INSURANCE LITIGATION™ Reporter

Volume 37 • Number 19 • November 20, 2015

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"BACKDATED" INSURANCE IS NOT INSURANCE AT ALL. IT IS A PENALTY.

by
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His first book, "Litigation and Prevention of Insurer Bad Faith, 3d" (Third Edition; 2015 Supplement, Thomson Reuters West), has been called "the Bible of Bad Faith," addressing over 5,000 cases, statutes and other legal authorities. Mr. Wall is also co-author of "Catastrophe Claims: Insurance Coverage for Natural and Man-Made Disasters" (Thomson Reuters West; 2015 Supplements).

"Lender Force-Placed Insurance Practices" published by the American Bar Association in 2015 is his third book.

The definitions and coverage provisions of an insurance policy often determine the outcome of a controversy between parties. The definition of "insurance" applied by Courts and lawyers in the first place, however, often determines whether litigants win or lose their insurance cases. Lender force-placed insurance or "LFPI" cases provide examples of how "insurance" determines outcomes in decided cases.

Uniform Mortgage Contracts Permit Lenders to Force-Place Insurance And to Charge the Premium to the Homeowners-Borrowers.

Like other borrowers, homeowners agree to provide their lenders with collateral. Homeowners also agree to provide insurance to protect the collateral. In some jurisdictions, homeowner's insurance is specifically exempted from the statutory definition and regulatory requirements of "collateral protection insurance." This does not change the nature of homeowner's insurance as collateral protection insurance in actual effect where the insurance exists for the purpose of protecting collateral for a loan.

As is the case with most loan contracts, mortgage contracts provide that where the borrower fails for whatever reason to maintain the insurance required by the loan contract to protect the collateral, then the lender or its servicer may select alternative collateral protection insurance and place the premiums on the borrower by force. In the event that homeowners do not maintain the insurance required to protect the collateral from loss, Uniform Mortgage Instruments used across the United States authorize the lender (or its agents, such as mortgage servicers) to obtain their own collateral protection insurance, place it on the property, and force the homeowner to pay the premiums.

Problems arise when many lenders charge borrowers for things which are not a part of the necessary cost of obtaining insurance to protect collateral. These add-ons are often called "kickbacks" in the lender force-placed insurance cases.[1] In particular, problems arise when lenders not only charge their borrowers with "kickbacks" but also attempt to force borrowers to pay premiums for "backdated" periods when no insurance existed.

Nevada provides a unique and, at first glance, a straight-forward example of these problems. In Nevada, "kickbacks" by another name have been restricted since 1971. Under a law enacted in that year, lenders may not receive or accept a fee paid by borrowers for "handling, servicing or processing" an insurance policy which is paid for by the borrowers.[2] However, this Nevada statute did not stop the forced placement of insurance premiums at issue in the seminal lender force-placed insurance case decided in Nevada in 2015, *Morris v. Green Tree Servicing, LLC,* No. 2:14-cv-01998-GMN-CWH, 2015 WL 4113212 (D. Nev. July 8, 2015).

Mr. Robert Morris sued his most recent mortgage servicer, among others, for a variety of reasons including charges both for alleged "kickbacks" and charges for "retroactive" or "backdated" insurance. Over all, Mr. Morris alleged that he paid his monthly mortgage payment in full including "the monthly escrow deposit used for insurance premiums, every month from April 2005 through March 2012."[3] Unbeknownst to Mr. Morris, his homeowner's insurance policy was cancelled in February, 2011 for nonpayment of premium.[4]

Green Tree took over as the new mortgage servicer on the Morris mortgage in November, 2011. Eventually, Green Tree arranged for a "retroactively dated" or backdated force-placed insurance policy to address the two months between the date that the policy incepted or began, and the earlier date when Green Tree took over the mortgage servicing. Green Tree charged Morris $660.00 for those two months. Green Tree refused to apply any of Morris's mortgage payments until he paid Green Tree $660.00 for two months of premium it claimed to incur on a force-placed insurance policy which it selected from American Reliable Insurance Company ("ARIC"). As was previously mentioned, the $660.00 charge represented two months of premium of "retroactively dated" insurance.[5]

When Morris did not pay the $660.00, Green Tree

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1. *See generally* DENNIS J. WALL, LENDER FORCE-PLACED INSURANCE PRACTICES (American Bar Association 2015).

