To Be Argued By:
STEVEN E. OBUS
Time Requested: 15 Minutes

APL-2020-00044
New York County Clerk's Index No. 600979/09

Court of Appeals

STATE OF NEW YORK

J.P. MORGAN SECURITIES INC., J.P. MORGAN CLEARING CORP., and THE BEAR STEARNS COMPANIES LLC,

Plaintiffs-Appellants,

—against—

VIGILANT INSURANCE COMPANY, THE TRAVELERS INDEMNITY COMPANY, FEDERAL INSURANCE COMPANY,

Defendants,

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURG, PA., LIBERTY MUTUAL INSURANCE COMPANY, CERTAIN UNDERWRITERS AT LLOYD'S, LONDON, and AMERICAN ALTERNATIVE INSURANCE CORPORATION,

Defendants-Respondents.

REPLY BRIEF FOR PLAINTIFFS-APPELLANTS

STEVEN E. OBUS
PROSKAUER ROSE LLP
Eleven Times Square
New York, New York 10036
Telephone: (212) 969-3000
Facsimile: (212) 969-2900

Attorneys for Plaintiffs-Appellants

Of Counsel:

SETH B. SCHAFLER
FRANCIS D. LANDREY
MATTHEW J. MORRIS

October 8, 2020

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES

OTHER AUTHORITIES

PRELIMINARY STATEMENT

Insurers would read this Court's prior decision in this case out of existence. This Court previously rejected Insurers' argument that the disgorgement payment at issue here is uninsurable, and held that Bear Stearns' Amended Complaint stated a claim on which relief could be granted. The IAS Court thereafter determined (R.399; R.434) that Bear Stearns proved all of its material allegations beyond genuine dispute.

Following that determination, however, Insurers renewed their argument that the payment was uninsurable, and also argued for the first time that the payment was an excluded "penalty imposed by law" within the meaning of Insurers' Policies, all based on a flawed interpretation of an intervening decision by the Supreme Court. Insurers argued below that *Kokesh v. SEC*, 137 S. Ct. 1635 (2017), held that disgorgement obtained by the SEC is a penalty for all purposes. The Appellate Division agreed, adopting that misreading. But the Supreme Court has since confirmed in *Liu v. SEC*, 140 S. Ct. 1936 (2020) that disgorgement is not a penalty for all purposes, and Insurers offer no basis to treat it as such for purposes of New York public policy. Nor do they offer any basis to transform this compensatory disgorgement payment, which offset Bear Stearns' liability for civil damages, into a "penalty" under Insurers' Policies.

Insurers assert a number of other arguments, all in an attempt to evade this Court's previous decision in this case. All of those arguments are equally meritless and should be rejected.[1]

ARGUMENT

I. THE COURT SHOULD ADHERE TO ITS PRIOR DECISION THAT BEAR STEARNS' DISGORGEMENT PAYMENT IS INSURABLE.

A. The Court Determined in 2013 That Disgorgement of Third-Party Gains Is Insurable.

When last before the Court, Insurers asserted (*e.g*. R. 2308), citing the same cases as now, that public policy against insuring punitive remedies excused them from complying with their contractual obligation to indemnify Bear Stearns for the $140 million disgorgement payment it had "deposited in a fund to compensate any mutual fund investors who had been harmed by Bear Stearns' conduct." *J.P. Morgan Sec. Inc. v. Vigilant Ins. Co.*, 21 N.Y.3d 324, 331 (2013). The Court rejected Insurers' arguments.

In doing so, the Court highlighted that the SEC Order clearly differentiated the disgorgement payment from a separate $90 million payment, which the Order expressly designated as a "penalty." The Court noted that, to preserve the "deterrent effect" of the separate penalty, the Order precluded its offset against

[1] Terms defined in Bear Stearns' opening brief have the same meaning herein.

Bear Stearns' civil damages liability, but "did not contain a similar restriction" on the disgorgement payment. *J.P. Morgan*, 21 N.Y.3d at 331.

The Court also specifically instructed that, for Bear Stearns ultimately to establish an insurable loss, it would need to establish the truth of its "allegation that the SEC disgorgement payment amount was calculated in large measure on the profits of others." *Id.* at 336.

Bear Stearns has established exactly what this Court held it was required to establish. It is now undisputed that the $140 million payment served "to compensate any mutual fund investors who had been harmed by Bear Stearns' [alleged] conduct," and it is beyond genuine dispute that the payment was calculated "on the profits of others." Bear Stearns has also shown that that calculation measured losses to harmed investors; that the payment was applied, in accordance with the terms of the SEC settlement, to compensate such investors; and that it offset Bear Stearns' liabilities for civil damages. Accordingly, on remand, the IAS Court rejected Insurers' contention that Bear Stearns' payment was uninsurable.

B. *Kokesh* and *Liu* Provide No Basis to Revisit This Court's Determination.

Notwithstanding that Bear Stearns satisfied the evidentiary standard set by this Court, the Appellate Division reversed. It based its Decision on its misreading of *Kokesh* to require that disgorgement be treated as a penalty for all purposes, including for purposes of New York public policy. The Supreme Court thereafter expressly rejected the contention that under *Kokesh*, "disgorgement is necessarily a penalty . . . ." *Liu*, 140 S. Ct. at 1946. *Liu* thus refutes the erroneous premise of the Appellate Division's Decision. Therefore, nothing about *Kokesh* or *Liu* warrants reconsideration of this Court's prior analysis, which rejected Insurers' argument that enforcing the terms of their insurance Policies would be contrary to public policy.

C. This Court Correctly Held That the Payment Is Insurable.

Assuming, *arguendo*, that *Kokesh* and *Liu* somehow opened the door for reconsideration of the public policy issue, this Court should adhere to its original decision, which correctly applied this Court's prior holding in *Zurich Ins. Co. v. Shearson Lehman Hutton*, 84 N.Y.2d 309 (1994). Under *Zurich*, the public policy prohibition of coverage for punitive damages does not apply to a remedy that, as here, has a compensatory element. *Id.* at 316-17.

Insurers argue that the *Zurich* ruling applies only to awards that are "indeterminate" as to whether they are compensatory. That is nonsensical. If awards that could potentially have a compensatory element are not uninsurable as "punitive," then awards that *certainly* have a compensatory element cannot be uninsurable as punitive.

Further, this Court did not characterize the awards in *Zurich* as "indeterminate," much less ground its decision on that basis. It held that an award of punitive damages that had "compensatory elements" was insurable. *Zurich*, 84 N.Y.2d at 316-17. It instructed that "the purpose of punitive damages is *solely* to punish the offender and to deter similar conduct" and that the Georgia award at issue was insurable because it "*also* had a compensatory purpose." *Id.* (emphasis added). Nor is *Zurich* limited to cases implicating "special comity concerns." Nowhere did the Court mention comity. In fact, while the Court upheld coverage for the dual purpose Georgia award at issue, the Court rejected the public policy of Texas as it applied to the Texas award also at issue because Texas public policy conflicted with New York policy. *See Zurich*, 84 N.Y.2d at 321.

Moreover, this Court has already admonished that the New York public policy in favor of enforcing contracts as written will be set aside in coverage cases only if the liability arises from an injury the insured intended to cause, or is for punitive damages. *J.P. Morgan*, 21 N.Y.3d at 334-35. This Court has never announced such a policy regarding what Insurers now call "punitive assessments." Nor is it surprising that this Court has never held that "punitive assessments" or "penalties" are *per se* uninsurable, since the Legislature has said just the opposite. Business Corporation Law §§ 721 and 722(a) expressly permit corporations to indemnify their directors and officers, in criminal cases as well as civil, for payments including "fines," and § 726 authorizes corporations to purchase insurance to cover such indemnification. If the Legislature permits indemnification through insurance for criminal fines, it could hardly have contemplated a blanket rule against such indemnification for civil punitive assessments.

