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NEWSLETTER

Breach of Contract Not a "Wrongful Act" Under D&O Policy

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The California Court of Appeal, applying California law, has affirmed summary judgment for an insurer, holding that the D&O liability portion of a liability policy did not cover damages resulting from a breach of contract because the policy expressly defined "wrongful acts" as "conduct sounding in negligence" and did not encompass intentional actions. *Oak Park Calabasas Condominium Assoc. v. State Farm Fire & Cas. Co.*, 2006 WL 391557 (Cal. Ct. App. Feb. 21, 2006).

The insurer issued a general liability policy with a D&O liability option, an umbrella liability policy and a property policy covering earthquake damage to a condominium association. The D&O option provided coverage for certain "wrongful acts," which were defined, in relevant part, as "negligent acts, errors, omissions or breach of duty directly related to the operations of the Condominium/Association."

The association suffered substantial property damage during the 1994 Northridge Earthquake and recovered approximately $4.9 million from the insurer under the property policy. After the earthquake, the association contracted with a construction company to repair the damage. The association eventually refused to pay the construction company the entire amount owed under the contract, resulting in the construction company recording a mechanic's lien on the property and suing the association in 1995 for breach of contract and foreclosure. The association tendered the suit to the insurer.

The insurer denied any indemnity obligation to the association, asserting that the policy provided coverage only for tort liability and not "for a contractual obligation of the type set forth in [the] lawsuit." The contractor's suit against the insured went to trial, and, in 2002, the construction company was awarded more than $7.1 million for breach of contract, fraud, punitive damages and attorneys' fees.
In 2003, the association initiated coverage litigation against the insurer. The trial court entered summary judgment for the insurer, holding that the policy only provided coverage for "negligent breaches of duty—not breaches of contractual duties." The policyholder appealed.

On appeal, the association asserted that there was coverage under the policy for breaches of contractual duties because the word "negligent" in the definition of "wrongful acts" modified "acts" but not "errors, omissions or breaches of duty"—such that breaches of contractual duties were covered as non-negligent "errors or omissions." The court rejected this argument, relying on *Group Voyagers, Inc. v. Employers Insurance*

of Wausau, 2002 U.S. Dist. Lexis 3674 (N.D. Cal. Mar. 4, 2002), which held that "negligent act, error or omission means negligent act, negligent error or negligent omission" and concluded that the policy at issue defined "wrongful act" as "conduct sounding in negligence" and not breach of contractual duties.

While noting that the parties had engaged in "exotic rules of grammar" to argue their positions, the court relied on three fundamental reasons in rejecting the association's arguments.

First, the court found the association's interpretation was "self defeating" because any intentional conduct could be characterized as a covered "error or omission." Second, the court observed that "[n]o rational insurer" would insure an association, or be able to calculate an appropriate premium, if the association could choose to enter into a contract, renege on paying the contract and shift the bill to its insurer. Finally, the court reasoned that the association's loss was not fortuitous because the result was not "unanticipated" from its perspective. According to the court, the association had agreed to pay the construction company with the $4.9 million recovery that it received for property damage, but later decided to keep the money for itself and "forc [e] [the insurer] to pay twice for the same property loss."