Lowenstein Sandler's Insurance Recovery Podcast: Don't Take No For An Answer

Episode 74:
Don't Cash that Refund Check! How to Challenge Insurance Rescission

By Lynda Bennett, Eric Jesse

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Eric Jesse: Welcome to Don't Take No for an Answer. I'm your host, Eric Jesse from Lowenstein Sandler's Insurance Recovery Group. Today, I'm joined by my partner and co-host, Lynda Bennett. Welcome, Lynda. How are you doing?

Lynda Bennett: Hey, Eric. Good to be back together again.

Eric Jesse: Absolutely. In today's episode, we're going to talk about, I think what we can both agree is a disturbing trend that we see in our practice, and that is, insurers are trying to rescind policies after, of course, they've collected the premiums and they've promised to stand by the insured and protect them against claims. We're seeing it increasingly, and it's troubling. But to do a little table setting, I just want to talk about how …or let our listeners know how the policy procurement process works. At the outset, the policyholder, they're usually required to fill out an application. In the application, they're going to ask a number of questions. Some of these questions are going to be basic, stats about revenue, number of employees, procedures, locations, things like that. Other questions are going to ask for the production of documents. They might be looking for narrative responses about the risk and for a policyholder that's information that's at their fingertips and that they'll be able to provide to the insurer. Most policy applications... so they're going to include more open-ended questions, right?

They're going to ask about known claims, and they're going to also ask those crystal ball questions about claims that might be asserted in the future. And those are judgment-call questions. And then there's also, we did a podcast on this a few months ago, where we talked about the warranty letter, where a policyholder is required to make an affirmative statement about the existence of claims and potential claims. And again, there's the gray area, and like these applications, warranty letters are going to be deemed to be part of the insurance policy in many cases. So after the premiums are collected, the policy is issued, and then this is where the rubber meets the road. The insured then tries to pull the rug out from the policyholders by declaring that

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the policy is null and void. 'Cause there was a supposed misrepresentation in the application or the warranty letter. So the legal term is rescission.

In today's episode, what we're going to do is, we're going to explore the rights and remedies that policyholders have when they try to rescind the claim. But enough from me, Lynda. First question for you, and we know insurers use this tactic, but insurers really get away with it.

Lynda Bennett: Great job setting the table there, Eric, and I do want to emphasize, that the reason that we're doing this podcast today on this topic is because insurers are getting increasingly aggressive in trying to rescind these policies. And the first thing that listeners need to know is that rescission is deemed under the law to be an extraordinary legal remedy that courts should be hard-pressed to provide without a really compelling fact pattern to justify that result. But as I said, it's remarkable, in the last couple of years in particular, we are seeing carriers trying to exercise this nuclear option, declaring the policy null and void. And in many instances, our experience has been that the insurers are being overly aggressive, and their effort will not withstand judicial scrutiny.

So there's two important guiding principles that we always talk about here at Don't Take No for an Answer. The facts of your claim are always going to matter. And two, and this is really important on this topic of rescission, choice of law always matters because, for rescission, there are really two places that you're going to look in the law. One is the common law. So go research the cases. How have courts interpreted this before? What standards have they used? But also with respect to rescission, many jurisdictions have statutory law on policy applications, misrepresentation, and that sort of thing. So if you find yourself in this situation, the very first thing you’ve got to do is get experienced coverage counsel who's going to be able to look at all the different potential jurisdictions' law which may apply to your particular claim.

Eric Jesse: No, that's a good point. And one that I feel like is in most, if not all, of our podcasts, choice of law matters. So that we're keeping with that theme. Now, Lynda, I know you were there the day they taught law at law school. What are the basics of the legal cause of action for rescinding the policy?

Lynda Bennett: Well, I did show up that day, Eric, when we talked about rescission, and I was a civ pro geek. So I absolutely love learning all about remedies. So there are really two core issues here. The first one is that there has to be either a misstatement or concealing of a fact on the application, or, as you mentioned, that second cousin, the warranty letter. So there has to be a misstatement or an omitted fact. The second pillar is, the misrepresentation or omission has to be material to the risk that the insurer agreed to ensure. Two pro tips that I want to put out right out of the gate, when a carrier tries to exercise that nuclear option of rescinding the policy, they are required to return your premium check. So pro tip number one, if you put that claim in and you get that denial letter and the carrier sends the premium check back, do not cash it. If you cash that check, you have accepted the insurer's position that the policy is null and void.

And the second pro tip, and this is equally important, don't assume that the insurers cry of foul with respect to a misstated or an omitted fact, immediately

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results in a winning argument on rescission. Eric and I, we've beaten back this argument many times, so you got to peel that onion back.

