

Contractual Liability Exclusion Bars Coverage for Claim Arising out of Asset Purchase Agreement

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A state intermediate appellate court, applying New Jersey law, has affirmed a trial court's grant of summary judgment in favor of two insurers, holding that the contractual liability exclusion in their D&O policies barred coverage for the claim because the insureds' liabilities in the underlying action arose out of an asset purchase agreement. *Porter v. Am. Int'l Cos.*, (N.J. Super. Ct. App. Div. Nov. 1, 2004).

Two insurers issued D&O policies to a company that provided home medical care. The policies provided coverage for "the loss of each and every Director, Officer or Employee of the Company arising from a Claim ...for any actual or alleged Wrongful Act in their respective capacities" In addition, the policies contained exclusions that barred coverage for "Loss in connection with a Claim made against an Insured ...alleging, arising out of, based upon or attributable to any actual or alleged contractual liability of the Company or any other Insured under any express contract or agreement"

The policyholder entered into an asset purchase agreement with another home medical care provider with the financial support of a third company. Under the terms of the asset purchase agreement, the company that sold its assets would continue to operate the business until the policyholder was able to get the necessary operations in place. The agreement, however, did not cover one division of the purchased company. The purchased company agreed to collect its billings and funnel the proceeds to the policyholder and the third-party financial institution. The policyholder agreed to return the portion of the proceeds resulting from the division still owned by the purchased company.

Instead, the policyholder and the third-party financial institution allegedly stopped forwarding the payments from the unpurchased division to the purchased company. The purchased company filed suit against the policyholder and various directors and officers, alleging, *inter alia*, that the policyholder owed the purchased company funds pursuant to the asset purchase agreement and that the CEOs of the policyholder and the third-party financial institution wrongfully withheld these payments. The insureds tendered the claim seeking both indemnity and defense costs. The insurers denied coverage based on the contractual liability exclusion.

The court determined that the claim against the insureds "could not have existed had there not been a contractual obligation requiring" the payments to be forwarded to the purchased company. In so ruling, the court stated that "[t]he phrase 'arising out of' whether used to define or exclude coverage 'is given a broad definition' ...synonymous with 'originating from,' 'growing out of,' or having a 'substantial nexus' with the activity for which coverage is provided." The court noted that "there is interdependence between the claims ...and the provisions of the Asset Purchase Agreement." More specifically, the court observed that the alleged wrongful acts of the insureds had their "origins in and flowed from the contractual obligation, without which there would be no claim."

Therefore, the court concluded that the exclusion applied to bar coverage because the underlying claims "flow [ed] from and [were] dependent upon the contractual obligations found in the Asset Purchase Agreement."

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