1 No. 25
Vigilant Insurance Company, et al.,
Appellants,
v.
The Bear Stearns Companies, Inc.,
Respondent.

Joseph G. Finnerty III, for appellants.
John H. Gross, for respondent.
Mark Pennington, for amicus curiae Securities and Exchange Commission.

GRAFFEO, J.:

In this insurance dispute, we conclude that the insured breached a policy provision obligating it to obtain the consent of its liability carriers before settling claims in excess of $5 million. We therefore reverse the order of the Appellate Division denying the insurers' motion for summary judgment.

Defendant Bear Stearns Companies, Inc., a financial services firm, was issued a primary professional liability insurance policy by plaintiff Vigilant Insurance Company that provided coverage for losses resulting from claims made against the insured for its wrongful acts. The Vigilant policy afforded $10 million in coverage after Bear Stearns exhausted its $10 million self-insured retention. Plaintiffs Federal Insurance Company and Gulf Insurance Company further provided Bear Stearns an additional $40 million in coverage under follow-form excess liability policies.[*] Pursuant to the terms of these insurance contracts, Bear Stearns agreed not to settle any claim in excess of $5 million without first obtaining the consent of its insurers. In addition, the policies excluded coverage for claims arising from investment banking work undertaken by Bear Stearns.

In early 2002, the U.S. Securities and Exchange Commission (SEC), National Association of Securities Dealers (NASD) and New York Stock Exchange (NYSE), along with state Attorneys General, initiated a joint investigation into the practices of research analysts working at financial services firms and the potential conflicts that could arise from the relationship between research functions and investment banking objectives. The investigation focused on allegations that

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[*] The Travelers Indemnity Company is the successor-in-interest by merger to Gulf Insurance Company. Bear Stearns was also covered by additional excess policies not relevant to this appeal.

research analysts employed at ten major financial institutions, including Bear Stearns, were improperly influenced by investment banking concerns. Toward the end of 2002, the regulators met separately with each of the investigated firms to discuss a global settlement.

On December 20, 2002, Bear Stearns signed a settlement-in-principle document, acknowledging that each regulator would commence an action or administrative proceeding against it and that Bear Stearns would subsequently "consent to the action and the relief sought without admitting or denying the allegations." Bear Stearns further agreed to pay $50 million in retrospective relief, plus $25 million to fund independent research and $5 million for investor education. The document indicated that the terms of the settlement were subject to approval by the SEC and other regulators. Also taking place on December 20, 2002, the regulators issued a press release announcing they had achieved an industry-wide settlement with the 10 financial institutions that would result in payments of more than $1.4 billion in penalties, restitution and education funds.

A few months later, Bear Stearns executed a consent agreement in which it acceded to the entry of a final judgment in the SEC's federal lawsuit against Bear Stearns in the United States District Court for the Southern District of New York. Under the terms of the "Consent of Defendant Bear, Stearns & Co. Inc.," dated April 21, 2003, Bear Stearns consented to be permanently enjoined from violating a number of NASD and NYSE rules and agreed to pay a total amount of $80 million allocated as follows: $25 million as a penalty, $25 million in disgorgement, $25 million for independent research and $5 million for investor education. Of the $50 million in retrospective relief, $25 million was designated to resolve the SEC action and related proceedings instituted by the NASD and NYSE, while the remaining $25 million covered the settlement of proceedings with various state regulators. Bear Stearns explicitly agreed not to seek insurance coverage for the $25 million penalty. The agreement also allowed the SEC to present a final judgment to the federal court "for signature and entry without further notice" to Bear Stearns.

Three days after executing the settlement agreement, Bear Stearns sent letters to its insurers requesting their consent to the settlement. The insurers disclaimed coverage and commenced this declaratory judgment action seeking a declaration that the $45 million sought by Bear Stearns (after depletion of the $10 million self-insured retention) was not covered by the policies.

In October 2003 the federal district court found the Bear Stearns settlement to be "fair, adequate, and in the public interest," and entered a final judgment ordering Bear Stearns to pay the agreed-upon sum of $80 million. Shortly thereafter, the insurers moved for summary judgment in this declaratory judgment action. In support of their motion, the insurers argued that they were not liable for all or part of the $45 million sought by Bear Stearns for four reasons. First, they asserted that Bear Stearns could not recover any of the settlement because it had breached the policy provision obligating it to obtain the insurers' consent before settling the case. Second, they claimed that the investment banking exclusion precluded recovery of the settlement proceeds. Third, the insurers contended that the $25 million disgorgement payment was uncollectible either as a matter of public policy or under contract interpretive principles. Finally, they posited that neither the $25 million payment for independent research nor the $5 million payment for investor education was covered because those liabilities were not "losses" within the meaning of the policies.

Supreme Court found that triable issues of fact existed as to whether Bear Stearns breached the policy clause prohibiting it from settling without the insurers' consent and whether the investment banking exclusion applied. Siding with the insurers on the disgorgement issue, the court held that the $25 million disgorgement payment did not constitute damages under the terms of the policies and that Bear Stearns was not entitled to look behind the settlement to ascertain whether the entire $25 million truly represented ill-gotten gains. The court also rejected the insurers' position that the $25 million payment for independent research and $5 million payment for investor education were not losses under the policies. Bear Stearns and the insurers appealed.

