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FRAUD LAW UPDATE

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I. FRAUD CASE LAW UPDATE

A. BURDEN OF PROOF IN THE FRAUD CASE

Prior to May 13, 1994, those who practiced in the area of insurance fraud law found the law to be in a state of flux. There was a line of cases in Alabama that stated in the insurance fraud case when fraudulent conduct had been discovered by a plaintiff, but between the time of purchase and the time of discovery no claims were made on the insurance policy in question, no cause of action for fraud would arise because the period of time had past without the plaintiff having made a claim. These cases stood for the principle that you must have made a claim and have incurred damages in order for a fraud case to exist. See *Moore v. Liberty National Life Insurance Company*, 581 So. 2d 833 (Ala. 1991); *Allen v. Gulf Life Insurance Company*, 617 So. 2d 664 (Ala. 1993); and *Applin v. Consumers Life Insurance Company*, 623 So. 2d 1094 (Ala. 1993).

However, there was a second line of cases that stood for the principle that a fraud claim was actionable at the time the alleged fraudulent transaction occurred, viewing the injury or damage as the payment of unnecessary premiums. See generally *Willingham v. United Insurance Company of America*, 628 So. 2d 328 (Ala. 1993); *Liberty National Life Insurance Company v. Waite*, 551 So. 2d 1003 (Ala. 1989); *Guinn v. American Integrity Insurance Company*, 568 So. 2d 760 (Ala. 1990); *Brewton v. Alabama Farm Bureau Mut. Casualty Ins. Co.*, 474 So. 2d 1120 (Ala. 1985); and *Old Southern Life Insurance Company v. Woodall*, 348 So. 2d 1377 (Ala. 1977).

The Alabama Supreme Court having discussed both line of cases decided that the

second line of cases was "the better law" and **overruled** the first line of cases, in its holding of *Boswell v. Liberty National Life Insurance Company*, 643 So. 2d 580 (Ala. 1994).

The *Boswell* decision is a key decision in fraud cases and is now the standard in making a *prima facie* case for fraud.

B. BURDEN OF PROOF IN THE FRAUDULENT SUPPRESSION CASE

To establish a *prima facie* case of fraudulent suppression, a plaintiff must show: (1) that the defendant suppressed a material fact, (2) that the defendant had a duty to communicate that material fact, either because of a confidential relationship between the parties, or because of the particular circumstances of the case, and (3) that the plaintiff suffered actual injury as a result of the suppression. § 6-5-102, *Ala. Code*, (1975); *Boswell v. Liberty National Life Insurance Co.*, supra at 581; see also *Dodd v. Nelda Stephenson Chevrolet, Inc.*, 626 So. 2d 1288, 1293 (Ala. 1993).

Whether or not an agent of an insurance company has a duty to disclose certain facts about an insurance transaction, appears to be determined on a case by case analysis. In two recent cases, the Alabama Supreme Court has found that insurance agents possess superior knowledge over the product they are selling, therefore, "particular circumstances" exists that create a duty, or a "confidential relationship" has developed as a result of inquiries made by the plaintiff concerning the product. See generally, *Miller v. Dobbs Mobile Bay*, 661 So. 2d 203 (Ala. 1995), and *Union Security Life Insurance Co. v.*

Crocker, 667 So. 2d 688 (Ala. 1995). See also, *Liberty National Life Insurance Co. v. McAllister*, supra.

The "confidential relationship" and/or "particular circumstances" which create a duty to disclose by agents of insurance defendants is discussed by the Alabama Supreme Court in *Hines v. Riverside Chevrolet/Olds, Inc.*, 655 So. 2d 909, 918 (Ala. 1994). The Court stated that "mere silence is not fraudulent in the absence of a duty to disclose. A duty to disclose may arise from a confidential relationship, from a request for information, or from the particular circumstances of the case." *Hines*, supra at 918. in *McAllister*, the Court stated that a "relationship of trust" that had developed over the years with the insured and the insurance company's agent, created a duty whereby the agent was required to disclose any and all differences between an old cancer policy and a new cancer policy that was being "switched" by the company and its agents.

