Settlement of Claims without an Insurer's Consent

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Andrea Martignoni, Partner, Allens Arthur Robinson
Malcolm Stephens, Senior Associate, Allens Arthur Robinson
Introduction

Liability policies almost invariably indemnify insureds for settlements made by those insureds with the consent of their insurers. On occasion, however, an insured will settle a claim without the consent of its insurer. This paper considers the circumstances in which an insured is entitled to be indemnified by its insurer notwithstanding the failure by the insured to obtain the insurer's consent to the settlement.

The options available to an insured depend on:

(a) the means by which the insurer provides cover for settlements, in particular, whether:
   (i) the policy provides cover for all settlements, but prohibits the insureds from settling claims without the insurer's consent; or
   (ii) the policy only provides cover for settlements made with the consent of the insurer,

(b) whether any obligation to obtain the consent of the insurer to settlement is a condition precedent to cover;

(c) whether the insured had failed to seek the consent of the insurer or whether the insurer has refused to provide its consent to a request from the insured for consent;

(d) whether the insurer has wrongfully denied indemnity under the policy;

(e) whether the insurance policy is governed by the Insurance Contracts Act.

We have therefore divided this paper into the following sections.

(i) A summary of the means by which insurance policies require the consent of insurers to settlements.

(ii) The consequences at common law of breaching an obligation to obtain consent.

(iii) Options available to an insured if the insurer refuses to consent to a settlement.

(iv) The consequences of an insurer directing an insured to act as a "prudent uninsured".

(v) The consequences of an insurer denying indemnity for the claim.


(viii) Special considerations which might apply where there are settlements of more than one claim.

1. The requirement for consent

A policy will normally only provide indemnity for a settlement made by an insured if that settlement was made with the consent of the insurer. The requirement that the insurer provide its consent is normally imposed by one or both of the following methods.

The first method is to make the insurer's consent an element of the cover provided by the policy. For example, a policy might provide cover for "judgments or orders or settlements made with the consent of the insurer". A similar, but slightly different example, is where a
policy only provides cover for "judgments or orders" and, separately, extends cover to "settlements made with the consent of the insurer".

The second method is to impose a contractual obligation on the insured not to make settlements without the insurer's consent. For example, a policy may provide cover for "legal liabilities" (or some similar phrase), but provide that the insured shall not settle any claims without the prior written consent of the insurer. It is well accepted that "legal liability" includes liability resulting from a settlement\(^1\). In this example, therefore, it is not necessary to obtain the insurer's consent in order to fall within the clause defining the cover, but a failure to obtain consent will be a breach of the policy.

In most cases, for the reasons given in the balance of this paper, the difference between these 2 methods may make no practical difference. It will, however, affect the manner in which an insured, which has settled a claim without consent, will need to frame its arguments when seeking indemnity.

2. Must insured prove actual liability or only a reasonable settlement?

One unresolved issue is whether the phrase "legal liability" includes liability pursuant to any settlement, or whether it only applies to liability under a settlement where, if the insured had not settled, the insured would have been found liable. This issue will not arise if the insurer has consented to a settlement, but may be particularly important if the insured has settled a claim without the insurer's consent.

The current state of the law was summarised by the NSW Court of Appeal in *Vero Insurance v Baycorp Advantage* [2004] NSWCA 390 (6 December 2004). In that case the court considered whether an insured was required to prove that a settlement was reasonable and made in good faith if the insuring clause expressly included legal liability "determined by … settlement". In the course of considering this issue, however, the court considered the meaning of "legal liability".

Tobias JA (with whom Giles and McColl JJA agreed) stated:

48 …. the expression "legally liable" refers to a legal liability established by judgment, arbitral award or settlement: see *The Distillers Co Bio-Chemicals (Aust) Pty Ltd v Ajax Insurance Co Ltd* (1974) 130 CLR 1 at 25-6; *Cacciola v Fire & All Risk's Insurance Co Ltd* (1971) 1 NSWLR 691 at 695; *Costi v Rodwell* (1985) VR 287 at 289. There are divergent lines of authority as to what, in such cases, the insured must prove where there has been a settlement without the insurer's consent. One line of authority favours the insured and establishes that provided the settlement is reasonable, the insurer is liable to pay the settlement sum: eg, *Edwards v Insurance Office of Australia* (1933) 34 SR (NSW) 88; *General Omnibus Company v London General Insurance Company Ltd* [1936] IR 596; *Distillers* at 9, 25. However the cases, which favour this approach, would seem to do so on the basis that the insurer has wrongfully repudiated liability.

