

Insurance Agency's Failure to Pay Back Promissory Notes Not Failure to Perform "Professional Services" Under Policy

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A federal district court in Pennsylvania, applying Pennsylvania law, has granted summary judgment to an insurer, holding that the insurer owed no duty to defend or indemnify an insurance agency against three class action lawsuits arising out of the agency's failure to pay principal and interest due under promissory notes because the lawsuits did not allege wrongful acts resulting from the performance of "professional services" under the policy. *Mallalieu-Golder Ins. Agency, Inc. v. Executive Risk Indem., Inc.*, 2006 WL 2322396 (M.D. Pa. Aug. 9, 2006).

An insurer issued a professional liability policy to an insurance agency covering the agency as well as "any Insured Subsidiary." The policy provided that the insurer would pay "loss" that any insured became legally obligated to pay that resulted from "wrongful acts." The policy defined "wrongful acts" as "any actual or alleged act, error, omission or breach of duty by an Insured solely in such Insured's performance of, or failure to perform, Professional Services." "Professional services" was defined under the policy as "insurance services performed for others for a fee or commission as an insurance agent . . . including premium financing . . ."

The insurance agency sold insurance policies and certain financial products such as annuities and mutual funds. In 1998, the agency's president created Premium Finance Trust (PFT) for the purpose of financing premiums for policies sold by the agency. PFT was held out to the public as a "wholly-owned subsidiary" of the agency, but in fact it was neither a separate corporation nor a separate partnership. As a purported method to generate funds for premium financing, PFT sold notes to investors. The notes promised that PFT would repay the principal with interest. The money generated by the notes, however, was used to meet the financial obligations of the agency. After the agency's president died, others within the agency became aware that PFT's obligations under the notes far exceeded its assets, and an FBI investigation soon commenced. The agency alerted its investors to the investigation and informed them that no principal or interest payments would be made until its true financial situation was determined.

After receipt of the letter, certain PFT investors brought three class actions against PFT, the agency and a securities broker. One class action alleged that PFT and the agency had breached their fiduciary duties to make the principal and interest payments owed to the investors. The second action alleged that the securities

broker negligently recommended investment in the promissory notes. The third action alleged that the agency's vice president and bookkeeper owed the investors a duty to provide a true and accurate accounting of PFT, and that they had negligently failed to reveal PFT's troubles. The agency sought a defense and indemnity from the insurer for all three actions, and the insurer denied coverage. After the insureds initiated a declaratory judgment action, the insurer sought summary judgment regarding its coverage obligations.

The court first rejected the insurer's argument that the policy did not provide coverage because PFT was neither a named insured nor an "insured subsidiary" under the policy. Although the court concluded that PFT was not an "insured subsidiary," it found that issues of material fact remained as to whether it was an insured because it was unclear whether PFT was a "part of" or a "department of" the policyholder agency.

The court also rejected the insurer's assertion that the agency could not incur a "loss" under the policy because any amounts that it or PFT would be ordered to pay to the class action plaintiffs would constitute "ill-gotten gains," and it would be against public policy to use insurance proceeds to pay back wrongfully acquired and disgorged funds. The court concluded that a necessary antecedent to accepting this argument would be finding that the agency and PFT were separate entities, which it could not conclude as a matter of law.

The court then concluded that summary judgment was appropriate because the wrongful conduct alleged in the class actions did not arise out of PFT's failure to perform "professional services" under the policy. Although the policy defined "professional services" to include "premium financing," the court concluded that the class action plaintiffs did not complain of wrongful acts associated with the financing of premiums or "insurance services performed for others for a fee or commission," but rather sought recovery because of PFT's failure to pay on the promissory notes. The court rejected the agency's contention that the issuance of promissory notes was an aspect of premium financing and observed that "[t]he making of promissory notes is not included in the definition of 'Professional Services,' and the financial arrangement between PFT and its investors did not involve" the sale of the agency's financial products identified in the policy and policy application. Accordingly, the court concluded that none of the claims arising from the three class actions was subject to coverage under the policy.