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905 A.2d 819

Supreme Judicial Court of Maine.

PATRONS OXFORD INSURANCE COMPANY

v.

Preston A. HARRIS et al.

Docket No. Pen-04-636.

Argued: Oct. 20, 2005.

Decided: June 16, 2006.

Synopsis

Background: Automobile liability insurer sought a declaratory judgment that driver was not insured as he and named insured's child fled hostile crowd. Accident victim filed counterclaim to reach and apply the policy to collect on settlement of tort claim without the insurer's consent. The Superior Court, Penobscot County, [Mead](#), J., entered judgment that driver was insured and settlement of tort claim bound insurer. Insurer appealed.

Holdings: The Supreme Judicial Court, [Silver](#), J., held that:

[1] driver was insured;

[2] insurer had a meaningful opportunity to defend its interests and was not deprived of due process when insured settled tort case without insurer's permission;

[3] as a matter of first impression, insurer gave up the ability to control insured's defense by choosing to defend him under a reservation of rights;

[4] the settlement was binding only if reasonable; and

[5] insured's mere lack of cooperation and settlement without the insurer's consent did not establish collusion defense to reach and apply statute.

Affirmed and remanded.

Procedural Posture(s): On Appeal.

West Headnotes (24)

[1] Appeal and Error Insurers and insurance

The meaning of language contained in an insurance contract is a question of law reviewed de novo.

1 Cases that cite this headnote

[2] Insurance Exclusions, exceptions or limitations

Insurance Exclusions and limitations in general

Exclusions and exceptions in insurance policies are disfavored and are construed strictly against the insurer.

2 Cases that cite this headnote

[3] Appeal and Error Judge as factfinder below

Appeal and Error Total failure of proof

The Supreme Judicial Court reviews a trial court's factual findings for clear error and will uphold the findings unless there is no evidence to support them.

1 Cases that cite this headnote

[4] Insurance Reasonable belief

Driver could be found to have an objectively reasonable belief that he was entitled to use named insured's truck to flee hostile crowd with named insured's child as passenger, and, thus, driver was insured under liability coverage, even though driver was intoxicated and did not tell passenger about expiration of his driver's license; driver was in driver's seat, had keys, and was confronted by emergency requiring driver and passenger to quickly leave.

[5] Constitutional Law Course and conduct of proceedings in general

Insurance 🔑 Notice to or consent of liability insurer

Automobile liability insurer had a meaningful opportunity to defend its interests and was not deprived of due process when insured settled tort case without insurer's permission; the insurer lost the opportunity to litigate insured's liability when it elected to defend insured under a reservation of rights, and the insurer availed itself of the opportunity to litigate coverage by undertaking declaratory judgment action. U.S.C.A. Const.Amend. 14; 24-A M.R.S.A. § 2904.

2 Cases that cite this headnote

[6] Constitutional Law 🔑 Enforcement**Insurance** 🔑 Rights of Injured Person Against Insurer

In the context of the reach and apply statute entitling insured's judgment creditor to recover from liability insurer, due process entitles an insurer to notice of a claim such that it has a meaningful opportunity to defend its interests. U.S.C.A. Const.Amend. 14; 24-A M.R.S.A. § 2904.

3 Cases that cite this headnote

[7] Insurance 🔑 Insurer's options in general

A liability insurer does not breach the insurance agreement by electing to defend its insured under a reservation of rights.

1 Cases that cite this headnote

[8] Insurance 🔑 Right to control defense

A liability insurer that reserves the right to deny coverage cannot control the defense of a lawsuit brought against its insured by an injured party.

[9] Insurance 🔑 Right to control defense

Automobile liability insurer gave up the ability to control insured's defense by choosing to defend him under a reservation of rights.

1 Cases that cite this headnote

[10] Insurance 🔑 Settlement by Insured; Insured's Release of Tort-Feasor

Insured's settlement of tort case without liability insurer's permission and stipulated judgment bound insurer that provided defense under reservation of rights if the settlement was reasonable and prudent.