The question as to whether a duty to disclose exists in a fraudulent suppression case **is a question for the jury**, which should consider the relationship of the parties, the value of the particular facts suppressed, and the relative knowledge of each party." *Backer v. Bennett*, 603 So. 2d 928, 935 (Ala. 1992).

In the insurance fraud case, it is becoming abundantly clear that the Alabama Supreme Court views the insurance agent relationship with the insured as being " confidential" and/or at least creating "particular circumstances", that impose a duty on the agent to disclose all important facts about the insurance policy at hand. It also appears clear that the Alabama Supreme Court view insurance agents as possessing superior

knowledge over the insurance products they sell, placing the consumer at a clear disadvantage, thus, a duty is created to protect consumers in these type transactions.

II. STATUTE OF LIMITATIONS IN A FRAUD CASE

A fraud action is subject to a two-year statute of limitations. See §§ 6-2-38, *Ala. Code* (1975). However, the statute has a tolling provision which provides that a fraud claim accrues only when the plaintiff discovers the fraud or when the plaintiff, acting as a reasonable person, should have discovered the fraud. § 6-2-3 *Ala. Code* (1975). Generally, the question of whether a party has discovered, or should have discovered the fraud, for purposes of the statute of limitations, is a question for the jury. *Massachusetts Mutual Life Insurance Co. v. Collins*, 575 So. 2d 1005 (Ala. 1990). Nonetheless, the question of when a plaintiff should have discovered fraud should be taken away from the jury and decided as a matter of law **only** in cases in which the plaintiff **actually knew** of facts that would have put a reasonable person on notice of the fraud. *Hicks v. Globe Life and Accident Insurance Co.*, 584 So. 2d 458 (Ala. 1991).

In the case of *Kelly v. Connecticut Mutual Life Insurance Co.*, 628 So. 2d 454 (Ala. 1993), a case where the Court found that the plaintiff's claims were barred by the statute of limitations, the Court stated that "'fraud is discoverable as a matter of law for purposes of the statute of limitations when one receives documents that would put one on such notice that the fraud reasonably should be discovered.'" *Kelley*, supra at 455 (quoting *Hickox v. Stover*, 551 So. 2d 259, 262 (Ala. 1989).

In *Liberty National Life Insurance Co. v. McAllister*, supra, the Alabama Supreme Court discussed *Kelley, Hicks* and *Hickox*, and ruled that Ms. McAllister had no reason to question her cancer switching policy coverage because she relied upon her agent's assurances that the new policy provided "better coverage", therefore, her statute of limitations did not run until she made a claim in 1992, five years after her policies were delivered. Again, the Alabama Supreme Court has recognized that insurance companies must be responsible for the acts of their agents in selling insurance.

If there is a potential statute of limitations problem in your case, all of these cases should be analyzed before the plaintiff submits to deposition testimony on the issue.

III. AGENCY IN THE FRAUD CASE

In the insurance fraud case, the issue of agency inevitably surfaces as a potential trouble area in connecting the company with the misconduct of the agent. However, the Supreme Court of Alabama issued an opinion in 1994, that more clearly defines the responsibilities of the insurance company with regard to the misconduct of its agents. In the case of *Ragsdale v. Life Insurance Company of North America*, 632 So. 2d 465 (Ala. 1994), the Court held that an insurance company cannot give authority to a person to solicit and obtain applications for insurance, and give them the power to explain benefits available under particular policies, and then attempt in the case of liability, to claim to be exempt from responsibility when that person misrepresents the coverage available to the insured. Id. at 469.

The *Ragsdale* Court specifically stated that the law of agency in Alabama is a jury question. The Court stated:

> "`In Alabama, agency is determined by the facts, and not by how the parties might characterize the relationship', *Semo Aviation, Inc. v. Southeastern Airways*, 366 So. 2d 936, 940 (Ala. 1978); *Battles v. Ford Motor Company*, 597 So. 2d 688, 689 (Ala. 1992). `If the facts establish the relationship of principal and agent, the intentions of the parties is immaterial, and the character of the relationship is not affected by an agreement between the parties that an agency does not exist, or that some other relation does exist', *Semo Aviation*, 366 So. 2d 940."

