

CORPORATE INSURANCE LAW

Expert Analysis

Delaware Ruling Underscores Significance of Warranty Statements

When policyholders switch insurance carriers or seek to increase the limits of their management liability or professional liability insurance programs by adding additional excess insurance layers, it is routine for the new insurers to require a warranty statement in which the policyholder represents that it is not aware of any facts or circumstances that may give rise to a claim—or, alternatively, discloses any known circumstances that may give rise to a claim. The warranty statement may be contained within a broader application or may be a separate document. In some cases, whether or not to disclose certain known circumstances in connection with a warranty statement is fairly apparent. In other cases,

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whether or not a particular situation requires disclosure to an insurer may fall within a gray area for which consultation with counsel is recommended.

Whether or not a situation merits disclosure can be an important decision because, depending on the specific terms of the warranty statement or applicable insurance policy, the failure to disclose where required may very well jeopardize coverage for a claim. For example, in a recent case that may be viewed as a cautionary tale, the Superior Court for the State of Delaware held that an investment advisor insured's failure to disclose was dispositive, granting summary judgment to the excess insurers

because, according to the court, the insured had executed a warranty statement without disclosing an ongoing SEC inquiry. *Infinity Q Capital Management, LLC, et al. v. Travelers Casualty and Surety Company, et al.*, 2022 WL 3902803, No. N21C-07-158 EMD CCLD (Superior Court of the State of Delaware, Aug. 15, 2022).

Infinity Q's Insurance Program

The plaintiff insured in the recent Delaware case was Infinity Q Capital Management LLC, a New York registered investment advisor organized under the laws of Delaware and an advisor to two funds.

According to the court's recitation of the facts, from 2014 through August 2020, Infinity Q maintained \$5 million in professional liability insurance through a primary insurance policy issued by Chubb. In August 2020, Infinity Q added three excess insurance policies that provided coverage

for claims made during the period from August 2020 through August 2021. Travelers issued the first layer excess policy, Axis issued the second layer excess policy and Arch issued the third layer excess policy. Each of the excess insurers issued policies with a limit of liability of \$5 million so that collectively Infinity Q had access to \$15 million in excess insurance above the \$5 million Chubb primary policy.

Prior to binding of the excess policies, Infinity Q executed a required warranty statement that provided as follows:

“To whom it may concern:

No person or entity for whom this insurance is intended has any knowledge or information of any act, error, omission, fact or circumstance that may give rise to a claim under the proposed insurance.

It is agreed that any claim for, based upon, arising from, or in any way related to any act, error, omission, fact or circumstance of which any such person or entity has any knowledge or information shall be excluded from coverage under the proposed insurance.

It is also agreed that Arch Insurance Group Inc. and its insurance company subsidiaries are relying upon the above representation and that this letter shall be deemed

incorporated into any insurance policy issued for the proposed insurance.”

2022 WL 3902803 at *4.

The Noticed Claims

In February 2021, Infinity Q notified its insurers of an SEC investigation into Infinity Q’s valuation policies which generally alleged that Infinity Q may have engaged in schemes to defraud clients or prospective clients in violation of federal securities laws. The SEC investigation included a subpoena issued to Infinity Q in

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November 2020. Infinity Q would subsequently provide notice of and seek coverage for related matters including a securities class action filed by investors, several other civil actions, an investigation by the U.S. Attorney’s Office, an indictment of Infinity Q’s chief investment officer, a SEC civil enforcement proceeding and a CFTC enforcement proceeding.

The primary insurer determined that the SEC investigation and the other noticed matters arose from the same facts, treated them as a single claim under the policy and agreed to advance defense costs related to the noticed matters. Travelers, the first layer excess insurer, issued a reservation of rights letter reserving its right to deny coverage on the basis that Infinity Q’s chief investment officer had knowledge of “an act, error or omission, fact or circumstance that may give rise to a claim under the proposed insurance” at the time that the warranty statement was submitted, and therefore coverage for the noticed matters was barred by a prior knowledge exclusion. 2022 WL 3902803 at *10.

On July 21, 2021, Infinity Q filed suit against its excess insurers seeking declaratory relief regarding the insurers’ defense and indemnification obligations. Several months later, the parties filed motions for summary judgment. Infinity Q moved for partial summary judgment seeking a declaration that the excess insurers were required to advance defense costs while the excess insurers moved for summary judgment asserting that Infinity Q’s failure to disclose an ongoing SEC inquiry in the warranty statement precluded coverage.

The Court's Ruling

According to the court's ruling, in the spring of 2020, prior to the time that Infinity Q increased its excess insurance limits, the SEC had commenced an inquiry focused on Infinity Q's valuation policies and concerns about the valuation of assets held by Infinity Q's funds. During this time period, the SEC Division of Enforcement sent multiple letters to Infinity Q including requests for documents and information, Infinity Q executives discussed the inquiry internally, retained outside counsel to assist in the response and determined to increase the insurance coverage limits.

In connection with procuring the excess insurance in August 2020, Infinity Q executed the warranty statement representing that no person or entity to be insured had knowledge of any facts or circumstances that may give rise to a claim. The warranty statement further provided that any claim arising out of a known and undisclosed circumstance would be excluded from coverage under any issued insurance policy.

According to the court, Infinity Q's failure to disclose the ongoing SEC inquiry in connection with the warranty statement was fatal to Infinity Q's insurance

claim. The court found that Infinity Q's executives were aware of the SEC inquiry at the time the excess policies were purchased and as such were aware of facts or circumstances that may give rise to a claim under the insurance policies at the time the warranty letter was executed.

Consequently, the court held that the prior knowledge exclusion in the warranty statement, which by its terms was incorporated into the insurance policies,

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barred coverage for the claims in dispute and granted summary judgment to the excess insurers.

Looking Forward

It is certainly possible that had Infinity Q disclosed the SEC inquiry to the excess insurers, the insurers would have included a specific exclusion in the policies barring coverage for costs related to the SEC inquiry and any related matters. But it is also possible that there was an

opportunity to insure the risk or, if not the costs of responding to the SEC investigation, perhaps the risks associated with related civil lawsuits.

The clear lesson from this case is that, in connection with a warranty statement, it is important to carefully evaluate known information prior to execution—particularly with respect to government inquiries and proceedings—and to carefully consider the impact of disclosing or not disclosing potentially significant matters. When there is a close call, best practice is to consult with counsel and/or a trusted insurance broker to determine the appropriate course of conduct under the circumstances.

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