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New York Insurance Law: Duty to Disclose Information on an Insurance Application

Memorandum prepared for the Law Commissions by David W Kenna
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MOUND COTTON WOLLAN & GREENGRASS

MEMORANDUM

To: David Hertzell Date: April 25, 2012

From: Mound Cotton Wollan & Greengrass Client/Matter: 008888.0099

RE: Summary of NY Law of Misrepresentation and Concealment

New York Insurance Law on Duty to Disclose Information on an Insurance Application

New York law requires that all policies of fire insurance contain certain provisions, which include language concerning the concealment or misrepresentation of information relevant to procurement of the insurance or relating to any other aspect of the coverage. They appear in New York Insurance Law § 3404, commonly referred to as the "165 Lines." Most relevant to this discussion are the first six lines:

> **Concealment, fraud.** This entire policy shall be void if, whether before or after a loss, the insured has willfully concealed or misrepresented any material fact or circumstance concerning this insurance or the subject thereof, or the interest of the insured therein, or in case of any fraud or false swearing by the insured relating thereto.'

The subject is also addressed by statute. New York Insurance Law § 3105 provides:

> (a) A representation is a statement as to past or present fact, made to the insurer by, or by the authority of, the applicant for insurance or the prospective insured, at or before the making of the insurance contract as an inducement to the making thereof. A misrepresentation is a false representation, and the facts misrepresented are those facts which make the representation false.
>
> (b) No misrepresentation shall avoid any contract of insurance or defeat recovery thereunder unless such misrepresentation was material. No misrepresentation shall be deemed material unless knowledge by the insurer of the facts misrepresented would have led to a refusal by the insurer to make such a contract.
>
> (c) In determining the question of materiality, evidence of the practice of the insurer which made such a contract with respect to the acceptance or rejection of similar risks shall be admissible.-

The fraud provision of the "165 Lines" requires a willful concealment of material facts and courts require a showing of materiality of the facts concealed, as well as a fraudulent intent on the part of the insured in concealing such facts.[3] Section 3105 of the New York Insurance Law addresses representations rather than omissions and makes clear that a misrepresentation by an insured will vitiate a contract of insurance, regardless of the insured's intent when making the representation.[4] Of course, policy provisions may be broadened or narrowed to further define which actions by an insured may lead to rescission. For example, ISO form IL 01 83 07 025 relates to statements made only in connection with a loss:

> The CONCEALMENT, MISREPRESENTATION OR FRAUD Condition is replaced by the following:
>
> We do not provide coverage for any insured...who has made fraudulent statements or engaged in fraudulent conduct in connection with any loss ... or damage for which coverage is sought under this policy.

When the issue is whether a policy should be declared void from inception, the insurer bears the burden of proof on the issue of materiality and must demonstrate that it would not have issued the same policy had the information been disclosed at the time of the application.[6] The insurer must introduce evidence of its underwriting practices in order to establish that it would have acted differently in the face of the misrepresented or undisclosed information. For example, in Interested Underwriters at Lloyd's v. H.D.I. 111 Assocs, the insured failed to disclose information regarding prior losses at the time of entering into the insurance contract. The Court held that the insurer, after submitting evidence of relevant underwriting practices, was entitled to void the policy:

> A fact is material so as to avoid *ab initio* an insurance contract if, had it been revealed, the insurer or reinsurer would either not have issued the policy or would have only at a higher premium. While materiality must be assessed as of the time the contract was entered into and is ordinarily a question of fact, where the evidence of the materiality of a misrepresentation is clear and substantially

> uncontradicted, the matter is one of law for the court to determine. We find that the evidence submitted sufficiently established defendant's relevant underwriting practices....7

Concealment and Omission

Generally, an applicant may remain silent on matters concerning which he or she is not questioned.[8] If an insured fails to disclose information in the absence of a question directed at obtaining such information, the mere failure to disclose is not on its own a sufficient basis for an insurer to void a policy of insurance inasmuch as a policy of insurance can be voided only when it is proven that the insured fraudulently concealed material facts.9

