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MISREPRESENTATIONS IN APPLICATIONS FOR INSURANCE

JOHN DWIGHT INGRAM*

I. INTRODUCTION

Insurance companies routinely request certain information from applicants for all forms of insurance. This information is needed to help in evaluating the risks to be covered by the insurer and to set appropriate premium rates. However, when a claim is made for the benefits of the policy, the insurer may sometimes discover that the insured misrepresented certain material facts in the application for the insurance. The misrepresentation may be in the form of an incomplete or false answer to a question on the application or rather the concealment of certain facts. The misrepresentation may be intentional with a purpose to deceive, or it may be merely an innocent and inadvertent mistake.

When a misrepresentation is discovered, the insurer is presumably entitled to deny the claim under the policy and rescind the policy.¹ Rescission has the effect of making the policy void *ab initio*; in other words, the policy was never in effect.² Ordinarily, it would be against public policy “to permit a dishonest insured to recover, [since] insurers would [then] include the cost of that risk in premiums charged to honest insureds.”³

II. WHAT ARE THE GROUNDS ALLOWED FOR RESCISSION OF A POLICY OR DENIAL OF A CLAIM?

There are four possible bases for allowing an insurer to rescind or deny liability:

1. Any material misrepresentation
2. Intent to deceive *or* a material misrepresentation
3. Intent to deceive *or* an increase in the risk of loss
4. Intent to deceive *and* materiality

¹ Professor of Law, The John Marshall Law School. A.B., Harvard University, 1950; C.L.U. American College of Life Underwriters 1957; J.D., John Marshall Law School, 1966. The valuable contributions of my very capable research assistants, Tiffany Karem, Lori Berko, and Alison Hayden are gratefully acknowledged.

¹ See, e.g., 17 AM. JUR. 2D, *Automobile Insurance* § 53 (2004).

² *Bennett v. Hedglin*, 995 P.2d 668, 672-73 (Alaska 2000).

³ *Paul Revere Life Ins. Co. v. Haas*, 644 A.2d 1098, 1108 (N.J. 1994).

A. Any Material Misrepresentation

In many states, any material misrepresentation is grounds for rescission or denial of liability. This is true whether the misrepresentation is made intentionally, knowingly, negligently, or innocently.⁴ There need not be any showing of fraud or intent to deceive.⁵

B. Intent To Deceive Or A Material Misrepresentation

In some states the standard for rescission or denial of a claim is that a misrepresentation “shall have been made with actual intent to deceive or materially affects either the acceptance of the risk or the hazard assumed by the company.”⁶ On its face, this would seem to allow rescission or denial based solely on intent to deceive and without regard to materiality. However, in my more than 50 years of involvement with insurance, first as an agent and broker and later as an attorney and teacher, I have *never* seen or heard of a case which allowed rescission or denial based solely on intent to

⁴ Carroll v. Metro. Ins. and Annuity Co., 166 F.3d 802, 805 (5th Cir. 1999) (applying Mississippi law); Modisette v. Found. Reserve Ins. Co., 427 P.2d 21, 25 (N.M. 1967).

⁵ Mass. Mut. Life Ins. Co. v. Manzo, 584 A.2d 190, 195 (N.J. 1991). See also Courtney v. Nationwide Mut. Fire Ins. Co., 179 F. Supp. 2d 8, 13 (N.D.N.Y. 2001) (finding that innocent misrepresentation is sufficient to allow rescission); Hartford Life and Acc. Ins. Co. v. Nittolo, 955 F. Supp. 331, 333 (D.N.J. 1997) (finding that an insurer need not prove intent to defraud; even innocent misrepresentation justifies rescission); Amerson v. Gardner, 681 So. 2d 570, 572-73 (Ala. Civ. App. 1996) (finding that an insurer may void a policy even if misrepresentation was unintentional); McQuay v. Ark. Blue Cross & Blue Shield, 98 S.W.3d 454, 458 (Ark. Ct. App. 2003) (“incorrect statement may justify rescission regardless of whether it was made with fraudulent intent”); Davis v. John Hancock Mut. Life Ins. Co., 413 S.E.2d 224, 226 (Ga. Ct. App. 1991) (issuing judgment for insurer even though “applicant may have acted in good faith, not knowing that a representation is untrue”); Fernandez v. Windsor Life Ins. Co. of America, 372 N.Y.S. 2d 357, 364 (N.Y. Trial Term 1975) (stating that an “insured is bound by the representations contained in the application whether these statements were deliberately or innocently made.”).

⁶ Methodist Med. Ctr. of Ill. v. Am. Med. Sec., 38 F.3d 316, 319-20 (7th Cir. 1994) (citing 215 Ill. Comp. Stat. 5/154 (2005)) which provides:

No misrepresentation or false warranty made by the insured or in his behalf in the negotiation for a policy of insurance, or breach of a condition of such policy shall defeat or avoid the policy or prevent its attaching unless such misrepresentation, false warranty or condition shall have been stated in the policy or endorsement or rider attached thereto, or in the written application therefore.

...

No such misrepresentation or false warranty shall defeat or avoid the policy unless it shall have been made with actual intent to deceive or materially affects either the acceptance of the risk or the hazard assumed by the company.

deceive. Instead, it appears that where an intent to deceive is found, less materiality may be required for the rescission or denial of a claim.

