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IN THE SUPREME COURT OF THE STATE OF DELAWARE

IN RE TIAA-CREF INSURANCE APPEALS	No. 478,2017 PUBLIC VERSION No. 479,2017 No. 480,2017 No. 481,2017 Court Below-Superior Court of the State of Delaware C.A. No. N14C-05-178 JRJ (CCLD)

REPLY BRIEF OF APPELLANTS ILLINOIS NATIONAL INSURANCE COMPANY, ACE AMERICAN INSURANCE COMPANY AND ARCH INSURANCE COMPANY REGARDING WHETHER TIAA-CREF SUFFERED COVERED "LOSS"

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New York law and public policy prohibit TIAA-CREF from receiving insurance coverage for disgorgement. Should TIAA-CREF prevail in this action, it will reap the benefits of its improper activities and recoup the wrongfully acquired money that it agreed to disgorge in settling the Underlying Actions by passing the financial burden on to its insurers. Allowing an insured to be compensated for its disgorgement of wrongfully acquired funds, and to control insurance coverage through a self-serving denial of liability in settlement, undermines New York law and the policy definition of "Loss," which, by its very terms, does not include matters uninsurable under New York law.

TIAA-CREF is desperate to avoid New York law on this threshold coverage issue. TIAA-CREF first argues that New York law does not apply because New York does not have a public policy against insuring disgorgement. In reality, that public policy has been in place for decades. TIAA-CREF then argues that the public policy only applies to settlements in regulatory actions. However, not a single New York court has reached that conclusion, and courts have applied the public policy to non-regulatory actions.

Finally, TIAA-CREF seeks to avoid any analysis of the facts other than the fact that it denied liability in the underlying settlement agreements, even though

[redacted]

the very cases it cites undertook a detailed review of the facts in the record, pleadings, and the nature of the settlements in those cases. Moreover, in lieu of addressing actual record evidence vis-à-vis New York law, TIAA-CREF attempts to confuse the issues by disputing facts already admitted and established. Despite TIAA-CREF's efforts, review of the record evidence here firmly establishes that there is no "Loss" of an insured because TIAA-CREF settled investors' claims for disgorgement of gains that rightfully belonged to the investors in the CREF and TIAA Funds. TIAA-CREF withheld investment gains from investors, used those gains to its own advantage, and faced suits from the investors which sought disgorgement of those same gains due to its unjust enrichment. After the underlying courts certified classes to pursue those gains and acknowledged that TIAA-CREF had denied investors the appreciated value of their accounts, and as trial approached, TIAA-CREF agreed to disgorge the gains that it had improperly withheld.[1]

[1] JA0604; JA5360 at 55:10-23. In accordance with Delaware Supreme Court Rule 14(j), the parties to the consolidated appeals filed a Joint Appendix of documents bates-stamped with the prefix "JA." Additionally, Defendants Below / Appellants Illinois National Insurance Company, ACE Insurance Company and Arch Insurance Company filed a Defense Appendix of documents bates-stamped with the prefix "DA" with their Opening Brief and have filed a separate appendix for additional documents cited in this Reply with the prefix "DAR." In this brief, Appellants cite documents contained in these appendices by the bates-stamped pages.

I. NEW YORK LAW AND PUBLIC POLICY APPLY TO THIS DISPUTE TO BAR TIAA-CREF'S CLAIM FOR COVERAGE UNDER THE POLICIES.

New York law applies to this dispute. The Policies have substantial contacts with New York, as it is the place of negotiation and issuance, and the place where each Named Insured is headquartered.[2] In light of the substantial contacts with New York, New York law governs interpretation of the Policies, with the result being that TIAA-CREF cannot receive coverage for the disgorgement it paid in the Underlying Actions. In fact, TIAA-CREF itself has relied on New York law where it favors TIAA-CREF. TIAA-CREF has repeatedly sought to apply New York law to other substantive issues in this action,[3] and, in its Opening Brief, for example,

[2] The Illinois National Policy expressly states that it is subject to New York insurance law and regulations. The TIAA-CREF entities, which are headquartered in New York, were represented by a New York broker during policy negotiation and issuance. Illinois National has its principal place of business in New York. JA5024-25 at 13:13-14:13; JA5044-46 at 33:7-35:3; JA5056 at 45:11-13; Ex. A at 22.

[3] *E.g.*, Opening Brief of Plaintiffs Below / Appellants TIAA-CREF Individual & Institutional Services, LLC; TIAA-CREF Investment Management, LLC; Teachers Advisors, Inc.; Teachers Insurance and Annuity Association of America; and College Retirement Equities Fund, at 25-26, Jan. 26, 2018, Lexis Trans. ID 61617264, ("TIAA-CREF's Opening Brief"); Answering Brief of Plaintiffs Below / Appellees TIAA-CREF Individual & Institutional Services, LLC; TIAA-CREF Investment Management, LLC; Teachers Advisors, Inc.; Teachers Insurance and Annuity Association of America; and College Retirement Equities Fund to Defendant Below / Appellant Arch Insurance Company's Opening Brief Regarding Consent to Settle and Reduction of Insurance Limits, at 25-28, Mar. 9, 2018, Lexis Trans. ID 61785202, ("TIAA-CREF's Answering Brief on Consent and Reduction.").

TIAA-CREF refers to "controlling New York law." TIAA-CREF should not be permitted to opportunistically pick and choose which state's law applies on which issue merely to suit its position.

