Colorado

By Laura T. Schneider and Melissa A. Wiese

What is the required procedure for seeking rescission? If there is no required procedure, what are the acceptable or customary procedures for rescission?

The procedure for rescinding a policy, assuming the elements necessary for doing so exist, is to simply notify the insured, in writing, of the rescission and refund the premium paid. The insurer need not wait for a court to approve or rule on rescission. If the policyholder voluntarily cashes the premium refund check with the knowledge and understanding that the purpose of the check is rescission of the policy, it creates an inference that mutual rescission has occurred. *See Avemco Ins. Co. v. N. Colo. Air Charter*, 38 P.3d 555, 563 (Colo. 2002) (analyzing *Equitable Life Ins. Co. of Iowa v. Verploeg*, 227 P.2d 333 (Colo. 1951). A policyholder may overcome the inference of rescission if he or she offers evidence, beyond a subjective intent not to rescind, to rebut the acts of the insurer. The *Avemco* court noted that the inference could be rebutted, for example, if the policyholder was illiterate and attempted to return the premium once he or she discovered the insurer's intent. It is not clear under Colorado law, however, whether rescission occurs if the policyholder does not cash the tendered premium check. In that event, the customary procedure would be to seek court approval of the rescission.

What must an insurer prove to be entitled to rescind a policy?

Is it required that the insured have committed an intentional or fraudulent misrepresentation on the application? Or is it sufficient that there was a material misrepresentation, regardless of intent?

An insurer may have grounds to rescind a policy under Colorado law if the insured made misrepresentations in the application for insurance. In order to rescind an insurance policy on this basis, the insurer must establish the following:

> (1) the applicant made a false statement of fact or concealed a fact in his application for insurance;
>
> (2) the applicant knowingly made the false statement or knowingly concealed the fact;
>
> (3) the false statement of fact or the concealed fact materially affected either the acceptance of the risk or the hazard assumed by the insurer;
>
> (4) the insurer was ignorant of the false statement of fact or concealment of fact and is not chargeable with knowledge of the fact; and
>
> (5) the insurer relied, to its detriment, on the false statement of fact or concealment of fact in issuing the policy.

Hollinger v. Mut. Benefit Life Ins. Co., 560 P.2d 824, 827 (Colo. 1977). These elements must be established by a preponderance of the evidence. *See Littlehorn v. Stratford*, 653 P.2d 1139 (Colo. 1982).

The representation need not be fraudulent; rather, the false statement must be knowingly made. Nor must the insurer prove an intent to deceive. *Hollinger*, 560 P.2d at 827. A court should examine the truth or falsity of a representation on an insurance application in the light of what the applicant knew or had reason to know at the time of his application." *Wade v. Olinger Life Ins. Co.*, 560 P.2d 446, 453 n. 8 (Colo. 1977).

Is there a separate requisite showing of reliance by the insurer, or is reliance presumed if materiality is found?

In regard to materiality and the insurer's reliance, the Colorado Supreme Court has explained that the misrepresentation "not only must be actually

material to the insurer's risk as demonstrated by customary underwriting procedures, it also must be such that a reasonable person would, under the circumstances, have understood that the question calls for disclosure of specific information." *Wade*, 560 P.2d at 446. Thus, in assessing the materiality of a misrepresentation under Colorado law, it is necessary to consider whether "a reasonable person would have perceived it as an item which, because of the nature of the questions asked and the type of insurance at issue, the insurer would desire to know about in assessing the risks." *Id.* at 452-53.

While the general rule is that a policy may be rescinded if the insured intentionally misrepresented a material fact upon which the insurer relied, an insurer is estopped from rescinding a policy on the basis of a misrepresentation in the application when the applicant acted in good faith and gave truthful information to the insurer's agent, but the agent inserted false information into the application. *See Silver v. Colorado Cas. Ins. Co.*, 219 P.3d 324, 329 (Colo. App. 2009); *see also Federal Life Ins. Co. v. Kras*, 45 P.2d 636 (Colo. 1935) (finding an agent's carelessness or neglect are deemed to be those of the insurer, rather than the insured such that the insurer is "estopped to set up any statements contained in the application to defeat recovery.") This concept, known as the *Van Fleet* rule (derived from *Pacific Mut. Life Ins. Co. v. Van Fleet*, 107 P. 1087, 1091 (Colo. 1910)), applies regardless of any language in the application which provides that the insured read the application and attests to its accuracy. *Silver*, 219 P.3d at 330.

