CHAPTER 1

John W. Blancett and Katelin O’Rourke Gorman

Policy Issuance

Introduction

In today’s climate, marked by an increase in regulatory enforcement suits and merger-related litigation against corporate directors and officers, Directors and Officers (D&O) Liability Insurance is more important than ever. The D&O policy application process marks the beginning of the relationship between an insurer and its potential insured.

Applications for D&O coverage typically include questions about the insured’s then-present knowledge of demands and lawsuits (i.e. “claims” as defined in any given policy) or circumstances that may give rise to a “claim” during the D&O policy period and trigger coverage thereunder. Along with an application, an insurer may require the insured to also submit copies of its most recent financials or annual reports. To the extent an insured fails to disclose a known claim or circumstance, or submits inaccurate or incomplete financials or annual reports, coverage may be barred. Depending on the application and policy wording, an insurer may be entitled to either: (a) disclaim coverage for any claim arising out of material facts the insured failed to disclose (and retain the premium) or (b) rescind the policy based on the insured’s failure to disclose material facts (and return the premium). Yet another outcome might be that disclaimer is warranted only as to the individual who had knowledge, but not as to any other insureds under the D&O policy. Close attention should be paid to the representations and severability language in both the application and the policy.

A. Application (New and Renewal); Incorporation of Additional Materials

If an insurer discovers it relied on misrepresentations during the application process, the insurer may consider rescinding the insurance policy issued. A frequent question in such instances is whether documents accompanying an application are considered a part of it, especially when the documents were not physically attached to the application. May an insurer rescind a renewal policy if the renewal application incorporates the information, including misrepresentations, of the original policy application? In some instances, the answer is yes; other times, no. May an insurer rescind a policy due to misrepresentations in financial statements incorporated into the policy application though not actually attached to it? Again, in some instances, yes; other times, no.

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2 Chapter 1

**United States Liability Insurance Company v. Kelley Ventures, LLC, No. 14-62840-CIV, 2015 WL 5827903 (S.D. Fla. 2015).** The insurer sought rescission based on the insured’s material misrepresentation that no entity or person for the proposed insurance was aware of any fact, circumstance, or situation that may result in a claim in a policy application. Before applying, the insured received multiple notifications from a member of its LLC threatening suit and demanding payment of a cash distribution. After the policy was issued, the insured received further correspondence containing a complaint, which was subsequently filed in Florida state court. The insurer attempted to rescind the policy and moved for summary judgment. The court denied the motion, finding a dispute of fact as to whether the insured materially misrepresented in the policy application because it was unclear whether the prior notifications were directed at the insured or a related, uninsured entity.

**SavaSeniorcare, LLC v. Beazley Insurance Company Inc., 309 F.R.D. 692 (N.D. Ga. 2015).** The insurer claimed it would not have provided D&O coverage to SavaSeniorcare, LLC had it received all information known to two individual insureds (Grunstein and Forman) at the time of application submission. The insurer moved to amend its answer to assert a counterclaim for rescission and additional affirmative defenses, which the insured opposed. Applying Georgia law, the court held that it “cannot conclude that allowing amendment of the answer to assert Beazley’s affirmative coverage defenses and rescission claim would be futile.”

**Continental Casualty Co. v. Piggly Wiggly Alabama Distributing Co., Inc., No. 2:13–cv–00607, 2015 WL 4426030 (N.D. Ala. 2015).** The court noted an insurer, under certain circumstances, may be entitled to rescind a renewal insurance policy based on misrepresentations that are made during the negotiations for its original insurance application. The plain language of Alabama’s statute states that misrepresentations made in “negotiations” for an insurance policy may serve as the basis for rescission.

**TIG Insurance Co. of Michigan v. Homestore, Inc., 40 Cal. Rptr. 3d 528 (Cal. Ct. App. 2006).** The insurer issued an excess D&O policy, relying on the falsified financial report, and later sought to rescind the policy following the filing of criminal and civil suits against the insureds. Applying California law, the court ordered rescission, concluding that the grossly misrepresented financial report “was material to the acceptance of the risk as a matter of law.”

**National Union Fire Insurance Co. of Pittsburgh, Pa. v. Xerox Corp., 792 N.Y.S.2d 772 (N.Y. Sup. Ct. 2004), aff’d, 807 N.Y.S. 2d 344 (N.Y. App. Div. 2006).** An excess insurer sought to rescind its policy under New York law based on its alleged reliance on the insured’s fraudulent financial statements. The court ruled in the insured’s favor because the complaint failed to plead that the insured induced the insurer to rely on the financial statements. The insured had not submitted any application for coverage. Therefore, the insurer could not demonstrate reliance upon the financial statements not part of the application.

**ClearOne Communications, Inc. v. Lumbermens Mutual Casualty Co., No. 2:04-CV-00119, 2005 WL 2716297 (D. Utah Oct. 21, 2005), aff’d, 494 F.3d 1238 (10th Cir. 2007).** Applying Utah law, the court held that an insurer was entitled to rescind a D&O policy issued based on material misrepresentations made in financial statements during the negotiation of coverage. The application at issue provided that “[a]ll written statements and materials furnished to the insurer in conjunction with this application are hereby incorporated by reference into this application and made part hereof.”
In this instance, the insurer specifically asked for the insured’s financial statements, and the insured’s broker directed the insurer to pull all pertinent documents from the Internet. The insurer established that it had carefully considered the insured’s financial statements, which were subsequently restated.

*Federal Insurance Co. v. Homestore, Inc.*, Nos. 03-55995, 03-55996, 2005 WL 1926483 (9th Cir. Aug. 12, 2005). Applying California law, insurers were entitled to rescind D&O policies due to misrepresentations made in SEC filings submitted with an application for coverage. The policies made clear that the information and statements in the application, as well as materials submitted to the insurers, would be considered attached to and part of the application, that this information was the basis of the policy, and that it was considered as incorporated and constituting a part of the policies.

*Cutter & Buck, Inc. v. Genesis Insurance Co.*, 306 F. Supp. 2d 988 (W.D. Wash. 2004), *aff’d*, No. 04-35218, 2005 WL 1799397 (9th Cir. 2005). Applying Washington law, an insurer was entitled to rescind the policy even though false financial documents submitted by the insured were not physically attached to either the application or the policy. The language of the policy and application confirmed that all submitted materials were part of the application and that they would be relied upon.

*In re Healthsouth Corp. Insurance Litigation*, 308 F. Supp. 2d 1253 (N.D. Ala. 2004). Excess insurers sought to rescind coverage under D&O policies, alleging that the insured used materially false and misleading financial information to procure coverage. The primary insurer had issued policies to the insured company since September 1993. However, the insured had not been required to submit an application for the policy at issue, and had not submitted applications for coverage since 1994. Under Alabama law, the primary policy’s severability clause narrowed the basis for rescission to representations made in the written application. The insurers could not claim reliance upon financial information not mentioned in the application or the policy. Notably, however, one of the excess insurers was allowed to proceed with its rescission efforts because the wording of its policy confirmed that it was relying on all statements and information provided, including financial documents obtained from the insured or from public sources.

*American International Specialty Lines Insurance Co. and National Union Fire Insurance Co. of Pittsburgh, Pa. v. Towers Financial Corp.*, 198 B.R. 55 (S.D.N.Y. 1996). The court allowed rescission of a D&O policy because the insured had materially misrepresented its financial situation in the insurance application. The application required that the insured provide its latest annual report and financial statements, and also confirmed that these documents were “hereby incorporated by reference into this application and made part thereof.”

*International Insurance Co. v. W.P. McMullan Jr.*, No. J84-0760(W), No. J84-0760, 1990 WL 483731 (S.D. Miss. 1990). Following the collapse of a Mississippi bank, the FDIC filed claims against the bank’s D&O insurer. The insurer sought to rescind a renewal policy on the basis of misrepresentations and omissions regarding self-dealing by the bank’s chairman and concerns regarding the bank’s solvency. On behalf of the bank, its chairman apparently included detailed financial disclosures about the bank in a “long-form” application submitted with the original policy. The bank’s application for the renewal policy merely required a “short-form” application that did not request the financial information. The FDIC argued that, in issuing the renewal policy, the insurer could not have relied on the financial information con-
tained in the application for the original policy because the renewal application did not ask for the same representations as the original application. The court rejected this argument; the renewal application stated both proposals were to be considered as the basis for the contract, the renewal application incorporated the representations in both the renewal and original applications.

B. Policy Exclusions for Claims or Circumstances Known by the Insured at the Inception of Coverage

An insurer may be entitled to exclude from coverage claims or circumstances about which the insured knew before the policy incepted, but failed to disclose. Liability policies typically contain exclusions for acts the insured knew or reasonably believed would result in a claim under the policy. An insurer may prefer exclusion of coverage to rescission because it enables the insurer to retain the premium and preserve its relationship with the insured, allowing the policy to continue as to other claims.

