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NEW YORK COURT OF APPEALS GRANTS SUMMARY JUDGMENT BASED ON INSURED'S BREACH OF CONSENT TO SETTLE PROVISION OF POLICY

Vigilant Ins. Co. v. The Bear Stearns Companies, Inc.

The New York Court of Appeals has reversed an order of the Appellate Division and has found that no coverage exists for Bear Stearns' \$80 million settlement with regulatory authorities in connection with the research analyst investigations.

This action arose out of the settlement entered into in 2002 by Bear Stearns with securities regulators in connection with the investigation into the practices of research analysts working at financial services firms. The investigation focused on allegations that research analysts employed at ten major financial institutions, including Bear Stearns, were improperly influenced by investment banking concerns.

In the settlement with the SEC, NASD and NYSE, Bear Stearns agreed to pay a total of \$80 million, including a \$25 million penalty, \$25 million in disgorgement, \$25 million for independent research and \$5 million for investor education. Bear Stearns agreed not to seek insurance coverage for the \$25 million penalty, but sought coverage for the remaining \$45 million (after application of a \$10 million self-insured retention).

The insurers raised several coverage defenses. First, the insurers argued that Bear Stearns could not recover because it had breached the policy provision obligating it to obtain the insurers' consent before entering into any settlement. Second, that the investment banking exclusion in the policy precluded coverage. Third, that the \$25 million disgorgement payment was not covered either as a matter of public policy or under the policy language itself. Finally, that neither the payments for research nor investor education constituted Loss under the policy.

The lower court held that a question of fact existed as to whether the investment banking exclusion applied. The court also held that the \$25 million disgorgement payment was did not constitute damages under the policy. As to the payments for research and investor education, the court rejected the insurers' position that such amounts were not losses under the policy. Both sides appealed to the Appellate Division. As to the settlement without consent, the court found that a question of fact existed.

The Appellate Division, First Department granted summary judgment to Bear Stearns on the investment banking exclusion and the research/investor education issues. As to disgorgement, the Appellate Division denied the insurers' motion for summary judgment, finding that a question of fact existed. The court also agreed that a factual issue existed as to whether Bear Stearns breached the settlement without consent provision.

On March 13, 2008, the New York Court of Appeals reversed the order of the Appellate Division and directed entry of judgment in favor of the insurers. The sole issue addressed by the Court of Appeals was Bear Stearns' breach of the consent to settle provision.

The policy provided that Bear Stearns "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 \$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 which it has not consented.”

The Court found that Bear Stearns had executed a settlement-in-principle in December 2002, and signed a consent agreement in April 2003 without advising the insurers. Bear Stearns argued that a question of fact existed as to whether it had breached the policy condition because the court did not approve the settlement and enter final judgment until October 2003, after Bear Stearns had notified the insurers.

The Court of Appeals held that the agreement signed by Bear Stearns contained no provision making it subject to the insurers’ approval. In addition, the

agreement signed by Bear Stearns acknowledged that the SEC could present a final judgment to the court without further notice to Bear Stearns. Thus, Bear Stearns had done everything in its power to settle the matter and no further action was required on its part. Moreover, the Court noted that prior to court approval, Bear Stearns was not free to walk away from the settlement agreement.

The Court concluded that Bear Stearns, “a sophisticated business entity,” expressly agreed that the insurers’ would “not be liable” for any settlement in excess of \$5 million entered into without the insurers’ consent. Bear Stearns thus may not recover any portion of the settlement from the insurers.



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