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NEWSLETTER

Third Party Payments Do Not Constitute Loss under Crime Policy

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In an unreported decision, a Minnesota appellate court has held that settlement payments to reimburse a third party for losses caused by thefts perpetrated by the insured's employees did not constitute a loss under an excess crime loss indemnity policy. *Cargill, Inc. v. Nat'l Union Fire Ins. Co.*, 2004 WL 51671 (Minn. Ct. App. Jan. 13, 2004).

An insurer issued an excess crime loss indemnity policy to a company that marketed hybrid corn seed used to grow feed corn. The genetic code of hybrid seeds is known as germplasm. The germplasm of a particular hybrid seed is a trade secret, which may be patented and registered pursuant to the Plant Variety Protection Act.

The policy provided that the insurer will indemnify the insured for "[l]oss sustained by the Insured by reason of any claim first made against the Insured during the Policy Period directly caused by Theft or Forgery by any Employee of the Insured and for which loss the Insured is liable." The policy excluded coverage for "damages of any type, including but not limited to, punitive, exemplary, and the multiplied portion of multiplied damages, for which the Insured is legally liable, except direct compensatory damages...arising from a loss covered under this Policy; [and] indirect or consequential loss of any nature."

In June 1998, the insured sold its seed business. Pursuant to the sale agreement, the company warranted that as of the date of the sale it was unaware of any "pending or...threatened litigation or claim of infringement or misappropriation" regarding the transferred germplasm. The sale agreement also provided that the transferred germplasm was not subject to "any claim or potential claim of joint ownership by a third party." In October 1998, a competitor brought suit against the insured company alleging violations of the Lanham Act for falsely representing in its advertising that its seed corn was the result of its own research when the company had actually used a competitor's germplasm in cultivating its seeds. In February 1999, the competitor brought suit against the company that had purchased the insured's seed business. The suit sought to enjoin the purchaser from using the competitor's proprietary germplasm in its seed corn. The purchaser in turn informed the insured that the competitor's claims could potentially lead to a breach of contract action.

In June 1999, the insured settled with the purchaser. The purchaser agreed to release all potential breach of contract claims in exchange for $335 million. Of that amount $295 million was designated as a return of the price paid as consideration for the purchaser's loss of the use of the insured's germplasm. In May 2000, the insured entered into a settlement agreement with the competitor company pursuant to which the insured agreed to pay the competitor $100 million, $71 million of which represented royalties for past use of proprietary information.

The insured sought coverage from the insurer for defense and settlement costs. In June 2000, the insured submitted a proof of loss to the insurer detailing six different thefts of the competitor's germplasm by its employees. After the insurer denied coverage, litigation followed.

The appellate court held in favor of the insurer. First, the court noted that the crime loss policy in question was an excess policy that was triggered only after the primary insurer has paid the full amount of limits on the underlying policy. The court found that the insured has made no showing that the primary insurer had paid or agreed to pay the full amount of limits on the underlying policy.

The court went on to hold that even if the full limits of the underlying policy had been paid, the insured was not entitled to coverage under the policy. The court concluded that the language of the policy's insuring clause was a fidelity provision, providing coverage solely for the insured's direct losses caused by an employee's theft and not for the insured's liability to third parties caused by the employee's theft.

The court also held that the insured would not be entitled to coverage because the insured had not suffered a loss. The court pointed out that the term "loss," though not defined in the policy, requires a financial detriment. In this case, the settlement monies were for a partial return of the purchaser's price and royalties owed to the insured's competitor. The court concluded that these amounts were restitutionary in nature and therefore did not represent a financial detriment to the insured. Additionally, the court noted that the misappropriated germplasm was used by the insured for its financial benefit. The Court held that it could not find that an insured has suffered a loss when it "reimburses a third party for employee dishonesty carried out for the benefit of the insured."

The court also held that the insured was unable to prove that its losses were even caused by theft. The court determined that the injured competitor's claim for damages was based on the insured's improper use of proprietary information and not on an actual conversion of property. The court also held that the insured could not recover under the policy because of a policy exclusion denying coverage for "loss resulting from the accessing of any confidential information, including...trade secret information."

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