CHAPTER 1

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Policy Issuance

Introduction

The main challenge for any insurer selling directors and officers (D&O) liability insurance is to understand the risk and to prepare terms commensurate with the risk assessed. That task is more important than it has ever been given the trend toward increasing exposure to corporate entities and their representatives arising from the insured's conduct. The D&O policy application process marks an important point in the relationship intended to allow the insurer to fully understand a prospective insured's business and the potential risks.

Applications for D&O coverage generally include questions about the insured's knowledge of claims or circumstances that may give rise to a claim during the D&O policy period. This information is critical to the underwriter's ability to understand the prospect and decide whether to offer coverage. In addition to the application, an insurer may require the insured to submit copies of its most recent financial statements or annual reports. If an insured fails to disclose a known claim or circumstance, or submits inaccurate or incomplete financials, coverage may be barred. Depending on the application and policy wording, an insurer may be entitled to disclaim coverage for any claim arising out of material facts the insured misrepresented or failed to disclose (and retain the premium) or rescind the policy. Depending on the applicable law and wording in the application and the policy, such a result may be limited to the individual who had the knowledge that was misrepresented or withheld, but not as to any other insureds under the D&O policy.

A. Application (New and Renewal); Incorporation of Additional Materials

While questions on an insurance application would most likely be viewed as inherently material to an insurer's decision to underwrite a risk, separate documents are often provided by an insured in connection with its application, particularly financial information. A frequent question in such instances is whether documents accompanying an application are considered a part of it. In some instances, an insurer may rescind a policy if the application incorporates the accompanying information or if the information is an integral part of the application. Indeed, renewal applications that refer to prior information provided may also be susceptible to subsequent challenges. Ultimately, the impact of such documents in the underwriting process will be examined on a case-by-case basis to determine if any relief to the insurer is available.

United States Liability Ins. Co. v. Kelley Ventures, LLC, No. 14-62840-CIV, 2015 WL 5827903 (S.D. Fla. 2015). The insurer sought rescission based on the insured's material misrepresentation that no entity or person for the proposed insurance was aware of any fact, circumstance, or situation that may result in a claim in a policy application. Before applying, the insured received multiple notifications from a member of its LLC threatening suit and demanding payment of a cash distribution. After the policy was issued, the insured received further correspondence containing a complaint, which was subsequently filed in Florida state court. The insurer attempted to rescind the policy and moved for summary judgment. The court denied the motion, finding a dispute of fact as to whether the insured materially misrepresented in the policy application because it was unclear whether the prior notifications were directed at the insured or a related, uninsured entity.

Continental Casualty Co. v. Piggly Wiggly Alabama Distributing Co., Inc., No. 2:13–cv–00607, 2015 WL 4426030 (N.D. Ala. 2015). The court noted an insurer, under certain circumstances, may be entitled to rescind a *renewal* insurance policy based on misrepresentations that are made during the negotiations for its *original* insurance application. The plain language of Alabama's statute states that misrepresentations made in "negotiations" for an insurance policy may serve as the basis for rescission.

TIG Ins. Co. of Michigan v. Homestore, Inc., 40 Cal. Rptr. 3d 528 (Cal. Ct. App. 2006). The insurer issued an excess D&O policy, relying on a falsified financial report, and later sought to rescind the policy following the filing of criminal and civil suits against the insureds. Applying California law, the court ordered rescission, concluding that the grossly misrepresented financial report "was material to the acceptance of the risk as a matter of law."

National Union Fire Ins. Co. of Pittsburgh, Pa. v. Xerox Corp., 792 N.Y.S.2d 772 (N.Y. Sup. Ct. 2004), *aff'd,* 807 N.Y.S. 2d 344 (N.Y. App. Div. 2006). An excess insurer sought to rescind its policy under New York law based on its alleged reliance on the insured's fraudulent financial statements. The court ruled in the insured's favor because the complaint failed to plead that the insured induced the insurer to rely on the financial statements. The insured had not submitted any application for coverage. Therefore, the insurer could not demonstrate reliance upon the financial statements not part of the application.

ClearOne Communications, Inc. v. Lumbermens Mutual Casualty Co., No. 2:04-CV-00119, 2005 WL 2716297 (D. Utah Oct. 21, 2005), *aff'd,* 494 F.3d 1238 (10th Cir. 2007). Applying Utah law, the court held that an insurer was entitled to rescind a D&O policy issued based on material misrepresentations made in financial statements during the negotiation of coverage. The application at issue provided that "[a]ll written statements and materials furnished to the insurer in conjunction with this application are hereby incorporated by reference into this application and made part hereof." In this instance, the insurer specifically asked for the insured's financial statements, and the insured's broker directed the insurer to pull all pertinent documents from the Internet. The insurer established that it had carefully considered the insured's financial statements, which were subsequently restated.

Humane Society of the U.S. v. National Union Fire Ins. Co. of Pittsburgh, Pa., No. 13-1822, 2015 WL 4616818 (D. Md. July 30, 2015). The insured did not disclose a preexisting claim in its insurance application for a D&O policy, which contained an exclusion of coverage for claims that would fall within questions on the application concerning such

prior claims. The court found the question and the exclusion to be ambiguous. In the question about prior claims, the term "entity liability matter" was unclear and the exclusion, purporting to bar coverage for any claim responsive to the prior claim question, rendered the question meaningless since irrespective of the insured's response, all prior claims would be subject to the exclusion.

Federal Ins. Co. v. Homestore, Inc., Nos. 03-55995, 03-55996, 2005 WL 1926483 (9th Cir. Aug. 12, 2005). Applying California law, insurers were entitled to rescind D&O policies due to misrepresentations made in SEC filings submitted with an application for coverage. The policies made clear that the information and statements in the application, as well as materials submitted to the insurers, would be considered attached to and part of the application, that this information was the basis of the policy, and that it was considered as incorporated and constituting a part of the policies.

