To Be Argued By:
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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 PITTSBURGH, PA., LIBERTY MUTUAL INSURANCE COMPANY, CERTAIN UNDERWRITERS AT LLOYD'S, LONDON, and AMERICAN ALTERNATIVE INSURANCE CORPORATION,

Defendants-Respondents.

BRIEF FOR DEFENDANTS VIGILANT INSURANCE COMPANY AND FEDERAL INSURANCE COMPANY AND DEFENDANT-RESPONDENT LIBERTY MUTUAL INSURANCE COMPANY

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PRELIMINARY STATEMENT

Defendants Vigilant Insurance Company ("Vigilant") and Federal Insurance Company ("Federal") and Defendant-Respondent Liberty Mutual Insurance Company ("Liberty Mutual") (collectively, "Defendants" or "Insurers") respectfully submit their brief in opposition to the appeal of Plaintiffs-Appellants J.P. Morgan Securities LLC, f/k/a J.P. Morgan Securities Inc., J.P. Morgan Clearing Corp., and The Bear Stearns Companies LLC (collectively, "Bear Stearns" or "Bear") from (i) the judgment of Supreme Court, New York County entered on September 23, 2019 (the "Judgment") dismissing Bear's Amended Complaint as to Defendants National Union Fire Insurance Company of Pittsburgh, Pa., Liberty Mutual, Certain Underwriters at Lloyd's, London, and American Alternative Insurance Corporation, and severing the remaining claims in the Amended Complaint as to Vigilant, The Travelers Indemnity Company, and Federal, and so much of the (ii) the decision and order of the Appellate Division, First Department, dated September 20, 2018 that necessarily affected the Judgment.[1]

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[1] Vigilant and Federal participate in this appeal pursuant to this Court's established procedure. See Appalachian Ins. Co. v. Gen. Elec. Co., 8 N.Y.3d 162, 170 n.1 (2007).

<u>DISCLOSURE STATEMENT PURSUANT TO RULE 500.1(f)</u>

Vigilant Insurance Company is a wholly-owned, indirect subsidiary of The Chubb Corporation.

Federal Insurance Company is a wholly-owned subsidiary of The Chubb Corporation. The Chubb Corporation is a publicly-traded corporation.

Liberty Mutual Insurance Company is a wholly owned subsidiary of Liberty Mutual Holding Company Inc., a Massachusetts mutual insurance holding company.

COUNTERSTATEMENT OF QUESTIONS PRESENTED

1. If, as Bear contends, $140 million of its $160 million SEC disgorgement payment represents the gains of its customers, rather than its own gains, is the $140 million a covered "Loss" under the insurance policies at issue, which do not cover "penalties imposed by law" and require covered amounts to have been paid as "damages"?
2. If, as Bear contends, $140 million of the disgorgement payment represents the gains of its customers, does the New York public policy prohibiting indemnification for punitive assessments bar coverage for that portion?
3. Were Insurers entitled to summary judgment on the ground that the $140 million portion of the disgorgement payment in fact reflected Bear's own gains rather than the gains of Bear's customers, where (a) the only support for Bear's contention that the $140 million portion represents customer gains was hearsay; (b) the SEC stated publicly that it disgorged Bear of *its* gains; and (c) the SEC separately sought disgorgement from the Bear customers whose gains Bear contended it disgorged?
4. Did Supreme Court err by granting Bear summary judgment as to the reasonableness of its settlement with the SEC?

5. Did Supreme Court err by granting Bear summary judgment as to Insurers' defense based on the public policy barring coverage for intentional harm, where the evidence showed Bear facilitated harmful late trades and market timing—trading Bear knew was causing harm to mutual funds and investors?
6. Is Bear's claim for coverage for its $14 million settlement with private class action plaintiffs properly before this Court, where there is no final judgment as to that claim?

INTRODUCTION

In 2005, the Securities and Exchange Commission and the New York Stock Exchange investigated Bear Stearns for facilitating the illegal market-timing trades of Bear's favored hedge-fund customers. The SEC and the NYSE ordered Bear to pay $160 million that the SEC denominated disgorgement. Bear seeks indemnification for $140 million of this payment on the theory that the undivided $160 million exaction represents two separate figures: $140 million in gains reaped by Bear's customers from the illegal trades—which Bear claims is insurable—and $20 million Bear received in fees, which Bear concedes is not insurable.

Without deciding whether Bear's contentions about the $140 million were correct, the Appellate Division held that the $140 million payment was not a covered "Loss" under the insurance policies, which excise from coverage "penalties imposed by law." It also held that the $140 million was a punitive assessment uninsurable under New York public policy. SEC disgorgement, the Appellate Division reasoned, is a penalty because it punishes wrongdoers for offenses against the public. The Appellate Division added that, if the $140 million did represent the gains of Bear's customers, the exaction would be all the more clearly an uncovered penalty. Both holdings are correct and should be affirmed.

At base, Bear's litigation positions put it between a rock and a hard place. Bear recognizes that return of one's own ill-gotten gains is not insurable. Bear therefore built its case around the factual theory that $140 million of the disgorgement represents the gains of customers, rather than its own gains. But the policies do not cover penalties imposed by law, and the United States Supreme Court has now confirmed—in Kokesh v. SEC, 137 S. Ct. 1635 (2017), and Liu v. SEC, 140 S. Ct. 1936 (2020)—that disgorgement payments exceeding the wrongdoer's own profits from illegal conduct constitute penalties. Indeed, Liu held that such payments fall outside the SEC's authority *precisely because* they are penalties. Therefore, whether Bear's factual theory of the case is right or wrong—whether the $140 million represents Bear's own gains or customers'—the payment is neither covered by the insurance policies nor insurable under public policy.

This result does not, as Bear suggests, render the coverage illusory. What the policies cover are "damages" payments, such as imposed under the Martin Act. Damages have long been understood as compensation paid to injured victims to redress injuries. Although some regulatory exactions count as such, SEC disgorgement does not because it is not measured by harm to injured parties.

In the Argument below, we explain why the Appellate Division's holdings were correct. Contrary to Bear's meritless contentions, this Court's pleading-stage decision does not control the result here. The Court's opinion makes it clear that it did not address either (i) the contractual definition of "Loss" or (ii) the applicability of the public policy against indemnification of punitive assessments.

See Argument I.A. Thus, the First Department properly reached and correctly decided both issues. See Argument I.B. In any event, the Appellate Division's grant of Insurers' summary-judgment motion was proper on the alternative ground that the record brooks no material dispute that the $140 million represents Bear's *own* gains and is therefore uninsurable. See Argument I.C.

At a minimum, summary judgment in Bear's favor was not proper for two separate reasons. First, Bear failed to prove that its settlement with the SEC was reasonable. See Argument II.A. Second, the record creates at least a material dispute on the applicability of the public policy prohibiting indemnification for intentional harm. A wealth of evidence shows that Bear acted with full knowledge that the trades it actively facilitated were hurting mutual-fund investors. Indeed, Bear acknowledged this internally. See Argument II.B.

Finally, Bear attempts to inject into this appeal the insurability of a civil settlement Bear paid to class-action plaintiffs, but the final judgment before this Court does not encompass that claim. See Argument III. That claim is therefore not properly before this Court.

STATEMENT OF THE CASE

I. The Policies Do Not Cover Penalties

Insurers agreed to pay "all Loss which the Insured shall become legally obligated to pay as a result of any Claim or Claims first made against the Insured ...

for any Wrongful Act of the Insured." R-2864, §I.[2] "Loss" encompasses two categories of monetary payments, both of which are limited to damages:

1. "[C]ompensatory damages, multiplied damages, punitive damages where insurable by law, judgments, settlements, costs, charges and expenses *or other sums the Insured shall legally become obligated to pay as damages* resulting from any Claim or Claim(s)." Id., §II.B.1 (emphasis added).

2. "[C]osts, charges and expenses *or other damages* incurred in connection with any investigation by any governmental body or self-regulatory organization (SRO) ...." Id., §II.B.2 (emphasis added).

As the italicized phrases demonstrate, both categories of "Loss" are limited to damages. The first category covers damages the Insured becomes legally obligated to pay (such as pursuant to a judgment or settlement), whereas the second covers damages "incurred" in connection with a governmental or SRO investigation.

Furthermore, the Policies also excise from coverage two items. "Loss shall not include," the Policies state, "fines or penalties imposed by law" and "matters which are uninsurable under" New York law. Id.

II. Bear Is Investigated And Punished By The Securities And Exchange Commission And The New York Stock Exchange For Illegal Trading

Bear seeks indemnification for certain sanctions it was ordered to pay, and related expenses it incurred, as a result of regulatory investigations into unlawful

[2] All references to "R-__" refer to the Record on Appeal.

late trading and market timing Bear covertly facilitated between 1999 and 2003. As this Court recognized in an earlier decision in this litigation, late trading refers to "placing orders to buy, redeem or exchange mutual fund shares after the 4:00 pm close of trading, but receiving the price based on the net asset value set at the close of trading." J.P. Morgan Sec. Inc. v. Vigilant Ins. Co., 21 N.Y.3d 324, 330 n.1 (2013). This practice "allows traders to obtain improper profits"—at the expense of mutual funds and their shareholders—"by using information obtained after the close of trading," analogous to betting on a horse after the race was run. Id. Similarly, market timing "involves the frequent buying and selling of shares of the same mutual fund or the buying or selling of mutual fund shares to exploit inefficiencies in fund pricing," which is "deceptive if it induces a mutual fund to accept trades it otherwise would not accept under its own market timing policies." Id.

The SEC and NYSE commenced investigations of Bear's conduct in the fall of 2003. See R-9252, ¶9; R-9253, ¶11; R-9345; R-9371–472. The investigations continued for two and a half years. The SEC issued over 20 subpoenas and requests for documents, interviewed and deposed more than 40 current and former Bear employees, and collected hundreds of thousands of pages of documents from Bear's files. R-9253, ¶¶12–13; R-11398–99; R-9344–46; R-9371–9473; R-11405–19; R-9473–9594; R-9613–15. The SEC also collected information from other sources, including hedge funds that traded through Bear, its clearing clients, and the mutual funds themselves. R-9253, ¶14; R-9630–31.

The SEC sought—and obtained—information about every way that Bear profited. For example, Bear produced information showing both the direct revenues it earned from the illegal trades themselves *and* the revenues it earned from the other trades placed by market-timing customers. R-9256, ¶27; R-9651; see also R-9254–56, ¶¶19–21, 27; R-9641; R-9635; R-9557–58; R-9651. Bear also produced calculations of the gains it enabled its customers to reap from the illegal trades. R-9256, ¶28; R-9654–70.

In the second half of 2005, the SEC and Bear came to a settlement agreement. Bear agreed to pay a total of $250 million—$160 million of which the SEC described as disgorgement and $90 million of which it described as a civil penalty. R-9257, ¶31; R-9673; R-9714; R-11460; R-3440. The settlement is embodied in an Order of the SEC issued March 16, 2006, which contains the SEC's factual findings of Bear's improper conduct (which Bear neither admitted nor denied), the SEC's determination that Bear intentionally violated a host of federal securities laws, and the remedies imposed. See R-11422–463.

The NYSE issued substantively identical factual findings in a Hearing Panel Decision, which found Bear "guilty" of violations of various securities laws and NYSE rules, censured Bear, and imposed a $250 million sanction. R-3457–58; R-

3495. The NYSE sanction was deemed satisfied by Bear's payment of the SEC settlement. R-3495 n.2.

III. The SEC Found That Bear Facilitated And Concealed From Mutual Funds Illegal Trading That Bear Knew Would Harm Those Mutual Funds

The SEC Order summarizes the agency's factual findings in 210 detailed paragraphs. R-11423–459. The SEC's factual findings are damning, and, as shown below, the evidence confirms them. The SEC concluded that, from 1999 to 2003, Bear operated a "timing desk" ("TD") through which its employees acted as "consultants and trouble shooters" for Bear's favored hedge fund clients to further their systematic late trading and deceptive market timing. R-11423–24, ¶4; R-11431, ¶48.

