COLORADO SUPREME COURT DECIDES INSURERS DEFENDING UNDER RESERVATION MAY NOT INTERVENE IN UNDERLYING SUIT AS A MATTER OF RIGHT AND TAKES THE OPPORTUNITY TO ADDRESS THE PRACTICE OF ASSIGNING COVERAGE CLAIMS

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A recent decision of the Colorado Supreme Court clarifies insurers' rights and promises to impact significantly the practice of insureds assigning coverage claims to third-party claimants. *Auto-Owners Insurance Company v. Bolt Factory Lofts Owners Association, Inc.*, 2021 CO 32, 2021 Colo. LEXIS 365, 2021 WL 2069736.

Colorado law recognizes the right of insureds to assign claims when an insurer acts unreasonably by either refusing to defend the insured, or refusing a settlement offer within policy limits thereby potentially exposing the insured to an uncovered excess verdict. Such assignments are commonly referred to as *Nunn* agreements and generally entail the assignment of the insured's contractual and extracontractual claims against insurers in exchange for a covenant by the third-party claimant to execute only against the tortfeasor's insurer. The Supreme Court confirmed that stipulated judgments are "not binding on the insurer until after *an adversarial proceeding* before a neutral factfinder, providing the insurer with an opportunity to advance its defense."

A common practice in recent years is for insureds to enter into a *Nunn* agreement and then seek a judgment in the underlying third-party suit from an arbitrator or the trial court in a proceeding in which the insured offers no defense, allowing third-party claimants to offer their evidence unchallenged. Predictably, this practice tends to result in high awards. Recognizing the risk of such high awards and defending against them in a subsequent coverage suit, insurers have attempted to intervene in these uncontested proceedings in order to offer defenses and contest the evidence. The *Auto-Owners* decision holds that, under C.R.C.P. 24(a)(2), insurers who defend under a reservation of rights may not intervene as a matter of right in these underlying proceedings.

Rule 24(a)(2) allows a non-party to intervene as a matter of right when it:

> claims an interest relating to the property or transaction which is the subject of the action and [it] is so situated that the disposition of the action may as a practical matter impair or impede [its] ability to protect that interest, unless the [non-party's] interest is adequately represented by existing parties.

The Supreme Court held that insurers defending under reservation do not have a right to intervene for two reasons. First, a reservation of rights renders the insurer's interest contingent and prior decisions hold that non-parties with contingent interests may not intervene as of right. Second, insurers have the opportunity to contest the judgment and protect their interests in a subsequent coverage action. The Court also expressed concern about the potential for a conflict of interest if an insurer intervenes as it could potentially learn information it could later use to defeat coverage, and the insurer may have a stronger interest in defending covered rather than uncovered claims.

Importantly, the Supreme Court took the opportunity to address the practice of seeking awards via uncontested arbitrations and trials and concluded that the result is "akin to a stipulated judgment." Because the result against the insured is the same, that is, the damages were not determined after an adversarial proceeding, the judgment is not binding on the insurer and it maintains the right to challenge the reasonableness of the underlying award before a neutral factfinder, as well as present coverage defenses, including the reasonableness of its own conduct.

The Dissenting Opinion took a particularly harsh view of the practice of uncontested proceedings, describing them as "bogus," "spurious," "faux," and a "masquerade" and urged the court to "categorically disallow[] lay down trials." While the Court did not disallow these proceedings, it made clear that trial courts may refuse to participate in such proceedings and instruct the parties to simply enter a stipulated judgment.

Finally, and perhaps most significantly, the Supreme Court reaffirmed that an insurer does not lose the "absolute right" to control the defense and settlement of claims even when defending its insured under a reservation of rights. An insurer's "reservation of rights alone is insufficient" to demonstrate unreasonable conduct to support an enforceable *Nunn* agreement.

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