The Appellate Division modified, by granting Bear Stearns summary judgment on the investment banking exclusion and independent research/investor education issues and denying the insurers summary judgment on the disgorgement issue, and otherwise affirmed. The court concurred with Supreme Court in finding an issue of fact as to whether Bear Stearns breached the provision obligating it to obtain the consent of the insurers, but determined that the investment banking exclusion was not applicable. Despite the agreement by Bear Stearns to pay $25 million as disgorgement, the court found "an issue of fact as to whether the portion of the settlement attributed to disgorgement actually represented ill-gotten gains or improperly acquired funds" (34 AD3d 300, 302 [2006]). Finally, the court rejected the insurers' contention that the combined $30 million payment for independent research and investor education were not covered losses.

The Appellate Division granted the insurers leave to appeal and certified the following question to this Court: "Was the order of the Supreme Court, as modified by this Court, properly made?" We conclude that it was not.

The insurers raise a number of objections to the Appellate Division order, but we find it necessary to address only one of them. The insurers contend that the Bear Stearns settlement is not recoverable because Bear Stearns breached the policy provision obligating it to obtain their consent prior to settling the regulator lawsuits. Specifically, the insurers claim that Bear Stearns resolved and finalized the settlement of the case when it executed the settlement-in-principle in December 2002 or, at the latest, when it signed the consent agreement in April 2003 without advising the insurers. Bear Stearns counters that the courts below properly found a triable issue of fact as to whether its execution of these two documents constituted a breach of the policy provision.

The primary insurance policy, whose terms and conditions are incorporated into the follow-form excess policies, provides in relevant part:

> "The Insured agrees not to settle any Claim, incur any Defense Costs or otherwise assume any contractual obligation or admit any liability with respect to any Claim in excess of a settlement authority threshold of $5,000,000 without the Insurer's consent, which shall not be unreasonably withheld . . . The insurer shall not be liable for any settlement, Defense Costs, assumed obligation or admission to which it has not consented."

As with the construction of contracts generally, "unambiguous provisions of an insurance contract must be given their plain and ordinary meaning, and the interpretation of such provisions is a question of law for the court" (White v Continental Cas. Co., 9 NY3d 264, 267 [2007] [citation omitted]).

We conclude that Bear Stearns breached this provision when it executed the April 2003 consent agreement before notifying the insurers or obtaining their approval. As contemplated by the earlier settlement-in-principle, Bear Stearns signed the April 2003 agreement acquiescing to the relief sought in the SEC federal action. Under this agreement, Bear Stearns agreed to pay $80 million, covering four payment categories, in order to resolve the various federal and state regulatory actions and proceedings pending against it. Bear Stearns further accepted injunctive relief that prevented it from violating certain NASD and NYSE rules. And it acknowledged that the SEC could present a final judgment to the federal court for signature and entry without further notice. In short, Bear Stearns did everything within its ability to settle the matter and no further action was required on its part.

We are unpersuaded by the contention that a triable issue of fact exists because the federal court did not approve the settlement until it entered a final judgment in October 2003. Parties are free to enter into a valid settlement agreement that is made subject to court approval. Notably absent from the agreement, however, was any provision similarly subjecting it to the insurers' approval. Having signed the consent agreement, Bear Stearns was not free to walk away from it before entry of a final judgment (see TLC Beatrice Intl. Holdings, Inc. v Cigna Ins. Co., 2000 WL 282967, *7, 2000 US Dist LEXIS 2917, *20-21 [SD NY 2000] ["Although the Court, whose approval was sought by the parties, could accept or reject the Settlement, subject to that approval the parties themselves were bound by the Settlement's terms" (citation omitted)], affd in unpublished op sub nom. Lewis v Cigna Ins. Co., 234 F3d 1262 [2d Cir 2000]). In executing the April 2003 agreement, Bear Stearns settled a claim within the meaning of the insurance policy provision.

As a sophisticated business entity, Bear Stearns expressly agreed that the insurers would "not be liable" for any settlement in excess of $5 million entered into without their consent. Aware of this contingency in the policies, Bear Stearns nevertheless elected to finalize all outstanding settlement issues and executed a consent agreement before informing its carriers of the terms of the settlement. Bear Stearns therefore may not recover the settlement proceeds from the insurers.

Accordingly, the order of the Appellate Division should be reversed, with costs, plaintiffs' motion for summary judgment granted, judgment granted declaring in accordance with this opinion and the certified question answered in the negative.

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Order reversed, with costs, plaintiffs' motion for summary judgment granted, judgment granted declaring in accordance with the opinion herein and certified question answered in the negative. Opinion by Judge Graffeo. Judges Ciparick, Read, Smith, Pigott and Jones concur. Chief Judge Kaye took no part.

Decided March 13, 2008