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NEWSLETTER

No Coverage for Breach of Contract Claims Against Company and Its Officer

February 2007

A California intermediate appellate court, applying California law, has held that a professional liability policy does not afford coverage for breach of contract claims asserted against a company and one of its officers. *August Entertainment, Inc. v. Philadelphia Indem. Ins. Co.*, 2007 WL 38898 (Cal. App. Jan. 8, 2007).

An insurer issued a professional liability policy to a film production and distribution company that covered D&O, employment practices and fiduciary liabilities. The insuring agreements of the D&O portion of the policy provided coverage to individuals, "in [their] capacity as a director or officer of the [company]," and to the company to the extent that it indemnified individual insureds pursuant to law or company charter. The policy excluded from coverage under the indemnity insuring agreement "any actual or alleged liability of the Company under any express contract or agreement."

The company contracted to purchase the distribution rights to certain films from a sales agent. In a letter sent to the seller, an officer of the company offered to purchase the distribution rights for $2 million. The president of the seller signed the offer letter in acceptance. Subsequently, the company told the seller that it was not going forward with the acquisition. The seller filed a lawsuit against the company alleging breach of contract and seeking $2 million. The seller subsequently added the officer of the company as a defendant in the suit, contending that he was personally liable for the breach because he had not signed the offer letter on behalf of the company.

The company tendered the lawsuit to the insurer. The insurer denied coverage on the grounds that: (1) there was no coverage for the company because its alleged liability arose out of a contract; and (2) there was no coverage for the officer because he had been sued in his individual capacity. The company then settled the lawsuit for $2 million plus interest and assigned its rights under the policy to the seller. The seller instituted the coverage action.

The appellate court first observed that D&O policies generally – and the policy at issue in particular – preclude coverage for breach of contract in several ways. It explained that the policy issued to the company expressly excluded the company's liability for breach of contract from coverage and also did not cover the officer for liability arising from acts committed outside of his insured capacity. Moreover, the court continued, to the extent that the officer was acting in his insured capacity when he signed the contract, the officer could

not be held personally liable for breach of a corporate contract.

Next, relying on *Oak Park Calabasas Condominium Association v. State Farm Fire and Casualty Co.*, 137 Cal. App. 4th 557 (2006), and cases from other jurisdictions in which courts refused to find coverage for breach of contract under D&O policies, the court concluded that the corporation's decision not to honor a contract was "not a loss resulting from a wrongful act within the meaning of the policy." If it were, the insurer would become "a de facto party to the corporate contract," letting the corporation "completely off the hook" for its actions.

The court rejected the company's contention that, by implication, the D&O coverage applied to all "non-employment" breach of contract claims because the D&O provisions excluded coverage for matters covered under the employment practices liability part of the policy, including claims for "breach of a written or oral employment contract or quasi-employment contract." Instead, the court found that this exclusion: (1) could not expand the D&O insuring provisions beyond their original scope, which did not include coverage for failing to make payment on a contract; and (2) simply made clear that employment-related claims were not covered under the D&O coverage part.

Finally, the court concluded that its decision was consistent with *Vandenberg v. Superior Court*, 21 Cal. 4th 815 (1999), in which the California Supreme Court held that a general liability policy could, in some situations, provide coverage for "losses pled as breach of contract." According to the court, under *Vandenberg*, coverage is to be determined by "the nature of the risk and the injury, in light of the policy provisions." In *Vandenberg*, the court addressed coverage for the contamination of the environment in violation of the insured's duties under a lease under a policy insuring "'damages' the insured was 'legally obligated to pay.'" In contrast, the court stated, this case involved injury caused by a corporation or officer's breach of a corporate contract under a D&O policy, "not an expanded comprehensive liability policy insuring the [corporation] against liability for everything it does."