

Insurer Bound by Award in Arbitration of Which It Had Notice But in Which It Decided Not to Participate

April 2009

The California Court of Appeal has held that an insurer that was notified of an underlying arbitration demand against its insured, an insolvent financial services firm, and was given an opportunity to participate in the arbitration was bound by the resulting award and judgment despite not having participated or having undertaken a duty to defend. *Executive Risk Indem., Inc. v. Jones*, 2009 WL 418072 (Cal. Ct. App. Jan. 29, 2009).

The insurer issued a professional and management services liability policy to the financial services firm. After the firm became insolvent and assigned its assets, a former client initiated an arbitration proceeding seeking damages for faulty investment advice. The plaintiff made the demand on the assignee of the policyholder's assets, and the assignee tendered the demand to the insurer. The assignee informed the insurer that the policyholder was insolvent and lacked funds to defend itself in the arbitration. Nevertheless, the insurer chose not to participate in the arbitration because it had no duty to defend and the claim was subject to a \$250,000 self-insured retention. After an uncontested hearing, the arbitrator issued a decision holding the firm liable and awarding the plaintiff over \$22 million in damages. The award was confirmed in the California Superior Court, and judgment was entered in favor of the plaintiff. Although it was provided notice of the motion to confirm, the insurer did not oppose the motion. The insurer instead brought a declaratory judgment action seeking, among other things, a declaration that the award and judgment did not bind it under principles of collateral estoppel.

The appellate court concluded that the insurer was bound by the prior award and judgment despite not having participated in the proceedings. In so holding, the court explained that "when an insurer (1) is duly notified of the underlying claim against its insured; and (2) is given a full opportunity to protect its interests, the resulting judgment—if obtained without fraud or collusion—is binding against the insurer in any later coverage litigation on the claim involving its insured. This rule applies regardless of whether the insurer has a contractual duty defend, or whether or not its refusal to participate in the underlying proceedings is legally justified."