For example, where a Contaminated Products policy application asked if the insured knew of any actual or suspected accidental contaminations involving any of its products, the insured answered in the negative. Soon thereafter, the insured sought to add coverage for another of its business entities whose products had previously been contaminated. The insurer did not, however, ask about contamination of the new entity's products and the insured did not volunteer the information. Seeking to void the policy, the insurer argued that the insured had notice as to the materiality of the contamination, but the Court found that the argument lacked merit,[10] noting that an insured's failure to disclose information it knows to be material will void a policy only if nondisclosure amounts to fraud or there is a failure to answer specific inquiries. The court found that the insured had not failed to answer a specific inquiry." The court strictly construed the law requiring the insurer to inquire into specific matters, even in the face of an obviously material omission.

Where an insured was asked no questions and furnished no information on a particular subject relevant to the risk insured, the Court of Appeals held that the insurer was not entitled to rescind the policy on the basis of concealment.[12] In Stecker, the insured, in procuring a policy insuring merchandise, failed to disclose that he had been convicted of a crime. The insurer,

however, asked no questions on the subject when the insured procured the insurance. The Court held that the insurer was not entitled to rescind the policy:

> [I]f the insurer makes no inquiry, and the insured no representation, as to the fact in question, then concealment, short of actual fraud, in respect to such a fact, does not void the policy.l3

It is also true, however, that in the face of a particular question on an insurance application, the concealment or omission of information responsive to that question can be a basis for avoidance of the insurer's obligations under the policy." In Vander Veer, which was a life case but with wider application in regard to the court's pronouncements respecting misrepresentation issues, the insured was asked whether he had received medical advice or treatment for certain types of ailments. The insured listed some ailments and treatments for which he had received treatment and advice but failed to disclose that he had received medical advice and treatment for one other relevant ailment. The Court held that the failure to disclose information related to the treatment of this ailment in response to a question pertaining specifically to that information amounted to a misrepresentation by omission.15

Thus, if an insurer fails to inquire as to particular facts on an insurance application, omission of such facts will generally not permit the insurer to void the policy. Where an insurer asks a particular question and the insured omits facts responsive to that question, a court would consider this a misrepresentation. Generally, the materiality of the information sought by the question is substantiated by the questions' presence on the application.

Courts have, however, also stated more amorphous standards by which omissions should be judged, and although courts have repeatedly held that an insured is under no obligation to volunteer information about which it is not questioned, the following has been noted as well:

> If the applicant is aware of the existence of some circumstance which he knows would influence the insurer in acting upon his application, good faith requires him to disclose that circumstance, though unasked.k)

Thus, if the insured knows of information which is obviously material to the risk and fails to disclose it, even if the insurer does not ask about it, there is a possibility that the failure to disclose would be considered a misrepresentation. Two inquiries must be made when considering whether such an omission will void a policy of insurance:

> I. Was the omission material to the risk? Materiality turns upon whether the underwriter would have accepted the risk with full knowledge of the facts.I7
>
> 2. Was the failure to disclose fraudulent? The question of what constitutes "fraud" is open to some interpretation. If a fact is obviously material to a risk and the insured fails to disclose that fact without being asked, fraudulent intent may be presumed.I8

In determining whether or not an insured has improperly failed to disclose a particular fact, New York courts employ an objective standard, that is, whether a reasonable person in the insured's position would know that the particular fact is materia1.[19] An insured's failure to answer a question on an insurance application will amount to actionable non-disclosure when it can also be shown that the information was material to the risk.[20] Additionally, inasmuch as concealment implies an intentional withholding of facts of which the insured had or should have had knowledge, where the insured had no knowledge, or no reason to know, of a particular fact, there is no basis for claiming that the insured fraudulently concealed the fact.[21] For example, where an insurer was unable to present evidence that a law firm had actual or constructive knowledge of an associate's malpractice, the insurer was not entitled to void the firm's malpractice policy as a result of the failure to disclose such malpractice.22

