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Insurance Application Fraud and Misrepresentation –
What is it, how to spot it and how to handle the claims?

Rescission of an insurance policy is one of the most powerful tools insurers have to combat insurance fraud and avoid unnecessary and unintended risks, and one of the most devastating outcomes to a policyholder seeking coverage for a claim. An action for rescission permits an insurer to void an insurance policy, returning the insured and the insurer to the *status quo ante*. Alternatively, an action for rescission may permit an insurer to avoid a specific loss depending on the circumstances and the applicable law. This paper will discuss the elements of a rescission claim, the legal and factual issues unique to these types of claims under a wide range of state laws.

A. The Elements of a Rescission Claim- Spotting Application Fraud/Misrepresentation

A rescission action generally arises when an insurer believes an insured has omitted or misrepresented facts or has committed a breach of warranty in connection with the issuance or renewal of an insurance policy. *Stipcich v. Metro. Life Ins. Co.*, 277 U.S. 311, 316, 48 S. Ct. 512, 513 (1928) ("Insurance policies are traditionally contracts *uberrimae fidei* [("utmost good faith")] and a failure by the insured to disclose conditions affecting the risk, of which he is aware, makes the contract voidable at the insurer's option.") The range of facts and circumstances that may support a rescission action can be broad and is dependent on the applicable law, the insured's knowledge, and the type of information requested from the insured. Common examples of the type of omissions or misrepresentations that may give rise to a rescission action include facts relating to the insured's business operations, identity, claims history, and knowledge of potential claims.

The basic remedy provided by a rescission action is the voiding of the insurance policy *ab initio* and a return of the parties to their *status quo ante*. Additionally, some states allow insurers to avoid a particular loss instead of rescinding an insurance policy. As will be discussed below, the availability of this option to avoid the loss depends on the types of risks involved, the amount of premiums received, and the insured's anticipated defenses. Finally, rescission actions are subject to a variety of defenses by policyholders seeking to enforce the coverage they purchased.

B. Common Issues in Application Fraud/Misrepresentation Rescission Cases

The majority of states have statutes governing an insurer's right to rescind an insurance policy[1] as well as a body of appellate decisions applying and interpreting each state's statutory scheme.[2] In most states, a policy rescission generally requires a misrepresentation by the insured as well as proof of one or more of the following: that the insured intended to deceive the insurer, that the misrepresentation was material, and/or that the insurer reasonably relied on the misrepresentation. However, states vary in terms of which elements they recognize as a part of a rescission action and how many of the elements an insurer must prove to support a rescission action.

The most elementary difference between states is whether they employ a three-element or a two-element statute. For instance, Alabama, Alaska, Delaware, Idaho, Kentucky, Nevada, South Dakota, and Vermont all employ substantially similar versions of the following three-element statute:

(a) All statements and descriptions in any application for an insurance policy or annuity contract or in negotiations for such, by or in behalf of the insured or annuitant, shall be deemed to be representations and not warranties.

(b) Misrepresentations, omissions, concealment of facts, and incorrect statements shall not prevent a recovery under the policy or contract unless:

(1) Fraudulent;

