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FIFTH CIRCUIT REJECTS INSURANCE COMPANY'S ATTEMPT TO RELY UPON SO-CALLED "COOPERATION CLAUSE" ABSENT PROOF OF "ACTUAL, CONCRETE PREJUDICE"

February 6, 2005, New York, New York – Policyholders who are abandoned by their insurance company at the altar of the settlement of a liability claim obtained a measure of protection today. The United States Court of Appeals for the Fifth Circuit held in the Motiva Enterprises case that the Texas Supreme Court's 1994 decision in Hernandez v. Gulf Group Lloyds, 875 S.W. 2d 691 (1994), unequivocally requires an "actual, concrete" showing of prejudice by the insurance company to avoid liability on the basis of a settlement-without-consent exclusion. Motiva Enterprises, LLC, v. St. Paul Fire and Marine Insurance Company and National Union Fire Insurance Company of Pittsburgh, Pennsylvania, No. 05-20139 (February 6, 2005).

The Motiva Enterprises case stemmed from a $16.5 million settlement reached between Motiva Enterprises, LLC, and a civil plaintiff for injuries sustained in a July 2001 sulfuric acid storage tank explosion at a Delaware refinery which killed one employee and injured several others. National Union Fire Insurance Company ("National Union", a member of the AIG group), an excess insurance company, failed to acknowledge coverage for these lawsuits for over a year, even after National Union had been properly notified that the primary policy had been exhausted and that it would be responsible for the defense costs relating to the remaining suits. Only two days before a scheduled mediation of one of these claims, National Union finally tendered its offer to defend the policyholder subject to a reservation of rights to deny coverage. At the mediation, which National Union left prematurely, Motiva agreed to pay $16.5 million to resolve the claim.

Motiva's policy contained a settlement-without-consent exclusion which required National Union's consent for any settlement. National Union did not argue prejudice or manifest unreasonableness of the settlement amount Motiva agreed to, but instead, refused to fund the settlement on the grounds that its consent had not been obtained as it asserted was required by the policy's so-called "consent to settle" clause.

In vacating and reversing the District Court's decision which found a breach of the consent to settle clause, the Motiva Enterprises court, interpreting Texas law, described the holding in the Hernandez case:

> The Texas Supreme Court held in Hernandez (citation omitted) that an insurer may escape liability on the basis of a settlement-without-consent exclusion only when the insurer is actually prejudiced by the insured's settlement. The court based its holding on general principles for interpreting contract law and observed that "when one party to a contract commits a material breach … the other party is discharged … from any obligation to perform."

Slip Op. at 9.

In reaching its decision, the court first applied Texas law in declining to hold that National Union's tender of a defense subject to a reservation of rights entitled Motiva to settle the lawsuit without the insurance company's consent. Applying unfavorable Texas law as stated in State Farm Lloyds Ins. Co. v. Maldonado, the court noted:

> Under Erie, we are, of course, obliged to decide questions of state law as we believe the state supreme court would decide the issue. Although a different policy condition was at issue in Maldonado, we see principled basis to distinguish it from today's case.

Slip Op. at 7-8.

Yet the court firmly acknowledged that when adjudicating a "material breach," the harm caused to a policyholder if the insurance company escapes liability must be weighed against the prejudice resulting to the insurance company by virtue of the policyholder's breach. The court stated:

> In determining the materiality of the breach, the court [in Hernandez] observed that it must consider *inter alia* "the extent to which the non-breaching party will be deprived of the benefit that it could have reasonably anticipated from full performance."

Slip Op. at 9.

National Union may be hard-pressed to show any conceivable prejudice resulting from Motiva's $16.5 settlement with an underlying plaintiff. In fact, the court found no evidence that National Union even considered the reasonableness of its policyholder's settlement when it refused to pay Motiva's insurance proceeds.

Relying on its recent decision in Ridglea Estate Condo. Ass'n v. Lexington Insurance Co., 415 F.3d 474 (5th Cir. 2005) which also interpreted Hernandez, the court held:

> [T]hat Texas law requires that an insurer show prejudice resulting from the insured's breach of a condition in the policy to defeat the insured's claim to policy proceeds.
>
> Although the district court made a brief reference to prejudice in its opinion, it did not consider the actual, concrete prejudice an insurer must show to avoid payment.

Slip Op. at 9. Accordingly, the court denied National Union's specious attempt to avoid payment.

William G. Passannante, Co-Chair of Anderson Kill's insurance coverage group, stated: "Texas policies that contain a settlement-without-consent exclusion place the policyholder in an unenviable position: agree to settle, but potentially lose coverage or refuse the settlement and risk liability in excess of limits. Instead of assistance with a favorable settlement, Motiva ended up being forced to ask a court to enforce the insurance promise. The Motiva decision provides

some additional protection for policyholders when they must protect themselves because their insurance companies will not."

Anderson Kill & Olick, P.C., a national law firm regularly representing policyholders in insurance coverage disputes, submitted an Amicus brief on behalf of United Policyholders in support of Motiva Enterprises. Bill Passannante and David A. Kochman, an associate at Anderson Kill, were responsible for filing the brief with the Fifth Circuit. The contacts listed above are available to answer questions, or for additional information visit http:andersonkill.com.