Misrepresentation

In New York, a misrepresentation on an insurance policy application, whether intentional or not, permits an insurer to void the policy.[23] Recently, however, at least one court has seemingly, and apparently mistakenly, inserted a requirement of fraudulent intent in order for an

insurer to be entitled to void a policy based on material misrepresentation.[24] In Kiss Construction, the insured, on its application for insurance, misidentified the nature of its business. The court noted that "fflor an insurer to be entitled to rescind a policy ab initio, it must show that the applicant made a material misrepresentation with an intent to defraud."[25] Notably, the court did not discuss whether the insured had acted fraudulently in identifying its business as it did, but instead rescinded the insurance policy solely on the basis that the insurance company was able to show that, had the insured been truthful, it would not have issued the policy. In Kiss, the court appears to have incorrectly relied on Dwyer for the proposition that fraud is required in order to void a policy based on material misrepresentations. Dwyer addressed an argument for rescission of a policy based on section 32 l6(d)(I)(B)(i) of the New York Insurance Law, which specifically requires a showing of fraud in order to void a life insurance policy after two years.26 The Court in Kiss appears to have missed this distinction.

If an insured were to make a mistake on an application, the issue whether rescission was warranted would depend on whether the mistake was an omission or a misrepresentation. As set forth above, a negligent -- unintentional -- misrepresentation will void an insurance policy.[27] On the other hand, an omission must be intentional.[28] Accordingly, if an insurer can demonstrate that the insured deliberately omitted a material fact from its application, it may be able to establish that the insured acted fraudulently, thereby meeting its burden with regard to omissions. In contrast, a negligent omission, where there is no evidence of fraud, will not provide a valid basis for rescission of an insurance policy.

Courts have applied the standards set forth above to both large, corporate insureds and individual insureds.[29] Furthermore, courts have held that corporate insureds for which corporate agents procure insurance are imputed with the fraudulent intent of the agent." Courts have also indicated that the size of a corporation does not justify ignorance of the conduct of its parts. For

example, an insurance company, while its health insurance department was aware of material misrepresentations made on an application for health insurance, continued to demand and accept premium payments from the insured.[31] After receiving four such payments, the insurance company rescinded the policy on grounds of material misrepresentation. The court, holding that the insurance company waived its right to rescind the policy, stated: "The fact that a corporation is large and complex and subject to interdepartmental breakdowns in communication does not excuse or put a different face on its conduct or omissions."[32] The court also stated, with regard to a corporation's duties, that "[t]he knowledge of its officers, agents or employees, constituting one of its departments, was the knowledge of defendant corporation...."[33] By way of analogy, a court would likely hold that a corporate insured could not claim ignorance of information relevant to a risk merely because the information could only be found at another corporate division or entity.

Similarly, in a case in which the president of an insured gave false information to the insurance company, the court held that the corporation was not entitled to defense by the insurer, stating that "Nile act of the president was the act of the corporation."34

Thus, a court may, when considering whether a large, corporate insured can claim ignorance as to some material fact affecting coverage, decide that the corporation is bound by the information disclosed to the insurer, regardless of the fact that it was not actually aware of the information at the time of submitting the application. As in Garbin, where the insurer was bound by the actions of its health insurance division and could not claim ignorance as to those actions, so too should an insured be bound by the actions of any of its corporate divisions or entities, where information is ascertainable. There is at least one holding, however, indicating that where a corporate insured is genuinely unaware of certain infonnation, and, based on the facts of the case, unable to ascertain such information, an inaccurate representation of that information on a

policy will not be a valid basis for rescission.[35] In Holloway, the insured made inquiries to all of its employees on the matter of malpractice and represented on its renewal application that inquiries had been made and that no information had been disclosed which would lead the insured to believe that there was any basis for a malpractice claim against it. It turned out that an associate had committed certain acts that gave rise to a claim for malpractice against the insured. The Court looked to whether the insured had actual or constructive knowledge of the potential malpractice claim. The court found that there was no evidence that the insured had actual knowledge of the potential malpractice claim. Furthermore, the court found that there was no basis for the assertion that the insured had constructive knowledge of the potential claim:

> While an innocently made material misrepresentation may serve to void an insurance contract, the precise issue here is whether the [insured] should have had actual or constructive knowledge of the former associate's misconduct. There was no actual knowledge on the part of the inquiring partner and there is insufficient evidence on which he or the firm could be deemed to have had constructive knowledge. The former associate concealed his misconduct and there is no basis for either imputing his knowlede to defendants or for finding that they should have known of such misconduct. 6

