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A Long Fly Ball is Still an Out: The Use of Underwriting in Claim Evaluation

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A LONG FLY BALL IS STILL AN OUT:
USE OF UNDERWRITING IN CLAIM DENIALS

Introduction:

Underwriting is the process of evaluating the risk of insuring a home, car, driver or individual (such as in the case of life insurance), to determine if it is profitable for the insurance company to take the chance and insure that person or thing. In order to determine if the company will take on the risk, the insurance company will ask questions of the applicant. The answers provided by the applicant are used by the insurance company to determine whether to refuse to sell the policy or enter into the insurance policy with the applicant. After determining the risk and making the decision to enter into the policy, the underwriter sets a price and establishes the insurance premium that will be charged in exchange for taking on that risk. However, there are instances where the information provided or actions taken by the insured allow for the insurer to deny claims or avoid coverage.

Preliminary Considerations:

Insurance is regulated by the states. The law which controls will vary depending on the jurisdiction you are in. However, it is important to remember that insurance policies are contracts. The terms, conditions, definitions and lack of definitions of the contract govern the duties of the insured and the insurer and will be used by courts in determining the duties and responsibilities of the insured and insurer.

- The policy terms should be given their plain and unambiguous meaning as understood by the man-on-the-street. State Farm Fire & Cas. Co. v. Castillo, 829 So. 2d 242, 244 (Fla. 3d DCA 2002).

- When the language is unambiguous, the insurance contract will be construed in accordance with its terms as bargained for by the parties and be enforced as written. State Farm Mut. Auto. Ins. Co. v. Baldassini, 909 F. Supp. 2d 1363, 1366 (S.D. Fla.2012).
- Terms and language that are ambiguous will be interpreted in favor of the insured. Taurus Holdings, Inc. v. United States Fidelity and Guaranty Co., 913 So. 2d 528, 532 (Fla. 2005). To allow for such a construction the provision must actually *be* ambiguous. Penzer v. Transp. Ins. Co., 29 So. 3d 1000, 1005 (Fla. 2010).
- Policy terms are important. If an insurer does not define a policy term, the insurer cannot take the position that there should be a narrow, restrictive interpretation of the coverage provided.

Misrepresentations/Omissions During Application/Underwriting

All states allow an insurer to deny a claim due to the misrepresentation by the insured during the application process. With minor variations in the anguage of statutes and court decisions, the law requires that the insurer prove one or all of the following regarding the statements/misrepresentations by the insured:

- Fraud;
- Material misrepresentation;
- Insurer in good faith would not have issued the policy or contract, would not have issued it at the same premium rate, would not have issued a policy or contract as large an amount, or would not have provided coverage.

The specific requirements vary by state. Some states also require injury to the insurer in order to rescind the policy. Injury must result to the party acting in justifiable reliance on the misrepresentation. Zarella v. Minnesota Mut. Life Ins. Co., 824 A.2d 1249, 1258 (R.I. 2003).

The burden of the insurer also varies by state. Washington requires the insurer to prove a material misrepresentation by clear, cogent and convincing evidence. Other states hold that it is a question of fact for the jury as to whether there was a material misrepresentation.

The Application Process: The Role of the Insured and Agent

In order for an underwriter to evaluate the risk of whether or not to insure a specific person, place or thing, the underwriter has to gather information from the applicant. The information provided to the underwriter can come from directly from the applicant or from an agent. When the information comes directly from the insured, the law reflects that the insurance company should be able to rely on the statements directly from the insured:

- "An insurer has the right to expect applicants for insurance policies to tell the truth." Am. Gen. Life and Accident Ins. Co. v. Lyles, 540 So. 2d 696, 699 (Ala. 1988).
- The insured has a duty to supply complete answer and accurate information to the insurer. Brandt v. Time Ins. Co., 302 Ill.App.3d 159, 164, 704 N.E. 2d 843, 846 (1st Dist. 1998).

- An applicant who is able to read is legally bound to know the contents of the application she signed, so that the incorrect answers cannot be treated as mistakes. This is not affected by the fact that she relied upon or trusted the agent to prepare the application for the policy. Schnatzmeyer v. Nat'l Life Ins. Co., 791 S.W.2d 815, 820-21 (Mo. App. E.D. 1990).

