HUNTON& WILLIAMS

INSURANCE LITIGATION ALERT

April 2008 Vol. 8

Contacts

McLean Office
1751 Pinnacle Drive, Suite 1700
McLean, VA 22102

Walter J. Andrews
(703) 714-7642
wandrews@hunton.com

Lon A. Berk
(703) 714-7555
lberk@hunton.com

Edward J. Grass
(703) 714-7649
egrass@hunton.com

Paul E. Janaskie
(703) 714-7538
pjanaskie@hunton.com

Washington DC Office
1900 K Street, NW
Washington, DC 20006

Neil K. Gilman
(202) 955-1674
ngilman@hunton.com

John W. Woods
(202) 955-1513
jwoods@hunton.com

Atlanta Office
Bank of America Plaza, Suite 4100
600 Peachtree Street, NE
Atlanta, GA 30308

Lawrence J. Bracken II
(404) 888-4035
lbracken@hunton.com

New York Office
200 Park Avenue
New York, NY 10166

Robert J. Morrow
(212) 309-1275
rmorrow@hunton.com

Charlotte Office
Bank of America Plaza, Suite 3500
101 South Tryon Street
Charlotte, NC 28280

Dana C. Lumsden
(704) 378-4711
dlumsden@hunton.com

Ruth S. Kochenderfer of the firm's McLean office authored this Alert.

New York Court of Appeals Holds that Policyholder's Breach of Consent to Settle Clause Bars Coverage

In a recent decision, the New York Court of Appeals held that a policyholder's breach of a consent to settle clause in a professional liability policy barred coverage for a policyholder's settlement. *Vigilant Ins. Co. v. Bear Stearns, Inc.*, No. 25 (N.Y. Mar. 13, 2008).

Factual and Procedural Background

Vigilant Insurance Company issued a professional liability policy to Bear Stearns, a financial services company. The policy provided $10MM in policy limits excess of a $10MM self-insured retention. Two other carriers issued follow-form excess liability policies providing an additional $40MM in policy limits. With respect to settlement, the Vigilant policy provided "[t]he Insured agrees not to settle any Claim, incur any Defense Costs or otherwise assume any contractual obligation . . . in excess of a settlement authority threshold of $5,000,000 without the insurer's consent, which shall not be unreasonably withheld." The policy also provided that "[t]he insurer shall not be liable for any settlement, Defense Costs, assumed obligation or admission to which it has not consented."

In early 2002, the U.S. Securities and Exchange Commission (SEC) and other regulators initiated an investigation into the practices of research analysts working at Bear Stearns and similar institutions. On December 20, 2002, Bear Stearns signed a settlement-in-principle document with the SEC and the other regulators and agreed to pay $80MM. On April 21, 2003, Bear Stearns executed a consent agreement in which it agreed to the entry of a final judgment in the SEC's lawsuit against Bear Stearns and to pay $80MM.

Three days after executing the consent agreement, Bear Stearns sent letters to its insurers requesting their consent to settle. The insurers disclaimed coverage and filed a declaratory judgment action.

The insurers sought summary judgment in the declaratory judgment action. Among other reasons, the insurers argued that there was no coverage because Bear Stearns had breached the consent to settle clause. With regards to the consent to settle clause, the trial court found issues of fact regarding whether Bear Stearns breached the clause. On appeal, the intermediate appellate court agreed that there were triable issues of fact. An appeal was then certified to the New York Court of Appeals.

Holding

The New York Court of Appeals reversed and held that because Bear Stearns breached the consent to settle provision, there was no coverage.

The Court began by stating that "[a]s with the construction of contracts generally, 'unambiguous provisions of an insurance contract must be given their plain and ordinary meaning.'" Applying this rule, the Court found that Bear Stearns breached the consent to settle provision when it executed the April 2003 consent agreement without notifying its insurers first.

The Court rejected Bear Stearns' argument that there was a triable issue of fact. The Court was "unpersuaded" by the argument that because the federal court did not approve the settlement until it entered final judgment in October 2003, there was an issue of fact. It reasoned that the parties were free to settle subject to court approval and "notably absent from the agreement . . . was any provision similarly subjecting it to the insurers' approval." According to the Court, after Bear Stearns signed the consent agreement, it "was not free to walk away from it before entry of a final judgment." Thus, the Court concluded that Bear Stearns settled a claim within the meaning of the policy without the insurers' consent.

The Court also reasoned that Bear Stearns was a "sophisticated business entity" that had expressly agreed that it would not settle without its insurers' consent. The Court found that, although aware of this condition, Bear Stearns chose to finalize a settlement without informing its insurers. Bear Stearns was therefore barred from recovering under its policies.

Implications

This decision shows that violating a condition to coverage, such as a consent to settle provision, may bar coverage. This decision confirms that a New York court will enforce unambiguous policy language as written. Additionally, this decision indicates that a more stringent standard may be applied to a policyholder that is a sophisticated business entity.