Crum & Forster Specialty Insurance Company v. DVO: The Importance of Critical Reading and Precise Drafting

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I. Introduction

We have all been there. We receive an insurance policy, either from the client or opposing counsel. The policy looks generally familiar. We glance at the insurance agreement to see if the facts alleged support a claim falling within the initial grant of coverage. We then quickly jump to the exclusions to see if the claim is excluded. Then, we shift our attention to the endorsements to see if one or more of them apply. From here, we reach a preliminary opinion as to coverage.

The fact that we constantly receive, and review policies makes the task of reading them critically even harder. Whenever we are asked to review a matter for coverage, however, it is critically important to guard against any tendency to assume that the policy's provisions are effective – especially when it comes to a consideration of the impact of endorsements on the coverage analysis. The safer course is to view the policy with a critical eye to see if there are potential issues. Whether you represent the carrier, the policyholder, or the claimant, a careful evaluation of the policy will allow you to provide the best advice to your client.

While there are many "standard" endorsements that have been construed by courts around the country, there are other endorsements that were drafted by or for a carrier for application to a specific policy. Sometimes these policy endorsements are well written and sometimes they are not.

The case of *Crum & Forster Specialty Ins. Co., v. DVO*[1] is a good example of the impact of a poorly written endorsement and the need to be a critical reader of insurance policies. At issue in *Crum & Forster* was the impact of a breach of contract exclusion contained in an endorsement that purported to preclude coverage for any liability of an insured for a breach of its contracts.

II. Background

DVO designs and installs anaerobic digesters.[2] DVO entered into a contract to design and build a digester and related equipment with WTE-S&S AG Enterprises, LLC ("WTE"). By way of background, an anaerobic digester "is designed to take manure produced at a dairy farm, and run it through a digester, where it is broken down into biogases, solid wastes and liquid wastes."[3] The produced biogas then flows into the digester through pipes to a generator and engine unit (a gen set) to produce energy.[4] Some of the energy produced is used to power the digester and excess energy is sold to a power company. In addition to these benefits, a digester owner can also receive revenue in the form of carbon credits which are monetized.[5]

DVO entered into a design-build agreement with "WTE"[6] which consisted of essentially two documents: (1) a Standard Form Agreement between Owner and Design/Builder on the Basis of a Stipulated Price ("Standard Form Agreement") and (2) the Standard General Conditions of the Contract Between Owner and Design/Builder.[7]

The Standard Form Agreement required DVO to provide professional services associated with the anaerobic digester, engineering, construction and

installation of the digester heating system, gas mixing system, and building interior plumbing and electrical work, digester startup, along with project management and administration.[8] The digester was designed and built along with the other necessary buildings and components. DVO was not the actual builder of the digester nor did it serve as the general contractor for the project.[9]

After the project's completion, punch lists were submitted to DVO containing claims of alleged construction and design errors associated with the project. At least one of the punch lists contained an estimate of the amount of the damages that the digester owner claimed resulted from DVO's breach of its contract.[10]

In August of 2013, WTE filed suit against DVO in state court for breach of contract.[11] The lawsuit alleged that DVO breached the contract for the construction of the anaerobic digester as it "did not properly design substantial portions of the structural, mechanical and operational systems of the anaerobic digester," which resulted in significant damages to WTE.[12] WTE sought over $2 million in damages and fees.[13] DVO denied the allegations and in the end, after trial, DVO was proven correct.[14]

DVO had purchased a package insurance policy that provided for primary and excess coverage from Crum & Forster.[15] The "package" included a Commercial General Liability Coverage Part, a Contractors Pollution Liability Coverage Part, an Errors and Omissions Liability Coverage Part, a Third Party Pollution Liability Coverage Part, an Onsite Cleanup Coverage Part, and excess liability coverage.[16]

Under the terms of the Errors and Omissions Policy, Crum & Forster had a duty to defend DVO as a result of "an act, error or omission in the rendering or failure to render" "functions performed for others by you … that are related to your practice as a consultant, engineer, architect, surveyor, laboratory or construction manager."[17] WTE's Complaint alleged that DVO was liable for damages caused by DVO's failure to "fulfill its design duties, responsibilities and obligations" in creating the anaerobic digester.[18] Designing and constructing the anaerobic digester are functions that fell within the definition of "professional services."[19] Professional services included engineering and construction management activities.[20] As an environmental engineering firm, DVO performed these activities for WTE. DVO's alleged failure to meet design requirements and alleged insufficient construction management met the definition of a "wrongful act."[21]

