

Insurance Claims May Hinge on Ill-Gotten Gains Determination

By Jay Spievack

Insurance policies covering damages claims commonly exclude only proven ill-gotten gains claims, or gains resulting from actions that are detrimental to the company. For example, a private equity investor acquires a company, and then pays excessive dividends using the acquired company's cash, thereby depriving the company of its operating capital. Since the private equity firm enriched itself to the detriment of this acquired company, this maneuver, if proven, would generally be excluded.

But how have courts determined a gain to be "ill-gotten?" The answer to that question has significant implications for insurance coverage, and the question is one that companies shopping for or renewing insurance need to keep in mind. While the policy language excludes coverage only for a proven ill-gotten gain claim, states interpret the provision differently than written. Some states allow the mere assertion of ill-gotten claims to limit recovery, even if there is no final adjudication regarding the underlying claim. These states allow insurers to apportion legal fees and settlement payments between the policyholder and themselves. Some states, in contrast, require insurers to prove that such an apportionment is proper when there is no final non-appealable adjudication.

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The time to address this question is during the policy purchase or renewal process. Allegedly uncovered ill-gotten gains claims usually involve tens of millions of dollars. Companies, including private equity and acquisition businesses, should consider an endorsement that broadens or clarifies that the simple assertion of an ill-gotten gain claim will not, for example, lead to the apportionment described above of legal fees incurred in connection with defending against such a claim. Policyholders must, however, also consider their existing state laws' interpretations of the standard form exclusionary language when proposing such an endorsement.

Remember, the mere assertion that a gain is ill-gotten is not supposed to be enough. Insurers regularly rely on these assertions to limit recovery, but policyholders can be proactive in making sure they recover all that they are due. Diligence during shopping or renewal can pay off in the event of such a dispute in the future.

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