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NEWSLETTER

Excess Insurer's Consent Was Required for Settlement But Excess Insurer Did Not Have an Implied Duty To Participate in Settlement Discussions

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The Delaware Superior Court, applying Missouri law, has held that an excess insurer did not have an implied obligation to participate in settlement negotiations under its policy. *Fed. Ins. Co. v. Hilco Capital*, 2008 WL 3021109 (Del. Super. Ct. Aug. 5, 2008). The court also held that the insured directors and officers were required to obtain not only the primary insurer's consent but also the excess insurer's consent to a settlement that potentially invaded the excess insurer's layer.

The policies at issue in the case consisted of a $10 million primary policy and a $10 million first layer excess policy, which were issued to a building materials supplier. The underlying claim was brought by two financial institutions that had provided asset-based financing to the insured entity before it had declared bankruptcy and generally alleged that certain directors and officers, by misrepresenting inventory levels, had induced the banks to make loans that they would not have otherwise made to the entity.

Prior to the scheduled trial date, the parties to the litigation participated in two mediations. The primary insurer attended both sessions, but the excess insurer did not, based in part on representations from the insureds and the primary insurer that the settlement value of the case was below the attachment point of the excess insurer's policy and representations from the primary insurer that it had no intention of paying the remaining limits of its policy to settle the lawsuit. At the second mediation, however, the mediator proposed that the parties resolve the matter pursuant to a single-issue, "high-low" arbitration. Specifically, the parties would arbitrate one issue, the outcome of which would determine whether the plaintiffs received a guaranteed "low" of an amount that ultimately was set at $3.8 million, or a "high" of $15.5 million. Because the proposed settlement presented the possibility of a payment by the excess insurer, the insureds sought its consent. The excess insurer, however, believing the settlement to be unreasonable, declined to consent.

Over the excess insurer's objection, the parties to the litigation and the primary insurer proceeded with the mediator's proposal. The plaintiffs prevailed at the ensuing arbitration, and judgment was entered against the

defendants in the amount of $15.5 million. The primary insurer paid its remaining limits (that is, after payment of defense costs) toward satisfaction of the judgment and the plaintiffs, who previously had agreed to accept an assignment of the insured's rights under the excess policy, sought the balance of the judgment—*i.e.*, $7.2 million—from the excess insurer.

In the coverage litigation that followed, the excess insurer argued that it had no obligation with regard to the settlement because, among other reasons, the insureds had breached the "consent to settle" provision in the primary policy, to which its policy followed form, by agreeing to a settlement without first obtaining the excess insurer's consent. In response, the plaintiffs argued that the excess insurer's consent was not required because the primary insurer had consented and, in that the term "Insurer," as used in the relevant provision in the primary policy, was defined to mean the primary insurer, the excess insurer had delegated the right to consent to the primary insurer. Alternatively, the plaintiffs argued that, even if the excess insurer had the right to consent, the excess insurer did not have a reasonable basis to withhold its consent and, therefore, the insureds were free to enter into a reasonable and non-collusive settlement to which the excess insurer would be bound. The plaintiffs also contended that the excess insurer was liable for the resulting judgment against the insureds because the excess insurer had breached its purported obligation to participate in the settlement negotiations.

Turning to this last argument first, the court determined that the excess insurer had no obligation under its contract with the insureds to involve itself in the settlement negotiations. In this connection, the court cited the "Participation Clause" in the excess policy, which provided that the excess insurer "may, at its sole discretion, elect to participate in the investigation, settlement or defense of any claim covered by the policy, even if the primary policy has not been exhausted." According to the court, this provision made clear that the excess insurer's participation was at its "option" and not required. On this basis, the court found that there was no implied duty on the part of the excess insurer to participate in the settlement discussion. The court further found that, under Missouri law, "there can be no breach of the implied promise or covenant of good faith and fair dealing where the contract expressly permits the action challenged, and the defendant acts in accordance with the express terms of the contract."

Regarding whether the excess insurer's consent was required, the court rejected the plaintiffs' interpretation of the consent to settle provision as incorporated into the excess insurer's policy. In reaching this conclusion, the court noted that it was undisputed that the insureds, the primary insurer and the excess insurer understood the consent to settle provision to require that the insureds request and obtain the excess insurer's consent to the settlement, and that the mutual intent of the contracting parties controls the construction of the contract. Moreover, the court pointed to the fact that, at the time the plaintiffs agreed to assume the insureds' rights under the excess policy, they did so with full knowledge of the parties' understanding that the excess insurer had a right to consent, and held that the plaintiffs could not later insist on a different interpretation.

Notwithstanding the court's conclusion that the excess insurer's consent was required but not obtained, the court denied the excess insurer's motion for summary judgment. The court found that there remained genuine

issues of material fact to be determined by a jury– namely, whether the excess insurer unreasonably withheld its consent and, if so, whether the settlement itself was reasonable and non-collusive.