2 Cases that cite this headnote

[11] Insurance 🔑 Settlement by Insured; Insured's Release of Tort-Feasor**Insurance** 🔑 Notice to or consent of liability insurer

If insured settles tort case without liability insurer's permission while being defended under reservation of rights, neither the fact nor amount of liability to the claimant is binding on the insurer unless the insured or claimant can show that the settlement was reasonable and prudent; the proper test for examining whether a settlement is reasonable and prudent is what a reasonably prudent person in the insureds' position would have settled for on the merits of the claimant's case, taking into account the possibility of the insured's liability, risk of an adverse verdict, and the damages portion of the claimant's case.

2 Cases that cite this headnote

[12] Insurance 🔑 Notice to or consent of liability insurer

If insured settles tort case without liability insurer's permission while being defended under reservation of rights, the insurer should not be liable for an unchallenged amount judicially determined after an uncontested hearing on damages or an amount not judicially determined to which its insured agrees; the insured could agree to settle for an inflated amount in exchange for a release from liability.

1 Cases that cite this headnote

[13] Insurance — Nonwaiver agreements and reservation of rights

The damages arising from a tort settlement without permission of liability insurer providing defense under reservation of rights are binding on the insurer only to the extent that the insured or the claimant can show that it is reasonable, and only after coverage is deemed to exist.

[1 Cases that cite this headnote](#)

[14] Insurance — Burden of proof
Insurance — Burden of proof

Although the burden is on the insured or claimant to establish the reasonableness of tort settlement, the burden remains on the liability insurer to establish, after coverage is shown, that the conduct at issue is subject to a policy exclusion.

[3 Cases that cite this headnote](#)

[15] Insurance — Bad faith
Insurance — Rights of Injured Person
Against Insurer

Insured's mere lack of cooperation with liability insurer is not dispositive on the issue of fraud or collusion as defenses to ability of insured's judgment creditor to reach and apply liability policy to judgment. 24–A M.R.S.A. § 2904(6).

[1 Cases that cite this headnote](#)

[16] Insurance — Right to control defense
Insurance — Settlement by Insured;
Insured's Release of Tort-Feasor

Where the insured is being defended under a reservation of rights, the insured is in control of the defense, may need to be in contact with the claimant, and may negotiate with the claimant and enter into a settlement that protects his interests.

[1 Cases that cite this headnote](#)

[17] Insurance — Rights of Injured Person
Against Insurer

An insured's settlement of tort claim without permission of liability insurer providing defense under reservation of rights does not necessarily rise to the level of collusion under reach and apply statute which makes collusion between insured and judgment creditor a defense to judgment creditor's ability to reach and apply liability policy to judgment. 24–A M.R.S.A. § 2904(6).

[2 Cases that cite this headnote](#)

[18] Insurance — Settlement by Insured;
Insured's Release of Tort-Feasor

Insured was entitled to settle with tort victim when automobile liability insurer tendered its defense under a reservation of rights; thus, the insured was entitled to negotiate with victim and enter into a reasonable, nonfraudulent settlement with him.

[19] Insurance — Notice to or consent of liability insurer

An insured being defended under a reservation of rights is entitled to enter into a reasonable, noncollusive, nonfraudulent settlement with a claimant, after notice to, but without the consent of, the liability insurer.

[2 Cases that cite this headnote](#)

[20] Insurance — Notice to or consent of liability insurer**Insurance** — Construction and Effect of Settlement or Release

A liability insurer that defends an insured under a reservation of rights is not bound by any factual stipulations entered as part of insured's settlement of tort claim without the insurer's permission, but is free to litigate the facts of coverage in a declaratory judgment action brought after the settlement is entered.

[3 Cases that cite this headnote](#)

[21] **Insurance** 🔑 Notice to or consent of liability insurer

Insurance 🔑 Defenses in general

If liability insurer prevails on the coverage issue, it is not liable on insured's settlement of tort claim without the insurer's permission while being defended under a reservation of rights.

3 Cases that cite this headnote

[22] **Insurance** 🔑 Settlement by Insured; Insured's Release of Tort-Feasor

Insurance 🔑 Notice to or consent of liability insurer

Liability insurer that defends insured under reservation of rights may be bound by insured's settlement of tort claim without the insurer's permission, if the settlement, including the amount of damages, is shown to be fair and reasonable and free from fraud and collusion. [24–A M.R.S.A. § 2904\(6\)](#).

