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Insurance Coverage Update

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"Fee Exclusion" in Bankers' Liability Policy Bars Coverage for Settlement Related to Overdraft Fees

The Seventh Circuit U.S. Court of Appeals recently affirmed the dismissal of a bank's lawsuit against its insurer for breach of contract and bad faith denial of coverage, finding an insurance policy's exclusion for claims "based upon, arising from, or in consequence of any fees or charges" (the "Fee Exclusion") barred coverage for claims alleging that the Bank imposed excessive overdraft fees on its customers. *BancorpSouth, Inc. v. Federal Ins. Co.,* No. 17-1425, 2017 WL 4546144 (7th Cir. Oct. 12, 2017).

A class of bank customers sought recovery from BancorpSouth (the "Bank") alleging that the Bank engaged in the "unfair and unconscionable assessment and collection of excessive overdraft fees." According to the underlying complaint, the Bank maximized the amount of overdraft fees it could charge its customers by manipulating checking accounts. The Bank allegedly resequenced debit card transactions, failed to provide accurate balance information to its customers, and failed to notify customers of overdrafts or that they had the ability to opt out of the Bank's overdraft policy.

The parties ultimately settled the lawsuit and the Bank agreed to pay $24 million to the plaintiff class. The Bank's professional liability insurer denied coverage for the lawsuit, relying on the policy's Fee Exclusion. The Bank then sued the insurer for breach of contract for failing to defend and indemnify the Bank, and also asserted a claim for bad faith denial of coverage.

The U.S. District Court for the Southern District of Indiana agreed with the insurer that the Fee Exclusion applied, and dismissed the lawsuit.

On appeal to the Seventh Circuit, the Bank asserted that the district court had overlooked the allegations concerning the Bank's general policies and procedures, which the Bank asserted were the primary sources of harm alleged by the plaintiffs. The Bank also contended that the Fee Exclusion was ambiguous. Rejecting the Bank's arguments in their entirety, the Court found that the exclusion unambiguously barred coverage because the crux of the lawsuit centered on the Bank's "unfair and unconscionable assessment and collection of excessive overdraft fees," and every claim was premised on the imposition of those fees. Because the essence of the allegations was the maximization of fees, the Fee Exclusion applied to bar coverage. Consequently, the insurer had no obligation to defend the Bank against the lawsuit or indemnify the Bank for the settlement. The Court also rejected the Bank's bad faith denial of coverage claim because the Bank failed to establish the existence of coverage.

Upholding the exclusion's application, the Seventh Circuit also noted that the policy's Fee Exclusion serves a necessary purpose of avoiding a "moral hazard", i.e. a situation in which the insured relaxes the care it takes to safeguard property knowing that any loss would be covered by the insurer.

Comment

When assessing coverage, the Seventh Circuit considered the individual allegations in the complaint in their entirety, refusing to read them in isolation or in a manner that disregarded their context. Additionally, the Court also recognized the fact that an exclusion's broad scope does not render it ambiguous. And the case is another example of the Seventh Circuit's historical concern for avoiding a "moral hazard." Consistent with its approach in other cases, the Court recognized that this type of exclusion can deter an insured from engaging in conduct whereby it can profit from a bad act, knowing that losses arising from such conduct would be covered by insurance.

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