

Collateral Consequences Cannot Be Used to Justify Reasonableness

February 2004

The Arizona Supreme Court has held that in evaluating the reasonableness of a settlement between an insured and an underlying plaintiff, a court may not consider any collateral consequences the insured would have faced by failing to settle. *Parking Concepts, Inc. v. Tenney*, 2004 WL 61153 (Ariz. Jan. 14, 2004).

The insured was a real estate broker who purchased an E&O policy that excluded coverage for fraudulent acts. A party to a real estate transaction sued the broker for allegedly misrepresenting the tax liability associated with a property. The complaint alleged fraud, negligent misrepresentation and breach of contract. The insurer defended the broker subject to a reservation of rights based on the fraud exclusion in the policy.

Two years into the litigation, the broker demanded that the insurer settle the case or withdraw its reservation of rights. The insurer refused. (The court explained that, under Arizona law, the insurer's refusal precluded it from arguing that any settlement the broker and claimant reached without the insurer's consent breached the cooperation clause of the policy.) The broker and the underlying plaintiff agreed to settle the lawsuit for \$430,000. The broker assigned his rights under the insurance policy to the underlying plaintiff in return for the plaintiff's covenant not to execute the settlement against the broker.

The plaintiff then sued the insurer to collect the settlement amount. The insurer contended that the settlement was the product of fraud and collusion and that the amount of the settlement was unreasonable. The broker argued (and the trial court had found) that the settlement was reasonable because the broker risked losing his license had the claimant ultimately prevailed on its fraud claim.

The Arizona Supreme Court rejected the broker's argument, holding that consideration of collateral consequences to the broker was improper because the insurer never agreed to cover such loss. The court reasoned that, under the terms of the policy, the insurer contracted to cover amounts the insured "became legally obligated to pay as damages" as a result of covered conduct, and that "[n]othing in the policy suggests that [the broker] purchased insurance against any consequences of their covered conduct other than the imposition of money damages." The court explained that the only proper considerations in determining the reasonableness of the settlement were facts bearing on the broker's liability and damages in the underlying litigation.

For more information, please contact us at 202.719.7130.