Georgia Cas. & Surety Co. v. Valley Wood, Inc., 336 Ga. App. 795 (2016). The application for a crime policy contained misrepresentations that its records were audited by a certified public accountant and that it required countersignatures on checks. The application was never signed or seen by the insured's principle and was submitted by the insured's broker to the insurer. Since the agency was authorized to procure insurance for the insured, the insured is bound by any misrepresentations in the application even if it is unsigned.

Cutter & Buck, Inc. v. Genesis Ins. Co., 306 F. Supp. 2d 988 (W.D. Wash. 2004), *aff'd,* No. 04-35218, 2005 WL 1799397 (9th Cir. 2005). Applying Washington law, an insurer was entitled to rescind the policy even though false financial documents submitted by the insured were not physically attached to either the application or the policy. The language of the policy and application confirmed that all submitted materials were part of the application and that they would be relied upon.

In re Healthsouth Corp. Insurance Litigation, 308 F. Supp. 2d 1253 (N.D. Ala. 2004). Excess insurers sought to rescind coverage under D&O policies, alleging that the insured used materially false and misleading financial information to procure coverage. The primary insurer had issued policies to the insured company since September 1993. However, the insured had not been required to submit an application for the policy at issue, and had not submitted applications for coverage since 1994. Under Alabama law, the primary policy's severability clause narrowed the basis for rescission to representations made in the written application. The insurers could not claim reliance upon financial information not mentioned in the application or the policy. Notably, however, one of the excess insurers was allowed to proceed with its rescission efforts because the wording of its policy confirmed that it was relying on all statements and information provided, including financial documents obtained from the insured or from public sources.

American International Specialty Lines Ins. Co. and National Union Fire Ins. Co. of Pittsburgh, Pa. v. Towers Financial Corp., 198 B.R. 55 (S.D.N.Y. 1996). The court allowed rescission of a D&O policy because the insured had materially misrepresented its financial situation in the insurance application. The application required that the insured provide its latest annual report and financial statements, and also confirmed that these documents were "hereby incorporated by reference into this application and made part thereof."

International Ins. Co. v. W.P. McMullan Jr., No. J84-0760(W), No. J84-0760, 1990 WL 483731 (S.D. Miss. 1990). Following the collapse of a Mississippi bank, the FDIC filed claims against the bank's D&O insurer. The insurer sought to rescind a renewal policy on

the basis of misrepresentations and omissions regarding self-dealing by the bank's chairman and concerns regarding the bank's solvency. On behalf of the bank, its chairman apparently included detailed financial disclosures about the bank in a "long-form" application submitted with the original policy. The bank's application for the renewal policy merely required a "short-form" application that did not request the financial information. The FDIC argued that, in issuing the renewal policy, the insurer could not have relied on the financial information contained in the application for the original policy because the renewal application did not ask for the same representations as the original application. The court rejected this argument; the renewal application stated both proposals were to be considered as the basis for the contract, and the renewal application incorporated the representations in both the renewal and original applications.

H.J. Heinz Co. v. Starr Surplus Lines Ins. Co., 675 F. App'x 122 (3d Cir. 2017). The insured attached a loss history spreadsheet and loss ratio analysis to its application for product liability insurance. The loss history disclosed only one loss over ten years greater than the requested retention of $5 million. The insurer concluded that the $5 million retention was appropriate. Subsequently, the insurer learned that in fact the insured sustained three losses exceeding the $5 million retention. The court found the misrepresentations on the spreadsheet were of such magnitude that they deprived the insurer of its freedom of choice in determining whether to accept or reject the risk.

B. Policy Exclusions for Claims or Circumstances Known by the Insured at the Inception of Coverage

Separate and apart from seeking to rescind the policy altogether, an insurer may be entitled to exclude claims or circumstances known by the insured before the policy incepted, but that were not disclosed. Liability policies typically contain exclusions for acts the insured knew or reasonably believed would result in a claim under the policy. Establishing the applicability of an exclusion may be a more straightforward undertaking than seeking to rescind a policy altogether. Further, applying an exclusion would not impact the insurer's right to retain the premium earned as the policy would remain in place.

1. Claims Arising from Known, Disclosed Information

Clark School for Creative Learning, Inc. v. Philadelphia Indemnity Ins. Co., 734 F.3d 51 (1st Cir. 2013). An insured brought this appeal to compel coverage for the costs and settlement of a claim arising from circumstances disclosed to the insurer in the application. The policy contained a provision regarding policy exclusions for known circumstances relating to the financial statements, specifically those that ultimately led to the claim at issue. The court affirmed the district court's decision in favor of the insurer. The plain language of the "Known Circumstances Exclusion" allowed the insurer to exclude the insured's claim from coverage.

F/H Industries, Inc. v. National Union Fire Ins. Co. of Pittsburgh, Pa., 635 F. Supp. 60 (N.D. Ill. 1986), *vacated in part,* 116 F.R.D. 224 (N.D. Ill. 1987). An application for D&O insurance asked whether any of the applicant's directors or officers knew of any act, error, or omission that might give rise to a claim under the proposed policy. In the application, the insured disclosed circumstances that could have, and ultimately did, give rise

to a claim. The insurer denied coverage for the claim under a provision of the application that stated "if such knowledge or information exists any claim or action arising therefrom is excluded from this proposed coverage." Applying Illinois law, the court concluded that the exclusion unequivocally precluded coverage for claims arising out of known circumstances, whether or not those circumstances were disclosed in the application.

2. Claims Arising from Known, Undisclosed Information

Admiral Ins. Co. v. SONICblue Inc., No. 07-4185, 2009 WL 2512197 (N.D. Cal. 2009). Failure to disclose a letter from a state investment board warning that the conduct of certain D&Os amounted to a breach of their fiduciary duties that might result in litigation constituted a material misrepresentation in policy application entitling insurer to rescission of the policy.