6 Cases that cite this headnote

[23] **Action** 🔑 Claims Arising Out of Same Transaction or Transactions Connected with Same Subject of Action

The fairness and reasonableness of insured's settlement of tort claim without liability insurer's consent and the issue of fraud and collusion between the insured and victim may be litigated by the insurer in the same action in which it asserts its coverage defense. [24–A M.R.S.A. § 2904\(6\)](#).

[24] **Insurance** 🔑 Settlement by Insured; Insured's Release of Tort-Feasor

Insurance 🔑 Rights of Injured Person Against Insurer

If tort claimant that settles with insured without liability insurer's consent cannot show that the settlement and the damages or the settlement amount is reasonable, the claimant may recover from the insurer only that portion which he proves to be reasonable.

3 Cases that cite this headnote

Attorneys and Law Firms

***822 James D. Poliquin**, Esq. (orally), Norman, Hanson & DeTroy, LLC, Portland, for plaintiff.

Benjamin R. Gideon, Esq. (orally), Berman & Simmons, P.A., Lewiston, Preston Harris did not file a brief, for party-in-interest Darrell Luce.

Panel: **SAUFLEY**, C.J., and **CLIFFORD**, DANA, **ALEXANDER**, CALKINS, LEVY, and **SILVER**, JJ.

Opinion

SILVER, J.

[¶ 1] Patrons Oxford Insurance Company appeals from a judgment entered in the Superior Court (Penobscot County, *Mead, J.*) declaring that (1) Preston A. Harris is an insured under an automobile policy issued by Patrons to David Ferguson; (2) Patrons is bound by a settlement agreement entered into between Harris and Darrell Luce Jr.; and (3) Luce could reach and apply against Patrons a judgment for damages entered against Harris. [24–A M.R.S. § 2904 \(2005\)](#). Finding no error, we affirm the judgment and remand to the Superior Court for a determination of the reasonableness of the settlement and the damages awarded to Luce, and the alleged existence of collusion.

I. FACTUAL AND PROCEDURAL BACKGROUND

[¶ 2] Darrell Luce Jr. was struck and injured in May of 2001, by a truck owned and insured by David Ferguson and driven by Preston Harris. The accident occurred shortly after Harris and Kurt Ferguson, David Ferguson's son, arrived at a party near Kurt's home. Upon arriving at the party, Harris and Kurt were confronted by a hostile crowd of people that demanded they depart or else they would be physically harmed. Harris and Kurt quickly reentered the truck, with the crowd physically ushering Harris into the driver's seat and Kurt into the passenger's seat. Without discussing with Kurt whether he should drive the truck, Harris, admittedly “in a panic,” started the truck to get himself and Kurt from the potentially violent crowd.¹ During the hasty departure, the

truck hit Luce, pinning him against another vehicle, injuring his legs.

1 The court found that Harris admitted to being intoxicated when he drove the truck. Further, it found that Harris did not possess a valid driver's license when he operated David Ferguson's truck. During the hearing in Patrons's declaratory judgment action, Harris testified that he simply failed to renew his license when it expired, that it had never been suspended or revoked. Finally, the court found that Harris never told Kurt that he did not possess a valid driver's license.

[¶ 3] At the time of the accident, David Ferguson had insured the truck through Patrons. Shortly after the accident, Patrons undertook an investigation to determine whether the accident was covered by the Ferguson policy with Patrons. In response to its investigation, particularly an interview Harris gave to Patrons's investigator, counsel for Patrons sent letters to Harris indicating that there was a question about whether Harris had permission to operate the truck, and it was therefore reserving its right to deny him coverage under the Ferguson policy. Patrons's decision *823 was premised on a policy exclusion, which states, in relevant part: "We do not provide Liability Coverage for any 'insured' ... [u]sing a vehicle without a reasonable belief that that 'insured' is entitled to do so."

