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Federal District Court Addresses Applicability of Fraud Provision to Post-Payment Conduct of Insured

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In *Great Lakes Insurance Se v. Nr 1 Transport, Inc. & Nz Services, Inc*., No. 20 C 5599, 2021 WL 2222607, at *1 (N.D. Ill. June 2, 2021), the United States District Court for the Northern District of Illinois addressed a complaint filed by an insurance carrier against its insured seeking the return of insurance payment made in connection with a damaged tractor. The facts as alleged are relatively straightforward. In March 2020, one of the insured's insured tractors was damaged in an accident. The claim was submitted to Great Lakes, and Great Lakes paid the costs to tow and store the tractor, along with the tractor's "actual cash value" which was approximately $100,000. Under the terms of the insurance policy, payment of the claim entitled Great Lakes to the tractor's salvage value, and Great Lakes was able to locate a buyer willing to pay approximately $23,000 for the damaged tractor.

Prior to the buyer retrieving the tractor, Great Lakes advised it's insured not to alter the tractor as title to the tractor had been transferred to Great Lakes. Despite those advices, the suit alleged that when the buyer arrived to pick up the damaged tractor, someone had removed a number of components and swapped out others for damaged parts. As a result of the alterations, the buyer refused to purchase the tractor. Although the basis for the assertion was not specified in the opinion, Great Lakes' complaint asserted that culpability for the alterations to the tractor and ultimate failure of the salvage deal fell upon the insured. In an effort to seek recompense, Great Lakes sought a declaration that the insured's alleged misrepresentations concerning the circumstances voided the policy under the fraud provision. Correspondingly, on the assumption that the policy was voided, Great Lakes also sought the return of the towing, storage, and ACV amounts paid in connection with the claim.

The insured moved under Civil Rule 12(b)(6) to dismiss the claims against it arguing that the policy's fraud provision provided no basis for voiding the policy. According to the insured, the fraud provision applies only when an insured "submits a false proof of loss, provides false information during the application process, or … makes a false statement … during the investigation of a claim." Thus, because the alleged misrepresentations made regarding the alterations to the tractor had nothing to do with the formation of the insurance contract or the validity of the claim, the fraud provision was inapplicable. Great Lakes took a broader view of the fraud provision and argued that the provision applies whenever "there are misrepresentations and concealment concerning the insurance generally" and that the provisions reach extends to post-payment conduct. In arguing in favor of a broad interpretation, Great Lakes relied heavily on the disjunctive nature of the provision which provided that the policy was void "if the insured has concealed or misrepresented any material fact or circumstance concerning this Insurance, or if the insured shall make any claim knowing the same to be false or fraudulent."

Agreeing with the insured's narrow reading of the fraud provision, the Court held that the provision's use of the disjunctive actually suggests that the clause governing concealment and misrepresentation of facts "concerning this Insurance" could not be as broad as Great Lakes proposed. Interpreting the term "concerning" as meaning "relating to", the Court began by addressing what it means for a misrepresentation to relate to "this Insurance." The Court identified two plausible answers—one interpreting "this Insurance" broadly and in reference to the ongoing relationship between the parties and a second interpreting "this Insurance" narrowly and referring only to the formation of the insurance contract.

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According to the Court, the broader meaning argued by Great Lakes could not be reconciled with the text of the fraud provision. If any misrepresentation concerning the ongoing coverage voids the policy under the first clause of the disjunctive, as Great Lakes asserted, then the second half of the provision becomes entirely superfluous. Such an interpretation would therefore violate the principle applied in Illinois that insurance policies should not be read in a manner that renders any provision superfluous. Conversely, the narrower reading of “this Insurance” where the term refers only to the process of contract formation allows the disjunctive's two clauses to operate independently by articulating two separate grounds for voiding the policy. The first clause applies if the insured made a material misrepresentation in the contract-formation process. The second clause applies if the insured submits a false or fraudulent claim. The Court therefore concluded that the fraud provision was inapplicable because the insured’s alleged misrepresentations regarding the alterations to the tractor did not relate to the formation of the insurance contract or constitute a fraudulent insurance claim.

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