11/00 - HAMILTON V. MARYLAND [AC]

S087346

IN THE SUPREME COURT OF CALIFORNIA

WILLIAM HAMILTON, et al.,

Plaintiffs and Respondents,

vs.

MARYLAND CASUALTY COMPANY,

Defendant and Appellant.

AFTER A DECISION BY THE COURT OF APPEAL
FIRST APPELLATE DISTRICT, DIVISION ONE
CASE NO. A085219

APPLICATION FOR LEAVE TO FILE AMICI CURIAE BRIEF; AMICI CURIAE BRIEF OF AMERICAN INTERNATIONAL COMPANIES, STATE FARM GENERAL INSURANCE COMPANY, TRUCK INSURANCE EXCHANGE, AND MERCURY GENERAL INSURANCE COMPANY IN SUPPORT OF DEFENDANT AND APPELLANT MARYLAND CASUALTY COMPANY

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TRUCK INSURANCE EXCHANGE, AND

MERCURY GENERAL INSURANCE COMPANY

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Under California Rules of Court, rule 14(b), American International Companies, State Farm General Insurance Company (State Farm), Truck Insurance Exchange (Truck), and Mercury General Insurance Company (Mercury) request permission to file the attached amici curiae brief in support of appellant Maryland Casualty Company.

The American International Companies (American Home Assurance Company, National Union Fire Insurance Company of Pittsburgh, Pa., Insurance Company of the State of Pennsylvania, Commerce & Industry Insurance Company, Birmingham Fire Insurance Company, and Lexington Insurance Company) are wholly owned subsidiaries of American International Group, Inc. They issue policies of liability insurance throughout California.

State Farm is a stock company wholly owned by State Farm Mutual Insurance Company, and issues policies of liability insurance throughout California.

Truck Insurance Exchange is a reciprocal or interinsurance exchange organized and existing under the laws of the State of California and issues policies of liability insurance throughout California.

Mercury is an independent agency writer of automobile insurance and issues policies of automobile liability insurance throughout California.

Amici are vitally interested in the issues presented by this case. Plaintiffs and respondents contend that if an insurer which honors its contractual obligation to defend its insured nonetheless rejects a reasonable settlement offer within policy limits, the insured may wrest control of the defense from the insurer and negotiate its own settlement with the claimant in excess of policy limits which will be binding on the insurer. Amici believe this proposed rule, by dramatically altering the well-established rights and duties between insurers and insureds, would deprive insurers of the opportunity to exercise their considerable expertise to negotiate the lowest possible settlements and to choose which cases should be tried. The net result would be higher premiums for all insureds.

Amici have reviewed the parties' briefs on the merits and believe this Court will benefit from additional briefing to explain why case law and public policy support allowing a defending insurance company to retain control of the defense, subject to the obligation to reimburse the insured if the insurer wrongfully rejects a settlement and a judgment subsequently is entered in excess of policy limits.

AMICI CURIAE BRIEF

INTRODUCTION

This case involves the allocation of rights and duties between an insurer and an insured under a standard liability insurance policy. Under such a policy, the insurer agrees to indemnify the insured for covered losses, up to the policy limits selected by the insured, and to provide the insured with a defense against lawsuits alleging potentially covered claims. By accepting such a policy, the insured, for its part, assumes the risk of liability in excess of the agreed upon coverage limits and agrees that, pursuant to the policy's insuring agreement and cooperation and no action clauses, the insurer, not the insured, has the right to control the defense of lawsuits and to decide whether to settle or take an action to trial.

Hamilton asks this court to turn this well-established allocation of rights and duties on its head. According to Hamilton, an insured should have the right to assume control of the defense and enter into a settlement with the claimant (in this case, for two million dollars above policy limits) that will be binding on the insurer whenever the insurer rejects a "reasonable" settlement offer. As we show, for a number of significant legal and policy reasons, Hamilton's attempt to dramatically restructure the relationship between an insurer and its insured should be rejected.

An insurer is a sophisticated commercial entity designed to spread costs effectively among policyholders and has the experience and capacity to predict the likelihood of an excess verdict, and to assess settlement offers accordingly. By contrast, an insured is likely to favor settlement even where the risk of an excess judgment is low, in order to be free of the litigation at no cost to itself. Even setting aside the potential for collusion between claimants and insureds, allowing an insured to decide when settlement is appropriate, as Hamilton proposes, would deny the insurer its bargained for right to control defense and settlement decisions, and to pay no more than fair value for a claim. The net result would be higher premiums for all insureds.

Further, Hamilton's proposed rule would create an incentive to underinsure by giving insureds who purchase low liability limits, and who therefore face a higher risk of an excess judgment than their properly insured counterparts, greater opportunities to wrest control over settlement decisions from insurers. Moreover, because Hamilton's proposed rule would force the settlement of even specious liability claims if the damages were sufficiently high and the policy limits were sufficiently low, it would increase the cost of insurance by encouraging the filing of tenuous claims.

