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NEWSLETTER

Coverage Barred by Breach of Consent-to-Settle Provision in D&O Policies

January 2009

The United States District Court for the Northern District of California ruled that a company forfeited coverage by settling the underlying action without its insurers' consent. *Crowley Maritime Corp. v. Fed. Ins. Co.*, 2008 WL 5071118 (N.D. Cal. Dec. 1, 2008).

The insurers provided primary and excess directors and officers liability coverage to the company. The policies at issue stated that "[t]he Insureds agree not to settle or offer to settle any Claim, incur any Defense Costs or otherwise assume any contractual obligation or admit any liability with respect to any Claim without the [the insurers'] prior written consent."

The underlying claimants sued the company for breach of fiduciary duty and waste based on certain benefits provided to its executives. The insurers reserved their rights and offered to advance defense costs once the applicable retention had been satisfied. Subsequently, the primary carrier contacted defense counsel regarding the status of the litigation and was told, "We settled . . . I thought the Company sent you the documents, but we will." At this point, the insurers learned that the policyholder had negotiated a settlement whereby it would create a new corporation and use that corporation to buy the current public shares held by the claimants at a significant premium. The parties already had executed the settlement agreement, and the company's board of directors already had approved the buy-out. The insurers thereafter paid the outstanding defense costs but denied coverage for any payment in connection with the settlement based on the insured's breach of the consent-to-settle provision, among other grounds.

In the coverage litigation that followed, the company argued that it had not breached the consent-to-settle provision because, at the time the insurers learned of the settlement, it was still contingent or otherwise not finalized. The company first argued that the settlement was not final because the *force majeure* language in the documents indicated that the parties would use their "best efforts" to consummate the settlement. The court responded by pointing to language in the settlement agreement stating that the claims were "forever compromised" and noted that the *force majeure* language did not give the company discretion to avoid consummating the settlement. Second, the company asserted that the agreement itself stated that the settlement would not be effective until both the tender offer associated with the buy-out was completed and the trial court approved the agreement. The court rejected this argument, stating that these were conditions

subsequent that did nothing to lessen the binding impact of the settlement. Third, the company argued that under the agreement, the board of directors had the discretion to terminate the offer. The court rejected this argument because the board of directors had, prior to notice to the insurers, ordered the company to take all steps to effectuate the agreement. Finally, the company noted that the agreement gave the company's Chief Executive Officer the discretion to retract the tender offer. The court rejected this argument as well, explaining that such provisions are void because they render all promises illusory and pointing out that the Securities and Exchange Commission had required the company to remove this provision for this reason.

Concluding that the insured breached the consent-to-settle provision, the court next considered the company's argument that the provision was not enforceable under *Fuller-Austin Insulation Co. v. Highlands Insurance Company*, 135 Cal. App. 4th 958 (2006). The court observed that *Fuller-Austin* involved an excess insurer that chose not to participate in settlement negotiations. According to the court, *Fuller-Austin* had no application here because the company never gave the insurers notice of the settlement negotiations and, thus, they had no opportunity to participate in the negotiations.

The court also rejected the notion that the insurers had waived their objection to the settlement and were estopped from relying on the consent-to-settle provision based on:

- The insurers' purported failure to respond to the company's post-settlement letters seeking consent for two months;
- One insurer's internal email correspondence purportedly suggesting that the insurer did not intend to provide coverage in any event; and
- An alleged oral statement by a claims handler that the insurer would consent to the settlement. The court rejected the argument that the letters could give rise to a waiver or estoppel argument because the company already had breached the contract and could not establish that it relied on the insurers' silence.

As to the internal email correspondence, the court held that it did not matter because the company was not aware of the correspondence until it was discovered in the course of the coverage litigation and, therefore, the company could not have relied on the correspondence to its detriment. Finally, the court held that the oral statement was irrelevant because the policy expressly requires "*written* consent."