In re Healthsouth Corp. Insurance Litigation, 308 F. Supp. 2d 1253 (N.D. Ala. 2004). Under Alabama law, an insurer can rescind a policy or exclude specific coverage if the insured made misstatements or omissions in the policy application or during negotiations relating to the issuance of the policy.

Federal Deposit Ins. Corp. v. Duffy, 47 F.3d 146 (5th Cir. 1995). Pursuant to Louisiana's direct action statute, the FDIC sued a law firm and its professional liability carrier to recover judgments entered against the firm for malpractice and breach of fiduciary duty in connection with its representation of a savings and loan. The insurer sought to void the policy given material misrepresentations in the application. The application inquired about prior acts that the insured believed might fall within the scope of the proposed coverage. The insurer claimed, because a judgment for malpractice and breach of duty had been entered against a partner of the law firm, the applicant (defined as all lawyers in the firm) was aware of prior acts that might lead to a claim. The district court held that the policy was void because the law firm did not disclose the prior acts in the application. The Fifth Circuit affirmed.

National Union Fire Ins. Co. of Pittsburgh, Pa. v. Federal Deposit Insurance Corp., No. 03A01-9405-CH-00179, 1995 WL 48462 (Tenn. Ct. App. Feb. 8, 1995). A bank president signed an application for D&O insurance stating that, to the best of his knowledge, no director or officer had "knowledge or information of any act, error, or omission which gives rise to a claim under the proposed policy." The application also provided that any claim or action arising from such knowledge would be excluded. The insurer denied coverage for regulatory claims on the basis of the applicant's failure to disclose the massive undercapitalization of the failed bank. The FDIC challenged the denial of coverage as the bank's receiver. The FDIC contended that there was no misrepresentation because the president had no personal knowledge of any misstatements. The court disagreed. In the application, the president represented he had inquired into the truthfulness of all statements. Because many D&Os knew of the facts giving rise to the claim, the president had made misrepresentations on behalf of the bank in the policy application. Further, even if the president had no personal knowledge of the bank's condition, the application excluded any claim about which any director or officer had knowledge or information.

National Union Fire Ins. Co. of Pittsburgh, Pa. v. Continental Illinois Corp., 643 F. Supp. 1434 (N.D. Ill. 1986). Insurers sought to disclaim D&O coverage for numerous stockholder derivative actions alleging that the renewal applications falsely asserted that

the insured had no knowledge of circumstances likely to result in claims. Pursuant to an assistance agreement, the FDIC brought a motion for judgment on the pleadings on behalf of the insured. Applying Illinois law, the court granted the FDIC's motion. The original application for coverage was submitted in 1969 and later supplemented in 1981. Because the supplemental application simply incorporated the 1969 application by reference and did not require the insured to disclose circumstances that could give rise to claims after 1969, the court found that the insured was required only to reaffirm the truth of the statements in its 1969 application. The insured had no obligation to disclose later circumstances that suggested a potential claim.

Axis Reinsurance Co. v. Bennett, Nos. 07-7924, 08-3242, 2008 WL 2485388 (S.D.N.Y. June 19, 2008). Insurers sought to disclaim D&O coverage on several bases, including the CEO's failure to answer an application question asking whether any proposed insured was "aware of any fact, circumstance or situation involving . . . any Insured Person . . . which he has reason to believe might result in a claim being made." The court found that the insurer's issuance of the policy constituted a waiver to any objection to coverage based on the officer's failure to answer because the insurer did not challenge the omission of an answer to this question.

KitBar Enterprises, LLC v. Liberty Ins. Underwriters, Inc., 291 F. Supp. 3d 758 (E.D. Va. 2018). The insured omitted knowledge of a complaint by a former partner on its application for D&O insurance in response to questions about whether it had any knowledge of claims or facts and circumstances. The court rejected the insured's argument that since it did not have the requisite knowledge as of the inception date of the policy, which preceded the date of the application, coverage should not be barred. The only relevant date for purposes of the insured's knowledge, the court held, is the date of the application, which tests the insured's "present" knowledge of any claims. The court further rejected the insured's waiver argument in holding that an insurer need not repeatedly reserve its rights in every correspondence with its insured as such a requirement would be "nonsensical."

LA Sound USA, Inc. v. St. Paul Fire & Marine Ins. Co., 67 Cal. Rptr. 3d 917 (Cal. Ct. App. 2007). The insured's false denial of a specific application question regarding its participation in a joint venture entitled the insurer to rescind the policy, despite the insured's contention that the misrepresentation was immaterial, unintentional, and resulted from broker error. An insurer's demand for answers to specific questions in an application for insurance is, in itself, sufficient to establish materiality. Further, misstatement or concealment of material facts on an insurance application is grounds for rescission, even if unintentional.

C. Rescission

1. General Considerations

Generally, state common and/or statutory law allow an insurer to rescind an insurance policy based on the insured's misrepresentation or omission of a material fact. The insurer would need to establish a misrepresentation or omission (concealment) of a material fact that it relied on in issuing the policy—such that had it known the true facts, it would not have issued the policy on the terms made.

In most states, an insurer is not required to show that the insured had fraudulent intent, particularly as to affirmative misrepresentations, in contrast to a concealment where scienter would

be relevant. However, some states may require that an insurer produce a separate warranty given by the insured as to the truth of the information provided, before that insurer may rescind on the basis of an innocent misrepresentation.

The test of materiality is evidence showing that had the insurer known the truth, it would not have issued the policy on the same terms and conditions, or for the same premium based on the incomplete facts. Thus, an insurer need not demonstrate that it would not have issued a policy at all absent the misrepresentation or omission, but rather that it would not have issued the policy on the same terms, had it known the truth.

In general, an insurer is not required to investigate or corroborate the information provided by an applicant. If, however, an insurer knows of information that would put a prudent person on notice that further inquiry is likely needed to reveal the truth, the insurer would be under an obligation to investigate further.

