

Fraud Not Necessary For Policy Rescission

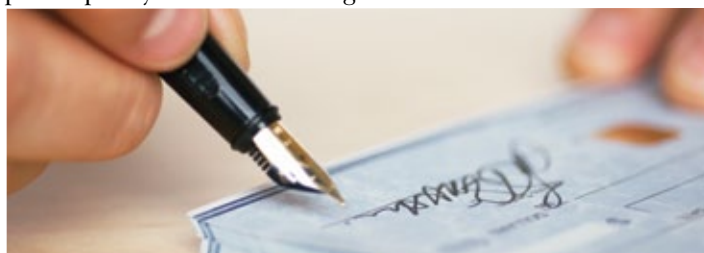
BY JONATHAN STERLING

In *National Bank of Andover v. Kansas Bankers Sur. Co., et al.*, the Kansas Supreme Court rejected the argument that rescission of an insurance policy is only proper where the insured knowingly or fraudulently includes incorrect information on an insurance application.

In 2002, the National Bank of Andover (Bank) submitted to Kansas Bankers Surety Company (KBS) a financial institution crime bond renewal application form. The application contained representations that the Bank had in place certain internal controls. The Bank agreed that any misrepresentation, omission, concealment or incorrect statement of a material fact in the application would be grounds for rescission of the policy.

Shortly after the renewal application was submitted, the Bank learned that its accounting clerk had cashed checks for three customers despite knowing the customers had insufficient funds in their accounts to cover the checks. The clerk's actions resulted in a loss to the Bank of approximately \$900,000. The Bank submitted a proof of loss statement to KBS seeking to recoup this amount.

KBS investigated the claim and found that the Bank had provided false answers to the internal control questions on the application. KBS commenced a declaratory action to rescind the policy, and a separate action was commenced by the Bank claiming that KBS breached the parties' contract. In the trial of the consolidated action, the Bank argued that only a fraudulent, and not simply a negligent misrepresentation was a proper basis for the rescission of the policy. The trial court instructed the jury that it must find a fraudulent misrepresentation by the Bank on the application for the rescission to have been proper. The Kansas Supreme Court reversed the jury's verdict in the Bank's favor, holding that KBS could have properly rescinded the policy for less serious than fraudulent misconduct. The court found that the policy provision allowing for rescission of a contract between two sophisticated commercial entities, did not contravene public policy and was not illegal.



Policy rescission not due to rubber checks

Bad Faith Claim Survives Summary Judgment Despite No Duty to Defend or Indemnify

BY JIM GOODFELLOW

In *North Seattle Community College Foundation (the Foundation) v. Great American E & S Insurance Co. (Great American)*, the U.S. District Court for the Western District of Washington concluded that even though Great American had no duty to defend or indemnify its insured, whether it acted in bad faith nevertheless raised genuine issues of material fact that precluded summary judgment.

The Foundation, which operated a credit counseling service, was sued in Georgia for allegedly violating the cap on fees imposed by Georgia's Debt Adjusting Act. The Foundation had a professional liability policy issued by Great American that excluded coverage for statutory penalties incurred and disgorgement of monies improperly collected.

When the Foundation notified Great American of the lawsuit, Great American declined to provide coverage, but allegedly did not communicate a definitive coverage position, merely stating that it had serious questions about coverage. The Foundation ultimately settled the underlying suit.

Great American later sued the Foundation in Georgia, seeking declaratory judgment regarding coverage. The Foundation successfully had the suit transferred to Washington, where it had initiated its own suit for breach of contract and bad faith. Both parties moved for summary judgment. While the court concluded that Great American had no obligation to defend or indemnify the Foundation because of the policy exclusion, it found that there was a genuine issue of material fact as to whether Great American acted in bad faith in failing to communicate a definitive coverage position, and then suing the insured without warning. The court stated that straightforward communication with the Foundation, rather than equivocation, could have benefitted the Foundation during underlying settlement negotiations. The court further found that Great American's decision to sue in Georgia caused the Foundation to incur unnecessary expenses associated with transfer of the action to Washington.