1. Claims Arising from Known, Disclosed Information

Clark School for Creative Learning, Inc. v. Philadelphia Indemnity Insurance Co., 734 F.3d 51 (1st Cir. 2013). An insured brought this appeal to compel coverage of the costs and settlement of a claim arising from circumstances disclosed to the insurer in the application. The policy contained a provision regarding policy exclusions for known circumstances relating to the financial statements, specifically those that ultimately led to the claim at issue. The court affirmed the district court’s decision in favor of the insurer. The plain language of the “Known Circumstances Exclusion” allowed the insurer to exclude the insured’s claim from coverage.

F/H Industries, Inc. v. National Union Fire Insurance Co. of Pittsburgh, Pa., 635 F. Supp. 60 (N.D. Ill. 1986), vacated in part, 116 F.R.D. 224 (N.D. Ill. 1987). An application for D&O insurance asked whether any of the applicant’s directors or officers knew of any act, error, or omission that might give rise to a claim under the proposed policy. In the application, the insured disclosed circumstances that could have, and ultimately did, give rise to a claim. The insurer denied coverage for the claim under a provision of the application that stated “if such knowledge or information exists any claim or action arising therefrom is excluded from this proposed coverage.” Applying Illinois law, the court concluded that the exclusion unequivocally precluded coverage for claims arising out of known circumstances, whether or not those circumstances were disclosed in the application.

2. Claims Arising from Known, Undisclosed Information

Admiral Insurance Co. v. SONICblue Inc., No. 07-4185, 2009 WL 2512197 (N.D. Cal. 2009). Failure to disclose a letter from a state investment board warning that the conduct of certain D&Os amounted to a breach of their fiduciary duties that might result in litigation constituted a material misrepresentation in policy application entitling insurer to rescission of the policy.

In re Healthsouth Corp. Insurance Litigation, 308 F. Supp. 2d 1253 (N.D. Ala. 2004). Under Alabama law, an insurer can rescind a policy or exclude specific coverage if the insured made misstatements or omissions in the policy application or during negotiations relating to the issuance of the policy.
Policy Issuance

Federal Deposit Insurance Corp. v. Duffy, 47 F.3d 146 (5th Cir. 1995). Pursuant to Louisiana’s direct action statute, the FDIC sued a law firm and its professional liability carrier to recover judgments entered against the firm for malpractice and breach of fiduciary duty in connection with its representation of a savings and loan. The insurer sought to void the policy given material misrepresentations in the application. The application inquired about prior acts that the insured believed might fall within the scope of the proposed coverage. The insurer claimed, because a judgment for malpractice and breach of duty had been entered against a partner of the law firm, the applicant (defined as all lawyers in the firm) was aware of prior acts that might lead to a claim. The district court held that the policy was void because the law firm did not disclose the prior acts in the application. The Fifth Circuit affirmed.

National Union Fire Insurance Co. of Pittsburgh, Pa. v. Federal Deposit Insurance Corp., No. 03A01-9405-CH-00179, 1995 WL 48462 (Tenn. Ct. App. Feb. 8, 1995). A bank president signed an application for D&O insurance stating that, to the best of his knowledge, no director or officer had “knowledge or information of any act, error, or omission which gives rise to a claim under the proposed policy.” The application also provided that any claim or action arising from such knowledge would be excluded. The insurer denied coverage for regulatory claims on the basis of the applicant’s failure to disclose the massive undercapitalization of the failed bank. The FDIC challenged the denial of coverage as the bank’s receiver. The FDIC contended that there was no misrepresentation because the president had no personal knowledge of any misstatements. The court disagreed. In the application, the president represented he had inquired into the truthfulness of all statements. Because many D&Os knew of the facts giving rise to the claim, the president had made misrepresentations on behalf of the bank in the policy application. Further, even if the president had no personal knowledge of the bank’s condition, the application excluded any claim about which any director or officer had knowledge or information.

National Union Fire Insurance Co. of Pittsburgh, Pa. v. Continental Illinois Corp., 643 F. Supp. 1434 (N.D. Ill. 1986). Insurers sought to disclaim D&O coverage for numerous stockholder derivative actions alleging that the renewal applications falsely asserted that the insured had no knowledge of circumstances likely to result in claims. Pursuant to an assistance agreement, the FDIC brought a motion for judgment on the pleadings on behalf of the insured. Applying Illinois law, the court granted the FDIC’s motion. The original application for coverage was submitted in 1969 and later supplemented in 1981. Because the supplemental application simply incorporated the 1969 application by reference and did not require the insured to disclose circumstances that could give rise to claims after 1969, the court found that the insured was required only to reaffirm the truth of the statements in its 1969 application. The insured had no obligation to disclose later circumstances that suggested a potential claim.

Axis Reinsurance Co. v. Bennett, Nos. 07-7924, 08-3242, 2008 WL 2485388 (S.D.N.Y. June 19, 2008). Insurers sought to disclaim D&O coverage on several bases, including the CEO’s failure to answer an application question asking whether any proposed insured was “aware of any fact, circumstance or situation involving . . . any Insured Person . . . which he has reason to believe might result in a claim being made.” The court found that the insurer’s issuance of the policy constituted a waiver to any objection to coverage based on the officer’s failure to answer because the insurer did not challenge the omission of an answer to this question.
LA Sound USA, Inc. v. St. Paul Fire & Marine Insurance Co., 67 Cal. Rptr. 3d 917 (Cal. Ct. App. 2007). The insured’s false denial of a specific application question regarding its participation in a joint venture entitled the insurer to rescind the policy, despite the insured’s contention that the misrepresentation was immaterial, unintentional, and resulted from broker error. An insurer’s demand for answers to specific questions in an application for insurance is, in itself, sufficient to establish materiality. Further, misstatement or concealment of material facts on an insurance application is grounds for rescission, even if unintentional.

C. Rescission

1. General Considerations

Generally, state common and/or statutory law permits an insurer to rescind an insurance policy based on the insured’s misrepresentation or omission of a material fact. An insurer who wishes to rescind a policy has the burden to prove that there has been a misrepresentation, that the misrepresentation was material, and that it relied on the misrepresentation in issuing the policy. In most states, an insurer is not required to show that the insured had fraudulent intent. However, some states may require that an insurer show a warranty by the insured, as to the truth of the information provided, before that insurer may rescind on the basis of an innocent misrepresentation.

To establish materiality, an insurer must prove that, had it known the truth, it would not have issued the policy on the same terms and conditions, or for the same premium. Thus, an insurer need not prove that it would not have issued a policy at all absent the misrepresentation or omission, but rather that it would not have issued the policy on the same terms, had it known the truth.

In general, an insurer is not required to investigate the information provided by an applicant. However, there are exceptions. If an insurer knows of information that would put a prudent person on notice that further inquiry is likely needed to reveal the truth; the insurer must investigate.

Unencumbered Assets Trust v. Great American Insurance Co., 817 F. Supp. 2d 1014 (S.D. Ohio 2011). Due to extensive publicity about the falsification of one company’s financial statements and its subsequent collapse into bankruptcy, the court ruled that a genuine issue of material fact existed as to whether the insurer knew this information at the time that it accepted payment for an additional period of coverage, and thereby waived its right to rescind the policy.

Scottsdale Insurance Co. v. Wave Technologies Communications, Inc., 341 F. App’x 569 (11th Cir. 2009). The insurer filed suit seeking a declaration allowing it to rescind its general liability insurance policy because the insured had made material misrepresentations on its application. The insured allegedly misrepresented that its business operations did not involve digging or use of heavy equipment. The insurer stated that it would have charged a substantially higher premium or not issued the policy at all had it known. The insured argued that the insurer was barred from rescinding the policy because they had failed to investigate the representations on the application after conducting a liability survey that revealed facts suggesting the need for further investigation. The trial court granted summary judgment in favor of the insurer. On appeal, the Eleventh Circuit vacated and remanded, noting that an inten-
Policy Issuance

An applicant of a material fact allows the insurer to void a policy under Florida law. However, the panel held that if the insurer “has sufficient indications that would have put a prudent man on notice and would have caused him to start an inquiry which, if carried out with reasonable thoroughness, would reveal the truth, he cannot blind himself to the true facts and choose to ‘rely’ on the misrepresentation.”

*Napoliello v. Metropolitan Life Insurance Co.*, No. 05-5534, 2008 WL 2557540 (D. N.J. 2008). The insurer rescinded a life insurance contract claiming the deceased insured had failed to disclose past malignant melanomas in a renewal application. The deceased insured’s beneficiaries filed suit, seeking payment in full under the policy. The beneficiaries contended that the deceased insured’s treatment for melanoma was disclosed in his application for the previous policy, and therefore the insurer had knowledge of conflicting information, triggering its duty to investigate the insured’s medical history. Applying New Jersey law, the court granted the insurer’s motion for summary judgment, concluding that, because the present application stated that it would be the only basis for coverage, the insurer had no duty to review its files to identify and assess information in prior insurance applications: “the fact that [the insurer] had the capacity to discover the truth on its own does not cure the misrepresentations made on [the insured’s] application.”

