Investigating and Litigating Suspicious Recreational Marine Insurance Claims

Presented by

Leonard R. Schwigen

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Introduction

Recreational boating claims present unique and interesting challenges to the claims adjusters and attorneys who investigate and litigate them. The variety of claims (e.g., allisions, collisions, fires, thefts, and unexplained sinkings), the often-encountered inability to view the scene of the loss or even inspect the vessel, and the complicated interplay between federal maritime law and state insurance law and regulations,[i] all combine to create a claims handling setting like no other.

Dealing with a suspicious claim[ii] in this already complex environment requires a skillful and thorough investigation.[iii] The purpose of this paper is to demonstrate how marine claims adjusters and maritime attorneys can and should work together to appropriately investigate suspicious recreational marine insurance claims, and how the results of such an investigation can be used in court to defend the insurer's claim decision. While there is no limit to the factors or combination of factors that may make a claim suspicious, there are certain fundamental tasks that should be completed in every investigation of a suspicious claim: reviewing the underwriting file; obtaining a properly completed proof of loss or similar form; obtaining the named insured's recorded statement; and, a properly documented examination of the cause and nature of damages.

The Initial Loss Report

Like other types of insurance, recreational marine insurance policies typically require prompt notice of a claim. Such clauses protect the insurer's rights by affording it an opportunity to conduct a timely investigation, which promotes early settlement and prevents fraudulent claims. While the law of many states holds that an insurer cannot deny a claim on the basis of late notice unless it has suffered prejudice, policy language may dictate a different result where the policy makes prompt notice a condition of coverage and the insured cannot justify its delay. See e.g., *Howard Fuel v. Lloyd's Underwriters*, 588 F.Supp. 1103, 1106 (D.C.N.Y. 1984).

When a claim is initially presented, the insurer should have in place procedures designed to record the insured's version of the loss accurately and thoroughly. That is, to obtain the essential facts of the loss and to document precisely what the insured is claiming. This is particularly important in theft cases because as each hour passes, the vessel becomes harder to locate and recover, and the claim becomes harder to investigate.

Insurers allow a variety of methods for insureds to report losses, including notifying agents or brokers, or centralized call centers. Whichever method is used, the initial report should include a description of the loss (e.g., theft, fire or collision), the date and time of the loss, the location of the loss, a description of the insured vessel (including the Hull Identification Number ("HIN")) and any other involved vessels or trailers, the identities and contact information of any witnesses, and whether the loss was reported to any fire or law enforcement agency.

Upon receipt of the foregoing information, the claim should immediately be assigned to a marine claims adjuster with training and experience regarding the type of loss involved. The marine claims adjuster should commence her or his investigation within 24 hours of the initial report, paying particular attention to obtaining the underwriting file, obtaining the insured's recorded statement and initiating the Proof of Loss procedure, and determining the nature and extent of the loss.

The Underwriting File

Promptly obtaining a copy of the underwriting file, including the application for insurance, is important to the investigation of any claim, particularly theft claims or any claim where fraud may be involved. The underwriting file will provide ready access to vital information about the vessel (including the HIN, the year and make, the color, engine type and horsepower, registration or documentation numbers, and condition) and the insured and any other owners or regular operators (name, address, prior insurance history).

Sometimes, a suspicious claim will be revealed by comparing the information documented in the underwriting file to the information reported at the time of the loss, either to the insurer or to law enforcement, and to information contained in manufacturers' and sellers' records. Any discrepancies between the information in the underwriting file and other sources should be thoroughly investigated. The discrepancies may turn out to be innocent or immaterial, but may still hamper a total loss investigation by leading it in the wrong direction.

