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Recent Developments in California Insurance Law: Enforceability of Stipulated Judgments Against Insurance Carriers

Steven L. Paine*
Wynn Heather Sourial**

I. INTRODUCTION

Over the past several years, insurance law has dramatically shifted from pro-insured to pro-insurer with respect to stipulated judgments. The time period from the 1950s through the mid-1980s marked the golden-age of plaintiff-oriented insurance litigation during which the courts almost uniformly protected the interests of the insured at the expense of the insurer. During that time, a tort claimant and the insured tortfeasor would enter into a stipulated judgment. The insured would assign his insurance rights to the tort claimant in exchange for a covenant not to execute against the insured's uninsured assets. The tort-claimant could then seek to enforce the stipulated judgment against the insured's insurance carrier using the stipulated judgment as a sword against a non-performing insurer.

Over the last several years, however, California courts have chipped away at this concept, sub-issue by sub-issue. In several recent deci-

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sions,¹ the California Court of Appeal rejected attempts to enforce stipulated judgments against insurers, viewing the judgments as almost collusive per se. As such, they were unenforceable under any circumstances. Even with this change in attitude toward stipulated judgments, courts will still enforce them where the evidence shows no risk of collusion.²

This Article examines current California case law and addresses the viability of stipulated judgments in light of this recent trend. Section II provides a historical perspective of cases through which the enforceability of stipulated judgments against non-performing insurers developed.³ Section III discusses the most recent cases which have addressed stipulated judgments and the various insurance provisions which affect the viability of enforcing a stipulated judgment.⁴ Section IV examines the effect an insurer's breach will have on enforcement of a stipulated judgment.⁵ Section V suggests to the practitioner how to fashion an enforceable stipulated judgment.⁶

II. HISTORICAL PERSPECTIVE

Historically, an assignment of rights by an insured to a third party tort claimant was viewed as a powerful and necessary tool to facilitate recovery against an insurer who refused to defend its insured. Although most of the early cases involving the assignment of rights and subse-

1. See, e.g., *McLaughlin v. National Fire Ins. Co.*, 29 Cal. Rptr. 2d 559, 571 (Ct. App. 1994) (contending that a stipulated judgment combined with a covenant not to execute absolutely protects the insured against liability, therefore, providing no incentive to contest liability or damages); *Xebec Dev. Partners, Ltd. v. National Union Fire Ins. Co.*, 15 Cal. Rptr. 2d 726, 768 (Ct. App. 1993) (holding that the record supported the trial court's conclusion that a stipulated judgment in exchange for a covenant not to execute does not have collateral estoppel effect against the insurer); *Wright v. Fireman's Fund Ins. Co.*, 14 Cal. Rptr. 2d 588, 603 (Ct. App. 1992) (explaining that there is a potential for collusion when a stipulated judgment under which the insured has no personal liability binds the insurer); *Smith v. State Farm Mut. Ins. Co.*, 7 Cal. Rptr. 2d 131, 137 (Ct. App. 1992) (holding that a stipulated judgment which does not represent a "recovery against" the insured will not bind the insurer); *Rose v. Royal Ins. Co. of Am.*, 3 Cal. Rptr. 2d 483, 486 (Ct. App. 1991) (acknowledging that a settlement agreement between the insured and the injured party does not protect the insurer against collusion).

2. See *Sanchez v. Truck Ins. Exch.*, 26 Cal. Rptr. 2d 812, 815 (Ct. App. 1994) (holding that an insurer cannot rely on a "no-action" clause and "refuse to defend its insured . . . where a stipulated judgment was obtained against the insured in good faith").

3. See *infra* notes 7-38 and accompanying text.

4. See *infra* notes 39-206 and accompanying text.

5. See *infra* notes 207-52 and accompanying text.

6. See *infra* notes 253-55 and accompanying text.

quent enforcement of a judgment against an insurer did not actually involve stipulated judgments, they are often cited as support for the enforcement of stipulated judgments. In the past, an insured's liability could only be enforced against an insurer if a default judgment had been entered or if an uncontested proceeding had been held.⁷ When the insurer breached its primary duties, an insured could "settle with the plaintiff upon the best terms possible, taking a covenant not to execute."⁸ Indeed, to demonstrate collusion on the part of the insured, courts often required the insurer to plead, and prove with specificity, that the plaintiff "had no substantial claim or chance of recovery and that the parties had permitted a judgment [in the victim's] favor which was disproportionate to his injuries"⁹

In *Critz v. Farmers Insurance Group*,¹⁰ the court stated, "[w]hen the injured person takes over the policyholder's cause of action against the insurer, actual or only potential, he arms himself with a weapon of great strength."¹¹ In *Critz*, the plaintiff suffered severe injuries as a result of the defendant insured's negligence.¹² Although the insured had a policy limit of \$10,000, the insurance carrier offered the plaintiff only \$8250.¹³ Subsequently, the plaintiff secured an assignment of rights for

7. In *Samson v. Transamerica Insurance Co.*, 636 P.2d 32 (Cal. 1981), the court held the insurer liable for damages in excess of its policy limits when it wrongfully rejected a settlement offer and refused to defend its insured. *Id.* at 46. The claimant established the amount of damage by an uncontested presentation to the trial court on the "short cause" calendar. *Id.* at 37. Similarly, in *Zander v. Texaco, Inc.*, 66 Cal. Rptr. 561 (Ct. App. 1968), the court approved a settlement agreement and an assignment of rights where, following settlement, the insured allowed a default judgment to be issued against him. *Id.* 567-69. Likewise, in *Critz v. Farmers Insurance Group*, 41 Cal. Rptr. 401 (Ct. App. 1964), because the insurer presented virtually no defense in the underlying action, a fully contested trial on the merits did not take place. *Id.* at 403.

8. *Samson*, 636 P.2d at 45 (quoting *Zander*, 66 Cal. Rptr. at 568); see also *State Farm Mut. Auto. Ins. Co. v. Paynter*, 593 P.2d 948, 951-52 (Ariz. 1979) (citing cases in which the court allowed the insurer to attack a stipulated judgment against its insured when the evidence showed collusion).

9. *Zander*, 66 Cal. Rptr. at 570.

10. 41 Cal. Rptr. 401 (Ct. App. 1964).

11. *Id.* at 408. The *Critz* opinion recognized two prevailing public policy considerations: First, "the public interest in encouraging settlements," and second, "fairness, that is, equalization of the contenders' strategic advantages." *Id.*

12. *Id.* at 402. At the time of the accident, defendant was driving on the opposite side of the road. *Id.*

13. *Id.* at 403.

the insured's cause of action for bad faith refusal to settle.¹⁴ In exchange, the insured received a covenant exempting him from any liability in any subsequent judgment.¹⁵ The plaintiff then secured a judgment in excess of the insured's policy limits and filed an action against the insurer.¹⁶ On appeal, the court held that the assignment of the insured's cause of action for bad faith against the insurer did not violate public policy, even though the assignment occurred prior to a determination of liability against the insured.¹⁷

In *Samson v. Transamerica Insurance Co.*,¹⁸ the California Supreme Court confronted a similar scenario in which an insurer breached its duties to defend and to accept a reasonable settlement offer within its policy limits.¹⁹ In *Samson*, the court addressed whether an insurer must satisfy a judgment entered against the insured even though the insurer was not a party to the action which gave rise to the judgment.²⁰

The underlying action involved an automobile accident.²¹ The insured had two insurance policies: one with State Farm Mutual Automobile Insurance Company (State Farm) for \$100,000, and the other with Transamerica Insurance Company (Transamerica) for \$300,000.²² State Farm agreed to assume the defense in the ensuing civil action while Transamerica denied coverage under its policy.²³

Prior to trial, the plaintiffs, the insured, and State Farm entered into a settlement agreement whereby State Farm paid its policy limit and the insured assigned his cause of action against Transamerica for a "covenant not to execute."²⁴ The court tried the case on the "short cause calendar" where the plaintiffs submitted the evidence of the insured's criminal conviction.²⁵ The plaintiffs presented evidence regarding the amount of damages.²⁶ The insured presented no defense and declined

14. *Id.*

15. *Id.*

16. *Id.*

17. *Id.* at 409.

18. 636 P.2d 32 (Cal. 1981).

19. *Id.* at 34-35.

20. *Id.* at 34.

21. *Id.* at 35. The collision occurred because the insured was driving on the "wrong side of the road." *Id.* The insured pled guilty to vehicular manslaughter. *Id.*

22. *Id.*

23. *Id.* at 36-37.

24. *Id.* at 37.

