

## **Recent Developments in Fraud Law**

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Recent developments in fraud law include litigation over reasonable reliance, arbitration issues, standing and damages. This paper will examine some of the recent Alabama Supreme Court decisions which discuss these issues.

The law of insurance fraud in Alabama is still developing in the wake of the Alabama Supreme Court's monumental decision, *Foremost Insurance Company v. Parham*, 693 So.2d 409 (Ala.1997). Before *Foremost*, most insurance fraud cases reached the jury under the standard of "justifiable reliance." In *Foremost*, the Alabama Supreme Court undertook to raise the bar for insurance fraud cases, changing the standard to "reasonable reliance."

By way of review, in order to establish the elements of fraudulent misrepresentation, the plaintiff must show:

- (1) that the representation was false; (2) that it concerned a material fact;
- (3) that plaintiff relied on the false representation; and (4) that actual injury resulted from that reliance.

*Boswell v. Liberty National Life Insurance Company*, 643, So.2d 580, 581 (Ala.1994); § 6-5-101, Alabama Code 1975.

Essentially, these four elements remain the same in post *Foremost* litigation. As discussed above, the *Foremost* opinion changed the standard of reliance from "justifiable" to "reasonable." In part, the *Foremost* court stated that returning to the reasonable reliance standard provided "a more practical standard that allows the fact finder greater flexibility in determining the issue of reliance based on all of the circumstances surrounding a transaction, including the mental capacity, educational

background, relative sophistication and bargaining power of the parties.” *Foremost v. Parham*, 693, So.2d 411. In addition, the court emphasized that a “return to the reasonable reliance standard will once again provide a mechanism...whereby the trial court can enter a judgment as a matter of law in a fraud case where the **undisputed evidence** indicates that the party or parties claiming fraud in a particular transaction were fully capable of reading and understanding their documents, but nonetheless made a deliberate decision to ignore written contract terms. *Id.* at 421 (emphasis added). Accordingly, summary judgment arguments on the reliance issue in insurance fraud cases often turn on whether the defendant can prove that the plaintiff “made a deliberate decision to ignore written contract terms.”

One of the biggest cases impacted by the *Foremost* rule in 2003 was that of *Alfa Life Insurance Corporation v. Green*, 2003 WL22113937 (Ala. September 12, 2003). In this case, the Greens sued Alfa alleging fraud, suppression, negligence and wantonness arising from the purchase of a \$500,000.00 whole life insurance policy from Alfa. In part, the Greens alleged that Alfa’s agent represented at the point of sale that the policy would be paid up in nine years. It is important to note that many of the facts in this case were undisputed. The court stated as follows:

The following evidence is undisputed. At this time of the events that are the basis for this action Andy Green was 47 years old; he has an eleventh-grade education and can read and write. He owned a tire business in Union Springs for 20 years and owned a hay business for 10 years. He had employed lawyers and what he referred to as a “big accounting firm” that filed his federal income tax returns and did accounting work for him on an annual basis. His wife, Bonnie, who was also 47 years old, has a

high-school education, can read and write, and worked as a bookkeeper for 20 years. The Greens, who had four children, wanted to leave each child \$125,000, free of estate tax. In 1991, they mentioned this plan to Ben May, their Alfa insurance agent, when he visited them to discuss the renewal of their property and casualty insurance policies. May told the Greens that he knew some people at Alfa who had expertise in estate planning.

Sometime after their conversation with May, the Greens met at the Alfa office in Union Springs with May and “a lawyer representing Alfa, named Steve Hughes.” This fact-finding meeting lasted over an hour, with Hughes asking the Greens questions about their financial situation. At the end of the meeting, Hughes told the Greens that he would analyze the information they had given him and would get back with them regarding his recommendations.

The meeting, with Hughes and May took place in April 1991, at the Alfa office in Union Springs. What happened at that meeting is disputed in part. It is undisputed that the Greens, Hughes, and May were present and that Hughes presented the Greens with proposals involving two Alfa life-insurance policies. The Greens rejected the first policy immediately because they would have had to pay premiums on the policy for too many years. What is in dispute is whether Hughes misrepresented or suppressed information concerning the second policy to the Greens. The Greens testified that Hughes informed them that the second policy would not require payments after either the seventh or ninth year, but in no case beyond the ninth year. Hughes testified that he did not explain to the Greens any feature of the life-insurance policy that the Greens ultimately purchased from Alfa, including the vanishing-premium feature.

