2023 PARMA ANNUAL RISK MANAGERS CONFERENCE
February 8, 2023 – 10:30 a.m. – 12:00 p.m.

Underwriting Public Entity Risks in the Twenty-First Century: Underwriting and Associated Legal Issues

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ADDITIONAL INSURED ENDORSEMENTS

I. Additional Insureds

Insureds will frequently have third parties whom they wish—or are contractually obligated—to verify the existence of coverage to and/or to provide insurance coverage for. The most common way of handling such obligations is through the issuance of "Certificates of Insurance" and the addition of third parties as "additional insureds".

A. Additional Insured Endorsements

1. An "Additional insured" is a person or entity who is not a "named insured" under the policy of insurance, who qualifies as an insured under the policy by either:

(a) satisfying the "insured person" definition; or

(b) by being named as and/or satisfying the conditions of an "Additional Insured" endorsement.

2. Effect of Additional Insured Status

(a) When a public agency has additional insurance status under the policy of a vendor or a contractor:

(i) The Named Insured (the vendor/contractor) pays the premiums and deductibles for the policy, retains the power to cancel the policy, and receives any notice of cancelation of the policy.

(ii) The Additional Insured receives protection under the policy, meaning the insurer owes a duty to defend and indemnify the additional insured, without the obligation to pay a policy premium or deductible. The Additional Insured may also be entitled to receive notice of cancellation, *if the policy or endorsement so specifies*. (*Kotlar v. Hartford Fire Ins. Co.* (2000) 83 Cal.App.4th 1116, 1121; Ins. Code, § 677.2(b).)

B. How Does A Party Become An Additional Insured?

1. Most commonly: by way of an Additional Insured is added to a policy is via an endorsement. An endorsement is a writing which is added or attached to a policy, and when correctly added the endorsement is part of the contract of insurance. The Insurance Services Office ("ISO") provides forms which are accessible online. These forms offer standardized and accepted language to add an Additional Insured to a policy.

2. Multiple forms of endorsement exist:

(a) a blanket additional insured endorsement;

(b) a specific standard endorsement, or

(c) a non-standard endorsement.

As part of a contract with a third-party, an agency *may* be able to specify which ISO forms should be used – though increasingly, there is no guarantee that commercial insurers will agree to utilize forms providing broader coverage.

(i) BLANKET ADDITIONAL INSURED ENDORSEMENT

The Blanket Additional Insured Endorsement- ISO forms 20 33 04 13 and 20 38 04 13.

A blanket additional insured or automatic blanket endorsement allows a Named Insured to add an Additional Insured to the policy by entering into a contract requiring such coverage without the need to actually list the name of the person or entity on the endorsement.

Other blanket additional insured endorsements are effective even without a contractual relationship between the parties. For example, a Sub-Contractor who is required by a General Contractor to add the Owner as Additional Insured.

(ii) SPECIFIC STANDARD ENDORSEMENT

A specific endorsement extends coverage only to parties which the Named Insured lists under "Names of Additional Insured Person(s) or Organization(s)." ISO forms CG 20 10 and CG 20 37.

If a specific endorsement is used, the Agency should request a copy of the endorsement to ensure that the entity and/or location has been correctly listed.

Some insurers may draft non-standard ("manuscript") additional insured endorsements. Review these non-standards forms carefully. Compare these forms to the standard ISO endorsements and when in doubt, have your insurance provider review the documents to make sure the agency is appropriately covered.

3. General Considerations

(a) An additional insured endorsement is a grant of coverage. As such, California courts will interpret it broadly in favor of coverage, *such that any limitations on coverage for the AI must be clear and unambiguous to be enforceable. See, e.g., Pulte Home Corp. v. Am. Safety Indem. Co.* (2017) 14 Cal.App.5th 1086, 1106 (additional insured endorsements interpreted "in favor of the insured's reasonable expectations" since the endorsement language itself was not "actually negotiated" or "jointly drafted").

(b) Additional insured endorsements provide flexibility:

(i) An additional insured endorsement can specify which individual(s) within a corporate entity are entitled to coverage (i.e. "members" or "managers" of an LLC, etc.);

(ii) Additional insured endorsements can limit which coverage provisions of the policy apply to the AI and which do not;

(iii) The additional insured endorsement can give the additional insured liability coverage only in certain situations (i.e. "bodily injury" and "property damage" coverage "arising out of" specified work or conditions.)

C. "On-going" vs "Completed Operations"

1. Additional Insured endorsements sometimes differentiate between whether they apply to "on-going" or "completed" operations:

(a) "On-going" operations coverage refers to work which is ongoing and which has not yet been completed or abandoned;

(b) In contrast, a project is "completed" when "(1) when all of the work called for in the insured's contract has been completed, (2) when all of the work to be done at the job site has been completed if the insured's contract calls for work at more than one job site, or (3) when that part of the work done at a job site has been put to its intended use by any person or organization other than another contractor or subcontractor working on the same project."

Failure to procure coverage for both "on-going" and "completed" operations could leave any agency exposed to losses which occur years after a project is completed. *Weitz Co., LLC v. Mid-Century Ins. Co.* (Colo. App. 2007) 181 P.3d 309.

(c) Different endorsement forms treat these categories differently:

(i) The CG 20 10 11 85 endorsement (now rarely used) refers to coverage arising out of "your work." The phrase "your work" was interpreted to cover both "on going" operations and "completed" operations.

(ii) The subsequent versions of the 20 10 form language changed "your work' to "your ongoing operations" and GC 20 37 form endorsement was introduced to cover completed operations.

(d) As it relates to the effect of such language, California courts interpreting the phrase "Ongoing operations" have stated that "[t]hose ongoing operations are defined in the Subcontract itself, that is, the work to be performed for [contractor] under the Subcontract. Thus, the language of the endorsement refers expressly to the Subcontract." *St. Paul Fire & Marine Ins. Co. v. American Dynasty Surplus Lines Ins. Co.* (2002) 101 Cal.App.4th 1038, 1057.

In turn, "Your work" is typically defined in the policy as: "(1) Work or operations performed by you or on your behalf; and (2) Materials, parts or equipment furnished in connection with such work or operations."

"The difference between 'your work' and 'your ongoing operations' is that 'your work,' within the parameters of the CGL definition, can be either work in progress or work that has been completed; 'ongoing operations' is not a defined CGL term, but suggests work only for as long as it is actually being performed. In short, coverage for the additional insured with respect to the named insured's completed operations was clearly present in the original edition of CG 20 10. The insurance industry sought to remove that component of coverage by insuring only liability arising out of the named insured's ongoing operations--or work in progress--beginning with the 1993 version of the endorsement." D. Malecki, P. Ligeros & J. Gibson, THE ADDITIONAL INSURED BOOK 184 (5th ed. 2004)

(e) The most recent ISO forms, effective December 1, 2019, have introduced separate blanket additional insured endorsements for ongoing and completed operations coverage.

D. Potential Issues Regarding Additional Insured Coverage

1. Notice to the Insurer of a Loss, Claim or Suit

(a) Most insurance policies require that "you" give notice of an occurrence, suit, or claim, referring to the Named Insured in the policy. In certain circumstances, notice by a named insured may inure to the benefit of an additional insured. *See, e.g., Sawyer v. Westchester Fire Ins. Co.* (2002) 2002 WL 31579159 *14 (unpub'd) (letters from

named insured pointing out basis for additional insured's coverage sufficed to place insurer on notice).

(b) However, a policy may require additional insured to provide notice of loss. *See, Wasson v. Atlantic Nat'l Ins. Co.* (1962) 207 Cal.App.2d 464, 468 (policy language may impose duty of notice on additional insured, though in this instance, delay in additional insured's provision of notice excused)

(c) Accordingly, an additional insured would be wise to provide notice to insurance carriers and risk pools, regardless of whether express policy language requires such notice, and regardless whether it believes other parties have provided such notice.

