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NEWSLETTER

# Excess D&O Policy Rescinded Based on Fraudulent Representations Regarding Solvency

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The United States District Court for the Southern District of Ohio, applying Ohio law, has held that an insurer could rescind an insurance policy based on an individual's fraudulent statements that the insured company was not facing bankruptcy. *Unencumbered Assets Trust v. Great Am. Ins. Co.*, 2007 WL 2029063 (S.D. Ohio July 10, 2007).

A company bought primary and excess D&O policies in March 2002. In November 2002, the company filed for bankruptcy. Several directors and officers thereafter faced civil lawsuits, an SEC civil action and an indictment. The company brought an adversary suit against the insurers in bankruptcy court seeking to apportion the policy proceeds among the insureds. The excess insurer filed counterclaims seeking rescission or alternatively a declaratory judgment that the policy was void based on fraud. In addition, several individuals filed a motion seeking the advancement of defense costs from the excess insurer. The district court granted a motion to withdraw the reference to the bankruptcy court of all claims relating to the insurance dispute.

The court first considered the rescission issue. The excess insurer argued that the policy was issued pursuant to a proposal form signed by an individual later investigated by the SEC and indicted. This proposal form confirmed that statements in the form "are material and that this Policy is issued in reliance upon the truth of such representations . . . ." The insurer argued that the proposal form included statements that the company was not contemplating bankruptcy within the next year despite the individual's knowledge that the company was insolvent. In addition, the insurer argued that the proposal form incorporated annual reports and financial statements that contained fraudulent information.

The company argued that the insurer could not seek rescission absent a statute providing for rescission or specific policy language allowing rescission. In rejecting this argument, the court noted that the cases the company cited for this argument discussed the distinct circumstance of when an insurer can cancel an insurance policy, not rescind it. The court distinguished between cancellation and rescission and allowed the rescission claim as grounded on a common law right under Ohio law.

The court concluded that the insurer had sufficiently established that the individual who signed the proposal form knew that the company was insolvent and was in fact primarily responsible for fraudulent transactions that led to that insolvency. The court therefore rescinded the policy on this ground but rejected the rescission claim to the extent it was based on the allegations of false annual reports and financial statements. The court determined that the allegations based on the financial statements did not specify the misrepresentations with particularity.