49 The other line of authority favours the insurer and requires the liability of the insured to be established before the insurer is liable to indemnify. It holds that the insured's liability cannot

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\(^{1}\) *Vero Insurance v Baycorp Advantage* [2004] NSWCA 390 – note, however, the issue discussed in section 2 as to whether an insured must prove that it would have been liable had it not settled the claim.
arise by any compromise reached between the insured and the claimant without the insurer's consent. Actual liability of the insured must be established; see, for example, Royal Insurance Fire & General (NZ) Limited v Mainfreight Transport Limited (1993) 7 ANZ Ins Cas 61-172 at 77, 976; Drayton v Martin (1996) 137 ALR 145 at 157.

... 69 I find it difficult to accept that the parties intended the reference to the amount which an Insured Person is legally liable to pay in respect of a Claim being determined by judgment or settlement, to relieve the insured of his or her usual obligations when a settlement has been effected without the consent of the insurer and the latter has not otherwise wrongfully repudiated liability under the policy. I consider that the words in question were inserted to make clear that the amount of the loss could be an amount determined in either way. It still had to be an amount for which the insured was legally liable, meaning (at the very least) in the case of settlement that the legal liability of the insured was established by a reasonable and bona fide settlement.

As indicated in this extract, the balance of authority in Australia is that an insured must prove its actual liability unless the insurer has wrongfully repudiated liability. However, the words "(at the very least)" in paragraph 69 show that the issue has not been finally resolved.

3. Consequences at Common Law

Before considering the possible application of the Insurance Contracts Act, it is necessary to consider the consequences at Common Law if an insured settles a claim without the consent of its insurer.

The consequences will depend on the form of the obligation of the Insured to obtain the consent of its insurer to any settlement. The position is as follows.

(a) If the policy only provides cover for settlements made with the insurer's consent, then there will be no cover (subject to the discussion in the balance of this paper) if an insured does not obtain the consent of its insurer to a settlement.

(b) If the policy provides cover for settlements, but includes a condition that the insured shall not settle claims without the insurer's consent, then:

(i) if the obligation to obtain consent is a condition or condition precedent, then the insured will not be entitled to indemnity; or

(ii) if the obligation is neither a condition nor a condition precedent, then the insured will be entitled to indemnity, but the insurer will be entitled to damages for the breach by the insured of the obligation.

The obligation to obtain consent will generally be a condition or a condition precedent if and only if:

• it is expressly stated to be so; or

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2 We discuss the relevance of an insurer repudiating liability in section 5 below.
• the policy expressly states that that the insurer shall not be liable for
   settlements made without consent.

4. **Contractual Arguments**

If an insured has sought the consent of an insurer to settle a claim, and the insurer has not provided that consent, then an insured might be able to argue that the failure to provide consent was either:

• a breach of an implied term not to withhold consent unreasonably; or
• a breach of an implied term to act with the utmost good faith.

Whether or not the insured has sought the consent of the insurer to a settlement, an insurer might also be able to obtain indemnity, notwithstanding the failure to obtain consent, if the insurer has denied indemnity to the claimant or has directed the insured to act as a "prudent uninsured".

We consider these possibilities below.

4.1 **An implied term not to withhold consent unreasonably**

Many policies expressly provide that an insurer shall not unreasonably withhold its consent to a settlement. In the absence of such an express term, an insured might still wish to argue that the policy contains an implied term to the same effect.

The normal test under Australian law for implying a term into a contract is to ask whether the proposed implied term is necessary to give commercial efficacy to the contract. An insured is likely to argue that, given that most claims are resolved by settlements, it would be commercially irrational for an insurer to be entitled unreasonably to withhold its consent to a settlement. On the other hand, an insurer might argue that no such term should be implied because the insurer will, at least in some cases, ultimately bear the financial consequences of a judgment against the insured.

There is English authority supporting the implication of an obligation on the insurer to act reasonably when controlling proceedings on behalf of its insured. This statement appears to have been implicitly supported by at least one High Court Judge. Although another judge in the same case expressly left this issue open, this reasoning could support the implication of such an obligation where the power of the insurer is to control the terms on which proceedings might be settled.

Whether or not a term can be implied to the effect that an insured shall not withhold its consent unreasonably is unlikely to be critical, as it is well established, both under the Insurance Contracts Act and at common law, that an insurer must act with utmost good faith when deciding whether to provide its consent.