Additional insureds should also consider placing *excess* carriers on notice, where the circumstances suggest a claim or suit potentially exceeding the limits of primary insurance.

2. Notice By Insurer to Insured of Termination of Policy

Because an insurer's notice obligations generally run to the Named Insured, and an insurer has no obligation to provide notice of cancellation to additional insureds. *See, Kotlar v. Hartford Fire Ins. Co.* (2000) 83 Cal.App.4th 1116, 1121, n. 3.

Consequently, the endorsement should state that policies must be endorsed to require the insurer(s) to provide at least 30 days written notice to the public agency before any termination of coverage.

3. "Occurrence" vs "Claims Made" Policies

(a) An "Occurrence" policy covers all incidents that occur during a policy period, regardless of when the claim is reported.

This ensures that liabilities that arise due to events that occur during the term of a contract are covered by the insurance policies.

(b) A "Claims-Made and Reported" policy only covers incidents that happen and are reported to the insurer within the policy's time frame, unless a 'tail' is purchased.

In many instances, professional liability insurance policies are written only on a claims-made basis and may be unavailable on an occurrence basis.

(c) On a claims-made policy, a claim must be submitted to the insurer while the policy is in effect.

4. Potential Issues Regarding Additional Insured Coverage "Primary" Coverage

(a) Unless so specified, coverage available to an Agency under an additional insured endorsement may be "co-primary" with the Agency's own insurance unless otherwise specified.

(b) Requiring that the third-party's policy is to provide "primary" protection for the Agency as an "additional insured" and that the public agency's insurance is not obligated to contribute to a loss which should be paid by the other party's insurer limits potential liability.

Such a provision also has other effects, including preventing the other party's insurer from seeking contribution from the public entity's insurer/risk pool.

To be effective and binding against the other party's insurer, this provision, *even if included in the contract between the agency and third-party, must also be stated in an endorsement to the policy*.

5. Waiver of Subrogation

Subrogation allows a party, often an insurer, who has paid a loss to step into the shoes of the injured party, often an insured, and assert the injured party's rights against a third party who is allegedly responsible for the loss, and thereby be reimbursed for the payment.

A party can waive its, and usually its insurer's, right of subrogation through an express contractual provision, but for certainty, a blanket waiver of subrogation endorsement may be desirable.

E. General Take-Aways:

1. Seek the broadest coverage possible, including ***both*** "ongoing" and "completed operations coverages;

2. Consider a "Waiver of subrogation" endorsement;

3. Review the endorsements provided to confirm that they provide the necessary and requested coverages.

CERTIFICATES OF INSURANCE

The issuance of a "Certificate of Insurance" is a common method of verifying to third parties the existence of a policy or MOC providing particular coverage for an insured.

A. Certificates of Insurance Merely Provide Evidence That A Policy or Coverage Exists When Issued

(a) Insurance Code § 384(a) provides:

> A certificate of insurance or verification of insurance provided as evidence of insurance in lieu of an actual copy of the insurance policy shall contain the following statements or words to the effect of:
>
> This certificate or verification of insurance is not an insurance policy and does not amend, extend or alter the coverage afforded by the policies listed herein. Notwithstanding any requirement, term, or condition of any contract or other document with respect to which this certificate or verification of insurance may be issued or may pertain, the insurance afforded by the policies described herein is subject to all the terms, exclusions and conditions of the policies.

(b) A certificate generally states, in the upper right hand comer, that it is issued as a matter of information only, confers no rights upon the certificate holder, and does not amend, extend, or alter the coverage afforded by the policies listed in the certificate.

Example

Certificate of Liability Insurance (COI)

DATE (MM/DD/YYYY)

1 THIS CERTIFICATE IS ISSUED AS A MATTER OF INFORMATION ONLY AND CONFERS NO RIGHTS UPON THE CERTIFICATE HOLDER. THIS CERTIFICATE DOES NOT AFFIRMATIVELY OR NEGATIVELY AMEND, EXTEND OR ALTER THE COVERAGE AFFORDED BY THE POLICIES BELOW. THIS CERTIFICATE OF INSURANCE DOES NOT CONSTITUTE A CONTRACT BETWEEN THE ISSUING INSURER(S), AUTHORIZED REPRESENTATIVE OR PRODUCER, AND THE CERTIFICATE HOLDER.

IMPORTANT: If the certificate holder is an ADDITIONAL INSURED, the policy(ies) must be endorsed. If SUBROGATION IS WAIVED, subject to the terms and conditions of the policy, certain policies may require an endorsement. A statement on this certificate does not confer rights to the certificate holder in lieu of such endorsement(s).

2 PRODUCER — CONTACT NAME: — PHONE (A/C, No, Ext): — FAX (A/C, No): — E-MAIL ADDRESS:

INSURER(S) AFFORDING COVERAGE — NAIC # — 4

INSURER A :
INSURER B :
INSURER C :
INSURER D :
INSURER E :
INSURER F :

3 INSURED

COVERAGES — CERTIFICATE NUMBER: — REVISION NUMBER:

THIS IS TO CERTIFY THAT THE POLICIES OF INSURANCE LISTED BELOW HAVE BEEN ISSUED TO THE INSURED NAMED ABOVE FOR THE POLICY PERIOD INDICATED. NOTWITHSTANDING ANY REQUIREMENT, TERM OR CONDITION OF ANY CONTRACT OR OTHER DOCUMENT WITH RESPECT TO WHICH THIS CERTIFICATE MAY BE ISSUED OR MAY PERTAIN, THE INSURANCE AFFORDED BY THE POLICIES DESCRIBED HEREIN IS SUBJECT TO ALL THE TERMS, EXCLUSIONS AND CONDITIONS OF SUCH POLICIES. LIMITS SHOWN MAY HAVE BEEN REDUCED BY PAID CLAIMS.

INSR LTR	TYPE OF INSURANCE	ADDL INSR	SUBR WVD	POLICY NUMBER	POLICY EFF (MM/DD/YYYY)	POLICY EXP (MM/DD/YYYY)	LIMITS
	GENERAL LIABILITY						EACH OCCURRENCE $
	COMMERCIAL GENERAL LIABILITY						DAMAGE TO RENTED PREMISES (Ea occurrence) $
	CLAIMS-MADE OCCUR						MED EXP (Any one person) $
	Broad Form Property Damage						PERSONAL & ADV INJURY $
	Blanket Contractual						GENERAL AGGREGATE $
	GEN'L AGGREGATE LIMIT APPLIES PER:						PRODUCTS - COMP/OP AGG $
	POLICY PRO-JECT LOC						$
	AUTOMOBILE LIABILITY						COMBINED SINGLE LIMIT (Ea accident) $
5	ANY AUTO						BODILY INJURY (Per person) $
	ALL OWNED AUTOS / SCHEDULED AUTOS						BODILY INJURY (Per accident) $
	HIRED AUTOS / NON-OWNED AUTOS						PROPERTY DAMAGE (Per accident) $
							$
	UMBRELLA LIAB OCCUR						EACH OCCURRENCE $
	EXCESS LIAB CLAIMS-MADE						AGGREGATE $
	DED RETENTION $						$
	WORKERS COMPENSATION AND EMPLOYERS' LIABILITY Y / N						WC STATU-TORY LIMITS OTH-ER
	ANY PROPRIETOR/PARTNER/EXECUTIVE OFFICER/MEMBER EXCLUDED? (Mandatory in NH)	N / A					E.L. EACH ACCIDENT $
	If yes, describe under DESCRIPTION OF OPERATIONS below						E.L. DISEASE - EA EMPLOYEE $
							E.L. DISEASE - POLICY LIMIT $

6 DESCRIPTION OF OPERATIONS / LOCATIONS / VEHICLES (Attach ACORD 101, Additional Remarks Schedule, if more space is required)

CERTIFICATE HOLDER — CANCELLATION

7

SHOULD ANY OF THE ABOVE DESCRIBED POLICIES BE CANCELLED BEFORE THE EXPIRATION DATE THEREOF, NOTICE WILL BE DELIVERED IN ACCORDANCE WITH THE POLICY PROVISIONS. 8

AUTHORIZED REPRESENTATIVE 9

(c) Thus, "[a] certificate of insurance is merely evidence that a policy has been issued . . . It is not a contract between the insurer and the certificate holder." *Empire Fire & Marine Ins. Co. v. Bell* (1997) 55 Cal.App.4th 1410, 1423, fn. 25. A certificate itself is not an endorsement to the policy. *Id*; *see also*, *Oakland Stadium v. Underwriters at Lloyds, London* (1957) 152 Cal.App.2d 292, 297.

