

Federal Court Predicts Restitution Is Uninsurable Under Hawaii Law

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The U.S. District Court for the District of Hawaii, predicting Hawaii law in a case of first impression, has granted partial summary judgment for an insurer, holding that Hawaii courts would deem restitutionary payments uninsurable and that an insurer had no duty to defend or indemnify a policyholder where the only claim in the underlying complaint for which the policyholder sought coverage was for restitution. *Executive Risk Indem. Inc. v. Pac. Educ. Servs., Inc.*, 2006 WL 2506467 (D. Haw. Aug. 25, 2006).

The insurer issued a D&O policy to a company formed to found a college. After the company registered a trade name for the college and began interacting with students, the state of Hawaii filed a complaint against the company and two of its officers, alleging that the company had violated numerous Hawaii statutes relating to the accreditation of educational institutions. The state of Hawaii sought relief that included restitution. The insurer initially agreed to defend the company and the directors and officers pursuant to a reservation of rights, but subsequently filed the instant action, seeking a declaration that it was not obligated to defend or indemnify the policyholder and the individual insureds. After the state court appointed receivers for the company's assets in a separate proceeding, the court in the instant action permitted the receivers to intervene in the coverage action. At a hearing on cross motions for partial summary judgment, the insurer and the intervenors agreed that the only claim for relief in the underlying action for which coverage was sought was the demand for restitution.

The court first noted that the question raised by the cross motions for partial summary judgment—whether restitution is uninsurable as a matter of Hawaii law—was a matter of first impression. The court accepted the insurer's contention that the court could predict how the Hawaii Supreme Court would rule on the issue, rejecting the company's contention that such a determination should be made by the Hawaii legislature in the first instance. The court reasoned that "[b]ecause Hawaii courts' power to award equitable restitution 'is not confined by or dependent on statute,' Hawaii courts need not wait for legislative guidance to determine when an award of restitution is proper," and thus Hawaii courts "need not await legislative action to determine whether restitution is insurable."

The court then noted that Hawaii courts have held that the equitable remedy of restitution is designed to "deter[] fraudulent conduct by wrongdoers." The court indicated that when Hawaii law is silent on issues of insurance law, at least one other judge of the court had relied on California insurance law, noting that "the

Hawaii Supreme Court has frequently followed California Courts in rendering opinions on insurance matters." Doing the same, the court relied heavily on the fact that, under California cases such as *Bank of the West v. Superior Court*, 833 P.2d 545 (Cal. 1992), restitution is uninsurable. The court also noted that "[o]ther jurisdictions agree with California courts in holding restitution uninsurable" and cited cases such as *Level 3 Communications, Inc. v. Federal Insurance Co.*, 272 F.3d 908 (7th Cir. 2001), *Granite State Insurance Co. v. Aamco Transmissions, Inc.*, 57 F.3d 316 (3d Cir. 1995), and *Vigilant Insurance Co. v. Credit Suisse First Boston Corp.*, 782 N.Y.S.2d 19 (N.Y. App. Div. 2004).

Based on these cases and its understanding of the purposes behind restitution under Hawaii law, the court predicted that the Hawaii Supreme Court would hold that restitution is uninsurable as a matter of law. The court stated that "[a] conclusion that restitution is insurable would contravene the express purpose of restitution recognized by Hawaii courts, which is to deter wrongdoers from benefiting or otherwise profiting from their improper actions" and that "[b]ecause Hawaii courts seek to return illegally obtained property to victims, the Hawaii Supreme Court would likely rule that claims for the return of ill-gotten gains should not be insurable." Accordingly, the court held that the insurer had no duty to defend or indemnify the insureds in connection with the underlying action.