(2) Material either to the acceptance of the risk or to the hazard assumed by

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[1] The following states have statutes governing an insurer's right to rescind: Alabama (Ala. Code § 27-14-7); Alaska (Ak. Stat. § 21.42.110); Arizona (Ariz. Rev. Stat. § 20-1109); California (Cal. Ins. Code § 330-61); Colorado (Colo. Rev. Stat. § 10-16-209); Delaware (Del. Code Ann. Tit. 18, § 2711); District of Columbia (D.C. Code § 31-4314); Florida (Fla. Stat. § 627.409); Georgia (Ga. Code § 33-24-7); Hawaii (Haw. Rev. Stat. § 431:10-209); Idaho (Id. Code § 41-1811); Illinois (215 Ill. Comp. Stat. 5/154); Kansas (Kan. Stat. §§ 40-2205, 40-2,118); Kentucky (Ky. Rev. Stat. § 304.14-110); Louisiana (La. Rev. Stat. § 22:619(A)); Maine (Me. Rev. Stat. tit. 24-A, § 2411); Massachusetts (Mass. Gen. Laws ch. 175 § 186); Minnesota (Minn. Stat. § 60A.08); Montana (Mont. Code § 33-15-403); Nebraska (Neb. Rev. Stat. § 44-358); Nevada (Nev. Rev. Stat. § 687B.110); New Hampshire (N.H. Rev. Stat. § 415:9); New Jersey (N.J. Stat. § 17B:24-3); New Mexico (N.M. Stat. § 59A-18-11); New York (N.Y. Ins. Law § 3105); North Carolina (N.C. Gen. Stat. § 58-3-10); North Dakota (N.D. Cent. Code § 26.1-29-13); Oklahoma (Okla. Stat. tit. 36, § 3609); Oregon (Or. Rev. Stat. § 742.013); Rhode Island (R.I. Gen. Laws § 27-18-16); South Carolina (S.C. Code Ann. § 38-71-40); South Dakota (S.D. Codified Laws § 58-11-44); Tennessee (Tenn. Code § 56-7-103); Texas (Tex. Ins. Code § 705.003); Utah (Ut. Code § 31A-21-105); Vermont (Vt. Stat. tit. 8, § 3736); Virginia (Va. Code Ann. §§ 38.2-309); Washington (Wash. Rev. Code § 48.18.090); and Wisconsin (Wis. Stat. § 631.11). However, some of these statutes may only apply to certain types of insurance policies.

[2] States that primarily rely on common law rules for rescission for all insurance policies include Connecticut, Iowa, and Pennsylvania; however, even in those states certain statutes and regulations may be relevant to an insurer seeking to rescind an insurance policy.

the insurer; or

(3) The insurer in good faith would either not have issued the policy or contract or would not have issued a policy or contract in as large an amount or at the premium rate as applied for or would not have provided coverage with respect to the hazard resulting in the loss if the true facts had been known to the insurer as required either by the application for the policy or contract or otherwise.

See, e.g., Ga. Code § 33-24-7

States with this type of statute state the elements of rescission in the disjunctive, allowing an insurer to obtain rescission of an insurance policy based on proof of any one element instead of all three elements. However, certain other three-element states, including Arizona, Maine, and Texas, require proof of all three elements. *See* Tex. Ins. Code § 705.003; *Liberty Ins. Underwriters, Inc. v. Estate of Faulkner*, 957 A.2d 94 (Me. 2008);[3] *State Comp.Fund v. Mar Pac Helicopter Corp.*, 752 P.2d 1 (Ariz. Ct. App. 1987). For instance, the Texas statute provides as follows:

(a) An insurance policy provision that states that a misrepresentation, including a false statement, made in a proof of loss or death makes the policy void or voidable:

(1) has no effect; and

(2) is not a defense in a suit brought on the policy?

(b) Subsection (a) does not apply if it is shown at trial that the misrepresentation:

(1) was fraudulently made;

(2) misrepresented a fact material to the question of the insurer's liability under the policy; and

(3) misled the insurer and caused the insurer to waive or lose a valid defense to the policy.

Tex. Ins. Code § 705.003

By contrast, in a two-element statute, such as those adopted in, among other states, the District of Columbia, Hawaii, Illinois, Louisiana, North Carolina, New Hampshire, South Carolina, and Tennessee, one of the elements, usually the third, is deleted. *See, e.g.,* D.C. Code § 31-

[3] The Maine statute only has two subsections, but the language used therein closely tracks with the example three-element statute. *Compare* Me. Rev. Stat. tit. 24-A, § 2411 *with* Ga. Code § 33-24-7.

4314; Haw. Rev. Stat. § 431:10-209; N.H. Rev. Stat. § 415:9; S.C. Code § 38-71-40. As with the three-element statute, most states with a two-element statute state the elements in the disjunctive, only requiring proof of one or the other element.

While the elements and proofs required for a rescission action vary from state-to-state, the same basic legal issues often arise in rescission actions regardless of where they are filed, including (1) whether the application for insurance must be attached to the policy; (2) what constitutes a misrepresentation; (3) whether the insured must have intended to deceive the insurer; (4) whether the misrepresentation must have been material; (5) whether the insured must have relied on or investigated the misrepresentations.

