wiley

NEWSLETTER

No Coverage Under New York Law When Policyholder Settles Without Insurers' Consent

April 2008

The Court of Appeals of New York has held that a financial services firm that agreed to a settlement without first obtaining the consent of its insurers could not recover the amounts paid in the settlement from its insurers. *Vigilant Ins. Co. v. Bear Stearns Cos., Inc.*, 2008 WL 656260 (N.Y. Mar. 13, 2008).

The policyholder firm purchased insurance, which included a consent-to-settle requirement. That provision of the primary policy stated that "[t]he 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."

The policyholder firm, along with several other financial institutions, came under investigation by regulators in 2002, who alleged that research analysts had been improperly influenced by investment banking objectives.

On December 2, 2002, the policyholder signed a settlement-in-principle providing, among other things, that the firm would consent to the filing of an action against it by the SEC and the relief sought therein without admitting or denying the allegations. The firm also agreed to pay $80 million.

On April 21, 2003, the firm executed a consent agreement acceding to entry of a final judgment in the action brought by the SEC. Pursuant to the terms of that consent agreement, the firm agreed to pay $80 million in relief, including a $25 million penalty.

Three days after executing the consent agreement, the firm sent letters to its insurers requesting their consent to the settlement and seeking coverage for the non-penalty portion of the settlement. The insurers disclaimed coverage and filed a declaratory judgment action.

The Court of Appeals, which took the case on a certified question from the Appellate Division, held that the policyholder "breached [the consent provision] when it executed the April 2003 consent agreement before notifying the insurers or obtaining their approval." The court explained that a "sophisticated business entity"

could not expressly agree in the insurance policy that its insurers would "not be liable" for settlements in excess of $5 million entered into without their consent and then obtain coverage for a such a settlement when it failed to obtain the requisite consent.

The court rejected the firm's argument that the case had not settled until the federal court approved the settlement many months later. According to the court, "[p]arties 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."