C. Intent To Deceive *Or* An Increase In The Risk Of Loss

In some states a misrepresentation will not be deemed material unless it increases the risk of loss.⁷ This is a more restrictive standard for the insurer because a fact may be material to that insurer even though it does not demonstrably increase the risk of loss. For example, some religious and fraternal organizations offer insurance coverage only to their members; thus the fact of membership is material to that insurer.⁸

D. Intent To Deceive *And* A Material Misrepresentation

In some states, an insurer wishing to rescind or deny a claim must meet a difficult standard. In addition to proving materiality, an insurer must also prove that the misrepresentation was knowingly false, and sometimes he or she must exceed the knowingly false standard and establish that it was made with intent to deceive.⁹

While there would appear to be a clear distinction between requiring materiality *and* intent to deceive as opposed to materiality *or* intent to deceive, some courts employing the “or” standard find ways to reach results that are the same as if they had openly applied the “and” standard.¹⁰ These

⁷ See *Vt. Mut. Ins. Co. v. Chiu*, 21 S.W.3d 232, 235 (Tenn. Ct. App. 2000); see also *NW. Mut. Life Ins. Co. v. Iannacchino*, 950 F. Supp. 28, 31 (D. Mass. 1997).

⁸ *E.g.*, *The Aid Association for Lutherans; College Life Ins. Co.*; malpractice coverage for members of a state medical or Bar association.

⁹ *Vining v. Ent. Fin. Group, Inc.*, 148 F.3d 1206, 1215 (10th Cir. 1998) (holding that, under Oklahoma law, there must be “a finding of intent to deceive before an insurer can avoid the policy . . . [A] statement made without intent to deceive is not a misrepresentation at all . . .” (citing *Okla. Stat. tit. 36, § 3609*)); *Friez v. Nat'l Old Line Ins. Co.*, 703 F.2d 1093, 1095 (9th Cir. 1983) (in Montana, must show intention to mislead); *McBean v. Guardian Ins. Agency*, 52 F. Supp. 2d 518, 521 (V.I. 1999) (finding that insurer must prove that insureds acted with intent to deceive); *Clyde A. Wilson Int'l. Investigations, Inc. v. Travelers Ins. Co.*, 959 F. Supp. 756, 761 (S.D. Tex. 1997) (insurer must plead and prove that misrepresentation was made “willfully and with design to deceive or defraud.”); *Jung v. Nationwide Mut. Fire Ins. Co.*, 949 F. Supp. 353, 356 (E.D. Pa. 1997) (discussing insured who knew that representation was false, or insured made representation in bad faith); *Nat'l Union Fire Ins. v. Seafirst Corp.*, 662 F. Supp. 36, 39-40 (W.D. Wash. 1986) (explaining that Washington statute provides that no misrepresentation shall avoid the contract unless it was made with intent to deceive); *Francois v. Alexander*, 771 So. 2d 656, 660 (La. Ct. App. 2000) (finding that an insurer may deny coverage only if misrepresentation was made with intent to deceive); *Bishop v. Farm Bureau Life Ins. Co.*, 421 N.W. 2d 423, 425 (Neb. 1988) (holding that there must be proof of intent to deceive to deny recovery).

¹⁰ See Robert H. Jerry, II, *Understanding Insurance Law* § 102, at 528-30 (1987).

courts seem to sympathize with an insured where it appears that the insured made an innocent mistake and would suffer hardship under the application of the “or” standard. Such courts stretch the facts to find that what appears to be a misstatement was not really false or, even if false, was not material, or that the insurer did not really rely on the misstatement in underwriting and issuing the policy.¹¹

A strong argument can be made that an insurer should not be allowed to deny a claim or rescind a policy unless a misrepresentation in the application is *both* material *and* was knowingly false, or was made with intent to deceive. If this standard is applied, insureds that make innocent or negligent misrepresentations on insurance applications will not be penalized for their errors. The cost of doing this will be borne by the diligent or lucky insurance buyers who do not unintentionally misrepresent, or do not have a claim, or whose misrepresentation is not discovered. Is this fair? Most people are capable of forgetting facts at the time they apply for insurance, especially if those facts relate to a condition or event in the past which is no longer (and perhaps never was) deemed a problem by the applicant. Most insurance policies do not exclude coverage for unintentional or negligent acts of the insured, and most insureds probably don't expect to lose their coverage for an unintentional misrepresentation.

How difficult will it be for courts to determine if a misrepresentation was “knowingly false” or made with an “intent to deceive”? Such determinations are frequently made in tort and criminal cases. However, there well may be a strong sympathy by both judges and jurors for an insured claimant who will be saddled with a huge loss if the misrepresentation is found to have been knowingly false. It may be that such a finding will be made only when the evidence of fraud is very strong.

III. WHAT CONSTITUTES A MISREPRESENTATION?

A. Definitions

A misrepresentation in an application for insurance is “a statement of something as a fact which is untrue and affects the risk undertaken by the insurer.”¹² “Incomplete answers or a failure to disclose material information on an application for insurance may constitute a misrepresentation when the omission prevents the insurer from adequately assessing the risk involved.”¹³

¹¹ *Id.*

¹² *Methodist Med. Ctr. of Ill. v. Am. Med. Sec.*, 38 F.3d 316, 319 (7th Cir. 1994) (citations omitted).

