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NEWSLETTER

Contract Exclusion Potentially Bars Coverage for Claim Under Construction Company's D&O Policy

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The United States Court of Appeals for the Ninth Circuit, applying California law, has held that a triable issue of fact existed as to whether a D&O insurer was obligated to indemnify its insured for loss stemming from a defective construction lawsuit. *S.J. Amoroso Constr. Co. v. Exec. Risk Indem., Inc.*, 2009 WL 1154202 (9th Cir. Apr. 30, 2009). The court held that the misrepresentations at issue in the underlying claim qualified as a wrongful act under the policy, but also determined that the policy's contract exclusion potentially barred coverage for that claim.

The insured and a second corporation (the Co-Owner), both construction companies, co-owned a limited liability company (the LLC). The Co-Owner entered into a construction contract with a property group in 2000. In 2001, the Co-Owner sought to assign this contract to the LLC. The insured, the Co-Owner, and the LLC agreed to the assignment and sought the property group's consent. In so doing, the insured's president told the property group that LLC's liability was assigned to both owners and, thus, that the LLC was financially stronger than the Co-Owner. In part on the basis of this representation, the property group consented to the assignment. However, the insured later argued that its president was not authorized to make such representations on its behalf.

In 2002, the property group filed a lawsuit against the LLC, the Co-Owner, the LLC's subcontractors, and the insured, alleging material construction defects. Among other allegations, the property group asserted that the insured misrepresented that the property group would benefit from the assignment of the contract from the Co-Owner to LLP because liability would be assigned to both the Co-Owner and the insured. The insured tendered the claim to its D&O insurer, which denied coverage, and the insured sued. The district court granted summary judgment for the insurer, holding that: (1) the president acted in his individual capacity, and not on behalf of the insured, in making the representations at issue; and (2) the policy's contract exclusion barred coverage. [That decision was summarized in the December 2007 Executive Summary.]

On appeal, the Ninth Circuit disagreed that the claim did not fall under the policy's insuring agreement because the president was acting in his individual capacity. Citing *Farmers Insurance Group v. County of*

Santa Clara, 11 Cal. 4th 992, 1003 (Cal. 1995), the court noted that "employees may be said to act within the scope of their employment, even when their actions are not authorized by their employer, so long as their actions are not so unusual or startling that it would seem unfair to include the loss resulting from it among other costs of the employer's business." Finding that the president's acts were not so "unusual or startling" that they should be classified as actions taken in his individual capacity, the court held that the alleged misrepresentations qualified as a wrongful act committed by the insured.

The Ninth Circuit also held that the district court erred by granting summary judgment for the insurer based on the existence of a contract exclusion in the policy. The contract exclusion excluded claims "arising from" liability "under any written or oral contract or agreement." The court noted that the underlying claim alleged, in part, that the insured made misrepresentations that induced the property group to contract *with* the LLC: "[t]his theory of liability . . . depends on the fact that [the insured] was not a party to the construction contract and, therefore, did not have liability under the contract." Under this theory, the court held, the insured's liability was not liability under a contract or agreement, as required by the contract exclusion. However, the court further held that a triable issue of fact remained with respect to whether the president's statements to the property group created a separate contract or agreement. If so, the court reasoned, the insured's liability would arise under such contract or agreement, and the contract exclusion would bar coverage.