An insurance company should also be able to rely on the statements made by the agent. The agent has a responsibility to provide to the insurance company all information known to him/her during the application process and information discovered afterwards. Whether the agent is employed by the insurer, or independent, his/her knowledge can have an affect on whether the insurer is able to rescind a policy.

- Under Mississippi law, an insurance agent's knowledge of the condition misrepresented by the insured is imputed to the insurer, and, therefore, waives the right to rescind the policy. Southern United Life Ins. Co. v. Caves, 481 So. 2d 764, 767 (Miss. 1985).
- An insurer may be bound by false answers in a policy application if "the agent knows the truth…should know the truth from the circumstances…or fills out the application without questioning the applicant." Priesmeyer v. Shelter Mut. Ins. Co., 995 S.W.2d 41, 48 (Mo. App. W.D. 1999).
- An insurer is charged with the knowledge of its agent and may not rescind a policy based on a false application if the agent has knowledge of the misrepresentation. Seidel v. Time Ins. Co., 157 Or. App. 556, 561-62, 970 P.2d 255, 257-58 (1998).

The insured's expectations in the overall transaction with the insurer are also relevant:

- The doctrine of reasonable expectations is not limited to cases in which the policy language is at issue; courts must examine the dynamics of the insurance transaction to "ascertain what are the reasonable expectations of the consumer." Barth v. Coleman, 118 N.M. 1, 5, 878 P.2d 319, 323 (1994).

Does an Insurer Need to Investigate the Statements Made During the Application Process?

Generally, an insurer cannot deny coverage when it should have known of the misrepresentation by the applicant. When the duty to investigate further varies by state. What the investigation would have found and result on the insurer's ability to deny a claim also varies by jurisdiction.

- If an insurer is on notice that it should investigate further, the insurer is bound by what a reasonable investigation would have uncovered. Misrepresentations on an application by an insured, therefore, may not provide grounds for denial where the insured has provided an agent with information that placed the insured on notice. Cox v. American Pioneer Life Insurance Co., 626 So. 2d 243 (Fla. 5th DCA 1993).
- An insurer has no general duty to investigate the truthfulness of answers given to question asked on an insurance application and may rely on the truthfulness of these answers when accepting the risk. Brandt v. Time Ins. Co., 302 Ill.App.3d 159, 164, 704 N.E. 2d 843, 846 (1st Dist. 1998).

- An insurer is under no duty to investigate the applicant's medical history or go any further than the four corners of the insurance application. Chawla v. Transamerica Occidental Life Ins. Co., 440 F. 3d 639, 647 (4th Cir. 2006).
- If the insurance company knew or could have reasonably discovered the misrepresentation, then Nevada courts will not apply the rule against misrepresentation to void a contract. Violin v. Fireman's Fund Ins. Co., 81 Nev. 456, 406 P.2d 286 (1965).
- Absent information giving the insurer notice that the applicant has misrepresented facts, the insurer has no obligation to investigate the applicant's misrepresentations. Story v. Safeco Life Ins. Co., 179 Or. App. 688, 693, 40 P.3d 1112, 1116 (2002).
- The insurer generally has no duty to investigate an application and is entitled to rely on the applicant's representations. White v. Continental General Insurance Company, 831 F. Supp. 1545, 1553 (D. Wyo. 1993).
- An insurer is not required to investigate the condition of the property insured. Where a policy contains a warranty that the property complies with all applicable laws, a building code violation increases the hazard insured and constitutes a breach of the warranty. Clarendon American Insurance Company v. Bayside Restaurant, LLC, 567 F. Supp. 2d. 1379 (MD. Fla. 2008).

Does the Intent of the Applicant When Making the Statement Matter?

The law in each state regarding the intent of the applicant when making the false statement varies. When an insurer is required to show intent – the standard of proof and the type of evidence that can be used varies.