With respect to late trading, Bear knowingly entered trades for selective customers after the 4:00 pm deadline, falsified order tickets to conceal the late trading, and assisted next-day cancellations of unprofitable late trades. R-11431, ¶¶48–49; R-11434, ¶75. For example, the SEC quoted the transcript of a phone call in which a TD supervisor advised one of Bear's in-house brokers that trades received after 4:00 pm—"after what's … a legitimate time"—should be marked as entered by or before 4:00 pm. R-11431, ¶48 ("What I'd like for you to do, we're going to populate either 4:00 pm or 3:59.")); see also R-9871; R-9875:24–9877:25.

Bear also "touted" its illegal late trading platform to its customers because "[t]he ability to enter trades after 4:00 p.m. was an important benefit" to them. R-11428, ¶32; see R-11428–29, ¶33; R-11435–36, ¶77; see also R-9862–63; R-9875:24–9877:25; R-9288–90. In another recorded conversation, the head of Bear's Mutual Fund Operations Department ("MFOD"), where Bear's TD was located, advised a broker that "we probably do the best clearance … on the Street on market timing." R-11429, ¶33. The MFOD head laughingly added: "you have plenty of time to do trades .... Pretty much a quarter to six, 5:45 to enter a trade." Id. Bear even made its trading system available to late traders so they could place trades after 4:00 pm themselves, with its TD ready to troubleshoot. R-11423–24, ¶4; R-11427, ¶24; R-11435, ¶77 ("Hedge Fund: 'They won't—I can't enter it. It won't let me enter it.' ... Timing Desk: 'Hold on. Let me open the system up for you.'").

With respect to market timing, Bear employed—and helped favored customers to employ—deceptive practices to conceal market-timing trades that violated the mutual funds' policies. These deceptive practices included:

> (1) opening new account numbers for blocked customer accounts and, in some cases, journaling funds from a blocked account to another account so the timer could continue timing the same mutual fund with the same money in a new account;

(2) creating new RR numbers to disguise timers from mutual funds;[3]

(3) assigning new branch codes to timers' accounts; and

(4) suggesting that timers trade in smaller amounts in order to avoid being detected as timers by mutual funds.

See R-11436–37, ¶81; see also R-9285–87.

The SEC Order is replete with examples of such fraudulent tricks. For instance, the SEC quotes an email from one of Bear's correspondent brokers recounting a call with a TD employee who had advised the broker that "if we want to trade in that fund family again, we have to use a different account AND rep number, otherwise they'll catch it again." R-11443, ¶116; see also id. ¶114.

In one remarkable email, a Bear employee tells his supervisors he opened new accounts for a particular broker "to keep 1 step ahead of the mutual fund companies." R-11446, ¶139; see also R-11449, ¶165 (quoting an email from one director to two other directors explaining that, "to keep the customer happy," Bear "change[s] the rr number on the trades or ... open[s] additional acct numbers … since the mf companies target certain office ranges and rr #'s and classify them as timers").

[3] "RR" stands for "registered representative." To evade mutual funds, Bear would "assign[] multiple RR numbers to registered representatives at [Bear] to try to conceal the identity of the traders." R-11423.

Bear well knew that mutual funds wanted to prevent market-timing. See also R-9285–87. Indeed, the SEC Order states that mutual funds sent Bear "thousands" of requests to stop facilitating market-timing. R-11428, ¶29; R-11437, ¶82; R-11439–441, ¶¶96, 97, 101, 103; R-11444, ¶124; R-11450, ¶172. Yet Bear persisted. In fact, after one mutual fund terminated its dealer agreement with Bear because of its processing of market-timing trades, Bear made a signed promise to that mutual fund, as a condition of reinstatement of its agreement, to implement a "systematic block . . . for known timers." R-11437, ¶84. Yet Bear "took no steps … to stop deceptive timing." R-11428, ¶30.

As detailed in Section II.B, Bear knew that the misconduct it facilitated was inherently harmful to mutual funds and their shareholders. The mutual funds made this clear to Bear. See infra 64. And one hedge fund even admitted to Bear that its trading harmed investors. See infra 65. Unsurprisingly, then, Bear's witnesses acknowledged under oath their awareness of the harmful impact of market-timing on mutual funds and their shareholders. R-9265–66, ¶¶66–67; R-3697:14–17; R3697:22–3698:2; R-3703:22–3704:6; see infra 65.

Furthermore, the SEC determined that "senior managers" and those at "the highest levels" of Bear knew the company regularly facilitated illegal trading, R-11446, ¶138; R-11450, ¶169; see also R-9818; R-3697:14–17; R-3697:22–3698:2; R-3703:22–3704:6; R-9859. The Chief Executive Officer of NYSE Regulation similarly declared in a press statement, “It is disturbing how so many people in so many different units [at Bear] worked to circumvent the blocks and restrictions set up by the mutual funds .... This type of behavior is completely outrageous and unacceptable.” R-9262, ¶56; R-3510.

Based on its factual findings—corroborated by the record amassed in this litigation—the SEC concluded that Bear Stearns had “willfully violated, willfully aided and abetted, and caused violations of” Sections 10(b), 15(c) and 17(a) of the Exchange Act and Section 17(a) of the Securities Act. R-11451–52, ¶¶179–84.

IV. <u>The $160 Million Disgorgement Payment Represents Bear’s Ill-Gotten Gains From the Illegal Trading Scheme</u>

In the trial court, the parties disputed the basis for the SEC disgorgement.

Bear argued that the disgorgement consists of two parts—$20 million reflecting Bear’s own revenue from the transactions at issue, which Bear agreed is uninsurable, and $140 million representing the ill-gotten gains of the customers whose illegal trades Bear facilitated. Bear pointed out that the SEC originally demanded $720 million to settle its claims. R-2022–23. According to Bear, that number was based on two estimates, using different calculation methods, that Bear provided to the SEC of how much Bear’s customers made from the illegal trading, one of $519 million and one of $306 million. R-9084–124. Bear then provided a third calculation of its customers’ gains of $140 million, using a so-called fair value calculation method, as well as an estimate of $16.9 million for the fees (*i.e.*, total revenue) Bear earned for clearing the illegal trades. R-9257–58, ¶¶36, 37; R-3357–58, ¶109; R-3378, ¶9; R-3243:3–13; R-3244:17–3245:7.

The outside counsel who represented Bear in the investigation, Lewis Liman, testified that someone at the SEC—at some unknown part of the chain of command—told him that "[t]he $160 million was based on the $140 million fair value customer gain estimate and $20 million to reflect Bear Stearns' gain, which ... is derived from the $16.9 million revenue figure." R-3378, ¶10; see also R-1092, ¶5. That testimony rests on a few scrawled lines on one page of the handwritten notes of Bear's counsel. R-3375, ¶3; R-9135–9142.

By contrast, the Insurers presented actual *evidence* that shows Bear disgorged *its own* ill-gotten gains. In the Commission's press release announcing the settlement, its Enforcement Director stated that, because of Bear's conduct, "market timers profited while long term investors lost. This settlement will not only deprive Bear Stearns ***of the gains it reaped*** by its conduct, but also require Bear Stearns to put in place procedures to prevent similar misconduct from recurring." R-9262, ¶54; R-3503 (emphasis added). The press release says *nothing* about Bear disgorging gains of its customers. Nor does the SEC Order. Indeed, the SEC separately investigated and obtained hundreds of millions in disgorgement from Bear's customers for the same trading. See, e.g., R-3010–26

($148 million from Millennium); R-3028–35 ($35.5 million from Veras); R-3037–48 ($30 million from Ritchie); R-3070–86 ($100 million from Canadian Imperial and CIBC).

In addition, Insurers' expert Professor Zitzewitz concluded that Bear earned hundreds of millions of dollars in revenue from hedge-fund customers engaged in illegal late trading and market-timing. R-9287–88. Professor Zitzewitz relied on data Bear produced to the SEC, which reflects approximately $350 million in revenue Bear received from customers engaging in the illegal trades. R-9287.

Bear's production to the SEC also shows that it evaluated the total revenue it earned from customers when deciding to let them use its illegal trading platform. R-9274, 9287–88. Bear employees testified that Bear accepted market-timing business *only* from customers who would provide other, more lucrative business. R-9269, ¶¶79–80; R-9915; R-9921:8–11. Bear thus used market timing both to maintain relationships with select customers and as a "sweetener," as Professor Zitzewitz noted, to attract other revenue. R-9274. This evidence accords with the SEC's conclusion that Bear offered its platform to "favored" customers. R-9260, ¶48; R-9262, ¶54; R-11423–24, ¶4; R-11427, ¶24; R-3503.

V. Bear Stearns Settled Investor Class Actions Predicated On Illegal Trading

Private plaintiffs brought 13 shareholder class action lawsuits against Bear relating to the same illegal mutual fund trading in the regulatory proceedings. Bear agreed to pay an additional $14 million to settle the private lawsuits. R-9262–63, ¶¶57-58.

PROCEDURAL HISTORY

Insurers promptly moved to dismiss Bear's Amended Complaint on several grounds, including that the SEC Order establishes the disgorgement payment was not insurable under New York law and that Bear committed intentionally harmful conduct. Justice Ramos denied the motion, and Insurers appealed. The Appellate Division reversed and dismissed the Amended Complaint. J.P. Morgan Sec. Inc. v. Vigilant Ins. Co., 91 A.D.3d 226, 234 (1st Dep't 2011).

In a pleading-standard decision, this Court reversed, ruling that the complaint was not properly dismissed at the "CPLR 3211 stage." J.P. Morgan Sec. Inc. v. Vigilant Ins. Co., 21 N.Y.3d 324, 336 (2013). The Court first held that "the documentary evidence [did] not *decisively* repudiate Bear Stearns' allegation that the SEC disgorgement payment amount was calculated in large measure on the profits of others." Id. (emphasis added). Similarly, the Court held that the findings by the SEC did not "*conclusively* demonstrate" that Bear had the "requisite intent to cause harm" for public policy to bar coverage. Id. at 335 (emphasis added).

After significant discovery, Justice Ramos granted Bear's motion for summary judgment seeking to dismiss Insurers' defenses and denied Insurers' cross-motion for summary judgment invoking the same defenses. The Court later entered judgment. R-480–83.

The Appellate Division reversed. J.P. Morgan Sec., Inc. v. Vigilant Ins. Co., 166 A.D.3d 1, 12 (1st Dep't 2018). It held that Bear's motion for summary judgment dismissing Insurers' defenses should have been denied, and granted Insurers' motion for summary judgment that Bear is "not entitled to coverage for the SEC disgorgement payment," stating "it is so declared." Id.

Explaining the latter ruling, the Court concluded that "the disgorgement paid by Bear" was neither a covered "'Loss' within the meaning of the policy" nor insurable under the public policy on punitive sanctions. Id. at 7–8. The Court held that the United States Supreme Court's decision in Kokesh v. SEC, 137 S. Ct. 1635 (2017)—consistent with "the long-standing legal principles on which it relied"—"fatally undermine" Justice Ramos's holding. 166 A.D.3d at 11. Thus, Kokesh "made clear that SEC disgorgement is a penalty because it punishes a public wrong, and its purpose is deterrence, whether you are remitting your own ill-gotten gains or those you generated for your customers through violations of the securities law, even if you did not directly share in those profits." Id. Indeed, the Court recognized that Bear's theory of the case was self-defeating: "[I]f the $140 million portion of the disgorgement payment ... reflects the gains of Bear Stearns's customers rather than of Bear Stearns itself"—Bear's central contention—"it makes it *more*, *not less*, of a penalty." Id. (emphasis added).

