Lawyer Insights

Court Refuses to Dismiss Claims in RWI Lawsuit

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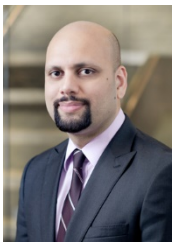

Disputes in court involving representations and warranties insurance (RWI) claims are rare because many claims are resolved before a formal dispute and many policies contain arbitration provisions. Thus, a New York state court's recent denial of a motion to dismiss in a case involving coverage under an RWI policy is especially notable.

The case arose out of Novolex Holding's $2.275 billion acquisition of The Waddington Group (TWG), a manufacturer of food packaging and disposable products, pursuant to an Equity Purchase Agreement (EPA). Following the transaction, Novolex alleged that various representations in the EPA had been breached. The breaches related to the overarching allegation that TWG knew that its third-largest customer, Costco, intended to significantly reduce its business with TWG. Novolex claimed damages of about $267 million.

Illinois Union Insurance Company insured an excess layer of Novolex's tower of representations and warranties insurance. It denied coverage, and Novolex sued. Illinois Union then moved to dismiss portions of the lawsuit that alleged TWG had breached Section 3.18 of the EPA. The relevant part of that representation stated that:

Since December 31, 2017, there has not been any written notice or, to the Knowledge of Parent, any oral notice, from any such Material Relationship that such Material Relationship has terminated, canceled or adversely and materially modified or intends to terminate, cancel or adversely and materially modify any Contract between a Purchased Company and any such Material Relationship.

In short, Illinois Union argued in its motion to dismiss that Novolex failed to allege that any "Contract" had been or was intended to be terminated, canceled, or adversely modified, and thus there was no breach of Section 3.18. Illinois Union reasoned that none of the written agreements between TWG and Costco imposed a legally binding commitment on Costco to make purchases from TWG in the future. Thus, according to Illinois Union, Costco's intention to reduce its purchases in the future was not a termination or modification of any existing "Contract."

The court rejected Illinois Union's arguments for two reasons. First, the court found that so-called promotional agreements, which Novolex had described as a type of purchase order and which involved the sale of products prior to the holidays, qualified as "Contracts" encompassed within Section 3.18. While the Court found those promotional agreements qualified as a "Contract," it did not explain why it did not make a similar finding for another type of purchase order called replenishment contracts. Novolex had also relied on those replenishment contracts in opposing the motion to dismiss.

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Second, the court found that Section 3.18 could be read to include a representation that TWG had no knowledge that any material relationship would be terminated, canceled, or adversely modified, regardless of whether any "Contract" would be affected. Focusing on the use of the word "or," the court explained that it was "possible" that the "or is first as to relationships and secondly as to contracts." Interestingly, Novolex had not expressly raised that argument in the motion to dismiss briefing.

These findings highlight the potential for uncertainty in asking courts to resolve disputes over claims under RWI policies. The disagreements can involve dense corporate agreements with ambiguous, wordy provisions ripe for creating disputes between contracting parties and insurers. Adding another third party (the court) to the mix to resolve those differences may even result in previously unconsidered interpretations. The court, of course, is not limited to the contentions made by the parties in their motions and responses.

In the Novolex decision, the court reached two conclusions that the contracting parties may not have anticipated. First, it might have considered promotional agreements as being encompassed within representations in the purchase agreement that did not also encompass other types of purchase orders like replenishment contracts. (The court's statements in its oral ruling do not reveal whether it in fact reached that conclusion.) Second, it interpreted a representation in the purchase agreement in a manner not expressly advanced by either contracting party during briefing.

In any event, the uncertainties that this decision highlight may explain, at least in part, why RWI claims are subject to more negotiation than more run-of-the-mill insurance claims. And it might help explain why RWI policies frequently contain arbitration clauses, which can lead to subject-matter experts resolving disputes rather than more generalized judges resolving disputes in court. The *Novolex* case now continues and, as one of the rare lawsuits involving RWI, is one to keep an eye on.

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