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Insurance - False Swearing by Insured as a Defense to Insurer - Vernon v. Aetna Insurance Company, 301 F.2d 86 (5th Cir. 1962)

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ents to furnish a college education for their children. This trend seems to be growing because of the need for educated citizens in our society, our families and our government. If the children of today, the leaders and citizens of tomorrow, are to take over our society and government and meet the responsibility of their calling, they must be prepared. The financially able should provide the training and educational support that their children need to meet this responsibility.

INSURANCE–FALSE SWEARING BY INSURED AS A DEFENSE TO INSURER

Marianne Vernon, a resident of Texas, brought suit against the Aetna Insurance Company, in the United States District Court,[1] for recovery of the value of certain insured jewelry. In her complaint she stated that the jewelry was taken from her home under circumstances constituting burglary or theft. After the filing of her complaint, but prior to the insurance company's answer thereto, she swore in an affidavit, confessing that the alleged burglary or theft was a hoax, scheme and conspiracy entered into between her father, mother and herself, devised to defraud the insurance company. The insurance company then filed a motion for summary judgment, attaching thereto a copy of the said affidavit. Prior to the hearing of this motion plaintiff filed a second affidavit, stating that everything in the first affidavit was untrue and completely false. The insurance company then filed another motion for summary judgment, this time relying on the forfeiture clause in its policy which provided for the voiding of the policy if the insured was guilty of making any fraudulant or false swearings in regard to the policy.[2] The insurance company contended that the two affidavits, as a matter of law, constituted fraud, attempted fraud, false swearing, concealment and misrepresentation within the meaning of its forfeiture clause. The United States District Court granted the motion for summary judgment[3] and the plaintiff appealed.

[1] Aetna Insurance Company is a resident of Connecticut, within the meaning of 28 U.S.C. § 1332 (1958). Thus, Federal jurisdiction was obtained under this statute which states: "The District Courts shall have original jurisdiction of all civil actions where the matter in controversy exceeds the sum or value of $10,000, exclusive of interest and costs, and as between citizens of different states, . . . (c) for the purposes of this section . . . a corporation shall be deemed a citizen of any state by which it has been incorporated and of the state where it has its principal place of business."

[2] The clause was worded as follows: "This policy shall be void if the assured has concealed or misrepresented any material fact or circumstance concerning this insurance or the subject thereof or in case of any fraud, attempted fraud or false swearing by the assured touching any matter relating to this insurance or the subject thereof, whether before or after a loss."

[3] Vernon v. Aetna Insurance Company, 189 F. Supp. 233 (S.D. Texas, 1960).

On appeal, this judgment was reversed and remanded, the court basing its reversal on two Texas statutes.[4] While holding that these statutes expressly covered false swearing only when pertaining to the application for insurance[5] or in the making of the proof of loss,[6] the court interpreted them as setting forth the public policy of Texas in all insurance matters pertaining to false swearing. The court found such policy as being opposed to the use of forfeiture clauses, unless the false swearing occurs in the application for insurance or in the proof of loss. The court further held that under this statutory scheme: (a) only those falsehoods material to the risk, and made prior to the occurence of the loss, or (b) those which mislead the insurer causing it to lose some valid defense, if made after the loss occurs, may be made the basis for voiding a policy pursuant to its forfeiture clause. The court found the conflicting affidavits neither material to the risk nor sufficient to mislead the insurer or cause it to lose some valid defense, and held that they were not fraud or attempted fraud under state policy as interpreted from the two aforementioned statutes. *Vernon v. Aetna Insurance Company*, 301 F. 2d 86 (5th Cir. 1962).

The law pertaining to false swearing[7] by an insured, relative to forfeiture clauses in insurance policies, may be broken down into three basic areas: (1) false swearing or fraud in the making of the application for the insurance policy, (2) false swearing or fraud in the making of the proof of loss and (3) false swearing or fraud made after the suit has been instituted.

Where the false swearing or fraud occurs in the making of the applica-

[4] VERNON'S TEXAS INS. CODE, art. 21.16 ,21.19.

[5] VERNON'S TEXAS INS. CODE, art. 21.16: "Any provision in any contract of insurance issued or contracted for in this state which provides that the answers or statements made in the application for such contract or in the contract of insurance, if untrue or false, shall render the contract or policy void or voidable, shall have no effect and shall not constitute any defense to any suit brought upon such contract, unless it be shown upon the trial thereof that the matter or thing misrepresented was material to the risk or actually contributed to the contingency or event on which said policy became due and payable, and whether it was material and so contributed in any case shall be a question of fact to be determined by the court or jury trying such case."