Bear moved the Appellate Division for leave to appeal to this Court. Insurers moved for clarification of the decision as to the $14 million civil settlement. The Appellate Division denied both motions.

On remand, Supreme Court (Schecter, J.) vacated the judgment entered by Justice Ramos. Supreme Court recognized that, whereas the Appellate Division determined that Bear was not entitled to coverage for the $140 million payment, Bear's claims for coverage of the $14 million civil settlement and certain defense costs remained unresolved. Supreme Court severed the remaining claims as against those Insurers at the bottom of the coverage tower. And it entered a final judgment in favor of those Insurers at the top of the tower, whose layers of coverage would not be reached even if Bear prevailed on its remaining claims. It is that severed, final judgment that is before this Court.

ARGUMENT

I. The Appellate Division Correctly Held That Bear Cannot Obtain Coverage For The $140 Million Portion Of Bear's Disgorgement

A. The First Department Did Not Contradict This Court's Pleading-Stage Decision.

Eliding the merits, Bear centers its argument on this Court's 2013 pleading-stage decision. Bear insists that this Court held categorically that Bear's disgorgement payment "is insurable under New York law, and is a covered 'Loss' under Respondents' insurance policies, to the extent the payment represented gains by Bear Stearns' customers[.]" Bear Br. 1–2. But Bear ignores the text of this Court's decision (barely quoting it), in which the Court expressly stated it *did not* address the meaning of "Loss" or the public policy against coverage for punitive assessments. Moreover, Bear brushes away this Court's repeated emphasis that its decision was subject to "the rules governing CPLR 3211 motions to dismiss" and that its ruling reflected that "early juncture" of the case. J.P. Morgan Sec. Inc. v. Vigilant Ins. Co., 21 N.Y.3d 324, 334, 337 (2013).

A holding "comprises only those statements of law which address[] issues which were presented to the [Court] for determination." Global Reins. Corp. of America v. Century Indem. Co., 30 N.Y.3d 508, 517 (2017) (quotation marks omitted). Yet Bear misreads or ignores this Court's own description of the specific issues that it determined to address, which arose from Insurers' CPLR 3211 motion. The Court unmistakably stated that it did not address either the meaning of covered "Loss" under the Policies or the public policy on punitive assessments.

With respect to coverage under the Policies, the Court recognized, in summarizing the arguments on Insurers' motion to dismiss, that "the Insurers do not earnestly dispute that the claims fall within the policy's definition of Loss." J.P. Morgan, 21 N.Y.3d 324 at 333. "***Rather***," the Court explained, the Insurers raised only "two public policy rationales" and "two insurance policy exclusions." Id. at 333-34 (emphasis added).

Having identified the issues before it,[4] the Court held that "the insurers are not entitled to a CPLR 3211 dismissal" on the basis of (as relevant here) the public policies. Id. at 330. First, the Court held that the "separate public policy" against insurance for "the risk of being ordered to return ill-gotten gains—disgorgement—" did not require dismissal because, taking Bear's contentions as true at the pleading stage, $140 million "did not actually represent the disgorgement of [Bear's] *own* profits." Id. at 335–36 (emphasis added). Second, the Court held that the "public policy exception for intentional injury" did not require dismissal because "the limited record before" the Court at this "early juncture" did not

[4] Indeed, the Court's analysis of *those* issues began with "[a]nalysis of the claims in this action." Id. at 334.

"conclusively demonstrate that Bear Stearns [] had the requisite intent." Id. at 330, 335-37.

The Court was therefore clear, as the Appellate Division recognized, that it issued no statement of law as to the meaning of "Loss." See R-15 ("[T]he Court of Appeals ... did not rely on the policy language in denying defendants' motions.").

Similarly, the Court did not rule on the applicability of the public policy on punitive assessments. To the contrary, the Court expressly distinguished the "separate" public policy on ill-gotten gains (which the Court analyzed) from the public policy on punitive assessments (which the Court did not analyze). J.P. Morgan, 21 N.Y.3d at 334–35. The Court explained that it had previously recognized two public policies barring insurance coverage—for punitive damages and for intentional harm—but that Insurers pressed "a separate public policy ground" against coverage for "being ordered to return ill-gotten gains." Id. at 335.[5]

These facts are inconvenient for Bear, and it ignores most of them in arguing the Court decided the questions of "Loss" and public policy on punitive assessments. As to the public policy on punitive assessments, Bear cites only the Court's passing citation of Zurich Insurance Co. v. Shearson Lehman Hutton (about which more below). 84 N.Y.2d 309 (1994).

[5] In its briefs before this Court, Bear recognized the distinction between the public policy on disgorgement and the public policy on punitive assessments. See Bear 2012 Opening Br. 26 ("[T]he prohibition on insurance recovery for ill-gotten gains is premised on the avoidance of the insured's unjust enrichment—not on the general deterrence of alleged wrongful conduct.").

With respect to contractual coverage, Bear focuses on the Court's observation that Insurers in 2013 did not "earnestly dispute" the issue of "Loss." According to Bear, that observation means the Court "necessarily rejected [Insurers'] 'Loss' arguments (or deemed them abandoned) when it remanded for proceedings to determine whether the payment was on account of third party gains." Bear Br. 25.

This makes no sense. The Court expressly stated it did not reach Insurers' "Loss" arguments, meaning that no binding holding on those arguments resulted. That the Court did not address those arguments is unsurprising, because Insurers dedicated barely two pages to those arguments in their brief, and because the Appellate Division did not address them. J.P. Morgan, 91 A.D.3d at 230–34 (resting its decision on the public policy against coverage for return of ill-gotten gains). The Court determined, in its discretion, to decide the appeal "on the narrowest ground available." Matter of Campagna v. Shaffer, 73 N.Y.2d 237, 240 (1989) (the Court of Appeals "traditionally" decides cases "on the narrowest ground available" and does not "reach ... other issue[s]" when it is unnecessary to do so). Were Bear correct that the Court necessarily issues a holding when it declines to address an undeveloped alternative argument, this Court would be required in every case to search the briefs in earlier appeals to see what it declined to address. To state Bear's unsupported, new-fangled jurisprudential rule is to refute it.

Nor could Insurers have "abandoned" their arguments that Bear's disgorgement payment is not a "Loss." There is no rule that a party's focus on certain arguments on a CPLR 3211 motion precludes it from making other arguments at summary judgment. See, e.g., 191 Chrystie LLC v. Ledoux, 82 A.D.3d 681, 682 (1st Dep't 2011) ("Our holding in relation to the prior motion to dismiss was based on the facts and law presented by the parties in that procedural posture, and no more.").[6] Both parties and courts would be ill-served by such a rule.[7]

B. Bear's Claim For Coverage Of The $140 Million Portion Of Its SEC Disgorgement Fails As A Matter Of Law

Bear acknowledges that its $160 million disgorgement payment is not insurable if it represented Bear's own ill-gotten gains. It argues, however, that $140 million was the disgorgement of third-party gains—those of Bear's customers—and that it is entitled to coverage for returning *those* ill-gotten gains. Bear is wrong.

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[6] See Friedman v. Conn Gen. Life Ins. Co., 9 N.Y.3d 105, 111, 116 (2007) (affirming Appellate Division, which "faulted Supreme Court" for treating order on motion to dismiss as dispositive of summary-judgment motion); In re Sipal Realty Corp., 8 N.Y.2d 319, 324 (1960).

[7] In any event, the law of the case doctrine is "not a limit to [courts'] power." People v. Cummings, 31 N.Y.3d 204, 208 (2018) (quotation marks omitted); see Aridas v. Caserta, 41 N.Y.2d 1059, 1061 (1977) (same); R-15–16 (same).

Even accepting *arguendo* that $140 million does represent third-party gains (the evidence is to the contrary, infra Argument I.C), Bear cannot meet its "burden to establish the existence of coverage" for that amount. Platek v. Town of Hamburg, 24 N.Y.3d 688, 694 (2015). As detailed below, and as the First Department held, Bear's payment of $140 million in (purported) third-party gains **(1)** constitutes an uncovered "penalt[y] imposed by law," R-2864, §II.B.2(i), rather than "damages" as required under the Policies for coverage; and **(2)** is uninsurable under the public policy on punitive assessments. Thus, the First Department was correct to "grant[]" Insurers' "motions for summary judgment declaring that plaintiffs are not entitled to coverage for the SEC disgorgement payment." R-21.

i. Bear's Disgorgement Payment Is Not A Covered "Loss" Under The Policies

The Policies instruct that "penalties imposed by law" do not constitute covered "Loss." R-2864, §II.B.2(i). In addition, to be covered "Loss," an amount must constitute "damages."[8]

1. The "parties' chosen words"—penalties and damages—have "legal import" and carry their ordinary legal meanings. See Burlington Ins. Co. v. NYC Transit Auth., 29 N.Y.3d 313, 321–24, 323 n.3 (2017) (applying general legal

[8] The requirement that an amount be "damages" is common to both prongs defining "Loss." The first prong makes clear that the amounts must be "pa[id] as damages," and the second prong enumerates covered amounts and adds a catchall for "*other damages*." Id. §II.B.1–2 (emphasis added).

principles to interpret the contractual terms "caused, in whole or in part" and disagreeing with the dissent that "our analysis is flawed for applying legal meaning to the plain words"). And in expounding "the legal import of the parties' chosen words," the Court looks to relevant "legal doctrine." Id. at 323; see Nau v. Vulcan Rail & Constr. Co., 286 N.Y. 188, 198–99 (1941) (contract invoking legal terms "was drawn with reference to applicable law," so terms should be given their "technical sense" in the law).

As the Appellate Division correctly recognized, centuries of law illustrate the difference between penalties and damages. See R-19 (invoking "longstanding legal principles").

A penalty (i) redresses a wrong to the public, not to an individual, and (ii) is primarily intended to punish and deter, not to compensate a victim for his loss. Thus, penalties are not measured by reference to "actual loss" suffered by victims. Sicolo v. Prudential Sav. Bank of Brooklyn, N.Y., 5 N.Y.2d 254, 258 (1959). By contrast, damages repair injury done to "the party who had sustained" the "damages." Brady v. Daly, 175 U.S. 148, 157 (1899). Thus, damages must be measured by reference to the injury suffered by the victim. See, e.g., Bates v. Holbrook, 89 A.D. 548, 554–55, 557–58 (1st Dep't 1904).

This distinction is well-settled. This Court recognized two hundred years ago that a "pecuniary penalty for a violation of, or nonconformity to, an act of

Congress, is as much a punishment for an offence against the laws, as if a corporal penalty had been inflicted." United States v. Lathrop, 17 Johns. 4, 9 (N.Y. 1819). And the United States Supreme Court has explained that penalties "go beyond compensation, are intended to punish, and label defendants wrongdoers." Gabelli v. S.E.C., 568 U.S. 442, 451–52 (2013); see also Black's Law Dictionary 1247 (9th ed. 2009) ("penalty" is, as relevant, "[p]unishment imposed on a wrongdoer, usu. in the form of imprisonment or fine; esp., a sum of money exacted as punishment for either a wrong to the state or a civil wrong (as distinguished from compensation for the injured party's loss)"). In other words, a penalty is "something imposed in a punitive way for an infraction of a public law." Meeker v. Lehigh, 236 U.S. 412, 423 (1915); see Sicolo, 5 N.Y.2d at 258 ("the true test" is whether the payment is primarily "impressed for punishment or redress of injury to an individual"); Huntington v. Attrill, 146 U.S. 657, 668 (1892) (same).

