

No Written Consent to Settlement, No Coverage under New York Law

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The United States District Court for the Southern District of New York, applying New York law, has held that an insured's failure to obtain the insurer's prior written consent to a settlement precludes coverage. It also held that an allocation of uncovered amounts paid in the settlement absolved the insurer of responsibility in any event. *Continental Casualty Co. v. ACE Am. Ins. Co.*, No. 07 Civ. 958 (PAC) (S.D.N.Y. Mar. 31, 2009). Wiley Rein LLP represented the insurer in the case.

The insurer issued an E&O policy to another insurance company (the "Insured"). The policy contained a consent-to-settlement provision under which the Insured agreed that it would not "agree to any settlement or make any settlement offer without [the insurer's] prior written consent" and that the insurer would not be liable for any loss incurred by the Insured entering into a settlement without such written consent.

The policy also contained an allocation provision stating that if a claim "includes both covered and uncovered matters . . . there may be an allocation between insured and uninsured loss." The policy's definition of "loss" carved out "criminal or civil fines or penalties imposed by law," as well as punitive and exemplary damages where such amounts are uninsurable under applicable law.

In the underlying litigation, a policyholder sued the Insured in Texas state court, alleging that the Insured had unjustifiably refused to pay a covered claim. The Insured ultimately paid the limit of its policy, leaving only the extra-contractual claims to be decided. Following a mediation on the extra-contractual claims, the mediator submitted a proposed settlement that included the consideration to be paid and provided for mutual general releases. The Insured agreed to the mediator's proposal with minor edits. The policyholder also agreed to the mediator's proposal and stated in a telephone conference that it did not believe the Insured's minor edits would be a problem. The claimant informed the court later that day that the case had been settled.

The following day, the Insured informed the insurer of the settlement. The insurer subsequently denied coverage for the settlement on two grounds: first, the Insured had agreed to the mediator's proposal without the insurer's prior written consent in violation of the policy's consent-to-settlement provision. Second, based on the nature of the underlying claims and damages sought, a substantial portion of the settlement should be attributed to non-covered penalties and multiple damages such that any covered amount could not possibly

exceed the policy's self-insured retention. The insurer filed this action seeking a declaratory judgment that the Insured was not entitled to coverage for the settlement under the policy.

The court granted summary judgment in favor of the insurer. Noting that consent-to-settlement provisions are routinely enforced under New York law, the court concluded that the key issue was whether the mediator's proposal "constituted a binding and enforceable settlement agreement, such that [the Insured's] assent to its terms amounted to a violation of the consent-to-settlement provision." The court determined that the mediator's proposal constituted a binding and enforceable settlement agreement under applicable Texas law because it stated the essential terms of a settlement, including the amount of the settlement and the parties' agreement to execute mutual general releases. In addition, the court determined that the Insured's proposed revisions relating to the scope of the release did not "alter the core of the settlement." The court noted that the policyholder assented to the proposed changes "almost immediately," and the claimant later notified the court that the parties had settled the lawsuit.

The court then determined that the policy provided for allocation of settlements between insured and uninsured loss. The court found that the Insured's own internal settlement communications revealed that it faced significant potential exposure in the underlying litigation with respect to penalty interest and multiple damages, which would not fall under the policy's definition of "Loss." The court held that once uninsured loss was deducted from the settlement amount, the potential insured amount could not possibly exceed the policy's self-insured retention.