[6] VERNON'S TEXAS INS. CODE, art. 21.19: "Any provision in any contract or policy of insurance issued or contracted for in this state which provides that the same shall be void or voidable, if any misrepresentations or false statements be made in proofs of loss or of death, as the case may be, shall be of no effect, and shall not constitute any defense to any suit brought upon such contract or policy, unless it be shown upon the trial of such suit that the false statement made in such proofs of loss or death was fraudulently made and misrepresented a fact material to the question of the liability of the insurance company upon the contract of insurance sued on, and that the insurance company was thereby misled and caused to waive or lose some valid defense to the policy."

[7] False swearing has been defined as "the deliberate and wilful making, under oath, of a false statement by a voluntary declaration or affidavit which is not required by law or made in the course of a judicial proceeding." Commercial Casualty Ins. Co. v. Holmes, 206 S.W. 2d 882 (Tex. Civ. App., 1947).

tion for the insurance policy, most states hold, whether by statute or by court decision, that misstatements or misrepresentations made by the insured in the application for insurance shall be of no effect and not a defense to the insurer, unless it is shown upon the trial that the matter or thing misrepresented was material to the risk,[8] actually contributed to the contingency or event in which said policy became due and payable or was intentionally made.[9]

Where the false statement or misrepresentation is made by the insured in his proof of loss, most courts hold that, while overvaluation resulting from a mere mistake of error or judgment will not defeat a recovery,[10] a knowingly and wilfully made false statement regarding a material fact[11] will defeat recovery. Where the false statement is knowingly made by the insured, with regard to a material matter, the intent to defraud will be inferred for the law presumes every man to intend the natural consequences of his acts.[12]

The law has not been as uniform, however, where the false statement or misrepresentation has occurred after the suit has been instituted. The most often cited authority[13] holds that "it is only fraudulant false swearing in furnishing the preliminary proofs, or in the examination which the insurer's have a right to require, that avoids the policies. . . ."[14] In the ninety

[8] "A misrepresentation material to the risk, is one concerning a fact which would induce the insured to decline the insurance or to charge a higher premium." St. Paul Fire & Marine Insurance v. Huff, 172 S.W. 755 (Tex. Civ. App., 1915).

[9] Campbell v. Prudential Insurance Co., 16 Ill. App. 2d 65, 147 N.E. 2d 404 (1958); Joseph Supornich & Son v. Imperial Assurance Co., 87 F. Supp. 232 (D. Minn. 1949); Modern Order of Praetorians v. Davidson, 203 S.W. 379 (Tex. Civ. App. 1911); Mecca Fire Ins. Co. v. Stricker, 136 S.W. 599 (Tex. Cic. App. 1911); VERNON'S TEXAS INS. CODE, art. 21.16; ILL. REV. STAT. ch. 73, § 766 (Insurance Code of 1937); 21 APPLEMAN, INSURANCE LAW AND PRACTICE, § 12122 (1941); VANCE, INSURANCE, § 143 (3rd ed. 1951).

[10] Hyland v. Millers National Insurance Co., 58 F. 2d 1003 (9th Cir. 1932), *aff'd.* 91 F. 2d 735 (9th Cir. 1937), *rehearing denied,* 92 F. 2d 462 (9th Cir. 1937), *cert. denied,* 303 U.S. 645 (1938).

[11] Gipps Brewing Corp. v. Central Manufacturer's Mutual Ins., 147 F. 2d 6 (7th Cir. 1945); Sundquist v. Camden Fire Ins. Ass'n., 119 F. 2d 955 (7th Cir. 1941); Hyland v. Millers National Insurance Co., 58 F. 2d 1003 (9th Cir. 1932), *aff'd* 91 F. 2d 735 (9th Cir. 1937), *rehearing denied,* 92 F. 2d 462 (9th Cir. 1937, *cert. denied,* 303 U.S. 645; Weininger v. Metropolitan Fire Ins., 359 Ill. 584, 195 N.E. 420 (1935); Atlas Assurance Co. v. Hurst, 11 F. 2d 250 (8th Cir. 1926); St. Onge v. Hartford Fire Insurance Co., 204 Ill. App. 127 (1917); VERNON'S TEXAS INS. CODE, art. 21.19; ILL. REV. STAT. ch. 73, § 766 (Insurance Code of 1937).

