THE INSURABILITY OF CLAIMS FOR RESTITUTION

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Does and should a wrongdoer's liability insurance cover an aggrieved party's claim for restitution (e.g., a claim for the disgorgement of ill-gotten gains)? This article answers those questions. It does so by first answering the question of whether claims for restitution are covered under the terms of liability insurance policies. Then, after concluding that they are, it addresses the question of whether claims for restitution should be insurable as a matter of public policy and insurance law theory. There are long-standing legal and equitable principles that, on the one hand, dictate that a wrongdoer should not be allowed to benefit from its wrongdoing, which the wrongdoer would if insurance were allowed to cover claims for restitution. On the other hand, there are competing public policies that favor enforcing contracts and compensating innocent victims. If a claim for restitution is covered by the terms of an insurance policy, but such claims are viewed as uninsurable as a matter of public policy, then policyholders would have paid millions of dollars in premiums for policies that provide illusory coverage and thousands of innocent victims with billions of dollars of claims would not receive compensation. In analyzing these issues, this article does so by using two common examples where the insurability of claims for restitution are regularly implicated—intellectual property infringement claims under Commercial General Liability insurance policies (CGL policies) and shareholder fraud claims under Directors and Officers liability insurance policies (D&O policies).

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INTRODUCTION

In essence, a claim for restitution is a claim by one party to recover something from another party who has obtained it unlawfully (e.g., the party stole it).[1] The guiding principle underlying claims for restitution is unjust enrichment.[2] The party who unlawfully has taken something from the other party should be required to return it or pay for it as a matter of law or equity. Consequently, a common remedy in an unjust enrichment case is the disgorgement of the ill-gotten gains.[3] But, what if the party who took the item no longer has it and cannot compensate the aggrieved party, which is the typical situation today because most people in America are judgment proof?[4] Does and should the wrongdoer's liability insurance cover the aggrieved party's claim for restitution? This article answers these questions. To do so, one must first determine whether claims for restitution are covered under the terms of liability insurance policies. If they are, then one must determine whether claims for restitution are and should be insurable as a matter of public policy and insurance law theory. Answering these questions results in a clash of public policies that directly conflict.

On the one hand, there are long-standing legal and equitable principles that dictate that a wrongdoer should not be allowed to benefit from its wrongdoing, which the wrongdoer would if insurance were allowed to cover claims for restitution. On the other hand, there are the competing public policies that favor enforcing contracts and compensating innocent victims. If a claim for restitution is covered by the terms of an insurance policy, but such claims are viewed as uninsurable as a matter of public policy, then insurers would receive windfalls in the form of millions of dollars of unearned premiums for policies that provide illusory coverage, and thousands of innocent victims would go uncompensated for losses that total billions of dollars.[5]

1. *See* Mark P. Gergen, *What Renders Enrichment Unjust?*, 79 TEX. L. REV. 1927, 1946 (2001) (describing that restitution can compensate for wealth someone acquires without consent).

2. RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 1 cmt. a (2010); *see also* JOHN P. DAWSON, UNJUST ENRICHMENT: A COMPARATIVE ANALYSIS 42-63 (1951) (explaining the development of remedies for unjust enrichment, including restitution, through Roman Law).

3. *See* Emily Sherwin, *Restitution and Equity: An Analysis of the Principle of Unjust Enrichment*, 79 TEX. L. REV. 2083, 2089 (2001) (stating that the relinquishment of profits is one of the common types of restitution cases).

4. *See, e.g.*, Stephen G. Gilles, *The Judgment-Proof Society*, 63 WASH. & LEE L. REV. 603 (2006) (discussing the reasons why judgments against most people are uncollectible); Kyle D. Logue, *Solving the Judgment-Proof Problem*, 72 TEX. L. REV. 1375 (1994) (discussing the impact insurance has on the judgment proof problem); S. Shavell, *The Judgment Proof Problem*, 6 INT'L REV. L. & ECON. 45 (1986) (analyzing the problems that result from judgment proof individuals).

5. There were 210 shareholder fraud cases filed in 2008, for example, with the median amount of damages sought being $340 million. *See, e.g.*, TOM BAKER & SEAN J. GRIFFITH, ENSURING CORPORATE MISCONDUCT: HOW LIABILITY INSURANCE UNDERMINES SHAREHOLDER LITIGATION 3, 4, 142 (2010) (stating that in 2008 the number of shareholder

To help frame the discussion, consider two scenarios that commonly occur where the issue of the insurability of claims for restitution arises. Scenario One: a company, the policyholder, purchases a Commercial General Liability ("CGL") policy to cover it against any liabilities that may arise as a result of its business operations. One of the products the policyholder sells has a brand name similar to one of the policyholder's competitors. The competitor subsequently sues the policyholder, alleging that the name of the policyholder's product infringes the competitor's trademark. For relief, the competitor seeks to disgorge the policyholder of all of the profits the policyholder allegedly made from the allegedly infringing product, which totals millions of dollars. When the policyholder tenders the claim to its CGL insurer, the insurer denies coverage on the basis that the plaintiff is seeking restitution—the disgorgement of ill-gotten gains—which is not covered by the policy and should be deemed uninsurable as a matter of law and public policy.

Scenario Two: a publicly traded company purchases a Directors and Officers ("D&O") insurance policy that covers corporate managers against losses arising from claims resulting from "wrongful acts" committed by corporate managers, which are defined to include misstatements and misleading statements made regarding the company. During the normal course of business, the company issues periodic reports and press releases regarding the status and financial performance of the company. In order to raise capital, the company sells additional shares of stock. After the sale of the additional shares, some unfavorable business developments come to light that result in the company's stock price sharply declining. Disappointed with the decline in the value of their investment, the new shareholders sue the corporate managers alleging the status reports and press releases issued prior to the stock sale were inaccurate and misleading because they failed to disclose the unfavorable business developments and/or did not adequately disclose the problems that resulted in the stock price decline. For relief, the new shareholders request an award of money equal to the amount they allegedly overpaid for the stock, which totals several hundred million dollars. Of course, the corporate managers could not personally satisfy a judgment for such an amount if they were to lose the case, and the shareholders know this. The corporate managers eventually settle the case by agreeing to pay the new shareholders some small fraction of the amount they were seeking without an admission of liability. When the claim is tendered to the corporate managers' Directors and Officers (D&O) insurers, the insurers deny coverage on the grounds

class actions concerning securities that were initiated totaled 210, and within the securities cases that reached settlements, investors suffered a median of $340 million in losses).

that they have no obligation to cover the settlement amount because the underlying plaintiffs were seeking restitution—the return of ill-gotten gains—which is not covered by the policies and should be deemed uninsurable as a matter of law and public policy.

In both scenarios, the argument in favor of denying coverage is that the insurance should not cover claims for restitution under the terms of the policies, but even if such claims are covered, it is against public policy to allow insurance to cover claims seeking the return of money allegedly "stolen" or wrongfully obtained by the policyholder. Allowing insurance to cover claims for restitution would create an incentive for policyholders to "steal" or otherwise engage in misconduct if they were permitted to then shift the liability for doing so to their insurers. In terms of insurance law theory, if insurance were allowed to cover claims for restitution, then a moral hazard[6] risk would be created and adverse selection[7] regarding the

6. "Moral hazard" is the concept that a policyholder will have a "tendency to take fewer precautions in the presence of insurance." Adam F. Scales, *The Chicken and the Egg: Kenneth S. Abraham's "The Liability Century"*, 94 VA. L. REV. 1259, 1263 (2008) (reviewing and citing KENNETH S. ABRAHAM, THE LIABILITY CENTURY: INSURANCE AND TORT LAW FROM THE PROGRESSIVE ERA TO 9/11 45-48 (2008)). *See also* ROBERT H. JERRY, II & DOUGLAS R. RICHMOND, UNDERSTANDING INSURANCE LAW 12 (5th ed. 2012) ("[T]he existence of insurance [could] have the perverse effect of increasing the probability of loss . . . . This phenomenon is called *moral hazard*."). Judge Easterbrook has described the theory underlying the concept by stating that "[o]nce a person has insurance, he will take more risks than before because he bears less of the cost of his conduct." W. Cas. & Sur. Co. v. W. World Ins. Co., 769 F.2d 381, 385 (7th Cir. 1985). In essence, the idea is that a person who is not required to personally bear the financial consequences of his behavior will take less care. The term "moral hazard" also generally encompasses situations where "[a] person . . . deliberately causes a loss . . . [or] exaggerates the size of a claim to defraud an insurer." MARK S. DORFMAN, INTRODUCTION TO RISK MANAGEMENT AND INSURANCE 480 (8th ed. 2005). A lot of articles have been written regarding moral hazard and all of the authors generally offer similar descriptions of the concept. *See, e.g.*, Scott E. Harrington, *Prices and Profits in the Liability Insurance Market, in* LIABILITY: PERSPECTIVES AND POLICY, 42, 47 (Robert E. Litan & Clifford Winston eds., 1988) ("Moral hazard is the tendency for the presence and characteristics of insurance coverage to produce inefficient changes in buyers' loss prevention activities, including carelessness and fraud . . . ."); George L. Priest, *The Current Insurance Crisis and Modern Tort Law*, 96 YALE L.J. 1521, 1547 (1987) ("Moral hazard refers to the effect of the existence of insurance itself on the level of insurance claims made by the insured . . . *Ex ante* moral hazard is the reduction in precautions taken by the insured to prevent the loss, because of the existence of insurance."); Gary T. Schwartz, *The Ethics and the Economics of Tort Liability Insurance*, 75 CORNELL L. REV. 313, 338 n.117 (1990) ("'Moral hazard' is sometimes distinguished from 'morale hazard', the former referring to deliberate acts like arson, the latter to the mere relaxation of the defendant's discipline of carefulness.") (citing C. ARTHUR WILLIAMS, JR. & RICHARD M. HEINS, RISK MANAGEMENT AND INSURANCE 217 (4th ed. 1981)).

7. "[A]dverse selection" is "the disproportionate tendency of those who are more likely to suffer losses to seek insurance against those losses." Kenneth S. Abraham & Lance Liebman, *Private Insurance, Social Insurance, and Tort Reform: Toward a New Vision of Compensation for Illness and Injury*, 93 COLUM. L. REV. 75, 102 n.82 (1993). *See also* Tom

purchase of insurance would occur. In short, allowing insurance to cover claims for restitution would encourage unscrupulous people or companies who intend to do bad things to purchase insurance to cover their intended wrongdoing, and policyholders that may not have specifically purchased insurance to cover intentional wrongdoing nonetheless would have less incentive to avoid wrongful conduct because they would not suffer the financial consequences of doing so. Thus, the goals of punishing and deterring unlawful conduct would be undermined if insurance were allowed to cover claims for restitution.

There are several responses to such arguments. One, a claim for restitution such as the disgorgement of ill-gotten gains is covered under the terms of the policies when the policies are interpreted in accordance with the rules of policy interpretation, so insurers should not be permitted to collect premiums for policies that provide illusory coverage. Two, public policy concerns have not prevented many types of intentional torts and awards of punitive damages from being covered by liability insurance so claims for restitution also should be insurable. Three, one of the overriding public policy goals of the tort liability system is the compensation of innocent victims, which is a central reason why punitive damages and intentional torts are allowed to be covered by liability insurance. The public policies that favor the enforcement of contracts and the compensation of innocent victims outweigh the "moral hazard" and "adverse selection" concerns associated with allowing insurance to cover claims for restitution. Indeed, if D&O insurance is not allowed to cover claims for restitution, then thousands of innocent victims in shareholder fraud cases annually could go uncompensated for losses totaling billions of dollars and insurers would receive millions of premium dollars for policies that provide illusory coverage.[8] Finally, duly elected legislatures, not judges, should be the parties who conduct the public policy analysis that could result in the divestment of insurance recoveries. When analyzed

Baker, *Containing the Promise of Insurance: Adverse Selection and Risk Classification*, 9 CONN. INS. L.J. 371, 373, 375 (2003) (defining adverse selection as occurring when an insurance risk pool includes many high risk individuals, but few low risk individuals, because the latter did not obtain insurance). Thus, the basic idea of adverse selection is that people or entities who intend to commit torts such as intellectual property infringement would buy insurance to cover the resulting claims that likely will be asserted against them while entities that do not intend to violate the law would not. Critics of the concept of adverse selection have argued that the impact the availability of insurance has on policyholder behavior is overblown. *See, e.g.*, Peter Siegelman, *Adverse Selection in Insurance Markets: An Exaggerated Threat*, 113 YALE L.J. 1223 (2004) (arguing that, in practice, adverse selection does not frequently occur).

8. *See supra* notes 4-5 (describing the judgment proof problem, and the amount of money at issue in shareholder cases).

from the legislative perspective, the will of the people could not be clearer—state legislatures have passed statutes across the country that expressly allow corporations: 1) to indemnify corporate managers for claims seeking restitution[9] and 2) to purchase insurance to cover such claims.[10]

This article discusses the insurability of claims for restitution in four parts. Part One discusses the theoretical basis of claims for restitution as well as typical intellectual property infringement and shareholder cases in which such relief is sought. Part Two sets forth the relevant policy language at issue in CGL policies and D&O policies. Part Three addresses the rules of policy interpretation and applies them to the relevant CGL and D&O policy language at issue in intellectual property infringement and shareholder cases. Part Four discusses the public policy arguments against and in favor of allowing insurance to cover claims for restitution, as well as the leading case law on the subject. The article ultimately concludes that: (1) claims for restitution are covered under the existing terms of D&O and CGL policies in many instances; and (2) although there are important public policy arguments against allowing insurance to cover claims for restitution, such arguments are outweighed by the competing public policy interests that favor allowing coverage.

9. *See, e.g.*, DEL. CODE ANN. tit. 8, §102(b)(7) (2015) (providing that a corporation can add a provision in its certificate of incorporation that affords directors with limited liability); BAKER & GRIFFITH, *supra* note 5, at 44 (describing that corporations can insure director liability under state law if they are unable to indemnify the loss); John C. Kairis, *Disgorgement of Compensation Paid to Directors During the Time They Were Grossly Negligent: An Available but Seldom Used Remedy*, 13 DEL. L. REV. 1, 4 (2011) (arguing that directors are rarely punished for negligent actions due to limited liability and indemnification provisions that corporations use).

10. Joseph Waren Bishop, Jr., *The Law of Corporate Officers and Directors: Indemnification and Insurance* §8.1 at 8-2 (West Supp. Nov. 2006) ("All states authorize the corporation to purchase and maintain insurance on behalf of directors and officers against liabilities incurred in such capacities, whether or not the corporation would have the power to indemnify against such liabilities."). Delaware's statute, for example, provides:

> "A corporation shall have power to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation . . . against any liability asserted against such person and incurred by such person in any such capacity, or arising out of such person's status as such, whether or not the corporation would have the power to indemnify such person against such liability under this section."

DEL. CODE ANN. tit. 8, §145(g) (2015).

I. CLAIMS FOR RESTITUTION

A. *The Theoretical Basis of Claims for Restitution*

In cases of unjust enrichment by wrongdoing, restitution is one of the available remedies.[11] In essence, a claim for restitution is a claim that the other party obtained an unconsented transfer from the aggrieved party.[12] Restitution cases typically are one of the following types: "(1) payments induced by fraud, mistake or coercion; (2) contribution among tortfeasors; (3) unsolicited benefits; (4) unwinding of failed contracts; (5) disgorgement of [ill-gotten gains]; or (6) fiduciary misconduct."[13] In all such cases, the plaintiff is seeking to disgorge the defendant of some benefit the defendant received but did not actually earn. Consequently, the guiding principle underlying claims for restitution is unjust enrichment: "Liability in restitution derives from the receipt of a benefit whose retention without payment would result in the unjust enrichment of the defendant at the expense of the claimant."[14] Although the most common situation in which restitution is sought is where a benefit to one party corresponds with an observable loss by the other party, restitution is also available in situations where a person's legally protected rights have been violated, in which case the claimant does not need to show he actually suffered a loss.[15] In such situations, the defendant is required to either "restore the benefit in question . . . or else pay money in the amount necessary to eliminate [the] unjust enrichment" (i.e., disgorgement of the ill-gotten gain).[16] In such situations, compensation of the aggrieved party is not the object of the relief.[17]

Some scholars consider the term "unjust enrichment" to be a descriptive term that is used to explain why relief was granted in individual cases where a controlling legal principle otherwise would not have allowed

11. Gergen, *supra* note 1, at 1933.

12. *Id*. at 1959-60.

13. Sherwin, *supra* note 3, at 2089.

14. RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 1 cmnt. a (2010); *see also* JOHN P. DAWSON, UNJUST ENRICHMENT: A COMPARATIVE ANALYSIS 42-63 (1951) (discussing the underlying principle of unjust enrichment in ancient Roman law and the use of the principle as an "important remedy in Roman law for the prevention of unjust enrichment").

15. RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 1 cmnt. a (2010).

16. *Id*.

