

Breach of Contract Not a Wrongful Act Under E&O Policy

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The United States District Court for the Northern District of Illinois, applying Illinois law, has held that a policyholder's alleged breach of contract was not a "Wrongful Act" within the meaning of an errors and omissions policy. *Benefit Sys. & Servs., Inc. v. Travelers Cas. & Sur. Co. of Am.*, 2009 WL 1106948 (N.D. Ill. April 22, 2009). The court also held that a claim made after the policy period could not relate back to the breach of contract lawsuit first made during the policy period because that initial lawsuit was not covered under the policy.

The insured, an administrator of group benefit plans, contracted with a hospital to arrange payment for health services provided to persons covered under the insured's administered health benefit plans. After the hospital provided certain health services to subscribers of one of the insured's plans, the hospital sought payment from the insured in September 2005. The policyholder refused to pay, and the hospital sued the policyholder for breach of contract. Subsequently, the policyholder filed a third-party complaint against its subscriber seeking indemnity, and, in January 2007, the subscriber counterclaimed against the hospital and the insured. The policyholder sought coverage for both the hospital's initial lawsuit and the subscriber's counterclaim against it. After the insurer denied coverage, the policyholder initiated a declaratory judgment action seeking to establish that the insurer was required to defend and indemnify it in connection with the hospital's breach of contract action and the subscriber's counterclaim.

The policy provided claims-made errors and omission coverage for Claims made between August 4, 2005, and August 4, 2006. The policy defined "Claim" as "any civil . . . action . . . seeking to hold the Insured responsible for Loss as a result of a Wrongful Act actually or allegedly committed by the Insured . . ." It defined "Wrongful Act" as "any actual or alleged negligent act, misstatement, misleading statement, error or omission in rendering or failure to render Professional Services." The policy defined "Related Claims" to mean "all Claims based on, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving the same or related facts, circumstances, situations, transactions or events." It further provided that "All Related Claims are a single Claim for purposes of all applicable Liability Coverage Parts, and all Related Claims shall be deemed to have been made at the time the first such Related Claim was made, regardless of whether such date is before or during the Policy Period."

The district court held that neither the hospital's breach of contract action nor the counterclaim was covered by the policy. In doing so, it first considered the policyholder's contention that the word "negligent" in the definition of "Wrongful Act" modified only the word "acts" and that the policy therefore covered misstatements, misleading statements, errors and omissions as long as they were not intentional. The court rejected this argument, noting that "it would be illogical [if the definition limited] coverage to negligent acts but [provided] coverage for intentional omissions or errors." Accordingly, the court concluded that, in order to be covered under the policy, a "Wrongful Act" must be negligent. Relying primarily on *Baylor Heating & Air Conditioning, Inc. v. Federated Mutual Insurance Co.*, 987 F.2d 415 (7th Cir. 1993), the court then determined that the breach of contract alleged by the hospital was not a negligent act and therefore was not covered by the Policy.

The court then considered the policyholder's argument that the third-party action was covered despite the fact that it was first made after the policy expired because it related back to the hospital's earlier breach of contract action. The court held that the counterclaim could not be related to the hospital's claim within the meaning of the policy because the hospital's claim was not covered by the policy. Consequently, the court held that the counterclaim could not be covered because it was made outside of the policy period, and there was no earlier covered claim to which the counterclaim could be related.