[12] "The burden is upon the insurer to establish fraud or false swearing. But a false answer in a proof of loss as to a material matter, made with intent to deceive, being fraudulant, an intent to deceive is presumed where such false statement is knowingly and wilfully made." 21 APPLEMAN, INSURANCE LAW AND PRACTICE, § 12122 (1941). *Accord:* Tenore v. American & Foreign Insurance Co., 256 F. 2d 791 7th Cir. 1958).

[13] Insurance Companies v. Weides, 81 U.S. (14 Wall) 375 (1872).

[14] *Id.* at 383.

years following this decision some courts have ostensibly rejected it.[15] The majority of those that have "rejected" the decision, allowing false swearing at the trial level to cancel the policy, could also have found for the insurer on the ground that there was false swearing prior to the trial.[16] In these decisions, the false swearing at the trial level always consisted of testimony directly related to a false swearing which had occurred prior to the time the suit was instituted. In *American Paint Service v. Home Insurance Co.*,[17] the court refused to allow false statements made at the trial level to cancel the policy and said that the statements in those cases which held that fraudulant statements made after the trial are sufficient to void a policy were dictum. The court concluded that those courts relied heavily on the fact that the insured was guilty of fraud and false swearing in the furnishing of the preliminary proofs of loss. This statement indicates that the courts will allow false swearing at the trial level to avoid the policy only where there has also been a previous false swearing that would of itself be sufficient grounds for voiding the policy. The majority of jurisdictions refuse to allow misrepresentations made after the suit has been filed to void the policy.[18] In so refusing, they hold that the rights of the parties are fixed as of the time the suit is brought and that to permit the insurer to await the testimony at the trial to create further defenses would be inconsistent with the function the trial normally serves.[19]

[15] American Alliance Insurance Co. v. Pyle, 63 Ga. App. 156, 8 S.E. 2d 154 (1940); Hyland v. Millers National Insurance Co., 58 F. 2d 1003 (9th Cir. 1932), *aff'd* 91 F. 2d 735 (9th Cir. 1937), *rehearing denied*, 92 F. 2d 462 (9th Cir. 1937), *cert. denied*, 303 U.S. 645; Moreau v. Palatine Insurance Co., 84 N.H. 422, 151 A. 817 (1930); Cuetara Hermanos v. Royal Exchange Assurance Co. v. Hurst, 11 F. 2d 250, (8th Cir. 1926); Columbian Insurance Co. v. Modern Laundry, Inc., 277 F. 355 (8th Cir. 1921); Follett v. Standard Fire Insurance Co., 77 N.H. 457, 92 Atl. 956 (1915). In all of the above cases, the court held that false testimony given at the trial was sufficient to cancel the policy.

[16] In all of the cases cited in note 15, there had been prior false statements made which were sufficient in themselves to cancel the policy. These cases are representative of the great majority of cases which have held that false swearing at the trial level was sufficient to cancel the policy.

[17] 246 F. 2d 91 (3d Cir. 1957).

[18] American Paint Service v. Home Insurance Co., 246 F. 2d 91 (3d Cir. 1957); Royal Insurance Co. v. Story, 34 Ala. App. 363, 40 S. 2d 719 (1947); Goldberg v. Provident Washington Insurance Co., 144 Ga. 783, 87 S.E. 1077 (1916); Deitz v. Providence Washington Insurance Co., 33 W. Va. 526, 11 S.E. 50 (1890).

[19] "The fraud and false swearing clause is one beneficial to the insurer and it reasonably extends to protect the insurer during the period of settlement or adjustment of the claim. When settlement fails and suit is filed, the parties no longer deal on the non-adversary level required by the fraud and false swearing clause. If the insurer denies liability and compels the insured to bring suit, the rights of the parties are fixed as of that time, for it is assumed that the insurer, in good faith, then has sound reasons based upon the terms of the policy for denying the claim of the insured. To

In view of the foregoing discussion, the decision in the *Vernon* case conforms with the prevailing legal view, i.e., false swearing at the trial level only, is insufficient to cancel the policy. Here, if the second affidavit had not been made or had been disqualified, the decision would have been for the insurer because the affidavit would have shown the proof of loss to have been fraudulant. However, the second affidavit stated that the proof of loss had been correctly made out leaving the insurance company with the first affidavit as its only evidence of false swearing. In light of previous decisions, the insurance company had an untenable position because there was no fraud in the application and it could not show that a material alteration of its risk had been induced or caused by the plaintiff. Since the second affidavit disclaimed the validity of the first, the insurance company could not claim the loss of any valid defense it had at the time the trial was commenced, for the second affidavit returned the parties to the same positions they had maintained prior to the filing of the suit. Therefore, all that the insurance company could claim was that the first affidavit was false on its face (in light of the second affidavit) and that it therefore violated the forfeiture clause of the policy. The court's interpretation and application of the statutes as forming public policy appears to have been unnecessary to the decision, because the court could have supported its decision with a multitude of precedent,[20] without having to rely on nonapplicable statutes.

