

## **PENNSYLVANIA SUPREME COURT RULES INSUREDS CAN SETTLE CLAIMS WITHOUT INSURER'S CONSENT UNDER RESERVATION OF RIGHTS SCENARIO**

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In an issue of first impression in Pennsylvania, the Supreme Court held that in a reservation of rights situation, an insured does not forfeit coverage if it agrees to settle a claim without the insurer's consent, so long as the settlement was fair, reasonable and non-collusive and within the policy limits.

The July 21, 2015 decision stems from a 1994 federal class action lawsuit filed against The Babcock Company and B&W Nuclear Environmental Services (collectively "Babcock") by individuals who worked in or lived near nuclear fuel processing facilities owned and operated by Babcock. The plaintiffs alleged they sustained bodily injury and property damage due to the radioactive and toxic emissions from Babcock's nuclear facilities. American Nuclear Insurers and Mutual Atomic Energy Liability Underwriters (collectively "ANI") agreed to defend Babcock in the case under a reservation of rights. After a trial in 1998, a jury awarded over \$35 million against Babcock on eight "test cases" filed in federal court; however, a new trial was granted on evidentiary issues.

Almost a decade later, with ANI defending throughout, Babcock settled the claims asserted against it for approximately \$80 million, an amount less than ANI's \$320 million policy limits. ANI did not consent to the settlement due to its conclusion that the case had a "strong likelihood of a defense verdict given the lack of medical and scientific support for plaintiffs' claims" and decisions from federal courts on the procedural and evidentiary issues. Nevertheless, Babcock sought reimbursement from ANI for the full amount of the settlement plus prejudgment interest. ANI argued that it had no obligation to make any payment because, by settling the cases without its insurer's consent, Babcock violated the consent to settlement clauses in the policies. In the ensuing declaratory judgment action in Pennsylvania state court, Babcock argued it could settle without the insurer's consent so long as its settlement was reasonable. ANI countered that under existing Pennsylvania Supreme Court authority, an insurer that honors its defense obligation maintains control of settlement.

The trial court agreed B&W was entitled to reimbursement from ANI if the settlement was "fair and reasonable." After a jury determined that the settlement was fair, reasonable, and non-collusive, the trial court entered an order against ANI in the amount of \$80 million plus prejudgment interest of more than \$15 million. ANI appealed the decision to the Superior Court, which reversed and remanded, and Babcock appealed to the Supreme Court, which vacated the Superior Court's decision and reinstated the judgment of the trial court.

Justice Baer wrote the majority opinion, which included a history of opinions involving an insurer's refusal to settle, as well as opinions from other jurisdictions touching on the issue. In Pennsylvania, an insured cannot reject an insurer's defense as that would be a breach of the policy, disclaiming coverage, but if the insurer and insured's interests are not aligned when it comes to settlement, particularly in a reservation of rights scenario, the insured is placed in a delicate situation, facing the potential of paying a verdict in excess of the policy limits or the entire verdict if coverage is found to be unavailable. Therefore, as long as the settlement is fair

and reasonable, an insurer must provide reimbursement when it did not consent to the settlement, should coverage be found. This solution allows the insured to protect itself from an excess verdict and allows the insured to control what sums of money to be paid out should coverage not be found. This solution also protect the insurer, as the insurer can still dispute coverage in the future and the settlement must be fair and reasonable. A determination of whether the settlement is fair and reasonable entails consideration of the terms of the settlement, the strength of the insured's defense against the asserted claims, and whether there is any evidence of fraud or collusion on the part of the insured.

In adopting the test it did, the Supreme Court reinstated the trial court's ruling and held that Babcock was entitled to reimbursement from ANI because the trial court had found the settlement to be fair and reasonable. This approach is consistent with the current draft of the Restatement of the Law of Liability Insurance, although it is still unpublished. This rule is beneficial to both insurers and insureds: policyholders are allowed to enter into a reasonable settlement over the insurer's objection, rather than risk a substantial and adverse verdict at trial, without forfeiting coverage, and at the same time, insurers can still contest coverage for a settlement that is unreasonable or one that is not covered under the terms of the policy. The court's "reasonable settlement" standard is a strong and fair statement of Pennsylvania law that protects and preserves policyholders' and insurers' rights and interests at the critical settlement stage of underlying litigation.

*Please contact the author if you'd like a copy of the opinion for Babcock & Wilcox Company, et al. v. American Nuclear Insurers, et al., No. 2 WAP 2014, \_\_ A.3d \_\_, 2015 Pa. LEXIS 1551 (2015).*