i. Misrepresentations, Omissions, Concealments, and Incorrect Statements

The most basic substantive requirement of a rescission in any state is the existence of some misrepresentation, omission, concealment, and/or incorrect statement by the insured during the process of obtaining an insurance policy, i.e., a false statement. *Home Ins. Co. v. Spectrum Info. Techs.*, 930 F. Supp. 825, 835 (E.D.N.Y. 1996) ("The concept of misrepresentation encompasses both false affirmative statements and the failure to disclose where such duty to disclose exists."). In most instances, a false statement will be made on the application, and, where the insured's responses on the application are at issue, courts will evaluate whether the question on the application was subjective or objective and whether the insured's response was a statement of objective fact or subjective belief. Either type of question and response can support a rescission action, but "[a]nswers to subjective questions do not [support a rescission action] if the question is directed toward proving the knowledge of the applicant and determining the state of his mind and the answer is a correct statement of the applicant's knowledge and belief." *See Federal Deposit Ins. Corp. v. Mascowitz*, 946 F. Supp. 322, 329 (D.N.J. 1996); *see Hauser v. Life Gen. Sec. Ins. Co.*, 56 F.3d 1330 (11th Cir. 1995) (where the language in an "application shifts the focus from a determination of truth or falsity of an applicant's statements to an inquiry into whether the applicant believed the statement to be true, the applicant's answer must be assessed in light of his actual knowledge or belief"). Further, a false statement can also be made during an insured's conversations with the insurance agent or other third parties involved in the application process, and those third parties can make false statements on behalf of the insured that can support a rescission action as well.

In *Chubb Life Insurance Co. v. Stanley*, 1992 Tex. App. LEXIS 2743, 1992 WL 289345 (Tex. App. 1992), an insurer sought a declaratory judgment and rescission of a group mortgage accident and health insurance policy based on an insured's misrepresentations that "he had never missed over five consecutive days of work" and "had only seen a doctor for 'regular checkups, tests, etc.'" when, just prior to applying for the insurance policy, the insured had actually spent twenty-three days in the hospital for back surgery. At trial, the insurer presented testimony from its underwriter as well as documentary evidence in the form of the insured's medical records, responses to written discovery, and personnel records, but the trial court did not rescind the insurance policy. On appeal, the insurer argued that the trial court erred by failing to rescind the insurance policy because the evidence established the insurer's right to rescission a matter of law. The court of appeals agreed and rendered a judgment in favor of the

insurer on rescission, holding that the insured's representations were unquestionably false as a matter of law because the evidence established that the insured had suffered a debilitating injury that was not disclosed on the insured's application.

In determining whether a misrepresentation was made, some courts may look to the questions asked in the insurance application. A finding that the question was ambiguous may hinder an insurer's ability to prevail on a rescission claim. For instance, in *Ocean's 11 Bar & Grill, Inc. v. Indemnity Insurance Corporation, RRG*, C.A. 11-CIV-61577 (S.D. Fla. 2012), following an undescribed incident at the insured's establishment and the insurer's subsequent investigation, the insurer sought to rescind the policy based on alleged misrepresentations in the insurance application. Specifically, in the insurance application, the insured was asked "Does the applicant allow persons other than employees trained in their Formal Alcohol Awareness training program to serve alcohol to patrons?" and answered in the negative. During the ensuing litigation, the insurer argued there was no formal training provided because the restaurant did not participate in an industry-certified training program, and that this lack of training rendered the insured's answer to the training question a misrepresentation warranting rescission of the policy. Conversely, the insured argued that by providing its own extensive training program it satisfied the requirement and had properly answered the question. Ultimately, the court ruled that the phrase "Formal Alcohol Awareness training" was ambiguous because it was not clear that it referred to industry-certified training and it denied the insurer's summary judgment motion to allow rescission of the policy.

Accordingly, if an insurer wants to prevail on a rescission claim against its insured, the falsity of the insured's misrepresentations should not be in serious dispute, especially in cases involving objective facts or the insured's undisputed awareness. When a misrepresentation is made under an insured's "knowledge and belief," however, the issues around misrepresentation often become more challenging. The falsity of the misrepresentation may present a fact question unless the insurer can prove as a matter of law the insured acted intentionally or the insured's "belief" is plainly contradicted by the known facts.

