

Prior Knowledge Exclusion Is Non-Severable under New York Law

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A United States District Court has held that, under New York law, a prior knowledge exclusion in an excess carrier's policy is non-severable and that the knowledge of the CEO of the insured company may be imputed to all insureds. *Axis Reinsurance Co. v. Bennett*, 2008 WL 2485388 (S.D.N.Y. Jun. 19, 2008). The court held that other severability provisions in the primary policy did not apply to the prior knowledge exclusion in the excess policy.

The insurer issued an excess directors and officers liability policy to Refco, Inc. that incepted in August 2005. Refco entered bankruptcy in October 2005. Numerous criminal and civil proceedings were filed against Refco's directors and officers. In February 2007, Refco's former CEO pleaded guilty to knowingly making false statements in Refco's financial statements.

The insurer denied coverage for the underlying lawsuits citing, among other things, a warranty statement and a prior knowledge exclusion. The warranty statement provided that "[n]o person(s) or entity(ies) proposed for this insurance is cognizant of any fact, circumstance, situation, act, error or omission which he/she/it has reason to suppose might afford grounds for any Claim, as such term is defined within the Policy, such as would fall within the scope of the proposed insurance." The policy also contained a prior knowledge exclusion that provided that "[i]n consideration of the premium charged, it is agreed that this Policy does not respond to Claims based upon, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving any fact, circumstance, situation, transaction or event, which as of the inception date of the Policy Period, any Insured had knowledge and had reason to suppose might give rise to a Claim that would fall within the scope of the insurance afforded by this Policy."

After the insurer instituted coverage proceedings, the directors and officers filed counterclaims and moved for summary judgment, contending, *inter alia*, that the warranty statement was not applicable to the policy at issue and that the insurer had improperly appended the prior knowledge exclusion to the policy. In addition, the directors and officers argued that, even if the warranty statement and exclusion were part of the policy, severability provisions in the primary policy made the warranty and exclusion fully severable.

The court held that fact issues precluded summary judgment as to the questions of whether the warranty

statement and prior knowledge exclusion properly were part of the policy at issue.

However, the court rejected the directors' and officers' argument that certain provisions in the primary policy operated to render the warranty statement and prior knowledge exclusion severable, assuming they were part of the policy. The insureds had pointed to language in the exclusions section of the primary policy form that stated that "[f]or purposes of determining the application of the above EXCLUSIONS, no Wrongful Act of any Insured Person will be imputed to any other Insured Person who did not have actual knowledge of, or directly participate in the commission of, such Wrongful Act." The court rejected the argument that this language applied to the excess insurer's warranty statement and prior knowledge exclusion because those provisions were not part of the "above" exclusions in the primary policy form. Second, the insureds had argued that the primary policy contained an endorsement titled "Full Severability" that read as follows: "[t]he Insureds represent that the particulars and statements contained in the Application are true, accurate and complete and are deemed material to the acceptance of the risk assumed by the Insurer under this Policy. This Policy is issued in reliance upon the truth of such representations. No knowledge or information possessed by any Insured will be imputed to any other Insured. If any of the particulars or statements in the Application is untrue, this Policy will be void with respect to any Insured who knew of such untruth." The court held that, read in its entirety, the endorsement clearly was intended to limit the insurer's remedy only with respect to misrepresentations in the application, and it therefore was inapplicable to the insurer's potential remedies based on the warranty statement and prior knowledge exclusion. Additionally, the court stressed that the warranty statement and the prior knowledge exclusion provided that the knowledge of "any Insured" would suffice to bar coverage for all insureds, thus undermining the insureds' contention that the provisions were severable. Accordingly, because neither severability provision applied, the court held that the CEO's knowledge could suffice to trigger the warranty statement and the prior knowledge exclusion and bar coverage for all insureds.