The dissenting Justice relied heavily on both the incorrect application of the statutes by the majority and on *Chaachou v. American Central Insurance Co.*[21] First, he held that unless a statute outlaws a defense as being against the public policy of the state, the courts have no power to do so.[22] He criticized the court for applying statutes to a set of facts to

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permit the insurer to await the testimony at trial to create further ground for escape from its contractual obligation is inconsistent with the function the trial normally serves. It is at the trial that the insurer must display, not manufacture, its case." American Paint Service v. Home Insurance Co., 246 F. 2d 91 (3rd Cir. 1957).

[20] American Paint Service v. Home Insurance Co., 246 F. 2d 91 (3d Cir. 1957); Royal Insurance Co. v. Story, 34 Ala. App. 363, 40 S. 2d 719 (1947); Goldberg v. Provident Washington Insurance Co., 33 W. Va. 526, 11 S.E. 50 (1890).

[21] 241 F. 2d 889 (5th Cir. 1957): "In the absence of a statute, the law which is founded on truth and justice, will not regard it as unsound that a person has lost the benefit of a contract by wilful, immoral, dishonest acts which the contract itself condemns. . . . If the law out of some misgivings about forfeitures, were to require that the insurer demonstrate that it had been misled to its prejudice by the fraud, the policy provision would be virtually worthless and put a premium on dishonest dealing by the assured. . . . The public interest is not furthered by these likely consequences of reading into the contractual language this burden nowhere expressed; a judge-made policy which thus gives advantage to dishonesty will retard, not accelerate, the orderly adjustment of the insurance losses.

[22] Modern Order of Praetorians v. Davidson, 203 S.W. 379 (Tex. Civ. App. 1918).

which he felt the legislature never intended them to apply. Second, he held that to allow an insured to make false statements at the trial level and still collect on the policy would promote an undesirable state of affairs whereby an insured could resort to all types of false swearing to collect on his policy. However, although his first argument is correct as applied to the court's method of interpreting public policy, as it has been pointed out, the court need not have relied on the statutes nor public policy to reach its decision. His second argument may be morally sound, in view of the actions of the plaintiff, but the courts have consistently held that since the insurance company suffers no loss, either by an increase of its risk or by the loss of a defense as a result of the insured's false statements at the trial level, it should not be allowed to use such false statements as a defense.

In conclusion, fraudulant or false swearing will cancel an insurance policy, within the meaning of its forfeiture clause, (a) where it occurs in the application for the policy and thereby increases the insurer's risk or (b) where it occurs in the proof of loss thereby inducing the insurer to make payment on a fraudulant claim; but it will not cancel the policy where its only occurrence is after the suit has been instituted. The insurance company must have a valid defense for refusing to make payment on its policy at the time it makes such a refusal, and it cannot wait until the trial to acquire such a defense.

OIL AND GAS–MINES AND MINERALS–TITLE TO GAS STORED IN NATURAL UNDERGROUND RESERVOIRS

Plaintiff, a public utility engaged in the business of transporting and distributing natural gas to the public, maintained an underground storage reservoir to meet the seasonal demands for gas. The reservoir consisted of an exhausted gas field to which plaintiff held mineral rights except for a small tract owned by defendants located in the southwest part of the reservoir. After plaintiff commenced storing gas in the reservoir, defendants drilled a well on their tract and removed some of the stored gas. Plaintiff brought an action for conversion and unjust enrichment. The trial court held that plaintiff's petition did not state a cause of action because, by analogy to the doctrine of animals *ferae naturae*, plaintiff lost title to the gas by returning it to its natural state.[1] On appeal, the Texas Court of Civil Appeals reversed and remanded, holding that title

[1] Defendants also attacked the jurisdiction of the trial court in their pleadings and briefs claiming the present action was a collateral attack on a certain order of the Railroad Commission of Texas authorizing the construction of defendants' well. The claim was disposed of by stating this was a common law action to determine title, and thus the Railroad Commission had no jurisdiction to decide such a question.