25. *Id.*

26. *Id.* The amount of damages included the extent of plaintiffs' injuries and the "value of the loss of the services of Mrs. Samson." *Id.*

to cross-examine adverse witnesses.²⁷ The court awarded the plaintiffs \$725,000 in damages.²⁸

The plaintiffs offered to settle the \$625,000 balance of their claim with Transamerica for the \$300,000 policy limit, but Transamerica did not respond.²⁹ Relying upon the assignment of rights from the insured, the plaintiffs sued Transamerica for bad faith and obtained a summary judgment award of \$625,000.³⁰

On appeal, Transamerica argued that the court should set aside the judgment because the parties engaged in collusion and "set up" the excess policy judgment against it" in bad faith.³¹ The court concluded that there was no evidence of collusion or bad faith.³² The court stated that "[w]hen the insurer 'exposes its policyholder to the sharp thrust of personal liability' by breaching its obligations, the insured 'need not indulge in financial masochism . . .'"³³ Moreover, the court found that, "[b]y executing the assignment, [the insured] attempt[ed] only to shield himself from the danger to which the company . . . exposed him."³⁴ The court concluded that Transamerica was bound to the full judgment against its insured.³⁵ In doing so, the court relied on the well established rule that "an insurer that wrongfully refuses to defend is liable on the judgment against the insured"³⁶ and the equally well established rule that an insurer that rejects a reasonable settlement offer within policy limits must also pay the overlimits portion of the judgment.³⁷

As illustrated by *Critz* and *Samson*, California courts considered an assignment of rights following a default judgment or settlement agreement a legitimate means of protecting the insured from personal liability. By contrast, the more recent cases view assignments of rights based

27. *Id.*

28. *Id.*

29. *Id.* at 37.

30. *Id.* at 37-38.

31. *Id.* at 44.

32. *Id.* at 45.

33. *Id.* (quoting *Critz v. Farmers Ins. Group*, 41 Cal. Rptr. 401, 408 (Ct. App. 1964)).

34. *Id.*

35. *Id.* at 46.

36. *Id.* at 42 (citing *Gray v. Zurich Ins. Co.*, 419 P.2d 168, 179 (Cal. 1966)).

37. *Id.* (citing *Johansen v. California State Auto Ass'n. Inter-Ins. Bureau*, 538 P.2d 744, 746 (Cal. 1975)).

solely upon a stipulated judgment between the insured and the tort claimant as collusive per se and unenforceable against the insurer.³⁸

III. RECENT DEVELOPMENTS PERTAINING TO THE ENFORCEMENT OF STIPULATED JUDGMENTS

A. *Insurer Must Have the Opportunity to Participate in Settlement Negotiations to Overcome the Presumption of Collusion*

In *Wright v. Fireman's Fund Insurance Co.*,³⁹ the court observed the potential for "abuse and collusion" when the insured and a third party tort claimant enter into a stipulated judgment that is not based upon a contested trial proceeding.⁴⁰ In *Wright*, the insured pled guilty to felony drunk driving that resulted in a head-on collision with the plaintiffs.⁴¹ Prior to trial, the insured's personal counsel negotiated a settlement agreement with the plaintiffs in exchange for a covenant not to execute against the insured.⁴² Counsel for the insurer did not participate in the settlement negotiations but was present at the hearing when the stipulated judgment was read into the record.⁴³

Subsequently, the plaintiffs proceeded to litigate the issue of insurance coverage.⁴⁴ The trial court granted summary judgment in favor of the plaintiffs, concluding that the identified policies insured the defendant.⁴⁵ The trial court then entered judgment against the insurer in the amount of the stipulated judgment.⁴⁶

On appeal, the court addressed whether the stipulated judgment was sufficient to bind the insurer.⁴⁷ The court opined that while a party must obtain a final judgment against the insured before suing an insurer directly,⁴⁸ the party does not always need to obtain a judgment on the merits.⁴⁹ The court recognized that default and stipulated judgments

38. See *infra* notes 207-52 and accompanying text.

39. 14 Cal. Rptr. 2d 558 (Ct. App. 1992).

40. *Id.* at 603. The court stated, "[w]e are frankly disturbed by the potential for abuse apparent in a situation where an insurer, in the absence of a breach of its duty to its insured, could be bound by a consent judgment of this nature." *Id.* at 600.

41. *Id.* at 589. The collision injured the plaintiff and killed the plaintiff's passenger. *Id.*

42. *Id.* at 590.

43. *Id.*

44. *Id.*

45. *Id.* at 592-93.

46. *Id.* at 594.

47. *Id.* at 595-604.

48. *Id.* at 598 (citing *Chamberlin v. City of Los Angeles*, 206 P.2d 661 (Ct. App. 1949)).

49. *Id.* (citing *Samson v. Transamerica Ins. Co.*, 636 P.2d 32 (Cal. 1981); *Clemmer*

have bound insurers.⁵⁰ The court further noted that a settlement agreement between the insured and a tort claimant binds the insured even where the agreement contains a covenant not to execute against the insured.⁵¹ The court stated that its judgment was "based upon the principle that an insurer who has an opportunity to defend and wrongfully fails to do so is liable on the judgment against the insured."⁵²

However, the court recognized the potential for fraud and collusion in the situation in which an insured, who has no incentive to contest liability or damages, attempts to bind its insurer through a settlement agreement.⁵³ On that basis, the court ruled that

where an insurer provided a defense to its insured in the underlying litigation, and the insured, without the participation or consent of the insurer, stipulated to a judgment without evidentiary support and with no potential for personal loss, such judgment is insufficient to impose liability on the insurer in a later action⁵⁴

The court concluded that "[t]o hold otherwise would create in the insured the ability to escape all liability for his or her own wrongdoing while imposing on the insurer totally unsupported liability."⁵⁵

B. A Final Determination of Liability is a Prerequisite to Enforcement of a Stipulated Judgment

One area which often causes confusion for practitioners and the court is the distinction between *enforcement of a stipulated judgment* against an insurer and a *bad faith action* against an insurer based upon a stipulated judgment. Often, a third party plaintiff brings a bad faith action against the insurer after entering into a stipulated judgment with the insured.

v. Hartford Ins. Co., 587 P.2d 1098 (Cal. 1978); *Zander v. Texaco, Inc.*, 66 Cal. Rptr. 561 (Ct. App. 1968).

50. *Id.* (citing *Samson*, 636 P.2d at 32, 42-46); *Clemmer*, 587 P.2d at 1108-09; *Zander*, 66 Cal. Rptr. at 568-70).

51. *Id.* at 599 (citing *Samson*, 636 P.2d at 45; *Johansen v. California State Auto. Ass'n Inter-Ins. Bureau*, 538 P.2d 744 (Cal. 1975); *Zander*, 66 Cal. Rptr. at 568; *Critz v. Farmers Ins. Group*, 41 Cal. Rptr. 401, 408-09 (Ct. App. 1964)).

52. *Id.* at 600 (citing *Samson*, 636 P.2d at 42; *Clemmer*, 587 P.2d at 1108; *Zander*, 66 Cal. Rptr. at 567).

53. *Wright*, 14 Cal. Rptr. 2d at 603-04.

54. *Id.*

55. *Id.* at 604.

This situation is distinctly different from an enforcement action, and accordingly, different legal principles apply.⁵⁶

In *Smith v. State Farm Mutual Automobile Insurance Co.*,⁵⁷ the court held that an insured cannot assign his rights against the insurer to a third party unless either a court has made a final determination of the insured's liability or the insured has personally paid part of the settlement.⁵⁸ In *Smith*, the insured struck and killed the plaintiffs' son in an automobile accident.⁵⁹ Subsequently, the plaintiffs brought a wrongful death action against the insured.⁶⁰

Before the case went to trial, the plaintiffs, the insured, and one of its insurers, Fireman's Fund Insurance Company, reached a settlement which included a stipulated judgment in the amount of \$500,000.⁶¹ Pursuant to the stipulated judgment, the insured assigned to the plaintiffs "all claims that he might have against State Farm for its failure to defend or settle the wrongful death action."⁶² The plaintiffs promised the insured that they would not execute the stipulated judgment against him as consideration for the assignment.⁶³ Fireman's Fund partially satisfied the judgment by paying its policy limits.⁶⁴ Plaintiffs then sued State Farm for breach of the implied covenant of good faith and fair dealing based upon State Farm's failure to defend its insured.⁶⁵

The *Smith* court acknowledged the well established rule that

[i]f an insurer 'erroneously denies coverage and/or improperly refuses to defend the insured' in violation of its contractual duties, 'the insured is entitled to make a reasonable settlement of the claim in good faith and may then maintain an action against the insurer to recover the amount of the settlement.'⁶⁶

The court recognized that an "insured may assign to the claimant his cause of action against the insurer for breach of the implied covenant"⁶⁷

56. See *Moradi-Shalal v. Fireman's Fund Ins. Cos.*, 758 P.2d 58, 69-70 (Cal. 1988) (holding that "there must be a conclusive judicial determination of insured's liability" and that "settlement is . . . insufficient").