Or the discrepancy could be a misrepresentation by the insured that voids the policy or provides grounds for rescinding the policy under the maritime doctrine of *uberrimae fidei*. See e.g., *Cigna Property & Casualty Ins. Co. v. Polaris Pictures Corp.*, 159 F.3d 412, 420 (9th Cir. 1998). For example, the insured's misstatement of the purchase price of the vessel on the application will void the policy *ab initio*. See *Certain Underwriters at Lloyds v. Montford,* 53 F.3d 219, 222 (9th Cir. 1995); *Rocco v. Continental Ins. Co.*, 2003WL21235478 (Conn.Super. 2003). So will the insured's failure to disclose a third party's ownership interest in the vessel (*Grande v. St. Paul Fire & Marine Ins. Co.*, 365 F.Supp.2d 57, 66 (D.Me. 2005)), her intent to use the vessel to carry passengers for hire (*Fireman's Fund Ins. Co. v. Wilburn Boat Co.*, 300 F.2d 631, 641 (5th Cir. 1962)), or the fact that a prior policy on the vessel had been cancelled (*Knight v. U.S. Fire Ins. Co.*, 804 F.2d 9, 13 (2nd Cir. 1986)).

Note that a lienholder that is simply a loss payee probably has no rights under a policy that is void *ab initio* due to the insured's application misrepresentations, but may have rights if the insured merely breaches a condition of the policy during the claims process. *Thomas v. NASL Corp.*, 2000 WL 1725011, 1976 A.M.C. 592 (S.D.N.Y. 2000); *Zurich Insurance Company v. Wheeler*, 838 F.2d 338 (9th Cir. 1988); *DeMay v. Dependable Insurance Co.*, 638 So.2d 96 (2 DCA 1994). Consideration must also be given to the lienholder if the lienholder is an additional insured or where the policy of insurance contains a Union or Standard Mortgage Clause. In these situations, the lienholder is protected against forfeiture due to the actions of the insured (even intentional acts during the formation process continuing through the cause of loss to post

loss misrepresentations). *Wells Fargo Bank International Corp. v. London Steamship Owners Mutual Insurance Association*, 408 F.Supp. 626 (S.D.N.Y. 1976). Courts have found such insurance contracts to be divisible and apply the innocent insured rule to the lienholder.

Documenting the Insured's Version of the Loss

After requesting the underwriting file, the claims adjuster should contact the insured in order to obtain an informal recorded statement and to initiate the insured's completion and submission of a Statement of Loss or Master's Protest. While the insurer's right to an examination under oath should be preserved, it is important for the claims adjuster to question the insured about the facts of the loss, which may include questions about the condition of the vessel, the insured's opinion regarding the cause of loss, how and where the vessel was being used at the time of the loss, and the insured's whereabouts at the time of the disappearance (in theft loss claims).

The utility of a Master's Protest should not be underestimated. A properly completed Master's Protest will memorialize the insured's original representations as to the facts and circumstances involved with the loss. It establishes the point of reference for further investigation.

In addition to being required under most recreational marine insurance policies, a sworn Proof of Loss is another important part of a thorough claims investigation. The Proof of Loss formally puts the insurer on notice as to what the insured claims is the nature of the loss, as well as the extent of the loss (that is, what damages the insured is claiming resulted from the loss). In order for the Proof of Loss to be useful, it must be fully completed by the insured and contain an unambiguous description of date, time, place & circumstances of the loss including the full measure of damages claimed. This will assist the claims adjuster in determining coverage and valuing valid claims, and may reveal discrepancies that are indicators of a fraudulent claim. Also, many state regulations require a proof of loss with fraud language as a condition precedent to any state investigation of a potential fraud claim. Lastly, the receipt of a

completed Proof of Loss generally triggers the policy or statutory timeframe for acceptance or rejection of the claim. See e.g., Florida Statutes Section 626.9541(i)(3)(f).

Where the claims representative determines there are issues of fact that need to be resolved or clarified, most marine insurance policies include "duties after loss" and cooperation clauses that require the insured to assist the insurer with the investigation. These clauses typically obligate an insured to submit to an Examination Under Oath ("EUO") and to produce documents and records to verify coverage, the claim, the extent of a claim, and the insured's interest in the property.

An EUO is a potent tool in the insurer's arsenal, but it should not be utilized indiscriminately or prematurely (i.e., before a Proof of Loss has been completed and submitted). A proper examination of an insured should seek to elicit all information relevant to the claim, including both evidence supporting coverage and evidence weighing against coverage. When properly employed, the EUO can be evidence of the insurer's good faith because the insurer can and should present the insured with any factual discrepancies and allow the insured to provide an explanation. See *Lorenzo-Martinez v. Safety Insurance Co.*, 58 Mass.App.Ct. 359, 363, 790 N.E.2d 692, 696 (Mass.App.Ct. 2003) (the purpose of an EUO provision is "to weed out fraud by providing an insurer with a mechanism for obtaining formal corroboration of a claim"). Sometimes there is an innocent explanation. Other times, the insured will contradict prior statements or create further discrepancies for future investigation.