*Saint Calle v. Prudential Insurance Co.*, 815 F. Supp. 679 (S.D.N.Y. 1993). Generally, an insurer may rely on facts disclosed in the application and is not required to independently investigate the veracity of those facts. The court held that an auto insurer that relied on the insured’s representations was entitled to rescind a policy even though a background check would have revealed the insured’s poor driving history.

*Christiania General Insurance Corp. v. Great American Insurance Co.*, 979 F.2d 268 (2d Cir. 1992). Under New York law, an insurer may rescind a policy or exclude a claim both where the insured affirmatively misrepresents a material fact in an application or where it fails to disclose material information.

*Mutual Benefit Life Insurance Co. v. JMR Electric*, 848 F.2d 30 (2d Cir. 1988). Under New York law, an insurer may rescind a policy of insurance if it can be established that the insurer would have issued the policy at a higher premium if the truth had been revealed. Further, an insurer is not required to establish an intention to deceive because even an innocent misrepresentation can justify rescission under New York law.

2. Misrepresentations Deemed Sufficient to Justify Rescission

An insured is on notice that a fact is material to an insurer if the insurer specifically inquires about that fact. Materiality is determined as of the time the policy was issued.

*Kurtz v. Liberty Mutual Insurance Co.*, No. 2:11-CV-7010 (C.D. Cal. 2014). The insurers were entitled to rescind their policies due to material misrepresentations of fact in the insured’s insurance application—the insured’s misrepresentation regarding commingling client funds with its operating expenses in its insurance application was false on a material point. The court applied a subjective standard to reach this conclusion and examined the effect of the misrepresentation on the insurers’ evaluation of the risk.
Chapter 1

Continental Casualty Co. v. Marshall Granger & Co., LLP, 921 F. Supp. 2d 111 (S.D.N.Y. 2013). An insurer sought to rescind an accounting firm’s professional liability insurance policy because of material misrepresentations made by the signatory. Under New York law, the insurer could be entitled to rescind the policy, but denied summary judgment for the insurer because it had yet to produce files on its underwriting decision for the policy that were necessary to demonstrate that the misrepresentation was material to the insurer’s decision to issue the policy.

Smith v. Pruco Life Insurance Co. of New Jersey, 710 F.3d 476 (2d Cir. 2013). The court held that an insurer was entitled to rescind a health insurance policy based on the insured’s failure to disclose his cancer diagnosis. The application contained an “unchanged health” provision requiring disclosure of any changes in the insured’s health between the date of application and issuance of the policy.

Pettinaro Enterprises v. Continental Casualty Co., 450 Fed. Appx. 178 (3d Cir. 2011). Applying Delaware law, the court held that “in an insurance action, a misrepresentation will be considered material if a reasonable insurance company, in determining its course of action, would attach importance to the facts misrepresented.”

State National Insurance Co. v. Anzhela Explorer, L.L.C., 812 F. Supp. 2d 1326 (S.D. Fla. 2011). The court held that an insurer’s post-issuance conclusory statements as to the materiality of a representation or omission are not enough to establish a material misrepresentation. Instead, the insurer must provide specific evidence that the court may consider under an objective reasonableness standard.

Federal Deposit Insurance Corp. v. Great American Insurance Co., 607 F.3d 288 (2d Cir. 2010). The court held that a matter is “conclusively material” if the insurer made a special inquiry into it. Here, information surrounding the insured’s prior losses was considered material because the insurer made specific inquiries into it.

Carolina Casualty Insurance Co. v. RDD, Inc., 685 F. Supp. 2d 1052 (N.D. Cal. 2010). An employment practices liability insurer filed suit against its insureds, seeking a determination that it was entitled to rescission because the insureds had made material misrepresentations in the application. The day before the insureds submitted the application, they had received a resignation letter from an employee that referred to sexual harassment. Nonetheless, they answered “no” to the questions of (1) whether, in the past five years, any employee had made a claim or otherwise alleged harassment and (2) whether they were aware of any fact, circumstance, or situation that might reasonably be expected to result in a claim. The insureds argued that by answering “no” they had been truthful at the time; it was not until months later, when they had received a Department of Fair Employment and Housing right to sue letter that they became aware that a “former employee” had filed a “claim” against them. The court disagreed, concluding that the insureds made a material misrepresentation: “[The insureds’] narrow interpretation of the word ‘claim’ . . . is amiss. The questions asked Defendants whether any current or past employees ‘made any Claim, or otherwise alleged discrimination, harassment, wrongful discharge and/or Wrongful Acts against any Insured.’ The clear language of the questions obliged Defendants to disclose Lemke’s allegations of sexual harassment, retaliation and infliction of emotional distress. Defendants failed to do so.”

Steadfast Insurance Co. v. Prime Title Services, LLC, No. 07-366, 2008 WL 5216020 (W.D. Mich. 2008). The insurer was entitled to rescind an errors and omissions policy on the ground that the insured title company made a material misrep-
sentation at the time the policy was renewed. It was undisputed that the insured had been engaged in the misappropriation of millions of dollars in escrowed funds for months prior to the policy renewal. The court found that the insured was obligated to disclose these facts (which, he acknowledged, objectively raised the potential for claims against the policy) at the time he sought renewal and that his subjective impression—that he expected no claims to arise because he intended for the misappropriated funds to be replaced—made no difference under Michigan law.

LA Sound USA, Inc. v. St. Paul Fire & Marine Insurance Co., 156 Cal. App. 4th 1259, 67 Cal. Rptr. 3d 917 (2007). An insurance application asked whether the insured had been or was currently involved in a joint venture, and whether it had a labor interchange with any other business. The insured answered “no” to each question, though he had been involved in a joint venture for six months at the time of the application. Applying California law, the court permitted rescission of the policy, despite the insured’s contention that the disclosure was inadvertent: “according to the [California] Insurance Code, case law, and leading commentary, [c]oncealment, whether intentional or unintentional, entitles the injured party to rescind insurance.”

The Unencumbered Assets Trust v. Great American Insurance Co., No. 04-908, 2007 WL 2029063, 2007 U.S. Dist. LEXIS 49711 (S.D. Ohio 2007). An insured brought an action to recover proceeds under a D&O policy. The insurer counter-claimed for rescission, alleging that the policy had been procured by fraud because the insured had indicated that the company and its affiliates were not contemplating bankruptcy or reorganization during the next 12 months, despite knowing that the company was insolvent. The court allowed the claim of rescission regarding insolvency to proceed. The insurer’s proposal form stated that representations made in the proposal form were material and that the insurer would issue the policy in reliance on the truth of the representations made therein.

U.S. Specialty Insurance Co. v. Bridge Capital Corp., 482 F. Supp. 2d. 1164 (C.D. Cal. 2007). A D&O liability insurer filed suit against its insured for a declaratory judgment confirming that certain policies issued were void due to the insured’s failure to disclose previous formal demands for money. The court agreed, concluding that the term “claim” in the application question was unambiguous, and that the insured’s interpretation that this referred only to actual lawsuits was unreasonable under California law.

Northwestern Mutual Life Insurance Co. v. Babayan, 430 F.3d 121 (3d Cir. 2005). An insurer may void a policy under Pennsylvania law if, by clear and convincing evidence, it can establish: (1) the insured made a false representation; (2) the insured knew the representation was false when it was made, or the insured made the representation in bad faith; and (3) the representation was material to the risk being insured.

Minnesota Lawyers Mutual Insurance Co. v. Hahn, 355 F. Supp. 2d 104 (D.D.C. 2004). Under Virginia law, a professional liability policy was properly rescinded because of the insured’s material misrepresentations in the policy application. An insurer seeking to rescind a policy must show: (1) that a statement on the application was false and (2) that the insurance company’s reliance on the false statement was material to the company’s decision to undertake the risk and issue the policy. Here, the insured replied “no” to the questions: (a) “[h]ave any claims been made against the applicant or the applicant’s predecessors in business, or any past or present firm mem-
bers or employees within the past five years?” and (b) “[i]s any firm member aware of any incident that could reasonably result in a claim being made against the applicant, its predecessors or any past or present firm members?” However, after the application was submitted, but before the policy was issued, the insured received a “claim letter” from certain individuals who threatened legal proceedings.

Continental Casualty Co. v. Graham & Schewe, 339 F. Supp. 2d 723 (E.D. Va. 2004). The court held that the insured’s misrepresentations in an application for professional liability insurance were “material,” and provided a basis for the insurer to rescind its policy. The insured law firm stated in its application that it was unaware of any act or omission that “might reasonably be expected to be the basis of a claim” at the time of the application. However, the insured was aware that a former client had been convicted of sexual assault against children, but then was acquitted upon a showing of the firm’s ineffective assistance of counsel. The former client subsequently filed a legal malpractice claim against the insured. Applying Virginia law, the court held the insurer was entitled to rescind the policy based on the insured’s material misrepresentations because the insured was aware of the circumstances that could reasonably give rise to a claim but failed to disclose them in the policy application.