This Court has applied the distinction in multiple cases. For example, in a case involving a right of action for seaman's wages wrongly withheld, Judge Cardozo found the exaction—two days of "wages" for each day of delay—operated "not [as] punishment of the master or owner, but [as] compensation to the seaman." Cox v. Lykes Bros., 237 N.Y. 376, 378–79 (1924). The additional wages were "not to be classified as a penalty" because, as compensation, they were measured by reference to the seaman's "loss of opportunity to ship upon another vessel" and "hardship during the term of waiting" while "stranded far from home." Id. at 379; see also, e.g., Loucks v. Standard Oil Co. of New York, 224 N.Y. 99, 101, 103, 106 (1918) (Cardozo, J.) (Massachusetts statute not "penal" because it authorizes "action[s] … to recover damages for injuries resulting in death" and "[t]he executor or administrator who sues … is not the champion of … public justice" but rather "vindicates a private right"). Similarly, in State of New York ex rel. Grupp v. DHL Express (USA), Inc., this Court explained that a statutory penalty and treble damages "evince[] a broader punitive goal of deterring fraudulent conduct against the State" "rather than redressing the harm actually suffered." 19 N.Y.3d 278, 286–87 (2012). Unlike damages, a penalty primarily "punish[es] and consequently deter[s] such future conduct." Id. at 287.

2. The foregoing principles make clear the sanction imposed on Bear is a penalty.

First, SEC disgorgement undoubtedly remedies a public wrong—violation of federal securities laws—rather than a private injury. "The violation for which" SEC disgorgement "is sought," the Supreme Court has explained, "is committed against the United States rather than the aggrieved individual." Kokesh, 137 S. Ct. at 1643. Indeed, the Government agrees that "[w]hen the SEC seeks disgorgement, it acts in the public interest, to remedy harm to the public at large, rather than standing in the shoes of particular injured parties." Id. (quoting Brief for United

States at 22). The SEC is an "enforcer" and "a far cry from the defrauded victim." Gabelli, 568 U.S. at 451. Thus, unlike damages, SEC disgorgement is measured ***not*** by reference to the harm suffered by private parties, but by the wrongdoer's illicit gain. Bear does not dispute this.

Second, SEC disgorgement is necessarily "imposed for punitive purposes" where, as Bear alleges happened here, it is measured by third-party gains and exceeds a defendant's net profits from the misconduct. Kokesh, 137 S. Ct. at 1643; Liu v. S.E.C., 140 S. Ct. 1936, 1944–46 (2020). It is clear that the SEC's practice of (i) disgorging from a defendant third-party gains it never received and (ii) failing to consider "a defendant's expenses that reduced the amount of illegal profit" does not "simply restore the status quo; it leaves the defendant worse off," which confirms its punitive nature. Kokesh, 137 S. Ct. at 1644–45; Liu, 140 S. Ct. at 1944–46. Indeed, New York courts have long held that requiring a wrongdoer to account for payments owed by others is punitive. See Bird v. Hayden, 24 N.Y. Super. Ct. 383, 22 Abb. Pr. N.S. 61, 65–66 (1863) (statute imposing liability on officers for corporation's debts for neglecting duty "is in the *nature* of a penalty, and was designed as a *punishment*").[9]

[9] See also Merchants' Bank v. Bliss, 35 N.Y. 412, 416–17 (1866) (statute imposing joint and several liability on officers for debts of the company "impose[s] a penalty"); Dabney v. Stevens, 32 N.Y. Super. Ct. 415, 10 Abb. Pr. N.S. 39, 44 (1870) (same).

Moreover, the fact that deterrence is "[t]he justification for this practice" of requiring disgorgement of more than a malefactor's net profits "demonstrates that disgorgement ... is a punitive, rather than remedial, sanction." Kokesh, 137 S. Ct. at 1645. "Sanctions imposed for the purpose of deterring infractions of public laws are inherently punitive because 'deterrence [is] not [a] legitimate nonpunitive governmental objectiv[e].'" Id. at 1643 (quoting Bell v. Wolfish, 441 U.S. 520, 539 n.20 (1979)); cf. Sperry v. Crompton Corp., 8 N.Y.3d 204, 214 (2007) ("the traditional purposes of penalties" are to "punish[]" and "deter[]").[10] Indeed, ***Bear's own expert***—former SEC Chairman Harvey Pitt—averred that the SEC's practice of "requir[ing] [defendants] to disgorge more than they may have obtained" is "***not*** designed to make injured investors whole," but rather furthers the SEC's "broader purpose—namely, to discourage any person from 'facilitating' the violative conduct of others[.]" R-1787; R-1799–1800 (emphasis added); see also Kokesh, 137 S. Ct. at 1643 ("[D]eterrence is not simply an incidental effect of [SEC] disgorgement," but its "primary purpose.").

And Bear alleges that the SEC imposed precisely this punitive sanction: disgorgement (i) of third-party gains Bear never received and (ii) that exceeded what Bear claims were its net profits from the wrongdoing. Bear claims the $160

[10] See also, e.g., Trop v. Dulles, 356 U.S. 86, 96 (1958) ("If the statute imposes a disability for the purposes of punishment—that is, to reprimand the wrongdoer, to deter others, etc., it has been considered penal.").

million represents two figures in a "fair value" analysis it gave the SEC: $140 million "of gains to … customers" and $20 million, an unstated "rounding up" from Bear's calculation that "its own revenues from handling the transactions at issue amounted to $16.9 million." Bear Br. 10–11; R-2604 (Liman) (same); see also R-2606; R-1806. Importantly, however, although it calculated $16.9 million in ***revenues***, Bear has alleged it made ***zero profits or gains***. R-108, ¶86 ("[T]he fees at issue … were designed merely to cover Bear Stearns' costs."); id. ¶88 ("Bear Stearns … did not share in any profits its customers earned ... or benefit in any other substantive way[.]").

Thus, on Bear's own view, it earned zero profits but paid $160 million—clearly a penalty. The Appellate Division rightly emphasized this point, reasoning that, "if the $140 million portion … reflects the gains of Bear Stearns's customers rather than of Bear Stearns itself, it makes it *more*, *not less*, of a penalty." R-19 (emphasis added). This is common sense: *Of course* a federal enforcer punishes when it requires wrongdoers to "disgorge" gains they never received. Critically, like other penalties, Bear's exaction was calculated with ***no reference*** to the harm suffered by victims.

3. If there was any doubt on this score, the Supreme Court has just dispelled it. Surveying hundreds of years of jurisprudence, the Supreme Court confirmed that the very disgorgement Bear claims the SEC imposed—disgorging the defendant of (i) gains exceeding net profits and (ii) gains (purportedly) obtained by third parties—amounts to "a penalty." Liu, 140 S. Ct. at 1942–46. Indeed, because either form of disgorgement is a penalty, it is "outside" the "equitable powers" Congress gave the SEC. Id. at 1944. Thus, the SEC has never had the authority to obtain disgorgement "in excess of a defendant's net profits from wrongdoing," as Bear alleges occurred here. Id. at 1946.

First, the Court explained that equity principles—incorporated by Congress into the statute—require that disgorgement be "limited … to the net profits from wrongdoing, that is, 'the gain made upon any business or investment.'" Id. at 1945 (quoting Rubber Co. v. Goodyear, 9 Wall. 788, 804 (1870)). The reason for this limitation? To *avoid* turning disgorgement "into a punitive sanction." Id. at 1942.

Second, the Court noted, disgorgement of third-party gains runs against "the common-law rule requiring individual liability for wrongful profits." Id. at 1949. That rule, like the limitation to net profits, prevents the "equitable profits-focused remedy" from being "transform[ed] … into a penalty." Id. For example, in Elizabeth v. Pavement Co., the Supreme Court held that disgorgement could be had *only* from "[t]he party who made the profit by" infringing activity and not from the other liable party, which "made no profit at all." 97 U.S. 126, 140 (1878) (cited in Liu, 140 S. Ct. at 1945, 1949).

To be sure, Liu recognized an exception allowing "joint-and-several" liability on "partners engaged in concerted wrongdoing." 140 S. Ct. at 1945. But that exception applies only where profits are shared jointly by the wrongdoers. Indeed, in the case the Supreme Court cited, the participant in a fraudulent scheme disgorged gains from patents he *jointly* held with another wrongdoer. See id. (citing Ambler v. Whipple, 20 Wall. 546, 559 (1874) (finding the participant, Dickerson, liable for "half of both the patents to Dickerson and Whipple, and of the profits made … of them")). In Liu itself, where the Court suggested that the exception might apply, the wrongdoers were a *married couple* whose "finances were … commingled." Liu, 140 S. Ct. at 1949. The exception thus comports with the "profits-based" nature of the disgorgement remedy. Id. at 1944–45, 1948, 1950. What matters is "which party realized profit from the transactions." Elizabeth, 97 U.S. at 140. Here, Bear claimed it "did not share in any profits its customers earned." R-108, ¶88; see R-89, ¶9. And it never suggested (nor could it) that it commingled its finances with customers' or anything similar.

In short, both hallmarks stressed in Liu are present here under Bear's theory. Bear claims it paid gains it never received, and every penny it "disgorged" exceeded its own gains—leaving Bear far worse off. Such a sanction undeniably operates as a penalty.

4. Bear's arguments to the contrary fail.

First, Bear dismisses Kokesh as "inapposite" and says it "has no bearing" on this case. Bear Br. 2–3. (Presumably, Bear will say the same about Liu.) As the Appellate Division explained, however, and as Kokesh shows, "the Supreme Court analyzed the fundamental nature and purpose of the SEC's disgorgement remedy, which does not change into some different nature for purposes of insurance coverage." R-19. The principles Kokesh invoked are mirrored in venerable New York cases. Compare Kokesh, 137 S. Ct. at 1642, with Lathrop, 17 Johns. at 9; supra 26–29. Similarly, Liu examined general legal principles. These foundational legal meanings—not any particular consideration springing from the statutes in those cases—establish that Bear's disgorgement is a penalty. And the parties incorporated these legal meanings into the phrase "penalties imposed by law." See Nau, 286 N.Y. at 198–99.

Second, Bear complains that its "reasonable expectation" in entering the Policies was that they "would cover ... third party disgorgement." Bear Br. 25–26; see id. at 4. Bear's declaration of its subjective intent years ago is pure *ipse dixit*. More to the point, it is *unreasonable*. There has long been caselaw holding that disgorgement is limited to a wrongdoer's own illicit profits. E.g., SEC v. Blatt, 583 F.2d 1325, 1335 (5th Cir. 1978) ("disgorgement [beyond] the amount with interest by which the defendant profited from his wrongdoing …. would constitute a penalty assessment"); SEC v. World Gambling Corp., 555 F. Supp. 930, 931

(S.D.N.Y. 1983) ("To the extent that joint liability requires payment of a sum greater than the profits unlawfully gained by the fraudulent transactions, it is a penalty and therefore improper.").[11]

In any event, Bear's purported subjective intent in entering the Policies is irrelevant. "The intention of the parties is found in the language used to express such intention." Nau, 286 N.Y. at 198. Thus, "[a]ll that matters is the language adopted by the parties to the insurance policy at issue in this appeal." Burlington, 29 N.Y.3d at 324; see Hotchkiss v. Nat'l City Bank of New York, 200 F. 287, 293 (S.D.N.Y. 1911) (Hand, J.) (same). The case Bear cites is in accord. In re Viking Pump, Inc., 27 N.Y.3d 244, 257 (2016) ("[I]nsurance contracts, like other agreements, should be enforced as written[.]") (quotation marks omitted). This bedrock principle of contract interpretation means that the "reasonable expectation of the averaged insured" in agreeing that "penalties imposed by law" are not covered is that if the law holds an amount is a penalty and not damages, it is not covered. Viking, 27 N.Y.3d at 257.

Nor would enforcing the Policies as written mean that Bear purchased illusory coverage. To the contrary. The Policies cover Loss incurred in any

[11] The World Gambling court elaborated: "Had [defendant] proved that he obtained only a certain amount from the scheme, then he could conceivably have argued convincingly that, despite his extensive participation in the conspiracy, he should not be required to disgorge what he did not receive." Id.

