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Notes: Insurance Law — Protecting the Public Under Maryland's Compulsory Motor Vehicle Insurance Scheme: The Abrogation of an Insurer's Common — Law Right to Void an Insurance Contract Ab Initio for a Material Misrepresentation in the Policy Application. *Van Horn v. Atlantic Mutual Insurance Co.*, 334 Md. 669, 641, A.2d 195 (1994)

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INSURANCE LAW—PROTECTING THE PUBLIC UNDER MARYLAND’S COMPULSORY MOTOR VEHICLE INSURANCE SCHEME: THE ABROGATION OF AN INSURER’S COMMON-LAW RIGHT TO VOID AN INSURANCE CONTRACT *AB INITIO* FOR A MATERIAL MISREPRESENTATION IN THE POLICY APPLICATION. *Van Horn v. Atlantic Mutual Insurance Co.*, 334 Md. 669, 641 A.2d 195 (1994).

I. INTRODUCTION

In face-to-face interviews, more than one out of five adults said that it was acceptable to lie when completing an automobile insurance application.<sup>1</sup> Such pervasive dishonesty is particularly disturbing to insurers because the application is used, often exclusively, to determine whether or not to insure the driver.<sup>2</sup> A difficult legal question arises when an insurer attempts to void an automobile insurance policy *ab initio*<sup>3</sup> for a material misrepresentation in the application when the policy has been issued under a compulsory insurance scheme. Such an attempt pits the insurer’s common-law right to rescind a contract obtained by a material misrepresentation<sup>4</sup> against the goal of compulsory automobile insurance statutes — to assure that all registered automobiles are insured.<sup>5</sup>

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1. *Study Finds Increasing Acceptance of Insurance Fraud*, PROPERTY & CASUALTY RISK & BENEFITS MANAGEMENT EDITION, Feb. 10, 1992, at 7 (citing a 1991 Roper Organization study).
  2. ANDREW JANQUITTO, MARYLAND MOTOR VEHICLE INSURANCE 614 (1992) (“The application is the window to the soul of insurance: it is through the application process that the insurer assesses the risk and sets the premium.”).
  3. The latin term *ab initio* is defined as “[f]rom the beginning; from the first act; from the inception.” BLACK’S LAW DICTIONARY 6 (6th ed. 1990). “An agreement is said to be ‘void *ab initio*’ if it has at no time had any legal validity.” *Id.* Rescission of a contract is defined as follows: “To abrogate, annul, avoid, or cancel a contract. . . . To declare a contract void in its inception . . . .” *Id.* at 1306. In this Note, rescind will refer to declaring a contract void in its inception.
  4. RESTATEMENT (SECOND) OF CONTRACTS § 164(1) (1981) (“If a party’s manifestation of assent is induced by either a fraudulent or a material misrepresentation by the other party upon which the recipient is justified in relying, the contract is voidable by the recipient.”).
  5. 7 AM. JUR. 2D *Automobile Insurance* § 37 (1980) (“[T]he purpose of a compulsory [automobile] insurance statute is to assure, so far as possible, that there will be no certificate of registration outstanding without concurrent and

In *Van Horn v. Atlantic Mutual Insurance Co.*,<sup>6</sup> the Court of Appeals of Maryland considered whether the enactment of Maryland's compulsory automobile insurance scheme altered an insurer's common-law right to void a policy *ab initio* for a material misrepresentation in the policy application.<sup>7</sup> The court held that the insurer's right had been statutorily abrogated with regard to claims made by persons not involved in making the misrepresentation.<sup>8</sup> Furthermore, the court held that the insurer's right to rescind had been abrogated to the full extent of the policy coverage and not merely to the minimum coverage required by statute.<sup>9</sup>

Atlantic Mutual Insurance Company (Atlantic Mutual) first issued an automobile insurance policy to Raymond Van Horn in October of 1985.<sup>10</sup> One question in the policy application completed by Van Horn asked whether the listed driver had any "physical impairment."<sup>11</sup> Van Horn, an epileptic, indicated "No" in response.<sup>12</sup> On January 14, 1987, the insured vehicle driven by Van Horn struck and injured Douglas Wines, a bicyclist, who then made a claim for compensation under the liability provisions of Van Horn's policy.<sup>13</sup> Van Horn was charged at the accident scene with driving while intoxicated.<sup>14</sup>

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continuous liability insurance coverage . . ."). *Id.* Compulsory liability insurance statutes make it illegal to operate a vehicle without first furnishing proof of insurance. Ruth Gastell, *Compulsory Auto Insurance*, INSURANCE INFORMATION INSTITUTE, Feb. 1994, at 1. For a list of the jurisdictions with compulsory liability insurance statutes, see *infra* note 53.

6. 334 Md. 669, 641 A.2d 195 (1994).

7. *Id.* at 671, 641 A.2d at 196.

8. *Id.* at 679, 641 A.2d at 199-200.

9. *Id.* at 679, 641 A.2d at 200.

10. *Id.* at 671, 641 A.2d at 196. The published opinion inadvertently indicated that the policy was issued in 1984 rather than in 1985. *Id.* The parties' initial briefs confirm that the policy was issued in 1985. See, e.g., Brief for Appellant at 1, *Van Horn v. Atlantic Mutual Insurance Co.*, 334 Md. 669, 641 A.2d 195 (1994) (No. 20, Sept. Term, 1990).

11. *Van Horn*, 334 Md. at 671, 641 A.2d at 196.

12. *Id.* at 671-72, 641 A.2d at 196.

13. *Id.* at 672, 641 A.2d at 196. The policy carried liability limits of \$100,000 per person/\$300,000 per accident. *Id.* Van Horn made a claim on the collision portion of the policy and was paid a few days later. *Id.*

14. *Id.* At the scene of the accident, Van Horn told the arresting officer that he had taken medication for his epilepsy about two hours previously. *Id.* Atlantic Mutual first learned of Van Horn's epilepsy from the police accident report and later received additional information from a detailed statement by Van Horn concerning his condition. *Id.* The court does not indicate in its opinion when Van Horn's detailed statement was made or to whom it was directed. The opinion also does not indicate whether Van Horn was truly intoxicated or whether Van Horn's epilepsy medication produced or may have produced symptoms similar to those of an intoxicated person.

After discovering that Van Horn had made a misrepresentation in his policy application, Atlantic Mutual notified Van Horn that it was treating the policy as void from its inception and later refunded all premiums paid on the policy.<sup>15</sup> The insurer sought a declaration in the Circuit Court for Baltimore County that the policy was void from its inception and that it had been properly rescinded by the company.<sup>16</sup>

The trial court concluded that although Van Horn had made a misrepresentation in the application, Atlantic Mutual had failed to establish that the misrepresentation was material.<sup>17</sup> On appeal, the court of special appeals reversed the circuit court, holding that the misrepresentation was material and that Maryland's compulsory automobile insurance statutes were not intended to abrogate the common-law right to rescind an insurance contract for a material misrepresentation in the policy application.<sup>18</sup>

The Court of Appeals of Maryland reversed the court of special appeals, holding that Maryland's compulsory automobile insurance statutes had abrogated Atlantic Mutual's right to void the policy *ab initio* with regard to claims of persons not involved in making the misrepresentation.<sup>19</sup> In support of its holding, the court offered the overall policy objective of Maryland's automobile insurance scheme,<sup>20</sup> specific statutory provisions governing mandatory insurance<sup>21</sup> and the cancellation of policies,<sup>22</sup> and the unanimous position of other jurisdictions that have addressed the same issue.<sup>23</sup>

## II. BACKGROUND

Rescissions and cancellations have distinct technical definitions.<sup>24</sup> A rescission retrospectively terminates a contract to its beginning,

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15. *Id.* at 672-73, 641 A.2d at 196-97.

16. *Id.* at 673, 641 A.2d at 197.

17. *Id.* at 675, 641 A.2d at 198. For further discussion of the trial court's reasoning, see *infra* note 109 and accompanying text.

18. *Van Horn*, 334 Md. at 677, 641 A.2d at 198-99.

19. *Id.* at 679, 641 A.2d at 199-200.

20. *Id.* at 684, 641 A.2d at 202. The policy objective is to ensure that there be insurance coverage for injuries sustained in automobile accidents. *Id.*

21. For a discussion of these statutory provisions, see *id.* at 684-85, 641 A.2d at 202.

22. *Id.* at 685-86, 641 A.2d at 202-03. These provisions allow, among other things, only the prospective cancellation of policies. *Id.*

23. *Id.* at 687, 641 A.2d at 203-04. For a list of jurisdictions with compulsory automobile insurance statutes, see *infra* note 53. See also C.C. Marvel, Annotation, *Rescission or Avoidance, for Fraud or Misrepresentation, of Compulsory, Financial Responsibility, or Assigned Risk Automobile Insurance*, 83 A.L.R.2D 1104 (1962 & Supp. 1991); 7 AM. JUR. 2D *Automobile Insurance* § 37 (1980).

24. 2 HENRY C. BLACK, A TREATISE ON THE RESCISSION OF CONTRACTS AND

while a cancellation provides a prospective termination.<sup>25</sup> Often, however, the terms are used interchangeably, which makes their application difficult and inconsistent.<sup>26</sup> The distinction becomes particularly important when statutes restricting cancellations are applied to situations in which insurance companies attempt to rescind a policy.