- An innocent misrepresentation can constitute equitable fraud justifying rescission and the insurer need not show that the insured had the intent to deceive. Ledley v. William Penn Life Ins. Co., 138 N.J. 627 (1995).
- In Louisiana, the insurer must prove that the false statement was made with the intent to deceive ***and*** that the false statement materially affected the risk. Coleman v. Occidental Life Ins. Co. of N.C., 418 So.2d 645, 646 (La. 1982).
    - Strict proof of fraud is not required to show the applicant's intent to deceive. The courts will look to the surrounding circumstances indicating the insured's knowledge of the falsity of the representation made in the application and his recognition of the materiality of his misrepresentations, or to the circumstances which create a reasonable assumption that the insured recognized the materiality. Perault v. Time Ins. Co., 92-2115 (La. App. 1 Cir. 11/24/93, 633 So.2d 262, 266.
- Oklahoma law requires a finding of intent to deceive before an insurer can avoid the policy for statements made in an application. Hays v. Jackson Nat'l Life Ins. Co., 105 F.3d 583 (10th Cir. 1997).

Does the Misrepresentation Have to Relate to the Claim?

In order to deny a claim, an insurer will also have to know the law as to whether the misrepresentation and subsequent claim have to be related. In some states, it does not matter if the two are correlated. Other states require direct correlation.

- Waxse v. Reserve Life Ins. Co., 248 Kan. 582, 809 P.2d 533 (1991), the court found that the falseness of the application statement will not bar recovery under the policy unless it actually contributes to the event upon which the policy because due and payable.
- No causal relation between the misrepresentation and the loss is necessary for the insurer to avail itself of the defense based on misrepresentation in negotiation of an insurance contract. West v. Safeway Ins. Co. of Louisiana, 42,028 (La.App. 2 Cir. 3/21/07), 954 So.2d 286, 290.
- An insurer is not required to establish any causal connection between the condition misrepresented or omitted from the application and the condition giving rise to the claim on the policy. Parker v. Prudential Ins. Co. of Am., 900 F. 2d 772, 777 (4th Cir. 1990).
- There is no requirement that the actual cause of loss be related to the risks concealed by an insurance applicant in order for the concealed facts to be material. Wesley v. Union Nat. Life, 919 F. Supp. 232, 234 (S.D. Miss. 1995).
- As a general rule, the mere fact that a misrepresentation is false does not in and by itself void the policy. In order to relieve the insurer of liability, the untrue representation must relate to a material matter. James v. Safeco Ins. Co. v. Illinois, 195 Ohio App.3d 265, 2011-Ohio-4241, 959 N.E.2d 599 (8th Dist. 2011).
- An insurer may cancel the insurance policy for a material misrepresentation. Utah Code Ann. § 31A-21-303. However, a misrepresentation does not affect

the insurer's obligation unless the misrepresentation contributes to the loss. Id. § 31A-21-105 (2).

- In Vermont, the focus is on the nexus between the false statement and the insurer's decision to issue a policy, not between the false statement and the ultimate loss.

How Does the Insurer Have to Respond Once the Misrepresentation is Discovered?:

Whether or not the insurer is required to return the premium or cancel the policy immediately upon discovery of the misrepresentation, can have an effect on the ability of the insurer to deny a claim.

- An insurer that seeks to void/rescind a policy based upon a representation made during underwriting must first offer to return the premiums it has collected from the insured within a reasonable time after the discovery of the alleged breach. Dodd v. Am. Family Mut. Ins. Co., 983 N.E.2d 568 (Ind. 2013). A failure to offer such return of premiums, or if refused, to pay it into the court, constitutes a waiver of the alleged fraud. Id.
- In order to obtain a decree rescinding a policy, an insurer must prove that it has fully and promptly tendered to the insured the return of all premiums paid plus interest to the date of tender. Hofmann v. John Hancock Mut. Life Ins. Co., 400 F. Supp. 827, 829 (D. Md. 1975).
- An insurer may waive the right to rescind by accepting premiums after learning of an event allowing for rescission. Security Mut. Life Ins. Co. of New York v. Rodriguez, 65 A.D.3d 1, 880 N.Y.S.2d 619 (1st Dept. 2009).

- If the insurer does not promptly attempt to rescind an accident, health or disability policy upon becoming aware that the insured's application contained false statements, the insurer may not subsequently use such false statement as a basis for attempted rescission or alternation of the policy. North Carolina Department of Insurance, 11 NCAC 4.0316.

Language Within the Application/Policy Which Can Affect the Ability of the Insurer to Deny Claim:

The terms, conditions, definitions and lack of definitions of the application and insurance policy govern the duties of the insured and the insurer. The language the insurer uses within the application and policy can be used against the insurer when it attempts to deny a claim or rescind a policy after a misrepresentation has been made.

