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The Truth Will Set You Free: Navigating Insured Misrepresentations

I. Issue and General Standard

Issues Surrounding Misrepresentation by Insureds

Insured misrepresentations, whether they be exaggerations of loss or fraudulent claims, can cost insurers significant money each year. Most recently, fraudulent claims have been blamed for a property insurance crisis in Florida, causing significant premium hikes, insolvent carriers, and cancellation of thousands of homeowner policies.[1] Despite an insured's representations in obtaining insurance being paramount to the insurer's decision to issue a policy, states often set high bars for insurers to support claims of material misrepresentation, in turn hindering the ability of insurers to rescind policies or deny coverage based on such misrepresentations. Understanding the applicable jurisdiction's laws regarding misrepresentations and the tools for investigation of claims, insurers can be better prepared to take the necessary steps to ensure they get the benefit of the bargain. This presentation aims to inform insurers of their remedies where an insured has misrepresented material facts and to provide guidance on issues that routinely present themselves in different jurisdictions with respect to use of those remedies.

Material Misrepresentation

The overarching contractual language with respect to this issue is similar in many applications. Insurance applications or binders commonly include language voiding coverage where the insured attempts to misrepresent facts to the insurer. For example, the applicable contractual language may state:

> This policy is void in any case of fraud by you at any time as it relates to this policy. It is also void if you or any other insured, at any time, intentionally conceal or misrepresent a material fact concerning:
> **1.** This policy;
> **2.** The Covered Property; [2]

[1] Jon Schuppe, *Florida Lawmakers Scramble to Fix a Property Insurance Crisis Before Hurricane Season*, NBC News, May 21, 2022. https://www.nbcnews.com/news/us-news/roofing-scams-florida-property-insurance-hurricane-rcna29649.

[2] This language was taken from a business owner's policy form labeled ISO Form BP 00 02 01 87.

Generally speaking, a misrepresentation is material with respect to an insurance application if the insured makes an untrue statement that is material to the acceptance of risk and, if known to the insurer, would have changed the premium rate for the insurance, would have resulted in a policy with a lesser limit of liability, or would have resulted in a policy that would not have provided coverage with respect to the hazard resulting in a particular loss. [3] This may include false statements about the use of property, animals contained on the property, the number of drivers, or the number of employees employed. With respect to the claims process, a misrepresentation is generally material if it pertains to facts that are relevant to the insurer's rights that provide it the ability to decide upon its obligations and protect itself against false claims.[4] Common examples of misrepresentations in the claims process include false statements as to amount of loss and circumstances surrounding an accident.

When considering whether a misstatement is material, it is important to review the statutes or case law regarding material misrepresentation in the proper jurisdiction. Many state legislatures have enacted laws explaining what constitutes a material misrepresentation. Nebraska, for example, has determined that a material misrepresentation made in applying for a policy will not void the policy unless the insurer was prejudiced.[5] Moreover, the law specifically dictates that the policy provision prohibiting misrepresentations shall not "avoid the policy nor avail the insurer to avoid liability, unless such breach shall exist at the time of the loss and contribute to the loss, anything in the policy or contract of insurance to the contrary notwithstanding."[6] Thus, Nebraska requires an insurer to prove more than a mere misrepresentation in order to rely on the contractual provision listed above voiding the policy.
Generally speaking, misrepresentation standards can be boiled down to states requiring intent and those that do not.[7] As is more fully explained below, a heightened intent standard for rescission may require additional investigation, cooperation with underwriting, and additional costs.

II. Misrepresentations in Applications

Types of Misrepresentations in Applications

Where an insured has made a material misrepresentation in an application for insurance, the general remedy under the policy is rescission, or, in other words, deeming the policy void. In property applications, the insured may misrepresent the ownership of the property, use of the property, or questions regarding a business, such as the type of business.

