SJC Addresses Whether and When Insured Can Settle Without Insurer's Consent and Limits on Enforceability Against Insurer of a Settlement to Which the Insurer Did Not Consent

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Case also determines when an insurer can stay a suit against the insured when there is a coverage dispute and whether paying the limits into court tolls the insurer's liability for interest

Commerce Insurance was confident that it was not obligated to indemnify Matthew Padovano and his father for a wrongful death suit under the latter's auto policy, beyond the policy's $20,000 compulsory limit. Commerce contended that Matthew's striking and killing another man with his car after an altercation at a bar had not been an "accident" within the meaning of the policy's $480,000 optional coverage.

Despite prevailing in a declaratory judgment action to establish its lack of coverage, however, Commerce found itself owing millions of dollars in post-judgment interest to the victim's estate.

Its appeal to the Massachusetts Supreme Judicial Court resulted in a decision this month providing guidance on the options available to insurers, policyholders, and tort plaintiffs when an insurer contests coverage for an underlying suit against an insured.

The Massachusetts Supreme Judicial Court held that trial court judge did not abuse his discretion by denying Commerce Insurance's efforts to limit its liability by intervening in the underlying case, staying it, or conditionally depositing its limits with the court. However, Chief Justice Ralph Gants wrote that Commerce was entitled to a judicial determination of the reasonableness of the insured's above-limits settlement agreement with the plaintiff entered into without Commerce's consent. In particular, the insurer would not be bound by the agreement of the claimant and the insureds that the insureds had been grossly negligent, and the amount of the settlement could not exceed policy limits. However, the high court left to a trial judge's discretion whether an insurer may intervene in a tort suit or seek to stay it pending a coverage determination, and foreclosed insurers from conditionally depositing their limits with the court pending such a determination in order to stop the accrual of post-judgment interest.

Commerce's Efforts to Get Out of the Case

Following a verbal altercation at a bar in Leominster, David Szafarowicz was struck and killed by a vehicle operated by Matthew Padovano, who later pleaded guilty to criminal charges of voluntary manslaughter. The vehicle was owned by Padovano's father, and insured by Commerce, whose policy provided $20,000 in compulsory insurance and $480,000 in optional insurance for bodily injury. The policy also obligated the insurer to pay post-judgment interest on any case it defended, unless it had "offered to pay up to the limits" of the policy.

Despite the driver's criminal plea, the subsequent wrongful death claim brought by Mr. Szafarowicz's estate against Matthew Padano and his father alleged only negligence, avoiding allegations of intentional conduct. Commerce undertook the defense of the wrongful death suit, acknowledging coverage up to the policy's limit of $20,000 (the Massachusetts compulsory auto coverage limit) but reserved its rights to disclaim coverage for the additional optional limit given the evidence that the incident fell outside of the policy's definition of a covered "accident."

While the wrongful death suit was pending, Commerce brought a declaratory judgment action against the Padovanos and the Szafarowicz estate, seeking a declaration that Commerce had no obligation under its optional insurance coverage to indemnify the Padovanos in the Szafarowicz suit. However, the trial in the wrongful death action loomed before the declaratory judgment matter was decided. Commerce then made a series of efforts to avoid being bound by the outcome of that trial.

First, Commerce sought to intervene in and participate in the trial, arguing that the case would be "underlitigated" otherwise since neither of the parties had any incentive to bring in evidence of Padovano's intentional conduct and thus forfeit insurance coverage for any judgment.

The trial court denied intervention, but ruled that the insurer would have the opportunity to challenge a "potentially collusive" damages award in a subsequent declaratory judgment action, wherein a judge would determine whether the issues had been "fairly litigated" in the tort trial or whether Commerce was entitled to relitigate whether Matthew's conduct had been intentional or merely negligent. (Commerce

did not appeal the denial of its motion to intervene.)

Second, Commerce sought to stay the wrongful death trial pending a determination in the declaratory judgment case. That motion was also denied by the trial court.

The Settlement of the Underlying Suit and Tender of the Policy Limits Into Court

Before the wrongful death trial, the estate and the Padovanos entered into a settlement and assignment agreement. Matthew agreed that he "grossly negligently" caused David's injuries, and his father admitted to negligently entrusting him with the vehicle. They also agreed that damages would be determined by a judge, but that the estate could only collect any resulting judgment from Commerce, with the Padovanos assigning to the plaintiffs their rights against the insurer. Commerce objected to the agreements, but it was overruled, and following a hearing the judge entered judgment in favor of the Szafarowiczs in the amount of $5,567,510, plus prejudgment interest of $2,201,744.41.

Following the entry of judgment, Commerce made its third attempt to limit its liability. It sought to stop the accrual of post-judgment interest by paying the $20,000 compulsory coverage limit to the Szafarowicz estate and then depositing its $480,000 optional coverage limits with the court, plus the already-accrued post-judgment interest. However, Commerce's offer of the optional limit was not unconditional; if it prevailed in the coverage suit, it would seek the return of these funds. A judge ruled that a conditional offer was not sufficient to stop the clock on post-judgment interest, and denied this motion as well.

Commerce ultimately won the declaratory judgment action, obtaining a declaration that Matthew's conduct was not an "accident" under the policy's optional coverage. However, the policy provided that Commerce would pay "interest that accrues after judgment is entered in any suit we defend," meaning it remained liable for post-judgment interest on the entire $5,567,510 judgment entered against the Padovanos – even though it was not required to pay the judgment itself, and even though the accrued interest already exceeded the limits of the policy. (This provision is no longer standard in Massachusetts auto policy forms, which now only require insurer to pay post-judgment interest on the portion of a judgment that is within policy limits.)