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3 *Groom v Crocker* [1939] 1 KB 194.

4 Stephen J in *The Distillers Company Bio-Chemicals (Australia) Pty Limited v Ajax Insurance Company Limited* (1973) 130 CLR 1 at 30

5 Menzies J at 10.
4.2 The implied obligation to act with the utmost good faith

Section 13 of the *Insurance Contracts Act 1994* provides that:

**The duty of utmost good faith**

A contract of insurance is a contract based on the utmost good faith and there is implied in such a contract a provision requiring each party to it to act towards the other party, in respect of any matter arising under or in relation to it, with the utmost good faith.

An insurer must therefore act with the utmost good faith in deciding whether to consent to a settlement if the policy is governed by the *Insurance Contracts Act*. It has been suggested that dishonesty is an essential prerequisite for a breach of this duty. This suggestion is wrong. There is no basis for limiting the duty in this manner and this argument was recently expressly rejected by the Full Court of the Federal Court. For example, Emmett J expressly stated that (at paragraph 89):

… while dishonest conduct will constitute a breach of the duty of utmost good faith, so will capricious or unreasonable conduct.

There are many cases suggesting that a similar duty is imposed on an insurer even where the *Insurance Contracts Act* does not apply. For example, Stephen J in *The Distillers Company Bio-Chemicals (Australia) Pty Limited v Ajax Insurance Company Limited* (1973) 130 CLR 1 stated (at 26 – 27):

Its power of restraining settlement by the insured must be exercised in good faith having regard to the interests of the Insured as well as to its own interest and in the exercise of its power to withhold consent the insurer must not have regard to considerations extraneous to the policy of indemnity.

On the other two judges in that case, Menzies J declined to express a view on this issue and Gibbs J recognised, as a minimum, a principle "that the insurer could not refuse his consent arbitrarily in complete disregard of the interests of the insured".

4.3 What is the consequence of a breach of the duty of utmost good faith?

For policies governed by the *Insurance Contracts Act*, a failure to act with the utmost good faith would be a breach of an implied term of the contract. The insurer would therefore be prevented from relying on the failure by the insured to obtain consent, by reason either of:

(a) the "prevention principle", which prevents a party relying on the other party's breach of contract where that breach was caused by the first party's own breach; or

(b) an award of damages for breach of contract, where the damages would be equal to the amount of indemnity which the insured would have been entitled to but for the breach.

For policies which are not governed by the *Insurance Contracts Act*, the duty of utmost good faith is not an implied term of the contract but an extra-contractual obligation. The House of Lords has held that the only remedy for an insured arising from a breach by an insurer of the duty of utmost good faith is for the insured to avoid the policy. This decision is manifestly unreasonable (an insured will want to claim under the policy, not avoid it).

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The decision is also unsupported by earlier authorities. It is unlikely that an Australian court would follow it, notwithstanding the persuasive authority of decisions of the House of Lords. It is very likely that an Australian court would, instead, prevent an insurer from relying on a breach of a policy condition caused by the insurer’s own failure to act with the utmost good faith.

4.4 Direction to act as a "prudent uninsured"

It is common practise for insurers to direct their insureds to act as a "prudent uninsured" while indemnity is being considered.

In AMP Financial Planning Pty Ltd v CGU Insurance Limited [2004] FCA 1330, Heerey J stated (corrected in accordance with a subsequent corrigendum):

62 The term "prudent uninsured" is not, as far as the evidence in this case goes, a term of art used with some special significance in the insurance industry. As a matter of ordinary language I think it simply means that AMPFP was to act as though it were uninsured, but as a prudent person would, faced with the Investors’ claims. Thus a prudent person in that situation would, amongst other things, take legal advice and have lawyers, or other suitable persons, investigate and verify the factual basis of the claims and, where appropriate, negotiate a settlement.

63 The real significance of the term to my mind is that CGU made it clear that AMPFP was to be no worse off in respect of it rights (if any) under the Policies by negotiating with the Investors and entering into the Settlements. One particular consequence of that is that CGU would not refuse indemnity on the basis that AMPFP had entered into the Settlements without CGU’s prior written consent (Policies cl 7.6) or that Investors had not obtained an order of a civil court or an originating process (Policies cl 12.1 and cl 12.2). A prudent uninsured person, being ex hypothese not bound by any policy of insurance, would not be subject to such restrictions. Neither would AMPFP.

