

Claims for Restitutionary Relief Held Uninsurable

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The United States District Court for the Central District of California has held that, under California law, claims for restitutionary relief are uninsurable as a matter of law. *Dobson v. Twin City Fire Ins. Co.*, 2012 WL 2708392 (C.D. Cal. July 5, 2012). Additionally, the court held that individual insureds breached a policy's no-voluntary payment provision by settling an underlying claim without insurer consent and that the insureds' breach was not excused by the carrier's failure to advance defense costs.

Three individual insureds were involved in underlying litigation arising out of the bankruptcy of a limited liability company. In the bankruptcy action, the official committee of unsecured creditors demanded \$9.5 million from the individual policyholders based on allegations that they "received cash and benefits aggregating at least \$62 million" as a result of fraudulent transfers. Additionally, the creditor committee's trustee sued the individual policyholders in an action that had ten causes of action alleging actual or constructive fraud and one cause of action alleging breach of fiduciary duty. The trustee sought "to recover payment of" millions of dollars and property "fraudulently . . . transferred" to the individuals. The individuals gave notice of the action to their D&O insurer, but the carrier advised the individuals that the underlying action was not covered by the relevant policy. While reserving its rights, the insurer agreed to advance 10 percent of the reasonable covered defense costs subject to the satisfaction of the retention under the policy. The individuals ultimately settled the underlying action, but none of them notified the insurer of the settlement in advance or requested its consent to the settlement. After the insurer refused to pay for additional sums per the individuals' demands, the individuals' expenses were paid by a separate insurer, and the individuals assigned their rights as against the defendant insurer to the second insurer, leading to this coverage action. On cross-motions for summary judgment, the court granted summary judgment to the defendant insurer.

First, the court held that the trustee's claims, to the extent that they were based on the demands of the creditors committee, were not covered as a matter of law because of California's public policy against the insurability of claims seeking restitution. The court noted that, although ten of the counts in the underlying complaint were based on actual or constructive fraud, the characterization of the claims was immaterial because "the inquiry turns on whether the claim seeks something that the insured wrongfully acquired." The court then concluded that the ten counts based on actual or constructive fraud, and the breach of fiduciary duty claim to the extent that it was based on the allegations regarding fraudulent transfers, were not covered under the policy because the relief sought was restitutionary in nature.

Second, and in the alternative, the court granted summary judgment to the defendant insurer on the basis that the individual insureds had materially breached the insurance contract by settling the underlying litigation without the carrier's consent. The court evaluated two provisions in the insurance contract in making this determination. First, it found that the insureds failed to comply with the policy's no-voluntary payments provision when they entered into a settlement without the carrier's consent. Second, the court rejected the insureds' argument that its performance under that provision was excused by the carrier's failure to advance 100% of their defense costs. The court acknowledged the "default rule" under California law, which requires insurers to "pay all legal expenses as incurred by the insured if apportionment between covered and uncovered claims and persons is not yet feasible." Nevertheless, the court held that the parties had contracted out of that default rule by way of the policy's "Allocation Provision," which provided that "Loss shall be allocated between covered Loss and non-covered loss," notwithstanding the fact that the provision did not specify which party would decide the appropriate allocation in the event of a dispute. Thus there was no breach by the carrier sufficient to justify the insureds' unauthorized settlement.

Finally, because the insureds' bad faith allegations were premised on the failure to advance 100% of defense expenses, the court granted summary judgment to the insurer with respect to the claim that it breached the implied covenant of good faith and fair dealing.