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The Strike Zone for Breach of Contract Policy Exclusions

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In a case of *Field of Dreams* gone wrong, the United States District Court for the Northern District of Illinois recently considered whether a contractual liability exclusion barred coverage for a claim by the operator of a minor league baseball team alleging that a stadium, promised by the insured city if the team came to town, was never built. *OneBeacon American Insurance Co. v. City of Zion*, No. 12-cv-4437 (N.D. Ill. July 29, 2015). In one of the first cases applying Illinois law to address a breach of contract and contractual liability exclusion in a professional liability policy, the court held that the exclusion barred coverage for the city but that the insurer had a duty to defend the city officials named in the suit. The court came to this conclusion even while applying a broad "but for" causation test to determine the applicability of the exclusion because the city officials were alleged to have made misrepresentations and engaged in a conspiracy of which the alleged breach of the city's contract to construct the stadium comprised but a part. Policyholders may attempt to use the decision in Illinois and elsewhere to urge courts to find a duty to defend notwithstanding broadly worded and broadly applied contract-related exclusions, depending upon the types of wrongdoing alleged and their nexus to the relevant contract.

The operator of the minor league baseball team brought suit against the city and its mayor and economic development director. The team alleged the city had agreed to build a stadium in consideration for the team coming there to play. The city council approved the sale of bonds to finance the construction, and the city entered a contract with a construction firm to build the stadium. The team alleged that the mayor and director then decided not to pursue construction at the

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site but continued to misrepresent to the team and to the public that construction of the stadium would occur. Instead, according to the team, the city officials conspired with a local real estate developer to prevent the bonds from being issued, delay the construction, and relocate the stadium to a site where it would not be financially successful, all causing the team substantial economic losses. The mayor then allegedly publicly blamed the project delays on the team owing back rent. The team asserted breach of the construction contract against the city, alleging that it was a third-party beneficiary to the contract. The team also asserted causes of action against the city officials for fraud and civil conspiracy. The city's insurer brought a coverage action for a declaration that it had no duty to defend the city or the individuals against the team's suit.

The court considered the breach of contract and contractual liability exclusion in the policy's errors and omission coverage part. The exclusion barred coverage for:

Any "claim" arising directly or indirectly out of, or in any way related to liability assumed under any contract or agreement or breach of contract to which the insured is a party or a third-party beneficiary, or any representations made in anticipation of such contract or agreement or any "claim" against any insured arising directly or indirectly out of, or in any way related to tortious interference with a contract or business relations. However this exclusion does not apply to liability the insured would have in the absence of the contract or agreement.

The court found that the exclusion precluded coverage for the city because the alleged wrongful acts of the city were limited to and would not exist "but for" the breach of the construction contract—the only causes of action asserted against the city were for breach of contract and specific performance. However, the court opined that application of the exclusion to the fraud and conspiracy claims against the individual defendants was "less straightforward." The court determined that the exclusion did not conclusively bar coverage for the claims because the underlying complaint alleged numerous wrongful acts by the officials, including making disparaging statements about the team to the public, frustrating the issuance of the construction bonds, and relocating the stadium to an inferior site. None of this conduct, in the court's view, "relie[d] on a provision in the [underlying construction] Contract."

Although it is one of the first times a court applying Illinois law has considered a breach of contract or contractual liability exclusion in a professional liability policy, the court's analysis was not consistent with many courts around the country applying such exclusions, even when assessing an insurer's duty to defend. Where a claim is solely for breach of contract, as with the claim against the city here, courts have had little trouble finding that such exclusions preclude coverage. However, when the underlying complaint asserts causes of action beyond breach of contract, courts have come to differing conclusions.

