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RESPONDING TO FRAUDULENT OR HOSTILE CLAIM UNDER A FIRST-PARTY POLICY

Special Nature of First-Party Insurance Policies

A distinctive aspect of first-party policies is the conditions and requirements that the insured must comply with to recover in the event of loss. Many first-party (property) policies still incorporate the 165 lines of the 1943 New York Standard Fire Policy, and the Duties In The Event of Loss, required of the insured, have remained substantially unchanged since the 1886 New York Standard (Old) Fire Policy. These conditions have been court tested for over 100 years and are well established both in case law and insurance practice. They are generally considered a condition precedent to recovery and have long been refined in practice by adjusters and attorneys involved in property insurance losses.

Case Study

A Case Study, which we will refer to for a factual context, is attached as Appendix A.

The First-Party Contract And Duties The Insured Must Satisfy

A first-party policy is a contract between the insured and the insurer. As a general proposition, the policy insures against direct physical loss or damage caused by a covered cause of loss during the policy period.

When a property claim is submitted by an insured, the insurer often needs to investigate — and is entitled to investigate — the claim. This is because the insurer will usually have limited knowledge of what happened, so it will investigate the claim to understand the nature of the loss and amount of damages. There are several purposes of investigating a claim. One is so the insurer can determine its rights and liabilities, such as determining whether the claim is covered, in whole, in part, or not at all. Other purposes are safeguarding against paying an excessive claim and preventing fraud.

One of the defining aspects of the property policy are the Conditions, most notably the Duties in the Event of Loss. These are policy conditions relating to how and when the notice of loss must be tendered to the insurance company and the authorities in the event of a crime; information and documents to be provided; allowing a full inspection of the property with taking of photographs and samples; and copying of records. These conditions further provide that the insured must submit a signed, sworn proof of loss and provide substantial support for all amounts claimed. Upon demand of the insurance company, the insured must submit to an examination under oath attesting to all facets of the insurance in place, the risk, the loss, and the claim.

A copy of sample Duties in the Event of Loss[1] is attached as Appendix B.

[1]ISO Building And Personal Property Coverage Form CP 0010 10/12

Generally, the insured is required to substantially comply with these requirements.

Claim Investigation Under The Property Policy

The claim process begins with the insured submitting a notice of loss to the insurer. This notice from the insured must be timely. Often "prompt" notice is required. The reason notice of loss must be given is so the insurer can begin its investigation close in time to when the loss happened. That is important for a productive and informative investigation.

Following receipt of the notice, an adjuster will commonly review the claim to determine the appropriate level of investigation needed to verify the loss and claim. In some instances, coverage may be questionable or the loss, as reported, requires further verification. The adjuster will often use consulting experts, such as engineers, accountants, or investigators, to determine what happened, the cause of loss, or the extent of actual damages.

As indicated, the insurer will not know much about the loss and will need to find out what happened and why. Therefore, a reservation of rights letter may be issued to inform the insured that an investigation is underway as well as to indicate that the claim may not be covered or, at least, that coverage issues are present. The reservation of rights letter is not intended to create an adversarial relationship with the insured. In fact, any coverage questions may be worked out and the claim may be resolved.

The content of the reservation of rights letter should not be boilerplate or run on with citations to policy provisions not relevant to the claim. Rather, the wording should be tailored to the claim and be sufficiently specific to inform the insured of what the insurer, at that stage, has spotted as potential issues. Accordingly, the reservation of rights letter will set out the policy terms, conditions, and exclusions that may apply to the claim. Besides advising the insured of these matters, the insurer, through the reservation of rights letter, will strive to avoid waiving or being estopped from raising policy rights or defenses.

The adjuster will rely on the Duties In The Event Of Loss to investigate the loss and seek support of the claim from the insured. The investigation may involve a site visit, inspection of damaged property, assessing the scene, and taking photographs, measurements, or samples

The adjuster will usually request documents related to the loss and claim, including the amount being claimed. A host of documents could be requested, depending on the loss and scenario, such as: investigative reports, consulting or expert reports, timelines, photographs, maintenance records, business records, contents list, inventory records, financial records, sales records, invoices, receipts, bank records, tax returns, estimates, or damages calculations. Again, what is requested is driven by the nature of the loss and claim.

The Proof of Loss

A proof of loss is a sworn document submitted by an insured. In the proof of loss, the insured attests to the facts relating to the loss, such as date and cause, the risk, the value of the property, and the amount claimed. Again, the statements in the proof loss are sworn to by the insured. Any false swearing by the insured may preclude recovery under the policy or subject the insured — the person signing the proof of loss — to penalties of perjury.