Shipley v. Arkansas Blue Cross and Blue Shield, 333 F.3d 898 (8th Cir. 2003). The Eighth Circuit affirmed the district court’s grant of summary judgment in favor of rescission, finding that the insured made numerous material misstatements in an application for health insurance.

American Guarantee & Liability Insurance Co. v. Jaques Admiralty Law Firm, PC, No. 99-CV-70264-DT, 2003 WL 22077774 (E.D. Mich. 2003). Under Michigan statutory law, an insurer was permitted to rescind a professional liability policy despite the fact the individual who had signed the application believed his answer was truthful when he indicated that the firm’s attorneys were not “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[.]” Upon the death of a named partner, the firm discovered a shortage in the client trust account, which was previously unknown to the signatory of the application, while taking up tasks that the deceased had previously performed. The firm later admitted that the deceased had embezzled funds, removed the funds as a result of a complex scheme, was in complete control of the firm’s cash flow, and wasted and misused the funds from the client escrow account. The court held that, “[e]ven if [the applicant] made the representation innocently, according to Manufacturers Life Insurance Co. v. Beardsley, 365 Mich. 308, 112 N.W. 2d 514 (1961), even a good faith representation made without knowledge of its falsity can serve to void a contract.”

Association of Retarded Citizens–Santa Barbara Council v. North American Specialty Insurance Co., No. 94-4602 (C.D. Cal. 1994), aff’d, No. 94-56745, 1996 WL 343561 (9th Cir. 1996). On July 30, 1992, the insured’s executive director submitted an application for D&O insurance, which represented that (1) the insured had not dismissed any employees within the previous 12 months; (2) no claim had been made against the company or its D&Os; and (3) the insured was not aware of any circumstances that might result in a claim. The application also required the applicant to immediately report any circumstances taking place before the policy began that might affect the truthfulness of any statement made in the application. Contrary to the representations in the insured’s application, the insured had terminated an employee in May 1992 who, upon her termination, had threatened to sue for sexual harassment.
On July 31, 1992, the insured received a settlement demand from this former employee, threatening litigation as an alternative. On August 1, 1992, the insurer issued the policy. The insurer rescinded the policy once the claim was reported. The insured then filed suit, seeking a declaratory judgment confirming coverage under the policy. The court granted summary judgment to the insurer, concluding that the insured had made material misrepresentations in its application. Under the California statute, the insurer was entitled to rescission even if the misrepresentations were unintentional because “concealment, whether intentional or unintentional, entitles the injured party to rescind.”

*Booker v. Blackburn*, 942 F. Supp. 1005 (D. N.J. 1996). A professional liability insurer filed an action to rescind a policy issued to a civil engineer based on intentional misrepresentations made in the application. The insured, as the sole principal, engineer, director, and officer of the firm, submitted an application for a civil engineer’s professional liability insurance policy. In completing the application, the insured failed to disclose his receipt three months earlier of a praecipe alleging defective workmanship. In Pennsylvania, a praecipe, like a summons, is a means of commencing a lawsuit. Upon receiving the complaint in the action commenced by the praecipe, the insured made a claim for coverage under the policy. The court granted summary judgment for the insurer based on the insured’s failure to disclose material information, stating that (1) the filing of a praecipe may constitute a claim against the insured within the meaning of the policy and (2) the omission of the praecipe was material in that it was reasonably related to the insurer’s estimation of the risk or the assessment of the premium. With respect to the insurer’s burden, the court explained that the insurer need only show that the insured’s omission of the material information was knowing rather than an oversight.

*Federal Deposit Insurance Corp. v. Duffy*, 47 F.3d 146 (5th Cir. 1995). A law firm partner signed an application for professional liability insurance, making the representation that “the proposed insured” was unaware of any act, error, or omission that might fall within the scope of the proposed insurance. The application, which was given to each partner before it was given to the insurer, stated that “[t]he applicant declares that to the best of his knowledge of all persons to be insured,” all statements and attachments are true and no material facts have been omitted. The FDIC later sued the firm and the partner for malpractice and breach of fiduciary duty, alleging that the partners encouraged a savings and loan institution to give bad loans to generate more legal fees. The court held the firm liable, finding that the partner had acted dishonestly. The FDIC then sought to recover from the professional liability policy under Louisiana’s direct action statute. The court determined that the policy was void due to the finding of dishonesty under Louisiana law because (1) the application represented the knowledge of all of the firm’s lawyers; (2) the partner knew at the time of the application that he was engaged in dishonest conduct; (3) the application misrepresented that the partner knew of no act, error, or omission that could give rise to a claim; and (4) the partner must have intended to deceive the insurer. The court determined that the partner’s misrepresentations rendered the policy void as to all insured lawyers because the policy did not contain a severability provision.

*First National Bank Holding Co. v. Fidelity and Deposit Co.*, 885 F. Supp. 1533 (N.D. Fla. 1995). A bank director represented that he had no “information of any act, error or omission which might give rise to a claim under the proposed policy” on the bank’s application for D&O insurance—even though he had been engaged in fraudu-
lent activity. The director’s fraud resulted in numerous claims against him, as well as a criminal conviction. Subsequently, the bank’s holding company obtained a $3 million judgment against the director. The insurer denied coverage for the claim asserting that the director’s misrepresentations rendered the policy void ab initio. The holding company sued the insurer, contending that the director had not made any misrepresentations in the application because he had truthfully believed that his conduct would not result in a claim (i.e., that he would “get away with it”). The court rejected the holding company’s argument, reasoning that (1) under Florida law, even an innocent misrepresentation will void a policy if it materially affects the insurer’s risk and that, in any event, (2) the director’s criminal conviction proved that he had knowledge of circumstances that might have resulted in a claim because those circumstances resulted from his own fraudulent activity.

*National Union Fire Insurance Co. of Pittsburgh, Pa. v. Sahlen,* 999 F.2d 1532 (11th Cir. 1993). Under Florida statutory law, misrepresentations and incorrect statements in a policy application bar recovery under the policy if: (1) they are fraudulent; (2) they are material to the risk; or (3) the insurer would not have issued the policy or would have altered the policy’s terms had it known the truth. In this case, an insured attached significantly overstated financial statements to its application for a D&O policy. The court held that the misrepresentations in the financial reports constituted statements sufficient to justify rescission of the policy.

*Monumental Life Insurance Co. v. United States Fidelity & Guaranty Co.,* 617 A.2d 1163 (Md. Ct. Spec. App. 1993), cert. denied, 624 A.2d 491 (table) (Md. 1993). In an application for D&O insurance, an insured denied that any of its D&Os were aware of circumstances that could give rise to a claim under the policy. The insured had received complaints from a competitor accusing it of unfair hiring practices and threatening litigation. The insurer issued the policy and the competitor subsequently sued the insured for their alleged unfair practices. Applying Maryland law, the lower court concluded that any reasonable insured would have known that the competitor’s complaints could result in a claim. Thus, it was held that the misrepresentations rendered the policy void, despite the insured’s assertion that it believed its representation to be true. The appellate court affirmed the lower court’s holding on other grounds.

*McCuen v. International Insurance Co.,* No. 87-54, 1988 WL 242680 (S.D. Iowa 1988), aff’d, 946 F.2d 1401 (8th Cir. 1991). In an application for D&O insurance, officers of a savings and loan (S&L) stated that none of the applicants knew of any circumstances that could give rise to a claim under the policy. The officers also represented that the S&L had not been denied similar insurance. In fact, the officers knew of regulators’ contentions of mismanagement. Further, the officers were aware that the S&L’s prior insurance carrier had offered a policy renewal terms that amounted to a de facto denial of renewal. Applying Iowa law, the court found that the insurer was entitled to rescind the policy because of the officers’ misrepresentations.

*Ratliffe v. International Surplus Lines Insurance Co.,* 550 N.E.2d 1052 (App. Ct. 1990). In an application for trustees’ errors and omissions insurance, a trustee represented that no trustees were aware of prior claims or circumstances that might give rise to a claim against the trusts or trustees. However, at the time of the application, the trust was represented by counsel in a construction dispute in which litigation was threatened. Under Illinois law, a misrepresentation in a policy application will void a policy if it was made with the intent to deceive or it is material to the insurer’s risk. The court stated that “the question in the policy application required the disclo-
sure of any facts which, objectively considered, might have given rise to a claim, despite the applicant’s subjective belief.” The court concluded that the trustee failure to disclose the potential litigation constituted a material misrepresentation because a reasonable trustee would have disclosed the potential claim.

*Chomat v. Spreckley*, No. 86-2215 (S.D. Fla. 1989). While applying for D&O insurance, the D&Os of the insured stated they knew of no act, error, or omission that might afford valid grounds for any future claim. The D&Os later admitted that they were aware of wrongdoing that would have prevented the insurer from issuing the policy. Under the Florida statute, an insurer may avoid liability under a policy where the insured misrepresented or concealed facts and (1) the misrepresentation or concealment was fraudulent; (2) the misrepresentation or concealment was material to the risk; or (3) the insurer would not have issued the policy had it known the truth. The district court granted summary judgment to the insurer, concluding the insured misrepresented facts that would have led the insurer to deny issuance of the policy, had it known the truth.