17. Kairis, *supra* note 9, at 9; *cf*. RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 3 cmt. b (2010) (describing the disgorgement remedy in restitution as another type of compensation available for an injury).

for an appropriate remedy,[18] while other scholars consider the term to be a guiding principle of law rooted in morality and a sense of what is fair.[19] The drafters of the Third Restatement recognize that both concepts play a role in the doctrine because courts are given great flexibility in fashioning relief in unjust enrichment cases, and the doctrine's foundation in English law was predicated upon the judge's exercise of a moral judgment apart from application of the legal rules.[20] Regardless of the conceptual heading affixed above the labels of restitution and unjust enrichment, at its heart the doctrine is based upon the idea that a person should not be able to profit from a wrong he commits.[21]

As illuminated by the Third Restatement, it is a mistake, however, to place claims for restitution solely under the heading of "equitable relief" because restitution actually may be awarded based on either equitable or legal principles.[22] For example, the equitable remedy of rescission is available to the aggrieved party where property is transferred as a result of fraud.[23] On the other hand, under federal statutes, one of the principal types of legal relief that may be awarded for the infringement of patents, copyrights, and trademarks is the disgorgement of the infringer's profits.[24]

18. *See, e.g.*, Stewart Macaulay, Comment, *Restitution in Context*, 107 U. PA. L. REV. 1133, 1134 (1959) (describing restitution as a "flexible body of case law" that allows courts "to consider many cases on their merits unhampered by doctrine"); Barry Nicholas, *Unjustified Enrichment in the Civil Law and Louisiana Law*, 36 TUL. L. REV. 605, 607-10 (1962) (explaining the criticism that the doctrine of unjust enrichment is overly broad and replaces other legal rules); Sherwin, *supra* note 3, at 2088 n. 19, 2088-89 (citations omitted) (describing restitution as a "[legal] device for filling [in] the cracks").

19. *See, e.g.*, RONALD DWORKIN, LAW'S EMPIRE 228-58 (1986) (discussing how judges reach decisions using fairness when viewing law within the principle of integrity); Sherwin, *supra* note 3, at 2088-89 (describing one view of unjust enrichment as a principle of equity and one definition of equity as generally about fairness).

20. RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 1 cmts. a-b (2010).

21. *See, e.g.*, RONALD DWORKIN, TAKING RIGHTS SERIOUSLY 22-23 (1977) (stating that fairness requires that "no man may profit by his own wrong"); Gergen, *supra* note 1, at 1934 (explaining that the non-utilitarian principle for disgorgement is "that a person ought not profit from a wrong he commits"); Kairis, *supra* note 9, at 9 (describing disgorgement as a remedy "to prevent an unjust windfall to the defendant"); Christopher T. Wonnell, *Replacing the Unitary Principle of Unjust Enrichment*, 45 EMORY L.J. 153, 177-90 (1996) (describing the increased harm caused by a defendant profiting from his wrong).

22. *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 4 (2010) ("Restitution May Be Legal or Equitable or Both"); Douglas Laycock, *Restoring Restitution to the Canon*, 110 MICH. L. REV. 929, 931 (2012) (noting that the Restatement (Third) explains that restitution does not only involve equitable remedies).

23. *See, e.g.*, RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 54 cmt. e (2010) (describing rescission for fraud as one of the two types of cases for which rescission can be used as the remedy).

24. *See* 15 U.S.C. § 1117 (a) (2014) (stating that in the case of a trademark violation, a trademark owner may "recover (1) defendant's profits, (2) any damages sustained by the

Consequently, it is incorrect to characterize restitution as exclusively within the domain of equity.[25]

B. *Intellectual Property Infringement Claims*

Although the factual and legal basis of each type of intellectual property infringement case varies considerably, all such claims have at least two things in common: 1) the disgorgement of the infringer's profits is an available remedy and 2) a plaintiff/competitor alleges that the defendant either improperly stole or used the plaintiff's intellectual property.[26] As an example of the typical facts alleged in an intellectual property infringement case, consider the trademark infringement and misappropriation of style of doing business case of *American Employers' Insurance Co. v. DeLorme Publishing Co*.[27]

In *DeLorme*, the plaintiff, Rand McNally Company, manufactured and sold a variety of maps, atlases, and computer mapping programs.[28] Rand McNally had registered trademarks for several of its software products such as TRIPMAKER.[29] The defendant, DeLorme Publishing Company, Inc., was a competitor of Rand McNally's.[30] DeLorme sold a product similar to Rand McNally's TRIPMAKER and used the name TRIPMATE.[31] In anticipation of being sued by Rand McNally in Northern Illinois where Rand McNally's principal place of business was located, DeLorme brought a declaratory judgment action in federal court in Maine.[32] Rand McNally asserted a counterclaim for infringement of its TRIPMAKER trademark under the Lanham Act,[33] alleging that DeLorme

plaintiff, and (3) the costs of the action"); 17 U.S.C. § 504(b) (2014) (stating that the infringer of a copyright may be liable for the copyright owner's actual damages and any additional profits); 35 U.S.C. § 289 (2014) (stating that the infringer of a design patent may be "liable to the [patent] owner to the extent of his total profit"); RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 42 (2010) (providing restitution as a remedy for "misappropriation or infringement of another's legally protected rights" in intellectual property).

25. Whether the relief is characterized as equitable or legal is important to insurers because, as is discussed in Part III.C, insurers contend that equitable relief is simply not covered by liability policies. Policyholders, and many courts, however, do not attach much importance to the label affixed to a monetary award when determining whether it is covered by insurance.

26. *See supra* note 24.

27. 39 F. Supp. 2d 64 (D. Maine 1999).

28. *Id*. at 67.

29. *Id*.

30. *Id*. at 67.

31. *Id*.

32. *Id*. at 69.

33. 15 U.S.C. §§ 1114, 1125(a) (2014); *id*. at 68-69.

intended to "trade off Rand McNally's goodwill" and for consumers to believe its TRIPMATE product was a Rand McNally product.[34] For relief, Rand McNally requested a permanent injunction and the disgorgement of all profits DeLorme made from the sale of TRIPMATE.[35] The case ultimately settled without a payment of any money from DeLorme to Rand McNally, but DeLorme nonetheless sought to recover its defense costs from its CGL insurer.[36] Among the defenses to coverage the insurer asserted was the argument that the disgorgement of profits is not "damages" that are recoverable under CGL policies.[37]

The *DeLorme* case is a typical case with respect to the issue of whether the disgorgement of ill-gotten gains in intellectual property infringement cases is "damages" that are covered under CGL policies. Disgorgement of the infringer's profits is a common type of relief sought in intellectual property infringement cases, particularly where the intellectual property holder would have a difficult time proving the amount of its own product it would have sold if the infringer had not been improperly selling the infringing product.[38]

C. *Shareholder Claims*

The nature of the claims and allegations in shareholder litigation generally is more uniform than in intellectual property infringement cases. Under state law, corporate managers owe their shareholders a duty of care and a duty of loyalty.[39] In general, the duty of care requires that they exercise the care that "[an] ordinarily careful and prudent [man] would use in similar circumstances."[40] The duty of loyalty essentially prohibits them

34. Am. Emp'rs' Ins. Co., 29 F. Supp. 2d at 68.

35. *Id.* at 69.

36. *Id.* at 70.

37. *Id.* at 78.

38. *See, e.g.*, Danielle Conway-Jones, *Remedying Trademark Infringement: The Role of Bad Faith in Awarding an Accounting of Defendant's Profits*, 42 SANTA CLARA L. REV. 863, 881 (2002) ("Another express goal [of the disgorgement of ill-gotten gains] is to provide a measure of recovery for a trademark owner who is otherwise unable to prove actual damages . . . ."); Richard C. Wolfe & Serona Elton, *Proving Disgorgement Damages in a Copyright Infringement Case is a Three-Act Play*, 84 FLA. B.J. 26, 28 (2010) ("Because actual damages are often difficult to quantify with reasonable precision, infringement cases usually focus upon the other portion of this damage option, commonly referred to as *disgorgement of the infringer's profits*.").

39. BAKER & GRIFFITH, ENSURING CORPORATE MISCONDUCT, *supra* note 5, at 25. *See also* Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 367 (Del. 1993) ("Duty of care and duty of loyalty are the traditional hallmarks of a fiduciary who endeavors to act in the service of a corporation and its stockholders.").

40. BAKER & GRIFFITH, ENSURING CORPORATE MISCONDUCT, *supra* note 5, at 25 (citations omitted). *See, e.g.,* Norlin Corp. v. Rooney, Pace, Inc., 744 F.2d 255, 264 (2d Cir.

from self-dealing or acting when there are conflicts of interest.[41]

Under federal securities laws—the Securities Act of 1933[42] and the Securities Exchange Act of 1934[43]—corporate managers are liable for misrepresentations, such as providing false or misleading information, made in connection with the offering or sale of securities.

Shareholder litigation against corporate managers includes direct and derivative state law corporate claims and federal securities claims.[44] Federal securities law claims are the most significant, with experts estimating that approximately 80% of shareholder claims litigated in federal court are federal securities class actions.[45] Most shareholder class actions are 10b-5 cases[46] brought under federal securities laws and approximately 94% of these 10b-5 claims are based upon alleged misrepresentations contained in financial statements.[47]

More specifically, in shareholder class actions, current or former shareholders allege that misrepresentations contained in financial statements or in the company's projections concerning future results induced the shareholders to trade.[48] Shareholders then allege that they suffered losses when the market price for the security reverted to its "true"

1984) ("The duty of care refers to the responsibility of a corporate fiduciary to exercise, in the performance of his tasks, the care that a reasonably prudent person in a similar situation would use under similar circumstances."); Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125, 130 (Del. 1963) ("[D]irectors of a corporation in managing the corporate affairs are bound to use that amount of care which ordinarily careful and prudent men would use in similar circumstances.").

41. BAKER & GRIFFITH, ENSURING CORPORATE MISCONDUCT, *supra* note 5, at 25. *See also* Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939) ("The rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest.").

42. 15 U.S.C. §§ 77a-77aa (2014).

43. 15 U.S.C. §§ 78a-78aa (2014).

44. *See* BAKER & GRIFFITH, ENSURING CORPORATE MISCONDUCT, *supra* note 5, at 27-28 (explaining that derivative actions are cases where the suit is brought by a shareholder on behalf of the corporation itself. Common examples of derivative suits are suits alleging excessive compensation or outright theft by a particular manager. Derivative suits only comprise 14% of all fiduciary duty claims filed in 1999 and 2000). Because of their relative scarcity, they are not the focus of the shareholder litigation addressed in this Article.

45. *See* BAKER & GRIFFITH, ENSURING CORPORATE MISCONDUCT, *supra* note 5, at 21 (explaining that federal securities law claims are the most prevalent form of direct and derivative suit).

46. *Id*., at 31 (*quoting* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975)) (explaining that Rule 10b-5 is the federal securities laws' catch-all anti-fraud provision which proscribes fraudulent conduct "in connection with the purchase or sale of any security").

47. *Id*., at 4, 31. (illustrating that in 2008, for example, 75% of securities class actions alleged violations of Rule 10b-5).

48. *Id*.

underlying value.[49] For relief, the shareholders seek the difference in price at which the trade would have occurred if not for the allegedly false information provided by the defendants.[50] In order to recover, the plaintiffs must show, among other things, that the defendants acted with scienter in making a material misstatement upon which the plaintiffs relied, and that their reliance on the misstatement caused a loss.[51] The scienter requirement generally can be satisfied by a showing of recklessness by the defendant, which means it was foreseeable that the statement could be misleading.[52]

Because of the way losses are calculated in shareholder litigation (the number of outstanding shares are multiplied by the movement in the stock price caused by the alleged misconduct),[53] defendants in shareholder litigation often face massive liabilities. In recent years, the median amount of damages sought in all shareholder cases was approximately $340 million[54] with the median settlement being 2.7% of that amount.[55] To protect themselves and their corporate managers against the costs associated with defending[56] and settling potentially financially devastating shareholder cases, corporations buy D&O insurance, which, as discussed in Part II, is specifically intended to cover such losses. Even with D&O insurance, however, almost all shareholder cases settle before going to trial because the policyholder does not want to risk an adverse verdict due to the potentially catastrophic amounts of the potential damage awards often sought in shareholder litigation (hundreds of millions or even billions of dollars in cases against large corporations), which routinely exceed the limits of the insurance purchased.[57] In the absence of insurance, due to the

49. *Id*.

50. *Id*.

51. *See* BAKER & GRIFFITH, ENSURING CORPORATE MISCONDUCT, *supra* note 5, at 32 (illustrating the scienter requirement of such cases).

52. *See, e.g*., AUSA Life Ins. Co. v. Ernst & Young, 206 F. 3d 202, 234 (2d Cir. 2000) (defining the concept of "foreseeability"); BAKER & GRIFFITH, ENSURING CORPORATE MISCONDUCT, *supra* note 5, at 32 (explaining that the key issues are what the reasonable investor would consider significant and foreseeable).

53. *See* BAKER & GRIFFITH, ENSURING CORPORATE MISCONDUCT, *supra* note 5, at 34 (describing damages as the difference between the price the plaintiffs paid (or received) for their shares when they bought (or sold) them and the price they would have paid but for the defendants' misrepresentations).

54. *Id*., at 142.

55. *Id*., at 8.

56. *See* BAKER & GRIFFITH, ENSURING CORPORATE MISCONDUCT, *supra* note 5, at 135 (explaining that the average defense costs in such cases are $3,042,159).

57. *See, e.g*., BAKER & GRIFFITH, ENSURING CORPORATE MISCONDUCT, *supra* note 5, at 162-65 (discussing the relationship between investor loss, potential damages and settlement); Christopher C. French, *Segmented Settlements Are Not the Answer: A Response to Professor Squire's Article, How Collective Settlements Camouflage the Costs of Shareholder Lawsuits,* 7 Va. L. & Bus. Rev. 589, 598 (2013) (discussing the consequences

enormous amounts at issue, the underlying plaintiffs' claims against the individual corporate manager would go uncompensated in many, if not most, cases.[58]

II. THE RELEVANT POLICY LANGUAGE

Insurance policies, almost without exception, are lengthy, complex standard form contracts of adhesion drafted by insurers that are sold on a take-it-or leave-it basis with respect to the wording contained in them.[59] The fact that insurers drafted the language becomes important when the rules of policy interpretation are applied to the language. The specific language that insurers have chosen to use with respect to the issue of whether their policies cover claims for restitution is discussed below.

A. *"Damages" Covered by Commercial General Liability Policies*

Commercial General Liability (CGL) policies were first introduced in 1941 and they provide the broadest form of liability coverage available.[60]

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of refusing to settle due to the risk of being held liable for more than the policy limits); Tom Baker & Sean J. Griffith, *How the Merits Matter: Directors' and Officers' Insurance and Securities Settlements*, 157 U. Pa. L. Rev. 755, 766-67, 793 (2009) (describing the role that the structure and size of a D&O policy along with the size of investor-loss play in deciding when and how to settle cases); Bernard Black, Brian Cheffins and Michael Klausner, *Outside Director Liability*, 58 Stan. L. Rev. 1055, 1064 (2006) (explaining that since 1980, only 37 of the thousands of securities fraud cases filed actually were tried to judgment).

58. *See supra* note 4 (discussing the reasons why judgments against most people are uncollectible).

59. *See, e.g.*, JEFFREY W. STEMPEL, 1 LAW OF INSURANCE CONTRACT DISPUTES § 4.06[b] at 4-37 (Aspen 2d ed. 1999) ("In a sense, the typical insurance contract is one of 'super-adhesion' in that the contract is completely standardized and not even reviewed prior to contract formation."); Michelle Boardman, *Insuring Understanding: The Tested Language Defense*, 95 Iowa L. Rev. 1072, 1091 (2010) (describing the "hyperstandardization" of insurance policies); Susan Randall, *Freedom of Contract in Insurance*, 14 Conn. Ins. L. J. 107, 125 (2007) ("[I]n some lines of insurance, all insurance companies provide identical coverage on the same take-it-or-leave-it basis."); James M. Fischer, *Why Are Insurance Contracts Subject to Special Rules of Interpretation? Text versus Context*, 24 Ariz. St. L. J. 995, 996 (1992) ("The only part of the standard policy that is generally customized to the consumer-insured is the Declarations Sheet.... [T]here is little, if any, freedom to negotiate the standardized language of the insurance contract that determines the scope of coverage."); Kent D. Syverud, *The Duty to Settle*, 76 Va. L. Rev. 1113, 1153 (1990) ("[P]roperty owner's liability insurance contracts are standardized across insurers in a form few insureds have the power or experience to bargain around.").

60. *See, e.g.*, E. W. SAWYER, COMPREHENSIVE LIABILITY INSURANCE, Chs. 2, 3 (1943) (describing the formation of the Insurance Services Office ("ISO") as well as the original objectives of CGL insurance); Jeffrey W. Stempel, *Assessing The Coverage Carnage: Asbestos Liability And Insurance After Three Decades Of Dispute*, 12 Conn. Ins. L. J. 349,

The CGL policy form initially was created by the two insurance rating bureaus that eventually merged and became the Insurance Services Office, Inc. ("ISO").[61] Under the 2007 standard form version of the CGL policy, which remains one of the forms most commonly in use today, the basic insuring agreement language in the personal injury and advertising liability section is worded as follows:

> We will pay those sums that the insured becomes legally obligated to pay as damages because of "personal and advertising injury" to which this insurance applies. We will have the right and duty to defend the insured against any "suit" seeking those damages . . . .[62]

Notably, the term "damages" is undefined.

