

# Court Rules Illinois Law and Policy Language Do Not Preclude Coverage for Breach of Contract

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The United States District Court for the Northern District of Illinois, applying Illinois law, has denied in part an insurer's motion for judgment on the pleadings, ruling that Illinois law does not preclude coverage for breach of contract damages under the management liability policy at issue. *Sigma Chi Corp. v. Westchester Fire Ins. Co.*, 2008 WL 4722295 (N.D. Ill. Oct. 22, 2008). The court also dismissed the policyholder's count for bad faith based on section 155 of the Illinois Insurance Code.

The insurer had issued a management liability policy that provided coverage for, among other things, "Loss of the Company which the Company becomes legally obligated to pay . . . for Wrongful Acts . . . ." The policy defined Wrongful Act as "[a]ny error, misstatement [or] misleading statement . . . committed . . . by the Company . . . ." The policy also contained an exclusion barring coverage for claims "alleging, based upon, arising out of, or attributable to the actual or alleged breach of any oral, written, express, or implied contract or agreement," except "to the extent that liability would have attached to the Company in the absence of such contract or agreement." The exclusion applied to "any Claim covered, in whole or in part, under Insuring Agreement A, Directors' and Officers' Liability."

A former manager for the policyholder executed several purchase orders, financing agreements and service agreements with two companies. After the manager resigned, the policyholder notified the companies that the agreements were invalid because the manager was not authorized to execute the agreements. The companies notified the policyholder that it was in breach of the agreements. The policyholder sought coverage under its management liability policy. After the insurer denied coverage, the policyholder filed the instant declaratory judgment action alleging breach of contract and violation of section 155 of the Illinois Insurance Code.

The court first determined that Illinois law does not generally bar insurance coverage for breach of contract damages. The court explained that the cases the insurer relied upon did not state a general rule but instead required examination of the specific policy language at issue. The court also relied on *Krueger International v. Royal Indemnity Co.*, 481 F.3d 993 (7th Cir. 2007) (Wisconsin law), which held that "if the act that precipitates

the insured's liability is negligent and therefore [tortious], the fact that it's also a breach of contract does not preclude coverage . . . ."

The court next ruled that the policy language at issue did not bar coverage for breach of contract damages. The court rejected the insurer's argument that the phrase "legally obligated to pay" should be interpreted to refer to tort liability and not to damages for breach of contract. In light of contrary case law, the court found that the insurer had not shown that its interpretation was the only reasonable interpretation of that policy language. The court also found that there was a factual issue whether the underlying claims involved a Wrongful Act. Specifically, the court found that an inquiry regarding the manager's authority to execute the agreements was necessary to determine whether there was a Wrongful Act.

The court further held that the breach of contract exclusion did not bar coverage for the underlying claims. The court determined that the policy language limited the exclusion to claims covered under Insuring Agreement A, Directors' and Officers' Liability, whereas the underlying claims were based on the Company Liability section of the policy.

Finally, the court dismissed the policyholder's allegations that the insurer's refusal to advance defense costs was "vexatious and unreasonable" under section 155 of the Illinois Insurance Code. The court explained that an insurer does not act vexatiously and unreasonably when, for example, "there is a bona fide dispute concerning coverage" or "the claim presents a genuine legal or factual issue regarding coverage." Here, the court found that there was a genuine dispute regarding coverage and thus dismissed the section 155 count.