[¶ 4] More than a year after the accident, Luce filed a complaint against Harris in the Superior Court. *Luce v. Harris*, CV-2002-149. After it learned of the suit, Patrons sent a letter to Harris, informing him that it was providing him with counsel, but that this representation was subject to a reservation of rights, with Patrons "reserving the right to withdraw from [Harris's] defense at any time if appropriate under the circumstances." Subsequently, Patrons filed a motion to intervene in *Luce v. Harris*.² Patrons, with its motion to intervene pending, also filed this declaratory judgment complaint in the Superior Court, requesting that the court declare that Harris was not covered by the Ferguson policy based on the "reasonable belief" exclusion.

2 In its motion to intervene, Patrons noted that it was defending Harris under a reservation of rights, and that it had recently learned that Luce proposed a settlement to Harris whereby Harris agreed to stipulate to liability and not contest a hearing on Luce's damages. In the alternative to its request

to intervene, Patrons requested that the court stay *Luce v. Harris* to allow resolution of the coverage issue posed in its declaratory judgment complaint.

[¶ 5] More than a month after Patrons filed its motion to intervene, Luce and Harris filed a stipulation for entry of judgment against Harris in *Luce v. Harris*. In exchange for Harris's stipulation, Luce agreed not to collect a judgment from Harris personally; he would attempt to collect such a judgment only from Patrons through Maine's reach and apply statute, 24-A M.R.S. § 2904,³ if coverage was later found. The parties also agreed that the Superior Court would determine Luce's damages. Judgment on the stipulation and damages was subsequently entered in the Superior Court (*Mead, J.*), with the court awarding Luce \$32,704.68.⁴

3 Maine's reach and apply statute, in relevant part, provides:

Whenever any person, administrator, executor, guardian, recovers a final judgment against any other person for any loss or damage specified in section 2903, the judgment creditor shall be entitled to have the insurance money applied to the satisfaction of the judgment by bringing a civil action, in his own name, against the insurer to reach and apply the insurance money, if when the right of action accrued, the judgment debtor was insured against such liability and if before the recovery of the judgment the insurer had had notice of such accident, injury or damage. The insurer shall have the right to invoke the defenses described in this section in the proceedings.

24-A M.R.S. § 2904 (2005). An insurer may invoke "fraud or collusion between the judgment creditor and the insured" as a defense in a reach and apply action. 24-A M.R.S. § 2904(6).

4 Although the court determined damages, the record reveals that Harris's counsel notified the court in advance of his intention not to attend the hearing on damages.

[¶ 6] Prior to the damages hearing and the court's damages determination, the court denied Patrons's motion to intervene in *Luce v. Harris*. Following the court's decision, Luce filed an answer to Patrons's declaratory judgment complaint and later added a counterclaim pursuant to section 2904. Following a bench trial on the declaratory judgment complaint and Luce's counterclaim, the court concluded that Harris was an insured under the Ferguson policy because the emergency situation

and the threat of bodily harm made it reasonable for Harris to believe that he was entitled to operate the vehicle to escape the potentially violent situation, despite being intoxicated and not possessing *824 a valid driver's license. The court also found that the Luce–Harris settlement agreement did not violate any law or insurance policy provision. As to Luce's counterclaim, the court found that Patrons had notice of the proceedings and Harris was an insured under the Ferguson policy. The court held that of the statutory defenses available to Patrons, fraud was inapplicable because Patrons was informed of the agreement at all times, and Harris's mere failure to cooperate with Patrons was not dispositive on the issue of collusion. The court therefore found that Luce could satisfy the damages judgment with money from the Ferguson policy.

II. DISCUSSION

A. Standard of Review

[1] [2] [3] [¶ 7] The meaning of language contained in an insurance contract is a question of law that we review de novo. *Foremost Ins. Co. v. Levesque*, 2005 ME 34, ¶ 7, 868 A.2d 244, 246. “Exclusions and exceptions in insurance policies are disfavored, and are construed strictly against the insurer.” *Id.* (citations omitted). We review a trial court's factual findings for clear error, *Fitch v. Doe*, 2005 ME 39, ¶ 17, 869 A.2d 722, 727, “and will uphold the findings unless there is no evidence to support them,” *Hartwell v. Stanley*, 2002 ME 29, ¶ 10, 790 A.2d 607, 611 (quotation marks omitted).

