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NEWSLETTER

Appellate Court: Misrepresentations in SEC Filing Justify Homestore Rescission

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In an unreported decision, the United States Court of Appeals for the Ninth Circuit has held that insurers may properly rescind D&O insurance policies based on misrepresentations in a U.S. Securities and Exchange Commission (SEC) filing submitted with the application. *Fed. Ins. Co. v. Homestore, Inc.*, (9th Cir. Aug. 12, 2005). The court also held that, under the plain meaning of the policy language at issue, the insurers could rescind as to all insureds since the signer of the application was aware of the misrepresentations.

In 2001, the company obtained D&O insurance coverage from several insurers. The applications were signed by the company's CFO, who also submitted, as required, the most recent 10K and 10Q SEC filings of the company. The policies all incorporated the terms of the primary policy, which stated that "the information and statements contained in the Application . . . and any material submitted therewith . . . are the basis of this Policy." The primary policy stated "[t]hat the statement in the Application and in any materials submitted therewith are their representations, and they shall be deemed material to the acceptance of the risk or hazard assumed by the Insurer . . . ." The policy also provided that if the application was signed by an individual with knowledge of misrepresentations contained in the materials submitted, then the "Policy in its entirety shall be void and of no effect . . . ." Subsequently, the CFO who signed the application, along with two other former officers of the company, were accused of illegally inflating the company's revenue. In 2002, the CFO pleaded guilty to conspiracy to commit securities fraud. The insurers rescinded the policies, and coverage litigation ensued.

The Ninth Circuit rejected the argument by the other officers that the undisputed misrepresentations in the applications were not material to the insurers' "acceptance of risk." The court noted that, under California law, materiality of a representation may be established when an insurer requests specific information from the applicant. Because the insurers requested the current 10Q filing as part of their applications, and the policy defined materials submitted along with the application as representations "material to the acceptance of the risk or hazard," the court held as a matter of law that the false representations were material. The court also stated that "[a]n ordinary lay person would understand that the veracity of past SEC filings are a key component in the determination of whether to issue coverage for security claims."

The officers next argued that the trial court erred in determining that the policy allowed rescission as to all insureds, arguing that the policy language was ambiguous as to "innocent officers." The appellate court, reviewing the policy *de novo*, noted that the court must interpret the express terms so as to "give effect to the 'mutual intention' of the parties." Those express terms are considered in their ordinary and plain meaning in the policy language. Here, the court observed that the policy stated that it was completely void if misrepresentations were known by "one or more of the individuals who signed the policy." Thus, one signer's knowledge of misrepresentations was expressly sufficient to void the entire policy as to all parties, innocent or otherwise.

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