DVO tendered its defense to Crum & Forster. Crum & Forster initially defended DVO subject to a reservation of its rights.[22] While the lawsuit was still pending, however, Crum & Forster advised DVO that it would stop providing a defense.[23] On December 31, 2015, Crum & Forster unilaterally stopped paying for DVO's defense.[24]

Shortly thereafter, WTE filed for bankruptcy. [25] The WTE lawsuit was eventually transferred to the United States Bankruptcy Court for the Northern District of Illinois as an adversary proceeding.[26] The bankruptcy court held an eight day trial that resulted in an award in favor of WTE in the amount of $65,961.86.[27] The bankruptcy court later awarded attorneys' fees in favor of WTE in the amount of $198,000.[28]

During the pendency of the bankruptcy court's trial, Crum & Forster commenced a declaratory judgment action in the United States District Court seeking a declaration that it had no duty to defend or indemnify DVO under its Errors and Omissions Policy.[29] In particular, Crum & Forster argued that WTE's only claim against DVO was for a breach of contract and its policy contained an exclusion in an endorsement which excluded coverage for damages based upon or arising out of any breach of contract. Crum & Forster argued that this exclusion precluded any obligation to defend or indemnify DVO.[30] DVO opposed Crum & Forster's position, contending that the exclusion was broader than the grant of coverage thereby depriving DVO of any coverage under the policy.[31]

III. The District Court's Decision

The breach of contract exclusion was the issue before the District Court. The exclusion as set forth in the policy provided:

> This Policy does not apply to "damages", "defense expenses", "clean up costs", or any loss, cost or expense, or any "claim" or "suit" […] Based upon or arising out of [a] Breach of contract, whether express or oral, nor any "claim" for breach of an implied in law or an implied in fact contract, regardless of whether "bodily injury", "property damage", "personal and advertising injury" or a "wrongful act" is alleged.[32]

According to its terms, the exclusion excused Crum & Forster from defending and indemnifying DVO for any damages, or defense costs, clean up costs, or any other loss, cost, expense, claim or suit that was based upon or arose of out any type of contract, regardless of the offense or damage alleged.

Shortly after the commencement of the declaratory judgment action, Crum & Forster brought a motion for summary judgment on the efficacy of the breach of contract exclusion. The parties agreed that WTE's Complaint fell within the initial grant of coverage.[33] The parties also agreed that *if* the exclusion was valid, then it would apply to preclude coverage under the policy.[34] Since the claim fell within the initial grant, the next step under Wisconsin's coverage analysis was to examine the language of the exclusion to determine if it precluded coverage.[35]

Crum & Forster contended that the exclusion was valid as the WTE Complaint alleged that DVO breached its contract and WTE sustained damages as a consequence of that breach. DVO contended that the language of the exclusion was so broad as to preclude coverage under the errors and omissions policy, thus making it illusory coverage.

According to DVO, the Errors and Omissions policy obligated Crum & Forster to defend and indemnify DVO for any wrongful acts as that term was defined in the Policy. A wrongful act was defined in the Policy to include a failure to render "professional services." The Policy defined "professional services" as "those functions performed for others by you or by others on your behalf that are related to your practice as a consultant, engineer, [or] architect."

As a professional architectural and engineering firm, DVO argued that it has to enter into contracts with its clients to perform its "professional services".[36] Errors and omissions policies are designed to protect professional service firms like DVO for wrongful acts. "Professional liability coverage for architects and engineers, often referred to as 'errors and omissions' coverage, provides insurance principally for economic injury caused by the professional's failure to perform his contractual duties properly."[37]

The WTE Complaint alleged that DVO breached its contract when it "did not properly design substantial portions of the structural, mechanical and operational systems of the anaerobic digester."[38] While couched in terms of a breach of contract claim, the WTE Complaint alleged facts of professional negligence. Under Wisconsin law, the focus of liability is not the label attached to the pleading, but rather the underlying facts.[39] Given this, DVO argued that regardless of the theory of liability, the facts alleged were of professional malpractice.