On appeal to the Full court of the Federal Court, Emmett J with whom Moore J agreed, referred to the judgment of Heerey J and stated:

76 His Honour concluded that, by telling AMP to act as a prudent uninsured, CGU was saying that AMP was to act as though it were uninsured, but as a prudent person would, faced with the demands by investors. A prudent person in that situation would, amongst other things, take legal advice and have lawyers, or other suitable persons, investigate and verify the factual basis of the demands and, where appropriate, negotiate a settlement. AMP does not quarrel with that conclusion but says that that is precisely what it did.

The third member of the Full Court, Gyles J, held:

161 On the other hand, contrary to the finding of Heerey J, in my opinion, it is clear that CGU could not conscientiously deny that AMP was entitled to act as a prudent uninsured. It repeatedly said so. AMP was entitled to rely upon that assurance. It follows that CGU is estopped from denying liability to indemnify AMP for any payment pursuant to a settlement reached accordingly, notwithstanding any policy conditions to the contrary. Whether it did in fact act as a prudent uninsured in making the payments is another and, in my opinion, the main, issue. If it did so, it would have acted to its detriment. There would be a clear case of estoppel – whether by representation … or by convention …

Notwithstanding the clear statements in this case, we suspect that many insurers would be surprised to learn that the standard "act as a prudent uninsured" instruction had the effect
of excusing an insured from its obligation to comply with the terms of the policy. The alternative interpretation of this phrase is that it simply informs an insured that it should protect its position pending a decision on indemnity, and it is possible that different judges may prefer this interpretation.

5. Consequences of a denial of indemnity

In many cases an insured will settle a claim, without the consent of its insurer, following a denial of indemnity by the insurer. Many cases have established that an insured is entitled to obtain indemnity from an insurer in these circumstances, notwithstanding a failure to obtain the insurer’s consent to a settlement, provided the settlement is reasonable. For example, in *The Distillers Company Bio-Chemicals (Australia) Pty Limited v Ajax Insurance Company Limited* Menzies J stated that:

The insured may make a reasonable settlement where the insurer breaches a contract by denying liability and refusing to defend or settle … but such is not the case here for the insurer has not repudiated its obligation and is not, so far as I can see, in breach of its obligations.

The New South Wales Court of Appeal recently observed:\(^7\):

There are divergent lines of authority as to what, in such cases, the insured must prove where there has been a settlement without the insurer's consent. One line of authority favours the insured and establishes that provided that settlement is reasonable, the insurer is liable to pay the settlement sum …. However the cases which favour this approach would seem to be so on the basis that the insurer has wrongfully repudiated liability.

One difficulty with these authorities, however, is that they refer to the repudiation of a "claim". As a matter of general contract law, it is not normally possible to repudiate a specific obligation in the contract. Instead, one can only repudiate an entire contract – a repudiatory act being an anticipatory breach that goes to the root of the contract.

In most cases, a denial of indemnity by an insurer before the insured settles would not be a breach of contract (there being no liability of the insured to indemnify) but an anticipatory breach of contract. Whether or not the anticipatory breach is a "repudiation" of the entire policy depends on the seriousness of the anticipated breach.

An insured might therefore wish to argue that any wrongful denial of indemnity by the insurer excuses the insured from its obligation to obtain the consent of the insurer to any settlement.

If the denial of indemnity by the insurer is also a repudiation of the contract, and if the insured accepts that repudiation, then insurance contract comes to an end and the insured will not be obliged to obtain the consent of the insurer to any settlement. In these circumstances, the insured will be recover damages from the insurer for breach of contract and its damages would include the loss of the opportunity to obtain the consent of the insurer to a settlement.

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\(^7\) *Vero Insurance v Bakecorp Advantage* [2004] NSW CA 390.
It can be risky for an insured to "accept" a repudiation, however, if it is unclear whether the denial of indemnity is a repudiation of the policy. If the denial of indemnity is not a repudiation, then there may be a risk for an insured that its own purported "acceptance" of the repudiation is itself a repudiation of the insurance contract, meaning the policy (and, with it, the right to indemnity) comes to an end.

An alternative argument available to an insured is to rely on estoppel. The High Court has held that an anticipatory breach of contract might be construed as a representation to the other party to the contract that there is no need for that other party to perform its contractual obligations. Although the law on this issue is unclear\(^8\) it is certainly arguable that an insurer which denies indemnity for a claim is implicitly representing to its insured that it will be futile for the insured to comply with this obligation to obtain the consent of the insurer to any settlement\(^9\).

