

ALERT

Statutory Claim Barred by Contract Exclusion Because it “Arises Out of” Contract

January 31, 2013

Applying Minnesota law, a Minnesota appellate court has held, in an unpublished opinion, that a contract exclusion bars coverage for statutory claims that arise out of contract. *Northstar Educ. Fin., Inc. v. St. Paul Mercury Ins. Co.*, 2013 WL 141712 (Minn. Ct. App. Jan. 14, 2013).

The insured nonprofit corporation, which provided student loans, was named in several class action lawsuits as a result of the suspension of a bonus program that gave borrowers a discount on their interest rate. The insured tendered the lawsuits for coverage under its directors and officers liability policy, and the insurer agreed to defend only certain statutory claims in two of the lawsuits while reserving its right to deny coverage in the future. The insured later requested indemnification for the settlements of the class action lawsuits. The insurer denied coverage for the settlements on the basis that the settlements were an attempt by the insured to satisfy its contractual obligations and, as a result, the contract exclusion in the policy applied. The exclusion relied on by the insurer barred coverage for claims “based upon, arising out of, or attributable to liability of the Company under any contract or agreement” Coverage litigation was filed, and the trial court entered judgement in favor of the insurer with regard to coverage for the settlements and ordered the insured to reimburse amounts previously paid by the insurer for the defense of the class action suits. The insured appealed.

The appellate court first determined that the lawsuits triggered coverage under the policy based on the inclusion of statutory claims that brought the class action suits “arguably within the scope of the policy.” The appellate court rejected the insurer’s argument that the

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amounts sought constituted non-covered restitutionary damages, explaining that the discounted interest rate was "a voluntary incentive" and "not an attempt to acquire a benefit to which it was never entitled in the first place."

In affirming the lower court's decision that the contract exclusion ultimately barred coverage for the statutory claims, the appellate court determined that the statutory claims "arose out of" a contract. In doing so, the court explained that the litigation was "causally connected" to the plaintiffs' contracts because the cancellation of the bonus program, which led to the statutory claims, only affected the underlying plaintiffs given that they had some form of contract with the insured. The court also pointed to the fact that there could not be a claim for damages under the relevant statute but for the existence of a contract between the parties. The appellate court disagreed with the insured's argument that the contract exclusion applied only to claims for breach of contract because the exclusion applied to liability "under" contract and not specifically for a breach thereof.

The appellate court also affirmed the lower court's ruling that the insured was required to reimburse the insurer for defense costs paid to defend the class action lawsuits based on the express language of the policy. The appellate court highlighted the fact that the insurer notified the insured that the reimbursement of defense costs was subject to repayment. Finally, the appellate court denied the insurer's appeal to recover pre-judgment interest, finding that the insurer was due only the interest that accrued once the judgment was entered by the lower court.