There are no countervailing policy considerations which support Hamilton's proposed rule. In keeping with its assumption of control, an insurer who declines a policy limits settlement offer does so at its own risk: "It is generally held that since the insurer has reserved control over the litigation and settlement it is liable for the entire amount of a judgment against the insured, including any portion in excess of the policy limits, if in the exercise of such control it is guilty of bad faith in refusing a settlement." (*Comunale v. Traders & General Ins. Co.* (1958) 50 Cal.2d 654, 660.)

As discussed at length in Maryland's briefs, the California Courts of Appeal consistently have held that an insured has no cause of action against a defending insurer for bad faith failure to settle until there is an excess judgment. As we explain, this rule best preserves the balance of rights among the parties while protecting the insured public from the costs of collusion and unmerited or excessive settlements.

LEGAL DISCUSSION

I.

HAMILTON IGNORES THE CRUCIAL DISTINCTION BETWEEN AN INSURER'S DUTY TO DEFEND AND ITS DISCRETIONARY RIGHT TO SETTLE .

A. Unlike an Insurer Who Refuses to Defend, a Defending Insurer Who Declines a Policy-limits Settlement Offer Has Not Repudiated the Contract.

Throughout its briefs, Hamilton fails to differentiate between an insurer's failure to defend its insured and an insurer's decision, following its assumption of the defense, to reject a claimant's policy limits settlement offer. Rather, Hamilton treats both kinds of conduct as breaches of contract which release the insured from its duties under the "no action" and "cooperation" clauses and entitle the insured to wrest control of the settlement process from the insurer. In fact, the failure to defend and the failure to settle are critically different and have critically different consequences.

It is well-settled that a liability insurer is required to defend its policyholder from all suits alleging even potentially covered claims. (See, e.g., *Isaacson v. California Ins. Guarantee Assn*. (1988) 44 Cal.3d 775, 791.) The standard liability policy gives the insurer the right to investigate and settle claims against the insured at its discretion. (See *New Hampshire Ins. Co. v. Ridout Roofing Co.* (1998) 68 Cal.App.4th 495, 500-502, 504-507; ABOM p. 8, reciting provisions at issue here.)[1/] The insured, for its part, agrees to let the

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1/ "RB" refers to Hamilton's Respondent's Brief in the Court of Appeal, which it elected to rely on in lieu of filing an Opening Brief on the Merits in this Court. "PFR" refers to Hamilton's Petition for Review, "ABOM" refers (continued...)

insured handle the defense, to cooperate with the insurer in defending the suit, and to refrain from assuming any obligation or incurring any expense without the insurer's consent. (See *New Hampshire Ins. Co. v. Ridout Roofing Co., supra*, 68 Cal.App.4th at p. 501; see also ABOM pp. 8-9.) VLP agreed to these terms and conditions when it accepted Maryland's policy.

In addition to these express terms, an insurance policy includes an implied covenant of good faith and fair dealing which serves "to prevent a contracting party from engaging in conduct that frustrates the other party's rights to the benefits of the agreement." (*Waller v. Truck Ins. Exchange, Inc*. (1995) 11 Cal.4th 1, 36.) The implied covenant requires the insurer to give equal consideration to its insured's interests as to its own (*Egan v. Mutual of Omaha Ins. Co.* (1979) 24 Cal.3d 809, 818-819) and to accept settlement offers within limits in appropriate cases, including cases where there is "a great risk of a recovery beyond the policy limits." (*Comunale v. Traders & General Ins. Co., supra,* 50 Cal.2d at pp. 659-660; *Crisci v. Security Ins. Co.* (1967) 66 Cal.2d 425, 430.)

California and other states have acknowledged that an insurer's breach of its contractual duty to defend releases the insured from its obligations under the contract and permits the insured to protect its interests by entering into a reasonable, noncollusive settlement with the injured party. (See *Isaacson v. California Ins. Guarantee Assn., supra*, 44 Cal.3d at p. 791; *Pruyn v. Agricultural Ins. Co.* (1995) 36 Cal.App.4th 500, 515.) The reason for allowing the insured to assume control of settlement decisions under these circumstances is plain: an insurer that denies a defense has repudiated the contract and abandoned the insured, leaving it to defend the case unassisted.

1/ (...continued)
to Maryland's Answer Brief on the Merits in this Court, and "RBOM" refers to Hamilton's Reply Brief on the Merits in this Court.

(See *Mora v. Phoenix Indemnity Ins. Co.* (Ct.App. 2000) 196 Ariz. 315 [996 P.2d 116, 120-121] ["By asserting that it owes no duty to defend its insured, an insurer also implies that it owes no duty to indemnify: the insurer has asserted that the policy does not apply and it therefore has no interest in the litigation"].)

