Motion No. 2019-01062
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# Court of Appeals

*of the*

# State of New York

J.P. MORGAN SECURITIES INC., et al.,

*Plaintiffs-Respondents,*

– against –

VIGILANT INSURANCE COMPANY, et al.,

*Defendants-Appellants.*

## BRIEF OF *AMICUS CURIAE* SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION

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## PRELIMINARY STATEMENT OF INTEREST OF *AMICUS CURIAE*

The Securities Industry and Financial Markets Association ("SIFMA") is a securities industry trade association representing the interests of hundreds of securities firms, banks, and asset managers, including local and regional institutions. SIFMA's mission is to support a strong financial industry, while promoting investor opportunity, capital formation, job creation, economic growth, and trust and confidence in the financial markets. SIFMA is the United States regional manager of the Global Financial Markets Association. It regularly files *amicus curiae* briefs in cases raising issues of vital concern to securities industry participants.

This appeal involves important issues concerning the characterization of remedies in U.S. Securities and Exchange Commission ("SEC") enforcement proceedings and whether and to what extent so-called "disgorgement" remedies are insurable under New York law. These issues are directly relevant to SIFMA's members and to SIFMA's mission of promoting fair and efficient markets and a strong financial services industry. The Appellate Division's opinion, if allowed to stand, would disrupt this Court's precedents, create significant uncertainty in insurance law, frustrate the reasonable expectations of SIFMA members regarding coverage under their existing policies, and impede SIFMA members' ability to obtain insurance to manage business risk.

## QUESTIONS PRESENTED

Plaintiffs (collectively, "Bear Stearns") have sought leave to appeal in order to secure review of the Judgment and Decision, which review would allow the Court to address the following questions:

1. Whether a payment to settle an SEC "disgorgement" claim is "uninsurable" under New York law, even though a key portion of that settlement was used to compensate the alleged losses of investors and which was *not* a disgorgement "of [the settlor's] own illicit gains," *J.P. Morgan Sec. Inc. v. Vigilant Ins. Co.*, 21 N.Y.3d 324, 336 (2013). (A9.) The answer is "no" because this Court's precedents—including this Court's prior decision in this very litigation—recognize that such a payment is insurable in New York, and the Appellate Division erred by treating that decision as impliedly overruled.

2. Whether the U.S. Supreme Court's recent decision in *Kokesh v. SEC*, 137 S. Ct. 1635 (2017), which held that an SEC disgorgement claim is subject to a five-year federal statute of limitations applicable to actions seeking a "penalty," preempts this Court's insurance-law precedents and controls the meaning of the term "penalt[y] imposed by law" as used in private parties' insurance contracts. The answer is "no" because the statute-of-limitations analysis in *Kokesh* is plainly irrelevant to the insurance-law context, and in any event could not limit the scope of coverage for claims under insurance policies that long pre-dated that ruling.

## REASONS FOR GRANTING LEAVE TO APPEAL

In 2013, this Court reversed the Appellate Division and held in this litigation that New York law does not prohibit insurance recovery of a "disgorgement" remedy imposed in an SEC proceeding, provided that the amount for which insurance is sought does not constitute the return of ill-gotten gains by the insured. *See J.P. Morgan Sec. Inc. v. Vigilant Ins. Co.*, 21 N.Y.3d 324, 337 (2013). Five years later, the Appellate Division held on remand that this Court's ruling no longer has any effect because an allegedly "missing" precedent in 2013 had subsequently been supplied by the U.S. Supreme Court in *Kokesh v. SEC*, 137 S. Ct. 1635 (2017). (A14.) But *Kokesh* was limited to the narrow question of whether SEC disgorgement should be considered a "penalty" for the purpose of assessing the applicability of a federal statute of limitations. *Id.* at 1642 n.3. The U.S. Supreme Court did not interpret insurance policy language or decide any question of insurance coverage under New York or any other state's law, and the Supreme Court's analysis has no bearing upon—and certainly does not control—the questions of insurance law before this Court in either 2013 or today.

