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California Court of Appeal Affirms Insurers' Right to Rescind

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California's Second District Court of Appeal last week issued an opinion that contains two important rulings on first-impression issues of major significance to health insurers. In *Nieto v. Blue Shield of California Life & Health Insurance Company*, __ Cal. App. 4th __, 2010 Cal. App. LEXIS 50 (Jan. 19, 2010), in which Manatt represented the defendant insurer, Division Two reaffirmed traditional principles of insurance and contract law, holding that an insurer is entitled to rescind a policy based on the insured's material misrepresentations in the application, regardless of whether the insured had intentionally deceived the company.

The court then interpreted three California Insurance Code statutes that plaintiffs' lawyers frequently argue bar an insurer from rescinding even when it would be entitled to do so under long-standing law. The court held that an insurer had "no statutory duty . . . to conduct further inquiries during the underwriting process to ascertain the truthfulness of appellant's representations before it issued the policy." *Nieto*, 2010 Cal. App. LEXIS 50, at *2. The court further held that the company's failure to physically attach a copy of the application to the policy did not bar rescission.

In so holding, the court rejected all of the arguments urged by plaintiffs in this and many other similar cases that have yet to reach the appellate courts. In addition, the opinion makes important clarifications to a procedural issue, making it easier for parties to ask courts to reconsider prior rulings that may not technically qualify for reconsideration under the California Code of Civil Procedure.

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The facts of *Nieto* are similar to those of many well-publicized rescission cases. Julie Nieto had a lengthy history of back and hip pain. She had repeatedly seen an orthopedist and a chiropractor (including 18 visits in the three months before she submitted her application to Blue Shield of California Life & Health Insurance Company ("Blue Shield Life"), one of which was on the very same day that she signed the application), and had taken steroid injections, been prescribed various pain medications, and even received a note from her doctor excusing her from work due to pain. Nonetheless, when she filled out her Blue Shield Life application, she checked "no" to every question asking whether she had any medical issues, stated that she took no prescription medications, and falsely indicated that her last physician visit was three years earlier, for the flu. When she was scheduled for hip replacement surgery shortly after her policy issued, Blue Shield Life investigated, learned of the misrepresentations, and rescinded the policy.

Nieto's lawsuit against Blue Shield Life alleged that the company had engaged in "postclaims underwriting" prohibited by Insurance Code Section 10384, which prevents rescissions that are due to an insurer's failure to complete medical underwriting. *See* Cal. Ins. Code § 10384 (insurer may not rescind a policy "due to the insurer's failure to complete medical underwriting and resolve all reasonable questions arising from written information submitted on or with an application before issuing the policy or certificate"). Nieto also argued that Blue Shield Life was prohibited from rescinding the policy under Sections 10113 and 10381.5. Nieto argued that those statutes precluded an insurer from rescinding if a copy of the application was not attached to or endorsed on the policy. Before *Nieto*, these three statutes had received little, if any, judicial interpretation.

The court began by holding that under traditional insurance law, Blue Shield Life was entitled to rescind Nieto's policy because of her material misrepresentations. The court acknowledged and relied upon various provisions of the California Insurance Code and a long line of cases holding that an insurer is entitled to rescind based on material misrepresentations, whether intended or unintended. As Nieto's intent was irrelevant to Blue Shield Life's right to rescind, the court held, her declaration that she did not intend to defraud Blue Shield Life did not create a triable issue of fact. *Nieto*, 2010 Cal. App. LEXIS 50, at *25-*33.

With respect to postclaims underwriting, the *Nieto* court declined Nieto's urging to follow the recent opinion in *Hailey v. California Physicians' Service*, 158 Cal. App. 4th 452 (2007). *Hailey* had discussed postclaims underwriting under a similarly worded provision of the California Health & Safety Code, and had concluded that the statute imposed an undefined requirement on plans to conduct "reasonable efforts" to ensure the accuracy and completeness of an application, even where the applicant attested that she had no medical conditions or history. *Hailey* rejected the entire line of cases establishing the principle that an insured is obligated to be

truthful with the insurer and that an insurer has the right to rely on the applicant to be truthful, on the ground that the cases were decided with reference to Insurance Code provisions inapplicable to the Knox-Keene Act health care service plan in *Hailey*. Therefore, the *Nieto* court decided that "[g]iven this qualification, we construe the *Hailey* court's medical underwriting requirements to be limited to health care service plans subject to the Knox-Keene Act." *Nieto*, 2010 Cal. App. LEXIS 50, at *50. Thus, the court rejected arguments, urged by plaintiffs' lawyers in many cases, that *Hailey* must be the law of the state with regard to insurers as well as health care service plans.

