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SUPREME COURT OF ARIZONA

APOLLO EDUCATION GROUP, INC., formerly known as Apollo Group, Inc., Plaintiff-Appellant, v. NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURG, PA, a Pennsylvania corporation, Defendant-Appellee.	**Arizona Supreme Court No. CV-19-0229-CQ** United States Court of Appeals for the Ninth Circuit Docket No. 17-17293 United States District Court for the District of Arizona Case No. 2:15-cv-01948-SPL

AMICUS CURIAE BRIEF OF UNITED POLICYHOLDERS

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The Certified Question

"What is the standard for determining whether National Union unreasonably withheld consent to Apollo's settlement with shareholders in breach of contract under a policy where the insurer has no duty to defend?"

Legal Argument

1. In 1957, this Court held that the standard for determining if an insurer unreasonably withheld consent to settle is whether the insured gave equal consideration to its own interests and to its insured's interests. Arizona courts still apply the equal-consideration standard.

In a 1957 opinion apparently never cited or discussed in this case by the Ninth Circuit or by any party, this Court considered what "standard" to apply when an insurance company "has sole power and opportunity to make a settlement which would result in the protection of the insured against excess liability." *Farmers Insurance Exchange v. Henderson*, 82 Ariz. 335, 338 (1957). The standard for an insurer to follow in exercising a sole power to settle was the question confronting this Court in *Farmers*—and it is the question confronting this Court now.

In *Farmers*, an insured sued for damages he suffered when his insurer failed to settle a claim against the insured within the policy limits, although there had been a chance to settle within those limits. A jury found the insurer had committed bad faith and awarded $45,000 against it, a large amount in the 1950s. One of the main issues was "the extent of the obligations of the insurer to the insured to settle within the policy limits a claim against the insured." *Id*. at 337.

As the Ninth Circuit did here, *Farmers* acknowledged that the "principal difficulty experienced by the courts has been in fixing a test for the degree of consideration the insurer must give the insured's interests in order to have met its legal obligation in this respect." *Id*. at 338.

The Ninth Circuit unnecessarily complicated its analysis by concluding there is a difference between an insurer's obligations under the implied covenant of good faith and fair dealing and its obligations under a consent-to-settle provision in an insurance contract. *Order Certifying Question* at 11 (Aug. 15, 2019). There *might* be a difference where a contract actually states a standard to use in making the consent-to-settle decision. After all, setting aside for a moment any possible issues of unconscionability, unequal bargaining power, boilerplate language, and public policy, parties to an insurance contract can, in theory, have leeway in crafting an insurance policy's terms and standards.

But here, the policy's consent-to-settle clause stated no standard for settling a liability claim. As a result, Arizona common law sets the standard because it is both the rule of decision in our state, A.R.S. § 1-201, and it is a part of every Arizona contract. *State ex rel. Romley v. Gaines*, 205 Ariz. 138, 142 ¶ 13 (App. 2003); *School Dist. No. One of Pima County*, 106 Ariz. 175, 77 (1970); *Yeazell v. Copins*, 98 Ariz. 109, 113 (1965).

In *Farmers*, this Court described three different "standards" for an insurer to

use in deciding whether to settle a claim against its insured within the policy limits:

- The first standard: The liability "insurer may give paramount consideration to its interests." *Farmers*, 82 Ariz. at 338 (citing *Wisconsin Zinc Co. v. Fidelity & Deposit Co.*, 155 N.W. 1081 (Wisc. 1916) and *Hillker v. Western Auto. Ins. Co.*, 235 N.W. 413 (Wisc. 1931)). Here, that is National Union's position.
- The second standard: The "paramount consideration must be given to protect the insured." *Id*. (citing *Tyger River Pine Co. v. Maryland Casualty Co.*, 170 S.E. 346 (S.C. 1933)). Here, that is Apollo's position.
- The third standard: The "insurer must give equal thought to the end that both the insured and the insurer shall be protected." *Id*. (citing *American Fidelity & Cas. Co. v. G.A. Nichols Co.*, 173 F.2d 830 (10th Cir. 1949) and *National Mutual Casualty Co. v. Britt*, 200 P.2d 407 (Okla. 1949)).