This Court should grant leave to consider the impact of *Kokesh* on New York insurance law and to correct the Appellate Division's significant legal errors. The Appellate Division's new rule has disrupted settled expectations, created substantial uncertainty, and could be interpreted to forbid insurance for an important category of potential liabilities—claims by the SEC bearing the "disgorgement" label—even though such liabilities were imposed in whole or in part for compensatory purposes and implicate no public policies that would or should preclude the availability of insurance coverage. Moreover, the Appellate Division's decision is unclear as to whether it holds that SEC disgorgement claims are always "uninsurable" as a matter of New York law—as the opinion states at one point (A9)—or whether its opinion is only an interpretation of Bear Stearns' insurance policy, which was issued prior to and covered a period long preceding *Kokesh* (*cf.* A9-12). The Appellate Division's error and resulting market uncertainty will adversely affect many individuals and businesses large and small, which rely on insurance to manage regulatory risk in a highly regulated industry and to ensure their future solvency.

## I. THIS COURT SHOULD GRANT REVIEW TO CONFIRM THAT NEW YORK LAW PERMITS INSURANCE COVERAGE FOR A PAYMENT THAT HAS A COMPENSATORY ELEMENT AND DOES NOT CONSTITUTE THE RETURN OF ILL-GOTTEN GAINS BY THE INSURED.

This Court held in 2013 that no recognized exception to insurability applied to the very disgorgement payment at issue in this case because "the SEC disgorgement payment amount was calculated in large measure on the profits of others," and did not represent Bear Stearns' own alleged ill-gotten gains. *J.P. Morgan*, 21 N.Y.3d at 336. The Appellate Division effectively overruled this

Court's prior decision and erroneously treated indemnity of an SEC "disgorgement" remedy as uninsurable, based upon the recent federal court ruling in *Kokesh* interpreting a *federal* statute of limitations that had nothing to do with insurance. The Appellate Division's legal error would create an unwarranted windfall to insurers and would undermine the reasonable expectations of insurance consumers. This Court should not permit it to go uncorrected.

### A. Payments Are Insurable If They Serve a Compensatory Purpose in Whole or in Part.

Relying on the unexceptional generalization that disgorgement is *often* designed to achieve punitive aims, the Appellate Division improperly concluded that *all* SEC disgorgement payments should be deemed "uninsurable penalt[ies]." (A9; *see* A16-17.) Under the Appellate Division's reasoning, however, it does not matter that Bear Stearns' disgorgement payment in this case was compensatory in nature, a fact not subject to dispute given this Court's prior acknowledgement that the payment "was deposited in a fund to *compensate* any mutual fund investors who had been harmed." 21 N.Y.3d at 331 (emphasis added). Nor does it matter that the SEC decree at issue expressly differentiated between a $90 million "penalty" for which Bear Stearns never sought coverage and the "disgorgement" amount for which coverage is sought. The Appellate Division's overbroad and inflexible rule contravenes this Court's prior decisions and should be reversed.

This Court has long held that the insurability of payments under New York law is determined by facts, not mere labels. In *Zurich Insurance Co. v. Shearson Lehman Hutton, Inc.*, this Court held that a legal remedy labeled as "punitive damages" is nonetheless insurable if it has "compensatory elements," even if "punitive . . . elements" are present as well. 84 N.Y.2d 309, 316-17 (1994). The Court reached this conclusion notwithstanding what it described as the "continuing and unabated force" of the New York "public policy precluding indemnification for punitive damages" awards. *Id.* at 319.

And in 2013, this Court was not swayed by the "disgorgement" label and held that public policy did not bar insurance coverage for SEC disgorgement payments that did not constitute an insured's "disgorgement of its own profits." *J.P. Morgan*, 21 N.Y.3d at 336. The Court's analysis began with the "basic principle that insurance contracts, like other agreements, will ordinarily be enforced as written." *Id.* at 334. The Court saw no reason to deviate from that principle under the circumstances of the case, given that no "precedent"—"from New York or otherwise"—has "prohibited [coverage] where . . . the disgorgement payment was (at least in large part) linked to gains that went to others" rather than going to the insured itself. *Id.* at 337.[1]

[1] The Appellate Division's decision below described *Kokesh* as the "missing precedent" alluded to and unavailable to this Court in its earlier *J.P Morgan* ruling. (A14.) But the "precedent" this (continued…)