The language of the contract-related exclusion in the city's policy was actually quite broad. It excluded claims "arising directly or indirectly out of, or in any way related to liability assumed under any contract ... or breach of contract." Some courts have held that tort claims, such as conversion, breach of fiduciary duty, or fraudulent inducement, are not precluded by such exclusions even though they are clearly related to the insured's contractual relationship with the claimant.[1] Other courts have concluded that such exclusions do bar coverage for tort claims arising out of an alleged breach of contract because such claims flow from or would

not exist but for the contractual relationship, even if the claims concern formation of the contract rather than the insured's manner of performance.[2] Perhaps to ensure judicial interpretation consistent with this latter line of cases, the exclusion in *City of Zion* also expressly excluded claims arising directly or indirectly out of, or in any way related to representations made in anticipation of a contract or the insured's tortious interference with a contract. However, the exclusion also contained a carve-out, commonly found in similar exclusions, excepting liability the insured would have in the absence of the contract or agreement.

The court concluded that the contract exclusion in *City of Zion* did not apply to the claims against the city officials because those claims alleged wrongdoing outside the scope of the city's construction contract and could arise in the absence of that contract. That is, the court applied a "but for" causation test—whether the alleged wrongful acts could have been asserted but for a breach of the stadium construction contract—that came up negative. The court agreed with the city officials' contention that the claims against them could have stood with or without the city's construction contract.

The court expanded on this reasoning when it later also determined that no coverage was available to the city under the policy's CGL coverage part because of the separate breach of contract exclusion in that section. The exclusion contained the same broad lead-in language as the parallel exclusion in the E&O coverage part—"arising directly or indirectly out of, or in any way related to"—but did not contain an exception for liability that would attach in the absence of a contract. The court interpreted "arising directly" and "in any way related to" broadly, finding that the "core factual allegations" of wrongdoing against the city plainly involved a breach of contract. In that regard, the court's analysis aligned with other Illinois cases interpreting "arising out of" lead-in language broadly, both in coverage grants[3] and in exclusions, [4] to require only "but for" causation.

Thus, on the one hand, *City of Zion* may serve as a reminder that contract-related exclusions might not be applied as written where an underlying claim is not pled solely on a contract-based theory of liability. On the other hand, the court's ultimate conclusion regarding the CGL policy was correct. The "but for" causation test remains a broad measure of whether a claim falls within an exclusion, and *City of Zion* does not foreclose the application of contract-related exclusions to other claims, even when determining the duty to defend.

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[1] *See, e.g.*, *Foodtown Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 412 F. App'x 502 (3d Cir. 2011) (contract exclusion did not apply to breach of fiduciary claim); *TranSched Sys. Ltd. v. Fed. Ins. Co.*, 958 F. Supp. 2d 331 (D.R.I. 2013) (contract exclusion did not apply to claims that insureds made misrepresentations before formation of contract); *McPeek v. Travelers Cas. & Sur. Co. of Am.*, No. 06-cv-114, 2006 WL 1308087 (W.D. Pa. May 10, 2006) (exclusion for claims arising out of any contract or agreement did not apply to fraudulent inducement claims that arose prior to contract).

[2] *See, e.g.*, *Spirtas Co. v. Fed. Ins. Co.*, 521 F.3d 833 (8th Cir. 2008) (applying contract exclusion to claims for breach of trust, conversion, and unjust enrichment because they "arose from" the contract); *Cousins Submarines, Inc. v. Fed. Ins. Co.*, No. 12-cv-387, 2013 WL 494163 (E.D. Wis. Feb. 8, 2013) (contract exclusion barred coverage for rescission claim); *Julio & Sons Co. v. Travelers Cas. & Sur. Co. of Am.*, 591 F. Supp. 2d 651

(S.D.N.Y. 2008) (contract exclusion barred coverage for breach of contract, fraud, and negligent misrepresentation causes of action, but not breach of fiduciary duty).

[3] *See, e.g.*, *Elec. Ins. Co. v. Nat'l Union Fire Ins. Co. of Pittsburgh*, 346 F. Supp. 2d 958, 966 (N.D. Ill. 2004); *Md. Cas. Co. v. Chi. & N. W. Transp. Co.*, 466 N.E.2d 1091, 1094 (Ill. Ct. App. 1984).

[4] *See, e.g.*, *Lemko Corp. v. Fed. Ins. Co.*, 70 F. Supp. 3d 905, 919 (N.D. Ill. 2014); *Citizens Ins. Co. of Am. v. Uncommon, LLC*, 812 F. Supp. 2d 905, 911 (N.D. Ill. 2011).