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Federal Court Rules Non-Participating Insurer Must Pay Pro Rata Share of Insured's Settlement Costs

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Applying Michigan law, the United States Court for the Eastern District of Michigan recently concluded that an insurance carrier who failed to participate in settlement negotiations regarding certain underlying lawsuits was, nonetheless, responsible for paying its pro rata share of the insured's settlement of those lawsuits.

In *City of Sterling Heights v United National Insurance Company*, available at 2007 WL 172529 (E.D. Mich. Jan. 19, 2007), the City of Sterling Heights settled various state and federal actions pending against it that involved defamation claims, as well as Section 1983 claims. At an earlier stage in the proceedings, the district court had determined that insurance policies issued to the city by three separate insurance companies were triggered by the underlying lawsuits. The three insurance companies were United National, GenStar and Specialty National.

All of the insurers were invited to participate in settlement negotiations regarding the underlying lawsuits, but United National "failed to do so." A $31 million settlement of the underlying lawsuits was ultimately reached in which GenStar and Specialty National participated. Of the $31 million settlement amount, GenStar was to pay $10.25 million and Specialty National was to pay $8.5 million. Upon United National's refusal to pay any settlement monies on the city's behalf, the city filed an action in federal court.

With respect to the city's coverage action, United National argued that an insured has the burden of proving what portion of the settlement amount should be allocated toward covered versus non-covered claims. For example, in a previous ruling, the district court determined that the Section 1983 claims in the underlying lawsuits were not covered under United National's policies, *see* 2004 WL 252091 at *13-*15. Therefore, United National contended that the city had the burden of proving what portion of the $31 million was for the defamation claims versus the Section 1983 claims.

United National also argued that the defamation claims were defensible, and as a result, the city had erred in settling these claims. Upon order of the court, the parties had briefed how the $31 million settlement should be allocated among the three insurers and the insured. United National asserted that the "pro rata by policy limits" allocation method be applied. However, the city argued that the "all sums" allocation method should apply.

The district court rejected United National's argument that, based upon Michigan law, the city had the burden of proof regarding what portion of the settlement amount should be attributed to covered versus non-covered claims. The court reasoned that the economic damages claimed by the plaintiffs in the underlying lawsuits were not divisible between the defamation and Section 1983 claims. Furthermore, the court found that the claimed damages could not be allocated to specific policy years because the claims were continuing. Finally, the district court noted that Michigan courts have not selected a method for allocating claim costs to covered versus non-covered claims.

The district court further rejected United National's contention that the city erred in settling the defamation claims because the claims were defensible. Rather, the court concluded that United National was repeatedly urged by the city to participate in the settlement negotiations pertaining to the underlying lawsuits but did not do so. As a result, the court found that United National was barred from raising any arguments regarding the reasonableness of the settlements, because such arguments could have been presented during the settlement discussions.

Finally, the court determined that the pro rata "time-on-the-risk" allocation method should be applied in order to calculate the amount due towards the $31 million settlement under the United National policies. The district court came to this conclusion by examining the language of the United National policies and considering the circumstances at issue ("i.e., continuing injury and successive insurance policies.")

This decision shows that, in Michigan, insurance carriers whose policies arguably provide coverage for a claim should participate in settlement negotiations, particularly where there are unresolved issues regarding allocation and where the insured requests the carriers' participation.

Should you have any questions about the *City of Sterling Heights v. United National* decision, or about an insurer's rights or liabilities pertaining to settlement negotiations, please feel free to contact any member of Plunkett & Cooney's Insurance Practice Group or the Insurance Practice Group co-leaders, Chuck Browning at 248-594-6247 or Ken Newa at 313-983-4848. A practice group directory can be found on the firm's web site at www.plunkettcooney.com,

A copy of the United States Court for the Eastern District of Michigan's ruling in *City of Sterling Heights v United National Insurance Company* is attached as a second PDF file to this e-mail communication.

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