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NEWSLETTER

Breach of Contract Exclusion Bars Coverage for Lawsuit Alleging That Insured Failed To Valuate Stock in "Good Faith"

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A New Jersey appellate court has held that a breach of contract exclusion barred coverage for a lawsuit alleging that the insured breached a warrant agreement by failing to valuate stock in good faith. *Old Berliner Liquidating Trust v. N. River Ins. Co.,* 2012 WL 1868379 (N.J. Super. Ct. App. Div. May 24, 2012).

The insured entered into a loan transaction with an investor. As part of the consideration for the loan transaction, the investor received a warrant allowing it to purchase shares of the insured subject to a good faith valuation of stock by the insured's board of directors. A dispute subsequently arose over the board's “good faith” valuation, and the investor sued the insured for breach of the warrant agreement. The insurer refused to defend the insured, asserting that coverage for the lawsuit was barred by the policy's breach of contract exclusion.

In the coverage litigation that followed, the court held that the policy's breach of contract exclusion unambiguously barred coverage for the underlying suit. In so doing, the court rejected the insured's argument that the underlying action was covered as a breach of fiduciary duty. According to the court, the underlying complaint clearly stated a breach of contract action because the alleged wrongful act (*i.e.*, the board of directors' alleged breach of duty in valuating the stock) was a breach of a contractual provision in the parties' warrant agreement. The court therefore explained that the underlying suit was rooted in compliance with the warrant agreement rather than the board of directors' adherence to its fiduciary duties.