By contrast, so long as an insurer honors its contractual obligation to defend, the insured may not wrest control of the defense and settle with the claimant on its own, even if the insurer rejects a reasonable settlement offer. (*Safeco Ins. Co. v. Superior Court* (1999) 71 Cal.App.4th 782, 787; *J.B. Aguerre, Inc. v. American Guarantee & Liability Ins. Co.* (1997) 59 Cal.App.4th 6, 13; *Finkelstein v. 20th Century Ins. Co.* (1992) 11 Cal.App.4th 926, 929; see also *Rose v. Royal Ins. Co.* (1991) 2 Cal.App.4th 709, 716; *Wright v. Fireman's Fund Ins. Companies* (1992) 11 Cal.App.4th 998, 1024; *Doser v. Middlesex Mutual Ins. Co.* (1980) 101 Cal.App.3d 883, 893-894.)[2/] The reason for allowing a defending insurer to retain control of the defense is equally plain: when an insurer assumes the defense, it honors the contract, and acquires, under the terms of the policy, the right to control the defense without interference by the insured. (See *Buss v. Superior Court* (1997) 16 Cal.4th 35, 41 & fn. 2, 42 & fn. 3, 45-46 & fn. 9 [carrier has not only the duty, but also the

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2/ See also *Allstate Ins. Co. v. Campbell* (1994) 334 Md. 381, 396 [639 A.2d 652, 659] ("An insurer's decision to reject, initially, an offer of settlement within the insured's policy limits is not enough, in itself, to create a conflict of interest as would require the insurer to give up direction of the defense . . . "); *Buysse v. Baumann-Furrie & Co.* (Minn. 1989) 448 N.W.2d 865, 872-874 (where insurer provides defense, insured's unauthorized settlement is improper and may void coverage); *Martin v. West American Ins. Co.* (Ct.App. 1999) 128 N.M. 446 [993 P.2d 763, 767] (defending insurer "was not required to indemnify Insured for a settlement made without requesting its consent"); *State Farm Fire & Cas. Co. v. Gandy* (Tex. 1996) 925 S.W.2d 696, 714, 719 ("In no event should a judgment agreed to between plaintiff and defendant be binding on defendant's insurer").

right to defend]; *Safeco Ins. Co. v. Superior Court*, *supra*, 71 Cal.App.4th at p. 787 [“When the insurer provides a defense to its insured, the insured has no right to interfere with the insurer’s control of the defense . . .”]; Croskey et al., Cal. Practice Guide: Insurance Litigation (The Rutter Group 1999) ¶ 12:207, pp. 12B-2 to 12B-3 [“right to control the defense of any action against the insured . . . [] includes the right to . . . negotiate settlement, and to otherwise conduct defense of the action. . . . [¶] . . . By accepting a liability insurance policy, the insured is bound by these terms”].)

If an insured could negotiate its own settlement with the claimant whenever an insurer rejected a “reasonable” settlement offer, the insurer’s contractual right to control the defense effectively would be written out of the policy. This is so because the right to make settlement decisions is important only when there is a conflict of interest between the insured and the insurer, i.e., when the exposure exceeds policy limits and the claimant makes a “reasonable” offer to settle within policy limits. (See *Brown v. Guarantee Ins. Co.* (1957) 155 Cal.App.2d 679, 682-683; *Ivy v. Pacific Automobile Ins. Co.* (1958) 156 Cal.App.2d 652, 659-660.) Until then, the insurer and the insured have the same interest in vigorously defending the action. However, under the rule espoused by Hamilton, at the very moment the interests of the insurer and the insured diverge and the insurer’s contractual right to control the defense and decide whether to settle or take the action to trial becomes important, the insurer loses that right.

An implied covenant cannot be utilized to limit or restrict an express grant of discretion in a contract. (See *New Hampshire Ins. Co. v. Ridout Roofing Co.*, *supra*, 68 Cal.App.4th at pp. 504-505.) For the same reason, the *remedy* for the breach of an implied covenant should not negate and render illusory an express contractual right. If an insurer’s right to control the defense and settlement of an action is to have any meaning at all, it must include the right to reject even "reasonable" settlement offers and take a case to trial in an attempt to obtain a more favorable result. (See Keeton & Widness, Insurance Law: A Guide to Fundamental Principles, Legal Doctrines and Commercial Practices (1988) § 7.8, p. 896 ["Since the insurer's decision [to reject a settlement offer] merely preserves and does not itself create the conflict of interests between the parties, it makes little sense to treat this decision as the basis for wresting from the insurer both the responsibility for and the right to continue to conduct the defense, including decisionmaking regarding the possibilities for settlement which may subsequently occur"].)

