



## Property Insurance Law

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# Public Adjuster Misappropriation of Claim Proceeds— A Cautionary Tale

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In the face of large and often complex property insurance losses, many insureds engage the services of a public adjuster. These insurance professionals, who are licensed by the state of Illinois, are retained directly by an insured and serve as advocates for policyholder's interest throughout the adjustment and presentation of a claim. The Illinois Public Adjusting Act, and ensuing case law make clear that public adjusters have a statutory lien on claim proceeds, and as a practical matter, insurers will schedule a public adjuster as a co-payee, along with an insured, on any check for claim proceeds. *See* 215 ILCS 5/1501; *Golub and Associates, Inc. v. State Farm Fire and Cas. Co.*, 406 Ill.App.3d 1195 (5th Dist. 2011)

An issue with sparse legal authority is what duties if any, the insurer has when it issues payment on a claim, and the draft, which is jointly payable to the insured and its public adjuster, is misappropriated by the public adjuster. In a recent opinion, the U.S. Court of Appeals, Seventh Circuit relied on the Illinois Commercial Code, which provides in relevant and pertinent part:

If a draft is accepted by a bank, the drawer is discharged, regardless of when or by whom acceptance was obtained. 810 Ill. Comp. Stat. 5/3-414(c)

Acceptance means the drawee's signed agreement to pay a draft as presented. 810 Ill. Comp. Stat. 5/3-409.

This article provides an overview of a recent case limiting an insurer's exposure where a public adjuster violates Illinois law and falsifies an endorsement on a payment draft. It also provides guidance for coverage practitioners on counseling their carrier-clients on not bearing the risk of a drawee bank's (here, an insurer's bank) from possible negligence in distributing funds without ascertaining proper endorsement by joint co-payees.

### Insurer Discharged Upon Check Endorsed and Acceptance from Insurer's Bank

In a recent and well-reasoned decision, the Seventh Circuit ruled on a question of Illinois law not yet addressed by the state's supreme court. In *Thirteen Inv. Co. v. Foremost Ins. Co. Grand Rapids Mich.*, No. 22-2203 (7th Cir. May. 2, 2023), the court addressed whether a contract obligor's delivery of a check to a joint co-payee, who then cashes the check, discharges an obligor's performance in the amount of the check. *Id.* at \*4. Given the court was faced with unresolved issues of state law, the court predicted how the relevant highest state court would rule. *Sanchelima Int'l, Inc. v. Walker Stainless Equip. Co., LLC*, 920 F.3d 1141, 1145 (7th Cir. 2019). Applying the sparse applicable law, specifically the Illinois UCC, the Northern District held that an insurer was discharged under its contractual obligations with its insured

when the insured's public adjuster cashed the settlement checks received by the insurer. *Thirteen Investment Co.*, No. 22-2203 at \*6.

The policyholder, Thirteen Investment Company, Inc. ("Thirteen") sued its insurer, Foremost Insurance Company ("Foremost"), alleging that the insurer wrongfully refused to indemnify the policyholder for a fire loss covered under a policy of commercial property insurance. *Id.* at \*2. There was no dispute, however, that Foremost had in fact paid the loss, and issued settlement checks jointly payable to the insured and its public insurance adjuster, Paramount Restoration Group, Inc. ("Paramount"), which unilaterally endorsed the checks and kept the proceeds. *Id.* The essence of Thirteen's position was that Foremost breached the insurance contract when it refused to issue a second round of duplicative settlement funds following the public adjuster's misappropriation of the original claim proceeds paid by Foremost.

Thirteen retained Paramount as its public adjuster and general contractor for fire damage repairs. *Id.* at \*5. Under their agreement, Thirteen hired Paramount "to be [Thirteen's] agent and representative to assist in the preparation, negotiation, adjustment, and settlement" of the fire loss. *Id.* Thirteen also "direct[ed] any insurance companies to include Paramount... on all payments on" the fire loss claim. *Id.* Paramount negotiated the fire loss, and Foremost delivered two settlement checks to Paramount. *Id.* at \*2. The checks named Thirteen, its mortgagee, and Paramount as co-payees. Paramount then endorsed the checks. *Id.*

