

Pennsylvania Public Policy Does Not Bar Coverage for Breach of Contract

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The United States District Court for the Eastern District of Pennsylvania, applying Pennsylvania law, has held that Pennsylvania public policy does not prohibit coverage for breach of contract claims under D&O policies. *Verticalnet, Inc. v. U.S. Specialty Ins. Co.*, 2007 WL 1490513 (E.D. Pa. May 21, 2007).

The insurer issued a D&O policy to a company. The policy provided entity coverage for "Securities Claims." The policy defined "Loss" to exclude "matters which are uninsurable under the law pursuant to which the Policy is construed." The policy did not contain a breach of contract exclusion.

The company was sued in connection with the issuance of stock as part of a merger. After an early motion to dismiss, only two counts remained in the complaint. The first was for breach of contract. It alleged that the company breached the applicable merger agreements by failing to issue and register stock certificates in a timely matter. The second count alleged violation of the Uniform Commercial Code as a result of the failure to register the shares owing from the merger. The company then agreed to settle the lawsuit for \$5.563 million, which was to be funded in part with the unspent portion of the retention, with the remainder to be satisfied by assigning rights to the insurance proceeds. This coverage litigation ensued.

The court in the coverage litigation rejected the insurer's argument that Pennsylvania public policy bars insuring breach of contract claims. The insurer pointed to a number of cases in Pennsylvania holding that general liability policies do not insure against breach of contract. However, the court distinguished those cases on the grounds that, "in [c]ontrast to those cases, [this D&O policy] does not simply protect against an 'occurrence': it expressly provides insurance for securities claims without limiting coverage of such claims to those that do not arise from breaches of contract." The court further reasoned that the cases on which the insurer relied were based on the plain meaning of the provisions of the general liability policies at issue, not on "'public policy' or any cognate of that term." It therefore concluded that Pennsylvania public policy does not forbid coverage for contract-based claims.

The insurer also pointed to public policy rationales supporting its position. It argued that allowing coverage for breach of contract would turn insurers into "guarantors" of transactions, would make it difficult to underwrite policies and would create a "moral hazard" by encouraging insureds to abandon their contractual

duties. The court explained that it did not want to "belittle" these concerns, but noted that the insurer could not point to any Pennsylvania cases mentioning these rationales. The court concluded that it would be inappropriate for a federal court to "expand the Commonwealth's jurisprudence to create such a public policy."

The court, however, declined to grant the motion for summary judgment against the insurance company. It explained that while the settlement could be covered, the insurer was entitled to discovery to challenge whether the settlement was reasonable and negotiated in good faith.