B. Harris's Coverage under the Ferguson Policy

[4] [¶ 8] David Ferguson's automobile policy issued by Patrons provides that the insurer will “pay damages for ‘bodily injury’ or ‘property damage’ for which any ‘insured’ becomes legally responsible because of an auto accident.” The policy defines an “insured” as “[a]ny person using ‘your covered auto,’ ” but excludes coverage for an “insured” “[u]sing a vehicle without a reasonable belief that that ‘insured’ is entitled to do so.”

[¶ 9] We have previously examined the “reasonable belief” exclusion and found that it is composed of the following elements: “A person lacks a reasonable belief that he or she is entitled to use a vehicle if that person: (i) knows that he or she is not entitled to use the vehicle; or (ii) lacks objectively reasonable grounds for believing that he or she is entitled to

use the vehicle.” *Craig v. Barnes*, 1998 ME 110, ¶ 7, 710 A.2d 258, 260. In assessing whether a person possessed an objectively reasonable belief that he or she was entitled to use a vehicle, we recognized that a “court must consider *any fact* relevant to the objective reasonableness of that person's belief,” including ownership of the vehicle, permission to use the vehicle, relationship to the insured, prior use of the vehicle, and legal entitlement to drive. *Id.* ¶ 8, 710 A.2d at 260 (emphasis added). This list of relevant factors is, however, not exhaustive.

[¶ 10] The court found that Harris had an objectively reasonable belief that he was entitled to use the truck. The court found that immediately upon arriving at the party, a confrontation ensued whereby Harris and Kurt Ferguson were ordered by an angry crowd to leave the party or else suffer bodily injury. The court found that Harris and Kurt quickly reentered the truck and Harris was in the driver's seat. The court found that given the exigency of the situation, there was no time for “extended colloquy” between Harris and Kurt regarding who should drive—both men understood that they needed to quickly leave the party. Based on the exigency, the court concluded that Harris operated the truck with Kurt's permission, despite the existence of factors, such as both men being intoxicated and Harris not possessing a valid driver's license—that *825 absent the exigency may ordinarily undercut such a belief. The court's finding was not clearly erroneous.

[¶ 11] Patrons argues that Harris could not reasonably believe that he was given permission because he did not inform Kurt that he did not hold a valid driver's license. Patrons's argument, however, ignores the circumstances under which Harris actually operated the vehicle.⁵ In the heat of the moment, there was no time for Harris and Kurt to converse about whether Harris should or should not drive because he was unlicensed. Harris was in the driver's seat, had the keys on his person, and knew that he and Kurt had to quickly leave the party. Harris's failure to apprise Kurt that he failed to renew his license is not dispositive, given the alternative. Accordingly, the court did not err in finding that Harris was an “insured” under the automobile policy issued by Patrons.

⁵ We only examine here Harris's reasonable belief that he was entitled to operate the truck under the unusual circumstances present here. We express no opinion whether Harris would have had a reasonable belief that he was entitled to operate the

vehicle on the way to the party or, for that matter, away from the party absent the exigency.

C. Patrons's Opportunity to be Heard

[5] [¶ 12] Patrons next argues that it should not be liable for Luce's damages award pursuant to 24-A M.R.S. § 2904 because it did not have a meaningful opportunity to litigate either Harris's liability or Luce's damages, resulting in an impermissible denial of due process. Luce argues that the judgment is binding on Patrons through section 2904 because Patrons had the opportunity to be heard but lost that opportunity by defending Harris under a reservation of rights, and because the terms of section 2904 have otherwise been met.

[6] [¶ 13] We have not previously addressed the tensions that exist between an insurer that reserves the right to deny coverage under the policy and the impact of that decision on the insured. We take this opportunity to do so. We have long recognized that “[t]he essence of due process is notice and an opportunity to be heard.” *Michaud v. Mut. Fire, Marine & Inland Ins. Co.*, 505 A.2d 786, 789 (Me.1986) (citing *Mutton Hill Estates v. Town of Oakland*, 468 A.2d 989, 992 (Me.1983)). In the context of section 2904, due process requires that an insurer be given notice of a claim such that it has a “meaningful opportunity to defend its interests.” *Jacques v. Am. Home Assurance Co.*, 609 A.2d 719, 721 (Me.1992).

