

Commentary

An Examination Of Coverage Disputes Involving Restitution And / Or Disgorgement In Light Of Pan Pacific v. Gulf

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The Ninth Circuit Court of Appeals, applying California law, held that the concept of "restitution" in the context of determining the application of insurance coverage may not be accorded as broad a meaning as in other situations, but rather would be limited to situations in which the insured is required to restore to the claimant what it had wrongfully acquired. The process of evaluating whether a settlement by a policyholder constitutes an uninsurable payment requires a factual examination of the facts relating to the elements of the claim, including the redress sought, and the basis and rationale for paying the settlement. See *Pan Pacific Retail Properties, Inc. v. Gulf Insurance Company*, 2006 WL 3026057 (9th Cir. Oct. 26, 2006).

Background

In October 2000, Pan Pacific Retail Properties, Inc. ("Pan Pacific") and Western Properties Trust ("West-

ern") proposed a merger transaction in which all shares of Western would be acquired by Pan Pacific with consideration paid in Pan Pacific stock. A class action lawsuit was later filed by Western shareholders challenging many aspects of the merger. The complaint alleged, *inter-alia*, that Pan Pacific, Western and their directors and officers were liable for breaches of fiduciary duty, fraud and unjust enrichment by failing to negotiate the highest possible price for the Western shares, by engaging in related transactions between Pan Pacific and Western that created a conflict of interest, and by failing to disclose all material information to shareholders before they voted overwhelmingly to approve the merger.

Western and Pan Pacific tendered notice of the lawsuit to Twin City Fire Insurance Company ("Twin City") and Gulf Insurance Company ("Gulf"), their respective Directors' and Officers' Liability insurers (collectively "insurers"). The insurers denied coverage on several grounds, including a contention that any award or settlement representing increased consideration for the acquisition did not constitute a Loss under their respective policies.

The lawsuit settled on February 7, 2003 for \$975,000 plus \$15,000 for administrative and notice costs. On March 6, 2003, Pan Pacific and Western filed a lawsuit against the insurers asserting claims of breach of contract, declaratory relief, breach of the covenant of good faith and fair dealing and unfair trade practices on grounds that the insurers unjustifiably refused to recognize any insurance coverage for the lawsuit and settlement. The trial court granted summary judg-

ment in favor of the insurers, concluding, *inter-alia*, that the settlement, which reflected additional consideration that was wrongfully withheld in the merger was, as a factual matter, restitutionary relief that was uninsurable under California law.

The Ninth Circuit's Holding

The Ninth Circuit reversed and remanded the case to the trial court for reconsideration. In so doing, the Ninth Circuit noted that in California "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." The Ninth Circuit determined that the insurers were required to cover claims that sought compensation for a loss, even if the loss to the victim could also be construed as an ill-gotten benefit to the insured. The Ninth Circuit explained that to make this determination a court must look beyond the way in which the claims or remedies are labeled:

In deciding whether a certain remedy is insurable, we must look beyond the labels of the asserted claims or remedies. An insurer is not required to provide coverage for claims seeking the return of something wrongfully received, but must still indemnify for claims that seek compensation for injury suffered as a result of the insured's conduct ... We must examine whether any genuine issues of material fact remain as to the nature of the claims reflected in the settlement and whether any of these claims may have sought non-restitutionary compensation for injuries suffered by the shareholders, which would be covered under the insurers' Policies.

Pan Pacific Retail Properties at *3.

Through its *de novo* review of the factual record on appeal, this Court of Appeals concluded that the shareholder actions did not clearly seek only additional merger consideration and thus the record contained material issues of fact. Accordingly, the Ninth Circuit reversed the trial court's grant of summary judgment and remanded the case for proceedings to determine whether the settlement constituted a matter entirely uninsurable under California law.

Commentary

As the Ninth Circuit noted, in California and other jurisdictions, it is a well-established principle that payments based on restitution and/or disgorgement are not "damages" or "settlements" and do not constitute a loss in the context of a professional liability policy. (See *Bank of the West v. Superior Court*, 2 Cal. 4th 1254 (Cal. 1992); *Level 3 Communications, Inc. v. Federal Insurance Co.*, 272 F.3d 908 (7th Cir. 2001); see also *Vigilant Insurance Co. v. Credit Suisse First Boston Corporation*, 782 N.Y.S.2d 19 (N.Y. App. 2004); *Reliance Group Holdings, Inc. v. National Union Fire Insurance Co.*, 594 N.Y.S.2d 20 (N.Y. App. 1993). This basic proposition articulated by the Ninth Circuit is the same under California law as in other jurisdictions. However, unlike other courts the Ninth Circuit interpreted the concept of restitution narrowly within the context of an insurance dispute. For summary judgment purposes, the Ninth Circuit looked beyond the labels of the claims or remedies asserted in the complaint. It applied a stringent standard that requires examination of the record to establish that the entire settlement payment, or an uncontroverted part of it, represents the return of funds wrongfully acquired by the insured. Under this standard applied by the Ninth Circuit in *Pan Pacific Retail Properties*, insurers may have less chance of prevailing on summary judgment in coverage disputes governed by California law which involve restitution and/or disgorgement. ■