In sum, whether it accepts a settlement offer or takes the case to trial in the hope of obtaining a defense verdict or a verdict lower than the settlement offer, a defending insurer, unlike an insurer that denies any obligation under its policy, is still engaged in exercising its rights and obligations under the contract. Accordingly, the insurer is entitled to expect the insured to abide by *its* contractual obligations and continue to cooperate with the insurer's administration of the defense.

B. Public Policy Favors Allowing Defending Insurers to Maintain Control of the Defense and Settlement Decisions.

For several reasons, public policy favors allowing a defending insurer to control the defense and settlement decisions.

First, allowing an insured to control settlement decisions would increase the cost of insurance because it would deny insurers the opportunity to exercise their considerable expertise to negotiate the lowest possible settlements and choose those cases which should be tried. Unlike an insurer, an insured is likely to favor settlement as a means of resolving the case, even where the risk of an excess judgment is low. (See *Merritt v. Reserve Ins. Co.* (1973) 34

Cal.App.3d 858, 869 ["settlement will always be to the interest of the assured — for the settlement will cost him nothing"].) Consequently:

> [A]ny rule giving [an] insured a power to make a settlement binding [an insurance] company . . . encourages less prudent settlements, at higher figures. From the point of view of public interest in the effective operation of the liability insurance mechanism this is a disadvantage. Insurance costs would rise, since the higher settlements made by insureds and reimbursed by companies would eventually be reflected in rates. . . . Even disregarding the danger of collusion between claimant and insured, it is to be expected that insureds would offer more than companies, and claimants would demand more because of the knowledge of the insureds' powers. The obvious reason for the policy provision giving company such exclusive control over the settlement decision is to keep down claims costs.

(Keeton, *Liability Insurance and Responsibility for Settlement* (1954) 67 Harv. L.Rev. 1136, 1165-1166; see Note, *An Insurance Company's Duty to Settle: Qualified or Absolute?* (1968) 41 So.Cal. L.Rev. 120, 126 ["Giving the insured the power to control the settlement of his own case would raise the possibility that the insured, inexperienced in evaluating claims and desiring to avoid potential excess liability, would settle in cases in which litigation would result in no liability"].) As an Illinois court put it, "'It is pretty evident that, if the insurer entrusted the matter of making settlements to its numerous policy holders, its existence would be precarious. We are all apt to be generous when it comes to spending the money of others.'" (*Piper v. State Farm Mut. Auto. Ins. Co.* (1953) 1 Ill.App.2d 1, 4 [116 N.E.2d 86, 87].)[3/]

3/ Indeed, insurers often are willing to settle claims which insureds, for (continued...)

Second, Hamilton's proposed rule would reward insureds for purchasing inadequate insurance and create an undesirable incentive to underinsure. As the Court of Appeal in *Merritt v. Reserve Ins. Co., supra,* 34 Cal.App.2d at pages 868-869, explained, it is an insured's sole responsibility to determine which part of the risk it is willing to assume and which part it will pass on to the insurer: "If the assured wishes to pass on the entire conceivable risk of liability for damages to one or more carriers, it will pay a higher premium. If it contracts for the carrier to underwrite only part of the conceivable risk, it will pay a lower premium." However, if an insured could negotiate its own settlement with the claimant whenever an insurer rejected a reasonable settlement, insureds who purchased policies with low liability limits paradoxically would enjoy greater opportunities to wrest control over settlement decisions from insurers than their properly insured counterparts.

This is so because, as Justices Croskey and Kaufman explain in their leading treatise on California insurance law, the amount of a reasonable settlement is determined by multiplying the estimated maximum exposure by the likelihood such a verdict will come to pass. Consequently, "[a]n insurer may be obligated to pay policy limits on claims of marginal liability but involving potential damages greatly in excess of policy limits." (Croskey et al., Cal. Practice Guide: Insurance Litigation, *supra*, ¶ 12:334, p. 12B-29.) Thus, under the rule proposed by Hamilton, if the estimated maximum exposure was one million dollars or more, an insured who purchased a policy with $10,000 in coverage could demand that the insurer pay policy limits or lose control of the defense even though there was only a one percent chance of a verdict in favor of the claimant, i.e., even though the lawsuit was close to

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non-economic, emotional reasons, would rather take to trial, which confirms the wisdom of allowing insurers to retain their contractual right to control defense and settlement decisions.

frivolous. (One percent of one million dollars equals $10,000.) If the insurer refused to pay policy limits, the insured could then enter into a settlement with the claimant well in excess of policy limits. However, rewarding insureds who purchase inadequate levels of insurance by allowing them to wrest control of settlement decisions from their insurers and negotiate settlements that exceed policy limits is "socially unproductive because it leads to lower levels of coverage, to greater externalization of liability, and thus to inadequate safety measures and excessive risk taking." (Sykes, *Judicial Limitations on the Discretion of Liability Insurers to Settle or Litigate: An Economic Critique* (1994) 72 Tex. L. Rev. 1345, 1364.)

