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NEWSLETTER

District Court Holds Interrelated Wrongful Acts Provision Precludes Coverage

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The United States District Court for the District of New Jersey, applying New Jersey law, has held that (1) coverage for fraudulent conveyance actions brought against the insureds was not available under a claims-made D&O Liability Policy's interrelated wrongful acts provisions; and (2) the insurer was not obligated to provide coverage under a previous, insolvent insurer's policy, even though the insurer had purchased the assets and renewal rights to the insolvent insurer's D&O book of business and agreed to reinsure the insolvent insurer for specifically defined risks. *G-I Holdings v. Hartford Fire Ins. Co.*, 2007 WL 842009 (D.N.J. Mar. 16, 2007).

Three lawsuits were brought against a company and its CEO alleging that the CEO's transfers of stock to other companies constituted fraudulent conveyances because the stock was transferred solely to place the shares beyond the reach of creditors. The insureds had purchased from an insurer a primary D&O claims-made policy, effective from July 1, 1999 to July 1, 2002. The company cancelled the policy effective July 1, 2000, due to concerns regarding the insurer's solvency. The insurer was later declared insolvent.

The company purchased a new D&O policy from a new insurer for the remainder of the time that the insolvent insurer was to have been on the risk. The new policy was effective from July 15, 2000 to July 1, 2002. The new policy was also a claims-made D&O policy. The policy contained an interrelated wrongful acts clause, providing that "[a]ll claims arising out of the same wrongful act or interrelated wrongful acts of one or more of the insureds shall be considered a single claim. Such claims shall be deemed to be first made on the date the first such claim is made."

The new insurer entered into an asset purchase agreement with the insolvent insurer on July 1, 2000. In separate agreements, the new insurer also agreed to reinsure the insolvent insurer for specifically defined risks, once the insolvent insurer made payment on the risks, and to act as the insolvent insurer's third-party administrator to manage to certain claims.

The insureds provided notice to the insolvent insurer of the three fraudulent conveyance claims in April 2000, October 2000, and October 2001. The insolvent insurer denied coverage. The new insurer also denied coverage, asserting that the fraudulent conveyance claims were first made before the inception of the new

policy. The company and the CEO then filed suit against the insurer.

The court first explained that "the terms and notice period of a 'claims-made' policy are to be strictly enforced. " The court then pointed out that the first fraudulent conveyance suit was filed in January 2000, six months before the inception of the new policy. Acknowledging that "exclusionary clauses, like the interrelated wrongful acts provision at issue here, are to be strictly construed against the insurer," the court nonetheless concluded that the two subsequent fraudulent conveyance actions related back to the date on which the original claim was filed, as each of the suits arose as a result of an insured's transfer of stock and was thus the result of interrelated wrongful acts. The court, therefore, held that none of fraudulent conveyance actions constituted claims first made during the new policy period, and thus, the new policy did not provide coverage.

The court rejected the insureds' argument that the two policies should be treated as one continuous policy. It pointed out that the deposition testimony of the company's risk manager indicated that he understood the two policies to be separate and distinct and explained that "a unilateral mistake of fact, unknown to the other party, does not warrant avoidance of a contract."

The insureds also argued that the new insurer was obligated to provide coverage for the fraudulent conveyance claims pursuant to the policy issued by the insolvent insurer because the new insurer "effectively took over all of [the insolvent insurer's] business and assumed its obligations to policyholders." The court rejected the argument, emphasizing that neither the new policy, the asset purchase agreement, the reinsurance agreement, nor the claims servicing agreement obligated the new insurer to provide coverage for claims pursuant to the insolvent insurer's policy. The court noted that the asset purchase agreement specifically stated that other than its obligations under the reinsurance agreement, the new insurer "shall not assume any liabilities" of any of the insolvent insurer's companies. The court further noted that because the insureds were not a party to the reinsurance agreement, even if the new insurer became obligated to reinsure the insolvent insurer, the insureds had no right to the reinsurance proceeds under the reinsurance agreement alone. Moreover, a reinsurer's duty to a primary insured generally depends on whether the reinsurer has some control over settlement with a third-party claimant. Because, according to the court, the new insurer did not have control over the insureds' claims under the insolvent insurer's policy, it was "inappropriate for the court to pierce the alleged reinsurance veil."