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AEI CLAIMS LAW QUIZ

UIM CLAIMS: NOTICE OF SETTLEMENT AND PROOF OF PREJUDICE

*[Ref. Law of Subrogation, Para. 3.06;
Law of Automobile Insurance: UM & UIM, Para. 3.06]*

FACTS: On August 16, 2010, Gasper Gonzalez was involved in a motor vehicle accident with a young motorist who was driving a vehicle that was insured under her father's auto policy. At the time of the accident Gonzalez was covered under his employer's insurance policy with Philadelphia Indemnity Insurance Company (Philadelphia). The policy included an endorsement that provided underinsured motorist (UIM) coverage but required the insured, among other things, to give the insurer prompt written notice of a tentative settlement with an underinsured motorist.

On August 27, 2012, Gonzalez's attorney notified Philadelphia that he was pursuing a claim against the other motorist and that he would be seeking UIM benefits. Philadelphia acknowledged receipt of the letter, stated that it was investigating the matter, and requested additional information. On September 24, 2012, Gonzalez's attorney supplied some of the requested information, including medical bills of at least \$26,000.

On November 2, 2012, Gonzalez settled with the tortfeasor for the \$25,000 limits of her father's policy without notifying Philadelphia. The settlement released all parties from all liability arising from the accident. Gonzalez did not notify Philadelphia of the settlement until March 6, 2014, when his attorney sent Philadelphia a letter requesting UIM benefits because Gonzalez's damages exceeded the \$25,000 settlement. Philadelphia refused to pay the claim and argued that the settlement breached the UIM insuring agreement and prejudiced its subrogation rights. Gonzalez sued for breach of contract. Gonzalez pointed out that the settlement was for the other motorist's policy limits and characterized the other motorist as a "young low-wage earning driver." Gonzalez contended that his damages exceeded the tortfeasor's policy limits, that Philadelphia had years to intervene in the third-party lawsuit, and had ample opportunity to investigate whether there were assets beyond the tortfeasor's policy limits. Gonzalez argued that the subrogation rights that Philadelphia lost as a result of the settlement had no value.

QUESTION: Can an insurer successfully deny UIM benefits to an insured who settled without providing notice of a tentative settlement when the settlement was for the tortfeasor's policy limits and the insured's damages exceeded the tortfeasor's policy limits?

ANSWER: Yes, but in most cases only if the insurer was prejudiced by the insured's failure to provide notice. Notice of a tentative settlement is part of a policy's consent to settle language that can be written as a policy exclusion or as part of a policy's cooperation clause. Some policies include language that specifically requires a showing of insurer prejudice. The main purpose of this policy language is to protect the insurer's right to subrogate. Even when there is no specific policy language requiring insurer prejudice, most jurisdictions will not permit a UIM insurer to deny coverage without proof that the insured's failure to provide notice of a tentative settlement prejudiced the insurer's subrogation rights.

In *Gonzalez v. Philadelphia Indemity Insurance Co.*, 2016 U.S. App. LEXIS 17602 (5th Cir. 2016), the court held that the insured's failure to provide notice of his settlement with the tortfeasor resulted in prejudice sufficient to warrant a denial of UIM coverage. Gonzalez was required under the terms of his auto policy to provide Philadelphia with written notice of a tentative settlement with a tortfeasor. The court explained that notice provisions afford insurers valuable rights such as the right to decide whether to seek subrogation against the tortfeasor. The court stated that notice given after a case is over is not just late, but "wholly lacking" and prejudices the insurer by depriving it of "a seat at the mediation table" and "the ability to do any investigation or conduct its own analysis of the case."

On the issue of whether the insurer's subrogation rights had any real value in light of the tortfeasor's financial situation, the court acknowledged that the tortfeasor was a college student who was living at home and working a low wage job but said that was not indicative of her financial worth or her future financial situation. Further, Gonzalez provided no evidence that the tortfeasor's father, the policyholder, could not satisfy a judgment that exceeded the policy limits. The court observed that had Philadelphia received notice of the tentative settlement: "this is precisely the type of information that Philadelphia could have investigated before releasing those parties from liability." The court held that Gonzalez prejudiced Philadelphia's subrogation rights because he did not notify Philadelphia until 16 months after the settlement was executed.

In *Progressive v. Jungkans*, 972 NE2d 807 (Ill. App. 2d 2012), the court, interpreting different but similar policy language, held that the insurer was not prejudiced by the insured's failure to provide notice because the insured proved that the tortfeasor was judgment proof. Jungkans was injured while he was riding in a car driven by Watts. Jungkans settled with Watts' insurer, State Farm, for its policy limit, then sought UIM coverage under his policy with Progressive. Progressive denied coverage on the ground that Jungkans, by failing to give notice, violated his insurance policy's cooperation clause and destroyed Progressive's right of subrogation against Watts and State Farm.

Jungkans relied on the same arguments as Gonzalez, namely that he settled for State Farm's policy limit and that Watts had no significant assets, therefore Progressive would suffer no prejudice from losing its subrogation rights. Unlike Gonzalez, however, Jungkans offered evidence that the tortfeasor was judgment proof. Jungkans hired a private investigator who established that the tortfeasor was incarcerated and already had two unsatisfied judgments against him. The court in *Jungkans* held that the insured sufficiently rebutted Progressive's claim of prejudice.

The court found that a judgment-proof tortfeasor negates an insurer's argument that it suffered prejudice by its insured's breach of the insurance policy's cooperation clause.

Allowing an insurer to avoid coverage when it lost subrogation rights which carried no reasonable possibility of collection beyond the tendered policy limits would constitute a forfeiture and would produce an undeserved windfall to the insurance company. A cooperation clause exists to protect the insurance company's substantial interests, not merely to afford it the chance to litigate for the sheer joy of it. We also

note that the substantial prejudice rule requires just that: substantial prejudice. Thus, the theoretical possibility that the tortfeasor might win the lottery or inherit millions before the statute of limitations runs does not create a reasonable possibility that the insurer will obtain significant relief by pursuing an action against him.

The *Jungkans* court held that the insured's failure to provide notice of settlement was immaterial because the insurer suffered no prejudice.

CONCLUSION

Even when there is no specific policy language requiring insurer prejudice, most states require proof of prejudice before an insured's failure to give notice can defeat a UIM claim. Prejudice requires proof of an actual, rather than a theoretical, impairment of the insurer's subrogation rights. Most states take this position because the purpose of notice of settlement language is almost exclusively to protect an insurer's subrogation rights and such language should not be enforced to deny a UIM claim when the insurer's subrogation rights are unaffected by the settlement.