As addressed in section B, the New York Court of Appeals has recognized that both contract interpretative principles and public policy goals prohibit insuring disgorgement claims, and, as TIAA concedes, there are several lower-level appellate court cases recognizing such doctrines.[4] The existence of such case law requires this Court to recognize and apply New York public policy prohibiting insurability of disgorgement.[5]

A. TIAA-CREF Bears the Burden of Proving that the Underlying Actions are Covered "Loss."

TIAA wrongly argues that it should be the Insurers' burden to prove that the underlying settlements did not constitute insurable "Loss." However, "Loss" is a part of the Insuring Agreement of the Policies. In both New York and Delaware, the insured has the initial burden of proving coverage under the insuring

[4] Answering Brief of Appellee TIAA-CREF Individual and Institutional Services, LLC; TIAA-CREF Investment Management, LLC; Teachers Advisors, INC.; Teachers Insurance and Annuity Association of America; and College Retirement Equities Fund Regarding Whether TIAA-CREF Suffered Covered "Loss," at 29, dated March 9, 2018, Lexis Trans. ID 61785151 ("TIAA-CREF's Answering Brief on Loss")

[5] *Motors Liquidation Co. v. Allianz Ins. Co.*, 2013 Del. Super. LEXIS 605, at *7 (Del. Super. Ct. Sept. 17, 2013).

agreements.[6] Only after this initial burden of proof has been satisfied by the insured would the burden of proof then shift to the insurer to prove that an exclusion applies.[7] The Insurers raise no exclusion in this appeal. Accordingly, TIAA-CREF bears the burden of proving that the Underlying Actions fall within the definition of "Loss," specifically that the matters settled are insurable in New York.

B. The Law In New York Is Clear that Disgorgement Is Not Covered Loss And Is Uninsurable As a Matter of Public Policy.

TIAA-CREF relies upon the New York Court of Appeals decision in *J.P. Morgan Sec. Inc. v. Vigilant Ins. Co.*, 992 N.E.2d 1076, 1083 (N.Y. 2013) ("*J.P. Morgan II*") to argue that New York courts have not adopted a public policy against insuring disgorgement. If TIAA-CREF were correct on this point, the New York Court of Appeals in *J.P. Morgan II* would have rejected the insurers' public

[6] *See Munzer v. St. Paul Fire & Marine Ins. Co.*, 538 N.Y.S.2d 633, 636 (N.Y. App. Div. 1989); *RSUI Indem. Co. v. Sempris, LLC*, 2014 Del. Super LEXIS 449, at *19 (Del. Super. Ct. Sep. 3, 2014); *New Castle County v. Hartford Acc. & Ind. Co.*, 933 F.2d 1162, 1181 (3d Cir. 1991); *see also Nat'l Union Fire Ins. Co. of Pittsburgh, PA. v. U.S. Bank, Nat'l Ass'n*, 2008 U.S. Dist. LEXIS 47413, *13 (S.D. Texas 2008) (stating that the insured had the burden of demonstrating that it suffered covered "Loss" under the policy), *aff'd, Stanley v. U.S. Bank Nat'l Ass'n (In re TransTexas Gas Corp.)*, 597 F.3d 298, 309 (5th Cir. 2010).

[7] *Consol. Edison Co. of New York v. Allstate Ins. Co.*, 774 N.E.2d 687, 691 (N.Y. 2002); *Jakobson Shipyard, Inc. v. Aetna Cas. & Sur. Co.*, 775 F. Supp. 606, 609 (S.D.N.Y. 1991), *aff'd*, 961 F.2d 387, 389 (2d Cir. 1992); *Moreau v. Orkin Exterminating Co.*, 568 N.Y.S.2d 466, 468 (N.Y. App. Div. 1991); *E.I. du Pont de Nemours & Co. v. Allstate Ins. Co.*, 693 A.2d 1059, 1061 (Del. 1997).

[redacted]

policy defense outright. It did not. Instead, the Court of Appeals simply refused to dismiss the insured's claim for coverage as a matter of law "at this early juncture [of the motion to dismiss stage]."[8]

The Court of Appeals cited with approval decisions from the New York Appellate Division that affirmed the public policy against insuring disgorgement.[9] For example, the Court of Appeals addressed prior rulings by the New York Appellate Division, stating: "In other words, they directly implicated the policy rationale for precluding indemnity for disgorgement – to [prevent] the unjust enrichment of the insured by allowing it to, in effect, retain the ill-gotten gains by transferring the loss to its carrier."[10]

It is equally clear that the insurers in *J.P. Morgan II* raised both the public policy precluding coverage for intentional injury and the public policy precluding coverage for disgorgement, and the Court of Appeals did not confuse or conflate the two separate public policy defenses.[11] The Court of Appeals addressed each separately vis-à-vis the insurers' motion to dismiss.[12] Specifically, the Court of Appeals first addressed the public policy precluding coverage for intentional injury

[8] *J.P. Morgan Sec. Inc. v. Vigilant Ins. Co.,* 992 N.E.2d 1076, 1083 (N.Y.2013)("*J.P. Morgan II*").
[9] *Id.*
[10] *Id.*
[11] *Id.* at 1081-82.
[12] *Id.*

and found that it could not decide the issue on the limited record before it, stating: "On the limited record before us, we are unable to say, as a matter of law, that this public policy exception clearly bars Bear Stearns' coverage claims."[13] After reaching this conclusion, the Court of Appeals turned its attention to what it characterized as a "separate public policy ground" raised by the insurers: namely that against insuring disgorgement. The *J.P. Morgan II* court stated:

> The Insurers also maintain – and the Appellate Division agreed – that, on a separate public policy ground, Bear Stearns is not entitled to recover any portion of the $160 million SEC disgorgement payment. Although we have not considered the issue, *other courts have held* that the risk of being ordered to return ill-gotten gains – disgorgement – is not insurable.[14]

The Court of Appeals further explained that the public policy rationale "precluding indemnity for disgorgement" is based on a desire to prevent the "unjust enrichment of the insured by allowing it to, in effect, retain the ill-gotten gains by transferring the loss to its carrier."[15] While Bear Stearns acknowledged "that it is reasonable to preclude an insured from obtaining indemnity for the disgorgement of its own ill-gotten gains," Bear Stearns argued that it was not unjustly enriched by the portion of that gain attributable to the profits of its

[13] *Id.*
[14] *Id.* (emphasis added).
[15] *Id.* at 1083.

[redacted]

customers.[16] The Court of Appeals then considered Bear Stearns' position "that a substantial portion of the SEC disgorgement payment . . . represented illicit profits obtained by its hedge fund customers rather than gains enjoyed by Bear Stearns itself."[17]

The Court of Appeals, thus, acknowledged New York's public policy against insuring disgorgement. The question being considered in *J.P. Morgan II* was whether the rule precluding coverage for disgorgement did or did not apply to a *portion* of the SEC payment:

> Put differently, Bear Stearns alleges that much of the payment, although labeled disgorgement by the SEC, did not actually represent the disgorgement of its *own* profits. [Bear Stearns] submits that the rule precluding coverage for disgorgement should apply only where the insured requests coverage for the disgorgement of its own illicit gains.[18]

The insured survived a motion to dismiss by asserting that a portion of its settlement payment was for ill-gotten gains taken by others, and the insurers were able still to pursue the public policy defense against insuring disgorgement.[19] As the case proceeded, there was no doubt in the trial court, or the Appellate Division, that the Court of Appeals had accepted the public policy against insuring disgorgement. In fact, the action continued to be litigated with respect to two

[16] *Id.* at 1080.
[17] *Id.*
[18] *Id.* at 1082 (emphasis added).
[19] *Id.* at 1082-83.

public policy grounds raised by the insurers and addressed in *J.P. Morgan II*.[20] Thereafter, the trial court stated:

> As stated by the Court of Appeals previously in this action, under both public policy grounds and insurance contract interpretation principles, "the return of improperly acquired funds does not constitute a 'loss' or 'damages' within the meaning of insurance policies (*J.P. Morgan Sec. Inc. v. Vigilant Ins. Co.*, 21 N.Y.3d 324, 335–36, 970 N.Y.S.2d 733, 992 N.E.2d 1076 [2013]).[21]

Furthermore, in a decision from this year, the trial court addressed the rulings in *J.P. Morgan II*, and recognized that the New York Court of Appeals had "premised its holding on both contract interpretive principles of what constitutes a loss or damages under an insurance policy, and *as a matter of public policy, that otherwise precludes an insured from receiving indemnification of its own illicit gains*."[22]

[20] *J.P. Morgan Securities Inc. v. Vigilant Ins. Co.*, 2 N.Y.S.3d 415, 419 (N.Y. App. Div. 2015) (*J.P. Morgan III*) (The action continued "with respect to assessing whether . . . the disgorgement payment to the SEC is linked to 'improperly acquired funds,' which would bar insurance coverage on the public policy grounds.").

[21] *J.P. Morgan Secs. v. Vigilant Ins. Co.*, 51 N.Y.S.3d 369, 373 (N.Y. Sup. Ct. 2017), *amended*, 2017 N.Y. Misc. Lexis 3051(N.Y. Sup. Ct. Aug. 7, 2017).

[22] *J.P. Morgan Sec. Inc. v. Vigilant Ins. Co.*, 2018 N.Y. Misc. LEXIS 132, at *2-*3 (N.Y. Sup. Ct. Jan. 17, 2018) (emphasis added).

Thus, contrary to TIAA-CREF's arguments, *J.P. Morgan II* both recognized and affirmed New York's firmly established public policy against insuring disgorgement.[23]

C. TIAA-CREF Cannot Avoid New York Law and Public Policy On Disgorgement Because It Settled The Claims Prior to A Final Adjudication.

In Section I.D.3 of its Answering Brief on Loss, TIAA-CREF seeks to elude the question of whether New York's law and public policy against insuring disgorgement apply to the Underlying Actions by contending that it defended and settled the claims, which were non-regulatory actions, prior to trial, and included a boilerplate denial of liability in the settlement agreements. One cannot avoid a state's public policy by defending a disgorgement claim unsuccessfully and then settling on the eve of trial with a disclaimer of liability. The cases on which TIAA-CREF relies do not hold otherwise. TIAA-CREF's arguments also ignore the nature of the underlying settlements themselves, the reality of the history of the litigation, and TIAA-CREF's admissions as detailed in the Insurers' Opening Brief.

[23] Even the case cited by TIAA-CREF recognized that this is the public policy in New York: *U.S. Bank Nat'l Ass'n v. Indian Harbor Ins. Co.*, 68 F. Supp. 3d 1044, 1049 (D. Minn. 2014) (citing *J.P. Morgan II* for the proposition that a public policy against coverage for disgorgement "makes sense because an insured does not suffer loss when it wrongfully takes money or property and is forced to return it; asking the insurer to pick up the tab would only bestow an unjustified windfall on the insured.").