There are a number of other similar cases. See, e.g., SEC v. Yun, 148 F. Supp. 2d 1287, 1291 (M.D. Fla. 2001) (citing cases).

government investigation, including by state attorneys general. To take a notable example, the Martin Act authorizes the Attorney General and district attorneys to seek "damages for injured parties." Kerusa Co. LLC vv. W10Z/515 Real Estate Ltd. P'ship, 12 N.Y.3d 236, 244 (2009). Those damages are measured by harm to victims.[12] The coverage Bear bargained for is real, just not as extensive as Bear would like. See Eujoy Realty Corp. v. Van Wagner Comm'cns, LLC, 22 N.Y.3d 413, 424 (2013) ("[T]he parties must live with the consequences of their agreement.").

Third, Bear strangely insists that the SEC Order—*not* the Policies—is the relevant contract, such that coverage is required because the SEC imposed a *different* sanction denominated a "civil penalty." Bear Br. 26–27. This makes no sense. Insurers were not parties to the SEC Order. The question here is whether the disgorgement Bear paid is a penalty imposed by law under the insurance contracts between Bear and Insurers.[13] The labels in the SEC Order do not govern that inquiry. Cf. United States v. Constantine, 296 U.S. 287, 294 (1935) ("Disregarding the designation of the exaction [as a tax], and viewing its substance

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[12] See Brief for State of New York, People v. Greenberg, 2012 WL 9502920, at *52 (N.Y.) ("Awards of damages are particularly critical … where defendants do not receive money or property from victims that may be subject to disgorgement[.]").

[13] Bear cites Navigators Insurance Co. v. Sterling Infosystems, Inc., but there the First Department explained, consistent with Insurers' position, that statutory damages did not constitute a penalty because "the actual and the statutory damages serve the same purpose"—to "compensate for actual damages sustained," rather than "to penalize intentional misconduct." 145 A.D.3d 630, 631 (1st Dep't 2016).

and application, we hold that it is a penalty[.]"). The fact that the SEC *also* imposed what it called a civil penalty does not mean that its disgorgement of third-party gains was not a penalty. See supra 29–32; Kokesh, 137 S. Ct. 1635. Bear elsewhere disclaims a labels-only approach. Bear Br. 18 ("insurability does not depend on how a remedy is 'labeled'"). Rightly so.

Moreover, if labels were to control, the NYSE imposed what it described as a "penalty" on Bear for the very $160 million amount at issue (to which label of "penalty" Bear consented) and deemed it satisfied by payment to the SEC. R-1637; R-9262; see R-3429.

Fourth, Bear claims that the term "penalty" is ambiguous "in the context of a settlement payment not denominated as ... a separate civil penalty," contradicting its position before the First Department that the term is *un*ambiguous. Bear Br. 29; Bear 1st Dep't Br. 53–54. This is meritless. A contractual term "does not become ambiguous merely because the parties urge different interpretations." Olin Corp. v. Am. Home Assurance Co., 704 F.3d 89, 99 (2d Cir. 2012). Moreover, a contractual term is either ambiguous as written or not; the term "penalty" does not transform from unambiguous to ambiguous because of a specific "context." See Riverside S. Planning Corp. v. CRP/Extell Riverside, L.P., 13 N.Y.3d 398, 404 (2009) ("Ambiguity is determined by looking within the four corners of the document, not to outside sources.") (quotation marks omitted).

The cases Bear cites undermine its position. Bear cites a Supreme Court case for the proposition that "'[p]enalty' is a term of varying and uncertain meaning." Life & Cas. Ins. Co. v. McCray, 291 U.S. 566, 574 (1934). Bear Br. 28. In McCray, Justice Cardozo rejected a challenge under the Due Process Clause to a state statute assessing, where payments under a life insurance policy had been improperly withheld, a "fixed award of damages" on top of the amount of the payments. 291 U.S. at 570. The Supreme Court reasoned that the *label* did not govern; "[t]he measure, not the name, controls." Id. at 572–73. And because the exaction "b[ore] a reasonable proportion to the loss" by the aggrieved party, it was not an unconstitutional "penalty" depriving the insurer of "access to the courts." Id. Thus, Justice Cardozo's decision in McCray reflects the same functional analysis that Judge Cardozo applied in Cox and Loucks (and the Supreme Court applied in Kokesh and Liu) in determining whether an exaction is a penalty.

Similarly, Borden v. 400 E. 55th St. Associates, L.P. ***stands for the opposite proposition Bear cites it for***. 24 N.Y.3d 382 (2014). This Court explained that "the word penalty does have a specific definition that does not apply to actual damages" and—disregarding "the nomenclature" of penalty used by the State—found "recovery of the base amount of rent overcharge to be actual, compensatory damages, not a penalty." Id. at 390. Again, substance and not form governs.

Fifth, Bear argues that the First Department "based" its decision on "new law created many years later," purportedly committing error. Bear Br. 29. Not so. As Insurers argued to the First Department and supra, the legal meaning of penalty springs from centuries of common law, and that settled law controls the meaning of the contractual term "penalty imposed by law." The First Department recognized as much. R-19 (invoking the "longstanding legal principles" articulated in Kokesh as a basis for its decision). Thus, in context, when the First Department elsewhere characterized Kokesh as "a change of law," it should be understood as saying no more than that Kokesh applied the settled meaning of penalty to a new factual setting—SEC disgorgement. R-16. Indeed, in both Kokesh and Liu the Supreme Court did not perceive itself to "change" the law, but merely to apply it. 137 S. Ct. at 1643; 140 S. Ct. at 1947. See People v. Favor, 82 N.Y.2d 254, 263 (1993) (no "new legal principle" is created where "a court's ruling merely applies previously established principles in a new factual setting").

5. Even if SEC disgorgement were not a penalty, it is still not paid as "*damages*," as the Policies require. R-2864, §II.B.1, §II.B.2 (emphasis added). As discussed, it has long been settled that damages compensate injured victims, and are therefore measured by the harm suffered. Supra 27–29. Thus, SEC disgorgement—which is not measured by calculating injury to victims—cannot be "damages" under the Policies. Haines v. St. Paul Fire & Marine Ins. Co., 428 F.

Supp. 435, 441 (D. Md. 1977) (SEC disgorgement is not "damages" under policy); see SEC v. Commonwealth Chemical Sec., Inc., 574 F.2d 90, 102 (2d Cir. 1978) (Friendly, J.) ("Unlike damages, [disgorgement] is a method of forcing a defendant to give up the amount by which he was unjustly enriched[.]").

Bear tellingly abandons its argument below that SEC disgorgement qualifies as "damages."[14] Instead, it claims that the $140 million is "Loss" because it falls within coverage for (1) "settlements" and "expenses" due to a "Claim" and (2) "costs ... incurred in connection with" a regulatory investigation. Bear Br. 24. This is implausible. A "settlement" (like a "judgment") is just a context in which damages are paid. And Bear's argument that disgorgement is covered as "expenses" and "costs" has no limiting principle. If disgorgement is an "expense" or a "cost," what isn't covered? "Expenses" and "costs" refer, rather, to payments incidental to a legal or regulatory proceeding, like "charges." Cf., e.g., Education Law §3812(1) (requiring officials involving in "any action or proceeding" to account for "all costs, charges and expenses paid").[15]

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[14] Bear 1st Dep't Br. 50. Originally, Bear claimed that the "entirety" of the $160 million amount was insurable as "compensatory damages." R-90.

[15] See also, e.g., State Finance Law § 190(6)(a) (successful qui tam plaintiffs "shall also receive an amount for reasonable expenses … and costs").

ii. Public Policy Bars Coverage For Bear's Disgorgement To The SEC Of Third-Party Gains As An Uninsurable Punitive Assessment

The \$140 million portion of the SEC payment—as envisioned by Bear to be payment of its customers' gains—is uninsurable for another reason. New York law prohibits insurance of punitive assessments to preserve the force of "punishment for intentional wrongdoing." Pub. Serv. Mut. Ins. Co. v. Goldfarb, 53 N.Y.2d 392, 400 (1981). "The rationale underlying this public policy exception emphasizes that allowing coverage 'would defeat the purpose of punitive damages, which is to punish and to deter others from acting similarly.'" J.P. Morgan, 21 N.Y.3d at 334 (quoting Home Ins. Co. v. Am. Home Prods. Corp., 75 N.Y.2d 196, 200 (1990)). Here, both law and common sense instruct that requiring a wrongdoer to account for gains another party received is a punishment. Supra 29–33.

SEC disgorgement of third-party gains "is imposed for punitive purposes"—to punish and to deter. Kokesh, 137 S. Ct. at 1643; supra 30–31. Bear's own expert—former SEC Chairman Harvey Pitt—explained as much:

> The SEC's Enforcement Program is not designed to make injured investors whole .... SEC enforcement actions also have a far broader purpose—namely, to discourage any person from "facilitating" the violative conduct of others ....

R.1799–1803. Indeed, as Pitt explained, the SEC has "required" defendants "to disgorge more than they may have obtained from violative conduct[.]" R-1800.

Again, Bear claims (implausibly) that it earned ***zero*** profits from the illicit transactions at issue. Thus, on Bear's own theory of the case its payment of $140 million in third-party gains is necessarily a punitive sanction.

In response, Bear asserts that public policy permits coverage of what it denominates a "dual-purpose remedy," and that SEC disgorgement is such an insurable remedy notwithstanding its punitive nature because the SEC ultimately returned Bear's disgorgement to investors. Bear Br. 2–3. Bear is wrong. Bear relies on one case—Zurich Insurance Co. v. Shearson Lehman Hutton—but it does not support Bear's position. 84 N.Y.2d 309 (1994).

Zurich is far narrower than Bear claims. For one thing, Zurich presented special comity concerns not present here. The Court explained that "[t]he question is whether New York's public policy precluding indemnification should prevail over the public policies of [other] judgment States, which allow indemnification." Id. at 313.[16] Having thus framed the issue, this Court analyzed whether New York public policy barred coverage for a sum a jury awarded under a Georgia statute authorizing a plaintiff to obtain "additional damages" ***either*** "to deter the wrongdoer" ***or*** "as compensation for the wounded feelings of the plaintiff." Id. at 316.

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[16] See Appellant Br., Zurich, 1994 WL 16044815, at *49 (1994) (arguing that "[t]he application of New York public policy would totally eviscerate the legitimate concerns of the judgment-rendering states").

In the peculiar circumstances of Zurich, the jury award could have been composed of compensatory damages, punitive damages, or a combination of the two, because "there was evidence to support" the imposition of "each." Id. Thus, as the insured argued, it was "impossible to determine whether the jury … contemplated an exemplary or a compensatory purpose, or indeed both." Id. In other words, this Court had no factual basis to conclude the jury award did not contain as little as $1 or $0 in punitive damages. The exaction in Zurich was therefore ***not*** "dual-purpose," to use Bear's new-fangled label, but rather an indeterminate exaction—possibly fish, possibly fowl, or a fish and a fowl put together. Indeed, had the jury specified that a certain amount of the award were compensatory damages and the rest punitive damages, public policy would prohibit indemnification of "that part of [the] damage award … in excess of compensatory amount." Rental & Mgmt. Associates, Inc. v. Hartford Ins. Co., 206 A.D.2d 288, 288 (1st Dep't 1994).[17]

Thus, Zurich can stand only for the proposition that where an award is indeterminate—such that it is unknown whether the award is compensatory damages, punitive damages, or a combination—then public policy will not categorically bar coverage. Indeed, Zurich reaffirmed the usual rule that "when the

[17] See Sperry, 8 N.Y.3d at 214 (treble damages a penalty under statute because "[a]lthough one third of the award unquestionably compensates a plaintiff for actual damages, the remainder necessarily punishes [and] deters").

damage award is of a 'punitive nature' … indemnification [is] precluded by New York policy." 84 N.Y.2d at 317.