*Jaunich v. National Union Fire Insurance Co. of Pittsburgh, Pa.*, 647 F. Supp. 209 (N.D. Cal. 1986). During the application process for D&O insurance, the insured failed to disclose all information about potential litigation. The undisclosed potential litigation eventually matured into actual claims under the issued policy. The insurer sought to rescind the policy because the insured failed to disclose all material facts. Under California statutory law, an insured must reveal, with certain exceptions, all facts within its knowledge that are material to the insurance contract. However, an insurer may lose its right to rescission by neglecting to inquire into facts that are “distinctly implied” in other facts the insured has disclosed. The court held that the insurer was entitled to rescind the policy because the insured withheld material facts about the potential litigation, and the insured’s reference to some potential litigation did not “distinctly imply” the existence of the other potential litigation, which the insured did not disclose.

3. Alleged Misrepresentations or Omissions Deemed Insufficient to Justify Rescission

When an insured makes a false affirmative statement or fails to disclose information while under a duty to disclose, an insurer may rescind a policy. However, in the absence of fraud, an applicant is not required to volunteer information that the insurer has not clearly requested. Nevertheless, even if an insurer did not request the information they may still rescind the policy upon a showing that the insured acted with fraudulent intent by omitting information that was clearly relevant to underwriting coverage. The circumstances of such a nondisclosure must amount to fraudulent concealment. In contrast to English law, and except in the context of marine insurance, U.S. courts do not require an insured to disclose all known circumstances that materially affect the risk being insured pursuant to the doctrine of utmost good faith.

*Travelers Casualty & Surety Co. of America v. Mader Law Group, LLC*, 2014 WL 5325745 (M.D. Fla. 2014). An insurer sought to rescind based on alleged incorrect statements made in the application for coverage. The court held that a misrepresentation clause in the policy, which imposed a heightened standard for rescission, trumped a state statute providing a lower standard for rescission. The court held that the parties contracted out of the state standard and denied cross motions for summary judgment.
Chapter 1

_Chism v. Protective Life Insurance Co._, 290 Kan. 645 (2010). Under Kansas law, an insurer may not rescind a policy based upon a negligent misrepresentation or omission, but may do so upon a showing of reckless disregard for the truth.

_ClearOne Communications, Inc. v. National Union Fire Insurance Co. of Pittsburgh, Pa._, 494 F.3d 1238 (10th Cir. 2007). After an insured publicly acknowledged that the previous two years of its financial statements (which had been submitted with the application) were unreliable, a D&O insurer attempted to rescind its policy. Under Utah statutory law, rescission is permitted if there is a misrepresentation or breach of an affirmative warranty that the insurer relies upon and the misrepresentation is either material or made with intent to deceive. Here, the court concluded that the insured’s financial statements were material to the insurer’s decision to issue the policy and that the insurer reasonably relied on them. The appellate court noted that at least one Utah appellate court had construed the term “misrepresentation” to contain a scienter element. Accordingly, the court remanded the case as to the insured’s lack of innocence: “[a]fter reviewing the record and examining Utah law, we agree with the district court that National Union sufficiently demonstrated three elements—misstatement, materiality, and reliance. Nevertheless, we disagree that lack of innocence was established as a matter of law and we therefore remand on that issue.”

_GuideOne Mutual Insurance Co. v. Rock_, No. 06-218, 2009 WL 1854452 (N.D. Miss. 2009). An insurer sought to rescind a homeowner’s policy on the basis that the insured failed to disclose he had previously been convicted of a crime. The court denied summary judgment, noting that there was a factual dispute as to whether the policy application included a question about criminal convictions. However, the court did note that, if the trier of fact ultimately determined that the criminal conviction question had not been asked, the insurer would have no right to rescind the policy under Mississippi law because there was information neither asked for by the insurer, nor volunteered by the applicant: “If the company intends to rely exclusively on the application, it should ask questions tailored to elicit all the information that it needs. An applicant has neither concealed nor misrepresented information when he has answered fully and truthfully all the questions asked of him.”

_Pereira v. National Union Fire Insurance Co. of Pittsburgh, Pa._, No. 04-1134, 2006 U.S. Dist. LEXIS 49263 (S.D.N.Y. 2006). Two D&O liability excess insurers asserted that their policies were void as matter of law because the applicants falsely stated they were “not aware of any facts” that might give rise to a future claim. Citing a pending suit alleging breach of fiduciary duty, the insurers contended that there could be no dispute that the representations were false when made. The court denied the insurers’ summary judgment, stating that there was a disputed material fact as to the insureds knowledge of the existence of any acts that would give rise to claims that would arise under the excess policies: “it is possible that [they] may have believed that any judgment from that action could not have reached [the] excess coverage.” In so concluding, the court noted that the language of the representations focused on the signatory’s state of mind (“we are not aware of any facts”), rather than on the objective state of affairs (e.g., “there are no acts”).

_OmniSource Corp. v. NCM Americas, Inc._, 313 F. Supp. 2d 880 (N.D. Ind. 2004). The insurer sought to rescind a credit insurance policy because of material misrepresentations in the policy application. The insurer alleged that the insured submitted false payment terms between it and its customers, and failed to disclose a past due
account that “caused it concern.” The court, applying Indiana law, held that the policy could not be rescinded without a showing that the data submitted was both false and material to the insurer’s decision to accept the risk or charge a higher premium.

*Home Insurance Co. v. Spectrum Information Technologies,* 930 F. Supp. 825 (E.D.N.Y. 1996). Applying New York law, the court held that no misrepresentation had occurred where an application for excess and renewal D&O coverage did not “plainly require” the insured disclose an “informal inquiry” by the SEC. The SEC had informed the insured that it was conducting “an informal inquiry” into the trading of the insured’s stock. Less than one week later, the insured applied for renewal and excess D&O policies. The application inquired whether the insured was a party to any “civil, criminal or administrative proceeding.” The court found that the insured had no duty to disclose the inquiry because it did not constitute a “proceeding.” The court deemed a “proceeding” to mean something more formal than an “informal inquiry.” Moreover, while the insured did not disclose the existence of the SEC inquiry, it had disclosed the facts underlying the inquiry.

*National Union Fire Insurance Co. of Pittsburgh, Pa. v. Mason, Perrin & Kanovsky,* 765 F. Supp. 15 (D.D.C. 1991). In this case a lawyer, applying for professional liability insurance, denied that any member of the law firm was aware of circumstances that may result in a claim. Charges were later brought against the firm for securities law violations that took place prior to the application, to which two lawyers pled guilty. In light of the charges insurer sought to rescind the policy based on the insured’s alleged misrepresentations. The court, applying District of Columbia law, found material issues of fact as to whether the lawyers knew, at the time of the application, that their acts could give rise to a claim. The court held that the guilty pleas were not preclusive on the issue of the lawyers’ knowledge at time of the application and that the lawyers who did not plead guilty could not be bound by the guilty pleas of others.

*Old Republic Insurance Co. v. Rexene Corp.*, Nos. 10,970, 10,979, 1990 WL 176791 (Del. Ch. 1990). In an application for D&O insurance, the insured denied presently considering, or having considered, any acquisitions, leveraged buyouts, tender offers, or mergers in the past six months. The insured subsequently participated in a merger that led to a D&O claim. Basing its decision on evidence that the insured was exploring the possibility of a merger before the issuance of the policy, the insurer sought to rescind the policy for misrepresentations in the application. Under Texas and Delaware law, to rescind a policy an insurer must show: (1) a false representation by the insured; (2) the materiality of that misrepresentation to the risk; and (3) the insurer’s reliance on the representation. Texas also requires that the misrepresentation be intentional. The court found that the questions in the applications regarding merger plans could be read to refer only to concrete merger plans, not to the exploration of a possible merger. As such, the court found that material issues of fact existed as to whether the insured made material misrepresentations in its application.

### 4. Severability: Whether a Misrepresentation or Omission by One Applicant Will Permit Rescission as to Other Insureds

One of the more difficult issues with rescinding an insurance policy arises in the context of severability. When rescinding a policy as to an insured that has misrepresented, to ensure that underwriting decisions are based on truthful information, an insurer may also strive to protect
“innocent” D&Os from the consequences of rescission. D&O policies typically contain one of following types of severability clauses: (1) a complete severability clause; (2) a partial severability clause that imputes knowledge to the company; or (3) a non-signatory severability clause that imputes only the knowledge of the person signing the application to all. A policy that contains a complete severability clause generally provides that no statement or knowledge possessed by an insured will be imputed to any other insured, and an insurer will be required to rescind the policy as to each separate insured if necessary. Partial severability clauses, providing for imputation to the company, allow an insurer to impute the knowledge of any one person to the insured company, but not to other individuals. Non-signatory severability clauses impute only the knowledge of the person signing the application to all insureds.

a. Severability Permitted to Protect Innocent Insureds

_Evanston Insurance Company v. Agape Senior Primary Care, et al.,_ 2016 WL 192748 (4th Cir. 2016). Despite a false application for professional liability insurance submitted by an applicant pretending to be a doctor, the Fourth Circuit affirmed the district court’s decision that the insurance afforded to the company and other doctors and nurses identified as named insureds under the policy remained in force, and was not void as to the innocent co-insureds.