Cooperation Between Insurer and Counsel

[3] *Conner v. Shelter Mut. Ins. Co.*, 779 F.2d 335, 339 (6th Cir. 1985).
[4] *Willis v. State Farm Fire & Cas. Co.*, 219 F.3d 715, 718 (8th Cir. 2000).
[5] Neb. Rev. Stat. Sec. 44-358.
[6] *Id*.
[7] *Compare Temcharoen v. United Fire Lloyds*, 293 S.W.3d 332, 341 (Tex. App. 2009) (requiring an intent to deceive to rescind) *with Selective Ins. Co. of New York v. St. Catherine's Ctr. For Child*, 123 N.Y. S. 3d 396 (N.Y. Sup. Ct. 2019) (allowing rescission in the event of a misrepresentation).

Like determining whether a misrepresentation is material, state law varies on whether a material misrepresentation in an insurance application must be intentional before an insurer may rescind the policy as a result of the misrepresentation. Generally, there are two different standards which states employ to demine whether the policy may be rescinded. First, a court may allow the insurer to rescind the policy if the insurer can establish that a material misrepresentation occurred, even if the misrepresentation was unintentional.[8] In these states, "a good faith mistake will not excuse the material misrepresentation."[9]

The second approach dictates that a policy may be rescinded only when the insured intended to deceive the insurer.[10] In Alaska, for example, an insurer may rescind a policy for misrepresentations, omissions, or concealment of facts if the statements were either fraudulent, material to the acceptance of risk, or the insurer, in good faith, would not have issued the policy, would not have issued the policy at the same premium, or would not have issued the same coverage.[11]

In *W. World Ins. Co. v. Majercak*, material statements included, for example, statements that inaccurately stated that the insured did not perform roofing work, that he did not have employees, that he worked only on buildings three stories or less in height, and that his payroll was only $33,500.[12] If the contractor would have disclosed that over fifty percent of his business was roofing, the premium would have increased.[13] Because the misrepresented facts were material to the premium amount, the policy was properly rescinded due to the statements.[14]

In some states, such as Florida, the approach may vary depending on the nature of the insurer attempting to rescind the policy. For example, Florida statutes generally allow admitted insurers to rescind policies based on unintentional misrepresentations, as long as the misrepresentation was material to the issuance of the policy.[15] Surplus lines insurers, however, may not avail themselves of the relevant section of the Florida statutes, and must instead rely on the right of equitable rescission, which arguably allows insurers to rescind policies only in the event of intentional material misrepresentations.[16]

Being aware of these approaches when considering when and whether to rescind the policy is also important as some jurisdictions place time limitations on the ability to rescind the policy. Some states, such as Illinois, prohibit the ability to rescind after certain policies have been effective for one year.[17] Regardless, in most if not all

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[8] *Selective Ins. Co. of New York v. St. Catherine's Ctr. For Child*., 123 N.Y. S. 3d 396 (N.Y. Sup. Ct. 2019); *Massachusetts Mut. Life Ins. Co. v. Nicholson*, 775 F. Supp. 954 (N.D. Miss. 1991).
[9] *Nicholson*, 775 F. Supp. 954 (N.D. Miss. 1991).
[10] *Bennett v. Hedglin*, 995 P.2d 668, 671 (Alaska 2000).
[11] *Id*.
[12] *W. World Ins. Co. v. Majercak*, 490 F. Supp. 2d 937, 938 (N.D. Ill. 2007)
[13] *Id*.
[14] *Id*.
[15] § 627.409, Fla. Stat.
[16] *See, e.g., Aspen Specialty Ins. Co. v. River Oaks of Palm Beach Homeowner's Ass'n*, No. 11-cv-81830, 2012 U.S. Dist. LEXIS 111190 (S.D. Fla. Aug. 7, 2012).
[17] *See* Illinois Code Sec. 154.

jurisdictions the insurer will likely need to obtain evidence from underwriting that the premium would have increased or the policy would have been material different had the truth been reported in the application to support rescission.