Under common law, a contract is voidable if it is procured by a material misrepresentation by one of the parties.<sup>27</sup> Insurance contracts, however, involve a unique combination of contract principles and strict regulatory control.<sup>28</sup> Thus, absent statutory provisions to the contrary, an insurer has a right to rescind an insurance contract for a material misrepresentation in the policy application.<sup>29</sup> The test for the materiality of a representation in an insurance contract is described in *Metropolitan Life Insurance Co. v. Samis*.<sup>30</sup> In *Samis*, the Court of Appeals of Maryland described the test as a "question [of] whether, if the true facts were known to the company at the time of its issuance of the policy, it would have entered into the contract."<sup>31</sup>

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CANCELLATION OF WRITTEN INSTRUMENTS § 480, at 1157 (1916) ("The right of an insurance company to cancel one of its policies is altogether different from a right of rescission.").

25. See JANQUITTO, *supra* note 2, at 607 (citing *Stiegler v. Eureka Life Ins. Co.*, 146 Md. 629, 127 A. 397 (1925)); see also *Reserve v. Duckett*, 240 Md. 591, 214 A.2d 754 (1965) (discussing the difference between rescission and cancellations). See generally 8B J.A. APPLEMAN & J. APPLEMAN, *INSURANCE LAW AND PRACTICE* § 5011 (1981 & Supp. 1994) (addressing the difference between cancellations and rescissions).
26. See JANQUITTO, *supra* note 2, at 630. The two terms "have a myriad of definitions in different contexts." *Id.*; see also, e.g., *Erie Ins. v. Insurance Comm'r*, 84 Md. App. 317, 322, 579 A.2d 771, 773 (1990) (using the terms "cancel" and "voidable" interchangeably).
27. See RESTATEMENT (SECOND) OF CONTRACTS, *supra* note 4. A voidable contract is capable of being enforced, as distinguished from a void contract, which has no legal effect and, thus, is incapable of being enforced. See BLACK'S LAW DICTIONARY 1573-74 (6th ed. 1990).
28. One commentator has described the relationship between contract principles and the public role in insurance regulation as follows: "The law of insurance falls within the broader field of contracts; however, given the State's ubiquitous hand in the regulation of insurance in general, and motor vehicle insurance in particular, any analysis of insurance cannot merely be contract centered. Rather, it must be statute-centered, but contract-conscious." JANQUITTO, *supra* note 2, at 8.
29. See WILLIAM R. VANCE, *HANDBOOK ON THE LAW OF INSURANCE*, ch. 7, § 67 (3d ed. 1951). In order to rescind a contract in Maryland, an insurer was required to proceed without unreasonable delay, inform the insured of its determination, and return all premiums received. See *Stiegler v. Eureka Life Ins. Co.*, 146 Md. 629, 127 A. 397 (1925). See generally Thomas R. Trenkner, *Automobile Insurance: Concealment or Nondisclosure of Physical Defects or Conditions as Avoiding Coverage*, 72 A.L.R.3d 804 (1976 & Supp. 1995).
30. 172 Md. 517, 192 A. 335 (1935).
31. *Id.* at 524, 192 A. at 338. A similar description of the test is found in Maryland

Prior to the enactment of Maryland's compulsory automobile insurance scheme, an insurer could exercise the common-law right to rescind an automobile insurance policy for a material misrepresentation in the application.<sup>32</sup> Case law suggests that this right could be exercised unilaterally by the insurer.<sup>33</sup> The court of appeals has held that a third-party claimant stands in no better position than the insured when making a claim against an insurance policy.<sup>34</sup> Thus, if the insurer had grounds to deny coverage to the insured, the same grounds permitted the insurer to deny coverage to an injured third party.<sup>35</sup>

In 1972, the Maryland General Assembly passed Maryland's current compulsory automobile insurance scheme, which went into

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Indemnity v. Steers, 221 Md. 380, 385, 157 A.2d 803, 806 (1960) ("The usual test of whether or not a misrepresentation is material is whether it concerns a fact that would affect the insurer's decision in entering into the contract and in estimating the degree or character of the risk . . ."); see 12A J.A. APPLEMAN & J. APPLEMAN, *supra* note 25, § 7294 (1981 & Supp. 1994) (discussing a generally accepted materiality test).

32. *Stumpf v. State Farm Mut. Auto. Ins. Co.*, 252 Md. 696, 251 A.2d 362 (1969), *superseded by statute as discussed in Van Horn*, 334 Md. 669, 641 A.2d 195 (1994); *Josey v. Allstate Ins. Co.*, 252 Md. 274, 250 A.2d 256 (1969), *superseded by statute as discussed in Van Horn*, 334 Md. 669, 641 A.2d 195 (1994); *Erie Ins. Exch. v. Lane*, 246 Md. 55, 227 A.2d 231 (1967), *superseded by statute as discussed in Van Horn*, 334 Md. 669, 641 A.2d 195 (1994); see *Southern Gen. Ins. Co. v. O'Keefe*, 275 F. Supp. 107 (D. Md. 1967); *State Farm Mut. Auto. Ins. Co. v. West*, 149 F. Supp. 289 (D. Md. 1957).
33. See *Stumpf*, 252 Md. at 713, 251 A.2d at 371 (addressing the steps an insurer must take to rescind a policy (citing *Stiegler v. Eureka Life Ins. Co.*, 146 Md. 629, 642, 127 A. 397, 402 (1925))), *superseded by statute as discussed in Van Horn*, 334 Md. 669, 641 A.2d 195 (1994). However, "ordinarily whether a representation in an insurance application was true or false, or material to the risk, is for the jury to determine." *Lane*, 246 Md. at 63, 227 A.2d at 236 (citing *Monumental Life Ins. Co. v. Taylor*, 212 Md. 202, 129 A.2d 103 (1956)), *superseded by statute as discussed in Van Horn*, 334 Md. 669, 641 A.2d 195 (1994). Thus, it appears that an insurer could *unilaterally* rescind a policy for a material misrepresentation, but it remained a jury question whether the representation was both false and material. See also JANQUITTO, *supra* note 2, at 625 ("Before Maryland adopted compulsory automobile insurance, several cases seemingly allowed the insurer to rescind a policy *ab initio* by unilateral action.").
34. See *Travelers Ins. Co. v. Godsey*, 260 Md. 669, 674, 273 A.2d 431, 434 (1971) ("As the third party beneficiary of the insurance contract, the claimant stands in the shoes of the insured wrongdoer and vis-a-vis the insurer his rights are no greater than those of the insured's."). In *Godsey*, the insured and the claimant collaborated to mislead the insurer about the details of the accident. *Id.* at 673-74, 273 A.2d at 434; see also *Stumpf v. State Farm Mut. Auto. Ins. Co.*, 252 Md. 696, 251 A.2d 362 (1969), *superseded by statute as discussed in Van Horn*, 334 Md. 669, 641 A.2d 195 (1994); *Indemnity Ins. Co. v. Smith*, 197 Md. 160, 78 A.2d 461 (1951).
35. See, e.g., *Stumpf*, 252 Md. at 706, 251 A.2d at 367 (1969), *superseded by statute as discussed in Van Horn*, 334 Md. 669, 641 A.2d 195 (1994).

effect on January 1, 1973.<sup>36</sup> This comprehensive scheme is largely codified, with later statutes, in the Transportation Article<sup>37</sup> and the Insurance Code.<sup>38</sup> Maryland's automobile insurance scheme includes compulsory motor vehicle liability insurance,<sup>39</sup> compulsory uninsured motorist coverage,<sup>40</sup> no fault personal injury protection (PIP),<sup>41</sup> a state insurer of last resort (MAIF-Insured Division),<sup>42</sup> and a public fund that compensates people who are injured by uninsured vehicles and who have no alternate source of recovery (MAIF-Uninsured Division).<sup>43</sup> If a claim is made upon an insolvent insurer, a private corporation known as the Property and Casualty Insurance Guaranty Corporation, or PCIGC, will stand in the shoes of the insolvent insurer.<sup>44</sup>

In addition, Maryland's Motor Vehicle Administration (MVA) may not issue or transfer registration of an automobile without evidence that the required insurance coverage has been obtained.<sup>45</sup> If insurance on an automobile lapses or terminates, the vehicle's registration is automatically suspended.<sup>46</sup> It is illegal to drive or to permit another to drive an uninsured or underinsured automobile.<sup>47</sup> Furthermore, the scheme strictly limits an insurer's ability to cancel a policy of automobile liability insurance.<sup>48</sup>