Eric Jesse: Absolutely. One thing that we've seen, and it's bizarre, but we've seen insurers try to rescind the policy when a risk was disclosed on one part of the application, but it may not have been disclosed in the supposed right spot. So we've seen cases where consumer complaints were disclosed in a narrative response to question number three, and the insurer never questions that during underwriting, and then the insurer tries to rescind the policy because they said questions 15 and 16 weren't answered correctly. I just love the double standard because, Lynda, when we're litigating with carriers, they love to tell us about how you have to read the policy and interpret it as a whole, but they don't think they have to read the application as a whole. So we've definitely seen those types of non-viable arguments.

Lynda Bennett: The cherry picking is on next level.

Eric Jesse: Exactly. So Lynda, does it matter if the policyholder makes a mistake, but it was not intentional, they made the honest mistake. How does that factor in?

Lynda Bennett: So this is one of the most surprising things, I think, for our clients sometimes, and I'm going to come back to my two core themes of today's episode. The facts matter, the applicable law matters because there are basically two schools of thought on that unintentional misrepresentation. Some courts will apply an objective standard. So what would a reasonable person who filled out the application have answered or disclosed in response to that question? Other jurisdictions have a lower standard, it's a subjective standard. What did the person who actually filled out the application, what did they actually know? So it's really important to understand before you engage with the carrier, is an objective standard or a subjective standard going to be applied to how that question was answered? And in some jurisdictions, the law is so unfavorable that there's case law or there's statutory language that says it doesn't matter if you were negligent. If it's an important fact that should have been disclosed or should have been disclosed in a different way, it doesn't matter that it was a negligent mistake.

Eric Jesse: Yeah, sad, but true that that's the case.

Lynda Bennett: So that's the worst is when it doesn't matter that you made a mistake. There are other jurisdictions that have a very high bar that requires the insurer to show that it was knowingly false. So understanding that legal standard is really, really important when you're faced with this argument.

Eric Jesse: So tell our listeners, how do you determine if a factor omission was material to the risk? And doesn't that put the insurer at an unfair advantage to have to claim after the fact that whatever was not disclosed was in fact material?

Lynda Bennett: Yeah, so as I mentioned, we've seen this movie many, many times before, and the carrier's always going to declare, whatever fact it is that they've found that they want to try to hang their rescission argument on. It immediately becomes a material thing that was obviously core to the insurer's decision to write the policy and issue the policy. And this is again where

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policyholders really need to dig into the facts, and policyholders have a really nice bit of leverage when this type of coverage dispute comes up. Because the carrier can't just say, "Well, of course, it was material to the risk that I was underwriting." And in many jurisdictions, the carrier's going to have to prove that by showing what their underwriting guidelines were. What did they do with other similarly situated policyholders?

And if there's one thing that insurers hate to disclose and share in a coverage litigation, it is the secret sauce of how they underwrite risks. It is the secret sauce of, do they treat all policyholders of similarly situated risks the same in terms of pricing, in terms of retention. So that is a really important lever for you, as a policyholder, to start gathering your case against rescission. You are entitled to all of that information. And in our experience, as you know, Eric, once we start to really press that button in a meaningful way, we can suddenly have a conversation around resolving the claim.

Eric Jesse: Absolutely. And I'll just mention it again, I love the double standard where, of course, the policyholder has to give everything, right? And then, when we try and prove that the claim is bogus, the carriers don't have to give anything. So you're right. It is a fight for the underwriting file, for the underwriting approach, for how they've handled other policyholder issues before, and you're in for a fight with the carrier. Once you make those requests, there's going to have to be a motion to compel in most cases too.

Lynda Bennett: And so, Eric, I just want to touch on, again, this now once we've pushed that button, what is the standard to prove materiality? Once again, we have a spectrum across different jurisdictions, and that spectrum is generally going to be to prove materiality. The insurer has the burden of showing that it wouldn't have issued the policy on the same terms and conditions if that undisclosed or inaccurately disclosed fact had been known. And that's a very high bar for most insurers to be able to prove. And I want to go back to the point I was making earlier, that there can be a spectrum. Is it that they have to prove they wouldn't have issued the policy at all, or that the terms and conditions on which they would've issued the policy would be different? And that's where, once again, choice of law is going to matter.

Eric Jesse: That's a critical distinction. Absolutely. When the insurer gets the application that the policyholder has filled and signed out, is there a duty for the insurance company to independently verify or investigate what's put on the application?

Lynda Bennett: So this is another surprise often to our clients, and I am going to be a broken record on this episode today. Choice of law is going to be absolutely critical to evaluate this independent duty to investigate. In most jurisdictions, however, the insurer is allowed to rely on the information that is in the application or in that warranty letter without having a further independent duty to investigate. One place that I've seen this really get murky, and most of our listeners know, the underwriting process oftentimes takes place over a matter of 30 to 60 days. You may fill out that application at the front end of the underwriting process and answer that important question, Eric, that you identified earlier of, do you have knowledge of any potential claims? And when you check the box, no, at the front end of that underwriting process,

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that's an accurate answer. And then, in the intervening 45 days, something crops up, do you have an obligation as the policyholder to update and bring that policy application forward or not?

