

SUPREME COURT OF THE STATE OF NEW YORK - NEW YORK COUNTY

PRESENT: RAMOS Justice

PART 53

JP MORGAN SECURITIES

INDEX NO. 600979/09

MOTION DATE

- v -

VIGILANT INS.

MOTION SEQ. NO. 011

MOTION CAL. NO.

The following papers, numbered 1 to , were read on this motion to/for

Notice of Motion/Order to Show Cause - Affidavits - Exhibits No(s)

Answering Affidavits - Exhibits No(s)

Replying Affidavits No(s)

Upon the foregoing papers, it is ordered that this motion is

Decided in accordance with the following memorandum decision.

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

DATED: 2/28/14

HON. CHARLES E. RAMOS J.S.C.

- 1. CHECK ONE : CASE NON-FINAL
2. CHECK AS APPROPRIATE : MOTIO GRANTED DENIED GRANTED IN PART OTHER
3. CHECK IF APPROPRIATE : SETTLE ORDER SUBMIT ORDER
DO NOT POST FIDUCIARY APPOINTMENT REFERENCE

**SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY**

PRESENT: RAMOS _____
Justice

PART 53

Index Number : 600979/2009
J.P. MORGAN SECURITIES
vs.
VIGILANT INSURANCE
SEQUENCE NUMBER : 013
SUMMARY JUDGMENT

INDEX NO. _____
MOTION DATE _____
MOTION SEQ. NO. _____

The following papers, numbered 1 to _____, were read on this motion to/for _____


Notice of Motion/Order to Show Cause — Affidavits — Exhibits _____	No(s). _____
Answering Affidavits — Exhibits _____	No(s). _____
Replying Affidavits _____	No(s). _____

Upon the foregoing papers, it is ordered that this motion is

**MOTION IS DECIDED IN ACCORDANCE
WITH ACCOMPANYING MEMORANDUM
DECISION IN MOTION SEQUENCE, P. 11...**

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

Dated: 2/29/14



HON. CHARLES E. RAMOS, J.S.C.

1. CHECK ONE: CASE DISPOSED NON-FINAL DISPOSITION
2. CHECK AS APPROPRIATE: MOTION IS: GRANTED DENIED GRANTED IN PART OTHER
3. CHECK IF APPROPRIATE: SETTLE ORDER SUBMIT ORDER
 DO NOT POST FIDUCIARY APPOINTMENT REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION

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

Index No. 600979/09

Plaintiffs,

-against-

VIGILANT INSURANCE COMPANY, THE TRAVELERS
INDEMNITY COMPANY, FEDERAL INSURANCE COMPANY,
NATIONAL UNION FIRE INSURANCE COMPANY OF
PITTSBURGH, P.A., LIBERTY MUTUAL INSURANCE
COMPANY, CERTAIN UNDERWRITERS AT LLOYD'S,
LONDON and AMERICAN ALTERNATIVE INSURANCE
CORPORATION,

Defendants.
-----x

Hon. Charles E. Ramos, J.S.C.:

In this insurance coverage action, plaintiffs¹ (together, plaintiffs) seek a declaration that its insurers are required to indemnify it for claims stemming from Bear Stearns's monetary settlement of a Securities and Exchange Commission (SEC) and New York stock Exchange (NYSE) administrative proceedings and related private litigation predicated on allegations that Bear Stearns facilitated its customers' deceptive market timing and late trading activities.

¹ Plaintiffs are J.P. Morgan Securities Inc. (JP Morgan), formerly known as Bear, Stearns & Co. Inc. (BS&Co.), and J.P. Morgan Clearing Corp., formerly known as Bear Stearns Securities Corporation (BSSCorp.), and The Bear Stearns Companies LLC, formerly known as The Bear Stearns Companies Inc. (TBSC) (together, Bear Stearns). In 2008, TBSC, through its merger with a subsidiary of JPMorgan Chase & Co. became a subsidiary of JPMorgan Chase & Co.