Since the exclusion purported to exclude coverage for "damages," "claims" or "suits," which are "based upon or arising out of" and any breach of any type of contract, DVO contended that the exclusion went too far. As written, the exclusion took away whatever coverage was afforded to DVO under the initial grant of coverage. After all, "arising out of" is broadly construed under Wisconsin law, requiring only some causal relationship between the injury and the event not covered.[40] Since all of DVO's work is performed pursuant to a contract, any damages that result because of any alleged failure of its professional services to meet the requisite standard of care would necessarily arise out of a "breach of [its] contract."[41]

Building upon this point, DVO pointed out that every failure to perform a professional contract is a professional act or omission.[42] Thus, there are no acts, errors or omissions that could occur that would not arise out of a breach of contract.[43] As such, there could never be coverage under the Errors and Omissions Policy because the act, error or omission would always arise out of a breach of its contract. Hence, DVO argued that the exclusion created illusory coverage.[44] Simply put, there could never be coverage for its errors and omissions under the policy as promised by Crum & Forster.

The District Court disagreed with DVO. The District Court felt that DVO's reading of the breach of contract exclusion was "too broad."[45] Rather, the District Court concluded that the breach of contract exclusion simply reflected Crum & Forster's intention to insure "DVO against liability it incurred to third parties for its negligent error or omissions" and not DVO's liability to "its own customers for failing to meet its contractual obligations."[46] In support of its decision, the District Court relied upon *General Casualty Company of Wisconsin v. Rainbow Insulators* for the proposition that breach of contract exclusions do not render errors and omissions policies "meaningless."[47]

Thus, the District Court held that to the extent the Crum & Forster Policy was called upon to indemnify DVO for liability claims by third parties, the policy would apply.[48] The District Court held that to the extent that Crum & Forster's Policy was called upon to indemnify DVO for claims by its clients that DVO failed to live up to its contractual obligations, the Policy would not apply.[49]

The District Court also addressed DVO's argument that the Policy should be reformed to provide coverage for the types of claims asserted in the WTE Complaint. The District Court noted that Wisconsin law holds that reformation is an extraordinary remedy – one that should be applied sparingly.[50] As a remedy, reformation would be applied to reform the policy to meet the reasonable expectations of the insured.[51]

Here, in order to meet the reasonable expectation of DVO, the District Court concluded that the exclusion would not be eliminated as requested by DVO, but rather, would remain. The District Court concluded that a reasonable insured, by reading the language of the breach of contract exclusion, would understand that liability for breaches of contracts is not covered under the Crum & Forster Policy. Since the WTE Complaint was for breach of contract, the reasonable insured would not expect the Policy to provide coverage.

IV. The Seventh Circuit Court of Appeals' Opinion

DVO appealed. The United States Court of Appeals for the Seventh Circuit reversed the District Court's grant of summary judgment and remanded the matter for a determination of DVO's reasonable expectations of coverage.[52]

The Seventh Circuit succinctly identified the pivotal issue: "whether the language in that breach of contract exclusion renders the exclusion broader than the grant of coverage, and therefore renders the coverage illusory."[53] To answer this question, the Seventh Circuit first examined the District Court's decision.

According to the Seventh Circuit, the District Court concluded that the exclusion eliminated coverage for contract-based claims against DVO by its clients but did not exclude coverage for claims by third parties against DVO. Central to the District Court's decision was its conclusion that irrespective of any contract, DVO had a duty to third parties to exercise reasonable care in executing its contracts and as such, a third party could sue DVO for injuries or damages in absence of a contract.[54] Under this circumstance, coverage would be afforded to DVO for third party claims.

The Seventh Circuit disagreed with the District Court as the language of the exclusion did not support its conclusion. According to the Seventh Circuit, had the exclusion's language been more precisely drafted, it might have been able to

accomplish what the District Court concluded was the scope of the coverage under the Crum & Forster policy as limited by the exclusion. However, the language Crum & Forster did use in its policy was simply too broad to accomplish what the District Court concluded was the impact of the exclusion.

