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NEWSLETTER

D&O Policies Void *Ab Initio* Where Policyholder Misrepresented Its Claims History in Policy Applications

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The United States District Court for the Central District of California, applying California law, has held that two policies providing D&O and EPL coverage were void *ab initio* due to the policyholder's failure to disclose material information about its claims history during the application process. *U.S. Specialty Ins. Co. v. Bridge Capital Corp.*, 2007 U.S. Dist. LEXIS 27946 (C.D. Cal. Mar. 12, 2007). Wiley Rein LLP represented the insurer in this action.

The policyholder first obtained a policy in 2004 and renewed the policy in 2005. The application for the 2004 policy sought disclosure of any claims made against the insured in the past five years. In response, the application disclosed the existence of a single claim filed by a former employee, which was characterized as a "frivolous gender discrimination suit." During the 2004 policy period, the company tendered to the insurer for defense a suit alleging sexual harassment, wrongful termination and gender discrimination. On the 2005 application, the company disclosed the claim that had been submitted to the insurer, which the company characterized as a gender discrimination suit. The company also provided an appendix of litigated matters that described another suit as one for "unpaid commissions."

In the course of reviewing information provided by defense counsel for the claim tendered under the 2004 policy, the insurer discovered the existence of additional undisclosed sexual harassment claims. The insurer learned that the claim that was disclosed on the 2004 application as a "gender discrimination" claim in fact included allegations of sexual harassment. It also learned that the "unpaid commissions" suit was an action based in part on sexual harassment and retaliation. Defense counsel also provided information sufficient to allow the insurer to determine that at least one additional sexual harassment claim was not disclosed on either application.

Based on the newly discovered information, the insurer determined that the insureds had made material misrepresentations during the application process and rescinded the policies. On the same day, the insurer filed the declaratory judgment action seeking to establish that the rescission was proper and that the policies were void *ab initio*.

On summary judgment, the court first concluded that the company's disclosure of its prior claims history was incomplete and misleading, as the CEO, who signed each application, was the subject of the undisclosed claims and was aware that each included allegations of sexual harassment. The court also concluded that the misrepresentations were material, emphasizing the fact that the insurer had specifically asked about claims history on the applications and citing testimony from several underwriters stating that they would not have issued the policies had they known about the CEO's "alleged history of sexual harassment."

The court then rejected the argument that the term "claim" was undefined in the application and that the defendants believed that the term only applied to complaints formally filed in court. According to the court, under California law, "the term 'claim' has a well-established, unambiguous definition . . . as 'the assertion of a liability of the party, demanding that the party perform some service or pay some sum." Citing the fact that there was no dispute that counsel for the subjects of the alleged sexual harassment had all made formal demands for money from the insureds, the court concluded that those demands constituted claims that should have been disclosed on the applications. Accordingly, the court determined that the policies were properly rescinded.