In motion sequence 011, plaintiffs move for partial summary judgment pursuant to CPLR 3212 dismissing the defendants' affirmative defenses based on claims that: (1) plaintiffs' insurance claims are excluded under the fraud or dishonesty exclusion of their policies' Dishonest Acts Exclusion); and (2) to permit indemnification for plaintiffs' losses would violate the public policy precluding coverage for intentional harmful conduct.

In motion sequence 013, Insurers move for partial summary judgment on the Dishonest Acts Exclusion.

Motion sequence numbers 011 and 013 are consolidated for disposition.

Background²

In 2003, the SEC and other regulatory entities undertook an investigation of BS&Co., a broker-dealer, and BSSCorp., a clearing firm, for allegedly facilitating late trading and deceptive market timing on behalf of certain customers for the purchase and sale of shares in mutual funds. During the course of its investigation, the SEC notified Bear Sterns of its intention to commence a civil proceeding charging Bear Stearns with violations of federal securities laws, and seeking

² The facts set forth herein are taken from the Court of Appeals' decision in *J.P. Morgan Sec. Inc. v Vigilant Ins. Co.* (21 NY3d 324 [2013]), and the parties' submissions and Rule 19-A Statements.

injunctive relief and sanctions of \$720 million. Bear Stearns disputed the proposed charges in a Wells Submission, arguing that it did not knowingly violate any law or share in the profits or benefits from late market trading.

Nevertheless, Bear Stearns made a formal offer of settlement, which the SEC accepted, and issued an "Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions" (SEC order) (Exhibits C, F annexed to the Connuck Aff.). As set forth in the SEC order, "solely for the purpose of these proceedings," and "without admitting or denying the findings," Bear Stearns agreed to pay \$160 million labeled as "disgorgement" and \$90 million as a civil penalty. The SEC order set forth 40 pages of detailed findings pertaining to Bear Stearns' facilitation of late trading and market timing practices, and that it "wilfully aided and abetted" violations of the federal securities law.

A hearing panel of the New York Stock Exchange (NYSE) also issued two decisions (NYSE decisions) (together with the SEC order, Administrative Orders) pertaining to Bear Stearns late trading and market timing practices following Bear Stearns' offer to settle similar charges. Bear Stearns submitted to the NYSE a "Stipulation of Facts and Consent to Penalty" and consented to a series of findings by the NYSE (Exhibit H, annexed to the Connuck Aff., 2-3). The NYSE imposed a disgorgement and penalty payment

identical to that imposed by the SEC, which was deemed satisfied by Bear Stearns' tender of payment to the SEC (Plaintiffs' Response to Insurers' Rule 19-A Statements, ¶ 29).

Following its settlement of the regulatory investigations, Bear Stearns also agreed to pay \$14 million to settle 13 civil class action lawsuits involving allegations that Bear Stearns had facilitated late trading and market timing.

Bear Stearns sought coverage from its insurers (Insurers)³ under professional liability policies (Policies) that provide Bear Stearns with \$200 million in coverage, above a \$10 million retention. The Insurers disclaimed coverage on the ground that the loss included disgorgement payments which are not insurable as a matter of law. Alternatively, Insurers disclaimed coverage on the ground that Bear Stearns failed to provide sufficient notice of a claim during the relevant reporting period.

Thereafter, plaintiffs commenced this insurance coverage action seeking a declaration that Insurers are obligated to indemnify Bear Stearns for its losses arising out of its settlement with the SEC and the NYSE and related civil class action lawsuits.

