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NEWSLETTER

Court Holds Personal Profit and Dishonesty Exclusions, Definition of "Loss" Preclude Coverage

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A New York intermediate appellate court has upheld the decision of a trial court dismissing an action brought against a professional liability insurer by the liquidator of a defunct insurance company seeking to recover a judgment against the company's former president for misappropriation of the defunct insurer's assets. *Serio v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa*, 2005 WL 1153375 (N.Y. App. Div., May 17, 2005). The court held that the personal profit exclusion, the dishonesty exclusion and the definition of "loss" all precluded the coverage sought by the liquidator.

In the underlying action, the liquidator of the defunct insurance company alleged that the former president violated New York insurance statutes and ultimately received a favorable jury verdict and judgment against the former president. The liquidator subsequently sought to execute judgment against the D&O insurer of the defunct insurer. The insurer denied coverage, and the liquidator subsequently filed this coverage action.

Regarding the "personal profit" exclusion, the court first noted that "[i]n convincing the jury in the underlying action of a violation of [New York statutes], [the liquidator] had argued that the president made personal use of [the defunct insurer's] funds rather than retaining them for appropriate purpose" and concluded that "[t]hus, plaintiff himself has previously taken the position that the president used [the defunct insurer] for 'personal profit or advantage,' an event which the D&O policy excluded from liability coverage." In doing so, the court rejected the liquidator's contention that the jury in the underlying action never found that the former president used the defunct insurer's funds for his own use, reasoning that the record indicated that both the jury and the court below found that the funds were diverted to another insurance company controlled by the former president such that "[t]he 'personal profit or advantage' the president received was more than just a mere 'derivative benefit.'" The court further rejected the liquidator's attempt to rely on *Federal Insurance Co. v. Kozlowski*, 792 N.Y.S.2d 397 (2005), noting that "[t]here, unlike the present case, the allegations against the director in the underlying actions did not solely and entirely fall within the personal profit exclusion." Accordingly, the court held that the insurer was entitled to rely on the personal profit exclusion in denying coverage.

In the alternative, the court held that the dishonesty exclusion in the policy at issue precluded coverage. The court noted that "[i]n the underlying action, we observed that the jury concluded the president had diverted [the defunct insurer's] premiums to his other entities 'as part of an integrated transaction designed to benefit [his] entities'" and stated that "[s]urely, the jury's finding in this regard and its decision that the president should pay the [defunct insurer's] estate millions of dollars demonstrated a determination that his actions had been intentional." Accordingly, the court concluded that "[o]ur final adjudication established that the insureds had purposely and intentionally committed active and deliberate dishonesty, and thus placed the matter squarely within the liability exclusion of the D&O policy."

Finally, the court also held that amounts sought by the liquidator did not fall within the definition of "loss" in the D&O policy at issue. The court did not fully set forth the basis for its holding in this regard, noting simply that "the record indicates that the 'loss' in this case is uninsurable under New York law" and citing to *Reliance Group Holdings v. National Union Fire Insurance Co. of Pittsburgh, Pa.*, 594 N.Y.S.2d 20 (N.Y. App. Div. 1993), and *Vigilant Insurance Co. v. Credit Suisse First Boston Corp.*, 782 N.Y.S.2d 19 (N.Y. App. Div. 2004), apparently as authority for the proposition that disgorgement of amounts previously improperly received does not constitute "loss" under New York law.

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