

Intentional Misrepresentation Claim Within “Liable in Absence of Contract” Carve-Back to Contract Exclusion; Fraud of VP and Chief Technology Officer Not Imputed to Company Under Severability Provision

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The United States District Court for the District of Rhode Island has held that a policy's contract and fraud exclusions did not bar coverage for a jury award on a claim for intentional misrepresentation because 1. the contract exclusion contained a carve-back for liability that would have existed in the absence of the contract and 2. the fraudulent acts of the company's vice president and chief technology officer could not be imputed to the company under the policy's severability clause. *TranSched Sys. Ltd. v. Fed. Ins. Co.*, 2013 WL 3974143 (D.R.I. Aug. 2, 2013).

In 2011, TranSched Systems obtained a favorable verdict in its action against an insured company for breach of contract and intentional misrepresentation related to a 2005 asset purchase agreement entered into by the two companies. The defendant company's insurer, which had provided a defense to the underlying action, denied any duty to indemnify the award against its insured pursuant to the policy's fraud and contract exclusions. TranSched then filed suit against the insurer seeking coverage for the jury award and damages for statutory and/or common law bad faith. The insurer moved to dismiss the action, arguing 1. that there was no indemnity coverage for the award and 2. that the plaintiff's bad faith claims were improper because it was neither an insured nor an assignee of the insured.

Examining the policy exclusions at issue, the court held that the plaintiff sufficiently pleaded a claim for coverage. Although the policy excluded coverage for the breach of contract claim in the underlying action, the court held that the intentional misrepresentation claim was not excluded because a carve-back to the policy's contract exclusion provided that the exclusion did not apply “to the extent that an Insured Organization would have been liable in the absence of the contract or agreement.” The court held that sufficient facts were alleged to find that some of the underlying conduct and liability related to misrepresentations that occurred before the contract existed and that the exclusion thus did not bar coverage for the misrepresentation claim. The court separately held that the fraud exclusion did not bar coverage for

the insured company because the exclusion applied only to “any deliberately fraudulent act or omission’ by ‘such Insured,’” and the conduct of the company’s vice president and chief technology officer could not be imputed to the company under the policy’s severability clause, which provided that only “facts pertaining to” the company’s chief executive officer, chief financial officer, president, or chairperson “shall be imputed to” the company.

Finally, holding that Rhode Island law was unclear as to whether the claimant in the underlying proceeding could bring a claim for bad faith against an insurer on a theory of “equitable assignment,” the court declined to rule on the insurer’s motion with respect to the bad faith claims. Instead, the court stayed the bad faith claim until coverage for the underlying claims has been determined.