

\$70 Million Disgorgement Paid to SEC and NASDR by CSFB Is Not "Loss" under E&O Policy

July/August 2003

A state trial court in New York has held that a \$70 million payment by Credit Suisse First Boston Corporation (CSFB) as disgorgement to settle a lawsuit by the U.S. Securities and Exchange Commission (SEC) and an investigation by the NASD Regulation, Inc. (NASDR) is not a "loss" under CSFB's E&O policy. *Vigilant Ins. Co. v. Credit Suisse First Boston Corp.*, No. 600854/02 (N.Y. Sup. Ct. July 8, 2003).

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 SEC brought a lawsuit against CSFB, alleging that CSFB 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 NASDR 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." After CSFB sought coverage for the \$70 million under its E&O policy, the insurer initiated coverage litigation.

The New York trial court held that CSFB could not recover the \$70 million from its insurer because "[s]uch a result would defeat the purpose of the disgorgement provision" in the settlement agreement. The court explained that the purpose of disgorgement is to deprive a party of ill-gotten gains and to deter unlawful conduct and that these objectives would be undermined if CSFB were able to recoup the money it disgorged from its insurers.

The trial court rejected CSFB's argument that the settlement agreement provided an insufficient basis to conclude that it had engaged in wrongdoing. The court noted that the settlement agreement expressly linked the disgorgement to allegations of wrongdoing set forth in the complaint. Accordingly, it reasoned that the settlement is "essentially the same" as a final adjudication.

The trial court also rejected CSFB's argument that it should not be barred from recovering the \$70 million from the insurers because CSFB was not returning any money to its customers. The court explained that the purpose of the disgorgement was not to compensate CSFB's customers. Rather, "[t]he purpose is to deprive CSFB of money that it obtained unjustly and to deter similar conduct in the future. To permit CSFB to recoup the disgorged money through its insurance carrier would undermine that goal."

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