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ALERT

Verdict Requiring Bank to Return Money to Customer Not Covered "Loss"

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The United States District Court for the District of Montana, applying Montana law, has determined that a judgment against a bank requiring it to return money it wrongfully took for principal and interest on a loan was not covered under professional liability policies for multiple reasons. *BancInsure, Inc. v. First Interstate Bank*, 2013 WL 5933652 (D. Mont. Sept. 23, 2013). In addition, the court concluded that the bank gave untimely notice of the underlying lawsuits as a matter of law but that this issue did not affect coverage because the matter was excluded regardless of the late notice issue.

An insurer issued three successive claims-made policies to a bank. The bank loaned money to an entity that intended to use the funds to finance a condominium project, and the entity executed a promissory note in favor of the bank. The entity's president also executed a personal guaranty of the entity's obligations to the bank under the loan agreement and promissory note. The president had a personal deposit account at the bank. On April 2, 2009, asserting alleged contractual rights, the bank sued the president under the personal guaranty, declared the loan in default, and declared itself unsecure under the loan agreement. The bank then removed $2,623,396.40 from the president's personal account and applied it as a loan payment to reduce the entity's liability for principal and interest under the promissory note. On June 25, 2009, the president filed a counterclaim against the bank alleging that the bank violated the contracts and should be required to repay the amount taken from his personal account. The president obtained a jury verdict in his favor that required the bank to repay the funds that the bank had taken from his personal account.

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On October 10, 2010, the bank formally notified the insurer of the counterclaim against it by an email that also stated, "They won't be happy with the late notice, but these cases have been very well defended and there has been no prejudice." The bank pointed to June 30, 2009 and June 2010 letters it had provided its senior management at First Interstate BancSystem, Inc., that summarized litigation pending against it and the fact that First Interstate BancSystem in turn provided those to the insurer's underwriting department in connection with the policy renewal process. However, the letters did not make any demand on the insurer or otherwise suggest that the insured was providing notice of a claim, though the June 2009 letter stated that "all claims involve a common nucleus of facts—the decision of the bank to deem itself insecure, make demand under [the personal] guarantee, and setoff his deposit account in the amount of nearly $2.7 million . . . ." Following the insured's formal notice of the counterclaim, the insurer filed a declaratory judgment action seeking a declaration that the policies afforded no coverage for the counterclaim and jury verdict.

The policies provided that the insurer had no duty to defend. The court therefore rejected the bank's argument that the insurer waived its defense to coverage by breaching a duty to defend since no such duty existed.

The policies' definition of "loss" carved out "any principal, interest or other monies paid, accrued or due as the result of any loan, lease or extension of credit." The court noted that the bank sought indemnification for the exact amount that the bank took from the president's personal account and was ordered to repay. Thus, "the jury simply made the Bank return what the Bank wrongfully took," and the bank did not suffer a covered loss. The court concluded that the insurer was entitled to summary judgment on this basis.

In addition, the policies contained several exclusions that the insurer raised as defenses to coverage. First, the policies excluded coverage for loss in connection with any claim arising out of "any insured person or the company gaining in fact any profit or advantage to which they were not legally entitled." The court concluded that the jury verdict and the bank's own description of the litigation showed that "all the litigation centered on the question whether the Bank took money it was not legally entitled to take [and] there is simply no other interpretation possible." The bank argued that the exclusion was ambiguous but the court noted that it did not "advance any credible ambiguity." This exclusion therefore applied.

The policies also excluded loss in connection with any claim arising out of "any assumption by the company or an insured person of any liability or obligation under any contract or agreement, unless such company or insured person would have been liable even in the absence of such contract or agreement." The court noted that the litigation began as a contract dispute that the bank initiated "under the guise of its own contract rights." The court held that the underlying litigation also fell within the scope of this exclusion.

Finally, the court concluded that the claim against the bank was made no later than June 26, 2009, over a year before the October 2010 notice was provided to the insurer. According to the terms of the applicable policy, the bank was required to provide notice as soon as practicable and no later than 60 days after the expiration of the applicable policy period. The court rejected the bank's argument that June 2009 letter to senior management that summarized the litigation was notice and instead observed that the letter supported the conclusion that the bank did not give notice as soon as practicable. As such, the bank's notice to the insurer failed as a matter of law to comply with the policy provision, and the insurer was entitled to a

judgment that the bank failed to meet a condition precedent to coverage.

The court therefore granted summary judgment in favor of the insurer.

The opinion is available here.