Zurich has no application here because the SEC's imposition of (alleged) third-party disgorgement on Bear was inherently punitive. See id. (New York public policy bars coverage for Texas judgment where "there is no evidence that the award was for other than deterrent purposes").

Bear nonetheless insists that the disgorgement is insurable because the SEC gave it to investors. That argument proves too much—the SEC *also* gave Bear's $90 million civil penalty to investors, and Bear concedes that this amount is an uninsurable penalty. Indeed, disgorgement ***cannot*** be a compensatory remedy because—like civil penalties—it is not measured by reference to the harm suffered by the injured victims. Supra 27–29; see SEC v. Tome, 833 F.2d 1086, 1096 (2d Cir. 1987) ("the district court possesses the equitable power to grant disgorgement without inquiring whether, or to what extent, identifiable private parties have been damaged" because "[w]hether or not any investors may be entitled to money damages is immaterial") (quotation marks omitted).

Bear's argument also misses a critical point. As Judge Cardozo explained, "the same provision may be penal as to the offender and remedial as to the sufferer," and "[t]he nature of the problem will determine whether we are to take one viewpoint or the other." Cox, 237 N.Y. at 380. Indeed, punitive damages—to which the public policy typically applies—are also awarded to the injured plaintiff. And in DHL Express, this Court noted that the State's "imposition of civil penalties" was "punitive" and did not "redress[] the harm actually suffered" by the State, even though such penalties are awarded to the State and the qui tam plaintiffs bringing the suit. 19 N.Y.3d at 286–87; State Finance Law §190(6)(a). The dispositive question is whether the imposition ***on Bear*** of the disgorgement of third-party gains was a punitive sanction. It was; under Bear's telling, the SEC could have disgorged the $140 million from Bear's customers, but chose instead to require Bear to pay the sanction—thereby punishing Bear. Public policy therefore bars indemnification.

C. Even If Disgorgement Of Third-Party Gains Were Insurable, Bear Is Not Entitled To Coverage Because It Disgorged Its Own Gains, Not Third-Party Gains

Even if disgorgement of third-party gains were insurable and a covered "Loss," the judgment should still be affirmed because the evidence showed that the $140 million was Bear's own gains and thus uninsurable on a separate public-policy ground.

As Bear concedes, New York law "preclud[es] indemnity for disgorgement" to "prevent the unjust enrichment of the insured by allowing it to, in effect, retain the ill-gotten gains by transferring the loss to its carrier." J.P. Morgan, 21 N.Y. 3d at 337. To obtain summary judgment, Bear was required to show there was no material issue of fact as to whether the $140 million represents third-party gains. Bear failed to meet that burden. The ***one and only*** tangible support Bear relied on—the testimony of its counsel about what was said by someone who was somewhere in the chain of command at the SEC—is textbook hearsay. Indeed, Insurers were entitled to summary judgment because the only permitted conclusion from the admissible evidence is that Bear's entire $160 million disgorgement payment reflected its own gains. Thus, the First Department correctly ruled that Bear is not entitled to coverage for $140 million of the disgorgement. C.f., e.g., Congel v. Malfitano, 31 N.Y.3d 272, 287 (2018) ("affirm[ing] on an alternative ground").

1. The SEC Order itself does not divide the $160 million disgorgement amount into portions. Bear's sole support for the proposition that $140 million of that amount represents customer gains is the testimony and handwritten notes of its outside counsel, Lewis Liman, that an unidentified person at the SEC told him so. Counsel submitted two affidavits describing his recollection of the negotiations and sat for four days of deposition. The affidavits state that someone (never identified) at the SEC "advised" counsel in a June 2005 phone call that the SEC staff was willing to recommend a settlement payment of $250 million, consisting of a $90 million penalty and $160 million disgorgement. Counsel further testified that the SEC staffer said $140 million of the disgorgement amount was "based on the estimation of the gains of Bear Stearns' customers." R-1092, ¶5; see also R-1098, ¶10 (attaching counsel's handwritten notes of the call).[18]

Counsel candidly admitted that, "[w]ith respect to the $160 million disgorgement figure, how the SEC arrived at that and their numbers I don't know." R-1114:19–21. He acknowledged that "the only thing I know is what the SEC [staffer] told me" (R-3270:12–13). The key Bear personnel had no independent recollection, either. Bear's general counsel, its Senior Managing Director, and its board of directors knew *nothing* of how the SEC arrived at its number. See R-3294:2–3297:16; R-3193:18–3194:17, R-3194:25–3195:5; R-3452:11–13; R3799:6–9. The statements conveyed by counsel are thus the only support Bear was able to muster for its position.

But counsel's testimony and handwritten notes about what someone at the SEC told him the $140 million number was "based on" is classic hearsay. "Out-of-court statements offered for the truth of the matters they assert are hearsay." Nucci ex rel. Nucci v. Proper, 95 N.Y.2d 597, 602 (2001). The statements of the SEC staffer counsel offered in his testimony and notes were out-of-court statements, and Bear offered them for "the truth of the matters they assert." Id. Bear's own arguments show as much: Bear argues that the hearsay statements are evidence

[18] Even taken on their own terms, the handwritten notes are no reliable guide to the SEC negotiations. See R-9135–42.

"that the $140 million consisted of third party gains." Bear Br. 36. The statements support Bear's contention only if offered for their truth—that the SEC "based" $140 million of the disgorgement on Bear's customer gains. Cf. United States v. Sampson, 898 F.3d 287, 308 (2d Cir. 2018) (FBI agent's interview notes were inadmissible hearsay because "offer[ed] … as an accurate reflection of what occurred during [the] interview").

Bear tries to avoid this bedrock rule by advancing the new-fangled assertion that "[e]vidence of what one party demanded in a negotiation … is not hearsay." Bear Br. 34. Unsurprisingly, Bear can eke no support from the two New York cases it cites. Smokes 'n' Sweets, Inc. v. W. Lake Associates does not even mention hearsay. 227 A.D.2d 757 (3d Dep't 1996). And the other case held that price tags on stolen jackets were not hearsay for purposes of showing "selling price," which was "their market value for Penal Law purposes." People v. Giordano, 50 A.D.3d 467, 467–68 (1st Dep't 2008). Of course, the "verbal acts" of price tags are light years from an assertion from an unknown SEC staffer somewhere in the agency's chain of command about how Bear's disgorgement payment was calculated.

The federal case Bear cites is equally off-point. In Twin City Fire Ins. Co. v. Country Mut. Ins. Co., the dispositive issue was whether a matter could have been resolved for less than $700,000. 23 F.3d 1175, 1182–83 (7th Cir. 1994). Judge

Posner held that a letter reporting a lawyer's bare demand of $500,000 "made in a pretrial conference" was admissible "as a verbal act" because *its "truth is irrelevant."* Id. By contrast, Bear's case turns *entirely* on whether the SEC's statement to counsel was true—*i.e.*, whether it is true that $140 million of the disgorgement was calculated "based on the estimation of the gains of Bear Stearns' customers." R-1092, ¶5.

Bear's near-total reliance on hearsay meant that Insurers' motion for summary judgment should have been granted. E.g., Zuckerman v. City of New York, 49 N.Y.2d 557, 562 (1980) ("error" to "conclude[] that the hearsay affirmation by … counsel was sufficient … to preclude the grant of summary judgment").

2. Indeed, setting aside this rank hearsay, there was no support for the contention that the disgorgement represents third-party gains.

Bear relies on the following reasoning. Bear provided to the SEC three estimates of its customers' ill-gotten gains—$519 million, $306 million, and $140 million—as well as a $16.9 million estimate of Bear's own fees from processing its customers' illegal trades. Because $16.9 million is close to $20 million, Bear insists, the SEC *must* have simply rounded up, and the remaining $140 million *must* represent customer gains. This is the chain of feeble inferences that Justice Ramos accepted.

Those inferences are pure conjecture. Bear's theory is that the SEC simply took Bear's lowest calculation of its customer gains at face value. That is to say, where the SEC conceivably *could* have asked for as much as $519 million, it chose instead to aim for $140 million. Nothing justifies that unlikely supposition, apart from the bare facts that $160 million can be divided into $140 million and $20 million, and $16.9 million can (perhaps) be considered close to $20 million. Such "bald, conclusory assertions [and] speculation … are insufficient to defeat summary judgment," let alone justify a *grant* of summary judgment. Stonehill Capital Mgmt., LLC v. Bank of the West, 28 N.Y.3d 439, 448 (2016).

Nor does Michael Quinn's testimony rescue Bear. Bear claims that Quinn "replicated the calculations, confirming that the data compiled by Bear Stearns … did in fact yield the $140 million." Bear Br. 35. So what? Bear's calculations under ***its*** chosen methods may be arithmetically accurate, but that hardly provides a non-speculative basis to conclude the SEC's undifferentiated $160 million exaction was actually divided as Bear says. Thus, the testimony raised an irrelevant fact, not a material one.

3. The record evidence showed that the SEC disgorged Bear's own gains.

First, it is undisputed that the SEC separately investigated Bear's customers and obtained distinct orders forcing them to disgorge ***hundreds of millions*** in their own ill-gotten gains. Supra 16–17. This fact alone powerfully contradicts Bear's account. After all, if the SEC accepted Bear's position that Bear had repaid its customers' gains, how could it separately and additionally seek disgorgement from those customers? Cf. R-1801 (Pitt) (SEC disgorgement "may not exceed the total amount of gain from the illegal action"); SEC v. Contorinis, 743 F.3d 296, 301 (2d Cir. 2014) ("[T]he disgorgement amount may not exceed the amount obtained through the wrongdoing."). Bear has no answer.

Second, Bear's claim that the SEC's calculation of its ill-gotten gains was limited to Bear's $16.9 million processing fees is but speculation. At the time, the SEC often measured disgorgement by a wrongdoer's direct *and indirect* gains. E.g., Contorinis, 743 F.3d at 306 (including "illicit benefits … that are indirect or intangible"); SEC v. Wyly, 71 F. Supp. 3d 399, 404 (S.D.N.Y. 2014) (same); SEC v. Tome, 638 F. Supp. 638, 639–40 (S.D.N.Y. 1986) (same). Although Liu clarified that the SEC may not reach beyond net profits, it cannot and did not retroactively alter what the SEC did in Bear's case.

Indeed, the evidence strongly supports the inference that the $160 million reflects the SEC's practice of disgorging both direct and indirect benefits. The SEC requested—and Bear produced—documents showing *all* the money Bear made from its market-timing customers. See supra 10. As Insurers' expert Dr. Zitzewitz explained, those documents established that Bear earned *at least $350 million* from other business with those customers—that is why Bear facilitated their illegal trading in the first place. Supra 17; see R-9287–88.[19] In other words, the SEC sought to identify *all* the gains that Bear reaped.

Bear dismisses Dr. Zitzewitz's calculation—which used the documents Bear provided the SEC—that Bear earned $350 million as "wholly irrelevant" and "speculative" because (Bear says) that is not how the SEC calculated Bear's earnings. Bear Br. 35–36 n.9. This begs the question. How the SEC calculated Bear's earnings is the very inquiry at issue, and Dr. Zitzewitz's work powerfully shows that the entire $160 million amount was the SEC's best attempt to recoup Bear's large amount of gains. Indeed, it strains belief to suppose Bear risked so much for so long in facilitating illegal trading for a paltry $16.9 million in revenue (yielding, according to Bear, zero profits).