When a loss investigation or adjustment has reached a point where a proof of loss is warranted, the insurer may request a proof. While the Duties usually refer to the insurer requesting a proof of loss, insureds often submit a proof when they feel ready to, regardless if the insurer or adjuster feels the investigation is at a stage warranting a proof of loss. The insured may file the proof of loss to prompt the insurer to respond to it, such as within 30 days. When the investigation is still in progress, documents from the insured about the loss, reports from consultants, or an examination under oath may still be needed. In such a case, the insurer or adjuster will need to advise the insured that the investigation is ongoing and must be completed before the proof of loss can be responded to.

The proof of loss is an important document and requires immediate attention as to the factual and substantive statements in it. A proof of loss that has been received, but not responded to or rejected, may be deemed to have been accepted. Acceptance of a proof of loss can signify that all is well and a payment will be issued pursuant to policy terms. Inadvertent acceptance of a proof of loss may waive or at least endanger the insurer's defenses.

The Examination Under Oath

Property insurance policies typically require that the insured(s) submit to an examination under oath, separate from other insureds and answer questions pertaining to the insurance, risk, claim, events surrounding the loss, and damages.

The purpose of the examination under oath (commonly referred to as an "EUO") is to enable the insurer to possess itself of the knowledge and information needed to decide upon its obligations and to protect against false claims. The scope of permissible questioning is broad and allows the insurer to question an insured regarding any fact that may lead to relevant information in determining its policy obligations.

Courts have held that the obligation to submit to an EUO is a condition precedent to coverage under the policy. This means that, if an insured refuses to submit to the EUO, the insurer has no obligation to pay and may use the failure to comply with the condition as an affirmative defense in any lawsuit brought by the insured on the policy.

The insurer must serve a proper demand and establish that the insured, knowing of its obligation, intentionally refused to comply with the EUO condition of the policy. The demand is usually prepared and served by legal counsel for the insurer. The demand should specify that the insured appear on a given date, time and location. If the demand is not definite in date, time and location, the insurer will not be able to avail itself of the failure to comply defense. Documents may be requested to be produced in advance of the EUO. The demand should set forth the policy language requiring the insured to appear and advise the insured that failing to do so may result in the denial of the claim. The insured should also be advised that it has a right to be represented by counsel at the EUO at its cost.

The EUO is usually taken by the insurer's attorney that sent the demand. If the insured refuses to answer questions, the insured is not complying with the EUO condition and is refusing to cooperate with the insurer in the investigation of the claim. Best practices require the attorney to explain why the question is believed to be relevant as well as the consequences that may follow by refusing to answer. An insured may choose to assert his 5th amendment privilege against self-incrimination; but, if the question is relevant to the claim investigation, most courts will find that, by this assertion, the insured is not complying with the policy condition or is not cooperating with the insurer in its investigation of the claim.

If the insured fails to appear for the EUO, a record of this should be made with the court reporter, followed by sending another letter to the insured, re-scheduling the EUO. This gives the insured another chance to appear and to explain why it did not appear as requested. Failure to again appear likely constitutes non-compliance with and a breach of the policy.

Usually, the EUO's are conducted separate from other insureds. Some policies specifically provide for this but others are silent. Courts have reached different conclusions depending on policy language. A review of the applicable policy and controlling state law should be examined when addressing these issues.

The insured may bring a designated representative whether that be legal counsel, a public adjuster or a support person. When the insured brings a representative of this sort, there are several things the questioner should be mindful of in conducting the EUO. The EUO is not a deposition and the rules of civil procedure or evidence are not applicable. Counsel is not allowed to make legal objections or "coach the witness" regarding answers during the EUO.

The property policy provision regarding examination under oath usually requires the insured to sign and attest to the transcript of the proceeding. Best practices dictate that, at the conclusion of the EUO, the questioner should advise the insured of this obligation and then on receipt of the transcript send it to the insured requesting it be reviewed and signed. The failure of the insured to sign, absent a reasonable excuse, may constitute separate grounds on which the insurer may deny the claim.

