

SEC Administrative Order Does Not Trigger Dishonesty Exclusion

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A New York state court has found that Securities Exchange Commission (SEC) administrative orders and related settlements do not trigger the final adjudication language in a policy's dishonesty exclusion. (*J.P. Morgan Securities Inc. v. Vigilant Insurance Co., et al.*, 2014 WL 804129 (N.Y. Sup. Ct. Feb. 28, 2014)).

The SEC and other regulatory entities investigated a broker-dealer and a clearing firm for alleged late trading and deceptive market timing on behalf of certain mutual fund customers. The insured ultimately settled with the SEC and agreed to pay \$160 million as "disgorgement" and \$90 million as a civil penalty "solely for the purpose of these proceedings" and "without admitting or denying findings." The insured also agreed to a series of findings by the New York Stock Exchange (NYSE) and paid \$14 million to settle related civil class action lawsuits.

The insured sought coverage for the settlements under its professional liability insurance. The insurers denied coverage on several bases, including the application of a dishonesty exclusion. In the coverage litigation, the insured argued that the operative administrative orders and settlements were not judgments or other final adjudications required to trigger the exclusion. The exclusion provided that the policy applied unless "judgment or other final adjudication thereof adverse to such Insured shall establish that such Insured was guilty of any deliberate, dishonest, fraudulent or criminal act or omission."

The court agreed with the insured, determining that a consent judgment or settlement embodied in the SEC and NYSE administrative orders were not final adjudications or judgments establishing that the insured engaged in the wrongful conduct included in the dishonesty

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exclusion. Relying on the language “solely for the purposes of these proceedings . . . ,” the court reasoned that the factual findings were neither admitted nor denied except as to the SEC’s jurisdiction and were not the subject of a ruling by a trier of fact. Additionally, the court noted that the insured reserved the right to take contrary legal and factual positions in future non-SEC proceedings. The court also rejected the insurer’s public policy argument, finding that the insurer expressly agreed to the final adjudication requirement in the dishonesty exclusion and could not write that requirement out of the policy.

The opinion is available [here](#).