Sticky Stipulations

What Insurers and Their Counsel Should Know About Consent Judgments

By Jeffrey N. Labovitch and Cody S. Moon

The circumstances under which an insured may properly agree to a consent judgment vary from state to state. An insurer will want to understand the various ways to challenge a consent judgment successfully.

Liability policies generally include consent to settlement clauses that give an insurer the right to negotiate and settle any claim or suit. As a condition to coverage, such policies forbid an insured from assuming any obligations or incurring any expenses without the insurer's consent, except at its own cost. These conditions grant an insurer the right to control settlement negotiations. While courts around the country universally recognize the contractual right of a liability insurer to negotiate and control the settlement of a potentially covered claim, some courts also recognize that an insurer's decision not to settle a claim could present a significant "hazard [to] the insured's financial well-being." *Cowden v. Aetna Casualty and Surety Co.*, 389 Pa. 459, 471, 134 A.2d 223, 226 (1957).

Reasoning that an insurer's right to control a settlement can conflict with an insured's interests, some courts—and even one state's legislature—permit an insured to settle around its liability insurer through a consent judgment when a claimant offers the insured a covenant not to execute against the insured's personal assets. The circumstances under which an insured may properly agree to a consent judgment vary from state to state. Insurers should be aware of the possibility that an insured may enter into a covenant not to execute and agree to entry of a consent judgment against it when an insurer conditions its offer to defend on a reservation of rights to deny coverage in whole or in part.

In this article we will (1) explain what covenants not to execute and consent judgments are, as well as their potential effect on an insurer's exposure: (2) provide examples of situations in which courts in different states have permitted an insured to enter into a covenant not to execute and agree to entry of a consent judgment; (3) discuss the ways in which an insurer

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may successfully challenge a consent judgment; and (4) offer practical tips for insurers to avoid unsupportable liability findings or unreasonable damage awards that often result from covenants not to execute and entry of consent judgments.

What Are Covenants Not to Execute and Consent Judgments?

A covenant not to execute is an agreement through which an injured claimant (as a result of bodily injury, property damage, personal and advertising injury, or other types of potentially covered damages) enters into an agreement with an insured tortfeasor only to seek to satisfy any judgment from the insured's available insurance and to release the insured from all personal liability. Depending on the jurisdiction, the covenant not to execute may also require the insured to pay a small sum in exchange for the release, admit liability for the claimant's damages, agree to forgo presenting evidence in a bench trial (and waive any prior jury demand), or assign any statutory or common law bad-faith claim (or the proceeds from such a claim) to the injured claimant, including contractual and non-contractual rights the insured may have against the insurer, or a combination of these. In addition, a covenant not to execute may include an express agreement by an insured tortfeasor to allow a judgment for a stipulated amount to be entered against the insured. Indeed, the Missouri legislature expressly recognized the permissibility of such an agreement when it enacted section 537.065 of the Missouri Revised Statutes (Mo. Rev. Stat.) in 1959, although the statute only applies to damages on account of bodily injury or death.

In numerous jurisdictions a claimant and insured tortfeasor will follow a covenant not to execute with the submission of a consent judgment (or a "judgment by stipulation") for entry by a court. The consent judgment is typically written to include a finding of liability against an insured and award a stipulated damage amount, which frequently equals or exceeds the limits of the insured's liability insurance. In some instances, a claimant's attorney may attempt to include findings of insurance coverage, including findings that the damages arose from an occurrence, which was neither expected or intended and is not otherwise excluded, or that the claimant is entitled to punitive damages and punitive damages are covered under the policy.

An insured's rights with respect to entering a covenant not to execute and consent judgment are state specific. Insurers should carefully review the laws of the applicable jurisdiction when considering issuing a reservation of rights and evaluating the likelihood of whether an insured may enter such an agreement. When researching the law in each jurisdiction, keep in mind that covenants not to execute and the resulting consent judgments tend commonly to be named after and referred to by the particular state's leading court decision addressing the right of an insured to enter into such agreements. For example, consent judgments in Minnesota are known as "*Miller-Shugart*" agreements for *Miller v. Shugart*, 316 N.W.2d 729 (Minn.1982). Arizona refers to consent judgments as "*Damron*" or "*Morris*" agreements. *Damron v. Sledge*, 460 P.2d 997 (Ariz.1969); *USAA v. Morris*, 741 P.2d 246 (Ariz.1987). And Floridians refer to consent judgments as "*Coblentz*" agreements. *Coblentz v. American Surety Company of NY*, 416 F.2d 1059 (5th Cir. 1969) (applying Florida law).