6. **Section 54 of the Insurance Contracts Act**

6.1 **Section 54**

Section 54 of the *Insurance Contracts Act* is as follows.

*Insurer may not refuse to pay claims in certain circumstances*

(1) Subject to this section, where the effect of a contract of insurance would, but for this section, be that the insurer may refuse to pay a claim, either in whole or in part, by reason of some act of the insured or of some other person, being an act that occurred after the contract was entered into but not being an act in respect of which subsection (2) applies, the insurer may not refuse to pay the claim by reason only of that act but the insurer's liability in respect of the claim is reduced by the amount that fairly represents the extent to which the insurer's interests were prejudiced as a result of that act.

(2) Subject to the succeeding provisions of this section, where the act could reasonably be regarded as being capable of causing or contributing to a loss in respect of which insurance cover is provided by the contract, the insurer may refuse to pay the claim.

(3) Where the insured proves that no part of the loss that gave rise to the claim was caused by the act, the insurer may not refuse to pay the claim by reason only of the act.

(4) Where the insured proves that some part of the loss that gave rise to the claim was not caused by the act, the insurer may not refuse to pay the claim, so far as it concerns that part of the loss, by reason only of the act.

(5) Where:

(a) the act was necessary to protect the safety of a person or to preserve property; or

(b) it was not reasonably possible for the insured or other person not to do the act;

the insurer may not refuse to pay the claim by reason only of the act.

(6) A reference in this section to an act includes a reference to:

(a) an omission; and

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\(8\) See the different approaches of the Judges of the High Court in *Foran v Wight* (1989) 168 CLR 385.

\(9\) This approach is arguably supported by the Canadian cases referred to by Stephen J in *The Distillers Company Bio-Chemicals (Australia) Pty Limited v Ajax Insurance Company Limited* [1973] 130 CLR 1 at 25.
(b) an act or omission that has the effect of altering the state or condition of the subject-matter of the contract or of allowing the state or condition of that subject-matter to alter.

6.2 Substance over form

Section 54 looks at the substance of the contract, rather than its form. It therefore does not matter whether the form or the insurance policy is to provide cover for all settlements, with a condition requiring the insurer's consent to any settlement; or whether the form of the policy is only to provide cover for settlements made with the insurer's consent. In either case, the "effect" of the insurance contract would be to withhold indemnity if there is a failure to obtain the insurer's consent to a settlement.

6.3 Section 54(2): what is the "loss" and what is the "act"?

The main issue in relation to the application of s54 is whether settling a claim without consent is, within the meaning of s54(2) an act which "could reasonably be regarded as being capable of causing or contributing to a loss in respect of which insurance cover is provided by the contract".

What is the loss?

The first issue is whether the word "loss" refers to:

- the loss suffered by the claimant, for which the claimant is seeking compensation from the insured; or
- the loss suffered by the insured, being its liability to the claimant, for which it is seeking indemnity from the insurer?

If the former interpretation is correct, then s54(2) would not apply because the failure of the insured to seek consent to a settlement cannot be a cause of a loss suffered by a claimant. If, however, the latter interpretation is correct, then an insurer might argue that settling a claim without consent is a cause of the "loss" – this is discussed further below.

Although the latter interpretation may seem more natural, given that it is the insured's liability which is covered by the policy, it is clear from the report of the Australian Law Reform Commission which led to the introduction of the Insurance Contracts Act that the former interpretation was intended. For example, one case referred to by the Australian Law Reform Commission to justify the introduction of s54 was the English decision of Terry v Trafalgar Insurance Co. Ltd. In that case, the insurer was entitled to deny indemnity because its insured admitted liability to the driver of another car. It did not matter that the insured would have been liable whether or not the admission had been made – a result which the Commission considered unfair. It is apparent from the context in which this case is discussed that the Commission considered this example to be remedied by (what became) s54(1), and not to fall with s54(2).

What is the act?

