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CLM 2016 National Construction Claims Conference
September 28-30, 2016
San Diego, CA

Navigating Consent Judgments

Summary/Description:

The discussion will include consent judgments and the ethical duties of counsel. We will discuss the tripartite relationship, managing consent judgments, and the pros and cons of the consent judgement for the client and the carrier. When faced with coverage issues, an option for an insured is to enter into a consent Judgment. Sometimes this is done with the participation of a carrier(s) and sometimes without. Either way, this is an area that is laden with pitfalls and ethical dilemmas.

I. Consent Judgments, Confession of Judgment, Stipulated Judgment, Consent Decree

Consent Judgment, confession of judgment, and consent decree are some of the names generally referring to agreements between the parties that result in an enforceable judgment and the end of the lawsuit. This is in lieu of, or in addition to, a settlement agreement. There are often conditions to enforcing the judgment. These judgments could also include a covenant not to execute the judgment.

In the insurance context, these type of judgments usually occur when an insurer does not defend or settle a claim or lawsuit. In the Construction Defect arena, what normally occurs is that the insured will enter into an agreement with the party that brought claims against it. The agreement will include a judgment, an agreement not to execute the judgment, and an assignment of the insured's rights against its insurer and other parties. Depending on the state, the procedure from that point on differs. *Litigating the Consent Judgment Case—A 50 State Overview*, Catalina J. Sugayan et al., 185-206, 185 (Mar. 2015) provides a multi-state overview.

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II. Different States, Different Rules

A. Washington

RCW 48.01.030 places a burden on both the insured and the insurer to act in good faith. RCW 4.22.060 further requires a reasonableness hearing for a judgment which contains a covenant not to execute. The courts in Washington has acknowledged that a covenant not to execute reduces the incentive of the insured to minimize the judgment. *Besel v. Viking Ins. Co.*, 146 Wn.2d 730. If the court concludes that a settlement is unreasonable, the court will determine what the reasonable settlement amount is. *Meadow Valley Owners Association v. St. Paul Fire & Marine Insurance Company,* 137 Wn. App. 810. The reasonableness is decided by the court, **not** the jury. In *Miller v. Kenny*, 180 Wn.App. 772, the Washington Court of Appeals held that a consent judgment sets the floor, not the ceiling, for damages that can be awarded in bad faith litigation. This allows for other bad faith damages other than the consent judgment.

B. Oregon

Until recently, Oregon did not look favorably upon consent Judgments. Oregon followed the *Stubblefield rule* which generally required a judgment on the merits and an insurance carrier's refusal to defend or indemnify before a consent judgment with a covenant not to sue and assignment of rights against the insurer could be entered into. *Stubblefield v. St. Paul Fire & Marine*, 267 Or 397 (1973). This was based on the concept that the insurer was only obligated to pay what the insured was "legally obligated to pay". *Brownstone Homes Condo Assn. v. Brownstone Forest Hts*., 358 Or 223 (2015) overruled *Stubblefield* and opened the door for consent judgments. Oregon, unlike Washington, does not require a reasonableness hearing. ORCP 71 C may allow a mechanism to get relief from a judgment. If the judgment is a judgment by confession, ORCP 73 has some requirements that the defendant sign, but it is unlikely that will be helpful to a carrier.

C. Arizona

Arizona refers to consent judgment as "*Damron*" or "*Morris*" agreements. *Damron v. Sledge, 105 Ariz. 151*; *USAA v. Morris*, 154 Ariz. 113. As in Washington, the Arizona courts have cautioned the potential for inflated damages. The Arizona Court of Appeals cautions that due to the risk of abuse in Morris agreements, a settlement will be unenforceable if there is no legal or economic support for it. *Leflet v. Redwood Fire & Cas. Ins. Co.*, 226 Ariz. 297.

The *Damron* agreement and the *Morris* agreement arise under slightly different circumstances. A *Damron* agreement arises when the insurer refuses to defend the insured in a claim that may or may not fall under policy coverage, or where the insurer chooses to defend and does not reserve any rights. *State Farm Mut. Auto Ins. Co. v. Peaton, 168 Ariz. 184*. A *Morris* agreement arises when the insurer defends its insured under reservation of rights.

The insured in Arizona has a duty to cooperate and cannot settle without breaching the cooperation clause, unless the insurer first breaches one of its contractual duties. *USAA v. Morris*. The insurer is entitled to reasonableness hearing when the insured enters into a *Morris* agreement. *Anderson v.* Martinez, 158 Ariz. 358; Monterey *Homes Arizona, Inc. v. Federated Mut. Ins. Co*., 221 Ariz. 351. The court will determine what is reasonable after hearing the evidence. The burden is on the Plaintiff, not the insurer, to prove reasonableness.

III. Pros and Cons of Consent Judgments

A. When to Use Consent Judgments

Consent Judgments can be used in different scenarios to achieve goals. As an insured, when faced with personal liability in litigation because a carrier has wrongfully failed to defend or is refusing to reasonably settle within policy limits, the consent judgment may be a life saver. Sometime the threat of a consent judgment might encourage a recalcitrant carrier to settle or defend. If the threat does not work, the consent judgment with a covenant not to execute will protect the insured from personal liability.

As a carrier, a consent judgment may be helpful when a co-carrier is refusing to defend or settle. The carrier may pay money towards the consent judgment and extinguish the liability of the carrier and its insured. It will also end the litigation and the cost of defense. It can be a good tool to fulfill the carrier's duties towards its insured and protect the insured.

