Of New Policies and Old

How Michigan's "Renewal Rule" Could Affect Your Client's Coverage

By Joe Kuiper

Like all contracts, insurance policies are generally governed by their plain language. Barring any ambiguity, there is no mystery as to what a policy covers and does not cover. But there are some cases in which even the plain language of a policy might not be controlling. A prime example of this phenomenon arises in the context of renewal policies. When an insurer issues a renewal policy to its insured, it has an obligation to put the insured on notice of any changes that reduce coverage when compared to the outgoing policy. If the insurer fails to meet its obligations under this so-called "renewal rule," the insured may be entitled to coverage that otherwise would not be available. This article provides an overview of the renewal rule and some of the interesting applications it has received by the courts. Understanding the rule gives insureds and their attorneys a unique and potentially valuable tool in insurance coverage litigation.

General Rule

In most circumstances, a party cannot escape its contractual obligations by pleading ignorance; failure to read a contract before signing it does not relieve the signer of his or her obligations. For the most part, this is true with insurance policies as with other contracts. Thus, an insured is ordinarily obligated to read his or her insurance policy and raise questions concerning coverage within a reasonable time after issuance.[1] An insured who fails to do so is bound by the policy's terms, just as if he or she had read them.

But courts recognize an exception to this rule in the context of renewal policies.[2] When an insured renews coverage from one policy year to the next, he or she is entitled to assume that the renewal policy contains the same terms and conditions as the expiring policy and is relieved of the obligation to read it.[3] If the insurer makes a change to the renewal policy that reduces the insured's coverage, the insurer must provide notice of the change.[4] If it fails to do so, courts hold that the change is unenforceable and that the insured is entitled to the benefit of the more favorable coverage found in the earlier policy.[5]

In *Farmers Petroleum Coop, Inc v Mutual Service Cas Ins Co,* the insured sought coverage under a policy issued in 1986 that had been renewed annually through the date of the incident in 1994.[6] As originally issued, the policy would have provided coverage for the claim, but the insurer made a change to the policy in 1991 that made coverage unavailable. The Michigan Court of Appeals held that the insurer had failed to give proper notice of the change. The court noted that, under established law, "[w]here a renewal policy is issued, without calling to the attention of the insured a reduction in coverage, the insurer is bound to the greater coverage in the earlier policy."[7] Applying that rule, the court found that the insurer had failed to meet its obligations: "Nothing in the notice form that followed the amendments in 1991 called attention to a withdrawal of coverage" in the renewal policy.[8] Thus, the court held that the insurer was bound to provide coverage under the more favorable, pre-1991 policy language.

Contract Reformation, Not Estoppel

The remedy imposed by the renewal rule is grounded in contract reformation. In an earlier case, *Connecticut Fire Ins Co v Oakley Improved Bldg & Loan Co,* the U.S. Court of Appeals for the Sixth Circuit held that a "clear[ ] case for reformation exists" when during negotiations for a contract, one party is mistaken and the other party knows of the mistake "and t[akes] advantage of it, or by his own conduct or representations l[eads] him into such a mistake."[9] Applying that standard, the court held that when an insurer issues a renewal policy without notifying the insured of a reduction in coverage, the insured is entitled to have the policy reformed to reflect the coverage of the earlier policy.

Fast Facts

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The Sixth Circuit recently confirmed this understanding of the renewal rule in *ADBA v Northfield Ins Co,* a case that demonstrates why the renewal rule's basis in contract reformation is important to insureds.[10] In that case, the insurer argued that the renewal rule was based on principles of estoppel, rather than reformation, and that the insured must therefore prove the elements of estoppel, including things like detrimental reliance on the policy term at issue, to benefit from the rule. This would have significantly increased the insured's burden by requiring proof that he or she appreciated and relied on the older, broader policy term when the policy was purchased—something that would be difficult to do in many cases since, for insureds, the full meaning of a policy term may not be evident until the policy is needed.

The Sixth Circuit found the insurer's argument unconvincing: "Despite Northfield's assertions to the contrary, we find no authority to support its contention that the renewal rule requires detrimental reliance by the insureds, and find numerous cases that have applied the rule with no discussion of estoppel" or reliance.[11] This holding is consistent with the treatment of the renewal rule by courts around the country,[12] which hold that the rule applies whenever an insurer reduces coverage in a renewal policy without giving proper notice.[13] There is no requirement that the insured prove the elements of estoppel to benefit from the renewal rule.

What Notice is Required?

The law imposes strict obligations on insurers to give notice about changes to renewal policies. Three basic rules must be followed, each of which is discussed below.

