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ALERT

Disgorgement of Undisclosed Contingent Commissions Collected by Insured Constitutes Restitution, Not a "Loss"

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The Circuit Court of Cook County, Illinois has held that an insurance broker could not recover under its multi-line professional liability policies amounts incurred defending and settling claims arising out of its alleged receipt of undisclosed contingent commissions because those claims sought from the broker only restitutionary damages, which the court concluded did not constitute insurable "loss." *Aon Corp. v. Certain Underwriters at Lloyd's of London*, No. 06 CH 16852 (Ill. Cir. Ct. Dec. 3, 2010).

In 1999, a class action lawsuit was initiated against the insured broker by a group of customers alleging that the broker had improperly received commissions from certain insurance companies with whom it had placed coverage without disclosing in advance to the customers that it had the opportunity to receive these contingent commissions. The original complaint sought for relief either disgorgement of the commissions or an award of damages. The plaintiff customers filed several amended complaints, though each was substantially and substantively similar to the original complaint. The third amended complaint, which was the operative one at the time the case ultimately settled, dropped the demand for an award of damages and, other than certain injunctive relief, sought only the disgorgement into a constructive trust of the allegedly improper commissions received by the insured. The insured moved to dismiss the third amended complaint—which was the first and only time it had filed such a motion in the litigation—arguing that plaintiffs had failed to state a claim upon which relief could be granted because they had not alleged any actual damages. The court denied the motion as to

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four of plaintiffs' five causes of action, concluding that "plaintiffs' damages are properly measured by the disgorgement of profits retained by [the insured.]"

Shortly thereafter, the attorneys general of New York, Connecticut and Illinois each filed a civil action against the insured based on the allegations asserted in the class action. These actions also similarly sought, among other relief, "disgorgement of the amounts [the insured] has improperly collected through its failure to disclose its eligibility to receive contingent commissions." The insured immediately entered into a settlement to resolve all three actions by the attorneys general, pursuant to which the insured deposited $190 million into a fund to be distributed to affected customers. Days later, the parties also settled the class action for $38 million.

The insured sought coverage from its multi-line professional liability insurers for both defense costs incurred and the settlements. The insurers denied coverage on the ground that the amounts at issue did not constitute "loss," which the policies defined "as damages, settlements, and [c]osts . . . but [not] . . . matters uninsurable under the substantive law governing the final resolution or adjudication of a [c]laim."

In the coverage litigation that followed, the court determined that Illinois law applied to the issues raised by the class action and that New York law applied to those raised by the three actions by the attorneys general. The court granted the insurers' motions for summary judgment, concluding that the policies did not afford any coverage for these actions because the only damages sought were restitutionary, which were not insurable under both states' law. In reaching this conclusion, the court found irrelevant the fact that the settlement amounts did not represent a "particular amount of contingent commissions" as well as the fact that no court had ever determined that the failure to disclose contingent commissions was unlawful so as to render them an "ill-gotten gain."

The court also rejected the insured's argument that the demands for damages other than disgorgement in the earlier complaints created a question of material fact as to whether the settlement of the class action resolved potentially covered claims. According to the court, only the relief sought in the operative complaint at the time of settlement was determinative. The court noted that the situation here was not one in which the potentially covered claims had been dismissed and the settlement represented a compromise of the risk that those claims could be revived on appeal.

As to defense costs in the class action, the court rejected the insured's argument that it was entitled to recover those costs incurred before the third amended complaint was filed and when the operative pleadings had sought actual damages. The court pointed out that these policies did not impose upon the insurers a duty to defend that required them to pay defense costs in the event of a potentially covered claim. Rather, the court observed, the insurers' obligation to reimburse defense costs applied only to costs incurred in connection with claims that actually were covered.