"Personal and advertising injury" is defined as follows:

> Personal and advertising injury" means injury, including consequential "bodily injury", arising out of one or more of the following offenses:
>
> a. False arrest, detention or imprisonment;
> b. Malicious prosecution;
> c. The wrongful eviction from, wrongful entry into, or invasion of the right of private occupancy of a room, dwelling or premises that a person occupies, committed by or on behalf of its owner, landlord or lessor;
> d. Oral or written publication, in any manner, of material that slanders or libels a person or organization or disparages a person's or organization's goods, products or services;
> e. Oral or written publication, in any manner, of material that violates a person's right of privacy;
> f. The use of another's advertising idea in your

355 (2006) (describing in detail the background and development of CGL policy).

61. *See, e.g.*, Hartford Fire Ins. Co. v. California, 509 U.S. 764, 772 (1993) (explaining that ISO develops its own standard policy forms and makes them available to its member insurers which then adopt them and present them to state insurance regulators for approval). ISO is comprised of approximately 1400 property and casualty insurers and "is the almost exclusive source of support services in this country for CGL insurance." *Id.* As a result, "most CGL insurance written in the United States is written on [ISO] forms." *Id.;* U.S. Fire Ins. Co. v. J.S.U.B., Inc., 979 So.2d 871, 879 n.6 (Fla. 2007) (explaining that ISO is an influential organization within the insurance industry that promulgates standard form insurance policies, including CGL policies that insurers across the country use to conduct their business).

62. Ins. Servs. Office, Inc., FORM NO. CG00011207, COMMERCIAL GENERAL LIABILITY COVERAGE FORM (2007), *reprinted in* DONALD S. MALECKI, COMMERCIAL GENERAL LIABILITY, at App. J, p. 471 (9th ed. 2012).

"advertisement"; or

g. Infringing upon another's copyright, trade dress or slogan in your "advertisement".[63]

> An "advertisement" is defined as:
>
> A notice that is broadcast or published to the general public for specific market segments about your goods, products or services for the purpose of attracting customers or supporters. For purposes of this definition: a. notices that are published include material placed on the Internet or on similar electronic means of communication; and b. regarding web-sites, only that part of a web-site that is about your goods, products or services for the purposes of attracting customers or supporters is considered an advertisement.[64]

Notably, along with several intentional torts, claims for misappropriation of an advertising idea and the infringement of a copyright, trade dress or slogan in an "advertisement" are expressly covered.

B. *"Losses" and "Damages" Covered by D&O Policies*

D&O policies were first sold in America by Lloyd's of London in the 1930s and other insurers began selling such insurance more widely in the 1960s.[65] D&O policies are intended to cover the corporate managers of a company and the company itself against claims that may be asserted against them related to corporate activities in order to protect their personal assets as well as the company's assets.[66] Nearly all public corporations purchase D&O policies.[67]

The most common explanation for why D&O insurance is allowed and considered desirable is that companies would not be able to attract

63. *Id*. at App. J, p. 479.

64. *Id*., at 477.

65. *See, e.g*., PETER J. KALIS, THOMAS M. REITER & JAMES R. SEGERDAHL, POLICYHOLDER'S GUIDE TO THE LAW OF INSURANCE COVERAGE §11.02 (1st ed. 1997 & Supp. 2015) (overview of the history and status of the D&O Insurance Market).

66. *See, e.g*., KALIS ET AL., *supra* note 65, at §11.01; BAKER & GRIFFITH, ENSURING CORPORATE MISCONDUCT, *supra* note 5, at 45 (explaining the purpose of D&O policies).

67. *See, e.g*., Tom Baker and Sean J. Griffith, *The Missing Monitor in Corporate Governance: The Directors' & Officers' Liability Insurer*, 95 Geo. L. J. 1795, 1797 (2007) ("U.S. publicly traded corporations – virtually all of them – protect themselves against the costs associated with corporate and securities law liability by purchasing D & O insurance."); Tom Baker and Sean J. Griffith, *Predicting Corporate Governance Risk: Evidence from the Directors' & Officers' Liability Insurance Market*, 74 U. Chi. L. Rev. 487, 487 (2007) ("Nearly all public corporations purchase D&O policies."); Tillinghast Towers Perrin, *2005 Directors and Officers Liability Survey*, 20 fig. 21 (2006) (reporting that 100% of public companies that responded to the survey purchased D&O insurance).

talented people to run companies if corporate managers had to risk their own personal assets in order to do so.[68] For similar reasons, many states, including Delaware where over 50% of all publicly traded corporations and over 63% of the Fortune 500 are incorporated,[69] have passed statutes that allow companies to indemnify corporate managers for many types of misconduct and to purchase insurance to cover the losses they are allowed to indemnify as well as the ones they are unable to indemnify.[70]

Although insurers use numerous D&O policy forms, like the CGL policy form, insurers are the drafters of all of them.[71] The insuring agreement language in many standard form D&O policies is worded as follows:

> If during the policy period any claim or claims are made against the Insureds . . . for a Wrongful Act (as hereinafter defined) while acting in their individual or collective capacity as Directors or Officers, the Insurer will pay on behalf of the Insureds or any of them [100%] of all Loss (as hereinafter defined), which the Insureds or any of them shall become legally obligated to pay . . . .[72]
>
> The term "Wrongful Act" is often defined as follows:
>
> > Any actual or alleged error or misstatement or misleading statement or act or neglect or breach of duty by the Insureds while acting in their individual or collective capacities, or any matter not excluded by the terms and conditions of this policy claimed against them solely by reason of their being Directors or Officers of the Company.[73]

68. *See, e.g.*, KALIS ET AL., *supra* note 65, at §11.01; BAKER & GRIFFITH, ENSURING CORPORATE MISCONDUCT, *supra* note 5, at 43-44 (explaining why D&O policies are allowed).

69. BAKER & GRIFFITH, ENSURING CORPORATE MISCONDUCT, *supra* note 5, at 162-65; *supra* note 5, at 24.

70. *See, e.g.*, Del. Code Ann. Tit. 8, §102(b)(7) (allowing a corporation to eliminate or limit personal liability of a director to the corporation or its stock holder for monetary damages for breach of fiduciary duty, so long as it is not a breach of the director's duty of loyalty, was not done in bad faith or involved intentional misconduct or a knowing violation of the law); BAKER & GRIFFITH, ENSURING CORPORATE MISCONDUCT, *supra* note 5, at 43, 44 (describing the Delaware statute as an example of state statutes that allow corporations to purchase and maintain D&O insurance even against those losses that the corporation cannot indemnify itself); KALIS ET AL., *supra* note 65, at §11.01 (explaining further the purpose of D&O policies); Kairis, *supra* note 9, at 4.

71. *See supra* notes 55 and 57; Baker & Griffith, ENSURING CORPORATE MISCONDUCT, *supra* note 5, at 45.

72. *International Insurance Co. v. Alfred M. Johns*, 874 F.2d 1447, 1452 n.9 (11th Cir. 1989).

73. *Id*.

The term "Loss" is commonly defined as follows:

> Any amount which the Insureds are legally obligated to pay for a claim or claims made against them for Wrongful Acts, and shall include but not be limited to damages, judgments, settlements and costs, costs of investigation . . . and defense of legal actions, claims or proceedings and appeals therefrom, cost of attachment or similar bonds; providing always, however, such subject of loss shall not include fines or penalties imposed by law, or matters which may be deemed uninsurable under the law pursuant to which this policy shall be construed.[74]

As is the case with CGL policies, the term "damages" is not defined.

III. A CONTRACTUAL ANALYSIS OF WHETHER CLAIMS FOR RESTITUTION ARE COVERED UNDER LIABILITY POLICIES

Insurance policies legally are considered contracts, and the interpretation of them is governed by two well-established rules of policy interpretation: (1) *contra proferentem* and (2) the "reasonable expectations" doctrine. As discussed below, when these rules are analyzed and applied to the issue of whether claims for restitution are covered under the terms of CGL and D&O policies, one can conclude that such relief is covered.

A. *Contra Proferentem*

It is Hornbook insurance law that because insurers are the drafters of the policy language that uses the terms "damages" and "loss,"[75] the doctrine of *contra proferentem* applies, which means the ambiguities in the policy language are construed against the insurers and in favor of coverage.[76] The

74. *Id.*
75. *See supra* notes 55, 57, 58, 67, 68 and 70.
76. *See, e.g.,* Crane v. State Farm Fire & Cas. Co., 485 P.2d 1129, 1130 (Cal. 1971) ("Any ambiguity or uncertainty in an insurance policy is to be resolved against the insurer."); *See also* Crawford v. Prudential Ins. Co. of Am., 783 P.2d 900, 904 (Kan. 1989) ("Since an insurer prepares its own contracts, it has a duty to make the meaning clear, and if it fails to do so, the insurer, and not the insured, must suffer."); *See also* RPM Pizza, Inc. v. Auto. Cas. Ins. Co., 601 So.2d 1366, 1369 (La. 1992) ("[A]ny ambiguity must be construed against the insurance company and in favor of the reasonable construction that affords coverage."); *See also* Ohio Cas. Ins. Co. v. Flanagin, 210 A.2d 221, 226 (N.J. 1965) ("If the controlling language will support two meanings, one favorable to the insurer, and the other favorable to the insured, the interpretation sustaining coverage must be applied."); *See also* Gomolka v. State Auto Mut. Ins. Co., 436 N.E.2d 1347, 1348-49 (Ohio 1982) ("Policies of insurance, which are in language selected by the insurer and which are reasonably open to

test under many states' laws for determining whether policy language is ambiguous is whether the provisions at issue can reasonably be interpreted in different ways.[77] If the policyholder and insurer both offer reasonable interpretations of the same policy language, then the policy language is ambiguous and it should be construed in favor of coverage.[78] The question is not whether the insurer or the policyholder has the better interpretation, but rather, whether the policyholder's interpretation is reasonable.[79] Where the controversy involves a phrase that has generated numerous lawsuits with inconsistent results, common sense dictates that the policy language is ambiguous.[80]

different interpretations, will be construed most favorably for the insured.").

77. *See, e.g.*, 2 Eric M. Holmes & Mark S. Rhodes, APPLEMAN ON INSURANCE § 6.1, at 169 (2d ed. 1996) (indicating that insurer has burden of establishing that insurer's interpretation is the only fair interpretation of contract); 2 Rowland H. Long, THE LAW OF LIABILITY INSURANCE § 16.06, at 16-32 (Supp. 1988). *See also* New Castle Cnty. Del. v. Nat'l Union Fire Ins. Co. of Pittsburgh, 243 F.3d 744, 750 (3d Cir. 2001) ("'The settled test for ambiguity is whether the provisions in controversy are reasonably or fairly susceptible of different interpretations or may have two or more different meanings.'") (quoting New Castle Cnty. Del. v. Nat'l Union Fire Ins. Co. of Pittsburgh, 174 F.3d 338, 344 (3d Cir. 1999)); *See also* High Country Assocs. v. N.H. Ins. Co., 648 A.2d 474, 476 (N.H. 1994) ("If the language of the policy reasonably may be interpreted more than one way and one interpretation favors coverage, an ambiguity exists in the policy that will be construed in favor of the insured and against the insurer."); *See also* Salem Grp. v. Oliver, 607 A.2d 138, 139 (N.J. 1992) ("When a policy fairly supports an interpretation favorable to both the insured and the insurer, the policy should be interpreted in favor of the insured."); *See* also Bonner v. United Servs. Auto. Ass'n, 841 S.W.2d 504, 506 (Tex. Ct. App. 1992) ("The court must adopt the construction of an exclusionary clause urged by the insured as long as the construction is not unreasonable, even if the construction urged by the insurer appears to be more reasonable or a more accurate reflection of the parties' intent.").

78. *Id.*

79. *Id.*

80. *See, e.g.*, Security Ins. Co. of Hartford v. Investors Diversified Ltd., Inc., 407 So.2d 314, 316 (Fla. Dist. Ct. App. 1981) ("The insurance company contends that the language is not ambiguous, but we cannot agree and offer as proof of that pudding the fact that the Supreme Court of California and the Fifth Circuit in New Orleans have arrived at opposite conclusions from a study of essentially the same language."); *See also* Crawford v. Prudential Ins. Co. of Am., 783 P.2d 900, 908 (Kan. 1989) ("Reported cases are in conflict, the trial judge and the Court of Appeals reached different conclusions and the justices of this court [disagree]. Under such circumstances, the clause is, by definition, ambiguous and must be interpreted in favor of the insured."); *See* also Allstate Ins. Co. v. Hartford Accident & Indem. Co., 311 S.W.2d 41, 47 (Mo. Ct. App. 1958) ("Since we assume that all courts adopt a reasonable construction, the conflict is of itself indicative that the word as so used is susceptible of at least two reasonable interpretations, one of which extends the coverage to the situation at hand."); *See* also George H. Olmsted & Co. v. Metropolitan Life Ins. Co., 161 N.E. 276 (Ohio 1928) ("Where the language of a clause used in an insurance contract is such that courts of numerous jurisdictions have found it necessary to construe it and in such construction have arrived at conflicting conclusions as to the correct meaning, intent and effect thereof, the question whether such clause is ambiguous ceases to be an open one.");

In addition, because the terms "damages" and "loss" limit coverages that otherwise are provided, the terms should be treated as exclusionary language which means: (i) they should be narrowly construed and (ii) the insurer has the burden of proving they eliminate or reduce coverage.[81] Further, it is well established that exclusionary language should not be interpreted or applied in such a way that the basic coverage provided under a policy becomes illusory because it is subsumed by the exclusion.[82]

B. *The "Reasonable Expectations" Doctrine*

Another chestnut of the rules of insurance policy interpretation is that the policy should be interpreted in such a way as to fulfill the "reasonable expectations" of the policyholder.[83] The seminal article regarding the

See also Cohen v. Erie Indem, Co., 432 A.2d 596, 599 (Pa. Super. Ct. 1981) ("The mere fact that [courts differ on the construction of the provision] itself creates the inescapable conclusion that the provision in issue is susceptible to more than one interpretation.").

81. *See, e.g.*, SCSC Corp. v. Allied Mut. Ins. Co., 536 N.W.2d 305, 313 (Minn. 1995) (indicating that the insurer has burden to prove the applicability of an exclusion as an affirmative defense); *See also* Continental Ins. Co. v. Louis Marx & Co., 415 N.E.2d 315, 317 (Ohio 1980) (stating that defense has burden of proving defense based upon exclusion); *See also* Brown v. Snohomish Physicians Corp., 845 P.2d 334, 340 (Wash. 1993) (*explaining* that once insured has made a *prima facie* case that there is coverage, the burden shifts to the insurer to prove an exclusionary provision applies). *See also* 13 John Alan Appleman And Jean Appleman, INSURANCE LAW & PRACTICE § 7405 (2nd ed. 2011); 2 Steven Plitt et al., Couch On Insurance, § 22:31 (3rd ed. 2015).

82. *See, e.g.*, Bowersox Truck Sales & Service, Inc. v. Harco Nat'l Ins. Co., 209 F.3d 273, 277-78 (3rd Cir. 2000) (rejecting insurer's interpretation of policy's two-year limitation period where interpretation would have rendered coverage illusory); *See also* Tews Funeral Home v. Ohio Cas. Ins. Co., 832 F.2d 1037, 1045 (7th Cir. 1987) (policy excluding acts explicitly covered in prior section of policy construed against insurer); *See also* Harris v. Gulf Ins. Co., 297 F. Supp. 2d 1220, 1226 (N.D. Cal. 2003) (rejecting insurer's interpretation of insured v. insured exclusion in policy because it "would render the coverage provided by the policy illusory"); *See also* Alstrin v. St. Paul Mercury Ins. Co., 179 F. Supp. 2d 376, 398 (D. Del. 2002) (rejecting a D&O insurer's interpretation of the policy's deliberate fraud exclusion where, if applied, "there would be little or nothing left to that coverage", because "[n]o insured would expect such limited coverage from a policy that purports to cover all types of securities fraud claims"); *See* also Titan Indem. Co. v. Newton, 39 F. Supp. 2d 1336, 1348 (M.D. Ala. 1999) (finding coverage even though "the limitations of [the] policy completely swallow up the insuring provisions"); *See also* Atofina Petrochemicals, Inc. v. Continental Cas. Co., 185 S.W.3d 440, 444-45 (Tex. 2005) (rejecting insurer's interpretation of additional insured endorsement because it "would render coverage under the endorsement largely illusory"); *See also* Bailer v. Erie Ins. Exch., 687 A.2d 1375, 1380 (Md. Ct. App. 1997) ("If the exclusion totally swallows the insuring provision, the provisions are completely contradictory. That is the grossest form of ambiguity.").