Third, for the same reason, Hamilton's proposed rule would increase the costs of insurance by encouraging the filing of tenuous claims. So long as the damages were sufficiently high and the policy limits were sufficiently low, a claimant never would have to worry about proving liability in a contested trial. If the insurer rejected a policy limits offer, the insured could do what VLP did here — enter into a settlement with the claimant (binding on the insurer) well in excess of policy limits.

C. There Are No Countervailing Policy Considerations Supporting Hamilton's Proposed Rule.

Not only are there sound public policy reasons why a defending insurer should be allowed to retain control of settlement decisions even if it rejects a reasonable settlement offer, there are no countervailing considerations which support Hamilton's proposed rule.

Hamilton argues that if an insurer wrongfully refuses to settle, the insured should be allowed to settle with the claimant in order to mitigate its damages. But this proposal does not allow the insured to mitigate its damages;

it allows it to *create* damages which otherwise might never exist. Even if it rejects a reasonable settlement offer, the insurer may settle at a later point after further discovery, or, if the case goes to trial, obtain a defense verdict or a verdict below policy limits, rendering harmless any "error" in rejecting the settlement demand. (See *Doser v. Middlesex Mutual Ins. Co., supra*, 101 Cal.App.3d at pp. 891-892 ["Even if [the insurer] did reject the settlement offer within policy limits, [it] would not have been subject to liability if [it] had been successful in the defense of the litigation and a judgment had been rendered below the settlement offer, or a complete defense verdict had been obtained"]; *J.B. Aguerre, Inc. v. American Guarantee & Liability Ins. Co., supra*, 59 Cal.App.4th at p. 13 ["'The excess judgment is necessary to establish both the insured's liability to the injured party and the amount thereof for damages purposes in the subsequent "bad faith" action against the insurer. After all, the insurer's refusal to settle may prove correct if a defense verdict is obtained or plaintiff's verdict comes in for less than policy limits'"]; *Finkelstein v. 20th Century Ins. Co., supra*, 11 Cal.App.4th at p. 930 ["the mere possibility or even the lack of any personal doubt by appellant's counsel that a jury verdict in excess of the policy limits would have ensued never ripened into an actionable event. Since there was no judgment in excess of the policy limits, appellant's cause of action never matured"]; Croskey et al., Cal. Practice Guide: Insurance Litigation, *supra*, ¶ 12:358, p. 12B-35 ["The insured cannot complain if the insurer decides not to settle and the jury renders a verdict for less than policy limits"].)[4/]

The insured is damaged by an insurer's wrongful refusal to settle only if a judgment is entered against it in excess of policy limits. However, in that

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4/ See also *State Farm Fire & Cas. Co. v. Gandy, supra*, 925 S.W.2d at p. 719 (observing it is "virtually impossible" to assess a defendant's liability once he has settled: "Once the parties have changed positions, their views are altered, and it is very difficult to determine what might have been").

eventuality the insured is entitled to reimbursement from the insurer: "It is generally held that since the insurer has reserved control over the litigation and settlement it is liable for the entire amount of a judgment against the insured, including any portion in excess of the policy limits, if in the exercise of such control it is guilty of bad faith in refusing a settlement." (*Comunale v. Traders & General Ins. Co., supra,* 50 Cal.2d at p. 660; see *Johansen v. California State Auto. Assn. Inter-Ins. Bureau* (1975) 15 Cal.3d 9, 12-13; *Crisci v. Security Ins. Co., supra,* 66 Cal.2d at p. 431.)

Indeed, the insured normally can protect itself against personal exposure to an excess judgment by assigning to the claimant its cause of action for bad faith refusal to settle in exchange for a covenant not to enforce the judgment against the insured's personal assets. (*Safeco Ins. Co. v. Superior Court, supra,* 71 Cal.App.4th at p. 788.) Because an assignment does not settle the third party's claim, it does not breach the insured's duty to cooperate or violate the no action clause. Thus, the rule in *Comunale* and *Safeco* fairly harmonizes the insurer's express contractual right to control the defense with its implied obligation to accept reasonable settlement offers.

Hamilton contends an assignment in return for a covenant not to execute is an inadequate remedy because "the claimant in an action against a solvent policyholder would have no incentive to accept an assignment of the policyholder's bad faith claim against its insurer in exchange for a covenant not to enforce. A claimant that made such a deal would have to prevail in *two* lawsuits — *i.e.,* against both the policyholder and the insurer — rather than one." (RB p. 43.) However, Hamilton's proposed remedy — allowing insureds to negotiate their own settlements — would provide them with no greater protection than they enjoy under existing law. Any claimant who was unwilling to accept a post-judgment assignment in exchange for a covenant not to enforce the judgment because the insured was solvent would be equally unwilling to settle prior to judgment for an assignment in lieu of cash. Rather, the same claimant who would refuse to give a solvent insured a post-judgment covenant not to enforce would demand a cash settlement, leaving the insured to seek reimbursement from the insurer.

