New Supreme Court Ruling – Recognition of the Innocent Co-Insured Doctrine

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Dear clients and friends,

On March 10, 2020, the Israeli Supreme Court, in a ruling by Justice Grosskopf, with the concurrence of Justices Amit and Karra, recognized the doctrine of the Innocent Co-Insured in Israeli Insurance law ("**the Ruling**" and "**the Doctrine**") – CA 7058/17 *Nathan Melamed v. Tziona Leibowitz Et al.*

According to the Doctrine, *mala fide* misconduct of one of the insured parties does not necessarily void the coverage of the other "innocent" insured parties.

The ruling addressed a case regarding embezzlement of funds by a hedge fund manager, for which he was sentenced to 68 months in prison. The investors sued, *inter alia*, the hedge fund manager, the hedge fund's investment broker, a director at the hedge fund and the insurance company which insured the hedge fund in a policy providing professional indemnity for its director and its broker.

The District Court ruled in favor of the investors (claimants) as regards claims against the convicted hedge fund manager – who did not file a defense; as regards the claims against the broker – on a theory of negligence; and as regards the director – for violating his duty of care and good faith. However, the District Court rejected the investors' claims against the insurance company, *inter alia*, because the director did not fully disclose pertinent information in the process of obtaining the insurance policy.

The ruling addressed several issues which were appealed, including as to the liability of the broker and director, as to the quantification of damages and others – including the application of the Innocent Co-Insured Doctrine, which is the subject of this update.

Justice Grosskopf, with the concurrence of Justices Amit and Karra, ruled, that the Doctrine should be recognized, yet not apply to this specific case. Justice Grosskopf further elaborated and delineated the situations in which the Doctrine should apply and how, a level of detail that Justices Amit and Karra thought did not need to be decided in this specific case.

According to Justice Grosskopf, the first distinct categorization of cases differentiates between parties who share a common interest in the insured where the insurance company has one liability to multiple parties (for example joint owners of property destroyed by fire), and parties with separate interests where the insurance company has multiple individual liabilities to the parties (for example neighbors or landlord and tenant).

Justice Grosskopf notes, that as a general principle, the further apart the interests of the parties are, the more justification there is for applying the Doctrine.

The second distinct categorization of cases distinguishes between matters relating to the formation of the policy and matters pertaining to conduct after the policy is in effect.

The third distinction is drawn between cases where the “guilty” insured party had intent to defraud, versus cases where the party had simply failed to disclose information, for example, where such was not specifically requested yet should have objectively been disclosed as relevant information.

Justice Grosskopf described prior Israeli jurisprudence, as relating to conduct and not to formation. As regards formation, Justice Grosskopf analyzed the US case of *Illinois State Bar Ass'n Mutual Insurance Co. v. Law Office of Tuzzolino & Terpinas* 2015 IL 117096 (S.C. of Ill.). In that case, Tuzzolino and Terpinas were partners in a law firm, and Tuzzolino submitted incorrect information in response to a question on the professional indemnity policy of their firm.

The majority opinion of the Illinois Supreme Court ruled that where there was intent to defraud, only then does the “innocence” of the co-insured become a factor, rather than simple non-disclosure where the issue is one of whether the insurance company issued a policy with a mistaken assessment of risk.

Justice Grosskopf proposes that in case the liabilities of the insurance company are to separate parties, with separate interests, it would be unfair to void all liabilities simply because one of the parties intentionally defrauded the insurance company if the liability to the other parties is severable.

In turn, Justice Grosskopf proposes the following chart for application of the Doctrine in each of these categories.

	Matters relating to formation		Matters relating to conduct	
	No “guilt”	“guilt”	No “guilt”	“guilt”
Parties with a shared interest	Would not apply	To be determined	Would not apply	To be determined
Parties with separate interests	Would not apply	Would probably apply but the scope of coverage may be limited	Would not apply	Would apply

Concurrently, since under article 7(c)(2) of the Israeli Insurance Contract Law, 5741-1981, and the jurisprudence which applied it, insurance companies have a defense to coverage when an insured party failed to disclose information which would have caused a reasonable insurer to avoid issuing a policy, the mere innocence of one of the parties in such a circumstance cannot be enough to circumvent a defense which in any case is not dependent on guilt.

In this case, Justice Grosskopf decided that the parties (director, broker and investors) have different interests. However, under the circumstances of the case, it was held that the director’s failure to disclose material information prior to the issuance of the policy, was not one of “guilt” but rather where a reasonable insurer would not have issued the policy had the omitted facts been known to it.

Accordingly, it was held that the Doctrine does not apply in this case.

Click here for the full ruling (in Hebrew).

Please do not hesitate to contact us with any questions or if you require any clarification regarding any of the matters above.

Sincerely,

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