83. Roland v. Georgia Farm Bureau Mut. Ins. Co., 462 S.E.2d 623, 625 (Ga. 1995) ("A contract of insurance should be strictly construed against the insurer and read in favor of coverage in accordance with the reasonable expectations of the insured."); A.B.C. Builders, Inc. v. American Mut. Ins. Co., 661 A.2d 1187, 1190 (N.H. 1995) ("[T]he policy language

"reasonable expectations" doctrine[84] was written more than forty years ago by then Professor Robert Keeton.[85] After subsequently becoming a judge, Judge Keeton summarized his version of the doctrine as follows:

> In general, courts will protect the reasonable expectations of applicants, insureds, and intended beneficiaries regarding the coverage afforded by insurance contracts even though a careful examination of the policy provisions indicates that such expectations are contrary to the expressed intention of the insurer.[86]

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must be so clear as to create no ambiguity which might affect the insured's reasonable expectations."); National Mut. Ins. Co. v. McMahon & Sons, Inc., 356 S.E.2d 488, 495-96 (W. Va. 1987) (indicating that the court will apply reasonable expectations doctrine to construe the policy in a manner that a reasonable person standing in the shoes of the insured would expect the language to mean, even though painstaking examination of the policy provisions would have negated those expectations) *See, e.g.*, Barry R. Ostrager & Thomas R. Newman, HANDBOOK ON INSURANCE COVERAGE DISPUTES §1.03[b][2][B], at 42-53 (14th ed. 2008) (identifying courts in forty-two states that have expressed support for, or applied a form of, the reasonable expectations doctrine); Robert E. Keeton & Alan I. Widiss, INSURANCE LAW, §§ 6.3(a)(3), at 633-34 (1988); LONG, *supra* note 77, § 16.07, at 16-39; Stempel, *supra* note 59, § 11.1, at 312 (1994). *See also* AIU Ins. Co. v. Superior Court, 799 P.2d 1253, 1264 (Cal. 1990) (ambiguous coverage clauses of insurance policies are to be interpreted broadly to protect the objectively reasonable expectations of the insured).

84. The reasonable expectations doctrine can find support in a number of contractual doctrines, but it largely is based upon the fact that insurance policies generally are contracts of adhesion drafted by insurers and offered to consumers on a take-it-or-leave-it basis. *See, e.g.,* Friedrick Kessler, *Contracts of Adhesion – Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 629 (1943); Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction,* 96 HARV. L. REV. 1173, 1226 (1983); Daniel Schwarcz, *A Product Liability Theory for the Judicial Regulation of Insurance Policies*, 48 WM. & MARY L. REV. 1389, 1394, 1401-02 (2007); Peter Swisher, *Symposium Introduction: The Insurance Law Doctrine of Reasonable Expectations after Three Decades*, 5 CONN. INS. L. J. 1 (1998).

85. Robert Keeton, *Insurance Law Rights at Variance With Policy Provisions*, 83 HARV. L. REV. 961, 967 (1970).

86. Keeton & Widiss, *supra* note 83, § 6.3(a)3, at 633. For commentary and criticisms of the reasonable expectations doctrine including discussions of the various iterations of it, *see* Schwarcz, *supra* note 84, at 1395 (criticizing the reasonable expectations doctrine and arguing that the case law endorsing the doctrine is "confused and inconsistent"); Roger C. Henderson, *The Doctrine of Reasonable Expectations in Insurance Law After Two Decades*, 51 OHIO ST. L.J. 823 (1990) (providing a detailed historical account of the doctrine and asserting that the doctrine is principled and can be applied within justifiable guidelines); Robert H. Jerry II, *Insurance, Contract, and the Doctrine of Reasonable Expectations*, 5 CONN. INS. L.J. 21 (1998) (discussing the doctrine as conceptualized by Keeton); William A. Mayhew, *Reasonable Expectations: Seeking a Principled Application*, 13 PEPP. L. REV. 267, 287-96 (1986) (formulating standards for applying the doctrine); Mark C. Rahdert, *Reasonable Expectations Reconsidered*, 18 CONN. L. REV. 323, 392 (1986) (arguing for refinements to the doctrine in response to the fading appeal that the doctrine holds for courts and commentators and contending that courts should "discard their unfortunate tendency to speak the platitudes of reasonable expectations without undertaking a careful and systematic

Stated differently, under Judge Keeton's version of the reasonable expectations doctrine, "even when the policy language unambiguously precludes coverage, under certain circumstances, courts will hold that coverage exists."[87] In short, the policyholder receives the coverage that it reasonably expected it would receive when it bought the policy even if there is some policy language or exclusion that credibly can be argued defeats coverage when a claim is presented.

C. *Application of the Rules of Policy Interpretation to the Issue*

When these rules of policy interpretation are applied to the terms of standard form CGL[88] and D&O[89] policies, one can conclude that claims for restitution are covered.

1. Analysis under CGL Policies

Under CGL policies, the insurer agrees to pay all "damages" that the policyholder becomes legally obligated to pay.[90] It is sometimes argued that "damages" do not include equitable forms of relief.[91] Yet, as previously noted, the term "damages" is undefined. Thus, under the

analysis"); Jeffrey W. Stempel, *Unmet Expectations: Undue Restriction of the Reasonable Expectations Approach and the Misleading Mythology of Judicial Role*, 5 CONN. INS. L.J. 181, 182-83, 191 (1998) (describing the various judicial approaches to the doctrine and noting both liberal and narrow approaches among the numerous states that have adopted the doctrine).

87. Francis J. Mootz III, *Insurance Coverage of Employment Discrimination Claims*, 52 U. MIAMI L. REV. 1, 22 (1997).

88. The conclusion that the term "damages" includes claims for restitution is not meant to suggest that all claims for intellectual property infringement are covered under CGL policies. The policyholder must prove the claim falls within the coverage granted in the insuring agreement of the CGL policy at issue and CGL policies contain a number of exclusions, such as the "Knowing Violation of Right of Another" and "Unauthorized Use of Another's Name or Product" exclusions, that may be applicable depending upon the facts of each individual case. *See, e.g.,* MALECKI, *supra* note 62, at App. J, p. 471-72 (reproducing the exclusions to the personal and advertising injury liability coverage provisions).

89. Again, the conclusion that covered "losses" includes claims for restitution is not meant to suggest that all claims in shareholder litigation are covered under D&O policies. D&O policies contain a number of exclusions, such as the "Insured Versus Insured," "Fraud/Dishonesty," "Personal Profit," and "Return of Remuneration" exclusions, which may be applicable depending upon the facts of the case at issue. *See, e.g.*, Lawrence J. Trautman & Kara Altenbaumer-Price, *D&O Insurance: A Primer*, 1 Am. U. Bus. L. Rev. 337, 352-57 (2012).

90. *See supra* note 62.

91. *See, e.g.*, New Castle County v. Hartford Accident & Indem. Co., 933 F.2d 1162, 1188-89 (3d Cir. 1991); Aerojet-General Corp. v. San Mateo County Superior Court, 257 Cal. Rptr. 621, 628 (Cal. App. 1989).

doctrine of *contra proferentem* if there is any ambiguity regarding whether the relief sought or paid to the underlying plaintiffs constitutes "damages," then the ambiguity should be resolved in favor of coverage.[92]

Arguably, one does not even need to rely upon *contra proferentem* to reach the conclusion that claims for restitution can constitute "damages" as the term is commonly used and understood. Black's Law Dictionary, for example, defines "damages" as follows:

> Money claimed by, or ordered to be paid to, a person as compensation for loss or injury . . . . Damages are the sum of money which a person wronged is entitled to receive from the wrongdoer as compensation for the wrong.[93]

Similarly, a Random House dictionary defines "damages" as "the estimated money equivalent for detriment or injury sustained" or as "cost; expense; charge."[94] In the same vein, a Webster's dictionary defines "damages" as "the money claimed by, or ordered paid to, a person to compensate for injury or loss caused by the wrong of the opposite party or parties."[95]

Under these definitions, the only question is whether the policyholder is required to pay money to the claimant.[96] Thus, regardless of whether the payments are based upon a legal or equitable theory of relief, monetary payments by a defendant to a plaintiff are "damages" as the term is commonly understood and defined.

The term "damages" also has been interpreted by many courts broadly to include a variety of forms of relief.[97] For example, the scope of the term "damages" was extensively litigated in environmental liability cases after the passage of CERCLA[98] in 1980 in cases where the policyholder agreed

92. *See supra* Part II.

93. BLACK'S LAW DICTIONARY (10th ed. 2014).

94. THE RANDOM HOUSE DICTIONARY OF THE ENGLISH LANGUAGE, at 365 (Unabridged ed. 1973).

95. WEBSTER'S NEW WORLD COLLEGE DICTIONARY, at 373 (5th ed. 2014). Insurance dictionaries similarly define "damages" without distinguishing between equitable and non-equitable relief. *See, e.g.*, DAVIDS, DICTIONARY OF INSURANCE, at 85 (6th rev. ed. 1983) ("The estimated reparation in money for injury sustained."); GLOSSARY OF INSURANCE TERMS, at 65 (5th ed. 1994) ("the amount required to pay for a loss"); RUBIN, BARRON'S DICTIONARY OF INSURANCE TERMS, at 71 (1987) ("Sum the insurance company is legally obligated to pay an insured for losses incurred.")

96. If the disgorged money were not paid to the plaintiff, but instead were paid to the court, for example, then a much stronger argument could be made that the payment is not "damages" as the term is used in liability insurance policies. Of course, in the absence of the prospect of actually receiving a monetary award, most plaintiffs would not pursue litigation.

97. *See, e.g.*, KALIS ET AL, *supra* note 65, at § 5.03.

98. Comprehensive Environmental Response, Compensation and Liability Act of 1980,

in a settlement, or was ordered by a court, to investigate and remediate environmental contamination as a result of a claim being asserted against the policyholder by a governmental agency. Many courts held the investigation and remediation costs not yet incurred by the policyholder constituted damages even though no money was actually paid by the policyholder to the government.[99]

The courts that reached that conclusion did so for a variety of reasons. Many courts noted that the common understanding of the word "damages" does not distinguish between legal and equitable claims.[100] Consequently, such courts refused to apply a "technical, arcane approach in discerning the meaning of damages."[101] Other courts considered the reasonable expectations of the policyholder and determined that policyholders reasonably could expect a broad reading of the term "damages."[102] According to one court, "[i]t would come as an unexpected, if not incomprehensible, shock to the policyholders to discover that their insurance coverage was being denied because the plaintiff chose to frame his complaint in equity rather than in law."[103] Still other courts noted that remediation costs are the equivalent of traditional compensatory damages because "cleanup costs 'are essentially compensatory damages for injury to [government] property.'"[104]

In intellectual property infringement cases, courts similarly have concluded that the relief sought by the plaintiffs is "damages" under CGL policies.[105] For example, in trademark infringement cases, even though one

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42 U.S.C. §9601, et seq.

99. KALIS ET AL, *supra* note 65, at §5.03 (concluding: (i) 18 of the 19 state supreme courts that have addressed the issue have held environmental remediation costs constitute "damages" and (ii) numerous federal appellate courts have reached the same conclusion).

100. *Id. (*citing New Castle County v. Hartford Accident & Indem. Co., 933 F.2d 1162, 1188-89 (3d Cir. 1991); Boeing Co. v. Aetna Cas. & Sur. Co., 784 P.2d 507, 511 (Wash. 1990)).

101. *Id*. (quoting Aetna Cas. & Sur. Co. v. Pintlar Corp., 948 F.2d 1507, 1513 (9th Cir. 1991)).

102. *Id*. (citing Hazen Paper Co. v. United States Fid. & Guar. Co., 555 N.E.2d 576, 583 (Mass. 1990)); Avondale Indus., Inc. v. Travelers Indem. Co., 887 F.2d 1200, 1207 (2d Cir. 1989), *cert. denied*, 496 U.S. 906 (1990)).

103. *Id*. (quoting Aerojet-General Corp. v. San Mateo County Superior Court, 257 Cal. Rptr. 621, 628 (Cal. App. 1989)).

104. *Id*. (quoting A.Y. McDonald Indus., Inc. v. Ins. Co. of N. Am., 475 N.W.2d 607, 622-23 (Iowa 1991)) (quoting United States Fid. & Guar. Co. v. Thomas Solvent Co., 683 F. Supp. 1139, 1168 (W.D. Mich. 1988)); *see also, e.g.,* Independent Petrochemical Corp. v. Aetna Cas. & Sur. Co., 944 F.2d 940, 947 (D.C. Cir. 1991), *cert. denied*, 503 U.S. 1011 (1992); AIU Ins. Co. v. Superior Court of Santa Clara County (FMC Corp.), 799 P.2d 1253, 1277 (Cal. 1990).

105. *See, e.g.,* School Union No. 37 v. United Nat. Ins. Co., 617 F.3d 554 (1st Cir. 2010) (stating that the term "money damages" in a liability policy includes amounts required to be

of the principal forms of statutory relief available to the trademark holder is the disgorgement of the infringer's profits,[106] numerous courts have concluded that such relief constitutes "damages" under CGL policies.[107]

The Eleventh Circuit's decision in *Limelight Productions, Inc. v. Limelite Studios, Inc.*,[108] is representative of courts' analysis regarding the issue. In finding in favor of coverage, the court stated:

> We find no merit to the argument that ill-gotten profits are not damages covered by the insurance policies . . . . Congress authorizes plaintiffs to recover these ill-gotten profits as the presumed equivalent of plaintiff's own lost profits . . . . That is, while Lanham specifies the plaintiff may recover its actual damages in addition to the defendant's ill-gotten profits, this Circuit recognizes ill-gotten profits as merely another form of damages that the statute permits to be presumed because of the proof unavailability in these actions. When [the insurers] issued these policies they knew of the Lanham Act, were on notice plaintiffs could recover ill-gotten profits, and must be held to have intended to cover these damages because they did not exclude them. Applying Florida law to construe the policy, we interpret "damages" broadly in favor of the insureds because [the insurers] wrote the policies, selected that term, and chose not to define or restrict it . . . . We refuse to allow [the insurers] to deny coverage for the very injury they took payment to insure against. Such amounts clearly are covered by the policies issued.[109]

The term "damages" also has been interpreted to include the disgorgement of ill-gotten gains under professional liability policies.[110] In

reimbursed to the claimants); Limelight Productions, Inc. v. Limelite Studios, Inc., 60 F.3d 767 (11th Cir. 1995) (explaining that award of ill-gotten profits and punitive damages for trademark infringement covered under a CGL policy because the undefined term "damages" should be interpreted broadly and the policy did not expressly exclude coverage for ill-gotten profits); Looney Ricks Kiss Architects, Inc. v. Bryan, 2014 WL 931781 (W.D. La. March 10, 2014) (citing *Limelight* and holding that the disgorgement of ill-gotten profits in a copyright infringement action are "damages"); American Employers' Insurance Co. v. DeLorme Publishing Co., Inc., 39 F.Supp.2d 64 (D. Maine 1999) (explaining that disgorgement of profits in a trademark infringement case are recoverable damages under CGL policy); International Communication Materials, Inc. v. Employer's Ins. of Wausau, 1996 WL 1044552 (W.D. Pa. 1996) (stating that disgorgement of profits in trademark infringement case is covered under a CGL policy because the term "damages" is undefined in policy and an award of disgorged profits is a type of damages); In re Estate of Mark F. Corriea, 719 A.2d 1234 (D.C. App. 1998) (indicating that disgorgement of ill-gotten gains constituted covered "damages" under a professional liability policy).

106. *See* 15 U.S.C. § 1117 (a)(1).

107. *See supra* note 105.

108. 60 F.3d 767 (11th Cir. 1995).

109. *Id*. at 769 (citations omitted).

110. *See, e.g.*, In re Estate of Corriea, 719 A.2d 1234 (D.C. App. 1998); School Union

In re Estate of Corriea,[111] for example, an attorney represented the parties on both sides of a transaction and was sued for breach of his fiduciary duties.[112] After a bench trial, the attorney, who had died prior to trial, was found liable and was ordered to disgorge the profits he had made in connection with the transaction.[113] Because the deceased attorney's estate did not have sufficient assets to satisfy the judgment, the claimants sought to recover under the attorney's professional liability policy.[114] The policy provided that, "the Company shall pay on behalf of the insured in excess of the deductible all sums which the insured shall become legally obligated to pay as Damages . . . ."[115]

Unlike in typical CGL policies and D&O policies, the term "damages" was actually defined in the professional liability policy at issue:

> [A]ny amount which the insured is legally obligated to pay for any Claim to which this insurance applies and shall include judgments and settlements: provided always that Damages shall not include fines or penalties imposed by law or by other matters which may be deemed uninsurable under the law pursuant to which this policy shall be construed.[116]

The Court of Appeals for the District of Columbia rejected the insurer's argument that the disgorgement of ill-gotten gains was not "damages":

> [F]ailure to order disgorgement in lieu of unproven damages would "leave [the claimant] without a remedy" and "also gut fiduciary law." We decline to hold such restitution "uninsurable" under the District's law and therefore beyond the coverage provided by the [insurance] policy . . . . 'Damages' in common usage means the reparation in money for a detriment or injury sustained. The reasonably prudent layperson does not cut nice distinctions between the remedies offered at law and in equity."[117]

In sum, courts have interpreted the term "damages" broadly in a variety of contexts to encompass numerous types of relief sought by

No. 37 v. United Nat. Ins. Co., 617 F.3d 554 (1st Cir. 2010) (stating that the term "money damages" in an Educator's Liability policy includes tuition amounts a school union agreed to reimburse a student).

111. 719 A.2d 1234 (D.C. App. 1998).

112. *Id*. at 1236-37.

113. *Id*. at 1237.

114. *Id*. at 1235.

115. *Id*. at 1237.

116. *Id*. at 1237-38.