Some Courts in a handful of cases have redefined proof of "kickbacks" to require evidence of "divided loyalties." The redefinition of proof of kickbacks originated in a Seventh Circuit case involving claims based on backdated or retroactive insurance: *Cohen v. American Security Insurance Co.,* 735 F.3d 601, 611 (7th Cir. 2013). In *Cohen*, the Federal appellate panel affirmed a District Court's dismissal of a complaint involving alleged kickbacks in an LFPI case. In the eyes of the Seventh Circuit panel deciding that case, the complaint's allegations of "kickbacks" were conclusory and not plausible under the Federal Court standard for stating a claim upon which relief can be granted because the allegations did not allege "divided loyalties" and "[t]he defining characteristic of a kickback is divided loyalties." *Cohen v. American Security Ins. Co.,* 735 F.3d 601, 611 (7th Cir. 2013). The plaintiffs' complaint did not state a claim upon which relief could be granted in part because, apparently as a matter of Illinois law interpreted by the panel, the lender was acting strictly in its own self-interest in force-placing insurance and insurance premiums on the borrower, including for backdated periods of time. In the words of the Seventh Circuit panel in that case, the lender "was not subject to divided loyalties; rather, it was subject to an undivided loyalty to itself, and it made this clear from the start." *Cohen v. American Security Ins. Co.,* 735 F.3d 601, 611 (7th Cir. 2013). *Accord, Feaz v. Wells Fargo Bank, N.A.*, 745 F.3d 1098, 1111 (11th Cir. 2014).

Aside from the Eleventh Circuit decision in *Feaz*, no other Circuit has followed or applied the Seventh Circuit definition of "kickbacks" given in *Cohen*. Lower Courts in both the Seventh and Eleventh Circuits have distinguished these Seventh and Eleventh Circuit decisions on the allegations involved or because of the legal claims alleged by the plaintiffs. *E.g., Consumer Fin. Prot. Bureau v. ITT Educational Serv's, Inc.*, No. 1:14-cv-00292-SEB-TAB, 2015 WL 1013508, at *27 (S.D. Ind. March 6, 2015)("the plaintiff's allegation [in *Cohen*] that the lender was providing a 'kickback' to its insurance affiliate was conclusory" and *Cohen* involved "formal contract principles" which are "'not conclusive' in an unfair practices claim"), *appeal docketed*, No. 15-1761 (7th Cir. April 8, 2015); *Hamilton v. Suntrust Mort. Inc.*, 6 F. Supp. 3d 1300, 1311 (S.D. Fla. 2014) (the Eleventh Circuit's *Feaz* decision involved Alabama law, which is different from Florida law at issue in the LFPI case at bar).

The *Cohen* and *Feaz* decisions have also been distinguished or rejected by name in LFPI cases filed in the lower Courts of other Circuits. *E.g., Longest v. Green Tree Servicing LLC*, 74 F. Supp. 3d 1289, 1297 (C.D. Cal. 2015)(declining to apply "the definition of 'kickback' adopted by the *Cohen* and *Feaz* courts" in part as involving "merits-based arguments" which are inappropriately placed on motions to dismiss); *Lauren v. PNC Bank, N.A.*, Case No. 13-762, 2013 WL 6123084, at *2 (W.D. Pa. November 21, 2013) (distinguishing *Cohen* as involving Illinois law and claims not involved under Ohio law which instead governed the LFPI case at bar).

Whether or not a lender or servicer charges borrowers for "kickbacks" in the sense that is alleged in the LFPI cases, or in the sense of "kickbacks" redefined by some judges, or at all, the essence of kickbacks by whatever name is not "divided loyalties" but accepting and receiving payment in exchange for selecting preferred insurance providers. *See* NRS 686A.210 ("No mortgagee, lessor, vendor or other person whose interest is insured under an insurance policy paid for by another shall … receive or accept any monetary charge or fee paid or payable by such other person, for … handling, servicing or processing the insurance policy".).

2. NRS 686A.201.

3. *Morris v. Green Tree Servicing, LLC,* No. 2:14-cv-01998-GMN-CWH, 2015 WL 4113212, at *1 (D. Nev. July 8, 2015).

4. Parenthetically, this raises a question beyond the scope of this article. The District Court ruled in *Morris* that Green Tree could not have breached the mortgage contract by failing to pay insurance premiums from Morris's escrow account because there was no insurance for which to pay a premium when Green Tree took over mortgage servicing in November, 2011. The *Morris* case presented a controversy on consideration of a motion to dismiss, not a motion for summary judgment. Mr. Morris alleged that he did not know his insurance was cancelled for nonpayment of premium until Green Tree told him in November, 2011. But Morris's homeowner's insurance was cancelled in February, 2011 or some nine months before. If Morris did not know that the insurance was cancelled, yet as Morris alleged he kept paying monthly mortgage payments into his escrow account which as he specifically alleged included the amount of the insurance premium, presumably Green Tree also would have known that there was no collateral protection insurance in place when it took over the servicing of the Morris mortgage in November, 2011.

