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AIG's $13M Battle May Bolster Insurers' Settlement Challenges

By **Jeff Sistrunk**

Law360 (August 20, 2019, 10:51 PM EDT) -- The Ninth Circuit recently sought the Arizona Supreme Court's help to decide whether an AIG unit was justified in its refusal to cover the University of Phoenix's $13 million settlement of a class action, and attorneys say a ruling in the insurance company's favor could give other carriers more leverage to challenge the reasonableness of policyholders' deals.

The long-running dispute revolves around a key term in a directors and officers policy that AIG unit National Union Fire Insurance Co. of Pittsburgh, Pa., issued the for-profit university's parent, Apollo Education Group, providing that the insurer won't unreasonably withhold consent for a settlement by the policyholder. While an Arizona federal judge held in 2017 that National Union had reasonably refused to consent to Apollo's underlying deal in a securities class action, a Ninth Circuit panel wasn't so sure, noting in an **Aug. 15 opinion** that there was no controlling precedent on the issue.

As a result, the appellate panel asked the Arizona Supreme Court to weigh in to establish the proper standard "for determining whether National Union unreasonably withheld consent to Apollo's settlement with shareholders in breach of contract" under a policy where the insurer has no duty to defend — that is, an obligation to cover the policyholder's costs to defend a lawsuit while it is ongoing. Apollo's D&O policy only requires National Union to reimburse certain defense and settlement expenses incurred by the policyholder after the fact.

National Union has argued that the analysis should focus on whether the insurer had a reasonable basis to refuse consent, not whether the settlement was "objectively reasonable" from Apollo's perspective.

According to attorneys interviewed by Law360, the Arizona justices' decision on the issue could have far-reaching implications both in the state and nationwide, given the dearth of case law directly addressing D&O insurers' obligations under identical or similar "consent-to-settle" provisions.

Lawyers who represent policyholders expressed concerns that a ruling endorsing National Union's position could permit insurance companies to second-guess their insureds' settlement decisions after the fact and contest any deals that implicate their policy limits. That could tie policyholders' hands and prevent them from efficiently resolving claims, attorneys said.

"Your goal as the policyholder's defense counsel is to minimize the client's liability," said Jassy Vick Carolan LLP partner William Um. "For the carrier in that situation to hold up the case and hold the policyholder's decision-making authority hostage is extremely frustrating."

However, attorneys who counsel insurance companies said it is unlikely that carriers would use a decision in National Union's favor as ammunition to mount unwarranted challenges to policyholders' settlements. That's because if an insurer refuses consent for a deal and a court later finds it acted unreasonably, it could find itself facing a large bad faith judgment, lawyers said.

"Even if the standard is based on the insurer's perspective, the insurer will still have to be conscious as to whether it will have to face a bad faith claim later," said Wilson Elser Moskowitz Edelman & Dicker LLP partner Jessica Collier.

Collier added that insurers often have "more distance from the [underlying] matter to decide whether a settlement is reasonable," whereas a policyholder and its counsel "usually have no reason to want to have a lower settlement if they won't owe any money towards it."

"As the one paying the settlement, the insurer is more likely to look at all the factors and analyze the insured's potential liability and the size of a potential judgment to determine the best possible amount," she said.

The roots of National Union's coverage dispute with Apollo date back to 2006, when a Teamsters pension fund hit the education company with a class action complaint claiming its top executives made hundreds of millions of dollars by selling backdated stock options. Apollo ultimately agreed to settle the case for just over $13 million in 2015, while the fund's appeal of a trial court's second dismissal order was pending, according to court documents.

National Union declined to cover the deal, contending that Apollo's chances of defeating the fund's appeal were strong, and Apollo responded by filing a breach of contract and bad faith suit in Arizona federal court. U.S. District Judge Steven P. Logan ruled in October 2017 that National Union was within its rights to withhold consent for the settlement, prompting Apollo to appeal to the Ninth Circuit.