With regard to life insurance, accident insurance, and other such policies, does your jurisdiction recognize that the policy becomes "incontestable" after a certain period of time? And must an insurer, in turn, prove fraud to rescind the policy?

A life insurance policy must be incontestable after it has been in force during the insured's lifetime for two years from its inception date pursuant to Colorado statute. C.R.S. §10-7-102(1)(b). Exceptions to that incontestability requirement are for nonpayment of premiums and violation of prohibited risks, including conditions related to military service in time of war. The two year incontestability period may start over on the date of a reinstatement application if it has lapsed due to non-payment of premium. *See Spencer v. Kemper Investors Life Ins. Co.*, 764 P.2d 408 (Colo. App. 1988). Other than the incontestability requirement, Colorado courts do not draw a distinction between the type of policy involved when analyzing rescission based upon misrepresentation, the factors set forth above in Section 2.a. must be proven. *See Murray v. Montgomery Ward Life Ins. Co.*, 584 P.2d 78, 80 (Colo. 1978) (setting forth the five factors listed above in connection with rescission of a life insurance company policy based upon a misrepresentation in the application; *Silva*, 219 P.3d 324, 328 (Colo. App. 2009) (finding carrier had to establish the above five factors to rescind a homeowner's policy based upon misrepresentation).

Can an insurer rescind based on the insured's failure to volunteer material information that was not requested by the application? That is, does the insured have a duty to volunteer material information?

While Colorado courts have not directly addressed the issue, it does not appear a Colorado court would permit an insurer to rescind a policy based upon the insured's failure to volunteer information that was not specifically requested in the application, unless a "reasonable person" would understand that the information is within the scope of the questions asked in the application. In regard to whether a false statement was knowingly made, courts must look to "whether a reasonable person, with the applicant's physical or mental characteristics, under all the circumstances, would understand that the question calls for disclosure of specific information." *Hollinger*, 560 P.2d at 827. Likewise, in order "to protect innocent insurance applicants, an applicant must be reasonably chargeable with knowledge that the facts omitted or misrepresented were within the scope of questions asked on the application." *Wade*, 560 P.2d at 452.

With those standards in mind, the Tenth Circuit Court of Appeals, construing Colorado law, found that the insured should have disclosed the fact that he participated in "heli-skiing" in response to a question which asked whether the applicant "engaged in auto, motorcycle or boat racing, parachuting, skin or scuba diving, skydiving or hang

gliding or other hazardous avocation or hobby." *West Coast Life Ins. Co. v. Hoar*, 558 F.3d 1151 (10th Cir. 2009). After reviewing the carrier's evidence suggesting the high risk of death by avalanche (the cause of the applicant's death) associated with heli-skiing, the court determined heli-skiing was a hazardous activity which should have been disclosed in the application. The court explained that "a reasonable, ordinary person would understand that a sport whose participants equip themselves with 'avalanche beacons' … and ride in helicopters to the summits of isolated backcountry mountains in order to ski down ungroomed alpine terrain … falls along with sky diving, hang gliding, and scuba diving into the commonsense category of 'hazardous' activities." *Id.* at 1158. Thus, the court in *West Coast Life v. Hoar* concluded it was appropriate for the carrier to rescind the policy, even though the question in the application did not specifically ask about "heli-skiing."

If your jurisdiction requires a showing that misrepresentations be material, what constitutes materiality? Does there need to be some sort of causal nexus between the misrepresentation and ultimate loss?

Colorado does not require a direct causal nexus between the misrepresentation and the ultimate loss. Rather, a "material fact" is one to which "a reasonable person under the circumstances would attach importance in determining his or her course of action." CJI-Civ.3d 19:4; *see also Wade,* 560 P.2d at 452, n.7. *Wade* explained that the misrepresentation "not only must be actually material to the insurer's risk as demonstrated by customary underwriting procedures, it also must be such that a reasonable person would, under the circumstances, have understood that the question calls for disclosure of specific information." *Id.* at 446. Thus, in assessing the materiality of a misrepresentation under Colorado law, it is necessary to consider whether "a reasonable person would have perceived it as an item which, because of the nature of the questions asked and the type of insurance at issue, the insurer would desire to know about in assessing the risks." *Id.* at 452-53.

It may be enough to establish materiality if an insurer can show it would have required different terms, higher premiums, or conducted additional investigation. In *West Coast v. Hoar*, for example, while not specifically addressing materiality, the court noted the insurer's evidence that the annual premium would have tripled had the insured disclosed his heli-skiing activities. 558 F.3d 1151. Of course, in that case, the insured was killed while doing the very activity he failed to disclose.

