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Stipulated Judgments to Set Up Insurers — Not In California

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The California Court of Appeal for the Fourth District, Division Two, in 21st Century Insurance Co. v. Superior Court (Tapia), 240 Cal.App.4th 322, 192 Cal.Rptr.3d 322 (No. E062244, Sept. 10, 2015), recently confirmed some of the important protections afforded to defending insurers against stipulated judgments and leaves little doubt that, under California law, policyholders may not "set up" a defending insurer for bad faith by entering into stipulated judgment in excess of limits without their insurer's consent. While this bedrock principle of California insurance law was firmly addressed and established in the Hamilton v. Maryland Casualty Co.[1] and Safeco Insurance Co. v. Superior Court[2] decisions, the court in 21st Century has limited the application of other appellate decisions that have been relied on by claimants and policyholders seeking to circumvent the Hamilton rule against bad faith actions premised on such stipulated judgments without a trial on damages.

In 21st Century, the Court of Appeal enforced the Hamilton rule established by the California Supreme Court and granted the insurer's petition for writ to reverse the denial of its summary judgment as to a bad faith claim premised on a $4.15 million stipulated judgment entered into between the injured passenger claimants and driver policyholder. The stipulated judgment coupled with a covenant not to execute against the policyholder's assets was entered in the underlying action while 21st Century defended its policyholder under only one of the three policies issued to the policyholder and after 21st Century's refusal to pay more than the defending policy's $100,000 limit in response to a settlement demand. Although the insurer later offered an additional $50,000 in limits ($25,000 from each of its two other policies), the claimant withdrew its offer to settle for the $150,000 and sought to transform 21st Century's initial refusal to settle for $150,000 into a multimillion-dollar bad faith lottery ticket.

The so-called Hamilton rule was fashioned by the California Supreme Court in 2002, when it held in that case that an insurer cannot be required to pay a settlement reached by its policyholder without the insurer's participation and consent where the insurer defended the underlying lawsuit and the policyholder did not bear any actual liability for the stipulated judgment amount, even if a court found the settlement was made in good faith.[3] By the time the Hamilton case was decided, a line of California intermediate appellate decisions — culminating in the Safeco decision — had concluded that settlements reached without the participation or consent of the defending insurer, for which the policyholder was not actually liable, did not prove liability or damages in a later action against the insurer for alleged bad faith failure to settle.[4] Although the claimant argued that the determination that the settlement was in good faith and was collusive should permit the settlement to be evidence of

damages caused by the defending insurer that declined to settle the case.[5] The California Supreme Court confirmed the correctness of the Safeco line of intermediate appellate cases and rejected the argument for an exception to that rule: even if the insurer's refusal to settle was unreasonable, and despite the settlement being approved as reasonable and not collusive, the court concluded that "the agreed judgment cannot fairly be attributed to the insurer's conduct."[6]

The Fourth District Court of Appeal based its reasoning on the fact that Hamilton had held that the damages agreed to in a stipulated judgment entered into between a defended insured and the claimant have no weight in a later bad faith action against the insurer because the damages were not determined after an adversarial actual trial. It noted that, under Hamilton and the Safeco case on which it relied, the defended policyholder whose insurer refuses a settlement may strike a deal to assign the policyholder's contract and bad faith rights after judgment in exchange for a covenant not to execute, but they cannot skip past the actual trial by directly settling for what they think the case is worth.

The policyholder in 21st Century tried to get around the Hamilton rule by arguing that 21st Century had breached its duty to defend by offering an inadequate and ineffective defense. But the court noted that both Hamilton and Safeco had rejected such arguments. The court observed that such stipulated judgments arise only when some party believes its insurer has acted in bad faith, and so "hyperbolic and accusatory" recitations of wrongdoing do not avoid the rule of Hamilton.[7]

The policyholder also relied on the post-Hamilton intermediate appellate decision in Risely (permitting action against defending insurer on stipulated judgment as to nondefending policies) and the pre-Hamilton decision of the California Supreme Court in Wint (permitting action against non-defending insurer on direct settlement despite policyholder being defended by settling insurer).[8]

The Court of Appeal rejected that argument, finding Risely and Wint distinguishable as being limited to the circumstance where the defending policy had significantly lower limits than the nondefending policy (one-seventh and one-tenth in those cases, respectively), so the protection offered by the defending policy was considered significantly less effective.[9] The court concluded that, "even if [the insurer] had a duty to defend under all [three] policies, its partial breach of that duty cannot have affected the defense offered" and observed it was "beyond dispute at the time the plaintiff's offer to settle for $150,000 was not accepted" that 21st Century did not have a duty to defend under the two other policies.[10]

Importantly, these protections against stipulated judgments apply only where the insurer is defending. If an insurer refuses to defend, "the insured is free to enter into a noncollusive settlement and then maintain or assign an action against an insurer for breach of the duty to defend. In the subsequent action the amount of the settlement *will* be presumptive evidence of the amount of the insurer's liability."[11]

The 21st Century decision confirms that the limitations against defended policyholders stipulating to judgments to create bad faith cases are alive and well under California law and stipulated judgments provide no reliable basis to establish damages resulting from a defending insurer's decision not to settle an underlying action.

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[1] 27 Cal.4th 718 (2002).

[2] Safeco Insurance Co. v. Superior Court (McKinney), 71 Cal.App.4th 782 (Ct.App. 1999).

[3] Hamilton, 27 Cal.4th at 724-725.

[4] Id. at 726-727.

[5] Id. at 728.

[6] Id. at 731.

[7] 21st Century, 240 Cal.App.4th at 328 n. 6.

[8] Risely v. Interinsurance Exchange of the Auto Club, 183 Cal.App.4th 196 (Ct.App. 2010); Wint v. Fidelity & Casualty Co., 9 Cal.3d 257 (1973).

[9] 21st Century, 240 Cal.App.4th at 329.

[10] Id. at 329-330.

[11] Id. at 328.

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