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NEWSLETTER

Contract Exclusion Not Applicable, But No Bad Faith

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The United States District Court for the Northern District of California has determined that an insurer wrongly relied upon a policy's contract exclusion to deny coverage, but the insurer was not held liable for bad faith because the insured suffered no damages as a result of the insurer's denial. *S.J. Amoroso Constr. Co. v. Exec. Risk Indem. Inc.*, 2009 WL 4907736 (N.D. Cal. Dec. 14, 2009).

The underlying litigation arose out of a construction contract between a property owner (the Owner) and a non-insured construction company (the Construction Company). After the contract had been executed, the insured and the Construction Company jointly created a new limited-purpose company, and they sought to assign the duties assumed under the construction contract to this new entity. The insured's president wrote a letter to the Owner in support of assignment suggesting that the limited-purpose company could complete the project that the Construction Company had started, and that the new company would be financially stronger than the insured and the Construction Company individually. Permission to assign was then granted. Subsequently, a lawsuit for defective construction was filed, and the insured tendered the lawsuit for coverage. The insured's D&O insurer denied coverage, explaining that the insured's liability arose from an agreement to guarantee performance of the contract, which it had entered into as part of its exchange of letters regarding assignment of the construction contract. The district court awarded summary judgment to the insurer based, in part, on its understanding that no claim had been made against an insured. On appeal, the Ninth Circuit concluded that the complaint did state a claim against an insured and remanded the case to allow the district court to resolve two questions: (1) whether the correspondence between the insured's president and the Owner constituted an agreement by the insured to guarantee the performance of a non-insured under the construction contract; and (2) whether the insured stated a claim for bad faith breach of the duty to defend. See S.J. Amoroso Constr. Co. v. Exec. Risk Indem. Inc., 325 F.Appx. 548 (9th Cir. 2009) (reported in the June 2009 edition of *Executive Summary*).

First, the trial court decided that the D&O insurer's denial of coverage was improper because the exchange of letters between the insured and the Owner did not constitute a contract or agreement by the insured to guarantee performance of the construction contract. In the court's view, no such contract existed because no definite offer to guarantee was made in the letter, no precise terms were negotiated, and no mutual consent was demonstrated. As a result, the policy's exclusion barring coverage for "any actual or alleged liability of an Insured Organization under any written contract or oral agreement . . ." did not apply.

Despite concluding that the denial was improper, the court did not find the insurer to be liable for bad faith breach of the duty to defend. According to the court, because the insured's general liability insurer provided a complete defense to the insured, it sustained no damages as a result of the D&O insurer's decision not to defend. Because the insured could not point to an injury caused by the denial of coverage, it was not entitled to recovery on its bad faith cause of action.