

Court Finds Coverage for Alleged Breach of Contract

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The United States District Court for the Eastern District of Virginia, applying Virginia law, has held that a professional liability policy affords coverage for allegations of breach of contract. *Transcontinental Ins. Co. v. Caliber One Indem. Co.*, 2005 WL 1017845 (E.D. Va. Apr. 28, 2005).

The policyholder, a company that installs, inspects and repairs fire suppression systems, had a maintenance contract for a fire suppression system it had installed in a bank. That system subsequently leaked, causing the bank to "incur millions of dollars in engineering and construction costs" to replace the system, as well as to incur significant fire safety-related expenses while the existing system was being replaced. The bank then filed suit against the company, alleging breach of contract, failure to maintain and inspect the system and breach of implied warranties.

The company had several commercial general liability and professional liability policies. The professional liability policies covered "any suit seeking damages because of any act, error, or omission in the rendering or failure to render 'professional services.'" The policies excluded coverage for bodily injury, property damage, advertising or personal injury "arising out of a negligent act, error or omission in the rendering or failure to render 'professional services.'" "Property damage" was defined as "[p]hysical injury to tangible property including all resulting loss of use of that property" and "[l]oss of use of tangible property that is not physically injured." The professional liability policies also excluded coverage for "[a]ny claim resulting from estimates or probable contract costs being exceeded; express warranties or guarantees; or breach of contract as respects any agreement to perform work for a specified fee" and "[a]ny claim arising out of the ownership, rental, leasing, maintenance, operation, use or repair of any real or personal property, including damage to property owned, occupied or used by or rented or leased to an insured."

One of the insurers denied coverage for the underlying suit, while the other insurer defended coverage under a reservation of rights. The company asked the denying insurer to reconsider its position when a third party cross-claimed, but the insurer refused. The defending insurer and the company ultimately settled the underlying lawsuit and sought a declaratory judgment that the denying insurer was required to pay defense and indemnity costs.

The insurer that did not participate in the defense or the indemnity of the underlying litigation (defendant insurer) subsequently moved for summary judgment with respect to its alleged duty to defend and indemnify. The court first determined that, because the underlying suit was based on the company's alleged failure to inspect and maintain the fire suppression system, the claim arose from a "failure to render 'professional services'" and thus the professional liability coverage portions of the defending insurer's policy, rather than the commercial general liability coverage portions, applied. It then considered the defending insurer's argument that coverage was precluded based on three separate exclusions.

First, the defending insurer relied upon an exclusion for claims for "[b]odily injury, property damage, advertising injury, or personal injury except arising out of a negligent act, error or omission in the rendering or failure to render 'professional services.'" It argued that there was no coverage for breach of contract claims because those claims are not "formally pleaded in negligence." The court rejected this argument, noting that, although there is case law to the contrary, the "better-reasoned decisions ... look to the nature of the act the insured is alleged to have committed, i.e., intentional or unintentional, rather than to the form of action pleaded to determine whether coverage and/or a duty to defend exists." As such, unless there is "no doubt" that the alleged breach was intentional, the duty to defend was triggered. Additionally, the court noted that, under Virginia law, the underlying allegations could be pled only as a tort, not as a breach of contract. As such, if the court focused on the form of the pleading, instead of the conduct, the company would not receive the benefit of professional liability coverage, which serves to "protect [the policyholder] from its own failures." Applying these principles, the court held that the exclusion did not bar coverage because the underlying complaint did not specifically allege intentional conduct.

The court then considered the defending insurer's argument that the exclusion for "any claim resulting from estimates or probable contract costs being exceeded . . . or breach of contract as respects any agreement to perform work for a specified fee" barred coverage. The court noted that, while the maintenance contract set an hourly fee for the work to be performed under the maintenance contract as well as a maximum total fee, the policy did not define the term "agreement to perform work for a specified fee." It then held the exclusion applied only to contracts that called for payment of a fixed amount rather than an amount that was subject to a maximum cap, as was the case with the underlying maintenance contract. Accordingly, the court concluded that the exclusion did not apply to the underlying litigation.

Last, the court held that the exclusion for "any claim arising out of the ownership, rental, leasing, maintenance, operation, use or repair of any real or personal property, including damage to property owned, occupied or used by or rented or leased to an insured" did not apply. The court noted that "[a]t first blush" the exclusion would eliminate all coverage under the professional liability portion of the policy, as the company's work consisted entirely of installation and maintenance of fire suppression systems, which are real property. As such, the court determined that "some limiting construction" of the exclusion was required and held that the exclusion could not apply to the enumerated activities listed in the professional services schedule. Because the underlying complaint implicated some of these activities, the court determined that the exclusion was inapplicable.

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