II. BEAR STEARNS' LOSS ARISING FROM ITS DISGORGEMENT PAYMENT IS INSURED UNDER THE POLICIES.

A. The Payment Was Not a Penalty.

1. "Penalty" Should Be Construed in Keeping with Common Usage and the Reasonable Expectations of the Parties.

Insurers have no basis to dispute that insurance policies must be construed in light of plain speech, common understanding and the reasonable expectations of the insured. *See Viking Pump, Inc. v. TIG Ins. Co.*, 27 N.Y.3d 244, 257 (2016). Under those principles, the disgorgement payment was not a "penalty imposed by law." At the time Insurers' Policies were written, and when the SEC Order was agreed, it was universally understood that disgorgement payments are equitable remedies, not penalties. Indeed, Insurers did not assert that "penalties imposed by law" included disgorgement when they first appeared before this Court, or at any time before the IAS Court granted summary judgment against them on remand.

Indeed, the relevant courts consistently classified disgorgement as "equitable relief" within 15 U.S.C. § 78u(d)(5), and rejected the argument that such relief – even when it exceeded the payer's own gains – was a penalty. *See, e.g.*, *SEC v.*

Contorinis, 743 F.3d 296, 305-07 (2d Cir. 2014) (rejecting argument that disgorgement in excess of payer's own gains was a penalty; reviewing authorities in other jurisdictions); *Riordan v. SEC*, 627 F.3d 1230, 1234 (D.C. Cir. 2010) (disgorgement not a penalty); *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1475 (2d Cir. 1996), *cert. denied*, 522 U.S. 812 (1997) (disgorgement in excess of payer's own gains not "punitive").

Nor do Insurers dispute that the SEC considered disgorgement to be an equitable remedy rather than a penalty. The SEC agreed in the SEC Order to a separately designated penalty, to be treated as such "for all purposes, including all tax purposes." (R.1600.) Unlike the disgorgement payment, the actual penalty was ineligible for use to offset civil liability, in order to "preserve" its "deterrent effect." (*Id.*) Indeed, under the SEC Order, if Bear Stearns obtained an offset in a civil action based on the penalty, it would be required to pay an *additional* penalty in that amount, a condition that did not apply to the disgorgement payment. (R.1600-01.) Bear Stearns also agreed not to seek insurance coverage for the penalty, but there was no similar provision for the disgorgement payment. (R.9223.)

Insurers would have the Court disregard the express differentiation in the SEC Order between the disgorgement payment and the penalty. But that differentiation is significant because a reasonable insured would not expect a payment to be treated as a penalty when the order requiring it did not characterize it as a penalty, and provided elsewhere for a separate "penalty." *Viking Pump*, 27 N.Y.3d at 257.

This is especially so here, where Insurers' Policies covered "multiplied damages" (R.1152), which, as discussed below (at 9), may be considered penalties for some purposes even though not labeled as such. An insured purchasing a policy that covers "multiplied damages" would reasonably understand the exclusion for "penalties imposed by law" to refer to penalties denominated as penalties. When legislatures wish to create a penalty, they typically call it a penalty, to make their intended punitive and exemplary effect clear. Both New York and federal law are replete with penalties so designated. *See, e.g.*, 15 U.S.C. § 78u(d)(3); 15 U.S.C. § 45(m); CPLR 5020(c); Financial Services Law § 408; General Business Law § 341; Insurance Law § 2605. If Insurers expected their "penalty" exclusion to apply to liability payments that are not actually identified as "penalties," they were obliged to say so.

Even assuming that the phrase "penalty imposed by law" could also be construed to encompass a compensatory disgorgement payment not characterized as a penalty, it is at the very least ambiguous in Insurers' Policies, and would still be covered. *See, e.g.*, *Belt Painting Corp. v. TIG Ins. Co.*, 100 N.Y.2d 377, 383 (2003); *State v. Home Indem. Co.*, 66 N.Y.2d 669, 672 (1985).

2. Payments That Compensate Others for Harm Are Not Penalties.

Nothing in Insurers' brief calls into question well-settled New York law that a payment made to compensate others and discharge liability to them for actual damages is not a penalty. As the Court held in *Borden v. 400 E. 55th St. Assocs. LP*, a statutory exaction is not a penalty except to the extent the payment amount "would exceed the injured party's actual damages." 24 N.Y.3d 382, 396-97 (2014) (citation omitted). *See also Sperry v. Crompton Corp.*, 8 N.Y.3d 204, 214 (2007) (under General Business Law § 340(5), one third of treble damages "compensates a plaintiff for actual damages," while the rest is a penalty); *Sicolo v. Prudential Sav. Bank of Brooklyn, N.Y.*, 5 N.Y.2d 254, 258 (1959) (penalties "do not include a liability created for the purpose of redressing a private injury, even though the wrongful act be a public wrong and punishable as such"); *Harvardsky Prumyslovy Holding, AS.-V Likvidaci v. Kozeny,* 117 A.D.3d 77, 82 (1st Dep't 2014) (citations omitted) ("That a judgment of restitution may serve a penological purpose" does not render it a "penalty" under CPLR 5301(b), where the judgment requires offenders "'to compensate the victims of their crimes' for actual damages sustained").

Moreover, unlike the disgorgement payment, penalties are not tethered to any remedial element or actual loss. *See, e.g.*, *Sicolo*, 5 N.Y.2d at 258 ("penalties [are] arbitrary exactions, unrelated to actual loss"); *Verona Cent. Cheese Co. v.*

Murtaugh, 50 N.Y. 314, 316-17 (1872) ("the act is penal, and not remedial; that is, it authorizes a recovery within certain limits as to amount, for each offence").

Because the disgorgement payment was based on actual harm to investors, was used to discharge liability for that harm, and did not exceed the investors' actual damages, it was not a penalty.

3. The Disgorgement Payment Was Calculated as a Proxy for the Losses of Harmed Investors.

Insurers depend heavily on the erroneous premise that the payment was not measured by harm to injured parties. However, the record demonstrates beyond genuine dispute that Bear Stearns' payment was based on harm to investors. The payment amount was derived by estimating the fair value of trading gains by Bear Stearns' customers who allegedly traded improperly. (R.1097-98; R.1915-62; R.2042-51.) That value served as a proxy for investor losses on those same trades. The record is unrefuted that the SEC sought from Bear Stearns a calculation of "the loss suffered by mutual fund shareholders" (which Bear Stearns' calculation spreadsheet referred to as "damages"), and that the SEC then used that calculation to determine the payment. (R.2044; R.2051.)

As Bear Stearns' expert, Michael Quinn, explained, the SEC reasoned "that the gain to the timers is the same amount as the loss to the other mutual fund shareholders, so the timers are achieving gains at the expense of long term shareholders by 'diluting' the value of their shares." (R.1748.) Insurers' expert, Eric Zitzewitz, agreed, noting that shareholder "dilution" is estimated by the "advantage that a market-timer earned." (R.2633; R.2635-36.) Likewise, Lori Richards, Director of the SEC's Office of Compliance Inspections and Examinations, testified to Congress in 2005 that, in determining disgorgement amounts, the SEC "considers shareholder dilution." (R.2555.) Trading gains were also used as an estimate of shareholder dilution in the Civil Actions. (R.2628.)

