

## SPECIAL REPORT

### CONCEALMENT, MISREPRESENTATION AND FRAUD PROVISIONS: WHEN YOU STRETCH THE TRUTH, WATCH OUT FOR THE SNAPBACK.

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*My 18-year-old son lives in my basement. Last year he was convicted of DUI. Since he won't be driving my car, do I have to list him on the insurance application?*

*Do I have to disclose to the insurance company that my property is vacant?*

*My daughter just turned 16 years old. She only drives my car on the weekends. Since my policy automatically covers family members, do I have to tell the insurance company she is a new driver?*

*When my insurance company asked about my garaging location, I gave them my parent's address. The premiums would be twice as much if I told them the actual garaging location.*

*If I have blanket property coverage or guaranteed replacement cost coverage, why do I have to insure the full replacement cost for each individual location? Can't I just underestimate the values to save on premium?*

### **INTRODUCTION**

Oftentimes insurance applications are looked upon as an administrative afterthought. The truth is applications are one of an insurance company's first lines of defense when attempting to deny a claim.

With this in mind, it is imperative that these documents be reviewed to ensure accurate information prior to submission.

The purpose of this Special Report is to review relevant provisions within most policies and applications governing misrepresentation, concealment and fraud.

### **Standard Policy Provisions**

Most insurance policies contain some sort of provision governing concealment, misrepresentation, or fraud.

These provisions allow the insurance company to void the policy if any insured conceals or misrepresents a material fact relating to coverage, the covered property, their interest in the covered property, or a claim presented under that coverage part.

Some of the standard policy provisions are as follows:

#### **COMMERCIAL PROPERTY CONDITIONS**

##### **A. Concealment, Misrepresentation or Fraud**

This Coverage Part is void in any case of fraud by you as it relates to this Coverage Part at any time. It is also void if you or any other insured, at any time, intentionally conceal or misrepresent a material fact concerning:

1. This Coverage Part;
2. The Covered Property;
3. Your interest in the Covered Property; or
4. A claim under this Coverage Part.

CP 00 90 07 88-Commercial Property Conditions

#### **GENERAL LIABILITY CONDITIONS**

##### **6. Representations**

By accepting this policy, you agree:

- a. The statements in the Declarations are accurate and complete;
- b. Those statements are based upon representations you made to us; and
- c. We have issued this policy in reliance upon your representations.

## **PERSONAL HOMEOWNERS CONDITIONS**

### **Section I: Property Conditions**

#### **Q. Concealment or Fraud**

We provide coverage to no "insureds" under this policy if, whether before or after a loss, an "insured" has:

1. Intentionally concealed or misrepresented any material fact or circumstance;
2. Engaged in fraudulent conduct; or
3. Made false statements;  
...relating to this insurance.

### **Section II: Liability Conditions**

#### **J. Concealment or Fraud**

We do not provide coverage to an "insured" who, whether before or after a loss, has:

1. Intentionally concealed or misrepresented any material fact or circumstance;
2. Engaged in fraudulent conduct; or
3. Made false statements;  
...relating to this insurance.

HO 00 05-Homeowners 5-Comprehensive Form

## **PERSONAL AUTO POLICY CONDITIONS**

### **FRAUD**

We do not provide coverage for any "insured" who has made fraudulent statements or engaged in fraudulent conduct in connection with any accident or loss for which coverage is sought under this policy.

\* \* \*

## **TERMINATION**

This policy may be cancelled during the policy period as follows:

\* \* \*

3. After this policy is in effect for 60 days, or if this is a renewal or continuation policy, we will cancel...:

\* \* \*

- c. If the policy was obtained through material misrepresentation.

PERSONAL AUTO PP 00 01 01 05

## **BUSINESS AUTO CONDITIONS**

### **Concealment, Misrepresentation or Fraud**

This Coverage Form is void in any case of fraud by you at any time as it relates to this Coverage Form. It is also void if you or any other "insured", at any time, intentionally conceal or misrepresent a material fact concerning:

- a. This Coverage Form;
- b. The covered "auto";
- c. Your interest in the covered "auto"; or
- d. A claim under this Coverage Form.

COMMERCIAL AUTO CA 00 01 03 06

The actual insurance application also contains a warranty statement which the insured must sign. The following is an excerpt from most standard insurance applications.

## **INSURANCE APPLICANT'S STATEMENT**

I HAVE READ THE ABOVE APPLICATION AND ANY ATTACHMENTS. I DECLARE THAT THE INFORMATION PROVIDED IN THEM IS TRUE, COMPLETE AND CORRECT TO THE BEST OF MY KNOWLEDGE AND BELIEF. THIS INFORMATION IS BEING OFFERED TO THE COMPANY AS AN INDUCEMENT TO ISSUE THE POLICY FOR WHICH I AM APPLYING.