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36. 1972 Md. Laws ch. 73. *See generally* JANQUITTO, *supra* note 2 (discussing in detail the provisions of Maryland's compulsory automobile insurance scheme); MICPEL, *AUTO INSURANCE* 1991 (1991) (same).
  37. MD. CODE ANN., TRANSP. §§ 17-101 to -110 (1992 & Supp. 1994).
  38. MD. ANN. CODE art. 48A, §§ 234B, 240AA-42, 243-43N, 538-47A (1994 & Supp. 1995).
  39. MD. CODE ANN., TRANSP. §§ 17-103(b)(1)-(2) (1992).
  40. *Id.* § 17-103(b)(4) (requiring coverage described in MD. ANN. CODE art. 48A, § 541 (1994 & Supp. 1995)). *See generally* Andrew Janquitto, *Uninsured Motorist Coverage in Maryland*, 21 U. BALT. L. REV. 171 (1992); Donna Maag, Comment, *Compensation for Victims of Uninsured Motorist Accidents*, 12 U. BALT. L. REV. 314 (1983).
  41. MD. CODE ANN., TRANSP. § 17-103(b)(3) (1992) (requiring coverage described in MD. ANN. CODE art. 48A, § 539 (1994)). Personal injury protection may be waived by the first named insured. MD. ANN. CODE art. 48A, § 539(a) (1994).
  42. MD. ANN. CODE art. 48A, § 243B (1994). "The purpose of the Fund is to provide automobile insurance to those eligible persons who are unable to obtain it in the private market." *Id.* § 243B(a)(3).
  43. *Id.* § 243H. For example, this fund would compensate a pedestrian with no insurance of her own who was struck by an uninsured motor vehicle.
  44. *Id.* §§ 504-19. The PCIGC stands in the shoes of the insolvent insurer after the claimant has exhausted coverage under any other policies. *Id.* § 512(a); *see also infra* note 52.
  45. MD. CODE ANN., TRANSP. § 17-104 (1992).
  46. *Id.* § 17-106 (1992 & Supp. 1995).
  47. *Id.* § 17-107 (1992).
  48. MD. ANN. CODE art. 48A, §§ 234A and 240AA (1994 Repl. Vol.). Section

Maryland's motor vehicle insurance scheme has been described as "the most comprehensive and intricate system in the United States."<sup>49</sup> The policy of this extensive statutory scheme is to ensure, as far as possible, that there be continuous insurance coverage on all motor vehicles so that automobile owners and operators are able to provide compensation for damages incurred in automobile acci-

234A prohibits cancellations based upon arbitrary, capricious, or unfairly discriminatory reasons. *Id.* § 234A(a). Section 240AA provides in part:

(a) *Compliance with article.* — Except in accordance with the provisions of this article, no insurer other than the Maryland Automobile Insurance Fund shall (i) cancel or fail to renew a policy of motor vehicle liability insurance or a binder of motor vehicle liability insurance, if the binder is in effect for 45 days or longer, issued in this state, as to any resident of the household of the named insured, for any reason other than nonpayment of premium, . . .

(b) *Notice to insured.* — An insurer intending to take an action subject to the provisions of this section shall, on or before 45 days prior to the proposed effective date of the action, send written notice of its intended action to the insured at his last known address. . . . All other notices of action subject to the provisions of this section shall be sent by certificate of mailing. The notice shall be in triplicate, and shall state in clear and specific terms, on a form approved by the Commissioner:

(5) The right of the insured to replace the insurance through the Maryland Automobile Insurance Fund, and the current address and telephone number of the Fund;

(d) *Protest.* — An insured shall have the right to protest the proposed action of the insurer by signing 2 copies of the notice and sending them to the Commissioner within 30 days after the date of mailing of the notice . . . .

(e) *Stay of proposed action.* — A protest duly filed shall stay the proposed action of the insurer pending a determination by the Commissioner, and the insurer shall maintain in force the same coverage and premium in effect on the day the notice of proposed change was sent until the final determination is made, provided that any lawful premium due or becoming due prior to the determination is paid

*Id.* § 240AA; see also J.M. Zitler, Annotation, Cancellation of Compulsory or "Financial Responsibility" Automobile Insurance, 44 A.L.R.4TH 13 (1986 & Supp. 1995); Notice of Insurer's Intention Not to Renew a Policy, 3 AM. JUR. LEGAL FORMS 2D, AUTOMOBILE INSURANCE § 32:38 (1988); Notice of Cancellation of Automobile Insurance Policy, 3 AM. JUR. LEGAL FORMS 2D, AUTOMOBILE INSURANCE §§ 32:35-36 (1988); Request, by Insured, for Reason for Cancellation or Nonrenewal of Automobile Insurance Policy, 3 AM. JUR. LEGAL FORMS 2D, AUTOMOBILE INSURANCE §§ 32:40-41 (1988); Statement of Reason for Cancellation or Nonrenewal of Automobile Insurance Policy—In Reply to Request by Insured, 3 AM. JUR. LEGAL FORMS 2D, AUTOMOBILE INSURANCE § 32:42 (1988).

49. JANQUITTO, *supra* note 2, at 7.



dents.<sup>50</sup> The overall remedial purpose of the legislation is to protect the public.<sup>51</sup> It has been suggested that the General Assembly also intended, by enacting the compulsory automobile insurance scheme, "to shift the burden of caring for victims of motor vehicle accidents from the State to the private sector."<sup>52</sup>

Many jurisdictions with compulsory automobile insurance statutes<sup>53</sup> have held that an insurer cannot void a policy *ab initio* for

50. *Pennsylvania Nat'l Mut. Casualty Ins. Co. v. Gartelman*, 288 Md. 151, 154, 416 A.2d 734, 736 (1980); see *Lee v. Wheeler*, 310 Md. 233, 240, 528 A.2d 912, 916 (1987) ("[T]here is harmony in the legislative design of Art. 48A, which seeks to provide minimum compensation to the innocent victims of motor vehicle accidents."); see also *Jennings v. GEICO*, 302 Md. 352, 357, 488 A.2d 166, 168 (1985) (invalidating a household exclusion clause as inconsistent with public policy); cf. *State Farm Mut. Auto. Ins. Co. v. Nationwide Mut. Ins. Co.*, 307 Md. 631, 641-44, 516 A.2d 586, 591-92 (1986) (holding that a household exclusion clause is invalid only to the extent of the minimum statutory liability coverage).

51. *Gartelman*, 288 Md. at 154, 416 A.2d at 736.

52. JANQUITTO, *supra* note 2, at 2. The concept that Maryland's General Assembly, by enacting compulsory insurance legislation, intended to shift the financial burden of automobile accidents from the public to the private sector was also suggested by the Court of Appeals of Maryland in the following dicta:

There is more than a modicum of appeal in [Petitioners'] contention that the General Assembly's action in setting up a system of compulsory automobile insurance . . . indicates its growing belief that all those injured while using the highways of this State should be properly recompensed. Furthermore, citizens of Maryland will have to bear the brunt of the expense when the injured are forced to rely on public aid for support due to their loss of employment and concomitant inability to pay medical bills incurred as a result of their injuries — even though the insurer has collected his fees to pay for just such occurrences and very likely has set up a reserve fund containing all the money necessary to reimburse the injured parties.

*Belcher v. GEICO*, 282 Md. 718, 726, 387 A.2d 770, 775 (1978). The statutory creation of the PCIGC, MD. ANN. CODE art. 48A, §§ 504-19 (1994), provides additional support for the burden shifting argument. The PCIGC is a private corporation which stands in the shoes of an insolvent insurer after any alternate coverage the claimant may have is exhausted. *Id.* § 504(a). Thus, when an insurer becomes insolvent, a claimant should first look to the next best private insurer for compensation and then turn to the PCIGC. Furthermore, the right to recover from the PCIGC is paramount to any right of recovery from Maryland's public MAIF-Uninsured Division. See *id.* § 243H(a)(3)(vi); *McMichael v. Robertson*, 77 Md. App. 208, 215-16, 549 A.2d 1157, 1161 (1988) (holding that both uninsured motorist benefits and personal injury protection benefits already received by claimant were deductible from recovery against PCIGC).

53. The following jurisdictions have enacted compulsory automobile insurance statutes: Alaska, ALASKA STAT. § 21.89.020 (1993); Arizona, ARIZ. REV. STAT. ANN. §§ 28-1161 to -1170 (1989 & Supp. 1995); Arkansas, ARK. CODE ANN. § 23-89-201 to -209 (Michie 1992); Colorado, COLO. REV. STAT. ANN. § 10-4-705 (West 1990 & Supp. 1995); Connecticut, CONN. GEN. STAT. ANN. §§ 38a-

fraud or misrepresentation in the application to escape liability to a third-party claimant.<sup>54</sup> In *Teeter v. Allstate Insurance Co.*,<sup>55</sup> New

