

Contractual Liability Exclusion Precludes Coverage for Breach of Contract and Negligence but not Breach of Fiduciary Duty

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The Court of Common Pleas of Pennsylvania, applying Pennsylvania law, has held that the contractual liability exclusion in a management liability policy precludes coverage for allegations of breach of contract and negligence against a health services company but does not bar coverage for allegations of breach of fiduciary duty against the officers of the company. *Temple U. Health Sys., Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 2005 WL 167583 (Pa. Ct. C.P. Jan. 7, 2005).

The plaintiffs in the case were several different health service companies ("the corporate insureds") and various corporate officers of those health systems ("the individual insureds"). The insurer issued a management liability policy to the plaintiffs for the period July 1, 2002 to July 31, 2003. The policy contained an exclusion for claims "alleging, arising out of, based upon or attributable to any actual or alleged contractual liability of the Organization or an Insured under any express written or oral contract or agreement. " However, "solely with respect to Directors, Officers or Trustees," the exclusion did not apply to "covered Defense Costs incurred in connection with a Claim alleging a Wrongful Act."

The underlying claim arose in connection with the issuance of tax-free bonds in 1999 by a Pennsylvania county higher education and health authority. The county authority loaned the proceeds of the bond sale to one of the corporate insureds in order for the insured to purchase and improve a nursing home. That insured independently contracted with the other corporate insureds to provide working capital and management services for the nursing home. The nursing home failed, and the insured defaulted on its loan with the county authority, which in turn defaulted on its payments to the bondholders. The bondholders sued the corporate and individual insureds for lost principal and interest, alleging breach of contract and negligence by the corporate insureds and breach of fiduciary duty by the individual insureds. The insureds tendered the lawsuit to the insurer for defense and indemnification. The insurer agreed to advance defense costs for the individual insureds, but declined to do so for the corporate insureds, or to indemnify any insureds on the grounds of the policy's contractual claim exclusion. The insureds subsequently initiated coverage litigation.

The trial court first determined that "the clear language of the policy exclusion" precluded coverage for the breach of contract claims against the corporate insureds. The court concluded that the exclusion also applied to a claim against the corporate insureds for breach of the covenant of good faith and fair dealing, as the court found this allegation to be "nothing more than a breach of contract claim."

Next, the court held that the "gist of the action" and "economic loss" doctrines precluded coverage for allegations that the corporate insureds had negligently operated the nursing home. Noting that Pennsylvania courts look to the "gist of the action" when a plaintiff "alleges that the defendant committed a tort in the course of carrying out a contractual agreement," the court concluded that the "[negligence] claim clearly sounds in contract" because the alleged duties that were violated were the same duties that were imposed on the corporate insureds by the contractual agreements. Accordingly, the court found that the negligence claim was "really a claim that the Corporate Defendants negligently breached the Loan Agreement, the Official Statement and the Management Agreement," and thus was barred by the exclusion. Moreover, the court indicated that the economic loss doctrine also precluded coverage for that claim. According to the court, the underlying plaintiffs alleged only economic losses, and "[w]here a plaintiff asserts negligence and seeks only damages for economic loss, the defendant is entitled to judgment as a matter of law."

Finally, the court rejected the insurer's contention that, under the "gist of the action" doctrine, the contractual exclusion also precluded coverage for the allegations of breach of fiduciary duty asserted against the individual insureds. Instead, the court noted that the individual insureds were not signatories to the loan agreement and that the underlying plaintiffs' allegations were that the insureds owed a fiduciary duty to the bondholders to manage the facility so as to place the interest of the creditors above their own interests. As a result, the court found that the "gist of the breach of fiduciary duty claim is not contractual in nature since the alleged fiduciary relationship exists independently from any contractual relationship between the parties." Therefore, the court concluded the exclusion did not bar coverage for the breach of fiduciary duty claim against the individual insureds.