57. 7 Cal. Rptr. 2d 131 (Ct. App. 1992).

58. *Id.* at 137.

59. *Id.* at 133.

60. *Id.*

61. *Id.* at 134.

62. *Id.*

63. *Id.*

64. *Id.*

65. *Id.*

66. *Id.* at 135 (quoting *Isaacson v. California Ins. Guarantee Ass'n*, 750 P.2d 297 (Cal. 1988) (citations omitted)).

67. *Id.* (citing *Murphy v. Allstate Ins. Co.*, 553 P.2d 584, 587 (Cal. 1976) (citations omitted)). As a limited exception to this rule, the court noted that an insured cannot assign claims for punitive damages or emotional distress. *Id.*

In light of these principles, the *Smith* court addressed two separate issues. First, the court determined whether “a judgment against the insured [is] a necessary condition to its power to assign a cause of action for bad faith against the insurer.”⁶⁸ The court ruled that an insurer may assign his rights only after a judgment against the insured has been entered.⁶⁹ The court indicated that its ruling was in accordance with California Evidence Code section 1155 which prohibits the admission of evidence as to insurance coverage in personal injury actions,⁷⁰ ensures that the insured’s liability is determined on the merits,⁷¹ and avoids placing “excess insurers at an unfair disadvantage.”⁷²

Second, the court addressed whether a stipulated judgment with a covenant not to execute suffices as the requisite “judgment.”⁷³ The court ruled that a stipulated judgment with a covenant not to execute is not a “judgment against the insured” because it does not impose liability against the insured.⁷⁴ The court explained that “[a] stipulated judgment with a covenant not to execute will not bind the insurer under Civil Code section 2778, subdivision 5, because it does not represent a ‘recovery against’ the insured”⁷⁵ The statute refers to a recovery which imposes liability, whereas a “covenant not to execute *shields* the insured from such liability.”⁷⁶ Accordingly, the court stated that an insurer would not be bound by a stipulated judgment which contains a covenant not to execute because it does not represent a recovery against the in-

68. *Id.* at 136.

69. *Id.* at 137 (discussing *Isaacson v. California Ins. Guarantee Ass’n*, 750 P.2d 297 (Cal. 1988) (holding that an insured who contributed to a settlement could sue its insurer before entry of a final judgment); *Continental Casualty Co. v. Royal Ins. Co.*, 268 Cal. Rptr. 193 (Ct. App. 1990) (permitting an excess insurer to sue primary insurer for bad faith refusal to settle).

70. *Smith*, 7 Cal. Rptr. 2d at 136; see CAL. EVID. CODE § 1155 (West 1993).

71. *Smith*, 7 Cal. Rptr. 2d at 136. The court noted that an assignment of a tort claim for damage to property does not “compromise the adjudication of liability to the same extent because it does not remove the tortfeasor as a party to the litigation.” *Id.*

72. *Id.* at 137. The court stated that “[i]f such assignments were allowed without restriction, the excess insurer would often face either a second round of litigation or the necessity of filing a cross-complaint for declaratory relief in the original action.” *Id.*

73. *Id.*

74. *Id.* at 137-38.

75. *Id.* at 137; see CAL. CIV. CODE § 2778(5) (West 1993) (stating that a settlement between the insured and the injured claimant is presumptive evidence of the insured’s liability).

76. *Smith*, 7 Cal. Rptr. 2d at 137 (emphasis added).

sured imposing liability.⁷⁷ The court concluded by stating that “to sanction such a transaction ‘would be to invite collusion between the claimants and the insured’ by allowing them to ‘boot-strap [] their damages with the ingenious assistance of counsel.’”⁷⁸

In *McLaughlin v. National Union Fire Insurance Co.*⁷⁹, the California Court of Appeal rejected the decision in *Smith*, finding the *Smith* rule too rigid in light of the countervailing policy concerns recognized in *Critz v. Farmers Insurance Group*⁸⁰ in favor of settlement and equalization of insured’s and insurer’s strategic advantages. The *McLaughlin* court held that a covenant not to execute is not fatal to the validity of a stipulated judgment; rather, each case must be evaluated to determine whether the problems of collusion and prejudice have been eliminated.⁸¹

In applying this determination to the facts of the case, the *McLaughlin* court found that the problems of collusion were eliminated and that the stipulated judgment satisfied the policy concerns requiring a conclusive judicial determination of liability of the insured based upon the following factors:⁸² (1) although the parties stipulated to the insureds’ liability, they did not stipulate to damages;⁸³ (2) the stipulated judgments were entered into after the court denied the insureds’ summary judgment motions;⁸⁴ (3) although the stipulated judgments included a covenant not to execute, which eliminated personal financial exposure for the judg-

77. *Id.* at 137-38. *But see* *Sunseri v. Camperos Del Valle Stables, Inc.*, 230 Cal. Rptr. 23 (Ct. App. 1986) (holding an insurer liable based on the principle that a stipulated judgment will not be set aside unless reached through fraud or collusion).

78. *Smith*, 7 Cal. Rptr. 2d at 138 (quoting *Doser v. Middlesex Mut. Ins. Co.*, 162 Cal. Rptr. 115, 120-21 (Ct. App. 1980)).

79. 29 Cal. Rptr. 2d 559, 571 (Ct. App. 1994).

80. 41 Cal. Rptr. 401 (Ct. App. 1964); *see also supra* note 10 and accompanying text.

81. *McLaughlin*, 29 Cal. Rptr. 2d at 572.

82. Before a third party plaintiff can bring a bad faith action against an insurer, there must first be a conclusive judicial determination of liability against the insured. *Moradi-Shalal v. Fireman’s Fund Ins. Cos.*, 758 P.2d 58 (Cal. 1988).

83. *McLaughlin*, 29 Cal. Rptr. 2d at 572. In *McLaughlin*, numerous investors sued the officers and directors of a financial services company. *Id.* at 565. The coordination judge set seven actions brought by 13 investors as a “test case” for trial. *Id.* In the test case, the jury awarded the investors approximately \$4,250,000 in economic damages, \$300,000 for emotional distress and \$147,000,000 in punitive damages. *Id.* The subsequent stipulated judgment between the investors and the insureds was based upon the jury award in the test case. *Id.*

After judgments were obtained in favor of the investors in the underlying actions, groups of investors brought a bad faith action against the company’s insurer, which insured the company under a directors and officers liability policy (D & O policy) and a comprehensive general liability policy (CGL policy). *Id.*

84. *Id.* at 572. The court recognized that although denial of the insureds’ summary judgment did not indicate that the insureds were necessarily liable, it did indicate that there were at least triable issues of fact as to the insureds’ liability. *Id.*

ments, personal judgments against the insureds still existed which could have adversely affected their future credit and business transactions;⁸⁵ (4) the insurer was aware of the underlying litigation and knew that the insureds might stipulate to liability;⁸⁶ and (5) the insurer encouraged the insureds to enter a stipulation of liability with protective covenants, and, therefore, was estopped from attacking the validity of the judgments.⁸⁷

Even though the *McLaughlin* court held that the stipulated judgment was a conclusive judicial determination of liability, the court rejected the amount of the stipulated judgment as the proper amount of damages in a bad faith action.⁸⁸ Thus, even though a stipulated judgment may, in some cases, satisfy the prerequisite of a court determination of liability against the insured, it does not necessarily represent the amount of damages that the plaintiff is entitled to recover.⁸⁹

85. *Id.*

86. *Id.*

87. *Id.* One of the insurer's executives testified in deposition:

I believe National Union was encouraging the directors and officers to enter into stipulated judgments in or about March 1988 so that the directors and officers wouldn't be compelled to go to trial. I think National Union was also . . . advising defense counsel of the insureds to insulate their clients from potential personal asset exposure by getting a non-recourse type of provision as part of the stipulated settlement with the plaintiffs. The thought being that once the stipulated settlement was entered into that the plaintiffs would have to submit their claim to the bankruptcy court and stand in line as an insured creditor against the policy limits which were the—which had been inter-pleaded by National Union in bankruptcy court.

