

Restitution Insurable in New Jersey If Benefit Accrues Only to Innocent Party

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The Superior Court of New Jersey, Appellate Division, in an unpublished opinion, has held that an "innocent insured party" may recover restitutionary amounts under a D&O insurance policy so long as the insured does not profit as a result. *Liss v. Federal Ins. Co.*, 2006 WL 2844468 (N.J. Super. Ct. App. Div. Oct. 6, 2006).

The insurance company issued a D&O policy to a family of companies. The president of the company hired a vice president for one of the subsidiaries. The vice president entered into an employment agreement, which provided him with a percentage of the shares of the parent company. After resigning due to differences with the president, the vice president accepted employment with a company that was seen as a competitor, prompting the president to block the redemption of the former vice president's shares in the parent company. The president undertook a company restructuring in which all of the original parent company's assets were transferred to the new parent company, leaving the former officer's shares with no value. The president brought claims under the employment agreement against the former vice president, who counterclaimed for redemption of his shares. Both the president and the former officer sought coverage under the D&O policy.

The president and former officer settled their claims, and the former officer was assigned the company president's claims against the insurance company. The insurer argued that the president's claim for indemnification for the former officer's redemption claim was not covered as a matter of public policy because any damages the former officer would receive would be restitutionary, or a return of "wrongfully withheld" funds. The insurer also challenged the reasonableness of the settlement. Coverage litigation ensued.

The appellate court concluded that no public policy precluded coverage or made the loss uninsurable as a matter of law. The insurer relied on *Level 3 Communications, Inc. v. Federal Insurance Co.*, 272 F.3d 908 (7th Cir. 2001), in which the court held that "[a]n insured incurs no loss within the meaning of the insurance contract by being compelled to return property that it had stolen." The court held that *Level 3* was inconsistent with existing New Jersey law. The court relied on the New Jersey Supreme Court decision in *Ambassador Insurance Co. v. Montes*, 76 N.J. 477 (N.J. 1978), in which the court held that public policy does not prohibit insurance for intentional acts in circumstances in which "the wrongdoer is not benefited and an innocent third party receives the protection afforded by the insurance."

The court concluded that "[the president's] conduct, even if wrongful in a civil sense, does not preclude coverage for the benefit of [the former officer], if he is an innocent injured party, as long as [the president] does not profit thereby." The court explained that the insurer should pay the innocent party and seek indemnification from the insured. This approach balanced the goals of compensating the victim, following a policy that provided coverage on its face and not relieving the insured party from financial responsibility for wrongful conduct.

Although the case rejected the restitution defense, the court remanded for trial on the question of whether the settlement was "reasonable in amount and entered into in good faith." It noted that the insured has the burden of proof on both issues and that the record did not support summary judgment.