334 to -336 (West 1992 & Supp. 1995); Delaware, DEL. CODE ANN. tit. 21, § 2118 (1995); District of Columbia, D.C. CODE ANN. § 35-2103 (1993); Florida, FLA. STAT. ANN. ch. 324.021 (Harrison 1995); Georgia, GA. CODE ANN. § 40-6-10 (1994); Hawaii, HAW. REV. STAT. § 431:10C-104 (1993); Idaho, IDAHO CODE § 49-1229 (1994); Illinois, ILL. ANN. STAT. ch. 625, para. 5/7-601 (Smith-Hurd 1993 & Supp. 1995); Indiana, IND. CODE ANN. § 9-25-4-1 (Burns 1991 & Supp. 1994); Kansas, KAN. STAT. ANN. § 40-3104 (1993 & Supp. 1995); Kentucky, KY. REV. STAT. ANN. § 304.39-090 (Baldwin 1994); Louisiana, LA. REV. STAT. ANN. § 32:861 (1989 & Supp. 1996); Maine, ME. REV. STAT. ANN. tit. 29, § 1601 (West Supp. 1995); Maryland, MD. CODE ANN., TRANSP. § 17-103 (1992); Massachusetts, MASS. GEN. LAWS ANN. ch. 175, § 113A (West 1987 & Supp. 1996); Michigan, MICH. COMP. LAWS ANN. §§ 257.519 - .520 (West 1990); Minnesota, MINN. STAT. ANN. § 65B48 (1986 & Supp. 1996); Missouri, MO. REV. STAT. § 303.025 (1994); Montana, MONT. CODE ANN. § 61-6-301 (1995); Nebraska, NEB. REV. STAT. ANN. §§ 60-507 to -511 (1993); Nevada, NEV. REV. STAT. § 485.185 (Michie 1994 & Supp. 1996); New Jersey, N.J. STAT. ANN. § 39-6B-1 (West 1990); New Mexico, N.M. STAT. ANN. § 66-5-205 (Michie 1994); New York, N.Y. VEH. & TRAF. LAW § 312 (Consol. 1986 & Supp. 1996); North Carolina, N.C. GEN. STAT. §§ 20-279.1 to -279.21 (1995); North Dakota, N.D. CENT. CODE § 39-08-20 (1991); Oklahoma, OKLA. STAT. ANN. tit. 47 § 7-601 (West 1988 & Supp. 1996); Oregon, OR. REV. STAT. §§ 806.010 to .080 (1995); Pennsylvania, 75 PA. CONS. STAT. ANN. §§ 1701-1781 (Supp. 1995); South Carolina, S.C. CODE ANN. § 56-9-20 (Law. Co-op. 1991); South Dakota, S.D. CODIFIED LAWS ANN. § 32-35-113 (1989); Texas, TEX. TRANSP. CODE ANN. § 601.051 (West 1996); Utah, UTAH CODE ANN. § 41-12a-301 (1994); Vermont, VT. STAT. ANN. tit. 23, § 800 (1987 & Supp. 1994); Washington, WASH. REV. CODE ANN. § 46.30.020 (West Supp. 1996); West Virginia, W. VA. CODE § 17D-2A-3 (1991); and Wyoming, WYO. STAT. § 31-4-103 (1994). Statutes in Ohio, OHIO REV. CODE ANN. § 4509.101 (Baldwin 1994), and Rhode Island, R.I. GEN. LAWS §§ 31-31-1 to 31-32-21 (1995), have some compulsory liability features. The following jurisdictions have financial responsibility laws, which only require drivers to prove their ability to pay for third-party losses after an accident, conviction, or judgment up to certain amounts: Alabama, ALA. CODE §§ 32-7-6, 32-7-22 (1992 & Supp. 1995); California, CAL. VEH. CODE § 16050 (Deering Supp. 1996); Iowa, IOWA CODE ANN. § 321A.5 (West 1985 & Supp. 1996); Mississippi, MISS. CODE ANN. § 63-15-11 (1989); New Hampshire, N.H. REV. STAT. ANN. § 264:2 (1993); Tennessee, TENN. CODE ANN. § 55-12-105 (1993); Virginia, VA. CODE ANN. § 46.2-427 (1994); and Wisconsin, WIS. STAT. ANN. §§ 344.24 to .48 (West 1991 & Supp. 1995). See also, Gastell, *supra* note 5, at 2-3.

54. Marvel, *supra* note 23, at 1104-05; see 7 AM. JUR. 2D § 37. This otherwise universal rule does not apply in jurisdictions whose compulsory automobile insurance schemes expressly allow liability avoidance for fraud or material misrepresentations. See, e.g., *Abrams v. General Ins. Co.*, 508 So. 2d 436, 437 (Fla. Dist. Ct. App. 1987) (applying FLA. STAT. ANN. § 627.409 (1983)); *State Farm Mut. Auto. Ins. Co. v. Crouch*, 706 S.W.2d 203, 207 (Ky. Ct. App. 1986) (applying KY. REV. STAT. ANN. § 304.14-110 (1970)). But cf. *Pearce v. Southern Guaranty Ins. Co.*, 268 S.E.2d 623, 627-28 (Ga. 1980) (holding that statutory cancellation provisions defeated statutory provision preventing claimant recovery for material misrepresentations).

55. 192 N.Y.S.2d 610 (1959), *aff'd*, 173 N.E.2d 47 (N.Y. 1961).

York's appellate division established the rationale for this position. First, the *Teeter* court reasoned that one aim of New York's compulsory insurance scheme, continuous liability coverage for all vehicles registered in the state, could not be reconciled with an insurer's right to rescind a policy *ab initio*.<sup>56</sup> Second, the court identified a supervening public interest that restricted the rights of the parties once the policy had been issued.<sup>57</sup> Third, the New York court noted that the statute's cancellation provisions applied to "termination for any cause whatsoever," including rescission for fraud.<sup>58</sup> The court construed the statute's use of the term "cancellation" in its colloquial rather than in its technical sense. Thus, a policy termination of any type, including rescission, would have to comply with the statutory cancellation provision, which required ten days notice to the insured.<sup>59</sup> Finally, the court opined that an insurer who wishes to minimize the risk of liability must investigate the applicant's truthfulness before issuing a policy.<sup>60</sup> The decision in *Teeter* abrogated the right of rescission as to claims by *both* the insured *and* third parties.<sup>61</sup>

Subsequent decisions in other compulsory insurance jurisdictions have applied reasoning similar to that applied in *Teeter* to reach the conclusion that an insurer cannot void a policy *ab initio* to escape liability to a third-party claimant.<sup>62</sup> In *Pearce v. Southern Guaranty Insurance Co.*,<sup>63</sup> the Supreme Court of Georgia determined that the cancellation notice requirements of its compulsory automobile insurance scheme preempted a statutory provision that allowed an insurer

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56. *Id.* at 615.

57. *Id.* at 616. "A certificate of insurance constitutes a representation by the insurance company to the public and to the State authorities that valid insurance coverage is in effect." *Id.* at 617.

58. *Id.* at 615.

59. *Id.* at 616. Accordingly, the attempt to void the policy *ab initio* violated the scheme's cancellation notice requirements. *Id.* at 619.

60. *Id.* at 617.

61. *Id.* at 619. The court rejected a distinction between the insured and third-party claimants on the following three grounds: (1) the statutory language governing the termination of coverage was all embracing; (2) the statutory scheme relied upon penal sanctions for driving without the required insurance, which were incompatible with an ability to rescind, whether the claimant was the insured or a third party; and (3) while a statute recognizing the distinction could be drawn, no such provisions existed. *Id.* at 617-18.

62. *See, e.g.,* *Pearce v. Southern Guaranty Ins. Co.*, 268 S.E.2d 623, 628 (Ga. 1980); *American Underwriters Group v. Williamson*, 496 N.E.2d 807, 810-11 (Ind. Ct. App. 1986); *Ohio Farmers Ins. v. Michigan Mut. Ins.*, 445 N.W.2d 228, 232 (Mich. Ct. App. 1989); *Atlantic Casualty Ins. Co. v. Bingham*, 92 A.2d 1, 3 (N.J. 1952); *Metropolitan Prop. & Liab. v. Insurance Comm'r*, 535 A.2d 588, 594 (Pa. 1987); *cf. Barrera v. State Farm Mut. Auto. Ins. Co.*, 456 P.2d 674, 682 (Cal. 1969) (not a compulsory automobile insurance jurisdiction); *Rauch v. American Family Ins. Co.*, 340 N.W.2d 478, 482 (Wis. 1983) (same).

63. 268 S.E.2d 623, 628 (Ga. 1980).

to avoid liability for a material misrepresentation in an insurance application.<sup>64</sup> Under the Georgia scheme, both liability and no-fault insurance were compulsory; thus, the no-fault provisions could not be separated from the liability provisions, and neither type of coverage could be rescinded.<sup>65</sup>

In *Continental Western Insurance Co. v. Clay*,<sup>66</sup> the Supreme Court of Kansas held that the right to rescind liability coverage was incompatible with the cancellation notice requirement for compulsory liability coverage. The court held that non-compulsory protection (such as collision coverage), however, could still be rescinded.<sup>67</sup> The *Clay* court also explained that public policy favors the compensation of innocent, injured third parties.<sup>68</sup> The court reasoned that the insurer should not be allowed to avoid liability after the public had innocently relied on the validity of the insurance contract.<sup>69</sup>

In *Barerra v. State Farm Mutual Automobile Insurance Co.*,<sup>70</sup> the Supreme Court of California announced that "an automobile liability insurer must undertake a reasonable investigation of the insured's insurability within a reasonable period of time from the acceptance of the application and the issuance of a policy."<sup>71</sup> Absent such an investigation, an injured third party could recover against the insurer despite material misrepresentations concerning the applicant's driving record.<sup>72</sup> Thus, in *Barerra*, the insurer's failure to conduct a reasonable investigation of the applicant's driving record precluded the rescission of his policy.<sup>73</sup>

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64. *Id.* at 628 (holding automobile insurance policy could not be voided retrospectively under GA. CODE ANN. § 56-2409 (1995), which expressly provided that material misrepresentations could prevent recovery). See generally Barbara J. Call, *Third Party Problems with Falsified Insurance Applications*, 24 TORT & INS. L.J. 671, 675 (1989) (briefly discussing *Pearce*).

65. See *Pearce*, 268 S.E.2d at 628.

66. 811 P.2d 1202 (Kan. 1991).