117. *Id*. at 1241 (quoting Bausch & Lomb Inc. v. Utica Mut. Ins. Co., 625 A.2d 1021, 1032-33 (Md. 1993)).

plaintiffs, including monetary payments and equitable relief. Consequently, the argument that a claim for restitution is not seeking "damages" under the terms of CGL policies has been rejected in many jurisdictions.

2. Analysis under D&O Policies

The analysis is similar under D&O policies. Under D&O policies, the term "loss" is broadly defined and includes "damages," which again is undefined: "any amount which the Insureds are legally obligated to pay for a claim or claims made against them for Wrongful Acts, and shall include but not be limited to damages, judgments, settlements and costs, costs of investigation . . . and defense of legal actions, claims or proceedings and appeals therefrom . . . ."[118] Consequently, in cases where the defendant actually pays money to the plaintiffs, the conclusion that the payment is covered by D&O policies can also be reached regardless of whether the payment is based upon a calculation of the value of the plaintiffs' injuries or is the disgorgement of the defendants' ill-gotten gains. For the insurance coverage analysis, it simply is not relevant whether the money paid is characterized as an ill-gotten gain or something else.[119]

Many courts have recognized that the term "loss" has been broadly defined and includes settlements and judgments even where the payments can be viewed as restitution in the form of the disgorgement of ill-gotten gains.[120] In *International Ins. Co. v. Johns*,[121] for example, shareholders

118. *See supra* note 74.

119. Indeed, because shareholder cases almost always settle, there usually are no findings of fact regarding the basis for the amounts paid to the plaintiffs so the policyholders and insurers typically can only characterize the payments as either for restitution or compensation in coverage disputes. *See supra* note 51.

120. *See, e.g.*, William Beaumont Hosp. v. Fed. Ins. Co., 552 F. App'x 494, 498-500 (6th Cir. 2014) (wages withheld from nurses in a class action antitrust action were covered "losses" because the money allegedly was illegally retained as opposed to illegally obtained); Va. Mason Med. Ctr. v. Exec. Risk Indem., Inc., 331 F. App'x. 473 (9th Cir. 2009) (affirming trial court opinion that allowed insurance recovery for settlement amount that constituted the return of monies allegedly charged improperly to the underlying claimants); Int'l Ins. Co. v. Johns, 874 F.2d 1447, 1453-55 (11th Cir. 1989) (portion of monies paid to executives under golden parachutes that was returned to shareholders under a settlement agreement was a covered "loss" under D&O policy); U.S. Bank Nat. Ass'n v. Indian Harbor Ins. Co., No. 12-CV-3175 PAM/JSM, 2014 WL 3012969, at *1, *3-5 (D. Minn. July 3, 2014) (rejecting insurer's argument that $55 million settlement of class actions to recover bank overdraft fees were not covered under D&O policies because such amounts represented the disgorgement of ill-gotten gains that were uninsurable as a matter of law); Classic Distrib. & Beverage Grp., Inc. v. Travelers Cas. & Sur. Co. of Am., No. CV 11-07075 GAF RZX, 2012 WL 3860597, at *8-9 (C.D. Cal. Aug. 29, 2012) (rejecting insurer's argument that the portion of the amounts paid under a settlement agreement in a

filed a derivative action against the directors of a company due to the directors' adoption of golden parachutes for themselves.[122] The directors settled the case by agreeing to return $600,000 paid to them under the golden parachutes with no admission of liability.[123] The directors then sought to recover the settlement amount from their D&O insurer.[124] The insurer refused to pay, contending the settlement payment was not a "loss" and instead constituted the return of "illegal profits."[125]

The policy at issue defined "loss" as follows:

> The term 'Loss' shall mean any amount which the Insureds are legally obligated to pay for a claim or claims made against them for Wrongful Acts, and shall include but not be limited to damages, judgments, settlements and costs, costs of

class action related to employees' unreimbursed work expenses were not covered "losses" under an Employment Practices Liability policy because such amounts allegedly were restitutionary), *vacated because of settlement*, No. CV 11-07075 GAF RZX, 2012 WL 5834570 (C.D. Cal. Nov. 6, 2012); Acacia Research Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh, No. SACV 05-501 PSG MLGX, 2008 WL 4179206, at *14-15 (C.D. Cal. Feb. 8, 2008) (payment of royalties under a settlement agreement in a patent infringement case was a covered "loss" under D&O policy where the policyholder did not admit liability); Alstrin v. St. Paul Mercury Ins. Co., 179 F. Supp. 2d 376, 398-401 (D. Del. 2002) (in light of the fact D&O policies are intended to cover securities fraud claims, disgorgement is covered unless the conduct at issue is illegal); Liss v. Fed. Ins. Co., No. A-6863-03T5, 2006 WL 2844468, at *4-7 (N.J. Super. Ct. App. Div. 2006) (rejects *Level 3* and a public policy argument that restitutionary damages are not covered "losses" under D&O policies); J.P. Morgan Sec. Inc. v. Vigilant Ins. Co., 992 N.E.2d 1076, 1082-83 (N.Y. 2013) (policyholder that agreed to pay $160 million in "disgorgement" to settle claims relating to the willful violation of securities laws by allowing its clients to trade mutual funds after hours were covered "losses" because most of the "disgorged" profits were the policyholder's clients', not the policyholder's); Bank of Am. Corp. v. SR International Business Ins. Co., SE, No. 05 CVS 5564, 2007 WL 4480057, at *17 (N.C. Super. Ct. Dec. 19, 2007) (settlement payment made in securities fraud case based upon misrepresentations associated with the underwriting of bonds are covered "losses" under professional liability policy because coverage provided by the policy would be illusory otherwise). *See also* 23 ERIC M. HOLMES, HOLMES' APPLEMAN ON INSURANCE 2D § 146.5[B] (Lexis Nexis 1996), Lexis (explaining various court decisions explaining court decisions on the issue); 3 NEW APPLEMAN LAW OF LIABILITY INSURANCE § 22.05[10] (Matthew Bender, Rev. Ed. 2015), Lexis (same).

121. 874 F.2d 1447 (11th Cir. 1989).

122. *Id*. at 1450. Golden parachutes are essentially termination agreements providing "substantial bonuses and other benefits for managers and certain directors upon a change in control of a company." Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 178 n. 5 (Del. 1986); *see also* Schreiber v. Burlington Northern, Inc., 472 U.S. 1, 4 n. 2 (1985) (explaining that the term golden parachutes generally refers "to agreements between a corporation and its top officers which guarantee those officers continued employment, payment of a lump sum, or other benefits in the event of a change of corporate ownership").

123. *Int'l Ins. Co*., 874 F.2d at 1452.

124. *Id*.

125. *Id*. at 1454-55.

> investigation . . . and defense of legal actions, claims or proceedings and appeals therefrom, cost of attachment or similar bonds; providing always, however, such subject of loss shall not include fines or penalties imposed by law, or matters which may be deemed uninsurable under the law pursuant to which this policy shall be construed.[126]

In rejecting the insurer's argument and holding the settlement payment was a covered "loss" under the policy, the Eleventh Circuit stated:

> The policy defines "loss" as any amount that the insureds are legally obligated to pay for claims of "wrongful acts," including settlements . . . . In settling the derivative action, the directors became legally obligated to pay a sum to reconcile allegations of breaches of fiduciary duties. Under the ordinary and popular meaning of the language defining loss, therefore, the $600,000 that settled the claims . . . is a loss.[127]

Similarly, in 2013, the New York Court of Appeals, the highest state court in New York, unanimously rejected insurers' attempts to avoid coverage for a settlement that included the "disgorgement" of ill-gotten gains.[128] In *J.P. Morgan Sec. Inc. v. Vigilant Ins. Co.*, the policyholder, a broker-dealer, was accused of improperly facilitating "late trading" by certain of its customers in violation of federal securities laws.[129] The SEC concluded the violations were willful, and the policyholder agreed to pay a $90 million civil penalty and $160 million in "disgorgement."[130] When the claim was presented to the insurers, they denied coverage, arguing that the disgorgement payment was uninsurable as a matter of law because it was against public policy to allow insurance to cover such payments.[131] The New York Court of Appeals rejected this argument because it was irrefutable that the definition of "loss" in the policies at issue covered the payment, and the "disgorged" profits largely benefited the policyholder's clients, not the policyholder.[132] Thus, public policy concerns about allowing insurance to cover illicit gains were not really implicated by the settlement despite (1) the "disgorgement" label attached to the settlement payment and (2) the finding that the policyholder's misconduct was willful.[133]

126. *Id*. at 1452 n.9 (ellipses in original).
127. *Id*. at 1454.
128. J.P. Morgan Sec. Inc. v. Vigilant Ins. Co., 992 N.E.2d 1076 (N.Y. 2013).
129. 992 N.E.2d 1076, 1078 (N.Y. 2013).
130. *Id*.
131. *Id*. at 1080.
132. *Id*. at 1080-82.
133. *Id*. at 1082-83 (noting that a finding of a "willful" violation by the SEC did not did not demonstrate the requisite finding of intent to cause harm to implicate the public policy

In addition to the New York Court of Appeals and the Eleventh Circuit, numerous other courts similarly have held that claims for restitution such as the disgorgement of ill-gotten gains are covered "losses" and "damages."[134]

IV. PUBLIC POLICY CONSIDERATIONS

A. *Public Policy Arguments Against Allowing Insurance to Cover Claims for Restitution*

As the above analysis reveals, the argument that claims for restitution, such as the disgorgement of ill-gotten gains, are not covered by liability policies is not firmly grounded in the policy language. Instead, the stronger argument is premised upon the public policy that "one may not insure against the risk of being ordered to return money or property that has been wrongfully acquired."[135] The underlying public policy rationale is as follows:

> When the law requires a wrongdoer to disgorge money or property acquired through a violation of the law, to permit the wrongdoer to transfer the cost of disgorgement to an insurer would eliminate the incentive for obeying the law. Otherwise, the wrongdoer would retain the proceeds of his illegal acts, merely shifting his loss to an insurer.[136]

In short, the argument is that if insurance were allowed to cover a claim for restitution such as the disgorgement of ill-gotten gains, then the wrongdoer (i.e., the policyholder) would not be punished or deterred from acting improperly.[137] Indeed, according to this argument, if insurance were

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exception for intentional injury).

134. *See* sources cited *supra* notes 105 and 120.

135. Bank of the W. v. Superior Court, 833 P.2d 545, 553 (Cal. 1992).

136. *Id*. at 555.

137. Notably, the public policy arguments against allowing insurance to cover claims seeking restitution – e.g., that a policyholder would be unjustly enriched if insurance were allowed to cover restitution such as the disgorgement of ill-gotten gains – are inapplicable to defense costs. Unlike the situation where a policyholder is required to return an ill-gotten gain taken from a claimant and thus insurance arguably should not be permitted to pay the "refund" because the bad actor effectively would be retaining the ill-gotten gain in such a situation, the costs a policyholder incurs to defend itself have not been "taken" from anyone. If an insurer reimburses its policyholder's defense costs, the insurer is not paying the policyholder's liabilities to the claimants such that the policyholder could be viewed as being allowed to keep "stolen" or improperly obtained money. Nor would a policyholder be incentivized to "steal" other people's money if its insurance were allowed to cover the defense costs the policyholder incurs defending itself. Stated differently, if the policyholder's defense costs are paid by an insurer, then the policyholder is placed in a

allowed to cover the disgorgement of ill-gotten gains, then the policyholder basically would be allowed to keep the money it "stole" because the insurer would be the party actually paying it back to the underlying claimants.

Several courts have endorsed this argument.[138] The leading case is the Seventh Circuit's decision in *Level 3 Communications, Inc. v. Federal Insurance Company*.[139]

1. The Level 3 Case

In *Level 3*, the directors and officers of a company were sued by the shareholders of a company they acquired based upon allegations that the directors and officers made fraudulent representations that induced the prior owners to sell the company for less than it was worth.[140] For relief, the prior owners were seeking an award of the difference between the value

revenue neutral position. The policyholder does not gain anything from its allegedly improper conduct, but it also does not suffer financially in defending the claims against it. Thus, the resolution of the issue of whether defense costs should be covered by insurance in securities cases or intellectual property infringement cases, where the claimants are seeking restitution, does not invite the public policy debate that accompanies a discussion of whether indemnification for such relief should be allowed.

138. *See, e.g.*, Level 3 Commc'ns, Inc. v. Fed. Ins. Co., 272 F.3d 908, 909-12 (7th Cir. 2001) (finding that restitution provided under settlement agreement in a securities fraud case was not covered under D&O policy); O'Neill Investigations, Inc. v. Ill. Emp'rs Ins. of Wausau, 636 P.2d 1170 (Alaska 1981) (holding that claims seeking injunctive relief and the restoration of monies wrongfully acquired are not covered under liability policy); Bank of the W., 833 P.2d at 553 (stating that it is against public policy to allow insurance to cover the return of monies wrongfully obtained); Cent. Dauphin Sch. Dist. v. American Cas. Co., 426 A.2d 94, 96-97 (Pa. 1981) (holding that taxes unlawfully collected and then returned are not insurable losses); Seaboard Sur. Co. v. Ralph Williams' Nw. Chrysler Plymouth, Inc., 504 P.2d.1139, 1143 (Wash. 1973) (finding that the Attorney General's complaint seeking injunctive relief to enjoin unfair business practices was not a claim for "damages"); Local 705 Int'l Bhd of Teamsters Health & Welfare Fund v. Five Star Managers, L.L.C., 735 N.E.2d 679, 684 (Ill. App. Ct. 2000) (stating that return of monies improperly received is not an insurable "loss"); Vigilant Ins. Co. v. Credit Suisse First Bos. Corp., 10 A.D.3d 528, 528-29 (N.Y. App. Div. 2004) (holding that disgorgement of ill-gotten gains are not covered "damages" or "losses"). *See also* 23 ERIC M. HOLMES, HOLMES' APPLEMAN ON INSURANCE 2D § 146.5[B] (Lexis Nexis 1996), Lexis (explaining various court decisions explaining court decisions on the issue); 3 NEW APPLEMAN LAW OF LIABILITY INSURANCE § 22.05[10] (Matthew Bender, Rev. Ed. 2015), Lexis (same).

139. 272 F.3d 908 (7th Cir. 2001).

140. *Level* 3, 272 F.3d at 909-10. Despite its apparent significance, the *Level 3* decision thus far has prompted only limited commentary by the scholarly legal community. *See, e.g.*, Eric W. Collins, Note, Level 3 v. Federal Insurance: *Do You Know What Is In Your Directors And Officers Liability Insurance Policy?*, 73 UMKC L. REV. 199, 210 (2004) (noting that the decision may render the coverage provided by D&O policies illusory); Richard F. Haus, *On the Level 3: Reviewing The (Un)Insurability Of Restitutionary Payments*, 42 TORT TRIAL & INS. PRAC. L.J. 165 (2006) (an attorney whose law firm represents insurers discusses the holding in *Level 3* with approval).

of their shares at the time of the sale and the value of the shares at the time of trial.[141] The allegations and the relief sought in the case were fairly standard for securities fraud cases.[142] Also typical of shareholder actions, the case settled for $11.8 million without an admission of liability or fault.[143]

An insurer had issued a D&O policy to the directors and officers of the acquiring company that covered, among other things, "losses" incurred in securities cases, but the insurer refused to pay the settlement.[144] "Loss" was defined in the policy as "the total amount which any Insured Person becomes legally obligated to pay . . . including, but not limited to . . . settlements."[145] The insurer contended that the relief sought in the case, and ultimately required to be paid under the settlement agreement, was "restitutionary in nature" and therefore, it (1) was not really a "loss" and (2) was against public policy to allow insurance to cover such relief.[146]

On appeal, the Seventh Circuit agreed with the insurer.[147] In explaining its decision, the court stated:

> [The relief sought] is standard damages relief in a securities-fraud case. But it is restitutionary in character. It seeks to divest the defendant of the present value of the property obtained by fraud, minus the cost to the defendant of obtaining the property. In other words, it seeks to deprive the defendant of the net benefit of the unlawful act, the value of the unlawfully obtained stock minus the cost to the defendant of obtaining the stock. It is equivalent to seeking to impress a constructive trust on the property in favor of the rightful owner. How the claim or judgment order or settlement is worded is irrelevant. An insured incurs no loss within the meaning of the insurance contract by being compelled to return property that it had stolen, even if a more polite word than "stolen" is used to characterize the claim for the property's return.[148]

The policyholder countered that the primary purpose of D&O insurance is to protect directors and officers against securities fraud claims and that the directors and officers had not been found liable for anything or been ordered to disgorge any ill-gotten gains because they had settled the

141. *Id*. at 910.
142. *Id*. at 911.
143. *Id*. at 909.
144. *Id*. (ellipses in original).
145. *Id*.
146. *Id*. at 909-10.
147. *Id*. at 911.
148. *Id*. at 910-11.

case.[149] The Seventh Circuit dismissed such reasoning, stating:

> That [argument] can't be right . . . . It would mean, as [the policyholder's] lawyer confirmed at argument, that if [the policyholder], seeing the handwriting on the wall, had agreed to pay the plaintiffs in the fraud suit all they were asking for (a very large amount-almost $70 million), which they surely would not have done had there been no evidence of fraud (no rational defendant settles a nuisance suit for the full amount demanded in the complaint, unless the amount is trivial), [the insurer] would still be obligated to reimburse [the policyholder] for that amount. And that would enable [the policyholder] to retain the profit it had made from a fraud.[150]

The legal analysis in the *Level 3* decision is subject to significant criticism. First, as also noted by another legal scholar, the Seventh Circuit used provocative language such as "thief" and "stolen" to describe the policyholder and the amount paid to settle the claims even though it is standard business practice in the corporate world for companies to acquire other companies in exchange for stock and to do so for as little as possible.[151] The fact that an acquired company may actually be worth more than the purchase price does not mean the buyer "stole" the company. Nonetheless, under the reasoning of the Seventh Circuit, any deal that turns out to be unfavorable for one of the parties could be characterized as a form of theft.

