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NEWSLETTER

# Default Judgment Against Insureds Unenforceable Against Insurer

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A federal district court, applying California law, has held that a default judgment entered against an insured real estate company and its employee to settle a suit by former clients was unenforceable against the company's insurer because the judgment was the product of fraud between the company and the former clients. *Carlson v. Century Sur. Co.*, 2012 WL 1029662 (N.D. Cal. Mar. 26, 2012). The court also held that the judgment was unenforceable against the insurer on the independent ground that it was unreasonable.

The insured real estate company and one of its realtors were sued by former clients in connection with a failed real estate deal. The company tendered the suit to the insurer, which denied coverage. The company and the realtor then agreed to a settlement with the former clients pursuant to which they would allow a default judgment to be entered against them and assign their rights against the insurer to the clients. In exchange, the clients agreed not to execute on the judgment. After the company and the realtor allowed a default judgment of $3.3 million to be entered against them, the former clients filed suit against the insurer.

In a prior coverage opinion in this case—which was reported in the March 2012 edition of *Executive Summary*—the court held that the insurer had breached the duty to defend and could be held liable for consequential damages in excess of the policy limits, but also held that the default judgment was unenforceable against the insurer because it was the product of collusion between the insureds and their former clients.

The former clients then filed a motion for reconsideration with respect to the court's rulings as to collusion. The court concluded that, in light of additional evidence from the clients, an issue of fact remained as to whether the settlement agreement was collusive. The court also went on to hold, however, that the default judgment was unenforceable on two independent grounds. First, the court determined that the judgment was the product of fraud because, as part of the settlement agreement, the insureds had signed false declarations in an attempt to manufacture insurance coverage for the former clients' suit. Second, the court ruled that the judgment was unenforceable because it was unreasonable as the former clients had sought "unrecoverable damages in an uncontested prove up hearing." Because the judgment was unenforceable against the insurer, the court held that the assignment of rights from the real estate company and the realtor to the former clients also was invalid and the former clients lacked standing to continue their suit against the insurer.