(d) Furthermore, a certificate of insurance "is not intended to inform the certificate holder of every, or any, limitation on or exclusion from coverage", and "no broker can be liable for failing to include such information in a certificate of insurance." *Travelers Prop. Cas. Co. of Am. v. Superior Court* (2013) 215 Cal.App.4th 561, 582

B. Effects of Certificate of Insurance

1. The Terms of the Policy, Not the Certificate, Control

(a) Under California law, "'[i]t is a general rule that the receipt of a policy and its acceptance by the insured without an objection binds the insured as well as the insurer and *he cannot thereafter complain that he did not read it or know its terms.*'" *Hackethal v. National Casualty Co.* (1987) 189 Cal.App.3d 1102, 1112 (emphasis added); *Sarchett v. Blue Shield of California* (1987) 43 Cal.3d 1, 15.

(b) Consequently an insured cannot rely on an agent's representations contrary to the terms of the policy. *Hadland v. NN Investors Life Ins. Co.* (1994) 24 Cal.App.4th 1578, 1589; *Malcom v. Farmers New World Life Ins. Co.* (1992) 4 Cal.App.4th 296, 304 ; *Hackethal v. National Cas. Co.* (1987) 189 Cal.App.3d 1102, 1106, 1112; see also *Continental Airlines, Inc. v. McDonnell Douglas Corp.* (1989) 216 Cal.App.3d 388, 419-21; *Price v. Wells Fargo Bank* (1989) 213 Cal.App.3d 465, 483-84.

(c) Thus "[U]nder California law, a certificate of insurance cannot amend an insurance policy." *Carolina Cas. Ins. Co. v. Estate of Fuentes* (9th Cir. 2011) 433 Fed. Appx. 608, 610 (citing *Empire Fire & Marine Ins. Co., supra,* 55 Cal.App.4th 1410, 1423, fn. 25.); *Robert McMullen & Son, Inc. v. U.S. Fid. & Guar. Co.* (1980) 103 Cal.App.3d 198, 203 ("[t]he certificate . . . was not issued 'for or effecting insurance.' It was not the contract of insurance; rather it was a statement issued by the insured's broker, verifying or acknowledging the then existence of a previously issued policy of insurance…The certificate is 'proof of insurance,' not 'an agreement for or effecting insurance.'").

2. A Certificate May Affect Coverage Where Policy Language Is Ambiguous

(a) Given the foregoing, where there is no ambiguity in a policy of insurance, then contentions based on certificates of insurance are not considered. *See, Prudential Ins. Co. v. State Bd. of Equalization* (1993) 21 Cal.App.4th 458, 477, n. 15 ("Since we find no ambiguity, we need not address Prudential's assertion that certificate of insurance forms approved by the Insurance Commissioner are conclusively presumed to comply with the Insurance Code.").

(b) However, where policy language is ambiguous, certificates of insurance may also be used as evidence for a claim of estoppel. *See, e.g., United Pacific Ins. Co. v. Meyer* (9th Cir. 1962) 305 F.2d 107, 116 ("It seems plain further that the estoppel here extends not merely to the representation as to coverage of subcontractors, but it extends by virtue of the issuance of the certificate of insurance to the specific

policy itself. We noted that the certificate above quoted contains the statement 'all operations covered'. Upon receipt of that certificate the State of Idaho had the right to rely upon the apparent meaning of that Language.").

C. Key Take-Aways

1. When *issuing* certificates, risk pools should avoid making additional statements concerning the meaning or effect of the Certificate, or providing additional assurances or guarantees re the coverage provided by a policy or memorandum of coverage.

2. Risk pools should ensure that when members entered into vendor contracts and agreements with third parties, *they should obtain and review* Certificates of Insurance reflecting the coverage available to the third parties.

3. This is especially so where the third party is to provide insurance for the member as an "additional insured", in which event the member should verify that the Certificate reflects that the requested or required coverage is provided by the policy.

4. Notwithstanding the forgoing, ***best practice*** is to also obtain a copy of the relevant insurance policy(ies) and verify that the necessary coverages and endorsements are in fact provided and contained therein, since the Certificate of Insurance is no guarantee of the coverage provided, and will be superseded by the unambiguous language of the policy ***even if*** the result is different from or contrary to what is indicated on the Certificate of Insurance.

LOSS PAYABLE ENDORSEMENTS

A. What are they?

Loss Payable clauses protects a property owner against loss or damage to the property while it's in the insured's possession. A loss payee is a person or entity who's eligible to receive payment under an insurance policy if property, in which they have an interest, is damaged by a covered peril. A loss payee may be a property owner, a lender, or a seller.

B. Simple Loss Payable

1. Sample Language:

> Loss or damage under this policy shall be paid, as interest may appear, to you and the loss payee shown in the Declarations or in this endorsement. This insurance with respect to the interest of the loss payee, shall not become invalid because of your fraudulent acts or omissions unless the loss results from your conversion, secretion or embezzlement of "your covered auto." However, we reserve the right to cancel the policy as permitted by policy terms and the cancellation shall terminate this agreement as to the loss payee's interest. We will give the same advance notice of cancellation to the loss payee as we give to the named insured shown in the Declarations.
>
> When we pay the loss payee we shall, to the extent of payment, be subrogated to the loss payee's rights of recovery.

2. The simple or open loss payable clause directs the insurer to pay the proceeds of the policy to the lienholder, as its interest may appear, before the insured receives payment on the policy. Under this type of policy, the lienholder is simply an appointee to receive the insurance fund to the extent of its interest, and its right of recovery is no greater than the right of the insured.

3. There is no privity of contract between the two parties because there is no consideration given by the lienholder to the insured. Accordingly, a breach of the conditions [or exclusions] of the policy by the insured would prevent recovery by the lienholder. *Home Savings of America v. Continental Insurance Co.*, 87 Cal.App.4th 835, 841-42 (2001).

C. Lender Loss Payable

1. Sample Language:

> The insurance under this policy as to the interest only of the Lienholder shall not be impaired . . . by any breach of warranty

> or condition of the policy, or by any omission or neglect, or by the performance of any act in violation of any terms or conditions of the policy or because of the failure to perform any act required by the terms or conditions of the policy or because of the subjection of the property to any conditions, use or operation not permitted by the policy or because of any false statement concerning this policy or the subject thereof, by the insured or the insured's employees, agents or representatives, . . .
>
> PROVIDED, however, that the wrongful conversion . . . by the Purchaser, Mortgagor, or Lessee in possession of the insured property . . . is not covered under this policy, unless specifically insured against and premium paid therefore.

2. Under a lender loss payable provision, the endorsement creates an agreement for insurance between the insurer and the lien-holder. This provides the lienholder with specific rights under the policy which generally include a right to notice prior to cancelation of the policy and a right to pay the insurance premium to continue coverage in the event the insured does not pay the premium.

3. In other words, there are two contracts of insurance within the policy — one with the lienholder and the insurer and the other with the insured and the insurer. *Home Savings of America v. Continental Insurance Co.*, 87 Cal.App.4th 835, 841-42 (2001).

4. This does not negate coverage exclusions as applied to the lender but does prevent coverage for the lender from being voided based on violations of policy conditions. *Certain Underwriters at Lloyds of London v. Engs Motor Truck Co.*, 135 Cal.App.3d 831, 836 (1982) ("an exclusion or exception in an insurance policy is a refusal by the insurer to assume a particular risk, while a condition provides for avoidance of liability if it is breached").