Unencumbered Assets Trust v. Great American Insurance Co., 817 F. Supp. 2d 1014 (S.D. Ohio 2011). Due to extensive publicity about the falsification of one company's financial statements and its subsequent collapse into bankruptcy, the court ruled that a genuine issue of material fact existed as to whether the insurer knew this information at the time that it accepted payment for an additional period of coverage, and thereby waived its right to rescind the policy.

Scottsdale Ins. Co. v. Wave Technologies Communications, Inc., 341 F. App'x 569 (11th Cir. 2009). The insurer filed suit seeking a declaration allowing it to rescind its general liability insurance policy because the insured had made material misrepresentations on its application. The insured allegedly misrepresented that its business operations did not involve digging or use of heavy equipment. The insurer stated that it would have charged a substantially higher premium or not issued the policy at all had it known. The insured argued that the insurer was barred from rescinding the policy because they had failed to investigate the representations on the application after conducting a liability survey that revealed facts suggesting the need for further investigation. The trial court granted summary judgment in favor of the insurer. On appeal, the Eleventh Circuit vacated and remanded, noting that an intentional misrepresentation by an applicant of a material fact allows the insurer to void a policy under Florida law. However, the panel held that if the insurer "has sufficient indications that would have put a prudent man on notice and would have caused him to start an inquiry which, if carried out with reasonable thoroughness, would reveal the truth, he cannot blind himself to the true facts and choose to 'rely' on the misrepresentation."

Napoliello v. Metropolitan Life Ins. Co., No. 05-5534, 2008 WL 2557540 (D.N.J. 2008). The insurer rescinded a life insurance contract claiming the deceased insured had failed to disclose past malignant melanomas in a renewal application. The deceased insured's beneficiaries filed suit, seeking payment in full under the policy. The beneficiaries contended that the deceased insured's treatment for melanoma was disclosed in his application for the previous policy, and therefore the insurer had knowledge of conflicting information, triggering its duty to investigate the insured's medical history. Applying New Jersey law, the court granted the insurer's motion for summary judgment, concluding that, because the present application stated that it would be the only basis for coverage, the insurer had no duty to review its files to identify and assess information in prior insurance

applications: "the fact that [the insurer] had the capacity to discover the truth on its own does not cure the misrepresentations made on [the insured's] application."

Saint Calle v. Prudential Ins. Co., 815 F. Supp. 679 (S.D.N.Y. 1993). Generally, an insurer may rely on facts disclosed in the application and is not required to independently investigate the veracity of those facts. The court held that an auto insurer that relied on the insured's representations was entitled to rescind a policy even though a background check would have revealed the insured's poor driving history.

Christiania General Ins. Corp. v. Great American Insurance Co., 979 F.2d 268 (2d Cir. 1992). Under New York law, an insurer may rescind a policy or exclude a claim where the insured affirmatively misrepresents a material fact in an application or where it fails to disclose material information.

Mutual Benefit Life Ins. Co. v. JMR Electric, 848 F.2d 30 (2d Cir. 1988). Under New York law, an insurer may rescind a policy of insurance if it can be established that the insurer would have issued the policy at a higher premium if the truth had been revealed. Further, an insurer is not required to establish an intention to deceive because even an innocent misrepresentation can justify rescission under New York law.

2. Misrepresentations Deemed Sufficient to Justify Rescission

An insured is deemed to know that a fact is material to an insurer if the insurer specifically inquires about that fact. The materiality of the information is determined as of the time the policy was issued.

Kurtz v. Liberty Mutual Ins. Co., No. 2:11-CV-7010. 2014 WL 12570983 (C.D. Cal. 2014), *aff'd* 668 F. App'x 755 (9th Cir. 2016). The insurers were entitled to rescind their policies due to material misrepresentations of fact in the insured's insurance application—the insured's misrepresentation regarding comingling client funds with its operating expenses in its insurance application was false on a material point. The court applied a subjective standard to reach this conclusion and examined the effect of the misrepresentation on the insurers' evaluation of the risk.

Continental Casualty Co. v. Marshall Granger & Co., LLP, 921 F. Supp. 2d 111 (S.D.N.Y. 2013). An insurer sought to rescind an accounting firm's professional liability insurance policy because of material misrepresentations made by the signatory. Under New York law, the insurer could be entitled to rescind the policy, but denied summary judgment for the insurer because it had yet to produce files on its underwriting decision for the policy that were necessary to demonstrate that the misrepresentation was material to the insurer's decision to issue the policy.

Smith v. Pruco Life Ins. Co. of New Jersey, 710 F.3d 476 (2d Cir. 2013). The court held that an insurer was entitled to rescind a health insurance policy based on the insured's failure to disclose his cancer diagnosis. The application contained an "unchanged health" provision requiring disclosure of any changes in the insured's health between the date of application and issuance of the policy.

Pettinaro Enterprises v. Continental Casualty Co., 450 F. App'x 178 (3d Cir. 2011). Applying Delaware law, the court held that "in an insurance action, a misrepresentation will be considered material if a reasonable insurance company, in determining its course of action, would attach importance to the facts misrepresented."

Hale v. Travelers Cas. and Sur. Co. of America, 661 F. App'x 345 (6th Cir. 2016). The insured submitted an application for insurance that answered in the negative questions asking whether there had been any claims against it in the last five years and whether it was aware of any facts or circumstances that could give rise to a claim. In fact, multiple complaints had been filed against the insured with certain consumer agencies, and one lawsuit was filed. The insured was also the subject of a television investigation. In upholding summary judgment for the insurer, the court found the insured was aware that consumers had filed complaints and demanded refunds of their money. Its failure to disclose those prior circumstances was a material misrepresentation warranting a coverage denial.

State National Ins. Co. v. Anzhela Explorer, L.L.C., 812 F. Supp. 2d 1326 (S.D. Fla. 2011). The court held that an insurer's post-issuance conclusory statements as to the materiality of a representation or omission are not enough to establish a material misrepresentation. Instead, the insurer must provide specific evidence that the court may consider under an objective reasonableness standard.

