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NEWSLETTER

"Innocent Insureds" Provision Does Not Bar Rescission

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The United States District for the Southern District of New York court has denied a policyholder's motion to dismiss a rescission suit, holding that the "innocent insureds" provision in the policy did not preserve coverage for an insured person uninvolved with material misrepresentations in the policy application. *Cont'l Cas. Co. v. Marshall Granger & Co., LLP*, 2013 WL 372162 (S.D.N.Y. Jan. 31, 2013). Wiley Rein LLP represented the carrier in this matter.

The policyholder accounting firm purchased a professional liability policy but did not disclose on the application any knowledge of circumstances that might give rise to a claim. Shortly after the policy issued, the Securities and Exchange Commission filed an emergency enforcement action against the principal officers of the accounting firm, alleging that they had sold over $2 million worth of fictitious stock and promissory notes, some to clients of the accounting firm. The policyholder later sought coverage for claims by clients who had lost money in connection with the investments. The carrier denied coverage and filed suit seeking rescission of the policy.

An individual insured who had not signed the application moved to dismiss the rescission suit as to himself on the basis of an "innocent insureds" provision in the policy. The "innocent insureds" provision stated that "if coverage under this Policy would be excluded as a result of any criminal, dishonest, illegal, fraudulent or malicious acts of any of you, we agree that the insurance coverage that would otherwise be afforded under this Policy will continue to apply to any of you who did not personally commit, have knowledge of, or participate in such criminal, dishonest, illegal, fraudulent or malicious acts or in the concealment thereof from us."

In denying the motion, the court distinguished cases relied upon by the insured by noting that those cases interpreted policies that specifically provided that misstatements in the policy application would not be attributed to other insured persons. The policy at issue did not contain such severability language, the court noted, and the sophisticated policyholder could have bargained for the inclusion of a severability clause. The court further observed that the "innocent insureds" language "mirrors that of the Policy's 'bad acts' exclusion," and "kicks in only where coverage would otherwise be disclaimed under the bad acts exclusion." The court also rejected the policyholder's argument that the innocent insureds provision's reference to concealment "from us" referred to concealment on the policy application, noting that the policy required written notice in

connection with claims and potential claims and cooperation with the carrier, situations in which an insured person's concealment of information could jeopardize coverage.

The court observed that its reasoning was in harmony with courts in other jurisdictions that considered similar arguments, citing, among others, Fourth and Eleventh Circuit cases in which Wiley Rein represented carriers in similar rescission actions.