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Appeals court considers if renewal omission is misrepresentation

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The 9th Circuit U.S. Court of Appeals' take on whether a company's failure to include $1.6 billion in financial liabilities on a directors and officers liability insurance renewal bars defense coverage will hinge on which state's law is applicable, legal observers say.

The appeals court will hear arguments Tuesday in *EB Holdings II Inc. et al. v. Illinois National Insurance Co.* and determine if a Nevada federal judge correctly applied that state's law when finding that an American International Group Inc. unit was not required to defend its insured.

Lee S. Siegel, a Hartford, Connecticut-based insurance coverage attorney and a member at Hurwitz Fine P.C., said that choice of law is "critical" in the case due to the difference between Texas and Nevada law.

When applying to renew a D&O policy from Illinois National for the 39th time in 2015, Dallas-based EB Holdings did not complete spaces on the form for listing its financial liabilities. The holding company for various mining and manufacturing operations provided financial information showing it had $29.9 million in long-term debt. In its 2013 renewal application, however, it disclosed $1.4 billion in debt. Illinois National approved the application and provided the policy, court records show.

Chubb unit Federal Insurance Co. and CNA Financial Corp. subsidiary Continental Casualty Co. also provided excess policies to EB Holdings.

EB Holdings and its president, Howard Meyers, were sued in 2016 by GoldenTree Group Master Fund Ltd. for fraud. Illinois National denied coverage in August 2017 but did not say anything about the renewal application omission regarding EB Holdings' long-term debt. Federal and Continental also denied coverage, according to court documents.

EB Holdings sued its insurers in February 2021 in Nevada federal court for breach of contract, bad faith and violations of fair claims practices laws in Nevada and Texas.

A judge found that EB Holdings' failure to include the financial liability information on the policy application was a material misrepresentation under Nevada law.

EB Holdings appealed the summary judgment, saying an omission is not a misrepresentation and that Texas law should apply to the dispute.

Under Nevada law, there is no requirement to show an intent to defraud by EB Holdings for a misrepresentation to be material, Mr. Siegel said. Conversely, the intent to defraud is a prerequisite for determining if a misrepresentation is material under Texas law.

"It's very difficult for a carrier to show a policyholder's intent on summary judgment. So much involves determinations of credibility and weighing of facts," Mr. Siegel said.

An insurer's knowledge about a policyholder's long-term debts when providing a D&O policy is crucial, he said.

A potentially insolvent policyholder faces a higher risk of bankruptcy litigation, suits from creditors for unpaid bills, and suits against directors and officers for breach of fiduciary duty and failure to disclose, Mr. Siegel said.

Lilit Asadourian, a Los Angeles-based policyholder attorney with Barnes & Thornburg LLP, said the choice of law issue could be decisive if the appeals court reverses and agrees with EB Holdings that Texas law should be applied.

"At a minimum, it seems like there's a factual question about whether or not the insured actually made misstatements. There's also a critical legal question, one that has wide-ranging consequences, which is how can leaving something blank then be concluded to be a misrepresentation," Ms. Asadourian said.

Additionally, there's an element of fairness when it comes to how long the insurer can wait to raise certain defenses, such as denial based on a material misrepresentation, she said.

"There's something to be said for the amount of time that the insurer sat on the issue without disclosing it or raising it as an affirmative defense and whether that constitutes a waiver," Ms. Asadourian said.

Michael Levine, a Washington-based insurance recovery partner at Hunton Andrews Kurth LLC, said the case should come down to whether, at the time the insurer sold the policy, it had sufficient knowledge of EB Holdings' $1.4 billion debt. With information detailing that debt from the insurer's 2013 underwriting, it is difficult to believe that the insurer did not have sufficient information at its disposal to at least prompt questions about the substantially lower long-term debt only two years later, he said.

"The bigger issue is whether Illinois National waived its right to disclaim coverage," Mr. Levine said.

The parties and their representatives did not respond to requests for comment.
