



Alerts

Material Misrepresentations in Life Insurance Policy Application Justified Rescission by Insurer

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The LHD/ERISA Advisor

In *Salopek v. Zurich Am. Life Ins. Co.*, 2020 U.S. Dist. LEXIS 46857 (D. N.M. March 18, 2020), a New Mexico district court affirmed an insurer's rescission of an individual life insurance policy based on material misrepresentations in the application regarding the insured's history of alcohol and tobacco use.

The insured, a pecan farmer in New Mexico, purchased the subject \$15 million life policy in August 2015 and died of colon cancer approximately five months later—well within the policy's contestability period. While investigating a claim on the policy made by the insured's wife, Marcie Salopek ("Plaintiff"), Zurich American Life Insurance Company ("Zurich") discovered that the insured failed to disclose in the application that he sometimes drank up to 16 beers a day, used chewing tobacco, and had a history of cancer. Zurich denied Plaintiff's claim and rescinded the policy.

Following the rescission, Plaintiff sued Zurich, alleging that Zurich had improperly rescinded the policy and asserting causes of action, *inter alia*, for breach of contract and bad faith. Applying New Mexico substantive law, the court granted Zurich summary judgment on Plaintiff's bad faith claim, but denied it as to breach of contract, finding a factual dispute existed for a jury.

Focusing on the bad faith claim, the court noted that under New Mexico law, a plaintiff may establish bad faith in two ways: either by showing the insurer did not deal with the insured fairly in assessing a policy claim; or by showing the insured did not act in good faith in performing the contract. In this case, Plaintiff alleged that Zurich's bad faith conduct fell into three categories: (1) allegations regarding pre-policy events; (2) allegations that Zurich's denial of Plaintiff's claim was unfounded; and (3) allegations that Zurich investigated the claim in bad faith.

As to the first category (pre-policy behavior), Plaintiff argued that Zurich had a duty to conduct a certain type of investigation before accepting the risk of insuring the applicant. The court determined that Zurich had no duty to do an expansive investigation before accepting the insured's application and in the absence of that duty, the failure to do so could not be evidence of bad faith.

As for the second category (allegations that Zurich's denial of Plaintiff's claim was unfounded), Plaintiff argued, *inter alia*, that Zurich acted in bad faith when it put its interests above hers, namely, misrepresenting pertinent facts or policy provisions relating to the coverage. While not identifying any language in the

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policy that constituted a misrepresentation or any specific terms that the insured was unaware of related to the denial of the claim, Plaintiff's arguments appeared to suggest that the insured did not understand the incontestability clause. The court held that this was insufficient to sustain a bad faith claim because the incontestability clause appeared in the policy and nothing in New Mexico law required the insurer to do more.

Still under the second category, Plaintiff alleged that Zurich unfairly denied her claim because the denial was baseless. Plaintiff argued that the insurer's claim review was unreasonable because it only took a few hours, the claims reviewer did not consider the fact that Zurich had pre-policy facts showing that the insured used alcohol and tobacco significantly more than what he represented on the application, and that the claims reviewer "cherry picked" information, so as to obscure the fact that Zurich had information that the insured used alcohol and tobacco exactly as stated on the application. Zurich countered that it denied the claim based on the policy terms and its investigation. The policy specified that if any statements in the application were untrue or incomplete, then Zurich may have the right to void the policy. When Zurich's investigation uncovered evidence that the insured used more alcohol and tobacco than he represented on the application, Zurich properly voided the policy. Under New Mexico law, an insurer who fails to pay a first-party claim acts in bad faith only when its reasons for denying the claim are frivolous or unfounded. The court found that there was sufficient evidence supporting Zurich's actions in denying the claim.

Finally, as for the third category (allegations that Zurich investigated Plaintiff's claim in bad faith), Plaintiff alleged that Zurich regularly conducted claims investigations in bad faith because it has "a policy and practice of overly scrutinizing and denying life insurance claims when the insured dies within two years of obtaining coverage." The court found, however, that there was no evidence of such conduct and, more importantly, the law permits an insurer to investigate a claim when a claim is made within two years of the issuance of the policy. Similarly, the court dismissed Plaintiff's allegations that Zurich acted in bad faith when Zurich did not attempt to settle Plaintiff's claim and took four months to render its claim decision.

Accordingly, the court found that Plaintiff had not met her burden of showing sufficient evidence of bad faith and dismissed the claim.