Bank and Corporate Governance Law Reporter
1601 Connecticut Avenue, N.W., Suite 701, Washington, D.C. 20009 • 202-462-5755 • Fax 202-328-2430

Recent Developments

Directors' and Officers' Insurance: The Importance of Consent to Settlements

Warren R. Stern, Igor Kirman & Martin J. E. Arms

Wachtell, Lipton, Rosen & Katz

Lawsuits against directors and officers that make it past a motion to dismiss almost always settle before trial and D&O insurance often funds these settlements. Almost all D&O policies give the insurer the right to consent to any settlement and the right to participate in (or be consulted with respect to) the settlement negotiations. These provisions should not be taken lightly, despite the complexity of involving multiple insurer carriers in settlement negotiations. The Delaware Supreme Court has recently handed down a decision that demonstrates the risks that insureds take if they engage in negotiating tactics that deprive an insurer of an opportunity to participate in settlement negotiations or to consent to a settlement.

In *Hilco Capital, L.P.* v. *Federal Insurance Co.*, -- A. 2d --, C.A. No. 06C-02-248 (Del. Aug. 10, 2009), the Delaware Supreme Court affirmed a judgment in favor of Federal Insurance Company in a suit brought by assignees of the insured's claims under an excess D&O policy issued by Federal. The assignment was given by the insureds at the conclusion of a mediation from which Federal absented itself after being advised that the insureds would not settle the case for more than $10 million, the attachment point for the Federal policy. The mediation continued into the late evening, and when the mediator proposed a high-low arbitration that could result in a settlement of more than $10 million, defense counsel could not reach Federal. Rather than wait until the morning, the parties entered into a settlement and agreed on an assignment of rights that, depending on the outcome of the arbitration, could have obligated Federal to pay up to $7 million. Federal ultimately denied coverage on the ground that the insureds breached the policy by settling the claims without Federal's consent.

The Delaware Supreme Court (applying Missouri and Delaware law) made several key rulings: (1) an insurer has discretion not to participate in a settlement negotiation but must exercise that discretion consistently with an obligation of good faith and fair dealing, an obligation that the Court found to have been met by Federal because the insureds had agreed that Federal should not attend the mediation; (2) by agreeing to settle without offering Federal an opportunity to consent or object to the settlement, the insureds denied Federal its consent rights; and (3) in determining whether a refusal to consent to a settlement is reasonable, a jury may consider all the facts and circumstances, not just the reasonableness of the settlement amount itself.

The lesson of *Hilco*—consistent with the 2008 opinion of the New York Court of Appeals in *Vigilant Insurance Co.* v. *The Bear Stearns Companies, Inc.*, 884 N.E.2d 1044 (N.Y. 2008)—is that courts are protective of insurance carrier consent rights, and that to reach a settlement, even on attractive terms, without affording carriers a meaningful consent right is to risk loss of coverage. In short, the process matters.

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