Previously, Insurers sought a 3211 dismissal of the coverage

³ Defendant-Insurers are Vigilant Insurance Company, the Travelers Indemnity Company, Federal Insurance Company, National Union Fire Insurance Company of Pittsburgh, PA, Liberty Mutual Insurance Company, Certain Underwriters at Lloyd's, London and American Alternative Insurance Company.

claims, which this court denied (*J.P. Morgan Securities Inc. v Vigilant Ins. Co.*, 2010 NY Slip Op 33799[U] [Sup Ct, NY County 2010]). The First Department reversed this Court's denial of the Insurers' motion to dismiss the complaint (*J.P. Morgan Securities Inc. v Vigilant Ins. Co.*, 91 AD3d 226 [1st Dept 2011]). In June 2013, the Court of Appeals reversed the First Department, reinstating this Court's decision (21 NY3d 324 [2013]).

Discussion

Plaintiffs move for summary judgment to dismiss certain of the Insurers' affirmative defenses on the ground that the Dishonest Acts Exclusion does not apply because the Administrative Orders are settlements and not judgments or other final adjudications of the underlying claims, and do not establish that Bear Stearns was guilty of conduct covered by the Dishonest Acts Exclusion.

In opposition and in support of their own motion for summary judgment, the Insurers contend that the Dishonest Acts Exclusion does not require that the SEC's and the NYSE's findings be the result of an actual trial because the Administrative Orders constitute final adjudications of Bear Stearns' dishonest conduct, which bars coverage as a matter of law.

The Dishonest Acts Exclusion in the Policies bars coverage for claims arising out of any "deliberate, dishonest, fraudulent or criminal act or omission," but only if a "judgment or other

final adjudication thereof" in the underlying case establishes that the insured was "guilty" of the excluded conduct:

The Policy "shall not apply to any Claim(s) made against the Insured(s) ... based upon or arising out of any deliberate, dishonest, fraudulent or criminal act or omission by such Insured(s), provided, however, such Insured(s) shall be protected under the terms of this policy with respect to any Claim(s) made against them in which it is alleged that such Insured(s) committed any deliberate, dishonest, fraudulent or criminal act or omission, unless judgment or other final adjudication thereof adverse to such Insured(s) shall establish that such Insured(s) were guilty of any deliberate, dishonest, fraudulent or criminal act or omission" (emphasis added).

Exclusionary provisions are generally accorded a strict and narrow construction, and an insurer bears the burden of establishing that the exclusion applies in a particular case (*Pioneer Tower Owners Assoc. v State Farm Fire & Cas. Co.*, 12 NY3d 302 [2009]; *Seaboard Sur. Co. v Gillette Co.*, 64 NY2d 304, 311 [1984]).

This Court confronted a similar argument that the Insurers now posit - that an SEC consent order entered after settlement supports application of a fraud coverage exclusion - in *National Union Fire Ins. Co. of Pittsburgh, Pa v Xerox Corp.* (6 Misc 3d 763 [Sup Ct, NY county 2004], affirmed 25 AD3d 309 [1st Dept 2006]). There, the insured, Xerox Corp., settled an enforcement action with the SEC over its alleged misstatements in its financial reports (*Id.*). The insured settled with the SEC and entered into a consent judgment without admitting or denying the

allegations in the complaint, and thereafter, sought indemnification from its insurer (*Id.*). The insurer invoked a fraud exclusion in the policy, which similarly provided that it did not apply until there was a "judgment or final adjudication" of a fraud (6 Misc 3d at 775). This Court dismissed the insurer's cause of action based upon the fraud exclusion without prejudice (*Id.* at 776).

The First Department affirmed, stating "the [SEC] consent agreement specifically precluded any collateral estoppel effect" (25 AD3d at 309-310; see also *Lipsky v Commonwealth United Corp.*, 551 F2d 887, 893-94 [2d Cir 1976] [A consent judgment between a federal agency and a private corporation is not the result of an actual adjudication of any of the issues, and thus, "can not be used as evidence in subsequent litigation between that corporation and another party."]).

Whether denominated as an administrative order, as in this action, or a consent judgment, as in *National Union Fire Ins. Co. of Pittsburgh, Pa* (25 AD3d 309) and *Lipsky v Commonwealth United Corp.* (551 F2d at 893-94), the settlements embodied in the Administrative Orders are not final adjudications or judgments establishing Bear Stearns' guilt in the underlying proceedings that it engaged in the wrongful conduct covered by the Dishonest Acts Exclusion.

