

Del. TIAA Case May Reshape Disgorgement Claims Coverage

By **Jeff Sistrunk**

Law360 (June 5, 2018, 2:41 PM EDT) -- Delaware's high court will hear arguments Wednesday in three insurers' appeal of a judgment requiring them to cover TIAA's costs to defend and settle class actions alleging that the retirement services giant profited from fund-transfer delays, and attorneys say a ruling affirming the award could help policyholders secure coverage of suits seeking disgorgement of illicit gains.

Primary insurer Illinois National Insurance Co. and excess carriers Ace American Insurance Co. and Arch Insurance Co. are asking the Delaware Supreme Court to upend a state court's holding under New York law that TIAA's costs in connection with a trio of underlying class actions constituted an insurable loss. That October 2016 decision paved the way for a favorable jury verdict and judgment for TIAA against the three insurers.

The case raises a thorny question that has challenged courts nationwide: whether policyholders are entitled to defense and indemnity coverage for actions that seek the return of profits allegedly generated by their dishonest conduct.

Illinois National, Ace and Arch have contended that New York has a strong public policy against insuring disgorgement or restitution claims. But the Delaware trial court rebuffed the insurers' assertion, emphasizing the fact that TIAA settled the underlying actions without admitting any wrongdoing or liability.

According to attorneys who represent policyholders, a decision by the Delaware Supreme Court blessing the lower court's ruling would deal another blow to insurers' broad public policy arguments against insurance for disgorgement claims.

"Here, the policy defines loss as including settlements, so coverage exists in the first instance, and no express exception takes that coverage away," said Covington & Burling LLP partner Mitchell F. Dolin, co-chair of the firm's global insurance recovery practice.

"I think the lower court here followed a trend of courts stepping back and saying, 'If the terms of the policy do not eliminate coverage in the absence of an adverse final judgment, we are not going to infer a public policy prohibition on coverage for a settlement.'"

On the other hand, according to Hinshaw & Culbertson LLP partner Scott Seaman, who represents

insurers, the Delaware trial court erroneously ruled in TIAA's favor on the basis that there was no adjudication by a court or other tribunal establishing the organization's liability.

New York law does not require any such "final adjudication" for the bar on coverage for disgorgement claims to apply, he said.

"The insurers' argument that there is no presumption of coverage under New York law where disgorgement is accomplished by settlement as opposed to adjudication is well-taken," Seaman said. "Settlement and rote denial by the insured should not allow it to circumvent public policy and transmogrify disgorgement into an insurable event."

Beginning in 2007, TIAA was hit with three class actions alleging it excessively delayed processing account holders' requests for transfers or withdrawals of funds. The plaintiffs in each suit sought the difference in the value of their accounts between the date a transfer or withdrawal was requested and the date on which the transaction was actually processed.

According to court documents, TIAA ultimately settled the three actions for tens of millions of dollars without admitting any liability or wrongdoing, while incurring millions more in defense costs. Illinois National, Ace, Arch and two of TIAA's other excess insurers refused to provide coverage for the underlying settlements and defense expenses, claiming those sums constituted uninsurable disgorgement under New York public policy.

In an October 2016 opinion, Delaware Superior Court Judge Jan Jurden disagreed and granted TIAA summary judgment. The judge said the suits against TIAA are unlike the New York court cases cited by the insurers, which all involved U.S. Securities and Exchange Commission orders definitively tying a company's improperly acquired profits to a government-mandated disgorgement payment.

"The court finds no conclusive link between the settlements in the underlying actions and wrongdoing by [TIAA] that would render the settlement agreements uninsurable disgorgement," Judge Jurden wrote.

On appeal to the Delaware Supreme Court, the three insurers have argued that Judge Jurden's summary judgment ruling improperly created a "presumption of coverage" for a policyholder's disgorgement payments if they are carried out via settlement.

"In allowing an insured to control the question of coverage for disgorgement by arranging a settlement with a self-serving denial of liability, the Superior Court failed to follow New York law, which treats all disgorgement claims as uninsurable," the insurers' attorneys wrote in a brief filed with the Delaware high court. "Because disgorgement claims are uninsurable to begin with, no amount incurred in connection with a disgorgement claim, even if settled with a denial of wrongdoing, is insurable or qualifies as 'loss.'"

Hinshaw & Culberton's Seaman said the insurance companies' stance is consistent with both the relevant policy language and New York public policy, as set forth in a number of decisions out of that state's appellate courts. A decision to the contrary would effectively result in a windfall for the policyholder, he said.