In order for an insurance company to void a policy on the basis of fraud, it must establish that the policyholder swore falsely, made material misrepresentations, or concealed material information relating to the insurance or a claim submitted under the policy.

### **What is a Material Misrepresentation?**

The test for the materiality of a misrepresentation is not whether the insurance company could have charged a greater premium but for the misrepresentation. Instead, the test is whether the policy application would have been outright rejected had the true facts been known.

### **FRAUD OR CONCEALMENT IN THE APPLICATION**

Insurance companies have the ability to deny coverage if they can establish that the insured misrepresented or concealed information on the initial application for insurance or during a subsequent claim.

#### **Misrepresentation of Value or Exposure**

An intent to deceive or defraud the insurance company can be inferred when the insured knowingly misrepresents the value of property on the basis of the theory that everyone is presumed to intend the natural consequence of his own deliberate acts.<sup>1</sup>

Oftentimes policyholders will attempt to use a deflated or underestimated replacement value in order to save premium. This is particularly true where the insurance company provides guaranteed replacement cost coverage, agreed value settlements, or blanket coverage limits. The insurance company will usually require the insured to sign a Statement of Values form at the time of application warranting that the values are accurate. The insured must typically sign the following statement:

ALL VALUES AND LOCATION INFORMATION ARE CORRECT TO THE BEST OF MY KNOWLEDGE AND BELIEF.
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The policyholder can also be required to give a sworn statement after a loss where the insured testifies that the insured values and location information were accurate to the best of their belief.

<sup>1</sup> *Stebane Nash Co. v. Campbellsport Mut. Ins. Co.*, 27 Wis. 2d 112, 133 N.W.2d 737, 16 A.L.R.3d 760 (1965), *Raley v. Terrill*, 253 Iowa 761, 113 N.W.2d 734 (1962).

Any attempt by the policyholder to overestimate or underestimate the insured values in order to take advantage of the insurance company through reduced premiums or an inflated loss settlement will likely be interpreted as fraud and result in the insurance carrier voiding all coverage.

Similarly, an insurance company will also deny coverage if the insured misrepresents any material fact related to the extent of the insured exposure. For example, failing to disclose household members, drivers, occupancy, or criminal records could allow the insurance company to deny coverage.

### **Supporting Cases**

The following cases illustrate those circumstances where insurance companies have denied coverage on the basis of misrepresentation, concealment or fraud.

#### **Who resides in your household?**

In ***Manier, et al. v. MIC Gen. Ins. Co.***, the insurance company denied coverage under an auto policy because the insured misrepresented her son's address. The insurer was able to retroactively reform the policy to reflect the son's actual address and then enforced a household-related exclusion.

Of course, some insureds have tried to argue that the insurance company could have discovered the misrepresentation through inspection, appraisal or audit. Courts have rejected this argument. In ***Hammoud v Metropolitan Prop & Cas Ins Co***<sup>2</sup>, the Court held that an insurer does not owe a duty to the insured to investigate or verify an applicant's representations or to discover intentional material misrepresentations.

In ***State Farm Mutual Automobile Ins. Co. v. Wilson, et al.***, the policyholder failed to disclose the presence of an uninsurable driver with a lengthy history of traffic offenses who lived in the insured's household. When the undisclosed driver was involved in an accident, the insurance carrier denied coverage. The court determined that the insured

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<sup>2</sup> 222 Mich App 485, 489; 563 NW2d 716 (1997).

misrepresented the facts about who was living in her household, and therefore the insurance company was permitted to void the policy.

**Whether the misrepresentation was easily ascertainable by the insurance company is irrelevant.**

In *Lake States Ins. Co. v. Wilson, et al.* the insured misrepresented in her application that she was the only driver and household resident. In fact, there were five other people living in the house. Later, the insurance carrier sent a written request for information about all persons in her household. The policyholder again indicated there was no one else in the household. One of the undisclosed residents was injured in a car accident and applied for PIP benefits through the subject auto insurance policy. The insurance company denied coverage on the grounds that the policyholder concealed household members and that one of the undisclosed household members had previously been convicted of drunk driving. The insurance company argued that it would not have written the policy had it known that the undisclosed individuals resided in the household.

In *Zeer v. Lake States Ins. Co., et al.*, the insurer denied coverage where the insured made material misrepresentations in the insurance application regarding his driving record, other drivers in the household and their driving records. The policyholder indicated that he and his wife were the only household drivers and that they had no moving violations within the last three years.

However, the insurance company was later able to establish that the policyholder had a number of children living in household, that they drove the insured vehicle, and that all but one of residents had incurred moving violations within the last three years.

