

BAD FAITH BLOG

It Still Doesn't Pay to Lie: Personal Umbrella Policy Voided by Material Misrepresentations on Insurance Application

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Summary: Whether the insured, a mother of a 17 year old boy, intentionally failed to tell her umbrella insurer that her son was now a driver, or the insured failed to sign the application, there was no coverage under the personal umbrella policy and no reason to assess "bad faith" penalties.

RLI Insurance Company v. Santos, 746 F.Supp.2d 255 (D.Mass., 2010)

RLI Insurance Company issued a personal umbrella insurance policy to Beli R. Lima. Ms. Lima's first language was not English. Her 17 year old son, Henrique Santos was involved in an automobile collision with Maria Lopez. Lopez sued Santos for her bodily injuries and shortly thereafter RLI filed a declaratory judgment action seeking a court declaration that the policy provided no coverage for the Lopez/Santos accident. Both Lopez and Santos counterclaimed against RLI. The case came before the court on cross motions for summary judgment. The court granted RLI's motion for summary judgment while denying that of Lopez and Sanchez.

When the umbrella policy was initially taken out, only Lima and her husband were licensed drivers. However, when renewal time came along, that was changing. Lima provided two renewal applications. At the time of the initial renewal application, her son was driving under a learner's permit. Even so, that information was not disclosed. Although Lima had signed the initial renewal application, it was obviously incomplete and not accepted by RLI. At the time the second renewal application, a month later, the son was a licensed driver. That important fact was not disclosed on the second renewal application. Furthermore, both renewal application forms stated that they would not be "accepted without applicant's original signature." The second renewal application appeared to RLI to be complete and it contained a signature. However, Lima testified that it was not her signature.

RLI's underwriters had determined that young and inexperienced drivers were higher risks than experienced drivers over the age of 22. After the accident, RLI learned about it from the underlying carrier and learned that Santos was the driver. After some investigation, RLI first sent out a reservation of rights letter and then sent out a denial letter. In each of those letters, Lima and Santos were advised that if they had any additional information which might cause RLI to reconsider its coverage positions, that information should be provided. Neither Lima nor Santos provided any additional information. The basis for the denial of coverage was that "Lima had a made material misrepresentations on her [second] renewal application...by not including Santos as a driver under the age of 22." *Id.* at 263.

The court reviewed this diversity case under Massachusetts law which provides that an insurer can void a policy of insurance if the policy holder "failed to disclose 'materials facts' when requested to do so in an application for the insurance." A fact is deemed material if "the knowledge or ignorance of [it] would naturally influence the judgment of the underwriter in making the contract at all, or in estimating the degree and character of the risk, or in fixing the rate of the premium." In response to the insured's contention that the application form was ambiguous, the court reviewed the application language and disagreed.

RLI believed that Lima had signed the second application, but Lima denied having done so. The court determined that it could accept her representation that she had not signed it. If she had not signed the application, that failure "constituted a breach of a condition precedent and would permit RLI to void the policy as a matter of law." *Id.* at 268. Even if she had submitted a valid application, the court found that she had a duty to advise RLI that she had a teenage driver in her household before the policy was issued. She had submitted the second application approximately one month before the policy went into effect. At no time before the policy issuance on September 10 did she advise RLI of the fact that Santos, her 17 year old son, had obtained a driver's license nearly two months earlier. Even if that failure was unintentional, the court concluded that "under any view of the undisputed facts, Lima reasonably should have known that RLI was proceeding in reliance on the statements she made in her application. Lima was obligated to inform RLI of the material changes that occurred between the time of her application and the inception of the renewal policy (citation omitted). It is undisputed that she never advised RLI that Santos had received a driver's license. Her failure to do so gives RLI the right to void the policy."

The defendants contended in the declaratory judgment action that RLI was estopped from relying on misrepresentations in the first application. They contended that RLI had failed to provide a reasonable explanation of its basis for denying the claim which is an unfair claim settlement practice. The court rejected that argument for several reasons, including the fact that RLI's denial was reasonable based upon the facts then available to it, that RLI reserved the right to assert additional grounds for a denial, and that there was no prejudice to the insureds by RLI's failure to state additional grounds for its denial. The court further concluded that the misrepresentation was material both because of the "increased risk of loss" of the 17 year old driver and because RLI would have charged a higher premium had it known of the inexperienced driver under the age of 22. *Id.* at 271.

The court concluded that RLI did not owe any coverage under the policy. "Either (1) the application for the policy contained a material misrepresentation, and the policy is therefore voidable; (2) no application or other document evidencing Lima's assent was ever submitted to RLI, and thus no insurance contract was ever formed; or (3) Lima failed to provide updated information to RLI after the application and before the issuance of the policy, and the policy is once again voidable. Summary judgment will therefore issue in favor of RLI on the declaratory judgment claim." *Id.* at 272.

The court denied the defendants' cross motions for summary judgment. In light of its ruling on the declaratory judgment action, the court found that there was no possibility for the insured to prevail on a breach of contract claim against RLI. Furthermore, the court rejected the various grounds raised that RLI's handling of the claim was an unfair trade practice or otherwise violated Massachusetts unfair trade or claims handling statutes. The court noted that the first contention (that RLI had wrongly denied insurance coverage) was obviously wrong. Since the court had determined that RLI had a right to void the policy, it necessarily "had a reasonable foundation for denying coverage and was not acting in bad faith when it did so." *Id.* at 272. The court also rejected the contention that RLI was duty-bound to investigate further. While acknowledging that insurers "are bound to conduct investigations in a reasonable manner," the court noted that when RLI made the decision to deny coverage, it was acting reasonably because at the time it denied coverage, RLI "did not have any reason to believe that anyone other than Lima had filled out the [second] renewal application." Although RLI learned additional information during discovery, the court noted that RLI "had several other bases for denying coverage for which interviews of the defendants and other parties was not necessary." Nor was the court troubled by the contention that RLI itself was guilty of misrepresentations in its denial letter. The evidence before RLI when it denied coverage was based upon "ample reason to believe that Lima had made misrepresentations on her applications." *Id.* at 273. "In sum neither RLI's handling of the claim nor its coverage position rise to the level of unfair trade practices or otherwise constitute violations of [the Massachusetts statutes]."

Lessons from Santos are to thoroughly investigate and evaluate claims, especially when misrepresentations seem apparent. As soon as questions regarding coverage arise, thoroughly investigate the issues, send out a reservation of rights letter detailing the concern(s) and reserving all rights and defenses under the policy, and thoroughly document all investigation findings (those supporting a denial and those supporting coverage). Thereafter, act decisively to accept or deny coverage based upon a careful and reasonable evaluation of all facts available.