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NEWSLETTER

Policyholder Conduct at Mediation Did Not Breach Cooperation Clause

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In an unreported decision, a Pennsylvania trial court has held that a company insured under an excess D&O policy did not violate the cooperation clause of the policy by failing to provide a written recommendation concerning settlement in advance of the mediation, bidding against itself during negotiations and requesting over the insurer's objections that the mediator make his recommended settlement number public. *Resource Am., Inc. v. Certain Underwriting Members of Lloyd's Subscribing to Policy No. 501/FT98AAAF*, 2004 WL 2580554 (Pa. Common Pleas Nov. 12, 2004). The court also held that the insurer could not withhold its consent to the settlement because it failed to show that the settlement was unreasonable, but that the insurer did not act in bad faith in refusing to consent to the settlement.

The insurer issued a second layer excess D&O policy to a company. The policy provided $4 million of coverage on top of a $3 million primary D&O policy and a $3 million first excess policy. The primary policy, to which the second excess policy followed form, provided that "the Insureds shall not ...enter into any settlement ...without the prior written consent of the Insurer." The primary policy also stated that the "Insurer's consent shall not be unreasonably withheld, provided that the Insurer shall be entitled to full information and all particulars it may request in order to reach a decision as to such consent."

The company was sued by a class of plaintiffs for securities fraud based on its alleged use of improper accounting practices. After defendants spent approximately $1 million under the primary policy to defend the class action, the parties to the underlying action participated in a mediation, which a representative of the second excess insurer attended. After the second excess insurer refused to participate in the settlement, the parties entered into an alternate two-tier settlement pursuant to which the primary and first excess insurers contributed the remaining $5 million of their layers towards the settlement. The company agreed to pay an additional $2 million if it succeeded in a coverage action against the carrier and $1 million if it failed.

The court rejected the insurer's argument that the policyholder breached the duty to cooperate by: (1) failing to provide a written settlement recommendation three weeks prior to the mediation, (2) bidding against itself at the mediation when it increased its offer from $1 million to $2 million without a counteroffer, (3) requesting that the mediator make his settlement recommendation public against its insurer's wishes and (4) entering into a settlement different from that it proposed to the insurer. The court reasoned that the insurer failed to prove prejudice as required by Pennsylvania law. Although the insurer did not receive the report it had requested,

the court explained that the company regularly apprised the insurer of its evaluation of the case prior to the mediation and the insurer participated in the mediation, negating any possibility that the insurer was unaware of the contours of the proposed settlement. The court held that the company's decision to bid against itself and to allow the mediator to make the settlement number public showed "at most, a disagreement ...as to what methodology to employ to settle the case." According to the court, "[s]ince the conduct of settlement negotiations is an art rather than a science, [the insurer] cannot show that [the company's] choice of alternative tactics resulted in prejudice to [the insurer]." Finally, the court explained that the two-tier settlement structure was necessitated only by the insurer's "recalcitrance" in refusing to participate in the settlement that was originally proposed.

The court also held that the insurer failed to carry its burden of proof on the issue of whether it reasonably withheld its consent. The court noted that an insurer must prove that a proposed settlement is prejudicial to it in order to reasonably withhold its consent. The court stated that because the insurer "has not offered persuasive evidence to show that the Two-Tiered Settlement is unreasonable, prejudicial, and not entered into in good faith, it has no valid ground on which to object to participating in it." The court rejected the insurer's effort to demonstrate prejudice based on the plaintiffs' willingness to accept less money in the absence of a contribution by the insurer, explaining that "class plaintiffs decided to accept what they could get from [the company] and opted not to try to get blood from a stone." The court also noted that the plaintiffs sought more than $100 million in damages. According to the court, the company's expert had opined that a $100 million verdict was possible and suggested that $13.5 million would be a reasonable settlement amount.

Finally, the court rejected the company's bad faith claim. The court did "not find that [the insurer] acted in bad faith in defending this action because it put forth legitimate, albeit not winning, arguments to justify its refusal to consent to the settlement [the policyholder] entered into with the plaintiff class."

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