Federal Deposit Ins. Corp. v. Great American Ins. Co., 607 F.3d 288 (2d Cir. 2010). The court held that a matter is "conclusively material" if the insurer made a special inquiry into it. Here, information surrounding the insured's prior losses was considered material because the insurer made specific inquiries into it.

Carolina Casualty Ins. Co. v. RDD, Inc., 685 F. Supp. 2d 1052 (N.D. Cal. 2010). An employment practices liability insurer filed suit against its insureds, seeking a determination that it was entitled to rescission because the insureds had made material misrepresentations in the application. The day before the insureds submitted the application, they had received a resignation letter from an employee that referred to sexual harassment. Nonetheless, they answered "no" to the questions of (1) whether, in the past five years, any employee had made a claim or otherwise alleged harassment and (2) whether they were aware of any fact, circumstance, or situation that might reasonably be expected to result in a claim. The insureds argued that by answering "no" they had been truthful at the time; it was not until months later, when they had received a Department of Fair Employment and Housing right to sue letter that they became aware that a "former employee" had filed a "claim" against them. The court disagreed, concluding that the insureds made a material misrepresentation: "[The insureds'] narrow interpretation of the word 'claim' . . . is amiss. The questions asked Defendants whether any current or past employees 'made any Claim, or otherwise alleged discrimination, harassment, wrongful discharge and/or Wrongful Acts against any Insured.' The clear language of the questions obliged Defendants to disclose allegations of sexual harassment, retaliation and infliction of emotional distress. Defendants failed to do so."

Steadfast Ins. Co. v. Prime Title Services, LLC, No. 07-366, 2008 WL 5216020 (W.D. Mich. 2008). The insurer was entitled to rescind an errors and omissions policy on the ground that the insured title company made a material misrepresentation at the time the policy was renewed. It was undisputed that the insured had been engaged in the misappropriation of millions of dollars in escrowed funds for months prior to the policy renewal. The court found that the insured was obligated to disclose these facts (which, he acknowledged, objectively raised the potential for claims against the policy) at the time he sought renewal and that his subjective impression—that he expected no claims to arise because he intended for the misappropriated funds to be replaced—made no difference under Michigan law.

Maryland Cas. Co. v. Malone, 90 F. Supp. 3d 1351 (N.D. Ga. 2015). The insured represented on its application for a retail liability policy that it did not repackage or relabel any products. The court acknowledged the insurer's evidence of a substantial difference between an insured whose only operations are retail sales and one who engages in packaging and labeling of products. The materiality of the representation went to the "heart of the risk" of whether the insured was simply a retail operation or whether it also repackaged and relabeled goods for sale.

LA Sound USA, Inc. v. St. Paul Fire & Marine Ins. Co., 156 Cal. App. 4th 1259, 67 Cal. Rptr. 3d 917 (2007). An insurance application asked whether the insured had been or was currently involved in a joint venture, and whether it had a labor interchange with any other business. The insured answered "no" to each question, though he had been involved in a joint venture for six months at the time of the application. Applying California law, the court permitted rescission of the policy, despite the insured's contention that the disclosure was inadvertent: "according to the [California] Insurance Code, case law, and leading commentary, [c]oncealment, whether intentional or unintentional, entitles the injured party to rescind insurance."

The Unencumbered Assets Trust v. Great American Ins. Co., No. 04-908, 2007 WL 2029063, 2007 U.S. Dist. LEXIS 49711 (S.D. Ohio 2007). An insured brought an action to recover proceeds under a D&O policy. The insurer counterclaimed for rescission, alleging that the policy had been procured by fraud because the insured had indicated that the company and its affiliates were not contemplating bankruptcy or reorganization during the next 12 months, despite knowing that the company was insolvent. The court allowed the claim of rescission regarding insolvency to proceed. The insurer's proposal form stated that representations made in the proposal form were material and that the insurer would issue the policy in reliance on the truth of the representations made therein.

U.S. Specialty Ins. Co. v. Bridge Capital Corp., 482 F. Supp. 2d 1164 (C.D. Cal. 2007). A D&O liability insurer filed suit against its insured for a declaratory judgment confirming that certain policies issued were void due to the insured's failure to disclose previous formal demands for money. The court agreed, concluding that the term "claim" in the application question was unambiguous, and that the insured's interpretation that this referred only to actual lawsuits was unreasonable under California law.

Northwestern Mutual Life Ins. Co. v. Babayan, 430 F.3d 121 (3d Cir. 2005). An insurer may void a policy under Pennsylvania law if, by clear and convincing evidence, it can establish: (1) the insured made a false representation; (2) the insured knew the representation was false when it was made, or the insured made the representation in bad faith; and (3) the representation was material to the risk being insured.

Western World Ins. Co. v. Professional Collection Consultants, 721 F. App'x 621 (9th Cir. 2018). Several months before the insured applied for D&O insurance, its offices were raided by law enforcement authorities, and its employees were the subject of various document subpoenas. The application asked whether any individuals to be insured had a basis to believe that any fact or circumstance might be the basis of a future claim, phrased as a question (i.e., no one has knowledge of a potential claim?). The answer was "no," and the insured argued it made no misrepresentation in answering "no" since that meant it was aware of circumstances. The court rejected the argument since the insured left blank the instructions to provide further information about the answer on the application. The court

found that the criminal investigation, even if closed or on hold, might have led to a claim under the policy and the specific demand for information on the application was an indication of its materiality.

