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NEWSLETTER

Insured's Failure to Disclose Pending Suit Precluded Coverage for Later Actions

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In an unreported decision, a California intermediate appellate court held that a real estate brokerage firm's failure to disclose a prior lawsuit on its application for insurance precluded coverage for later suits arising out of the same transaction. *College Park Realty, Inc. v. TOPA Ins. Co.*, 2006 WL 978944 (Cal. Ct. App. Apr. 13, 2006).

The insurer issued a claims-made real estate agents and brokers errors and omissions policy to the real estate brokerage firm. The policy incepted on August 1, 2002, and the firm had previously obtained coverage from a different insurer under a policy that expired on June 30, 2002. The policy included a retroactive coverage date of July 1, 2002, to address the one-month gap in coverage for the firm. On the application for insurance, the firm denied being "aware of any act, error, omission, or other circumstance which might reasonably be expected to be the basis of a claim or suit." Additionally, as a prerequisite to providing the retroactive coverage date, the insurer required the brokerage firm to execute a claims-free warranty letter, which stated that "from 7-1-2002 to present, this firm has not had any claims, nor are we aware of any incidents which could reasonably be expected to give rise to a claim."

The underlying dispute arose between one of the firm's affiliated real estate agents and two separate potential purchasers of a single piece of property. In June 2002, following a dispute over the escrow date on the first potential purchaser's contract on the property, the firm's agent allowed the second potential purchaser to submit a contract. On June 28, 2002, the first potential purchaser, by letter, demanded specific performance from the firm's agent and warned that "[i]f you fail to effect the foregoing, my clients will immediately file a lawsuit for specific performance, as well as a notice for pending action." On July 8, 2002, the first potential purchaser filed the threatened action against the owner of the property and the firm's agent.

On August 1, 2002, the firm filed an application for insurance with the insurer. On September 18, 2002, the second potential purchaser, by letter, also demanded specific performance on its purchase contract, warning that if the transaction was not completed he would "utilize any and all legal remedies . . . including the filing of a lawsuit." Shortly thereafter, the second potential purchaser filed the threatened suit against the owner of the property, the firm and the firm's agent. The property owner then filed a cross complaint against the firm and the firm's agent, alleging professional negligence.

The insurer denied coverage for all three actions. In its denial, the insurer asserted that the last two actions stemmed from the initial action, which, although known to the firm before it had obtained the insurance, was not disclosed on the insurance application. The firm filed suit against the insurer seeking a declaration that the insurer was required to defend and indemnify against the specific performance action filed by the second potential purchaser as well as the cross-complaint filed by the property owner. The trial court held in favor of the insurer, and the firm appealed.

The court rejected the firm's argument that coverage under the policy was not precluded because the question on the insurance application regarding the firm's knowledge of circumstances that "might reasonably be expected to be the basis of a claim" was unclear. The court emphasized that the language of the question referred to circumstances that a firm could have reasonably expected to lead to a claim or a suit. Therefore, even if the firm was unsure whether the circumstances would lead to a claim, it was already aware that the circumstances had led to the pending suit filed by the first potential purchaser.

The court also rejected the firm's assertion that because the first potential purchaser's demand letter and lawsuit were not "claims" under the insurer's policy and because it could not have expected the second potential purchaser's later action and the property owner's cross-complaint, its claims-free warranty letter was accurate. The court emphasized that "regardless whether the [first demand letter] or [first action] qualify as 'claims,' [the firm] knew of an incident which could reasonably be expected to give rise to a claim." Because the firm had knowledge that the first action included an interference with contract claim that arose out of its agent's actions with regard to selling the disputed property, the firm, according to the court, should have reasonably expected a later claim of professional negligence against its agent, which "would indisputably constitute a 'claim' under the policy."

While the firm argued that the insurance application and the claims-free warranty letter should be construed in its favor, the court emphasized that such was the case only when "an asserted ambiguity is not eliminated by the language and context of the policy." The court explained that the principle was inapplicable in the case at hand because the purpose of both the claims-free warranty letter and the insurance application—namely, to prevent the provision of coverage for previously known claims—was clear to the firm. Accordingly, the court concluded that because coverage would not have been available for the action filed by the second potential purchaser or the subsequent cross-complaint filed by the property owner if the firm had divulged the first action on its application, the insurer was not required to defend or indemnify against these suits.