

# Printing insurance doesn't cover 'known loss'

Today's 7th U.S. Circuit Court of Appeals case deals with a Business Owner's Policy and a Printers Errors and Omissions Endorsement and the question of whether the Printers E & O coverage, which was added to the policy and became effective on Oct. 15, 2003, provided coverage for a printer's error claim that occurred on Sept. 11, 2003. *Grey Direct Inc. v. Erie Insurance Exchange*, 460 F.3d 895.

The court found no potential or actual coverage and no duty of the insurer to defend based upon the "known loss" rule, as discussed by the Illinois Supreme Court in *Outboard Marine v. Liberty Mutual Insurance Co.*, 154 Ill.2d 90, 607 N.E.2d 1204 (1992). Under the "known loss" rule, there is no coverage where the insured purchases insurance coverage knowing a loss has already occurred.

The underlying facts were as follows. Grey Direct Inc., a direct mail advertising company managed United Airlines' advertising campaign, called: "Fly Three, Fly Free," which offered a free travel certificate for one free round-trip flight to customers purchasing three round-trip flights. Grey contracted with CommDirect to print and mail the travel certificates. CommDirect then contracted the printing and mailing work to Unicomm.

On Sept. 11, 2003, Unicomm made an error and mailed two travel certificates, instead of one, to 6,000 United customers. Unicomm admitted the error to Grey Direct Inc. who paid United \$967,720. Thereafter, Grey sued CommDirect, unaware Unicomm actually did the work and made the mistake. Upon learning of the proper defendant, Grey dismissed the action against CommDirect and filed a new suit against Unicomm and, when no appearance was made for Unicomm, obtained a default judgment on June 20, 2004. Grey took an assignment of Unicomm's rights under its Business Owner's Policy with Erie Insurance Exchange and brought a declaratory judgment action against Erie.

Unicomm purchased its Business Owner's Policy with Erie effective Aug. 25, 2003, to Aug. 25, 2004. After the Sept. 11, 2003, error on the travel certificates was revealed to Grey on Sept. 18, 2003, Grey required that Printers E & O Coverage be obtained. On Oct. 15, 2003, Unicomm's policy was endorsed with the Printers E & O Endorsement.

Grey filed suit against CommDirect in December of 2003, and CommDirect sent the complaint to Unicomm who requested coverage by letter of Jan. 2,



## Federal Courts

By Jay S. Judge

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2004. Erie refused a defense and coverage advising Unicomm, in part, that "some of the damages being claimed occurred prior to our policy inception." The Printers E & O Endorsement was not referred to. Erie was not given notice of Grey's second complaint against Unicomm until after the default judgment in June of 2003 against Unicomm.

Grey's declaratory judgment action against Erie sought coverage, contending Erie breached its duty to defend Unicomm and was estopped to deny coverage.

The U.S. District Court, Judge Amy St. Eve presiding, granted summary judgment for Erie finding the "known loss" rule barred coverage (the loss occurred on Sept. 11, 2003, prior to the effective date of the Printers E & O coverage on Oct. 15, 2003).

Grey Direct appealed, contending Erie was estopped from asserting the "known loss" rule. The 7th Circuit, in an opinion written by Judge Diane P. Wood, affirmed, holding that the "known loss" rule applied; therefore, Erie Insurance Exchange owed no coverage or defense.

Wood began the court's discussion suggesting that what appeared to be a simple, straight-forward issue — the Printers E & O endorsement and the "known loss" rule — became confusing because Erie mistakenly produced a copy of its policy, inadvertently omitting the Oct. 15, 2003 date of the Printers E & O endorsement:

"Erie's response boils down to the simple assertion that Unicomm's policy did not include coverage for Printers Errors and Omissions until Oct. 15, 2003, well after the date when the loss occurred, and nothing in Illinois's 'known loss' doctrine, rules of estoppel, or other insurance rules required Erie to defend Unicomm. Even taking the facts in the light most favorable to Grey, as we must,

see *Valentine v. City of Chicago*, 452 F.3d 670, 677 (7th Cir. 2006), it is hard to imagine what the thread is on which Grey hangs its case. A closer look, however, shows that a single error on Erie's part is what seems to underlie this litigation."