Second, the Seventh Circuit essentially held the policyholder would have to prove its conduct was not fraudulent in order to recover under a D&O policy even though the policyholder settled without an admission of liability or fault.[152] Such a holding is simply wrong from a legal perspective because insurers bear the burden of proving that the conduct at issue falls within an exclusion that precludes coverage.[153]

Third, in order to make an insurance coverage determination, a court is supposed to evaluate only: 1) the allegations in the underlying complaint

149. *Id*. at 911.

150. *Id*. at 911 (citing Reliance Group Holdings, Inc. v. Nat'l Union Fire Ins. Co., 188 A.D.2d 47, 55 (NY App. Div. 1993) ("[D]etermination of this appeal should not hinge on the circumstance that [the policyholder] made restitution by way of settlement instead of in satisfaction of a judgment after trial.")).

151. *See* JEFFREY W. STEMPEL, STEMPEL ON INSURANCE CONTRACTS, § 19.04[B] (3d ed. 2012) (discussing the harsh language used in the *Level 3* decision).

152. *See Level 3*, 272 F.3d at 911-12 (noting that the policyholder "has made no attempt to show that the fraud suit was groundless and the settlement merely an effort to avoid the expense of defending a nuisance suit").

153. *See supra* note 81 (showing that an insurer has the burden of proof regarding an exclusionary clause as a defense).

(for the duty to defend) and the findings of fact (for indemnity if the case is tried), 2) the relevant policy language, 3) the purpose of the insurance, and 4) the rules of policy interpretation.[154] The court should not be evaluating whether the amount of the settlement was a "nuisance" value settlement or an implicit admission of wrongdoing.[155] Thus, the Seventh Circuit erred in *Level 3* by analyzing whether, in the court's judgment, the settlement was fair to the underlying claimants or was an implicit admission of wrongdoing.

Fourth, when the *Level 3* decision is closely analyzed, one will note that the Seventh Circuit spent very little time actually discussing or analyzing: (1) the actual policy language at issue, which did not expressly exclude coverage for claims for restitution or (2) whether the insurer agreed to provide the coverage for the claims at issue under the terms of the policy in exchange for a premium.[156] In fact, the underlying claims at issue in *Level 3* were fairly routine security law claims for which corporate managers specifically purchase D&O coverage and for which insurers readily accept premiums.[157]

Finally, insurers do not need the judicial activism evidenced in the *Level 3* decision in order to avoid liability for claims for restitution because insurers draft the language contained in policies and they can and do

154. *See, e.g.*, *supra* Parts II and III (discussing the relevant policy language and rules of policy interpretation). *See also* Cyprus Amax Minerals Co. v. Lexington Ins. Co., 74 P.3d 294, 299 (Colo. 2003) ("Initially, we must revisit the distinction between an insurance company's duty to defend its insured, and its duty to indemnify. The duty to defend concerns an 'insurance company's duty to affirmatively defend its insured against pending claims.' We have long held that to determine whether a duty to defend exists, courts must look no further than the four corners of the underlying complaint (the 'four corners' or 'complaint' rule). An insurer is not excused from this duty 'unless there is no factual or legal basis on which the insurer might eventually be held liable to indemnify the insured.' Hence, if the alleged facts even potentially trigger coverage under the policy, the insurer is bound to provide a defense.") (citations omitted); Am. & Foreign Ins. Co. v. Jerry's Sport Ctr., Inc., 2 A.3d 526, 541 (Pa. 2010) ("The question of whether a claim against an insured is potentially covered is answered by comparing the four corners of the insurance contract to the four corners of the complaint . . . . An insurer may not justifiably refuse to defend a claim against its insured unless it is clear from an examination of the allegations in the complaint and the language of the policy that the claim does not potentially come within the coverage of the policy . . . . In making this determination, the 'factual allegations of the underlying complaint against the insured are to be taken as true and liberally construed in favor of the insured . . . .' Indeed, the duty to defend is not limited to meritorious actions; it even extends to actions that are 'groundless, false, or fraudulent' as long as there exists the possibility that the allegations implicate coverage.") (citations omitted).

155. STEMPEL, *supra* note 151, § 19.04[B] (criticizing the factual judgments made in the *Level 3* decision).

156. *Level 3*, 272 F.3d at 909-10.

157. *See supra* Part C (shareholder claims for restitution). *See also* STEMPEL, *supra* note 151, § 19.04[B] (noting that the losses in this case are viewed as "common").

expressly exclude coverage for such relief when they desire to do so.[158] In short, because insurance policies are contracts of adhesion drafted by sophisticated insurers, the Seventh Circuit should have interpreted and applied the terms of the policy subject to the rules of policy interpretation instead of substituting its own view of justice.

2. The Bank of the West Case

One of the principal cases the Seventh Circuit cited and relied upon in *Level 3* to support its decision was *Bank of the West v. Superior Court of Contra Costa County*.[159] In *Bank of the West*, the policyholder, a bank, developed a program to finance automobile premiums for customers to be paid in installments.[160] The policyholder used insurance agents to sell the program to customers.[161] Under the program, the insurance agents obtained the customers' power of attorney and applied for loans to pay the premiums in the customers' names.[162] Many customers were unaware that the agents had agreed to loans in the customers names and that the loans were in fact made.[163] The customers were also unaware of the terms of the loans, which had interest rates over 126%, substantial fees and penalties, and did not allow for unilateral cancellation by the customer.[164]

158. *See supra* Part II (discussing relevant policy language). *See also* STEMPEL, *supra* note 151, § 19.04[B] (questioning whether the insurers in *Level 3* needed judicial activism). Some D&O policies do contain express exclusions for claims for restitution so it is irrefutable that insurers know how to draft policy language to exclude such claims. *See, e.g.*, McCostis v. Home Ins. Co. of Ind., 31 F.3d 110, 112 (2d Cir. 1994) (the definition of the term "damages" in the policy expressly excluded coverage for "the return of or restitution of legal fees, costs and expenses"); Berkeley v. Home Ins. Co., Civ. A. 93-0254-LFO, 1994 WL 35865 (D.D.C. Jan. 26, 1994) *aff'd and remanded*, 68 F.3d 1409 (D.C. Cir. 1995); Trautman & Altenbaumer-Price, *supra* note 89, at 349 (the term "loss" is defined in some policies "to exclude such things as disgorgement, restitution, taxes, fines and penalties"). Notably, if policyholders are aware of the existence of such exclusions, however, then insurers that have added such exclusions to their policies may be at a competitive disadvantage to insurers that do not contain such exclusions in their policies when attempting to sell their policies, as D&O insurers discovered when they tried to impose corporate governance requirements on policyholders in exchange for lower premiums or as a condition to selling them policies. *See* Baker & Griffith, *The Missing Monitor*, *supra* note 67, at 1808-12 (describing empirical research that showed the D&O insurers were mostly unable to cause any business practice changes regarding corporate governance concerns, including an example of a D&O insurer that was forced to drop a loss prevention program in response to a decline in business).

159. *Level 3*, 272 F.3d at 909.

160. Bank of the W. v. Superior Court, 833 P.2d 545, 547-48 (Cal. 1992).

161. *Id.* at 548.

162. *Id.*

163. *Id.*

164. *Id.*

A consumer class action was filed against the policyholder where the class claimants sought "restitution . . . of any and all amounts collected by defendants through their unlawful and unfair business practices . . . ."[165] The policyholder ultimately settled the case by agreeing to make changes to the program and by paying the class claimants $500,000.[166]

When the claim was tendered to the policyholder's CGL insurer, the insurer denied coverage on the basis, among other things, that the policy did not cover claims for restitution.[167] The policy provided, "[the insurer] will pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages . . . ," and the term "damages" was undefined.[168] Thus, the question that ultimately was presented to the California Supreme Court was whether the $500,000 payment required under the settlement agreement was "damages."

The California Superior Court held the settlement payment was neither "damages" nor insurable, reasoning as follows:

> It is well established that one may not insure against the risk of being ordered to return money or property that has been wrongfully acquired. Such orders do not award "damages" as that term is used in insurance policies . . . . If insurance coverage were available for monetary awards [for unfair business practices], a person found to have violated the act would simply shift the loss to his insurer and, in effect, retain the proceeds of his unlawful conduct. Such a result would be inconsistent with the act's deterrent purpose. As we have previously explained, "'[t]o permit the [retention of even] a portion of the illicit profits, would impair the full impact of the deterrent force that is essential if adequate enforcement [of the law] is to be achieved. One requirement of such enforcement is a basic policy that those who have engaged in proscribed conduct surrender all profits flowing therefrom.'"[169]

The court further explained the public policy behind its holding:

> When the law requires a wrongdoer to disgorge money or property acquired through a violation of the law, to permit the wrongdoer to transfer the cost of disgorgement to an insurer would eliminate the incentive for obeying the law. Otherwise, the wrongdoer would retain the proceeds of his illegal acts,

165. *Id*. (ellipses in original).

166. *Id*. at 548-49.

167. *Id*. at 549.

168. *Id*. at 550 (alterations in original omitted).

169. *Id*. at 553-54 (some alterations in original) (citing Fletcher v. Sec. Pac. Nat'l Bank, 591 P.2d 51 (Cal. 1979) and quoting SEC v. Golconda Mining Co., 327 F. Supp. 257, 259-60 (S.D.N.Y. 1971)).

merely shifting his loss to an insurer.[170]

Unlike the *Level 3* decision, the *Bank of the West* decision is based upon something more than the court's own sense of justice or public policy. In particular, the California Supreme Court based its decision largely upon the legislative intent behind the Unfair Business Practices Act that gave rise to the claims against the policyholder at issue:

> The section [of the statute at issue] also authorizes courts to make such orders as "may be necessary to restore to any person in interest any money or property, real or personal, which may have been acquired by means of such unfair competition." The purpose of such orders is "to deter future violations of the unfair trade practice statute and to foreclose retention by the violator of its ill-gotten gains." The Legislature considered this purpose so important that it authorized courts to order restitution without individualized proof of deception, reliance, and injury if necessary to prevent the use or employment of an unfair practice.[171]

Thus, unlike the Seventh Circuit in *Level 3*, the court did not create law based upon its own views of public policy, but rather, relied upon the legislature's pronouncements in that regard.

Nonetheless, the court's analysis of whether the undefined term "damages" that is contained in CGL policies covers claims for restitution is based solely upon public policy arguments and California law rather than the rules of policy interpretation and the common definitions of the term "damages." As discussed in Part III, any award or settlement that requires the payment of money to a claimant constitutes "damages" for insurance purposes. As noted by numerous other courts, policyholders do not make fine legal distinctions between claims seeking monetary restitution and claims seeking only money when they purchase insurance to cover claims asserted against them.[172] Also, under the reasoning in *Bank of the West*, insurance coverage would not be allowed in many breach of contract claims where the plaintiff is not seeking restitution but rather only a money award because the claims asserted in breach of contract cases typically are predicated upon the idea that the breaching party has wrongfully acquired money or property from the non-breaching party.

Despite these analytical problems, several courts in other jurisdictions have employed reasoning similar to the *Level 3* and *Bank of the West*

170. *Id.* at 555 (citations omitted).

171. *Id.* at 553 (citations omitted) (quoting *Fletcher v. Sec. Pac. Nat'l Bank*, 591 P.2d at 55).

172. *See supra* note 105 (discussing how "damages" has been interpreted broadly to include legal and equitable forms of relief).

decisions and have held it would be against public policy to allow insurance to cover claims for relief that could be characterized as seeking restitution.[173]

B. *Public Policy Arguments in Favor of Allowing Insurance to Cover Claims for Restitution*

1. The Theoretical Foundation of the Public Policy against Allowing Insurance to Cover Claims for Restitution is Unsound

The soundness of the theoretical foundation underlying the public policy against allowing insurance to cover claims for restitution is questionable. Moral hazard,[174] the basic insurance law theory underlying the *Level 3* and *Bank of the West* decisions, posits that policyholders would be encouraged to engage in misconduct if claims for restitution were allowed to be covered by insurance because policyholders would have little or no incentive not to engage in misconduct if the injuries caused by their bad behavior were covered.[175] Courts often apply this logic in the first party insurance context such in situations where a court rejects a beneficiary's attempt to recover under a life insurance policy where the beneficiary murdered the insured person.[176] Similarly, if the policyholder

173. *See supra* note 138 (discussing why courts have rejected claims that insurance policies should pay damages for money wrongfully obtained by the policyholder).

174. *See supra* note 6 (defining the concept of moral hazard).

175. Of course, a moral hazard argument can be made against allowing insurance to cover all types of claims, which is that the presence of insurance lessens the financial impact of the loss or liability so people are encouraged to take less care to avoid losses and accidents due to the presence of insurance. *See supra* note 6. Nonetheless, despite such moral hazard concerns, insurance is still allowed to cover countless perils and types of liabilities due to the important risk transference and risk management role that insurance plays and the importance of compensating innocent victims. *See, e.g.*, Jeffrey W. Stempel, *The Insurance Policy as Social Instrument and Social Institution*, 51 Wm. & Mary L. Rev. 1489 (2010).

176. *See, e.g.*, New Eng. Mut. Life Ins. Co. v. Null, 605 F.2d 421, 424 (8th Cir. 1979) (citing "the accepted rule that a life insurance policy is void *ab initio* when it is shown that the beneficiary thereof procured the policy with a present intention to murder the insured"); Commercial Travelers Mut. Accident Assn. v. Witte, 406 S.W.2d 145, 149 (Ky. 1966) (a beneficiary cannot recover life insurance proceeds if he murders the insured); 1B JOHN A. APPLEMAN & JEAN APPLEMAN, INSURANCE LAW AND PRACTICE, at 481 (1981) ("It has uniformly been held that a beneficiary under a contract of personal insurance who murders the insured cannot recover the policy benefits."); Christopher C. French, *Debunking the Myth that Insurance Coverage is Not Available or Allowed for Intentional Torts or Damages*, 8 Hastings Bus. L. J. 65, 93 (2012) ("The basic theory, known as the "moral hazard" problem, posits that the policyholder is encouraged to engage in bad behavior because the policyholder would either be rewarded for bad behavior by being able to recover under insurance policies for the damage he causes to his own property . . .").

intentionally destroyed the property by arson, then courts often will not require an insurer to cover the amount of a property loss.[177] Such decisions make sense in the first party context because the policyholder's conduct is tantamount to insurance fraud and often is criminal.

Yet, when examined, the suggestion that a policyholder would be deterred from engaging in illegal conduct if liability insurance were not available to compensate injured parties is suspect. In fact, there is scant empirical evidence to support the argument that a primary deterrent to corporate manager misconduct at the center of shareholder litigation is the unavailability of insurance to cover the injuries caused by such conduct.[178] Indeed, in many instances, there are substantial deterrents to convince corporate managers not to engage in criminal behavior that are unrelated to insurance. For example, shareholder fraud is a felony.[179] One would expect that imprisonment would be a better deterrent to corporate misconduct than the forfeiture of insurance proceeds.[180]

In addition, what empirical evidence exists that a corporate manager actually possesses a copy of the company's D&O insurance policy, reviews it to determine whether the insurance will cover the potential shareholder claims that could be asserted, and then engages in the improper conduct

177. *See, e.g.,* 12 JOHN A. APPLEMAN & JEAN APPLEMAN, INSURANCE LAW AND PRACTICE, at 7031 ("Arson by the insured will prevent him from recovering."); JERRY & RICHMOND, *supra* note 6, at 422-23. *See also* Checkley v. Illinois Cent. R.R., 100 N.E. 942, 944 (Ill. 1913) ("A fire insurance policy issued to any one, which purported to insure his property against his own willful and intentional burning of the same, would manifestly be condemned by all courts as contrary to a sound public policy. . . ."), *quoted in* U.S. Fire Ins. Co. v. Beltmann N. Am. Co., 695 F. Supp. 941, 948 (N.D. Ill. 1988). One commentator refers to this as the "'barn burning' defense," stating "the insured who intentionally burns his own barn is not entitled to collect the insurance on it!" WARREN FREEDMAN, RICHARDS ON THE LAW OF INSURANCE, §1:13, at 48-49 (6th Ed. 1990).

178. *See, e.g.*, Ranger Ins. Co. v. Bal Harbour Club, Inc. 509 So.2d 945, 947 (Fla. Dist. Ct. App. 1987) ("The proposition that insurance taken out by an employer to protect against liability under Title VII will encourage violations of the Act is . . . speculative and erroneous."); *French, Debunking the Myth, supra* note 176, at 97 (discussing the lack of empirical evidence to support the argument that intentional misconduct would be deterred by the lack of insurance to cover the liabilities that arise from such misconduct).