In briefs filed with the appellate court, Apollo contended that, under Arizona law, an insurer is required to consent to any objectively reasonable settlement. To bolster its position, Apollo cited the Arizona Supreme Court's 1987 decision in United Services Automobile Association v. Morris and a midlevel Arizona appeals court's 2003 ruling in Himes v. Safeway Insurance Co., which applied Morris' reasoning.

In Morris, the Arizona justices found that a policyholder's settlement will generally be deemed reasonable — such that the insurer must accept it — if "a reasonably prudent person in the [policyholder's] position" would have settled for that sum "on the merits of the claimant's case."

But the Ninth Circuit panel agreed with National Union that Morris and Himes don't govern the case at hand because neither matter interpreted a consent-to-settle provision like the one in Apollo's D&O policy. Moreover, the panel said, both of those prior cases involved insurers that had a duty to defend, while National Union only has a duty to reimburse Apollo.

Some attorneys who represent policyholders told Law360 that the reasonableness standard endorsed in Morris and Himes may be even more appropriate in coverage battles involving reimbursement policies like National Union's.

"With a duty to defend policy, the carrier is controlling the policyholder's defense strategy, but that is not the case with a duty to reimburse policy," said Barnes & Thornburg LLP partner John Corbett. "It would seem unfair that an insurance company that has no duty to defend the case could be allowed to come in after the fact, disagree with defense counsel and effectively assume veto control over the settlement process, then hand the case back to the policyholder to continue defending."

Conversely, Hinshaw & Culbertson LLP partner Larry Golub, who represents insurers, said the rationale of Morris and Himes is not applicable in National Union's situation. The fact that the insurer did not control Apollo's defense strategy provides a compelling reason for it to be able to question the wisdom of the education company's settlement, he said.

As Golub sees it, the consent-to-settle provision at issue "makes clear that the question of whether National Union's decision to withhold consent was reasonable must be viewed from the insurer's perspective."

"The insured here, Apollo, happened to — perhaps not coincidentally — cut a deal for the remaining policy limits. Naturally, then, the insurer is entitled under the policy provision to consider whether the settlement was justified, so long as it does not unreasonably withhold its consent."

Other attorneys opined that the Arizona Supreme Court could expand on its pronouncements in Morris or take a different approach entirely.

Pillsbury Winthrop Shaw Pittman LLP partner Joan Cotkin said she hopes the state high court will adopt

a benchmark requiring an insurer to conduct a full investigation and assert specific reasons for disagreeing with the settlement recommendations made by the policyholder's defense counsel. Here, she noted, Apollo's defense attorneys recommended the $13 million deal after concluding the company could have faced liability up to $1 billion if the shareholders' case had been resurrected on appeal.

"The defense counsel recommendations must be of paramount importance, and to contradict the recommendations, the insurer should have to show that before the decision to withhold is made, it made a thorough and objective investigation of the liability and damages that pertain to the case," Cotkin said.

"The consent provision should not be a blank check to say, 'We don't consent and we'll do our investigation later," she added.

Clark & Fox partner Michael Savett, who represents insurance companies, suggested that the state justices could follow Judge Logan's lead and endorse an intermediate Arizona appellate court's 1999 ruling in the case of Bills v. Arizona Property & Casualty Insurance Guaranty Fund .

Applying the Bills decision, Judge Logan determined that National Union was required to give "equal consideration to both the interests of itself and of its insured" — a duty that the judge concluded National Union had met by "considering the terms of the Teamsters' settlement" with Apollo before denying consent.

In its Aug. 15 opinion, though, the Ninth Circuit panel said Bills did not answer the core question in National Union's dispute with Apollo because the 1999 decision was "plainly setting forth the meaning of an insurer's obligations under the 'implied covenant of good faith and fair dealing,' not an insurer's obligations under a consent-to-settle provision." But Savett said he thought the principles articulated in Bills are equally applicable to a consent-to-settle clause.

"In my view, the implied covenant of good faith and fair dealing governs an insurance company's conduct regardless of the type of claim or whether or not an insurer has a duty to defend," he said. "That standard should equally govern an insurer's decision to grant or withhold consent for settlement."

--Editing by Aaron Pelc and Emily Kokoll.