Nor is there anything unusual about measuring compensatory damages by reference to the gains of others. For example, as this Court explained in *E.J. Brooks Co. v. Cambridge Sec. Seals*, courts may in various circumstances "award a defendant's unjust gains as a proxy for compensatory damages," because they are a "*method of computing damages*." 31 N.Y.3d 441, 450 (2018) (citations omitted).

Insurers harp on a statement by Bear Stearns' expert on SEC enforcement, former SEC Chairman Harvey Pitt, that the SEC has a "broader purpose" than compensation. (R.1799-1800.) But, as the Supreme Court explained in *Kokesh*, 137 S. Ct. at 1645, having a broader purpose is not the same as denying that disgorgement payments can be used to compensate those injured. Indeed, Mr. Pitt cited an SEC report stating that the SEC aims to "develop the law of disgorgement in a manner favoring compensation of investors." (R.1800.) The Supreme Court has accordingly identified the use of the funds to compensate investors as one of the hallmarks of disgorgement as an equitable remedy. *Liu*, 140 S. Ct. at 1947-49.

4. Neither *Kokesh* nor *Liu* Supports Insurers' Contention That the Payment Was a Penalty.

Now that the Supreme Court has explicitly confirmed in *Liu* that disgorgement payments are not necessarily penalties even for securities law purposes, Insurers have pivoted. They effectively concede that some SEC-ordered disgorgement payments are not penalties, but argue that any disgorgement payment that (as here) exceeds the payer's gains or fails to deduct expenses is a penalty for New York insurance law purposes. The *Liu* Court did not, however, determine how payments that may fall outside the parameters of traditional equitable remedies must be characterized, much less hold that all such payments are necessarily penalties under any law, let alone New York insurance law. The Court's focus was to assure that the SEC not act beyond its equitable authority and, in particular, that it not require a wrongdoer to "pay more than a fair compensation to the person wronged." *Liu*, 140 S. Ct. at 1943 (quoting *Tilghman v. Proctor*, 125 U.S. 136, 145-46 (1888)). Nor did the payment at issue in *Liu* have the compensatory attributes of the payment here. *See Liu*, 140 S. Ct. at 1947 ("the SEC has not returned the bulk of funds to victims").

But even assuming, *arguendo*, that a federal court might hereafter hold that the SEC's power to obtain equitable relief does not include the power to obtain compensatory disgorgement of third-party gains, the SEC did obtain such a payment here. No interpretation of *Liu* allows Insurers to rewrite an existing consent order to re-characterize such a previously made disgorgement payment into a penalty imposed by law.

a. Coverage Is Determined at the Time the Liability Is Incurred, and Based on What the Parties Actually Settled.

Whether the SEC could impose the same disgorgement remedy today is beside the point. Coverage is determined based on what the parties actually agreed when they settled in 2006 in light of the then-governing authorities. *See Zurich*, 84 N.Y.2d at 316 & 316 n.3 (applying law at time of settlement to determine insurability). At the time of the settlement, the SEC took the position that its statutory mandate to seek equitable relief included authority to obtain disgorgement of third-party gains, in excess of what the payer earned. Courts had upheld that position, as this Court itself noted. *See J.P. Morgan*, 21 N.Y.3d at 336 n.7 (citing *First Jersey Sec., Inc.*, 101 F.3d at 1475).

Furthermore, it is "the agreement of the parties, rather than the force of the law upon which the complaint was originally based, that creates the obligations embodied in a consent decree." *Local No. 93, Int'l Ass'n of Firefighters, AFL-CIO C.L.C. v. City of Cleveland*, 478 U.S. 501, 522 (1986). In the agreement here, the SEC and Bear Stearns provided for separate penalty and disgorgement amounts. Each was labeled as such and treated differently for tax and offset purposes.

b. Even Assuming the SEC Demands Exceeded Its Authority in Light of *Kokesh* and *Liu*, the Payment Was Not a Penalty Imposed by Law.

Even assuming the Court were to adopt Insurers' legal fiction that *Liu* and *Kokesh* state the law as it "really" was in 2006 – and that, under *Liu*, the SEC overstepped its statutory mandate when it obtained Bear Stearns' disgorgement of third-party gains – Bear Stearns' disgorgement payment would not be transformed into a "penalty imposed by law" under Insurers' Policies. The payment would still be a settlement between a private party and a government agency, both of which understood that it constituted compensatory equitable relief.

Moreover, the payment cannot be reclassified retroactively as a "penalty imposed by law" because, among other reasons, under the securities laws penalties may not be based on third-party gains. *See SEC v. Pentagon Capital Mgmt. PLC*, 725 F.3d 279, 287-88 (2d Cir. 2013); 15 U.S.C. § 78u(d)(3)(B) (penalties obtainable from a defendant based on gain are limited to "the pecuniary gain to *such* defendant") (emphasis added). If it was unlawful under *Liu* for the SEC to obtain disgorgement based on such gains, it was equally unlawful under § 78u(d)(3)(B) for it to obtain a penalty on that basis.

Thus, even if this compensatory disgorgement payment could be deemed in retrospect, after *Kokesh* and *Liu*, to have some characteristics similar to a "penalty," it still would not be a "penalty imposed by law," as the Policy language requires. (R.1152.) It would be a compensatory payment demanded under color of equity jurisdiction but beyond the SEC's authority, and neither intended nor permitted as a penalty. In that case, it would be a covered settlement payment, both because the settlement agreement and law in effect in 2006 control, and because any ambiguity as to the meaning of the Policy language must be resolved in Bear Stearns' favor. *See, e.g.*, *Belt Painting*, 100 N.Y.2d at 383.

B. Insurers' "As Damages" Argument Is Also without Merit.

Insurers' fallback contention – that Bear Stearns' $140 million disgorgement payment, even if not penalty, is not "damages" within the definition of "Loss" – is the same they made in 2013. (*E.g.*, R.2278; R.2298; R.2340-41; R.2384.) The Court rejected that argument, *J.P. Morgan*, 21 N.Y.3d at 333, and need not revisit the issue. In any case, Insurers' arguments are no more persuasive the second time around.

1. The Third-Party Disgorgement Payment Would Be Covered Even if "Loss" Were Limited to Damages.

The term "damages" – undefined in Insurers' Policies – must be construed in light of plain speech, common understanding, and the reasonable expectations of the insured. *Viking Pump*, 27 N.Y.3d at 257. So construed, "damages" encompasses a wide array of payments, regardless of the formal label placed on them, especially payments that have a compensatory purpose and effect, and discharge an insured's liability to harmed parties, as the disgorgement payment here did.

Generally, compensatory damages serve "to make the injured [party] whole." *Campagnola v. Mulholland,* 76 N.Y.2d 38, 42 (1990); *see also Sokolowski v. Aetna Life & Cas. Co.*, 1986 WL 9232, at *4 (S.D.N.Y. Aug. 11, 1986) (policy defined damages as "sums of money payable as compensation for loss"). The payment Bear Stearns made as disgorgement was not merely used to compensate investors, but was required to be so used. (R.1600.) Moreover, the record confirms that the payment was applied, as expressly permitted, as an offset against damages claimed in the Civil Actions. (R.2234; R.2609.) Thus, Bear Stearns suffered "damages."