¹³ *Id.* at 320 (citation omitted). *See also* *New Eng. Mut. Life Ins. Co. v. Bank of Ill. in DuPage*,

B. Is There A Voluntary Duty For An Applicant To Disclose?

Many centuries ago a rule requiring voluntary full disclosure of all relevant information was established in regard to ocean marine insurance.¹⁴ It was a rule of necessity; the insurer had no access to the information and had to rely completely on the applicant.¹⁵ The rule appears to have continued to the present day for marine insurance,¹⁶ but it is not applied to other forms of insurance.¹⁷ In other lines of insurance, it's usually held that the applicant has no duty to disclose unless he is asked;¹⁸ the assumption is that an applicant can assume that facts are not material if the insurer fails to inquire.¹⁹

C. How Specific Must A Disclosure Be?

It seems clear that, where the applicant has disclosed some information that might raise questions about his insurability, the insurer must follow up any leads it has. If there is sufficient information to put the insurer on warning, it should investigate further. “[A]n insurance company cannot rely on [a misrepresentation] to rescind the policy if facts were known that would cause a prudent insurer ‘to start an inquiry, which, if carried out with reasonable thoroughness, would reveal the truth.’”²⁰

994 F. Supp. 970, 976 (N.D. Ill. 1998) (citations omitted) (“An incomplete answer or a failure to disclose material information in response to a question can constitute a misrepresentation.”); *Fernandez v. Windsor Life Ins. Co. of Am.*, 372 N.Y.S. 2d 357, 363 (Sup. Ct. Trial Term 1975) (“[A] failure to disclose in response to a particular question is as much a misrepresentation as a disclosure that is a mistruth or a half truth.”).

¹⁴ 7 COUCH ON INSURANCE § 99:1 (3rd ed.) (2004).

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ When the gender for a personal pronoun could be either male or female, I use the masculine pronoun generically, due to habit and my masculine personal orientation. By doing so I avoid the rather awkward “he or she” and the grammatically incorrect “they.” I trust that female authors will balance the scales on the other side.

¹⁹ *Fernandez v. Bankers Nat'l Life Ins. Co.*, 906 F. 2d 559, 567 n.32 (11th Cir. 1990); *Mattox v. W. Fid. Ins. Co.*, 694 F. Supp. 210, 216 (N.D. Miss. 1988).

²⁰ *Carroll v. Metro. Ins. & Annuity Co.*, 166 F. 3d 802, 806 (5th Cir. 1999) (applying Miss. law) (citation omitted).

D. Should The Courts Impute Negligence Or Knowledge Of An Insurance Agent To The Insurer?

It is generally held that knowledge held by an insurer's agent will be imputed to the insurer, regardless of whether the agent actually communicates the information to the insurer. This view is based on the idea that an applicant will assume that the agent knows what information the insurer is seeking and how best to communicate that information to the insurer.²¹ In some states the insurer is bound by what the applicant orally tells the agent regardless of what the agent writes on the application.²² In other states, the insured is bound by what is written on the application, regardless of who filled it in.²³ Even in the latter states, an exception is usually recognized if the insurer's agent induced the applicant to sign the application without reading it.²⁴ Therefore, in *Rutherford v. Prudential Insurance Company of America*,²⁵ the court found that the insurer's medical examiner had led the insured to believe that certain information as to his medical history, which was not included in the application filled out by the doctor, was not essential.²⁶ It reasonably could be inferred "that [the doctor]

²¹ *Marionjoy Rehab. Hosp. v. Lo*, 535 N.E. 2d 1061, 1064 (Ill. App. Ct. 1989); *Johnson Int'l Co. v. Jackson Nat'l Life Ins. Co.*, 19 F.3d 431, 435-36 (8th Cir. 1994) (applying Wash. law).

²² *Marionjoy Rehab. Hosp.*, 535 N.E. 2d at 1063-64. *See also* *Byrd v. Mut. Benefit Health & Acc. Assn.*, 166 P.2d 901 (Cal. Ct. App. 1946) (detailing that insurer was estopped to assert omission of information from application, which agent filled out and insured merely signed; the insured had no knowledge that his answers were incorrectly recorded; he wasn't asked to read application or do anything except sign his name; he acted in good faith and gave truthful answers to questions he was asked); *Logan v. Allstate Life Ins. Co.*, 312 N.E. 2d 416, 420 (Ill. App. Ct. 1974) (citations omitted) ("It has long been the rule in Illinois that when an applicant for insurance gives correct oral answers to questions propounded by an insurance agent but the insurer's agent incorrectly records these answers the insurer cannot rely upon the falsity of the answers to avoid the policy.").