Finally, Justice Ramos dismissed the best evidence of how the SEC itself viewed the disgorgement remedy—the press release accompanying the SEC Order. When the SEC publicly announced the settlement, the SEC's Enforcement Director stated that the settlement with Bear would "deprive Bear Stearns of the gains ***it reaped*** by its conduct," and said nothing about Bear disgorging the gains of others. R-3503 (emphasis added). That statement—unlike the hearsay on which Bear

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[19] Justice Ramos thus erred in concluding that the SEC accepted as fact Bear's claim that it made "virtually no profit" from the illegal trading. (R-447–48; R-133, ¶24.) For that proposition Justice Ramos relied *solely* upon Bear's outside counsel, who stated only that he "recall[ed] no further dialogue with the SEC staff" regarding Bear's revenue calculation. (R-1096, ¶6.) That snippet is hardly probative, as counsel barely recalled the discussions with the SEC.

relies—is admissible. See Moses v. Westchester Cnty. Dep't of Correction, 2017 WL 4386362, at *10–11 (S.D.N.Y. Sept. 29, 2017) (admitting into evidence under the public-records exception a U.S. DOJ report "and accompanying press release").[20]

The only permitted conclusion is that the SEC's $160 million figure represents Bear's own unlawful gains. Bear presented no "evidentiary proof in admissible form sufficient to require a trial of material questions of fact" on this question. Gilbert Frank Corp. v. Fed. Ins. Co., 70 N.Y.2d 966, 967 (1988). For this independent reason, Insurers' motion for summary judgment that the entire disgorgement payment is uninsurable should have been granted.

II. In The Alternative, This Court Should Remand For Further Proceedings On The Grounds Of (i) The Reasonableness Of Bear's Settlement With The SEC And (ii) The Public Policy Prohibiting Indemnification Of Intentionally Harmful Conduct

In the alternative, this Court should hold that Bear was not entitled to summary judgment on its coverage claim for the $140 million and remand for further proceedings regarding (i) the reasonableness of Bear's settlement with the

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[20] See also Gen. Mills Operations, LLC v. Five Star Custom Foods, Ltd., 703 F.3d 1104, 1108–09 (8th Cir. 2013) (USDA press release "falls within the public-records hearsay exception"; "[T]he press release sets out findings from an investigation pursuant to authority granted by law, and is therefore admissible."); Cramer v. Kuhns, 213 A.D.2d 131, 135–36 (3d Dep't 1995) ("deriv[ing] some guidance ... from … the Federal counterpart to CPLR 4520"). Even if it is not, "hearsay evidence may be considered to defeat a motion for summary judgment as long as it is not the only evidence submitted in opposition." Fountain v. Ferrara, 118 A.D.3d 416, 416 (1st Dep't 2014).

SEC and (ii) the applicability of the public policy barring indemnification for intentionally harmful conduct.

A. Bear Failed To Prove The Reasonableness Of Its Settlement With The SEC

To obtain insurance coverage for any part of the settlement with the SEC, Bear had to prove it was reasonable. As Supreme Court correctly recognized, Bear was required to show "potential liability ... culminating in a settlement in an amount reasonable in view of [1] the size of possible recovery and [2] degree of probability of claimant's success." R-460 (citing Luria Bros. & Co. v. Alliance Assur. Co., 780 F.2d 1082, 1091 (2d Cir. 1986)).[21] But Bear failed to do so, and that failure required denial of its motion for summary judgment.

Bear claims "the amount of the disgorgement payment to the SEC was reasonable" because (1) "the size of the potential liability was at least triple the amount of the settlement"; (2) "the risk of liability was substantial"; and (3) Bear paid the settlement "with no guarantee that it [would] be reimbursed." Bear Br. 41–43. These contentions are unavailing.

[21] See also Olin Corp. v. Ins. Co. of North America, 221 F.3d 307, 321 (2d Cir. 2000) ("insured need establish … that the settlement was reasonable"). Bear argues that Insurers carry the burden, but its cases do not support that proposition. See Deutsche Bank Trust Co. of Americas v. Tri-Links Inv. Trust, 74 A.D.3d 32 (1st Dep't 2010) (no mention of burden); Servidone Constr. Corp. v. Sec. Ins. Co. of Hartford, 64 N.Y.2d 419, 423 (1985) ("the reasonableness of the settlement amount is [not] disputed"); PepsiCo, Inc. v. Continental Cas. Co., 640 F. Supp. 656, 662 (S.D.N.Y. 1986) ("Continental has now made clear that it finds the settlement is reasonable as a whole.").

First, as to "the size of possible recovery" (Luria, 780 F.2d at 1091), Bear's assertion (which Justice Ramos accepted) that the SEC settlement *must* be reasonable because it was lower than the highest potential settlement numbers is untenable. R-422–23. Under Luria, it was *Bear*'s obligation to demonstrate reasonableness. The bare fact that a party pays less, even much less, than initial demands says nothing about probable recoveries and the strength of each side's case. See, e.g., Tom Baker & Sean J. Griffith, Ensuring Corporate Misconduct 62, 136–37 (2010) (doubting insured's incentive to arrive at reasonable settlement).

Moreover, "Congress prohibited the SEC from seeking an equitable remedy in excess of a defendant's net profits from wrongdoing," and Bear alleges that the SEC did ***exactly that*** in its settlement. Liu, 140 S. Ct. at 1946. Thus, Bear claims the SEC accepted Bear's calculation that it earned only $16.9 million in revenues (and accepted that Bear made zero profit), but nonetheless required Bear to pay $160 million in disgorgement. Accepting Bear's contentions *arguendo*, Bear's decision to agree to disgorge third-party gains disregarded its meritorious legal defenses. Cf., e.g., Societe Generale Energie Corp. v. N.Y. Marine & Gen. Ins. Co., 368 F. Supp. 3d 296, 303 (S.D.N.Y. 2005) ("the settlement was unreasonable" given insured's "meritorious defenses to [adversary's] claims").[22]

[22] Nor can Bear convincingly plead ignorance of the law that disgorgement cannot reach beyond a wrongdoer's own illicit profits. Supra 35–36 (citing cases).

Second, Bear's (unsupported) claim that the liability risk was "substantial" is belied by the fact that Bear refused to provide basic information necessary to evaluate the settlements.[23] Bear offered *no* analysis of its liability exposure to the SEC, of the merits of the SEC's charges, or of the merits of its defenses. To be sure, as Justice Ramos noted, Bear did "permit[] extensive interrogation of its former legal counsel, Lewis Liman." R-425. But Mr. Liman was prevented on privilege grounds from answering questions about the basis for Bear's settlement with the SEC, including questions about Bear's evaluation of the SEC's charges, Bear's defenses, and its rationale for settling. See, e.g., R-9259, ¶45; R-3189:25–3190:15; R-3291:11–17; R-3295:7–10; R-3225:16–21; R-3275:18–3276:4; R-3451:19–3452:13. Bear was free to invoke the privilege, but must live with the consequences of its decision not to provide any information.

Bear notes that its motion to dismiss the class action was denied. That non sequitur says nothing about the ***SEC's*** probability of success at trial. Nor did Pitt opine about that. R-1787. What's more, as Bear's Wells submission attests, Bear believed it had strong defenses (even putting aside the meritorious contention about the limits of SEC disgorgement just discussed). R-1967–2041.

Despite recognizing the correct legal standard, Justice Ramos failed to apply it. He focused first on a meaningless fact—Bear was "undoubtedly potentially

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[23] R-9263, ¶¶59–60; R-3202:11–3203:13; R-3300:4–25.

liable"—and then simply compared the highest settlement numbers in the record to the final numbers. Under that approach, insureds would effectively bear no substantive burden. All they need do is settle for less than an opening demand.

B. Bear Did Not Meet Its Burden To Show That The Public Policy Barring Indemnification Of Intentionally Harmful Conduct Did Not Apply

To guard against moral hazards, New York law prohibits indemnification for a party's intentionally harmful conduct. See Goldfarb, 53 N.Y.2d at 400 ("[S]uch indemnity would be to violate the fundamental principle that no one shall be permitted to take advantage of his own wrong.") (citation and internal quotation marks omitted); see also Wausau Underwriters Ins. Co. v. United Plastics Grp., Inc., 512 F.3d 953 (7th Cir. 2008) (Posner, J.) (coverage for "the intentional infliction of a tortious harm" poses "obvious" risks "of moral hazard (the disincentive that being insured removes to engage in the conduct insured against)"); Baker & Griffith, supra, at 60 (noting "particular problem" of "moral hazard" "in the context of corporate D&O coverage"). After this Court held that the SEC Order did not "conclusively" show such intentional harm at the pleading stage, Insurers developed a detailed factual record demonstrating that Bear did, in fact, act with the requisite intent. R-9264–67. In concluding otherwise, Supreme Court improperly brushed aside Insurers' evidence.

1. The law makes clear that a person intends harm where he knowingly takes an action with substantial certainty that the harm will result. See, e.g., Copart Indus., Inc. v. Consol. Edison Co. of New York, Inc., 41 N.Y.2d 564, 571 (1977) (harm is "intentional" where "the actor … knows that [the harm] is resulting or is substantially certain to result from his conduct"); Union Carbide Corp. v. Affiliated FM Ins. Co., 101 A.D.3d 434, 435 (1st Dep't 2012) (an insured "intended the damages" if he had an "expectation of damage"); City of Amsterdam v. Daniel Goldreyer, Ltd., 882 F. Supp. 1273, 1285 (E.D.N.Y. 1995) (painting over artwork is intentional harm because the harm was "reasonably foreseeable").[24]

Brushing aside this caselaw, Bear argues that public policy bars coverage only if Bear "knew and intended" that its illegal conduct "would directly and immediately harm particular investors—not merely that they allegedly acted without regard to the likelihood of such harm." Bear Br. 44–45. Common sense and the law are to the contrary.

The moral hazard animating the public policy is present as long as the insured acted with certainty of resulting harm: If an insured is certain his act will

[24] See also, e.g., Restatement (Second) of Torts §8A (1965) ("The word 'intent' … denote[s] that the actor desires to cause consequences of his act, or that he believes that the consequences are substantially certain to result from it."); Vumbaca v. Terminal One Grp. Ass'n L.P., 859 F. Supp. 3d 343, 379 (E.D.N.Y. 2012) ("Under New York law, … [a] result is intended if the act is done … with knowledge that to a substantial certainty such a result will ensue …."); Cont'l Ins. Co. v. Colangione, 107 A.D.2d 978, 979 (3d Dep't 1985) ("damages which flow directly and immediately from an intended act … thereby preclud[e] coverage").

cause harm but knows he will be indemnified for it, he lacks a disincentive to refrain. Thus, in accordance with the authorities cited above, the proper formulation is the one Bear adopted before the First Department: An insured intends harm where "the insured knew that the damages *would* flow *directly and immediately* from its intentional act." Bear 1st Dep't Br. 73 (quoting City of Johnstown, N.Y. v. Bankers Standard Ins. Co., 877 F.2d 1146, 1150 (2d Cir. 1989) (citations omitted)). That standard necessarily includes cases in which an insured acted with substantial certainty that harm would result.

The stingy alternative Bear now proposes—the public policy applies only where the insured's conscious objective is to cause the harm—makes no sense. Bear would afford coverage to every insured whose acts inflict injury, no matter how certain the injury was to occur, when the insured's objective is to turn a profit. Under Bear's view, unsurprisingly, the entire financial industry—in which firms that knowingly inflict harm presumably always do so to make money—would never be at risk from this public policy. See Bear Br. 49 (actions are immune if "taken for the purpose of obtaining profits"). That is not how courts have assessed intent in the securities-law context. The Second Circuit, for example, has explained that intent to deceive and defraud exists under the securities laws "[w]hen it is clear that a scheme, viewed broadly, is necessarily going to injure" and "a defendant could have foreseen the consequences of his actions but forged ahead nonetheless." AUSA Life Ins. Co. v. Ernst & Young, 206 F.3d 202, 220–21 (2d Cir. 2000). As detailed below, that is exactly what happened here.

