

INSURER DEFENDING UNDER RESERVATION OF RIGHTS LOSES ITS SUBROGATION RIGHTS IF IT RECEIVED NOTICE AND THE INSURED'S SETTLEMENT WAS REASONABLE

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Monterey Homes v. Federated Mutual Insurance Company
Ct. Appeals, Div. One, February 10, 2009

Authored by the [JSH Appellate Team](#)

Monterey Homes was sued for construction defects. Monterey filed a third-party complaint against several subcontractors, including BBP Concrete. BBP tendered its defense to its insurer, Federated, who defended under a reservation of rights. Ultimately, without Federated's consent, BBP settled with Monterey to release all claims against each other, and agreed to "no indemnity or defense payments," thereby waiving Federated's subrogation rights. Federated was not a party to the agreement. Thereafter, Federated sought to intervene to assert its right to subrogation for defense payments in defending BBP. The trial court denied the request.

The court of appeals reversed and remanded. The court reasoned that when an insurer defends under a reservation of rights, control of the litigation for settlement shifts to the insured, and the insured can enter into a settlement that releases the insurer's subrogation rights. However, in order to extinguish the subrogation rights, appropriate notice and a reasonable and prudent settlement must be established. If *Monterey* could show on remand that Federated received appropriate notice and the settlement was reasonable and prudent under the circumstances, Federated would not be entitled to pursue its subrogation claim as an intervenor, and would be bound by the settlement between Monterey and BBP.