[redacted]

1. The Insureds Cannot Avoid Public Policy By Making Rote Denials in Settlement.

TIAA-CREF argues that it can negotiate around the public policy of New York by settling a disgorgement claim without a final adjudication and by denying any wrongdoing.[24] TIAA-CREF, however, cites no New York case that allows an insured to evade policy language and a state's public policy. Under New York law, an insured cannot obtain coverage for an uncovered claim by settling the claim, because "even in cases of negotiated settlements, there can be no duty to indemnify unless there is first a covered loss."[25] The existence of a countervailing public policy, moreover, overrides the freedom to contract.[26] Consequently, the public policy of a state cannot be eliminated or circumvented by self-serving statements in an agreement among private parties.[27]

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[24] *See* TIAA-CREF's Answering Brief on Loss, at 34-36.

[25] *See Servidone Const. Corp. v. Sec. Ins. Co. of Hartford*, 477 N.E.2d 441, 444 (N.Y. 1985).

[26] *J.P. Morgan II*, 992 N.E.2d at 1081.

[27] *Deutsche Bank Nat'l Tr. Co. v. Flagstar Capital Mkts. Corp.*, 36 N.Y.S.3d 135, 139 (N.Y. App. Div. 2016) (quotations omitted) ("[F]reedom of contract is fundamental in New York law, but it is not absolute, and must give way to 'countervailing public policy concerns' in appropriate circumstances."); *Abry Partners V. L.P. v. F & W Acquisition LLC*, 891 A.2d 1032 (Del. Ch. 2006); *Sternberg v. Nanticoke Mem'l Hosp., Inc.*, 62 A.3d 1212, 1217 (Del. 2013) (quoting *Marshall v. Baltimore and Ohio RR Co.*, 57 U.S. 314, 334 (1853) ("It is an undoubted principle of the common law that it will not lend its aid to enforce a contract to do an act that is illegal, or which is inconsistent with sound morals or public policy, or which tends to corrupt or contaminate, by improper influences,

Contrary to TIAA-CREF's contention, the public policy applies to settlements of disgorgement actions that were not brought by a government agency.[28] Although TIAA-CREF does cite cases involving government agencies making allegations against the insured instead of class action claimants, not one of those cases held that the public policy against insuring disgorgement only applies to regulatory actions. Because each of those cases involved settlements, prior to a final adjudication and without the insureds admitting wrongdoing, it cannot be said that those cases required determinations of liability as a prerequisite to applying the public policy against insuring disgorgement.[29]

Moreover, there is not a single New York decision supporting TIAA-CREF's suggestion that the law changed post-*Reliance* so that the public policy against insuring disgorgement does not apply to settlements in non-regulatory actions. The appellate courts in *Credit Suisse* and *Millennium* both cited *Reliance* with approval even though *Reliance* concerned a settlement of a non-regulatory

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the integrity of our social or political institutions.")); *Progressive Universal Ins. Co. v. Liberty Mut. Fire Ins. Co.*, 828 N.E.2d 1175, 1180 (Ill. 2005) ("It is axiomatic that a statute that exists for protection of the public cannot be rewritten through a private limiting agreement.").

[28] TIAA-CREF's Answering Brief on Loss, at 4-5.

[29] As discussed in the Insurers' Opening Brief, those actions indicated that the insured's consent to the relief was without admitting to wrongdoing. *See* Opening Brief of Appellants Illinois National Insurance Company, Ace American Insurance Company and Arch Insurance Company Regarding Whether TIAA-CREF Suffered Covered "Loss" at 27-29. Jan. 26, 2018, Lexis Trans. ID 6164599, ("Insurers' Opening Brief on Loss").

action.[30] In addition, TIAA-CREF's position ignores *Shapiro v. Onebeacon Insurance*, 824 N.Y.S.2d 46 (N.Y. App. Div. 2006), which was issued after both *Credit Suisse* and *Reliance*. There, the Appellate Division held that the two underlying proceedings, where it was "alleged that the [policyholder's] improper conduct as a fiduciary warranted disgorgement of fees already paid," did not suggest a reasonable possibility of coverage, and, thus, that there was no obligation to defend or indemnify.[31] As is pertinent here, one basis for this decision was that: "the risk of being directed to return improperly acquired funds is not insurable and restitution of such funds does not constitute 'damages' or 'loss' as those terms are used in insurance policies."[32] Finally, TIAA's position contradicts the contract interpretative principles and public policy goals enunciated by the Court of Appeals in *J.P. Morgan II*.

2. Neither the "Loss" Definition Nor the New York Public Policy Include A Final Adjudication Requirement.

Notwithstanding several decisions applying New York's public policy against insuring disgorgement to settlements involving disgorgement, TIAA-CREF

[30] *Vigilant Ins. Co. v. Credit Suisse First Bos. Corp.*, 782 N.Y.S.2d 19, 20 (N.Y. App. Div. 2004) ("*Credit Suisse II*"); *Millennium P'rs, L.P. v. Select Ins. Co.*, 889 N.Y.S.2d 575, 576 (N.Y. App. Div. 2009); *Reliance Grp. Holdings, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 594 N.Y.S.2d 20, 24 (N.Y. App. Div. 1993), *appeal denied*, 619 N.E.2d 656 (N.Y. 1993).
[31] *Shapiro v. One Beacon Ins.*, 824 N.Y.S.2d 46, 47 (N.Y. App. Div. 2006).
[32] *Id.*

still insists that a "final adjudication" is required. Specifically, TIAA-CREF contends that a personal profit or advantage exclusion in the Policies with a "final adjudication" requirement implies that, absent a final adjudication, the policy definition of "Loss" should be interpreted to include an uninsurable matter – disgorgement.[33] A policy exclusion cannot be used to alter or ignore a state's public policy.[34] Rather, because New York's public policy trumps contract language, it remains necessary to examine the public policy independently of the contract language.[35]

