

## **LAW REVIEW**

Published in the Sierra Sun  
January 16, 2009

By: Jim Porter

### **BLUE SHIELD SUED FOR CANCELING COVERAGE AFTER CLAIM MADE**

---

Picture yourself applying for healthcare coverage with Blue Shield (or Blue Cross or some other healthcare provider). You fill out the form completely as to your health but leave out health information regarding your husband and son. You underestimate your husband's weight by 45 pounds.

Two months after Blue Shield issues a policy for healthcare coverage for the family, your husband ends up in the hospital, at which point Blue Shield thoroughly reviews the application and your husband's medical records. They find a history of serious medical issues.

Soon afterwards your husband is in an automobile accident and is left completely disabled—racking up medical bills over \$460,000, \$60,000 paid by Blue Shield.

Three months later Blue Shield cancels your medical coverage retroactively--claiming you misrepresented your husband's medical history. But that's not all. Blue Shield demands reimbursement of the \$60,000. And if that is not bad enough, your husband's medical care providers demand the \$400,000 for their services.

Who you gonna call? Your lawyer of course.

Hailey v. Blue Shield

That was the Hailey family's nightmare. Their lawyer sued Blue Shield for breach of contract, intentional infliction of emotional distress constituting extreme and outrageous behavior and breach of the contractual covenant of good faith and fair dealing.

*Hailey v. Blue Shield* changed the law in California when someone misstates or incompletely fills out an application for health insurance coverage. Blue Shield took the view it was entitled to rescind/terminate the Hailey's healthcare service plan if the Haileys negligently or inadvertently made misrepresentations in the application for coverage, so that after a claim is submitted if Blue Shield found misstatements in the application, it could retroactively terminate the coverage contract, which is exactly what happened to the Haileys, putting them in a dire financial situation.

#### Postclaims Underwriting

In 1993 the California Legislature passed a law prohibiting so-called "postclaims underwriting", meaning cancelling a healthcare plan due to healthcare claims issues raised after the healthcare plan is issued unless the applicant "willfully misrepresented" healthcare information in the application.

The Haileys argued that Blue Shield should have told them they had not completely filled out the application and should have done homework to make sure the application was basically accurate and complete before Blue Shield is entitled to rescind the health care contract after a claim is filed.

#### Good Faith

Every contract imposes on each party an implied "duty of good faith and fair dealing," meaning that neither party may do anything which will injure the right of the

other to receive the benefits of the agreement. Remember that. It comes up a lot in contract disputes.

### Ruling

The Court of Appeal ruled that an applicant for a health services plan has a responsibility to exercise care in completing an application. Likewise the plan provider must make reasonable efforts to ensure it has all the necessary information to accurately assess the risks it takes *before* issuing the plan contract--if the plan provider wishes to preserve the right to later rescind and retroactively cancel the contract if it is later determined the applicant willfully misrepresented information in the application.

In the Hailey case Blue Shield should have insisted they fill out the application completely before the plan was issued.

Not only that, a healthcare services plan may not adopt a "wait and see" attitude by continuing to collect premiums while keeping open its rescission option if the applicant later experiences a serious accident or illness that generates large medical expenses. The Court found that it was possible that Blue Shield acted in bad faith in canceling the coverage especially because it did so after knowing of substantial medical bills.

The Haileys are entitled to take their case to a jury. Blue Shield will win if it can prove the Haileys intentionally misrepresented the husband's medical history in the application, but not otherwise.

This is a significant pro-consumer decision which will cause companies like Blue Shield to do interviews, make physician inquiries and search medical records before issuing healthcare coverage. Costs we will all pay in increased premiums.

## Automobile Insurance

The Court in the Blue Shield case discussed insurance applications for automobile and other coverage, noting that the Insurance Code provides:

“Concealment, whether intentional or unintentional, entitles the injured party (the insurer) to rescind insurance.” E.g. you list that you do not smoke when you do. Blue Shield is not an insurance company so that law did not apply.

On insurance applications in California, like fire, auto and life insurance, the insurer must make a reasonable investigation of the insured's insurability within a reasonable period of time from acceptance of the application and issuance of a policy. A healthcare services plan, however, must complete its underwriting and investigation before issuing the plan providing coverage.

*Jim Porter is an attorney with Porter Simon, with offices in Truckee, South Lake Tahoe, Incline Village and Reno and a licensed California Real Estate Broker. He was the Governor's appointee to the Bipartisan McPherson Commission on political ethics and the California Fair Political Practices Commission. He may be reached at [porter@portersimon.com](mailto:porter@portersimon.com) or at the firm's web site [www.portersimon.com](http://www.portersimon.com)*