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Consumer Reliance on Statements About Pre-Existing Condition Coverage Creates Potential Liability for Insurance Company

Jonathan D. Schultz

Negligent Inspector

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The Hosfords consequently sued State Termite and the Inspector alleging negligence and several other theories of recovery.

Circuit Court Proceedings

In the Circuit Court of Lowndes County, Mississippi, State Termite did not deny that a pest control operator is held to a duty of reasonable care similar to that imposed upon anyone providing expert or specialized services to the public. Rather, State Termite claimed there was no contract between State Termite and the Hosfords, and therefore, the Hosfords had no basis for their suit. The circuit court agreed. State Termite had contracted with McCrary and therefore the Hosfords lacked privity of contract. Further, the court ruled that State Termite could not have foreseen that the Hosfords would rely on the inspection report. The circuit court granted summary judgment for State Termite and the Inspector and dismissed the complaint. The Hosfords appealed to the Supreme Court of Mississippi.

Privity of Contract

The Supreme Court of Mississippi rejected State Termite's lack of privity of contract argument. The court looked to a state statute in which the Mississippi Legislature had declared that privity of contract would not be a prerequisite to any suit for personal injury, property damage, or economic loss brought under negligence, strict liability, or breach of warranty. Miss. Code Ann. 11-7-20 (1991). Because the Hosford's action against State Termite alleged negligence, there was no legal consequence to the fact that the Hosfords did not have a contract with State Termite. Thus, State Termite could not assert lack of privity of contract as a defense.

Foreseeability

The Mississippi Supreme Court also rejected State Termite's defense of lack of foreseeability. The court looked to the Restatement (Second) of Torts 552 (1977) which states that one who, in the course of business, supplies false information due to a failure to exercise reasonable care or competence in obtaining or communicating the information is liable to those who justifiably rely upon the information in their business transactions. However, under the Restatement, the supplier of false information is only liable to those whom he knows will use the information. The court also cited an analogous case that extended liability to those whom the supplier knows or reasonably should know will use the information. Therefore, the fact that McCrary, and not the Hosfords, requested the termite inspection was not decisive.

Because the record clearly reflected that McCrary bought and sold houses professionally, the court charged State Termite with inferential knowledge that McCrary was not planning to live in the house but would probably use the termite inspection report in connection with the sale of the house to another. Thus, the court found that both State Termite and the Inspector reasonably should have foreseen that McCrary's immediate purchaser would obtain and rely on the inspection report. In fact, the Hosfords did receive the report shortly after it was issued and did rely on its accurateness in purchasing the house.

Therefore, the Mississippi Supreme Court reversed the circuit court's decision and remanded the case for further proceedings.

Daniel Hynes

ANNOUNCEMENT

The ***Loyola Consumer Law Reporter*** is currently accepting lead articles and feature columns for publication in upcoming issues. The ***Reporter*** publishes articles by practitioners, scholars and consumer experts that explore in depth legal developments affecting consumers. Upcoming articles will address insurance issues for CERCLA claims and steps consumers can take to avoid environmental liability when purchasing real estate.

If you are interested in submitting an article to the ***Reporter*** please contact the Chief Lead Articles Editor, ***Loyola Consumer Law Reporter,*** Loyola University Chicago School of Law, One East Pearson Street, Chicago, Illinois 60611, (312) 915-7181.

Consumer Reliance On Statements About Pre-Existing Condition Coverage Creates Potential Liability For Insurance Company

In ***Peek v. Reserve National Insurance Company***, 585 So. 2d 1303 (Ala. 1991), the Supreme Court of Alabama held that an insurance company could be liable for breach of contract and fraudulent misrepresentation when consumers relied on an insurance agent's statements about pre-existing condition coverage and the company later refused to pay the claim. The court also held, however, that the insurance company did not act in bad faith.

Background

On September 3, 1985, Rayburn and Eve Peek ("the Peeks") met with Lee Porter, Jr. ("Porter"), an agent of Reserve National Insurance Company ("Reserve National"), to purchase major medical health insurance for their family. At that time, the Peeks disclosed to Porter that their daughter had previously suffered menstrual difficul-

ties. Additionally, they furnished Porter with a doctor's report certifying that exploratory surgery performed in January, 1985 revealed no abnormalities.

