California Workers' Compensation Institute

Significant Decision

No. 17-04 May 22, 2017

SOUTHERN INSURANCE v. WCAB (BERRIOS-SEGOVIA)

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT
B278412
FILED: MAY 10, 2017
PUBLICATION ORDER: MAY 22, 2017

A workers' compensation policy may be rescinded by the carrier, and the rescission may be enforced by a civil action for relief or by asserting it as a defense.

Significance: The Court of Appeal reversed the findings of the Appeals Board, and held that that the arbitrator was *incorrect* when he found that, as a matter of law, the insurer could not rescind a workers' compensation insurance policy based on an allegation that the policy was procured by fraud.

Facts: When employer EJ Distribution applied for California workers' compensation coverage through Southern Insurance, the application stated that the employer did not operate outside of California. The policy issued effective January 1, covering "local hauling." On April 6, employee David Berrios-Segovia was injured while on a trucking job in Tennessee; he filed his DWC-1 on May 13. On June 12, Southern notified EJ that the policy was being rescinded based on material misrepresentations of fact in the application, specifically that employees did not travel out of state. Southern contended that the policy would not have issued had the true facts been known, and returned the policy premiums paid by EJ. The Uninsured Employers Benefit Trust Fund (UEBTF) was joined, and the coverage dispute was submitted to arbitration. Southern called an underwriter as a witness who testified that Southern never insured long-haul trucking and that, had Southern known that EJ's employees traveled out of state, Southern would not have issued the policy. An investigator for Southern testified that EJ had always operated out of state, and was doing so prior to policy inception (although there was insufficient information in the record as to whether EJ operated out of state at the time the application was submitted). The arbitrator ruled: that the insurer could not validly retroactively rescind the policy; that California law offered no mechanism for rescission of a policy while a claim is pending; and that Southern's argument for a "unilateral, retroactive rescission" would leave the injured employee without coverage for his claim. On Reconsideration, the Appeals Board largely adopted the arbitrator's decision.

Holding: A workers' compensation policy may be validly rescinded. If rescission is asserted as a defense to a claim in a workers' compensation proceeding, the statutory arbitration proceeding over disputed coverage can function to ensure that the rescission is not used for the improper purpose of obtaining impermissible modifications to a workers' compensation insurance policy or otherwise used as a subterfuge to evade the laws governing workers' compensation insurance.

Discussion: First addressing a jurisdictional issue, the Court of Appeal ruled that the WCAB has jurisdiction to determine the coverage dispute via arbitration. If an insurer disputes workers' compensation coverage because it claims there was no contract of insurance in effect, it must submit to the jurisdiction of the WCAB -- and that includes a ruling on whether the insurance contract was in effect.

Turning to the question of whether a workers' compensation insurance policy may be rescinded, the Court of Appeal applied Insurance Code section 650, which provides "[w]henever a right to rescind a contract of insurance is given to the insurer by any provision of this part such right may be exercised at any time previous to the commencement of an action on the contract." Accordingly, the court rejected UEBTF's contention that a workers' compensation insurance policy cannot be rescinded. The court further rejected UEBTF's argument that once a workers' compensation claim has been filed, section 650 precludes rescission. Because a workers' compensation claim is not filed, pursued, or adjudicated in a court of law, it does not constitute an action on the contract.

Finally, the Court of Appeal outlined the available procedures for enforcing a rescission. First, the court noted that a rescission is effected pursuant to Civil Code section 1691 by giving notice and restoring everything of value received on the contract. But the court explained the distinction between the *effectuation* of a rescission under Civil Code section 1691 and the *enforcement* of a rescission under section 1692. Once a contract has been rescinded in accordance with section 1691, a party to the contract may seek legal or equitable relief based upon the rescission pursuant to the remedies outlined in section 1692. Mere compliance with section 1691 does not discharge an insurer's obligations under the contract; instead, an insurer must proceed to judgment in an action filed to enforce the rescission under section 1692. Alternatively, the same finding could be entered if the insurer asserts rescission as a defense to a workers' compensation claim: "Of course, such a finding would not be entered until the facts were tried and determined in the workers' compensation hearing."

Because the question of the legal validity of Southern's purported rescission had not been determined below, the matter was remanded for a decision on the record as to whether EJ made misrepresentations at the time it entered into the policy, and whether those misrepresentations were "material."

The decision represents a potentially important tool for insurers seeking to curb the growing problem of premium fraud. Originally unpublished, the Court of Appeal accepted the WCAB's request to publish this decision on May 22, 2017. As a published case, the rules outlined in the decision now provide binding authority for the WCAB and guidance for future litigants.

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