Id. at 572. The executive was then asked: "So is it correct then that you were aware that certain of the outside directors were planning to enter into stipulated judgments with the plaintiffs before it actual occurred?" Answer: "I would take it one step further. I think we were encouraging stipulated judgments . . ." *Id.*

88. *Id.* at 574. The court held that the plaintiffs could seek recovery for all damages proximately caused by the insurer's bad faith conduct, except for punitive and emotional distress damages. *Id.* Because the stipulated judgment did not reflect the damages proximately caused by the insurer's bad faith conduct, it could not be used as a proper measure of damages. *Id.* The plaintiffs had previously received the insurance policy benefits, and the extent of damages suffered by the plaintiffs as a result of the insurer's bad faith conduct was undetermined. *Id.*

89. *Id.*

C. *Good Faith Confirmation of a Stipulated Judgment May Not be Sufficient to Satisfy the "Reasonable and Non-Collusive" Requirement*

In *Diamond Heights Homeowners Ass'n v. National American Insurance Co.*,⁹⁰ the insured entered into a stipulated judgment with the plaintiffs and moved for an order confirming that a good faith settlement was entered into pursuant to California Code of Civil Procedure section 877.6.⁹¹ The trial court found that the parties had, in fact, entered into the settlement in good faith and without collusion.⁹² As such, it confirmed the settlement pursuant to section 877.6.⁹³ Based upon the good faith determination of the trial court, the fact that the insurer failed to object to the settlement at the good faith hearing, and the insurer's failure to petition for a writ of mandate, the appellate court concluded that the insurer was bound by the stipulated judgment.⁹⁴

The court explained that the insurer must present its objections to the settlement at the good faith confirmation hearing.⁹⁵ The court added that an excess insurer may stand in the position of a "co-obligor," barred from making a claim of bad faith or collusion against the settling parties if the trial court finds that the settlement was made in good faith.⁹⁶ Accordingly, the court concluded that the excess insurer's claims of bad faith and collusion were barred as a matter of law under both section 877.6 and the principles of res judicata and collateral estoppel.⁹⁷

More recently, in *Pacific Estates v. Superior Court*,⁹⁸ the court expressly declined to follow *Diamond Heights*.⁹⁹ The second district appellate court rejected the reasoning in *Diamond Heights*, holding that a non-participating insurer is *not* conclusively bound by a good faith determination under section 877.6.¹⁰⁰ As such, an insurer is not barred from asserting the defense of collusion.¹⁰¹

The court agreed with the contention that a trial court's good faith finding "should have some evidentiary value in a later action."¹⁰² However, the court noted that a good faith settlement would, at most, be con-

90. 227 Cal. Rptr. 906 (Ct. App. 1991).

91. *Id.* at 909.

92. *Id.*

93. *Id.*

94. *Id.* at 917 (citing CAL. CIV. PROC. CODE § 877.6(e) (West 1993)).

95. *Id.* at 917.

96. *Id.* (citing CAL. CIV. PROC. CODE § 877.6(c)(West 1993)).

97. *Id.* at 917.

98. 17 Cal. Rptr. 2d 434 (Ct. App. 1993).

99. *Id.* at 442.

100. *Id.*

101. *Id.* at 442-43.

102. *Id.* at 443.

sidered "presumptive evidence of liability and the amount of damages in a later action against an insurer who wrongfully withheld indemnity or a defense" ¹⁰³ In this regard, the *Pacific Estates* court attached very little substantive weight to the good faith hearing in determining the insurer's liability. ¹⁰⁴ As the *Pacific Estates* court specifically acknowledged, the evidentiary value of the good faith hearing in subsequent litigation it may be advantageous for a plaintiff to secure a ruling under California Code of Civil Procedure section 877.6.

Comparing *Diamond Heights* and *Pacific Estates*, it is clear that the latter is the better reasoned case in applying the good faith settlement hearing process to non-participating insurers. Although California Code of Civil Procedure section 877.6(c) prohibits the release of a non-settling co-obligor, the prohibition is limited to co-obligors on a contract debt. ¹⁰⁵ Although an insurer is a co-obligor on the judgment against the insured, ¹⁰⁶ it is neither a joint tortfeasor nor a co-obligor on a contract debt. Therefore, the *Pacific Estates* case may carry substantial persuasive impact irrespective of the trial venue.

The *Diamond Heights* decision, compelling insurers to raise a collusion defense in a good faith settlement hearing, is not unfair when an insurer has *wrongfully* refused to defend its insured. Indeed, a California appellate court could require such an insurer to litigate its collusion defense simply as a matter of decisional law.

D. *The "No Action" or "Actual Trial" Clause as a Defense to Enforcement of Stipulated Judgments*

Insurers can assert various affirmative defenses with respect to the enforcement of a settlement agreement entered into without the consent of the insurance carrier. One of the more common defenses is that such enforcement is barred by the "no action" clause of the insurance policy. Where there is no evidence of breach by the insurer, a "no action" clause precludes an action to recover settlement amounts which the insured paid to the claimant without the insurer's consent. ¹⁰⁷ The rationale be-

103. *Id.* at 444.

104. *Id.*; see also *Xebec Dev. Partners, Ltd. v. National Union Fire Ins. Co.*, 15 Cal. Rptr. 2d 726, 749 (Ct. App. 1993) (acknowledging the presumption that settlement indicates liability as a tool for determining damages).

105. See CAL. CIV. PROC. CODE § 877.6(a)(1) (West 1993).

106. See CAL. INS. CODE § 11580 (West 1993).

107. A typical "no action" clause provides: "No action shall lie against the compa-

hind this rule is that the insurer is only contractually obligated to indemnify the insured for legal liabilities. Such liabilities must be established by either an action in which the insurer had the opportunity to defend or by a settlement in which the insurer participated. “[A]bsent a demonstration of bad faith, a liability insurer acts within its contract rights whenever it refuses to voluntarily settle a claim and insists there be an adjudication of the matter on its merits.”¹⁰⁸

In *Rose v. Royal Insurance Co. of America*,¹⁰⁹ an insurer successfully employed a “no action” clause to bar enforcement of a stipulated judgment.¹¹⁰ The court found that a settlement agreement, following a trial judgment for the tort claimant, did not satisfy the policy’s “actual trial” requirement.¹¹¹

In the underlying action, the plaintiffs were awarded a judgment in the amount of \$1,058,800.¹¹² The judge, however, suggested that the parties consider entering into a stipulated or consent judgment.¹¹³ The parties did so and allocated \$30,000 as the damages incurred as a result of the insured’s willful and intentional wrongdoing and \$1,058,800 as the amount of damages stemming from the insured’s negligent conduct.¹¹⁴

The plaintiffs attempted to enforce the consent judgment against the defendant’s insurer.¹¹⁵ The insurer, however, denied coverage claiming that the insurance policy’s “no action” clause barred the action.¹¹⁶ The insurer claimed that the policy required that the liability of the insurer be established by either (1) “a judgment against the insured after actual trial” or (2) a “written agreement of the insured, the claimant, and the [insurer].”¹¹⁷

On appeal, the court held that the policy’s “actual trial” requirement had not been satisfied because the parties had entered into a *consent judgment*.¹¹⁸ The court stated that a consent judgment is “merely a contract of the parties and entered by the court exercising an administrative

ny . . . until the amount of the insured’s obligation has been finally determined either by judgment against the insured *after actual trial* or by *written agreement* of the insured, the claimant and the company.” *Clarke v. Bellefonte Ins. Co.*, 169 Cal. Rptr. 832, 837 (Ct. App. 1980) (citations omitted) (emphasis added).

108. *Id.* at 838 (quoting *Willet’s Plumbing Co. v. Northwestern Nat’l Cas. Co.*, 548 S.W.2d 830, 831 (Ark. 1977)).

109. 3 Cal. Rptr. 2d 483 (Ct. App. 1991).

110. *Id.* at 487-88.

111. *Id.* at 486.

112. *Id.* at 484.

113. *Id.* At the judge’s suggestion, the parties renewed settlement negotiations. *Id.*

114. *Id.* at 486.

115. *Id.* at 485.

116. *Id.*

117. *Id.*

118. *Id.* at 486.

function in simply recording what has been agreed upon."¹¹⁹ On that basis, despite the fact that an actual trial was held before the parties entered into the stipulated judgment, the court concluded that there was no "actual trial", and therefore, ruled in favor of the insurer.¹²⁰

Apparently, the fact that the stipulated judgment attributed only a small portion of the plaintiff's damages to the insured's intentional and willful conduct influenced the court.¹²¹ Under the consent judgment, the insurer was obligated to pay the majority of the damages.¹²² The court's strict application of the "actual trial" requirement thereby prevented the perceived collusion between the insured and the tort claimant.¹²³

The court further supported its ruling with the observation that the insurer had not provided its consent in *writing*.¹²⁴ The court allowed the insurer to deny its consent even though it provided the insured's attorney who consented at the settlement.¹²⁵

E. An Insurer's Participation in Settlement Negotiations May Create Collateral Estoppel and/or Res Judicata Effects

In determining whether to enforce a stipulated judgment against an insurer, the courts may consider the insurer's participation in settlement negotiations and the insurer's opportunity to defend the insured in the underlying litigation.¹²⁶ On that basis, an insurer that has ample oppor-

119. *Id.* (citing *Wright v. Allstate Ins. Co.*, 285 S.W.2d 376 (Tex. Civ. App. (1955))).

