

No Duty to Defend Based on Insured's Material Misstatement at Time of Renewal

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[Blum Collins LLP v. NCG Professional Risks, Ltd., C.D. Cal., 2014 WL 3844620](#)

Brief Summary

The U.S. District Court for the Central District of California ruled that an insurer's duty to defend against a malpractice claim was not triggered by the insured's material misstatement about the nonexistence of a potential claim when the insured entered into a tolling agreement that gave notice that there were allegations which could lead to a malpractice claim.

Complete Summary

In the underlying case, plaintiff insured law firm began representing its former client in a property dispute in December 2004. In September 2007, the attorney-client relationship was terminated, and the parties entered into a tolling agreement wherein the insured agreed to furnish the former client with time to evaluate her malpractice claim and potential damages without filing an action during the time period that her appeal rights were in place. The statute of limitations was suspended pursuant to the agreement (September 2007 Agreement). In October 2007, judgment was entered against the former client in the property dispute and the appellate court affirmed in January 2009. In February 2009, the former client gave notice to the insured that the adverse judgment was caused by the insured's malpractice. In March 2009, the insured gave notice of the malpractice claim to defendant insurer.

The insured had obtained professional liability insurance from the insurer in July 2008. The application for insurance contained a clause whereby the insurer could rescind or deny coverage as a result of any material misstatement or omission. It also asked whether the applicant was aware of any circumstances, allegations, tolling agreements or contentions that might result in a claim being made against the applicant (Question 10C),

to which the insured replied “No.” The policy also defined several grounds of exclusion on which the insurer could deny coverage, including “any Claim arising out of any acts, errors or omissions which took place prior to the effective date of insurance, if any Assured on the effective date knew or could have reasonably foreseen that such acts, errors or omissions might be expected to be the basis of a Claim” (Exclusion I). The effective period of the insurance policy was July 27, 2008 to July 27, 2009.

The malpractice action was filed against the insured in January 2011. In February 2011, the insured forwarded the malpractice complaint to the insurer, invoking the insurer’s duty to defend and seeking indemnification. In June 2011, the insurer sent a denial letter advising the insured that no coverage was available under the policy, asserting its right to deny coverage based on Exclusion I and citing the insured’s answer to Question 10C, which the insurer claimed constituted “material misrepresentations and omissions in the policy application,” as an additional justification for its denial. In the months that followed, the parties continued to disagree about whether denial of coverage was warranted.

In June 2012, the insured filed a complaint against the insurer for breach of insurance policy, breach of duty of good faith and fair dealing, fraud and declaratory relief. The parties filed cross-motions for summary judgment as to whether there existed a duty to defend the insured against the malpractice action. Specifically, at issue was whether the insured’s failure to give the insurer notice of a potential lawsuit was such a material omission as to warrant the insurer’s refusal to defend or whether such refusal constituted a breach of contract.

The district court used the ordinary rules of contract interpretation and considered the contract as a whole and interpreted the language in context. *Employers Reinsurance Co. v. Superior Court* (2008) 161 Cal. App. 4th 906, 919. If the policy language is ambiguous, the court must determine whether the coverage under the policy would result from such a construction that is consistent with the insured’s objectively reasonable expectations. *Id.* at 919-20.

The district court found that the insured’s contention that it did not know of its former client’s malpractice allegations until much later when she served the malpractice complaint in 2011 ignored the plain language of the September 2007 Agreement, which unequivocally gave the insured notice that there were allegations that could result in a claim. The court found that any expectation or understanding to the contrary stretched the bounds of credulity. The court further determined that the existence of Question 10C asking for information pertaining to knowledge of any potential claims is in itself enough to establish materiality. The insurer also provided evidence that a truthful answer to Question 10C would have altered whether the insurer would have insured the insured. Thus, the court determined that the materiality of the undisclosed potential suit was obvious and constituted sufficient grounds for denial of coverage.

Accordingly, the district court found that the facts conclusively eliminated the potential that the policy provided coverage for the malpractice claim. As such, the insurer did not breach its duty to defend the insured and was thus not liable for breach of the implied covenant of good faith and fair dealing or fraud claims premised on the breach of the insurance contract at issue. The district court found that the insurer was entitled to summary judgment as to all of the claims asserted in the insured’s complaint.

Significance of Opinion

This decision is significant because the district court applied the ordinary rules of contract interpretation in an insurance coverage dispute in favor of coverage consistent with the insured's objectively reasonable expectations, yet ruled against coverage given the materiality of the insured's misstatement on the insurance application.

For more information, please contact [Terrence P. McAvoy](#).

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