An insured will be unable to pass on an excess judgment to the insurer only if the insurer did not breach the implied covenant of good faith and fair dealing, in which case the insured's damages are the result of its own failure to purchase adequate insurance, not anything the insurer did or failed to do. But the latter risk does not justify a rule which effectively reads the cooperation and no action clauses out of the policy. As Professor Keeton explains:

> [T]he risk [of an excess judgment] . . . is not one caused by a breach of duty by [the insurance] company. If there is such a breach of duty . . . , then [the] insured is entitled to full reimbursement from [the] company in excess of policy limits, and he may safely keep hands off and await the outcome of claimant's suit without fear of personal loss. Only if [the] company is not guilty of a breach does insured suffer a loss. No possible rule, short of changing the obligations of the parties before breach, would protect insured against this risk. *This risk of loss is one which insured had from the first, and could have transferred by taking a policy with high limits when he chose instead to buy a less expensive policy with low limits*.

(Keeton, *Liability Insurance and Responsibility for Settlement*, *supra*, 67 Harv. L.Rev. at p. 1167, emphasis added.)

Hamilton also argues an insured should be allowed to wrest control of the defense from an insurer in order to mitigate the risk of a punitive damage award. However, an insurer "does not . . . insure the entire range of an insured's well-being, outside the scope of and unrelated to the insurance policy, with respect to paying third party claims" (*Camelot by the Bay Condominium Owners' Assn. v. Scottsdale Ins. Co.* (1994) 27 Cal.App.4th 33, 52), and therefore does not have to consider an insured's potential exposure to punitive damages in deciding whether to accept a settlement offer (*PPG Industries, Inc. v. Transamerica Ins. Co.* (1999) 20 Cal.4th 310, 316, 318; *J.B. Aguerre, Inc. v. American Guarantee & Liability Ins. Co., supra*, 59 Cal.App.4th at p. 17). If the risk of a compensatory damage award in excess of policy limits is not a valid basis for depriving an insurer of its contractual right to control the defense, certainly an insurer should not lose that right because the insured is concerned that its own conduct might lead to an award of punitive damages.

D. Most of the California and Out-of-State Cases Cited By Hamilton Concern an Insurer's Failure to Defend and Are Thus Inapposite.

Most of the California cases relied on by Hamilton are inapposite because they concern the consequences of an insurer's *failure to defend*, not a defending insurer's refusal to accept a settlement offer. (See *Clemmer v. Hartford Insurance Co.* (1978) 22 Cal.3d 865, 884, cited in RB pp. 32, fn. 26, 38; *Samson v. Transamerica Ins. Co.* (1981) 30 Cal.3d 220, 224, cited in RB pp. 31, 47, fn. 37); *Roman v. Unigard Ins. Group* (1994) 26 Cal.App.4th 177, 180, cited in PFR pp. 4, 18, 27, 28, RB pp. 27, 33 & RBOM p. 11; *Zander v. Texaco, Inc*. (1968) 259 Cal.App.2d 793, 799, cited in PFR p. 25; *Xebec Development Partners, Ltd. v. National Union Fire Ins. Co.* (1993) 12 Cal.App.4th 501, 544-545, cited in PFR p. 16, fn. 8.)

Similarly, many of the out-of-state cases on which Hamilton relies concern options open to an insured when its insurer fails to defend. (See *Gulf Ins. Co. v. Parker Products, Inc*. (Tex. 1973) 498 S.W.2d 676, 679, cited in PFR p. 17, fn. 8 & RB p. 37, fn.32 [insurer that denies coverage and defense may not rely on no-action clause]; *North American Van Lines, Inc. v. Lexington Ins. Co.* (Fla. 1996) 678 So.2d 1325, 1332, cited in RBOM p. 8, fn. 7 [excess insurer may waive rights to approve a settlement if it "rejects a reasonable settlement *and at the same time fails to offer to undertake the defense*" (emphasis added)]; *id.* at p. 1333 ["if the insurer *refuses to defend* and the insured undertakes the defense and settles the case, the insured can certainly sue for reimbursements regardless of whether there is an excess judgment" (emphasis added)]; accord *Krutsinger v. Illinois Cas. Co.* (1957) 10 Ill.2d 518, 526-527 [141 N.E.2d 16, 21], cited in PFR p.17, fn. 8 & RB p. 31; *Nixon v. Liberty Mutual Ins. Co.* (1961) 255 N.C. 106, 112 [120 S.E.2d 430, 435-436], cited in PFR p. 17, fn. 8 & RB p. 37, fn. 32; *Red Giant Oil Co. v. Lowlor* (Iowa 1995) 528 N.W.2d 524, 532, cited in RB p. 31; *Sarnafil, Inc. v. Peerless Ins. Co.* (1994) 418 Mass. 295, 303-304 [636 N.E.2d 247, 252-253], cited in RB p. 31; see also *Buysse v. Baumann-Furrie & Co., supra*, 448 N.W.2d at pp. 872, 874 [holding that *Miller v. Shugart* (Minn. 1982) 316 N.W.2d 729, cited in RB pp. 37, 47 and PFR p. 17, applies only to cases where insurer denies existence of any coverage, and rejecting the Arizona Supreme Court's reasoning in *Arizona Property & Cas. Ins. Guar. Fund v. Helme* (1987) 153 Ariz. 129 [735 P.2d 451, 459], cited in RB pp. 31, 37 and PFR p. 17].)[5/]