120. *Id.* at 488.

121. *Id.* at 486.

122. *Id.*

123. *Id.* The court stated: "a judgment against the insured after actual trial eliminates the possibility of collusion since it "imposes the requirement of an actual contest of issues and does not include a judgment entered by the court after the approval of a compromise settlement agreement by the insured and the injured party." *Id.* (quoting 12A GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW*, § 45.866 (2d ed. 1981) (citations omitted)).

124. *Id.* at 487.

125. *Id.* The court determined that the requirement that a judgment be "after actual trial" is more restrictive than California Insurance Code § 11580, which specifies only that a judgment be "secured" against the insured. *Id.* at 485-86. The court found that the purpose of § 11580 was to protect claimants against insolvency of the insured and to permit a post-judgment resort to the policy even though the insured is in bankruptcy. *Id.*; see CAL. INS. CODE § 11580 (West 1993).

126. See generally *Xebec Dev. Partners, Ltd. v. National Union Fire Ins. Co.*, 15 Cal. Rptr. 2d 726 (Ct. App. 1993) (explaining that a stipulated judgment has no significance to an insurer who has not signed the agreement); *Studley v. Benicia Unified Sch. Dist.*, 281 Cal. Rptr. 631 (Ct. App. 1991) (holding that an insurer is not bound

tunity to defend its insured and participates in settlement negotiations will probably be bound by the terms of a resulting settlement agreement.¹²⁷

In *California State Automobile Ass'n Inter-Insurance Bureau v. Superior Court*,¹²⁸ the court ruled that a stipulated judgment which was signed by the insurer, the insured, and the plaintiff constituted a final and conclusive "judicial determination" of the underlying action.¹²⁹ However, the court stressed that its holding was to be narrowly construed.¹³⁰ The court noted that the insurer "participated in the settlement negotiations and signed the stipulation."¹³¹ The court recognized that the stipulated judgment would only have been presumptive evidence of the insured's liability if either "the insurer had not received reasonable notice of the settlement" or the insured was "not allowed to control the insured's defense"¹³²

The court further held that the stipulated judgment in question, as compared to a "simple settlement agreement," constituted an enforceable final determination of liability.¹³³ In distinguishing between stipulated judgments and settlement agreements, the court stated that a stipulated judgment is based upon a judicial act which "a court has discretion to perform."¹³⁴ The court added that "a stipulated judgment may properly be given collateral estoppel effect . . . when the parties manifest an intent to be collaterally bound by its terms."¹³⁵ On that basis, the court concluded that because the insurer had signed the stipulation, it was collaterally estopped from relitigating liability.¹³⁶

by a stipulated judgement to which it did not consent and to which it specifically denied consenting); *California State Auto. Ass'n Inter-Ins. Bureau v. Superior Court*, 788 P.2d 1156 (Cal. 1990) (holding that a stipulated judgment is a final judicial determination if it is signed by the insured, insurer, and claimant).

127. See *California State Auto.*, 788 P.2d at 1156.

128. *Id.*

129. *Id.* at 1157.

130. *Id.* at 1160 n.5 (stating that the holding is a narrow one).

131. *Id.*

132. *Id.*

133. *Id.* at 1160.

134. *Id.* at 1159; see also CAL. CIV. PROC. CODE § 664.6 (West 1993 & Supp. 1994). Section 664.6 states that "[i]f parties to pending litigation stipulate . . . for settlement of the case, or part thereof, the court, upon motion, may enter judgment pursuant to the terms of the settlement." *Id.*

135. *California State Auto.*, 788 P.2d at 1160.

136. *Id.*; see also CAL. CIV. CODE § 2778(6) (West 1993 & Supp. 1994) (stating that if "the person indemnifying . . . has no reasonable notice of the action or proceeding against the person indemnified, or is not allowed to control its defense, judgment against the latter is only presumptive evidence against the former"); 14 CAL. JUR. 3D *Contribution and Indemnification* §§ 70-71 (1974 & Supp. 1994) (stating that judgment against indemnitee will be conclusive whether or not she appeared unless the

When the insurer does not participate in the stipulated judgment, the insurer will often not be bound by its terms. This principle is exemplified in *Studley v. Benicia Unified School District*,¹³⁷ where the court held that an insurer that is neither in breach of its duty to defend, nor a party to the settlement negotiations, is not bound by a stipulated judgment entered into with respect to the claimant and the insured.¹³⁸ In *Studley*, the insured's son shot a schoolmate and the insured sought insurance coverage under his homeowners policy.¹³⁹ The insurer denied coverage on the grounds that the policy did not provide coverage for the incident in question.¹⁴⁰ Subsequently, the plaintiff and the insured entered a stipulated judgment by which the insured assigned his rights against the insurer to the plaintiff.¹⁴¹

The court found that the policy's willful conduct exclusion disallowed coverage.¹⁴² The court further held that the plaintiff could not enforce the stipulated judgment against the insurer because the judgment did not include the insurer, and therefore, the insurer was not collaterally estopped from raising defenses against the enforcement of the judgment.¹⁴³

More recently, in *Xebec Development Partners, Ltd. v. National Union Fire Insurance Co. of Pittsburgh, Pa.*,¹⁴⁴ the court again held that an insurer who does not participate in a stipulated judgment may not be bound by its terms.¹⁴⁵ In *Xebec*, several different parties sued the in-

indemnitor did not have reasonable notice, in which case the judgment has only the effect of being presumptive evidence).

137. 281 Cal. Rptr. 631 (Ct. App. 1991).

138. *Id.* at 634.

139. *Id.* at 632.

140. *Id.* at 633.

141. *Id.* at 634. In consideration of the assignment of rights, plaintiff agreed not to execute upon the judgment against the insured. *Id.*

142. *Id.* at 634.

143. *Id.*; see also *Pacific Estates, Inc. v. Superior Court*, 17 Cal. Rptr. 2d 434 (Ct. App. 1993). In *Pacific Estates*, the court ruled that "non-participating insurers are not conclusively bound by a stipulated judgment by principles of *res judicata* or collateral estoppel" or as "co-obligers" under California Code of Civil Procedure § 877.6. *Id.* at 444; see CAL. CIV. PROC. CODE § 877.6 (West 1993).

144. 15 Cal. Rptr. 2d 726 (Ct. App. 1993).

145. *Id.* at 749 (stating "[w]here insurer did not join in the stipulation, a judgment based on the stipulation may be entitled to presumptive weight but should bind the insurer only to the extent it represents a true and independent adjudication of the insured's liability").

sured for allegedly diverting research funds to unauthorized uses.¹⁴⁶ The insured notified its insurance carrier of some of the lawsuits that represented a “potential occurrence” under its Director and Officers Insurance Policy (D & O Policy).¹⁴⁷ The insurance carrier refused to participate in the arbitration proceedings and settlement negotiations on the ground that it was substantially prejudiced because it had only received notice of the lawsuit four days prior to the scheduled arbitration.¹⁴⁸

During arbitration proceedings, the insured entered into a settlement agreement with the plaintiffs in the amount of \$9,833,479, plus costs and attorney’s fees.¹⁴⁹ The court subsequently entered this settlement agreement as a final stipulated judgment.¹⁵⁰ The stipulated judgment included a covenant not to execute against the insured that provided in pertinent part: [plaintiffs] “will not at any time levy execution on or otherwise seek to enforce the Final Judgment” as against [the insureds] but that the covenant “shall not limit enforcement of the Final Judgment or any claim or right against any person or entity other than” [the insureds] “including without limitation [their] insurers.”¹⁵¹

An “award of arbitrators” was attached to the settlement agreement in accordance with the parties’ stipulation.¹⁵² Two days later, the superior court entered an order, “confirming and adopting the award ‘as the final judgment in the action.’”¹⁵³

Following entry of the stipulated judgment, the plaintiffs demanded payment from the insurer pursuant to the terms of the agreement.¹⁵⁴ The insurer did not respond, and the plaintiffs filed a lawsuit alleging (1) breach of the insurance contract and (2) breach of the covenant of good faith and fair dealing.¹⁵⁵

146. *Id.* at 731.

147. *Id.*

148. *Id.* at 734-35. The attorney for the insurance carrier wrote to the insured:

Due to the complete failure of Xebec and its directors and officers [the insureds] to provide National Union with any information regarding this claim, which conduct constitutes breaches of [enumerated provisions] of the policy, National Union hereby disclaims any responsibility for the costs of defense and/or indemnity which may be asserted by Xebec and/or Messrs. Toreson and Hoebich under National Union’s policy in connection with the claims asserted by XDP against Xebec, its subsidiaries and Messrs. Toreson and Hoebich.