If, contrary to the view above, the "loss" is the liability of the insured, then it is necessary to consider whether "the act could reasonably be regarded as being capable of causing or
contributing to” that loss. If an insured settles a claim without consent, is the relevant act the settlement without consent, which arguably causes the loss, or is it the failure to obtain consent, which does not cause the loss? The Full Court of the Supreme Court of Western Australia has recently preferred the latter interpretation in the analogous situation of an insured incurring defence costs without consent.¹¹

In that case, the policy expressly prohibited the insured from settling claims or incurring litigation expenses without the insurer's consent. The insured sought indemnity for litigation costs incurred without the insurer's consent, relying on s54. The Full Court stated:

We take the view, as the High Court did in Antico, that it could not be suggested that s54(2) and (4) could have application. That is, the case would not fall outside s54 (1) because the failure to obtain written consent could reasonably be regarded as being capable of causing or contributing to the loss in respect of which the insurance cover was provided.

This reasoning applies equally to a failure to obtain consent to a settlement.

6.4 Section 54: summary

An insured has good prospects of being able to rely on s54 to excuse a failure to obtain the consent of its insurer to a settlement. In these circumstances, however, the insurer would still be entitled to reduce its liability to the insured to the extent that it has been prejudiced by the conduct of the insured. If for example an insurer can prove that:

(a) it would never have consented to a settlement; and

(b) its insured would successfully have defended the claim against it,

then the insurer would be entitled to reduce its liability to put the insurer in the same position as if the insured had successfully contested the claim (eg being legal costs incurred by the insured and not recovered from the unsuccessful plaintiff).

7. Section 41

Section 41 of the Insurance Contracts Act provides that (emphasis added):

Liability insurance: insured may require insurer to elect

(1) This section applies where it would constitute a breach of a contract of liability insurance if, without the consent of the insurer, the insured were to:

(a) settle or compromise a claim made against the insured; or

(b) make an admission or payment in respect of such a claim.

(2) An insured who has made a claim under a contract of liability insurance may at any time, by notice in writing given to the insurer, require the insurer to inform the insured in writing:

(a) whether the insurer admits that the contract applies to the claim; and

(b) if the insurer so admits, whether the insurer proposes to conduct, on behalf of the insured, the negotiations and any legal proceedings in respect of the claim made against the insured.

¹¹ Manufacturers Mutual Insurance Ltd v Murray River North Pty Ltd [2004] WASCA 276 (S): note that the "(S)" signifies that this is the supplementary decision on 20 October 2005, rather than the original decision on 26 November 2004.
(3) Where the insurer does not, within a reasonable time after the notice was given, inform the insured that the insurer admits that the contract of liability insurance applies to the claim and that the insurer proposes to conduct, on behalf of the insured, the negotiations and any legal proceedings in respect of the claim made against the insured, the insurer may not refuse payment of the claim, and the amount payable in respect of the claim is not reduced, by reason only that the insured breached the contract as mentioned in subsection (1).

The section only operates to excuse a breach of contract. If, therefore, the obligation to obtain the insurer's consent is necessary to fall within the primary insuring clause of the policy\textsuperscript{12}, then this section would not assist the insured. The narrow wording of the section "breach of contract" can be compared with broader wording of s54, which refers to "the effect of a contract".

A further limitation on s41 is that if, contrary to our opinion expressed above, the phrase "legal liability" only covers settlements:

- made with the insurer's consent; or
- in circumstances where the insured would have been found liable but for the settlement;

then s41 will not release the insured from the obligation to prove its actual liability. This would therefore deprive an insured of much of what would appear to have been the intended benefit of s41, and may be another reason for preferring our interpretation of the phrase "legal liability".

8. Multiple claims

Insureds need to take special care when settling multiple claims (including both claims and cross-claims, or claims against different but connected parties). In particular, insureds need to consider what insurance claims might ultimately flow from a settlement.

Two recent cases have illustrated these hazards.

The first case is the English decision last year in Lumbermens Mutual Casualty Company v Bovis Lend Lease Limited\textsuperscript{13}. In that case, Bovis Lend Lease claimed approximately £40 million under its contract with Braehead Glasgow Limited and Braehead cross-claimed for approximately £100 million from Bovis Lend Lease. The claims were settled by a payment from Braehead to Bovis Lend Lease of £15 million. The settlement agreement did not state how this amount was calculated (i.e., what amount was paid in respect of the claim by Bovis Lend Lease and the reduction in respect of the cross claim by Braehead).

Bovis Lend Lease asserted that it could prove how much of the settlement amount was attributable to the cross-claim. It therefore sought indemnity from its insurers for this amount. The claim failed. The court held that, even if Bovis Lend Lease could prove how the settlement was in fact calculated, the failure to apportion the settlement meant that Bovis Lend Lease lost its right to be indemnified by its insurers.