Ragsdale, 632 So. 2d at 468.

Most importantly, the Court went further to state:

> "`An agent's authority is measured by the powers which his principal has caused him or permitted him to `seem to possess'. As to third persons without knowledge or notice, it is not limited to the powers actually conferred and those to be implied as flowing therefrom, but includes as well the apparent powers which the principal by reason of his conduct is estopped to deny'".

Ragsdale, 632 So. 2d at 468 (citing *Patterson v. Williams*, 206 Ala. 527, 528, 91 So. 315 (1921); *Blue Cross-Blue Shield of Alabama v. Thorton*, 56 Ala. App. 678, 683, 325 So. 2d 187 (1975)).

It is abundantly clear from the *Ragsdale* Opinion that the question of agency must go before the jury. Therefore, any argument by a defendant insurance company stating that they are not responsible for the acts of the agent is defeated by *Ragsdale*.

The Alabama Supreme Court has also made it abundantly clear that an insurance company is bound by the actions of its agent when the agent knows of an applicant's

adverse health history and yet sells a policy of insurance without disclosing that health history. More specifically the Court stated:

> "It is well settled that an insurance company cannot defend its refusal to pay benefits on grounds that the insured made a misrepresentation in the application if the misrepresentation was the fault of the agent and that fault was without participation by the insured."

Miller v. Dobbs Mobile Bay, Inc., 661 So. 2d 203, 206 (Ala. 1995).

Insurance companies often attempt to hide behind § 27-14-7, *Ala. Code* (1975), by citing that the insured has misrepresented facts on the application, therefore, they are not liable to pay a claim made on the policy. However, if evidence is presented that the agent made the misrepresentation, not the insured, the company is bound by the agent's misconduct and the consumer is not penalized for such conduct.

IV. VENUE IN THE FRAUD CASE

It seems that in the last five years that the issue of venue in the insurance fraud case has been before the Alabama Supreme Court more often than any other issue involving fraud. Nonetheless, the Court seems to have definitively stated its position with regard to proper venue in the insurance fraud case in the recent cases of *Ex parte The Prudential Insurance Company of America*, Nos. 1941037 and 1941038 (Ala. Feb. 9, 1996), and *Ex parte Gauntt*, No. 194059, 1996 WL 55604 (Ala. Feb. 9, 1996).

At issue in *Gauntt*, supra and *Prudential*, supra, was the application of § 6-3-5(a), and 6-3-7, *Ala. Code* (1975), and which one governed over the other. Section 6-3-5(a),

simply states that the plaintiff must file their case if it involves a dispute with an insurance company, in the county where they reside as long as that insurance company does business in that county. Doing business has been defined as simply mailing the policy through the mail.

Section 6-3-7, which applies to personal injury claims and contract claims, provides that a foreign corporation may be sued in any county where it does business by agent. Section 6-3-7 is complicated by § 232 of the *Alabama Constitution of 1901*, whereby it was amended in 1988 by Amendment No. 473, which provides that foreign corporations must be treated like domestic corporations when being sued.

In *Prudential*, supra, the plaintiff resided in Tuscaloosa County, but filed her lawsuit in Greene County, but the Court concluded that venue was not significantly more convenient in Tuscaloosa County, thereby, affirming the trial court's denial of defendant's motion to transfer the case to Tuscaloosa County. The Court reached its decision by simply stating that no provision in Section 6-3-7, stated that is shall govern personal injury actions against insurers and that all insurance contract actions are governed exclusively by Section 6-3-5. Therefore, the Court concluded that the venue for claims on insurance policies provided for by Section 6-3-5(a) is simply **supplemental** to that provided for by Section 6-3-7.

It is important to note that the plaintiff in *Prudential* alleged a breach of contract claim, which the Court viewed significant in analyzing Section 6-3-5(a), and 6-3-7. The Court also definitively stated that tort actions were considered personal injury actions for purposes of venue. However, the Court also acknowledged in *Prudential* that the plaintiff's

breach of contract claim was clearly proper in Greene County under Section 6-3-7, and because of that claim, the Court did not feel the need to further address the issues raised by the defendants under Section 6-3-5(a). Because under Rule 82(c), *Alabama Rules of Civil Procedure*, venue was proper in Greene County on the plaintiff's complaint because of the breach of contract claim, therefore, venue was proper as to all defendants.