It is undisputed that the Greens purchased the second policy and that they at least saw the following schedule before they signed the application to purchase the policy or paid any money to Alfa: (Here the court published a copy of part of the illustration for the policy at issue.)

\* \* \* \*

In addition, May was present at the meeting. The Greens testified at trial that May had been “up-front” with them in everything he had handled for them, that they had no problem with anything May did in selling the policy, and that the jury should not find May responsible for “some

alleged fraud or lying.” May testified that he explained the specific policy to the Greens, that he explained to them that if interest rates went up it would take less time “for the policy to pay for itself” and that if the rates went down, “it would take a longer time for the policy to pay for itself.” May’s presentation to the Greens took 30 minutes. He explained the “Statement of Policy Values” previously set out in this opinion, showing what was guaranteed and what would happen if the interest rate remained at 8.5% (that rate was guaranteed for one year only). May showed the Greens that if the 8.5% rate remained the same the Greens could discontinue the premium payments after the ninth year. May testified that he thought the Greens understood the way the policy worked. May further testified that he and Hughes answered every question the Greens asked. May testified that he did not represent to the Greens that the policy would sustain itself in seven years or nine years. The Greens did not take the stand to challenge May’s testimony.

After the representations the Greens said that Hughes made to them, the Greens received documents showing that the policy they purchased was an “Interest Sensitive Policy”; that under the column headed “Guaranteed” on the Statement of Policy Values the annual premium for the policy was \$8115 until Bonnie reached age 75; that under “Projected Vanish - - 8.500%,” the annual premium was \$8,115 through the ninth year of the policy. In addition, May had explained to the Greens that if interest rates went down it would take longer than nine years for the policy “to pay for itself.” Likewise, May, who was “up-front” with the Greens and with whom they had no problem about anything is selling the policy, was present and answered all questions asked of him by the Greens.

The Greens paid the premiums on the policy for nine years. They were then told that they would have to pay additional premiums. The Greens then sued Alfa.

The court began its analysis by reciting the reasonable reliance set forth in *Foremost*, which was first pronounced in the case of *Torres v. State Farm Fire & Casualty Company*, 438 So.2d 757 (Ala.1983) as follows:

Because it is the policy of courts not only to discourage fraud but also to discourage negligence and inattention to one’s own interests, the right of reliance comes with a concomitant duty on the part of the plaintiffs to

exercise some measure of precaution to safeguard their interests. In order to recover for misrepresentation, the plaintiffs' reliance must, therefore, have been reasonable under the circumstances....If the purchaser blindly trusts, where he should not, and closes his eyes where ordinary diligence requires him to see, he is willingly deceived, and the maxim applies, "*voluntati non fit injuria.*"

*Torres v. State Farm*, 438 So.2d 758-759; citing *Munroe v. Pritchett*, 16 Ala. 785, 789 (1849).

In applying the facts to the law, the court rationalized as follows:

At the time of or after Hughes made his alleged misrepresentation to the Greens, the Greens were shown a document showing that the policy they were presented with was an "Interest Sensitive Plan"; that the column of the policy headed "Guaranteed" showed that the Greens would have to pay the \$8,115 annual premium until Ms. Green was 75 years of age or for 28 years; and that the policy would be paid up in nine years only if the interest rates remained at 8.5% as indicated in the column headed "Projected Vanish - - 8.500%." In addition, after Hughes made his alleged misrepresentation and before the Greens paid over \$700 as an advance on the first premium, May explained the specific policy and explained to the Greens that if interest rates rose, it would take less time "for the policy to pay for itself. If the rates go down, it would take a longer time for the policy to pay for itself." May showed the Greens, using the document set out earlier, that if the interest rate remained at 8.5% the Greens could discontinue the premium payments after the ninth year. As to May, the Greens testified that he was "up-front" with them and that they had no problem with anything May did in selling the policy and that they would not want the jury "to find Ben May responsible for some alleged fraud or lying."