Moreover, an insurer's actions may constitute waiver or estoppel, prohibiting or limiting the ability to rescind the policy. For example, in *Am. Gen. Life Ins. Co. v. Salamon*, the insurer mistakenly accepted premium after notifying the insured that it was rescinding the policy.[18] New York law states that accepting premiums after learning of the right to rescind constitutes a waiver of the right to rescind.[19] The carrier argued that inadvertent acceptance of premiums cannot waive the right to rescind since prior cases allowed carriers the right to rescind when they returned premium payments mistakenly accepted after learning of the right to rescind.[20] It further argued that it intended to return the premiums if it was successful in rescinding the policy.[21] However, the United States Court of Appeals for the Second Circuit affirmed the district court's decision determining there was no right to rescind the policy because the intent to return the premiums was not enough to overcome the waiver rule.[22]

Additionally, some courts may deem the right to rescind waived when the insurer fails to investigate obvious red flags during the underwriting process. In *Star Ins. v. Sunwest Metals, Inc.*, the insurer failed to follow up on red flags on the insurer's website which contradicted the representation in the application.[23] After applying the waiver analysis, the court found the insurer was not permitted to rescind the policy.

III. Misrepresentation in the Claims Process

When an insured misrepresents facts during the claims process, different standards from those mentioned above may apply. Common issues when an insured misrepresents facts during the claims process can include exaggeration of the amount of loss or misrepresentations as to how the accident occurred.

Tools in the Policy to Investigate/Considerations

One policy tool to assist when a misrepresentation is suspected is the sworn statement of loss. The applicable policy may also have a term like the below:

> Duties In The Event Of Loss Or Damage
> You must see that the following are done in the event of loss or damage to Covered Property . . . Send us a signed, sworn statement of loss containing the information we request to settle the claim. You must do this within 60 days after our request. We will supply you with the necessary forms.[24]

[18] 483 F. App'x 609, 610 (2d Cir. 2012).
[19] *Id.*
[20] *Id.*
[21] *Id.*
[22] *Id.*
[23] *Star Ins. Co. v. Sunwest Metals, Inc.*, 691 F. App'x 358, 361 (9th Cir. 2017).
[24] ISO Form BP 00 02 01 87

When requesting a sworn statement of loss, the form should be provided to the insured. Once received, the form may be rejected or accepted. If rejected, the insured may be notified of the deficiencies and provided the form again.

Some policies will have a false swearing clause, which states that the entire policy will be void if the insured makes false statements relating to the insurance. In some jurisdictions, false statements on a sworn statement of loss will void the policy.[25] However, others may only void coverage for the portion of the statement that was fraudulent.[26]

Another helpful tool in the case of misrepresentations is the examination under oath. Policies may include the following language:

> Duties In the Event Of Loss Or Damage
> You must see that the following are done in the event of loss or damage to Covered Property . . . If requested, permit us to question you under oath at such times as may be reasonably required about any matter relating to this insurance of your claim, including your books and records. In such event, your answers must be signed.[27]

Since an examination under oath is a contractual term, failure to participate could result in a claim denial.[28] As an initial matter, an insurer should carefully consider the reasons for requesting an examination under oath because making the request without a reasonable basis could give rise to a bad faith claim.[29] Courts have concluded that an insurer's insistence upon an examination under oath after the insured fails to provide the requested documentation does not constitute bad faith.[30] When the request is made, the request to take an examination under oath should be in writing and include a clear time and place of the examination. It is also beneficial to include the rights of the insured and insurer, consequences for failure to appear, and include any records the insurer would like the insured to bring to the examination.

Another tool utilized is the appraisal clause. The language in the policy may look like the following:

> If we and you disagree on the amount of loss, either may make written demand for an appraisal of the loss. In this event, each party will select a competent and impartial appraiser. The two appraisers will select an umpire. If they cannot agree, either may request that selection be made by a judge of a court having jurisdiction. The appraisers will state separately the amount of loss. If they fail to

