

INSURANCE ALERT

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Information about COVID-19 and its impact on local, state and federal levels is changing rapidly. This article may not reflect updates to news, executive orders, legislation and regulations made after its publication date. Visit our [COVID-19 resource page](#) to find the most current information.

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Rescission in the time of COVID-19

When disasters strike, claims to insurance companies follow. In investigating claims, an insurer may discover facts showing an insured made material misrepresentations of fact on the insurance application, and may seek to rescind the insurance policy, retroactively voiding that policy. The COVID -19 pandemic may bring an increase in such rescissions.

Rescission is a drastic remedy governed by state law. Some policies, such as life insurance policies that become incontestable, cannot be rescinded. However, where rescission is permitted, the grounds are generally:

- The insured made a material representation on the insurance application;
- The misrepresentation was made by the insured with the intent to deceive the insurer or the misrepresentation, even if innocent, was material, regardless of the insured's intent;
- The misrepresentation was made by the insured with the intent to deceive the insurer or the misrepresentation, even if innocent, increased in the risk of loss to the insurer; or
- The misrepresentation was made by the insured with the intent to deceive the insurer and the misrepresentation was material.ⁱ

Definitions of "material misrepresentation" vary by state, but generally include a representation of a fact by the insured that was untrue and relied upon by the insurer in issuing the insurance policy. In most states, a misrepresentation can be material regardless of whether the misrepresented fact contributed to the loss for which an insurance claim was submitted. However, a few states, particularly in connection with life, health, and accident insurance policies, require the misrepresentation to contribute to the loss in order for it to be deemed material.ⁱⁱ

Rescission is retrospective in nature: it is based on a misrepresentation

made by the insured, on reliance by the insurer, and the nature of the risk assumed, all existing as of the time the insurance application was submitted and approved. Even where these occurred before the COVID -19 pandemic, we may see insureds argue rescissions are not based on the asserted misrepresentations but instead are bad faith, post-pandemic attempts to avoid paying losses.

Rescission actions may be governed by statute or permitted under common law. Common law rescission is equitable in nature, granted in the sound discretion of the court. Thus, in deciding whether to rescind an insurance policy, a court might consider the nature and extent of the COVID -19 related loss, whether the misrepresentation caused the loss, and who between the insurer or the insured is in the best position to bear that loss.

Courts have taken differing positions on whether an insurer can rescind an insurance policy when an “innocent” third party – one who had no involvement with the misrepresentation in the policy application – seeks benefits under an insurance policy. For example, California prohibits, but Illinois permits, such rescissions. *Compare Barrera v. State Farm Mut. Auto. Ins. Co.*, 71 Cal. 2d 659 (1969) with *Ill. State Bar Ass’n Mut. Ins. Co. v. Law Office of Tuzzolino & Terpinas*, 2015 IL 117095. And Michigan rejects both approaches, instead requiring courts to “balance the equities” to determine whether to rescind a policy when an innocent third-party claimant is involved. See *Bassi v. Sentinel Ins. Co.*, 502 Mich. 390 (2018). Courts engaged in balancing the equities may well consider the COVID -19 pandemic and its economic impact as they choose who will bear a loss: the innocent third-party claimant or the insurer.

The COVID-19 pandemic will likely create a new generation of insurance and reinsurance issues. Rescission is likely to be one of them.

Endnotes

i See, e.g., *Courtney v. Nationwide Mut. Fire Ins. Co.*, 179 F. Supp. 2d 8, 13 (N.D.N.Y. 2001) (finding that an innocent misrepresentation is sufficient to allow rescission); 215 Ill. Comp. Stat. 5/154 (“No such misrepresentation or false warranty shall defeat or avoid the policy unless it shall have been made with actual intent to deceive or materially affects either the acceptance of the risk or the hazard assumed by the company.”); *NW. Mut. Life Ins. Co. v. Iannacchino*, 950 F. Supp. 28, 31 (D. Mass. 1997) (“Under Massachusetts law, in order to void or rescind a policy of insurance or deny a claim based upon misrepresentations in an application for insurance, the insurer must demonstrate that the misrepresentations were made with intent to deceive or that they increased the risk of loss to the insurer.”); *Clyde A. Wilson Int’l Investigations v. Travelers Ins. Co.*, 959 F. Supp. 756, 759 (S.D. Tex. 1997) (“It further observed that the statutes and common law of some states required that the false representation of a material fact be made with an intent to deceive or defraud or with a reckless disregard for its truth or falsity.”)

ii See, e.g. Kan. Stat. Ann. §§ 40-418, 40-2205 (1986); Mo. Rev. Stat. § 376.580 (1986); R.I. Gen. Laws § 27-4-10 (1989).