INDEMNITY AND HOLD HARMLESS AGREEMENTS

A. Distinction Between "Indemnity" and "Hold Harmless" Agreements

Although frequently treated as synonymous, the terms "hold harmless" and "indemnification" are actually distinct obligations.

1. The term "indemnification" or "indemnify" is offensive, allowing the indemnitee to affirmatively seek indemnification.

2. Conversely, the term "hold harmless" is defensive, insulating the party from another party who is seeking indemnification.

3. Example:

To illustrate this relationship, consider the following example: a homeowner hires a contractor to perform work on the home. The contractor hires subcontractor #1 and subcontractor #2 to complete the job. Sub #1 has an "indemnity and hold harmless" agreement with sub #2. Subsequently, Homeowners sues the contractor who sues sub #1 and #2 to cover his liability. Sub #1 can use the "indemnity" portion of the agreement as a basis to sue sub #2 to indemnify sub #1 for any possible liability that sub #1 incurs to the general contractor. Further, sub #1 can use the "hold harmless" provision to prevent sub #2 from suing sub #1 for any indemnification for any possible liability that sub #2 incurs to the general contractor. By utilizing both the "indemnity" and "hold harmless" portions of the contract, sub #1 has effectively minimized their exposure to risk of loss

B. Rules of Interpretation

1. California Civil Code § 2778 provides a set of rules to assist courts when evaluating a contract for indemnity.

2. However, the general rules embodied in the Civil Code will not apply where "a contrary intent appears" in the contract.

C. The Duty to Defend Under A Contractual Indemnity Agreement

1. Under the statutory rules of interpretation, a non-insurance contract for indemnification has been interpreted to embrace separate duties of the indemnitor to both indemnify and defend the indemnitee:

2. Under the duty to defend, the indemnitor must typically retain an attorney to defend the indemnitee and to pay for all attorney's fees and costs incurred.

3. Although an indemnitee has a right to conduct their own defense, they may not refuse a good faith offer of a defense from the indemnitor and still recover their own defense fees:

4. "[A]bsent some contractual privilege so to do or some showing of sufficient justification or need therefor, an indemnitee ordinarily may not refuse to join in or cooperate with the indemnitor's proffered defense and still recover his separate and redundant attorneys' fees and costs." *Buchalter v. Levin* (1976) 252 Cal.App.2d 367, 371.

5. Pursuant to an indemnity obligation, an indemnitor must generally pay for any resulting settlement or judgment embraced within the indemnity agreement.

6. Interpreting and applying the language of Civil Code § 2778, California courts have paid special attention to the language of the indemnity agreements when interpreting whether a duty to "defend" is actually imposed:

   (a) Where a contract provides for indemnity and defense of "any" suit, a duty to defend will exists even where no liability is eventually found. *Crawford v. Weather Shield Mfg., Inc.* (2008) 44 Cal.4th 541; *UDC-Universal Development, L.P. v. CH2M Hill* (2010) 181 Cal.App.4th 10. Conversely, limiting the defense duty with words such as "solely" will restrict an indemnitors' duty to defend. *Mel Clayton Ford v. Ford Motor Co.* (2002) 104 Cal.App.4th 46.

   (b) Finally, if a duty to defend is established, it may only be extinguished prospectively, not retrospectively. *Centex Homes v. R-Help Construction Co., Inc.* (2019) 32 Cal.App.5th 1230, 1237.

7. There is a **KEY LIMITATION**:

   (a) In a "construction contract", a public agency may not contract for indemnification regarding liability for its own "active" negligence.

      (i) The term "construction contract" has a rather open-ended statutory definition, including contracts for the "construction, surveying, design, specifications, alteration, repair, improvement, renovation, maintenance, removal of or demolition of any building…or other improvement to real or personal property" as well as "an agreement to perform…any act collateral thereto, or to perform any service reasonably related thereto." (Civ. Code, § 2783.)

      (ii) Thus, an agreement which attempts to relieve a public agency for its own "active" negligence entered into before January 1, 2013, as well as after January 1, 2013, is void and unenforceable. (Civ. Code, § 2782(b)(1)-(2).)

D. Other Considerations

1. A contractual indemnity clause does not render the indemitee an "additional insured" under the indemnitor's insurance policy unless: (1) the contract so requires; and (2) the policy so provides.

   (a) Where the contractual indemnitee is not an "additional insured", under California law, the payment of defense fees on behalf of the indemnitee by the indemnitor's insurer is considered the payment of *damages* (i.e., it is a liability of the insured).

   (b) Thus, where the indemnitee is not an additional insured under the indemnitor's policy, payment of defense fees on behalf of the indemnitee by the indemnitor's insurer **will reduce the limits of liability** available to indemnify the insured and contractual indemnitor **unless the policy expressly provides otherwise.**

   (c) *See, e.g., Navigators Spec. Ins. Co. v. Moorefield Const., Inc.* (2016) 6 Cal.App.5th 1258, 1282; *Golden Eagle Ins. Co. v. Ins. Co. of the West* (2002) 99 Cal.App.4th 837, 848-849 [quoting *R.W. Beck & Assoc. v. City and Borough of Sitka* (9th Cir. 1994) 27 F.3d 1475, 1485 fn. 14 (applying Alaska law)]; *Id.* at 847 fn. 5 ("Because defense costs assumed by the insured are covered as 'damages,' they reduce indemnity limits on all claims covered by the policy (whereas defense costs are in addition to indemnity limits).") (quoting Croskey et al., Cal. Practice Guide: Insurance Litigation (The Rutter Group 2001) ¶ 7:1475, p. 7E-27], and at 851-852 [holding that "the insurance industry believed that when an insured contract includes the assumption of the indemnitee's attorney fees and costs, such expenses are covered 'damages'…".); *see also, St. Paul Fire and Marine Ins. Co. v. Ins. Co. of the State of Pennsy.* (N.D.Cal. 2017) 2017 WL 897437 *26 ("*Golden Eagle* is directly on point here. Devcon has passed costs and attorney's fees incurred in the Regents' third-party action against Devcon to Brady. Just as in *Golden Eagle*, so long as Brady and Devcon's subcontract agreement is an 'insured contract,' the costs passed through to Brady are covered 'damages' rather than 'taxed costs' that must be paid out of the policies' Supplementary Payments provisions.")

RESCISSION/MISREPRESENTED RISK

A. What is Rescission?

1. Rescission is an equitable remedy based on a basic premise of contract law: there must be a "meeting of the minds" regarding the subject matter of a contract and the parties' respective obligations for there to be a valid, binding contract. *Amex Life Assurance Co. v. Superior Court*, 14 Cal.4th 1231, 1241-42 (1997).

2. Without a meeting of the minds, there was never a contract to begin with, thus, an insurer seeking rescission generally is not bound by other contractual limitations on canceling coverage, such as an "incontestability" clause in a life insurance contract. *Amex Life Assurance Co. v. Superior Court*, 14 Cal.4th 1231, 1241-42 (1997) ("The invocation of an incontestability provision presupposes a basically valid contract").

   a. Exception: If the incontestability clause is interpreted by the court as merely providing a reasonable time for the insurer to discover misrepresentations or concealments made during the insurance application process, such clauses can be enforced as a way of "cutting down" the applicable statute of limitations for an insured's fraud, misrepresentation or concealment claim.