²³ *Keaten v. Paul Revere Life Ins. Co.*, 648 F. 2d 299, 303 (5th Cir. 1981); *Monarch Life Ins. Co. v. Donahue*, 708 F. Supp. 674, 676 (E.D. Pa. 1989). *See also* *Courtney v. Nationwide Mut. Fire Ins. Co.*, 179 F. Supp. 8, 12 (N.D.N.Y. 2001) (finding that insured may be held responsible for misrepresentations in application even though agent completed application which was signed by insured; even if insured provided accurate answers to agent, he was deemed to adopt information in application when he signed the application; applicant has duty to review application and correct incomplete or incorrect answers); *Jung v. Nationwide Mut. Fire Ins. Co.*, 949 F. Supp. 2d. 353, 358 (E.D. Pa. 1997) (ruling that an applicant can't avoid responsibility by signing blank form and leaving it to another to fill in answers); *Stuart v. Am. States Ins. Co.*, 932 P.2d 697, 700 (Wash. Ct. App. 1997) (citation omitted) (finding that insured has duty to read application and correct any misrepresentations; failure to correct becomes a ratification).

²⁴ *Pinette v. Assur. Co. of Am.*, 52 F.3d 407, 410 (2d Cir. 1995) (applying Conn. law).

²⁵ 44 Cal. Rptr. 697 (Cal. Ct. App. 1965).

²⁶ *Id.* at 703.

gave [the insured] the impression that the answers the doctor wrote covered all the matters in which [the insurer] was interested, and therefore a reading of the application by [the insured] when he later received it would not alert him to its insufficiency.”²⁷

E. Attach A Copy Of The Application To The Policy

It is generally held that statements in the application do not bind an insured unless a copy of the application or the information contained therein is attached to, or made a part of the policy.²⁸ On the other hand, a majority of states hold that the insured is bound by misstatements in the application if a copy thereof is attached to the policy.²⁹

The purpose of the requirement of attaching a copy of the application is clearly to “allow for objective evidence of negotiations at the time of application for [the] protection of the insured from possible frauds by insurance agents in falsifying answers given by the insured in applying for insurance.”³⁰ “[T]he insured [should] have the material terms of the contract at hand during his lifetime in order that he might examine and correct any misrepresentations”³¹ This requirement is not only beneficial to the insured but also to the insurer, since it means that “the

²⁷ *Id.*

²⁸ *See, e.g.,* *Lawndale Nat. Bank v. Am. Cas. Co. of Reading, Pa.*, 489 F.2d 1384, 1385-86 (7th Cir. 1973) (striking insurer’s defense of misrepresentation; Ill. Ins. Code provides that no misrepresentation “shall defeat or avoid the policy . . . unless such misrepresentation . . . shall have been stated in the policy or endorsement or rider attached thereto, or in the written application therefore, of which a copy is attached to or endorsed on the policy, and made a part thereof”); *Horowitz v. Fed. Kemper Life Assur. Co.*, 946 F. Supp. 384, 387 (E.D. Pa. 1996) (stating that “if an insurer fails to attach the insurance application . . . at the time the policy is delivered, the insurer is barred from asserting any fraudulent misrepresentations contained in the application . . . as justification for its failure to pay the policy proceeds.”) (citing 40 PA. STAT. ANN. § 441 (2005)); *Irving v. U.S. Fid. & Guar. Co.*, 606 So.2d 1365, 1367 (La. Ct. App. 1992) (“[N]o application for life or health and accident insurance shall be admissible in evidence . . . unless a correct copy of the application was attached to or otherwise made a part of the policy . . . when issued and delivered.” (quoting LA. REV. STAT. ANN. § 22:618 A (1978))).

²⁹ *See, e.g.,* *Davis v. John Hancock Mut. Life Ins. Co.*, 413 S.E. 2d 224, 226 (Ga. Ct. App. 1991) (holding that “where the application for insurance is attached to and becomes a part of the policy, in order to avoid the policy for a misrepresentation . . . in the application, the insurer need only show that the representation was false and that it was material”); *Mayes v. Mass. Mut. Life Ins. Co.*, 608 S.W.2d 612, 617 (Tex. 1980) (finding that insured may be conclusively presumed to have knowledge of contents of application and to have ratified any false statements therein if application is attached to and made part of policy and is accepted and retained by insured).

³⁰ *Gibraltar Cas. Co. v. A. Epstein & Sons, Int’l, Inc.*, 562 N.E. 2d 1039, 1042 (Ill. App. Ct. 1990).

³¹ *Adams v. John Hancock Mut. Life Ins. Co.*, 797 F. Supp. 563, 565 (W.D. Tex. 1992), *aff’d* 49 F.3d 728 (5th Cir. 1995) (unpublished opinion).

knowledge of the insured of the statements contained in the application is thereby conclusively established."³²

IV. WHAT CONSTITUTES "MATERIAL"?

Most courts use three tests to determine materiality:

1. Is the fact deemed to be material by all similar insurers?
2. Would a reasonable and prudent insurer regard it as material?
3. Would this particular insurer regard it as material?³³

Courts uniformly hold that a representation is material if it would affect the insurer's decision to accept or reject the application.³⁴ Many courts add to this minimal definition of materiality by holding that a statement is material if it affects the nature of the risk, or the insurer's determination of the premium or of any exclusions or limitations of coverage.³⁵ For many years, in my Insurance Law class, I have used a very simple example of what is or is not material. Suppose, in an application for life insurance, an applicant falsely states that he has not consulted a doctor recently.