Insurers cite no law since the Court's 2013 decision that would justify a different conclusion. As noted in the briefing then, courts routinely hold that remedies that are not labelled as "damages" are nonetheless covered under insurance policies that cover "damages" due to the remedial nature of the payment. For instance, in *Unified Western Grocers, Inc. v. Twin City Fire Insurance Co.*, 457 F.3d 1106, 1115 (9th Cir. 2006) the court found that "'damages' include monetary awards that represent compensation for harm to third parties, even if such awards bear the label 'restitution.'" (Citation omitted.) *See also XL Specialty Ins. Co. v. Loral Space & Commc'ns, Inc.*, 82 A.D.3d 108, 113-14 (1st Dep't 2011) (coverage for fees paid to derivative action plaintiffs' counsel); *Vigilant Ins. Co. v. Bear Stearns Cos., Inc.*, 34 A.D.3d 300, 302-03 (1st Dep't 2006) (coverage for payments for disgorgement, independent research and investor education), *rev'd on other grounds*, 10 N.Y.3d 170 (2008); *Gerrish Corp. v. Universal Underwriters Ins. Co.*, 947 F.2d 1023, 1030 (2d Cir. 1991) (rejecting insurer's contention that environmental remediation costs are not covered because not paid "as damages"); *AIU Ins. Co. v. Superior Court*, 51 Cal. 3d 807, 828-31 (1990) (same).

2. "Loss" Is Not Limited to Payments Made "as Damages," and Includes the Payment at Issue Here.

Insurers' contention that the disgorgement payment is not "Loss" also fails because, even if it were not "damages," it would come within the definition of "Loss," which is much broader.

One of the two definitions of "Loss" expressly includes coverage for "any investigation by any governmental body or self-regulatory organization (SRO)." (R.1152.) That grant would effectively be a nullity if Insurers were right that only a narrow category of payments labeled as "damages" is insurable, since the relevant regulator for a broker-dealer like Bear Stearns is the SEC and it is not empowered to obtain a remedy labeled as "damages." *See* 15 U.S.C. § 78u. If Insurers had intended to exclude remedies obtainable by the SEC or other regulators, they could have said so plainly in an exclusion. *See, e.g.*, *Certain Underwriters at Lloyds London v. Huron Consulting Grp., Inc.*, 127 A.D.3d 663, 664 (1st Dep't 2015) (policy excluded claims brought by any "government entity"). Instead, they said just the opposite by including government investigations in their definition of Loss.

Insurers argue that coverage under their Policies is not illusory because the New York Attorney General can obtain damages under the Martin Act, which might be covered. But the Policies expressly provide coverage for investigations by SROs. For Bear Stearns, that grant of coverage meant only the NASD and the regulatory arm of the NYSE in 2000-2006, and, after their merger in 2007, FINRA. These SROs could not obtain remedies labeled as "damages." *See* NYSE Rule 476(a)(11); NASD Rule 8310. If Loss were limited to payments denominated as "damages," that grant would be illusory even by Insurers' own standard.

Contrary to Insurers' contention, the payment also fits within the first "Loss" definition, which includes "compensatory damages . . . settlements, costs, charges and expenses or other sums the Insured shall legally become obligated to pay as damages . . . ." (R.1152.) Insurers' argument that "as damages" qualifies all the previous terms would improperly nullify the references to "costs, charges and expenses." Those terms unquestionably include defense costs, which plainly are not "damages" as Insurers define that term. *See Thomas J. Lipton, Inc. v. Liberty Mut. Ins. Co.*, 34 N.Y.2d 356, 360 (1974) (distinguishing "expenses" from "damages"). The only plausible reading of the definition is that the phrase "other sums [paid] as damages" indicates an additional category of covered payments, without limiting the items that precede it. *See, e.g.*, *Maurice Goldman & Sons, Inc. v. Hanover Ins. Co.*, 80 N.Y.2d 986, 987 (1992) (where each in a series of contractual terms had a distinct meaning, final term could not be construed to modify prior terms). Accordingly, like "costs, charges and expenses," "settlements" – which are also included in the first definition – need not be "damages" to constitute "Loss."

III. THE APPELLATE DIVISION ERRED BY REVERSING THE AWARD OF COVERAGE FOR THE CLASS ACTION SETTLEMENT.

Bear Stearns showed in its opening brief (at 31) that the Appellate Division also erred by reversing the award of coverage for the Civil Action settlement, which was not disgorgement but damages, even under Insurers' definition. Insurers argue that the Court cannot reach this issue because even with coverage for the settlement, Bear Stearns would not penetrate to the layer of Respondents' excess Policies. But Bear Stearns had a judgment against all Insurers, which included the Civil Action settlement, and which was vacated due to the erroneous Decision. The vacatur of the portion of that judgment derived from the Civil Action settlement reduces the damages and prejudgment interest owed by all Insurers, including Respondents. It is "axiomatic that, once an appeal is properly before it, a court may fashion complete relief to the appealing party." *See Hecht v. New York*, 60 N.Y.2d 57, 62 (1983).

IV. INSURERS' OTHER DEFENSES ARE WITHOUT MERIT.

A. Insurers Failed to Raise a Genuine Issue of Material Fact Rebutting Bear Stearns' Showing That the Disgorgement Payment Consisted of Third-Party Gains Required to Be Used to Compensate Investors.

Insurers seek to dispute that Bear Stearns' disgorgement payment in excess of $20 million (for which Bear Stearns has not sought coverage) represented customer gains by arguing that (1) Bear Stearns supposedly has no evidence that the other $140 million represented customer gains, other than the testimony of its counsel, Lewis Liman; (2) the Liman testimony is "hearsay"; and (3) there is evidence that the SEC based its entire demand for $160 million in disgorgement on Bear Stearns' own gains. Each of those contentions is meritless.

1. Ample Undisputed Evidence Apart from the Liman Testimony Proves the $140 Million Disgorgement Payment Represented Third-Party Gains.

Contrary to Insurers' assertion, there is extensive uncontroverted evidence, in addition to the Liman testimony, that the $140 million of the disgorgement payment represented third-party gains. The evidence consists of the calculations of those gains and the correspondence with which Bear Stearns transmitted those calculations to the SEC. At the SEC's request, Bear Stearns first used the Delta NAV and "holding period realized gain/loss" methods to calculate third-party gains, producing estimates of $519 million and $306 million. (R.1918-19.) Bear Stearns then provided the SEC with a fair value analysis that produced the $140 million estimate of third-party gains. (R.2044, R.2051.) Mr. Liman's testimony provides context (R.1097; R.2588-90; R.2593), but the calculations and cover letters are compelling in themselves. (R.1915-21; R.1922-62; R.2044-51; R.2625; R.2633.)

For instance, in his November 30, 2005 cover letter to the SEC submitting the fair value calculation, Liman wrote that the SEC had asked Bear Stearns to "produce to the Staff information and data supportive of the figure of approximately $140 million in restitution" that Bear Stearns had cited in a previous "settlement meeting" as an estimate "of the loss suffered by mutual fund shareholders as a result of purported late trading" by Bear Stearns' customers. (R.2044.) The calculation follows. (R.2051.) Insurers do not contend that Liman – who was then a partner at a major law firm and is now a federal judge – misrepresented the facts. And there is no evidence that the SEC denied requesting the calculation, or disputed that it represented third-party gains.

2. The Liman Testimony Also Is Undisputed and Is Not Hearsay.

In any case, the Liman testimony is itself sufficient admissible evidence that the parties agreed to the $140 million calculation of third-party gains. Insurers' erroneous "hearsay" argument mischaracterizes the record, the issue, and the law.

