wiley

NEWSLETTER

Tenth Circuit Finds No Coverage for Collusive Settlement

March 2001

The Tenth Circuit Court of Appeals recently affirmed a district court's summary judgment ruling in favor of an insurer and found that no coverage was available under New Mexico law under a professional liability policy for a state court judgment against an insured that was deemed "collusive." *Cont'l Cas. Co. v. Hempel,* Nos. 97-2136, 97-2147, 97-2190, 97-2194, 97-2195, 2001 U.S. App. LEXIS 2757 (10th Cir. Feb. 22, 2001). (Please note that the rules of the Tenth Circuit Court of Appeals may limit citation to unpublished opinions.)

Continental Casualty Company ("CNA") filed this action seeking a declaratory judgment that it had no obligation to indemnify one of its insureds, Frank O. Westerfield, Jr. ("Westerfield"), for a New Mexico state court judgment. The state court action was brought by Charles Hempel ("Hempel") following the death of his mother, Ada Mudge ("Mudge"), and concerned Mudge's rights under the will of her late husband. Westerfield ultimately was appointed as the attorney for a trust established in connection with the husband's will. In the state court suit, Hempel alleged that Westerfield and others had participated in the wrongful appropriation of trust assets in contravention of the husband's will. Westerfield held policies issued by several insurers, including CNA, and he requested that the insurers defend him in the state court suit. Although the other insurers agreed to defend Westerfield, CNA refused coverage on the basis that Hempel's allegations fell within the policies' exclusions for "dishonest, fraudulent, criminal or malicious acts, or omissions."

About one week prior to the state court trial, Westerfield's and Hempel's respective attorneys first discussed the idea of agreeing to an uncontested trial. The attorneys ultimately entered into a written settlement agreement on behalf of their clients. Under the agreement, Hempel executed a covenant not to execute on the judgment against Westerfield, although he did not agree to release Westerfield from liability. Moreover, Westerfield assigned to Hempel 90% of the proceeds of a bad faith lawsuit that Westerfield agreed to pursue against the non-settling insurers after the entry of judgment in the state court. At the outset of the trial, the attorneys informed the judge of the terms of the settlement agreement and offered the written agreement into evidence. The trial proceeded with Hempel's attorney calling four witnesses. Westerfield's attorney did not conduct cross-examination, did not call any witnesses and did not make an opening statement or closing argument. The judge ultimately entered a judgment in favor of Hempel and against Westerfield for $26,381,851.

In the instant coverage action, the lower court ruled as a matter of law that the parties to the state court lawsuit had engaged in collusion, citing several characteristics of the state court proceeding in support of its conclusion. Hempel and Westerfield appealed. Upon review, the appellate court considered several factors and ultimately concluded that the lower court properly determined that the Hempel-Westerfield settlement and resulting state court judgment were unenforceable against the non-participating insurers. Specifically, the appellate court noted that "the record establishes that the amount of the judgment . . . is unreasonable." Moreover, "the procedure through which the judgment was entered—an uncontested trial in which plausible defenses were not advanced and in which plaintiff and defendant had a joint interest in maximizing the amount recovered—evinces collusion between the parties." According to the court, when a settlement is the product of fraud or collusion at the expense of a non-participating insurer, the insurer is released from any obligation under the settlement.