

ALERT

Insolvency Exclusion Bars Broker's Claim for Coverage and Broker's Payments Deemed Not Amounts It Was "Legally Obligated to Pay"

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The United States District Court for the Northern District of Illinois, applying Illinois law, has ruled that an insolvency exclusion barred coverage for claims arising out of an insurance broker's placement of coverage with an insolvent insurance association. *American Automobile Insurance Co. v. B.D. McClure & Associates, Ltd.*, 2011 WL 211204 (N.D. Ill. Jan. 21, 2011). The court also ruled that the insured's out-of-pocket payments for claims tendered under the insolvent association's insurance were not amounts the insured was legally obligated to pay and therefore did not fall within the scope of coverage of the broker's errors and omissions policy.

The insured was a licensed insurance broker in Illinois that sold workers' compensation coverage to employers through a professional employer association. The broker stopped selling insurance through the association around May 2007 and, in April 2008, an Illinois circuit court determined that the association was insolvent and entered an order of liquidation. Due to the association's insolvency, the broker began paying workers' compensation claims tendered under the association's insurance out of its own pocket even though it did not have a contractual obligation to do so. In February 2008, the broker sought coverage for the out-of-pocket payments for workers' compensation claims from its errors and omissions insurer.

In addition, one of the broker's customers filed a lawsuit against it in Illinois state court in September 2009 alleging in part that the broker was negligent in placing the customer's insurance coverage with the now-insolvent association. The insurer filed the instant declaratory judgment action in March 2009 seeking a ruling that it had no duty

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under the errors and omissions policy to defend or indemnify the broker for claims arising out of its sale of the association's insurance, including the state court lawsuit. Specifically, the insurer argued that the policy's insolvency exclusion barred coverage and that the payments the broker made on the association's claims were voluntary payments.

On cross-motions for summary judgment, the court ruled that the insolvency exclusion barred coverage. That exclusion barred coverage for "[a]ny claim arising out of or in any way involving any . . . insolvency, or financial inability to pay of any organization regardless of when the financial impairment of such organization began and whether or not an INSURED was aware or could have been aware of the financial impairment of such organization" The court determined that the exclusion applied to preclude coverage for the underlying claims because the insured's alleged negligence "depends on the insolvency of [the association]," and therefore "without [the association's] insolvency [the insured's] conduct would not have caused harm."

The court also ruled that exceptions to the exclusion did not apply. First, the court determined that an exception applicable where the insolvent entity was guaranteed or operated by a governmental body did not apply because it was undisputed that the insolvent association was not authorized to transact business in Illinois and therefore was not covered by the Illinois Insurance Guaranty Fund. The court also reasoned that in contrast to the state legislature-created insurance programs listed as examples of the types of organizations to which the exception would apply, the association here was a private entity. In addition, the court concluded that the exception would be rendered meaningless if it were interpreted to apply every time the Director of Insurance is involved in the liquidation of an insurance company.

The court further rejected the broker's arguments that exceptions applicable where the insolvent organization had a specified A.M. Best Company rating applied. The court found that there was no evidence in the record that A.M. Best Company ever rated the association in the first instance, and ruled that the broker failed to raise a genuine issue of material fact with respect to these exceptions.

Next, the court ruled that the broker's errors and omissions policy did not afford coverage for the payments it made on the insolvent association's claims because such payments did not constitute amounts that the broker was "legally obligated to pay as DAMAGES" within the meaning of the policy's insuring agreement. In this regard, the broker acknowledged that it did not have a contractual obligation to pay the claims. In addition, the court concluded that the broker did not have an obligation under Illinois law to pay the claims.

Because it granted the insurer's motion for summary judgment, the court dismissed with prejudice the broker's counterclaims seeking coverage and alleging improper claims practices. In this regard, the court dismissed the broker's counterclaim seeking attorneys' fees and costs based on the insurer's allegedly improper refusal to pay because there was a bona fide dispute concerning insurance coverage.