Covenants not to execute in Missouri are often referred to as "065 agreements" based on Mo. Rev. Stat. §537.065. Missouri, which we discuss in greater detail below, is the only state in which the legislature has enacted a statute giving an insured the right to enter into a covenant not to execute.

When May an Insured Enter a Consent Judgment?

An insurer that offers an unconditional defense (without a reservation of rights to deny coverage) has a right to control the defense and settlement strategy. On the other hand, if an insurer refuses to defend an insured or otherwise denies coverage, courts recognize that the insured has the right to control its own defense, including settlement. In between these two scenarios some courts recognize that a grey area exists where an insured and insurer may have competing interests with respect to control of the defense and settlement of the underlying lawsuit. Courts primarily take one of two views when evaluating how to balance the interests of an insured and insurer, while still giving effect to the plain language of the liability insurance policy. Some courts permit an insured to enter into a settlement agreement with a covenant not to execute only when an insurer refuses to settle in bad faith. Other courts permit an insured to enter into a settlement agreement with a covenant not to execute as long as the stipulated amount is fair, reasonable, and non-collusive.

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An Insurer Refuses to Settle in Bad Faith

In states that generally require that an insurer refuse to settle in bad faith, an insurer defending an insured under a reservation of rights retains the ability to control the defense and settlement negotiations, and the insured's potential interests in settlement are considered protected by the insurer's duty of good faith and fair dealing to the insured. Thus, an insured likely breaches its duties under the insurance policy by entering into a covenant not to execute unless the insured can show that the insurer acted in bad faith in refusing to settle.

With respect to the negotiation and settlement of claims, liability policies generally include the following standard provisions:

- Insured shall cooperate with insurer in the investigation, settlement, or defense of the claim or suit;
- Insurer may make such investigation, negotiation, and settlement of any claim or suit as they deem expedient; and
- Insured shall not, except at its own cost, make any payment, assume any obligation, or incur any expense.

Some courts permit an insured to enter into a settlement agreement with a covenant not to execute only when an insurer refuses to settle in bad faith.

These cooperation and consent to settlement clauses are intended "to prevent collusion and to invest the insurer with the complete control and direction of the defense or compromise of suits or claims." *Vincent Soybean & Grain Co., Inc. v. Lloyd's Underwriters of London*, 246 F.3d 1129, 1131 (8th Cir. 2001) (applying Arkansas law) (*quoting* 14 Russ & Segalla, *Couch on Insurance* §203.3, at 203-08 (3d ed. 1999)). In *Vincent Soybean*, the insured was provided a defense under a reservation of rights against allegations that it negligently stored and processed its client's wheat seeds. The insured, acting without its insurer-retained counsel, entered into a settlement with the claimant without the insurer's permission and subsequently sought coverage for its settlement. 246 F.3d at 1130–31. The court found that the insured's breach of the cooperation and consent to settlement clause would absolve the insurer of liability unless the insurer, "in bad faith, breached the contract by arbitrarily refusing to settle." *Id.* (quoting *Home Indem. Co. v. Snowden*, 223 Ark. 64, 264 S.W.3d 642, 645 (1954)).

Many other states are in accord with Arkansas in that when an insurer offers a defense subject to a reservation of rights regarding coverage, the insurer retains full authority to negotiate and settle the claim under the policy's consent to settlement provision unless the insurer refuses to settle in bad faith. *See, e.g., Motiva Enterps., LLC. v. St. Paul Fire & Marine Ins. Co.*, 445 F.3d 381 (5th Cir. 2006) (Texas law); *Danrik Constr. Inc. v. Amer. Cas. Co. of Reading, Penn.*, 314 Fed. Appx. 720 (5th Cir.2009) (Louisiana law) (unpublished*); First Bank of Turley v. Fid. & Dep. Ins. Co. of Md.*, 928 P.2d 298 (Okla.1996); *Maine Bonding & Cas. Co. v. Centennial Ins. Co.*, 298 Or. 514, 693 P.2d 1296 (Or. 1985). These states generally entrust an insured's interests to an insurer's general obligation of good faith and fair dealing when considering settlement.