Situation A: The applicant has cancer, but the doctor did not detect it and thinks the applicant is in good health. Is the false answer about consulting a doctor a material misrepresentation? No, because if a true answer had been given, the insurer would have asked for a report from the doctor, and would thereafter have issued the policy.

Situation B: The doctor made a diagnosis of cancer, but did not tell the patient. In fact, the diagnosis was wrong, and the patient was in

³² *Id.* at 565 (quoting *Johnson v. Prudential Ins. Co. of Am.*, 519 S.W.2d 111, 114 (Tex. 1975)).

³³ *Merchs. Fire Assur. Corp. v. Lattimore*, 263 F.2d 232, 241 (9th Cir. 1959).

³⁴ See, e.g., *Dorsey v. Mutual of Omaha Ins. Co.*, 991 F. Supp. 868, 873-74 (E.D. Mich. 1998) (holding that if insurer had known applicant's true health condition it would not have provided any coverage); *Matilla v. Farmers New World Life Ins.*, 960 F. Supp. 223, 225-26 (N.D. Cal. 1997) (ruling that insurer's underwriters "would not issue a policy to an applicant who did not have a valid visa;" insurer was concerned about deportation, and visits to unstable countries where health care might be inadequate; also, visa validation process often led to discovery of pre-existing health problems).

³⁵ See, e.g., *Pinette v. Assur. Co. of Am.*, 52 F.3d 407, 411 (2d Cir. 1995) (explaining that prior loss history is material as to issuance of policy, or rate of premium); *York Mut. Ins. Co. v. Bowman*, 746 A.2d 906, 909 (Me. 2000) (facts "would have influenced . . . [acceptance of] the risk, . . . the premium rate, . . . the amount of . . . coverage, or in providing coverage with respect to the hazard resulting in the loss."); *Case v. RGA Ins. Servs.*, 521 S.E. 2d 32, 33-34 (Ga. Ct. App. 1999) (insurer would not have issued policy, would "not have issued a policy in as large an amount or at the given rate, or would not have provided coverage with respect to the hazard resulting in the loss."); *Farley v. St. Charles Ins. Agency, Inc.*, 807 S.W.2d 168, 170 (Mo. Ct. App. 1991) (might have influenced acceptance of risk or premium charged).

good health. Is the answer now a material misrepresentation? Yes, because the insurer would have asked for a report from the doctor, learned of his diagnosis of cancer, and refused to issue the policy.

V. MUST THERE BE A CAUSAL CONNECTION BETWEEN FACT MISREPRESENTED AND CAUSE OF DEATH OR LOSS?

In most jurisdictions, a misrepresentation is considered material and sufficient grounds for rescission or denial of a claim regardless of whether the fact misrepresented has any causal connection with the death or loss involved in the claim.³⁶ A small minority of jurisdictions require that, in order to establish materiality, the insurer must also prove that the facts misrepresented in the application contributed to the loss on which the claim is based.³⁷ There is a very sound reason for not requiring a causal connection: such a requirement may encourage fraud. If a loss is caused by something other than the fact misrepresented, there will be coverage. If the cause of loss is connected to the misrepresented fact, the insured has lost nothing, because he wouldn't have had coverage anyway. If the cause of loss is not connected, he has coverage he otherwise couldn't have obtained. Thus, he had nothing to lose by misrepresenting.

³⁶ See, e.g., *Carroll v. Metro. Ins. and Annuity Co.*, 166 F.3d 802, 807 n.18 (5th Cir. 1999) (ruling that Mississippi law does not require that actual cause of death be related to risks concealed); *Davies v. Centennial Life Ins. Co.*, 128 F.3d 934, 943 (6th Cir. 1997) (finding that misrepresentation need not be connected with or related to illness or injury); *Hartford Life & Acc. Ins. Co. v. Nittolo*, 955 F. Supp. 331, 335 (D.N.J. 1997) (citation omitted) (holding that false statements need not relate to ultimate claim); *Unger v. Metro. Life Ins. Co.*, 242 N.E.2d 907, 910 (Ill. App. Ct. 1968) (finding that misrepresentation need not "be one with regard to a matter upon which a claim is later predicated."); *Mass. Mut. Life Ins. Co. v. Manzo*, 584 A.2d 190, 196-97 (N.J. 1991) (stating that a majority of jurisdictions accept the general rule that in the absence of a statute establishing a different rule, there need be no causal connection between the cause of death and the misrepresentation); *Carroll v. Jackson Nat. Life Ins. Co.*, 414 S.E.2d 777, 778 (S.C. 1992) ("The majority rule is that there is no requirement that the loss be causally related to the material misrepresentation under a void insurance policy." (citing JOHN J. APPLEMAN, ET AL., *INSURANCE LAW & PRACTICE* § 245 (Rev. ed. 1972))); *Berger v. Minn. Mut. Life Ins. Co. of St. Paul, Minn.*, 723 P.2d 388, 391 (Utah 1986) (holding that insurer need not prove that fact misrepresented resulted in insured's death).

