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NEWSLETTER

# No Coverage for Breach of Contract Claims Under D&O Policy Under Texas and Florida Law

August 2005

The United States District Court for the Southern District of Florida, interpreting both Florida and Texas law, has held that a D&O liability policy does not provide coverage for breach of contract claims against the insured company. *Waste Corp. of Am., Inc. v. Genesis Ins. Co.*, No. 03-61480 (S.D. Fla. Aug. 5, 2005). The court found that the terms of the insuring agreement did not encompass coverage for such claims, a result it determined was supported by public policy. Wiley Rein & Fielding LLP represented the insurer in this case.

The underlying lawsuit involved the insured company's acquisition of two businesses. In 1999, the company purchased the stock of two businesses from three individuals for an up-front cash payment as well as the potential for certain future royalty payments based on the businesses' performance over a three-year period. In 2001, the three sellers sued the company, alleging that it had breached the terms of the purchase agreement by failing to allow the three sellers to manage the day-to-day operations of the business. The sellers' lawsuit alleged breach of contract, fraud and negligent misrepresentation. Two of the sellers subsequently settled their lawsuit against the insured company, but the third seller proceeded to trial. At trial, all of the plaintiff's claims were dismissed except for a breach of contract claim, which resulted in a jury verdict of $3 million for the plaintiff. Before the verdict was entered, however, the insured settled with the plaintiff for $2 million.

The insurer advanced defense costs to the company throughout the trial in the underlying litigation. The insurer declined to provide coverage for the pre-trial settlements, however, and likewise declined coverage for the breach of contract verdict. The company subsequently brought suit to obtain coverage for all three settlements. During the course of the coverage litigation, however, the company dropped its claims for coverage for the first two settlements and maintained only its claim for the post-verdict settlement.

The court granted summary judgment in favor of the insurer. The court held that, under either Texas or Florida law, the policy's insuring agreement did not encompass breach of contract damages. First, the court held that such damages did not constitute "loss," defined in the policy as "any amounts which the [insureds] are legally obligated to pay." The court relied on Fifth and Eleventh Circuit precedents distinguishing between "legal" obligations imposed by tort law and contract obligations voluntarily undertaken by the insured. Second, the

court held that the breach of contract damages did not result from a "wrongful act," as required by the policy but rather from the insured's act of entering into the contractual obligations. The court explained that the jury verdict against the insured resulted from the insured's failure to allow the sellers to continue to manage the acquired businesses after the sale as required by the contract. The court noted that the purchase agreement itself was the source of the insured's obligation to pay not the insured's refusal to honor its contractual bargain.

The court also concluded that public policy considerations buttressed its textual analysis. The court noted that the D&O policy at issue was a liability policy and that liability policies are not intended to provide coverage for acts within the insured's control. The court found a "strong public policy" against allowing insurance for breach of contract claims: if such insurance were permitted, the insured "could enter into a contract safe in the assumption that if he later decides to engage in an act which might be considered a breach, the insurance company will step forward to cover the consequences of his act if he was wrong. . . . There would be nothing to stop an insured from trying his hand and betting all his chips on a breach if he could be assured that the consequences of such an act had no impact on him."

Finally, the court noted that the company essentially had admitted that the policy provided no coverage for breach of contract damages by dropping its claim for coverage for the initial two settlements. The company ultimately conceded that there was no coverage for the initial two settlements because those settlements simply represented the amount of royalty payments the two sellers were due under the purchase agreement. The company argued that the third settlement should nevertheless be covered because the amount of the settlement was in "excess" of the company's contractual obligations (as determined by the company). The court rejected this distinction, holding that the jury had determined that the company had breached its contractual obligations to the third seller and that the jury verdict simply represented the jury's calculation of the third seller's expectation of damages.

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