The Appellate Division failed to justify its overbroad new rule, which improperly proscribes insurance for SEC disgorgement payments even where they would compensate victims. As this Court has recognized, a court may deem a contractual provision unenforceable only if it "clearly contravene[s]" a "weighty and countervailing" public policy. *159 MP Corp. v. Redbridge Bedford, LLC*, 33 N.Y.3d 353, 360-61 (2019) (citations and ellipsis omitted). "Only a limited group of public policy interests has been identified as sufficiently fundamental to outweigh the public policy favoring freedom of contract." *Id.* at 361. In the insurance context, moreover, this Court has emphasized that it is "reluctant to inhibit freedom of contract by finding insurance policy clauses violative of public policy." *Slayko v. Sec. Mut. Ins. Co.*, 98 N.Y.2d 289, 295 (2002). The Appellate Division's decision is inconsistent with New York's strong public policy in favor of enforcing parties' private contracts, which promotes "certainty," "predictability" and "respect[ for] the autonomy of commercial parties in ordering their own business arrangements." *159 MP Corp.*, 33 N.Y.3d at 360. Because freedom of contract enhances the State's "status as the preeminent commercial center in the United States, if not the world," New York recognizes the doctrine as "'deeply

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Court had not found in *J.P. Morgan*, 21 N.Y. at 337, plainly was precedent precluding insurance "coverage," *id.*, not precedent about the application of a statute of limitations under federal law.

rooted' public policy" and a "right of constitutional dimension." *Id.* at 359 (citing U.S. Const., art. I, § 10).

When applying public policy exceptions to honoring an insurance contract, this Court has rejected a categorical approach based on the remedy's label, and instead has applied the exceptions narrowly and based on the specific facts in each case. This Court has recognized only two "very narrow circumstances" in which a party's right to indemnity under an insurance policy has yielded to a weighty, countervailing New York public policy. *Spandex House, Inc. v. Hartford Fire Ins. Co.*, 2019 WL 4014232, at *12 n.17 (S.D.N.Y. Aug. 26, 2019) (citing *J.P. Morgan*, 21 N.Y.3d at 334-35). Neither of those narrow circumstances exists here.

*First*, although New York courts will not enforce insurance for "damages flowing from" an insured's "intent to injure" others, this Court has applied that exception narrowly. *Pub. Serv. Mut. Ins. Co. v. Goldfarb*, 53 N.Y.2d 392, 400 (1981) (emphasis omitted). In particular, New York law allows insurance coverage for "intentional acts caus[ing] an unintended injury," which do not trigger any public policy exception to coverage. *Id.* at 399; *see id.* at 400-01 ("Where no finding of an intent to injure has been made, nothing in the public policy of this State precludes indemnity for compensatory damages flowing from a defendant's volitional act."). This narrow exception for intended harm, identified in this Court's prior *J.P. Morgan* ruling, is not even arguably implicated here.

*Second*, although New York public policy precludes insurance "indemnification for punitive damage awards," New York law distinguishes indemnity for payments made "solely" to punish an offender from those made for a dual purpose. *Zurich Ins. Co.*, 84 N.Y.2d at 314, 321. To the extent an award "could include both punitive and compensatory elements and there was evidence to support each, [an insurer] must supply coverage." *Id.* at 316-17. "[O]nly when the damage award is of a 'punitive nature' is indemnification precluded by New York policy"; that is, an insurer must indemnify an insured if "damages awarded in the [underlying] action also had a compensatory purpose." *Id.* at 317. Indeed, "[t]he mere fact that an act may have penal consequences does not necessarily mean that insurance coverage for civil liability arising from the same act is precluded by public policy." *Pub. Serv. Mut. Ins. Co.*, 53 N.Y.2d at 399. Thus, where, as here, an amount has been paid to compensate private claimants, and not solely to punish an insured (*see* A16), there is no public policy barrier to insurance coverage.

### B. The Public Interest in the Availability of Insurance Compensation Dictates That Any Exceptions to Insurability Be Applied Narrowly and Prospectively, If at All.