\textsuperscript{12} This distinction is discussed in section 1 above.

\textsuperscript{13} [2004] EWHC 2197 (Comm) per Colman J.
A few weeks ago an English judge in a different cases expressed disagreement with the reasoning in this case, and considered that it should have been open to Bovis Lend Lease to prove the amount attributable to the cross claim. Whether or not Bovis Lend Lease remains good law, the safer option for insureds will be to allocate any settlement payments between the difference claims.

A recent Australian case emphasised the importance of clarifying which person or entity has a legal obligation to indemnify. In Vero Insurance v Bakecorp Advantage the court considered the right of a company to be indemnified under a D&O policy following the settlement of certain claims against Bakecorp Advantage and its directors. The court in that held that, properly construed, the payment obligations in the settlement agreement only lay with the company, and not with the directors. The court therefore held that there was no liability of the directors and therefore no right to be indemnified for the settlement amount (although, as claims had been made against both Bakecorp Advantage and its directors, there was a right to recover defence costs).

Bakecorp Advantage shows that sometimes form will be more important than substance: presumably if the settlement deed has stated that the directors were liable to pay the claimants, and if that liability had been satisfied by the company (eg pursuant to a deed of indemnification), then the company could have claimed under the company reimbursement section. The actual form of the settlement agreement was in substance merely a means for achieving this same result, but with very different consequences for the claim for indemnity.

In summary, care should be taken in settlement agreements to specify:

• which entity (or entities) is responsible for each payment; and
• the amount attributable to each liability being satisfied.

9. Conclusion

The consequences of an insured settling a claim without the consent of its liability insurer may depend upon one or more the following issues:

(a) whether the claim relates to a liability covered under the policy;

(b) the terms of the policy itself, in particular:
   (i) does the insuring clause cover settlements?
   (ii) is there a breach of a ‘no compromise’ clause?
   (iii) does an exclusion clause apply, whereby liability for the settlements entered without consent is expressly excluded?

(c) whether the insurer has wrongly denied indemnity, or possibly wrongfully repudiated the policy;

14 Enterprise Oil Ltd v Strand Insurance Co Ltd [2006] EWHC 58 (Comm).
(d) whether any refusal by the insurer to give consent constitutes a breach of the duty of utmost good faith;

(e) whether the insured is estopped from requiring proof of loss, typically by reason of conduct of the insurer. In particular, a direction to the insured to act as a ‘prudent uninsured’ may have the effect that the insured need only prove that any settlement was reasonable;

(f) whether, in cases where there is no wrongful conduct on the part of the insurer, the insured can prove it would have been liable to the claimant;

(g) whether, if that is all that is required, the insured can prove that the settlement was reasonable;

(h) whether s41 of the ICA has been effectively invoked by the insured;

(i) whether s54 of the ICA operates, and if so, its effect on the burden of proof.

For insurers, it is important to be mindful of relevant policy terms relating to settlements, including consideration of whether a settlement gives rise to a covered liability for the purpose of the insuring clauses of the policy. Insurers are obliged to investigate claims with reasonable diligence, and consistently with those obligations they should request further information if unable to make a decision either on indemnity or whether to consent to the settlement. Insurers should carefully consider any grounds for refusing cover, and if there is a denial of indemnity on a number of grounds it may be best to avoid more spurious grounds. In particular, if the insurers are not satisfied that the insured is liable to the claimant, any concerns in that regard should be raised with the insured prior to the settlement.

So far as insureds are concerned, at the outset it is important to seek consent. Insureds should invoke s41 of the ICA if the insurer is ‘fence sitting’. However, insureds should be mindful of their obligations to provide sufficient information to insurers to enable them to make a decision in relation to indemnity, and should keep insurers informed and up to date in relation to the progress of any investigations and developments relating to settlement. Insureds should avoid entering into any settlement until proper investigation of the facts is carried out and proper legal advice is obtained. Insurers need to be mindful that settlements motivated by extraneous concerns eg pressure from a regulator, reputational considerations, or a concern to ‘wrap up’ any uninsured liabilities may make a settlement unreasonable. Finally, in any settlement documentation on insured should be careful to ensure that liability is separately ascertained for insured claims, and the amount of that liability is consistent with legal advice received as to the insured’s exposure. Any payment obligation in the settlement documentation must lie on the relevant insured that is liable to the claimant.

8 February 2006