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LAW ALERT

The Reasonableness of an Insurer's Decision to Withhold Consent to Settle is Assessed from the Insurer's Perspective, Not the Insured's

Apollo Education v. National Union Fire Ins. Co.
Arizona Supreme Court | February 17, 2021
By: **Eileen GilBride**

Apollo operates several universities in various countries. National Union insured Apollo's directors and officers under a directors and officers' liability policy. The policy included no duty to defend the insured if sued. Instead, Apollo would defend itself against any claims. Correspondingly, the policy contained no clause requiring the insured to cooperate with a defense provided by National Union. The policy also required the insured to obtain the insurer's consent before admitting liability, settling, stipulating to any judgment or incurring defense cost; and required that the insurer "shall not [ ] unreasonably withh[o]ld consent."

Shareholders filed a class action against Apollo after an investigation revealed Apollo backdated stock options for corporate executives. During the case, plaintiffs and Apollo agreed to settle for an amount just under the remaining National Union policy limits, but National Union refused to consent. Apollo entered the settlement agreement anyway and paid plaintiffs. It then sued National Union to recover the settlement amount, alleging breach of contract and bad faith.

The federal court certified to the Arizona Supreme Court the question of whether the court should assess National Union's reasonableness in refusing to consent from the perspective of the insurer or the insured. The Supreme Court responded in a 5-to-2 split decision. The majority interpreted the policy language to mean that the insured's only obligation was not to do things without the insurer's consent; otherwise, "it speaks entirely to the insurer's perspective." The policy vests the power of consent to a settlement in the insurer, modifying that power with the requirement that the insurer may not "unreasonably" withhold consent. Thus, the standard here should focus on the reasonableness of the insurer's conduct, as it was the party given the right to withhold consent under the contract. Further, said the court, the insured has a strong and often adverse interest in settling within policy limits regardless of the merits of the claim. On the other hand, where the insurer has no control over the defense, it is more reasonable "that the insurer's perspective, which necessarily includes consideration of the strength of the underlying claim in accord with its interest in avoiding unnecessary payment, should prevail." The converse would be true, though, if the insurer controls the defense. The majority rejected the argument that this issue is controlled by USAA v. Morris, which holds that the test of whether a settlement is reasonable is assessed from a reasonably prudent person in the insured's position. The insurer's duty to defend, the insured's duty to cooperate, and the insurer's reservation of rights in that case distinguishes it from this one.

The court then explained how to determine reasonableness from the insurer's perspective. The inquiry is an objective one: "did the insurance company act in a manner consistent with the way a reasonable insurer would be expected to act under the circumstances"? To act reasonably, the insurer must conduct a full investigation into the claim and fairly value it. It may, however, discount considerations that matter only or mainly to the insured in desiring to settle the case—for example the insured's financial status, public image, and policy limits. The insurer may decline consent if the settlement exceeds its reasonable determination of the value of the claim. And the insurer's determination should be sustained if, under the totality of the circumstances, it protects the insured's benefit of the bargain so that the insurer is not refusing to pay a valid claim without justification. The court concluded that an insurer is unlikely to reject a settlement if the objective value of the claim is commensurate with the settlement, for it will likely have to pay out regardless. Should the insurer act unreasonably in rejecting the settlement, the insured may challenge that determination, and may file a bad-faith tort action if circumstances warrant.

The two dissenting justices believed the policy was silent on whether the reasonableness of the insurer's decision should be viewed from the insurer's or the insured's perspective. They believed the answer to the certified question is that, under
Arizona law, the implied covenant of good faith and fair dealing required National to give equal consideration to Apollo's interests as well as its own in deciding whether to consent to the settlement agreement. This framework for third-party settlement offers has been the law in Arizona for decades. Furthermore, said the dissent, the majority's explanation of how to determine reasonableness uses a standard that is indistinguishable from the equal consideration standard.

The dissent explained that for first-party claims, the reasonableness of a settlement is examined from the perspective of the insurer. But in the third-party context, the insured's liability to the claimant may exceed the policy limits, and thus there is "the added risk of subjecting the insured to liability in excess of the policy limits because of the insurer's bad faith refusal to settle within those limits." As such, in third-party contexts, the duty of good faith requires an insurer to give equal consideration to the protection of the insured's as well as its own interests." The dissent criticized the majority for applying a first-party standard to a settlement involving a third-party claim. The duty defend is not the determinative factor; it is the implied duty of good faith and fair dealing.

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