Minnesota Lawyers Mutual Ins. Co. v. Hahn, 355 F. Supp. 2d 104 (D.D.C. 2004). Under Virginia law, a professional liability policy was properly rescinded because of the insured's material misrepresentations in the policy application. An insurer seeking to rescind a policy must show: (1) that a statement on the application was false and (2) that the insurance company's reliance on the false statement was material to the company's decision to undertake the risk and issue the policy. Here, the insured replied "no" to the questions: (a) "[h]ave any claims been made against the applicant or the applicant's predecessors in business, or any past or present firm members or employees within the past five years?" and (b) "[i]s any firm member aware of any incident that could reasonably result in a claim being made against the applicant, its predecessors or any past or present firm members?" However, after the application was submitted, but before the policy was issued, the insured received a "claim letter" from certain individuals who threatened legal proceedings.

Continental Casualty Co. v. Graham & Schewe, 339 F. Supp. 2d 723 (E.D. Va. 2004). The court held that the insured's misrepresentations in an application for professional liability insurance were "material" and provided a basis for the insurer to rescind its policy. The insured law firm stated in its application that it was unaware of any act or omission that "might reasonably be expected to be the basis of a claim" at the time of the application. However, the insured was aware that a former client had been convicted of sexual assault against children, but then was acquitted upon a showing of the firm's ineffective assistance of counsel. The former client subsequently filed a legal malpractice claim against the insured. Applying Virginia law, the court held the insurer was entitled to rescind the policy based on the insured's material misrepresentations because the insured was aware of the circumstances that could reasonably give rise to a claim but failed to disclose them in the policy application.

Shipley v. Arkansas Blue Cross and Blue Shield, 333 F.3d 898 (8th Cir. 2003). The Eighth Circuit affirmed the district court's grant of summary judgment in favor of rescission, finding that the insured made numerous material misstatements in an application for health insurance.

Oregon Mutual Ins. Co. v. Victorville Speedwash, Inc., No. 14-7909, 2015 WL 1265274 (C.D. Cal. July 6, 2015). In connection with an application for employment liability insurance, the insured failed to disclose that it continued to employ the claimant notwithstanding that a court previously found that he had harassed another employee, and that he later resigned and made demands for wage compensation to the insured and government agencies. The court rejected the insured's argument that its failure to disclose was excused because it believed the employee's claims to be meritless.

American Guarantee & Liability Insurance Co. v. Jaques Admiralty Law Firm, PC, No. 99-CV-70264-DT, 2003 WL 22077774 (E.D. Mich. 2003). Under Michigan statutory law, an insurer was permitted to rescind a professional liability policy despite the fact the individual who had signed the application believed his answer was truthful when he indicated that the firm's attorneys were not "aware of any claim, incident, act or omission in the last year which might reasonably be expected to be the basis of a claim or suit[.]" Upon

the death of a named partner, the firm discovered a shortage in the client trust account, which was previously unknown to the signatory of the application, while taking up tasks that the deceased had previously performed. The firm later admitted that the deceased had embezzled funds, removed the funds as a result of a complex scheme, was in complete control of the firm's cash flow, and wasted and misused the funds from the client escrow account. The court held that, "[e]ven if [the applicant] made the representation innocently, according to *Manufacturers Life Insurance Co. v. Beardsley*, 365 Mich. 308, 112 N.W. 2d 514 (1961), even a good faith representation made without knowledge of its falsity can serve to void a contract."

Association for Retarded Citizens–Santa Barbara Council v. North American Specialty Ins. Co., No. 94-4602 (C.D. Cal. 1994), *aff'd*, No. 94-56745, 1996 WL 343561 (9th Cir. 1996). On July 30, 1992, the insured's executive director submitted an application for D&O insurance, which represented that (1) the insured had not dismissed any employees within the previous 12 months; (2) no claim had been made against the company or its D&Os; and (3) the insured was not aware of any circumstances that might result in a claim. The application also required the applicant to immediately report any circumstances taking place before the policy began that might affect the truthfulness of any statement made in the application. Contrary to the representations in the insured's application, the insured had terminated an employee in May 1992 who, upon her termination, had threatened to sue for sexual harassment. On July 31, 1992, the insured received a settlement demand from this former employee, threatening litigation as an alternative. On August 1, 1992, the insurer issued the policy. The insurer rescinded the policy once the claim was reported. The insured then filed suit, seeking a declaratory judgment confirming coverage under the policy. The court granted summary judgment to the insurer, concluding that the insured had made material misrepresentations in its application. Under the California statute, the insurer was entitled to rescission even if the misrepresentations were unintentional because "concealment, whether intentional or unintentional, entitles the injured party to rescind."

Minnesota Lawyers Mut. Ins. Co. v. Schulman, No. 14-cv-50142, 2016 WL 4988006 (N.D. Ill. 2016). The insured's application for a professional liability policy that certified it had no knowledge of any circumstances that could result in claims constituted a material misrepresentation given its knowledge of abandonment notices from the agency handling its client's patent applications that it did not report to the client in addition to petition dismissals and docketing errors. The misrepresentation prevented an adequate assessment of the insurance risk. The application question asking for awareness of facts or circumstances that "could reasonably result" in a claim does not call for a wholly subjective evaluation of known facts by the insured but requires the disclosure of "any" facts that "could" result in a claim. The insured's subjective beliefs about the merits of any potential claim do not impact the court's analysis.

Booker v. Blackburn, 942 F. Supp. 1005 (D.N.J. 1996). A professional liability insurer filed an action to rescind a policy issued to a civil engineer based on intentional misrepresentations made in the application. The insured, as the sole principal, engineer, director, and officer of the firm, submitted an application for a civil engineer's professional liability insurance policy. In completing the application, the insured failed to disclose his receipt three months earlier of a praecipe alleging defective workmanship. In Pennsylvania, a praecipe, like a summons, is a means of commencing a lawsuit. Upon receiving the

complaint in the action commenced by the praecipe, the insured made a claim for coverage under the policy. The court granted summary judgment for the insurer based on the insured's failure to disclose material information, stating that (1) the filing of a praecipe may constitute a claim against the insured within the meaning of the policy and (2) the omission of the praecipe was material in that it was reasonably related to the insurer's estimation of the risk or the assessment of the premium. With respect to the insurer's burden, the court explained that the insurer need only show that the insured's omission of the material information was knowing rather than an oversight.

