Ruling Clarifies Requirements for Rescission

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Traditionally, the application process for a policy of homeowners or medical insurance included a face-to-face meeting with the insurance agent. During the course of that meeting a written application was executed during which the insurance agent would ask the prospective insured a series of questions designed to assist the insurer in making an informed underwriting decision as to whether or not to issue the policy. The insured would generally be required to review the application and sign an attestation clause confirming that all of the information contained in the application was true and correct. This process was important to the insurer in that it set the stage for the possible rescission of a policy in the event the insured was guilty of misrepresenting or concealing facts material to the underwriting process.

The criterion for rescinding a policy of insurance in the State of Illinois is set forth in Section 154 of the Illinois Insurance Code, 215 ILCS 5/154. This section provides in pertinent part as follows:

> Sec. 154. Misrepresentations and false warranties.
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> No misrepresentation or false warranty made by the insured or in his behalf in the negotiation for a policy of insurance, or breach of a condition of such policy shall defeat or avoid the policy or prevent its attaching unless such misrepresentation, false warranty or condition shall have been stated in the policy or endorsement or rider attached thereto, or in the written application therefore. No such misrepresentation or false warranty shall defeat or avoid the policy unless it shall have been made with actual intent to deceive or materially affects either the acceptance of the risk or the hazard assumed by the company. With respect to a policy of insurance as defined in subsection (a), (b), or (c) of Section 143.13, except life, accident and health, fidelity and surety, and ocean marine policies, a policy or policy renewal shall not be rescinded after the policy has been in effect for one year or one policy term, whichever is less. This section shall not apply to policies of marine or transportation insurance.

Section 154 requires three elements for the rescission of a policy:

1) A misrepresentation or false warranty contained in the policy itself or written application;

2) The misrepresentation or false warranty must be false and made with the intent to deceive; or,

3) The misrepresentation must materially affect the acceptance of the risk or hazard assumed by the insurer.

The methods utilized by major insurance companies in marketing both property, casualty and medical insurance policies, however, has been dramatically altered over the past several years. Increasing competition amongst insurers and the rise of the internet have resulted in increasing use of telephone interviews and applications taken solely over the internet. These practices, although cost efficient, have impacted the ability of insurance carriers to successfully pursue rescission actions.

Two recent Illinois cases are illustrative of the difficulties faced by the insurance industry in attempting to rescind policies. The Illinois Supreme Court decision in the case of Golden Rule Insurance Company v. Mark Schwartz, 323 Ill. App. 3d 86, 256 Ill. Dec. 70, 751 N.E. 2d 123 (1st Dist. 2001), provides a good overview of both the traditional concepts applicable to rescission and the Illinois Supreme Court's current perspective under the doctrine. In 1985, Spencer Schwartz contacted his insurance broker in an attempt to obtain medical insurance covering his 23 year old son Mark, a full-time medical student. The broker advised that a separate policy would have to be acquired because Mark was too old to be covered as a dependant under Spencer's family policy. The broker then took a telephone application from Spencer who answered questions on his son Mark's behalf. Question nine in the in the application asked if Mark was covered by, or had applied for any other medical coverage.

The policy application utilized by Golden Rule Insurance Company contained an attestation clause above the signature line which read as follows:

"I represent that the statements and answers in this application are true and complete to the best of my knowledge and belief. I agree that … the statements and answers given in this application and any amendments to it will form the basis of any insurance issued."

The opinion is silent as to whether the application was actually forwarded to and signed by Spencer Schwartz. Given the fact that the Illinois Supreme Court focused upon the attestation clause quoted above, it is our assumption that Spencer Schwartz did, in fact, receive, review, sign and return the application.

In March, 1985, Mark Schwartz suffered serious injuries in an automobile accident. Following the accident, Spencer Schwartz realized that Mark was covered not only by the Golden Rule Insurance policy which he had acquired on his behalf, but also by a Mutual of Omaha policy which Spencer held through the American Bar Endowment. During its investigation, Golden Rule learned of the existence of the Mutual of Omaha policy and elected to rescind the medical policy issued to Mark. Golden Rule filed a Declaratory Action seeking rescission of the policy and Mark Schwartz counterclaimed for, among other things, breach of contract and for extra contractual damages under Section 155 of the Insurance Code.

The trial court granted summary judgment in favor of Mark Schwartz and against the Plaintiff and also ruled that the defendant was entitled to sanctions under Section 155. The

Appellate Court reversed, finding that the misrepresentations contained in the Golden Rule Application were sufficient to sustain a rescission action if they were made either with the intent to deceive or were material to the risk assumed by the insurance company. The Appellate Court held that the issue of whether the misrepresentation was material was sufficient to create a question of fact and, therefore, reversed the trial court's entry of summary judgment in favor of Schwartz. The Illinois Supreme Court agreed to review the case.