"Simply stated, an entity should not be unjustly enriched by retaining its ill-gotten gains and attempting to transfer responsibility to its insurer," Seaman said.

TIAA, however, has said Judge Jurden properly distinguished the New York appellate rulings because they involved scenarios different from TIAA's.

“The New York intermediate appellate cases on which insurers rely are inapplicable, as they all involve governmental directives requiring disgorgement directly tied to findings of policyholder wrongdoing, while [TIAA’s] civil settlements contain no such finding,” TIAA told the Delaware Supreme Court in its own brief.

TIAA pointed out that the last time New York’s highest court grappled with a disgorgement coverage dispute, in a 2013 decision in the case of JPMorgan Securities Inc. v. Vigilant Insurance Co., it didn’t recognize a blanket public policy forbidding coverage for all actions seeking disgorgement.

In that ruling, the New York high court — known as the Court of Appeals — permitted JPMorgan to pursue insurance coverage for part of the \$160 million its predecessor Bear Stearns & Co. Inc. paid in a market-timing settlement with the SEC. The New York justices noted Bear Stearns’ argument that \$140 million of the "disgorgement" payment it made represented improper profits that its hedge fund customers pocketed, not Bear Stearns' own revenues.

Critically, the Court of Appeals said in the JPMorgan decision that New York law expressly precludes coverage for two categories of claims: punitive damages awards and claims of intentional injurious conduct. That finding could work to TIAA’s benefit in its coverage battle, said Jenner & Block LLP partner Matt Jacobs, who represents policyholders.

"The New York Court of Appeals has identified these two exceptions to the 'freedom of contract,' and neither applies here," Jacobs said. "There was no evidence that [TIAA] intended to cause harm, and there were no punitive damages awarded."

The Court of Appeals’ ruling in the JPMorgan case may also bolster TIAA’s stance on another front, attorneys say. According to TIAA, under the New York high court’s rationale, any public policy ban on insurance for disgorgement claims would still not apply to funds that have not been retained by the policyholder but have instead "gone to others" — which is what TIAA says happened to the disputed funds here.

“Here, as a matter of undisputed fact, the alleged investment gains at issue in the underlying actions did not reside with [TIAA], but automatically flowed to nonwithdrawing participants, as required by the at-cost agreements between [TIAA] and its account holders,” TIAA’s attorneys wrote.

Hunton Andrews Kurth LLP partner Syed Ahmad said the Delaware Supreme Court may well model its analysis after the New York Court of Appeals’ findings in the JPMorgan matter.

“I expect the Delaware Supreme Court to be a lot more interested in what the New York Court of Appeals has held than the rulings from [New York’s] lower courts,” Ahmad said. “Reading the ‘tea leaves’ from an oral argument is difficult, but the more the court focuses on Bear Sterns, the more the insurers should worry.”

Regardless of the outcome, though, the Delaware high court’s decision will provide valuable guidance on how courts should approach coverage disputes over disgorgement claims, which can be dauntingly complex, attorneys say.

“As the long-running saga in the Bear Sterns dispute shows, disgorgement claims often result in a multipronged battle, with insurance typically playing a key role given the tens or even hundreds of millions of dollars that can be at stake,” Ahmad said. “The Delaware Supreme Court’s ruling about New York law on this topic will likely have significant ramifications for insurance coverage for disgorgement-related litigation.”

TIAA is represented by Robin Cohen, Adam Ziffer and Michelle Migdon of McKool Smith PC and Jennifer Wasson and Andrew Sauder of Potter Anderson & Corroon LLP.

Illinois National is represented by Lawrence Bistany and Timothy Martin of White & Williams LLP and Celestine Montague of Wright & O'Donnell PC. Arch is represented by Michael Zigelman, Daniel Brody and Patrick M. Kennell of Kaufman Dolowich & Voluck LLP and Chase Brockstedt and Stephen A. Spence of Baird Mandalas Brockstedt LLC. Ace American is represented by James Semple of Cooch & Taylor PA and Edward Gibbons of Walker Wilcox Matousek LLP.

The case is In Re: TIAA-CREF Insurance Appeals, case numbers 478, 2017; 479, 2017; 480, 2017 and 481, 2017, in the Delaware Supreme Court.

--Editing by Rebecca Flanagan and Orlando Lorenzo.