Some jurisdictions, however, impose a heightened or enhanced obligation of good faith when an insurer defends an insured subject to a reservation of rights. For example, in *L & S Roofing Supply Co. v. St. Paul Fire & Marine Ins. Co.*, 521 So.2d 1298 (Ala. 1987), the Alabama Supreme Court adopted the reasoning of the Washington Supreme Court in *Tank v. State Farm Fire & Cas. Co.*, 105 Wash.2d 381, 715 P.2d 1133, 1137 (Wash. 1986), which set forth specific criteria that an insurer must meet to fulfill its "enhanced obligation of good faith." First, an insurer must thoroughly investigate the claim. Second, it must retain competent defense counsel for an insured and it must be understood that only the insured is the client. Third, an insurer must fully inform the insured of the reservation-of-rights defense and all developments relevant to coverage and the progress of the lawsuit. Finally, an insurer must refrain from engaging in any action that demonstrates a greater concern for the insurer's monetary interest than for the insured's financial risk. *L & S Roofing Supply Co.*, 521 So.2d at 1303 (citing to and adopting *Tank). See also Advantage Buildings & Exteriors, Inc. v. Mid-Continent Casualty Company*, 449 S.W.3d 16 (Mo. App. 2014).

An Insurer Offers to Defend Under a Reservation of Rights

Some jurisdictions recently have permitted an insured to reject an insurer's offer of defense subject to a reservation of rights. If an insurer does not withdraw its reservations, then an insured is permitted to enter into a covenant not to execute with the injured claimant and agree to entry of a consent judgment. In subsequent garnishment litigation, an insurer generally can assert its coverage defenses, raise defenses of fraud, collusion, and failure to comport with due process, as well as challenge the reasonableness of the settlement or amount of damages.

These courts reason that an insurer's general obligation of good faith and fair dealing and even an "enhanced obligation of good faith" do not provide sufficient protection for an insured's financial risks when presented with an opportunity to avoid exposure to its personal assets. *Babcock & Wilcox Co. v. Am. Nuclear Insurers and Mutual Atomic Energy Liab. Underwriters*, 76 A.3d 1, 15 (Pa. Super. 2013), *appeal granted in part,* 84 A.3d 699 (2014). This view rationalizes that the best way to balance an insured's right to protect its own financial interests, and to avoid the risk of a judgment larger than the policy limits or a potentially non-covered judgment, is to permit the insured to exercise some control over settlement negotiations. However, recognizing that an insured facing no personal exposure may not have an incentive to limit the settlement or consent judgment amount, most courts only require an insurer to indemnify an insured for the amount of settlement up to the policy limit if the settlement is covered and the settlement is reasonable and was not entered "in bad faith, fraudulently, collusively, or without any effort to minimize [the insured's] liability." *Taylor v. Safeco Ins. Co.*, 361 So.2d 743, 746–47 (Fla. App. 1978).

Missouri courts follow a different variation, which insurers should be aware of when handling claims in that state. As noted above, Missouri codified the right to enter into covenants not to execute in 1959, with the passing of Mo. Rev. Stat. §537.065. Missouri courts also recognize the right of an insured to reject a defense offered under a reservation of rights. *Butters v. City of Independence*, 513 S.W.2d 418 (Mo. 1974). However, Missouri courts also generally recognize the right of an insurer to challenge the reasonableness of a settlement agreement because the reasonableness requirement strikes the appropriate balance between the interests of an insured and an insurer. *Gulf Ins. Co. v. Noble Broadcast*, 936 S.W.2d 810, 815–16 (Mo.

banc 1997). Recently, however, the Missouri Supreme Court denied an insurer the right to challenge the reasonableness of a settlement in two different circumstances. The Missouri Supreme Court reversed a garnishment court's judgment determining that the damage award entered after an uncontested bench "trial" was unreasonable and should be reduced from $4.6 million to $2.2 million. *Schmitz v. Great Am. Assurance Co.*, 337 S.W.3d 700, 705–09 (Mo. banc 2011). The *Schmitz* court reasoned that an insured's decision not to contest liability or damages during a bench trial protected the insurer's interests because the insured did not admit liability or damages, but rather, the plaintiff had the burden to prove liability and damages. *Id*. The court further held that entry of a judgment after an uncontested bench trial was not a settlement and was not subject to the *Gulf Insurance* reasonableness test. *Id*.

