

Disciplinary Action Ending in Consent Order May Be Material Misrepresentation Justifying Rescission

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In an unreported decision, a United States District Court in Minnesota, applying Minnesota law, has held that failure to disclose a consent order and licensing restrictions imposed on an insurance agent employed by the policyholder insurance agency may constitute a material misrepresentation, thereby allowing rescission. *Westport Ins. Corp. v. Endres Processing, LLC*, 2005 WL 1267817 (D. Minn. May 25, 2005). The court, held, however, that disputed facts precluded summary judgment as to whether the misrepresentation was material to the risk insured, as well as whether the fact that the agent was later issued a probationary license by a different state should have been disclosed.

Before completing a renewal application for a professional liability policy, the president of the Minnesota insurance agency/policyholder was aware that one of its agents had been the subject of a disciplinary action in Iowa. In that action, the Insurance Division of Iowa agreed to a consent order resolving allegations that the agent improperly withheld premiums after his former employer refused to pay termination compensation. The consent order resolved the matter "without admission as to the truth or falsity of the allegations made." Subsequently, the president of the insurance agency successfully assisted the agent in obtaining his Minnesota insurance agent's license subject to certain restrictions, including an initial probationary period.

On its renewal application, the insurance agency responded "no" to the question "During the past policy period, has any owner, officer, director, partner, employer [sic] or solicitor of the firm been the subject of disciplinary action by any insurance regulatory authority?" On two subsequent renewal applications, the insurance agency responded "no" to similar questions, which asked about "complaints filed and/or disciplinary action by any insurance regulatory authority." After learning of the agent's licensing problems, the insurer rescinded the policies. The coverage action followed.

Minnesota law allows rescission if "there was material misrepresentation, material omission, or fraud made by or with the knowledge of the insured in obtaining the contract or in pursuing a claim under the policy." A misrepresentation is material if it either (1) increases the risk of loss to the insurer or (2) is made with intent to deceive or defraud. The court first determined that the plain meaning of "disciplinary action" as used in the renewal application is "limited to coercive or punitive action." The court found that the license suspension and

limits imposed by the Insurance Division of Iowa were disciplinary. The court explained that, notwithstanding the consent order, the Insurance Division of Iowa's "expressed intention and adversarial stance show that [it] sought to correct or punish" the agent's behavior.

The court, however, found material issues of fact regarding the materiality of this misrepresentation and more specifically, whether "the misrepresentation increased the risk of loss." An underwriter for the insurer testified that it would have insured the agency, excluding the disciplined agent, if it was aware of the licensing problems as to that agent. The court also noted that it was unclear whether the insurer had notice of these licensing problems. As a result, the court denied summary judgment on this issue.

Regarding the Minnesota licensing restrictions, the court explained that a jury could find that these limits were "preventative or precautionary" because they were based on the Iowa disciplinary action. The court therefore denied summary judgment on the issue of whether the agency was obligated to disclose that information.

For more information, please contact us at 202.719.7130.