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[25] *Wendel v. State Farm Fire & Cas. Co.*, 435 So. 2d 284, 284 (Fla. Dist. Ct. App. 1983).
[26] *Kerr v. State Farm Fire & Cas. Co.*, 731 F.2d 227, 229 (4th Cir. 1984).
[27] ISO Form BP 00 02 01 87
[28] *Lester v. Allstate Prop. & Cas. Ins. Co.*, 2013 U.S. Dist. LEXIS 101380 (E.D. Tenn. July 18, 2013); *Kerr v. State Farm Fire & Cas. Co.*, 934 F. Supp. 2d 853 (M.D. La. 2012).
[29] See *Reid v. Allstate Ins. Co.*, 2000 WL 502848, at *3 (N.D. Cal. Apr. 14, 2000) (noting that a plaintiff may not base a bad faith suit for delay in payment when the plaintiff fails to comply with *reasonable* examination requests).
[30] *West v. State Farm Fire & Cas. Co.*, 868 F.2d 348, 351 (9th Cir. 1989).

agree, they will submit their differences to the umpire. A decision agreed to by any two will be binding.
Each party will:
a. Pay its chosen appraiser; and
b. Bear the other expenses of the appraisal and umpire equally.

If we submit to an appraisal, we will still retain our right to deny the claim.

(ISO Form BP 00 02 01 87)

The use of and scope of appraisals may vary from state to state. For example, in Nebraska, the appraisal clause is void as against public policy.[31] The rationale for this rule is that appraisal clauses force parties outside of the judicial system, where parties have a right to bring their claims.[32]

When considering whether to invoke an appraisal clause or when an insured invokes an appraisal clause, one should consider whether the claim has any current outstanding coverage issues, as appraisals are typically not intended for that use. For example, in *Brewer v. State Farm Fire and Casualty Co.*, the insured submitted an estimate of personal property lost.[33] This estimate varied significantly from the estimate drafted by the insurer since the insured's estimate included items not covered.[34] The insured petitioned the circuit court to invoke the appraisal clause and appoint an umpire. [35] Over the insurer's objections, the court granted the motion.[36]

On appeal, the appellate court reversed the decision, noting that because the parties disagreed as to the items to be covered, not just the value to assign to each item, the parties had a coverage issue.[37] Since appraisals are not allowed for coverage disputes, the court vacated the decision and judgment was entered dismissing the insured's petition to appoint an umpire.[38]

Another item to consider when determining whether to invoke an appraisal clause or which umpire to use is whether a causation issue exists. In Iowa, for example, the state supreme court determined that factual causation opinions can be determined through the appraisal process.[39] This may have direct implications on whether any coverage exclusions apply.[40] However, as evidenced by *Rogers v. State Farm Fire & Cas. Co.*, where the Alabama Supreme Court held that "[t]he determination of the causation of

[31] *Rawlings v. Amco Inc. Co.*, 438 N.W.2d 769 (Neb. 1989).
[32] *Id.*
[33] *Id.*
[34] *Id.*
[35] *Id.*
[36] *Id.*
[37] *Id.*
[38] *Id.*
[39] *Walnut Creek Townhome Ass'n v. Depositors Ins. Co*., 913 N.W.2d 80 (Iowa 2018).
[40] *See Id*. at 91. ("But this does not mean the court is free to disregard the appraisal award as to factual disputes that may be dispositive of coverage questions.")

these matters is within the exclusive purview of the courts, not the appraisers", this viewpoint is not unanimous. [41]

The choice of appraiser is important. In complex cases requiring different areas of expertise, a general contractor or consulting firm may be named as an appraiser. Despite policy language requiring an "impartial" appraisal, courts differ on this requirement. For example, a Florida appellate court held that an appraiser whose fees are measured by a percentage of the award constituted an "independent appraiser" within the meaning of the appraisal provision.[42] Meanwhile, the Iowa Supreme Court has reasoned that incentives like contingency fees give appraisers a financial interest in the outcome of the appraisal process, which may void the appraiser's assessment.[43]

Finally, despite many policies indicating that the appraisal decision will be binding, jurisdictions provide different standards with respect to when a decision is binding. Texas will disregard an appraisal decision when 1) the award was made without authority or 2) the award was made as a result of fraud, accident or mistake.[44] In Indiana, however, an appraisal is binding unless permeated with unfairness or injustice, such as fraud, collusion, and partiality of appraisers.[45]

When making considerations about which tools to utilize, insurers should consider the standard in the jurisdiction, the cost of obtaining the evidence to deny coverage, and how much of the claim would be void.