An EUO conducted by experienced maritime counsel can greatly influence a claim, and the insured's failure to sit for, or to sign the transcript of, an EUO can be grounds for denying the claim. See *Brizuela v. CalFarm Insurance Co.*, 116 Cal.App.4th 578, 587, 10 Cal.Rptr.3d 661, 667 (2nd Dist. 2004); *Thomson v. State Farm Insurance Co.*, 232 Mich.App. 38, 45, 592 N.W.2d 82, 85 (1999).

If fraud indicators are present, the claims adjuster is justified in seeking, and should seek, additional documentation from the insured. Such additional documentation might include financial and credit information regarding the

insured (including the status of any loans relating to the vessel), the insured's claims history, and documents relating to the history of the vessel. A breach of the cooperation clause may relieve the insurer of further obligations under the policy. See *Rocco*, *supra*; *Nelson v. Peerless Insurance Co.*, 1994 WL 592031 (Conn. Super. New Haven 1994).

Another important reason for documenting the insured's version of the loss is that this portion of the investigation may reveal facts indicating that the vessel was used in breach of a warranty in the policy (e.g., a lay-up, navigation limits, or private pleasure use warranty) or that the insured may be hiding a breach of a warranty. Because many Circuits generally hold that federal maritime law strictly enforces explicit warranties when a breach occurs regardless of the cause of the loss (see e.g., *Lexington Insurance Co. v. Cooke's Seafood*, 835 F.2d 1364 (11th Cir. 1988); *Employers Insurance of Wausau v. Trotter Towing Corp.*, 834 F.2d 1206 (5th Cir. 1988); *Port Lynch, Inc. v. New England International Assurety of America, Inc.*, 754 F.Supp. 816 (W.D.Wa. 1991)), discovering and documenting a breach of a warranty can have a significant impact on any litigation arising out of the claim.

Documenting the Nature and Extent of the Loss

Although addressed last in this paper, a properly conducted investigation into the nature and extent of a loss is essential to the proper resolution of every recreational marine insurance claim. Whenever possible, this investigation should include photographing the vessel and the scene of the loss, and gathering all relevant physical evidence. For this part of the claims investigation, marine insurers often retain qualified marine surveyors. In many states and under federal law, an insurer's reasonable reliance on the opinions of a qualified expert will preclude liability for a breach of the covenant of good faith and fair dealing. See *Guebara v. Allstate Insurance Co.*, 237 F.3d 987, 992 (9th Cir. 2001); *Chateau Chamberay Homeowners Association v. Associated International Insurance Co.*, 90 Cal.App.4th 335, 349, 108 Cal.Rptr.2d 776, 785 (2001).

When determining the cause of the loss, the claims adjuster should keep in mind that federal maritime law controls the issue of causation in suits involving marine insurance policies (see, *Commodities Reserve Co. v. St. Paul Fire & Marine Insurance Co.*, 879 F.2d 640, 642 (9th Cir. 1989)), and that proximate cause in marine cases is defined as "that cause most nearly and essentially connected with the loss as its efficient cause." *Standard Oil Co. v. United States*, 340 U.S. 54, 58, 71 S.Ct. 135, 137, 95 L.Ed. 68 (1950). Thus, a loss caused by an insured's failure to properly prepare his yacht for winter lay up may be covered, although the inevitable freezing which subsequently occurred was an excluded peril. See e.g., *Goodman v. Fireman's Fund Ins. Co.*, 600 F.2d 1040, 1042 (4th Cir. 1979).

Often times a thorough examination of the vessel will include tearing down mechanical components or destructive testing to determine the precise cause of loss. Again, reasonable reliance on experts will not only help the insurer make the appropriate claims decision, but may also shield the insurer from bad-faith liability. *Guebara*, *supra*.

