You Can't Insure What's Not Yours: NY Court Determines SEC Disgorgement Payment Not Insurable Loss as Matter of Public Policy

Insurance Law Update

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New York's Appellate Division, First Department

In *J.P. Morgan Securities, Inc. v. Vigilant Ins. Co.*, ___ N.Y.S.2d ___, 2011 WL 6155586 (N.Y. App. Div. Dec. 13, 2011), New York's Appellate Division, First Department, held that a disgorgement payment made as part of a settlement with the Securities and Exchange Commission (SEC) does not constitute an insurable loss under New York law.

In the underlying action, the SEC had alleged that between 1999 and 2003, Bear Stearns violated securities law by knowingly facilitating deceptive market timing for large, hedge-fund clients, assisting them in evading detection, and enabling them to earn hundreds of millions of dollars at the expense of mutual fund shareholders. Bear Stearns disputed the SEC's findings, but settled with the SEC and, without admitting or denying SEC's charges, agreed to disgorge $160 million and pay $90 million in civil money penalties.

Bear Stearns' insurance covered "loss" that it was legally obligated to pay as a result of any claim for any wrongful act. "Loss" was defined broadly to include compensatory damages, settlements and costs, and charges and expenses incurred in connection with any governmental investigation. "Loss" excluded fines, penalties, matters not insurable under law, and claims based upon or arising out of any deliberate, dishonest, fraudulent or criminal act or omission or based upon or arising out of the insured gaining in fact any personal profit or advantage to which the insured was not legally entitled.

Bear Stearns sought indemnification from Vigilant for the SEC disgorgement payment. Vigilant denied coverage on the grounds that the disgorgement payment was not a loss or was excluded from coverage. Bear Stearns argued that it was entitled to coverage, since its disgorgement payment actually constituted compensatory damages.

The trial court denied Vigilant's motion to dismiss, but the Appellate Division reversed. Rejecting Bear Stearns' argument, the court held that disgorgement of ill-gotten gains or restitutionary damages is not insurable as a matter of public policy, which prohibits wrongdoers from shifting liability for disgorgement payments to insurers, as that would impermissibly allow the wrongdoers to retain the benefit of their illegal acts and would severely undermine the intended deterrent effect of disgorgement.

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