Because the exclusion contained the phrase "based upon *or arising out of,*" the scope of the exclusion necessarily encompassed claims other than those based upon contract. In order to trigger the exclusion's application, all that is necessary is that the "damages," "defense expenses," "clean up costs," loss, cost, expense, "claim" or "suit" be based upon or arise out of a breach of any type of contract, *i.e.*, a written, oral, or implied in fact or implied in law contract. If so, then the exclusion applied to bar coverage.[55]

Since the "arising out of" language was included in the exclusion, there need only be *some* causal relationship between the injury and the event not covered, and thus, the Seventh Circuit noted that claims of third parties would be precluded under the exclusion's application. As any of DVO's professional work would have to be performed pursuant a contract (even one implied by law), injuries or damages sustained by third parties would necessarily arise out of DVO's contractual breach with its client.[56] Thus, the Seventh Circuit concluded that the "breach of contract exclusion in this case rendered the professional liability coverage in the E&O policy illusory."[57]

The Seventh Circuit then addressed the reformation argument. DVO argued that the Policy was rendered illusory by the exclusion's impact, requiring reformation to be consistent with DVO's reasonable expectation of coverage. DVO argued that the exclusion should be stricken from the policy. The court noted that where a policy is to be reformed, the reformation must "meet an insured's reasonable expectation of coverage."[58]

In order to meet an insured's reasonable expectation of coverage, courts are to consider the intended purpose of the coverage purchased. As an errors and omissions policy, the policy's purpose is "to insure members of a particular professional group from liability arising out of the special risk such as negligence, omission, mistakes and errors inherent in the practice of the profession."[59] Accordingly, the Seventh Circuit concluded that the Policy must be reformed to meet DVO's reasonable expectations of coverage, arising out of negligence, omissions, mistakes and errors inherent in the practice of its profession.[60]

The Seventh Circuit remanded the case to the District Court for a determination of DVO's reasonable expectation of coverage under the Crum & Forster policy. In assessing this reasonable expectation, the focus on remand is to be on the reasonable expectation of coverage that was "upended by the breach of contract exclusion that rendered [the coverage] illusory."[61]

V. Takeaways

The takeaways from *Crum & Forster* are the need to carefully read a policy's language and to think about the precise language chosen to draft policy provisions. It would have been easy to simply read the exclusion and conclude that it barred breach of contract claims. Had the analysis stopped at that point, coverage would not have been afforded as DVO would not have contested Crum & Forster's position.

However, by considering the exclusion's exact language, in conjunction with the purpose of the policy and the intent of DVO in acquiring the policy, it became obvious that the exclusion "upended" DVO's reasonable expectation of coverage. As DVO performs its professional services through contracts, the broad scope of the exclusion took away the policy's promised coverage in the initial coverage grant – to defend and indemnify DVO for damages arising out of its wrongful acts – regardless of who asserted the claim.

As Judge Rovner pointed out, "The overlap between claims of professional malpractice and breach of contract is complete, because the professional

malpractice necessarily involves the contractual relationship."[62] Since the exclusion barred coverage for all damages, defense expenses, clean up costs, loss, cost or expense, claims and suits that are based upon or arise out of the breach of any type of contract, including those imposed by law, the exclusion simply reached too far, rendering the errors and omissions policy illusory.

The Seventh Circuit hinted at the possibility that had the exclusion been more artfully drafted, it might have been able to accomplish its purpose: "If more narrow language was used, the district court's determination that third-party liability would still be covered might have merit."[63] Had the exclusion delineated between covering third party claims but not client-based contract claims, then perhaps the exclusion could have accomplished what the District Court believed was Crum & Forster's intent in drafting the exclusion. With the additional language clarification, the exclusion would not have been "broader than the grant of coverage."[64]

The more precisely drafted exclusion was highlighted in the *Rainbow Insulators* case that Crum & Forster relied upon as support for its argument that breach of contract exclusions are valid and enforceable.[65] In *Rainbow Insulators*, the errors and omissions policy at issue contained a breach of contract exclusion, but that exclusion was not as all-encompassing as the one contained in the Crum & Forster Policy.