Noting that Erie, like most insurers, does not keep a complete hard copy of all policies, but recreates them from the forms shown on the declarations page when needed and Erie's recreation resulted in the omission of the Oct. 15, 2003, effective date on the Printers E & O endorsement, the court explained:

"Erie does not keep hard copies of the original insurance policies that it delivers to its clients, because of the prohibitive amount of space this would require. Instead, Erie stores in electronic format the various documents that make up a policyholder's contract. When Erie receives a request from its insured or another authorized person for a copy of a policy, it refers that request to a processor (not to an underwriter). The processor must ascertain whether any endorsements were added after the original issuance of the policy. If, as in the case of the Unicomm policy, there was a later endorsement with a different effective date, the processor must work backward through the different versions of the policy to arrive at the actual language of the policy on any given earlier date.

"In this case, Erie's processor, Rebecca Murzynski, failed to notice that there was an endorsement to the Unicomm policy added effective Oct. 15, 2003. When, in January 2004, she created a paper copy of the policy, she therefore failed to back up and recreate the policy as it had existed prior to Oct. 15, 2003. This meant that the copy of the policy she printed in January 2004 erroneously indicated that Printers Errors and Omissions coverage had existed from the outset (August 2003), rather than only from Oct. 15, 2003."

Wood found Grey's contention that the erroneously produced policy omitting the effective date of the Printers E & O endorsement altered the policy so as to provide coverage unpersuasive and contrary to the evidence that it became effective on Oct. 15, 2003:

"In other words, Grey suggests that the copy of the policy recreated months after its purchase materially altered the terms of the contract. But nothing in the record supports this rather outlandish hypothesis. First, other evidence makes it clear that Lipuma purchased the Errors and Omissions provision in October in response to the Sept. 11, 2003, printing mistake so that Grey would con-

tinue to work with Unicomm in the future. Nothing indicates that either party, at that time, thought that the change would be retroactive. Second, there is no evidence indicating that either Erie or Lipuma asked for a change in terms in January 2004, when Unicomm asked for a copy of the policy. The fact that the insurance company inadvertently provided flawed evidence of the policy, in the form of the computer-generated copy does not change the terms of the contract itself."

Next, the 7th Circuit considered whether the "known loss" rule barred coverage:

"Nevertheless, even if we did treat the January 2004 copy as somehow modifying the policy, the September printing error remains a 'known loss' that would not be covered by the policy. Illinois, whose law governs here, holds that 'the insurer has no duty to defend or indemnify the insured with respect to the known loss ab initio, unless the parties intended the known loss to be covered.' *Outboard Marine v. Liberty Mut. Ins.*, 154 Ill.2d 90, 180 Ill.Dec. 691, 607 N.E.2d 1204, 1210 (1992). A known loss occurs when 'the insured knows or has reason to know, when it purchases a policy, that there is a substantial probability that it will suffer or has already suffered a loss.' *Id.* Viewed from the perspective of Oct. 15, 2003, or any time thereafter, the loss incurred as a result of the Sept. 11 mailing was known. Outboard Marine indicates that Erie had no duty either to defend in proceedings relating to that loss or to indemnify any resulting judgment. Even if we thought that Murzynski's January 2004 error had the effect of adding the Printers Errors and Omissions clause to the policy effective August 2003, it would cover only other unknown events meeting that description, not the Sept. 11, 2003, gaffe, unless there is evidence that the parties intended also to cover the known loss. Grey argues that the January document is exactly the kind of evidence of intent to assume the known risk to which the Illinois Supreme Court referred, but we cannot accept it as such. The loss, recall,

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was known by that time to be at least \$967,720; Unicomm paid \$54 for the Printers Errors and Omissions endorsement. It is simply beyond the pale to think that Erie was willing to accept \$54 in exchange for a certain duty to pay out nearly a million dollars.”