Id. at 734 (second alteration in original)(quoting Kristiansen’s letter to National Union).

149. *Id.* at 735.

150. *Id.*

151. *Id.*

152. *Id.*

153. *Id.*

154. *Id.*

155. *Id.* A third cause of action was alleged for breach of subdivision (h) of Insur-

A jury trial against the insurer resulted in a general verdict for the plaintiffs and against the insurer in the amount of \$7,375,000.¹⁵⁶ Specifically, the jury found that the insureds had acted unreasonably towards the insurer by providing late notice and that the insurer had acted unreasonably toward the insureds in its handling of the claim after it received notice.¹⁵⁷ In so finding, the jury determined the comparative percentages of unreasonable conduct were 25 percent attributable to the insureds and 75 percent attributable to the insurer.¹⁵⁸

On appeal, the court considered various issues including the effect of the stipulated judgment in determining the rights, liabilities and amount of damages in a subsequent lawsuit against the insurer.¹⁵⁹ The appellate court confirmed the jury finding that the insurer was in breach of its duties under the insurance policy.¹⁶⁰

The insurer argued that its obligation to indemnify its insureds would arise "only after they had paid the amount of liability asserted against them" and that since the "covenant not to execute [in the stipulated judgment] removed any compulsion upon [the insureds] to pay the asserted liability, [the insurer] did not have a duty to indemnify [the insureds]."¹⁶¹ The court of appeal rejected the insurer's contention and stated that even if the policy required indemnity only after the insured has paid the liability, the covenant not to execute would not "ipso facto release" the insurer from any indemnification obligation under the policy.¹⁶²

The plaintiffs asserted that the policy entitled them to recover from the insurer the full amount of damages pursuant to the stipulated judgment.¹⁶³ The court of appeal set forth the general rule that "the insurer that wrongfully refused to defend will be liable to the insured in the amount of the judgment against him or her, plus his or costs of defense."¹⁶⁴ However, in *Xebec*, the D & O insurance policy did not impose

ance Code § 790.03. *Id.* However, in the course of trial "the superior court granted [the insurer's] motion for judgment on the pleadings as to . . . Insurance Code § 790.03 theories." *Id.* at 736; see CAL. INS. CODE § 790.03 (West 1993).

156. *Xebec*, 15 Cal. Rptr. at 737. The court noted that this amount was almost exactly 75% of the amount fixed in the stipulated judgment. *Id.*

157. *Id.*

158. *Id.* at 736.

159. *Id.* at 737-42.

160. *Id.* at 742.

161. *Id.* at 733-34.

162. *Id.* at 744.

163. *Id.* at 745.

164. *Id.* (citing *Gray v. Zurich Ins. Co.*, 419 P.2d 168, 169 (Cal. 1966); *Arenson v.*

on the insurer a duty to defend; rather, it only imposed a duty to pay for the insureds' defense.¹⁶⁵ More importantly, the court emphasized that the stipulated judgment was not the result of contested proceedings and therefore, "none of the assurances of validity implicit in judicial proceedings openly contested to final judgment, or even in contested arbitration proceedings, were furnished"¹⁶⁶ As a result, the court of appeal refused to apply the general rule "applicable to contested judgments."¹⁶⁷

Plaintiffs further claimed that the stipulated judgment bound the insurer because the insurer had received a sufficient opportunity to object to the stipulated judgment as collusive.¹⁶⁸ As a result, plaintiffs argued the insurer "should have been precluded as a matter of collateral estoppel from contesting the amount of the stipulated judgment."¹⁶⁹ The insurer asserted that it could not have intervened or objected to the stipulated judgment because intervening would have conflicted with the interests of the insured.¹⁷⁰ Rather, the insurer chose to litigate in a separate proceeding its assertion against the enforcement of the stipulated judgment.¹⁷¹ The court of appeal held that the insurer was entitled to challenge the enforcement of the stipulated judgment in a separate proceeding and was not barred by the doctrine of collateral estoppel.¹⁷²

Next, the court addressed whether the stipulated judgment represented a proper measure of damages against the insurer for breach of the insurance contract. The court stated that when an insurer joins a stipulation, "it may be properly bound by the figure to which it stipulated."¹⁷³ Where, however, the insurer does not join the stipulation, the judgment amount "may be entitled to presumptive weight as the proper measure of damages, but should bind the insurer only to the extent it represents a true independent adjudication of the insured's liability."¹⁷⁴

National Auto. & Cas. Ins. Co., 286 P.2d 816, 819 (Cal. 1955).

165. *Id.*

166. *Id.*

167. *Id.* at 746.

168. *Id.* at 747. Plaintiffs contended that the insurer could have raised such objections during the arbitration proceedings, or at the confirmation hearing in superior court, and had six months to move to set aside the judgment under Code of Civil Procedure § 473, but failed to do so. *Id.* at 746.

169. *Id.*

170. *Id.* at 747.

171. *Id.*

172. *Id.*

173. *Id.* at 749.

174. *Id.*

F. The Insured Cannot Enforce a Stipulated Judgment by Seeking Reimbursement From its Insurer Prior to a Final Determination of Liability

In *Isaacson v. California Insurance Guarantee Ass'n*,¹⁷⁵ the court held that an insured may seek reimbursement from its insurer when the insured pays all or part of a settlement and enters into a reasonable stipulated judgment in good faith, even if the settlement is in excess of the insurance policy limits.¹⁷⁶ The fact that the insured paid part of the settlement, however, does not bind the insurer to reimburse the amount paid.¹⁷⁷

In *Isaacson*, the plaintiffs sued the insureds for medical malpractice.¹⁷⁸ The insureds settled the claim and entered into a stipulated judgment for \$500,000.¹⁷⁹ The insurer offered a maximum of \$400,000 to settle the case.¹⁸⁰ The insureds, fearing additional liability if the case proceeded to trial, paid the additional \$100,000 to the plaintiffs.¹⁸¹ Thereafter, the insureds filed suit against their insurer for reimbursement of the \$100,000 and for further damages based on several tort theories.¹⁸²

The California Supreme Court held that the insurer could be held liable for reimbursement of the \$100,000 if the insurer breached its statutory duty¹⁸³ to pay and discharge "covered claims."¹⁸⁴ The court stated that if an insured either pays an adverse judgment or contributes a reasonable amount in settlement of a claim, the insured has a cause of action against its insurer for reimbursement.¹⁸⁵ In order to recover reimbursement from an insurer, the insured must prove only that the insurer breached its duty to accept a reasonable settlement offer.¹⁸⁶ In order to

175. 750 P.2d 297 (Cal. 1988).

176. *Id.* at 308.

177. *Id.*

178. *Id.* at 300.

179. *Id.*

180. *Id.* at 302. Following the stipulated judgment, the insurer paid a total of \$400,000. *Id.*

181. *Id.*

182. *Id.* The insureds based their claims on the Guarantee Act, the implied covenant of good faith and fair dealing, and intentional infliction of emotional distress. *Id.*

183. See generally CAL. INS. CODE § 1063.2(a) (West 1993) (requiring CIGA to pay and discharge covered claims in accordance with the policy provisions).

184. *Isaacson*, 750 P.2d at 308. "Covered claims" are defined as "the obligations of an insolvent insurer . . ." CAL. INS. CODE § 1063.1(c) (West 1993).

185. *Isaacson*, 750 P.2d at 309.

186. *Id.*

establish damages, the insured need not prove actual liability for the underlying claim.¹⁸⁷ After establishing breach, the insured can establish damages based on the amount of the settlement.¹⁸⁸

In addressing the facts of the case, the court concluded that the insured did not offer sufficient evidence that the insurer breached its duty to accept a reasonable settlement offer, and therefore, the insurer was not required to reimburse the insureds.¹⁸⁹ The court noted the present case was distinguishable from those cases in which an insurer either: (1) denies coverage entirely; or (2) wrongfully refuses to defend the insured.¹⁹⁰ In those cases, the insured *is* entitled to a presumption that the amount of the settlement is equivalent to the reasonable value of the claim.¹⁹¹

It is critical to note that *Isaacson* was decided in the context of a stipulated judgment entered into between the claimant and the insured. The results are significantly different when an insurer refuses to accept the claimant's settlement offer and the case proceeds to trial. If a judgment is entered against the insured in an amount in excess of the insurer's maximum settlement offer, the excess of the resulting judgment over the claimant's settlement offer is presumptive evidence of the damage award for breach of the insurer's implied covenant of good faith and fair dealing.¹⁹² In that instance, the amount of damages determined by a trier of fact is assumed to be reasonable.¹⁹³ Likewise, when an insurer wrongfully refuses to defend a claim, and the insured settles, the amount of the settlement is presumptive evidence of the plaintiff's damages because the insured is bargaining with his or her own money.¹⁹⁴ In *Isaacson*, however, there was no contested trial, and the insured could not prove that the insurer breached its duties.¹⁹⁵ Therefore, the settlement amount was not presumptive evidence of the amount of damages.¹⁹⁶

In *Finkelstein v. 20th Century Insurance Co.*,¹⁹⁷ the court held that an insured's bad faith action against an insurer is premature if brought

187. *Id.*

188. *Id.*

189. *Id.* at 310.

