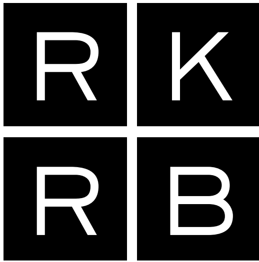

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TORT AND INSURANCE NEWSLETTER

Summer 2008 Issue

The Foreclosure Crisis and Insurance Claims: How Foreclosure Initiation May Affect a Mortgagee's Interest

Most states have enacted statutory mortgage clauses which are designed to protect the interests of mortgagees in insured property. These statutes are designed to create an independent contract of insurance between the mortgagee and the insurer which may not be invalidated by acts of the named insured, even in the case of fraud by the insured. In exchange for this elevated protection, mortgagees have certain notification duties. For example, under Tennessee's statutory "mortgage clause" embodied in Tenn. Code Ann. § 56-7-804, a mortgagee is required to provide notification to an insurer of "any change of ownership or occupancy or increase of hazard which shall come to the knowledge of the mortgagee…" Most insurance policies include a similar requirement.

The Tennessee Court of Appeals recently addressed the issue of the effect that initiation of foreclosure proceedings has on a mortgagee's interest in an insurance policy in U.S. Bank, N.A. v. Tennessee Farmers Mutual Insurance Company, 2007 WL 4463959 (Tenn. Ct. App. 2007). The Court in U.S. Bank held that commencement of foreclosure proceedings constitutes an "increase of hazard" under Tenn. Code Ann. § 56-7-804. Because the mortgagee bank failed to notify the insurer of the initiation of foreclosure proceedings against the insured property, the bank was not entitled to the special protection afforded either by statute or the policy's mortgagee clause when a fire destroyed the property after foreclosure proceedings were begun. The Court reasoned that initiation of foreclosure proceedings constituted an "increase of hazard" because it gives a financially delinquent insured an incentive to destroy the property in order to receive insurance proceeds to apply against the debt. This risk arises the moment the insured knows that foreclosure proceedings have begun. The Court stated that the mortgagee bank should have notified the insurer that it had initiated foreclosure proceedings at the same time that it notified the insured so that the insurer could have determined whether to cancel the policy or continue with coverage.

The reasoning applied by the Tennessee Court of Appeals in U.S. Bank makes good business sense and is documented in the media. When the economy is down, an increase in fraud tends to occur. Jon Birger, *Will Foreclosures Spark an Arson Boom?* Fortune, January 10, 2008. For example, in 2006, when the real estate downturn began to take hold, there was a significant increase in arson- related fires. Id. This statistic represents a change from the prior three years when arson was on the decline. Id. 2007 statistics are not yet available. Id. Nonetheless, it is not unforeseeable that with foreclosures increasing and with the real estate market in a devastating slump, more homeowners may see arson as a way out of their financial woes.

Thus, although "foreclosure proceedings" do not necessarily invalidate the mortgagee's interest, insurance professionals should be aware that, in Tennessee, mortgagees are required to give notice to insurers of the initiation of foreclosure proceedings or they may risk losing insurance coverage for fires occurring after the initiation of foreclosure. Insurers should consider this issue in all cases of fire loss occurring after the initiation of foreclosure proceedings as a potential defense to the payment of a claimed loss.

NEW MEDICARE REPORTING REQUIREMENTS FOR INSURERS

Effective July 1, 2009, the Medicare Secondary Payer Statute (MSPS) places a new requirement on liability insurers, self-insurers, no-fault insurers, and workers' compensation insurers, along with their third- party administrators (TPAs) and self-insured plan administrators or fiduciaries. These insurers and TPAs must determine Medicare beneficiary status on all claims and must report any claims involving a Medicare beneficiary to the Secretary of Health and Human Services (HHS) at the time of settlement, judgment or award. This new requirement is included in Section 111 of the "Medicare, Medicaid, and SCHIP Extension Act of 2007" recently enacted on December 29, 2007, and amends the Medicare Secondary Payer Statute (MSPS). The new reporting requirements allow Medicare to ensure consideration of its interests whenever a claim results in a settlement, judgment, or award.

Under the new Act, an insurer, administrator or TPA must (1) determine whether a claimant is entitled to Medicare benefits on any basis and (2) submit specified information about any claimant entitled to Medicare benefits to HHS. The HHS Secretary may require additional information to be submitted. The notification must be made in liability cases, as well as in workers' compensation cases, and must be made even if the insurer believes Medicare/Medicaid has made no conditional payments on behalf of the claimant.

The time for submitting this information will be determined by the HHS Secretary. Currently, no time limit is specified. The statute suggests that the notification must be made at the time of the settlement, judgment or award. However, notification may be required even after the claim is resolved by settlement, judgment, award or other payment (regardless of any determination or admission of liability). Failure to comply with the new Act carries significant civil monetary penalties: *$1,000 per day per unreported individual*. These penalties are in addition to any other penalties imposed by law and any Medicare secondary payer claim or lien.

The new Act does not affect current standards for Medicare Set-Aside Agreements required in workers' compensation plans. Likewise, insurers are not required to notify Medicare of claims involving non-beneficiaries. However, insurers must continue to adequately consider Medicare's interest in recovering conditional payments and settlement agreements should protect Medicare's interest in the claim. Thus, to protect themselves, insurers, administrators and TPAs should secure written confirmation of a claimant's benefit status from Medicare prior to a settlement, judgment or award. In this regard, signed claimant releases may be needed, although the HHS Secretary is to share information concerning Medicare entitlement with entities required to comply with the new Act. Furthermore, recent regulations effective March 24, 2008, require all insurers to provide notice to Medicare/Medicaid when it is "demonstrated" that Medicare/Medicaid has made a conditional payment in a case in which an insurer has made payment or will be responsible to make payment to the claimant.

The Centers for Medicare and Medicaid Services (CMS) is expected to release mandatory reporting requirements under the new Act on its website within the next few months. A Mandatory Insurer Reporting web page has already been established by CMS at: https://www.cms.hhs.gov/MandatoryInsRep/. This web page allows users to sign up for e-mail updates from CMS.

To ensure compliance with the Act's requirements, all liability insurance companies must develop a system for determining a claimant's benefit status. Insurers are encouraged to develop such a system as soon as possible in order to avoid administrative difficulties in complying with the Act.

AVAILABLE:

The Tort and Insurance Newsletter is available by email. Please send your email address to Alicia Robinson at arobinson@raineykizer.com to sign up for a free pdf version of our newsletter.

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Important Changes in the Family and Medical Leave Act and Other Recent Developments in Employment Law: Including HIPAA and Workers' Compensation Updates

RKRB Employment Law Seminar (June 27, 2008)

On Friday, June 27, 2008, the law offices of Rainey, Kizer, Reviere & Bell, P.L.C., will be presenting a half day seminar for employers focusing on the recent changes in the federal Family and Medical Leave Act (FMLA) regarding enlisted service men and women and new proposed FMLA regulations. These are the most substantial regulatory changes since the regulations were first issued following the passage of the FMLA in 1993. The seminar will also cover recent developments in Tennessee Workers' Compensation Law as well as new regulations under the Health Insurance Portability and Accountability Act (HIPAA). The seminar will be at the Jackson Area Chamber of Commerce, located at 197 Auditorium Street, Jackson, Tennessee 38301. Registration will begin at 8:30 a.m. The seminar will start at 9:00 a.m. and last until 12:00 p.m. A light breakfast will be provided. RSVP by calling 731.425.7951.

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