

ALERT

Contract Exclusion Bars Coverage for Related Fraud Allegations

August 28, 2012

Applying Pennsylvania law, a federal district court has held that a directors and officers liability policy's contract exclusion precluded coverage for a suit against the insured operator of a chain of gas stations and convenience stores, where the suit included breach of contract allegations as well as tort allegations for fraudulent inducement and negligent misrepresentations in connection with the sale of convenience stores to third parties. *Federal Ins. Co. v. KDW Restructuring & Liquidation Services, LLC*, 2012 WL 3579840 (M.D. Pa. Aug. 17, 2012).

The convenience store chain sold approximately 150 of its stores to third parties. A number of the new store owners then filed suit against the convenience store chain, asserting causes of action for breach of various contracts, as well as fraudulent inducement and negligent misrepresentations in connection with the sale of the stores. The insured settled the suit for a cash payment and an agreement to modify certain terms of the contracts with the store purchasers.

In the subsequent coverage litigation, the court granted summary judgment to the insurer based on the policy's contract exclusion, which precluded coverage for claims "based upon, arising from, or in consequence of any actual or alleged liability of an Insured Organization under any written or oral contract or agreement, provided that this [exclusion] shall not apply to the extent that an Insured Organization would have been liable in the absence of the contract or agreement." The court observed that, while the parties agreed that the contract exclusion barred coverage for the breach of contract allegations, the convenience store chain argued that the fraudulent inducement and negligent misrepresentation allegations did not fall within the scope of the exclusion. The court concluded that

Practice Areas

- D&O and Financial Institution Liability
- E&O for Lawyers, Accountants and Other Professionals
- Insurance
- Professional Liability Defense

the contract exclusion barred coverage for both the breach of contract and tort causes of action under three separate tests. First, the court held that the plain language of the contract exclusion was unambiguous and broadly precluded coverage for the entire suit because all of the allegations were “based upon, arising from, or in consequence of” alleged liability under contracts. Second, the court applied the more stringent “but for” test, concluding that “but for” the convenience store chain’s alleged breach of its contracts with the store owners, the store owners would not have had causes of action for fraudulent inducement and negligent misrepresentations. Third, the court applied the “gist of the action” doctrine, holding that the contracts between the convenience store chain and the store owners were central, rather than a collateral, to the suit. Accordingly, the court granted the insurer summary judgment on the contract exclusion.

The opinion is available [here](#).