### **Have you had any claims or losses?**

In *Echols v. Indiana Ins. Co.*, the plaintiff incorrectly answered “no” to the question on the application regarding whether he had ever filed a “loss” before. In fact, the insured had previously filed several claims for stolen automobiles. When the insured then filed a new claim alleging that his vehicle was stolen, the insurance company denied the claim on the basis of the misrepresentation.

**In Michigan, a material misrepresentation made in an application for insurance entitles the insurer to rescind the policy.**

**It does not matter whether the misrepresentation was innocent or intentional; the only thing that matters is whether the insurance company relied on the misrepresentation.**

*Vernor's Dollars Discount, Inc. v. Fremont Mut. Ins. Co.* involved an insured's failure to disclose claim history. In that case, the application stated that the insured had not had a loss within the previous three years. After a fire, the insurance company refused to pay the claim on the grounds that the insured failed to disclose prior claims incurred by the insured under a separate legal entity. The court agreed with the insurance company and ultimately agreed with the coverage denial.

In *American Guarantee & Liability Ins. Co. v. The Jaques Admiralty Law Firm, P.C., et al.*, the insurance company denied coverage under a malpractice insurance policy based on material misrepresentations regarding whether any insured "was aware of any claim, incident, act or omission in the last year which might reasonably be expected to be the basis of a claim or suit, arising out of the performance of professional service for others." In this case, the policyholders were aware that their deceased founding partner allegedly embezzled funds belonging to clients and they were aware of potential liability.

The court agreed with the coverage denial and held that a reasonable underwriter would have regarded the misrepresentations as sufficient grounds for rejecting the risk. The coverage denial was appropriate.

### **Is the structure occupied?**

In *Nolan v. Nationwide Mutual Fire Insurance Co.*, the plaintiff sought insurance coverage for property damage to her home as a result of a fire. While investigating the fire, the insurance company suspected that the insured had made misrepresentations in the application regarding occupancy. Subsequent depositions of the insured, the insurance agent and the loss adjuster revealed that the insured had not moved into the residence, but only planned to move into the residence in the future, which was contrary to the statement on the application that the premises were



currently “owner occupied” by a family of four persons with thermostat-controlled central heat. The court also held that the insurance company did not have to show that the misrepresentation was intentional nor did they have a duty to investigate to determine if the representations were correct.

**Courts do not distinguish between intentional and unintentional misrepresentations.**

In *Nolan*, the court also determined that the policyholder did not advise the agent that the premises had no central heat thermostat which was also contrary to her statement on the application

### **What if my employee completes the application?**

In *NCMIC Ins. Co. v. Dailey, et al.*, the insurer was entitled to rescind its professional malpractice policy based on the insured’s intentional misrepresentation in the application. In addition, the insurer was entitled to seek restitution for certain claims it had already paid. In this case, the policyholder’s employee had made intentional misrepresentations in the insurance application.

**Statements made by an employee in completing an insurance application are binding on the policyholder even if they were a material misrepresentation.**

Although the company owner admitted signing the insurance application, he indicated that after he signed the application he specifically told the employee “You can’t submit this, and I don’t want you to do this.” Dailey averred in his later affidavit, “I told (her) that I could not sign those boxes and initial them because such statements would not be accurate [if signed].”

The evidence established that the employee submitted the inaccurate insurance application despite the owner’s specific instructions not to submit it. Further, the application was submitted in a form that, on its face, suggested that the owner had initialed the statements.

The employee’s intent can be imputed to the policyholder, regardless of whether the owner personally intended to misrepresent facts in the

application. Thus, the policyholder is bound by all conditions in the insurance policy, including the fraud and misrepresentation condition. Accordingly, in light of the intentional misrepresentations of defendants' agent, the insurance company was correct in its decision to seek rescission of the policy.

**“But I did not make the misrepresentation because my agent prepared the application.”**

In *Montgomery v. Fidelity and Guaranty Life Ins. Co.*, the court held that a plaintiff can not argue that they failed to read the policy or they simply signed an application that the agent prepared on their behalf.

**Failure to read the policy is not a defense to a material misrepresentation in an insurance application.**

**Statements made by your insurance agent in preparing an insurance application are binding on the policyholder even if it contained a material misrepresentation.**

### **Do you have a valid drivers' license?**

In *General Motors Acceptance Corp. v. Titan Ins. Co., et al.*, the insurance company denied coverage based on the insured's material misrepresentation regarding the status of his driver's license at the time he applied for insurance.

The insurance company was able to show that the policyholder's driver's license was suspended when he applied for insurance coverage. The insurance company denied coverage on the basis of the misrepresentation.

