

E-ALERT | White Collar & Insurance

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NEW YORK'S HIGHEST COURT RULES SEC DISGORGEMENT SETTLEMENT NOT EXCLUDED FROM INSURANCE

New York's highest court recently issued an important decision for companies seeking insurance coverage for SEC settlements. In *J. P. Morgan Securities Inc. v. Vigilant Insurance Co.*, No. 113 (June 11, 2013), the New York Court of Appeals rejected a blanket rule that would have made SEC orders using the "disgorgement" label uninsurable as a matter of public policy under New York law. Rather, the decision requires a close analysis of the factual basis for the SEC order and specific insurance contract terms. New York has thus added a strong corrective to a commonly asserted insurer position on coverage for such monetary awards.

The decision overturned a lower court's dismissal of the policyholder's action on the pleadings. The Court of Appeals distinguished a line of cases precluding coverage for disgorgement payments based on the asserted public policy against insuring ill-gotten gains, finding that such cases applied at most to remedies compelling the insured to return its *own* gains. In this case, the bulk of the SEC award, although labeled as "disgorgement," covered profits earned by the insured company's customers (from alleged "market timing" and "late trading")—not by the insured company itself. Similarly, the decision held that the insurance policies' exclusion for "personal profit or advantage" was not satisfied, because the company had not itself received the lion's share of the profits. These issues can arise in many different types of SEC enforcement actions where "disgorgement" awards may be based on a third-party's monetary gains, such as control-person, aiding-and-abetting, and failure-to-supervise cases; insider trading by "tippees"; and Ponzi schemes.

Finally, the Court of Appeals reaffirmed that the public policy against insuring "intentionally harmful" conduct is "narrow." In particular, the court held that an insurer must "establish[] not only that the insured acted intentionally but, further, that it acted with the intent to harm or injure others." Thus, the court ruled, the policy did not bar coverage even though the SEC found that the claimant had acted "knowingly and recklessly," engaged in deception, and "willfully" violated the federal securities laws. This ruling is particularly significant because many SEC settlements contain similar allegations.

The *J. P. Morgan Securities* decision highlights the importance of involving knowledgeable insurance counsel in the negotiation of SEC settlements, whenever the settling party intends to pursue coverage for disgorgement or other settlement-related payments.

Covington, with its premier securities enforcement and insurance policyholder practices, is ideally situated to represent companies in complex SEC and other government investigations as well as in seeking coverage for resulting defense and settlement costs. We have successfully recovered hundreds of millions of dollars in insurance coverage on behalf of corporate policyholders for securities-related matters. If you have any questions concerning the material discussed in this client alert, please contact the following members of our white collar and insurance coverage practice groups:

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