

Theoretical Allegations of Property Damage Do Not Trigger the Duty to Defend

Insurance Law Update

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By: [Aaron Mandel](#)

U.S. Court of Appeals for the Seventh Circuit

In *Amerisure Mut. Ins. Co. v. Microplastics, Inc.*, --- F.3d ---, 2010 WL 3619785 (7th Cir. Sept. 20, 2010), the U.S. Court of Appeals for the Seventh Circuit held that hypothetical allegations of property damage could not trigger an insurer's duty to defend under Illinois law.

Microplastics manufactured plastic insert molding components used by original equipment manufacturers (OEMs) to manufacture various mechanical devices. One wholesaler of Microplastics' inserts, Valeo, refused to pay for inserts after an OEM to which Valeo sold the inserts complained that they were defective. Microplastics sued Valeo for breach of contract and Valeo counterclaimed, seeking "setoff and damages for economic losses incurred as a result of Microplastics' ... failure to comply with engineering and quality specifications" contained in the purchase agreements entered into between Valeo and Microplastics. Valeo's counterclaim did not specify the cause of its alleged "economic losses."

Microplastics tendered its defense of Valeo's counterclaim to Amerisure, which had issued CGL policies covering damages that Microplastics became legally obligated to pay as a result of "property damage" caused by an "occurrence." Amerisure denied coverage on the ground that the Valeo counterclaim did not contain any allegations of "property damage" within the meaning of the policies. Microplastics filed a declaratory judgment action against Amerisure and the parties cross-moved for summary judgment regarding Amerisure's duty to defend. The district court found Valeo's counterclaim did not allege "property damage" and granted Amerisure's summary judgment motion. Microplastics appealed.

On appeal, Microplastics argued that Valeo's vague allegations of economic losses could hypothetically be based on "property damage" suffered by customers who bought products manufactured by OEMs to which Valeo sold the defective inserts. The Seventh Circuit acknowledged that Valeo's vague allegations did not "logically foreclose the theoretical possibility" that Valeo's economic losses were based on covered "property damage," but concluded that Microplastics' hypothetical extrapolation went "too far" and that "[t]he duty to defend applies only to facts that are explicitly alleged" as opposed to hypothetical or implied claims not specifically alleged. Because the allegations in the Valeo counterclaim were

“perfectly consistent with simple replacement costs and consequential damages based on breach of contract, and no language expressly stated, or even insinuated, that they might pertain to physical injury to property,” the Seventh Circuit affirmed the district court’s grant of summary judgment to Amerisure.

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