B. Pitfalls of Consent Judgments

In many states, including Arizona and Washington, a reasonableness hearing will be conducted. If the consent judgment is too overreaching a court may find it unreasonable or fraudulent and reduce it. Before entering into the consent judgment, the parties need to make sure that the amount of the judgment is supported by the evidence.

Beware of consent judgments with excess carriers. If the consent agreement is set to trigger duties in excess carriers, this might be impossible in certain states without notice and exhaustion of the primary insurance. *Twin City Fire Ins. Co. v Burke*, 204 Ariz. 251.

Depending on the jurisdiction, a consent judgement might open the insurer's claim file or the coverage file and defense counsel evaluations. It may also result in discovery battles and

depositions of everyone including claims handlers. In some situations, consent judgments and bad faith litigation might result in the waiver of the attorney client privilege.

Tit for Tat. If you are a carrier encouraging a consent judgment, be prepared to have the same carrier in a different case use the tactic against you.

C. Pros of Consent Judgments

A consent judgment is a tool, that if properly handled, can extinguish the liability of the insured and the defending insurer.

A consent judgment may also be a tool to go after subcontractors and their insurance carriers in a construction defect case.

D. Protection From and Challenging Consent Judgments

The best protection from a consent judgement is an early defense and careful and thoughtful evaluation of coverage disputes.

If you are an excess carrier, you might want to hire monitoring counsel. If you are a primary carrier, be on the look out and be aware of demands to settle sent by coverage counsel or defense counsel.

If the insurer believes collusion or fraud is occurring in the obtaining of the consent judgment, then request discovery regarding the settlement discussions between the parties involved in the consent judgment. If you believe the amount in the consent judgment is unreasonable, be ready to present evidence, including expert evidence, showing the unreasonableness of the amount.

If the insurer was not given an opportunity to settle the claim before a judgment is entered into, they might be able to use this as a defense to a bad faith claim.

IV. Ethical Duties of Counsel, Adjusters and Insureds

A. Coverage Counsel

Coverage counsel for both the insured and the insurer have one client only, the insured or the insurer. This makes their ethical obligations to their client clear in the context of a consent judgment. Coverage counsel for the insured needs to make sure that the client complies with the policy cooperation and notice clauses before entering into a consent judgment, but owes the insurer no duties.

Coverage counsel for the insurer needs to be aware of the jurisdiction's bad faith laws and assist the client in avoiding a bad faith trap. The counsel only has one client, the carrier. Following the recent case of *Cedell v. Farmers*, in Washington there is now a presumption that the claim file is discoverable in a bad faith action – this may include communication with counsel. Coverage counsel need to be clear in its role – that she/he is "not engaged in the quasi-fiduciary tasks of investigating and evaluating or processing the claim, but instead in providing the insurer with counsel as to its own potential liability; for example, whether or not coverage exists under the law".

B. Defense Counsel

Defense counsel's role in the consent judgment scenario is the more ethically ambiguous one. If defense counsel is hired directly by the insured, the role of counsel is clear cut. Counsel has one client only, the insured, therefore counsel does not have to balance the relationships between the insured and the insurer. If the defense counsel is hired by the carrier, the defense counsel needs to balance the Tripartite relationship they are in. American Bar Association Model Rules of Conduct – Rule 1.8 and 5.4 govern attorney behavior when a third party pays for the defense. A lawyer is prohibited from allowing the third party payor from directing or regulating the lawyer's professional judgment in representing the client. Depending on the state, "Who is the Client" differs. For example, in Oregon, the defense counsel has two clients with the primary client being the insured. In Washington, there is only one client, the insured.

If the defending insurer and its insured are on the same page and want to enter into a consent judgment, the defense counsel role is clearer. Counsel can assist in the negotiation. There are no cases directly on point regarding the role of defense counsel as it relates to consent judgments. If the insured wants to enter into a consent judgment that adversely impacts the defending insured, in most jurisdictions, especially ones like Oregon, where the insurer is also considered a client, defense counsel cannot act in a way that will negatively impact the insurer, therefore, counsel should not be participating in the defense. In states where there is one client only, the counsel may be able to advise the insured regarding the advantages and the disadvantages of the consent judgments. For a defense counsel faced with this dilemma, the safest route may be to recommend that both the insured and insurer hire coverage counsel to deal with the consent judgment. The other option is to withdraw as counsel, which risks adversely affecting the defense of the case.

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C. Insured

Insureds have a duty to cooperate with their insurance carrier. They also, depending on the policy, may have to request consent for the consent judgment.

D. Adjusters

Adjusters owe their insured a variety of duties including in states like Oregon a duty to settle. In addition, each state has requirements and deadlines that adjusters have to comply with. What might surprise some, is that in some states, the primary carrier may owe a duty to the excess carrier to settle and maybe exposed to bad faith litigation by the excess carrier for non-settlement.

V. Similar Tactics to Consent Judgments

A Loan Receipt is a different but related concept to that of consent judgment. It is another method that allows the insured, this time with the assistance of an insurance carrier, to settle or resolve a claim but allow a suit by the insured directly against a recalcitrant insurance carrier that either did not participate in the defense of refused to settle. The Loan Receipt is an acknowledgement of the insured receiving an interest free loan from the insurance company repayable to the insurance company to the extent of recover from a third party or insurer. *The Loan Receipt and Insurers' Subrogation--How to Become the Real Party in Interest without Really Lying,* J. Thomas Ray, Jr., 50 Tul. L. Rev. 115 (Nov. 1975) discuss the history of how the loan receipt concept was born.