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TWO RECENT DECISIONS HIGHLIGHT DIFFERENT APPROACHES TO WHETHER DISGORGED PROFITS ARE COVERED AS DAMAGES

By James P. Steele

Do insurance policies cover claims for disgorged profits? Should they? Are disgorged profits "Damages" or "Loss" as most policies define those terms? Recent decisions in Colorado and New York highlight different ways in which jurisdictions answer these questions.

Genesis Ins. Co. v. Crowley, Civ. Action No. 05-cv-00335, 2007 WL 1832039, in the United States District Court for the District of Colorado, is a declaratory judgment action that arises out of an underlying lawsuit in the District Court for the District of Delaware in which the defendant insureds sought coverage and a defense under their Directors and Officers Liability Policy. Genesis, the D&O carrier, filed the declaratory judgment action, seeking to preclude coverage and a defense. Count IV of Genesis's Complaint sought a declaration that coverage does not extend to any amounts sought as recovery in the underlying lawsuit that are precluded by the policy.

The insured's policy defined "Loss" to exclude "criminal or civil fines or penalties imposed by law, multiplied portions of damages in excess of actual damages, taxes or any matter which may be deemed uninsurable under the law pursuant to which this Policy shall be construed." The insured moved for summary judgment on Count IV, arguing that Genesis did not identify what part of the damages sought in the underlying lawsuit fell outside the scope of this definition. Genesis responded that the plaintiffs in the underlying suit sought disgorgement, which is not insurable by law.

On June 25, 2007, Judge Walker D. Miller denied as premature the insured's motion for summary judgment on Count IV. Judge Miller noted that the cases Genesis cited, Reliance Group Holdings, Inc. v. National Union Fire Ins. Co., 188 A.D. 2d 47, 594 N.Y.S. 2d 20 (N.Y. App.1993) and Westfield Group v. Campisi, 2006 WL 328415 (W.D. Pa. Feb 10, 2006), stand for the proposition that disgorgement of profits wrongfully acquired are not insurable damages. However, Colorado law is silent on the issue, and in the absence of facts concerning the basis for any relief that had not yet been awarded in the underlying suit, the court could not determine whether such relief might be excluded.

By contrast, on May 24, 2007, New York's Supreme Court, Appellate Division, First Department, in Great N. Ins. Co. v. Kobrand Corp., 40 A.D.3d 462, 837 N.Y.S.2d 41, 2007 N.Y. Slip Op. 04403, made short shrift of the insured's argument that the insurer must defend and indemnify it in an underlying lawsuit involving claims for disgorgement of profits. In the underlying lawsuit, the plaintiff's disgorgement claim arose out of the insured's alleged illegal marketing of alcohol to minors. The liquor liability provisions of the disputed policy covered only "all damages" resulting from "injury" arising out of "the selling, serving or furnishing of any alcoholic beverage."

In a 3-1 decision, the court declined to find that disgorged profits are recoverable damages and affirmed a trial court's order of summary judgment in the insurer's favor. The court noted that a plain reading of the underlying complaint and the applicable insurance policy supported the trial court's finding that the policy did not cover "liability for the mere consump-

tion of an alcoholic product without resultant injury and damages." Disgorged profits resulting from marketing alcohol to minors do not fall within the scope of coverage afforded under the policy.

These two cases reflect the different approaches courts have taken when facing the issue of whether insurance policies cover disgorged profits. A number of jurisdictions agree with New York that disgorgement claims are not covered. The California Supreme Court, in Bank of the West v. Superior Court, 833 P.2d 545 (Ca. 1992), held that a CGL policy did not cover disgorgement claims arising from unfair trade practices. The Bank of the West court found that allowing recovery for disgorged profits violated public policy because it would reward the insured for acting illegally. The Texas Court of Civil Appeals, in Nortex Oil & Gas Corp. v. Harvard Ins. Co., 456 S.W.2d 490 (Tx. Civ. App. 1970), found that an insured would be unjustly enriched if its insurance policy covered a disgorgement claim. Similarly, in Seabord Surety Co. v. Ralph Williams, Northwest Chrysler-Plymouth, Inc. 504 Pd. 1139 (Wash. 1993), the court held that disgorged profits under consumer protection laws were not "damages," and therefore not covered, under the insured's policy.

However, there are jurisdictions that join Colorado in being more receptive to the argument that policies cover disgorgement claims. In Limelight Productions, Inc. v. Limelight Studios, Inc., 60 F.3d 767 (11th Cir. 1995), the court interpreted the Lanham Act, under which the plaintiff brought a copyright claim, to find that ill-gotten profits arising from the alleged copyright violation were merely another form of damages available to a plaintiff, and were covered unless the policy otherwise expressly excluded them. Similarly, the United States District Court for the District of Maine, in American Employers Ins. Co. v. Delorme Publ'g Co., 39 F. Supp. 2d 64 (D. Me. 1999), which also involved a copyright claim under the Lanham Act, found that an accounting for profits constitutes "damages" covered under a policy because, under the Lanham Act, a defendant's profits are awarded as a surrogate for damages.

It seems self-evident that disgorged profits would not be covered by most insurance policies. Disgorged profits are normally only sought for intentional wrongful acts, penalties under consumer protection statutes or in other contexts that imply deliberate conduct not normally covered by policies. Thus, the rulings in Great N. Ins. Co., Bank of the West and the others that find no coverage appear to be well reasoned. Yet, as the Genesis Ins. Co. v. Crowley and Limelight Productions, Inc. decisions show, there are courts that are willing to leave the door open on that issue.

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