Thus, if a corporation were to claim ignorance as to information on an application that constitutes a material misrepresentation, it would have to prove that it had no actual knowledge of the information and that it had no constructive knowledge, i.e., "knowledge that one using reasonable care or diligence should have."[37] A claim of ignorance of certain information material to the risk would therefore not succeed unless the insured demonstrated that it acted reasonably and with due diligence in attempting to ascertain the information in the first place. It should be noted that the analysis in Holloway may be fact-specific. The relevant information existed only in the mind of an associate who was unwilling to disclose it. The court might have come to a different conclusion if the facts had been different. If, for example, the policy had been a property policy and the misrepresentation pertained to certain information not exclusively

within the mind of a particular employee, the court might have held that the innocent misrepresentation was a valid basis for rescission.

In conclusion, where material information has been omitted in the absence of a specific question, courts generally will not find a valid basis for rescission. If, however, the information is so obviously material to the risk that an omission amounts to fraud, a court may rescind a policy. Where an insured omits information responsive to a specific question, an insurer may void a policy by showing that the information was material to the risk.

In the case of misrepresentation, fraud is not required and the insurer may void the policy if it can show that the information misrepresented was material.

The extent to which large, corporate insureds may claim ignorance as to information material to a risk will likely turn on the nature of the information sought. If an insured, with due diligence, could have discovered the information, i.e., had constructive knowledge, then ignorance is no defense. lf, however, the information was unobtainable, as in Holloway, ignorance may be a valid defense.

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[1] N.Y. Ins. L. § 3404(e). Section 3404 of the New York Insurance Law relates only to fire insurance contracts. While section 3404 mandates only that the section of the "I65 Lines" addressing concealment and fraud appear in fire insurance policies, identical or similar provisions appear in most other insurance policies as well and so section 3404 is referenced as an example of such language.

[2] N.Y. Ins. L. § 3105.

[3] See, e.g., Sebring v. Fidelity-Phenix Fire Ins. Co. of New York, 255 N.Y. 382, 387 (1931).

[4] See, e.g., Parmar v. Hermitage Ins. Co., 21 A.D.3d 538, 800 N.Y.S.2d 726 (N.Y. App. Div. 2005)("To establish its right to rescind an insurance policy, an insurer must demonstrate that the insured made a material misrepresentation. A misrepresentation is material if the insurer would not have issued the policy had it known the facts misrepresented."); Falcon Crest Diamonds, Inc. v. Dixon, 173 Misc.2d 450, 655 N.Y.S.2d 232 (Sup. Ct. N.Y. Co. 1996).

[5] The Insurance Services Office provides certain forms and endorsements that can add to or alter provisions of an insurance policy.

" See, e.g.. Interested Underwriters at Lloyd's v. H.D.1. III Assocs., 213 A.D.2d 246, 623 N.Y.S.2d 871 (N.Y. App. Div. 1995).

[7] Interested Underwriters. 213 A.D.2d at 247. 623 N.Y.S.2d at 873 (citations omitted).

[8] See. e.g., National Union Fire Ins. Co. of Pittsburgh. PA v. Stroh Cos., Inc., 265 F.3d 97 t2c; Cir. 2001); Stecker v. American Home Fire Assur. Co., 299 N.Y. I (1949); Nadel v. Manhattan Life Ins. Co., 621 N.Y.S.2d 180 (N.Y. App. Div. 1995); Boyd v. Otsego Mut. Fire Ins. Co.. 125 A.D.2d 977, 510 N.Y.S.2d 371 (N.Y. App. Div. 1986).

[9] See. e.g.. National Union Fire Ins. Co. of Pittsburgh, PA v. Stroh Cos., Inc., 265 F.3d 97 (2d Cir. 2001); Sebring v. Fidelity-Phenix Fire Ins. Co, of New York, 255 N.Y. 382 (1931); H.B. Singer, Inc. v. Mission Nat'I Ins. Co.. 636

N.Y.S.2d 316, 316 (N.Y. App. Div. 1996)("[N]ondisclosure of a fact concerning which the applicant has not been asked does not ordinarily void an insurance policy absent an intent to defraud.").