190. *Id.* at 309-10.

191. *Id.*

192. See *Crisci v. Security Ins. Co.*, 426 P.2d 173, 177 (Cal. 1967), for a discussion of these propositions.

193. *Id.* at 192.

194. *Id.*

195. *Isaacson*, 750 P.2d at 310.

196. *Id.*

197. 14 Cal. Rptr. 2d 305 (Ct. App. 1992).

prior to a judgment being rendered against the insured.¹⁹⁸ In the underlying action, the claimant was involved in an automobile accident.¹⁹⁹ The insured's policy had a maximum coverage of \$100,000 per injured party.²⁰⁰ The case was eventually settled for \$85,000, of which the insured personally paid \$6700.²⁰¹ Subsequently, the insured brought a breach of implied covenant of good faith and fair dealing action against the insurer.²⁰²

The court ruled that the "mere possibility" that a jury verdict could have exceeded the insured's policy limits was insufficient grounds to bring a cause of action.²⁰³ The court concluded that "[s]ince there was no judgment in excess of the policy limits, [the insured's] cause of action never matured."²⁰⁴

The *Isaacson*²⁰⁵ and *Finkelstein*²⁰⁶ decisions illustrate that an insured, who decides personally to pay a portion of a settlement prior to a final judicial determination of liability, does so at his or her own risk. In these situations, an insured will not be reimbursed unless the insurer either refuses to accept a reasonable settlement offer, or a final judgment has been entered against the insured.

IV. WHERE THE INSURER IS IN BREACH OF ITS DUTY TO DEFEND OR SETTLE A CLAIM, A STIPULATED JUDGMENT MAY BE ENFORCED

As a general rule, an insurer is obligated to pay the full amount of a judgment against its insured, including any amounts in excess of the insured's policy limits, when the insurer refuses to accept a reasonable

198. *Id.* at 306-07.

199. *Id.* at 306. The insured was later convicted of felony for driving while under the influence. *Id.*

200. *Id.*

201. *Id.*

202. *Id.*

203. *Id.* at 307 (citing *Doser v. Middlesex Mut. Ins. Co.*, 162 Cal. Rptr. 115 (Ct. App. 1980)). In *Doser*, the court ruled that the plaintiff had no claim for breach of implied covenant of good faith and fair dealing because no judgment had been entered against the insured in the underlying wrongful death action. *Doser*, 162 Cal. Rptr. at 121.

204. *Finkelstein*, 14 Cal. Rptr. 2d at 307.

205. *Isaacson v. California Ins. Guarantee Assoc.*, 750 P.2d 297 (Cal. 1988) (holding that because plaintiff doctors did not establish that the insurer breached its duty to settle for a reasonable amount, plaintiffs were not entitled to recovery).

206. *Finkelstein*, 14 Cal. Rptr. 2d at 305.

settlement offer within the policy limits.²⁰⁷ This general rule holds true irrespective of whether the insurer assumes a duty to defend the insured. Under the terms of a typical insurance policy, the insured has the right to reach a reasonable settlement with a claimant; however, the settlement amount is usually subject to the insurer's consent. Nonetheless, courts have permitted an insured to settle without such consent when the insurer has, in some way, repudiated or breached its duties under the policy. As with any contractual relationship, once the insurer refutes or materially breaches the insurance contract, the insurer cannot enforce the policy terms, including the consent requirement.²⁰⁸

These principles were addressed in *Diamond Heights Homeowners Ass'n v. National American Insurance Co.*²⁰⁹ In *Diamond Heights*, the plaintiff, seeking damages for construction defects, sued the insured.²¹⁰ Ultimately, the parties entered into a settlement agreement which provided for a stipulated judgment in the amount of \$2,671,000.²¹¹ Various insurers denied coverage, and therefore, did not participate in the settlement.²¹² The insured moved to confirm the settlement pursuant to California Code of Civil Procedure section 877.6.²¹³ The trial court confirmed the settlement, stating that it had been entered into in good faith and without collusion.²¹⁴ In addition, the trial court found that the insured was clearly liable to the plaintiff.²¹⁵ Subsequently, the plaintiff initiated an action against the non-contributing insurers to satisfy the balance of the stipulated judgment.²¹⁶ One of the excess insurers sought summary judgment on the following grounds: (1) its policy excluded coverage; (2) the stipulated judgment was entered into without its consent; (3) the settlement violated the policy's "no action" clause; and (4) the settlement appeared to be the result of collusion.²¹⁷

In addressing this carrier's contentions, the court noted that the primary insurers had provided a defense in the underlying action.²¹⁸ Further,

207. See *Johansen v. California State Auto. Ass'n. Inter-Ins. Bureau*, 538 P.2d 744 (Cal. 1975) (holding insured liable for entire judgment when it failed to accept settlement offer within policy limits).

208. See *Diamond Heights Homeowners Ass'n v. National Am. Ins. Co.*, 277 Cal. Rptr. 906 (Ct. App. 1991).

209. *Id.*

210. *Id.*

211. *Id.*

212. *Id.* at 909.

213. *Id.*

214. *Id.*

215. *Id.* at 912.

216. *Id.* at 909.

217. *Id.* at 913.

218. *Id.* at 909-10. The court granted summary judgment to the primary insurer based on the "work product" exclusion contained in the policy. *Id.*

the court observed that the excess insurer failed to join in the defense or the settlement despite the fact that it knew of the action and the settlement negotiations.²¹⁹ The excess insurer took the position that no duty to defend existed even though it had received notice that the plaintiff's demand exceeded primary coverage limits.²²⁰ The excess insurer only responded by retaining counsel to monitor the case.²²¹

The appellate court held that a primary insurer may negotiate a good faith settlement in an amount which invades excess coverage when both the insured's liability is established and the excess insurer is in breach of its duties.²²² In addition, the court concluded that a primary insurer may enter a settlement agreement and bind the excess insurer without the excess insurer's approval.²²³ The court further found that an insurer can relinquish its power under the "no action" clause if it refuses a fair settlement and declines to participate in the defense.²²⁴

This same principle was upheld in *Consolidated American Insurance Co. v. Mike Soper Marine Services*,²²⁵ where the court reaffirmed the rule that an insurer may be bound to a stipulated judgment, even in an amount in excess of its policy, if it is in breach of its duties.²²⁶ In *Consolidated*, the plaintiff filed suit against the insured.²²⁷ The insurer assumed the defense, but it did not reserve the power to raise the issue of

219. *Id.* at 911.

220. *Id.* at 912.

221. *Id.* In May 1987, the primary carriers informed the excess insurer that the primary policy limits would probably be exhausted. *Id.* In June 1987, the excess insurer asked for all discovery documents. *Id.* In November 1987, two of the primary carriers advised the excess insurer that their policy limits had been reached. *Id.*

222. *Id.* at 913-16.

223. *Id.* at 915. The court's rationale was based upon its interpretation of the primary insurer's policies. *Id.* Thus, the primary carriers were obligated to provide a defense without any right to demand that the excess carrier participate in it before settlement or judgment. *Id.*

224. *Id.* at 916; see *Fireman's Fund Ins. Co. v. Security Ins. Co.*, 367 A.2d 864 (N.J. 1976). In *Fireman's Fund*, the court held that an excess insurer is in breach of the covenant of good faith and fair dealing unless he makes a reasonable effort to obtain a fair settlement. *Id.* at 868-70. The court further ruled that the insured was free to mitigate its liability by settling the claim, even though the policy contained a "no action" clause. *Id.* at 869. Further, the insured may "then recover the settlement amount from the insurer." *Id.* (citations omitted). The court concluded that the insurer loses the right to approve settlements when it breaches its contractual duty to the insured. *Id.* at 868.

225. 951 F.2d 186 (9th Cir. 1991).

226. *Id.* at 189-91.