Under the doctrine of mistake, reflected in the Restatement (Second) of Contracts, the court concluded Unicomm knew it had no coverage because the Printers E & O endorsement was purchased only after the 9/11/03 loss:

“Another way of looking at this problem is through the lens of the doctrine of mistake. The Restatement (Second) of Contracts recognizes that under some circumstances a mistake of one party makes a contract voidable:

‘Where a mistake of one party at the time a contract was made as to a basic assumption on which he made the contract has a material effect on the agreed exchange of performances that is adverse to him, the contract is voidable by him if he does not bear the risk of the mistake under the rule stated in Section 154, and (a) the effect of the mistake is such that enforcement of the contract would be unconscionable, or (b) the other party had reason to know of the mistake or his fault caused the mistake. Restatement (Second) of Contracts § 153 (1981).’

“Here, the relevant time relates to the endorsement to the Unicomm policy. Erie, taking matters as favorably to Grey as we can, thought that the effective date of the endorsement was Oct. 15, 2003; because of Murzynski’s mistake, one version of the contract said that the Printers Errors and Omissions coverage had existed from the start, and thus prior to the Sept. 11, 2003, loss. This mistake has a material effect on the agreed exchange, as we have just noted; the criteria spelled out in Section 154 do not suggest that Erie should bear this loss (it was not allocated by the agreement, Erie did not enter into the contract aware that its knowledge was limited about the facts relevant to the mistake, nor is it reasonable for the court to allocate the risk to Erie), see Restatement (Second) of Contracts Section 154; and the effect of holding Erie to the erroneous January version of the policy would be unconscionable. Moreover, the record leaves no doubt that Unicomm had reason to

know that it did not have this coverage, well before it received the erroneous version of the policy and long before it filed this lawsuit.”

Wood concluded that the “known loss” rule applied and Erie had no duty to defend or provide coverage to Unicomm, relying on Illinois case law:

“As the district court held, an insurance company is not estopped from arguing that it should be relieved of a duty to defend, if there was never any such duty in the first place. See *Employers Ins. of Wausau v. Ehlico Liquidating Trust*, 186 Ill.2d 127, 708 N.E.2d 1122, 1135 (1999) (‘Application of the estoppel doctrine is not appropriate if the insurer had no duty to defend.... These circumstances include ... when the policy and the complaint are compared, there clearly was no coverage or potential for coverage.’); *U.S. Fidelity & Guar. Co. v. Wilkin Insulation Co.*, 144 Ill.2d 64, 578 N.E.2d 926, 930 (1991). We thus have no need to speculate about whether the Illinois Supreme Court would hold that the known loss defense is exempt from general estoppel doctrine. Second, we disagree with Grey that Erie waived its arguments that it had no duty to defend Grey’s first suit against CommDirect because it never issued a policy to CommDirect, and that it had no duty to defend Unicomm because it did not learn of the new suit against Unicomm until after the default judgment was entered. Erie’s answer to Grey’s second amended complaint pleaded that CommDirect was never an insured under any Erie policy. The record is devoid of evidence showing that Erie received actual notice of the second complaint — the one against Unicomm — prior to the time when Grey’s counsel sent it a letter in June 2004 alerting it to the default judgment. It is noteworthy, in this regard, that the CommDirect suit and the Unicomm suit were filed under separate docket numbers and heard by two different district court judges. The record thus does not support the proposition that they were really just one big integrated piece of litigation that Erie failed to handle properly.”

Therefore, the 7th Circuit concluded that because Erie owed no coverage to Unicomm, Grey, as assignee, received no coverage and the District Court’s judgment for Erie was affirmed.