

Breach of Contract Exclusion Bars Coverage for Conspiracy Claim Arising Out of Construction Contract

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The United States District Court for the District of New Jersey, applying New Jersey law, has held that a lawsuit asserting that commissioners of a utilities authority conspired to hold a construction firm liable for alleged faulty design and construction of a sewage treatment facility arose out of an alleged breach of the construction contract and therefore was excluded from coverage under a liability policy's exclusion for claims arising out of breach of contract. *Light v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, 2008 WL 5233867 (D.N.J. Dec. 12, 2008).

The insureds, commissioners of a county utilities authority, were insured under a public officials and employment practices liability policy. The policy contained an exclusion providing that "[t]his policy does not apply to any Damages or Claim . . . [a]rising out of breach of contract." The insureds were sued by a builder with which the utility authority had contracted for the construction of the sewage facility. The complaint alleged breach of contract and related tort claims against the insureds, engineering firms and others involved in the alleged faulty design and construction of the facility. The lawsuit's one cause of action against the commissioners alleged that they fraudulently conspired to hold the builder liable for errors and omissions associated with the construction of the facility. The insureds tendered the suit to the insurer, which denied coverage based in part on the breach of contract exclusion. The insureds then filed a declaratory judgment action, which the insurer moved to dismiss. The insureds argued that the claim alleged independently tortious acts not related to the contract and therefore was not so barred.

In granting the insurer's motion to dismiss, the court first noted that New Jersey courts interpret the phrase "arising out of" to mean "originating from," "growing out of" or having a "substantial nexus" with the relevant subject. The court then determined that the underlying lawsuit focused "primarily on the alleged breach of the construction contract entered into by the [commission]" and that the "sole claim against the Commissioners individually clearly [had] its origin in, flow[ed] from or [had] a connection to that contract and any breach thereof." Accordingly, the court held that the breach of contract exclusion barred coverage. In doing so, the court noted this result was consistent with precedent of the U.S. Court of Appeals for the Third Circuit, which applied a "but for" test for interpreting similar exclusions. According to the court, under this test, "[b]ut for the

breach of contract alleged in the [underlying action], the injuries allegedly perpetrated by the commissioners would not have occurred," and thus the exclusion also would apply.

The court then rejected the policyholder's argument that, irrespective of the breach of contract's application to any resulting indemnity obligation, the insurer owed a duty to defend the insureds. The court stated that, unlike the breach of contract exclusion involved in a case cited by the policyholder—and unlike other exclusions in the policy at issue—the breach of contract exclusion did not include a carve-back for coverage for defense costs. Thus, based on the plain language of the exclusion, the court held that the insurer had no indemnity or defense obligations for the underlying claim against the insured commissioners.