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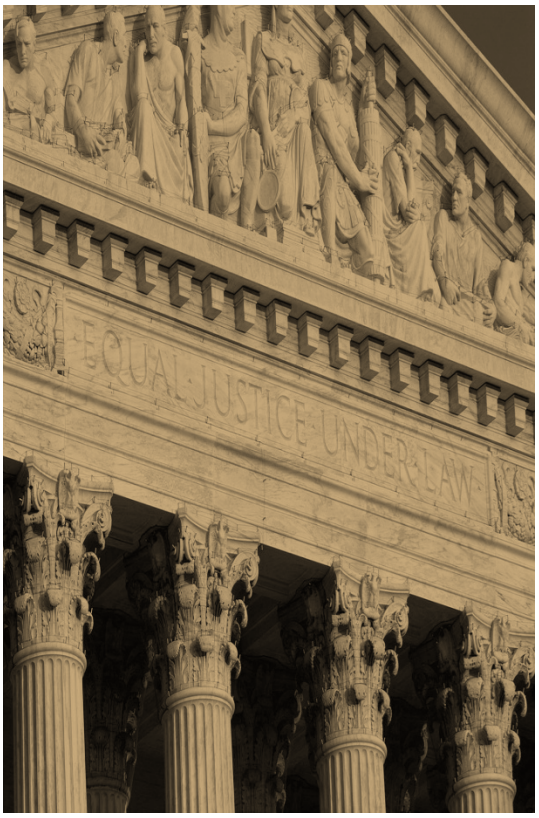
California Court Finds No Postclaim Underwriting in Allowing Rescission of Health Insurance Policy

There has been considerable attention given lately to health insurers' attempts to rescind health insurance policies and the California Department of Insurance has recently issued regulations concerning rescission of the these policies. The Second Appellate District has now added some heat to the controversy about these types of rescissions with its decision in *Nieto v. Blue Shield of California Life & Health Insurance Company*, __ Cal. App. 4th ___ No. B214669 (January 19, 2010).



Blue Shield offers several health insurance plans to individuals. As part of the determination whether to issue coverage, Blue Shield provides an application to an individual seeking coverage that requests detailed information of past and current health problems, treating physicians, prescribed medications and recommended treatment. Using proprietary written guidelines, Blue Shield engages in the underwriting process by evaluated the responses provided by each applicant to determine eligibility for health insurance and, if so, at what premium rate. Julie Nieto applied for one of these policies but failed to disclose information about her back and hip condition and treatment on a health insurance application she submitted to Blue Shield. Blue Shield issued her a policy based upon her representations.

After issuing the policy, Blue Shield's underwriting investigation unit opened a file on Nieto after it received a referral from the medical management department indicating that she had received a diagnosis of necrosis of the hip and was scheduled for hip replacement surgery. As part of the investigation Blue Shield sought and obtained her medical and pharmacy records. At that point, Blue Shield learned that immediately preceding her application appellant had received extensive treatment for back and hip pain and had been prescribed multiple medications. Blue Shield proffered evidence that if it had been aware of the undisclosed information it either would have declined to issue the policy or, at a minimum, would not have issued the policy until receiving additional information from appellant.

The trial court ultimately granted Blue Shield's summary judgment motion, ruling that it was entitled to rescind, as a matter of law, because of the undisputed evidence that Nieto had made material misrepresentations and omissions regarding her medical history. Nieto appealed.

The Second Appellate District affirmed, holding that as a matter of law, Blue Shield was entitled to rescind coverage if the undisputed evidence showed that Nieto committed fraud by making material misrepresentations or omissions concerning her medical history or condition to Blue Shield before it issued the policy. Turning to the evidence submitted in connection with the motion, the court affirmed the trial

court's finding "that the undisputed facts establish each element of fraud and deceit under California law, with respect to [Nieto's] misrepresentations when applying for coverage with Blue Shield Life."

The court found that undisputed evidence established that Nieto made material misrepresentations and omissions on the application regarding her medical condition and treatment finding that she responded negatively to the inquiries in the "Medical History" portion of the application, when in fact she had suffered from chronic back problems throughout 2005 and previously. Moreover, she represented that her last doctor's visit had occurred three years earlier, when in fact she had seen and received significant treatment her doctor, and she had seen him at least 17 times between February and May 2005, including the day she signed the application. She further represented that she had not taken or been directed to take any prescription medications when in fact she had filled at least 10 prescriptions for four different medications and had received two steroid injections as well as an oral steroid.

The court found that the undisputed evidence further established that Nieto's misrepresentations and omissions were material. In support of summary judgment, Blue Shield offered a declaration that it would not have approved Nieto for coverage had it known about her medical history. According to Blue Shield's underwriting guidelines, the medical conditions reflected in Nieto's medical and pharmacy records, if disclosed on her application, would have rendered her ineligible for enrollment in any Blue Shield product.

The court also rejected Nieto's assertion that even if the undisputed evidence established that she misrepresented and omitted material information on her application, Blue Shield was precluded from rescinding the policy because it neither attached nor endorsed the application to the policy. Nieto relied on *Ticconi v. Blue Shield of California Life & Health Insurance Company*, 160 Cal. App. 4th 528 (2008).

In *Ticconi*, the insured alleged that Blue Shield issued his policy without either attaching or endorsing a copy of his application and that therefore he was not bound by any representation made in the application. He further alleged Blue Shield had rescinded multiple policies that did not have the applications attached to or endorsed on the policies and that such rescission violated sections 10113 and 10381.5 and was an unfair business practice. *Id.* at pp. 535–536. Determining that the insured had stated a claim suitable for class certification, the court summarized the pertinent statutes, stating that "section 10113 prohibits incorporating applications into a disability insurance policy by reference unless they are endorsed upon or attached to the policies when issued. [Citation.] If a copy of an application for a policy is not attached to or endorsed on the policy when the policy is issued, then the insured is not bound by statements made in that application. [Citation.]" *Id.* at p. 540.