IV. Misrepresentations and Third Parties

Innocent Co-Insureds

Misrepresentations by one insured may also affect other interested parties depending upon the jurisdiction. Some jurisdictions will dictate that the wrongdoing of one coinsured will not be imputed to another to preclude the recovery of proceeds under a policy.[46]

However, some jurisdictions may alter that position when the misrepresenting insured will indirectly benefit due to a mutual interest based on public policy or express policy language. For example, with respect to married couples, a court noted "[t]o permit the other spouse, in this case the wife, to get the benefit of the insurance would mean that the community [*i.e.*, the misrepresenting husband] would benefit from the wrongful act of one of its members. This would be contrary to public policy."[47]

The language of the policy is also important to this issue. In *Postell v. American Family Mutual Ins. Co.*, the Iowa Supreme Court presided over a case involving the denial of

[41] *Rogers v. State Farm Fire & Cas. Co.*, 984 So. 2d 382 (Ala. 2007).
[42] *Rios v. Tri-State Ins. Co.*, 714 So. 2d 547 (Fla. Dist. Ct. App. 1998).
[43] *Cent. Life Ins. Co. v. Aetna Cas. & Sur. Co.*, 466 N.W.2d 257 (Iowa 1991).
[44] *Barnes v. W. All. Ins. Co.*, 844 S.W.2d 264, 267 (Tex. App. 1992).
[45] *Atlas Const. Co. v. Indiana Ins. Co.*, 309 N.E.2d 810 (Ind. App. 1974).
[46] *Economy Fire & Casualty Company v. Warren*, 71 390 N.E.2d 361 (Ill. 1st Dist. 1979).
[47] *U.S.F & G Ins. Co. v. Brannan*, 589 P.2d 817 (Wash Ct. App. Div. 3 1979).

coverage under a fire policy.[48] The policy specifically stated that it would not provide coverage for any loss where *any* insured has committed fraud.[49] The husband committed arson and insurance fraud, while the wife was an innocent insured.[50] The court determined that prohibiting coverage where "any" insured has committed intentional fraud barred coverage by the clear terms of the policy.[51]

The plaintiff attempted to argue that the severability clause applied to provide coverage to the wife. However, the court determined that the language barring coverage for the acts of "any insured" instead of "the insured" did not invoke the severability clause.[52] Moreover, it reasoned that construing references to "any insured" the same as "the insured" would operate to nullify the express obligations of all insureds under the policy.[53] Thus, the innocent spouse was not afforded coverage. In jurisdictions that look to the direct language of the policy, the insurer may want to check the language of the fraud provision and severability clauses.

Mortgagee Clause

With respect to mortgage holders, the mortgagee clause will provide insight. Many times, the terms of the policy with respect to coverage will still apply to the mortgage holder's interests. However, the failure of the insured to truthfully provide information as required by the terms of the policy may not impair the mortgage holder's interests.[54]

V. Conclusion

In conclusion, when dealing with insured misrepresentations, it is important to fully understand the policy language, statutes, and case law in the applicable jurisdiction. While the insurance policy may provide clear remedies such as voiding or rescinding the policy, states may require additional evidence to deny coverage. Moreover, while the policy may provide multiple tools to assist in investigating misrepresentations, reviewing the guidelines set forth in different jurisdictions may assist the insurer in making a strategically beneficial decision in choosing how to proceed in its investigation.

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[48] *Postell v. American Family Mut. Ins. Co.*, 823 N.W.2d 35 (Iowa 2012).
[49] *Id.*
[50] *Id.*
[51] *Id.*
[52] *Id.*
[53] *Id.*
[54] *See* ISO Form BP 00 02 01 87 (If we pay the mortgage holder for any loss or damage and deny payment to you because of your acts or because you have failed to comply with the terms of this policy:
(1) The mortgage holder's rights under the mortgage will be transferred to us to the extent of the amount we pay; and
(2) The mortgage holder's right to recover the full amount of the mortgage holder's claim will not be impaired.)