In addition to prohibiting an insurer from challenging the reasonableness of a damage award after an uncontested "trial," the Missouri Supreme Court recently held that a trial court's approval of the reasonableness of a proposed class action settlement agreement between the claimant and the insured prevented the insurer from challenging the reasonableness of the settlement during a subsequent declaratory judgment action. *Columbia Casualty Company v. HIAR Holding, LLC*, 411 S.W.3d 258, 273 (Mo. banc 2013). The *HIAR* court further found that the settlement amount constituted covered damages, and it then held that the insurer was liable for the full $5 million settlement amount despite the insurer's $2 million policy limits. *Id*. at 273–74. The *HIAR* court's holding is more remarkable given the court's express acknowledgement that the plaintiff class did not make a request for extra-contractual damages. *Id*. at 273. The court rejected the insurer's assertion that only a bad-faith claim could result in an award of extra-contractual damages. *Id*. The court reasoned that the insurer's "wrongful refusal to defend HIAR put it in a position to indemnify HIAR for all damages flowing from its breach of the duty to defend." *Id*.

Thus, the Missouri Supreme Court prevented an insurer from challenging the reasonableness of a settlement amount that was approved by a trial court or entered after an uncontested bench trial. Moreover, in Missouri, an insurer may be liable for amounts in excess of its policy limits even in the absence of an extra-contractual claim. However, both *Schmitz* and *HIAR* required the claimant to first establish coverage under the particular insurance policies as well as the insurer's breach of the policies before imposing those harsh penalties on the insurers.

Potential Effect on an Insurer's Exposure

Consent judgments may carry with them a threat of significant extra-contractual exposure if an agreement reached by an insured is premised on an insurer's alleged bad-faith refusal to defend or settle within policy limits. As a practical matter, whether or not based on an insurer's alleged bad faith, consent judgments generally present a risk to insurers of having to satisfy a judgment that does not accurately reflect the claimant's actual damages or the liability issues. And, as noted above, while an insurer defendant in a garnishment action generally has a right to challenge the reasonableness of a covered damage award, an insurer in Missouri may not challenge the reasonableness of the damage award entered after a bench trial or a settlement receives court approval, without fraud or collusion. *Compare Miller v. Shugart*, 316 N.W.2d 729, 735 (Minn. 1982), *with Schmitz*, 337 S.W.3d 700 (Mo. banc 2011), *and HIAR Holding*, 411 S.W.3d 258, 273 (Mo. banc 2013). In certain states, subsequent extra-contractual or bad-faith liability could include punitive damages. *See, e.g.*, *Jenkins v. Ohio Cas. Ins. Co.*, 794 So.2d 228 (Miss. 2001); *Shobe v. Kelly*, 279 S.W.3d 203 (Mo. App. 2009). Furthermore, at least one jurisdiction—Missouri—requires an insurer to indemnify an insured for all covered amounts, including amounts in excess of the policy's limits of insurance, even without a bad-faith or extra-contractual claim against the insurer. *HIAR Holding*, 411 S.W.3d at 273–74 (Mo. banc 2013) (holding primary liability insurer liable to injured claimant for covered damages in excess of policy's limits of insurance, even though insured had not filed a bad faith or extra-contractual claim against the insurer).

In addition, a primary insurer that acts in bad faith in failing to settle may be liable for amounts paid by an excess or umbrella liability insurer. *See, e.g.*, *Scottsdale Insurance Company v. Addison Insurance Company*, 448 S.W.3d 818 (Mo. banc 2014) (recognizing an excess insurer's right to bring an action against a primary insurer for bad-faith refusal to settle under theories of assignment, conventional subrogation, and equitable subrogation).

