

# Apply Here

## Stay fully informed when applying for company insurance policies

BY LAURA GOODMAN

Most corporate counsel never see their company's insurance applications. Usually the finance or risk managers complete the applications with help from the company's insurance broker. The legal department is frequently overlooked in the process, perhaps only being consulted on occasion with an inquiry or two.

Rarely does anyone within the company notice the warranties that statements contained within the insurance applications are true and correct and that the company has undertaken a "reasonable investigation" or conducted a "reasonable inquiry" to obtain the information requested by the application.

Applications provide insurance underwriters with information necessary to understand the prospective insured's business and the risks associated with that business. Under California law — specifically, California Insurance Code section 332 — there may be serious consequences to a company that does not disclose information that it knows, or should reasonably know, in response to questions asked in an insurance application. A material fact is one that would influence the insurer in deciding to write the insurance policy, what risks will be included or excluded or how the insurance will be priced. If a company does not accurately disclose requested material information, an insurer may not only deny coverage for a particular claim down the road, but may rescind the insurance policy entirely, leaving the company with no coverage at all.

Many reported decisions in insurance nondisclosure cases do not involve actual fraud or intentional concealment. Instead, they result from the failure to make reasonable internal inquiries, which can lead to an unintentional and inadvertent failure to disclose facts that such an inquiry would uncover. However, even negligent or inadvertent failures to disclose claims or potential claims are sufficient to support rescission when an insurer issues a policy it would not have otherwise written (or would have written only

with different terms and conditions) had it known the nondisclosed information. While severability provisions in some insurance applications may provide a degree of protection, they are not a substitute for reasonable investigation and disclosure.

To help clients comply with the requirement of reasonable inquiry and disclosure, corporate counsel should be integrally involved in the insurance application process, especially in connection with directors and officers, fiduciary, errors and omissions, employment practices, environmental and general liability insurance. The role of in-house counsel in the application process will depend on the structure and organization of a company. While there is no "one size fits all" model, the following suggestions may assist corporate counsel in helping their company meet its disclosure obligations and protect it in the insurance application process.

- *Encourage the company to formalize the application process.*

Companies should be urged to make a formal determination of who is ultimately responsible for gathering and reporting information regarding claims, potential claims, facts and circumstances required in the insurance application and renewal process. Often there is an internal communication breakdown when facts concerning situations, circumstances or potential claims are known to some within the company but are never communicated to the legal, finance or risk management departments. Insurance claim problems and internal finger-pointing can be avoided by establishing and communicating responsibility for information gathering and reporting.

- *Work with risk management to establish a "reasonable investigation" process.*

Corporate counsel should work closely with risk management and finance managers — those traditionally tasked with insurance procurement — to establish a "reasonable investigation" process designed to identify, gather, assess and maintain information for insurance applications. Identify and understand the processes, information custodians and major players in each corporate and business unit. Go through your company's organizational chart to assist in the process.

- *The insurance application is important. Read it.*

Corporate counsel should read insurance applications as early as possible to understand what information is requested and to for-

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mulate a plan to obtain necessary information. If your company is submitting applications to different insurers, be consistent. Many insurance applications require updated disclosures if relevant and material information develops between the time of the application and the issuance of the policy. Thus, identifying and obtaining information about claims, potential claims, situations and circumstances should be an ongoing process.

- *Pay close attention to questions regarding claims, potential claims, situations and circumstances.*

Nearly all insurance applications ask about past and existing claims, as well as facts, circumstances, situations, errors or omissions that might reasonably be expected to give rise to new claims. Policy applications covering directors and officers, fiduciary and employment liability will likely ask whether any director or officer has knowledge of “any fact, circumstance or situation” involving the company or its directors or officers that he or she has reason to believe might result in a future claim. An errors and omissions application will ask whether any person or entity proposed for insurance has knowledge of any “act, errors or omission” that might give rise to a claim under the policy. Applications for commercial general liability policies may ask whether the insured is aware of “any facts or past incidents, circumstances or situations” that could give rise to a claim.

- *Conduct internal due diligence concerning claims, potential claims, situations and circumstances.*

Each member of executive management, along with the company’s directors and those responsible for each corporate and business unit, should be contacted for information and formally requested to perform an inquiry involving their own reports concerning any claims that have been made against the company and issues that might reasonably result in a claim. It is important to drill down to the level of those people who actually possess the relevant knowledge.

Corporate counsel can design questions or checklists to elicit the information needed that may not be apparent to a business person. For example, for general liability and professional liability risks, counsel should ask business division and unit managers about business disputes with customers or business partners, including claims of nonperformance, nonpayment and product or service issues. Concerning employment practices, counsel can work with the human resources department to obtain information about claims made by current and former employees, threats of claims, internal

investigations and any actions that the company has recently taken or is currently contemplating that may result in a claim.

General counsel should conduct due diligence with the chief executive officer, chief financial officer, chief operating officer and the company’s auditors in identifying potential claims situations that are relevant to directors and officers liability insurance, including issues with accounting, executive compensation, compliance and mergers and acquisitions. Other steps necessary to conduct a “reasonable investigation” about claims, potential claims, situations and circumstances will be mandated by the specific type of coverage for which the company is applying and the nature of the company’s business operations.

- *Make sure the person responsible for completing the application has all the facts.*

Too often a company assigns the task of gathering information and completing insurance applications to an employee who is not privy to all of the facts needed to correctly complete the application. Make sure that any employee who is tasked with the job has been “brought over the wall” with respect to sensitive and new matters so that they can be properly addressed in the insurance application.

- *Ensure that the warranties made by your client are accurate.*

Many insurers require that applications be signed by an executive officer of the company. After a reasonable investigation has been completed and decisions have been made about what should be disclosed, corporate counsel should review the completed insurance application and warranties with the executive officer who is signing the application. Explain the processes used to obtain information and to complete the application and ask whether the officer is comfortable with what has been done or whether additional due diligence is required. The person who signs the application needs to have the knowledge of the matters to which he or she attests.

- *Establish a protocol for maintaining application information.*

Work with your company’s risk management and technology departments to design and create an electronic database of application information, including information about claims, potential claims, situations and circumstances. Be sure to frequently check the status and maintain updates as needed.

In sum, taking the time to review insurance applications at the beginning of the process is well worth the effort. Following the suggestions outlined above will help to protect your company and avoid potential insurance-related headaches down the line. ❖

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