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NEWSLETTER

Severability Provision in Primary Policy Inapplicable To Excess Policy Prior Knowledge Exclusion

April 2010

Applying New York law, the United States Court of Appeals for the Second Circuit has summarily affirmed the district court's summary judgment ruling that prior knowledge exclusions in policies issued by two excess carriers barred coverage for all insureds despite a severability provision in the primary policy. *Murphy v. Allied World Assur. Co., Inc.*, No. 09-1362-bk, 09-1365-cv (2d Cir. Mar. 23, 2010). Wiley Rein LLP represented one of the excess carriers.

The insurers issued excess directors and officers liability policies 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. Citing the CEO's guilty plea, the excess insurers denied coverage on the basis of prior knowledge exclusions in their respective policies that barred coverage where, prior to the inception of the policies, "any insured" had knowledge of facts and circumstances that might give rise to a claim.

The district court granted summary judgment to the insurers. The court rejected the directors and officers' argument that a severability provision in the primary policy barring the imputation of knowledge among insureds applied. The court held that, assuming the severability provision applied to exclusions as well as to rescission, the "any insured" language in the excess policy prior knowledge exclusions trumped the non-imputation language in the severability provision. On appeal, the Second Circuit affirmed, agreeing that "the words 'any insured' unambiguously preclude coverage for innocent co-insureds," and that, to the extent the "language in the excess policies cannot be reconciled with the severability provision of the underlying policy, the language in the excess policies controls."

The district court also rejected the directors and officers' argument that the prior knowledge exclusions did not bar coverage for all of the underlying lawsuits that had been filed against them. The insureds contended that the underlying lawsuits contained multiple causes of action, not all of which could be construed as "arising out of" the facts and circumstances of which the CEO admitted having knowledge. The district court held that the policies defined a "claim" as a lawsuit and therefore it was sufficient to demonstrate a nexus between the

CEO's knowledge and each lawsuit as a whole. The Second Circuit affirmed, noting that, under New York law, the phrase "arising out of" is broadly construed and that the insurers had demonstrated a sufficient nexus between each claim and the CEO's knowledge.