Indeed, Bear's cases do not support its position. Bear grasps for support from Baldinger v. Consol. Mut. Ins. Co., in which the trial court determined that the tortfeasor—"*an infant six years of age*"—did not intend to harm another infant by shoving her. 15 A.D.2d 526, 526 (2d Dep't 1961) (emphasis added), aff'd, 11 N.Y.2d 1026 (1962). That peculiar case says only that the harm a six-year-old caused another child by a shove was "the unintended result of an intentional act," but does not say what it means for a result to be unintended. Id. Thus, Baldinger stands for the simple proposition that a child is less likely to expect the harm that may flow from her actions. Surely Bear does not expect to be judged by the undemanding standards of cognition applicable to a six-year-old. Nor should it receive such solicitude, since the record precludes any inference Bear acted with cherubic innocence.

Bear's other cases are similar far afield. Town of Massena v. Healthcare Underwriters Mutual Insurance Co. held only that the recklessness standard for actual malice in defamation law does not require intent. 98 N.Y.2d 435, 445 (2002). Slayko v. Security Mutual Insurance Co. is about an intentional act exclusion, not the public policy. 98 N.Y.2d 289 (2002). Moreover, in that case, the evidence showed that the tortfeasor neither intended nor expected to injure the victim when he discharged a gun because he "believ[ed] the gun to be unloaded" and "was surprised when the gun discharged." Id. at 292–93. Thus, the Court in Slayko did not even address the public policy question, let alone whether the public policy distinguishes between an insured who acts with the objective of causing harm and one who acts with certainty that harm will result.

2. Here, Insurers adduced evidence showing at least that Bear acted with substantial certainty of harm to mutual funds and their investors. Bear's summary judgment motion should therefore have been denied.

The SEC's factual findings, summarized above, powerfully illustrate Bear's awareness of the harm it was causing. Bear claims that the SEC Order is inadmissible. Justice Ramos, too, suggested that SEC Order should not be accepted as true because Bear "neither admitted nor denied its findings." R-457. But this Court, in 2013, considered the SEC's findings as part of the public policy analysis. J.P. Morgan, 21 N.Y.3d at 335 ("The SEC order … undoubtedly [found] Bear Stearns' numerous securities laws violations to be willful[.]").[25] And the First Department correctly held that Insurers may rely on the SEC Order here. J.P.

[25] Notably, Bear earlier took a different position before this Court. Bear argued, more modestly, that the First Department erred "[i]n treating the SEC's findings as undisputed facts." Bear 2012 Opening Br. 50.

Morgan Sec. Inc. v. Vigilant Ins. Co., 126 A.D.3d 76, 88 (1st Dep't 2015).[26] Bear invokes CPLR 4547, but that provision renders inadmissible settlement-related evidence only when offered as "proof of liability for … the [settled] claim or the amount of damages." Insurers are not arguing that the evidence proves Bear's liability. Moreover, Bear's own cited authority supports "the proposition that [SEC] orders can establish knowledge or intent." In re Blech Sec. Litig., 2003 WL 1610775, at *11 (S.D.N.Y. Mar. 26, 2003).

In any event, discovery in this case confirmed the SEC's findings. Bear's market-timing and late trading undoubtedly harmed mutual funds. "Each time a market timer purchased shares at a net asset value per share that was below the true value of the mutual fund's assets at the time of the trading decision," Insurers' expert Professor Zitzewitz explained, "the mutual fund received less cash than it should have received." R-9280. Similarly, "[e]ach time a market timer redeemed shares at a net asset value per share that was above the true value of the assets, the mutual fund paid out more cash than it should have." Id.

Multiple sources of evidence further confirm Bear knew the harm to the mutual funds it was facilitating. The mutual funds, in repeated requests that Bear stop enabling illegal trading, told Bear of the harm:

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[26] The First Department cogently explained that courts "have a stronger interest in enforcing public policy" and therefore that "language in consent orders … [with] the purpose of avoiding [insurance] exclusions" should not be "countenance[d] ... for the purpose of preserving coverage for wrongful acts intended to harm others." Id. at 87–88.

- For example, in 1999, Fidelity Investments informed Bear that one Bear client's trading activity "has reached a level that is deemed disruptive," and that "[t]he expense of excessive or otherwise disruptive trading is borne by all shareholders." R-9771.

- Similarly, in 1999, Putnam Investors informed Bear that, "[a]s you know, market timing activity has an adverse effect on a fund's long-term performance and thus a detriment to the existing long-term shareholders." R-9777; see R-9779 (MFS Investment Management) (same). American Century Investments informed Bear that market timing "erode[s] returns," and the costs "are ultimately borne by the fund's remaining shareholders." R-9782.

- "By August 1999, Bear Stearns received many Stop Letters that requested that it stop clearing trades from specific accounts, clients, or brokers." R-9285; see R-11428, ¶¶29–30 ("thousands").

Bear received the message, as documents and testimony of its employees show:

- On May 23, 2000, during a meeting of the Operations Committee, Jeffrey Bernstein, a Senior Managing Director, reported that "over the last year we have been contacted by approximately 15 mutual fund families to restrict specific customers, who are engaging in market-timing activity[,] from investing in their respective funds. We have been informed by these funds that they discourage market-timers *because of the negative effect of large volume exchange activity on other shareholders and the funds*." R-9859 (emphasis added).

- Evelyn Cardenas, an employee in the Mutual Fund Operations Department [(MFOD)], testified that her supervisor explained to her that "when there's market timing, it hurts the fund portfolio and, therefore it kind of trickles down to a regular, you know, investor." R-3697:14–17. Cardenas also "received ... e-mails from mutual funds complaining about market-timing trades," forwarded to her by supervisors. R-3699:5–8.[27]

Even the market-timers themselves admitted the evident truth. In a meeting in 1999, one market-timing hedge fund informed a Bear employee that its trading harmed mutual fund investors. See R-9265, ¶65. That employee told Bear's senior management. Id.

In addition, Bear's steps to conceal its harmful conduct further demonstrates its intent. Bear's employees worked, in their words, "to keep 1 step ahead of the mutual fund companies." R-11446, ¶139. They created new RR numbers to disguise timers, suggested that timers trade in smaller amounts to avoid detection, and opened new account numbers for blocked customers. Supra 12–13. Such "evidence ... that [a party] concealed [its] involvement .... supports an inference of [its] knowledge" of wrongfulness. United States v. Davis, 690 F.3d 127, 133 (2d Cir. 2012).

Bear's claim that it was exonerated by conclusory denials from Bear employees (as Justice Ramos held) is unsupportable. Bear Br. 47. First, those "obviously self-interested" denials by Bear witnesses cannot justify summary judgment for *Bear*. Eagle Ins. Co. v. Lucia, 33 A.D.3d 552, 554–55 (1st Dep't

[27] Justice Ramos incorrectly discounted the testimony by Cardenas and Bernstein as hearsay. R-458. But an out-of-court statement introduced "only to demonstrate ... state of mind rather than for the truth of its contents" is not hearsay. People v. Wharton, 184 A.D.2d 472, 473 (1st Dep't 1992). Here, the testimony of Cardenas and Bernstein is offered to establish Bear's knowledge. Cf. 708 Estates Corp. v. Royal Globe Ins. Co., 160 A.D.2d 621, 622 (1st Dep't 1990).

2006). And the evidence contradicts the denials. The SEC found that "senior managers" and others "at the highest levels" of Bear knew that it facilitated illegal trading. R-11446, ¶138; R-11450, ¶169. Indeed, the denials Bear proffered from the head of MFOD are *directly rebutted* by the SEC's findings. R-11428–29, ¶33; R-11438, ¶90; R-11450, ¶169.

As SEC staff recognized, Bear's "prolonged and repeated abuses ... worked to the extraordinary monetary detriment of mutual fund shareholders" to such an extent that the SEC considered revoking Bear's registration. R-9648 (quotations omitted); R-3505.

The notion that Bear was not certain this harm was occurring is implausible. Public policy should not sanction coverage for Bear's intentional infliction of harm on mutual funds and their investors. At a minimum, summary judgment for Bear was inappropriate.

III. <u>The Question Of Bear's $14 Million Class Action Settlement Is Not Properly Before This Court</u>

Finally, Bear raises in this Court its unresolved claim for coverage for the $14 million civil settlement. That claim was severed from, and is not a part of, the final judgment (entered by Justice Schecter) that is on appeal. <u>See</u> N.Y. Const. art. 6, §3(b)(6); CPLR 5602(a)(1)(i), (ii). After the First Department ruled that Bear is not entitled to coverage for the $140 million amount, Justice Schecter—acting on a letter filed jointly by both sides—vacated the judgment entered by Justice Ramos and entered a new final judgment in favor of the four Insurers at the top of the coverage tower. The judgment is final as to those Insurers because no ruling on the remaining claims could create an obligation for them to indemnify Bear. Thus, the three remaining Insurers, against whom Bear has unresolved claims (including as to the $14 million civil settlement), were not party to that judgment. R-23–29.

As a result, this Court granted Bear's motion for leave to appeal only "insofar as it seeks leave to appeal as against" the four excess Insurers and "otherwise dismissed" Bear's motion "upon the ground that, as to the other parties, the order sought to be appealed from does not finally determine the action[.]" R-2.

Review in this Court may therefore be had ***only*** as to the four excess Insurers, as to whom judgment was entered regarding exactly one claim—the claim for coverage of the $140 million. See R-2; Hain v. Jamison, 28 N.Y.3d 524, 528 n.2 (2016); Sokoloff v. Harriman Estates Development Corp., 96 N.Y.2d 409, 413-15 & n.* (2001); Sontag v. Sontag, 66 N.Y.2d 554, 555 (1986); Arthur Karger, Powers of the New York Court of Appeals §5:9 (describing party finality principles).

Nor can Bear find refuge in CPLR 5501(a)(1), which states that "[a]n appeal from a final judgment brings up for review" "any non-final judgment or order which necessarily affects the final judgment." Even if the Appellate Division had ruled that Bear was entitled to coverage for the $14 million, it could not have affected the final judgment in favor of the excess Insurers.

Even were review permitted (it is not), Bear's summary-judgment motion on this issue should have been denied.

Bear argued that "the $14 million settlement ... was a fraction of the claimed exposure and likely far less than the costs of continued litigation." R-461. Again, Bear proffered no witness testimony about Bear's liability exposure in the class actions. R-9263, ¶60; R-3279:14–25; R-3282:13–3283:20. Bear invokes expert testimony, Bear Br. 44, but Bear offered only Michael Quinn, an *economics* expert, R-1737–1785. Quinn could not and did not analyze Bear's potential liability in the class actions. By contrast, Liman advised Insurers that Bear believed that the "proper method" of calculating investor loss "would … eradicate *any* damages claim," after applying the disgorgement offset. R-2237 (emphasis added).

<u>CONCLUSION</u>

The judgment should be affirmed. In the alternative, this Court should remand for further proceedings as to Bear's claim for coverage of the $140 million on (i) the reasonableness of the SEC settlement and (ii) the public policy barring coverage for intentional harm. Bear's claim for coverage of its $14 million settlement is not properly before this Court, and the Court should not rule on it. If the Court does address the $14 million settlement, it should hold that Bear's summary-judgment motion on this issue should have been denied, and remand for further proceedings. This Court should grant such other and further relief as this Court deems just and proper.

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CERTIFICATION

I certify pursuant to 500.13(c)(1) that the total word count for all printed text in the body of the brief, exclusive of the statement of the status of related litigation; the corporate disclosure statement; the table of contents, the table of cases and authorities and the statement of questions presented required by subsection (a) of this section; and any addendum containing material required by subsection 500.1(h) of this Part is 15,572 words.

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Respectfully submitted,

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