2011 IL App. (1st) 103386

SECOND DIVISION
December 6, 2011

No. 1-10-3386

IN THE
APPELLATE COURT OF ILLINOIS
FIRST JUDICIAL DISTRICT

ESSEX INSURANCE COMPANY, Plaintiff-Appellee, v. SWEPORTS, LTD., GEORGE CLARKE, and UMF CORPORATION, Defendants-Appellants. (O'Rourke Katten & Moody, Perkaus & Farley, John A. Dore, Michael C. Moody, Michael I. O'Rourke, and A.G. Chelle, Defendants.)	)	Appeal from the Circuit Court of Cook County 08 CH 20149 Honorable Richard J. Billik, Jr., Judge Presiding.

JUSTICE CONNORS delivered the judgment of the court.
Justices Cunningham and Harris concurred in the judgment.

ORDER

Held: In a declaratory judgment action regarding plaintiff's duty to defend under an insurance policy, plaintiff had no duty to defend in five underlying lawsuits against defendants because express language of the insurance policy did not provide coverage.

¶1 Defendants were sued in a number of different lawsuits and they tendered their defense to plaintiff Essex Insurance Company pursuant to a claims-made general liability insurance policy. Plaintiff denied coverage and filed this declaratory judgment action. The circuit court granted summary judgment in plaintiff's favor. We affirm.

¶2 BACKGROUND

¶3 Defendant George Clarke is the sole director and majority shareholder of defendant Sweports, Ltd., which is in turn the majority shareholder of defendant UMF Corporation. The underlying lawsuits in this action involve a complicated series of transactions that are related to the corporate financing of UMF and its governance.

¶4 In 2005, UMF executed a series of consulting and financing agreements with a third party, Sandbox Industries LLC. The most notable of these agreements gave Sandbox the right to purchase shares of UMF's common stock in exchange for a $100,000 loan from Sandbox, as well as granted Sandbox the right to name one of UMF's three directors. The promissory note was amended several times in exchange for more stock. In July 2006, Sandbox proposed a large investment deal with UMF that was referred to as "Sandbox II." To represent its interests in the deal, Sweports retained two law firms: O'Rourke Katten & Moody (OKM), and Perkaus & Farley (PF).

¶5 Things began to fall apart in September 2006, when Sandbox declared UMF in default on the promissory notes and threatened to use its power over UMF's governance in order to effectively take control of UMF. Sweports' attorneys managed to temporarily head this off by threatening lawsuits against Sandbox. On September 27, 2006, however, Sandbox obtained nearly 4,500 shares of UMF pursuant to the agreements and renewed its threats to declare UMF in default on the notes. Sweport's attorneys ultimately negotiated a deal (Sandbox III) that resulted in an extension of the notes at the cost of granting Sandbox significantly more power over UMF. A fourth deal, Sandbox IV, was executed later that fall.

¶6 At some point during the wrangling over Sandbox III and IV, Clarke executed a stockholder purchase agreement that purported to convert OKM and PF's bills for legal services,

(which together amounted to something over $200,000) into Sweports stock. OKM found out about this sometime before March 2007, when it wrote to John A. Dore, who was then a director on Sweports' board, and demanded to be paid. OKM asserted that Sweports was in breach of its retention agreement with OKM due to Clarke's action.

¶7 Matters came to a head shortly thereafter. In April 2007, Sandbox resigned from its seat on UMF's board, and in June 2007, Clarke unilaterally executed an "Informal Action" (IA) on behalf of both Sweports and UMF. The IA purported to rescind all outstanding stock interests in Sweports, which included those of PF and OKM, as well as Dore and several other investors. Dore and another individual were also summarily removed from their posts on Sweports' board.

¶8 This led to five lawsuits by various parties against Sweports, Clarke, and UMF. The first lawsuit was filed on June 7, 2007, by OKM against Sweports. The OKM lawsuit asserted a number of different counts but was essentially over OKM's unpaid legal fees for the various Sandbox deals and the purported termination of OKM's stock interests by the June 2007 IA. The second lawsuit was filed the next day, June 8, 2007, by PF against Clarke, Sweports, UMF, and other parties. The PF lawsuit was also primarily about PF's attorney fees for the Sandbox deals, but also included various conspiracy and fraud counts and sought a declaration that the IA was illegal. Sweports and Clarke were served with notice of these suits on June 25 and 26, respectively.

¶9 The third lawsuit came from Sweports' shareholders, including Dore, who had been disenfranchised and removed from Sweports' board by the IA. The shareholder lawsuit was filed on October 26, 2007, and sought a declaratory judgment on the extent of the shareholders' rights and the legality of the IA. The complaint also alleged several tort counts such as breach of

fiduciary duty and conversion against Clarke and Sweports. All of the counts in the shareholder lawsuit were based on the events leading up to the June 2007 IA.

