

Seventh Circuit Holds Underfunding of a Pension Plan Does Not Constitute Loss

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The United States Court of Appeals for the Seventh Circuit ruled that an insurer owed no duty to defend or indemnify a local municipality in connection with allegations that the municipality failed properly to fund a pension plan. *St. Paul Fire & Marine Ins. Co. v. Village of Franklin Park*, 523 F.3d 754 (7th Cir. April 23, 2008).

The insurer issued two policies providing specified coverage for "claims arising from administering employee-benefit plans" to the municipality. The policies provided that the insurer would "have the right and duty to defend any protected person against a claim or suit for loss covered by this agreement." The underlying plaintiffs alleged that the municipality failed to make required payments to the pension plan, used "the wrong funding formula," failed to "enroll an actuary," failed "to levy sufficient taxes," and misused "money that should have gone to the fund." The insurer denied coverage on the basis that the suit failed to allege "loss" that could be covered by the relevant policies. Thereafter, the insurer brought this declaratory judgment action to establish that it had no duty to defend or indemnify the municipality.

The Seventh Circuit, citing *Local 705 Int'l Bd. of Teamsters Health & Welfare Fund v. Five Star Managers, L.L.C.*, 735 N.E.2d 679, 683 (Ill. Ct. App. 2000), noted that the policies afforded coverage only for "loss" and that "[i]n coverage litigation involving a similar allegation of underfunding a pension, the Illinois Appellate Court defined 'loss' as 'the act or fact of losing: failure to keep possession: DEPRIVATION.'" The court explained that the Illinois appellate court had ruled that amounts sought to remedy the underfunding of a pension plan are not "loss" because the policyholder "had no 'right to possess [those amounts] in the first place.'" The court held that the same reasoning applies to bar coverage in the case before it and further noted that, as the court previously ruled in *Level 3 Communications, Inc. v. Federal Insurance Co.*, 272 F.3d 908, 910 (7th Cir. 2001), coverage does not exist because "'loss' does not 'include the restoration of an ill-gotten gain.'" The court rejected the municipality's argument that the complaint's allegations of various acts of negligence, which may have caused certain of the underfunding, triggered the duty to defend. "Whatever caused the alleged underfunding, the remedy would be for [the municipality] to contribute money that it was legally required to contribute all along" and such amounts would not constitute "loss." The court also held that the insurer was not estopped from asserting coverage defenses because it did not breach its duty to defend.