Furthermore, although the Administrative Orders contain

factual findings, it was the product of a settlement between Bear Stearns, the SEC and the NYSE. Bear Stearns consented to entry of the orders "[s]olely for the purpose of these proceedings and any another other proceedings brought by or on behalf of the Commission or to which the Commission is a party" (Exhibit 4, annexed to the Gross Aff.).

The factual findings were neither admitted or denied except as to the SEC's jurisdiction and the subject matter of the proceedings, and were not the subject of hearings or rulings on the merits by a trier of fact. To infer, as the Insurers urge, that the term "final adjudication" encompasses settlement of an administrative order, is to expand its reasonable interpretation beyond what is permitted under New York law. "[W]henver an insurer wishes to exclude certain coverage from its policy obligations, it must do so in 'clear and unmistakable' language," and exclusions are "not to be extended by interpretation or implication, but are to be accorded a strict and narrow construction'" (*Seaboard Sur. Co.*, 64 NY2d at 311).

In its offer of settlement which preceded the SEC order, Bear Stearns expressly reserved the right to take contrary legal and factual positions in proceedings in which the SEC was not a party (Exhibit 3, annexed to the Landry Reply Aff.). Therefore, the Administrative Orders were the product of settlements and do not constitute a "judgment or other final adjudication" in the

underlying proceedings establishing the excluded conduct.

The Insurers' reliance upon *Millennium Partners, L.P. v Select Ins. Co.* (24 Misc 3d 212, 217-18 [Sup Ct, NY County], affirmed 68 AD3d 420 [1st Dept 2009]), and *Vigilant Ins. Co. v Credit Suisse First Boston Corp.* (6 Misc3d 1020[A] [Sup Ct NY County 2003], modified on other grounds 10 AD3d 528 [1st Dept 2004]), is misplaced. Those actions did not involve the applicability of a fraud or dishonest acts exclusion or confront whether the findings issued in connection with SEC administrative orders following settlement constituted a judgment or final adjudication within the meaning of a dishonest acts exclusion. In contrast, *National Union Fire Ins. Co. of Pittsburgh, Pa* (25 AD3d 309), cited by this Court supra, similar to this case, involved an exclusion which was triggered only if there was a "judgment or other final adjudication" as to wrongful conduct.

For the same reasons, the Insurers' affirmative defense based upon the argument that findings contained in the Administrative Orders conclusively establish that Bear Stearns acted with intent to injure mutual fund investors for which coverage is barred under New York public policy, also fails. The Insurers expressly agreed in the Dishonest Acts Exclusion to cover claims arising out of allegations of "deliberate, dishonest, fraudulent or criminal conduct" unless there is a final adjudication of guilt in the underlying proceedings.

Insofar as this Court concludes that the Administrative Orders do not trigger the Dishonest Acts Exclusion, Insurers cannot now be permitted to rewrite this contractual language out of the Policies.

The Court has carefully considered the Insurers' remaining arguments and finds them unavailing.

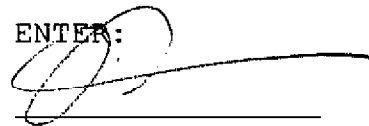
This action continues with respect to assessing whether there is evidence demonstrating Bear Stearns "had the requisite intent to cause harm," and if the disgorgement payment to the SEC is linked to "improperly acquired funds," which would bar insurance coverage on the public policy grounds (see *J.P. Morgan Sec. Inc.*, 21 NY3d at 335).

ORDERED that plaintiffs' motion for partial summary judgment (011) is granted, and the affirmative defenses based upon the Dishonest Acts and public policy exclusions are severed and dismissed; and it is further

ORDERED that Insurers' motion for partial summary judgment (013) is denied in its entirety.

Dated: February 28, 2014

ENTER:



J.S.C.

HON. CHARLES E. RAMOS