

Misrepresentations In Insurance Applications: How To Avoid Them And How To Minimize Consequences When They Happen

When faced with a policyholder's claim for insurance coverage, with increasing frequency insurance companies will comb through the policyholder's policy application in an effort to identify potential misrepresentations or omissions which could justify the insurance company's rescission (voiding) of the policy or pressure the policyholder into accepting less than full payment of a claim. This practice is often referred to as "post-loss underwriting".



The use of misrepresentations or omissions in a policy application as a means for insurance companies to escape payment of an otherwise covered claim is exemplified by a recent case, *Pope v. Mercury Indem. Co. of Georgia*, 297 Ga.App. 535 (Ga.App., 2009). In *Pope*, the policyholders made a claim for insurance coverage as a result of damage to their property from a tornado. The insurance company's investigation, however, revealed that contrary to the representation made in the insurance policy application that the policyholders' pool had no diving board, the policyholders' pool did in fact have a diving

board. The insurance company subsequently refused to pay the tornado damage claim and sought to rescind the policy on the basis of the diving board misrepresentation in the policy application. The appellate court affirmed the insurance company's right to rescind the policy, even though the tornado damage claim was unrelated to the policyholders' use of a diving board.

The *Pope* case exemplifies why policyholders should be aware of the potential pitfalls when completing policy applications and of the strategies to minimize the consequences of any misrepresentation or omission if it occurs.

Beware of the "Broad" Question in an Insurance Policy Application

Whether in a property policy, a commercial general liability policy, a directors and officers' liability policy or any other type of policy, the questions asked in an application and the breadth or specificity those questions can often determine whether an insurance company may later succeed in rescinding a policy on the basis of a misrepresentation or omission.

Many rescission cases have centered on a policyholder's failure to disclose knowledge of facts at the time of the application that ultimately led to a claim after the pol-

icy was sold. An application that asks broadly: "Does any Director, Officer, Manager, Supervisor, Employee or Partner have knowledge of any Claim(s), fact(s), circumstance(s), situation(s), transaction(s) or event(s) as of the date this Application is signed, which could reasonably give rise to a claim and/or allegation" sets a standard that is next to impossible to satisfy in any organization that has significant numbers of employees essentially. It requires the application signer to conduct interviews with all employees and potentially list an infinite number of events or facts which could give rise to a claim in the future. In contrast, an application that requests the same information but limits its scope to the knowledge of the application signer, leaves much less potential for a future accusation of misrepresentation or omission by the insurance company.

Policyholders should also ensure that all questions are answered as completely and accurately as possible. For example, a number of rescission cases have focused on the policyholder's failure to disclose all aspects its business leading to accusations by the insurance company that the policyholder misrepresented the nature of the risk being insured.

Accordingly, policyholders should work closely with their brokers to change or clarify questions in applications that are overly broad or ambiguous. They may even wish to consider the breadth of questions in an insurance application as a factor when deciding which insurance company to purchase a policy from.

Know Your Defenses To Rescission

Even if a misrepresentation or omission in an application occurs, a policyholder does not automatically forfeit its insurance coverage. Although it varies by state, an insurance company must meet a number of standards in order to rescind a policy and a policyholder may have a number of defenses available.

In general, an insurance company must prove that any misrepresentation or omission is “material” in order to justify rescission of an insurance policy. “Materiality” typically is determined by whether the insurance company would have issued the policy or changed the premium in the absence of the misrepresentation or omission. Unlike the *Pope* case, to meet the “materiality” standard some states require the misrepresentation or omission to be causally related to the insurance coverage claim at issue. In addition, to meet the “materiality” standard some states also require that a policyholder’s misrepresentation or omission must have been made with an intent to deceive the insurance company.

Even assuming that an insurance company meets the applicable state’s “materiality” standard, a policyholder may still have a number of defenses available to defeat a rescission attempt. For example, policyholders should closely examine the application questions giving rise to the material misrepresentation or omission for any ambiguity. To the extent that an application question is ambiguous, a court may refuse to permit an insurance company to rely on the policyholder’s answer to that question as a ground for rescission of the policy. In addition, if an insurance company had knowledge that should have caused the insurance company to investigate the policyholder further at the time of the application (whether because of a policyholder’s answers in the application or otherwise), a policyholder may have a defense that the insurance company has waived its right to rely on any undisclosed or misrepresented fact that could have been discovered in such an investigation. Similarly, if an insurance company continues to accept premiums or otherwise takes any actions that ratify the policy after the insurance company has knowledge of the misrepresentation or omission, then the insurance company may have waived its right to rescind the policy.

Conclusion

Insurance companies use alleged misrepresentations and omissions in insurance policy applications as a tool to support claim denials or

pressure their policyholders into accepting less than full payment on a claim. Policyholders can minimize their exposure to these tactics by ensuring that they provide accurate and comprehensive information during the application process and by being aware of the defenses available in the face of an insurance company’s attempted rescission of a policy.

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