Insurers contend that the Liman testimony consists of hearsay as to what an "SEC staffer" said about internal SEC deliberations. Liman said nothing of the sort. Instead, he testified about what the SEC demanded and what Bear Stearns ultimately agreed to pay after negotiation. (R.1095-98.) The SEC Order was the product of that negotiation; it expressly recites that it was created by Bear Stearns' delivery of an offer of settlement, which the SEC accepted. (R.1562, R.1600.) Liman's testimony that the $140 million estimate of customer gains became the basis for part of the settlement is direct testimony confirming what the rest of the evidence of the negotiation history also shows.

United States v. Sampson, 898 F.3d 287, 308 (2d Cir. 2018), cited by Insurers, actually undermines their hearsay argument. In *Sampson*, a witness was permitted to describe fully his discussions with a third party. The only thing excluded was a set of notes taken by a different person who did not testify, which were proffered to rebut the testimony of the witness who did. Like the witness in *Sampson*, Liman testified, and his testimony describing his discussions with the SEC was not hearsay.

3. Insurers Proffered No Competent Evidence That the SEC Calculated Bear Stearns' Own Gains As Exceeding $20 Million.

Insurers ignore the uncontroverted record and instead speculate that the SEC demanded the disgorgement based on gains that Bear Stearns itself allegedly had from transactions having nothing to do with mutual funds, market timing or late trading. There is no basis on the record to support that speculation. The SEC Order makes no reference to such unrelated gains; nor is there any other evidence that the SEC took such unrelated gains into account. Absent such evidence, the hypothetical calculation of such gains by Insurers' expert Zitzewitz proves nothing.

Insurers further speculate that, because the SEC also obtained disgorgement awards from some of Bear Stearns' customers, the SEC supposedly could not have obtained an award from Bear Stearns based on those customers' gains because such an award would have been duplicative. That assertion also lacks any support on the record.

The Bear Stearns disgorgement payment was based on the gains of dozens of customers. (R.1872-77; R.1926-32.) Insurers rely on awards against just four (R.3010-48; R.3070-87), and do not even attempt to prove that those awards overlapped with the customer gains recovered from Bear Stearns. The four customers to which Insurers refer used many clearing brokers in addition to Bear Stearns. For example, Millennium alone used *39*. (R.3015.) The component of Bear Stearns' $140 million payment attributable to Millennium would clearly not be duplicative of any part of Millennium's disgorgement payment that represented trading cleared by the other 38 brokers, and there is no evidence that it is duplicative even as to trades cleared through Bear Stearns.

Finally, Insurers rely on a press release the SEC issued after settling with Bear Stearns, in which an SEC officer claimed the settlement would "deprive Bear Stearns of the gains it reaped . . . ." (R.3503.) But that assertion contains no specifics, and certainly does not identify the $140 million disgorgement payment – rather than the $20 million portion for which Bear Stearns does not seek coverage – as Bear's gains. In any event, the press release is inadmissible hearsay.

B. The Profit Exclusion Does Not Bar Coverage.

This Court previously rejected Insurers' contention that the Profit Exclusion required dismissal of Bear Stearns' Amended Complaint, explaining that since the conduct alleged by the SEC "profited others, not itself, this exclusion does not defeat coverage under CPLR 3211." *J.P. Morgan*, 21 N.Y.3d at 337. Only Travelers (joined by National Union) seeks to reargue the previously rejected Profit Exclusion, but it cites no change in the law or evidence in the record that should cause the Court to revisit that holding.

The Profit Exclusion bars coverage for Claims "based upon or arising out of" Bear Stearns "gaining in fact any personal profit or advantage to which" Bear Stearns "was not legally entitled, including but not limited to any actual or alleged commingling of funds or accounts." (R.1155.) Travelers argues that the terms "based upon or arising out of" are "broad" and apply if the SEC's Claim had any "connection" with Bear Stearns' obtaining an unlawful profit or advantage. As this Court held in *Mount Vernon Fire Ins. Co. v. Creative Hous. Ltd.,* 88 N.Y.2d 347, 352 (1996), however, for a claim to be based upon or arise out of certain conduct, such conduct must be the "operative act" giving rise to the claim. The claim that Bear Stearns facilitated late trading and excessive market timing, as asserted in the "Violations" section of the SEC Order (R.1591-92), did not require the SEC to prove (and was not supported by any allegation) that Bear Stearns obtained an improper profit or advantage. Bear Stearns cleared trades requested by customers and obtained lawful fees for doing so.

Courts construing this exclusion reject arguments that any benefit to the insured can trigger it, and instead require the acquisition of the benefit to be a required element of the claim. *See, e.g.*, *Alstrin v. St. Paul Mercury Ins. Co.*, 179 F. Supp. 2d 376, 400 (D. Del. 2002). Travelers's argument that under *Alstrin* the exclusion may also apply when, as here, unlawful profit is not an element of the claim is mistaken. The case is clear that the carrier must demonstrate that the underlying "cause of action . . . requires" proof that the insured gained a profit or advantage to which it was not legally entitled. *Alstrin*, 179 F. Supp. 2d at 400-01.

Even the cases Travelers cites demonstrate that the exclusion applies only where the insured's obtaining an unlawful profit or advantage is an element of the claim. For instance, in *Jarvis Christian College v. National Union Fire Insurance Co.*, 197 F.3d 742, 749 (5th Cir. 1999), an insured college trustee breached his fiduciary duty to the college by causing it to invest in a business he owned. The court held the exclusion applied to the college's claim to recover lost funds because the trustee's improper acquisition of those funds was an essential element of the claim. *See id.*

Travelers' fallback argument – that because $20 million of the disgorgement payment represented Bear Stearns' own revenues (for which no claim was made), the $140 million representing customer gains is excluded too – was also raised by Insurers on the prior appeal (R.2333) and necessarily rejected by the Court. *J.P. Morgan*, 21 N.Y.3d at 337. Nothing changes that result.

In any event, under New York law, an insurer must establish that a "loss falls *entirely* within the policy exclusion as claimed" for the exclusion to apply. *Servidone Constr. Corp. v. Sec. Ins. Co. of Hartford*, 64 N.Y.2d 419, 425 (1985) (emphasis added); *see also Westpoint Int'l, Inc. v. Am. Int'l S. Ins. Co.*, 71 A.D.3d 561, 562 (1st Dep't 2010) (for purposes of policy exclusion, each cause of action must be treated as separate claim). Travelers' argument runs afoul of that rule. The Loss for which Bear Stearns seeks coverage is the $140 million payment it made as disgorgement to settle a claim for its alleged facilitation of conduct that produced gains for others. Bear Stearns has not sought coverage for amounts reflecting its own gains. But even if Bear Stearns' "Loss" were deemed to be the full $160 million it paid as disgorgement, including of its own revenues, a claim is not excluded from coverage merely because a portion of the remedy is. The $160 million Loss would not be a "loss fall[ing] entirely within the policy exclusion," as the law requires.

C. Insurers Failed to Raise a Genuine Issue of Material Fact Regarding the Reasonableness of the Settlements.

Insurers, who devote much space to arguing that Bear Stearns could have been required to pay even more than it paid and that its conduct was intentionally damaging to investors, nonetheless contend that it was not "reasonable" for Bear Stearns to have paid so much in settlement. Insurers' contention is meritless.