Based upon this evidence, we hold that the Greens have not shown any reasonable reliance by them on anything Hughes said before the Greens paid the partial premium.

*Alfa v. Green, supra.*

Clearly, the Supreme Court reversed this case because the plaintiff failed to disprove the notion that he “made a deliberate decision to ignore written contract terms.” The key to surviving the reasonable reliance standard involves testimony that the plaintiff both read the policy and listened to the agent, relying on both in making the decision to purchase the policy. The issue then becomes whether the agent’s representations and the policy language itself are contradictory. Of course, this issue is to be analyzed “based on all of the circumstances surrounding the transaction, including the mental capacity, educational background, relative sophistication and bargaining power of the parties.” *Reynolds Metals Company v. Hill*, 825 So.2d 100, 108 (Ala.2002), citing *Foremost*, 693 So.2d 421.

Any discussion of recent developments in insurance fraud law must include the topic of arbitration. More and more insurance companies are including arbitration clauses in insurance policies, and the courts are making it harder and harder for plaintiffs to litigate insurance fraud claims before a jury. In the past, one argument around an insurance arbitration clause was that the contract at issue “did not substantially affect interstate commerce.” However, the Alabama Supreme Court, with a little help from the United States Supreme Court, decimated this argument in the case of *Liberty National Life Insurance Company v. Ester*, 2003 WL22419314 (Ala. October 24, 2003.) There, the insureds brought an action against Liberty National and its agents to recover fraud in the inducement by telling the insureds that a credit life insurance policy had to be canceled and converted to a whole life policy. Initially, the trial court denied the motion

to compel arbitration finding that the policy at issue did not substantially affect interstate commerce. Subsequently, the United States Supreme Court decided *Citizens Bank v. Alafabco, Inc.*, 123 S.Ct. 2037 (2003), “which changed the case law in Alabama regarding a contracts affecting interstate commerce.” However, the plaintiffs argued that the denial of the motion to compel arbitration should be upheld based on fraudulent inducement. In response, the trial court held that the arbitration clause in this case encompasses “any dispute, claim, question or disagreement arising out of relating to this policy, including any claim alleging fraud.” The court then applied the *Foremost* reasonable reliance standard and held that the plaintiff could not be induced by any representations to the exclusions of the written disclosures in the contract. *Ester, supra*.

The Alabama Supreme Court case of *Newson v. Protective Industrial Insurance Company of Alabama*, 2003 WL22463336 (Ala. October 31, 2003) examined the issues of standing and damages in the insurance fraud context. In *Newson*, the plaintiff filed suit against the defendant insurance company and its agents for theft of premiums. Specifically, the plaintiff alleged that they were fraudulently induced into surrendering five insurance policies with the promise of increased coverage. In truth, the defendants used the proceeds to make unauthorized premium payments on other policies as well as the purchase of new insurance.

The defendants argued that the plaintiff had not been damaged and lacked standing to sue. With respect to damages, the court held as follows:

This court has recognized that a plaintiff can be damaged by the loss of cash value that has accumulated in a whole life insurance policy. This court has also held that allegations that fraud by a defendant insurer had caused the plaintiff unnecessarily to replace an existing policy with a new policy at a higher premium cost for the same coverage, sufficiently alleged damage to withstand a motion to dismiss.

*Newson, supra*, citing *Boswell v. Liberty National life Insurance Company*, 643, So.2d 580, 582 (Ala. 1994).

With respect to standing, the court held as follows:

Factors important to this standing were that the insured was related to the plaintiff, the plaintiff occupied a special relationship with the insured and was involved in some degree of the application process, the plaintiff had assumed some responsibility for the care of the insured, the benefits paid under the policy would have been beneficial to the plaintiff in paying any obligation arising out of the plaintiff's assumption of responsibility for the care or burial of the insured and the plaintiff had paid either all of the premiums or some of the premiums.

*Newson*, quoting *Accord North Carolina Mutual Life Insurance v. Holley*, 533 So.2d 497, 499 (Ala.1987).

These are some of the cases that discuss recent developments and trends in insurance fraud law during the year of 2003. In sum, defense lawyers have enjoyed a conservative supreme court while plaintiff's lawyers have been forced to work harder and more creatively in order to reach the jury in an insurance fraud case.