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Challenging Consent Judgments Entered After a Covenant Not to Execute

Even in states allowing an insured to reject an insurer's defense under reservation of rights, a consent judgment is not binding on an insurer until the insurer has an opportunity to contest the validity of the judgment before a neutral fact finder. *See, e.g.*, *Nunn v. Mid-Century Ins. Co.*, 244 P.3d 116, 123 (Colo. 2010). Depending on the particular jurisdiction, an insurer generally can challenge its liability for all or any part of the stipulated judgment on the grounds that (1) there is no coverage under the policy; (2) the agreed-upon judgment is unreasonable; or (3) the judgment is the result of fraud or collusion.

No Proof of Coverage

Most states require proof that the damages awarded in a judgment or settlement are actually covered under the appropriate insurance policy before the policy may be garnished to satisfy a consent judgment. In Texas, for example, when "an insurer wrongfully refuses to defend, it still has the right to assert the defense of non-coverage and will only be liable to indemnify

the insured up to the policy limit." *Quorom Health Res., LLC v. Maverick County Hospital Dist.*, 308 F.3d 451, 468 (5th. Cir. 2002) (applying Texas law). In Florida, proof that the underlying claim against an insured is actually covered under a policy is considered "a condition precedent" to recovery against the insurer to satisfy a consent judgment. *Steil v. Florida Physicians Insurance Reciprocal*, 448 So.2d 589, 592 n. 8 (Fla. Dist. Ct. App. 1984). Courts in Pennsylvania and Washington also require proof of coverage. *See American States Ins. Co. v. State Auto Insurance Co.*, 721 A.2d 56, 64 (Pa. Sup.1998) ("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); *Kagele v. Aetna Life & Cas. Co.,* 40 Wash. App.194, 199 (1985) (holding that the question of coverage must be resolved first before determining whether consent judgment may be enforced under policy).

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In Illinois, "an insurer which breaches its duty to defend is liable for defense costs and the amount of any judgment or settlement." *Maneikis v. St. Paul Ins. Co. of Ill.*, 655 F.2d 818, 827 (7th Cir. 1981). As a result, in Illinois when an insurer refuses to defend an insured, the burden shifts to the insurer to prove that no possibility of coverage exists when a consent judgment is entered. While not yet addressed by the Missouri Supreme Court, federal courts applying Missouri law predict that Missouri will still require an actual coverage finding before garnishing an insurance policy. *Esicorp, Inc. v. Liberty Mut. Ins. Co.*, 193 F.3d 966, 970–71 (8th Cir. 1999); *Cincinnati Ins. Co. v. Mo. Highways & Transp. Comm'n*, No. 4:12-cv-01484-NKL, 2014 WL 4594207, at *16 (W.D. Mo. Sept. 15, 2014) (applying Missouri law after *HIAR*).

Challenging the Reasonableness of a Judgment

As noted by the Minnesota Supreme Court in *Miller v. Shugart*, a "judgment" agreed to by an insured "does not purport to be an adjudication on the merits; it only reflects the settlement. It is also evident that, in arriving at the settlement the defendants would have been quite willing to agree to anything as long as plaintiff promised them full immunity." *Miller,* 316 N.W.2d at 735. In most jurisdictions, the amount of the consent judgment should not be conclusive; an insurer should still be able to argue the settlement was unreasonable. *Nunn*, 244 P.3d at 124 (consent judgment "merely serves as evidence" of the value of the claim as bargained for and does not represent the presumptive value of the actual damages).

Some states, similar to Minnesota, place the initial burden of proof on a plaintiff judgment creditor to show that a judgment reasonably reflects an underlying claim's worth, which involves considering the facts bearing on the liability and the damage aspects of a plaintiff's claim, as well as the risks of going to trial. Colorado and Arizona follow Minnesota's lead, placing the initial burden of proof on a plaintiff judgment creditor. *Nunn*, 244 P.3d at 123; *USAA v. Morris*, 741 P.2d 246 (Ariz.1987).