What types of proof can or must an insurer rely on to seek rescission?

In seeking to rescind, evidence such as an affidavit or testimony from an underwriter stating that the policy would not have been issued if truthful answers had been given appears to suffice to establish the misrepresented or omitted fact was material to the risk assumed and/or the insurer's reliance on the facts in the application. *See Spencer v. Kemper Investors Life Ins. Co.*, 764 P.2d 408, 412 (Colo. App. 1988) (finding elements of rescission met where insured knowingly misrepresented his recent medical history and insurer's manager and chief underwriter testified that, had the insured given truthful answers on the application, the policy would not have been reinstated). Thus, it does not appear Colorado courts require objective evidence of underwriting guidelines or past underwriting to establish materiality of the misrepresentation or omission; however, such information is certainly helpful. Further, while each case is fact specific, Colorado courts appear to require some showing that the misrepresented information was actually considered by an underwriter in deciding whether to issue the policy.

The elements of rescission do not contain a requirement that the misrepresentation be in writing. No published Colorado decisions to date have discussed whether oral misrepresentations may form the basis of rescission, however. Thus, the issue appears to be an open question.

Does an actionable misrepresentation in a policy application render the policy voidable or void *ab initio*?

Where a policyholder misrepresents material facts to obtain insurance, the provisions obtained under those circumstances are void from their inception (*ab initio*). *See Safeco Ins. Co. v. Gonacha*, 350 P.2d 189, 191 (Colo. 1960). Materiality is established if a false or concealed fact materially affected either the

risk accepted or the hazard insured against such that the insurer would not have included the coverage provision had it been truthfully informed. *See State Comp. Ins. Fund v. Indus. Comm'n*, 737 P.2d 1116, 1118 (Colo. App.1987). *See also Nationwide Mut. Ins. Co. v. Mrs. Condies Salad Co.,* 141 P.3d 923, 925 (Colo. App. 2006).

Of note, however, the Colorado Division of Insurance has issued regulations limiting rescission of certain types of insurance policies. In pertinent part, the following regulations may apply:

With respect to rescission of Long Term Care Insurance, 3 CCR 702-4, Reg. 4-4-1 §11—Prohibiting Against Post-Claims Underwriting provides that where an application requests a listing of medications, and the applicant lists medications prescribed by a physician on the application, if the insurer knew or should have known at the time of the application that such medication relates to a medical condition for which coverage would otherwise be denied, then the policy cannot be rescinded for that condition.

With respect to automobile insurance policies, 3 CCR 702-5, Reg. 5-2-12 §5—Rules provides that an insurer may not rescind a policy of insurance affording the coverages required by C.R.S. §§10-4-609 (insurance protection against uninsured motorist), 10-4-620 (required coverage), and 10-4-621 (required coverages are minimum), or otherwise void such applicable coverages, except in case of fraud, as defined in §10-1-128, C.R.S., or if the insurer does not receive appropriate premium payment (i.e., insufficient funds) for the policy at the time of application. When the basis for rescission is based on fraud (as opposed to insufficient premium payments), C.R.S. §10-1-128 states:

> A fraudulent insurance act is committed if a person knowingly and with intent to defraud presents, causes to be presented, or prepares with knowledge or belief that it will be presented to or by an insurer, a purported insurer, or any producer thereof any written statement as part or in support of an application for the issuance or the rating of an insurance policy or a claim for payment or other benefit pursuant to an insurance policy that he or she knows to contain false information concerning any fact material thereto or if he or she knowingly and with intent to defraud or mislead conceals information concerning any fact material thereto.

Upon a showing of the requisite elements of rescission, is rescission effective as to innocent insureds and third-parties?

Colorado has yet to rule on the innocent third-party rule that exists in many states; however, the Motor Vehicle Financial Responsibility Act, C.R.S. §42-7-102, contains the following specific legislative declaration:

> The general assembly is acutely aware of the toll in human suffering and loss of life, limb, and property caused by negligence in the operation of motor vehicles in our state. Although it recognizes that this basic problem can be and is being dealt with by direct measures designed to protect our people from the ravages of irresponsible drivers, the general assembly is also very much concerned with the financial loss visited upon innocent traffic accident victims by negligent motorists who are financially irresponsible. In prescribing the sanctions and requirements of this article, it is the policy of this state to induce and encourage all motorists to provide for their financial responsibility for the protection of others, and to assure the widespread availability to the insuring public of insurance protection against financial loss caused by negligent financially irresponsible motorists. *Id.*

This statement of public policy may eventually result in a ruling in favor of coverage where an innocent third party is involved.