This Court adopted the third "standard." *Farmers*, 82 Ariz. at 338. Thus, in Arizona, when an insurer has "sole power and opportunity to make a settlement which would result in the protection of the insured against excess liability, common honesty demands that it not be moved by partiality to itself nor be required to give the interests of the insured preferential consideration." *Id*. at 338-39. The standard is, in short, equal consideration.

This Court held an insurer violating the "rule of equality of consideration

cannot be said to have acted in good faith." *Farmers*, 82 Ariz. at 339 (citing *American Fidelity*, 173 F.2d at 832). Although stating the rule is "not difficult," this Court explained that the rule's actual "application is troublesome" and "a matter of consideration of comparative hazards." *Id*. But if the trier of fact finds that the insurance company's "good faith obliges the company to terminate the litigation by settlement, its failure to do so renders it liable as between the insured and insurer for the full amount of the judgment." *Id*. at 341.

What standard an insurer must apply when considering whether to settle within the policy limits was a problem this Court "first considered" in the 1957 *Farmers* opinion. *State Farm Auto. Ins. Co. v. Civil Service Employees Ins. Co.*, 19 Ariz. App. 594, 601 (1973). Under the equal-consideration standard, the insurer has liability when it "'refuses to settle in an appropriate case'" and its "'liability may exist when the insurer unwarrantedly refuses an offered settlement where the most reasonable manner of disposing of the claim is by accepting the settlement.'" *Id*. at 602 (quoting *Crisci v. Security Ins. Co. of New Haven, Conn.*, 426 P.2d 173, 176-77 (Cal. 1967)).

In the 1990 *Clearwater* opinion, this Court provided more specificity on the details of the equal-consideration standard when it quoted the following trial-court jury instruction on that standard:

> In determining whether the State Farm Mutual Automobile Insurance Company breached its duty of good faith and fair dealing, you must

> consider the *comparative hazards to which it exposed itself and its policyholder*, Edward Francis, *in rejecting offers of settlement*. In doing so, you must consider:
>
> 1. The amount of financial risk to which each party is exposed in the event of a refusal to settle;
>
> 2. The strength of the injured claimants' case on the issues of liability and damages;
>
> 3. The failure of the insurance company to inform the insured of offers of settlement; and
>
> 4. The failure of the insurance company to properly investigate the circumstances so as to ascertain the evidence against the insured.
>
> In every insurance policy there is a duty imposed by law of good faith and fair dealing. This obligation requires an insurance company, such as the defendant, State Farm Mutual Automobile Insurance Company, to deal in good faith and fairly with its insured in handling a claim against its insured.
>
> This duty of good faith and fair dealing requires the insurance company to give *equal consideration* to the interests of its insured as it gives its own interests.

Clearwater v. State Farm Mut. Auto. Ins. Co., 164 Ariz. 256, 259 (1990) (emphasis added).

Clearwater held that: "The trial court *properly instructed the jury* as to the duty and standard of conduct in third-party bad faith claims for failure to accept reasonable settlement offers." *Id*. at 260-61 (emphasis added).

The equal-consideration standard the 1957 *Farmers* opinion adopted, and that this Court elaborated and more specifically explained in the 1990 *Clearwater*

opinion, is still a part of Arizona insurance law's fabric.

In 2018, for instance, this Court explained that it "recognizes that even in a settlement context an insurance carrier has an obligation to act in good faith toward a claimant by giving equal consideration to the claimant's interest." *Twin City Fire Ins. Co. v. Leija*, 244 Ariz. 493, 499 ¶ 28 (2018). And over a decade earlier, this Court affirmed that an "insurer owes the insured an implied contractual 'duty to treat settlement proposals with equal consideration' to its interests and those of an insured." *Safeway Ins. Co., Inc. v. Guerrero*, 210 Ariz. 5, 9 ¶ 11 (2005) (quoting *Arizona Property & Cas. Guaranty Fund v. Helme*, 153 Ariz. 129, 137 (1987)).

