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NEWSLETTER

Funds Exclusion Does Not Prevent Duty to Defend in Action Alleging Misappropriation of Insurance Premiums

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The United States District Court for the Middle District of Pennsylvania, applying Pennsylvania law, has held that an insurer had a duty to defend an insurance brokerage company under a professional liability policy, rejecting the insurer's argument that a "funds exclusion" barred coverage where the underlying complaint alleged that the insured failed to remit insurance premiums it owed to the plaintiff. *Westport Ins. Corp. v. Black, Davis & Shue Agency, Inc.*, 2007 WL 1576412 (M.D. Pa. May 30, 2007). The court also rejected the insurer's argument that the policy's intentional acts exclusion, personal profit exclusion, and other insurance provision applied to preclude any duty to defend.

The insured brokerage company entered into a contract with the plaintiff, an insurance company, to procure and service workers compensation insurance for certain customers. The plaintiff brought an action alleging that the insured improperly transferred some premiums to a reinsurance entity owned in part by principals of the insured, and that the insured engaged in a fraudulent scheme of falsely representing to customers that it had secured insurance coverage for them and then collecting premiums for non-existent coverage. The plaintiff sought to recover millions of dollars in premiums that the insured allegedly refused to remit. The insurer brought this action seeking a declaratory judgment that it had no duty to defend or indemnify the insured.

In addressing the duty to defend, the court first considered the funds exclusion, which stated that the policy would not apply to any claim "based upon, arising out of, attributable to, or directly or indirectly resulting from . . . the failure to collect, pay, or return premiums." The insurer argued that this provision precluded coverage because the underlying complaint focused on what happened to the premiums that the company collected or should have collected. After noting the lack of Pennsylvania law on the breadth of the funds exclusion, the court discussed *Utica Mutual Insurance Co. v. Miller*, 746 A.2d 935 (Md. Ct. Spec. App. 2000), which had held that a funds exclusion would prevent a duty to defend if the sole cause of action were a failure to remit premiums. The court acknowledged that the "gravamen of the underlying action" in the present case was the company's failure to remit premiums collected on behalf of the plaintiff. However, the court found that the complaint "clearly seeks damages beyond the return of premiums." The court also noted that the complaint alleged that the company failed to provide requisite underwriting information, to cancel or to non-renew policies falling outside the controlling underwriting guidelines, and to provide an accounting of monies due and owing. The court concluded that these allegations did not fall within the funds exclusion's express provisions and held that the insurer's duty to defend remained in force.

The court next considered the intentional acts exclusion, which excluded coverage for any claim "based upon, arising out of, attributable to, or directly or indirectly resulting from . . . intentional acts, including but not limited to acts of dishonesty, fraud, criminal conduct, malice, or assault and battery." The insurer argued that this exclusion applied because the underlying complaint alleged that the company engaged in dishonest and fraudulent conduct. The court acknowledged that the crux of the plaintiff's allegations was that the company engaged in a fraudulent scheme. However, the court held that, where the allegations "arguably sound in negligence, the duty to defend attaches." The court then observed that some aspects of the company's conduct could have resulted from poor business management rather than a fraudulent scheme. Therefore, the court held that the intentional acts exclusion likewise did not eliminate the duty to defend.

The court then addressed the personal profit exclusion, which stated that the policy would not apply to claims that any "insured . . . gained, in fact, any personal profit or advantage to which he or she was not legally entitled." The insurer argued that this provision barred coverage because the underlying complaint alleged that certain persons appropriated premiums for their own personal benefit. The court, however, noted that the exclusion applied only where an insured gained a personal profit, and the underlying complaint did not identify the "certain persons" such that the court could determine whether those persons were insureds under the policy. Therefore, the court found that the insurer "ha[d] not met its burden to prove the applicability of the personal profit exclusion to the underlying action."

Finally, the court turned to the other insurance provision of the policy, which provided as follows:

[I]f there is other insurance applicable to a "claim" covered by this "policy," this "policy" shall be deemed excess insurance over and above the applicable Limits of Liability of all such other insurance unless such other insurance is specifically written as excess over the Limits of Liability provided in the "policy."

The insurer argued that it owed no duty to defend because the policy provided "excess insurance over and above" a separate professional liability policy issued to the company by another insurer. The court stated, however, that "[o]ther insurance provisions are 'invoked only when the insured has made some payment in discharge of a liability'" and that the duty to defend is "'independent of liability and any limitations thereon,'" citing *Pacific Indemnity Co. v. Linn*, 590 F. Supp. 643, 652 n.10 (E.D. Pa. 1984), *aff'd*, 766 F.2d 754 (3d Cir. 1985). The court thus concluded that "other insurance provisions cannot remove an insurer's duty to defend" and the provision had "no effect upon [the insurer's] duty in the instant case."

The court then granted the company's partial judgment on the pleadings and denied the insurer's motion for summary judgment. However, the court stated that its decision had no bearing on the insurer's duty to indemnify, explaining that the duty to indemnify arises only if the insured's damages are established as being actually covered by the terms of the policy, an issue that was not currently before the court.