

Partners and Partnership Policy Rescinded Based on Material Misrepresentation

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The United States District Court for the Northern District of California, applying California law, has awarded summary judgment to an insurer and ordered that a general partners liability and partnership indemnification policy be rescinded on grounds of breach of warranty, concealment and material misrepresentation because the policyholder failed to reveal the existence of a dispute with a limited partner on the policy application. *Butcher v. Gulf Ins. Co.*, 2005 WL 1514086 (N.D. Cal. June 15, 2005). In so ruling, the court scrutinized the policyholder's representations as of the date on which the policy was issued, rather than the date on which the insurer sent the policy binder to the policyholder.

The policy at issue was a general partners liability and partnership indemnification policy covering the period from February 1, 2000, to February 1, 2001, with a renewal period of February 1, 2001, to February 1, 2002. The coverage applied to any "loss" incurred by any general partner as a result of any "claim" for a "wrongful act" made against any general partner during the policy period. The policy defined "claim" to include "written demand(s) for monetary or non-monetary relief," and "civil proceeding(s) commenced by the service of a complaint or similar pleading."

The insureds were the named defendants in three civil suits for which they sought coverage under the policy. With respect to one of those suits, the court noted that in January 2001, a limited partner in one of the insured limited partnerships sued the limited partnership concerning a disputed real estate transaction. The limited partner alleged breach of contract, breach of fiduciary duty and other tort violations. In October 1999, a general partner for one of the insured entities had advised the entity's other general partners that "we need to provide the [requested] information [to the limited partner] or be prepared for litigation." This same general partner proposed to the plaintiff that the two sides engage in a settlement meeting that would be "governed by" California Evidence Code Sections 1152 and 1154, which the court noted, "relate to negotiations for the settlement of a claim." Another general partner attended the settlement meeting and later wrote a memorandum stating that the limited partner "believes...he has a claim." On February 16, 2000, an attorney for the limited partner wrote a letter to the insured entities proposing a tolling agreement as a condition to continued negotiations. In a handwritten notation to that letter, the general partner who proposed the settlement meeting wrote an "instruction to tender" the matter "under the GPL policy." On March 23, 2000, the limited partner's attorney wrote to the insured entities making a formal written "demand for settlement of [the limited partner's] claim against" one of the insured entities and its individual partners. The limited partner

subsequently filed suit against the insureds in January 2001.

In response to the policyholder's claim for coverage for the January 2001 lawsuit and other claims made under the policy, the insurer filed for summary judgment before the district court, arguing that the policy should be rescinded on grounds of breach of warranty, concealment, material misrepresentation and fraud. The insurer specifically cited the policyholder's failure to disclose in its policy application the existence of a dispute with the limited partner that ultimately culminated in the January 2001 suit. The policyholders had responded "None" and "No," respectively, to questions asking whether there had "been...[or were] pending any claim against anyone proposed for insurance," or whether any general partner "has knowledge or information of any fact, circumstance or situation which might give rise to a Claim."

In assessing the rescission claim, the court first determined that the insured entities' representations and warranties to the insurer "must be judged as of April 27, 2000, the date the policy was issued." The insureds had urged the court to consider instead whether its representations to the insurer were accurate as of February 1, 2000, the date on which the insurer had sent the policyholders a binder of insurance for the liability policy. The court concluded that the dispute with the limited partner constituted a claim "at least as of March 23, 2000," and noted that the completed policy application was not submitted to the insurer by the broker until March 29, 2000. The court rejected the insureds' arguments that the insurer waived its right to the subject information because it failed to investigate general references to litigation contained in the policyholder's financial statements. It explained that California law imposed such a duty only where the insurer has evidence contradictory to application answers. The court also found that, under California law, the materiality of the information pertaining to the dispute with the limited partner was established by the fact that the insurer "demanded answers to specific questions." The court accordingly concluded that the policyholders' failure to supply the subject information constituted breach of warranty, concealment and material misrepresentation warranting rescission. In addition, the court rejected the policyholder's contention that the insurer was required to advance defense costs until the court granted rescission of the policy, reasoning that such an approach was contrary to the policy's specific language providing that it did not impose a duty to defend on the insurer.

Although the rescission determination resolved the case, the court also addressed the insurer's coverage arguments "to complete the record." It then indicated that coverage for the insureds' claims would have been barred by the policy's notice provision, insured vs. insured exclusion and the prior and pending litigation exclusion. The court separately rejected the policyholders' bad faith claim.

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