And further, how and why was Morris's homeowner's policy cancelled *for nonpayment of premium* when, as Morris alleged, he paid each of his monthly mortgage payments including the amount of the insurance premium, over the course of nearly six years before the policy was cancelled for nonpayment of premium? To say again, these questions are beyond the scope of the present article, but they may have some bearing on the decision of whether Morris's allegations were "plausible" enough under the governing Federal Court standard, to withstand Green Tree's motion to dismiss on more than the parts of three counts as to which the District Court denied Green Tree's motion.

5. *Morris v. Green Tree Servicing, LLC,* No. 2:14-cv-01998-GMN-CWH, 2015 WL 4113212, at *1 (D. Nev. July 8, 2015).

foreclosed and arranged for Morris's home to be sold at public auction.

Mr. Morris sued. In pertinent part, Morris alleged that during the time periods for which Green Tree demanded that Morris pay premiums, "'there was no risk of loss.'"[6] With this allegation, Mr. Morris was apparently trying to address the pleading defect pointed out in *Lane v. Wells Fargo Bank, N.A.,* No. C12-04026 WHA, 2013 WL 269133, at *10 (N.D. Cal. January 24, 2013), a case involving California and Arkansas substantive law. The District Court granted a motion to dismiss in that case as to all "backdated insurance" causes of action because the plaintiffs in that case alleged only "conclusory allegations that Wells Fargo retroactively purchased insurance policies for periods of time where coverage had lapsed *but no claims had been made*." [Emphasis added.] When the opportunity arrived for Morris to address this issue in his own complaint, Morris alleged instead that *no* claims *could* be made for the 'retroactive' period in question in his case, i.e., that there was *no risk of loss* during that already elapsed period.

If this is truly what Morris was attempting to do, it did him and his complaint no good. The District Court ignored his allegation that "'there was no risk of loss'" during the backdated period involved in his case. Instead, the District Court held in *Morris* that Green Tree's forced placement of retroactive or backdated "insurance" was not actionable because Green Tree was authorized by the mortgage to force-place "insurance."

Under the law of insurance in universal effect throughout the United States including in Nevada, there is very simply no room for backdated or "retroactively dated" policies to provide coverage for periods when there was no risk.

"Insurance" transfers risk; it is not an authorized penalty.

Insurance universally involves risk and the transference of risk. The insured or policyholder transfers a risk of loss to an insurance company for a premium. The Supreme Court of Nevada has quoted the universal definition of "insurance" with approval, citing to Black's Law Dictionary 814 (8th ed. 2004), which defined "insurance" as:

> A contract by which one party (the *insurer*) undertakes to indemnify another party (the *insured)* a**gainst risk of loss, damage, or liability** arising from the occurrence of some specified contingency [and] … **[a]n insured party … pays a premium to the insurer in exchange for the insurer's assumption of the insured's risk.**[7]

The District Court in *Morris* quoted Morris's allegation that there was no risk of loss during the two backdated months, but apparently did not recognize the significance of this allegation. *There cannot be "insurance" in Nevada or anywhere else when there is no risk, and no insurer anywhere can assume the insured's risk when the insured does not have any risk for the insurer to assume*.

Conclusion: Lenders have a right to force borrowers to pay insurance premiums under their loan contracts, but they have no right to call penalties "insurance."

The definition of "insurance" can determine the outcome of any given case in which insurance is at issue. This article provides one example, in the field of lender force-placed insurance practices under mortgage contracts. When lenders manipulate force-placed insurance agreements by imposing charges for things which are not "insurance," they are assessing unauthorized penalties and not "insurance." They may impose such penalties by force, but they have no right to label their charges "insurance" premiums.

6. *Morris v. Green Tree Servicing, LLC,* No. 2:14-cv-01998-GMN-CWH, 2015 WL 4113212, at *5 (D. Nev. July 8, 2015).

7. *MGM Mirage v. Nevada Ins. Guar. Ass'n,* 125 Nev. 223, 231, 209 P.3d 766, 771 (2009) (holding that self-insured employers under worker's compensation laws are not "insurers"). [Italics in original; boldface added for emphasis.] *See* NRS 679A.100 (defining "insurer;" construed and applied in *MGM Mirage*).