Recent Decision Highlights the Importance of Avoiding Disclosure Pitfalls

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Earlier this month, the US District Court for the Northern District of Illinois ruled that Call One Inc., a tele-communications company, must litigate a claim by its insurer, Berkley Insurance Company, seeking to rescind coverage based on the information provided by the policyholder in its application for insurance. The coverage dispute is illustrative of insurers' increased scrutiny of the answers to all policy application questions—including where no response is provided—to identify new or additional grounds to avoid coverage, even if it requires rescission of the policy. Policyholders should thus carefully consider all questions and requirements during the policy application process (including during renewal) to avoid potential disclosure disputes should a claim arise.

Background

The Insurance Claims

In March 2019, the OAG served a subpoena under the Illinois False Claims Act related to Call One's collection and payment of taxes. Call One asked Berkley to cover its subpoena response costs under a professional liability insurance policy covering the period of June 2018 to June 2019 for the OAG subpoena. Berkley agreed and provided a defense. Berkley later learned about a pending lawsuit against Call One for alleged IFCA violations, filed under seal, by the OAG in 2018. Call One sought coverage for the IFCA lawsuit under the 2018 Policy, but Berkley denied coverage, and Call One later settled the lawsuit with the OAG for $2.5 million. Call One then sued Berkley for Berkley's failure to cover anything beyond the OAG subpoena. In response, Berkley counterclaimed for rescission of the 2018 Policy alleging Call One mispresented facts in its renewal application.

The Alleged Misrepresentations

Berkley argued that, after Call One tendered defense of the OAG subpoena, it discovered misrepresentations in Call One's applications for the 2018 Policy and prior policies. The insurer stated, for example, that it learned of a complaint filed by a Call One executive alleging that, in 2015, he discovered material accounting deficiencies in Call One's records that were also disclosed to the company's CEO and Board of Directors. Further, according to Berkley, Call One's CFO learned in

2017 that Call One had failed to collect and remit taxes under Illinois law.

In June 2018, Call One submitted a renewal application for the 2018 Policy, but omitted an answer to question 5, which asked "[w]ithin the last 12 months, has there been any change in the status of any claims, loss or circumstances reported in any application previously submitted to the Insurer?" Call One had answered "no" to that same question in the 2015 and 2017 renewal applications. According to Berkley, based on the alleged discovery of accounting and tax issues, Call One misrepresented that it was unaware of any circumstances that could result in liability. Berkley brought a counterclaim alleging misrepresentation and seeking rescission of the 2018 Policy. Call One moved to dismiss. That motion was denied.

Decision

In denying Call One's motion, the court reasoned that, at the motion-to-dismiss stage, Berkley had sufficiently alleged that the 2018 Policy's application renewal contained a misrepresentation by "omission." That is, Call One did not answer whether there had been any changes in the status of any circumstances that could result in a claim previously reported to Berkley, even though in 2015 and 2017 members of Call One's senior leadership allegedly discovered such circumstances. The court concluded that, based on the premise that "incomplete answers and failures to disclose can be misrepresentations," Berkley plausibly alleged that Call One's failure to respond affirmatively or negatively to Question 5 was a misrepresentation.

Takeaways

Berkley's win may be short-lived since the ruling on Call One's motion assumed as true all of the insurer's well-pled factual allegations. Berkley now must prove those allegations to support its misrepresentation claim. Whether it can do so with evidence sufficient to withstand a dispositive summary judgment motion remains to be seen. Still, the Call One coverage dispute illustrates that insurers will often dig into not only policies across many years (in Call One's case an 8-year period dating back to the year it first procured a policy from Berkeley), but also will investigate all parts of an application (even questions that are incomplete or unanswered) and assert all potentially available defenses, including rescission of the policy altogether.

Vigilance by policyholders during the application process (whether for the first policy or a renewal) is therefore critically important. For instance, risk managers or other individuals responsible for verifying and signing applications should conduct their own diligence concerning the represented information and refuse to sign applications reflexively simply because they were prepared by an insurance broker or even another individual at the company. Instead, the signatory should assess the application thoroughly and identify potential issues before leaving application sections blank or providing shortened or incomplete answers to help streamline the application process.

Nor should policyholders assume they are in the clear by leaving a question blank. While there are limitations on an insurer's ability to rescind (such as if a reasonable insurer already knew or ought to have known about information before the inception of the policy), and an insurer may have a duty of inquiry to investigate incomplete or unclear answers, those issues are fact-specific and vary depending on governing law. Insurers regularly argue that misrepresentations can arise, not just from providing inaccurate or incomplete answers, but also from failing to answer questions at all, like what Call One purportedly did in the 2018 Policy's application.

Engaging experienced risk professionals, including coverage counsel, before a claim or dispute arises can help ensure policy applications are submitted properly, consistent with the requisite disclosure requirements. The time to assess disclosure obligations is before the policy is procured or renewed because doing so months or years later when a claim arises may be too late.

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