[lo] National Union, 265 F.3d at 115 n.6.

" Id.

[12] Stecker, 299 N.Y. 1.

" Id. at 8.

[14] See Vander Veer v. Continental Cas. Co., 34 N.Y.2d 50, 356 N.Y.S.2d 13 (I 974)(construing an omission of information material to the risk as a misrepresentation).

[15] Vander Veer, 34 N.Y.2d at 53, 356 N.Y.S.2d at 15.

[16] Sebring v. Fidelity-Phenix Fire Ins. Co. of New York, 255 N.Y. 382, 387 (1931); see also Boyd v. Otsego Mut. Fire Ins. Co., 125 A.D.2d 977, 510 N.Y.S.2d 371 (N.Y. App. Div. 1986); Lighton v. Madison-Onondaga Mut. Fire Ins. Co., 106 A.D.2d 892, 483 N.Y.S.2d 515 (N.Y. App. Div. 1984).

" Sebring, 255 N.Y. at 385 ("If the underwriter, with full information, would have refused to accept the risk, then concealment is material."); see also N.Y. Ins. L. § 3 I05(b).

[18] See, e.g., Boyd v. Otsego Mut. Fire Ins. Co., 125 A.D.2d 977, 510 N.Y.S.2d 371 (N.Y. App. Div. 1986)(holding that, where the insured used a fictitious name and failed to disclose that he was a fugitive from justice, there were questions of fact as to the insured's intent).

[19] Alaz Sportswear v. Public Service Mut. Ins. Co., 195 A.D.2d 357, 600 N.Y.S.2d 63 (N.Y. App. Div. 1993); Falcon Crest Diamonds v. Dixon, 175 Misc.2d 450, 655 N.Y.S.2d 232 (Sup. Ct. N.Y. Co. 1996).

[20] See, e.g., Sebring v. Fidelity-Phenix Fire Ins. Co. of New York, 255 N.Y. 382 (1931); H.B. Singer, Inc. v. Mission Nat'l Ins. Co., 636 N.Y.S.2d 316, 316 (N.Y. App. Div. 1996)("[N]ondisclosure of a fact concerning which the applicant has not been asked does not ordinarily void an insurance policy absent an intent to defraud.").

[21] Fratello v. Savings Bank Life Ins. Fund, 186 A.D.2d 1061, 588 N.Y.S.2d 488 (N.Y. App. Div. 1992).

[22] Holloway v. Sacks & Sacks, Esqs., 275 A.D.2d 625, 713 N.Y.S.2d 162 (N.Y. App. Div. 2000).

[23] See, e.g., Rafi v. Rutgers Cas. Ins. Co., No. 08-00800, 2009 N.Y. App. Div. LEX1S 949 (N.Y. App. Div. Feb. 6, 2009)(reversing judgment for insured on basis that jury instruction did not include statement that misrepresentations may be innocently made to warrant rescission); Precision Auto Accessories, Inc. v. Utica First Ins. Co., No. 06-03547, 2008 N.Y. App. Div. LEX1S 5182, *2 (N.Y. App. Div. June 6, 2008)("[A] material misrepresentation, even if innocent or unintentional, is sufficient to warrant a rescission of the policy.")(citing McLaughlin v Nationwide Mut. Fire Ins. Co., 8 A.D.3d 739, 777 N.Y.S.2d 773; Jonari Mgt. Corp. v St. Paul Fire & Mar. Ins. Co., 58 N.Y.2d 408, 461 N.Y.S.2d 760).

[24] See Kiss Constr. NY, Inc. v. Rutgers Cas. Ins. Co., No. 602373/05, 2009 N.Y. App. Div. LEXIS 2450, *I (N.Y. App. Div. Apr. 2, 2010)("For an insurer to be entitled to rescind a policy ab initio, it must show that the applicant made a material misrepresentation with an intent to defraud.")(citing Dwyer v. First Unum Life Ins. Co., No. 604342/01, 2007 N.Y. App. Div. LEX1S 6707 (N.Y. App. Div. June 5, 2007)).