The *J.P. Morgan* case illustrates this point. The exclusions examined in *J.P. Morgan* included those barring coverage for (1) claims arising out of Bear Stearns's "gaining in fact any personal profit or advantage to which [it] was not legally entitled, including but not limited to any actual or alleged commingling of funds or accounts," and (2) claims based upon or arising out of any deliberate, dishonest, fraudulent or criminal act or omission where there was a judgment or

[33] TIAA-CREF's Answering Brief on Loss, at n. 17; JA0357 at § IV(h). TIAA-CREF labels the exclusion as the "Ill-Gotten Gains Exclusion." There is no exclusion in the policy that contains such a label or that includes the phrase "ill-gotten gains."

[34] An exclusion cannot be used to create coverage under an insurance policy where there is no coverage under the insuring agreement. *Raymond Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 833 N.E.2d 232, 235 (N.Y. 2005); *J.P. Morgan III*, 2 N.Y.S.3d at 423.

[35] *See J.P. Morgan II*, 992 N.E.2d at 1083; *J.P. Morgan III*, 2 N.Y.S.3d at 418-419.

other final adjudication adverse to the insured.[36] Like TIAA-CREF here, Bear Stearns argued that the absence of a final adjudication of wrongdoing required for a policy exclusion to apply should also preclude the insurers from relying on New York public policy defenses that had been raised.[37] The Appellate Division disagreed, holding that the lack of a final adjudication only precluded reliance on the express "final adjudication" exclusion, and that the carriers still could invoke public policy defenses, such as "the affirmative defense invoking the public policy against permitting insurance coverage for disgorgement."[38]

The court went on to affirm that an insurer may "rely on a settlement agreement for the limited purpose of establishing whether a payment constituted disgorgement, *even if the insured did not admit guilt*, but not for the purpose of determining whether the agreement was an adjudication that established guilt for the purpose of satisfying an exclusion."[39] Relying on *J.P. Morgan II*, the *J.P. Morgan III* court confirmed that courts have a "stronger interest in enforcing public policy" than "in regulating private dealings between insurance companies

[36] *See J.P. Morgan Sec. Inc. v. Vigilant Ins. Co.*, 936 N.Y.S.2d 102, 105 (N.Y. App. Div. 2011) ("*J.P. Morgan I*").
[37] *J.P. Morgan III*, 2 N.Y.S.3d at 423.
[38] *Id.* at 423.
[39] *Id.* (emphasis added).

and their customers."[40] Accordingly, no final adjudication is necessary to apply the public policy against insuring disgorgement.

3. The Underlying Case Histories Do Not Justify Avoiding Analysis And Application of the Public Policy Against Insuring Disgorgement.

In the Underlying Actions, TIAA-CREF indeed asserted that the procedures that it put in place to retain the gains were proper and lawful. TIAA-CREF, however, did not prevail on this defense, which is why, as trial approached in both actions, it chose to settle *Rink* with full disgorgement of gains for class members who submitted a timely claim form[41] and settle *Bauer-Ramazani* by setting up a $19.5 million fund disgorging [redacted]% of the gains to wronged investors.[42]

The record itself refutes TIAA-CREF's position that it fully abided by contractual and legal requirements when it withheld millions in investment gains from certain account holders to be used to cover other losses caused by the broker-dealer.[43] Plaintiffs in the Underlying Actions rightfully challenged TIAA-CREF's valuation practices on the grounds that – under the SEC Rules, industry practice, and Plan documents – the transactions should have been valued on the date the

[40] *Id.*
[41] JA2084 at 168:6-24; JA2265.
[42] JA2058 at 113:17-23; JA2346-47; JA2445.
[43] TIAA-CREF does not contend that the trading losses are covered under the Policies.

[redacted]

transaction was processed and that the SEC Rules did not permit TIAA-CREF to withhold gains.[44]

In any event, in addition to being wrong and contrary to the Funds' position, TIAA-CREF never prevailed on its theory that its withholding of its customers'

[44] JA4116; JA4219; JA4235.
[45] JA2120 at 53:6-20. . DA0071-74 at 115:14-118:19; JA1955-56 at ¶¶ 13-16.
[46] JA3791-92 at 73:7-74:5; JA3796 at 78:2-24; JA3828 at 110:7-23. The Underlying Class Actions involved the broker-dealer's delays in *processing* transactions for transmittal to the Funds. JA3408 at 56:3-21.
[47] JA1174-75 (Supplemental Response to Interrogatory No.2); JA3972 at 91:5-9; JA3615-16 at 52:23-53:16; JA3619 at 56:17-21.
[48] JA4042 (emphasis added); JA3466 at 114:5-24.

gains was appropriate under, or protected by, SEC Rule 22(c)(1). Thus, this theory did not then, and cannot now, avoid the disgorgement which ultimately occurred.

Further, TIAA-CREF's contentions that a court never "ordered that TIAA-CREF make any payment in response to the disgorgement claims" or never found that its treatment of gains was improper or unlawful[49] are irrelevant to the public policy against insuring disgorgement, which, again, does not include a final adjudication requirement.

