

BAD FAITH BLOG

# Insured Breached Umbrella Policy's Cooperation Clause by Entering Miller-Shugart Consent Judgment

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**Summary:** After an evening of under-age drinking, Jacob Patton drove his father's minivan while his friend, John Donaldson, rode in the passenger seat. When Jacob saw the sirens from a police car, he panicked and attempted to flee. After a short chase, Jacob lost control of the van and crashed into a tree. Donaldson was seriously injured and was hospitalized for almost a month. A blood analysis revealed Jacob had a blood alcohol content of .20.

*American Family Mutual Ins. Co. v. Donaldson*

Jacob's father, Todd Patton, had his car insurance with American Family Mutual Insurance Company (American Family) that provided \$100,000 in coverage. Todd had also purchased an umbrella policy through American Family that provided an additional \$1,000,000 in coverage.

Shortly after the accident, American Family entered into a Drake-Ryan settlement with Donaldson. A Drake-Ryan settlement is a creation of Minnesota case law that allows the primary insurance carrier to settle with a plaintiff in exchange for a complete release of any claims against the insured defendant, but also allows the plaintiff to pursue a claim against any secondary or excess carriers. Due to this settlement, Jacob was not at risk for personally paying a judgment.

After the Drake-Ryan settlement was entered into, Donaldson filed suit against Jacob and Todd in order to recover under the umbrella policy. American Family filed a declaratory judgment action, arguing it had no duty to defend. While American Family provided defense counsel to Jacob to negotiate the Drake-Ryan settlement, the declaratory judgment action led the Pattons to retain separate counsel. Their new attorney then entered into a Miller-Shugart settlement with Donaldson. Like a Drake-Ryan settlement, a Miller-Shugart settlement is a creation of the Minnesota Supreme Court. If the insurer abandons both its duty to defend and its duty to indemnify, a Miller-Shugart settlement allows an insured to consent to having a judgment against him in exchange for the plaintiff's agreement to only seek satisfaction of the judgment from the contested insurance proceeds.

Per the Miller-Shugart settlement, Donaldson's personal injury claim against Jacob proceeded to binding arbitration where the arbitrator set damages at \$1,250,000. American Family did not attend the arbitration and instead advised Jacob that the settlement violated the cooperation clause of the umbrella policy. After final judgment was entered, American Family filed a motion for summary judgment seeking a determination that there was no coverage. The trial court ruled in favor of American Family and found that Jacob's conduct fell within umbrella policy's intentional act exclusion.

While an appeal of that ruling was pending, Jacob was convicted of felony criminal vehicular operation of a motor vehicle. The court of appeals declined to review the case because the conviction may have triggered the umbrella policy's violation-of-law exclusion. On remand, the trial court again granted summary judgment in favor of American Family.

On appeal, American Family maintained that the Pattons' Miller-Shugart settlement violated the cooperation clause of the umbrella policy, while Donaldson argued that, irrespective of whether the policy provided coverage for Jacob, the severability clause meant that coverage for Todd should be determined separately.

The Eighth Circuit Court of Appeals held that Donaldson's argument missed the point. Under Minnesota law, an insured can only enter into a Miller-Shugart settlement if the insurer is denying coverage for the claim *and* if the insured is risking personal liability for a damages award. As part of the Drake-Ryan settlement American Family negotiated on behalf of the Pattons, Donaldson settled all claims against the Pattons and could only seek further recovery from the umbrella policy. Thus, the second prerequisite to a Miller-Shugart settlement had not been met because the Pattons did not risk any personal liability.

Because the circumstances were not ripe for a Miller-Shugart settlement, the Pattons' agreement with Donaldson violated the umbrella policy's cooperation clause. Donaldson's attempt to use the severability clause to obtain coverage for Todd therefore failed because Todd was also party to the Miller-Shugart settlement which violated the policy's terms.

Like most jurisdictions, an insurer can only avoid liability under a policy if the insured's breach is both material and prejudicial. Here, the Pattons' breach of the cooperation clause was material because it foreclosed the possibility of a later settlement in which American Family could participate. It was also prejudicial because it took away American Family's right to contest liability and the amount of damages and also took away its right to a trial by jury.

Having been protected from personal liability due to the prior settlement with Donaldson, Minnesota law did not allow the Pattons to consent to entry of judgment against them in exchange for the plaintiff's agreement to seek recovery only from the insured's umbrella policy. Under these circumstances, the entry into a Miller-Shugart settlement violated the policy's cooperation clause and released American Family from its duty to indemnify.

The *Donaldson* ruling helps Minnesota insureds, insurers, and claimants know the parameters of enforceable Miller-Shugart settlements.

By Brett Simon

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