³⁷ See, e.g., *KAN. STAT. ANN. § 40-418* (2003); *MO. REV. STAT. § 376.580* (2004); *R.I. GEN. LAWS § 27-4-10* (2003); see also Kathryn H. Vratil & Stacy M. Andreas, *The Misrepresentation Defense in Causal Relation States: A Primer*, 26 *TORT & INS. L.J.* 832, 834-52 (1991) (listing also Arizona, Arkansas, Nebraska, New Jersey and Oklahoma).

VI. EFFECT OF AN INCONTESTABLE CLAUSE

Most property and casualty insurance policies are written for relatively short periods of coverage—commonly one, three, or five years. Usually the insurer will have a right to rescind the policy or deny a claim if there has been a material misrepresentation in the application for insurance. On the other hand, life and health insurance policies are usually written for a longer term of coverage, often for the lifetime of the insured.

Life insurers introduced incontestability clauses toward the end of the nineteenth century.³⁸ These clauses “dispel[led] the public’s fear that insurers would not honor claims if the insured had made a technical mistake in the application.”³⁹ By the early 1900s, statutes in many states mandated “that certain insurance policies be incontestable.”⁴⁰ The purpose of these statutes was “to give the insured a sense of security after the stated period elapses.”⁴¹

Obviously, people with medical problems may be faced with a difficult conflict of interest in applying for life and health insurance. If they give full and honest answers to the questions in the application, they may be rejected for the desired coverage, be charged a higher premium, or their medical condition may be excluded from coverage. However, if they misrepresent or conceal their medical problems, and survive for the prescribed period, they will have full coverage thereafter. For some, the temptation is irresistible.

The modern incontestable clause is usually very similar to the following: “After this policy has been in force for a period of two years *during the lifetime of the insured*, it shall become incontestable as to the statements contained in the copy of the application.” The italicized phrase is important, because it means that if the insured dies within the specified period, the policy will *never* become incontestable. This avoids the common situation where the insured dies near the end of the contestable period and the misrepresentation is not discovered until later. Thus, the insurer is assured a reasonable time in which to investigate.

Incontestable clauses serve valuable public interests. Much costly litigation is eliminated, insurers’ expenses are reduced, and resolution of

³⁸ An incontestable clause provides that, after the policy has been in force for a specified period (usually one or two years), the insurer can no longer contest the validity of the policy, even if there were misstatements in the application.

³⁹ Paul Revere Life Ins. Co. v. Haas, 644 A.2d 1098, 1102 (N.J. 1994).

⁴⁰ *Id.* (citations omitted).

⁴¹ *Id.* (citations omitted).

conflicts does not depend on evidence that is stale or nonexistent years after the policy took effect. Therefore, both insureds and beneficiaries can feel secure that their claims will not be denied in the future.⁴²

Some states allow an insurer to choose between two statutory alternatives for the incontestable clause.⁴³ The first alternative clause is absolute: the policy will become incontestable *for any reason*. The second alternative clause allows an exception for fraudulent misstatements in the application. Thus, the policy may *always* be contested on grounds of intentional or knowing misrepresentation in the application.⁴⁴ It is difficult to understand why any insurer would choose the absolute incontestable clause rather than the clause with a fraud exception. It is sometimes suggested that the most likely reason is increased marketability.⁴⁵ But what honest buyer would care about a fraud exception? An even more puzzling question is what insurer would want to insure people who wanted to be rewarded for their fraud?

In any case, is the presence of *any* incontestable clause really of any value to an insurer in the marketing of life and health insurance? In her Note, Katherine Cooper suggested that "insurance agents undoubtedly point out the clause to potential buyers and explain that coverage may not be denied after a period of time."⁴⁶ I was an insurance producer for twenty years, and have been involved in insurance in various ways for more than fifty years. I never even mentioned the incontestable clause to a client, nor did a client ever ask me about it. I also have never heard of *any* insurance producer using the clause as a saleable, valuable feature of a policy—or indeed mentioning the clause at all.

It is sometimes argued by a beneficiary that, if death occurs during the contestable period, the amount of proceeds payable should be reduced to what would have been payable for the premium dollars paid, if it appears that, had the insurer known the insured's true medical history, it would have issued a policy at a higher premium.⁴⁷ While this approach may be tempting at first glance, the obvious fallacy was clearly pointed out by the *Hays* court. That court held "[i]f the only consequence of a fraudulent

⁴² See *Maxwell v. Cumberland Life Ins. Co.*, 748 P.2d 392, 395-97 (Idaho 1987).

⁴³ See *Kaufman v. Mutual of Omaha Ins. Co.*, 681 So. 2d 747 (Fla. Dist. Ct. App. 1996) (citing FLA. STA. ANN. § 627.607 (West 2005)).

⁴⁴ See, e.g., FLA. STA. ANN. § 627.607 (West 2005).

⁴⁵ See Katherine Cooper, *Liar's Poker: The Effect of Incontestability Clauses After Paul Revere Life Ins. Co. v. Haas*, 1 CONN. INS. L.J. 225, 233 (1995).

⁴⁶ *Id.* at 233-34.