TIAA-CREF's position, moreover, ignores that, while there were no final adjudications, there were meaningful court orders that led to the disgorgement of gains. As discussed in the Insurers' Opening Brief, courts in each Underlying Action denied TIAA-CREF's motions seeking to avoid liability for disgorgement on the very grounds TIAA-CREF asserts here. Because of the nature of class actions, each court approved the class action settlements and, thus, ordered disgorgement of the very gains that TIAA-CREF had withheld and agreed to disgorge in settlement. There can be no dispute that the courts in the Underlying Actions ruled that the shares had appreciated in value and that TIAA-CREF kept and diverted the gains,[50] or that the class action fees in *Rink* were awarded based

[49] TIAA-CREF's Answering Brief on Loss, at 32.

[50] *See, e.g.*, JA4712-13 at ¶¶ 1, 4 ("Dr. Rink alleged common law and statutory claims against CREF arising from CREF's retention of the appreciated value of his (and all other similarly situated participants') retirement accounts during the time

upon a statutory provision that, by its own terms, plainly applied to "actions for . . . the recovery of money or property which has been illegally or improperly collected, withheld or converted."[51]

Moreover, the courts in *Rink* and *Bauer-Ramazani* certified classes of investors who, respectively, had been "denied the appreciated value" or "denied the investment gains" that accrued in their accounts.[52] In *Rink*, TIAA-CREF tried to challenge this language used by the court, acknowledging that it presumed that TIAA-CREF had already been found to engage in certain wrongful conduct, and that it would be certifying "a class in which its members can only be identified by assuming plaintiff has prevailed on the merits."[53] The *Rink* court rejected TIAA-CREF's challenge.[54] TIAA-CREF's defense counsel in *Rink* testified that the court's Order requiring inclusion of this language in the Class Notices, along with

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that CREF delayed distribution requests in excess of seven (7) days. . . . The results obtained for the settlement class are exceptional. Upon submission of a simple claim form, . . . each settlement class member will recover in excess of 100 cents on the dollar of the amount of undistributed gains on delayed account transfers.).

[51] KRS 412.070 (emphasis added).

[52] JA2130; JA2325.

[53] DAR0001; DAR0004-05; DAR0008; DAR0015; DAR0027; DAR0048; DAR0062.

[54] DAR0001; DAR0004-05; DAR0008; DAR0015; DAR0027-28; DAR0048; DAR0062.

[redacted]

prior orders denying TIAA-CREF's motions and the approaching jury trial, were serious motivations to settle.[55]

In short, TIAA-CREF cannot dodge an inquiry into whether New York's public policy against insuring disgorgement applies to the Underlying Actions merely because it denied liability or because there was no government entity involved. Put simply, where a risk is uninsurable as a matter of public policy, an insured cannot make it insurable by a denial of wrongdoing in a settlement. If this were true, then the public policy against insuring disgorgement would be rendered meaningless. Accordingly, this Court must examine whether the risk that was settled implicates New York's public policy against insuring disgorgement.

D. There is a Conclusive Link Between the Disgorgement Paid to Settle the Underlying Actions and the Funds Wrongfully Withheld by TIAA-CREF for Its Own Benefit.

TIAA-CREF also argues that there is coverage for the uninsurable disgorgement payments it made in the Underlying Actions because the "TFE gains" at issue were passed on to other participants in the purported "At-Cost Accounts."[56] Neither TIAA-CREF's expense mechanisms nor its creative labelling efforts eliminate the "conclusive link" between the disgorgement payment in the Underlying Actions and the wrongfully retained "TFE gains." According to

[55] JA5665 at 135:20-22; JA5670-71 at 140:11-141:8.
[56] TIAA-CREF's Answering Brief on Loss, at 35.

TIAA-CREF, there is no such conclusive link because it did not ultimately retain the investors' gains. What TIAA-CREF ignores, however, is that [redacted]. In other words, there *is* a conclusive link between the disgorgement payments in the Underlying Actions and the amounts that TIAA-CREF improperly withheld.

As detailed in the Insurers' Opening Brief on Loss, TIAA-CREF admitted [redacted] (2) that the Underlying Actions sounded only in disgorgement.[57] As to the latter point, though TIAA-CREF's Answering Brief makes passing references to the Underlying Actions seeking disgorgement "among other relief,"[58] the Insurers have already established, and TIAA-CREF has already admitted, that the Underlying Actions only asserted disgorgement theories.[59]

As to the former point, TIAA-CREF admitted that it retained the TFE gains instead of paying them to the investors whose open accounts had generated the

[57] Insurers' Opening Brief on Loss, Filing ID 61614599 at 30-40.
[58] *See, e.g.*, TIAA-CREF's Answering Brief on Loss, at 17, 32.
[59] JA2864; JA4192-93; JA2312-13; JA2318-19; JA1993-94; JA2016 at n. 14; *see also*, Insurers' Opening Brief on Loss, at 33-38.

gains. TIAA-CREF disingenuously refers to amounts "allegedly" withheld by TIAA-CREF from the underlying plaintiffs; however, to be clear, [redacted]. The amount each class member recovered in settlement was governed by the gains that TIAA-CREF had withheld from them. The *Rink* settlement paid settlement class members "the full amount of undistributed gains,"[61] and the *Bauer-Ramazani* settlement paid each class member a pro rata share of a settlement fund "based on the investment gains associated with" his or her investment.[62]

In arguing that it did not retain the improperly withheld TFE gains, TIAA-CREF also relies on the labeling of its billing arrangements as "at-cost." TIAA-CREF never established that those arrangements were actually or purely at-cost, or that such arrangements did not profit the for-profit entities.[63] Further, the fact that

[60] Insurers' Opening Brief on Loss, at 31-33.
[61] JA2274 at ¶ 3.
[62] JA2477 at ¶ 61; JA2453.
[63] It is worth noting that the term "at-cost" is somewhat of a misnomer because the costs allocated to the Funds are set by TIAA management and allocated based [redacted]

TIAA-CREF purportedly treated the gains as an "expense," —so that it could use the gains to cover losses and other expenses that it had incurred—does not change the fact that [redacted][64].

