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NEWSLETTER

# California Appellate Court Confirms That Misrepresentations Made in Connection with Application Support Rescission As to All Insureds

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In a decision certified for publication, the California Court of Appeal has held that an excess insurer was entitled to rescind a D&O policy as to the company and all individual insureds because the company's chief financial officer (CFO) knew that materials he submitted to the primary carrier, which were also relied upon by the excess insurer in the underwriting process, contained material misrepresentations. *TIG Ins. Co. of Michigan v. Homestore, Inc.*, No. B176533 (Cal. Ct. App. March 13, 2006).

In 2001, the policyholder obtained D&O insurance coverage from several insurers. The applications were signed by the company's CFO, who also submitted, as required, the most recent 10K and 10Q SEC filings of the company. The primary policy stated "[t]hat the statements in the Application and in any materials submitted therewith are their representations, and they shall be deemed material to the acceptance of the risk or hazard assumed by the Insurer . . . ." That policy also provided that if the application was signed by an individual with knowledge of misrepresentations contained in the materials submitted, then the "[p]olicy in its entirety shall be void and of no effect . . . ." Subsequently, the CFO who signed the application, along with two other former officers of the company, was accused of illegally inflating the company's revenue. In 2002, the CFO pleaded guilty to conspiracy to commit securities fraud. Thereafter, the primary insurer rescinded the policy, and that rescission was ultimately upheld by the United States Court of Appeals for the Ninth Circuit. *See Fed. Ins. Co. v. Homestore, Inc.* (9th Cir. Aug. 12, 2005) (reported in the August 2005 issue of *The Executive Summary*). In affirming the rescission, the Ninth Circuit held that the operative policy language was unambiguous and permitted the primary carrier to rescind as to all insureds based on the CFO's knowing submission of a materially false 10Q in connection with the application.

The excess insurer filed a complaint for rescission in state court, relying on the same misrepresentation alleged in the federal action. The trial court granted the excess insurer's motion for summary judgment, and the policyholder and several individual insureds appealed. The insureds contended that the operative policy language was ambiguous as to whether the excess insurer could rescind with respect to individual insureds who were unaware of the misrepresentations, and that triable issues of fact existed regarding whether the

elements for rescission had been met.

The appellate court first disposed of the argument that the policy language on which the excess insurer relied was ambiguous. That language, contained in the underlying primary policy, provided that "[i]n the event that the Application, including materials submitted therewith, contains misrepresentations made with the actual intent to deceive, or contains misrepresentations which materially affect either the acceptance of the risk or the hazard assumed by the Insurer under this Policy, no coverage shall be afforded . . . for any Director or Officer who did not sign the Application but who knew on the inception date of this Policy the facts were so misrepresented, and this Policy in its entirety shall be void and of no effect whatsoever if such misrepresentations were known to be untrue on the inception date of the Policy by one or more of the individuals who signed the application." In response to the insureds' contention that this language was "reasonably subject to the interpretation that a misrepresentation known by one or more of the individuals who signed the application renders the policy voidable only as to the signers and not innocent non-signers," the appellate court determined that the insureds' arguments relied on a "distorted dissection of the provision's grammar and sentence structure and would render the distinction between signers and non-signers essentially meaningless." Accordingly, the court concluded that the language was unambiguous and operated to render the excess policy void as to all insureds.

The court then considered the insureds' contention that the policy language should not be enforced because it is contrary to public policy and because it was not "conspicuous, plain and clear." With respect to the public policy argument, the court noted that that California Insurance Code Section 650 belied that argument, as rescission as to all insureds could not be contrary to public policy where California statutory provisions specifically contemplated that rescission "shall apply to all insureds under the contract, including additional insureds, unless the contract provides otherwise." In considering the insureds' argument that the policy language was unenforceable because it was not conspicuous, the court first distinguished the authority on which the insureds relied, determining that such a requirement was imposed on exclusions that limited coverage and that might be otherwise contrary to an insured's reasonable expectations. The court also noted that, in any event, the policy language was sufficiently "plain and clear" that the insureds' argument was without merit.

Finally, the court rejected the argument that the excess insurer was required to establish that the misrepresentations in fact had a material effect on its acceptance of the risk, noting that, "on this record [the policyholder's] grossly misrepresented financial condition was material to the acceptance of the risk as a matter of law."