

[Liability Insurer Does Not Waive Right to Raise Misrepresentations in Application for Failing to Follow Internal Underwriting Guidelines](#)

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While this blog is dedicated to Life, Health and Disability Insurance, including ERISA matters, a recent Court of Appeal liability insurance decision concerning waiver, estoppel and [Health & Safety Code § 1389.3](#) – [Colony Insurance Co. v. Crusader Insurance Co.](#) – should apply with equal force to life, health and disability insurers.

Colony Insurance Company sought a declaration that Crusader Insurance Company improperly refused to defend a tenant lawsuit and share the costs incurred in defending the tenant litigation. Among the many issues argued was Colony's contention that Crusader engaged in post-claims underwriting in violation of Health & Safety Code § 1389.3, relying on [Hailey v. California Physicians' Service](#), a case tried and won by Barger & Wolen partner John LeBlanc, as discussed [here](#).

Mr. LeBlanc and Jason Love have taken the time to analyze the issue in *Colony*.

In *Colony*, both Colony and Crusader insured an apartment building in Los Angeles that became the subject of a tenant lawsuit. The apartment building was insured by Crusader from December 2003 to December 2004, after which Colony insured the building. Colony sought a declaration that Crusader improperly refused to defend the tenant lawsuit and share the costs incurred in defending the tenant litigation.

An application for coverage on the apartment building was submitted to Crusader in November 2003. In the application, the insured indicated that the building had been inspected by a governmental department in 1999 and 2000, but failed to disclose inspections occurring in 2002. The insured also failed disclose that in 2002 a governmental department found deficiencies and code violations. At the time it issued the policy, Crusader was unaware of the insured's omissions, but denied coverage for the tenant lawsuit once it learned of the material misrepresentations and concealments in the application.

Colony sued Crusader, seeking a declaration that the misrepresentations and concealments in the application were not material and for payment from Crusader for a portion of the defense costs in the tenant litigation. At trial, the insured admitted that the 2002 citations should have been included in the application, and the evidence demonstrated that if the 2002 citations had been revealed, Crusader would not have insured the building. However, the evidence also demonstrated that Crusader failed to comply with its internal underwriting guidelines in issuing the policy. The trial court entered judgment in Crusader's favor.

On appeal, Colony relied on principles of equitable estoppel and waiver to argue that Crusader was precluded from denying coverage for the underlying litigation because it failed to follow its internal underwriting guidelines. The Court of Appeal rejected these arguments on the grounds

that Colony forfeited the arguments by failing to timely raise them in the trial court, but also found the contentions lacked merit.

First, the Court of Appeal found that there was no estoppel. The Court stated that Crusader's internal guidelines, standing alone, did not create any rights enforceable by Colony. In so holding, it noted that the insurance agreement reinforced this conclusion: "By acceptance of this policy, the insured agrees ... that this policy embodies all agreements existing between the insured and the company or any of its agents relating to this insurance." Further, there was no evidence that the insured detrimentally relied on the guidelines when applying for the policy. Thus, Crusader was not estopped from denying coverage for failing to comply with its own guidelines.

Similarly, the Court of Appeal held that Crusader had not waived its right to deny coverage based on the misrepresentations due to a failure to comply with its internal underwriting guidelines. In so doing, the Court cited to [Insurance Code § 336](#), which provides:

The right to information of material facts may be waived, either (a) by the terms of insurance or (b) by neglect to make inquiries as to such facts, where they are distinctly implied in other facts of which information is communicated."

The Court also noted that Colony failed to provide any explanation as to how Crusader's internal guidelines could rewrite the provisions in the Insurance Code expressly permitting an insurer to rely on an insured's representations in the application when issuing a policy.

Finally, Colony attempted to rely on *Hailey v. California Physicians' Service*, 158 Cal. App. 4th 452 (2007), to contend that Crusader engaged in post-claims underwriting in violation of Health & Safety Code § 1389.3.

The Court of Appeal dismissed this argument, indicating that Colony's reliance on Hailey is misplaced because *Hailey* applied a specific statute applicable to health services plans. This case does not involve a health services plan and the prohibition on post-claims underwriting in section 1389.3 is inapplicable."

Colony also attempted to rely on [Barrera v. State Farm Mutual Automobile Insurance Co.](#), 71 Cal. 2d 659 (1969), to support its argument that Crusader engaged in post-claims underwriting. The Court rejected this argument, relying in part on [Nieto v. Blue Shield of California Life & Health Insurance Co.](#), 181 Cal. App. 4th 60 (2010), because *Barrera* involved an automobile liability insurer and the public policy of protecting injured third parties, neither of which was a concern in the present case.

Thus, judgment in Crusader's favor was affirmed.