In *Gauntt*, there were numerous plaintiffs who brought separate actions in the Circuit Court of Macon County, Alabama, containing both contract and fraud claims against defendant United Insurance Company of America, et al. All of the plaintiffs lived either in Elmore County, Montgomery County, Chilton County or Tallapoosa County. United did business in all counties where the plaintiffs resided.

Defendants filed a motion to transfer all cases to Shelby County, Alabama, primarily based on the argument of *forum Non Conveniens*. The defendants further argued that Section 6-3-7 controlled the question of venue and that proper venue was where the wrongful act occurred, not where the resulting non-bodily injuries occurred. The trial court transferred the case to Shelby County. However, the Supreme Court reversed the trial court and ordered it to transfer the cases back to Macon County based on the argument *forum Non Conveniens*.

On rehearing, the Alabama Supreme Court issued the same ruling it had in *Prudential*, supra, in that § 6-3-5 was enacted to supplement venue as established by § 6-3-7, not to replace it, as to corporate insurers. The Court further ruled that on the specific facts in *Gauntt*, that the trial court was to determine which cases involved personal injury

actions and to transfer them to the county where the injury occurred, or the county where the plaintiff resides. The Court further directed the trial judge to retain those cases which stated both contract and personal injury claims.

The holdings in *Prudential* and *Gauntt*, are consistent and appear to be definitive on the issue of venue in the insurance fraud setting. The issue became clouded in the case of *Ex parte Bloodsaw*, 648 So. 2d 553 (Ala. 1994), and *Ex parte New England Mutual Life Insurance Co.*, 663 So. 2d 952, 955 (Ala. 1995). The main message of *Bloodsaw*, supra, and *NewEngland*, supra, is simply to make sure that the parties establishes a good record of evidence in the trial court to support your position. Primarily, this is done through affidavits by the plaintiff, potential witnesses in the plaintiff's case for the purposes of putting to rest the *conveniens* issue, and affidavits demonstrating that the defendant does business in the county where the plaintiff has filed his/her lawsuit. These cases along with *Gauntt*, supra, and *Prudential*, supra, appear to have cleared the issue on proper venue in the insurance fraud case.

V. WARRANTY NOT AN INSURANCE CONTRACT

In 1993, the Alabama Supreme Court declared that an extended warranty contract can, for purposes of bad faith, be considered an insurance contract. However, a recent amendment to the Alabama Mini Code appears to have destroyed that legal theory.

In 1993 the Alabama Supreme Court released the opinion of *Schoepflin v. Tender Loving Care Corporation*, 631 So. 2d 909, (Ala. 1993) in which the Court declared that an

extended warranty contract can, for purposes of bad faith, be considered an insurance contract. This case appears to have been overruled upon the passing of § 5-19-32, *Ala. Code* (1975), which provides in pertinent part:

> "A service contract does not constitute insurance for any purpose other than for the purpose of a service contract holder's claim against a service contract provider for failure to comply with the provisions of the service contract if so provided by other law."

§ 5-9-32, *Ala. Code* (1975).

This provision also provides that extended service contracts are permissible under the Mini Code, and that the cost of such contracts may be financed as part of the purchase.

VI. NEGLIGENT AND/OR WANTON SUPERVISION

In the case of *Northwestern Life Insurance Company v. Sheridan*, 630 So. 2d 384 (Ala. 1993), an insurance fraud case resulting in a $26,000,000 award to the plaintiffs, which was ultimately reduced to half that figure on appeal, seemed to resurrect the tort of negligent and/or wanton supervision, a tort that has been around since 1910. See *Sloss-Sheffield, Steel & Iron Co. v. Bibb*, 164 Ala. 62, 51 So. 345 (1910). The tort has variations such as wrongful hiring and retention, wrongful supervision, negligent supervision, and wanton supervision. However, it is the wanton supervision claim that results in the award of punitive damages.

