

Eighth Circuit: "Error" Under E&O Policy Includes Intentional, Non-Negligent Acts or Mistakes, Including Breach of Contract Claims

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The United States Court of Appeals for the Eighth Circuit, applying Texas law, has held that the definition of "error" in an E&O policy includes intentional, non-negligent acts or mistakes, including breaches of contract, and thus an insurer had a duty to defend its insured against breach of contract and breach of warranty allegations. *St. Paul Fire & Marine Ins. Co. v. Compaq Computer Corp.*, 2008 WL 3540609 (8th Cir. Aug. 15, 2008).

The insurer issued a liability insurance package, including a Technology Errors and Omissions Liability Protection policy, to the insured, a computer manufacturer. The Technology E&O policy provided that the insurer would "pay amounts any protected person is legally required to pay as damages for covered loss . . . that is caused by an error." The E&O policy defined "error" as an "error, omission or negligent act." "Damages" were defined as "compensatory damages imposed by law [or] consequential damages," though the policy excluded "the contract price of [the] computer."

A number of class action suits were filed against the insured alleging breach of contract and breach of warranty based on alleged defective floppy diskette controllers in the insured's computers. The insured provided notice to the insurer of these suits, and the insurer initially agreed to defend the insured under the policy, while reserving its rights to deny coverage. Subsequently, the insurer denied coverage for a number of the class actions suits on the basis that the complaints only alleged causes of action resulting from the insured's intentional conduct, and thus did not allege "an 'error' under the Technology E&O policy." That denial was ultimately upheld by a Minnesota state appellate court. See *Compaq Computer Corp. v. St. Paul Fire and Marine Ins. Co.*, 2003 WL 22039551 (Minn. Ct. App. Sept. 2, 2003) [summarized in the October 2003 Executive Summary]. Subsequently, the insurer brought a declaratory judgment action in Minnesota against the insured regarding a similar lawsuit then pending in Texas. The insured then removed to the declaratory judgment action to the United States District Court for the District of Minnesota. In the declaratory judgment proceeding, the federal district court held that under Texas law, the insurer had a duty to defend the insured, holding that the complaint alleged an "error" under the policy, that the complaint sought "damages" as defined in the policy, and that no exclusions applied to preclude coverage.

The federal appellate court, in affirming in part and reversing in part the district court's decision, agreed that the complaint alleged "a loss caused by an 'error' for which the plaintiffs request 'damages.'" The court first looked to the definition of "error" in the policy. Stating that "[b]ecause the policy uses the term 'error' to define itself, [the court] look[s] to common usage" and found that "an error is an unintentionally incorrect act, assertion, or belief, or a mistake." In addition, the court stated that, under the policy, an error "encompasses intentional, non-negligent acts like those associated with the breach of a contract[, but] does not, however, include intentional wrongful conduct."

The court next looked to the operative underlying complaint and the policy, as required by Texas law, to evaluate the insurer's duty to defend, and concluded that "there is no allegation that the conduct [by the insured] was intentionally wrongful" and that "the allegations support the inference that [the insured] unintentionally sold defective computers and unintentionally provided a defective product to fix the original defect." The court rejected the insurer's contention that the complaint's allegation of the insured's "knowing breach" was a "conclusory remark unsupported by any factual allegations." Thus, the court held that the insured's conduct fell within the policy's definition of "error." Accordingly, the court concluded that the insurer had a duty to defend the action.

The court then addressed the insurer's contention that coverage was excluded under the policy's "intentionally wrongful act" exclusion. Adopting the Texas Supreme Court's interpretation that such an exclusion requires a showing of "more than reckless or wanton conduct" in order to disclaim coverage, the Eighth Circuit noted that the operative complaint did not allege any such act. The court also rejected the insurer's assertion that an exclusion barring coverage for losses "resulting from a 'delay in delivery' or 'failure to deliver [the insured's] computer or electronic products or services'" applied, reasoning that because the complaint did not allege that the insured would repair any potential defect by a certain date, the exclusion was inapplicable.

Lastly, the court reversed the district court's ruling that the insured was not entitled to bad faith damages under Texas's "prompt payment statute," Tex. Ins. Code §§ 542.051-.061, which provides that an insurer that "fails to comply with the prompt payment statute must pay the insured eighteen percent of the amount of the claim." The court rejected the insurer's contention that Minnesota, rather than Texas law, governed this issue, noting that the insurer had waived that argument by failing to raise it with the trial court. The Eighth Circuit then ruled that the insured was entitled to the statutory damages under Texas law because "an insurer's breach of its duty to defend its insured gives rise to statutory damages under the Texas prompt payment statute."