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NEWSLETTER

SEC Proceeding for Disgorgement Seeks "Equitable Relief," Not "Money"

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The United States District Court for the Eastern District of Michigan, applying Michigan law, has held that: (1) the broadened coverage of an amended policy form applied to a claim under a professional liability policy arising from a Securities and Exchange Commission (SEC) proceeding; (2) the SEC proceeding seeking disgorement constituted a "suit" but did not constitute a written demand for "money or services" under the policy; (3) the costs of defending the SEC proceeding were not a "claim expense" under the policy; and (4) the insurer had a duty to defend the policyholder against a state administrative proceeding because the proceeding was a "claim" as defined by the policy. *Doeren Mayhew & Co. v. CPA Mut. Ins. Co. of Am. Risk Retention Group*, 2007 WL 118939 (E.D. Mich. Jan. 10, 2007).

The insurer provided a certified public accounting firm with professional liability insurance. The policy defined "claim" as "a written demand received by You for money or services naming You and alleging an act or omission, in the rendering of Professional Services. A demand shall include the service of suit or the institution of arbitration proceedings against You." The policy defined "claim expenses" as "those fees charged by an attorney we designate to consent to, and all other fees, costs and expenses resulting from the investigation, adjustment, expert analysis, defense and appeal of a Claim, if incurred by us or by You with our written consent." The policy also contained a duty to defend provision, which stated that the insurer has "the right and duty to defend any Claim."

The policyholder company provided auditing services for a financial group that subsequently filed for bankruptcy. In 1999, numerous civil lawsuits were filed against the company alleging that it contributed to fraud committed by the financial group by way of approving the group's financial statements. The insurer paid the defense costs incurred by the company in defense of the suits, which did not result in liability to the company.

In 2003, the company was notified by the SEC that administrative proceedings might be commenced against it. After the SEC filed a disciplinary proceeding, the company settled the action, agreeing to disgorge fees that it had earned, pay prejudgment interest, and implement procedures to improve its auditing practices. The parties disputed whether the SEC proceeding and subsequent administrative proceedings instituted by the state of Michigan, constitute a "claim" under the policy and whether the 1999 Policy Form or the 1998 Policy Form applied.

The company argued that the SEC proceedings constituted a claim, while the insurer argued that the proceeding did not constitute a claim since there was neither a suit or arbitration nor a written demand for money or services.

Relying on *Michigan Millers Mutual Insurance Co. v. Bronson Plating Co.*, 519 N.W.2d 864 (Mich. 1994), the court held that both the SEC and the Michigan state proceedings constituted a suit as "courts have found administrative proceedings to constitute a suit for purposes of an insurance policy." The court, however, rejected the company's argument that the SEC proceeding constituted a written demand for "money or services." While the company argued that disgorgement constituted a demand for money, the court determined that the demand for disgorgement instead constituted "a demand for equitable relief in order to prevent unjust enrichment." The court also rejected the company's assertation that an email sent from the company's managing director to its shareholders, acknowledging that the SEC may accept $500,000 plus the disgorgement of fees to settle the action, did not constitute a written demand for money.

The court reasoned that the company had not provided any evidence that the company had made a demand for $500,000. The court agreed with the insurer that the undertakings to implement certain policies and procedures to which the company agreed in the settlement did not constitute "services," as the "undertakings identified by [the company] as services are for the direct benefit of [the company]" and "were arguably not demanded by the SEC." Accordingly, because the SEC suit was not a demand for "money or services," the court held that it did not satisfy the policy's definition of "claim."

The court next addressed whether the costs of defending the SEC proceeding qualified as a "claim expense" of the litigation related to the financial group. The company argued that the proceeding was a claim expense since it delayed settling with the SEC so as not to affect the outcome of the lawsuits involving the financial group. The court noted that while one attorney advised the company to delay settlement, another attorney advised that settlement would not affect the ongoing litigation. Thus, the court determined that the company had a choice as to whether to delay settlement of the SEC proceeding and its choice to delay settlement "[did] not transform the costs associated with that delay into a 'claims expense' as defined by the policy."

Lastly, the court concluded that the insurer had a duty to defend the company against the proceeding before the Michigan licensing agency arising out of the SEC proceeding, in which the state agency issued a written demand for money in the form of a $10,000 fine. The court first acknowledged that such civil fines were excluded as damages under the policy but then emphasized that the insurer had "the right and duty to defend any claim" under the 1999 Policy Form, and a claim included a written demand for money. Therefore, the insurer had a duty to defend the Michigan proceeding.