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New York High Court Denies Coverage to Bear Stearns for Settlement Entered Into in Violation of Consent to Settle Clause

The New York Court of Appeals upheld judgment in favor of Bear Stearns' professional liability insurers, denying coverage for Bear Stearns' $80 million settlement with regulatory agencies for research analysts' conflict of interest claims. *Vigilant Insurance Company v. The Bear Stearns Companies, Inc.*, 2008 N.Y. Slip. Op. 2080, 2008 N.Y. LEXIS 542 (March 13, 2008) New York's highest court held that Bear Stearns breached a consent to settle clause in its primary professional liability policy and upheld the insurers' denial without requiring a showing of prejudice.

In early 2002, the U.S. Securities and Exchange Commission (SEC), the National Association of Securities Dealers (NASD), the New York Stock Exchange (NYSE) and State Attorneys General began investigations into the practices of research analysts working at financial services firms, including Bear Stearns. Among other things, the investigation centered on whether research analysts were improperly influenced by the banks' investment banking interests.

On December 20, 2002, Bear Stearns signed a settlement-in-principal in which it agreed to pay $80 million. In April 2003, Bear Stearns signed a Consent Order wherein it agreed to be permanently enjoined from violating various NASD and NYSE rules, and pay the $80 million. The Consent Order was approved by the court in October 2003.

Three days after executing the settlement agreement, but before the Court approved the settlement, Bear Stearns notified its insurers. The insurers disclaimed coverage based on Bear Stearns' violation of the consent to settle clause of the policy and filed the present declaratory judgment action.

The Court of Appeals rejected Bear Stearns' arguments that the policy's consent to settle requirement had not been breached because the settlement had not yet been court approved at the time Bear Stearns notified its insurers. The Court held that, although the settlement was subject to regulatory and court approval, it was not similarly conditioned on consent of Bear Stearns' insurers and no further action was required on Bear Stearns' part to settle the matter.

The Court determined that Bear Stearns had expressly agreed in the policies 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." Id. at *5. Consequently, Bear Stearns was precluded from recovering any settlement proceeds from its insurers.

The decision provides a good example of a court upholding clear policy language and requiring insureds to comply with preconditions to coverage. Courts often avoid the effect of unambiguous policy conditions, including consent to settle provisions, by requiring insurers to prove prejudice before upholding a denial of claim based upon the breach of such conditions. Thus, a court upholding a disclaimer based upon the breach of a policy condition without requiring a showing of prejudice is a significant victory for insurers. If you have any questions concerning the Court of Appeals' decision, please contact Adam Smith, Esq. or Sally Clements, Esq.