[¶ 14] Patrons does not argue that it did not receive notice of the underlying suit. Patrons does, however, argue that it did not have a meaningful opportunity to defend its interests because Harris settled the case without its permission. We disagree with Patrons's position, however, because Patrons did have the opportunity to litigate Harris's liability under the Ferguson policy in the underlying suit between Luce and Harris, but it lost that opportunity when it elected to defend Harris under a reservation of rights.

[7] [8] [¶ 15] We start from the premise that an insurer does not breach the insurance agreement by electing to defend its insured under a reservation of rights. See *Gates Formed Fibre Prods., Inc. v. Imperial Cas. & Indem. Co.*, 702 F.Supp. 343, 346 (D.Me.1988). Furthermore, we agree with those courts that have held that “an insurer who reserves the right to deny coverage cannot control the defense of a lawsuit brought against its insured by an injured party.” *Travelers Indem. Co. v. Dingwell*, 884 F.2d 629, 638–39 (1st Cir.1989); see also *826 *Cay Divers, Inc. v. Raven*, 812 F.2d 866,

870 (3d. Cir.1987); *United Servs. Auto. Ass'n v. Morris*, 154 Ariz. 113, 741 P.2d 246, 252 (1987) (stating that “[t]he insurer's reservation of the privilege to deny the duty to pay relinquishes to the insured control of the litigation”); *Ins. Co. of N. Am. v. Spangler*, 881 F.Supp. 539, 543–44 (D.Wyo.1995); 22 ERIC MILLS HOLMES, HOLMES' APPLEMAN ON INSURANCE 2d § 136.7, at 49 (2003) (stating that, “if the insurer has reserved its right to deny coverage, the insurer cannot compel the insured to surrender control of the litigation”). This position strikes a fair balance between the insurer and the insured. If the insurer could continue to control the insured's defense despite reserving its rights to later deny coverage, it could assert a liability defense and insist on fully litigating the insured's case, thus exposing the insured to personal liability if there is a verdict favorable to the claimant. If the verdict is favorable to the claimant, the insurer still has another opportunity to avoid liability by doing exactly as Patrons did here, litigating coverage in a declaratory judgment action. Thus, we agree with the Arizona Supreme Court that the insured “risk[s] financial catastrophe if [he is] held liable, while the insurer may save itself by litigating both issues—the insured's liability and the coverage defense—and winning either.” *Morris*, 741 P.2d at 251.

[9] [¶ 16] By allowing the insured to control his own case when the insurer issues a reservation of rights, the insured can protect himself “from the sharp thrust of personal liability,” *id.* (quotation marks omitted), and the insurer still has a meaningful opportunity to protect its own interests in a declaratory judgment action where it may assert, among other things, a coverage defense. Because Patrons chose to defend Harris under a reservation of rights, it gave up the ability to control Harris's defense. Therefore, Patrons cannot now assert that it was denied the opportunity in the personal injury action to litigate Harris's liability to Luce because it was an opportunity Patrons possessed and relinquished when it proceeded under the reservation of rights. See *Miller v. Shugart*, 316 N.W.2d 729, 733–34 (Minn.1982) (concluding that an insurer who disputes coverage cannot “compel the insureds to forego a settlement which is in their best interests”).

[¶ 17] Although Patrons may have lost the opportunity to control the tort litigation when it decided to proceed under the reservation of rights, it was not left without the ability to contest its liability under the policy. Patrons had, and in fact availed itself of, the opportunity to litigate coverage by undertaking this declaratory judgment action at an appropriate point relative to *Luce v. Harris*. See *Patrons*

Oxford Mut. Ins. Co. v. Garcia, 1998 ME 38, ¶ 6, 707 A.2d 384, 385 (“Except in limited circumstances, an insurer cannot avoid its duty to defend by establishing, before the underlying action has concluded, that ultimately there will be no duty to indemnify.”) (quotation marks omitted). Therefore, we find that Patrons was not denied a meaningful opportunity to contest liability under the insurance policy. See *Michaud*, 505 A.2d at 790.

