



Directors & Officers Report

Presented By Tucker Ellis & West LLP

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CALIFORNIA APPELLATE COURT UPHOLDS POLICY RESCISSION AS TO ALL INSUREDS DESPITE PRESENCE OF SEVERABILITY PROVISION

In a recent case handled by the firm of Tucker Ellis & West LLP, the California Court of Appeal for the Second District ruled that a D&O liability policy may be properly rescinded based on fraud in the application. The court held that rescission of a D&O liability policy is permitted against all insureds where the rescission provision is unambiguous and consistent with California law. The court also ruled that financial statements submitted with an application are material to the insurer's acceptance of the risk assumed under the policy.

In TIG Insurance Company of Michigan v. Homestore, Inc. et al., 137 Cal. App. 4th 749 (2006), TIG issued an excess D&O liability policy to Homestore based, in part, on a Form 10-Q that was submitted with the company's application. The application was signed by the company's CFO on behalf of himself and other non-signing officers. Thereafter, several shareholder class actions and a criminal investigation were commenced against Homestore alleging financial fraud. After Homestore's CFO plead guilty to the criminal counts and admitted that the company had filed false Form 10-Qs with the SEC during the relevant time period, TIG denied coverage for the shareholder litigation and unilaterally rescinded the excess policy.

In the resultant coverage litigation, the trial court entered summary judgment in favor of TIG, holding that, the policy was properly rescinded because the application contained factual misrepresentations which the CFO had admitted were made with the actual intent to deceive, and which were material to the acceptance of the risk and the hazard assumed by TIG. Homestore appealed.

The California Court of Appeal upheld

TIG's policy rescission based on its finding that the policy's representation and severability provisions were consistent with California Insurance Code Sections 331, 359 and 650, and did not restrict TIG's statutory right to unilaterally rescind the policy as to all insureds notwithstanding the fact the innocent insureds did not sign the application and were apparently unaware of the false financial information included in the Form 10-Q. In so ruling, the Court expressly rejected appellants' argument that the existence of severability provisions in certain policy exclusions is indicia of severability that should be extended to the policy's rescission provision, and held that the policy language unambiguously supports imputation of any wrongful conduct to the "innocent" D&Os.

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