3. As a result, a successful rescission claim is designed to put the parties back in the same position they were in before the purported contract was executed. *Village Northridge Homeowners Assn. v. State Farm Fire & Casualty Co*., 50 Cal.4th 913, 922 (2010).

   a. A court still has discretion to award "rescission damages" based on breach of the voided contract, such as attorney's fees for seeking rescission if the contract has an attorney's fee provision. *Leaf v. Phil Rauch, Inc*., 47 Cal.App.3d 371, 378-79 (1975) ("although a contract is extinguished by its rescission, and the instant action sought restitution based on plaintiffs' prior rescission of the motor vehicle conditional sale contract, the action nevertheless 'involved' that contract…. Therefore plaintiffs, the prevailing parties…were entitled to attorneys' fees.").

   b. However, to recover such "recessionary damages," fault on the part of the party making the misrepresentation usually must be proved. *Runyan v. Pac. Air Indus*., 2 Cal.3d 304, 317 (1970) ("Only in the former category have courts of equity required the nonrescinding party to pay to the other restitutionary damages, for the obvious reason that otherwise he would be unjustly enriched.").

B. Grounds for Rescission

1. Material misrepresentation of fact

a. Insurance Code §359 provides that "[i]f a representation is false in a material point, whether affirmative or promissory, the injured party is entitled to rescind the contract from the time the representation becomes false."

2. Concealment of a material fact

a. Insurance Code §330 states that "[n]eglect to communicate that which a party knows, and ought to communicate, is concealment." Insurance Code §331 further states that "[c]oncealment, whether intentional or unintentional, entitles the injured party to rescind insurance."

3. Breach of material warranty or other material provision

a. Ins. Code §447 provides that "[t]he violation of a material warranty or other material provision of a policy, on the part of either party thereto, entitles the other to rescind."

4. Consent

a. "It is a self-evident proposition that a contract of insurance may be as readily rescinded, as it was made, by the mutual agreement of the parties or their authorized representatives." *Apparel Mfrs' Supply Co. v. National Auto. & Casualty Ins. Co.*, 189 Cal.App.2d 443, 459 (1961).

C. Key Issue: Materiality of Misrepresentation or Concealment

1. Reason for Materiality Standard

a. An insurer "has the unquestioned right to select those whom it will insure and to rely upon him who would be insured for such information as it desires as a basis for its determination to the end that a wise discrimination may be exercised in selecting its risks." *Mitchell v. United National Ins. Co*., 127 Cal.App.4th 457, 469 (2005).

b. Because an insurer has this "unquestioned right" to choose the risks and persons it will insure, the materiality inquiry focuses on whether or not the insurer actually assumed the risks that it thought it was assuming. *Merced County Mut. Fire Ins. Co. v. State*, 233 Cal.App.3d 765, 772 (1991) ("The purpose of the materiality inquiry is…to make certain that the risk insured was the risk covered by the policy agreed upon.").

c. The focus is on the insurer's intent at the time it was evaluating the insurance application and deciding whether or not to provide coverage, and the central issue is generally whether or not the insured made a material misrepresentation or concealment of facts when applying for coverage. *Mitchell v. United National Ins. Co.*, 127 Cal. App. 4th 457, 474 (2005) ("In order to constitute grounds for avoidance of an insurance policy, misrepresentation or concealment must be with respect to a material fact.").

2. Standards for Materiality

a. Insurance Code §334 provides that "[m]ateriality is to be determined…solely by the probable and reasonable influence of the facts upon the party to whom the communication is due, in forming his estimate of the disadvantages of the proposed contract, or in making his inquiries."

b. The focus is on the insurer's "state of mind" at the time the policy was issued, so materiality is determined solely by the "subjective" effect the correct information would have had on the insurer's underwriting decision.

(i) "Materiality is determined solely by the probable and reasonable effect which truthful answers would have had upon the insurer." *Thompson v. Occidental Life Ins. Co.*, 9 Cal.3d 904, 916 (1973).

(ii) "This is a subjective test viewed from the insurer's perspective. Thus, a misrepresentation or concealment is material if a truthful statement would have affected the insurer's underwriting decision." *Superior Dispatch, Inc. v. Insurance Corp. of New York*, 181 Cal.App.4th 175, 191 (2010).

c. A misrepresentation or concealment is "material" if the insurer would have, with correct information, either: (1) refused to offer coverage; (2) would have evaluated the risk differently; or (3) would have charged a higher premium.

(i) "The most generally accepted test of materiality is whether or not the matter misstated could reasonably be considered material in affecting the insurer's decision as to whether or not to enter into the contract, in estimating the degree or character of the risk, or in fixing the premium rate thereon." *Old Line Life Ins. Co. v. Superior Court*, 229 Cal. App. 3d 1600, 1604 (1991).

d. The information misrepresented or withheld would have had to have "played a substantial part" or have been "as substantial factor" in

influencing the underwriting decision. *Engalla v. Permanente Medical Group, Inc*., 15 Cal.4th 951, 976-77 (1997).

3. Evidentiary Issues Regarding Materiality—Evidence of Underwriting Intent

a. An insurer may be required to provide written underwriting guidelines and other evidentiary materials which demonstrate that the misrepresented or concealed information would have influenced the underwriting decision because that information was material to the risk.

(i) The "trier of fact is not required to believe the 'post mortem' testimony of an insurer's agents that insurance would have been refused had the true facts been disclosed." *Thompson v. Occidental Life Insurance Company of California*, 9 Cal. 3d 904, 916 (1973).

(ii) "It seems unreasonable to conclude that an incorrect answer to any question on an insurance application automatically would constitute a material misrepresentation for purposes of rescission." *Mitchell v. United National Ins. Co.,* 127 Cal.App.4th 457, 475 (2005).

b. If the insured can show that the insurer would have issued the policy notwithstanding the misrepresentation or concealment, the insurer's misrepresentation or concealment claim fails.

(i) "An incorrect answer on an insurance application does not give rise to the defense of fraud where the true facts, if known, would not have made the contract less desirable to the insurer." *Mitchell v. United National Ins. Co*., 127 Cal.App.4th 457, 474 (2005).

c. A court can also determine as a matter of law that a particular fact was not material if the "fact misrepresented is so obviously unimportant that the jury could not reasonably find that a reasonable man would have been influenced by it." *Mitchell v. United National Ins. Co*., 127 Cal.App.4th 457, 475 n.9 (2005).

(i) Caveat: A misrepresentation or concealment is still material, even if it would not be material to a reasonable person, so long as the person making the misrepresentation or concealment "knew or has reason to know that its recipient regards or is likely to regard the matter as important in determining his choice of action." *Kwikset Corp. v. Superior Court,* 51 Cal.4th 310, 333 (2011).

4. Evidentiary Issues Regarding Materiality—Insurance Application Questions

a. Evidence of underwriting intent can be shown by the presence or absence of specific application questions. The fact that an insurer did not seek specific information on certain issues can be used by an insured to establish that those issues were not material to the risks assumed by the insurer.

(i) An insurer's "failure to inquire into such facts in the first instance has been held to demonstrate a lack of interest in them, negating their materiality." *American Mut. Liability Ins. Co. v. Goff*, 281 F.2d 689, 694 (9th Cir. 1960).

(ii) "Had plaintiff desired to know each particular business in which the automobile was used, such questions could have been included in the application. This was not done. The failure to inquire into that subject indicates an entire lack of interest in it." *Farmers Auto. Inter-Insurance Exchange v. Calkins*, 39 Cal.App.2d 390, 396 (1940).

b. Additionally, if an insurer fails to request certain information relevant to its underwriting decision and later pays a claim, this may be used as evidence that the missing information was "insignificant" to the underwriting decision.

(i) In one instance, an applicant's DMV record seemed insignificant to auto liability insurer when a policy was issued based on the insurance application and the insurer paid on one claim prior to ordering the insured's DMV report. *Barrera v. State Farm Mut. Auto. Ins. Co*., 71 Cal.2d 659, 667 (1969).

c. On the other hand, the fact that an insurer asked for certain specific information in its application process is usually sufficient to establish that information was material to the underwriting decision.