[10] [11] [¶ 18] Patrons further asserts that it should not be bound by the terms of the Luce–Harris settlement agreement and subsequent judgment simply because it chose to proceed under a reservation of rights. In other words, Patrons argues that principles of collateral estoppel and res judicata prevent it from being bound by a judgment to which it was not a party. Other courts have held, in a similar context, that an insurer is bound by a reasonable settlement entered into by its insured being defended under a reservation of *827 rights. See *Morris*, 741 P.2d at 253–54. The Arizona Supreme Court, after holding that such a settlement did not violate the insurance policy, turned to the issue of whether the insurer could “‘relitigate’ any aspect of the original tort claim.” *Id.* at 253. In the face of the insurer’s argument that it possessed “an absolute right to relitigate all aspects of the liability case, including liability and the amount of damages,” the court rejected this position as an end-run on the permissibility of the agreement. *Id.* The court noted, however: “an insured being defended under a reservation might settle for an inflated amount or capitulate to a frivolous case merely to escape exposure or further annoyance.” *Id.* To balance the competing interests, the court held that “neither the fact nor amount of liability to the claimant is binding on the insurer unless the insured or claimant can show that the settlement was reasonable and prudent.” *Id.* (citing *Miller*, 316 N.W.2d at 735). The court determined that the proper test for examining whether a settlement is reasonable and prudent “is what a reasonably prudent person in the insureds’ position would have settled for on the *merits* of the claimant’s case,” taking into account the possibility of the insured’s liability, risk of an adverse verdict, and the damages portion of the claimant’s case. *Id.* at 254; see also *Cambridge Mut. Fire Ins. Co. v. Perry*, ¶ 11, 197 Me. 94, 692 A.2d 1388, 1391. We agree with this approach.

[12] [13] [14] [¶ 19] Making settlements such as this one binding on the insurer prevents the insurer from circumventing such settlements when it has already ceded control of the litigation to its insured. We conclude, however, that the insurer should not be liable for an unchallenged

amount judicially determined after an uncontested hearing on damages, or an amount not judicially determined to which its insured agrees because the insured could agree to settle for an inflated amount in exchange for a release from liability. Thus, the damages arising from a settlement such as the one seen here is binding on the insurer only to the extent that the insured or the claimant can show that it is reasonable, and only after coverage is deemed to exist.⁶ Because we herein affirm the declaratory judgment court’s finding that coverage exists, and because Luce has not yet shown the reasonableness of the settlement and the damages awarded, we remand to the Superior Court for Luce to make this showing. In addition to assessing the reasonableness of damages, the court, on remand, must determine whether the settlement entered into by Harris was reasonable, taking into account Harris’s potential liability, the amount of damages, and his potential personal risk in the face of an adverse verdict.⁷

⁶ The binding nature of the settlement is a secondary question to the existence of coverage. Although the burden is on the insured or the claimant to establish the reasonableness of the settlement, the burden remains on the insurer to establish, after coverage is shown, that the conduct at issue is subject to a policy exclusion. See *Mut. Fire Ins. Co. v. Hancock*, 634 A.2d 1312, 1312–13 (Me.1993); Brett D. Baber, *Ten Rounds with the Insurance Company*, 16 Me. Bar J. 148, 153 (2001).

⁷ Patrons argues that the inclusion of a covenant not to execute ipso facto renders the Luce–Harris settlement unreasonable. Although, given the fact that we are remanding for a determination of reasonableness, we need not fully address this argument, we do pause to note that settlements including non-execution provisions have routinely been upheld. See, e.g., *Midwestern Indem. Co. v. Laikin*, 119 F.Supp.2d 831, 841 (S.D.Ind.2000) (stating that many courts have held “that when an insured and tort claimant enter into an agreed judgment and a covenant not to execute the judgment against the insured, the judgment can be enforced against the insurer if coverage is shown”); see also Steven Plitt, *The Evolving Boundaries of Damron/Morris Agreements: A Search for the Missing Link, A Judicial Determination of the Length of a Reasonable Person’s Arm, and Other*

Progressive Issues, 35 ARIZ. ST. L.J. 1331, 1341–42 (2003).