_TIG Insurance Co. of Michigan v. Homestore, Inc.,_ 40 Cal. Rptr. 3d 528 (Cal. Ct. App. 2006). An insurer issued an excess D&O policy providing that if it became clear that the signer had knowledge of material misrepresentations in the policy, it would be voided in its entirety. The policy also stipulated the denial of coverage to “any non-signing director or officer who knew on the policy’s inception date of the misrepresentations.” Applying California law, the court held that “[t]his distinct right to rescind as to non-signing individuals with actual knowledge of the application’s false representations . . . does not, under any reasonable interpretation of the policy language, restrict [the insurer’s] broader right . . . to rescind the contract as to all insureds in the case of an application actually signed by an officer who had actual knowledge of the false statements.” The court noted the insured “could have purchased a policy with a severability provision,” thus protecting innocent insureds against imputation of the misrepresentation.

_In re Healthsouth Corp. Insurance Litigation,_ 308 F. Supp. 2d 1253 (N.D. Ala. 2004). The court found that the insurers had to limit rescission of fiduciary liability policies to those insureds with the requisite knowledge of the material misrepresentations only. The insured company purportedly concealed the true financial state of the company from investors, among various other acts of wrongdoing. The insurers sought to rescind, asserting that the misrepresentations were material to their decision to enter into the insurance contract. Applying Alabama law, the court held that the relevant severability clause prohibited the insurers from rescinding the policy as to all insureds. It provided that the insured’s application for insurance “shall be construed as a separate application for each of the Insured Persons.” Thus, the court prohibited universal rescission in light of the insurers’ failure to establish that each insured person had knowledge of the company’s purportedly false statements.

_Wedtech Corp. v. Federal Insurance Co.,_ 740 F. Supp. 214 (S.D.N.Y. 1990). The insurer’s D&O policy explicitly stated that “[t]he written application for coverage shall be construed as a separate application for coverage by each of the Insured Persons . . . no statement in the application or knowledge possessed by any Insured Person(s) shall be imputed to any other Insured Person(s) for the purpose of deter-
Policy Issuance

mining the availability of coverage.” Applying New York law, the court determined that this severability provision was designed to protect innocent D&Os; therefore, the policy was void only to D&Os who participated in the fraud that induced the insurer to issue the policy.

*International Insurance Co. v. McMullan, No. J84-0760, 1990 WL 483731 (S.D. Miss. 1990).* A bank’s president represented in a D&O coverage application that none of the bank’s D&Os knew of any act, error, or omission that they had reason to suppose might afford valid grounds for any future claim. He made these representations although he had engaged in self-dealing by purchasing interests in the bank’s loans. Under Mississippi law, the president’s misrepresentations would not be imputed to the bank or to all of the insured D&Os because the president’s interests were adverse to the bank’s when he applied for insurance. The court further concluded that the president’s misrepresentations did not void the policy as to innocent D&Os because (1) the application required the signature of only one director or officer; (2) the application did not require that individual to discuss the application with other directors or officers; and (3) the policy contained a severability clause. The court also found disputed issues of material fact as to whether (1) the president’s self-dealing was material to the insurer’s risk; (2) the insurer waived its rescission argument by renewing the policy or by accepting a premium for the discovery period after it knew or should have known facts giving rise to its rescission claim; (3) the insurer’s rescission claim was barred by laches; and (4) the insurer relied on financial misstatements in the application.

*Atlantic Permanent Federal Savings & Loan Association v. American Casualty Co., 839 F.2d 212 (4th Cir. 1988), cert. denied, 486 U.S. 1056 (1988).* Here, a D&O policy contained a provision that, under Virginia law, prevented a material misrepresentation in an application from voiding coverage to innocent D&Os. The provision stated that “this policy shall not be voided or rescinded and coverage shall not be excluded as a result of any untrue statement in the proposal form, except as to those persons making such statement or having knowledge of its untruth.”

**b. Severability Denied: Rescission Valid as to All Insureds**

*Illinois State Bar Association Mutual Insurance Co. v. Law Office of Tuzzolino & Terpinas, 2015 IL 117096 (2015).* Innocent insured doctrine was inapplicable to prevent rescission of professional liability policy for attorney’s misrepresentation in renewal application, without his partner’s knowledge, that he was unaware of any circumstances, acts, errors, or omissions that could give rise to a claim, even though policy contained severability clause creating separate agreement with each insured. The alleged misrepresentation affecting acceptance of the risk would affect validity of policy as a whole and go to formation of the contract.

*Continental Casualty Co. v. Marshall Granger & Co., LLP, 921 F. Supp. 2d 111 (S.D.N.Y. 2013).* An insured moved to dismiss the insurer’s action for rescission based on material misrepresentations by the signatory. The insured asserted that an “Innocent Insured Provision” in the policy prevented rescission of coverage as to innocent insureds. The court held that the “Innocent Insured Provision” did not constitute a severability clause and therefore the insurer could rescind as to all insureds.

*Unencumbered Assets Trust v. Great American Insurance Co., 817 F. Supp. 2d 1014 (S.D. Ohio 2011).* Excess D&O policy was void as to all insureds and subject to
rescission under Ohio law where the primary application form signed by insured’s principal officer and director included material misrepresentations about various aspects of insured’s financial condition, excess policy followed form of the primary policy, primary proposal form unambiguously indicated that “any misstatement or misrepresentation made by the insured shall render the policy void,” and policy provided that material facts or circumstances known by principal officer when he signed the form would be imputed to other insureds “for purposes of determining the validity” of the policy.

_Federal Insurance Co. v. Homestore, Inc.,_ WL 1926483 (9th Cir. 2005). Here, D&O policies provided that if “one or more of the individuals who signed” the policy knew of misrepresentations the entire policy would be void. Under California law, insurers had the right to rescind entire D&O policies as to all insureds based on misrepresentations by one officer in the application. The court held that the application misrepresentations of one insured rescinded the policies as to all insureds.

_Cutter & Buck, Inc. v. Genesis Insurance Co.,_ 306 F. Supp. 2d 988 (W.D. Wash. 2004), aff’d, 2005 WL 1799397 (9th Cir. 2005). Under Washington law, the language of a severability provision was not unlimited and did not prohibit the insurer from rescinding coverage to innocent D&Os for material misrepresentations made by the chief financial officer of the insured in a renewal application. The severability provision preserved coverage for those D&Os who had no knowledge of misrepresentations within application materials. However, the policy at issue stated that the signer’s knowledge of misrepresentations in the application could be imputed to all other D&Os.

_Shapiro v. American Home Assurance Co.,_ 584 F. Supp. 1245 (D. Mass. 1984). In an application for D&O insurance, a company’s president represented that no director or officer knew of any act or omission that might give rise to a claim under the proposed policy. As part of the submission he attached grossly overstated company financial statements to the application. Under a Massachusetts statute, a misrepresentation in an application for insurance voids the policy if it is made with the intent to deceive, or if the matter misrepresented increased the risk of loss. Applying the statute, the court determined that the financial statements submitted constituted a material misrepresentation that increased the risk of loss and therefore, the policy was void, regardless of the insured’s intent or the insurer’s reliance on the statements. The court further found the policy void as to innocent D&Os because the application inquired as to the knowledge of any director or officer.

_Bird v. Penn Central Co.,_ 61 F.R.D. 43 (E.D. Pa. 1971). In answering an application for D&O insurance, a director falsely stated that no person proposed for insurance was aware of facts that might give rise to a claim. The court, applying Pennsylvania law, held that, because the director acted as agent for all other D&Os of the insured, the insurer could rescind the policy as to all D&Os based on the director’s misrepresentation, even those who were otherwise innocent.

5. Effect of Misrepresentations in Supporting Documentation That Are Not Incorporated into the Policy

An insurer usually may not rescind a policy based upon material misrepresentations in materials that have not been incorporated into the application or the policy. Where the policy or application provides only that the policy is issued based on the information provided in a written application, courts may find that the insurer cannot establish that it relied on misrepresentations in other materials. However, there are exceptions to this general rule.
Nieto v. Blue Shield of California Life & Health Insurance Co., 181 Cal. App. 4th 60, 103 Cal. Rptr. 3d 906 (2010). An insured filed an action against her insurer after the insurer rescinded her health insurance policy. In the application, the insured failed to disclose information about her medical condition and treatment. Applying California law, the trial court granted the insurer’s motion for summary judgment, ruling that the insurer was entitled to rescind the policy given undisputed evidence that the insured had materially misrepresented and omitted information about her medical history in the policy application. The appellate court affirmed, rejecting the insured’s urging that the court adopt “the blanket conclusion that material misrepresentations and omissions in an application which is not physically attached to a policy may not be relied upon by the insurer to rescind the policy.”