67. *Id.* at 1207; see *Dunn v. SafeCo Ins. Co.*, 798 P.2d 955 (Kan. Ct. App. 1990). See generally John J. Knoll, Note, *Kansas Automobile Insurance: Current Issues and Problems*, 29 WASHBURN L.J. 600, 621-23 (1990) (discussing the issue in Kansas prior to *Clay* and *Dunn*).

68. See *Clay*, 811 P.2d at 1206-07 (citing *Dunn v. SafeCo Ins. Co.*, 798 P.2d 955 (Kan. Ct. App. 1990); *United Sec. Ins. Co. v. Commissioner of Ins.*, 348 N.W.2d 34 (Mich. Ct. App. 1984)).

69. *Id.*

70. 456 P.2d 674 (Cal. 1969).

71. *Id.* at 677.

72. *Id.*

73. *Id.* In its determination of whether the investigation was reasonable, the appellate court directed the trial court to weigh the cost, availability, and administrative burden of making the investigation against the importance of protecting the public from the consequences of those who drive with voidable liability policies. *Id.* at 690.

While California does not have a compulsory automobile insurance scheme, there is a policy goal behind its Financial Responsibility Law that is similar to compulsory insurance scheme goals.<sup>74</sup> Notably, the California statutes recognize the technical distinction between a "rescission" and a "cancellation";<sup>75</sup> therefore, statutory notice requirements applying to policy cancellations could not have been applied to prevent a policy rescission in *Barrera*.<sup>76</sup> Unlike the New York court in *Teeter*, the California court distinguished claims made by an injured third-party claimant from those made by the insured. The California court reasoned that the right of the insurance company to use the insured's material misrepresentations as a defense to a claim by the insured "d[id] not conflict with the purpose of the Financial Responsibility Law," which was meant to assure "a solvent defendant for those innocently injured by the use of automobiles."<sup>77</sup>

Despite the contrary positions taken by other jurisdictions, the Attorney General of Maryland stated, in a 1986 opinion, that an insurer "could seek a judicial rescission and a declaration that the policy is void *ab initio*" based on a material misrepresentation in the application.<sup>78</sup> The Attorney General opined that, while an insurer could not unilaterally rescind a policy, both a cancellation in accordance with the applicable statutory provisions and a judicial rescission remained viable alternatives.<sup>79</sup>

The Opinion of the Attorney General examined the cancellation and nonrenewal provisions of the Maryland statutes,<sup>80</sup> reviewed the common-law background of rescission,<sup>81</sup> and discussed the rationale applied by the New York court in *Teeter*.<sup>82</sup> The opinion, however, declined to follow the reasoning of the *Teeter* court.<sup>83</sup> Based largely upon the principle that statutes in derogation of the common law should be strictly construed,<sup>84</sup> the Attorney General concluded that

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74. *Id.* at 682-83. "The law aims to make owners of motor vehicles financially responsible to those injured by them in the operation of such vehicles." *Id.* (citing *Wildman v. GEICO*, 307 P.2d 359, 364 (Cal. 1957)).

75. *Id.* at 678 n.3.

76. *Id.* See generally Call, *supra* note 64, at 675-76 (criticizing *Barrera*).

77. *Barrera*, 456 P.2d at 689.

78. 71 Op. Att'y Gen. 173 (1986).

79. *Id.*

80. *Id.* at 173-76.

81. *Id.* at 176-77.

82. *Id.* at 177-78.

83. *Id.* at 179 ("[W]e do not believe that we need to go as far as did the court in *Teeter* and conclude that the common law right to rescission has been entirely supplanted by the statutory scheme."). *Id.*

84. *Id.* at 179 n.6 (citing *Bradshaw v. Prince George's County*, 284 Md. 294, 303, 396 A.2d 255, 260 (1979)). The principle that statutes in derogation of the common law should be strictly construed stems from the presumption that the

“[a]bsent a clear expression of legislative intent to the contrary, we believe that the right to seek judicial rescission of an automobile liability insurance policy remains intact.”<sup>85</sup>

The comprehensive nature of Maryland’s compulsory automobile insurance scheme<sup>86</sup> and this opinion by the Attorney General of Maryland, which ran contrary to the overwhelming weight of authority in other jurisdictions,<sup>87</sup> served as background for a judicial determination of the rescission question in Maryland.

### III. THE INSTANT CASE

Raymond Van Horn began having epileptic seizures in 1983.<sup>88</sup> Yet, in 1984, he denied having any physical disability, other than poor vision, in an MVA driver’s license renewal application.<sup>89</sup> In October of 1985 Van Horn signed and submitted an application for automobile insurance with the Atlantic Mutual Insurance Company.<sup>90</sup> The application, which listed Van Horn as the only driver, contained a list of questions with “Yes” or “No” response boxes.<sup>91</sup> One question, asking whether the “driver listed above” had “a physical impairment,” was answered with an “X” in the “No” box.<sup>92</sup> A six month policy carrying injury liability limits of \$100,000 per person/\$300,000 per accident was issued on October 4, 1985 and was renewed at six month intervals thereafter.<sup>93</sup> On January 14, 1987, while driving his insured vehicle, Van Horn collided with a bicyclist, Douglas Wines.<sup>94</sup> Van Horn was charged at the accident scene with driving while intoxicated, and he told the investigating officer that he had

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legislature is aware of the common law when it enacts a statute and would expressly override the common-law rule if it intended. *See* SUTHERLAND STAT. CONST. § 61.01 (5th ed. 1992) (discussing strict construction of statutes in derogation of the common law). This rule is followed in Maryland. *E.g.*, *Bruce v. Dyer*, 309 Md. 421, 524 A.2d 777 (1987). However, it is also a general rule of statutory construction that a remedial statute should be construed liberally in order to advance the remedy. *State v. Barnes*, 273 Md. 195, 328 A.2d 737 (1974); *see* SUTHERLAND STAT. CONST. § 60.01 (5th ed. 1992) (discussing liberal construction of remedial statutes). The remedial purpose of Maryland’s mandatory automobile insurance statute has been held to require liberal construction. *Tucker v. Fireman’s Ins. Co.*, 308 Md. 69, 517 A.2d 730 (1986).

85. 71 Op. Att’y Gen. at 179.

86. *See supra* text accompanying notes 36-52.

87. *See supra* note 54 and accompanying text.

88. *Van Horn*, 334 Md. at 672, 641 A.2d at 196.

89. *Id.* at 674, 641 A.2d at 197.

90. *Id.* at 671, 641 A.2d at 196.

91. *Id.*

92. *Id.*

93. *Id.* at 671-72, 641 A.2d at 196.

94. *Id.* at 672, 641 A.2d at 196.

taken medication for his epilepsy two hours earlier.<sup>95</sup> Atlantic Mutual was subsequently informed of the accident and began its investigation, which included a review of the police report.<sup>96</sup> Having discovered the information regarding Van Horn's epilepsy in the report, the insurer obtained more detailed information about its policyholder's medical condition.<sup>97</sup>

The following claims were made on the policy: (1) Van Horn made a claim under the policy's collision coverage and was paid a few days later;<sup>98</sup> and (2) Douglas Wines made a claim under the policy's liability coverage.<sup>99</sup> After sending Van Horn a "reservation of rights" letter<sup>100</sup> in March and renewing his policy for a six month period (April-October 1987), Atlantic Mutual sent a letter to Van Horn stating that his policy was being treated as void from its inception due to the existence of a material misrepresentation in his application.<sup>101</sup> The result of treating the policy as void from its inception would have been to deny the victim, Douglas Wines, any recovery under the policy.

On April 29, 1987, Atlantic Mutual filed a complaint in the Circuit Court for Baltimore County seeking a declaratory judgment that Van Horn's policy was void from its inception and had been properly rescinded.<sup>102</sup> Van Horn counterclaimed, seeking a declaration that the policy was valid when the accident occurred and that Atlantic Mutual's attempt to void the policy *ab initio* was improper.<sup>103</sup> Following the commencement of the action, Atlantic Mutual sent Van Horn a check for \$1,190.86, which was alleged to reflect the sum of the premiums that Van Horn had paid on his policy.<sup>104</sup> Van Horn

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95. *Id.*

96. *Id.*

97. *Id.* Atlantic Mutual obtained a detailed statement from Van Horn in which he described his condition. Thereafter, Atlantic Mutual obtained Van Horn's medical records. *Id.*

98. *Id.* Atlantic Mutual did not contest this claim and, hence, did not seek its return.

99. *Id.*

100. A "reservation of rights" letter protects the insurer against an estoppel of its attempt to deny coverage for a failure to act promptly when a possible absence of coverage is discovered. See 7C APPLEMAN & APPLEMAN, *supra* note 25, § 4693.

101. *Van Horn*, 334 Md. at 672-73, 641 A.2d at 196-97.