⁴⁷ *Hays v. Jackson Nat. Life Ins. Co.*, 105 F.3d 583, 590 (10th Cir. 1997) (applying Okla. law).

misrepresentation in a life insurance application is to reduce the amount paid under the policy, there is every incentive for applicants to lie.”⁴⁸

Insurance contracts often include a provision called the Age Adjustment Clause. Such a clause provides that where an insured has misstated his or her age in the application, that the benefit to be paid is reduced to the amount that could have been purchased by that premium at the insured’s correct age. This is not an exception to the incontestable clause because the insurer is not contesting the validity of the policy. Rather, the insurer is simply enforcing the policy as written. The rationale for including this clause is that a misstatement of age is usually unintentional, and does not injure the insurer if the coverage can be appropriately adjusted. Some people, especially those born in foreign countries, honestly do not know when they were born; others have lied about their age for so long that they honestly believe their “adopted” age.⁴⁹

VII. CONTESTABILITY OF PROPERTY AND CASUALTY POLICIES

A. Does An Insurer Have A Duty To Investigate?

It is generally held that “[a]n insurance company has the right to expect a prospective insured to give truthful information on the application, and the insurance company normally has no duty to inquire further into whether an insured has told the truth on the application.”⁵⁰ It is also generally held that an insurer may still rely on the applicant’s representations even if it does carry out some investigation of its own.⁵¹ If, however, an insurer obtains some information that might cause it to question the information provided by the applicant, it will usually be held to have a duty to investigate further.⁵²

⁴⁸ *Id.* (quoting *N.Y. Life Ins. Co. v. Johnson*, 923 F.2d 279, 284 (3d Cir. 1991)).

⁴⁹ A classic example is the case of a very well known movie star whose birthday is recognized each year in the Almanac column in the *CHICAGO TRIBUNE*. Her year of birth is always listed as 1934. However, she entered the University of Wisconsin as a freshman in 1948, and her two roommates, both friends of mine, were born in 1930. Apparently the Hollywood star understated her age early in her career and it was never corrected.

⁵⁰ *Amerson v. Gardner*, 681 So. 2d 507, 573 (Ala. Ct. App. 1996) (citations omitted). *See also*, *Foster v. Auto-Owners Ins. Co.*, 703 N.E.2d 657, 660 (Ind. 1998) (holding that an insurer has no duty to investigate or cross-check, and that to so require would “generate additional costs to insurers and no legitimate benefit to insureds.”).

⁵¹ *John Hancock Mut. Life Ins. Co. v. Cronin*, 51 A.2d 2, 5 (N.J. 1947).

⁵² *Ledley v. William Penn Life Ins. Co.*, 651 A.2d 92, 97 (N.J. 1995) (citation omitted).

B. First Party Claims

Courts are sometimes very liberal in imputing information to an insurer, which will then negate a claim of misrepresentation by the insured. For example, in *Graphic Arts Mutual Insurance Company v. Pritchett*,⁵³ an applicant answered “no” to a question as to whether he had had any insurance policies cancelled within the past three years. In fact, he had had three such cancellations, including one policy with the corporate parent of Graphic Arts. Both the new policy and the cancelled policy were sold by the same insurance agency through two different agents.⁵⁴ The court held that Graphic Arts thus had actual knowledge of the misrepresentation, because its agent, the corporate insurance agency, was aware of the previous cancellation. Therefore, Graphic Arts was estopped from asserting the misrepresentation.⁵⁵

Another rather extreme example of estoppel based on the imputation of knowledge to an insurer can be found in *Violin v. Fireman’s Fund Insurance Company*.⁵⁶ The applicants falsely answered “no” to a question on the application: “Has any company ever refused or cancelled insurance?”⁵⁷ In fact, four years earlier the same insurer, Fireman’s Fund, had cancelled a policy which it had issued to the same insureds covering musical instruments. “The lower court found that [the insureds’] misrepresentation was material to the risk against which the applicants sought coverage and was not innocently made.”⁵⁸ Therefore, the insureds were denied recovery for the loss of the insured violin.⁵⁹ The Nevada Supreme Court reversed because the insurer’s claim department in Los Angeles had “a record of the prior loss and subsequent cancellation.”⁶⁰ However, there was no connection between “the solicitation and issuance of the present policy” and the claims department.⁶¹ No one “connected with the solicitation or issuance of the present policy” was aware of the misrepresentation.⁶² “[B]ecause of the expense, volume, and complexity of its business, the insurer believed [it could] rely upon the representations . . . in an application for insurance and

⁵³ 469 S.E.2d 199 (Ga. Ct. App. 1995).

⁵⁴ *Id.* at 201.

⁵⁵ *Id.*

⁵⁶ 406 P.2d 287 (Nev. 1965).

⁵⁷ *Id.* at 288.

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ *Id.* at 289.

⁶¹ *Violin*, 406 P.2d at 289.