5/ *Washington Ins. Guarantee Assn. v. Ramsey* (Alaska 1996) 922 P.2d 237, cited in Hamilton's RBOM page 8, footnote 7, is also inapposite. That case is limited to suits against the Washington Insurance Guarantee Association (WIGA), a statutory entity similar to the California Insurance (continued...)

This Court should disregard authorities pertaining to the distinct duty of an insurer to provide its insured a defense, a duty which indisputably was met by Maryland.

E. No California Authority Supports Hamilton's Argument.

The only California cases relied on by Hamilton which do not involve a breach of the duty to defend are *Camelot by the Bay Condominium Owners' Assn. v. Scottsdale Ins. Co., supra,* 27 Cal.App.4th 33 and *Isaacson v. California Ins. Guarantee Assn., supra,* 44 Cal.3d at page 791. However, the suggestion in *Camelot* that an excess judgment may not be required to support a bad faith claim is mere dicta (see ABOM pp. 28-29 & fn. 8) and *Isaacson* is distinguishable as a matter of law and fact.

First, and most significantly, the insureds in *Isaacson* did not attempt to do what Hamilton contends VLP was entitled to do here — wrest control of

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5/ (...continued)
Guaranty Association (CIGA). Because WIGA caps awards at $300,000, an insured bears the risk of excess judgments, which cannot be passed on to WIGA even if its refusal of a policy-limits settlement offer proves to have been in bad faith. (See *id*. at p. 246.) Further, as the Court noted, its "holding differs from California law," since CIGA has been deemed immune from the common law claims at issue in *Ramsey*. (See *id*. at p. 244, fn. 24, citing *Isaacson v. California Ins. Guarantee Assn., supra*, 44 Cal.3d 775; see also *Bills v. Arizona Prop. and Cas. Ins. Guar. Fund* (Ct.App. 1999) 194 Ariz. 488, 495 [984 P.2d 574, 581] [rejecting *Ramsey* approach].)

Glenn v. Fleming (1990) 247 Kan. 296 [799 P.2d 79], cited at RBOM page 8, footnote 7, supports Maryland's position, not Hamilton's. There, the Kansas Supreme Court held that an insurer could be held liable for an *excess jury verdict* should its refusal of a settlement offer prove to have been in bad faith. (See *id*. at p. 91.) Far from condoning a settlement unilaterally entered by an insured prior to judgment, the Court reaffirmed its holding to the contrary in *Heinson v. Porter* (1989) 224 Kan. 667 [772 P.2d 778]. (See *ibid*.)

The remaining out-of-state cases cited by Hamilton are wrongly decided for the reasons stated in this brief.

the case from the insurer and settle notwithstanding the insurer's desire to take the case to trial. To the contrary, in *Isaacson*, CIGA, an entity created by the Legislature to provide financial and legal assistance to insureds whose insurers became insolvent, *agreed that the case should be settled* and paid $400,000 of the $500,000 settlement demand. (See *Isaacson v. California Ins. Guarantee Assn., supra*, 44 Cal.3d at p. 782.) The insureds paid the remaining $100,000 and then sued CIGA for reimbursement. This Court ruled against the insureds because they failed to prove $500,000 was a reasonable settlement, but left open the possibility that CIGA could be liable for breaching its statutory duties if its decision to pay less than the full amount requested in settlement were unreasonable. (See *id*. at pp. 792-794.[6/]) CIGA's partial payment of a settlement, which concluded its duty to defend, cannot be equated with Maryland's decision to pursue the defense further, in the hopes of reaching an outcome more favorable both to itself and the insured.

Second, *Isaacson* did not concern the contractual obligations of a private insurer like Maryland, but the statutory duties of CIGA. (*Id.* at p. 784, 786; see *id*. at pp. 786-787 ["CIGA is not, and was not created to act as, an ordinary insurance company. . . . [nor does it] "'"stand in the shoes" of the insolvent insurer for all purposes'"].) Because CIGA does not have a contractual relationship with the insured, the insured is not constrained by the usual obligations to cooperate and avoid independent settlement.