Are there any statutory or regulatory time limits on seeking rescission of a policy? If so, does the statutory or regulatory language override or supersede express policy language allowing for rescission beyond the time limitation?

There is little guidance in Colorado regarding time limits for seeking rescission of a policy. 3 CCR 702-5, Reg. 5-2-12 §5 addresses cancellation of a policy, allowing an insurance company to cancel a newly issued policy that has been in effect less than sixty (60) calendar days at the time the notice of cancellation is sent by the insurer. Any such notice of cancellation may not be based on any of the prohibited reasons listed in C.R.S. §§10-4-626 (cancella-

tion because of the age, race, creed, color, religion, sex, sexual orientation, national origin, ancestry, residence, marital status, or lawful occupation, including the military service, of anyone who is or seeks to become insured or solely because another insurer has canceled a policy or refused to write or renew such policy), 10-4-627 (cancellation because of convictions for traffic violations that resulted in less than seven points being assessed under the point system), 10-4-628 (cancellation because an accident for which the insured was not at fault or due to a suspended license for failure to pay child support), and 10-4-629 (for any reason other than nonpayment of premium). Notice requirements for such cancellations are governed by policy termination provisions. The notice shall be mailed at least ten (10) calendar days prior to the cancellation effective date. Whenever the insurer chooses to cancel a policy, the earned premium shall be determined on a pro-rata basis, including cancellation for nonpayment of premium. As noted, rescission requires a full premium refund.

What is the requirement for an insurer to be considered to have waived its right to rescind the policy, and what other equitable defenses are available to insureds?

Does an insurer need to have actual knowledge that the insured has made a misrepresentation, or will constructive knowledge be sufficient?

Will an insurer be estopped from rescinding the policy if it waits too long to do so after acquiring actual or constructive knowledge of the misrepresentation?

When is an insurer required to investigate application answers? If an insurer is so required, does the duty extend only to "easily ascertainable" fraud, or does it go further?

If the insured intentionally made the misrepresentation or otherwise acted in bad faith, can there be any waiver by the insurer at all?

Under long-standing Colorado law, an insurer is estopped from rescinding an insurance contract and denying coverage on the basis of a misrepresentation in the application when the applicant acted in good faith and gave truthful information to the insurer's agent, but the agent inserted false information into the application. *Silver v. Colorado Cas. Ins. Co.,* 219 P.3d 324, 329 (Colo. App. 2009). The rationale for this rule (referred to as the Van Fleet rule, see Section 2.b. above) is that because the applicant gave correct information to the insurer's agent, the insurer is deemed to know that contrary information in the application is false, and, having issued the policy despite knowing of the false information, may not later avoid liability on the policy based on the false statements. *See, e.g., National Mut. Fire Ins. Co. v. Duncan*, 98 P. 634, 639-40 (Colo. 1908).

A contrary rule applies, however, if the applicant gave the insurer's agent false information, or did not give the agent any information, and the agent inserted false information into the insurance application. In such circumstances, the insurer may rescind (or otherwise avoid liability on) the insurance contract based on any material misrepresentations contained therein. *Silver,* 219 P.3d at 330. This rule (referred to as the Wich rule, derived from *Sun Fire Office v. Wich*, 39 P. 587 (Colo. App. 1894)) is based on the rationale that in such circumstances the applicant is not entitled to assume that the agent included correct information in the application, and in contrast to the situation in the cases applying the Van Fleet rule, the applicant's culpability outweighs that of the agent. *See Modern Woodmen of Am. v. International Trust Co.*, 136 P. 806, 810-14 (Colo. App. 1913). Note, however, that shortly after the Wich case was decided, legislation was passed which holds that insurance solicitors represent the insurer, not the insured. See Colo.Rev.Stat. §10–2–401. Given this, despite the analysis in *Silver*, one judge from the U.S. District Court of Colorado has noted that it is questionable whether the Wich rule is still applicable. *See, e.g., Barrera v. Am. Nat'l Prop. & Cas. Co.,* No. 12-CV-00413-WYD-MEH, 2013 WL 5426349, at *10 (D. Colo. Sept. 27, 2013).

An insurer has a duty to investigate representations in an application only if it has sufficient information that would put a reasonably prudent insurer on notice of a possible misrepresentation and would have caused the insurer to begin an inquiry, which,

if carried out with reasonable thoroughness, would have revealed the truth. *Silver,* 219 P.3d at 331.