(i) "The fact that defendant put the questions in writing and asked for written answers was itself proof that it deemed the answers material." *Mitchell v. United National Ins. Co*. 127 Cal.App.4th 457, 474 (2005).

d. California courts have been willing to grant rescission in cases where there was a clear misrepresentation or concealment of facts in response to a written insurance application question. *See Superior Dispatch, Inc. v. Insurance Corp. of New York*, 181 Cal.App.4th 175 (2010) (upholding summary judgment for insurer regarding right to rescind when insured misrepresented types of cargo hauled.); *Nieto v. Blue Shield of California Life & Health Ins. Co.* 181 Cal.App.4th 60 (2010) (upholding summary judgment for insurer regarding right to rescind when insured failed to disclose her chronic back problems.);

West Coast Life Ins. Co. v. Ward, 132 Cal.App.4th 181 (2005) (upholding summary judgment for insurer regarding right to rescind when insured failed to disclose existing coverage under other insurance policies.).

e. Based on the view that questions on an insurance application are strictly construed against the insurer – just as is exclusionary language in an insurance policy, there is no representation where the information provided is a reasonable response to an unclear or ambiguous application question.

(i) "We should also observe that we are considering an application for insurance and an insurance policy which were prepared by plaintiff and which must be strictly construed against it." *Farmers Auto. Inter-Insurance Exchange v. Calkins*, 39 Cal.App.2d 390, 393 (1940);

(ii) Where a life insurance applicant had answered "no" to the application questions "Have you smoked cigarettes in the past 36 months?" and "Have you used tobacco in any other form in the past 36 months?", and the undisputed evidence showed that the applicant had "smoked a couple of cigarettes" during that time period, but that she was not a habitual smoker and that she had understood the questions to be asking whether or not she was a habitual smoker, the California Supreme Court held the insurer could not prove concealment based on evidence of the applicant's admitted occasional smoking because the application questions could be reasonably read to refer to habitual tobacco use rather than occasional use. *O'Riordan v. Federal Kemper Life Assurance Co.*, 36 Cal.4th 281, 287-88 (2005).

5. Evidentiary Issues Regarding "Materiality" – Issue Of Insured's Intent

a. Generally, the insurer is not required to show that the insured intended to mislead the insurer as part of a successful misrepresentation or concealment claim (although showing intent supports the further action for fraud discussed above.)

(i) Ins. Code §331 ("Concealment, whether intentional or unintentional, entitles the injured party to rescind insurance.").

(ii) Ins Code §359 ("If a representation is false in a material point, whether affirmative or promissory, the injured party is entitled to rescind the contract from the time the representation becomes false.").

b. California case law has been inconsistent on whether or not an

"innocent" misrepresentation or concealment by the insured can provide a sufficient basis for a misrepresentation or concealment claim.

c. In the context of life, health and disability insurance contracts, the California courts have often applied a negligence standard to the insured (i.e. the right to rescind requires that the insured knew or should have known that the information was material to the risk.)

(i) "On the other hand, if the applicant for insurance had no present knowledge of the facts sought, or failed to appreciate the significance of information related to him, his incorrect or incomplete responses would not constitute grounds for rescission." *Thompson v. Occidental Life Insurance Company of California*, 9 Cal.3d 904, 916 (1973).

d. The California Supreme Court has emphasized that an insured's "innocent misrepresentations" may be grounds for a misrepresentation claim. *Philadelphia Indemnity Ins. Co. v. Montes-Harris*, 40 Cal.4th 151, 157 (2006) ("Moreover, the injured party may rescind, even though the misstatements 'were the result of negligence, or, indeed, the product of innocence.'").

e. At the same time, the Insurance Code expressly provides that if an applicant makes a factual representation based "on information and belief," such an answer does not constitute a misrepresentation unless the applicant bases his or her answer on information provided by his or her authorized agent.

(i) Ins. Code §357 ("When an insured has no personal knowledge of a fact, he may nevertheless repeat information which he has upon the subject, and which he believes to be true, with the explanation that he does so on the information of others; or he may submit the information, in its whole extent, to the insurer. In neither case is he responsible for its truth, unless it proceeds from an agent of the insured, whose duty it is to give the information.").

f. Also, it has been held that if the insurance contract itself sets a higher misrepresentation or concealment standards than that provided by the Insurance Code, the policy's higher standard will be enforced rather than the Insurance Code standard.

(i) "The fraud provision states that the policy is void if the insured intentionally conceals or misrepresents a material matter. To interpret it to mean that unintentional, or negligent, misrepresentations also render the policy ineffectual would

remove any limiting effect of the provision and render the specification of intentionality mere surplusage, a result not only precluded by the pertinent canon of construction, but also not within an insured's reasonable expectation." *Clarendon Nat'l Ins. Co. v. Ins. Co. of the West*, 442 F. Supp. 2d 914, 926 (E.D.Cal. 2006).

g. Furthermore, there are different standards for rescission based on statutory requirements for specific types of coverage. While, as a general matter, an "innocent" or "negligent" misrepresentation may be sufficient to avoid coverage for many types of risks, the Insurance Code does set higher standards for certain types of insurance policies.

(i) Ins. Code §10380 (false statement in application for disability policy does not bar recovery unless "made with actual intent to deceive or unless it materially affected either the acceptance of the risk or the hazard assumed by the insurer.").

(ii) California Standard Form Fire Insurance Policy Ins. Code §§ 2070-2071 ("entire policy shall be void if, whether before or after a loss, the insured has *willfully* concealed or misrepresented any material fact or circumstance concerning this insurance or the subject thereof, or the interest of the insured therein, or in case of any fraud or false swearing by the insured relating thereto.").

A) Thus, on its face, the Insurance Code appears to require intentional misrepresentation or concealment to avoid coverage under a fire policy.

B) However, the Court of Appeal in *Mitchell v. United National Ins. Co.*, 127 Cal.App.4th 457, 473 (2005) held that the rescission standards of §331 and §359 apply to the California Standard Form Fire Insurance Policy. As a result, the *Mitchell* court held that inadvertent or negligent misrepresentations or concealments which met the standard of Insurance Code §331 and §359 provide sufficient grounds for rescission.

h. An insured cannot avoid his or her disclosure obligations by relying on a broker or other agent to provide the correct, requisite information on an insurance application.

(i) An insurance broker who secures a policy only acts on behalf of the client – the insured – and not the insurer. *Carlton v. St. Paul Mercury Ins. Co.*, 30 Cal.App.4th 1450, 1457 (1994).

(ii) Insurance brokers with no binding authority are not agents of insurance companies, but are rather independent contractors. *Marsh & McLennan of Calif., Inc. v. City of Los Angeles,* 62 Cal.App.3d 108, 118 (1976).

(iii) At the same time, under Civil Code §2332, "as against a principal, both principal and agent are deemed to have notice of whatever either has notice of, and ought, in good faith in the exercise of ordinary care and diligence, to communicate to the other."

(iv) As a result, any knowledge regarding information material to an insurance application which is known to a broker or another authorized agent of the insured providing information relative to an insurance application may be imputed to the insured by operation of law.

A) "Representations in an insurance application prepared by an insurance broker on behalf of an insured are attributed to the insured as a matter of law." *Superior Dispatch, Inc. v. Insurance Corp. of New York,* 181 Cal.App.4th 175, 192 (2010).

B) "Awareness of an insured's agent that information is important or material may be imputed to the insured; thus, a duty to communicate information pursuant to Cal. Ins. Code §332 may rest upon the agent's knowledge, and belief in the materiality of withheld facts may be based on the belief of an authorized agent." *Clarendon Nat'l Ins. Co. v. Ins. Co. of the West,* 442 F. Supp.2d 914, 936 (E.D.Cal. 2006).

(v) In this context, California law makes a distinction between insurance "brokers" and insurance "agents." An insurance "broker" is "a person who, for compensation and *on behalf of another person,* transacts insurance other than life, disability, or health *with, but not on behalf of, an insurer*." Ins. Code §33 (emphasis added); *see also* Ins. Code §1623(a)(1) ("it shall be presumed that" a licensed insurance broker "is transacting insurance on behalf of the consumer.").

(vi) Conversely, an "insurance agent" is "a person authorized, by and on behalf of an insurer, to transact all classes of insurance other than life, disability, or health insurance, on behalf of an admitted insurance company." Ins. Code §31.