Third, this Court held that CIGA, unlike a private insurer, is immune from tort liability for breach of the implied covenant of good faith and fair

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6/ This Court observed: "If CIGA fails to accept a reasonable settlement offer within its statutory limit, in a case in which a judgment against the insured in excess of that limit is likely, it violates its statutory duty to pay and discharge 'covered claims.' It may thereby become liable to the insured for reimbursement if the insured expends his own funds to settle, within the statutory limit." (*Isaacson v. California Ins. Guarantee Assn., supra,* 44 Cal.3d at p. 792, footnote omitted.)

dealing, which "arises only from a contractual relationship, not a statutory one" (see *id*. at p. 789), and cannot in any event become liable for a judgment beyond the statutory limit of $500,000 (see *id*. at p. 782; Ins. Code, § 1063.1, subd. (c)(6)). Because CIGA is not subject to tort liability or liability for an excess judgment if it unreasonably fails to settle within the statutory limit, an insured would have no remedy for CIGA's unreasonable failure to settle unless it were allowed to negotiate its own settlement within that limit and then seek reimbursement from CIGA. For good reason, no California court has extended this remedy to a commercial insurance relationship, where the insured has an adequate remedy if the insurer's bad faith causes a judgment in excess of policy limits.

II.

EVEN IF THE RULE IN *ISAACSON* APPLIED IN AN ACTION AGAINST AN INSURER, THE SETTLEMENT AGREED TO BY HAMILTON IS NOT PRESUMPTIVELY REASONABLE.

As we have shown, *Isaacson* applies only to actions against CIGA, not actions between an insurer and an insured. But even if the *Isaacson* rule applied here, Hamilton's contention that its settlement with VLP was presumptively reasonable (see RB pp. 35, fn. 30, 39, fn. 34; RBOM p. 2) is wrong. This Court held in *Isaacson* that a settlement is deemed presumptively reasonable only "where the insurer has wrongfully refused to cover or defend a claim, leaving the insured to mount his own defense or suffer a default." (*Isaacson v. California Ins. Guarantee Assn.*, *supra*, 44 Cal.3d at p. 793; see *Hartford Accident & Indemnity Co. v. Superior Court* (1995) 37 Cal.App.4th 1174, 1182, 1184.) Contrary to Hamilton's position, which the trial court erroneously accepted, this Court in *Isaacson* explained that because CIGA provided a defense, the settlement negotiated by the insureds was *not* presumptively reasonable. Rather, *the insureds* had the burden of proving their unauthorized settlement was reasonable. (See *Isaacson v. California Ins. Guarantee Assn*., *supra*, 44 Cal.3d at pp. 793-794.)

And, contrary to Hamilton's contention, the fact the trial court in the underlying action found the settlement was in good faith under Code of Civil Procedure section 877.6 does not establish it was reasonable and binding on Maryland. The Court of Appeal in *Hartford Accident & Indemnity Co. v. Superior Court*, explicitly considered the effect of a good faith settlement under section Code of Civil Procedure 877.6, like the one at issue here, and determined that such a settlement could *never* be deemed binding on an insurer. (37 Cal.App.4th at pp. 1184-1185; see *id.* at pp. 1179-1180, distinguishing *Sanchez v. Truck Ins. Exchange* (1994) 21 Cal.App.4th 1778 and *Roman v. Unigard Ins. Group*, *supra*, 26 Cal.App.4th 177.) A section 877.6 proceeding may not be used offensively against insurers, the court explained, because it does not afford the insurer *due process*. (See *Hartford Accident & Indemnity Co. v. Superior Court*, *supra*, 37 Cal.App.4th at pp. 1182-1184; see *id*. at p. 1181 ["insurers are not 'parties' authorized by section 877.6 to seek hearings on the issue of the good faith of a settlement"]; accord *Pruyn v. Agricultural Ins. Co.*, *supra*, 36 Cal.App.4th at pp. 523-527; *Pacific Estates, Inc. v. Superior Court* (1993) 13 Cal.App.4th 1561, 1567-1575; *Western Steamship Lines, Inc. v. San Pedro Peninsula Hospital* (1994) 8 Cal.4th 100, 118 ["a judgment cannot bind one who was not a party thereto"].)

In sum, even if this court were to accept Hamilton's proposal that an insured may settle without the consent of a defending insurer after the insurer wrongfully rejects a policy-limits settlement offer, such a settlement should afford the insured no presumption of reasonableness. To the contrary, it is the insured's burden of proof to show that its settlement was reasonable. (*Isaacson v. California Ins. Guarantee Assn.*, *supra*, 44 Cal.3d at p. 793.)