In the *Sheridan* case, a rogue agent for Northwestern Mutual Life Insurance

Company had represented certain qualified retirement pension plans and deferred compensation plans to the plaintiffs, plans which were not available from Northwestern, but the evidence presented in that case allowed the jury to conclude that Northwestern knew of the agent's unethical conduct and not only tolerated such conduct, but actually exploited the agent's misconduct all for the benefit of profit. This evidence was significant in supporting the statutory requirements for vicarious liability found under § 6-11-27, *Ala. Code*, (1975). Again, it was the evidence establishing wantonness that allowed the punitive damage award to withstand the scrutiny of an appeal.

In the insurance fraud case where there is misconduct by an agent, a negligent and/or wanton supervision claim should be alleged as a separate count in the complaint.

VII. NO POLICY DELIVERED, CLAIM CANNOT BE DENIED

Recently, the Honorable Judge Ira DeMent, United States District Judge for the Middle District of Alabama, delivered a certified question to the Alabama Supreme Court concerning a defendant insurance company's failure to deliver an insurance policy to the insured, and the effect of that failure to deliver the policy on the company's denial of a claim based on an exclusion contained in the undelivered policy.

Believe it or not, this was a case of first impression in Alabama. The Alabama Supreme Court created an exception to the general rule that insurance coverage in Alabama cannot be created or enlarged by estoppel. The Court citing such in 27-14-19, *Ala. Code*, (1975), which requires that an insurance policy be "mailed or delivered" to the

insured within a reasonable time. The normal practice in the industry is thirty to sixty days. The Court ruled in *Brown Machine Works & Supply Co. v. The Insurance Company of North America*, 659 So. 2d 51 (Ala. 1995), that an insurer who fails to deliver a policy to the insured may be estopped from asserting conditions of, or excluding from, coverage when the insured is prejudiced by the defendant insurance company's failure to comply with § 27-14-19, or simply, failure to timely deliver a policy.

The Court acknowledged that the insured and the defendant insurance company are so obviously included within the terms of § 27-14-19, the mere delivery of a certificate of insurance, even one disclaiming any effect on the insured's legal right under the policy, will not be sufficient to comply with § 27-14-19.

Effectively, the Alabama Supreme Court has stated that if an insurance company fails to deliver the policy of insurance to the insured, and the insured makes a claim on that policy, then the insurance company cannot exclude coverage based on an exclusion contained in that policy. Clearly, the plaintiff could not have been aware of the exclusions if the policy had not been delivered. This is a significant opinion especially in the health insurance fraud case.

VIII. DISCOVERY IN THE INSURANCE FRAUD CASE

The *Alabama Rules of Civil Procedure* provide an abundance of discovery methods that can be used in obtaining information from the defendant insurance company in the insurance fraud, or bad faith case.

The most effective way of beginning the discovery process is to file discovery with your complaint, typically a good set of interrogatories, request for production, request for admissions and notices of deposition should all be filed with the complaint. This allows you to maintain control over the discovery process from the outset.

For purposes of this seminar, it would be unnecessary to review each and every rule of civil procedure governing discovery in the insurance fraud case, but you should have a good understanding of Rule 30, Rule 33, Rule 34 and Rule 36, *A.R.Civ.P.*

The key to the insurance fraud or bad faith case is evidence of similar acts by the defendant, also known as "pattern and practice evidence". This topic will be discussed later, but there are three important cases that you should be familiar with during the discovery process in the insurance fraud case. The first case, *Pugh v. Southern Life & Health Insurance Company*, 544 So. 2d 143, (Ala. 1988), serves as a general guideline in establishing what is discoverable in the initial stages of the insurance fraud or bad faith cases.

Another important case is that of *Ex parte Clarke*, 582 So. 2d 1064 (Ala. 1991), which gives the counsel for the plaintiff the right to contact other policyholders. The Court reasoned in *Clarke* that the plaintiff's burden is so high that a broader range of discovery must be allowed.

