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Innocent Third Party Rule Is Abolished, *Titan v Hyten Ins Co* Applies to PIP Claims

By: Sidney A. Klingler **June 15, 2016**

SECREST WARDLE NOTES

This published case settles the question of whether *Titan v Hyten* applies to abrogate the innocent third party rule in the PIP context. While it is next to certain that leave to appeal to the Michigan Supreme Court will be sought, the filing of an application does not diminish the precedential effect of *Bazzi* unless and until the Supreme Court speaks on the issue. For now, the innocent third party doctrine is abolished.

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The Court of Appeals in the long awaited decision of *Bazzi v Sentinel Ins Co*, ___ Mich App ___; ___ NW2d ____ (2016), has held that a contract for personal protection insurance benefits may be rescinded for fraud, and that rescission is effective even against an innocent third party. Judge Sawyer authored the majority opinion, with Judge Boonstra concurring and Judge Beckering dissenting.

This case required the Court of Appeals to decide whether the Supreme Court's holding in *Titan Ins Co v Hyten*, 491 Mich 547; 817 NW2d 562 (2012) – that "an insurer is not precluded from availing itself of traditional legal and equitable remedies to avoid liability under an insurance policy on the ground of fraud in the application for insurance, even when the fraud was easily ascertainable and the claimant is a third party" -- applied to abrogate the "innocent third party" doctrine in the PIP context. While *Titan* involved a third party claim, the Court of Appeals held that it applies equally in the context of a first party claim: "if an insurer is able to establish that a no-fault policy was obtained through fraud, it is entitled to declare the policy void ab initio and rescind it, including denying payment of benefits to innocent third-parties."

The panel first concluded that the "easily ascertainable" rule that was overruled in *Titan* was "one and the same" as the innocent third party doctrine. In so concluding, the panel reasoned that "it would make no sense to conclude that an insurer has no liability if the fraud is easily ascertainable, but would retain liability if the fraud was not easily ascertainable." Thus, the Court in *Bazzi* held, "in rejecting the 'easily ascertainable' rule, the Supreme Court of necessity also rejected the 'innocent third party' rule because they are, in fact, the same rule." Even if the rules could be regarded as distinct, moreover, the panel concluded

that both had their roots in the *Kurylowicz* decision, which was overruled by the *Titan* Court, along with its progeny.

Having concluded that the "easily ascertainable" rule and the "innocent third party" rule are one and the same, the Court turned to the question whether the holding of *Titan* extended to mandatory no-fault benefits. The panel noted *Titan*'s holding that "because insurance policies are contracts, common-law defenses may be involved [sic: invoked] to avoid enforcement of an insurance policy, *unless those defenses are prohibited by* statute." (Emphasis added by *Bazzi* Court.) The panel thus identified the key question as not merely whether PIP benefits were mandated by statute, but "whether that statute prohibits the insurer from availing itself of the defense of fraud." The panel noted that "none of the parties identify a provision in the no-fault act itself where the Legislature statutorily restricts the use of the defense of fraud with respect to PIP benefits."

The Court in *Bazzi* went on to consider the effect of MCL 257.520(f)(1), a provision restricting the availability of a fraud defense in certain limited circumstances. *Titan* had examined this provision and found that it only applied to a liability insurance policy if "it has been certified under MCL 257.518 or MCL 257.519." The Court of Appeals found that MCL 257.520 would only apply under limited circumstances not present in the instant case. The Court in *Bazzi* reiterated that it was not relevant that the coverage at issue was mandatory; "[r]ather, it is only relevant whether the Legislature has restricted the availability of the fraud defense with respect to a particular coverage." The Court found no statute that did so.

Ultimately, the Court held that "(1) there is no distinction between an 'easily ascertainable rule' and an 'innocent third party rule,' (2) the Supreme Court in *Titan* clearly held that fraud is an available defense to an insurance contract except to the extent that the Legislature has restricted that defense by statute, (3) the Legislature has not done so with respect to PIP benefits under the no-fault act, and, therefore (4) the judicially created innocent third-party rule has not survived the Supreme Court's decision in *Titan.* Therefore, if an insurer is able to establish that a no-fault policy was obtained through fraud, it is entitled to declare the policy void ab initio and rescind it, including denying payment of benefits to innocent third parties."

Judge Boonstra issued a concurring opinion elaborating on some of the reasoning of the majority opinion.

Judge Beckering dissented, reasoning that the "easily ascertainable rule" and the "innocent third party rule were in fact distinct, the former historically applied to liability policies and the latter to no-fault policies. Noting that "*Titan* did not address benefits that were required by statute," she was "disinclined to extend *Titan* and its reasoning to the innocent third-party rule as that rule applies to statutorily mandated PIP benefits."

We welcome your questions -

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