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The Influence Of Settlements On Contribution Claims

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Disputes among insurers regarding claims for contribution are not new, but appear to be on the increase. Whether it involves disagreements among primary liability insurers regarding their respective defense or indemnity obligations for various long tail exposures, such as asbestos, or among all risk and boiler and machinery insurers regarding responsibility for first party property damage, insurers are increasingly joining issue over their respective rights and obligations. As a result, insurers are also more frequently confronting issues relating to the effects of settlement agreements on contribution claims against other insurers. One issue that arises is how an insurer can structure a settlement with its insured so as to preserve to the fullest extent possible contribution claims against non-settling insurers.

Recently, a California federal court's decision in MGA Entertainment Inc. v. The Hartford Group, et al., Case No. ED CV 08-0457 (C.D. Calif. Feb. 24, 2012) (Order Granting Lexington and Chartis Excess Insurers' Motions for Summary Judgment) illustrated both the potential pitfalls for a settling insurer who later brings an equitable contribution claim and the means by which the settling insurer can preserve its contribution rights. In that case, the insured, MGA Entertainment, filed separate lawsuits against its insurers, including Lexington Insurance Co. and Evanston Insurance Co., arising from a coverage dispute surrounding the defense of MGA

Entertainment in its well-publicized trade secrets battle with Mattel Inc. over the popular Bratz doll line.

After Lexington agreed to participate in MGA Entertainment's defense and paid significant sums toward defending the underlying suit, Lexington and MGA Entertainment entered into a settlement agreement that resolved disputes between them over billing rates and the funding of certain outstanding defense costs. The settlement agreement also released a bad faith claim that MGA Entertainment had brought against Lexington based on Lexington's alleged initial failure to defend.

After this settlement, the court in the same action entered an order against Evanston, finding that it also had an ongoing duty to defend MGA Entertainment. Since Lexington had already reimbursed over $20 million in defense costs, it filed a contribution action against Evanston seeking payment for Evanston's apportioned share of those defense costs.

Ultimately, the MGA Entertainment court ruled that Evanston owed equitable contribution to Lexington because, based upon a time on the risk allocation method, Lexington demonstrated that it paid more than its fair share of defense costs. In rejecting Evanston's arguments against contribution, the court provided helpful guidance to insurers who settle with their insureds and wish to preserve future equitable contribution claims.

The MGA Entertainment court accepted the general proposition that Lexington could not recover from Evanston amounts it had paid to settle MGA Entertainment's bad faith claim against Lexington. Evanston's main argument was that Lexington could not seek contribution because the settlement agreement did not allocate the settlement amount between costs incurred in the defense of the MGA Entertainment and the release of the MGA Entertainment's bad faith claim.

Evanston argued that where a settlement agreement does not apportion the settlement between payment of claims covered under the policy and other non-covered claims, the settling insurer may not seek contribution from other insurers.

In analyzing this issue, the court reasoned that, for Lexington to succeed on its equitable contribution claim, Lexington had to prove that it paid more than its fair share of defense costs such that some of those were allocable to Evanston, and that Lexington was not seeking recovery of any amount it had paid in settlement of the bad faith claim. Significantly, the settlement agreement itself was a major source of such proof. Although the agreement included a release of the bad faith claim against Lexington, the court found that "the plain language of the settlement agreement demonstrates that the amounts paid correspond with defense fees and costs, and are thus allocable to Evanston ..."

The court noted that, if the parties had intended to allocate a portion of the settlement amount to the bad faith claim, they could have done so expressly. To the contrary, Lexington and MGA Entertainment used "precise language" that detailed the agreed-upon number of hours, hourly rates and total legal fees and costs to defend MGA Entertainment in the underlying action. The court held that the "detailed nature" of these provisions supported the conclusion that the amount paid in the settlement was solely for defense fees and costs. Moreover, even though Evanston suggested that there might be reasons that no amount was allocated to the bad faith claim, the court found that, since the agreement did not contain any designation of an amount allocated to settling the bad faith claim, Evanston failed even to create a genuine issue of material fact.

Further underscoring the critical and essentially dispositive role played by the language of the settlement agreement, the court also rejected Evanston's arguments based upon statements made by MGA Entertainment asserting that the settlement agreement did, in fact, include a payment for the release of the bad faith claim. The court noted in this regard that, if MGA Entertainment prevailed on a claim that portions of the settlement amount went toward settlement of the bad faith claim and were not for the reimbursement of defense costs, then MGA Entertainment would be in line for a windfall recovery because Evanston would be required to reimburse more in defense fees and costs then were actually incurred by MGA Entertainment. The court thus found that the MGA Entertainment statements were "self-serving" and insufficient to create an issue of fact regarding the terms of the MGA Entertainment/Lexington settlement agreement.

The court also addressed two additional arguments made by Evanston which illustrate the key role that the terms of a settlement agreement can later play in a contribution action. First, the court rejected Evanston's argument that Lexington attempted to "bootstrap" pre-settlement payments into the settlement agreement so that Lexington would "look better vis-à-vis the other primary insurers" like Evanston. The court found the argument illogical because "the fact that Lexington already made certain payments before settlement does not support the inference that these payments had nothing to do with disputes surrounding fees and costs resolved under the settlement agreement."

Similarly, the court rejected Evanston's argument that Lexington had to provide evidence demonstrating how MGA Entertainment actually spent the defense cost reimbursements paid by Lexington. The court reasoned that "[s]uch a rule would penalize a participating insurer for subsequent bad behavior of an insured, something that is out of the insurer's control" as well as "provide an escape hatch for a non-participating" if a participating insurer was unable to produce such evidence.

Overall, the MGA Entertainment case provides significant guidance to an insurer who finds itself considering both settlement with its insured and the potential for contribution claims against other insurers. First and foremost, any insurer in this position should ensure that any written settlement agreement contains "precise language" detailing that payments are being made for defense costs and/or covered claims. To the extent that details regarding how the settlement was calculated are extant, such as the number of hours, hourly rates and total agreed legal fees and costs, these should be itemized. Second, the law must support that the obligation for which contribution is sought is shared with the other insurer and, if so, the settling insurer must determine the basis on which it is shared — for example, pro rata by time on the risk, by limits or per capita — a final issue addressed and resolved by the MGA Entertainment court, which found the defense obligation allocable on a pro rata time on the risk basis.

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