The Court began its analysis by noting that Section 154 provides the basic framework for a rescission action in Illinois. Of significance, the Court noted that such "statutes provide insureds with basic protections, but do not preclude the parties to the contract from entering into an agreement which is more favorable to the insured than the statute provides." The Court noted that although an insurer may not draft a contract or, indeed, rely upon an application which directly contradicts the statute, it is free to negotiate contract terms which are more liberal or advantageous to the insured.

The Court then aptly noted that the attestation clause contained in the Golden Rule application was significantly broader than the specific terms of Section 154 in that it only required the insured to attest that the information contained in the application was true and correct to the best of his "knowledge and belief". The Court noted that courts in other jurisdictions which have examined the knowledge and belief language have concluded that an attestation clause of this type establishes a "lesser knowledge standard" than that required by the statute. The use of the knowledge and belief standard shifts the focus upon an objective evaluation of whether or not the answer to a particular question was false to an evaluation of the subjective knowledge and intent of the insured at the time the question was answered. The Court stated as follows:

In this case, Golden Rule opted to include language in its application that had the effect of shifting the focus in a determination of the truth or falsity of an applicant's statement, from an inquiry into whether the facts asserted were true to whether, on the basis of what he knew, the applicant believed them to be true. Thus, the response given to question 9 must be assessed in light of the applicant's actual knowledge and belief.
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To that end, we approve the following test, adopted by the District of Columbia Circuit Court of Appeals, for examining responses to questions asked according to an applicant's knowledge and belief:

"The twin qualifiers [knowledge and belief] require that knowledge not defy belief...What the applicant in fact believed to be true is the determining factor in judging the truth or falsity of his answer, but only so far as that belief is not clearly contradicted by the factual knowledge on which it is based. In such event, a court may properly find a statement false as a matter of law, however sincerely it may be believed. To conclude otherwise would be to place insurance

companies at the mercy of those capable of the most invincible self-deception-persons who having witnessed the Apollo landings, still believe the moon is made of cheese."

Based upon its ruling, the Illinois Supreme Court affirmed the Appellate Court's decision to remand to the trial court for a trial on the rescission issues by a jury. The Illinois Supreme Court did, however, affirm the Appellate Court's decision to reverse the trial court's award of extra contractual damages and sanctions under Section 155 of the Illinois Insurance Code. In so doing, the Court cited longstanding case precedent for the proposition that where a bonafide dispute exists between an insured and an insurer concerning coverage, the imposition of Section 155 damages is not appropriate. See Mohr v. Dix Mutual County Fire Insurance Co., 143 Ill. App. 3d 989, 97 Ill. Dec. 831, 493 N.E. 2d 638 (1986).

In summary, the decision of the Illinois Supreme Court in the Golden Rule Insurance Company case provides a good overview of both the statutory scheme applicable to rescission and the pitfalls which an insurer faces in utilizing either policy provisions or policy applications which do not strictly adopt the wording of an applicable statute.

By contract, the recent decision of the Fourth District Appellate Court in the case of Pekin Insurance Company v. Amanda Adams, Docket Number 4-01-1056, presents a good illustration of how an Illinois Appellate Court can torture a well reasoned opinion to justify a desired result. Amanda Adams contacted the Bybee Insurance Agency and ultimately purchased a policy of renter's insurance. During the course of her negotiation for the policy, Adams spoke with a representative of the insurance agency by telephone on several occasions. Amanda Adams testified that although she was asked a series of questions, she was never asked if she owned any animals, including a dog. Adams also testified that she subsequently received an application in the mail from the agent which was partially completed. Question 9 on the application read as follows:

"Does applicant or any tenant have animals or exotic pets?"

An "X" appeared in the box corresponding to the answer "No." Adams testified, however, that she had not read the application in full and only filled out those questions which had been left blank but highlighted by the agent. Adams further testified that although she had signed the application, she did not read the attestation clause which appeared directly above her signature. The attestation clause provided as follows:

I have read the application and I declare that to the best of my knowledge and belief all of the foregoing statements are true; and that these statements are offered as an inducement to the company to issue the policy for which I am applying.

In reality, Amanda Adams owned a Doberman Pinscher, which bit a seven year old boy. During the course of its investigation, Pekin ascertained that not only had Amanda Adams owned the dog for nine years, the dog had bitten a girl three or four years earlier.