[25] Kiss Constr. NY, Inc., 2009 N.Y. LEXIS at *1.

[26] N.Y. Ins. L. § 3216(d)(1)(B)(i). This section of the New York Insurance Law mandates that certain provisions be included in all "health and accident" policies falling within the general definition appearing in § 1113 of the Insurance Law. Section 3216(d)(1)(B)(i) states that the following provision must appear in all such policies:

> After two years from the date of issue of this policy no misstatements, except fraudulent misstatements, made by the applicant in the application for such policy shall be used to void the policy or to deny a claim for loss incurred or disability (as defined in the policy) commencing after the expiration of such two year period.

[27] See, e.g., Rail v. Rutgers Cas. Ins. Co., No. 08-00800, 2009 N.Y. App: Div. LEX1S 949 (N.Y. App. Div. Feb. 6, 2009)(reversing judgment for insured on basis that jury instruction did not include statement that misrepresentations may be innocently made to warrant rescission); Precision Auto Accessories, Inc. v. Utica First Ins. Co., No. 06-03547, 2008 N.Y. App. Div. LEXIS 5182, *2 (N.Y. App. Div. June 6, 2008)("[A] material misrepresentation, even if innocent or unintentional, is sufficient to warrant a rescission of the policy."); McLaughlin v. Nationwide Mut. Fire Ins. Co., 8 A.D.3d 739, 777 N.Y.S.2d 773 (N.Y. App. Div. 2004)("[The insured's] material misrepresentation, even if innocent or unintentional, is sufficient to warrant a rescission of the policy."): Curanovic v. New York Cent. Mut. Fire Ins. Co., 307 A.D.2d 435, 436, 762 N.Y.S.2d 148, 150 (N.Y. App. Div. 2003)("Rescission is available even if the material misrepresentation was innocently or unintentionally made.")

[28] See, e.g., National Union Fire Ins. Co. of Pittsburgh, PA v. Stroh Cos., Inc., 265 F.3d 97 (2d Cir. 2001); Sebring v. Fidelity-Phenix Fire Ins. Co. of New York, 255 N.Y. 382 (1931); H.B. Singer, Inc. v. Mission Nat'l Ins. Co., 636 N.Y.S.2d 316, 316 (N.Y. App. Div. 1996)("[N]ondisclosure of a fact concerning which the applicant has not been asked does not ordinarily void an insurance policy absent an intent to defraud.").

[2g] See, e.g., Sun Ins. Co. of New York v. Hercules Sec. Unlimited, Inc., 195 A.D.2d 24, 605 N.Y.S.2d 767 (N.Y. App. Div. 1993)(applying the standard for fraudulent concealment of a material fact to an armored car company); Curanovic v. New York Cent. Mut. Fire Ins. Co., 307 A.D.2d 435, 436, 762 N.Y.S.2d 148, 150 (N.Y. App. Div. 2003)(applying rescission standard to an individual insured).

[3°] See Sun Ins. Co. of New York v. Hercules Sec. Unlimited, Inc., 195 A.D.2d 24, 30, 605 N.Y.S.2d 767, 771 (N.Y. App. Div. 1993)("[T]here can be no question that the insured, Hercules, acting through its corporate agent ... for whose fraudulent conduct Hercules is by imputation responsible ....).

[31] Garbin v. Mut. Life Ins. Co. of New York, 77 Misc. 2d 689, 356 N.Y.S.2d 741 (Sup. Ct. 1974).

[32] Garbin, 77 Misc. 2d at 690, 356 N.Y.S.2d at 742.

" Id.

[34] Peerless Ins. Co. v. Sears, 32 A.D.2d 725, 312 N.Y.S.2d 347 (N.Y. App. Div. 1970).

[35] See Holloway v. Sacks & Sacks, Esqs., 275 A.D.2d 625, 713 N.Y.S.2d 162 (N.Y. App. Div. 2000).

[36] Holloway, 275 A.D.2d at 626, 713 N,Y.S.2d at 164.

" BLACK'S LAW DICTIONARY 876 (7th ed. 1999).