***828** D. Application of the Reach and Apply Statute

[¶ 20] The court found the reach and apply statute, 24–A M.R.S. § 2904, to be applicable here because Patrons had notice and Harris, as it found, was an insured under the Ferguson automobile policy. The court further found that of the enumerated defenses applicable to such an action, fraud and collusion, fraud was inapplicable because Harris kept Patrons advised of the agreement,⁸ and Harris's mere lack of cooperation with Patrons was not dispositive on the issue of collusion.

⁸ Patrons does not challenge the court's finding as to fraud.

[15] [16] [17] [18] [¶ 21] Patrons nonetheless argues that the Luce–Harris settlement was the product of collusion because Luce and Harris worked together to orchestrate a scheme whereby Luce induced Harris to breach the insurance policy. See 24–A M.R.S. § 2904(6). The only defenses to a reach and apply action are those contained in section 2904. See *Michaud*, 505 A.2d at 788–89. The mere lack of cooperation by the insured is not dispositive on the issue of fraud or collusion. *Id.* at 788 n. 1. Additionally, where the insured is being defended under a reservation of rights, the insured, who, as we have noted, is in control of his defense, may need to be in contact with the claimant, and may negotiate with the claimant and enter into a settlement that protects his interests. Although the insurer may be opposed to the insured entering into the settlement, such conduct on the part of the insured does not necessarily rise to the level of collusion. See BLACK'S LAW DICTIONARY 259 (7th ed.1999) (defining collusion as “[a]n agreement to defraud another or to obtain something forbidden by law”); see also *Medico v. Employers Liab. Assurance Corp.*, 132 Me. 422, 427, 172 A. 1, 4 (1934) (noting that the defense of collusion may be found where the insured and the claimant “attempt[] to defraud the [insurance] company by refusing to testify to the real facts of the accident or testify[] falsely concerning them”). Here, Harris was entitled to settle with Luce when Patrons tendered its defense under a reservation of rights. Thus, Harris was entitled to negotiate with Luce and enter into a reasonable, nonfraudulent settlement with him. The court, after a hearing on the declaratory judgment, found no fraud, and we find no error in that conclusion. The issue of collusion, however, has not been finally determined by the court, and must be considered on remand.

III. CONCLUSION

[19] [20] [21] [22] [23] [24] [¶ 22] In conclusion, an insured being defended under a reservation of rights is entitled to enter into a reasonable, noncollusive, nonfraudulent settlement with a claimant, after notice to, but without the consent of, the insurer. The insurer is not bound by any factual stipulations entered as part of the underlying settlement, and is free to litigate the facts of coverage in a declaratory judgment action brought after the settlement is entered. If the insurer prevails on the coverage issue, it is not liable on the settlement. If the insurer does not prevail as to coverage, it may be bound by the settlement, provided the settlement, including the amount of damages, is shown to be fair and reasonable, and free from fraud and collusion. The issues of the fairness and reasonableness of the settlement,^{*829} as well as whether it is the product of fraud and collusion, may be brought by the insurer in the same action in which it asserts its coverage defense. If the claimant cannot show that the settlement and the damages or the settlement amount are reasonable, the claimant may recover only that portion which he proves to be reasonable. If the claimant cannot prove reasonableness, the insurer is not bound. Likewise, if the settlement is found to be the product of fraud or collusion, the insurer is not bound.

[¶ 23] Because Patrons has not had an opportunity to be heard on the reasonableness of the settlement and consequent damages,⁹ Luce must establish these on remand. Patrons is only bound to the extent, if at all, that Luce establishes the settlement and damages to be reasonable. Further, because coverage and fraud have already been fully litigated here, the reasonableness of the settlement, the alleged existence of collusion, and the reasonableness of the damages award are the only issues remaining for the court on remand.

⁹ Damages were, in fact, judicially determined, but were determined in the personal injury action, where Patrons did not have an opportunity to be heard.

The entry is:

Judgment affirmed. This matter is remanded to the Superior Court for a determination of the reasonableness of the settlement, the alleged existence of collusion, and the reasonableness of Luce's damages award.

All Citations

905 A.2d 819, 2006 ME 72

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