ii. Fraud or Intent to Deceive

In most states, an insurer does not have to prove fraud or intent to deceive to prevail on a rescission claim. Only eight states—Iowa, Kansas, Louisiana, Nebraska, Pennsylvania, South Carolina, Texas, and Washington—require an insurer to prove the insured made a misrepresentation on an application fraudulently or with intent to deceive. *Rubes v. Mega Life & Health Ins. Co.*, 642 N.W.2d 263, 269-71 (Iowa 2002); Kan. Stat. § 40-2,118; La. Rev. Stat. § 22:619; *Lowry v. State Farm Mut. Auto. Ins. Co.*, 421 N.W.2d 775, 778-79 (Neb. 1988); *Tudor Ins. Co. v. Twp. of Stowe*, 697 A.2d 1010, 1016-17 (Pa. Super. Ct. 1997); *Lanham v. Blue Cross & Blue Shield of S.C., Inc.*, 563 S.E.2d 331, 334-35 (S.C. 2002);[4] Tex. Ins. Code § 705.003; Wash. Rev. Code Ann. § 48.18.090. Further, some states require a showing of fraud or intent to deceive in

[4] Only South Carolina common law requires a showing of intent. Despite the conflict with South Carolina's rescission statute, courts applying South Carolina law apply the common law requirements. *Evanston Ins. Co. v. Agape Senior Primary Care, Inc.*, 636 Fed. Appx. 871, 876 n.5 (4th Cir. 2016).

certain circumstances: New Jersey (subjective questions), *Mokowitz*, 946 F. Supp. at 330; New York (hospital, medical, surgical, or prescription drug expense insurance), N.Y. Ins. Law § 3105(b)(2); North Carolina (fire insurance); and Ohio (life, sickness, and accident insurance) Ohio Rev. Code §§ 3911.06, 3923.14.

Even in states where a showing of fraud or intent to deceive is required, strict proof of fraud or intent to deceive may not be required and, in fact, may be presumed. *See e.g., State Farm Mut. Auto. Ins. Co. v. Bridges*, 36 So. 3d 1142, 1147 (La. App. 2 Cir. 2010) ("Because of the inherent difficulties of proving intent, strict proof of fraud is not required to show intent to deceive."); However, in Texas, intent cannot be inferred and must be proven either directly in most instances or through a showing of scienter and intent to induce reliance, a warranty that the representations in the application are true, or collusion with the insurance agent. *Dowling v. NADW Marketing, Inc.*, 631 S.W.2d 726 (Tex. 1982).

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iii. Materiality

Materiality is an element of practically every rescission statute[5] and, unlike intent, is generally based on evidence generated by the insurer instead of the insured. *Mut. Ben. Life Ins. Co. v. JMR Elecs. Corp.*, 848 F.2d 30, 32 (2d Cir. 1988) (materiality "permits avoidance of liability under the policy where 'knowledge by the insurer of the facts misrepresented would have led to a refusal by the insurer to make such contract.'" (*citing* N.Y. Ins. Law § 3105(b)(1))). Generally, "[t]he tests of materiality is whether knowledge of the facts would have influenced the insurer in determining whether to accept the risk or in fixing the amount of premiums." *Id.* at 45 n.2 (*quoting* C.J.S. Insurance § 595, at 406 (1946)). As with the different views on the falsity of an insured's answers to questions in an application, there is both an objective and subjective view of materiality. In the majority of states, materiality is viewed subjectively from the standpoint of a particular insurer, but other states view materiality from standpoint of a reasonable insurer. However, regardless of whether a state uses a subjective or objective approach to materiality, the testimony of the insurer's underwriting department can be critical to proving the materiality of an insured's misrepresentations.

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[5] Arizona (Ariz. Rev. Stat. § 20-1109); California (Cal. Ins. Code § 334); Colorado (*Hollinger v. Mut. Bene. Life Ins. Co.*, 560 P.2d 824 (Colo. 1977); Indiana (Ind. Code § 27-8-5-5); Iowa (*Rubes*, 642 N.W.2d at 269); Kansas (Kan. Stat. Ann. § 40-2205); Louisiana (La. Rev. Stat. § 22:619); Maryland (*Essex Ins. Co. v. Hoffman*, 168 F. Supp. 2d 547, 552 (D. Md. 2001); Michigan (Mich. Comp. Laws § 500.2218); Minnesota (*Transamerican Ins. Co. v. Austin Farm Center, Inc.*, 354 N.W.2d 503 (Minn. Ct. App. 1985); Mississippi (Miss. Code § 83-9-11); Nebraska – sickness and accident insurance only (Neb. Rev. Stat. § 44-710.14); New Jersey (*Moskowitz*, 946 F. Supp. at 331); New Mexico (N.M. Rev. Stat. § 59A-18-11(C)); New York (N.Y. Ins. Law § 3105(b)(1)); Ohio (*Pers. Serv. Ins. Co. v. Lester*, 2006 Ohio App. LEXIS 5089 (Ohio Ct. App. 2006)); Oregon (Or. Rev. Stat. § 742.013); Pennsylvania (*A.G. Allebach, Inc. v. Hurley*, 540 A.2d 289 (Pa. Super. Ct. 1988)); Rhode Island (R.I. Gen. Laws § 27-18-16); South Carolina (*see* note 4, *supra*) (*Agape Senior Primary Care*, 636 Fed. Appx. at 876 n.5); Texas (Tex. Ins. Code § 705.004(b)); and Virginia (Va. Code § 38.2-309) require a showing of materiality.