102. *Id.* at 673, 641 A.2d at 197. The named defendants were Raymond J. Van Horn, Douglas Wines, University of Maryland Medical System Corporation (which treated Wines), and the Maryland Medical Assistance Program, Maryland Department of Health and Mental Hygiene (which paid a portion of Wines's medical expenses). *Id.*

103. *Id.*

104. *Id.*

did not cash the check.<sup>105</sup> Atlantic Mutual did not seek a return of the collision claim paid to Van Horn.<sup>106</sup>

At the *Van Horn* trial, the circuit court, sitting without a jury, determined that although Van Horn made a misrepresentation in his policy application, the misrepresentation was not material.<sup>107</sup> Citing the materiality test set forth by the court of appeals in *Metropolitan Life Insurance Co. v. Samis*,<sup>108</sup> the trial judge found that Atlantic Mutual had failed to persuade the court that it would not have issued the policy if it had known Van Horn had epilepsy.<sup>109</sup> Thus, after applying standard contract principles, the trial court stated that Atlantic Mutual could not rescind the policy *ab initio* because Van Horn's misrepresentation was not material.<sup>110</sup>

In reversing the circuit court's decision, the court of special appeals stated that "since epilepsy can cause at least momentary loss of consciousness, on the very face of it the existence of such a condition is material to the risk involved in an automobile liability insurance policy."<sup>111</sup> Furthermore, the court held that Maryland's compulsory automobile insurance statutes were not intended to abrogate an insurer's right of rescission "for a material misrepresentation that induced the insurer to issue the policy."<sup>112</sup>

The court of appeals first heard oral argument in this case on October 10, 1990.<sup>113</sup> Thereafter, the court ordered that the case be

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105. *Id.*

106. *Id.*

107. *Id.* at 675-76, 641 A.2d at 198. Thus, the circuit court did not address the issue of whether enactment of Maryland's compulsory insurance scheme had abrogated Atlantic Mutual's common-law right of rescission.

108. 172 Md. 517, 528, 192 A. 335, 339 (1937); *see supra* notes 30-31 and accompanying text.

109. *Van Horn*, 334 Md. at 676, 641 A.2d at 198. At the close of the trial, counsel for Atlantic Mutual conceded that the company would insure people with epilepsy if they met MVA requirements. *Id.* at 675, 641 A.2d at 197-98. The trial court found that Atlantic Mutual had failed to persuade the court of the materiality of Van Horn's misrepresentation in two respects: First, if Van Horn had informed Atlantic Mutual of his epilepsy in the insurance application, there was no evidence to indicate Atlantic Mutual would not have issued the policy when it discovered that he had not reported his condition to the MVA. Second, there was no evidence that the MVA would have refused to license Van Horn if he had disclosed his condition when renewing his driver's license. *Id.* at 675-76, 641 A.2d at 198.

110. *Id.* at 675, 641 A.2d at 198.

111. *Id.* at 677, 641 A.2d at 199 (citing the unreported opinion by the court of special appeals).

112. *Id.* (citing the unreported opinion by the court of special appeals).

113. The following three questions were presented in the defendants' petition for a writ of certiorari:

1. Should the burden of proof as to whether a misrepresentation made by the insured, Raymond J. Van Horn, in his application for



reargued in consideration of more specific questions dealing with the rescission of automobile liability policies.<sup>114</sup> The case was reargued on May 7, 1992. In holding that Maryland's compulsory automobile insurance scheme abrogated an insurer's common-law right of rescission with regard to innocent third-party claimants, the court relied on the legislative purpose of the scheme,<sup>115</sup> the requirement that insurance be maintained during the registration period,<sup>116</sup> and the statutory provisions governing policy terminations.<sup>117</sup> The decisions of similarly situated jurisdictions on the same issue lent further support to the court's holding.<sup>118</sup>

In *Van Horn*, the court of appeals discussed the following aspects of Maryland's automobile insurance statutes in order to identify the scheme's legislative purpose: the "Required Security" subtitle to the Transportation Article,<sup>119</sup> the MAIF-Insured Division's operation as

insurance was material have been on the insurer, Atlantic Mutual?

2. Was the decision of the trial judge clearly erroneous when he found that the misrepresentation made by Raymond J. Van Horn in his application for insurance was not material?

3. Assuming arguendo that there was a material misrepresentation in Van Horn's application for insurance, should the policy be held not to be void *ab initio* as against Wines, an injured third party?

*Id.*

114. *Id.* at 678, 641 A.2d at 199. The court asked the following additional questions:

1. Is the law that generally permits rescission of an insurance contract for first-party coverage without the necessity of showing a causal relationship between the misrepresentation and the loss applicable to third-party motor vehicle insurance coverage cases, or should rescission be permitted as to third parties only upon a showing of such causal relationship?

2. Has Maryland's compulsory motor vehicle insurance law abrogated the common-law right of an insurer to rescind an automobile insurance policy for fraud or material misrepresentation after an accident covered by the policy has occurred?

3. If so, should the right of rescission be denied:

(a) as to third-party coverage only, and not as to first-party coverage?

(b) only to the limits of financial responsibility required by State law, or as to the entire policy coverage?

4. Is the rescission of a motor vehicle insurance policy subject to the provisions of §§ 234A, 240AA, and 240D of Article 48A of the Maryland Code?

*Id.*

115. *Id.* at 684, 641 A.2d at 202. The legislative purpose of the scheme is "that there be continuous insurance policy coverage for injuries incurred in motor vehicle accidents." *Id.*

116. *Id.* (citing MD. CODE ANN., TRANSP. § 17-104(b) (1992)).

117. *Id.* at 685, 641 A.2d at 202 (citing MD. ANN. CODE art. 48A, §§ 234A and 240AA (1994)).

118. *Id.* at 687, 641 A.2d at 203-04.

119. *Id.* at 680-81, 641 A.2d at 200-01 (citing MD. CODE ANN., TRANSP. §§ 17-101 to -110 (1992 & Supp. 1995)).

a state insurer of last resort,<sup>120</sup> provisions governing policy cancellations,<sup>121</sup> no-fault PIP coverage,<sup>122</sup> and mandatory uninsured motorist insurance.<sup>123</sup> The court opined that “[t]hese statutory provisions complement each other in achieving the legislative purpose that there be continuous insurance policy coverage for injuries incurred in motor vehicle accidents. Recognition of a common-law contract right to void a motor vehicle insurance policy *ab initio* is inconsistent with this legislative purpose.”<sup>124</sup>

The court also noted that the precursor to Maryland’s compulsory insurance scheme, the Assigned Risk Plan,<sup>125</sup> contained language expressly preserving an insurer’s right of rescission for a material misrepresentation in procuring the insurance.<sup>126</sup> Because no such provision was inserted when the current scheme was enacted, the court concluded that the former provision regarding rescission for material representations was inconsistent with the new scheme’s legislative purpose.<sup>127</sup>

The court applied the present scheme’s statutory provisions and legislative purpose to the facts in *Van Horn* and reasoned that if Atlantic Mutual were allowed to void the policy *ab initio*, Van Horn’s automobile would be retrospectively uninsured for a two-year period,<sup>128</sup> which “would flatly violate the statutory requirement that one ‘shall maintain’ the insurance ‘during the registration period’ . . . .”<sup>129</sup>

The court also reasoned that an insurer’s right to void a policy *ab initio* was inconsistent with the scheme’s policy cancellation procedures.<sup>130</sup> In particular, the court noted that only prospective can-

120. *Id.* at 681, 641 A.2d at 201 (citing MD. ANN. CODE art. 48A, § 243 (1994 & Supp. 1995)).

121. *Id.* at 681-82, 641 A.2d 201 (citing MD. ANN. CODE art. 48A, § 240AA (1994)).

122. *Id.* at 682-83, 641 A.2d at 201 (citing MD. ANN. CODE art. 48A, §§ 539, 540 (1994)).

123. *Id.* at 683, 641 A.2d at 201-02 (citing MD. ANN. CODE art. 48A, § 541(c) (1994 & Supp. 1995)).

124. *Id.* at 684, 641 A.2d at 202.

125. This statutory scheme was designed to help individuals obtain motor vehicle insurance policies from insurance companies. *Id.* at 683, 641 A.2d at 202 (citing 1972 Md. Laws ch. 73, at 290-93) (repealed).

126. “No eligible applicant may be refused or canceled by the insurer for underwriting reasons, provided that nothing in this paragraph shall prevent . . . rescission for . . . material misrepresentation in procuring the insurance.” *Van Horn*, 334 Md. at 683-84, 641 A.2d at 202 (quoting 1972 Md. Laws ch. 73, at 292 § (v) (repealed)).

127. *See Van Horn*, 334 Md. at 684, 641 A.2d at 202.

128. *Id.*

129. *Id.* (quoting MD. CODE ANN., TRANSP. § 17-104(b) (1992)).

130. *Id.* at 685, 641 A.2d at 202; *see supra* note 48.

cancellations were permitted. Thus, a rescission, which the court considered a "retroactive cancellation," was inconsistent with the statutory scheme.<sup>131</sup> The court decided not to recognize a technical distinction between the two terms and applied the statutory provisions governing policy *cancellations* to this case of an attempted *rescission*.<sup>132</sup>

In support of its holding, the court of appeals also pointed towards decisions in other compulsory insurance jurisdictions that did not expressly permit an insurer to void a policy *ab initio*.<sup>133</sup> The court adopted the position that, when innocent third parties are involved, rescission *ab initio* is inconsistent with the compulsory, statutory automobile insurance scheme.<sup>134</sup> The court placed primary reliance on the New York opinion in *Teeter v. Allstate Insurance Co.*,<sup>135</sup> pointing to that court's reasoning that rescission *ab initio* violated the New York statute's prospective cancellation provisions and was irreconcilable with the compulsory insurance requirement that insurance be continuously maintained.<sup>136</sup> The *Van Horn* court also adopted the position of the Supreme Court of Kansas in *Continental Western Insurance Co. v. Clay*<sup>137</sup> that compulsory automobile liability statutes with no-fault provisions further the public policy that one who suffers a loss due to an automobile accident shall have a source and a means of recovery.<sup>138</sup> The *Van Horn* court found additional support for this public policy rationale in reasoning expressed by the Supreme Court of Georgia in *Sentry v. Indemnity Co. v. Sharif*.<sup>139</sup> Finally, the court of appeals, in *Van Horn*, quoted with approval an Arkansas case, *Ferrell v. Columbia Mutual Casualty Insurance Co.*,<sup>140</sup> in which the court reasoned that "[i]f an insurer could unilaterally rescind coverage, unscrupulous insurers could hold the threat over the head of third party claimants in an attempt to bargain down their claims . . . ."<sup>141</sup>

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131. *Van Horn*, 334 Md. at 685, 641 A.2d at 202.