1. It is not enough to tell the insured to read the policy.

Under caselaw from Michigan and other jurisdictions, an insurer must do more than simply tell the insured to read the renewal policy.[14] In *ADBA v Federal Ins Co,* the insurer made a change to the renewal policy and, rather than notify the insureds, simply attached a cover letter instructing the insureds to "READ [the] POLICY CAREFULLY to determine rights, duties, and what is and is not covered."[15] The court found that instruction insufficient to put the insureds on notice of the change: "[O]ther than a general admonition to read the policy carefully, Federal did not inform Plaintiffs that advertising injury coverage had been reduced."[16] The court therefore held that Federal was "bound to provide coverage under the earlier, more extensive, definition of advertising injury."[17]

2. It is not enough to tell the insured that the policy has been revised.

An insurer must also do more than notify the insured that the policy has been changed in some way. Courts hold that the insurer has an affirmative obligation to call the insured's attention to "the *reduction* in coverage, and not merely to the fact that [the] policy has been revised."[18] In one Michigan case, the insurer added a new exclusion to the policy and sent a brochure and cover letter informing the insured about certain changes, but the court found both to be insufficient.[19] The court found the letter lacking because it listed a number of changes but did not state that a new exclusion had been added, and the brochure inadequate because it "consisted of a single unemphasized reference in a twelve-page booklet," and thus did not explain that the policy's coverage was being reduced.[20]

3. It is not enough to simply attach an endorsement to the renewal policy.

An insurer must also be specific when relying on policy endorsements. Merely attaching an endorsement to a renewal policy is not sufficient to put the insured on notice of a change. This is true for two reasons.

First, because an insured has no duty to read a renewal policy, the insurer must notify the insured that the endorsement is attached to the policy or the insured is not on notice. In *American Cas Co v Rahn,*[21] a renewal policy was issued with a new endorsement that reduced the insured's coverage. Upon receiving the policy, the insured was not aware of the endorsement and believed for a short time that coverage had been renewed without change. The court found that the insurer had agreed to renew the policy and "there is no evidence or allegation by [the insurer] that it alerted [the insured] to the fact that the…[e]ndorsement was attached."[22] Thus, the court concluded, "[the insurer] may be bound by the greater terms of the [earlier] policy."[23]

Second, even if the insurer gives notice of a new endorsement, it must also explain that the endorsement reduces the insured's coverage when compared with the outgoing policy, since an endorsement with technical policy language does not put the insured on notice that coverage is being reduced. In *Canadian Universal Ins Co v Fire Watch,*[24] the insurer attached an endorsement that reduced the policy's coverage by changing only one key word in a relevant definition. The court held that, because the insurer "did not provide a written explanation notifying [the insured] that the endorsement substantially reduced its insurance coverage," the endorsement was void and could not be enforced.[25]

The Renewal Rule Binds Excess Insurers to Changes Made by Underlying Carriers

Another notable aspect of the renewal rule is its application to excess insurers. Like any other insurer, an excess insurer is liable

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for changes it makes to its own policy without notice to the insured. However, an excess insurer may also be bound to a change made by an *underlying carrier* if the change has the effect of reducing the insured's coverage under the excess policy. This could occur when the excess policy either incorporates specific policy terms (such as definitions) from the underlying policy or when the excess policy follows form over the underlying policy. Although caselaw on this issue is scant, the one court to have considered the issue has held that the excess insurer is bound by the changes made by the underlying carrier in these circumstances.

In *ADBA v Northfield Ins Co,* the excess insurer issued a policy that followed form over a primary policy issued by a different carrier.[26] When originally issued, the primary policy contained a broad definition of "advertising injury," making the coverage more favorable to the insured, but when the policy was renewed after several years, the primary carrier inserted a narrower, less favorable definition. In a suit by the insured against the primary carrier, the trial court held that the primary carrier had failed to give proper notice of the change and thus was bound by the earlier definition of advertising injury. However, in a later suit against the excess insurer, the same court held that the excess insurer, despite its position as a form-following carrier, was not the one responsible for narrowing the insured's coverage and thus was not bound to provide coverage under the older, more favorable definition.

On appeal to the Sixth Circuit, the court reversed, holding that the excess insurer was bound by the primary insurer's failure to give proper notice.[27] The court explained its ruling as follows:

> [The] question…is whether an excess carrier…is bound as a matter of law by the underlying carrier's failure to comply with the renewal rule. We believe that the answer is "yes," because the "follow form" linkage between an excess insurer and the primary insurer should logically apply to procedural as well as substantive obligations to their common insured. In effect, an excess insurer who lives by the sword must die by the sword.[28]

Therefore, the court held that Northfield, like the primary carrier, was bound to provide coverage under the earlier, more favorable policy definition.

