

Court Holds Rescissory Damages Are Uninsurable as a Matter of Law

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The United States District Court for the District of Arizona, in an unpublished opinion, has determined that an underlying suit seeking "rescissory damages"—consideration that the policyholder "should have paid" in connection with an allegedly undervalued stock transaction—did not allege loss as defined by the claims-made policy at issue because the damages were "deemed uninsurable under the law." *Alanco Technologies, Inc. v. Carolina Casualty Ins. Co.*, 2006 WL 1371633 (D. Ariz. May 17, 2006).

The insurer provided claims-made coverage to the insured corporation covering all loss arising from a claim first made during the policy period. "Loss" was defined to include "damages, judgments, settlements, and Costs of Defense." The definition further provided that loss did not include "matters which may be deemed uninsurable under the law pursuant to which this Policy shall be construed."

The company sought coverage for legal fees incurred in connection with an underlying action in which the plaintiff sought various types of rescissory relief, including voiding the transaction, seeking the benefit of the bargain, recovery of assets through a constructive trust and damages relating to misrepresentations that allegedly induced the plaintiff to enter into the transaction with the company. As summarized by the court, the underlying litigation "seeks to recover [the policyholder's] ill-gotten gains . . . the stock value [the company] promised to pay [the plaintiff], but never actually delivered."

The insurer sought summary judgment, arguing that there was no coverage under the policy because none of the relief sought in the underlying litigation fell within the definition of loss. The company contended that, because the claim for rescission itself was actually dropped, the remaining claims for relief sought damages within the definition of loss. However, the court disagreed, stating that dropping the claim for rescission did not mean that the remaining claims did not seek rescissory remedies or did not seek recovery of the corporation's ill-gotten gains. The court noted that rescission was the gravamen of the litigation and concluded: "Because rescissory damages are uninsurable under the law, and defense costs are recoverable only for covered losses, [the corporation has] suffered no loss under the policy."