ARONBERG GOLDGEHN

Insurance Coverage Update

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Lawsuit Demanding Withheld Premiums Falls Outside of "Damages"

An insurer does not need to defend and indemnify insurance broker in fraud suit because the only damages claimed in the underlying action were for the disgorgement of premiums, which were excluded from coverage according to an Illinois Federal Court. Westport Ins. Corp. v. M.L. Sullivan Ins. Agency, Inc., et al., Case No. 1:15-cv-07294 (N.D. Ill. January 5, 2017).

In the underlying action, American Inter-Fidelity Exchange ("AIFE"), an insurance company, claimed that the M.L. Sullivan Insurance Agency ("Sullivan") and its employee, Sebastian Miklowicz, provided false information to AIFE that resulted in its losing out on insurance premiums it was owed.

Sullivan acquired insurance from AIFE on behalf of trucking and interstate transportation companies. Each insured provided Sullivan with information about its power units and miles driven, and AIFE used that information to calculate its premiums. The insured would pay the premiums to Sullivan and Sullivan would turn over the premiums to AIFE.

However, according to AIFE, it believed that Sullivan misrepresented to AIFE the information that the insureds provided, leading AIFE to believe that lower premiums were owed. Sullivan would collect the correct (higher) premium from the insured, and then, based on the incorrect information it provided to AIFE, would remit payment to AIFE in an amount lower than what was rightfully owed. AIFE brought the underlying suit to recover wrongfully withheld premiums.

Westport ("the Insurer") insured Sullivan under a professional liability policy, which provided coverage for damages that were defined as "monetary amounts for which an insured is held legally liable," but do not include, amongst other items, "reimbursement or return of premiums or funds."

As an initial matter, U.S. District Judge Feinerman held that AIFE's suit alleged wrongful acts as defined by the policy. The Insurer asserted that AIFE's suit was excluded from coverage in its entirety because it centered on allegations that Sullivan had deliberately orchestrated a fraudulent scheme, and the policy did not cover intentional acts. Sullivan countered that the underlying suit contained additional claims that it acted negligently, which fall within the policy's scope, and the Court agreed.

Despite finding that the conduct fell within the scope of a wrongful act as defined in the policy, the Court held that the Insurer had no duty to defend because AIFE only sought withheld premium payments, which were explicitly excluded from coverage.

Sullivan argued that the AIFE Complaint seeks compensatory damages for negligence in addition to equitable relief and that AIFE could seek consequential damages such as lost profits, lost business, damage to good will and

loss of use of capital, all of which are beyond the withheld premiums. "The trouble for Sullivan is that nothing in AIFE's complaint supports that assertion. To the contrary, the complaint plainly states that 'AIFE brings this suit to recover premiums collected and wrongfully withheld by [Sullivan]."

Additionally, Judge Feinerman noted in dicta that AIFE had every incentive to amend its complaint to specifically articulate damages beyond the premiums because it could collect a judgment pursuant to the policy; however, no such amendment was made. The Court concluded that the Insurer had no duty to defend or indemnify in the underlying action and granted the Insurer's motion for judgment on the pleadings.

Comments

The Seventh Circuit and the lower District Courts have repeatedly held that damages in the form of restitution do not constitute loss within the meaning of an insurance contract. Rather, and as observed in Westport, damages in the form of "restitution" or simply repaying ill-gotten gains is essentially returning stolen property and is not a loss that should be the responsibility of an insurer. See Level 3 Commc'ns, Inc. v. Fed. Ins. Co., 272 F.3d 908, 910-11 (7th Cir. 2001) (holding that "[a]n insured incurs no loss within the meaning of the insurance contract by being compelled to return property that it had stolen, even if a more polite word than 'stolen' is used to characterize the claim for the property's return," reasoning that such relief "is restitutionary in character" because "it seeks to deprive the defendant of the net benefit of the unlawful act"). This rationale of this decision falls squarely within this reasoning.

If you have any questions about this Update, please contact the author listed below or the Aronberg Goldgehn attorney with whom you normally consult.

Sara E. Spratt
sspratt@agdglaw.com
312.755.3146