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NEWSLETTER

Right to Rescind Waived by Failure to Raise Misrepresentation During Policy Renewal

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Applying Utah law, the United States District Court for the Eastern District of Kentucky has held that an insurer waived its right to rescind a policy when it failed to raise any alleged misrepresentations throughout the policy period or during the negotiations of a renewal policy. *Colony Nat'l Ins. Co. v. Sorenson Med., Inc.*, 2011 WL 6740537 (E.D. Ky. Dec. 21, 2011). In addition, the court held that no coverage is available under a claims-made-and-reported policy for claims made in one policy period but not reported until the subsequent policy period.

An insured medical equipment manufacturer purchased a $10 million primary policy and a $10 million excess policy for the claims-made-and-reported policy period of July 1, 2007 to July 1, 2008. In February 2008, a lawsuit alleging defects in the manufacturer's medical pain pumps was filed, and the manufacturer provided timely notice of the claim to the insurers. Two other suits were filed in May 2008 but not reported to the insurers until July 15, 2008 and sometime in August 2008, respectively. Meanwhile, the insurers had renewed the policies for the July 1, 2008 to July 1, 2009 policy period.

In August 2008, an underwriter for the excess insurer began reviewing in more detail the increasingly numerous lawsuits related to the manufacturer's pain pumps. On November 17, 2008, the excess insurer issued a general reservation of rights letter to the manufacturer. On February 23, 2010, the excess insurer issued another reservation of rights letter noting potential misrepresentations in the manufacturer's policy applications. After the various pain pump cases settled in March 2010, the excess insurer issued a final letter stating that no coverage was available for the second and third pain pump lawsuits because they were made in the 2007-2008 policy period but not reported until the 2008-2009 policy period.

The excess insurer filed suit seeking rescission of both policies based on the manufacturer's misrepresentations in the applications regarding the manufacturer's business operations. The court granted the manufacturer's motion for summary judgment as to both rescission counts, finding that material disputes existed regarding whether the manufacturer had answered the application questions incorrectly and in bad faith. Moreover, the court held that the excess insurer had waived its right to seek rescission of the policies by failing timely to raise the potential misrepresentation issues. Specifically, the court determined that information that had come to light during the first policy period should have put the excess insurer on notice of any potential misrepresentation issues when negotiating the renewal policy. The court further concluded that

the insurer's failure to raise any alleged misrepresentations shows that they could not have been material to the insurer's risk in issuing the renewal policy.

The excess insurer also sought a declaratory judgment that no coverage was available for the second pain pump lawsuit, which was filed May 28, 2008, because it was a claim made in the first policy period but not reported until the second policy period. The court granted summary judgment for the manufacturer on this issue, finding that the claim was both made and reported in the second policy period. The primary policy provided that a claim is made "on the date of service upon or other receipt by" the manufacturer. Because the manufacturer did not receive a copy of the second lawsuit until July 15, 2008, at which point it tendered the claim, the court held that the claim was both made and reported during the second policy period, and thus coverage was available for the claim under the 2008-2009 policy.

Similarly, the excess insurer argued that the policies' claims-made-and-reporting requirements barred coverage for the third pain pump lawsuit, which was filed May 30, 2008 and reported in August 2008. The court agreed, finding that this claim had been made during the first policy period but not reported until the second policy period. Thus, the court held, any expenses associated with this claim would not erode the limits of the 2008-2009 primary policy for purposes of triggering the excess policy. Moreover, the court found that the excess insurer was not estopped from raising this coverage defense due to its failure initially to raise the issue because estoppel could not be used to create coverage where none exists.

Finally, the excess insurer argued that no coverage was available for certain claims made in the 2008-2009 policy period because they related back to claims made in the 2007-2008 policy period under the primary policy. The excess policies, however, had no such related claims provision, and thus the excess insurer argued that no coverage was available for these claims under the 2007-2008 excess policy either. The court held that because construction of the primary policy was not properly before the court, there was no "case or controversy" and it could not rule on that issue.