Turning to legislative history, the court observed that section 10381.5 "was designed to 'repeat[ ] a provision of section 10113 . . .' [citation]" and separately established that when a copy of the application is neither attached to nor endorsed on the policy the insured is not bound by any statement made in the application. *Id.* at p. 540.) Further, citing *Telford v. New York Life Ins. Co.,* 9 Cal. 2d 103 (1937), the court determined that "[a]nother consequence of violating sections 10113 and 10381.5 is that the insurer may not invoke *the defense* of misrepresentations in or omissions from the unattached and unendorsed application." *Id.* at p. 541. Thus, it concluded that the insured's claim that Blue Shield "fail[ed] to attach applications to or endorse them on disability policies when issued and later engage[ed] in post-claims underwriting by holding insureds

to statements in those unattached and unendorsed applications as grounds for voiding or rescinding the policies" alleged unlawful conduct that could serve as a predicate unlawful business practice in violation of Business and Professions Code section 17200.

The court explained that, though not cited by the *Ticconi* court, *Metzinger v. Manhattan Life Ins. Co.,* 71 Cal. 2d 423 (1969) that section 10113 does not apply to a situation where an insurer seeks to rescind a policy because of *fraudulent* misrepresentations made by the insured. It further explained that in Blue Shield did not seek to incorporate any document into the policy by reference. Rather, it sought to demonstrate that, in accordance with sections 331 and 359, it was entitled to rescind the policy.

The appellate court also agreed with the trial court that the undisputed evidence failed to establish that Blue Shield was precluded from rescinding the policy because it engaged in postclaims underwriting in violation of section 10384. That statute prohibits an "insurer issuing or providing any policy of disability insurance covering hospital, medical, or surgical expenses" from engaging in postclaims underwriting, defined as "the rescinding, canceling, or limiting of a policy or certificate due to the insurer's failure to complete medical underwriting and resolve all reasonable questions arising from written information submitted on or with an application before issuing the policy or certificate." *Id.* The trial court ruled: "Blue Shield Life did not engage in postclaims underwriting for at least two reasons: (1) the undisputed facts establish that Blue Shield Life properly completed its underwriting and resolved all reasonable questions arising from the written information submitted on or with respect to [Nieto's] application; and (2) even if one were to assume that Blue Shield Life had some obligation to contact the providers listed in the application, [Nieto] did not even list the providers who had treated her for the conditions that led to the rescission. Thus, the rescission was not 'due to' (*i.e.*, the result of) any claimed underwriting deficiency."

The court rejected Nieto's reliance on *Hailey v. California Physicians' Service,* 158 Cal. App. 4th 452*,* (2007). *Hailey* involved an interpretation of Health and Safety Code section 1389.3, which applies exclusively to health care service plans licensed and regulated by the Department of Managed Health Care. The statute is phrased similarly to section 10384, but does not apply upon a showing of willful misrepresentation. *See* Health & Saf. Code § 1389.3. In *Hailey*, the insured completed a Blue Shield application, mistakenly believing the application sought information only about her—not her husband and son for whom she also sought coverage; she also incorrectly underestimated her husband's weight. After Blue Shield extended coverage to the insured and her family, the insured's husband was admitted to the hospital for stomach problems and later became completely disabled as the result of an automobile accident. Following the first hospitalization, a Blue Shield investigation revealed that the insured had misrepresented and omitted material information concerning her husband's medical condition. Blue Shield rescinded the policy. The trial court granted summary judgment in favor of Blue Shield on the insured's complaint for breach of contract and breach of the implied covenant of good faith and fair dealing and on Blue Shield's declaratory relief cross-complaint.

The *Hailey* court reversed, concluding that there were triable issues of fact as to whether Blue Shield engaged in postclaims underwriting and whether the insured willfully misrepresented her husband's medical condition. It explained that Blue Shield was operating as a health care service plan subject to the Knox-Keene Health Care Service Plan Act of 1975 (Knox-Keene Act, Health & Saf. Code, § 1340 et seq.), which was designed "to 'ensure the best possible health care for the public at the lowest possible cost by transferring the financial risk of

health care from patients to providers.' *See* § 1342, subd. (d).)" Consistent with that goal, the Legislature enacted Health and Safety Code section 1389.3 to prevent providers from shifting the financial risk of health care back to patients. *Hailey, supra*, at p. 463. Given these particular policy considerations, the Court determined that "to effectuate section 1389.3's purpose, and in light of the equitable nature of rescission, we interpret 'medical underwriting' to require a plan to make reasonable efforts to ensure a potential subscriber's application is accurate and complete." *Id.* at p. 469. The Court rejected Blue Shield's argument that it could rely on the truthfulness of an applicant's responses as part of its medical underwriting process, explaining that while such a position was consistent with section 331—permitting an insurer to rescind a policy for concealment—the Knox-Keene Act does not have a counterpart to Insurance Code section 331." *Id.* at p. 470. The court held that "given this qualification, we construe the *Hailey* court's medical underwriting requirements to be limited to health care service plans subject to the Knox-Keene Act."

The court went on to hold that Blue Shield did not commit bad faith.

It will be interesting to see if the California Supreme Court weighs in on this issue and resolves the conflicting holdings in this case and *Ticconi*.

By: Robert J. McKennon
Partner
McKennon|Schindler LLP
384 Forest Avenue, Suite 20
Laguna Beach, California 92651
877-MSLAW20
(877) 675-2920