In *Maryland Casualty Co. v. Malone*, 90 F. Supp. 3d 1351 (N.D. Ga. 2015), the insurer sought rescission of a commercial general liability policy issued to the seller, developer, and (re)packager of synthetic marijuana products when the insured asserted that it was engaged in the sale of natural health food products. Further, the insured denied that it performed any operations deemed ineligible under the insurer's "health foods" classifications, including manufacturing, formulating, mixing, blending, repackaging, labeling, or relabeling of any products. In its motion for summary judgment, the insurer presented to the court, *inter alia*, an affidavit from its director of underwriting, asserting that, had the insurer known the truth of the insured's operations, it would not have issued the policy to the insured. The court held that the insured's misrepresentations were material under Georgia's objective standard because "reasonable minds c[ould not] differ" that the misrepresentations "went to the heart of the risk."

Regardless of whether a state applies a subjective or objective approach to materiality, the evidence about what the insurer did or would have done is critical to proving that a misrepresentation was material. Therefore, before pursuing a rescission action, an insurer should conduct a thorough review of its underwriting file and confirm with the underwriters that the materiality element is present.

iv. Reliance and the Duty to Investigate

The specific requirement of reliance varies in every state; however, generally stated, reliance, particularly in three-element states, is a requirement that the insurer show that, in good faith, it would not have issued the policy or would not have issued it in as large an amount or at the rate applied for had the true facts been known. Inducement being the substance of reliance,[6] this requirement is not substantially different than the concepts of materiality discussed *supra*. *See Campbell v. Liberty Mut. Group*, 2011 U.S. Dist. LEXIS 63031, 2011 WL 2447506 (E.D. Mich. June 14, 2011) (finding reliance based on insured's testimony that "no such policy would have been written had" the insurer known the true facts); *see also JMR Elecs. Corp.*, 848 F.2d 30; *Malone*, 90 F. Supp. 3d 1351; *Patterson*, 155 So. 3d 729.

Instead, the more significant consideration in a reliance analysis is the insurer's duty to investigate, if any, and what that investigation did reveal or could have revealed. Generally speaking, an insurer does not have a duty to conduct an investigation or perform due diligence into an insured's application responses. *See Indep. Fire Ins. Co. v. Arvidson*, 604 So. 2d 854, 856 (Fla. Dist. Ct. App. 1992) ("An insurer is entitled, as a matter of law, to rely upon the accuracy of the information contained in the application and has no duty to make additional inquiry."); *Koral Indus. v. Sec.-Conn. Life Ins. Co.*, 802 S.W.2d 650, 651 (Tex. 1990) ("Failure to use due diligence to suspect or discover someone's fraud will not act to bar the defense of fraud to the contract."). However, an insured's actual knowledge of facts demonstrating the falsity of a misrepresentation can preclude an insured from establishing reliance in a rescission action. *See Koral Indus.*, 802 S.W.2d at 651 ("only the insurer's actual knowledge of the misrepresentations would have destroyed its defense of fraud"). Likewise, if an insurer conducts an investigation, it may be charged with knowledge of facts that its investigation disclosed. Similarly, if the insurer

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[6] *Holmes v. Grubman*, 691 S.E.2d 196, 198 (Ga. 2010) (*quoting Gutman v. Howard Savings Bank*, 748 F. Supp. 254, 264 (D.N.J. 1990)).

is in possession of information that would give it a reason to inquire further before issuance of a policy, the insurer may be charged with notice of what would have been learned. For instance, if the underwriting file discloses the use of certain medications by the insured, the insurer could be charged with knowledge that the insured suffered from conditions treated by that medication, thereby rendering a rescission claim difficult.