However, an insurer challenging the reasonableness of a consent judgment is still in a difficult position of in effect trying the underlying case, and the difficulty can be compounded if the insured provides testimony to assist the claimant establish the reasonableness of the stipulated judgment. When considering whether a settlement was reasonable and made in bad faith,

> [a court or a jury may] take into account the amount of the overall settlement in light of the value of the case; a comparison with awards or verdicts in similar cases involving similar injuries; the facts known to the settling insured at the time of the settlement; the presence of a covenant not to execute as part of the settlement; and the failure of the settling insured to consider viable defenses.

Andrade v. Jennings, 54 Cal. App. 4th 307, 330-331, 62 Cal. Rptr. 2d 787 (1997) (citations omitted). *See also Red Oaks Condominium Owners Assoc. v. Sundquist Holdings, Inc.*, 116 P.3d 404, 407 n. 8 (Wash. Ct. App. 2005) (discussing factors to be examined when considering reasonableness of settlement).

It is also worth noting that even if a stipulated judgment is found unreasonable, an insurer may remain potentially liable for the amount of the settlement that is reasonable and represents covered damages. *Nunn*, 244 P.3d at 123–24 (if stipulated judgment is found unreasonable, insured may recover amount that is reasonable). *See also Six v. Am. Mut. Ins. Co.,* 558 N.W.2d 205, 207 (Iowa 1997) (even when a jury finds that the amount of a stipulated judgment is not reasonable, an insured is allowed to recover the portion of the judgment that is considered reasonable); *Gulf Insurance*, 936 S.W.2d at 817.

The Judgment Is the Result of Fraud or Collusion

An insurance policy can only potentially be garnished to satisfy a consent judgment if the award is free from both fraud and collusion. *Pruyn v. Agricultural Ins. Co.*, 36 Cal. App. 4th 500, 515, 42 Cal. Rptr. 2d 295 (1995). The principles of fraud and collusion are characterized in California as "self-evident" and "limited only by the imagination of those who would cheat and deceive." *Id.* at 530. But for those who do not have a penchant for deceit, a few California decisions provide examples for insurers looking to attack a consent judgment on the grounds that it is a product of fraud or collusion or both.

In California, "Collusion occurs when the insured and the third party claimant work together to manufacture a cause of action for bad faith against the insurer or to inflate the third party's recovery to artificially increase damages flowing from the insurer's breach. *Andrade,* 54 Cal. App. 4th at 327. *See also J.B. Aguerre, Inc. v. Am. Guarantee & Liability Ins. Co.,* 59 Cal. App. 4th 6, 18, 68 Cal. Rptr. 2d 837 (1997). When a case involves substantial evidence of collusion, its existence is a question of fact for a jury to determine. *Andrade*, 54 Cal. App. 4th at 328. But what constitutes collusion can differ with each factual situation.

In *Span, Inc. v. Assoc. Internat. Ins. Co.*, 227 Cal. App. 3d 463, 484, 277 Cal. Rptr. 828 (1991), the court noted,

> Collusion has been variously defined as (1) a deceitful agreement or compact between two or more persons, for the one party to bring an action against the other for some evil purpose, as to defraud a third party of his right; (2) a secret arrangement between two or more persons, whose interests are apparently conflicting, to make use of the forms and proceedings of law in order to defraud a third person, or to obtain that which justice would not give them, by deceiving a court or its officers; and (3) a secret combination, conspiracy, or concert of action between two or more persons for fraudulent or deceitful purposes."

The appellate court in *Andrade* upheld the jury's finding that the insured and the third-party claimant participated in collusion against an excess maritime insurer to produce a $1.5 million consent judgment. The jury in *Andrade* heard evidence that the reasonable settlement value of the underlying claim was between $150,000 and $250,000 and that no maritime claim with a similar fact pattern had ever been settled for over $350,000. *Id.* The jury also heard evidence that the insured's primary insurer was insolvent and that the insured failed to provide the excess insurer with timely notice of demands, settlement negotiations, or any other relevant information, despite repeated requests for them. *Id.* at 330. Finally, the evidence indicated that a vigorous defense would have raised weaknesses in the third party's claim to such an extent that at a minimum, such factors should have been considered for settlement purposes. *Id.* at 332. Based on these factors, the appellate court found that the jury reasonably concluded that the settlement was the product of collusion, crafted specifically to injure the excess liability insurer. *Id.* The jury's conclusion necessarily involved drawing reasonable inferences of the settling parties' intentions based on the evidence presented.