179. *See, e.g.*, 18 U.S.C.A. § 1348 (2002) (authorizing prison sentences of as high as 25 years under Sarbanes-Oxley for misrepresentations regarding securities).

180. Of course, the fact very few people responsible for the financial collapse of 2008 have been prosecuted undermines the deterrent effect of imprisonment for corporate misconduct. *See, e.g.*, Nizan Geslevich Packin, *Breaking Bad? Too-Big-To-Fail Banks Not Guilty as Not Charged*, 91 Wash. U. L. Rev. 1089 (2014); Jed S. Rakoff, Peter J. Henning, *Making Sure "The Buck Stops Here": Barring Executives for Corporate Violations*, 2012 U. Chi. Legal F. 91 (2012); *The Financial Crisis: Why Have No High-Level Executives Been Prosecuted?*, The New York Review of Books (April 3, 2014); Gretchen Morgenson and Louise Story, *In Financial Crisis, No Prosecutions of Top Figure*, N.Y. Times (April 14, 2011).

because the manager is confident that she can do so with financial impunity? In short, such arguments are based upon theory, not evidence.

Further, if punishment for and deterrence of corporate misconduct were really overriding public policies that would be diluted by allowing insurance to cover claims for restitution, then why do most states have laws that expressly allow corporations: 1) to indemnify their corporate managers against claims for personal misconduct and 2) to purchase insurance to cover the liabilities arising from such misconduct?[181] The most persuasive source of public policy – statutes – suggests that society has determined that punishing and deterring corporate misconduct are not the most important public policies when it comes to corporate management and governance. If punishment for and deterrence of corporate misconduct were the overriding public policies, then the legislation that has been passed across the country that insulates corporate managers from financial liability for their misconduct would not exist. And, of course, one would expect widespread criminal prosecution of corporate managers who violate securities laws, but that has not happened in the wake of the 2008 financial crisis.[182] Consequently, the argument that the overriding public policy prohibits liability insurance from covering claims for restitution rings hollow.

2. Competing Public Policies that Weigh in Favor of Allowing Insurance to Cover Claims for Restitution

On the other hand, there are several competing public policies that favor allowing insurance recoveries for claims seeking restitution such as the disgorgement of ill-gotten gains. For example, public policy favors compensating innocent victims.[183] Many, if not most, injured people would

181. *See supra* note 70.

182. *See supra* note 180.

183. *See, e.g.,* Yousuf v. Cohlmia, 718 F. Supp. 2d 1279, 1288 (N.D. Okla. 2010) (compensating a wrongdoer's innocent victims outweighs the concern that the wrongdoer would unjustly benefit); St. Paul Fire & Marine Ins. Co. v. Jacobson, 826 F. Supp. 155, 163-64 (E. D. Va. 1993) (where insurance policy does not explicitly exclude coverage of intentional acts, public policy of compensating innocent victims outweighs public policy of not permitting coverage of intentional action); St. Paul Fire & Marine Ins. Co. v. Asbury, 720 P.2d 540, 542 (Ariz. Ct. App. 1986) (Arizona public policy favors compensating injured persons); St. Paul Fire & Marine Ins. Co. v. Shernow, 610 A.2d 1281, 1285-86 (Conn. 1992) (public policy does not prohibit indemnity for compensatory damages flowing from dentist's intentional sexual assault of patient); Hudson v. State Farm Mut. Ins. Co., 569 A.2d 1168, 1170-71 (Del. 1990) (refusing to void coverage for intentional wrongdoing under an automobile policy because of the competing public policy behind the state motor vehicle financial responsibility law); Grinnell Mut. Reinsurance Co. v. Jungling, 654 N.W.2d 530, 539 (Iowa 2002) ("Compensating [the policyholder's] innocent victims [of fraud] — the

go uncompensated for their injuries in the absence of insurance because bad actors, whether corporate managers or other tortfeasors, often do not have sufficient assets to adequately compensate the people they injure.[184] Indeed, in the context of shareholder litigation where the plaintiffs often seek to recover hundreds of millions or billions of dollars from corporate managers, despite the exceptionally high compensation of corporate managers today, most of them simply do not have sufficient personal assets to cover the settlements (or judgments in the few cases tried) in such cases.[185] Thus, because the victims often would go uncompensated in the absence of D&O insurance, providing the victims a source of funds from which their losses can be paid is an important public policy that weighs in favor of allowing insurance to cover claims for restitution.

Another competing public policy that favors allowing insurance to cover claims for restitution is the public policy that favors the enforcement of contracts, including insurance policies, in accordance with their terms. As one court has noted, when it comes to insurance, there are numerous competing public policies: "One such policy is that an insurance company which accepts a premium for covering all liability for damages should honor its obligation."[186] Insurers draft the language contained in their

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Steckels — outweighs the concern that [the policyholder] will unjustly benefit from coverage."); Vigilant Ins. Co. v. Kambly, 319 N.W.2d 382, 385 (Mich. Ct. App. 1982) (allowing insurance recovery for a physician's sexual assault of his patient because "[i]t is not the insured who will benefit, but the innocent victim who will be provided compensation for her injuries"); Independent Sch. Dist. No. 697 v. St. Paul & Marine Ins. Co., 495 N.W.2d 863, 868 (Minn. Ct. Ap.) (victims of doctor's sexual abuse can be compensated through doctor's professional liability policy) (*citing Ranger*, 549 So.2d at 1010 n.1 (Ehrlich, C.J., dissenting)), *review granted*, No. 92-1625, 1993 Minn. LEXIS 225 (Mar. 30, 1993); S.S. v. State Farm Fire & Cas. Co., 808 S.W.2d 668, 671 (Tex. Ct. App. 1991) (concluding that a homeowner's insurance policy provides coverage for the transmission of a sexually transmitted disease by relying on the analogous context of automobile insurance in which public policy favors the compensation of tort victims).

184. *See supra* note 4.

185. BAKER & GRIFFITH, ENSURING CORPORATE MISCONDUCT, *supra* note 5, at 142.

186. Creech v. Aetna Cas. & Sur. Co., 516 So.2d 1168, 1174 (La. Ct. App. 1987). *Accord* School Dist. for the City of Royal Oak v. Cont'l Cas. Co., 912 F.2d 844, 848 (6th Cir. 1990), *reh'g denied*, 921 F.2d 625 (6th Cir. 1990) (public policy favors enforcing the terms of insurance policies and "common sense suggests that the prospect of escalating insurance costs and the trauma of litigation, to say nothing of the risk of uninsurable punitive damages, would normally neutralize any stimulative tendency that insurance might have."); *Royal Oak* 912 F.2d at 849 ("Public policy normally favors enforcement of insurance contracts according to their terms.") (citing Ranger Ins. Co. v. Bal Harbour Club, Inc., 549 So.2d 1005, 1010 n.1 (Fla. 1989) (Ehrlich, C.J., dissenting); Northwestern Natl. Cas. Co. v. McNulty, 307 F.2d 432, 444 (5th Cir. 1962) (Gewin, J., concurring) (noting the public policy favoring the enforcement of contracts); Union Camp Corp. v. Cont'l Cas. Co., 452 F. Supp. 565, 568 (S.D. Ga. 1978) ("Exercise of the freedom of contract is not lightly to be interfered with. It is only in clear cases that contracts will be held void as against public

policies so they do not need courts to resort to public policy arguments to help them avoid coverage for the types of claims that they do not want to insure. Insurers can simply state, in clear terms, the specific types of claims that are not covered under the policy.[187] Indeed, as previously noted, some D&O policies do expressly exclude coverage for claims for restitution.[188] Thus, if an insurer does not want to cover claims for restitution, but fails to make that clear in the policies it sells, then public policy favors enforcing the terms of the policy by requiring the insurer to honor the deal for which it accepted premiums.

Instead of asking courts to strike down the agreements they have drafted and entered, insurers should exercise their considerable insurance policy drafting powers to discourage undesirable behavior by their policyholders by expressly excluding coverage for such claims.[189] Indeed, several courts have recognized this point and commented that insurance companies have ample ability, at the policy drafting stage, to prevent policyholders from being shielded from liability for intentional misconduct.[190]

policy."); Indep. Sch. Dist. No. 697 v. St. Paul Fire & Marine Ins. Co., 495 N.W.2d 863, 868 (Minn. Ct. App. Mar. 30, 1993) (noting that it is questionable whether the inference that insurance stimulates wrongdoing can overcome the "competing public policies . . . that favor freedom of contract and the enforcement of insurance contracts according to their terms").

187. Creech, 516 So.2d at 1174.

188. *See supra* note 158.

189. *See, e.g.*, *Ranger*, 509 So.2d at 948 ("The marketplace itself will discourage wrongful acts of discrimination."); *Indep. Sch. Dist.*, 495 N.W.2d at 867 (quoting *Royal Oak*, 912 F.2d at 848); Omri Ben-Shahar and Kyle D. Logue, *Outsourcing Regulation: How Insurance Reduces Moral Hazard*, 111 MICH. L. REV. 197 (2012) (analyzing insurers' ability to regulate policyholders' conduct as a substitute for government regulation).

190. *See, e.g.*, *Royal Oak*, 912 F.2d at 849 ("Had the company wished to exclude coverage for intentional religious discrimination in employment, it could and should have said so."); Union Camp Corp. v. Cont'l Cas. Co., 452 F. Supp. 565, 568 (S.D. Ga. 1978) ("Continental and other insurers which have issued policies containing such clauses have not up to now conceived that they were violating public policy by writing insurance policies insuring against losses resulting from discriminatory employment practices."); *Ranger*, 509 So.2d at 947 (citing *Union Camp*, 452 F. Supp. at 567-68); University of Ill. v. Cont'l Cas. Co., 599 N.E.2d 1338, 1350-51 (Ill. App. Ct. 1992) ("The insurer is an informed contracting party with no inferiority in bargaining position and should not be allowed to escape from the contract it freely entered into . . . . This court will not rewrite . . . [the] policy to create an exclusion."), *appeal denied*, 606 N.E.2d 1235 (Ill. 1992); *Indep. Sch. Dist.*, 495 N.W.2d at 868 ("The carrier is, of course, free to expressly provide an exclusion for such conduct in the future.").

3. Insurance Is Already Allowed to Cover Numerous Types of Intentional Torts

Another fact that weighs heavily in favor of allowing insurance to cover claims for restitution is the fact that, despite public policy concerns to the contrary, many intentional injuries or damages caused by a policyholder are already allowed to be expressly covered under liability policies sold by insurers.[191] In other words, insurers have been accepting premiums for and paying claims against their policyholders for liabilities due to intentional misconduct for decades.[192] For example, under the Personal and Advertising Injury Liability Section of the 2007 standard form CGL policy form quoted above in Part II.A, coverage for intentional torts such as malicious prosecution,[193] wrongful eviction,[194] defamation,[195] libel,[196]

191. *See supra* Part II.A; French, *Debunking the Myth, supra* note 176.

192. French, *Debunking the Myth, supra* note 176, at 67-69.

193. *See, e.g.,* Global NAPs, Inc. v. Fed. Ins. Co., 336 F.3d 59, 61 (1st Cir. 2003) (recognizing that the purchased insurance policy covered malicious prosecution); Atl. Mut. Ins. Co. v. Atlanta Datacom, 139 F.3d 1344, 1346 (11th Cir. 1998) (recognizing that the insurance policy covered malicious prosecution, but noting that malicious prosecution under Georgia law is limited to the pursuit of criminal actions); City of Erie v. Guar. Nat'l Ins. Co., 935 F. Supp. 2d 610, 615 (W.D. Pa. 1996) (the duty to defend in a malicious prosecution matter is triggered when first criminal charges were filed); Lincoln Nat'l Health & Cas. Ins. Co. v. Brown, 782 F. Supp. 110, 112-13 (M.D. Ga. 1992) (where policy specifically includes malicious prosecution as a covered claim, provision limiting coverage to unintentional acts does not apply); Fluke Corp. v. Hartford Accident & Indem. Co., 34 P.3d 809, 814 (Wash. 2000) (concluding that coverage for malicious prosecution does not violate public policy).

194. *See, e.g.*, Century Sur. Co. v. Seductions, LLC, 349 Fed. Appx. 455, 459 (11th Cir. 2009) (recognizing insurance coverage for wrongful eviction, but noting split in authority regarding the necessity of possessory interest to assert claim); Nautilus Ins. Co. v. BSA Ltd. P'ship, 602 F. Supp. 2d 641, 651 (D. Md. 2009) (coverage defining personal and advertising injury included wrongful eviction); Westfield Ins. Group v. J.P.'s Wharf, Ltd., 859 A.2d 74,77 (Del. 2004) (recognizing insurance coverage for wrongful eviction, but not finding coverage because the plaintiffs did not have a possessory interest); Dixon Distrib. Co. v. Hanover Ins.Co., 641 N.E.2d 395, 398 (Ill. 1994) (umbrella policy covered wrongful eviction); Sallie v. Tax Sale Investors, 814 A.2d. 572, 574 (Md. Ct. App. 2002) ("[C]overage for the wrongful eviction may exist if there is a sufficient connection between the wrongful eviction and . . . the operation of, or operations incidental to, the designated premises.").

195. *See, e.g.*, Indiana Ins. Co. v. North Vermillion Comm. Sch. Corp., 665 N.E.2d 630, 635 (Ind. Ct. App. 2002) (duty to defend arose from claims alleging slander and libel); Cmty. TV Corp. v. Twin City Fire Ins. Co., 15 Mass. L. Rep. 435 *4 (Mass. Super. 2002) (although the insured did not expressly allege defamation as a cause of action, a duty to defend arose where alleged facts constituted defamatory act); McCormack Baron Mgmt. Services Inc. v. Am. Guar. & Liab. Ins Co., 989 S.W.2d 168, 170 (Mo. 1999) (recognizing in defamation case that so long as "the complaint merely alleges facts that give rise to a claim potentially within the policy's coverage, the insurer has a duty to defend"); Town of Massena v. Healthcare Underwriters Mut. Ins. Co., 779 N.E.2d 167, 171-72 (N.Y. 2002)

slander,[197] disparagement,[198] and invasion of privacy[199] are all expressly provided.

There is little question that most, if not all, of these types of torts are often committed intentionally by policyholders. Indeed, is it even possible to unintentionally prosecute someone maliciously? The "malicious" qualification in the phrase "malicious prosecution," by definition, means there was an improper intent. Similarly, can someone wrongfully evict someone unintentionally? It is hard to imagine unintentionally or unknowingly evicting someone. When an individual disparages another, is it typically done unintentionally? Coverage for all of these intentional torts and many more are expressly provided under the standard form language in CGL policies and courts routinely require insurers to pay such claims.[200]

Similarly, insurance is also available to cover improper employment practices despite the fact that many such claims arise due to intentionally

(finding the insurer had a duty do defend in defamation case); Butts v. Royal Vendors, Inc., 504 S.E. 2d 911, 916 (W. Va. 1998) (finding a duty to defend in a defamation case where elements in complaint were "reasonably susceptible of an interpretation that the claim may be covered by the terms of the insurance policies").

196. *See, e.g.*, Indiana Ins. Co. v. North Vermillion Comm. Sch. Corp., 665 N.E.2d 630, 635 (Ind. Ct. App. 2002) (duty to defend arose from claims alleging slander and libel).

197. *Id.*

198. *See, e.g.*, Microtec Research v. Nationwide Mut. Ins. Co., 40 F.3d 968, 972 (9th Cir. 1994) (holding that an insurance policy provided coverage for disparagement and comparing defamation to disparagement by noting that "[disparagement] is more akin to unfair competition than to true libel"); Lime Tree Village Cmty. Club Ass'n v. State Farm Gen. Ins. Co., 980 F.2d 1402, 1406 (11th Cir. 1993) (duty to defend triggered by allegations in complaint that policyholder had falsely and maliciously slandered or disparaged homeowners' titles); Atl. Mut. Ins. Co. v. J. Lamb, Inc., 123 Cal. Rptr. 2d 256, 269 (Cal. Ct. App. 2002) ("Whether characterized as a trade libel or product disparagement, an injurious falsehood directed at the organization or products, goods, or services of another falls within the coverage of the [policy]."); Pekin Ins. Co. v. Phelan, 799 N.E.2d 523, 527 (Ill. App. 2003) (upholding insurance coverage where defendant's statements were specific to plaintiff, they misled, and they tended to influence the consuming public not to buy plaintiffs' services).

199. *See, e.g.*, Universal Underwriters Ins. Co. v. Lou Fusz Auto. Network, Inc., 401 F.3d 876, 883 (8th Cir. 2005) (finding no support in policy for limiting the interpretation of the term "invasion of privacy" and ordinary, lay definitions must be apply); Lineberry v. State Farm Fire & Cas. Co., 885 F. Supp. 1095, 1099 (M.D. Tenn. 1995) (insurer cannot escape explicit coverage for invasion of privacy by reference to exclusion for injuries that were intended or expected); Purrelli v. State Farm Fire & Cas. Co., 698 So.2d 618 (Fla. Ct. App. 1997); Bailer v. Erie Ins. Exch., 687 A.2d 1375, 1376, 1384-85 (Md. 1997) (intentional tort of invasion of privacy covered despite "expected or intended" exclusion); United States Fire Ins. Co. v. St. Paul Fire & Marine Ins. Co., 511 N.E. 2d 127 (Ohio Ct. App. 1986) (duty to defend claim which "potentially" or "arguably" would fall under coverage for invasion of privacy).