Conclusion

The renewal rule is a valuable tool for insureds and their attorneys. The rule applies any time an insurer reduces coverage in a renewal policy without giving proper notice. Attorneys who understand the rule and its applications may have the ability to change the otherwise plain terms of a renewal policy to something more favorable to their clients. ■

Joe Kuiper is a partner at Warner Norcross & Judd LLP. He is chair of the firm's Insurance Practice Group, which concentrates in bringing coverage claims on behalf of policyholders. He regularly represents clients in insurance matters in state and federal courts, including successfully representing the insured distributors in the ADBA v Northfield *case discussed in this article. He can be reached at (616) 752-2481 or at jkuiper@wnj.com.*

FOOTNOTES

1. See *Koski v Allstate Ins Co,* 213 Mich App 166, 170; 539 NW2d 561 (1995), rev'd on other grounds 456 Mich 439; 572 NW2d 636 (1998).
2. *Id.* (citing *Parmet Homes, Inc v Republic Ins Co,* 111 Mich App 140, 145; 314 NW2d 453 (1981)).
3. See *Koski,* 213 Mich App at 170; *Parmet Homes,* 111 Mich App at 145; *Amway Distributors Benefits Ass'n ("ADBA") v Federal Ins Co,* 990 F Supp 936, 942 (WD Mich, 1997).
4. See *Koski,* 213 Mich App at 170; *Parmet Homes,* 111 Mich App at 145; *ADBA,* 990 F Supp at 942–943.
5. See *Koski,* 213 Mich App at 170–171; *Parmet Homes,* 111 Mich App at 145; *ADBA,* 990 F Supp at 942; *J.C. Wyckoff & Assoc v Standard Fire Ins Co,* 936 F2d 1474, 1494 (CA 6, 1991); *Government Employees Ins Co v United States,* 400 F2d 172, 174–175 (CA 10, 1968); *Gaston-Lincoln Transit, Inc v Maryland Cas Co,* 201 SE2d 216, 220–221 (NC App, 1973), aff'd 285 NC 541 (1974).
6. *Farmers Petroleum Co-op, Inc v Mutual Service Cas Inc, Co,* unpublished opinion per curiam of the Court of Appeals issued July 22, 1997 (Docket No. 191490).
7. *Id.*
8. *Id.*
9. *Connecticut Fire Ins Co v Oakley Improved Bldg & Loan Co,* 80 F2d 717, 719–720 (CA 6, 1936) (quoting 4 Page on Contracts (2d ed), § 2218).
10. *ADBA v Northfield Ins Co,* 323 F3d 386 (CA 6, 2003).
11. *Id.* at 393 (citations omitted).
12. See, e.g., *American Cas Co v Glaskin,* 805 F Supp 866, 872 (D Colo, 1992) (holding that the renewal rule "is most analogous to the cause of action for contract reformation" (quoting 3 Corbin on Contracts § 614 n 21 (1960)); see also 2 Couch on Insurance (3d ed), § 27:2, pp 27-5, -6 (1997) (discussing reformation and stating that "[a] renewal [policy] may be reformed to show that it was to provide the same coverage as the original policy…."); 4 Bender, The Law of Liability Insurance 17-98, -99 (2001) (same).
13. See, e.g., *Koski,* 213 Mich App at 170–173 (applying renewal rule with no discussion of reliance or other elements of estoppel); *Gaston-Lincoln Transit,* 201 SE2d at 222–223 (same); *Kung v Kung,* unpublished opinion per curiam of the Court of Appeals issued November 27, 2001 (Docket No. 225412) (same); *Taylor v Omaha Prop & Cas Ins Co,* 739 F Supp 1069, 1072–73 (ED Va, 1990) (same); *Canadian Universal Ins Co v Fire Watch, Inc,* 258 NW2d 570, 574–575 (Minn, 1977) (same); *Bauman v Royal Indemnity Co,* 174 A2d 585 (NJ, 1961) (same).
14. See *ADBA,* 990 F Supp at 943; *Koski,* 213 Mich App at 170–172 (citing *Parmet Homes,* 111 Mich App at 145); *Farmers Petroleum, supra.*
15. *ADBA v Federal Ins Co,* 990 F Supp at 942.
16. *Id.* at 942–943.
17. *Id.*
18. *Koski,* 213 Mich App at 171 (emphasis added); accord *J.C. Wyckoff,* 936 F2d at 1494.
19. See *Koski,* 213 Mich App at 171–172.
20. See *id.*
21. *American Cas Co v Rahn,* 854 F Supp 492 (WD Mich, 1994).
22. *Id.* at 501.
23. *Id.*
24. *Canadian Universal Ins Co v Fire Watch,* 258 NW2d 570, 574–575 (Minn, 1977).
25. *Id.* at 575; accord *Benton v Mutual of Omaha Ins Co,* 500 NW2d 158, 160 (Minn App, 1993) (finding rider inadequate because it "contains a full, technical description of benefits, but without signaling which provisions are new").
26. *ADBA v Northfield Ins Co,* 323 F3d 386 (CA 6, 2003).
27. *Id.* at 393.
28. *Id.*