Pekin filed a Complaint for Declaratory Judgment followed by a Motion for Summary Judgment supported by a Pekin underwriter who attested to the fact that Pekin would never had issued a policy to a dog owner with a prior dog bite history. The trial court granted Pekin's Motion for Summary Judgment. Unfortunately, the story does not end there.

Adams appealed, and the Appellate Court reversed. On May 14, 2003, however, in the exercise of its authority, the Supreme Court directed the Fourth District Appellate Court to vacate its judgment and reconsider its decision in light of the Supreme Court's ruling in the Golden Rule Insurance Company case analyzed above. The Fourth District agreed to vacate its original opinion, but , after reconsidering the facts of the case in light of the Golden Rule decision, it still reversed and remanded the case for further proceedings.

To its credit, the majority of the Fourth District Appellate Court at least recognized that since Amanda owned a dog for nine years prior to the date she signed the application, this constituted "circumstantial evidence that she knew and believed she had a dog." The Court also noted that the record was devoid of any "countervailing evidence" establishing that Amanda Adams was unaware of having owned the dog for a period of nine years. Therefore, the majority found that there was no genuine issue of material fact concerning the issue of whether or not Amanda knew and believed that she owned a dog which, the majority also held constituted a type of "animal." We note this in passing because in his dissent, Justice Myerscough stated that he would reverse on this issue as well because from his perspective, there was a question of fact as to whether Amanda Adams realized that "an animal included a dog."

The Court next went on to address the issue of whether Pekin should be estopped from asserting misrepresentation as a defense. In this regard, the Court unilaterally noted as follows:

From an early date, Illinois Courts have held that if an insurance agent fills out an application for an applicant, and without any collusion between the agent and applicant, and asserts a false answer into the application, a provision that the applicant has read the application and verified the answers before signing it will not save the insurer from being estopped from asserting the false answer as a defense. Royal Neighbors of America v. Boman, 177 Ill. 27,32, 52 N.E. 264, 266 (1898), cited in Beck, 48 Ill. App. 3d at 941, 363 N.E. 2d at 173; Niemann v. Security Benefit Ass'n, 350 ll. 308, 315-16, 183 N.E. 223, 226-27 (1932).

There must be "no fraud or intent to deceive on the part of the applicant." Royal Neighbors, 177 Ill. at 32, 52 N.E. at 266.. "If the applicant has acted in bad faith, either on his own or in collusion with the insurer's agent, knowledge of the agent will not be imputed to the insurer."

Marionjoy Rehabilitation Hospital v. Lo, 180 Ill. App. 3d 49, 53, 535 N.E. 2d 1061, 1064 (1989).

In the Marionjoy case cited by the Court an insurance agent completed an application and presented to the prospective insured for review and signature. Upon reviewing the application, the insured noted a mis-statement, but the agent told him "not to worry." The insurer then sent an additional copy of the application to the insured and requested that he verify that all of the information contained in the application was true and correct. The insured signed it and returned it to the insurer. The Appellate Court held that the insured's representation to the insurer that all of the information contained in the application was correct was sufficient to establish a misrepresentation defense. The Court emphasized the fact that the insured was aware of the misstatement made in the application and signed an attestation clause with full knowledge of the misrepresentation.

In the case at bar, the Court emphasized the fact that the agent apparently never asked Amanda Adams whether she owned an animal and furthermore, highlighted only those portions of the application which Amanda Adams was to complete. Since Amanda Adams testified that she had never read the questions which were completed by the agent, the Court concluded that there was insufficient evidence established that Amanda Adams intended to deceive Pekin or acted in collusion with the agent.

Of some interest, the Court also went on to address the materiality of the misrepresentation contained in the application. The Court noted that in support of its Motion for Summary Judgment, Pekin attached an Affidavit from a Pekin underwriter attesting to the fact that Adam's ownership of the dog (especially a dog that had bitten someone in the past) was material to Pekin's acceptance of the risk. Pekin also produced a copy of a written underwriting manual indicating that Pekin would not have issued a policy to a prospective insured who owned a dog with a history of biting incidents. Nevertheless, the Court held that a "reasonable trier of fact would not have to believe Pekin." This, despite the fact that there was apparently no evidence of record challenging or contradicting the Pekin underwriter.

Both the Golden Rule and Pekin cases analyzed above stand for several propositions of which the insurance industry should be aware. First, it is better to have an insured completely fill out an application without the agent's assistance. Second, written applications signed and attested to by the insured are obviously far preferable to telephone and/or internet applications in rescission actions. Third, the attestation clause contained in the application itself should mirror the specific wording of Section 154 of the Illinois Insurance Code and should not be based upon the subjective belief of the insured.

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