2. The main case that this Court relied on in the 1957 *Farmers* opinion similarly adopted the standard of equal consideration.

In its discussion of the standard to apply in a situation like the present one, the 1957 *Farmers* opinion relied on *American Fidelity & Cas. Co. v. G.A. Nichols Co.*, 173 F.2d 830 (10th Cir. 1949). In that opinion, the Tenth Circuit held that when an insurer has an irrevocable power to decide whether to accept or reject a settlement, the insurer "creates a fiduciary relationship between it and the insured with the resulting duties that grow out of such a relationship." *Id*. at 832.

"While the insurance company, in determining whether to accept or reject an offer of compromise, may properly give consideration to its own interests, it must, in good faith, give at least equal consideration to the interests of the insured and if it fails so to do it acts in bad faith." *Id*.

In 1968, this Court cited *American Fidelity* for the principle that, when an insurer "evaluates a claim without looking to the policy limits and as though it alone would be responsible for the payment of any judgment rendered on that claim it views that claim objectively, and in doing so renders 'equal consideration' to the interests of itself and the insured." *General Accident Fire & Life Assur. Corp., Ltd. v. Little*, 103 Ariz. 435, 442 (1968).

In a later case applying *American Fidelity*'s principles, the Tenth Circuit further explained that the "'equal consideration' requirement mediates the conflict of interest that arises between the insurer and the insured in the face of a possible judgment in excess of policy limits." *Magnum Foods, Inc. v. Continental Cas. Co.*, 36 F.3d 1491, 1504 (10th Cir. 1994). The equal-consideration standard "prohibits the insurer from taking a gamble that only its insured stands to lose." *Id*. That standard prevents the insurer from frustrating the purpose of insurance by selfishly and cavalierly refusing to settle and exposing "the insured to liability beyond the specific monetary protection that his premium has purchased." *Id*.

3. Why would it matter if the insurer has no duty to defend?

The certified question asks: "What is the standard for determining whether National Union unreasonably withheld consent to Apollo's settlement with shareholders in breach of contract under a policy *where the insurer has no duty to defend*?" (Emphasis added.) But why would it matter if an insurance company has

no contractual duty to defend?

It is true that an Arizona liability insurer generally "owes two express duties and one implied duty to its insured. The express duties are the duty to defend the insured and the duty to indemnify the insured. The implied duty is the duty to treat settlement offers with equal consideration." *Waddell v. Titan Ins. Co., Inc.*, 207 Ariz. 529, 533 ¶ 14 (App. 2004). Under the present insurance contract, there was no duty to defend. But that does not affect the common-law duty to treat settlement offers with equal consideration. Nor does it alter the analysis to use in deciding if an insurer has complied with that standard.

Here, the policy states that: "The Insurer's consent shall not be unreasonably withheld." *Order Certifying Question* at 6 (Aug. 15, 2019). But that clause cannot affect how to apply the equal-consideration standard. Obviously, no insurer can "unreasonably" withhold consent to settle. Any insurer unreasonably doing that is *not* giving equal consideration to its own interests and to its insured's interests. Any insurer doing that would, in fact, breach the contract, violate the implied covenant of good faith and fair dealing, and act in bad faith.

4. The Ninth Circuit and the district court appear to believe that *how* to apply the correct standard is a question of law. What standard applies is a question of law. But *how* that standard applies is a question of fact.

The Ninth Circuit and the district court appear to regard as a question of law the application of the correct standard for settling. *Order Certifying Question* at 3

(Aug. 15, 2019). As a matter of law, the correct standard to apply is the equal-consideration standard. But in a case where the facts are in dispute, as here, the *jury* decides if the insurer has given equal consideration to its own interests and to its insured's interests.