TIAA-CREF's accounting protocol also does not erase the conclusive link between the wrongful retention of gains and the money later disgorged in the Underlying Actions. [redacted]

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upon net assets under management. JA3754-57 at 36:17-39:12; JA3758-59 at 40:16-41:5.

[64] JA1176-77 (Supplemental Response to Interrogatory No. 8).

[65] JA3412 at 60:19-24 (emphasis added).

[66] JA3921 at 40:10-23; *see also,* JA1174-75 (Supplemental Response to Interrogatory No. 2) [redacted]; JA2145-46 (Response to Interrogatory No. 2) [redacted]

There is, therefore, a "conclusive link" between the disgorgement payments in the Underlying Actions and the wrongfully withheld funds.

Additionally, TIAA-CREF's designed expense mechanism did not excuse TIAA-CREF from having to disgorge those gains, and does not render that disgorgement insurable. Rather, TIAA-CREF used money that did not belong to it. The investors to whom TIAA-CREF passed on gains and its costs were not the same investors involved with the initial trades, and also were not alleged to have received any gains through their own wrongdoing.

TIAA-CREF's attempts to draw a comparison between the non-trading investors at issue here and the hedge fund customers accused of wrongdoing in the

(emphasis added).

[67] JA5233, n.139.

[68] *See, e.g.*, JA2163-64; JA2157-58 (Response to Interrogatory No. 29); JA4523-24; JA4525-26; *see also* JA3928 at 47:9-24, JA3934-35 at 53:3-54:4, JA3948 at 67:4-15.

J.P. Morgan litigation are misplaced. According to TIAA-CREF, *J.P. Morgan II* "held that there could be no bar to coverage where the funds allegedly subject to disgorgement were actually retained by Bear Stearns' clients."[69] In contrast here, there was no allegation in any of the Underlying Actions that any of the Fund participants—either the participants whose TFE gains were withheld or the remaining Fund participants to whom expenses were ultimately allocated—engaged in any wrongdoing. Rather, the Underlying Actions alleged that TIAA-CREF *itself* improperly withheld the gains. There was no contention that TIAA-CREF's investors improperly withheld the gains. TIAA-CREF cannot obtain coverage for the benefit it received (the improperly retained funds) by ultimately redistributing the wrongfully withheld amounts to others.

E. A Remand Would Be Warranted If This Court Finds Genuine Issues of Material Fact.

For the reasons discussed in the Opening Brief and the preceding sections, the record evidence is clear that the Underlying Actions settled by TIAA-CREF were for the disgorgement of customer gains that TIAA-CREF wrongfully withheld. There is, therefore, no "Loss" to insure, and New York's public policy against insuring disgorgement precludes coverage.

[69] TIAA-CREF's Answering Brief on Loss, at 34.

[redacted]

TIAA-CREF, however, attempts to confuse the matter in two notable ways. First, TIAA-CREF continues to argue points that have been disproved by court orders and record admissions (*e.g.*, the suggestion that the Underlying Actions involved anything other than disgorgement, or that the gains were not improperly withheld). Second, as it did with the Superior Court, TIAA-CREF seeks to focus attention entirely on its own self-serving denial of liability in the underlying settlements in order to avoid examination of record evidence, including key admissions by TIAA-CREF and facts established by court orders. In its ruling on Loss, the Superior Court noted only that TIAA-CREF had settled, while expressly denying liability, and that neither the SEC nor any other governmental agency was involved in the Underlying Actions. Accordingly, the Superior Court misconstrued New York law, overlooked record evidence that bore on the issue before it, and ultimately erred in determining that the underlying settlements do not constitute insurable disgorgement as a matter of law. Therefore, if this Court determines that it cannot resolve the issue of whether the underlying settlements were uninsurable as a matter of law based on the record before it, then a remand is warranted to address facts never acknowledged by the Superior Court because of its flawed acceptance of TIAA-CREF's arguments upon which its finding of insurability is based.

[redacted]

F. TIAA-CREF Cannot Bootstrap Coverage for its Defense Costs and Class Counsel Fees if the Settlements in the Underlying Actions are Not Insurable.