New York's rule requiring insurability to be determined on the facts of each case, and not on the basis of broad labels, is consistent with the purposes of insurance. Where the payment in fact serves the purpose of compensation, it should be insurable, because "compensation of the injured party" is often described as the “most important objective” in assessing the validity of indemnification provisions. *Indian Harbor Ins. Co. v. Dorit Baxter Skin Care, Inc.*, 430 F. Supp. 2d 183, 190 (S.D.N.Y. 2006). Otherwise, when courts refuse to permit indemnity, that “will often, if not usually, result in an injury being unredressed by compensation.” 8 Williston on Contracts § 19:20 (4th ed. 2019). The insured’s ability to pay upfront in this case—and only then to seek coverage from its insurers—does not diminish the likelihood that the Appellate Division’s ruling will leave injured parties uncompensated in other cases.

A careful assessment of the facts is particularly appropriate to determine the insurability of SEC disgorgement payments. The purposes for disgorgement payments vary from case to case. *Kokesh* itself acknowledged that “disgorgement serves compensatory goals in some cases.” 137 S. Ct. at 1645. Indeed, sometimes a disgorgement payment in connection with an SEC claim “mean[s] something more akin to [compensatory] damages” than restitution or a penalty. Richard A. Rosen, *Settlement Agreements in Commercial Disputes: Negotiating, Drafting & Enforcement* § 34.15[B] (2012). Given this diversity of purposes and forms, disgorgement payments may and should often be considered insurable settlements or compensatory damages rather than “uninsurable penalties.”[2]

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[2] This Court would not need to address whether disgorgement may be uninsurable in other instances. In *J.P. Morgan*, this Court assumed without deciding that certain types of (continued…)

*Kokesh* dealt with a statute of limitations, not an exception to insurability. The purpose of the former, unlike the latter, may best be served by a categorical procedural rule that applies to all SEC disgorgement actions. A statute of limitations is intended to provide a bright-line, fixed date when exposure to specified government enforcement efforts ends. *See Kokesh*, 137 S. Ct. at 1641. "Statutes of limitations are intended to 'promote justice by preventing surprises through the revival of claims that have been allowed to slumber until evidence has been lost, memories have faded, and witnesses have disappeared.'" *Gabelli v. SEC*, 568 U.S. 442, 448 (2013) (quoting *R.R. Telegraphers v. Ry. Express Agency, Inc.*, 321 U.S. 342, 348-49 (1944)). These purposes are consistent with a categorical rule. Accordingly, the U.S. Supreme Court applied a statute of limitations broadly to any SEC remedy that could be even partially punitive, including all SEC disgorgement remedies. *See Kokesh*, 137 S. Ct. at 1641.

Exceptions to insurability, by contrast, are applied narrowly so that insureds are not left without the insurance they purchased—nor third-party victims

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disgorgement remedies would be uninsurable on public policy grounds. 21 N.Y.3d at 335-36 (observing that "we have not considered the issue" and noting that Bear Stearns "does not disagree" that disgorgement may in certain instances be uninsurable). This Court once again need not reach this issue because no party appears to contest that a disgorgement that is solely punitive in nature and exclusively implicates the insured's return of its own ill-gotten gains would be uninsurable. Courts in other jurisdictions have refused to find such a public policy exception or have held that it is inapplicable where a disgorgement claim has been settled. *See, e.g.*, *Burks v. XL Specialty Ins. Co.*, 534 S.W.3d 458, 469 (Tex. App. 2015); *Va. Mason Med. Ctr. v. Exec. Risk Indem. Inc.*, 2007 WL 3473683, at *4 (W.D. Wash. Nov. 14, 2007).

potentially left uncompensated—unless the specific facts of their case would render insurance inappropriate. For that reason, the standard for the federal statute of limitations—whether a payment has some penal purpose—is exactly the opposite of the standard for insurability—whether a payment has some compensatory purpose. The Appellate Division erroneously conflated these standards.

## II. THE APPELLATE DIVISION ERRED TO THE EXTENT IT RELIED ON *KOKESH* TO INTERPRET INSURANCE POLICY LANGUAGE, PARTICULARLY WITH RESPECT TO A PRE-*KOKESH* POLICY AND LOSS.

