

Seventh Circuit Rules Background Facts and General Allegations Must Point to a Theory of Recovery to Trigger Duty to Defend

The Seventh Circuit recently addressed the outer limits of a professional liability insurer's duty to defend where a claim contains background facts regarding an insured's professional services, but the allegations do not point to any theory of recovery against the insured for breach of professional obligations. *Madison Mut. Ins. Co. v. Diamond State Ins.*, No 15-32922017 WL 1065557 (7th Cir. March 21, 2017) (Illinois law).

Geraldine Davidson was a real estate broker who obtained a professional liability errors and omissions policy from Diamond State, effective from October 2005 through November 22, 2007. The Diamond State policy applied to claims made and reported during the policy period and provided coverage for "wrongful acts" arising out of the performance of real estate professional services.

In 1999, Dr. William and Wendy Dribben purchased a home in a development in southern Illinois containing several large parcels, a man-made lake, and a dam on the Dribbens' property. Davidson represented the sellers in the transaction, was one of the developers, and also owned a parcel of the development.

In 2006, the Dribbens filed suit against Davidson, among others, alleging the original owners/developers never obtained a permit authorizing the dam. The Dribbens alleged that Davidson's failure to disclose the un-permitted dam on the property amounted to fraudulent concealment and consumer fraud. Diamond State defended

Davidson against the 2006 lawsuit under a reservation of rights.

The Dribbens filed another suit in 2011 against Davidson and her husband, alleging the Davidsons engaged in a pattern of harassment, intimidation, and interference with the Dribbens' property rights, and asserting various tort causes of action. The Davidsons tendered that suit to Madison Mutual, their homeowner's insurer, and it accepted coverage. Ms. Davidson also tendered the 2011 suit to Diamond State, seeking coverage under the expired E&O policy under which Diamond State defended the 2006 lawsuit. But Diamond State disclaimed coverage, asserting that the 2011 suit did not seek relief for acts arising out of Ms. Davidson's professional services. Madison Mutual initiated coverage litigation, seeking reimbursement from Diamond State for defense costs Madison Mutual paid for the 2011 suit.

The District Court granted summary judgment for Diamond State. The court found Diamond State had no duty to defend because the factual allegations in the 2011 lawsuit did not support a claim against Mrs. Davidson as a broker that, in turn, would relate the 2011 suit back to the 2006 lawsuit that Diamond State defended.

The Seventh Circuit affirmed on appeal. The Court rejected Madison Mutual's argument that Diamond State had a duty to defend the 2011 lawsuit because the suit alleged breach of a general "duty of care" encompassing Ms. Davidson's role as a broker and her alleged

failure to disclose the un-permitted dam. Madison Mutual contended the 2011 lawsuit fell within the Diamond State policy's terms because it potentially arose out of the same "wrongful act" as the 2006 lawsuit. And the Court noted that the operative complaint in the 2011 lawsuit contained allegations concerning the dam and Ms. Davidson's status as a real estate broker. However, despite those general allegations, the Court found that the 2011 lawsuit did not either expressly or implicitly allege that Ms. Davidson wronged the Dribbens in her capacity as a realtor by not disclosing that the dam was not properly permitted. Rather, the Court found the 2011 lawsuit was actually about the Davidsons' pattern of alleged misdeeds as neighboring landowners that interfered with the Dribbens' ability to use, enjoy, and/or sell their property.

The Seventh Circuit Court agreed with Diamond State that any legal duty at issue in the 2011 lawsuit was not a professional duty that Ms. Davidson owed as a realtor, but the Davidsons' duty of care to act reasonably and to hold themselves to the neighborly standard of care. Indeed, the Court found that reference to Ms. Davidson's status as a realtor appeared aimed at suggesting that she should have understood how her actions *as the Dribbens' neighbor* would interfere with the quiet enjoyment of their rights as property owners. Beyond that, the 2011 lawsuit contained no allegation that Ms. Davidson was providing professional services to the Dribbens or breached any duty that she may have owed them in that regard.

According to the Court, background facts and context regarding Mrs. Davidson's status as a realtor and the previous non-disclosure regarding the dam permit similarly did not implicate the Diamond State policy because the 2011 suit did not allege injury resulting from her non-disclosure and did not predicate any recovery on that failure. The Court observed that the 2011 suit contained "a small subset of factual

allegations that overlap with the factual underpinnings of the 2006 suit regarding the dam permit." Madison Mutual argued those facts could possibly support a claim related to Davidson's capacity as a realtor. Citing *Health Care Indus. Liability Ins. Program v. Momence Meadows Nursing Ctr., Inc.*, 556 F.3d 689, 695-95 (7th Cir. 2009), the Court rejected that argument and noted that factual allegations are only important to trigger a duty to defend insofar as they point to a theory of recovery. Accordingly, the Court found that while those factual allegations may have provided explanatory background for the Davidsons' alleged acts of harassment, they did not point to any theory of recovery against Mrs. Davidson for breach of her professional obligations as a realtor.

Madison Mutual advanced two other unsuccessful arguments. First, it argued that a catch-all request for relief left open the possibility for a theory of liability tied to Mrs. Davidson's professional services as a realtor. The Court rejected that position because a "boilerplate request" does not operate as an independent request for relief, let alone an independent theory of recovery not otherwise factually supported in the body of the complaint. Second, Madison Mutual contended that the property dispute arose out of Ms. Davidson's failure to disclose the dam permit issue because the Dribbens would have never purchased the property had they known the full facts.

The Court disposed of that argument because, while it suggested the 2011 suit arose from the wrongs alleged in the 2006 suit "in the very broadest factual sense," it did not "transform what is otherwise a suit about the Davidsons' actions as the Dribbens' neighbors into a suit about Ms. Davidson's prior actions as the broker who sold them the property." Accordingly, Diamond State owed no duty to defend the 2011 suit.

Comment:

The *Madison Mutual* decision demonstrates that courts are willing to closely analyze underlying factual allegations and draw an outer boundary on the “eight-corners” rule under Illinois law. In the Seventh Circuit’s view, background facts, boilerplate requests for relief, or logical extremes of what constitutes a plausible potential claim against an insured should not be enough to trigger a liability insurer’s duty to defend where the suit does not otherwise fall within coverage. The case reinforces the concept that the duty to defend, while broad, is not unlimited. There is no

magic language to trigger the duty to defend, and mere reference to a professional service will not automatically transform a suit into a professional liability claim.

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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