¶10 The fourth lawsuit involved several of the same individuals but was based not on shareholders' rights but on Sweports' alleged failure to repay a $500,000 promissory note that had been executed in connection with Sandbox III/IV in November 2006. The promissory note lawsuit was filed on November 26, 2007. The last lawsuit was a derivative action that was filed on January 24, 2008, by Sweports' shareholders against UMF and sought to recover from UMF under the same promissory note. The derivative lawsuit was voluntarily dismissed on July 3, 2009.

¶11 The insurance policy that is actually at issue in this case was incepted in the middle of all of this. On July 6, 2007, Clarke, on behalf of Sweports, submitted a written application for insurance to plaintiff. Plaintiff issued a claims-made general liability insurance policy to Sweports as the named insured. The policy period ran from July 6, 2007, to July 6, 2008. After Sweports, Clarke, and UMF were notified of the five lawsuits against them, they attempted to tender their defense to plaintiff. Plaintiff denied coverage and filed the instant declaratory judgment lawsuit in order to settle the matter. Plaintiff moved for summary judgment, and the circuit court found in favor of plaintiff in a comprehensive 20-page written memorandum order. Defendants appealed.

¶12 ANALYSIS

¶13 Summary judgment should be granted "if the pleadings, depositions, and admissions on file, together with the affidavits, if any, show that there is no genuine issue of material fact and that the moving party is entitled to a judgment as a matter of law." 735 ILCS 5/2-1005(c) (West 2010). We review summary judgment orders *de novo*, viewing the facts in the light most

favorable to the nonmoving party. See *State Farm Mutual Automobile Insurance Co. v. Illinois Farmers Insurance Co.*, 226 Ill. 2d 395, 400 (2007).

¶14 There are no disputed material facts in this case, so the sole issue is whether plaintiff has a duty to defend in the underlying lawsuits pursuant to the terms of the insurance policy. See *Crum & Forster Managers Corp. v. Resolution Trust Corp.*, 156 Ill. 2d 384, 391 (1993) ("The construction of an insurance policy and a determination of the rights and obligations thereunder are questions of law for the court which are appropriate subjects for disposition by way of summary judgment."). When the issue is whether an insurance company has a duty to defend, "a court ordinarily looks first to the allegations in the underlying complaint and compares those allegations to the relevant provisions of the insurance policy. [Citations.] If the facts alleged in the underlying complaint fall within, or potentially within, the policy's coverage, the insurer's duty to defend arises." *Pekin Insurance Co. v. Wilson*, 237 Ill. 2d 446, 455 (2010). Although the duty to defend " 'flows in the first instance from the allegations in the underlying complaint' " (*id.* at 461 (quoting *Fidelity & Casualty Co. of New York v. Envirodyne Engineers, Inc.*, 122 Ill. App. 3d 301, 304-05 (1983))), courts may consider other evidence in the record in addition to the underlying complaint when deciding a motion for summary judgment (*id.* at 462).

¶15 The starting point is the terms of the insurance policy. The policy in this case is a hybrid of a "claims made" policy and an "occurrence" policy. A claims-made policy is " 'an agreement to indemnify against all *claims made* during a specified period, regardless of when the incidents that gave rise to the claims occurred.' " (Emphasis added.) *Central Illinois Light Co. v. Home Insurance Co.*, 213 Ill. 2d 141, 173 (2004) (quoting Black's Law Dictionary 821 (8th ed. 2004)). This is in contrast to an "occurrence" policy, under which the insurance company agrees " 'to indemnify for any loss from an event that *occurs* within the policy period, regardless of when the

claim is made.' " (Emphasis added.) *Id.* (quoting Black's Law Dictionary 822 (8th ed. 2004)). In the "Claims Made" section on page one of the "Declarations" rider, the policy that plaintiff issued in this case specifically declares,

> "The coverage afforded by this policy is limited to liability for only those Claims that are first made against the Insured during the Policy Period or the Extended Reporting Period, if exercised, and reported in writing to the Company pursuant to the terms herein."

¶16 In paragraph F of the "Definitions" section on page three of the policy proper, the policy defines a claim as

> "a notice received by the insured of an intention to hold the Insured responsible for: (1) a Bodily Injury; (2) a Property Damage; (3) an Advertising Injury; or (4) a personal injury; involving this policy *and shall include the service of suit* or institution of arbitration proceedings against the Insured."

And perhaps most importantly for purposes of this case, the "Defenses, Settlements and Claim Expenses" section on page 11 of the policy states that plaintiff's duty to defend only arises for "any Claim to which coverage under this policy applies."

