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Insurance Coverage Update

Products and Services Exclusion Bars Coverage Under D&O Policy

A Products and Services Liability Exclusion relieved an insurer of the duty to defend lawsuits alleging fraud in the sale of technology, despite allegations that the insured was not the entity that sold the product to the plaintiff and that another entity could have developed the product, according to a recent Illinois appellate court decision. *Hanover Insurance Company v. MRC Polymers, Inc. et al.*, 2020 IL App. (1st) 192337 (Sept. 10, 2020).

MRC Polymers, the insured entity, was in the recycled plastics business manufacturing plastic "flake" using a proprietary "Washline Technology." It formed an LLC (MRH) to hold the intellectual property rights to the technology and another LLC (Operations) to hold its assets. An investor in the waste and recycling industries purchased the washline technology from MRH and Operations as well as washline equipment from MRC. The investor also entered into certain facility and equipment leases with MRC.

The investor later became dissatisfied with the performance of the technology and equipment and sued MRH, Operations, and a principal associated with all of the entities. The investor alleged fraudulent inducement, misrepresentation, contractual indemnification, and breach of contract. The investor separately sued MRC seeking rescission of the leases based upon fraudulent inducement. It also added MRC to the suit against MRH and Operations, alleging alter ego liability and for aiding and abetting the fraudulent inducement and misrepresentations.

MRC's insurer denied coverage for the lawsuits, relying on the Products and Services Liability Exclusion in a private company management liability

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policy, and filed a declaratory judgment action in Illinois state court. The exclusion barred coverage for "*Loss* for any *Claim* based upon, arising out of or in any way related to any actual or alleged *Claim* for a *Wrongful Act* by reason of or in connection with the efficacy, performance, health or safety standards and/or proprietary licensing rights for any services, products or technologies offered, promised, delivered, produced, processed, packaged, sold, marketed, distributed, advertised and/or developed by the *Insured Entity* (MRC)." MRC argued that the exclusion did not obviate the duty to defend because the investor's complaints included allegations that MRH or one of MRC's affiliates developed the technology. Further, the theories of alter ego liability and aiding and abetting sought to hold MRC liable for the acts of someone else, allegations that would fall outside the exclusion. The trial court entered summary judgment in favor of the insurer, from which MRC appealed.

The appellate court (and insurer) acknowledged that "if any part of the underlying complaint sets forth alleged facts that are within the scope of coverage, the duty to defend arises." And "if several theories of recovery are alleged in the underlying complaint against the insured, the insurer's duty to defend arises even if only one of several theories is within the potential coverage of the policy." The court disagreed with MRC's reading of the exclusion as applying only where MRC offered the product directly to the end user. The court noted the "extremely broad" language of the exclusion that clearly applied to preclude coverage. The Complaints alleged that MRC sold its rights to the washline technology to MRH and Operations, which in turn sold the technology to the investor. The defendants allegedly engaged in wrongful acts in connection with the performance of the technology. Therefore the claims against MRC alleged "wrongful acts in connection with the efficacy or performance of services, products, or technologies sold by MRC," and fell within the exclusion.

Comments

Management liability policies typically are not intended to provide coverage for customer complaints concerning the efficacy of the insured's products or services. Those exposures are more often included within the scope of general liability or professional liability policies. The insurer here likely used the broad "based upon, arising out of or in any way related to" language in the exclusion in order to keep this claim in its "proper lane." Insurers can take some comfort in this decision where the court recognized the breadth of the insurer's exclusionary language and applied it as written.

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

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