200. *See* Part II.

improper employment practices.[201] In addition to being able to recover under CGL and D&O policies for certain types of improper employment practices claims, since the early 1990s employment practices liability insurance has been available.[202] Employment practices liability insurance specifically provides coverage for many intentional and improper employment practices such as racial discrimination, wrongful termination, sexual discrimination and retaliatory discharge.[203]

The Sixth Circuit's consideration of insurance for intentional employment discrimination in *School District for Royal Oak v. Continental Casualty Co*.[204] is instructive in this regard. In *Royal Oak*, the insured school board settled an intentional religious discrimination suit brought by an aggrieved teacher and then sought indemnification for that settlement under a CGL policy.[205] The policy covered "'all loss' that the school district or its employees become legally obligated to pay . . . provided that the subject of the loss does not include 'matters which shall be deemed uninsurable under state law.'"[206]

The district court in *Royal Oak* held that the policy covered the school district's liability for its intentional discrimination.[207] The insurer invoked both the policy exclusion for "matters that are uninsurable under state law" and the public policy argument that Michigan public policy allegedly precluded enforcement of the coverage.[208] Citing cases in which Michigan courts found coverage for a psychiatrist's liability for "felonious sexual activity," the district court held that, "'Michigan does not as a general rule bar recovery under public liability policies simply because some illegal act was involved in the damage.'"[209]

201. *See* French, *Debunking the Myth, supra* note 176, at 89.

202. For various commentators' thoughts regarding issues related to insurance coverage for wrongful employment practices and a discussion of the case law in that area, see Richard A. Bales and Julie McGhahy, *Insuring Title VII Violations*, 27 S. ILL. U. L. J. 71 (2002); Whitney L. Elzen, *Workplace Violence: Vicarious Liability and Negligence Theories as a Two-Fisted Approach to Employer Liability. Is Louisiana Clinging to an Outmoded Theory?,* 62 LA. L. REV. 897 (2002); Jeffrey W. Stempel, *Judge-Made Insurance That Was Not on the Menu: Schmidt v. Smith and the Confluence of Text, Expectation, and Public Policy in the Realm of Employment Practices Liability*, 21 W. NEW. ENG. L. REV. 283 (1999); Francis J. Mootz III, *Insurance Coverage of Employment Discrimination Claims*, 52 U. MIAMI L. REV. 1 (1997); Douglas R. Richmond, *Insurance Coverage for Wrongful Employment Practices*, 48 OKLA. REV. 1 (1995).

203. *Id*.

204. 912 F.2d 844 (6th Cir. 1990).

205. *Id*. at 845-46.

206. *Id*. at 846.

207. *Id*. at 849-50.

208. *Id*. at 847-48.

209. Id. at 849 (quoting Bowman v. Preferred Risk Mut. Ins. Co., 83 N.W.2d 434, 436 (Mich. 1957)).

The Sixth Circuit affirmed. As an initial matter, the court questioned the assumption that insurance for intentional discrimination promotes wrongdoing: "[p]erhaps the existence of liability insurance might occasionally 'stimulate' discrimination, but common sense suggests that the prospect of escalating insurance costs and the trauma of litigation . . . would normally neutralize any stimulative tendency the insurance might have."[210]

The Sixth Circuit then noted that "public policy normally favors enforcement of insurance contracts according to their terms."[211] The court further reasoned that the insurer is responsible for drafting the policy, not the policyholder or the court. Thus, the insurer is in the best position to eliminate coverage for claims it does not want to insure.[212] On this point, the Sixth Circuit quoted the District Court, which noted that, "'insurers can always exclude or limit coverage'" for discrimination.[213] Finally, the Sixth Circuit stated, "had the company wished to exclude coverage for intentional . . . discrimination in employment, it could and should have said so."[214]

Thus, if public policy allows insurance to cover claims for numerous intentional torts and employment discrimination, then one would expect that public policy also would allow insurance to cover claims for restitution.

4. Insurance Already Is Allowed to Cover Punitive Damages

Finally, the public policy arguments against allowing insurance to cover claims for restitution are quite similar to the public policy arguments against allowing insurance to cover punitive damages, which also have been rejected in most jurisdictions. Under the terms of many standard form liability policies, punitive damages are covered because liability policies typically cover all "damages" for which the policyholder is liable without

210. *Id.* at 848. *See also* Ranger Ins. Co. v. Bal Harbour Club, Inc., 509 So.2d 945, 948 (Fla. Dist. Ct. App. 1987) ("[W]rongdoers can be adequately punished under present law by the imposition of punitive damages, where appropriate, since it is against the public policy of this state to insure against such damages."), *revd.*, 549 So.2d 1005 (Fla. 1989); *Ranger*, 509 So.2d at 947 ("The proposition that insurance taken out by an employer to protect against liability under Title VII will encourage violations of the Act is . . . speculative and erroneous.") (quoting Union Camp Corp. v. Cont'l Cas. Co., 452 F. Supp. 565, 567 (S.D. Ga. 1978)); Indep. Sch. Dist. No. 697 v. St. Paul & Marine Ins. Co., 495 N.W.2d 863, 867 (Minn. Ct. App.) (quoting *Royal Oak*, 912 F.2d at 848), *review granted*, No. 92-1625, 1993 Minn. LEXIS 225 (Mar. 30, 1993).

211. 912 F.2d at 849 (citing *Ranger*, 549 So.2d at 1010 n.1 (Ehrlich, C.J., dissenting)).

212. *Id.*

213. *Id.* (quoting the transcript of the proceedings in the district court).

214. 912 F.2d at 849.

distinguishing between compensatory damages and punitive damages.[215] Yet, when it comes to actually paying punitive damages claims, insurers often argue it would be against public policy to do so because awards of punitive damages are often predicated upon egregious misconduct that should be deterred and punished without insurance undermining such goals.[216] To remove the inconsistency between the policy language and insurers' public policy position when punitive damage claims are actually tendered for payment, ISO proposed that punitive damages be expressly excluded from coverage under standard form liability policies in 1977.[217] Notwithstanding their litigation position and public policy pronouncements, however, insurers rejected the proposal because they concluded that doing so would impede their ability to market such insurance.[218]

215. Standard form commercial general liability policies, for example, state that the insurer agrees to pay "all sums" the policyholder is "legally obligated to pay as damages" without limiting the covered damages to only compensatory damages. *See* MALECKI, *supra* note 62, at App. J, p. 470 (defining damages under insurance policy). *See also* Tom Baker, *Reconsidering Insurance for Punitive Damages*, 1998 WIS. L. REV. 101, 115 (1998) ("The agreements do not distinguish among kinds of damages . . . . Indeed, there is little dispute that, on their face, most primary general and automobile policies provide coverage for punitive damages.").

216. *See, e.g.*, Casey v. Calhoun, 531 N.E.2d 1348, 1348 (Ohio Ct. App. 1987); St. Paul Surplus Lines Ins. Co. v. Int'l Playtex, Inc., 777 P.2d 1259, 1269 (Kan. 1989), *cert. denied*, 493 U.S. 1036 (1990); Santos v. Lumbermens Mut. Cas. Co., 556 N.E.2d 983, 990-92 (Mass. 1990); Heartland Stores, Inc. v. Royal Ins. Co., 815 S.W.2d 39, 43 (Mo. Ct. App. 1991); Home Ins. Co. v. Am. Home Prods. Corp., 550 N.E.2d 930, 932 (N.Y. 1990). The inconsistency of insurers asking courts to enforce the terms of their policies strictly when it comes to interpreting the scope of coverage under the insuring agreement and exclusions while simultaneously asking them to ignore the broad meaning of terms such as "damages" on public policy grounds when doing so is to their advantage has not been lost on insurance law scholars. *See, e.g.*, Baker, *Reconsidering Insurance*, *supra* note 215, at 124, n. 78 ("It takes some familiarity with insurance practice to fully appreciate the irony of insurance companies relying upon public policy arguments to avoid paying claims otherwise covered by their policies. The irony comes from the steadfast complaints of insurance interests about judges who 'rewrite' insurance policies to provide coverage that the insurance companies did not sell. According to the same logic, a judge who refused to enforce an insurance company's promise to pay a punitive damages claim would be 'rewriting' the policy to take away coverage that the policyholder bought.").

217. *See* KENNETH S. ABRAHAM, INSURANCE LAW & REGULATION, at 106-07 (5th ed. 2010) (noting that ISO's attempt to introduce a punitive damages exclusion was met with protest); Alan I. Widiss, *Liability Insurance Coverage for Punitive Damages? Discerning Answers to the Conundrum Created by Disputes Involving Conflicting Public Policies, Pragmatic Considerations and Political Actions,* 39 VILL. L. REV. 455, 488 (1994) (acknowledging that ISO's attempt to eliminate coverage for punitive damages was rejected by the insurance industry).

218. Baker, *Reconsidering Insurance, supra* note 215, at 122 (stating that the insurance industry chose to not exclude coverage for punitive damages because such efforts were met with hostility by the industry as a whole and rejected on marketing grounds).

Not surprisingly, when addressing the issue of whether insurers should be permitted to draft policies that cover all types of damages including punitive damages, collect premiums from policyholders for such insurance, and then turn around and argue it is against public policy to provide such coverage when a claim arises, the majority of courts have held that policyholders can recover from their insurers for punitive damages awarded against them unless such damages are expressly excluded from coverage.[219] In addition, even in jurisdictions where courts have held that allowing insurance to cover punitive damages would be against public policy, most of them still allow insurance to cover punitive damages if the punitive damages are awarded on the basis of vicarious liability.[220]

In short, if public policy concerns regarding insurance's impact on the goals of deterring and punishing egregious misconduct that results in the award of punitive damages have been considered and rejected by courts across the country, then one could conclude that similar public policy concerns regarding the impact that allowing insurance to cover claims for restitution would have on the goals of deterrence and punishment of intentional misconduct are not sufficient to override insurers' contractual commitment to cover such claims.

5. State Legislatures Have Concluded Claims for Restitution Should Be Insurable

Finally, when analyzing courts' efforts to determine the prevailing "public policy" in the context of whether insurance should be allowed to cover claims for restitution, on what basis do courts have authority to decide public policy? One answer is the insurance policy language commonly found in the policies themselves, which provide the policies do

219. *See, e.g.*, KALIS ET AL, *supra* note 65, at §5.04 ("Courts in most jurisdictions have held that coverage for even directly assessed punitive damages may be available unless the policy at issue specifically excludes coverage for punitive damages . . ."; George L. Priest, *Insurability and Punitive Damages*, 40 ALA. L. REV. 1009, 1031 (1989) (discussing cases in which coverage for punitive damages was allowed in failed suicide attempts where the motor vehicle involved caused injuries to others); Catherine M. Sharkey, *Calabresi's The Costs of Accidents: A Generation of Impact on Law and Scholarship: Revisiting the Non-Insurable Costs of Accidents*, 64 MD. L. REV. 409 (2005) (discussing the various approaches courts have taken to determine whether punitive damages awards should be covered by insurance).

220. *See, e.g.*, JERRY & RICHMOND, *supra* note 6, at 525-26 (arguing that the imposition of punitive damages for vicarious liability has a less compelling public policy argument); KALIS ET AL, *supra* note 65, at §5.04; Michael A. Rosenshouse, Annotation, *Liability Insurance Coverage as Extending for Punitive or Exemplary Damages*, 16 A.L.R. 4th 11 (1982) (listing the various approaches taken by different states).

not cover claims that are uninsurable as a matter of law.[221] Under the reasonable expectations doctrine and *contra proferentem*, however, such language should not be construed to give courts blanket authority to decide whether claims should be covered under the policies simply as a matter of public policy because it would create too much uncertainty at the time the policy is purchased regarding what types of claims are actually covered. If the obligations of the insurer are unpredictable under the policy when it is purchased, then one of the central purposes of contracts and contract law—that the parties' obligations will be predictable—would be vitiated.[222]

A second, and perhaps better, source for courts' authority is the Restatement (Second) of Contracts. Under the Restatement, a contract or term is unenforceable when public policy considerations clearly outweigh the interest of enforcement.[223] Thus, the Restatement provides courts the authority to decide what is needed to protect the public welfare.[224]

The Restatement provides courts with one central guiding principle in discerning public policy. Specifically, a contract term is unenforceable "if legislation provides that it is unenforceable or the interest in its enforcement is clearly outweighed in the circumstances by a public policy against the enforcement of such terms."[225] In other words, before attempting to discern public policy from other sources, courts should first look at legislation to determine whether the public's duly elected legislature, which purports to represent the public's will, has spoken on the issue.

221. *See, e.g.*, Reliance Grp. Holdings, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa., 188 A.D.2d 47, 53 (N.Y. App. Div. 1993) (the D&O policy excluded coverage for "matters which may be deemed uninsurable under the law pursuant to which this policy shall be construed"); McCalla Corp. v. Certain Underwriters at Lloyd's, London, 2014 WL 1745647 (D. Kan. May 1, 2014) (the D&O policy excluded coverage for "matters uninsurable under the law pursuant to which this Policy is construed").

222. *See, e.g.*, MICHAEL HUNTER SCHWARTZ & DENISE RIEBE, CONTRACTS: A CONTEXT AND PRACTICE CASEBOOK 5 (2009) ("[P]redictability promotes our free market economy by providing certainty for those involved in exchanging goods and services. If a merchant knows the legal consequences of her negotiating efforts or of the language she selects for her contracts, she can act accordingly. This predictability encourages people to enter into contracts, secure in the knowledge that those contracts will be enforced."); Eric A. Posner, *Contract Law and Radical Judicial Error*, 94 NW. U. L. REV. 749, 751 (2000) ("Long-term contracts raise a straightforward, but seemingly intractable problem: in the long term events are so hard to predict, that parties will not be able to allocate future obligations and payments in a way that maximizes the value of their contract.").

223. *See* RESTATEMENT (SECOND) OF CONTRACTS §178 (1981) (stating that terms may be unenforceable on public policy grounds).

224. *See Id.* at §179, cmt. a (commenting that the rule which allows for the derivation of public policy is "an open-ended one that does not purport to exhaust the categories of recognized public policies").

225. *Id.* at §178(1).

With respect to the availability and enforceability of D&O insurance, the legislatures have spoken: insurance is allowed to be purchased and to insure shareholder claims against corporate managers, which typically are claims sounding in fraud for which restitution is sought.[226] Consequently, because legislatures have spoken, judges should not substitute their own judgment for the people's judgment regarding the controlling public policy.

Of course, in addition to potentially assessing public policy incorrectly, another problem with courts substituting their own views on public policy for legislatures' with respect to insurance matters is that it can also lead to the unjust enrichment of insurers and the frustration of the reasonable expectations of policyholders. For example, if a D&O policy or a CGL policy were not enforced after the policyholder has paid a premium and acted in accordance with the reasonable expectation that it has insurance, then the insurer would be unjustly enriched because it has collected and retained a premium in exchange for illusory coverage. Thus, in such circumstances, although it is the policyholder who allegedly has been unjustly enriched according to the allegations of the underlying plaintiffs, the insurer undoubtedly would be unjustly enriched if it were allowed to collect a premium for a policy that purports to cover the types of claims at issue but it were not required to actually cover such claims when they were asserted. In such a situation, not only would the insurer be unjustly enriched at the policyholder's expense, but in many cases the underlying plaintiffs would also be deprived of a significant, if not only, source of funds available to pay their losses. It is hard to imagine how the prevailing public policy could favor such a result.

CONCLUSION

So, do liability insurance policies cover claims for restitution? Yes. Should they be allowed to do so? Yes.

Insurers are sophisticated entities that draft the language contained in liability policies. They collect substantial premiums for policies that purport to provide broad coverage unless the type of claim at issue is expressly excluded. Under the rules of policy interpretation, most versions of standard form D&O policies and CGL policies cover "losses" and

226. *See supra* Part B and note 70. Even in the absence of clear legislative guidance, some courts have expressly stated their reluctance to hold that public policy disallows insurance for the disgorgement of ill-gotten gains when such losses are otherwise covered under liability policies. *See, e.g.*, Cohen v. Lovitt & Touche, Inc., 308 P.2d 1196, 1200 (Ariz. Ct. App. 2013) ("The policy forbidding insurance coverage for restitutionary payments in Arizona is not strong; it has never been expressed in any legislation or judicial decisions . . . . [T]he public has a countervailing interest in the enforcement of insurance policies . . . .").

"damages" without excluding coverage for claims for restitution. Thus, such claims are covered under the terms of the policies and insurers should be required to honor the terms of the deals they enter with policyholders. If insurers were not required to do so, particularly in the context of securities fraud claims, then the D&O policies that insurers sell would provide only illusory coverage for the most common types of claims asserted against corporate managers that purportedly are covered by such policies.

The theoretical and public policy bases for disallowing insurance to cover claims for restitution implicitly or explicitly were rejected long ago when legislatures and courts allowed liability insurance to cover punitive damages and intentional torts. Although there are legitimate theoretical and public policy concerns raised by allowing insurance to cover claims for restitution, such concerns are outweighed by the competing public policy interests of enforcing the terms of contracts and compensating innocent victims.