- Where an insurance policy contains a provision stating that the "entire policy shall be void if any insured has intentionally concealed or misrepresented any material fact or circumstances relating to this insurance" and the issue is whether the stated language encompasses allegation of fraudulent claim for loss, it has been held that, since the provision fails to include the words "whether before or after loss" or "in case of any fraud or false swearing by the insured relating thereto," the said provision is ambiguous and should be construed to favor the insured. Fiore v. State Farm Fire & Cas. Co., 135 A.D.2d 602, 603, 522 N.Y.S.2d 180 (2nd Dept. 1987).
- Where questions in an insurance contract contains prefatory language that states "to the best of my knowledge and belief" in regard to answers by the insured, the insurer will be bound by that lower standard of accuracy and cannot be protected by the more stringent statutory requirements regarding

misrepresentations. Green v. Life & Health of America, 704 So. 2d 1386 (Fla. 1998).

Rescission and Reformation

By statute or common law, in many states misrepresentations made or incorrect information provided by the insured in the application and underwriting process, even without fraudulent intent, can result in the insurer having the opportunity to reform or rescind a policy that was issued on the basis of the misrepresentations.

- It is generally held that an insurer has a right to know all that the applicant for insurance knows regarding the risk to be insured. Material misrepresentation or concealment of such facts are grounds for rescission of the policy, and an actual intent to deceive need not be shown. Materiality is determined solely by the probable and reasonable effect which truthful answers would have had upon the insurer. The fact that the insurer has demanded answers to specific questions in an application for insurance is in itself usually sufficient to establish materiality as a matter of law. Duarte v. Pacific Specialty Ins. Co., 13 Cal.App.5th 45, 53, 220 Cal.Rptr.3d 170, 177 (2017).
- As a general rule, a misstatement in, or omission from, an application for insurance need not be intentional before recovery may be denied. Kieser v. Old Line Life Ins. Co. of America, 712 So. 2d 1261, 1263 (Fla. 1st DCA 1998).
- The insurer need only show the misrepresentation or omission "affect[ed] the insurer's risk or [was] a fact which, if known, would have caused the insurer not

to issue the policy or not to issue it in so large an amount." Universal Prop & Cas. Ins. Co. v. Johnson, 114 So. 3d 1031, 1036 (Fla. 1st DCA 2013)

- A misrepresentation or concealment of a material fact in an insurance application also establishes a complete defense in an action on the policy. As with rescission, an insurer seeking to invalidate a policy based on a material misrepresentation or concealment as a defense need not show an intent to deceive. Douglas v. Fidelity Nat. Ins. Co., 229 Cal.App.4th 392, 408, 177 Cal.Rptr.3d 271, 283-284 (2014).
- Where the extent of a policy's coverage is the result of a mutual mistake by the insured and the insurer, reformation of the policy to reflect the intent of the parties is appropriate. Cabs, Inc. v. Hartford Ins. Group, 151 Fed.Appx. 604 (10th Cir. 2005).

Claims by Third-Parties:

An insurer may not be able to deny a claim when it is being made by a third-party, regardless if the insurer can prove a misrepresentation, fraud or that it would not have issued the policy. The majority of states do not allow an insurer to do this, citing public policy reasons. Nebraska holds contrary to this majority: The insurer may rescind based on a material misrepresentation in the application even when it affects an innocent third party injured by the insured's negligence in operating an automobile. Glockel v. State Farm Mut. Auto. Ins. Co., 224 Neb. 598, 400 N.W.2d 250 (1987).

- An insurer cannot avoid coverage under a compulsory insurance or financial responsibility law because of fraud when the claimant is an innocent third

party. Mooney v. Nationwide Mut. Ins. Co., 149 N.H. 355, 357-58, 822 A.2d 567, 569-70 (2003).

- Public policy prohibits an insurer from avoiding liability to an innocent third party under a voidable policy of compulsory automobile liability insurance because of a misrepresentation by the insured in the insurance application after an accident has occurred in such a way as to trigger coverage. Harkrider v. Posey, 2000 OK 94, 24 P.2d 821.
- An automobile insurance policy cannot be rescinded based on misrepresentation so as to void coverage for an innocent third party, except within 60 days of the policy's inception. Klopp v. Keystone Insurance Companies, 528 Pa. 1, 595 A.2d 1 (1991).