The *Nieto* court further concluded that even if *Hailey* did apply, Blue Shield Life's inquiries into Nieto's application, including several requests for additional information and a search of its own databases, met *Hailey*'s "reasonable efforts" requirement. Moreover, the rescission could not have been "due to" any failure of underwriting, as even had Blue Shield Life ordered medical records from the doctor's visit of three years earlier that Nieto did disclose, those records would have contained no information about her back problems. *Nieto*, 2010 Cal. App. LEXIS 50, at *50-*53.

The court also rejected the argument that Sections 10113 and/or 10381.5 prohibited the rescission. *Nieto*, 2010 Cal. App. LEXIS 50, at *33-*45. Section 10113, which requires that an insurer attach to or endorse on the policy any documents it may use to alter the policy's terms, and prohibits incorporation by reference, was simply inapplicable because, in rescinding Nieto's policy based on her application misstatements, Blue Shield Life was not seeking to alter any term of the policy. Section 10381.5 likewise did not bar rescission, the court held. That statute provides that an insured will not be "bound by" statements in an application that is not attached to or endorsed on the policy. While Blue Shield Life had not physically attached the application, the policy's repeated references to and incorporation of the application met the statute's requirements. The court declined to follow the conclusions of another recent opinion, *Ticconi v. Blue Shield of California Life & Health Insurance Company*, 160 Cal. App. 4th 528 (2008), which had concluded that an insurer that did not attach or endorse the application could not rely on the insured's material misstatements to rescind a policy. *Ticconi* had based its conclusion not on the statutory language, but rather on a case that had interpreted specific policy language that was very different from the later-enacted statute. Thus, "it is evident that the Legislature did not intend to codify the holding" in that case. *Nieto*, 2010 Cal. App. LEXIS 50, at *44.

Finally, in a ruling with ramifications across all areas of civil litigation, the court rejected Nieto's argument that the trial court had not been entitled to grant Blue Shield Life's motion for summary judgment because it presented no new issues from a prior motion that was denied. Nieto argued that California Code of Civil

Procedure Section 437c(f)(2) barred the sequential motions unless new facts or issues were presented. After first concluding that the motion did in fact present a new issue, *Nieto*, 2010 Cal. App. LEXIS 50, at *17-*19, the court held that the trial court's inherent authority to reconsider its prior rulings allowed it to grant the motion. The record showed that the trial court had already determined that it would reconsider its denial of the prior motion if Blue Shield Life could show that there was no triable issue of fact as to Nieto's fraud. "That reconsideration may have been prompted by a motion filed in violation of [Section 437c(f)(2)] did not alter the trial court's inherent authority to reconsider its prior order denying summary judgment." *Nieto*, 2010 Cal. App. LEXIS 50, at *23. This holding appears to loosen the restrictions on parties that want to urge a trial court to reconsider a ruling, even though the party may not have grounds for a new motion.

The ramifications of the *Nieto* opinion for insurers are significant. It reaffirms the traditional principles of rescission – that an insurer may rescind based on material misrepresentations, regardless of deceptive intent, and that an insurer may rely on its applicants to be truthful. This body of law, while well established, has suffered serious battering in recent plaintiff-oriented decisions, including *Hailey*. While *Hailey* continues to govern health care service plans under the Knox-Keene Act, *Nieto* provides a solid foundation for rescission by insurance plans that learn of material misstatements after issuing coverage to applicants who say they have no medical problems. Lastly, *Nieto*'s first-impression interpretation of the "attach or endorse" statutes establishes that those statutes will not bar rescission for an insurer's mere failure to attach an application.

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