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NEWSLETTER

"Insolvency Exclusion" Bars Coverage for Suits Alleging Misrepresentations Regarding Companies' Financial Health

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Reversing a lower court ruling, the United States Court of Appeals for the Second Circuit recently found that an insurer was entitled to summary judgment as to its right to disclaim coverage based on the "insolvency exclusion" included in a non-profit organization liability insurance policy. *Coregis Ins. Co. v. Am. Health Foundation, Inc., et al.,* No. 99-9300, 2001 U.S. App. LEXIS 2156 (2d Cir. Feb. 14, 2001).

The policyholders, non-profit nursing home companies and certain of their directors, officers, and affiliates, brought this coverage action seeking to require their insurer, Coregis Insurance Company ("Coregis"), to defend and indemnify them in connection with two lawsuits charging that they failed to repay certain loans allegedly obtained through fraudulent misrepresentations about the financial health of the companies. The policy provision on which the insurer relied to deny the claim barred coverage for any claim "arising out of, based upon or related to . . . [t]he insolvency . . . [or a] financial impairment" of the company named in the policy declarations.

In the lower court, both sides moved for summary judgment on what they agreed was the sole dispositive issue – the interpretation of the insolvency exclusion. Coregis argued that the underlying suits would not have been brought but for the insolvency of the companies, and that the suits consequently arose out of, were based upon or related to the insolvency and/or financial impairment of the companies. The insureds contended that, because the claims against them were based on alleged misrepresentations made prior to the occurrence of the companies' financial failure, such claims could have been brought whether or not the companies became insolvent and thus did not come within the scope of the exclusion. The lower court agreed with the insureds and concluded that "the suits arise not from the plaintiffs' insolvency . . . but from plaintiffs' conduct which gave rise to the financial plight and their misrepresentations related thereto."

On review, the appellate court found that the lower court's ruling did not fully dispose of the coverage issue because the lower court focused only on the "arising out of" language in the exclusion. Thus, the appellate court considered the "related to" language and found that this term typically is defined more broadly than "arising out of" and often is used synonymously with phrases such as "in connection with," "associated with," "with respect to" and "with reference to." The appellate court concluded that "regardless of whether coverage

for the [underlying suits] would constitute a claim 'arising out of' the Companies' insolvency or financial impairment, the ordinary meaning of the broad term 'related to' as used in the Provision is clear and unambiguous in its application to exclude such coverage."