The jury instruction in the 1990 *Clearwater* opinion, quoted in Section 1 of this Brief, is an example of instruction the federal district-court jury will need to receive in this matter on remand, if this Court advises the Ninth Circuit that the equal-consideration standard is the correct one to apply under this case's facts. The current basic Arizona jury instruction on the subject of equal consideration provides that:

> There is an implied duty of good faith and fair dealing in every insurance contract. [*name of plaintiff*] claims that [*name of defendant*] breached this duty. The duty of good faith and fair dealing requires an insurance company to give the same consideration to its insured's interests as it gives to its own when it considers a settlement offer.
>
> The test for evaluating whether an insurance company has given equal consideration to the interests of its insured is whether a prudent insurer without policy limits would have accepted the settlement offer.

Bad Faith 8 (Third-Party), Third Party Standard, RAJI (Civil) (5th ed. July 2013) .

Usefully, the "Factors to Be Considered" note to the *Bad Faith 8* RAJI explains that, if a "trial court does decide to list specific factors in the instruction, the following language could be used, modified to delete any factors not relevant to the case." *Id*. The explanatory note then provides a proposed instruction listing

some of the specific factors to consider in the equal-consideration analysis:

> "In determining whether defendant breached its duty of good faith and fair dealing, you may consider the following:
>
> 1. The strength of the injured claimant's case on the issues of liability and damages;
>
> 2. Whether the insurer attempted to induce its insured to contribute to a settlement;
>
> 3. Whether the insurer failed to properly investigate the circumstances of the claim in order to ascertain the evidence against its insured;
>
> 4. Whether the insurer rejected the advice of its attorneys or other agents;
>
> 5. Whether the insurer failed to inform its insured of a compromise offer;
>
> 6. The amount of financial risk to which each party would be exposed in the event of a refusal to settle;
>
> 7. Whether the insured was at fault in inducing the insurer's rejection of the compromise offer by misleading the insurer about the facts; and
>
> 8. Any other factors tending to establish or eliminate bad faith on the part of the insurer."

Explanatory Note to *Bad Faith 8 (Third-Party), Third Party Standard*, RAJI (Civil) (5th ed. July 2013).

That detailed jury instruction offers solid guidance for the Ninth Circuit in understanding the Arizona equal-consideration standard. It also offers a good outline for the federal district court in fashioning a proper jury instruction to fit the

disputed facts of this particular case.

5. The Ninth Circuit—and Apollo and National Union, for that matter—regard this issue as an "either-or" proposition. Under Arizona law, it is not an "either-or" proposition.

The Ninth Circuit sees this situation as one where the federal district court must "assess the objective reasonableness of the decision to withhold consent [to settle] from the perspective of an insurer or from the perspective of an insured. *Order Certifying Question* at 2 (Aug. 15, 2019). For the Ninth Circuit, it's either one or the other. Indeed, Apollo and National Union also believe there are only two choices. The "either-or" belief is wrong because there are not just *two* choices.

In fact, as discussed earlier, there are *three* main choices for the standard to apply to determine if an insurer has unreasonably withheld consent to settle:

Choice One: The standard Apollo advocates is that an insurer "is obligated to consent to a "non-collusive and objectively reasonable settlement." *Brief of Apollo Education Group, Inc. on the Certified Question from the Ninth Circuit* at 20 (Dec. 9, 2019). That standard strongly favors the insured.

Choice Two: The standard National Union advocates is that "the objective reasonableness of the insurer's withholding of consent is evaluated from the insurer's perspective." *National Union's Supplemental Brief* at 19 (Dec. 9, 2019). That standard strongly favors the insurer.

Choice Three—The Correct One: The standard this Court adopted in 1957,

and that still applies, is the middle position of equal consideration for the interests of the insured and the insurer.

As a result, under Arizona law, when an insurer possesses "sole power and opportunity to make a settlement which would result in the protection of the insured against excess liability, common honesty demands that it not be moved by partiality to itself nor be required to give the interests of the insured preferential consideration." *Farmers*, 82 Ariz. at 337-38. "A violator of this rule of equality of consideration cannot be said to have acted in good faith." *Id*. at 339.

Conclusion

That third standard—the equal-consideration standard—provides a fair and reasonable accommodation of the interests of the insured and the insurer. That is the standard Arizona courts have applied since 1957. And it is thus the standard the Ninth Circuit must apply as well.

DATED this 23rd day of December, 2019.

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