First, contrary to Insurers' assertion, they bore the burden of proof on the issue of the reasonableness of the settlement. *PepsiCo, Inc. v. Continental Casualty Co.*, 640 F. Supp. 656, 662 (S.D.N.Y. 1986), citing *H.S. Equities, Inc. v. Hartford Accident & Indem. Co.*, 661 F.2d 264, 269 (2d Cir. 1981), holds that "[e]vidence of a good faith settlement of the underlying litigation . . . creates a presumption that the costs are covered by the policy" and therefore that the insurer "bear[s] the ultimate burden of proving what amount of the settlement costs," if any, "should be excluded from the policy coverage." This is in accord with settled New York law. *See Conner v. Reeves*, 103 N.Y. 527, 532 (1886) (judgment on consent is "presumptive evidence" of reasonableness).

Second, the record amply demonstrates the significant extent of Bear's potential liability and risk absent a settlement. The Delta NAV calculation of Bear

Stearns' customers' trading gains, which the SEC required, produced an estimate of $519 million. (R.1097-98; R.1975; R.2022-23.) Reducing the disgorgement component of Bear Stearns' settlement payment to less than a third of that was self-evidently a substantial achievement. Former SEC Chairman Harvey Pitt also opined that the SEC would probably have prevailed in litigation. (R.3867-70.)

Instead of evidence that Bear Stearns paid too much, Insurers cite an inadmissible academic study "doubting insured's incentive to arrive at reasonable settlement" (Vigilant Brief at 56), but neglect to mention that the study presupposes a scenario where the insured expects its insurer to pay the settlement. Of course, Bear Stearns could not rely on Insurers to pay, since they had already "repudiate[ed]" coverage. *See J.P. Morgan Sec. v. Vigilant Ins. Co.*, 151 A.D.3d 632, 633 (1st Dep't 2017). That is exactly the circumstance in which courts recognize that settlements are most likely to be reasonable, as in *Taco Bell Corp. v. Continental Casualty Co.*, 388 F.3d 1069, 1075-76 (7th Cir. 2004).

Finally, Insurers contend that the settlement was unreasonable because, under the subsequent reasoning in *Liu*, Bear Stearns could have argued that disgorgement exceeding $16.9 million would be a penalty. But it is absurd to suggest that a settlement is unreasonable because the settling defendant might have litigated all the way to the Supreme Court based on a theory that had theretofore been rejected, *see First Jersey*, 101 F.3d at 1475, and that the Court did not in fact even agree to consider until well over a decade later.

D. Insurers Failed to Raise a Genuine Issue of Material Fact Regarding Intent to Harm.

1. The Exception Applies Only to Acts Performed with Actual Intent to Injure.

When first before this Court, Insurers argued that coverage was barred as a matter of public policy because Bear Stearns' alleged facilitation of its customers' late trading and market timing supposedly was "inherently harmful" conduct established by the SEC Order. (R.2325-32.) The Court rejected those contentions, reiterating that "the public policy exception for intentionally harmful conduct is a narrow one, under which it must be established not only that the insured acted intentionally but, further, that it acted with the intent to harm or injure others." *J.P. Morgan*, 21 N.Y.3d at 335 (citing *Pub. Serv. Mut. Ins. Co. v. Goldfarb*, 53 N.Y.2d 392, 399 (1981)). Insurers have cited no basis for the Court to revisit that ruling.

In *Goldfarb*, the Court "emphasize[d]" that even acts of sexual abuse, leading to criminal liability and the imposition of punitive damages, do not satisfy the standard for applying the public policy exception to coverage for the compensatory component of an award unless a "finding of an intent to *injure* has been made." 53 N.Y.2d at 400. The Court further explained that such an award is insurable even where the conduct is "reckless" or even "wanton." *Id.* By citing *Goldfarb* and reiterating its requirement that a carrier demonstrate the insured's actual intent to injure, the Court rejected Insurers' contention that profit-seeking acts that may violate the securities laws and cause losses to others trigger the "narrow" public policy exception.

Insurers try to circumvent *Goldfarb* once again, this time attempting to import from tort cases a "substantially certain" (or even "reasonably foreseeable") standard that this Court has never adopted with respect to the public policy exception. The only case they cite by this Court, *Copart Industries, Inc. v. Consolidated Edison Co. of New York, Inc.*, 41 N.Y.2d 564 (1971), in fact demonstrates that that tort foreseeability standard is inapplicable in coverage disputes. *Copart* did not deal with or discuss insurance coverage. Rather, it cited *Boomer v. Atlantic Cement Co.*, 26 N.Y.2d 219 (1970), as an example of the "substantially certain" standard for intent applicable to the common law tort of nuisance. *Id.* at 571-72. But this Court later *upheld* coverage in the insurance dispute that arose from the very same *Atlantic Cement* nuisance case, rejecting an intentional harm defense based upon that tort standard. *See Atl. Cement Co. v. Fid. & Cas. Co. of New York*, 63 N.Y.2d 798, 801 (1984) (affirming the Appellate Division's holding that it was error to instruct jury that intent to harm could be shown by proving that harm was "substantially certain" to follow from alleged conduct, 91 A.D.2d 412, 415-16 (1st Dep't)).

2. None of the "Evidence" Adduced by Insurers Satisfies the Applicable Standard.

Insurers argue that the "findings" in the SEC Order suggest that Bear Stearns intended to harm investors. But those "findings," which are in any case mere allegations, suggest no such thing. Moreover, Bear Stearns did not admit or deny the SEC's allegations. (R.1562.) And, as Bear Stearns demonstrated (R.4064) when Insurers made the same argument to this Court on the first appeal, "findings" in a consent judgment are not evidence of the facts alleged. *See, e.g.*, *Lipsky v. Commonwealth United Corp.*, 551 F.2d 887, 893 (2d Cir. 1976); *In re Platinum & Palladium Commodities Litig.*, 828 F. Supp. 2d 588, 594 (2d Cir. 2011). The SEC "findings" determined nothing.

Insurers contend that the Appellate Division held they can rely on the "findings" to support their public policy defense. *See J.P. Morgan Sec., Inc. v. Vigilant Ins. Co.*, 126 A.D.3d 76, 88 (1st Dep't 2015). All the Appellate Division did was allow Insurers to try to prove their public policy defense with admissible evidence. It did not hold that the SEC's "findings" could ultimately serve as a substitute for such evidence.

Insurers proffered scant evidence of any sort concerning the transactions that were the subject of the SEC investigation, but no evidence at all that any Bear

Stearns employee acted for the purpose of inflicting harm in connection with those transactions. Most of the alleged late trades were input directly by Bear Stearns' customers or their brokers without participation by any Bear Stearns employee. (R.1984-85; R.2567.) And in those instances when employees cleared such trades, they believed the investor had made its trading decision before the 4:00 p.m. close of trading, and the introducing broker submitted the trade later because the "manual process" took time. (R.2658; R.2675.) Late trading exploits "information obtained after the close of trading," *J.P. Morgan*, 21 N.Y.3d at 330 n.1, but the record contains no admissible evidence that Bear Stearns' employees believed the trades they processed were based on such information.

Moreover, market timing "is not per se improper," and different mutual funds have different "policies" about it, *J.P. Morgan*, 21 N.Y.3d at 330 n.1, as the record confirms. (R.6541-43; R.6581; R.6706-07; R.6898-6902.) Even the definition of market timing was "evolving" at the time, without the benefit of SEC guidelines. *SEC v. Pentagon Capital Mgmt. PLC*, 844 F. Supp. 2d 377, 414-15 (S.D.N.Y. 2012), *aff'd in part, vacated in part*, 725 F.3d 279 (2d Cir. 2013). That some Bear Stearns employees did not curb trading activity in some funds when other funds permitted the same activity is not evidence that those employees acted for the purpose of harming anyone. Indeed, Insurers' own expert, Zitzewitz, admitted to using a market timing trading strategy without intending to harm other investors. (R.2637-38.)