SJC Provides Some Guideposts

The SJC's decision examines the parties' maneuverings in this (not unusual) situation where coverage is contested, but not resolved before resolution of the suit against the insured, and offers some guidance but few prescriptions for parties looking to get the upper hand in future fights between insurers and tort plaintiffs and defendants.

Motions to Intervene and Stay

The court largely agreed with the decisions of the trial court, excluding Commerce from interfering with or staying the wrongful death trial while defending its insureds under a reservation of rights. Commerce did not appeal from the denial of its motion to intervene, but the decision quotes with apparent approval the trial court's use of a "carefully balanced procedural solution" adapted from Maryland law, which permits the insurer to re-litigate facts in a subsequent coverage action in order to challenge a "potentially collusive damages award" where it is prevented from intervening in a tort suit.

Regarding Commerce's efforts to stay the wrongful death action, the trial court was within its discretion to deny the motion. A stay would delay resolution of the tort case until the declaratory judgment could be resolved and, if it were resolved in the insurer's favor, until the insured could retain new counsel. That could be "fundamentally unfair" to the plaintiff. However, the high court held, a trial judge in similar cases may consider "whether disposition of the tort action may be expedited, rather than delayed, by first resolving whether an insurer would be responsible for paying all or part of any settlement or judgment." Slip Op. at 18. On the other hand, a defense verdict in the tort action could render any declaratory judgment "moot." The trial judge has broad discretion to weigh these factors and fairness to all parties.

Settlement Without Consent

The court's treatment of the settlement and assignment agreement creates new limitations on the use of such agreements in the future – and another judicial review standard that will be honed in future cases.

The SJC held that the settlement itself was permitted despite the policy's provision requiring insurer consent, because the insurer was defending under a reservation of rights. "Where an insurer reserves its right to indemnify, the insured faces the risk that he or she alone will be responsible to pay the judgment. The insured is entitled to mitigate that risk by entering into a settlement that will either protect him or her from liability or diminish the amount of a judgment that he or she might be obligated to pay." Slip Op. at 27.

However, the SJC determined, first, that Commerce was "not bound by the parties' stipulation of negligence," and was not foreclosed from establishing in the declaratory judgment action that Padovano's acts were intentional rather than negligent.

Second, the court held that in order to bind an insurer who has not consented to pay damages agreed to in a settlement and assignment agreement, the agreement must be reviewed by a judge for reasonableness. Breaking with the minority of states that consider settlement and assignment agreements unenforceable in this context, the SJC required that an insured, facing its insurer's objections, show that "the settlement is reasonable in amount."

Critically, the standard for reasonableness of a settlement and assignment agreement is not limited to an assessment of an insured's exposure. Because its express purpose is to put the insurer on the hook for the entirety of any settlement amount, "having released the insured defendants from personal liability, a reasonable settlement amount may not exceed the limits of the insured's potential insurance coverage…." Slip Op. at 33.

The agreed judgment in the wrongful death case (determined by a judge with reference only to the facts of the case, not the insurance available) was many times larger than Commerce's policy limits. It was therefore unreasonable.

Although Commerce ultimately won the declaratory judgment action on its indemnity obligations, its contractual liability for post-judgment interest meant that the amount of the settlement was not a moot point. The SJC therefore remanded the case to the trial court for a hearing on a reasonable settlement amount – with post-judgment interest accruing on whatever smaller amount (within the $500,000 limits) was deemed to be reasonable.

Although the high court remanded for a determination by the trial court of what would have been a reasonable settlement amount in this case, it stressed that in future cases, the trial court would not be in the position of setting the amount. Rather, where an insurer challenges a settlement and assignment before judgment enters, a judge may decide only whether the amount agreed upon is reasonable, and if it is not, "invite the parties to renegotiate an agreement that might prove reasonable in amount." Slip Op. at 36-37.

Use of a Tender Into Court To Stop Liability For Post-Judgment Interest

Hoping to stop the accrual of post-judgment interest on the wrongful death judgment during the pendency of the declaratory judgment action, Commerce sought to deposit with the court $480,000, plus already accrued post-judgment interest, pursuant to Mass. R. Civ. P 67.

The SJC's previous decision in *Davis v. Allstate Ins Co*., 434 Mass. 174, 183 (2001), held that an insurer may stop the accrual of post-judgment interest by making "an unconditional offer of payment of the full policy limit, plus the accrued post-judgment interest," including by depositing those limits with the court. However, that method was not available here, the high court held, because Commerce's "offer of payment of the optional bodily injury coverage limit was not unconditional; Commerce would seek its return if it prevailed in the declaratory judgment action." Slip Op. at 15.

The judge did not abuse his discretion in denying Commerce's motion to deposit the funds with the court, because doing so would not have stopped the accrual of post-judgment interest, the high court held. The decision notes that the post-judgment interest provision of the standard auto policy was intended to "protect injured plaintiffs from unreasonable delays by insurers or, where delay arises from an appeal, to compensate the plaintiffs for that delay." Slip Op at 22-23. Permitting a conditional deposit of the proceeds to stop the accrual of post-judgment interest would undermine those goals.

The Takeaways

The decision hands some wins to policyholders and tort claimants and some to insurers. While the question of whether the insurer may interfere with the underlying trial remains in the trial judge's discretion, the opinion offers many reasons for the court to keep the insurer from staying an action or intervening to prevent collusive "underlitigation" when a declaratory judgment regarding coverage cannot be obtained quickly enough.

However, the ruling regarding settlement and assignment agreements provides some consolation for insurers: The trial court will be required to assess the reasonableness of an agreed judgment amount where an insurer has objected to a settlement and assignment agreement – and that amount may never exceed the policy limits.