132. *See id.* at 685-86 n.6, 641 A.2d at 202-03 n.6. *See generally supra* note 24-26 and accompanying text.

133. *Van Horn*, 334 Md. at 687, 641 A.2d at 203-04.

134. *Id.* at 687, 641 A.2d at 204.

135. *Id.* (citing *Teeter v. Allstate Ins. Co.*, 192 N.Y.S.2d 610 (1959), *aff'd*, 173 N.E.2d 47 (N.Y. 1961)).

136. *Id.* at 688-89, 641 A.2d at 204.

137. 811 P.2d 1202 (Kan. 1991).

138. 334 Md. at 689-90, 641 A.2d at 205 (citing *Continental Western Ins. Co. v. Clay*, 811 P.2d 1202 (Kan. 1991); *Dunn v. SafeCo Ins. Co.*, 798 P.2d 955 (Kan. Ct. App. 1990)).

139. *Id.* at 690-91, 641 A.2d at 205 (citing *Sentry Indem. Co. v. Sharif*, 282 S.E.2d 907 (Ga. 1981)).

140. 816 S.W.2d 593 (Ark. 1991).

141. *Van Horn*, 334 Md. at 691, 641 A.2d at 205-06 (quoting *Ferrell v. Columbia Mut. Cas. Ins. Co.*, 816 S.W.2d 593, 595-96 (Ark. 1991)).

The court of appeals also held that Atlantic Mutual's right to rescind its policy *ab initio* had been abrogated as to the entire policy coverage and not merely as to the statutorily required minimum coverage.<sup>142</sup> Thus, the insurer was required to make available the full \$100,000 per person/\$300,000 per accident liability limits provided in Van Horn's policy, rather than only the \$20,000/\$40,000 minimum liability coverage required by the statute.<sup>143</sup>

Atlantic Mutual argued that if it were liable for Wines's claim, its liability should not extend beyond the minimum liability limits required by statute.<sup>144</sup> The company's argument was based on the court of appeals's holding in *State Farm Mutual Insurance Co. v. Nationwide Mutual Insurance Co.*<sup>145</sup> In *State Farm*, the court of appeals held that a contractual provision that violated the public policy of Maryland's compulsory automobile insurance scheme was invalid to the extent of the conflict between the contractual provision and the scheme's stated public policy.<sup>146</sup> Based on the *State Farm* holding, Atlantic Mutual argued that its contract with Van Horn should only be enforced to the extent that it supported public policy, that is, to the extent of the minimum coverage required by statute.<sup>147</sup>

The contractual provision at issue in *State Farm* was a household exclusion clause that excluded coverage for injury to the insured and to members of the insured's family.<sup>148</sup> Based on the invalidity of the household exclusion clause, the insurer in that case was required to provide the insured with coverage up to the \$20,000/\$40,000 minimum liability required by statute, but it was not required to pay any amount above the statutory minimums.<sup>149</sup>

The *Van Horn* court rejected Atlantic Mutual's argument for two reasons. First, the court distinguished *State Farm* on the basis that the *State Farm* holding invalidated a contractual provision that the insurer and insured had agreed upon, thereby forcing the insurer to provide coverage for which it received no premium.<sup>150</sup> The court reasoned that the situation in *Van Horn* was different because the parties to the policy had agreed to the full \$100,000/\$300,000 liability

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142. *Id.* at 696, 641 A.2d at 208.

143. *Id.*

144. *Id.* at 644, 641 A.2d at 207.

145. 307 Md. 631, 516 A.2d 586 (1986).

146. *Id.* at 694, 516 A.2d at 592; *see also* Jennings v. Government Employees Ins., 302 Md. 352, 488 A.2d 166 (1985) (invalidating household exclusion clauses).

147. *Van Horn*, 334 Md. at 694, 641 A.2d at 207.

148. *State Farm*, 307 Md. at 646, 516 A.2d at 586 (citing Jennings v. GEICO, 302 Md. 352, 488 A.2d 166 (1985)). Household exclusion clauses typically exclude coverage for injury to the insured or members of the insured's household. *Id.* at 633, 516 A.2d at 587.

149. *Id.* at 643-44, 516 A.2d at 592.

150. *Van Horn*, 334 Md. at 695, 641 A.2d at 208.

limits, and Atlantic Mutual received a premium based on that coverage.<sup>151</sup> Second, the court concluded that the cancellation statutes applicable to Van Horn's policy applied to the full policy coverage and not merely to the minimum coverage required by statute.<sup>152</sup>

An important question not answered in the *Van Horn* decision was whether an insurer's right to rescind a policy for a material misrepresentation in the application would be denied when the claims of injured third parties were not involved.<sup>153</sup> This would have been the situation in *Van Horn* if Atlantic Mutual had refused to pay a claim by Van Horn under his policy's collision, personal injury, or uninsured motorist coverage. That question was not at issue in *Van Horn*,<sup>154</sup> and the court expressly declined to decide it.<sup>155</sup> The court, however, specifically asked that question when it ordered that the case be reargued.<sup>156</sup>

#### IV. ALTERNATIVE APPROACHES

The principal question addressed in *Van Horn v. Atlantic Mutual Insurance Co.* was whether the insurer had a right to rescind coverage as to the claim of Douglas Wines, an injured third party. The court's holding on this issue was well-supported and sound. While the General Assembly did not expressly preclude the common-law right to rescind a policy for a material misrepresentation in the application, the legislative policy of the insurance scheme<sup>157</sup> indicated that the General Assembly intended to abrogate the insurer's right of rescission with regard to innocent third-party claimants.

The legislative purpose of Maryland's compulsory automobile insurance scheme is to assure a means of recovery to persons who incur damages in automobile accidents.<sup>158</sup> This public policy provides the most compelling justification for the court's holding. Although the scheme provides a means of recovery for injuries caused by uninsured Maryland drivers,<sup>159</sup> which Van Horn would have been if a rescission were permitted, the scheme does not *allow* a driver to

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151. *Id.*

152. *Id.*

153. *Id.* at 679, 641 A.2d at 200.

154. *Id.* at 678-79, 641 A.2d at 199 ("This litigation does not concern any claim under the policy made by or on behalf of Van Horn.").

155. *Id.* at 679, 641 A.2d at 200 ("[W]hether the material misrepresentation would furnish a valid defense to a claim made by Van Horn is a question not presented by this case, and we do not decide it.").

156. *Id.* at 678, 641 A.2d at 199; *see also supra* note 114 (listing the four reargument questions).

157. *See supra* notes 50-52 and accompanying text.

158. *See supra* note 50 and accompanying text.

159. *See supra* note 43 and accompanying text.

drive while uninsured. If the insurer were allowed to rescind the insured's policy whenever innocent third parties asserted claims under it, a legislative exception would be created in a scheme that is intended to be all encompassing. While the insurance company may also be an innocent party,<sup>160</sup> Maryland's compulsory automobile insurance scheme is intended to protect the public, not the insurer.

The court's reliance on specific statutory provisions provides less compelling support for its holding than its reliance on the scheme's overall purpose. The *Van Horn* court reasoned that if Atlantic Mutual were allowed to rescind the policy, Van Horn's automobile would have been left uninsured for a two-year period.<sup>161</sup> By leaving Van Horn with no means available at the time of the insurance company's action to remedy the situation, the insured would be violating the requirement that insurance be maintained during the registration period.<sup>162</sup> An argument can be made, however, that the vehicle was rendered uninsured for the two-year period because Van Horn misrepresented his physical condition in the policy application.

The court's reliance on the statutory cancellation provisions is subject to criticism on the ground that the court should have recognized the distinction between a "cancellation" and a "rescission." The technical distinction between the two terms is well established;<sup>163</sup> however, the court noted that the existence of a distinction between the terms does not reveal an intention by the General Assembly or the Maryland courts to *recognize* the distinction.<sup>164</sup> It is plausible that the General Assembly intended the term "cancellation" to refer to *any* action that terminates or nullifies insurance coverage. The fact that the terminology is often used interchangeably<sup>165</sup> bolsters this contention because it underscores the imprecision with which the terms are used. Accordingly, the court's determination that a rescission is a retrospective cancellation, which is prohibited by the cancellation notice requirements, can be justified.

The decision not to recognize the distinction between a cancellation and a rescission is the stronger of the two grounds upon which

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160. See *Van Horn*, 334 Md. at 704 n.3, 641 A.2d at 212 n.3 (McAuliffe, J., dissenting) (discussing circumstances when insurer would be "innocent").

