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J.P. Morgan Securities Inc. v. Vigilant Insurance Co.

On February 28, 2014, a New York trial court in *J.P. Morgan Securities Inc. v. Vigilant Insurance Co. et. al.*, 2014 N.Y. Misc. LEXIS 796, held that settlements with the SEC and NYSE in which the Plaintiffs agreed to disgorgement payments and penalties were not excluded by the Dishonest Acts Exclusion of a professional liability policy, since the applicable settlements were not judgments or other final adjudication of the underlying claims, and did not establish that the Insured was guilty of conduct which would trigger the Dishonest Acts Exclusion.

In the underlying actions, the SEC notified Bear Stearns (n/k/a J.P. Morgan) that it would commence a civil proceeding charging Bear Stearns with violations of federal securities laws for alleged violations of late trading and deceptive market timing on behalf of customers for the purchase and sale of shares in mutual funds. The SEC also stated that it would seek injunctive relief sanctions of $720 million. Bear Stearns had denied the allegations in a Wells Submission. Ultimately, however, Bear Stearns and the SEC agreed to settle the case and the SEC issued an "Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions" (SEC Order). Importantly, the SEC Order expressly stated that it was "solely for the purpose of these proceedings," and Bear Stearns neither admitted nor denied the findings contained within the SEC Order. As part of the settlement, Bear Stearns agreed to pay $160 million in "disgorgement" and $90 million in civil penalties.

Interestingly, however, the 40 page SEC Order included specific findings regarding Bear Stearns facilitation of late trading and market timing practices. Also, Bear Stearns entered into a "Stipulation of Facts and Consent to Penalty" with the NYSE that was identical to the SEC penalty and which was deemed satisfied by the payment to the SEC. In addition, Bear Stearns also paid $14 million to settle 13 civil class action lawsuits involving similar allegations concerning late trading and deceptive market timing.

As a result of the various late trading and deceptive market timing actions, Bear Stearns sought coverage under its professional liability policies. However, the Insurers denied coverage, arguing, *inter alia*, that the loss included disgorgement payments which are not insurable as a matter of law. Consequently, the Insureds commenced a coverage action and ultimately moved for partial summary judgment on the insurers' affirmative defenses that: 1) the Plaintiffs' insurance claims were excluded under their policies' Dishonest Acts Exclusion; and 2) to permit indemnification for plaintiffs' losses would violate the public policy precluding coverage for intentional harmful conduct. The Insurers also filed a partial motion for summary judgment regarding the applicability of the Dishonest Acts Exclusion contained within their policies.

Specifically, the Dishonest Acts Exclusion excluded coverage for claims arising out of any “deliberate criminal act or omission,” but only if a “judgment or other final adjudication thereof adverse to such Insured(s) shall establish that such Insured(s) were guilty of any deliberate, dishonest, fraudulent or criminal act or omission.” Thus, the insurers argued that it did not matter that the SEC and the NYSE's findings were not the result of an actual trial because the Administrative Orders constitute “final adjudication” of Bear Stearns dishonest conduct.

The court did not agree with the insurers. Rather, the court held that “the settlements embodied in the Administrative Orders [were] not final adjudications or judgments establishing Bear Stearns’ guilt in the underlying proceedings that it engaged in the wrongful conduct covered by the Dishonest Acts Exclusion.” The court reasoned that the factual findings were neither admitted nor denied *except* as to the SEC's jurisdiction and the subject matter of those proceedings, and were not the subject of hearings or rulings on the merits by a trier of fact. **“To infer, as the Insurers urge, that the term "final adjudication" encompasses settlement of an administrative order, is to expand its reasonable interpretation beyond what is permitted under New York law.”**

We note, however, that this coverage action continues with respect to determining whether there is evidence demonstrating Bear Stearns "had the requisite intent to cause harm," and whether the disgorgement payment to the SEC is linked to "improperly acquired funds," which would bar insurance coverage on public policy grounds.