Thus, even though there may not be a blanket duty to investigate on the insurer's part, a rescission action could fail if the insurer was privy to or could have obtained information demonstrating the true facts about an application through an investigation.

C. The Option to Avoid the Loss.

The normal conclusion of a rescission action is the voiding of the insurance policy *ab initio* and a return of the insurer and insured to the *status quo ante.* This typically entails returning any benefits received under the insurance policy, specifically including any premium funds received. However, the statutes in some states allow insurers to use a misrepresentation on an insurance application to avoid a specific insurance claim or loss instead of rescinding the entire insurance policy.

For example, in *Marchant v. Travelers Indemnity Co.*, 650 S.E.2d 316 (Ga. Ct. App. 2007), the insurer exercised this option by seeking a declaration that it had no duty to defend or indemnify the insured in a particular claim because, *inter alia*, the insured misrepresented the nature of its business in a renewal form. Unlike many of the other cases cited herein, the insurer discovered the misrepresentation in an audit and terminated the policy thereafter. However, after the termination, the insured was sued for its actions prior to the termination and tendered its defense. The insurer defended under a reservation of rights and then sought and obtained a declaration that it had no duty to defend or indemnify the claim. On appeal, the insured argued that Georgia's rescission statute only applied to initial applications and not policy renewals and that interpretation of the classification assigned presented a jury question. The court rejected both arguments, holding that it was irrelevant when the misrepresentation was made and that the insurer carried its burden of showing falsity and materiality of the misrepresentation by presenting the testimony of its underwriters concerning the increase in risk under the insured's undisclosed operations.

The circumstances under which seeking avoidance of a claim or loss can vary depending on the facts, but, as in *Marchant*, it can be a powerful tool for the insurer where it has already taken unilateral action in response to a known misrepresentation. Always check the state statute at issue to see whether it allows for avoidance of a "loss" or only allows for rescission of the entire policy. For example, the Georgia rescission statute provides that: "Misrepresentations, omissions, concealment of facts, and incorrect statements shall not prevent a recovery under the policy or contract unless…" O.C.G.A. § 33-24-7(b). Nothing in this statute text requires a full rescission of the policy, rather it simply allows an insurer to "prevent a recovery." Avoidance of a claim or loss can provide additional options to a insurer when presented with claims involving additional insureds or when some of the policyholder's main defenses may apply.

D. Potential Defenses and Pitfalls.

Even if an insurer can meet its burden of proof under the applicable statutory or common law standards for a rescission action, a rescission action may still be unavailable to the insurer depending on the insurer's action prior to rescinding the insurance policy. Moreover, even if a policy is otherwise subject to rescission, the existence of severability clause in the policy may bar a rescission action as to those insureds who were not involved in the application process. Finally, the involvement of third parties such as insurance agents may provide insureds with a defense to a rescission action depending on principles of state contract and agency law.

i. Waiver

The delayed or untimely investigation and pursuit of rescission of an insurance policy and/or a rescission action, including a failure to timely reserve the right to rescind or return policy premiums, can subject an insurer to an argument that it waived or abandoned the right to rescind the insurance policy. A waiver argument raises two related issues: whether the insurer moved to rescind the insurance policy in a timely manner and whether the insurer moved to return the insurance policy premiums received. With regard to the first issue, most states impose a requirement of prompt action on insurers seeking to rescind an insurance policy on the grounds that an insurance policy obtained through a misrepresentation is voidable and, thus, not void *ab initio* until the insurer takes action to rescind or, at a minimum, reserves its right to rescind. *Am. Serv. Ins. Co. v. United Auto. Ins. Co.*, 947 N.E.2d 382, 390 (Ill. Ct. App. 2011). With regard to the second issue, an insurer's "[f]failure to return a premium is a factor to consider in determine whether the right to rescind has been waived." *Am. Gen. Life Ins. Co. v. Schoenthal Family, LLC*, 555 F.3d 1331, 1342 (11th Cir. 2009). However, as with an insurer's overall actions, "immediate tender of the premium is not required as a prerequisite to rescission." *Id.* Thus, the primary issues raised by a waiver argument relate to the timing of the insurer's actions. If an insurer acts promptly in moving to investigate, reserve its rights, rescind the insurance policy, and return the premiums, then a successful waiver argument will be untimely.