Although the reasoning of the Appellate Division's decision is not entirely clear, it appears to hold not only that SEC disgorgement payments may be "uninsurable" (A9), but also that even if such payments could ordinarily be insurable under New York law, *Kokesh* was a "change of law" (A13) that means that Bear Stearns' insurance policies now exclude those losses from coverage under policy language precluding coverage for "fines or penalties imposed by law." (A9-11.) That is incorrect. To the extent that the Appellate Division's decision is based "on the policy language" rather than notions of public policy, the meaning of the policy language in Bear Stearns' policies did not change when the U.S. Supreme Court decided *Kokesh*.

To the contrary, the Appellate Division's decision does violence to the intent of the parties when they entered into their contract in 2000. By relying on a purported 2017 change in federal law, the Appellate Division extinguished insurance coverage that Bear Stearns bargained and paid for almost 20 years ago. Moreover, when Bear Stearns settled with the SEC in 2006, it signed a decree differentiating between a "penalty," on the one hand, for which it has never sought coverage, and a "disgorgement" remedy, for which it seeks partial coverage and which would compensate victims and offset private liabilities. *See J.P. Morgan*, 21 N.Y.3d at 330-31.

In any event, nothing in Bear Stearns' insurance policies excludes coverage for settlements that "represent[] the improper profits acquired by third-part[ies]" and that are used to compensate victims. *Id.* at 336. For the reasons stated above, the policies' exclusions for "penalties" apply only to losses that are in fact penalties and that are denominated as such. The fact that *sometimes* disgorgement payments may be akin to penalties is not a reason to exclude from coverage payments that, notwithstanding the label attached to them, *actually* serve a compensatory purpose.[3] Nothing in the text of the policies supports such an interpretation, and it is well settled that under New York law, exclusions in insurance policies must be interpreted narrowly, with any ambiguity resolved in favor of coverage. *See Selective Ins. Co. of Am. v. Cnty. of Rensselaer*, 26 N.Y.3d

[3] *Kokesh* did not hold that SEC disgorgement relief is denominated as a penalty or is *in fact* a penalty. Rather, the Court held that such relief "operates as a penalty" or "represent[s] a penalty" "within the meaning of [28 U.S.C.] § 2462." *Kokesh*, 137 S. Ct. at 1643-45.

649, 655-56 (2016); *Pioneer Tower Owners Ass'n v. State Farm Fire & Cas. Co.*, 12 N.Y.3d 302, 306-07 (2009) ("We have enforced policy exclusions only where we found them to 'have a definite and precise meaning, unattended by danger of misconception . . . and concerning which there is no reasonable basis for a difference of opinion.'" (quoting *Breed v. Ins. Co. of N. Am.*, 46 N.Y.2d 351, 355 (1978))).

## III. OUTLAWING INSURANCE FOR SEC DISGORGEMENT CLAIMS WOULD REDUCE COMPENSATION FOR VICTIMS AND IMPEDE RESPONSIBLE RISK MANAGEMENT.

The Appellate Division's decision to treat *Kokesh* as potentially precluding coverage for all SEC disgorgement payments undercuts important New York public policy objectives. New York law recognizes that absent clear contrary mandates, insurance should be promoted, not proscribed, because it serves important interests, including ensuring the availability of compensation for victims and encouraging businesses to provide valuable services in industries that are highly regulated and otherwise exposed to potentially prohibitive liability. The Appellate Division's decision, which cast uncertainty over the availability of insurance for SEC disgorgement claims, undermines these interests.

*First*, by undermining or eliminating insurance for an important category of regulatory risk, the Appellate Division's decision increases costs and the risk of insolvency for many financial services businesses and their customers. That the financial institution seeking coverage here did not face such a risk at the time in no way lessens the industry-wide concern. Businesses rely on insurance in order to operate in the highly regulated financial services industry, which faces variable and often unpredictable enforcement activity. *See*, *e.g.*, *SEC v. Shanahan*, 646 F.3d 536, 544-45 (8th Cir. 2011) (finding no reasonable juror could find director liable for back-dating stock options); *Upton v. SEC*, 75 F.3d 92, 98 (2d Cir. 1996) (vacating SEC censure when agency knew of industry practice of evading SEC rule but took no steps to advise the public about it until after the defendant had stopped the practice).