And our listeners would be surprised to know how many times this issue comes up, and it's another one where the facts and the law will matter on a particular claim, but as a best practice, I would recommend that you update that application and/or warranty letter to bring it forward.

Eric Jesse: Yes, definitely a best practice. Now, again, because you were at law school the day they taught law, Lynda, what defenses does a policyholder have when an insurer tries to play this game and rescinds the policy? What can the insurer do to waive their ability to do so?

Lynda Bennett: So there's a concept called ratification. So if an insurer has knowledge of a misrepresentation or an omission on the application, but they continue to perform the insurance policy, then that policy cannot be rescinded as a matter of law. It has been what the courts will deem, it's been ratified. And, Eric, you may remember, I want to give a specific example. We worked on a case a couple of years ago where an insurer was trying to develop their case to rescind the policy based on an alleged misrepresentation in the application. And then, while they were conducting that investigation, the insurer was asked to provide consent for a settlement opportunity that arose with respect to the claim that was under consideration, and the insurer said, "Yes, we will agree. We won't raise lack of consent." Right? And that was our "aha" moment because, then, we said, "Okay, you can't ride the fence and say that you think we had a misrepresentation that allows you to rescind the policy because you ratified it by providing consent." So yeah, yes, we did awesome on that one.

Eric Jesse: Yes, we confirmed that policy did, in fact, exist. All right, so just to bring it to a close and to wrap up here, what can a policyholder do to protect itself on the front end and really just hopefully avoid this whole issue altogether?

Lynda Bennett: So I'm going to rattle off a couple of really important best practices. First, be careful in considering and answering the policy application question. My best practices advice is, when you're in doubt, disclose, but do it wisely. So if you've got a potential claim brewing and you know the name of the claimant and you know what, the nature of the claim might be very specific in doing that because, by the way, when you answer that question in the application and you identify that potential problem, that will immediately be followed by a specific exclusion on the policy for that risk. But rather than having your entire policy be voided, my advice is, you should be thoughtful, careful, and disclose when needed. Another big mistake that policyholders often can make before you answer the question on the application, pull the audience. Make sure that you send something out to your stakeholders to say, "Hey, we're being asked, are we aware of anything that might morph into a claim one day? So let us know."

Also, when you're completing your application, and particularly these warranty letters, narrow the field of the audience on whose behalf the representations being made. A lot of times these applications and definitely

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the warranty letters will say no insured, and that's a defined term in your policy that is literally going to include every person in your organization. And when you're signing that application, you are making that representation on behalf of the knowledge held by every person in that organization. There are things that you can do to narrow that field and who the representation's being made on behalf of. Another important one, actually, on certain insurance policies, you can negotiate for language into the policy that says the policy is non-rescindable. So no matter what happens in the application, you can get language in your policy that says the insurer promises they are not going to pull the rug out from underneath you. So negotiate for that language.

Eric Jesse: And that's important in a D&O policy, right? Where you want that language as applied to individual directors and officers, that regardless of what the company represented, right, the directors and officers aren't going to be out of coverage.

Lynda Bennett: And that's severability. Another thing is, once you find yourself in the soup of a rescission claim by a carrier, carefully look at the questions because one of the things that I've noticed in many jurisdictions is, a court will look at the question and say, "This isn't an artfully framed question, it's ambiguous." Maybe this is where the innocence of, I thought I answered it correctly, and maybe I didn't understand the question because the question was ambiguous. That's another thing because ambiguity in the question. As we know, Eric, as we tell our listeners all the time on Don't Take No for an Answer, ambiguities get resolved in favor of policyholders. I've beaten the dead horse of applicable law. And so, last but not least, I am going to finish with my number one pro tip. Eric, bring it home. What is that tip?

Eric Jesse: Do not cash that premium refund check, right? You will walk right into the insurer's argument if you do so. So protect yourself.

Lynda Bennett: So to wrap up, the facts matter, the law matters. Don't take a knee-jerk denial and rescission claim lightly. There are places that you can go to rebut that, but keep an eye out for it because the carriers have really fallen in love with this tactic of late.

Eric Jesse: Yes, they have. And this was a great discussion for our listeners, great advice for them so that they're on guard against this trend that, unfortunately, insurance companies have been engaging in some time, and we're just seeing it increase. So, thank you for joining us on Don't Take No, Lynda.

Lynda Bennett: Thanks so much for having me, Eric.

Eric Jesse: All right, sounds good. Thank you.

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