During that meeting, Porter discussed the doctor's report with someone on the telephone. Porter then told the Peeks that their daughter would be covered under the policy. At that time, Eve Peek signed a document entitled "Outline of...Coverage." Porter failed to notify the Peeks that the outline contained a clause which excluded coverage for pre-existing conditions. The Peeks contended that they never received a copy of that document. The insurance policy which was subsequently issued and delivered to the Peeks contained no such exclusion.

In January, 1986, the Peeks' daughter was admitted to a hospital because of pelvic pain; exploratory surgery revealed a four-centimeter ovarian cyst that was removed. The surgeon reported that the cyst had been documented by sonar three times during the previous year. Based on this report, Reserve National refused to pay the Peeks' claim because the need for surgery arose from a pre-existing condition.

The Peeks sued Reserve National and Porter for breach of contract, fraudulent misrepresentation, and bad faith refusal to pay a claim. Porter and Reserve National motioned for summary judgment on all three counts. The Jefferson County Circuit Court granted the motion, and the Peeks appealed to the Supreme Court of Alabama.

Breach of Contract Claim

The Peeks contended that the insurance contract did not exclude coverage for pre-existing conditions. The only reference to pre-existing conditions was in the outline of coverage which was not part of the contract. As a result, the Peeks argued, Reserve National breached the contract by refusing to pay their claim. The Alabama Supreme Court agreed. Because the outline of coverage was not referenced in the insurance contract, it was not a part of the contract.

Additionally, the Peeks asserted that their daughter's ovarian cyst was not a pre-existing condition. The exploratory surgery performed in January, 1985 revealed no abnormalities. Therefore, the Peeks claimed that the cyst manifested itself after the effective date of the policy, September, 1985. They argued that at the very least, the timing of the condition was a factual issue that should have precluded summary judgment. Further, the Peeks alleged that Reserve National had failed to meet its burden of proving prior manifestation of the condition.

Reserve National submitted evidence that the daughter's cyst had manifested itself prior to the effective date of the insurance contract. It introduced the surgeon's report, which stated that the cyst had been present for one year prior to the surgery. On the basis of that report, Reserve National claimed that the cyst was a pre-existing condition and therefore was excluded from coverage.

The supreme court rejected Reserve National's evidence as dispositive proof requiring summary judgment. The court held that a question of fact existed as to whether the cyst was present before the effective date of the insurance contract. Moreover, the court stated that even if the cyst had manifested prior to the contract, Reserve National may have waived any rights to exclude further treatment of that condition from coverage since it had previously paid related claims. As a result, the court reversed summary judgment as to the breach of contract claim and remanded the issue to the lower court.

Fraudulent Misrepresentation Claim

The Peeks also alleged that Porter's acts constituted fraudulent misrepresentation. The Peeks provided Porter with accurate information regarding their daughter's medical condition. After discussing this information with someone over the phone, Porter told the Peeks their daughter would be covered. Moreover, the Peeks asserted that Porter never mentioned that pre-existing conditions would not be covered by the policy they purchased.

Reserve National argued that no false misrepresentation had occurred because the daughter was covered by the insurance policy. However, the policy excluded coverage for additional treatment of the daughter's condition.

Additionally, Reserve National argued that Eve Peek had signed the outline of coverage, which included the pre-existing condition provision and therefore, the Peeks were aware of the limitation of coverage for pre-existing illnesses. Reserve National thus argued that the Peeks did not rely on Porter's statements about coverage. Because reliance is a necessary part of a claim of fraudulent misrepresentation, Reserve claimed that the Peeks should not prevail.

The Alabama Supreme Court reversed summary judgment on the fraudulent misrepresentation issue. The court held that a jury could reasonably find that by telling the Peeks their daughter would be covered and by not mentioning that further expenses related to the treatment of her condition would be excluded, Porter made a misrepresentation. Moreover, while the outline of coverage apparently contradicted these statements, the court held that a jury could find that Porter neither gave the Peeks a copy of the document nor read it to them. As a result, the court held that an issue of fact existed as to whether the Peeks justifiably relied on Porter's misrepresentation.

Bad Faith Claim

Finally, the court addressed the claim of bad faith refusal to pay an insurance claim. The court stated that the Peeks were required to show that Reserve National had no reasonable basis for disputing their claim. At the time Reserve National denied payment of the claim, the evidence before it, including the doctor's report referring to the existence of the cyst for one year prior to surgery, created a valid question as to whether payment was appropriate. As a result, the court found that Reserve National had not acted in bad faith and affirmed summary judgment on this issue.