Cooperation

One of the basic tenents of the property policy is the duty of the insured to cooperate with the investigation and adjustment of the claim. The duty of the insured to cooperate is an express condition, and the duty to cooperate ripples through the other Duties of the insured listed in the policy. Basically, the insured must assist the insurer with the steps of its investigation. Therefore, as a threshold matter, the adjuster and insurer must consider whether the insured has cooperated in the investigation, such as having been responsive, permitting an inspection of the property, or providing requested documents. Similarly, did the insured provided a sworn statement in proof of loss, if requested, or submitted to an examination under oath? The insured's non-cooperation must be material, and the adjuster or insurer must show diligence in enlisting the insured's cooperation through clear requests and follow-up. If the insured does not comply with these policy conditions, i.e., does not cooperate, it violates the policy and coverage may be jeopardized.

The case, *Tran v. Fed. Ins. Co.*, 728 Fed. Appx. 576 (6th Cir. 2018) (unpublished), addressed several points relating to the insured's duty to cooperate. The case involved the alleged theft of gold jewelry — $374,330 worth. *Id.* at 576. Because of inconsistencies and oddities in the insured's story, the insurer repeatedly requested various business and personal records, but the insured repeatedly failed to produce many of them. *Id.* at 577. Also, instead of retrieving copies of records from third parties, such as from her bank and accountant, the insured gave the insurer written authorization to get the documents. Many of the third parties, however, would not provide the records to the insurer. *Id.* The court stated that, under Ohio law, the insured had a duty to cooperate in the event of loss and, if the insured did not comply with that duty, the insurer was relieved from its obligation to the insured, if the non-cooperation resulted in material and substantial prejudice to the insurer. *Id.* at 577. The court found that the insured's non-compliance was material and substantial. *Id.* at 578. Of note, the court found that:

- The insured's compliance with some of the policy requirements did not excuse her material failure to comply with others; and

- Even though the insured provided the insurer with authorization to obtain records from third parties, the insured had the responsibility under the policy to obtain the requested documents, not the insurer. *Id.* at 578.

Accordingly, summary judgment was granted in favor of the insurer on the ground that the insured failed to cooperate. *Id.* at 579.

Here are other examples of a court finding an insured's non-cooperation precluded coverage:

- *Double G.G. Leasing, LLC v. Underwriters at Lloyd's*, 116 Conn. App. 417, 978 A. 2nd 83 (Conn. App. 2009) — where a building was destroyed by fire of incendiary origin, the insured failed to cooperate by not providing federal and state tax returns, even though the insured claimed substantial compliance.

- *Habecker v. Peerless Ins. Co.*, 2008 U.S. Dist. LEXIS 92894 (M.D. Pa., Nov. 14, 2008) — In a loss involving a suspicious fire, the insured failed to provide an inventory and tax authorization to the insurer; the court deemed the inventory request critical to evaluating the insurance claim and the tax record authorization reasonable, relevant, and material to the claim.

- *Edge Construction, LLC v. Owners Ins. Co.*, 2015 U.S. Dist. LEXIS 85835 (D. Colo., June 29, 2015) — where roofs of condominiums were damaged by hail and windstorm, the insured did not provide documents relating to subcontractors on the project, which the court deemed key to the overhead and profit claim.

- *State Auto Prop. & Cas. Co. v. Strauss (In re Am. Wood Concepts, LLC)*, 2010 Bankr. LEXIS 1329 (W.D. Mo., April 20, 2010) — after a fire loss to a business, the insurer requested the examination under oath of the insured, who failed to submit to the examination, despite the insurer's reasonable diligence in attempting to secure the insured's cooperation.

Avoid Bad Faith

The special nature of the property policy imposes duties on the insurer to act in good faith, that is, reasonably and fairly. Contentions by an insured of improper conduct or bad faith are serious allegations and may expose the insurer, depending on the jurisdiction, to significant extra-contractual damages. Most states have adopted or otherwise closely mirror the National Association of Insurance Commissioners model Unfair Claims Settlement Practices Act (https://www.naic.org/). However, the carriers exposure varies greatly by jurisdiction. Whereas New York does not recognize an individual right of action for bad faith, Louisiana invokes significant financial penalties for not making payments promptly and California and Texas represent significant exposures to the unwary insurer. It is critical that the insurance practitioner be aware of their state regulations and legal environment.

Beyond the financial exposure, such allegations insinuate lack of professionalism and poor claim handling. In representing the insurer, the adjuster must avoid unnecessary delays and the appearance of unreasonableness. When requesting documents, the adjuster should avoid requesting meaningless or repetitive documentation. Also, the adjuster should maintain regular and open communications and keep the insured advised, in writing, of the status of the investigation. Finally, the adjuster should maintain a record of non-compliance or hurdles/disputes raised by the insured.