⁶² *Id.*

[so did not have] a program for communicating information in the files of the claims department to those in the production end of the business.”⁶³

The Nevada Supreme Court stated that if the insurer was able “to promptly discover the misrepresentation after the loss has occurred, [it would] prefer that diligence be exercised at an earlier time – when the application for insurance is taken.”⁶⁴ The court therefore held that “the insurer waived its power to rescind the insurance contract by issuing the policy with knowledge that the insureds had fraudulently misrepresented a material fact in their application for insurance.”⁶⁵ In a vigorous dissent, Judge Zenoff urged that “[t]here should not be a reward for a knowing and willful misrepresentation.”⁶⁶ In this case, the “knowledge” of the insurer consisted of facts in an *inactive* file. The court found that issue quite different from facts in an *active* file for coverage currently in force.⁶⁷

While I would certainly concur with Judge Zenoff, why should waiver or estoppel apply to information in *any* record, even if active? Even in this modern electronic age, it costs something to check the records for all applications. Why should all insureds bear this cost to benefit dishonest applicants? If the cancellation had been by any other company, it could not have been discovered. Why reward those insureds merely because they possess the impudence to apply again to the same company that cancelled them?

C. Third Party Liability Claims

When the claim involves coverage calling for payment, not to the insured, but rather to a third party for injury or damage caused by an insured, different public policy issues are presented. It is one thing to deny recovery to an insured that has misrepresented a material fact, especially if it was intentional. It may be quite different when the claim is brought by an innocent third person who may go uncompensated if the insurer is allowed to deny the claim or rescind the policy on grounds of the insured’s misrepresentation.

A number of courts have held that, “as to innocent third parties, the insurer could not rescind an automobile liability policy [after an accident] that it alleged to have been procured by the fraud of its insured.”⁶⁸ The

⁶³ *Id.* at 289.

⁶⁴ *Id.* at 290.

⁶⁵ *Id.*

⁶⁶ *Violin*, 406 P.2d at 291 (Zenoff, D.J. dissenting).

⁶⁷ *Id.* at 291-92.

⁶⁸ *Nat’l Ins. Ass’n. v. Peach*, 926 S.W.2d 859, 860 (Ky. Ct. App. 1996).

court in *National Insurance Association v. Peach* pointed out that the objective of the state's compulsory automobile liability insurance law was "to insure continuous liability insurance coverage in order to protect the *victims* of motor vehicle accidents and to insure that one who suffers a loss as the result of an automobile accident would have a source and means of recovery."⁶⁹ This rule and the rationale thereof have been widely followed and applied even in states that do not have compulsory automobile liability insurance.⁷⁰ It is generally held, as was the case in *Peach*, that even though the insurer may not rescind as to the injured third party, it may still deny a claim by its insured for indemnification if the insured has paid the third party's claim.⁷¹ The insurer may also seek indemnification from its insured after the insurer has paid the third party's claim.⁷²

Perhaps the most cited case in this area of the law is *Barrera v. State Farm Mutual Automobile Insurance Company*.⁷³ In *Barrera*, an injured pedestrian sued State Farm to recover the amount of a judgment against State Farm's insured motorist. State Farm denied the validity of the policy, on grounds of the insured's material misrepresentation, and cross-complained seeking a declaration that the policy was void *ab initio*.⁷⁴ The California Supreme Court held

that an automobile liability insurer must undertake a reasonable investigation of the insured's insurability within a reasonable period of time from the acceptance of the application and the issuance of a policy. This duty directly inures to the benefit of third persons injured by the insured. Such an injured party, who has obtained an unsatisfied judgment against the insured, may properly proceed against the insurer; the insurer cannot then successfully defend upon the ground of its own failure reasonably to investigate the application.⁷⁵

⁶⁹ *Id.* at 861. The court cited a number of cases in other jurisdictions with compulsory automobile liability insurance laws which, without exception, have held "that where an innocent third party has suffered injury from an insured's operation of an automobile, the insurer is prohibited from rescinding the policy—even where the insurance coverage was procured through the misrepresentations of the insured." *Id.* at 861-62.

⁷⁰ See, e.g., *Barrera v. State Farm Mut. Auto. Ins. Co.*, 456 P.2d 674 (Ca. 1969).

⁷¹ *Nat'l Ins. Ass'n*, 926 S.W.2d at 862.

⁷² *Barrera*, 456 P.2d at 689.

⁷³ *Id.*

⁷⁴ *Id.* at 677.

⁷⁵ *Id.* at 677.

The court supported its position by pointing to “the ‘quasi-public’ nature of the insurance business and the public policy underlying the [state’s] Financial Responsibility Law.”⁷⁶ The court reviewed a variety of factors when assessing the reasonableness of an insurer’s conduct in the investigation of the applicant’s driving record. These include:

the cost of obtaining the information from the Department of Motor Vehicles, the availability of this information from the department or elsewhere . . . , and the general administrative burden of making such an investigation. These factors must be weighed against the importance of the protection of innocent members of the public against the consequences of automobile owners driving with voidable liability policies.⁷⁷

VIII. CONCLUSION

As demonstrated by the foregoing, public policy is always an important part of the equation in determining whether to allow an insurer to rescind a policy or deny a claim. How demanding should we be as to what constitutes “materiality” and what is deemed to be a “misrepresentation”? Should we penalize innocent beneficiaries, or third parties who suffer injury or damage at the hands of the insured? In all of these decisions we must consider the cost of requiring coverage, because such cost will ultimately be borne by all of those honest insureds who do not misrepresent, but whose premiums must be increased to offset the additional payments mandated.

⁷⁶ *Id.* at 680-81.

⁷⁷ *Id.* at 690.