161. *Van Horn*, 334 Md. at 684, 641 A.2d at 202 (citing MD. CODE ANN., TRANSP. § 17-104(b)).

162. *Id.*

163. See *supra* notes 24-25 and accompanying text.

164. *Van Horn*, 334 Md. at 685-86 n.6, 641 A.2d at 202-03 n.6 (discussing Maryland statutes and case law that do not support a distinction between "rescission" and "cancellation"). *But see* *Stiegler v. Eureka Life Ins. Co.*, 146 Md. 629, 646, 127 A. 397, 404 (1925) ("The policy had no term permitting a cancellation by the assured, and its sole right to avoid the policy was its option of rescission.").

165. See *supra* note 26 and accompanying text.

the court based its determination that Atlantic Mutual had to make the full liability coverage specified in the policy available. First, the court contended that Atlantic Mutual received a premium based on the full \$100,000/\$300,000 liability coverage;<sup>166</sup> however, the court did not recognize that Atlantic Mutual also based the amount of its premium on the belief that Van Horn had no physical disability. Consequently, the contention that the relationship between the premium and the coverage required the insurer to provide the full liability limits was questionable. Second, the court asserted that the statutory provisions governing cancellations applied to the full, agreed upon policy coverage.<sup>167</sup> Having decided that the cancellation notice statutes applied to rescissions, the court properly determined that no coverage in the policy could be terminated without strict adherence to the statutes.<sup>168</sup>

The court rejected Atlantic Mutual's argument that *State Farm* required the insurer to provide coverage only to the extent that its rescission was inconsistent with the public policy of the insurance scheme.<sup>169</sup> Had the court accepted Atlantic Mutual's approach, Wines's recovery would have been limited to the \$20,000 per person liability limit mandated by statute,<sup>170</sup> instead of the \$100,000 per person limit specified in Van Horn's policy.

The decision that an insurer cannot void an automobile liability policy issued under a compulsory insurance scheme when an innocent third-party claimant is involved is consistent with the unanimous position taken by other jurisdictions.<sup>171</sup> Disagreement exists, however, when the claim is brought by the insured who made the misrepresentation.<sup>172</sup> This question of first-party coverage was not at issue in *Van Horn*, and the court expressly declined to decide it;<sup>173</sup> however, the reasoning used in support of the court's holding could substantially affect the alternatives available when that question is ultimately decided.

The *Van Horn* court reasoned that permitting a rescission would violate the statutory requirement that the required insurance coverage be continuously maintained.<sup>174</sup> This requirement also applies to first-

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166. *Van Horn*, 334 Md. at 695, 641 A.2d at 208.

167. *Id.*

168. *Id.*; see MD. ANN. CODE art. 48A, § 240AA(a) (1994) (prohibiting cancellations or reductions of coverage except in accordance with the section's notice requirements).

169. See *supra* text accompanying notes 144-47.

170. See MD. CODE ANN., TRANSP. § 17-103(b)(1) (1992 Repl. Vol.).

171. See *supra* note 54 and accompanying text.

172. See *Van Horn*, 334 Md. at 693 n.8, 641 A.2d at 206 n.8.

173. *Id.* at 679, 641 A.2d at 200.

174. *Id.* at 684, 641 A.2d at 202 (citing MD. CODE ANN., TRANSP. § 17-104(b) (1992 Repl. Vol.)).

party PIP<sup>175</sup> and to first-party uninsured motorist coverage,<sup>176</sup> which suggests that the rescission of those types of coverage would also be precluded. The court also relied on statutory provisions that allow only prospective cancellations.<sup>177</sup> Those provisions apply only to motor vehicle liability insurance.<sup>178</sup> Maryland's policy regarding mandatory first-party coverage<sup>179</sup> and optional first-party collision coverage remains an open question.<sup>180</sup>

Judge McAuliffe, in his dissenting opinion, offered an alternative to the position taken by the majority in *Van Horn*.<sup>181</sup> Judge McAuliffe argued that an insurer's right of rescission should not be abrogated in any instance absent a clear expression to the contrary by the General Assembly.<sup>182</sup> While this approach would protect against unfair risk assumption by an insurer,<sup>183</sup> it would not provide sufficient protection to injured claimants, the group the scheme is intended to protect.<sup>184</sup> Under this approach, *Van Horn* would have been uninsured at the time of the accident, and Wines would have had to turn to the limited compensation available from the MAIF-Uninsured Division.<sup>185</sup> Naturally, this approach would eliminate coverage for claims by the insured as well.<sup>186</sup>

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175. See MD. CODE ANN., TRANSP. § 17-103(b)(3) (1992 Repl. Vol.) (specifying personal injury protection (PIP) as required security, unless waived); *id.* § 17-104(b) (compelling maintenance of required security during vehicles registration period).

176. See *id.* § 17-103(b)(4) (specifying uninsured motorist coverage as required security); *id.* § 17-104(b) (compelling maintenance of required security during vehicle's registration period).

177. *Van Horn*, 334 Md. at 685, 641 A.2d at 202 (citing Md. Ann. Code art. 48A, §§ 234A, 240AA (1994 Repl. Vol.)).

178. Md. Ann. Code art. 48A, § 240AA(a) (1994 Repl. Vol.).

179. Compare *Teeter v. Allstate Ins. Co.*, 192 N.Y.S.2d 610, 617-18 (1959) (holding that no insurance policy could be rescinded), *aff'd*, 173 N.E.2d 47 (N.Y. 1961) with *United Sec. Ins. Co. v. Commissioner of Ins.*, 348 N.W.2d 34, 36 (Mich. Ct. App. 1984) (holding that both mandatory first-party coverage and optional first-party coverage could be rescinded).

180. Compare *United Sec. Ins. Co. v. Commissioner of Ins.*, 348 N.W.2d 34, 36 (Mich. Ct. App. 1984) (holding that both mandatory first-party coverage and optional first-party coverage could be rescinded) with *Dunn v. SafeCo Ins. Co.*, 798 P.2d 955, 959-60 (Kan. Ct. App. 1990) (appearing to distinguish between compulsory first-party coverage and optional first-party coverage).

181. 334 Md. 669, 641 A.2d 195 (1994) (McAuliffe, J., dissenting).

182. *Id.* at 707, 641 A.2d at 213 (McAuliffe, J., dissenting) ("In the absence of any express resolution of the question by the legislature, I would not presume an intent to abrogate the common law . . .").

183. *Id.* at 704, 641 A.2d at 212 (McAuliffe, J., dissenting).

184. Judge McAuliffe recognized this point in his dissent but also noted that prohibiting rescission was unfair to an innocent insurer. *Id.* at 703-04, 641 A.2d at 212.

185. See MD. ANN. CODE art. 48A, § 243(I) (1994 Repl. Vol.). The MAIF-Uninsured



Douglas Wines suggested an additional alternative in the brief he initially submitted to the court of appeals.<sup>187</sup> Wines's approach would allow a rescission only if the material misrepresentation were related to the proximate cause of the accident.<sup>188</sup> While logical in some respects, this approach is not supported by the statutory scheme. Under this approach, because epilepsy was not the proximate cause of the accident, a rescission would not have been allowed in *Van Horn*, and a claim by either Wines or Van Horn would have been covered.

## V. CONCLUSION

Maryland's compulsory insurance statutes require that every motor vehicle registered in the state be insured. Given the public's dishonesty when completing automobile insurance applications,<sup>189</sup> there is a high likelihood that many of the required insurance policies were procured by material misrepresentations. The existence and extent of an insurer's obligation to bear the expense incurred following an automobile accident is, therefore, an important issue. Considering the comprehensive and intricate nature of Maryland's motor vehicle insurance scheme, and the recognized legislative purpose of ensuring compensation to those injured in automobile accidents, the decision of the court of appeals in *Van Horn v. Atlantic Mutual Insurance Co.* is well-founded and fair.

Furthermore, the reasoning the court employed to reach its decision has important implications for future litigation. This reasoning suggests that Maryland may join the jurisdictions that have held that rescission of an automobile insurance policy is impermissible even when innocent third-party claims are not involved. Such a result would be desirable in cases where personal injuries are involved. When optional first-party collision and comprehensive coverage are at issue, however, such a position would unfairly shift the financial

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Division limits payments to those eligible to make a claim on the fund to \$20,000 per person/\$40,000 per accident. *Id.*

186. This is, arguably, the correct result because the insured should expect no coverage from a policy procured by a material misrepresentation.

187. Appellant Douglas Wines's Brief at 35, *Van Horn v. Atlantic Mut. Ins. Co.*, 334 Md. 669, 641 A.2d 195 (1994) (No. 20, Sept. Term, 1990). The court of appeals directed the parties to consider this "causal connection" alternative when it ordered that the case be reargued. *Van Horn*, 334 Md. at 678, 641 A.2d at 199; *see supra* note 114 and accompanying text (listing Wines's proposed alternative among the four additional issues to be discussed by the court during reargument).

188. Appellant Douglas Wines's Brief at 36, *Van Horn v. Atlantic Mut. Ins. Co.*, 334 Md. 669, 641 A.2d 195 (1994) (No. 20, Sept. Term, 1990).

189. *See supra* note 1 and accompanying text.

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burden to the insurer without justification in the public policy of the statutory scheme.

*Joel P. Williams*