

## Is A Settlement Of A Restitution Claim Covered If Your Policy's Ill-Gotten Gains Exclusion Applies Only In The Event Of A Final Adjudication?

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Can liability insurance insure a policyholder's legal obligation to return to a third party amounts that the policyholder was never permitted to obtain in the first place? Insurance carriers would cite comments from Judge Posner, of the Seventh Circuit Court of Appeals: "[a]n insured incurs no loss within the meaning of the insurance contract by being compelled to return property that it had stolen, even if a more polite word than 'stolen' is used to characterize the claim for the property's return." In this vein, insurance company personnel and their coverage counsel frequently take the position that if liability policies exclude from covered "Loss" "matters which are uninsurable" under applicable law, that encompasses a judgment of liability for restitution of amounts which the policyholder was not entitled to obtain, for those states that have precluded coverage for pure restitution in full. What about coverage for a **settlement** of a restitution claim? Should that be considered uninsurable? Many Errors & Omissions and Directors & Officers liability policies define "Loss" as including "settlements." Moreover, while many of those policies exclude "Loss" for claims brought about by profit or remuneration to which the policyholder was not entitled, this "ill-gotten gains" exclusion often applies only if the gain is established as such by a final adjudication in the underlying action. In recent years, courts considering the interplay of these provisions have reached differing conclusions as to whether they permit coverage of a settlement of a restitution claim against the policyholder. The first case to squarely address the application of an ill-gotten gains exclusion with a final adjudication requirement to a settlement of a restitution claim was *U.S. Bank N.A. v. Indian Harbor Insurance Co.*, 68 F. Supp. 3d 1044 (D. Minn. 2014). The case arose out the settlement of several class actions against the policyholder, U.S. Bank, alleging it had improperly maximized overdraft fees by posting debit card transactions in order from largest to smallest, thereby depleting consumer accounts at a faster rate and exposing more transactions to overdraft charges. U.S. Bank's liability insurers asserted the settlement was restitution and denied coverage. U.S. Bank sued them in Minnesota federal court. The court granted U.S. Bank's motion for summary judgment, concluding that the settlement was not restitution within the meaning of the policies. The court's analysis was guided by the principle that a policy must be read as a whole, with each provision in the policy understood in the context of all other provisions. In that light, the court reasoned that if the definition of "Loss" were to exclude coverage of a settlement of a restitution claim, that interpretation would "nullify" the ill-gotten gains exclusion, which precludes coverage of "Loss" only after a final adjudication in the underlying litigation establishing that the gain was

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ill-gotten. To reconcile these provisions, the court concluded that the policy represented a decision by the parties to “require that the payment is actually – and not just allegedly – restitution.” Noting that it was disputed in the underlying litigation whether the overdraft fees were unlawfully assessed, the court reasoned that “[i]f allegations of unlawful activity are never determined to be true, a payment to dispose of those allegations is not restitution because restitution can only occur if that which is being returned was wrongfully taken.” The recent decision in *Philadelphia Indemnity Insurance Co. v. Sabal Insurance Group, Inc.*, 2017 U.S. Dist. LEXIS 159508 (S.D. Fla. Sep. 28, 2017), however, concluded that settlement of a restitution claim is “restitutionary” despite the lack of a final adjudication triggering the ill-gotten gains exclusion. In the underlying litigation, the policyholders were charged with five counts of grand theft by the State of Florida for allegedly overcharging for workers’ compensation and general liability insurance. The policyholders settled with the State of Florida before final adjudication of the underlying litigation and sought coverage of the settlement under their D&O policy, which had relevant terms largely identical to those in the policy at issue in *U.S. Bank*. The insurer denied coverage on grounds that the settlement payment would “restore Defendants for ‘ill-gotten gains,’” and therefore constituted restitution. The policyholders and the insurer brought cross motions for summary adjudication in coverage litigation in the Southern District of Florida. The court agreed with the insurer that the settlement was not covered by the policy, and granted the insurer’s motion for summary judgment. Unlike the court in *U.S. Bank*, the district court in *Sabal Insurance Group* regarded the definition of “Loss” and the applicability of the ill-gotten gains exclusion as two separate inquiries that need not be informed by the other. As the court put it, “the exclusions do not come into play unless the Stipulated Settlement Agreement constitutes a ‘Loss.’” In evaluating the nature of the settlement, the court reasoned that “the ultimate determining fact in deciding if a payment is restitutionary is the claim” resolved by the settlement. In that light, the court concluded that “[p]ayments made to resolve [the overcharging claim] can only be said to disgorge Defendants of property to which they were allegedly not legally entitled,” regardless of how the payment was characterized by the settlement. The court rejected the suggestion in *U.S. Bank* that treating the settlement as restitution would “nullify” the ill-gotten gains exclusion, which requires a final adjudication to apply to “Loss.” The court concluded that, because the definition of “Loss” includes defense costs, the ill-gotten gains exclusion is not nullified because the lack of a final adjudication triggering the exclusion meant that the policyholders’ defense costs in connection with the underlying claims would still be covered, even if the settlement was not covered. The *Sabal Insurance Group* decision currently is on appeal to the Eleventh Circuit, with docket number 17-14844. The differing rulings in *U.S. Bank* and *Sabal Insurance Group* underscore the importance that a court’s choice of analytical framework plays in deciding a case. In *U.S. Bank*, the court emphasized giving each provision in the policy a purpose in the context of all other provisions in the policy. This focus led the court to conclude that the “final adjudication” requirement in the ill-gotten gains exclusion mandates a construction under which settlement of an underlying claim cannot be considered restitution. This analysis strikes the author as correct. If a policy does not consider a gain to be “ill-gotten” until there is a final adjudication establishing that fact, how can a settlement short of a final adjudication involve ill-gotten gains such that it is restitution without rendering the exclusion nonsensical? In contrast, the court in *Sabal Insurance Group* simply treated the final adjudication requirement in the ill-gotten gains exclusion as

wholly irrelevant to understanding whether a settlement short of a final adjudication nonetheless involves an ill-gotten gain and therefore constitutes uninsurable restitution. In concluding that the settlement was uninsurable, the court merely relied on the fact that the settled claim **alleged** ill-gotten gains – despite the fact that elsewhere the policy clearly instructed that such a characterization is not permissible for purposes of coverage until the underlying court adjudicates that the money paid was **in fact** a return of ill-gotten gains. Despite its view that interpretation of the policy’s insuring agreement need not be informed by exclusions in the policy, even this court implicitly recognized the need to address what purpose the ill-gotten gains exclusion serves if the policy can never insure any settlement or judgment of a claim alleging ill-gotten gains in the first place. The court concluded that the purpose of the exclusion was to permit coverage of **defense costs** in connection with a claim alleging ill-gotten gains that is settled before a final adjudication. But this did not reconcile the exclusion to the rest of the policy, and only exposed the weakness of the court’s reasoning. The exclusion expressly applied to all “Loss” in connection with a claim alleging ill-gotten gains, not merely defense costs. Arguably, that means the exclusion also contemplates coverage of a “settlement,” which is included in the policy’s definition of “Loss” prior to a final adjudication. In effect, the court preserved the portion of the exclusion that fit its theory of what the insuring agreement was supposed to cover, and discarded the remainder that did not. Such a construction runs afoul of a basic rule of contract interpretation: No part of a contract should be interpreted as having no purpose where a reasonable alternative interpretation gives it a purpose. The *U.S. Bank* and *Sabal Insurance Group* cases, which had dramatically different approaches to assigning interpretive value to the ill-gotten gains exclusion, highlight the importance of this rule in practice.