The district court granted summary judgment for Foremost because when Paramount received and cashed the checks, it effectively discharged the insurer's performance obligation under the policy. *Id.* Thirteen offered three reasons for reversal, two of which the court proficiently denied. *Id.* 4. The merits of the case hinged on the effect of Paramount, designated as Thirteen's public adjuster, act of cashing in the settlement checks. *Id.* at \*4-5

The court noted nothing in the policy indicated checks were to be sent from Foremost to Thirteen. However, the court explained how Foremost's delivery to Paramount was, by law, delivery to Thirteen. *Kelly v. Parker*, 54 N.E. 615, 619 (Ill. 1899) ("A delivery to an agent is a delivery to the principal.") The court then shifted to the legal effect of Paramount unilaterally cashing the checks and relied on Illinois's version of the Uniform Commercial Code. The Commercial Code says: "If a draft is accepted by a bank, the drawer is discharged, regardless of when or by whom acceptance was obtained." 810 ILCS 5/3-414(c). Further, "Acceptance means the drawee's [(here, Foremost's bank)] signed agreement to pay a draft as presented." 810 Ill. Comp. Stat. 5/3-414(c). Similarly, the court relied on 810 Ill. Comp. Stat. 5/3-310(b)(1), that states if a check is taken for an obligation, "[p]ayment or certification of the check results in discharge of the obligation to the extent of the amount of the check."

Here, the court ascertained that Paramount was Thirteen's agent and joint co-payee, authorized to receive the checks. *Id.* at \*6. Therefore, under Illinois's statutes and its version of the UCC, Foremost's performance obligation regarding the fire loss was discharged when the checks endorsed by Paramount were accepted by Foremost's bank. *Id.*

The court also addressed Paramount's conduct of retaining the proceeds. The court relied on Illinois regulatory authority for public adjusters. *See generally* 215 Ill. Comp. Stat. 5/art. XLV. The court reasoned that public adjusters must be bonded to provide recovery "on behalf of any person to whom the public adjuster has been found to be legally liable as the result of erroneous acts, failure to act, fraudulent acts, or unfair practices in her or her capacity as a public adjuster." 215 Ill. Comp. Stat. 5/1560(a)(1)(B), (2)(B). The court refused to require an insurer to bear the costs of a public adjuster's violation of statutory standards. More specifically, for an insured to pursue an insurer- who had no participation in the selection of the public adjuster/agent- for the agent's alleged wrongs. *Thirteen Investment Co.*, No. 22-2203 at \*10. In addition, the court refused for an insurer to bear a drawee bank's possible negligence in disbursing funds without ascertaining proper endorsement by joint co-payees. *Id.*

Here, the insured sought to impose monitoring duties upon the insurer far beyond their insurance contract. *Id.* at \*10-11. While the insurer agreed to provide coverage and payment for negotiated claims, it did not take responsibility for the

actions of the public adjuster hired or to ensure the bank performed proper diligence before paying a draft. *Id.* at \*11. In other words, nothing in the policy agreement between Thirteen and Foremost required Foremost to pay settlement amounts to exclusively to Thirteen. *Id.* Foremost’s delivery of the checks to Paramount constituted delivery to Thirteen under an agency theory, and when Paramount cashed the checks, that discharged Foremost’s payment obligations under the policy. *Id.*

### Conclusion

The decision in *Foremost* reiterates the importance of scheduling both the policyholder and statutory lienholders, like public adjusters, as joint payees on drafts for policy proceeds. While the *Foremost* decision turned on the language of the underlying public adjusting contract, which designated the public adjuster as the insured’s “agent” for purposes of the loss, oftentimes public adjusting contracts lack any such agency language and simply instruct carriers to schedule the public adjuster as a payee on drafts for claim proceeds. The court did not address what the insurer’s liability would have been, if any, if the public adjusting contract failed to include such “agency” language. In the absence of such “agency” language in a public adjusting contract, it is best practice for coverage practitioners to counsel their carrier clients to transmit policy proceeds directly to the policyholders, being sure that all payment drafts are jointly payable to both the insured and the public adjuster. Notwithstanding, *Foremost* reiterates the commonsense position that the insurer’s burden is to timely issue policy proceeds, and to properly schedule all payees on the payment, and that the policyholder has the duty to police the conduct of its public adjuster in the negotiation and disbursement of drafts for policy proceeds.

### About the Authors

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