The case of *Ex parte Asher, Inc.*, 569 So. 2d 733 (Ala. 1990), establishes the general rule that information regarding other policyholders, other complaints, other lawsuits of similar type, must be produced when properly requested by the plaintiff.

Recently, in the case of *Ex parte Stephens*, No. 1941630 1996 WL 100193 (Ala.), the Alabama Supreme Court addressed the plaintiff's right to conduct meaningful discovery with potential pattern and practice witnesses that have resulted from the customer list being produced by the defendant insurance company. In *Stephens*, the trial court attempted to limit the plaintiff's right to interview potential pattern and practice witnesses discovered as a result of customer list produced by the insurance company, Life Insurance Company of Georgia. In this particular case, it was the agent list only that was the subject of the trial court's order. The trial court ordered that the defendant hasd the right to be present during any interviews conducted by the plaintiff on any potential pattern and practice witnesses that were contained on the customer list produced by the defendant insurance company.

The plaintiff appealed and the Alabama Supreme Court agreed with the plaintiff's position stating that the plaintiff's attorneys had a heavy burden in their fraud case and they should be afforded the opportunity to conduct meaningful discovery, which included the use of interviews of former policyholders of the defendant. The Court acknowledged that it would be unfair to plaintiff's counsel to conduct interviews in front of defense counsel and be forced to reveal their strategies, impressions, and opinions of the case to defense counsel through the procedure ordered by the trial court. The Court further acknowledged that the plaintiff's counsel has a right to certain work product as a result of interviews conducted on former policyholders of the defendant insurance company.

The *Stephens*' opinion is a significant step in protecting the plaintiff's right to conduct meaningful discovery in the insurance fraud case. While the opinion does not

discourage protective orders concerning policyholder lists of defendant insurance companies, it does provide guidelines for the trial court to follow in issuing protective orders concerning these types of discovery matters.

Finally, the case of *Valentine v. World Omni Leasing, Inc.*, 601 So. 2d 1006 (Ala. Civ. App. 1992), the only case issued to date on the issue of pattern and practice evidence in a fraud case, is a case that should be read prior to conducting interviews with potential pattern and practice witnesses. The *Valentine* case sets forth the limitations of admissibility of certain pattern and practice evidence. A reading of this case will help you reduce the number of potential pattern and practice witnesses necessary to interview.

In light of *Pugh*, *Clarke*, *Asher*, *Stephens,* and *Valentine,* pattern and practice evidence is easily obtainable, but must be pursued by counsel for the plaintiff.

XI. FRAUD IN THE YIELD SPREAD CASE

Recently, the Alabama Court of Civil Appeals released the opinion of *Bramlett v. Adamson Ford and Ford Motor Credit Co.*, No. 2950526, 1996 WL 342283 (Ala. Civ. App.) which breathes new life into the claim of fraud in the yield spread case.

In *Bramlett*, supra, the plaintiffs purchased an automobile from defendants whereby the sales person advised that he would "obtain the best financing rate possible". However, sometime after purchase, the plaintiff discovered that the defendant dealership received a three percent (3%) commission on the rate of interest charged to the plaintiff. Plaintiff Bramlett sued the defendant dealership and the lender, Ford Motor Credit Co., alleging

fraud by suppression and misrepresentation, conspiracy to defraud, breach of contract, unconscionability, and outrage. The trial court entered summary judgment for the defendants. Plaintiff Bramlett appealed the summary judgment as to this claims of fraudulent suppression, misrepresentation, civil conspiracy, and unconscionability.

On appeal, the Alabama Court of Civil Appeals reversed the trial court concerning the plaintiff's claims of fraudulent suppression, fraud, and civil conspiracy. The Court stated that issues of fact existed as to these claims, and the trial court erred in issuing summary judgment on these counts. However, the Court affirmed summary judgment on the plaintiff's count for unconscionability.

This is an important decision because the transaction described in *Bramlett*, is a common transaction which the Court has now declared to be fraudulent when the representation is made that the financing is "the best possible financing available" based on the plaintiff's credit record. If the defendant is profiting by way of a yield spread, the Court has stated that such a profit of spread should necessarily be disclosed to the borrower.