If the Court determines that the settlements in the Underlying Actions constitute uninsurable disgorgement, TIAA-CREF is not entitled to coverage for the defense costs and class counsel fees associated with those uncovered settlements. Contrary to Plaintiffs' assertion, the Insurers do not argue that these amounts are themselves disgorgement. What the Insurers do argue, and what the New York case law supports, is that there is no coverage for amounts like defense costs and attorneys' fees related to otherwise uncovered amounts (*i.e.*, the settlements in the Underlying Actions). This is a matter of policy interpretation and New York public policy. There can be no coverage for amounts incurred in connection with claims for disgorgement when there is no coverage for the disgorgement itself.[70] Specifically, since the Policies only provide for coverage of "Loss," and since "Loss" does not include "matters which may be deemed

[70] *See, e.g.*, *Big 5 Corp. v. Gulf Underwriters Ins. Co.*, 2003 U.S. Dist. LEXIS 27209, at *11, *16 (C.D. Cal. July 14, 2003) (claimed damages were not "Loss" as defined by the policy, so corresponding defense costs were similarly not covered, and attorney fee award was not covered either because an attorneys' fee award "cannot exist independent of a damages award"); *see also*, *Health Net, Inc. v. RLI Ins. Co.*, 206 Cal. App. 4th 232, 256-257 (Cal. Ct. App. 2012) (rejecting holding of *UnitedHealth Grp. Inc. v. Hiscox Dedicated Corporate Member Ltd.*, 2010 U.S. Dist. LEXIS 10983 (D. Minn. February 9, 2010) and concluding that if underlying action was not covered, "coverage cannot be bootstrapped based solely on a claim for attorney fees.").

[redacted]

uninsurable under the law pursuant to which this policy shall be construed" (*i.e.*, New York law), there can be no coverage for the defense expenses and attorneys' fees incurred in connection with the uninsurable disgorgement sought by the Underlying Actions.[71]

TIAA-CREF also fails to distinguish *Millennium,* the most relevant New York case on point.[72] TIAA-CREF argues that the *Millennium* court's holding—that defense costs incurred in connection with a claim for disgorgement are not covered "Loss"—is premised upon the policy language in *Millennium* defining "Defense Costs" to mean "that part of Loss consisting of costs, charges and expenses incurred in the defense of Claims."[73] TIAA-CREF claims that no link between "Loss" and "Defense Costs" exists here because the concept of "Loss" was not incorporated into the definition of "Defense Costs."[74] However, TIAA-CREF's argument ignores that the definition of "Loss" explicitly incorporates the concept of "Defense Costs" (the converse equivalent of the policy language in

[71] The Court's analysis on this issue must take into consideration that the "Loss" definition in the Policies incorporates the defined term "Defense Costs," and, thus, that "Defense Costs" must relate to an insurable matter. The instant matter is not analogous to the circumstances presented by *UnitedHealth*, where the policy defined "Damages" extremely broadly as "*any monetary amount* . . . which an Insured is legally obligated to pay as a result of a Claim." 2010 U.S. Dist. LEXIS 10983 at *17-*18 (emphasis added). An award of attorneys' fees that relates to an uninsurable matter would not fall within the "Loss" definition in the Policies.

[72] *Millennium,* 882 N.Y.S.2d at 853-54.

[73] *Id.* at 851.

[74] TIAA-CREF's Answering Brief on Loss, at 39-40.

[redacted]

Millennium), so there *is* a link between the two. As the *Millennium* court properly held, where there is no coverage for "Loss" because a claim seeks only disgorgement, there can be no coverage for corresponding defense costs as part of that "Loss."

II. TIAA-CREF'S ALLOCATION AND EXPENSE METHODOLOGIES DO NOT CREATE "LOSS" OF AN INSURED.

TIAA-CREF's expense mechanism is not the same as a policyholder passing on litigation costs to customers in the form of higher prices, or to shareholders in the form of reduced dividends or earnings. TIAA-CREF has contended that, with respect to the amounts paid in connection with settling the Underlying Actions, its operating structure requires it to allocate those amounts as an expense to the Fund participants[75] If TIAA-CREF is indeed correct, and if these matters are the contractual responsibility of Fund participants, then it necessarily follows that TIAA-CREF itself, the Named Assured, is not out-of-pocket for any amount and has not suffered a "Loss" as defined in the Policies.[76]

TIAA-CREF's contention that its operating structure allows it to pass on the cost of its errors to remaining investors in the Funds as an expense does not assist its cause. As previously discussed, TIAA-CREF used this arrangement to its benefit and to shield its for-profit broker-dealer operations. TIAA-CREF used its expense mechanisms to withhold and use gains to its advantage to cover losses caused by the broker-dealer, and then having passed the remainder to the Fund participants, to require the remaining investors in the Funds to pay the costs of

[75] TIAA-CREF's Answering Brief on Loss, at 43.
[76] DAR0025 at note 10.

litigation and settlement – *i.e.*, to pay back the gains that had been withheld from the owners of the accounts that generated the gains. Where settlement and litigation costs were passed on to remaining investors, TIAA-CREF sustained no "Loss" of its own. This is not a construction that renders coverage illusory. It simply reflects the fact that TIAA-CREF settled a risk that is not a "Loss" and that it is uninsurable.

[redacted]

III. CONCLUSION

The Underlying Actions alleged that TIAA-CREF received and used funds belonging to the underlying plaintiffs for its own benefit. TIAA-CREF admittedly received and chose to divert those gains, instead of paying them to the investors whose open accounts had generated them. The only remedy sought was disgorgement and that is what the underlying settlements accomplished. Thus, discovery established that the settlements disgorged gains in the hands of the insured, which implicates the New York public policy rationale against insuring disgorgement, which has been recognized by New York's Court of Appeals in the *J.P. Morgan* litigation.

For the reasons above, the Superior Court's ruling on summary judgment in favor of TIAA-CREF on the issue of "Loss" should be reversed. Judgment in favor of TIAA-CREF should be reversed and judgment should be entered in favor of Illinois National, ACE and Arch, that no coverage is owed to TIAA-CREF in connection with the Underlying Actions. In the alternative, should this Court determine that there are genuine issues of material fact, as to whether the contract interpretative principles and public policy against insuring disgorgement apply, the matter should be remanded.

[redacted]