¶17 Accordingly, the threshold question that must be settled in order to invoke plaintiff's duty to defend in any of the underlying suits is whether a claim was made against defendants during the policy period. Two of the lawsuits are immediately out. The policy period began on July 6, 2007, yet defendants were served in the OKM and PF lawsuits nearly two weeks earlier, on June 25 and June 26, respectively. There is no question that these claims were not first made

against defendants during the policy period, so under the terms of the policy plaintiff has no duty to defend them in those cases.[1]

¶18 This leaves three cases that were served on defendants during the policy period, but there is an immediately obvious problem with one of them: although the derivative lawsuit against UMF was filed on January 24, 2008, which is well within the policy period, UMF is not an insured under the insurance policy. UMF is not a named insured under the express declarations of the policy. Sweports, Ltd. is the only named insured on the policy, and the policy states that if the named insured is a limited liability company, then the policy covers only the company itself and any manager or member acting in the course of their duties. UMF does not fall under this definition and it does not qualify for coverage under any other provision. Plaintiff consequently has no duty to defend UMF in the derivative lawsuit.

¶19 The last two lawsuits are slightly more complicated. Both the promissory note lawsuit and the shareholder lawsuit were filed within the policy period, and in both cases the defendants are Sweports and Clarke, who are indisputably insured under the policy. The question, then, is whether the claims against Sweports and Clarke are covered under the policy. There are only two categories of coverage under the insurance policy, which are described under the "Insuring Agreements" section on pages two and three of the policy: "Coverage A", which is for bodily injury and property damage; and "Coverage B", which covers personal and advertising injuries. In order to be covered, however, a claim under either category must meet two prerequisites. First, "the *entirety* of such [injury] happens during the Policy Period or on or after the Retroactive Date stated in *** the Declarations," and second, "such [injury] arises out of only

[1] Defendants also argue that the *amended* complaints in the PK and OKM cases, which were filed during the policy period, include allegations about actions that took place during the policy period and would therefore be covered. Even if we were to accept this argument, plaintiff would still have no duty to defend in the OKM and PK suits because of the policy language that we discuss below in connection with the shareholder lawsuit.

those products, goods, operations or premises specified in *** the Declarations." (Emphasis added.)

¶20 As for the shareholder lawsuit, we need not determine whether it meets the second prerequisite because it fails to meet the first one. Although the shareholder lawsuit was first filed during the policy period, the problem is that the lawsuit does not concern an injury that occurred *entirely* during the policy period. In fact, every claim in the shareholder lawsuit is premised on the events surrounding the Sandbox financing deals that culminated in the IA, which was executed in June 2007, before the policy period even began. The complaint in the shareholder lawsuit sought a declaratory judgment on the effect of the IA and alleges conversion and breaches of contract and fiduciary duty by Clarke because of his alleged actions in relation to Sweports' finances and the IA. Because the shareholders alleged that Sweports and Clarke caused injuries to them outside of the policy period, the shareholder lawsuit cannot be a covered claim under the insurance policy.

¶21 This leaves only the promissory note lawsuit. In that lawsuit, Sweports was named as a defendant in a one-count complaint for breach of contract on its failure to repay a promissory note. The complaint alleged that Sweports executed a promissory note for $500,000 in November 2006, and that the note was due and payable on November 13, 2007, but Sweports refused to pay. The payment date on the note and the date that the lawsuit was filed are both within the policy period, so the question is only whether a breach of contract claim is covered under the policy. As we mentioned, the policy only covers personal, bodily, and advertising injuries as well as property damage. The policy expressly defines each type of injury as follows on pages three and six in the "Definitions" section:

"**Advertising Injury** means injury, including consequential bodily injury, arising out of oral or written publication of material that libels or slanders a person or organization or a person's or organization's products, goods or operations or other defamatory or disparaging material, occurring in the course of the Named Insured's Advertisement.

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Bodily Injury means bodily injury, sickness or disease sustained by a person, including death resulting from any of these at any time.

Bodily Injury shall also mean incidental Medical Malpractice Injury ***.

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Personal Injury means injury, including consequential Bodily Injury, arising out of one or more of the following offenses:

1. false arrest, detention or imprisonment or malicious prosecution;
2. wrongful eviction from, wrongful entry into, or invastion of the right of private occupancy of a room, dwelling or premises that a person occupies, committed by or on behalf of its owner, landlord, or lessor; or
3. oral or written publication of material that violates a person's right of privacy.

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Property Damage means:

1. physical injury to or destruction of tangible property, including consequential use thereof; or

2 loss of use of tangible property which has not been physically injured or destroyed; provided, however, such loss of use is caused by an Occurrence."

¶1 Nowhere in this language is a breach of contract claim mentioned. Given that the policy only covers claims for the listed injuries, a breach of contract action such as the promissory note lawsuit cannot be a covered claim. Plaintiff therefore has no duty to defend Sweports in that case.

¶2 CONCLUSION

¶3 Based on the express terms of the insurance policy and the undisputed facts in the record, plaintiff is not obligated to defend any of the defendants in any of the five lawsuits. Summary judgment in favor of plaintiff was therefore appropriate.

¶4 Affirmed.