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PERSPECTIVE

Equitable estoppel may limit ability to enforce policy conditions

By Shaun H. Crosner

Insurance policies frequently contain various procedural conditions purporting to impose requirements or deadlines with which the insured must comply in order to obtain coverage for a loss or claim. For instance, first-party insurance policies often specify time periods in which the insured is to (i) file a sworn proof of loss; (ii) elect whether to repair or replace a damaged building or property; and (iii) in the event of a dispute over coverage, file suit against the insurer. Liability insurance policies also typically include a number of procedural conditions. For example, most liability policies specify that after providing notice of a claim or suit, the insured is to (i) cooperate with the insurer in the investigation, defense, and settlement of the claim or suit and (ii) obtain the insurer's consent before incurring defense costs or entering into a settlement.

Insurers often argue that an insured's noncompliance with procedural policy conditions of this sort can limit or negate the insured's coverage for a loss or claim. To help avoid this draconian outcome, California law obligates an insurer to advise its insured of all potentially applicable procedural conditions in its policy and take all steps necessary to facilitate the insured's compliance with such conditions.

An insurer's obligations in this regard are rooted in both statute and common law. California's Fair Claims Settlement Practices Regulations obligate the insurer to, among other things, (i) respond to every communication regarding an insurance claim within 15 days of receipt; (ii) "diligently pursue a thorough, fair, and objective investigation" of the insured's claim; (iii) promptly disclose all time limits and other provisions that could impact coverage; and (iv) issue a coverage decision within 40 days of receiving notice of the claim. 10 Cal. Code Regs. Sections 2695.4(a), 2695.5(b), 2695.7(b), (d). Furthermore, the covenant of good faith and fair dealing implied in every insurance policy obligates the insurer to "affirmatively cooperate" with its insured, advise its insured of potentially applicable policy conditions, and take the necessary steps to "assist the insured to recover bargained-for policy benefits." *City of Hollister v. Monterey Ins. Co.*, 165 Cal. App. 4th 455, 490 (2008).

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When an insurer fails to honor these statutory and common law duties, California's doctrine of equitable estoppel may preclude the insurer from relying on the insured's subsequent noncompliance with a policy condition to avoid its coverage obligations. In the insurance context, "estoppel may arise from a variety of circumstances in which the insurer's conduct threatens to unfairly impose a forfeiture of benefits upon the insured." *City of Hollister*, 165 Cal. App. 4th at 488. Indeed, California courts have recognized that broad equitable relief may be available in proper cases to relieve an insured of forfeitures following technical violations of policy conditions. *See, e.g., O'Morrow v. Borad*, 27 Cal. 2d 794, 800 (1946) (because technical forfeitures of coverage are disfavored, courts "may, in a proper case, excuse compliance with [a policy condition] or give equitable relief against its enforcement"); *Root v. Am. Equity Specialty Ins. Co.*, 130 Cal. App. 4th 926, 947-48 (2005) ("[T]he possible equitable excuse of a condition precedent is ... flexible and nuanced [and] is not a bright-line test. Equities vary with the peculiar facts of each case.").

For instance, in *Spray, Gould & Bowers v. Associated Int'l Ins. Co.*, 71 Cal. App. 4th 1260 (1999), the insurer denied coverage based on the insured's failure to file suit within the one-year period imposed by the policy's contractual limitations clause. The insured argued that the insurer should be estopped from relying on the condition because the insurer had not previously advised it of the deadline, in violation of Section 2695.4(a) of the Fair Claims Settlement Practices Regulations. The California Court of Appeal agreed, noting that "[a]n estoppel may arise from silence where there is a duty to speak." The court held that Section 2695.4(a) imposes on insurers "an unmistakable duty to advise" insureds of potentially relevant time limits.

In so holding, the *Spray* court rejected the insurer's argument that because the contractual limitations clause was part of the insured's policy, the insured was on constructive notice of the condition. The court stressed that "[t]he whole purpose of such notice is to assure actual, not merely constructive, knowledge, of" applicable policy conditions. The court added that the "mere existence of the policy provision is not enough, no matter how 'plain, clear and conspicuous."

Other courts have reached similar conclusions. In *City of Hollister*, a policy condition provided that in the event of a loss, the insured was entitled to coverage for the damaged building's "functional replacement value" (as opposed to property's market value), but only if the insured entered into a contract to repair or replace the building within 180 days of the loss. After a fire loss, the insured timely provided notice to its insurer, and the insurer advised the insured of the 180-day time limit. However, the insurer delayed in responding to numerous time-sensitive com-

munications from the insured, refused to promptly confirm coverage for the insured's loss, and generally frustrated the insured's ability to comply with the 180-day deadline. Citing *Spray*, the California Court of Appeal held that, under the facts presented, the insurer was equitably estopped from relying on the policy condition to limit its coverage obligations.

Notably, the *City of Hollister* court held that the logic of *Spray* was not limited to undisclosed contractual limitations provisions. The court ruled that estoppel likewise could flow from an insurer's violations of Sections 2695.5 and 2695.7 of the Fair Claims Settlement Practices Regulations — which, as noted above, require an insurer to promptly respond to claims-related communications and diligently pursue a thorough and fair investigation. The court stated: "Although no decision has held that violations of these requirements may sustain the imposition of an estoppel to assert a procedural condition of coverage, we see no reason to exempt them from the logic of *Spray*. Application of these regulations in this manner causes no enlargement of an insurer's substantive liabilities .... At worst imposing an estoppel against a procedural defense obligates the insurer to pay what it has agreed to pay when its only defense to payment is brought into being by its own inequitable conduct .... We thus detect neither injustice nor any offense to public policy in holding an insurer subject to estoppel based on its violation of claims practices regulations. Such a result merely means that it is equitably prevented from exploiting procedural violations that are a product of its own failures to comply with governing law."

The *City of Hollister* court also made clear that, by virtue of its implied covenant of good faith and fair dealing, an insurer must take whatever affirmative steps are necessary to facilitate the insured's compliance with applicable policy conditions. As the court stated: "[T]he law does not merely prohibit a contracting party from *actively interfering* with the other's performance of a condition; it may also impose a duty to *affirmatively cooperate* in that performance. If one party's cooperation is "necessary for successful performance" by the other, the contract will generally be held to include an implied obligation to "give that cooperation," as well as to refrain from doing "anything that prevents realization of the fruits of performance."

Further clarifying the reach of the estoppel doctrine, the *City of Hollister* court stressed that application of the doctrine does not necessarily require that the insurer's conduct be "blameworthy." Even if the insurer's conduct is merely negligent or innocent in its own right, estoppel nonetheless may be appropriate when the insurer's prior conduct "cast[s] a pall of unfairness over the position now asserted."

Thus, as *Spray* and *City of Hollister* make clear, an insurer is obligated both to advise its insured of each potentially applicable policy condition and to take all steps necessary to allow the insured to satisfy each such condition. If the insurer fails in either regard, California's broad and flexible doctrine of equitable estoppel may preclude the insurer from enforcing policy conditions to bar or limit coverage for an insured's claim or loss.

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