Fraud, on the other hand, can be easier to detect if it is based on evidence that the settling parties made fraudulent statements to an insurer or a court. The United Stated District Court in *Carlson v. Century Co.*, 2012 WL 1029662 (N.D. Cal. Mar. 26, 2012), considered whether a consent judgment, agreed to after the insured declined coverage under a claims-made real estate errors and omissions policy, was the product of fraud or collusion. Undisputed evidence presented to the court in a summary judgment motion demonstrated that both parties to the settlement agreement were aware of the fact that the underlying claim was first made against the insured before the inception of the claims-made policy. Nevertheless, and in direct contradiction to the undisputed evidence, the insureds signed declarations in exchange for the covenant not to execute stating that they were not aware of any circumstances that could even become a claim before the effective date of the policy. These false declarations rendered the settlement agreement fraudulent and the consent judgment unenforceable against the insurer.

While fraud and collusion exist as affirmative defenses that an insurer may raise in a garnishment action filed after a covenant not to execute and consent judgment are agreed to, it is important to note that Missouri courts found no fraud or collusion under some factual scenarios that seem egregious on their face. For example, Missouri courts hold that if an insured admits liability and does not defend attacks on a plaintiff's damages claims or object to improper arguments during a trial, such as the jury need not consider where the money would come from, this does not constitute fraud and collusion. *U.S. Fidelity & Guaranty Co. v. Safeco Ins. Co. of America*, 522 S.W.2d 809, 819–20 (Mo. banc 1975). In *Vaughan v. United Fire*, the court found that when a claimant's attorney paid the insured's mother cash and gave stamps to the insured while in prison to secure deposition testimony and the insured admitting at least 50 percent liability when the other driver pleaded guilty to four charges stemming from the accident, it did not amount to fraud or collusion. 90 S.W.3d 220, 226 (Mo. App. 2002). As such, insurers await further guidance from Missouri courts clarifying the conduct that may constitute fraud or collusion in the context of covenants not to execute entered between claimants and insureds and subsequent consent judgments.

Considerations for Insurers Facing the Potential of a Consent Judgment

When coverage issues justifying a defense under a reservation of rights arise, an insurer should pay particular attention to the applicable jurisdiction's laws, including whether an insured has the right to reject a defense offered under a reservation of rights. This requires insurers to consider carefully whether the bases to reserve rights are truly viable coverage defenses warranting taking the risk that an insured would agree to a covenant

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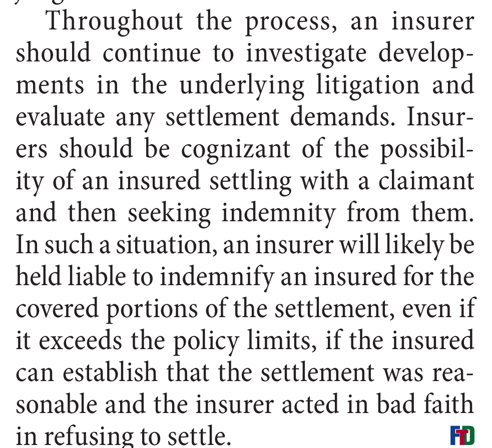
not to execute and a subsequent consent judgment. In the event that an insured rejects a defense offered under a reservation of rights, the insurer should consider exercising its rights to associate in the defense, monitor the case's docket, participate in liability and damages discovery, and attend proceedings in all trial settings. Insurers should also consider whether a basis exists to intervene in the underlying action to put on a liability or damages defense, or even to obtain a stay in the action pending resolution of the coverage issues in a separate declaratory judgment action.



Throughout the process, an insurer should continue to investigate developments in the underlying litigation and evaluate any settlement demands. Insurers should be cognizant of the possibility of an insured settling with a claimant and then seeking indemnity from them. In such a situation, an insurer will likely be held liable to indemnify an insured for the covered portions of the settlement, even if it exceeds the policy limits, if the insured can establish that the settlement was reasonable and the insurer acted in bad faith in refusing to settle. FD