Under what circumstances must an insurer refund the premiums to the insured when rescinding a policy, and when must the refund be dispensed? Does the insurer have to refund the premiums even in situations where the insured procured the policy through willful fraud?

As set forth in *Barrera v. Am. Nat'l Prop. & Cas. Co.,* No. 12-CV-00413-WYD-MEH, 2013 WL 5426349, at *7 (D. Colo. Sept. 27, 2013), "Rescission in its most basic form is an equitable remedy designed to return the parties to the status quo prevailing before the existence of an underlying contract." *Rosenfield v. HSBC Bank, USA*, 681 F.3d 1172, 1183 (10th Cir. 2012). While such rationale supports the return of a premium, Colorado courts have followed the general rule that, in the usual instance of policy defenses, a return of premiums paid, or tender thereof is not necessary prior to defending against the claim. *Security Ben. Association v. Henning,* 222 P. 396 (Colo. 1924); *Simpson v. Millers Nat. Ins. Co.,* 486 P.2d 12, 14 (Colo. 1971).

In *Simpson*, a claim arose out of a fire loss on a policy issued by Millers National Insurance Company ("Miller"). The policy had been issued in 1958 and renewed in 1961 with the building rated as a general warehouse. Miller contended that prior to the fire, the building was rented by plaintiff to a tenant engaged in manufacturing mattresses and that the use with its attendant volatile cotton matting and dust increased the hazard over that contemplated by use as a warehouse. Under its terms, the policy was suspended during the period of the hazardous use if notification of change in use was not communicated to the company and if the additional premium were not paid. The trial court held that Miller had no obligations to pay for the fire damage under the policy. On appeal, Simpson claimed that Miller was estopped to refuse payment of the proceeds of the policy due to its failure to return premiums paid by Plaintiff at the time of the loss. Following the fire, however, Miller refunded that portion of the premium which was unearned, e.g., the premium for the policy period subsequent to the fire. No demand or counterclaim was ever made by the plaintiff for the return of the premiums earned as of the time of the loss, and these premiums were never returned by Miller. In affirming the trial court's ruling, the Colorado Supreme Court stated:

> In holding that the defendant was not estopped from refusing payment by its failure to return those premiums earned, we choose not to pass on the question of whether the policy here under consideration was void ab initio, or whether coverage was merely suspended during the period of during which the hazard or risk was increased. Rather, our holding is posited upon the theory that where, as here, the insurer did not acquire knowledge of the change … until after the loss for which indemnity is claimed, there is no waiver or estoppel by a failure to return premiums.
>
> 'Nor can the mere retention of the premium, after the loss has occurred, and where the liability is steadfastly denied, constitute either a waiver of the defense or an estoppel. To constitute such waiver or estoppel by the action or nonaction of the insurer after the loss, it is essential that one party should have relied upon the conduct of the other, and been induced by it to put himself in such a position that he would be injured if the other should be allowed to repudiate his action. * * * Here nothing was done which could have led the insured to believe that the defendant would not take advantage of the breach of warranty. Upon the contrary, it persistently asserted its reliance upon such breach.' *Goorberg v. Western Assurance Co.,* 150 Cal. 510, 89 P. 130 (1907) (Footnotes omitted.)

Simpson, 486 P.2d at 14.

Are there any other notable cases or issues regarding an insurer's right and ability to rescind?

No–this is not a very well developed area of the law in the state of Colorado, other than those cases discussed above.

AUTHORS

For over twenty years, **Laura Schneider** has vigorously defended lawsuits arising out of first and third-party insurance claims. She also advises insurance companies on coverage issues under a wide variety of insurance policies/forms. In 2000, Ms. Schneider co-authored an article on multiply triggered policies and allocation of damages across the same. She also authored the "Evidence" chapter in the Annual Survey of Colorado Law from 2008 through 2016. Ms. Schneider is an active member of the Arapahoe County Bar Association, which she ran as the President from 2012 to 2013.

Pearl Schneider LLC | 303.525.6800 |
lschneider@pearlschneider.com

Melissa Wiese has over 20 years of experience in insurance coverage, construction defect, general liability defense, and appellate work. She has argued before the Colorado Supreme Court and the Tenth Circuit Court of Appeals. Ms. Wiese has also spoken at national conferences, including the West Coast Casualty Construction Defect Seminar. Ms. Wiese advises insurance clients on pre- and post-suit claims handling, and the defense and prosecution of coverage and bad faith actions. Her litigation practice ranges from two-party personal injury cases to complex, multi-party construction defect actions, including contract disputes.

Pearl Schneider LLC | 303.525.6800 |
mwiese@pearlschneider.com