Insurers also argue that certain Bear Stearns employees attempted to conceal market timers' conduct by providing multiple account numbers to them. But a trader may be provided with multiple account numbers for legitimate purposes. *See SEC v. Ginder*, 752 F.3d 569, 572-73 (2d Cir. 2014). There is no evidence that Bear Stearns employees provided multiple account numbers to traders to conceal market timing. And even if a Bear Stearns employee did so, it would not follow that any such employee intended to inflict harm on anyone.

E. The Knowledge Exclusion Does Not Apply.

1. "Officer" in the Exclusion Means Top Managers, Not Thousands of Rank-and-File Employees.

Respondent Certain Underwriters at Lloyd's, London ("Underwriters"), with AAIC, contends that because Bear Stearns' by-laws classified 4,000 of its 10,000 employees as "officers," it follows that if any of those 4,000 employees knew of a Wrongful Act before March 21, 2000, such knowledge could be the predicate for applying the Knowledge Exclusion. That exclusion bars coverage for Claims based on Wrongful Acts before that date if a Bear Stearns "officer" knew of them and knew or should have known they would lead to a Claim. Underwriters contends that even if an employee would not be regarded, based on their responsibilities, as an "officer" under ordinary usage, the by-laws definition would still control. But if Underwriters and AAIC had intended the by-laws definition to trump the ordinary meaning of the term, they should have said so in their Policies. At a minimum, the Policy term is ambiguous and therefore must be construed in favor of coverage. *See Belt Painting*, 100 N.Y.2d at 383.

Underwriters says the ambiguity does not matter because Bear Stearns was a "sophisticated" insured. But this Court has never held that the rules for construing ambiguous language in insurance policies are suspended for sophisticated policyholders, much less where such language appears in a policy exclusion. Nor has Underwriters proffered any extrinsic evidence relevant to the meaning of "officer." Construction of the undefined term "officer" must turn, as it would for any insured, on the practical business reality of the insured rather than the rote application of a label from the by-laws.

2. Underwriters Failed to Meet Its Burden to Show That a Bear Stearns Officer Knew by March 21, 2000 of the Alleged Wrongful Acts at Issue or That They Could Lead to a Claim.

Contrary to Underwriters' characterization, Bear Stearns has never contended that it had only "four" officers in the sense relevant to the exclusion. Rather, the meaning of "officer" depends on ordinary usage, and Bear Stearns offered four examples of actual officers. However, even if all of Bear Stearns' 456 (R.6174) Senior Managing Directors were "officers," the exclusion would not apply. Underwriters lists nine people who held the title of Senior Managing

Director or higher, but does not offer evidence that any of those nine had the requisite knowledge of Wrongful Acts likely to lead to a Claim before March 21, 2000 needed to satisfy the exclusion.

Indeed, Underwriters failed to adduce admissible evidence that any Bear officer, under any definition of that term, had the requisite knowledge. Underwriters relies heavily on the SEC Order as purported evidence that the exclusion applies. The SEC Order establishes what Bear Stearns agreed to pay, what sections of the securities laws the SEC invoked, and what the SEC claimed it could prove, but it does not constitute evidence of the truth of the SEC's allegations. *See Lipsky*, 551 F.2d at 893; *In re Platinum*, 828 F. Supp. 2d at 594. Bear Stearns consented to the SEC Order "[s]olely for the purpose" of the SEC investigation, and expressly did so "without admitting or denying" the SEC's allegations. (R.1562.) Nor, in any case, does the SEC Order allege that any Bear Stearns officer knew of a likely Claim before March 21, 2000. Thus, Underwriters' reliance on the allegations in the SEC Order to prove that "during the period 1999 to 2003," Bear Stearns' officers, even if viewed as "senior management" (Underwriters' Brief at 33), knew of "late trading and deceptive market timing" is misplaced.

On summary judgment, it was incumbent on Underwriters to proffer admissible evidence, rather than allegations, that a Bear Stearns "officer" knew the company was facilitating late trading and that a Claim would result. To establish knowledge at the corporate level, the securities laws require proof that "senior officers" knew the relevant fact. *See, e.g.*, *Jackson v. Abernathy*, 960 F.3d 94, 99 (2d Cir. 2020). Underwriters failed to make that showing. Its evidence shows only that two employees who were not officers even under Underwriters' definition told their supervisors, on unstated dates, that customers canceled or sought to cancel unidentified trades for unspecified reasons. (R.5452-53; R.5492.)

As for market timing, Underwriters had to proffer evidence that before March 21, 2000, a Bear Stearns officer not only knew that customers were timing, but had reason to believe it was deceptive and that a Claim would result. That burden was all the more steep because there is no evidence that any mutual fund customer ever threatened to sue Bear Stearns. The evidence is only that some funds asked Bear Stearns to help curb market timing. Underwriters points to no case suggesting that such requests are sufficient to trigger the exclusion.

Underwriters argues that a previous SEC investigation of Bear Stearns, involving improprieties by a Bear Stearns customer called A.R. Baron, somehow alerted Bear Stearns that it could be liable for aiding and abetting violations of the securities laws by its customers that resulted in "complaints." A.R. Baron is irrelevant, as it had nothing to do with market timing or the mutual fund investigation. The SEC did not allege any violation of the A.R. Baron Order in the SEC Order.

3. Underwriters Has Not Established, and Bear Stearns Did Not Admit, That the Alleged Wrongful Acts Were "Interrelated."

Even if it were applicable (which Bear Stearns' disputes), the Knowledge Exclusion would bar coverage at most for Claims for Wrongful Acts the insured knew before March 21, 2000 could lead to a Claim. (R.1264.) As for later "Wrongful Acts, " coverage is only barred if those acts are shown to be "interrelated" with Wrongful Acts known before March 21, 2000. (*Id.*) As the proponents of the exclusion, Insurers had the burden to establish "from the actual facts" that "this loss falls *entirely* within the policy exclusion as claimed." *Servidone*, 64 N.Y.2d at 425 (emphasis added); *Westpoint*, 71 A.D.3d at 562. Insurers have failed to establish that any conduct alleged in the SEC Order after March 21, 2000 (the bulk of the conduct at issue) was "interrelated" to any pre-March 21 conduct. Thus, even if Underwriters (and AAIC) had proved a Known Wrongful Act before March 21, 2000 – and it has not – the Knowledge Exclusion could not relieve them of responsibility to indemnify Bear Stearns for the bulk of its Loss, which arose from transactions after March 2000.

"Interrelated Wrongful Acts" is not a defined term in any of the Policies. Courts construing "interrelated" have interpreted it narrowly and consistently held it to mean more than "related," requiring a mutual relationship between the acts in question rather than mere similarity. Thus, a "common set of circumstances" – such as events involving "the same deficient corporate structure or [party's] lack of oversight" – is "insufficient" to establish Interrelated Wrongful Acts. *Glascoff v. OneBeacon Midwest Ins. Co.*, 2014 U.S. Dist. Lexis 64858, at *18-20 (S.D.N.Y. May 8, 2014). At most, that is what is at issue here – a common lack of sufficient oversight over customers' trading.