Federal Deposit Ins. Corp. v. Duffy, 47 F.3d 146 (5th Cir. 1995). A law firm partner signed an application for professional liability insurance, making the representation that "the proposed insured" was unaware of any act, error, or omission that might fall within the scope of the proposed insurance. The application, which was given to each partner before it was given to the insurer, stated that "[t]he applicant declares that to the best of his knowledge of all persons to be insured," all statements and attachments are true and no material facts have been omitted. The FDIC later sued the firm and the partner for malpractice and breach of fiduciary duty, alleging that the partners encouraged a savings and loan institution to give bad loans to generate more legal fees. The court held the firm liable, finding that the partner had acted dishonestly. The FDIC then sought to recover from the professional liability policy under Louisiana's direct action statute. The court determined that the policy was void due to the finding of dishonesty under Louisiana law because (1) the application represented the knowledge of all of the firm's lawyers; (2) the partner knew at the time of the application that he was engaged in dishonest conduct; (3) the application misrepresented that the partner knew of no act, error, or omission that could give rise to a claim; and (4) the partner must have intended to deceive the insurer. The court determined that the partner's misrepresentations rendered the policy void as to all insured lawyers because the policy did not contain a severability provision.

Travelers Casualty and Surety Co. of America v. Gold, Scollar, Moshan, PLLC, No. 14-10106, 2018 WL 1508573 (S.D.N.Y. March 14, 2018). A partner at the insured law firm improperly removed client funds from an attorney trust account. In subsequently applying for a professional liability policy, the firm's representative represented that no employee of the firm had knowledge of any incident that could be the basis of a claim. Since the partner had subjective knowledge of her misconduct beginning a year before the application, any reasonable attorney in her position would have known that misappropriation of client funds had the potential to be the basis for a malpractice claim. The representation on the application was attributable to the entity based on the subjective knowledge of one of its partners. Further, there is no reason to require the insurer to produce a specific underwriting guideline addressing whether to issue a policy where the insured is engaged in a fraudulent enterprise since it is inconceivable any insurer would write such coverage.

First National Bank Holding Co. v. Fidelity and Deposit Co., 885 F. Supp. 1533 (N.D. Fla. 1995). A bank director represented that he had no "information of any act, error or omission which might give rise to a claim under the proposed policy" on the bank's application for D&O insurance—even though he had been engaged in fraudulent activity. The director's fraud resulted in numerous claims against him, as well as a criminal conviction. Subsequently, the bank's holding company obtained a $3 million judgment against the director. The insurer denied coverage for the claim asserting that the director's

misrepresentations rendered the policy void ab initio. The holding company sued the insurer, contending that the director had not made any misrepresentations in the application because he had truthfully believed that his conduct would not result in a claim (i.e., that he would "get away with it"). The court rejected the holding company's argument, reasoning that (1) under Florida law, even an innocent misrepresentation will void a policy if it materially affects the insurer's risk and that, in any event, (2) the director's criminal conviction proved that he had knowledge of circumstances that might have resulted in a claim because those circumstances resulted from his own fraudulent activity.

National Union Fire Ins. Co. of Pittsburgh, Pa. v. Sahlen, 999 F.2d 1532 (11th Cir. 1993). Under Florida statutory law, misrepresentations and incorrect statements in a policy application bar recovery under the policy if: (1) they are fraudulent; (2) they are material to the risk; or (3) the insurer would not have issued the policy or would have altered the policy's terms had it known the truth. In this case, an insured attached significantly overstated financial statements to its application for a D&O policy. The court held that the misrepresentations in the financial reports constituted statements sufficient to justify rescission of the policy.

Scottsdale Ins. Co. v. CSC Agility Platform, Inc., No. 17-7762, 2019 WL 1452910 (C.D. Cal. Feb. 4, 2019). The insured, a cloud management start-up, answered in the negative a question on the D&O application whether it contemplated transacting any mergers or acquisitions in the next 12 months. While the insured acknowledged it had a series of discussions with a potential suitor, it argued that the question on the application refers only to consideration of a formal acquisition offer. The court disagreed, finding that the insurer was entitled to know if the applicant engaged in serious and sustained conversations with a potential business partner that appeared somewhat likely to lead to a formal acquisition offer. The question was thus intended to determine the applicant's potential for being taken over by another company. The fact that the insurer demanded answers to specific questions establishes a presumption that the answers are material, and the insured failed to rule out that the insurer would have increased the premium had the insured admitted it contemplated being acquired.

Monumental Life Ins. Co. v. United States Fidelity & Guaranty Co., 617 A.2d 1163 (Md. Ct. Spec. App. 1993), *cert. denied*, 624 A.2d 491 (table) (Md. 1993). In an application for D&O insurance, an insured denied that any of its D&Os were aware of circumstances that could give rise to a claim under the policy. The insured had received complaints from a competitor accusing it of unfair hiring practices and threatening litigation. The insurer issued the policy and the competitor subsequently sued the insured for their alleged unfair practices. Applying Maryland law, the lower court concluded that any reasonable insured would have known that the competitor's complaints could result in a claim. Thus, it was held that the misrepresentations rendered the policy void, despite the insured's assertion that it believed its representation to be true. The appellate court affirmed the lower court's holding on other grounds.

McCuen v. International Ins. Co., No. 87-54, 1988 WL 242680 (S.D. Iowa 1988), *aff'd,* 946 F.2d 1401 (8th Cir. 1991). In an application for D&O insurance, officers of a savings and loan (S&L) stated that none of the applicants knew of any circumstances that could give rise to a claim under the policy. The officers also represented that the S&L had not been denied similar insurance. In fact, the officers knew of regulators' contentions of

mismanagement. Further, the officers were aware that the S&L's prior insurance carrier had offered a policy renewal terms that amounted to a de facto denial of renewal. Applying Iowa law, the court found that the insurer was entitled to rescind the policy because of the officers' misrepresentations.

