wiley

NEWSLETTER

Post-Closing Price Adjustment for Stock Purchase Not Insurable Loss

November 2010

The United States District Court for the Northern District of Illinois has held that an insured's payment to settle allegations that it fraudulently induced the purchase of its subsidiary at an artificially inflated price did not constitute insurable "loss" under Illinois law. *Ryerson, Inc. v. Fed. Ins. Co.*, No. 09 C 4173 (N.D. Ill. Sept. 30, 2010).

The insured sought coverage under its directors and officers liability policy for amounts incurred in the defense and settlement of a suit arising from the sale and purchase of its subsidiary. The plaintiff in that action alleged that the insured, in connection with the parties' negotiations, had effectively concealed the fact that the subsidiary was on the verge of losing its largest customer and therefore caused the plaintiff to pay more for the subsidiary's stock than the subsidiary actually was worth. The insured ultimately settled the suit for a payment of $8.5 million.

Citing the Seventh Circuit's decision in *Level 3*, the court held that the settlement payment by the insured was "restitution for ill-gotten gains and therefore not an insurable 'loss' under Illinois law." In reaching this conclusion, the court rejected the insured's reliance on the fact that the plaintiff had sought "compensatory and punitive damages." According to the court, it was not the "labels" applied but the "nature of the relief sought" that was determinative. In this regard, the court pointed out that the plaintiff had sought only to recover from the insured "damages that would account for the inflated price it paid for [the subsidiary]-*i.e.*, restitution." The court also noted that the parties' settlement agreement unambiguously described the $8.5 million as a "post-closing price adjustment" to the stock purchase agreement for the subsidiary and dismissed as irrelevant evidence from the insured suggesting that the payment was described as such only to avoid certain tax consequences.

The court rejected the insured's reliance on the "mend-the-hold" doctrine as well. The insured had argued that the insurer should be estopped from invoking its "no loss" position because the insurer had not specifically raised the issue in its original letter to the insured denying coverage for the suit. According to the court, however, the doctrine did not apply here because an insured "cannot create coverage by estoppel."