### **How is your driving record?**

In *Burton v. Metro. Property and Casualty Ins. Co.*, the insured's application misrepresented the details of his driving record and prior insured status. The insurance company subsequently denied coverage when the insured filed a theft and vandalism claim. The insurance company provided evidence that it would not have issued the policy had it known about the prior driving infractions. The insured party argued that the misrepresentations were innocent because he disclosed his record to an

agent who failed to incorporate it into the application, and because his prior policy lapsed without his knowledge. **However, even innocent misrepresentations permit rescission when, as in this case, there is reliance on the misrepresentations.**

In ***Auto Owners Ins. Co. v. Johnson, et al.***, the policyholder intentionally misrepresented to the insurance company that he had not been involved in any accident or been convicted or paid a fine for any moving violation in the last three years.

It was later determined that the insured had been involved in a collision the day he applied for insurance. When the insured later submitted a claim for liability defense coverage, the insurance company rescinded the policy and declared it *void ab initio* (void from the beginning) in light of the material misrepresentation.

***Hammoud v Metropolitan Prop & Cas Ins. Co.*** involved a misrepresentation about the identity of the driver of the vehicle covered by a no-fault insurance policy. The plaintiff was the owner of the insured vehicle but, to save money, he allowed his older brother to obtain the necessary insurance by failing to disclose the owner's status as a driver of the vehicle.

### **Do you have any alcohol-related offenses?**

In ***Brisboy v. Farm Bureau Ins. Co.***, the insured stated in her application that she had no alcohol-related traffic offenses within the previous 36 months. In fact, she had an alcohol-related conviction within the last 36 months even though the citation originated more than 36 months from the date of the application. When the policyholder submitted a claim for damage to her vehicle, the insurance carrier voided all coverage on the basis of the misrepresentation.

In ***Legel, et al. v. American Community Mutual Ins. Co.***, the insured indicated on the insurance application that he had never been treated or arrested for the use of alcohol or narcotics. Yet, he had been convicted of operating a vehicle while under the influence of alcohol and possession of drug paraphernalia before he filled out the application. Further, he had undergone substance abuse counseling as a condition of his sentence. Based on the insured's misrepresentation, the insurance company refused to provide coverage and canceled the policy.

## Who is the primary driver?

In ***Farmers Insurance Exchange v. Anderson, et al.***, the policyholder applied for motor vehicle insurance coverage and represented herself as the primary driver of the subject vehicle. She did not disclose that her son would actually be the primary driver of the vehicle. In fact, her son was an unlicensed driver and ineligible for motor vehicle insurance. He was intoxicated and driving the vehicle when the collision occurred. The policyholder misrepresented in her application that she was the primary driver of the vehicle. When the insured later submitted a claim, the insurance company denied coverage based on her material misrepresentation and that the policy was void *ab initio*.

## MISREPRESENTATIONS, FRAUD OR CONCEALMENT IN A CLAIM

Coverage denials can also occur if the insurance company determines that the insured made any misrepresented or concealed information during the claim process.

In ***Jones v. Auto Club Group Ins. Ass'n.***, the policyholder made a material misrepresentations in her claim for wage loss benefits under her automobile policy. The policy indicated that coverage would be denied if there were any misrepresentations relating to a claim for which coverage is sought under this policy. A fraud and concealment provision allowed the insurance company to void coverage as a result of the misrepresentation in connection with the insured's claim.

In ***Martin v. Farm Bureau General Ins. Co. of Michigan***, the insurance company denied all coverage where the insured made false statements regarding his claim for fire damage to his home. The language of the policy clearly stated that the entire policy was voided if the insured concealed or misrepresented material facts, engaged in fraudulent conduct, or made false statements relating to a loss to which the insurance applied.

In ***Home Owners Ins. Co. v. Selfridge***, the insurer denied coverage where the policyholder made a misrepresentation during a liability claim. The case arose from severe burns suffered policyholder's grandchild during a family Christmas celebration. The child was injured when he pulled or tipped over a large coffee urn, spilling hot coffee over his upper body. The homeowner's insurance carrier provided personal liability coverage for

injury suffered by third parties. The grandchild, through his parents, filed suit against the homeowner seeking to recover damages for Porter's injuries. The insurance company sought a declaration that the policy was void, based on collusion by the parties or because the policyholder made material misrepresentations of fact or circumstances during the claim. Once it was determined the policyholder made false statements, the entire policy became void and the severability of insureds provision clause was of no effect.

## **CONCLUSION**

Insurance companies are quick to deny claims if there is any indication that insured misrepresented or concealed information during the application or claim process. Insureds should be as accurate as possible when completing insurance documents and maintain a record of all supporting information such as appraisals, balance sheets, and inventories in order to substantiate their representations.

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