Both individual and firm participants in the financial services industry must manage the risk of responding to and resolving potential SEC enforcement actions, which without insurance can be financially devastating. That risk makes insurance availability particularly "important to individual defendants, who often would not be able to afford to pay disgorgement without indemnification from their former employer, insurance company or some other source." Dixie L. Johnson & M. Alexander Koch, *Reflections on* Kokesh v. SEC*: Potential Ramifications of SEC Disgorgement Being a Penalty*, L. J. Newsletters (Sept. 2017).[4] Individuals and firms that are unable to return ill-gotten gains may have only themselves to blame,

[4] *Available at* http://www.lawjournalnewsletters.com/sites/lawjournalnewsletters/2017/09/01/reflections-on-kokesh-v-sec-2/?slreturn=20190927180407.

but that punitive logic has no application when the "disgorgement" remedy in fact serves a compensatory purpose. Smaller businesses, including local and regional financial institutions, also rely on insurance to ensure their solvency in the event of an SEC action.

*Second*, it was contrary to New York public policy for the Appellate Division to change the law with respect to an insurance policy "unless impelled by 'the most cogent reasons,'" *Maxton Builders, Inc. v. Lo Galbo*, 68 N.Y.2d 373, 381 (1986) (citation and emphasis omitted), because the contracting parties should be entitled "to rely on the stability of" precedent as they "engage in transactions based on prevailing law," *Holy Props. Ltd., L.P. v. Kenneth Cole Prods., Inc.*, 87 N.Y.2d 130, 134 (1995). SIFMA members paid substantial premiums for insurance coverage based on settled New York law, which never before suggested that a settlement payment that serves a compensatory purpose and does not implicate an insured's ill-gotten gains might be uninsurable. Given such reliance interests, this Court has recognized that "certainty of settled rules is often more important than whether the established rule is better than another or even whether it is the 'correct' rule." *Id.* Here, the Appellate Division's decision improperly cast doubt on the effectiveness of an important aspect of the insurance coverage that businesses purchased from their insurers at significant cost.

The reliance interest is particularly compelling here, where *Kokesh* was cited below to change the law nearly two decades after Bear Stearns' insurance policies were issued and approximately five years after this Court left the law well-settled in its *J.P. Morgan* decision. *See, e.g.*, *In re TIAA-CREF Ins. Appeals*, 192 A.3d 554, at *2 & n.8 (Del. 2018) ("[T]he principle which emerges from these cases is that New York public policy prohibits enforcement of insurance agreements in cases involving disgorgement *where the payment is conclusively linked, in some fashion, to improperly acquired funds in the hands of the insured*." (emphasis added) (citing, *inter alia*, *J.P. Morgan*, 21 N.Y.3d 324)).

*Third*, the Appellate Division's decision would have the deleterious effect of encouraging litigation and deterring compromise with the SEC, to the detriment of public resources and the SEC's law enforcement function. If a settlement of an SEC disgorgement claim that is intended to compensate victims is uninsurable, businesses and individuals may be forced to litigate. This would hamper the SEC, which considers settlement "a significant carrot" in exercising its enforcement authority. Statement of SEC Chairman Jay Clayton Regarding Offers of Settlement (July 3, 2019), https://www.sec.gov/news/public-statement/clayton-statement-regarding-offers-settlement. The SEC "has long recognized that an appropriately-crafted settlement can be preferable to pursuing a litigated resolution, particularly when . . . the Commission obtains relief that is commensurate with what it would reasonably expect to achieve in litigation." *Id.* For both the SEC and businesses, settlement is a "means to manage risk," including the risk of "the prospects of coming out . . . worse, after a full trial, and the resources that would need to be expended in the attempt." *SEC v. Citigroup Global Mkts., Inc.*, 752 F.3d 285, 295 (2d Cir. 2014) (quoting *SEC v. Citigroup Global Mkts., Inc.*, 673 F.3d 158, 164 (2d Cir. 2012)). New York courts should not undermine the SEC's prerogatives in exercising its enforcement authority.