ii. Estoppel

The defense of estoppel is conceptually similar to an insurer's duty to investigate and can arise when the insurer knew of or could have discovered the falsity of the insured's misrepresentation through a minimal investigation or inquiry. *See Violin v. Fireman's Fund Ins. Co.*, 406 P.2d 287 (Nev. 1965). For instance, if information showing the actual facts concerning the insured's misrepresentations can be found in the insurer's files, then a finding of estoppel could be possible. *Id.* "The overwhelming body of authority favors the insured and holds that the insurer, as a matter of law, is chargeable with knowledge of the misrepresentation, because of full information about it present in its own files." *Id.* at 290 (collecting cases). However, courts often conflate estoppel and waiver. *Id.* Regardless, any issues raised concerning the timing of a rescission action or the information available to the insurer prior to filing a rescission action may result in the assertion of a waiver or rescission argument by the insured.

iii. The Severability Clause and Innocent Insureds

Rescission actions involving insured organizations and/or multiple individual insureds may be subject to a defense under the insurance policy's severability clause or the innocent insured doctrine. In the majority of states, the rule is that innocent insured will not be protected from the misrepresentations of another insured unless there is a severability clause in the insurance policy. *See Am. Guar. & Liab. Ins. Co. v. Jacques Admiralty Law Firm*, 121 Fed.

Appx. 573, 575-76 (6th Cir. 2005) ("The prevailing rule, however, is that a misrepresentation by an insured in an application for insurance permits rescission even as to innocent insureds." (*citing Home Ins. Co. v. Dunn*, 963 F.2d 1023, 1026 (7th Cir. 1992))); *see also Am. Int'l Specialty Lines Ins. Co. v. Towers Fin. Corp.*, 1997 U.S. Dist. LEXIS 22610, at*31-32, 1997 WL 906427 (S.D.N.Y. Sept. 12, 1997) (procurement of directors and officers insurance involved "sophisticated businessmen," including the allegedly innocent insured, who "could have protected himself by requiring the policy to include a severability clause"). However, in *Illinois State Bar Association Insurance Co. v. Law Offices of Tuzzolino & Terpinas*, 27 N.E.3d 67 (Ill. 2015), the court held that neither the innocent insured doctrine nor an insurance policy's severability clause applied to protect a law partner and law firm from a rescission action based on the misrepresentations of the other law partner because: (1) the Illinois rescission statute applied to misrepresentations "made by the insured or in his behalf;" (2) the innocent insured doctrine only applied to coverage defenses; and (3) even if the insurance policy was viewed as a separate contract for each insured, the misrepresentations in the application could not be separated from any one individual contract. In most states, though, courts will consider the application of a severability clause to determine if one or more insureds can avoid rescission. *See Jacques Admiralty Law Firm*, 121 Fed. Appx. at 575-76.

iv. Insurance Agents and Third Parties

A common issue in rescission actions is whether the misrepresentations of others can bind the insured for the purposes of a falsity analysis. Most rescission statutes specify that any misrepresentation made "by or in behalf of the insured" is sufficient to support a rescission action. However, this statutory language also encompasses insurance agents.

For example, in *Georgia Casualty & Surety Co. v. Valley Wood, Inc.*, 336 Ga. App. 795 (2016), the court reversed the denial of a directed verdict on a rescission claim when the misrepresentations at issue were contained in an unsigned application submitted by the insured's insurance agent. At trial, the insured's owner testified that he had never seen the application prior to a week before trial and denied being asked the questions in the application or giving anyone permission to answer the questions on behalf of the insured. The insured argued that it could not be bound by the application based on those facts, but the court rejected the argument, holding that, because "independent insurance agents or brokers are generally considered the agent of the insured," the insured was bound by the application under general agency principals.

Thus, while the plain language of most rescission statutes would seem to bind an insured to most representations made on their behalf in an application, the specific state laws, including general agency and contract principles, should be reviewed to determine whether the actions of third parties and insurance agents in particular can bind an insured for the purposes of a rescission action.

E. Conclusion

Rescission can be a powerful defense for an insurer, so it is important for insurers to make sure they are familiar with the applicable law. When handling claims of application fraud or misrepresentation be sure you have a full handle on all of the facts surrounding the issuance and/or renewal of the policy, so you can make sure that your facts line up with the applicable law.