Ratcliffe v. International Surplus Lines Ins. Co., 550 N.E.2d 1052 (App. Ct. 1990). In an application for trustees' errors and omissions insurance, a trustee represented that no trustees were aware of prior claims or circumstances that might give rise to a claim against the trusts or trustees. However, at the time of the application, the trust was represented by counsel in a construction dispute in which litigation was threatened. Under Illinois law, a misrepresentation in a policy application will void a policy if it was made with the intent to deceive or it is material to the insurer's risk. The court stated that "the question in the policy application required the disclosure of any facts which, objectively considered, might have given rise to a claim, despite the applicant's subjective belief." The court concluded that the trustee failure to disclose the potential litigation constituted a material misrepresentation because a reasonable trustee would have disclosed the potential claim.

Imperium Ins. Co. v. Shelton & Associates, P.A., 761 F. App'x 412 (5th Cir. 2019). The insured represented that it knew of no incidents that might reasonably be expected to lead to a claim on its application for a professional liability policy. In fact, the insured was aware of mishandling of the file by prior counsel but failed to take steps to rectify the matter. The fact was material as it might have led a prudent insurer to decline the risk, accept the risk only for an increased premium, or otherwise decline to issue the policy as requested by the applicant.

Chomat v. Spreckley, No. 86-2215 (S.D. Fla. 1989). While applying for D&O insurance, the D&Os of the insured stated they knew of no act, error, or omission that might afford valid grounds for any future claim. The D&Os later admitted that they were aware of wrongdoing that would have prevented the insurer from issuing the policy. Under the Florida statute, an insurer may avoid liability under a policy where the insured misrepresented or concealed facts and (1) the misrepresentation or concealment was fraudulent; (2) the misrepresentation or concealment was material to the risk; or (3) the insurer would not have issued the policy had it known the truth. The district court granted summary judgment to the insurer, concluding the insured misrepresented facts that would have led the insurer to deny issuance of the policy, had it known the truth.

Jaunich v. National Union Fire Ins. Co. of Pittsburgh, Pa., 647 F. Supp. 209 (N.D. Cal. 1986). During the application process for D&O insurance, the insured failed to disclose all information about potential litigation. The undisclosed potential litigation eventually matured into actual claims under the issued policy. The insurer sought to rescind the policy because the insured failed to disclose all material facts. Under California statutory law, an insured must reveal, with certain exceptions, all facts within its knowledge that are material to the insurance contract. However, an insurer may lose its right to rescission by neglecting to inquire into facts that are "distinctly implied" in other facts the insured has disclosed. The court held that the insurer was entitled to rescind the policy because the insured withheld material facts about the potential litigation, and the insured's reference to some potential litigation did not "distinctly imply" the existence of the other potential litigation, which the insured did not disclose.

3. Alleged Misrepresentations or Omissions Deemed Insufficient to Justify Rescission

When a prospective insured makes a false affirmative statement or fails to disclose information while under a duty to disclose, an insurer may rescind a policy if the information was material to the preparation of the policy. By itself, however, an applicant is not required to volunteer information that the insurer has not clearly requested. In those circumstances, an insurer would need to show the insured acted with fraudulent intent by omitting information that was clearly relevant to the underwriter.

Travelers Casualty & Surety Co. of America v. Mader Law Group, LLC, 2014 WL 5325745 (M.D. Fla. 2014). An insurer sought to rescind based on alleged incorrect statements made in the application for coverage. The court held that a misrepresentation clause in the policy, which imposed a heightened standard for rescission, trumped a state statute providing a lower standard for rescission. The court held that the parties contracted out of the state standard and denied cross motions for summary judgment.

Chism v. Protective Life Ins. Co., 290 Kan. 645 (2010). Under Kansas law, an insurer may not rescind a policy based upon a negligent misrepresentation or omission, but may do so upon a showing of reckless disregard for the truth.

Westport Ins. Corp. v. Hippo Fleming & Pertile Law Offices, 349 F. Supp. 3d 468 (W.D. Pa. 2018). In connection with an application for a professional liability policy, the insured disclosed an entity in which its individual insureds were involved but omitted the entities in which the identified entity had ownership shares. The insurer subsequently sought rescission of the policy when that information was revealed. The court found factual issues prevented rescission as a matter of law, since the entity that was disclosed held the individuals' shares in the undisclosed entities and the insured lacked any bad faith or intent to deceive in failing to mention the other entities. Further, the insurer did not offer any evidence that the insureds' involvement in the other entities would have influenced its decision on issuing the policy, its risk assessment, or setting of the premium rates.

ClearOne Communications, Inc. v. National Union Fire Ins. Co. of Pittsburgh, Pa., 494 F.3d 1238 (10th Cir. 2007). After an insured publicly acknowledged that the previous two years of its financial statements (which had been submitted with the application) were unreliable, a D&O insurer attempted to rescind its policy. Under Utah statutory law, rescission is permitted if there is a misrepresentation or breach of an affirmative warranty that the insurer relies upon and the misrepresentation is either material or made with intent to deceive. Here, the court concluded that the insured's financial statements were material to the insurer's decision to issue the policy and that the insurer reasonably relied on them. The appellate court noted that at least one Utah appellate court had construed the term "misrepresentation" to contain a scienter element. Accordingly, the court remanded the case as to the insured's lack of innocence: "[a]fter reviewing the record and examining Utah law, we agree with the district court that National Union sufficiently demonstrated three elements—misstatement, materiality, and reliance. Nevertheless, we disagree that lack of innocence was established as a matter of law and we therefore remand on that issue."

Admiral Ins. Co. v. Brookwood Management # 10, LLC, 2018 WL 5622595 (E.D.N.Y. Mar. 30, 2018). The insured did not disclose certain prior losses and lawsuits on its application for a general liability policy. There is no presumption that representations about prior