, the Supreme Judicial Court of Massachusetts transferred the case to its own docket on its own motion.

The Supreme Court rejected Commerce's contention that the trial court abused its discretion in refusing to allow the insurer to intervene in the wrongful-death action.

It reiterated the trial court's reasoning, described above, and added that Commerce was not prejudiced by the court's decision on intervention because the judge in the declaratory relief action independently determined that Szafarowicz's injuries and death were caused by intentional conduct.

However, the Supreme Court reversed and remanded the trial court's holding that Commerce was obligated to pay post-judgment interest on the full amount of the judgment in the wrongful-death action.

The court did so despite finding that the trial court acted properly in refusing to allow Commerce to deposit its policy limits under the reasoning of *Davis v. Allstate Insurance Co.* The trial court's mistake was to presume the wrongful-death judgment was binding despite the absence of a judicial finding of the judgment's reasonableness.

The court therefore vacated the judgment and remanded the case for a determination of reasonableness.

This aspect of the Supreme Court's opinion is likely to have far-reaching implications for the right of liability insurers to control settlement of suits against their insureds while reserving the right to contest coverage.

VALIDITY OF NON-PERSONAL LIABILITY SETTLEMENTS/ASSIGNMENTS

At the outset, the Supreme Court made short work of Commerce's argument that settlements entered into without

the insurer's consent are never enforceable in light of policy language that states, "If any person covered under this policy settles a claim without our consent, we will not be bound by that settlement."

In the court's view, the policy's consent-to-settlement clause protects the insurer against settlements reached without its consent only if the insurer acknowledges its duty to indemnify and suffers material, actual prejudice from the settlement.

The Supreme Court held that "where, as here, the insurer agrees to pay for the defense of a claim against an insured under a reservation of rights, and thereby reserves its right to seek a declaration from a court that it owes no obligation to indemnify the insured for damages arising from the claim, the insurer has no right to control the defense with respect to the settlement of the claim."

Such a rule is necessary, the court explained, to allow policyholders to mitigate the risk of financial ruin when an insurer contests coverage.

Refusing to join the "minority of states" that allow the insurer to retain control of settlement as long as the insurer honors its duty to defend, the court held "that an insurer who defends a claim under a reservation of rights is bound by the amount of a judgment arising from a prejudgment settlement/assignment agreement where:

- The insurer is given notice of the settlement/assignment agreement and an opportunity to be heard by the court before judgment enters.
- The insurer contests the judgment.
- The insured, after hearing, meets his or her burden of showing that the settlement is reasonable in amount."

Here, the trial judge's determination of the amount of damages that would have been awarded in a bench trial did not qualify as a reasonableness review.

A proper reasonableness review would have asked the reasonable compromise value of the claim in light of the risks of going to trial — and particularly the risk of a finding that Matthew Padovano intentionally ran over Szafarowicz, which would have undermined insurance coverage.

Accordingly, the court remanded the case for a proper reasonableness determination and ordered that post-judgment interest will accrue nunc pro tunc from the date of the original judgment on the amount that the court deems reasonable.

COMMENT

The Supreme Court suggests that coverage issues are a critical factor in a reasonableness determination in light of the plaintiff's ultimate goal of enforcing the judgment against the insurer.

The potential for a factual finding at trial that would undermine coverage, such as a finding regarding the nature of the insured defendant's conduct, will lower the reasonable settlement value of the claim.

In the context of this case, the court went as far as to say, "Because the consequence of a settlement/assignment agreement is that the plaintiff may collect damages only from the insurer, having released the insured defendants from personal liability, a reasonable settlement amount may not exceed the limits of the insured's potential insurance coverage, because the plaintiff may recover in damages no more than that from the insurer."

The court's statement that a settlement value in excess of policy limits is per se unreasonable is understandable in light of the absence of evidence of extra-contractual liability for insurance bad faith and the estate's promise that it would not seek to collect or enforce any judgment against the Padovanos beyond the amount payable under their insurance policy.

However, the court's statement that "a reasonable settlement amount may not exceed the limits of the insured's potential insurance coverage" arguably is dicta.

Because the criminal proceeding provided strong evidence of the intentional nature of Matthew Padovano's conduct and Commerce ultimately prevailed on its coverage defenses, the estate could not effectively argue that Commerce acted unreasonably in reserving its rights and refusing to settle.

But there are times when it is not in the interests of the parties to settle within the policy limits. When an insurer refuses to settle within policy limits despite evidence suggesting a substantial likelihood of a judgment in excess of policy limits, the insured (or the claimant as the insured's assignee) may sue the insurer under Mass. Gen. Laws ch. 93A for the amount of any resulting excess judgment and treble damages.

Massachusetts courts have permitted policyholders to settle such claims for an amount in excess of policy limits in exchange for a release against the policyholder and an assignment of rights against the insurer. The *Szafarowicz* decision does not address whether stipulated judgments in excess of policy limits are reasonable in that situation.

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