Hammond v. Pacific Mutual Life Insurance Co., 56 Fed. Appx. 118 (4th Cir. 2003). The court prohibited an insurer from rescinding a policy based on omissions, because the insurer had failed to attach the application to the insurance policy. Applying Virginia law, the court held that the insured’s medical examination form, that was completed by an independent medical examiner, had to be attached to a life insurance policy if it was to be used to deny coverage under the policy. Because the insurer had failed to attach the application to the policy, the information contained within it could not be used to rescind the policy.

National Union Fire Insurance Co. of Pittsburgh, Pa. v. Federal Deposit Insurance Corp., 1995 WL 48462 (Tenn. Ct. App. 1995). Under Tennessee law, the court allowed an insurer to rescind a D&O policy due to misrepresentations in financial statements required as part of the application. Although the misrepresentations “were strictly speaking not part of the application,” the trial court still allowed rescission. The appellate court affirmed.

National Union Fire Insurance Co. of Pittsburgh, Pa. v. Continental Illinois Corp., 643 F. Supp. 1434 (N.D. Ill. 1986). An insurer sought to rescind a policy because of misrepresentations in financial statements submitted by the applicant. The financial statements were not made part of the proposal, and the insured did not represent or warrant the truth of the financial statements. The court found that the insurer could not rescind a D&O policy based on misrepresentations in financial statements that were not incorporated by the policy or the application for coverage.

6. Issues of Waiver or Estoppel in Connection with Rescission

An insurer must rescind a policy or institute a declaratory judgment action within a reasonable time after learning facts that justify rescission; otherwise, it may be estopped or deemed to have waived the right to rescind. For example, an insurer may be estopped from rescinding a policy if the insured incurs another loss during the period in which the insurer knew of, but failed to exercise, its right to rescind. Further, an insurer may be deemed to have waived its right to rescind if it accepts premiums while it is investigating potential rescission.

Omni Insurance Group v. Poage, 966 N.E. 2d 750 (Ind. Ct. App. 2012). Where an insurance company had knowledge of the truth of facts separate from any material misrepresentation in an application, yet still issued the policy, it has no right of rescission.

U.S. Life Insurance Co. in City of New York v. Blumenfeld, 938 N.Y.S.2d 84 (1st Dep’t 2012). An insurer sought a declaratory judgment for rescission of a life insur-
ance policy due to material misrepresentations of the insured’s financial status. The insured asserted that the insurer had ratified the policy and waived its right of rescission by retaining premiums and failing to promptly seek rescission after discovering the grounds to rescind the policy. The insurer argued that any retention of premiums was inadvertent and that it had not waived its right to rescission because it lacked the intent to do so. The court held that the insurer had indeed ratified the policy and waived its right to rescission, stating that an insurer who fails to promptly rescind a policy or return premiums upon learning of grounds for rescission has ratified that policy and waived its right to rescind.

*Unencumbered Assets Trust v. Great American Insurance Co.*, 817 F. Supp. 2d 1014 (S.D. Ohio 2011). In response to an insurer’s attempts to rescind an excess D&O policy, the insured argued that the insurer had waived its right to rescission by accepting premium payments for “tail coverage” after discovering the facts they assert as the basis for rescission. The court denied the insurers’ motion for summary judgment, concluding there was a genuine issue of material fact as to whether the insurer was aware of the grounds for rescission at the time of the premium payments and noting that if the insurer did in fact have this knowledge at the time, it would have effectively waived its right to claim rescission of the policy.

*Certain Underwriters at Lloyd’s, et al. v. Milberg, LLP, et al.*, 2009 WL 3241489 (S.D.N.Y. 2009). Insurers of a law firm sought rescission of their professional liability policies on the basis that they had been defrauded. In the policy application, the firm had purportedly represented that no attorney knew of “any circumstances . . . which may result in a claim being made against” the firm. A grand jury later indicted the firm on federal bribery and fraud charges, which the firm settled with a guilty plea and payment of $75 million. In largely granting the insureds’ motion to dismiss, the court ruled that the insurers could not rescind coverage or sue for repayment of money spent defending the firm because the insurer’s claims fell outside New York’s six-year statute of limitations. The court further stated: “Rather than awaiting the results of the government’s prosecution of Milberg, [the insurers] should have committed their own inquiry into whether Milberg might have committed fraud in obtaining the London Policies.”

*Allianz Insurance Co. v. Guidant Corp.*, 884 N.E.2d 405 (Ind. App. Ct. 2008). In a policy application an insured medical device company represented that it was unaware of product defects that might give rise to liability in excess of $2 million. However, the insured then announced a voluntary recall of one of its devices and suspended its sales. Following the recall, the FDA began an investigation of the insured’s failure to make certain disclosures about the device’s performance. Additionally, the Department of Justice charged the company with one felony count of making false statements to a government agency in connection with an FDA inspection, to which the insured pled guilty. The insurer initially sought to rescind the policy for misrepresentations in the application, but later elected to withdraw that defense. The insured asserted that the insurer could not successfully argue that the policy was void because the insurer chose not to rescind the policy and to retain the insured’s premium payments. The court agreed with the insured, holding that the insurer affirmed the contract by retaining the premiums and therefore could not pursue a fraud defense.

*Nixon v. Lincoln National Insurance Co.*, 131 Fed. Appx. 188 (11th Cir. 2005). In her policy application, the insured failed to reveal health problems, leading the insurer to issue a health insurance policy, based on the insured’s representations and
omissions. Shortly after the insurer issued the policy, the insured died of pancreatic cancer. Four months later, the insurer rescinded the insured’s life insurance policy. The court held that the insurer did not waive its material misrepresentation defense by rescinding the policy four months after the insured died. The insurer’s actions comport with Georgia’s standard that an insurer must “promptly move to have the contract of insurance rescinded.”

*Progressive Northern Insurance Co. v. Bachmann,* 314 F. Supp. 2d 820 (W.D. Wis. 2004). The court granted the insured’s motion for summary judgment on the ground that the insurer did not timely move to rescind the policy, thus violating Wisconsin Statute § 631.11(4)(b), which requires an insurer to notify the insured within 60 days after acquiring knowledge of its intent to either rescind the policy or defend against a claim. In this instance, the insurer waited more than five months to rescind the insured’s policy, asserting that the insured misrepresented the horsepower of his boat in his application for boat insurance.

*General Star Indemnity Co. v. Duffy,* 191 F.3d 55 (1st Cir. 1999). In this case, the insurer was permitted to rescind a policy one year after learning of the insured’s misrepresentations, even though an inspection report in the insurer’s files contradicted the insured’s misrepresentations. The insured submitted a signed insurance application verifying it had all building improvements to its premises updated in the last five years and the premises was outfitted with sprinklers. Thirteen months after the application was submitted, a fire destroyed the premises. One year after learning that the premises did not have sprinklers, contrary to what the application indicated, the insurer sought to rescind the policy. While the insurer possessed an inspection report indicating that the premises did not have sprinklers, the court granted summary judgment to the insurer given the misrepresentations in the policy application.

*Association of Retarded Citizens–Santa Barbara Council v. North American Specialty Insurance Co.,* No. 94-4602 (C.D. Cal. 1994), aff’d, 87 F.3d 1317, 1996 WL 343561 (9th Cir. 1996). Here, the court held that neither waiver nor estoppel prevented the insurer from rescinding a D&O policy although the insurer did not rescind the policy until eight months after learning of the grounds for rescission. The court pointed out that the insurer had reserved its right to rescind on several occasions during the eight-month period. While acknowledging some lack of clarity in California law on waiver and estoppel, the court ultimately concluded that the insured could not establish “waiver by conduct,” because the insurer’s conduct was consistent with its right to rescind. Moreover, the insured could not establish either waiver or estoppel based on delay because the insured had not demonstrated that it had relied to its detriment on the insurer’s conduct.

*Federal Deposit Insurance Corp. v. Duffy,* 47 F.3d 146 (5th Cir. 1995). Under Louisiana law, an insurer’s approximately four-year delay in rescinding a D&O policy after learning that the insured made misrepresentations in the application did not constitute a waiver. Although the insured was adjudicated dishonest in 1988, giving rise to grounds for rescission, the insurer did not assert that the policy was void until 1992. Under Louisiana law, the insurer did not waive its right to seek rescission or deny coverage as it had consistently reserved those rights and did not waive them simply by continuing to handle claims.

*Old Republic Insurance Co. v. Rexene Corp.,* Nos. 10,970, 10,979, 1990 WL 176791 (Del. Ch. 1990). The insurer sought rescission of a D&O policy asserting that the insured had misrepresented that it was not considering or contemplating a merger
in its policy application. The insured argued that in issuing a runoff policy after first learning of the insured’s planned merger, the insurer had waived its right to rescission. The court, applying Delaware law, found issues of material fact existed regarding the insurer’s knowledge of the grounds for rescission when it issued the runoff policy. The court reasoned that the insurer’s knowledge of the merger did not necessarily prove that it knew about a misrepresentation in the application.