Fraud may be suspected where the insured's description of the cause of loss is inconsistent with the documented damages. A common example of this is the insured claims to have struck a submerged object when the cause of loss is really due to mechanical failure due to wear and tear or lack of maintenance, or where the insured claims to have run over plastic that was sucked into the engine when the true cause of loss is simply a clogged manifold due to lack of maintenance. An experienced surveyor or claims adjuster should be able to confirm or refute whether the documented damages are consistent with these types of occurrences.

When determining the value of a loss, the claims adjuster must keep in mind the specific definitions and loss payment provisions of the policy; and if the policy does not define it, the general maritime principles regarding constructive total loss.

Conclusion

A comprehensive and balanced investigation of recreational marine claims is essential to fulfilling the insurer's duties to both the insured, its other policyholders and insurance regulators. Such investigations enable insurers to efficiently pay legitimate claims and to expose fraudulent claims. Moreover, an appropriate investigation that is properly documented will enable the insurer to defend its conduct in any litigation or regulatory review arising out of its claims-handling decisions.

Lastly, it is important for insurers to recognize the uniqueness of the maritime law principles that apply to recreational boating claims, and to select experienced marine claims adjusters and maritime attorneys to handle those claims. Most suits arising out of recreational marine insurance claims are filed in state courts and will be heard by judges not trained in maritime law. Thus, it will fall to the insurer's claims adjusters and attorneys to educate the court about the unique features of marine insurance policies and maritime law, including the doctrine of u*berrimae fidei*, the strict application of warranties, burdens of proof, and the various presumptions regarding seaworthiness. An insurer's failure to avail itself of those maritime principles can lead to unsatisfactory litigation results and the dilution of the strong body of maritime law.

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[i] A thorough examination of the jurisdictional and choice of law issues presented by recreational marine insurance claims is beyond the scope of this paper, except to note the following: (1) The federal Circuit Courts have developed differing statements of the standard, first enunciated in *Wilburn Boat Company v. Fireman's Fund Insurance Company*, 348 U.S. 310, 314 (1955), for determining whether federal admiralty law or state law applies to a dispute involving a marine insurance contract; (2) Although the differences in the Circuits' statements is slight, those differences appear to influence a Circuit's willingness to find controlling federal maritime principles in any particular case. For example, it has been noted that the Fifth Circuit's approach is "pro-state law" and stacks the deck in favor of state law, while the Ninth Circuit's approach weighs in favor of application of federal maritime rules. See, Schoenbaum, "*The Future of Maritime Law in the Federal Court: A Faculty Colloquium, Marine Insurance*" 31 Journal of Maritime Law and Commerce 281 (April 2000); (3) Regardless of whether federal admiralty law or state law provides the basis for resolving the pure contract issues in a recreational marine insurance claim, the insurer's claims-handling conduct will nearly always be judged under state law. See e.g., *The Carney Family Investment Trust v. Insurance Company of North America*, 296 F.Supp.2d 629, 631 (D. Md. 2004); and (4) Once it is determined that federal admiralty law will or will not provide the rule of decision for some aspects of a claim, the claims adjuster or attorney must attempt to determine which state's law will apply to the claim by employing the federal maritime choice of law rules (*Kossick v. United Fruit Company*, 365 U.S. 731, 735 (1961)). Not

surprisingly, the federal Circuits have also adopted differing "horizontal" choice of law rules, thereby further complicating the claims adjuster's or attorney's task.

[ii] For purposes of this paper a “suspicious claim” is one that appears to involve an attempt to defraud an insurer as evidenced by at least one of the following factors: over insurance; the insured is in financial distress; the vessel was held for unsuccessful sale for a long period of time; the vessel financing is upside-down; the insured is experiencing personal, business or familial problems; there is someone with an undisclosed ownership interest in the vessel; lack of use or abandonment of the vessel; evasive or inconsistent explanations regarding the loss; combative behavior; piecemeal disclosure of facts relating to the loss; and, an undisclosed claim history or undisclosed commercial use.

[iii] All but three states require insurers to report suspected arson claims and 38 require that insurers implement procedures to investigate and report on all suspected fraudulent insurance claims. See e.g., California Insurance Code Section 2698.30; Florida Statutes Section 626.9891.