(vii) As a result, information transmitted to an authorized insurance

"agent" during the application process may be imputed to the insurer as a matter of law. *See Bonaparte v. Allstate Ins. Co.*, 49 F.3d 486, 489 (9th Cir. 1994).

i. Moreover, an insured is presumed to read an insurance application that he or she receives and to be aware of any misstatements in it.

(i) Reason: the implied duty of good faith and fair dealing falls on both parties to the insurance contract and "entails a duty on the part of the insured to read the contract and the application in accordance with her representations and to report to the company any misrepresentations or omissions…By neglecting to inform the company of the material omissions, the insured became responsible for such misrepresentations or omissions." *Rutherford v. Prudential Ins. Co.*, 234 Cal.App.2d 719, 726-27 (1965).

D. Available Equitable Defenses To A Rescission Claim

1. Because rescission is an equitable remedy, it is subject to equitable defenses such as waiver, estoppel and laches (i.e. undue delay in seeking rescission).

a. Insurance Code §336 (waiver).

b. Civil Code §1693 (laches defense based on delay and "substantial prejudice.").

c. If "the insurance company actually has knowledge that the answers of the applicant are untrue, but it nevertheless issues a policy to him, the company may be estopped to claim later that it was defrauded." *Anaheim Builders Supply, Inc. v. Lincoln Nat'l Life Ins. Co.*, 233 Cal.App.2d 400, 411 (1965).

d. An insurer can waive right to rescind by notice of facts which "should have put the underwriter on notice that the application form was incomplete and inaccurate in material respects [and] [b]y failing to request additional information" in connection with insurance application." *Rutherford v. Prudential Ins. Co.*, 234 Cal.App.2d 719, 734-35 (1965).

e. "Delay in giving notice is grounds for denying relief if the nonrescinding party has been substantially prejudiced." *Donovan v. RRL Corp.*, 26 Cal.4th 261, 295 (2001).

(i) Where insurer rescinded contract *prospectively* only and, two years later, raised right to rescind *retrospectively* in defense to insured's claim for failure to pay covered claims during the period the policy was in effect, held that its "conduct was wholly inconsistent with the assertion of its known right to rescind." *DuBeck v. California Physicians' Serv.,* 234 Cal.App.4th 1254, 1266-1267 (2015).

2. An auto liability insurer has a "duty to conduct a reasonable investigation of insurability within a reasonable period of time after issuance of the policy" and failure to conduct such a "reasonable investigation" precludes the auto insurer from seeking rescission. *Barrera v. State Farm Mut. Auto. Ins. Co.* 71 Cal.2d 659, 674 (1969).

a. Reason: An auto liability insurer acts in a "quasi-public" capacity by providing insurance that satisfies California's financial responsibility law. Also, the *Barrera* court emphasized that without such a rule the insurer could "take the chances of a loss, and, if none occurred, retain the premium; but if one does occur, repudiate the contract and compel the assured to bear the loss." *Id.* at 673-74.

b. Courts following *Barrera* have emphasized that absent such a "reasonable investigation" by the auto liability insurer it "may not rescind an automobile insurance policy based upon the material misrepresentations of its insured *after the insured injures a third party*." *United Services Automobile Assn. v. Pegos*, 107 Cal.App.4th 392, 394-95 (2003) (emphasis in original).

(i) The same duty to conduct a "reasonable investigation" arises whenever the insured made a significant change to the policy's coverage, such as adding a new driver or vehicle. *Id.* at 399. However, the duty is not retriggered by a "simple renewal of the existing policy" or "every time the insured makes a change to the policy." *Id.*

c. However, the *Barrera* approach has been rejected in the context of other types of liability policies. *See Colony Ins. Co. v. Crusader Ins. Co.*, 188 Cal.App.4th 743, 756 (2010) (rejecting *Barrera* approach in connection with "multi-peril liability" policy); *Am. Cont'l Ins. Co. v. C & Z Timber Co.*, 195 Cal. App. 3d 1271, 1278 (1987) ("a careful reading of *Barrera* and later kindred decisions compels the conclusion that the duty defined in *Barrera* must in any event be limited to automobile liability insurers who deny coverage for reasons arising out of their own negligence.").

3. Even if estopped from seeking rescission, an insurer can still raise an affirmative fraud or misrepresentation claim against the insured and thereby

seek to recover benefits provided under the policy (i.e. reimbursement for a third-party judgment). *Barrera v. State Farm Mut. Auto. Ins. Co.*, 71 Cal.2d 659, 981 (1969) ("That the automobile liability insurer that fails to make such an investigation loses its right to rescind does not, however, necessarily mean that it forfeits all remedies against the insured for his misrepresentations.").

E. Procedural Requirements

1. Civil Code §§1689-1693 sets forth the procedural requirements for rescission. The two primary requirements for rescission are (1) notice to the other party; and (2) either restoring or offering to restore all consideration and/or contractual benefits received from the other party on the condition that the other party do the same, unless the other party refuses or is unable to do so. (Civ. Code §1691(a)-(b).)

2. Under Insurance Code §650, an insurer may seek to rescind the policy at any time prior "to the commencement of an action in the contract."

   a. An "action on the contract" is an action by the insured "to enforce the insurance contract at law." As a result, Insurance Code §650 only bars an insurer from filing a separate action when the insured has already filed an action seeking withheld policy benefits. However, even if the insurer has been sued by the insured, the insurer can still seek to avoid paying policy benefits by raising rescission as an affirmative defense and/or via a cross-complaint against the insured. *LA Sound USA, Inc. v. St. Paul Fire & Marine Ins. Co.*, 156 Cal.App.4th 1259, 1267-1268 (2007). In both cases, the burden of proof regarding rescission is on the insurer as it is the party seeking relief via rescission. *American Mut. Liability Ins. Co. v. Goff*, 281 F. 2d 689, 694 (1960).

F. Alternative Contract Formation Defenses

1. As an alternative to rescission, an insurer can avoid coverage under the policy if it can prove the basis for another contract defense against formation, such as fraud, duress or failure of consideration.

   a. The "rights of rescission which the Insurance Code recognizes and limits are not in derogation of other remedial rights which are recognized and implemented by other provisions of law." *De Campos v. State Compensation Ins. Fund*, 122 Cal.App.2d 519, 529 (1954).

2. If the insurer can prove that the misrepresentation or concealment by the insured was intentional and designed to induce the insurer into providing coverage, it can also make a claim for fraud.

   a. "Rescission is not the exclusive remedy of one who has become entitled to avoid a contract by reason of acts or omissions of the other party to it which are fraudulent in their nature. He may cancel the

contract by its rescission; or he may seek affirmative relief in a court of equity for any injury sustained by the wrongful act or omission of the other; or he may set up the fraud by way of defense to an action brought to enforce the apparent liability." *Williamson & Vollmer Engineering, Inc. v. Sequoia Ins. Co.*, 64 Cal.App.3d 261, 275 (1976).

3. A fraud defense to coverage, like a rescission defense, can either be asserted affirmatively in an action by the insurer or asserted as an affirmative defense in an action on the policy by the insured.

   a. "It is well established that material misrepresentations or concealment of material facts in an application for insurance entitle an insurer to rescind an insurance policy, even if the misrepresentations are not intentionally made." *Douglas v. Fid. Nat'l Ins. Co.*, 229 Cal.App.4th 392, 408 (2014).

   b. "A misrepresentation or concealment of a material fact in an insurance application also establishes a complete defense in an action on the policy." *Superior Dispatch, Inc. v. Insurance Corp. of New York,* 181 Cal.App.4th 175, 192 (2010).