227. *Id.* at 187.

the policy's coverage.²²⁸ Subsequently, the insurer decided not to defend the insured, maintaining that the claim fell within the policy's "watercraft exclusion."²²⁹ The insured incurred liability for \$1,000,000 pursuant to a stipulated default judgment.²³⁰ The insured then assigned his claim against the insurer to the plaintiff.²³¹ The plaintiff sued the insurer for bad faith and breach of its duty to the insured to settle the claim in accordance with the policy.²³² The lower court awarded the plaintiff summary judgment for the full amount of the settlement and post-judgment interest.²³³

The Ninth Circuit Court of Appeals held that if an insurance carrier fails to agree to a fair settlement within its policy limits, it assumes the risk of liability for damages caused by its breach.²³⁴ Thus, the carrier may be subject to damages that exceed the insured's coverage.²³⁵ The Ninth Circuit affirmed the judgment against the carrier for \$1,000,000 plus post-judgment interest.²³⁶

In *Sanchez v. Truck Insurance Exchange*,²³⁷ the plaintiff brought a lawsuit against her employer for sexual harassment alleging wrongful constructive discharge, assault and battery, and negligent supervision by the employer.²³⁸ The employer "tendered defense of the lawsuit to their insurer . . . but [the insurer] refused to defend or to be involved in any way."²³⁹

Before trial, "the parties entered into a proposed settlement which they presented to the court for approval."²⁴⁰ The court found that the terms of the proposed settlement met the criteria of a good faith settlement as articulated in *Tech-Bilt, Inc. v. Woodward-Clyde & Associates*.²⁴¹

228. *Id.*

229. *Id.* at 188.

230. *Id.*

231. *Id.*

232. *Id.* at 187.

233. *Id.*

234. *Id.* at 190.

235. *Id.*

236. *Id.* at 191.

237. 26 Cal. Rptr. 2d 812 (Ct. App. 1994).

238. *Id.* at 814.

239. *Id.*

240. *Id.*

241. *Id.* at 814-15 (citing *Tech-Bilt, Inc. v. Woodward-Clyde & Assocs.*, 698 P.2d 159 (Cal. 1985)). Among the factors articulated in *Tech-Bilt* for determining whether a settlement is in good faith are: a rough approximation of the damages for which the plaintiff is likely to recover, the amount of those damages attributable to the settling defendant, the amount paid in settlement, the amount of insurance, and whether there is any evidence of collusion, fraud, or tortious conduct between the plaintiff and the settling defendant. *Tech-Bilt*, 698 P.2d at 166.

The settlement agreement provided an award to the plaintiff in the amount of \$250,000.²⁴² The agreement further provided that Sanchez "covenanted not to execute on the judgment against . . . [the employer] . . . until the direct action against the insurer was resolved."²⁴³ "After a reasonable time, if [the plaintiff] was unsuccessful against the insurer, [Sanchez] could execute against the employer for no more than \$25,000."²⁴⁴

Sanchez then filed a direct action against the insurer seeking to enforce the judgment.²⁴⁵ The insurer filed a demurrer "on the ground that the 'no action' clause in the policy precluded Sanchez's action because the judgment she obtained was not after 'actual trial' or by 'written agreement' of the insurer."²⁴⁶ The court granted the insurer's demurrer, and plaintiff appealed.²⁴⁷

On appeal, the Sixth Appellate District of the California Court of Appeal, addressed "whether an insurer that refuses to defend its insured can rely on the 'no action' clause in its policy to preclude an action under section 11580."²⁴⁸ The court found that where the insurance carrier refused to defend its insured and where the stipulated judgment had been entered in good faith, the insurer is bound to the settlement amount regardless of the "no action" clause.²⁴⁹

The court distinguished cases where a stipulated judgment was not enforceable because the insured had not satisfied the "actual trial" or "written agreement" of the insurer requirements by illustrating that in *Rose v. Royal Insurance Co.*²⁵⁰ and *Wright v. Fireman's Fund Insurance Cos.*,²⁵¹ the insurers provided a defense to the insured.²⁵²

242. *Sanchez*, 26 Cal. Rptr. 2d at 815.

243. *Id.*

244. *Id.*

245. *Id.*

246. *Id.*

247. *Id.*

248. *Id.*

249. *Id.*

250. 3 Cal. Rptr. 2d 483 (Ct. App. 1991) (insurer argued that "no action" clause precludes judgment creditor's action).

251. 14 Cal. Rptr. 2d 588 (Ct. App. 1992) (holding that a stipulated judgment against an insured, to which insurer did not consent, was insufficient to constitute a judgment).

252. *Sanchez*, 26 Cal. Rptr. 2d at 815-16.

V. HINTS TO THE PRACTITIONER—FASHIONING ENFORCEABLE STIPULATED JUDGMENTS

In light of recent California case law, the parties to a stipulated judgment should take into account the following suggestions to ensure that the judgment will have a binding effect on insurers in subsequent litigation:

1. The settlement should be subject to a “good faith settlement” ruling and the insurers should be given notice of the hearing. There is some authority for the proposition that the good faith hearing is the insurer’s one and only opportunity to contest the stipulated judgment on the grounds of unreasonableness or collusion.²⁵³ Since the insurer will rarely have an adequate opportunity to prepare for such a hearing, it would be strategically favorable to ultimate enforcement of the settlement if litigation of the unreasonableness and collusion defenses could be contained within the good faith settlement proceeding. Be advised, however, that some recent authority would permit the insurer to litigate the merits of the entire underlying case in the follow-up enforcement action.²⁵⁴

2. Each policy should be inspected from the standpoint of whether it contains an “actual trial” requirement in its “no action” clause. Insurers whose policies contain such language have enhanced prospects for fending off enforcement actions.²⁵⁵

3. The insured should consider a settlement under which it does not receive an unqualified covenant not to execute upon the stipulated judgment. The insured should retain some personal exposure to liability on the judgment.

Another option may be to protect the insured in a different fashion. For example, the insured may receive protection in the form of greatly extended payment terms. To this might be added an absolute cut-off of further liability on the judgment if the balance of the judgment has not been satisfied by one or more insurance carriers after a certain date. However, this latter form of protection might draw into question the ultimate enforceability of the judgment against the insurer, simply because it is, arguably, a form of non-recourse agreement.

253. *See* Diamond Heights Homeowners Ass’n v. National Am. Ins. Co., 277 Cal. Rptr. 906, 917 (Ct. App. 1991) (holding that the appropriate time for the insurer to object is at the good faith confirmation hearing).

254. *See* Xebec Dev. Partners, Ltd. v. National Union Fire Ins. Co., 15 Cal. Rptr. 2d 726 (Ct. App. 1993) (demonstrating that an insurer may litigate the merits of the underlying case during a follow-up).

255. *See* Rose v. Royal Ins. Co. of Am., 3 Cal. Rptr. 2d 483 (Ct. App. 1991) (validating a policy provision which only permits an action against the insurer where a judgment is entered against it “after actual trial”).

Despite all of these precautionary measures, in the present judicial climate, there is no way to assure that a stipulated judgment with non-recourse elements will ultimately be enforceable against a non-performing insurer. If, however, the parties are willing to take the risks and enter some variant of this sort of settlement, they should set the stage by first making timely "within-limits" settlement demands, so that upon rejection, the insurers might be liable not only for the amount of a judgment within their limits, but the portion in excess of their limits as well.

VI. CONCLUSION

It is uncertain as to whether a non-consenting insurer may be bound by a stipulated judgment entered against the insured unless (1) the liability of the insured has been conclusively established by judgment following a contested proceeding; (2) coverage exists for the claim; (3) the settlement was entered into in good faith; and (4) the settlement amount is reasonable. However, an insurer may be liable for a stipulated judgment, even in an amount in excess of its policy provisions where the insurer either wrongfully refuses to defend, is in breach of its duty to accept a reasonable settlement offer, or was a party to the settlement agreement.

The courts' recent cautionary posture toward enforcement of stipulated judgments against insurers is based largely upon the perceived potential for collusion between the insured and the tort claimant. An assignment of rights, coupled with a covenant not to execute, presents substantial risks of collusion due to the absence of true adversity, which is perceived as an incentive to bargain for a low settlement amount. Thus, recent case law illustrates a shift in favor of protecting an insurer from enforcement of a stipulated judgment where there has been no adjudication on the merits. In light of the *Xebec*,²⁵⁶ *Wright*,²⁵⁷ *Smith*,²⁵⁸ and *Rose*²⁵⁹ decisions, it appears that California courts are strongly disinclined to enforce stipulated judgments against insurers unless the liability of the insured has been contested on the merits and a judgment is entered against the insured.

256. *Xebec*, 15 Cal. Rptr. 2d 726; see *supra* notes 144-74 and accompanying text.

257. *Wright v. Fireman's Fund Ins. Co.*, 14 Cal. Rptr. 2d 588 (Ct. App. 1992); see *supra* notes 39-55 and accompanying text.

258. *Smith v. State Farm Mut. Auto Ins. Co.*, 7 Cal. Rptr. 2d 131 (Ct. App. 1992); see *supra* notes 57-78 and accompanying text.

259. *Rose*, 3 Cal. Rptr. 2d 483; see *supra* notes 109-25 and accompanying text.