Indeed, years ago, the SEC considered and rejected proposals to require that disgorgement payments be treated as uninsurable, even though it routinely prevented indemnification of remedies labeled as penalties. *See* Rosen, *supra*, § 34.15[A] ("[N]o-insurance-for-penalties language has become standard in SEC settlement documents."). The SEC considered that if companies were deprived of means to insure all SEC payments, it "likely [would] result in more litigation and fewer agreements as defendants balk at the stricter terms." Deborah Solomon, *SEC Considers Stronger Sanctions --- Applying Stiffer Penalties in Coming Cases Is Seen As Having Deterrent Value*, Wall St. J., June 16, 2003. Thus, the SEC itself believes that the purpose of disgorgement payments is not undermined by insurance, but rather would be undermined if such payments were deemed uninsurable.

*Fourth*, by holding that SEC disgorgement is categorically "uninsurable" and thus calling into question whether New York courts will enforce insurance policies as written, the Appellate Division's unexpected decision cast a pall of uncertainty over insurance coverage in other contexts and under different insurance lines. For example, cyber insurance, which is increasingly important to a broad range of businesses, is often "used to offset *penalties* or reparations, plain and simple." Samantha Ann Schwartz, *What Industry Gets Wrong About Cyber Insurance*, CIO Dive (Oct. 31, 2019) (emphasis added).[5] Under the Appellate Division's reasoning, the mere fact that payments imposed by cyber regulators are described as "penalties" may encourage insurers to deny coverage for policyholders who incur such losses, notwithstanding explicit promises of protection in their cyber policies.

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[5] *Available at* https://www.ciodive.com/news/what-industry-gets-wrong-about-cyber-insurance/566080/. *See also, e.g.*, Draft Int'l Standard ISO/IEC DIS 27102:2018(E), *Information Technology—Security Techniques—Information Security Management Guidelines for Cyber Insurance* § 6.4.2 (listing "legal and regulatory fines and penalties" as a "primary categor[y] of business impacts [that] can be covered by cyber insurance"); Kevin P. Kalinich, *US Treasury Makes Standalone Cyber Insurance Policies More Valuable*, Aon, at 2 (Jan. 3, 2017), https://www.aon.com/attachments/risk-services/cyber/TRIA-2017Update.pdf (noting "first-of-its-kind" policy insuring cyber perils, including EU GDPR "fines and penalties, where insurable"); JLT-Tex. Water Conservation Ass'n Risk Mgmt. Fund Cyber Liab. Overview, at 12 (Oct. 12, 2016), https://www.twcarmf.org/wp-content/uploads/2016/10/2016-10-5-Cyber_Overview.pdf (stating in potential claims scenario involving imposition of regulatory fines and penalties that cyber "policy will . . . affirmatively cover any fines levied"); Comm'n on Enhancing Nat'l Cybersecurity, Meeting Minutes of May 16, 2016, https://web.archive.org/web/20170706034416/https://www.nist.gov/sites/default/files/may_16_2016_nyc_meeting_minutes.pdf ("Statutory penalties are also an issue and [buyers of cyber insurance] expressed concern about what is considered a settlement and a fine.").

The Appellate Division should have been especially reluctant to expand an unlegislated common-law exception to the enforceability of contracts because doing so was likely to disrupt widely held and settled expectations. Courts should hesitate to create a new public policy exception that may be based only on "their subjective view of what is sound policy or good policy." *Matter of Estate of Walker*, 64 N.Y.2d 354, 359 (1985). Indeed, the "question, what is the public policy of a State, and what is contrary to it," when left to judicial fiat, "will be found to be one of great vagueness and uncertainty, and to involve discussions which scarcely come within the range of judicial duty and functions, and upon which men may and will complexionally differ." *Hollis v. Drew Theological Seminary*, 95 N.Y. 166, 172 (1884). Rather than "assum[e] legislative functions," *id.* at 171, the Appellate Division should have left the parties to bear "the consequences of their bargain," *159 MP Corp.*, 33 N.Y.3d at 359.

## CONCLUSION

For all the foregoing reasons, the Court should grant Bear Sterns' Motion for Leave to Appeal.

Dated: November 21, 2019

Respectfully submitted,

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**DISCLOSURE STATEMENT PURSUANT TO 22 N.Y.C.R.R. 500.1(F)**

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