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Insured's Breach of Consent Provision Precludes Coverage for Settlement

In a recent decision, New York's highest court weighed in on a long-standing debate over an insurance policy's requirement that insureds obtain their insurers' consent before settling a claim made against an insured. In an opinion dated March 13, 2008, the New York Court of Appeals held that policyholder Bear Stearns had breached a "consent to settle" provision in its professional liability insurance policies by settling a claim without first obtaining its insurers' consent.[1]

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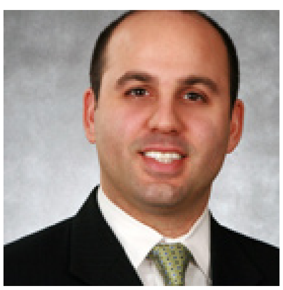

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In light of the fact that "consent to settle" requirements are considered to be a condition precedent to insurance coverage, the result of the Court of Appeal's decision is that there is no coverage available for any part of Bear Stearns' $80 million settlement with federal securities regulators.

Background/Procedural History

In April 2002, the Securities and Exchange Commission ("SEC") opened an investigation into whether Bear Stearns' research analysts exposed the firm to impermissible conflicts of interest by producing purportedly objective research analyst reports that were intended to support Bear Stearns' investment banking unit. Bear Stearns provided notice of the investigation under its professional liability insurance policies, which consisted of a series of primary and excess policies issued by a variety of insurers. The primary insurer was Vigilant Insurance Company, part of the Chubb Group.

Bear Stearns and the SEC subsequently agreed to a settlement in principle in a written agreement that Bear Stearns executed on December 20, 2002 (the "Settlement"). The Settlement required, among other things, that Bear Stearns pay $80 million and would agree to injunctive and other relief that the regulators subsequently would seek in an action to be filed in federal court by the SEC.[2] Consistent with the terms of the Settlement, on April 28, 2003, the SEC filed a complaint against Bear Stearns in the United States District Court for the Southern District of New York, detailing the allegations supporting the regulators' claims for relief, and seeking injunctive and other relief that Bear Stearns had agreed not to contest. That same day, the SEC and Bear Stearns together prepared and submitted for entry by the federal court a proposed final judgment memorializing the terms of the settlement previously agreed upon by the parties (the "Consent Agreement"). The United States District Court for the Southern District of New York entered a final judgment on October 31, 2003 incorporating the terms of the Consent Agreement.

When Bear Stearns sought coverage from its professional liability insurers for financial liability it incurred through the Settlement and Consent Agreement, Bear Stearns' professional liability insurers denied coverage for the Settlement citing several coverage defenses, including that Bear Stearns had breached the Vigilant policy's "consent to settle" provision by agreeing to the Settlement and executing the Consent Agreement without first securing the insurers' consent, as required by the Vigilant policy. The Vigilant "consent to settle" provision provided, in part, that "the Insured agrees not to settle any Claim...without the Insurer's consent...the Insurer shall not be liable for any settlement...to which it has not consented."

The insurers, led by Vigilant, commenced a declaratory judgment action in the Supreme Court for New York County, and sought summary judgment by the court declaring that Bear Stearns was not entitled to coverage for the Settlement on several grounds, including Bear Stearns' alleged breach of the Vigilant "consent to settle" provision. In response, Bear Stearns argued that summary judgment was not appropriate because, among other things, a triable issue of fact existed on the consent issue given that the federal court did not approve the Settlement until it entered a final judgment in October 2003. The New York Supreme Court (New York's trial court) agreed and found that triable issues of fact existed as to whether Bear Stearns had breached the "consent to settle" provision. Vigilant appealed to New York's intermediate appellate court, known as the Appellate Division, and the Appellate Division concurred with the Supreme Court. Vigilant then appealed the Appellate Division decision to New York's highest appeals court, the Court of Appeals.

Court of Appeals Reverses

Although a number of significant coverage issues were argued as part of the latest appeal (including whether coverage should be made available for the $25 million settlement payment labeled as "disgorgement"), the Court of Appeals found that it was only necessary to address the dispositive issue whether Bear Stearns' breach of the "consent to settle" provision voided coverage for the entire settlement.

The insurers argued that Bear Stearns had resolved and finalized the Settlement when it executed the settlement-in-principle in December 2002, or at the latest, when Bear Stearns signed the Consent Agreement in April 2003. Bear Stearns countered that the court below properly found a triable issue of fact as to whether its execution of these two documents factually constituted a breach of the "consent to settle" provision.

The Court of Appeals concluded that Bear Stearns did breach the "consent to settle" provision when it executed the April 2003 Consent Agreement before notifying the insurers of the Settlement or without first obtaining their consent to the terms of the Settlement. The Court of Appeals reasoned that by signing the April 2003 Consent Agreement acquiescing to the relief sought by the SEC, Bear Stearns "did everything within its ability to settle the matter and no further action was required on its part."

The Court of Appeals stated that it was unpersuaded by Bear Stearns' contention that there was no "settlement" until the federal court entered a final judgment in October 2003. Citing to *TLC Beatrice Int'l. Holdings, Inc. v. Cigna Ins. Co.*, 2000 WL 282967, *7 (SDNY 2000), the Court of Appeals found that once Bear Stearns signed the Consent Agreement it was not free to walk away from the Settlement before entry of the final judgment. Accordingly, in executing the Consent Agreement, the Court of Appeals ruled, Bear Stearns indeed had settled the claim without obtaining the insurers' consent.

Finally, the Court of Appeals ruled that because the insurers' consent was a condition precedent to coverage for *any* settlement, the insurers would "not be liable" for any portion of the Settlement.

The *Bear Stearns* decision is an important court precedent for non-duty-to-defend policies such as D&O and E&O policies. Given that the insureds select their own defense counsel and direct their own defense strategy, the "consent to settle" provision – like the "cooperation" provision is an important restraining tool for insurers to use to maintain some degree of control over the use of policy proceeds for defense and settlement purposes. By affirming the condition precedent implication of "consent to settle" provisions, the New York Court of Appeals will help re-set the balance between insureds and their insurers in managing claims under non-duty-to-defend policies.

1 Vigilant Ins. Co. et al. v. Bear Stearns Cos., Inc. The Opinion is uncorrected and subject to revision before publication in the New York Reports.

2 Of the $80 million, (i) $25 million was a "penalty," (ii) $25 million was "disgorgement;" (iii) $25 million was to fund independent research, and (iv) $5 million was to fund investor education.

This article is for guidance only and is not intended to be a substitute for specific legal advice. If you would like any further information please contact John or Maurice, members of Edwards Angell Palmer & Dodge's Insurance and Reinsurance Department.

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