Jonathan D. Schultz

Consumer News: Prescription Drugs

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selves as a promotional message. When the television audience does not recognize that there is a promotional objective to be achieved, that is inherent deception."

Because many stations never evaluate or edit the VNRs, these "news" segments are broadcast without any mention of the drug company who produced the video. By way of contrast, Dr. George Lundberg, editor in chief for scientific publications of the American Medical Association notes that "Our ten A.M.A. journals require full disclosure of financial interests of authors, editors, reviewers and editorial board members."

In these tough economic times, many stations are grateful for pre-edited, slick news segments that help them attract viewers without spending lots of money. Professor Secunda predicts that in the current marketplace, the use of VNRs is likely to increase.

The FDA made its first move against VNRs last year when it sent a letter to all pharmaceutical companies stating the VNRs would have to be submitted to the agency for review. Kenneth D. Feather, branch chief of drug marketing surveillance and enforcement for the FDA explains, "When they drop a cassette in the mail to NBC they should drop one in the mail to the FDA."

New more stringent regulations are most likely forthcoming. The FDA has indicated that it is most concerned with broadcasts of VNRs that do not clearly reveal the nature of the "news segment" as a promotional device paid for by a pharmaceutical company. Other concerns include misleading claims in VNRs and promotion of unapproved drugs or unapproved uses for drugs.

New Food Labeling Guidelines May Fall Short of Consumers' Expectations

Last November, the Food and Drug Administration released its proposals for stricter guidelines in food labeling. The FDA first began working on the new guidelines in 1990 after Congress passed the Nutrition Labeling and Education Act. Final guidelines are supposed to come out in November, 1992, and all food packaged after May 8, 1993 will feature revised labels.

The new guidelines, however, may fall short of consumers' expectations for simpler, easier to understand food labels. All interested citizens had until the end of February to submit their comments on the proposed labeling guidelines. Consumer advocates have pushed for stricter limitations on the claims food producers may make about their products.

A 1989 Roper poll showed that 52 percent of consumers look to food labels for information on nutrition. The new labeling standards are supposed give meaning to claims on food packaging, and consumers have been waiting for changes for quite awhile.

"During the Reagan Administration, the theory went that if competition were allowed to take its course, the false and misleading claims would be weeded out," explains F. Edward Scarbrough, director of the Office of Food Safety and Food Sciences at the FDA's Center for Food Safety and Applied Nutrition. "Instead, we saw oat bran in just about everything from beer to donuts," Scarbrough adds.

The FDA's original proposed guidelines, released last November, contained strict definitions for some of the claims commonly appearing on food labels. For example, the term "reduced" was strictly defined in a dictionary of "descriptors." Any food labeled "reduced fat" had to have at least 50 percent less fat than comparable products. Any product labeled "reduced sodium" would have to have at least 50 percent less sodium than comparable products.

The FDA, however, knew that it would have to soften its initial proposals. The Office of Management and Budget ("OMB"), which oversees all actions by the FDA, directed the FDA to modify its original proposals.

The OMB directed these guidelines to be changed, and the FDA was obliged to come up with alternative guidelines. Under the alternative guidelines, any product for which the fat content is reduced by at least 3 grams may be labeled "less fat" or "reduced fat." If the sodium content is lowered by 140 milligrams, a product may be labeled "reduced sodium."

If the product is a premium ice cream bar, containing 27 grams a fat, it may be labeled "reduced fat" if the fat content is lowered to 24 grams or less. Similarly, if the product is a salty can of soup, containing 900 milligrams of salt, it may nonetheless be labeled "reduced sodium" if the sodium content has been lowered by 140 milligrams.

The OMB may have been advocating a return to the hands off approach of the Reagan Administration. The OMB reportedly contends that relaxed standards will encourage companies to compete with healthier products.

Recent Legislative Activity

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Disclosure on Credit Cards

California is considering an amendment to the **Song-Beverly Credit Card Act of 1971** which would require issuers of credit cards secured by real or personal property to disclose in advertisements and solicitations that credit extended under the credit card is secured by the cardholder's property. The amendment would also require that the credit card be identified as a "secured credit card" and must clearly describe the security by item or type. The amendment provides for this type of disclosure in order to protect consumers from unknowingly losing their property, especially their homes, by not meeting the cardholder's obligations.

The provisions of this amendment would not be applicable where the agreement creates a purchase money security interest in property purchased with the credit card. A violation of the amendment would constitute unfair competition. **1991 CA A.B. 998.**