

New York Appellate Court Affirms Ruling on Disgorgement as “Uninsurable” and Extends Uninsurability Holding to Defense Costs Too

In an order entered September 16, 2004, the New York Supreme Court, Appellate Division, First Department, modified an order of the trial court by ruling in favor of two positions taken by insurers relating to coverage under professional liability insurance policies: 1) that insurance coverage is not available for the disgorgement of ill-gotten gains, and 2) that defense costs are not payable under a non-duty-to-defend policy where there is no covered claim. *Vigilant Ins. Co. v. Credit Suisse First Boston Corporation*.

The case arose out of a demand by Credit Suisse First Boston (CSFB) to its professional liability insurers to cover a \$70 million settlement payment made by CSFB to federal securities regulators, which was characterized in settlement documents as a “disgorgement” of amounts improperly received by CSFB. CSFB made this settlement payment, along with an additional \$30 million “fine” for which insurance was not sought, in connection with an investigation by the Securities and Exchange Commission (SEC) and the National Association of Securities Dealers (NASD) into CSFB’s receipt of kickbacks from its customers in exchange for allocations in “hot” initial public offerings of company stock during the technology boom of the late 1990s. The documents describing the terms of CSFB’s settlement stated that CSFB’s \$70 million payment represented a “disgorgement” of the amounts obtained by CSFB as a result of its allegedly illicit IPO allocation practices.

CSFB’s insurers refused to cover this payment and commenced an action in the Supreme Court of the State of New York, County of New York, for a declaratory judgment that CSFB’s insurance policy does not cover either the \$70 million disgorgement payment or the legal expenses incurred by CSFB in connection with the SEC/NASD investigation.

In an order dated July 8, 2003, the trial court (Judge Moskowitz) ruled that public policy precluded insurance coverage for the \$70 million disgorgement payment, because allowing CSFB to recover this payment from its insurers would defeat the very purpose of requiring CSFB to disgorge the wrongfully obtained monies. However, the court held that the legal expenses incurred by CSFB in connection with the SEC/NASD investigation fell within the policy’s “Loss” definition and ordered a reference to determine the amount of CSFB’s legal expenses to see how much, if any, would be covered by the insurance policy.

Both sides appealed Judge Moskowitz’s order to the Appellate Division, which delivered its order on the appeal on September 16, 2004.

First, the Appellate Division affirmed that part of the trial court order which held that CSFB was not entitled to coverage for the \$70 million portion of its settlement with the SEC and NASD that required disgorgement of funds obtained through violations of securities regulations. The court broadly stated that the risk of being directed to return improperly acquired funds is not insurable, thus setting a clear public policy defense to coverage for such a claim under New York law.

Second, the Appellate Division reversed that part of the trial court order which held that CSFB was entitled to coverage for its defense costs incurred because of the regulatory investigation. This holding was based both on the public policy issues discussed above and on the no-duty-to-defend nature of the defense provisions in the policy. The court thus ruled favorably for the insurers on an issue for which there is a definite dearth of precedent.

The Appellate Division order is not subject to appeal as a matter of right, but may be appealed to the Court of Appeals only by permission, which is rarely granted.

For Further Information

If you have any questions about the information in this Alert, please contact one of the members of the Duane Morris Insurance and Financial Products Practice Group listed below or the lawyer in the firm with whom you are regularly in contact.

Duane Morris

Insurance and Financial Products Practice Group

Philadelphia**215.979.1000**

Lewis R. Olshin

London**011.44.20.7786.2100**

Alexander M. Geisler

San Francisco**415.371.2200**

Stephen H. Sutro

New York**212.692.1000**

Michael R. Delhagen

Kimball Ann Lane

Michael J. Stringer

Chicago**312.499.6700**

Joanne J. Matousek

Westchester**914.749.3700**

John F. McCarrick

Christine J. Testaverde

www.duanemorris.com