

S.C. Court Finds Insufficient Proof in Life Insurance Fraud Case



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- Insurance Coverage
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S.C. Court of Appeals says Jury Could Conclude Insured Did Not Make Misrepresentations on Life Insurance Application With Fraudulent Intent

In a recent opinion, the South Carolina Court of Appeals found a jury could reasonably conclude a life insurance company insurer was not entitled to a directed verdict in a suit to void a policy. The insurer sought to void a policy based on misrepresentations of alcohol and drug use.

In *Shenandoah Life Insurance Co. v. Smallwood*, Lorenzo Smallwood sought medical treatment in October 2006, two years after having been honorably discharged from the Marine Corps. Medical notes revealed Smallwood complained to medical personnel, including Dr. Pathak, that he had difficulty sleeping, believed he suffered from post-traumatic stress disorder, felt depressed, and abused drugs and alcohol. In his assessment, Dr. Pathak wrote, "Substance Abuse (Alcohol) – current; Cocaine Abuse – current." Dr. Pathak later testified the assessment was based upon what he discussed with Smallwood, and his notes showed Smallwood expressed his understanding of the assessment. Dr. Pathak could not confirm Smallwood agreed with the assessment. Dr. Pathak referred Smallwood for a mental health consultation, but Smallwood did not attend.

In November 2007, Smallwood's wife sought an insurance policy through Shenandoah on the life of her husband. The application asked the following:

Within the last 10 years, have any persons proposed for coverage been diagnosed or treated by a member of the medical profession for ... mental or nervous disorder, alcohol or drug dependency?

Within the past 5 years, have any persons proposed for coverage ... [u]sed cocaine?

Smallwood answered "No" to each of these questions and Shenandoah issued the policy. In September 2008, Smallwood was shot to death. Shenandoah denied Lakeisha's claim on the ground Smallwood provided false statements on the application regarding his medical history. Shenandoah also brought an action to void the policy.

To void a life insurance policy for misrepresentation, an insurer must prove by clear and convincing evidence: (1) the applicant made a false statement on the application; (2) the applicant knew the statement was false; (3) the applicant's misrepresentation was material to the risk undertaken by the insurance company; (4) the insurer issued the policy in reliance on the misrepresentation; and

(5) the applicant made the misrepresentation with the intent to defraud the insurance company. At trial, after the close of all the evidence, the court granted Shenandoah's motion for a directed verdict.

The issue on appeal was whether there was evidence in the record from which the jury conclude Shenandoah failed to prove by clear and convincing evidence that Smallwood intended to defraud Shenandoah. The Court of Appeals concluded there was such evidence and listed "several plausible explanations" for Smallwood's misrepresentations:

[A] jury could reasonably conclude he was attempting to hide this information from his wife, who did not know he had used drugs. Haynes [insurance agent] testified that if Lorenzo had disclosed his drug use, Lakeisha would have seen that on the application when she signed it. His aunt Gayle's presence when the application was being completed and Gayle's friendship with Haynes could provide another reason Lorenzo wanted to hide the information. Gayle testified Lorenzo was extremely close to her—she was "like a second mother to him" and had no knowledge of his previous drug use. As to Shenandoah's claim that Lorenzo's failure to disclose his PTSD was fraudulent, in addition to the fact that Lakeisha did not know Lorenzo thought he had PTSD, there is no evidence Lorenzo was ever diagnosed with or treated for it—only Lorenzo's statement to O'Toole and Dr. Pathak that he suspected he suffered from it.

Reviewing South Carolina cases in which courts determined the insured had an intent to defraud the insurer, the court of appeals noted the facts concealed in those cases were indisputably known by the insured to relate directly to a significantly increased risk of death: "In those cases, the insured obviously knew at the time of the misrepresentation that he or she faced a substantially increased risk of death from the very condition he or she lied about on the insurance application." The court noted, Shenandoah presented no evidence that Smallwood associated his alcohol or cocaine use with any increased risk. Although medical records indicated Smallwood admitted "drug and alcohol abuse," neither the nurse nor the doctor could say what led them to write that in the records. Thus, the court determined that Dr. Pathak's used the term "abuse" to refer to isolated cocaine and alcohol use. As to any mental disorder, the record contained nothing more than Smallwood's suspicion he had PTSD. The court determined these facts supported a reasonable inference that Smallwood's misrepresentations were not fraudulent.

Shenandoah also argued that Smallwood's signature on the application was conclusive evidence of his fraudulent intent, and that there was no evidence in the record to support the idea that Smallwood concealed the information to hide it from his wife and aunt. The court rejected these arguments. As to the argument regarding Smallwood's intention behind the misrepresentations, the court clarified that, in holding a jury could reasonably conclude Shenandoah failed to meet its burden of proof, the court did not rely on the existence of evidence presented by Lakeisha. Rather, the court held the evidence Shenandoah presented was insufficient to support a conclusion that it proved Smallwood's fraudulent intent clearly and convincingly as a matter of law. The court remanded the case for trial.

About Logan Wells

Logan Wells is an associate practicing in the areas of insurance coverage and professional liability. She also writes about insurance coverage issues and trends in the South Carolina Insurance Law Blog. She received her undergraduate degree in history and political science from Furman University and earned her juris doctor from the University of South Carolina School of Law. During her undergraduate career, she worked for a law firm in Spartanburg as a legal assistant. While in law school, she worked as a summer associate for Collins & Lacy, before joining the firm as an attorney in the fall of 2009.

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