4. A claim of fraud is not subject to the same statutory limitations under Insurance Code §650 as is rescission.

   a. Cal. Ins. Code § 650 provides, "[w]henever a right to rescind a contract of insurance is given to the insurer by any provision of this part such right may be exercised at any time previous to the commencement of an action on the contract. The rescission shall apply to all insureds under the contract, including additional insureds, unless the contract provides otherwise."

   b. "Regardless of whether section 650 bars rescission at this stage, National Union is clearly entitled to proceed with proof of misrepresentation as a defense to movants' claims of wrongful insurance practices. If there was no representation, then movants may be able to obtain damages and the other relief they seek in their counterclaim. If there has been misrepresentation, then National Union should be made whole for its losses." *National Union Fire Ins. Co. v. Dixon*, 663 F.Supp. 1121, 1123 (N.D.Cal. 1987).

G. Court Action Is Not Necessary to Rescind

1. In California, rescission may be executed by written notice alone, but an insurer may file a declaratory relief action to *confirm* the validity of the rescission if it wishes. *West Coast Life Ins. Co. v. Ward*, 132 Cal. App. 4th 181, 183-84 (2005) (life insurer rescinded policy for application fraud committed by deceased insured, then brought declaratory judgment action against beneficiary to confirm rescission and establish that no benefits need

be paid.); *Civil Serv. Emp. Ins. Co. v. Blake*,. 245 Cal. App. 2d 196, 197-98 (1966) (auto insurer rescinded policy, then sought declaratory relief against both the insured and an injured third party to quiet any assertion that the rescission was improper).

REFORMATION

I. What Is Reformation?

1. Reformation is an equitable remedy that allows a court to alter (rewrite) a written agreement which fails to conform to the parties' oral or other prior agreement as the result of fraud or mistake. The purpose of reformation is "to make a written contract truly express the intention of the parties." *American Home Ins. Co. v. Travelers Indem. Co.*, 122 Cal. App. 3d 951, 963 (1981).

2. The court's power to reform insurance contracts is derived from its power to reform contracts generally.

3. Civil Code § 3399 provides that "[w]hen, through fraud or a mutual mistake of the parties, or a mistake of one party, which the other at the time knew or suspected, a written contract does not truly express the intention of the parties, it may be revised on the application of a party aggrieved, so as to express that intention, so far as it can be done without prejudice to rights acquired by third persons, in good faith and for value."

4. Civil Code § 3401 further provides that "[i]n revising a written instrument, the court may inquire what the instrument was intended to mean, and what were intended to be its legal consequences ... "

5. Reformation operates retroactively like rescission. But unlike rescission, the usual result is to make pending claims payable rather than to extinguish the policy. *American Sur. Co. of N.Y. v. Heise*, 136 Cal. App. 2d 689, 696 (1955) ("A suit for a reformation may be and usually is maintained after a loss which would fall within the policy as reformed.")

A. Who May Obtain Reformation?

1. The party seeking reformation must be either a party to the insurance contract or an intended beneficiary thereof. *American Home Ins. Co. v. Travelers Indem. Co.*, 122 Cal. App. 3d 951, 962 (1981) ("A person who has no present interest in the policy cannot obtain its reformation.").

2. A third party claimant has no standing to obtain reformation of a liability insurance policy. *International Serv. Ins. Co. v. Gonzales* 194 Cal. App. 3d 110, 118–119 (1987) ("Reformation of a liability insurance policy may be sought only by the contracting parties, their assignees or the intended beneficiaries of the insurance contract."); *Zaghi v. State Farm Gen. Ins. Co.*, 77 F.Supp.2d 974, 978 (N.D.Cal. 2015) (plaintiff mortgagee not entitled to reformation of homeowner's policy where not named on policy as mortgagee because not a party to the contract).

B. Grounds for Reformation

1. An insurance policy may be reformed "where, by reason of fraud, inequitable conduct or mutual mistake, the policy as written does not express the actual and real agreement of the parties." *American Sur. Co. of N.Y. v. Heise*, 136 Cal. App. 2d 689, 695–696 (1955).

2. The right to reformation must be shown by "clear and convincing" evidence. *Truck Ins. Exch. v. Wilshire Ins. Co.*, 8 Cal. App. 3d 553, 560-561 (1970).

3. The elements which must be established for reformation are:

   a. an antecedent oral agreement between insured and insurer as to which there was no mistake;

   b. the insurance policy as drafted contains terms materially different from the parties' antecedent agreement; and

   c. that difference was the result of: fraud (party drafting contract intentionally inserted different terms); mutual mistake (neither party was aware that the contract contained different terms); or "inequitable conduct" by the party opposing reformation (i.e., one party knew or suspected the policy contained different terms and was attempting to take advantage). *American Home Ins. Co. v. Travelers Indem. Co.*, 122 Cal. App. 3d 951, 964 (1981).

C. Reformation on the Ground of Mutual Mistake

1. "The principal prerequisite is the demonstration of a mistake which results in the failure of a written contract to express the true intention of the parties to the agreement. This mistake may be the mutual error of both parties to the contract, or the oversight of one party which the other knew or suspected at the time of entering the agreement." *American Home Ins. Co, supra*, 122 Cal. App. 3d 951, 961.

2. "A mistake of one party not known or suspected by another party to a written contract will not justify its reformation." *Insurance Co. of North America v. Bechtel*, 36 Cal. App. 3d 310, 310 (1973).

3. Where there is no evidence that the parties' mutual agreement was not properly reduced to writing, no "mistake" exists sufficient to justify either reforming the policy or not enforcing its terms under Civil Code § 1640. *H. Moffat Co. v. Rosasco*, 119 Cal. App. 2d 432, 440-442 (1953).

   a. "Even though the parties act under mistake, if the written agreement actually conforms to the oral understanding there is no basis for reformation." 1, Witkin, Sum. Cal. Law, (10th Ed. 2010) Contracts

§278, p. 308.

b. Factual error cannot support reformation where it is "not a failure accurately to reduce a specific understanding of the parties to writing, but rather, a failure of the parties to know the true state of the facts. As indicated by the foregoing authorities, such a 'mistake' is not one which the court can correct by reformation…A court cannot, under a theory of reformation, create a new agreement for the parties which conforms to the circumstances that they had mistakenly assumed were true. If the written instrument accurately reflects the agreement of the parties, albeit an agreement based upon a mistaken assumption of fact, an action for reformation does not lie." *Getty v. Getty*, 187 Cal. App. 3d 1159, 1178 (1986).

4. Reformation cannot be granted where the parties had different understandings of their agreement. A court cannot make a new contract for the parties on matters on which they never agreed. *Gillis v. Sun Ins. Office, Ltd.*, 238 Cal. App. 2d 408, 414 (1965) ("It is ... axiomatic that the court cannot reform and remake a contract ... where there was never any such common intent.").

5. The insured's receipt and retention of an insurance policy without examining it to determine whether it conforms to the application or the insurer's representations does not necessarily defeat reformation. *American Sur. Co. of N.Y. v. Heise*, 136 Cal. App. 2d 689, 696 (1955).

a. As a general rule, "(a)n insured has the right to rely on the presumption that the policy he receives is in accordance with his application; and his failure to read it will not relieve the insurer or its agent from the duty of so writing it." *Laing v. Occidental Life Ins. Co. of Calif.*, 244 Cal. App. 2d 811, 819 (1966).

b. Reason: the rule presuming contracting parties are familiar with the terms of their contract "should not be strictly applied to insurance policies" because so few policyholders actually read their policies and rely instead on the agent securing the insurance. *Haynes v. Farmers Ins. Exch.*, 32 Cal. 4th 1198, 1210 (2004) (not specifically addressing reformation).

6. Since reformation is an equitable remedy, it may be denied if the mistake was the result of "the want of that degree of care and diligence which would be exercised by persons of reasonable prudence under the same circumstances." *Appalachian Ins. Co. v. McDonnell Douglas Corp.*, 214 Cal. App. 3d 1, 19 (1989).

D. Statutory Requirements

1. California Code of Civil procedure § 338(d) provides that a suit for reformation must be initiated within 3 years of "the discovery, by the aggrieved party, of the facts constituting the fraud or mistake."

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