

Coverage for Different Claim Filed Within the Policy Period Does Not Waive Insurer's Right to Rescind Policy

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In an unreported decision, the Court of Appeal of California has affirmed the grant of summary judgment to an employment practices liability insurer based on material misrepresentations made during the application process. *Sigue Corp. v. Farmers Ins. Group*, 2007 WL 586689 (Cal. Ct. App. Feb. 27, 2007). The court also held that the insurer's decision to provide coverage for a claim made during the policy period did not constitute a waiver of the insurer's right to rescind the policy because the insurer reserved its rights and defenses under the policy as to the other claims.

The insured entity, in applying for the policy, signed an employment practices warranty that it was unaware "of any employment practices claims or any facts, incidents or circumstances that may result in a claim" against any prospective insured as defined in the policy. The entity further warranted that it had not "received any employment related inquiry, complaint or charge from any municipal, state or federal regulatory authority or agency" and it had not had a "claim, demand, suit or grievance" brought against it. The insurer subsequently issued a policy with a policy period from April 7, 2003 to April 7, 2004.

Unbeknownst to the insurer, the entity was subject to numerous employment discrimination claims at the time the application and warranty letters were signed. The insured had received notice of several formal complaints from the California Department of Fair Employment and Housing and had obtained outside counsel and investigators in anticipation of litigation in 2002. Suits were filed against the insured on January 31, 2003 and April 22, 2003. The insurer did not receive notice of these claims until March 17, 2004, and it denied coverage because the claims were not first made during the policy period. However, the insurer issued a reservation of rights letter and agreed to pay reasonable defense expenses for a February 2004 claim.

The insured subsequently sued the insurer, alleging breach of contract and breach of the duty of good faith and fair dealing in connection with the denied claims. The insured argued that the insurer waived its right to rescind the policy when it agreed to cover the February claim. The court of appeal disagreed.

First, the court reasoned that a insurer is entitled to rescind a policy when "a representation is false in a material point, whether affirmative or promissory, . . . from the time the representation becomes false." CAL. INS. CODE § 359 (2005). According to the court, whether a representation is material requires a subjective determination from the insurer's perspective. The insurer's underwriter testified that had the insurer known of the existing claims, the policy would have been issued with different terms and might not have been issued at all, which was sufficient to support rescission. Second, the court reasoned that waiver requires an intent to relinquish a known right, so an insurer cannot waive its right to rescind a policy based on false representations when it is unaware of the falsity of those representations. Further, the court stated that the insurer properly reserved its rights and defenses when it agreed to cover reasonable defense costs for the February claim.