Rather than offer proof of interrelatedness, Underwriters claim that Bear Stearns "admits" in four paragraphs of its Amended Complaint that the alleged Known Wrongful Acts occurring before March 21, 2000, are "Interrelated Wrongful Acts" with Wrongful Acts that allegedly occurred thereafter. But Bear Stearns has made no such admission. Bear Stearns alleged merely that some acts that were the subject of the SEC investigation were also the subject of the Civil Actions, and that some expenses that Bear Stearns incurred in responding to the investigation also applied to the Civil Actions. Bear Stearns did not "admit" that any post-March 2000 conduct was interrelated with pre-March 2000 conduct.

F. The National Union Policy Does Not Include the Knowledge Exclusion.

National Union seeks to raise a Knowledge Exclusion defense even though it did not plead such a defense in its Answer (R.345-77) and the Knowledge Exclusion is absent from its Policy (R.658-67). The only support it offers is that in

August 2001, a year after the inception of it Policy, it issued a binder purporting to amend the Policy to "follow the terms and conditions" of the primary Vigilant Policy except with respect to Loss arising from Known Wrongful Acts as of March 21, 2000. (R.671.) The binder does not add or reference the terms of a particular Knowledge Exclusion.

Once a formal policy is issued, the policy controls over any binder. *See Springer v. Allstate Life Ins. Co. of New York*, 94 N.Y.2d 645, 649 (2000). Parties may amend a policy by endorsement, but such an amendment is effective only when the endorsement is issued. (R.693.) National Union's affiant admitted that no endorsement was ever issued. (R.656 ¶ 8.)

G. The Award of Prejudgment Interest Was Proper.

Insurers contend the Court cannot reach the prejudgment interest issue because Respondents have "no liability" under the Judgment. But Bear Stearns had a judgment against all Insurers, with interest, and the current Judgment, entered because of the Decision, eliminates that interest. The prejudgment interest issue is thus properly before the Court by virtue of its power to provide "complete relief," *Hecht*, 60 N.Y.2d at 62, in this eleven-year-old case.

CPLR 5001(a) requires courts to award prejudgment interest, from the earliest possible date, to compensate the prevailing party for loss "because of breach of performance of a contract." "Because of" means "by reason of" or "on account of," a concept that "incorporates" the "standard of but-for causation." *Bostock v. Clayton Cty., Ga.*, 140 S. Ct. 1731, 1739 (2020). The CPLR 5001(a) obligation does not depend on a party's fault; what matters is that, because of a contract breach, the defendant retained funds the plaintiff would otherwise have received. *See Aurecchione v. N.Y. State Div. of Human Rights*, 98 N.Y.2d 21, 27 (2002) (rejecting defendant's contention that it should not pay prejudgment interest because delay in payment was caused by another party). For that reason, coinsurers liable for contribution have been required to pay prejudgment interest even though they have not breached a contract with the insured or a paying insurer. *See, e.g.*, *U.S. Fire Ins. Co. v. Fed. Ins. Co.*, 858 F.2d 882, 888 (2d Cir. 1988).

The same reasoning applies here. Even if it were true that some of the excess Insurers did not breach, Bear Stearns suffered a covered loss when it had to pay the SEC settlement itself in 2006. That loss predictably flowed from breach of performance of an insurance contract to which the entire insurance tower subscribed and from which all Insurers benefitted. They all repudiated that obligation, and were enriched at Bear Stearns' expense.

All excess Insurers argue that they are not liable for prejudgment interest because each excess Policy purportedly requires as a condition precedent to payment that all of the underlying Insurers have already paid. Even if their Policies said that (as discussed below, most do not), CPLR 5001 would require the award of prejudgment interest in any case. Moreover, the IAS Court correctly cited *Varda, Inc. v. Insurance Co. of North America*, 45 F.3d 634, 640 (2d Cir. 1995) and *Granite Ridge Energy, LLC v. Allianz Global Risk U.S. Ins. Co.*, 979 F. Supp. 2d 385, 393 (S.D.N.Y. 2013), to hold that all Insurers are liable for prejudgment interest accruing since 2006, notwithstanding any such condition precedent in their Policies, because all Insurers "repudiat[ed] coverage" before the SEC settlement. *J.P. Morgan*, 151 A.D.3d at 633.

Insurers' only answer to this well-settled law overriding supposed conditions precedent to payment is to claim that such law does not apply because only conditions requiring action by the insured are excused. Insurers cite no authority for that mistaken position. And their argument amounts to saying, nonsensically, that while each of them would be liable for prejudgment interest if it breached independently of the others, they are excused from liability because they all breached in lockstep. Perhaps worse, by the illogic of Insurers' argument, Bear Stearns could recover prejudgment interest if it failed to fulfill a condition precedent, but would be barred from recovering by conduct of others (Insurers failing to provide coverage), which is beyond Bear Stearns' control.

In any event, Insurers' argument is wrong based on the language of the Policies, which makes clear that the Insurer's obligation attaches once the settlement payment is made by the insured itself, which occurred in 2006. For instance, the National Union Policy says the payment of the "Total Underlying Limits" can be by the "Underlying Insurers *and/or the Insureds*," *i.e.*, Bear Stearns. (R.1239 (emphasis added).)

Similarly, Travelers' Policy requires it to pay "for Loss by reason of exhaustion by all payments" of underlying limits. (R.1170.) "[A]ll payments" includes payments by Bear Stearns. Indeed, *Ali v. Federal Insurance Co.*, 719 F.3d 83 (2d Cir. 2013), cited by Insurers, indicates that the necessary payment could be by the insured itself. *See id.* at 92. Thus, Insurers' distinction of *Zeig v. Massachusetts Binding & Insurance Co.*, 23 F.2d 665 (2d Cir. 1928), based on the fiction that the policy there did not specify that payment had to be by an insurer and the Travelers Policy supposedly does, is groundless.

The Liberty Mutual Policy requires exhaustion by reason of the underlying Policies' paying "or being held liable to pay." (R.1248.) Those underlying Insurers became liable in 2006. The attachment provision does not condition Liberty Mutual's attachment on the timing of the legal determination, but rather on whether Liberty Mutual was liable. At the very least, the provision is ambiguous in this regard and must be construed in Bear Stearns' favor.

While the Federal Policy requires exhaustion by payment by a carrier, Federal is an affiliate of Vigilant, which created the primary breach. (R.2140; R.2170.) Federal participated in that repudiation and breach jointly with Vigilant through Chubb; the positions taken in the claims-handling correspondence, which constituted a repudiation of coverage, were asserted on behalf of both Federal and Vigilant. (*Id.*)

In sum, most of the excess Policies do not contain the condition precedent upon which excess Insurers rely, the purported condition precedent was excused when Insurers repudiated, and all excess Insurers are in any case responsible for prejudgment interest under CPLR 5001.

CONCLUSION

For all of the foregoing reasons, the Decision should be reversed and the judgment in favor of Bear Stearns should be reinstated.

Dated: New York, New York
October 8, 2020

PROSKAUER ROSE LLP

By: Steven E. Obus

Steven E. Obus
Francis D. Landrey
Seth B. Schafler
Matthew J. Morris
Eleven Times Square
New York, New York 10036
Tel.: (212) 969-3000
Fax: (212) 969-2900

Attorneys for Appellants

PRINTING SPECIFICATIONS STATEMENT

This computer-generated brief was prepared using a proportionally spaced typeface.

Name of Typeface: Times New Roman

Point Size: 14 point

Line Spacing: Double

The total number of words in the brief, inclusive of point headings and footnotes and exclusive of pages containing the table of contents, table of authorities, proof of service, certificate of compliance, or any authorized addendum, is 9,981.

The Court granted Bear Stearns permission to file a reply brief of up to 10,000 pages in a letter from John P. Asiello to Steven E. Obus dated September 17, 2020.