

Insurer Must Advance Defense Costs Despite Rescission of Policies

March 2004

A New York trial court has held that an insurer that issued D&O and fiduciary liability policies to Tyco International Ltd. must advance defense costs to former CEO Dennis Kozlowski even though the insurer had rescinded the policies based on material misrepresentations and omissions made to the insurer in application. *Fed. Ins. Co. v. Tyco Int'l Ltd.* (N.Y. Sup. Ct. Mar. 5, 2004).

The insurer issued a series of D&O and fiduciary liability policies to Tyco from March 15, 1999 through March 15, 2003. The fiduciary policy required the insurer to defend the insureds in covered litigation; the D&O policy required the insurer to advance defense expenses for covered claims. Both policies contained a personal profit exclusion precluding coverage for loss "based upon, arising from, or in consequence of such [insured] having gained in fact any personal profit, remuneration or advantage to which such [insured] was not legally entitled."

Subsequently, Tyco officers and directors were named as defendants in numerous lawsuits alleging liability for misstatements about the company's finances, misrepresentations in SEC filings and the misappropriation of hundreds of millions of dollars through improper bonuses and interest-free loans. Kozlowski sought coverage for the ERISA litigation, the securities litigation and a criminal indictment. Many of the plaintiffs' allegations were confirmed in Form 8-K filed by the company on September 8, 2002, which disclosed that Kozlowski and other officials had misappropriated more than \$700 million in Tyco funds. The 8-K also stated that "[d]uring at least the five years prior to June 3, 2002, Tyco's three top corporate officers—its CEO, its CFO and its Chief Corporate Counsel—engaged in a pattern of improper and illegal conduct by which they enriched themselves at the expense of [Tyco] with no colorable benefit to [Tyco] and concealed their conduct from the Board and its relevant committees."

On February 13, 2003, subsequent to Tyco filing the Form 8-K, the insurer wrote a letter to Tyco that tendered the premium and notified the company that it was rescinding the policy then in effect "based upon material misrepresentations and omissions in the information that [the insurer] relied upon in issuing and extending the Policy." The letter noted that the underwriters had relied on various SEC filings that the company now conceded were inaccurate. The same day it sent the letter, the insurer filed a declaratory judgment action against Kozlowski, Tyco and 14 other defendants. It subsequently amended the complaint to drop its claims except as to Kozlowski and three other defendants. Kozlowski filed a motion for a declaration that the insurer

had a duty to defend and advance defense costs under the policies, notwithstanding the rescission.

The trial court agreed with Kozlowski, concluding, with little explanation, that "until [the insurer's] rescission claims are litigated in its favor and the Policies are declared void *ab initio*, they remain in effect and bind the parties." While noting that there was little law on this issue in New York, the court pointed to decisions from other jurisdictions. The court did note that if the insurer were to prevail in its lawsuit and obtain a declaration that the policies were void *ab initio*, it "may" be able to recover the defense costs it had previously reimbursed.

The court also held that the insurer was required to defend Kozlowski or reimburse his defense costs for each of the matters notwithstanding the personal profit exclusion. The court reasoned that each of the matters contained at least some allegations of wrongful acts that were not based on allegations of personal profit.

For more information, please contact us at 202.719.7130.