The General Casualty policy exclusion provided "damages arising out of any .. [d]elay or failure by you or anyone acting on your behalf to perform a contract or agreement in accordance with its terms."[66] By its terms, the exclusion did not bar all coverage. Rather, as the *Rainbow Insulators* court noted, the exclusion applied only where the was a delay or failure to perform a contact by the insured AND the damages arose out of that failure.[67] If the damages arose out of a contract, but did not involve a delay or failure to perform a contract, the exclusion would not apply.[68] In the Crum & Forster Policy, however, there was no exception to the exclusion's reach: as long as a contract is involved or related to the event to be excluded, the exclusion barred coverage.

Precise drafting of an exclusion was also highlighted in *Great Lakes Bevs., LLC v. Wochinski*.[69] One of the policies addressed in *Great Lakes* was issued by AMCO Insurance Company. The AMCO policy contained a breach of contract exclusion that barred coverage for personal and advertising injury "[a]rising out of a breach of contract, except an implied contract to use another's advertising idea in your 'advertisement.'"[70]

Significantly, AMCO's exclusion contained an exception. The exclusion would not apply if the breach of contract arose out of "an implied contract to use another's advertising idea in your 'advertisement.'"[71] Thus, the exclusion was not all-encompassing – it did not bar all coverage for breach of contract claims. Rather, it carved out an exception for a certain class of contracts – those that arose out of "an implied contract to use another's advertising idea in your 'advertisement'.

Since the AMCO exclusion did not bar all coverage, AMCO's policy was not illusory – coverage was triggered under some circumstances. This is the distinction between AMCO's exclusion and the Crum & Forster's exclusion. All that was necessary for the Crum & Forster exclusion to apply is for DVO's liability – tort or contract - to be based upon or arise out of any breach of any type of contract. There was no exception. Since DVO's "professional services" would always be performed pursuant to a contract, even "claims" for negligence (read malpractice) will be with the ambit of the exclusion's application as DVO's "professional services" will always "arise out" of or be "based upon" any type of contract. It is this lack of exceptions to the exclusion's application that made the Crum & Forster professional errors and omissions policy illusory.

VI. Conclusion

Critical reading and precise drafting of insurance policies are necessary if the policies are to meet

the reasonable expectation of coverage. After all, courts will not bind a carrier to risks that were not contemplated and for which the carrier was not paid a premium.[72] Likewise, courts "will not rewrite the contract to create a new contract to release the insurer from a risk that it could have avoided through more foresighted drafting of the policy." [73]

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42 Every contract contains a common-law duty to perform the contract with care, skill, reasonable expedience and faithfulness. *Colton v. Foulkes*, 259 Wis. 142, 146, 47 N.W.2d 901 (1951).
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49 *Id*.
50 *Id*. at 925.
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52 *Crum & Forster*, 939 F. 3d at 852.
53 *Id*. at 855 (7th Cir. 2019).
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WI 94, 293 Wis. 2d 410, 716 N.W.2d 822, 838) (noting that a claim based upon a negligent act for failure to adhere to professional standards is one sounding in negligence but arising in the context of a contract) and *Colton v. Foulkes*, 259 Wis. 2d 142, 146, 47 N.W.2d 910 (1951) (the contract creates the state of things which furnishes the occasion of the tort)).

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61 *Id.* at 859.

62 *Id.* at 857.

63 *Id*. at 855.

64 *Id*.

65 *Id.* at 856 (citing *General Casualty Co. of Wisc. v. Rainbow Insulators, Inc.*, 2011 WI App 58, 332 Wis. 2d 804, 798 N.W.2d 320 (Ct. App. 2011)).

66 *Id.*

67 *Id*. ("the 'contract' exclusion would not operate to preclude E&O policy coverage arising from a tort claim that involves conduct that is not a delay or failure to perform under a contract term.").

68 *Id*.

69 *Great Lakes Bevs., LLC v. Wochinski*, 2017 WI App 13, ¶4, 373 Wis. 2d 649, 892 N.W.2d 333.

70 *Id*. at ¶18.

71 *Id*.

72 *Davis v. Allied Processors*, 214 Wis. 2d 294, 301, 571 N.W.2d 692, 695 (Ct. App. 1997).

73 *Kremers-Urban Co. v. American Employers Ins. Co*., 119 Wis. 2d 722, 743-44, 351 N.W.2d 156 (1984).