Lowenstein Sandler

Insurance Recovery

June 13, 2023

A Cautionary Tale Highlights the Importance of Carefully Reviewing a Warranty Letter Before Signing

By Lynda A. Bennett and Heather Weaver

When buying an insurance policy, a policyholder is sometimes required to sign a warranty letter affirming that they are not aware of any impending claims nor any facts or circumstances that may reasonably give rise to a claim. These letters are separate and apart from the insurance application, and they are typically used by insurers to lay the groundwork to try to exclude coverage for future claims arising out of acts or omissions that the policyholder was aware of prior to signing the letter.

The U.S. Court of Appeals for the Ninth Circuit is poised to weigh in on the perils associated with signing warranty letters without careful consideration and diligence. In *Ironshore Indemnity Inc. v. Kay*, 2022 WL 4329790 (D. Nev. September 16, 2022), now on appeal, Ironshore sought a declaratory judgment that it has no duty to defend or indemnify Eric Kay–the former chief legal officer of the now-bankrupt tech company NS8 Inc.–for a claim based on wrongful acts allegedly committed by the company's former chief executive officer, Adam Rogas.

To obtain excess directors and officers (D&O) insurance coverage from Ironshore, Rogas signed a warranty letter affirming that he and "all insureds" had no knowledge of acts that could give rise to a claim under the policy, and the letter excluded any claims arising from such knowledge. The U.S. Securities and Exchange Commission and the Department of Justice subsequently filed civil and criminal suits against Rogas, alleging that he committed fraud while he was CEO. The following year, Cyber Litigation Inc. (NS8's successor) sent a demand letter to Kay claiming that he breached his fiduciary duties to the company by failing to report Rogas' fraud. Kay tendered the claim to Ironshore for D&O coverage, Ironshore denied, and the insurance coverage lawsuit ensued.

Last September, a Nevada district court held that the claim against Kay fell squarely within the warranty letter's exclusion, rejecting Kay's argument that Ironshore must prove that Rogas had "actual" knowledge of his fraudulent conduct at the time of signing because it would add language to the letter that does not exist.

Recently, the Ninth Circuit held oral argument on the appeal of the district court's decision, where Kay argued that Ironshore had to prove that Rogas clearly knew about actions that would trigger the exclusion at the time he signed the letter. Ironshore argued that the district court correctly found that the claim against Kay is excluded from coverage because the letter falsely warranted on behalf of "all insureds" (including Kay) that Rogas was not aware of any facts or circumstances that could lead to a claim, yet when he signed that letter, he was perpetrating the criminal fraud for which he is now serving five years in prison.

No matter how this appeal shakes out, the lessons are the same:

- The language in warranty letters matters, and a few words could be the difference between no coverage and maintaining coverage for innocent insureds.
- Policyholders should consult their broker and experienced coverage counsel to determine whether a warranty letter is necessary under the circumstances and, if so, how to carefully craft and narrow the language of the letter.
- Policyholders should conduct diligence internally to obtain adequate support for representations being made on behalf of multiple insureds.
- As insurers increasingly take aggressive positions to avoid their coverage obligations, policyholders should fully (but narrowly) disclose knowledge of potential claims or circumstances because it is better to have a specific matter exclusion than have all coverage under the policy at risk based on a rescission argument from the insurer.

Contacts

Please contact the listed attorneys for further information on the matters discussed herein.

LYNDA A. BENNETT
Partner
Chair, Insurance Recovery
T: 973.597.6338
lbennett@lowenstein.com

HEATHER WEAVER
Counsel
T: 862.926.2134
hweaver@lowenstein.com