*Mt. Hawley Insurance Co. v. Federal Savings & Loan Insurance Corp.*, 695 F. Supp. 469 (C.D. Cal. 1987). Under California statutory law, to rescind an insurance contract after learning of the facts that justify rescission, an insurer must notify the insured promptly, return any premiums, and rescind the policy prior to commencing an “action on the insurance contract.” In this case, the court found that an interpleader action, unlike a declaratory relief action, was an action on the insurance contract. Therefore, the court concluded that an insurer who attempted to rescind after bringing an interpleader action was foreclosed from rescinding the policy.

*Jaunich v. National Union Fire Insurance Co. of Pittsburgh, Pa.*, 647 F. Supp. 209 (N.D. Cal. 1986). Here, an insurer’s choice to wait three months to rescind a D&O policy after receiving all information relating to its decision to rescind was timely because under California statutory law a delay does not preclude an insurer from seeking rescission unless an insured experiences “substantial prejudice” due to the delay.

### 7. Tender of Premium

Generally, when an insurer rescinds a policy, it must return any premium charged to the insured. There have been exceptions, however.

*PHL Variable Insurance Co. v. P. Bowie 2008 Irrevocable Trust ex rel. Baldi*, 718 F.3d 1 (1st Cir. 2013). A life insurer and irrevocable trust agreed to rescission of a policy based on material misrepresentations. Both parties sought summary judgment regarding the insurer’s duty to tender the premium paid on the policy. The court held that the appropriate equitable remedy was to allow the insurer to retain the premium paid as rescission alone would not make it whole.

*Kiss Construction NY, Inc. v. Rutgers Casualty Insurance Co.*, 877 N.Y.S.2d 253 (N.Y. 2009). Under New York law, the insurer could rescind its commercial general liability policy based on material misrepresentations in the policy application, but would then be obligated to refund the premiums paid on the policy.

*In re WorldCom, Inc. Securities Litigation*, 354 F. Supp. 2d 455 (S.D.N.Y. 2005). The court held that, under New York law, in addition to repudiating the insurance contract an insurer must return any insurance premium paid to effect rescission of a policy.

*TIG Insurance Co. v. Reliable Research Co., Inc.*, 2002 WL 31133206 (S.D. Ill. 2002). Applying Illinois and Missouri law, the court held that the insurer could rescind a title and escrow professional liability policy only upon complying with the court’s order to tender the premiums paid to the insured.

*Federal Deposit Insurance Corp. v. Bryan*, 1991 WL 268896 (10th Cir. 1991). An insurer sought to rescind a D&O policy as to bank officers who allegedly made misrepresentations in the policy application. Oklahoma statutory law requires that a party seeking to rescind must promptly restore “to the other party” everything of value the rescinding party received “from him.” The insurer argued that the statute did not require
it to return any premium to the two officers because the bank had paid the premiums, not the officers. The court disagreed, holding that the insurer “was required as a condition precedent to obtaining rescission against the two officers to restore to the bank any part of the premium affected by the rescission.” The court further noted that the insurer could satisfy the condition precedent by showing that it would not have charged any additional premium for the two officers, recognizing that if the bank had waived its right to return of the premium, the result would be different.

D. Breach of Warranty

Most state insurance statutes characterize an applicant’s statements to a prospective insurer as representations, and thus require the insurer to bear the burden of proving that the representation was inaccurate, material to the risk, and relied upon when issuing the policy. However, many states still recognize the difference between answers to questions asked (statements), and affirmative assurances of key facts and conditions. These affirmative assurances, known as warranties, may be accorded greater weight because, in providing a warranty, the insured is asked to provide an attested assurance.

Safeway Insurance Company v. Dukes, et al., 2015 WL 8481604 (Miss. 2015). Insured sought coverage, under her automobile insurance policy, for an auto accident, which occurred while her boyfriend was driving her car. The court held that the insured’s automobile policy was void due to her warranting that there were no other regular, frequent drivers of her car when, in fact, insured’s boyfriend was a regular, frequent driver of her car.

Executive Risk Indemnity Inc. v. AFC Enterprises, Inc., 510 F. Supp. 2d 1308 (N.D. Ga. 2007), aff’d 279 F. App’x 793 (11th Cir. 2008). Under Georgia law, an insurer who offers no evidence to establish that the signatory of an application knew of any falsity associated with an application is not entitled to rescind a D&O policy that conditions rescission on knowledge of untruth in an application. In this case, the insured did not make any warranties in answering the questions on the application, which asked only that the signatory declare “to the best of his or her knowledge and belief that the statements set forth herein are true.” As the insurer offered no evidence to establish that the signatory of the application knew of any false matter associated with the application, it could not seek to rescind the policy.

Association of Retarded Citizens–Santa Barbara Council v. North American Specialty Insurance Co., No. 94-4602 (C.D. Cal. Nov. 29, 1994), aff’d, 1996 WL 343561 (9th Cir. 1996). On July 30, 1992, the insured’s executive director submitted an application for D&O insurance on behalf of the insured representing that (1) the insured had dismissed no employees within the previous 12 months, (2) no claim had been made against the company or its directors or officers, and (3) the insured was not aware of any circumstances that might result in a claim. The application also required that the applicant immediately report any circumstances that occurred prior to the inception of the policy that might affect the truthfulness of any statement made in the application. Contrary to the representations in the insured’s application, the insured had terminated an employee in May 1992, who then threatened to sue the executive director for sexual harassment. On July 31, 1992, the insured received a settlement demand from this former employee, threatening litigation as an alternative. On August 1, 1992, the insurer issued the policy, which stated that statements in the applica-
tion constituted the basis for the issuance of the policy and were incorporated therein. The insurer later rescinded the policy based on misrepresentations in the application. Subsequently, the insured filed suit for a declaratory judgment seeking coverage under the policy. The court granted summary judgment to the insurer, reasoning that the misrepresentations in the insured’s application constituted statutory breach of warranty, which entitled the insurer to deny coverage under California statutory law.

*National Union Fire Insurance Co. of Pittsburgh, Pa. v. Walker,* 1989 WL 56164 (W.D. Mo. May 24, 1989). An insured’s president stated that no directors or officers had knowledge of facts that might give rise to a claim in an application for D&O insurance. The court determined that, because the application contained a statement above the signature line that the “undersigned authorized officer of the corporation declares that to the best of his knowledge the statements set forth herein are true,” the president’s statement was true, even though one of the insured’s officers knew of facts that could give rise to a claim. Missouri law requires that a nonfraudulent misrepresentation constitute a warranty in order to invalidate a policy. The court refused to treat the president’s statement as a warranty because the application did not ask the president to affirm the knowledge of others, and the facts of the case did not mandate treating the president’s statement as a warranty.

*National Union Fire Insurance Co. of Pittsburgh, Pa. v. Continental Illinois Corp.,* 643 F. Supp. 1434 (N.D. Ill. 1986). The insurer sought to rescind two D&O policies based upon financial statements attached to, but not incorporated in, the applications. In the applications, the insured warranted that the statements made in the applications were true to the best of his knowledge. The court, applying Illinois law, determined that the insurer could not seek rescission based on the truth of financial statements because those documents were not incorporated into the applications by reference.

**E. The Insurer’s Ability to Recover Damages from the Party Responsible for the Misrepresentations in an Application**

As an alternative to rescission of an insurance policy, an insurer may also attempt to recover from those responsible for the misrepresentations during the insured’s application process. Such recovery efforts have been pursued against the insureds on affirmative themes of fraud or misrepresentation, as well as against third parties.

*Harbor Insurance Co. v. Essman,* 918 F.2d 734 (8th Cir. 1990). Under Missouri law, to state a claim against an accounting firm for the negligent preparation of financial statements, an insurer must allege that (1) the accounting firm prepared financial statements to enable the insurer to determine whether it should issue the D&O policy; (2) the accounting firm knew that the insurer would receive the statements; or (3) the insurer was within a limited, foreseeable class of reliant parties. The D&O insurer failed to state a claim against an accounting firm because it merely alleged that the firm should have known that the insurer would rely on statements it prepared for the insured.

*National Union Fire Insurance Co. of Pittsburgh, Pa. v. Continental Illinois Corp.,* 654 F. Supp. 316 (N.D. Ill. 1987). Insurers sought indemnification from an insured for negligent misrepresentations that the insured allegedly made in procuring D&O insurance. The court rejected the insurer’s claim recognizing that a party must have supplied false information for the guidance of others in the course of its business to be
liable for negligent misrepresentation under Illinois law. The court reasoned that the insured bank could not be liable for negligent misrepresentations in its application because the insured was not in the business of providing the information sought in the proposal. 

*National Union Fire Insurance Co. of Pittsburgh, Pa. v. Seafirst Corp.*, 662 F. Supp. 36 (W.D. Wash. 1986). Under Washington statutory law, misrepresentations in an application for insurance are only considered material if they are made with the intent to deceive. Applying this statute, the court held that the insurer could not evade this statutory requirement by seeking damages against an insured for negligent misrepresentation to offset payments that the insurer makes under the policy.