

Settlement Requiring Disgorgement of Funds Does Not Constitute "Loss"

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A state intermediate appellate court, applying New York law, has held that settlement payments representing the disgorgement of funds wrongfully obtained does not constitute "loss" under an errors and omissions policy. *Vigilant Ins. Co. v. Credit Suisse First Boston Corp.*, 2004 WL 2066353 (N.Y. Sup. Ct. App. Div. Sept. 16, 2004). The appellate court also held that the insurer was not obliged to reimburse defense costs incurred by the insured in connection with the underlying action. In doing so, the court reasoned that, because the underlying claim was for disgorgement of ill-gotten funds, defense costs for the claim could not be recovered, as they were not incurred in connection with a covered claim.

Credit Suisse First Boston Corp. (CSFB) purchased an E&O policy providing coverage "for any actual or alleged Wrongful Act arising from the rendering of, or the failure to render, services to any client, customer or other person or entity." The policy defined "loss" as "all damages, awards, judgments, settlements, costs and Defense Costs, and shall include, without limitation, pre-judgment interest, post-judgment interest, equitable relief, punitive or exemplary damages, treble or other multiplied damages and the legal expenses of any plaintiff or claimant if the Insured(s) is legally liable for such expenses."

The U.S. Securities and Exchange Commission (SEC) brought a lawsuit against CSFB, alleging that it had unlawfully coerced customers into paying a portion of their profits to CSFB when they "flipped" CSFB-underwritten IPO stock. ("Flipping" refers to purchasing shares in an IPO and then selling the shares in the immediate aftermarket to realize a profit.) CSFB subsequently entered into a settlement with the SEC and other regulators pursuant to which it agreed, among other things, to "pay \$70 million, representing disgorgement of monies obtained improperly by CSFB as a result of the conduct alleged in the Complaint." When CSFB sought coverage for the \$70 million payment under its E&O policy, the insurer denied.

The intermediate appellate court held that CSFB could not recover the settlement amount from its insurers. In so ruling, the court stated that "[r]estitution of ill-gotten funds does not constitute 'damages' or a 'loss' as those terms are used in insurance policies." The court further determined that the "risk of being directed to return improperly acquired funds is not insurable." The court noted that, even though the disgorged funds were based on a settlement, the "final judgment expressly state[d] that the money ordered disgorged was 'obtained improperly by CSFB as a result of the conduct alleged in the Complaint.'"

With respect to defense costs, the appellate division observed that the "policy defines defense costs as a component of 'Loss,' which 'shall not include matters which are uninsurable under the law pursuant to which this coverage section of this policy shall be construed.'" The court reiterated that "restitution of ill-gotten funds is not insurable under the law," and concluded that "defense costs are only recoverable for covered claims."

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