APPELLATE

MICHIGAN SUPREME COURT CONFIRMS THAT CONTRACTS ARE TO BE ENFORCED AS WRITTEN AND THAT TRADITIONAL CONTRACT PRINCIPLES MUST BE APPLIED EVEN-HANDEDLY

by Phillip J. DeRosier
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In two recent opinions, the Michigan Supreme Court has confirmed that it requires courts in Michigan to enforce contracts as written, and that courts must apply traditional contract principles in an even-handed manner, regardless who the parties are.

DeFrain v State Farm Mutual Auto Ins Co

The first case involved a no-fault insurance policy provision requiring 30 days' notice of a hit-and-run motor vehicle claim. See *DeFrain v State Farm Mutual Auto Ins Co*, ___ Mich ___ (Docket No. 142956, May 30, 2012). DeFrain was seriously injured when he was struck by an uninsured hit-and-run driver. DeFrain had an uninsured-motorist ("UM") policy with State Farm, which contained a provision requiring hit-and-run accidents to be reported "to the police within 24 hours and to [State Farm] within 30 days[.]" Because State Farm did not receive notice of the accident within 30 days of the accident, it denied coverage. DeFrain filed suit seeking UM benefits. After he subsequently died from his injuries, DeFrain's wife, Nancy, became the personal representative of his estate and substituted into the case as the plaintiff.

State Farm moved for summary disposition, "arguing that the failure to comply with the 30-day notice provision applicable to hit-and-run cases required dismissal of [the] plaintiff's complaint." The trial court agreed and dismissed the case, but the Court of Appeals reversed, concluding that State Farm could not rely on the 30-day notice provision because it was unable to establish that it was prejudiced by the delay.

In reversing the Court of Appeals' decision and remanding for entry of summary disposition in State Farm's favor, the Supreme Court concluded in a 4-3 opinion (authored by the Court's newest member, Justice Brian Zahra, and joined by Chief Justice Robert P. Young, Jr., and Justices Stephen Markman and Mary Beth Kelly) that "[i]n reading a prejudice requirement into the notice provision where none existed, the Court of Appeals disregarded controlling authority laid down by this Court and frustrated the parties' right to contract freely." The *DeFrain* majority reiterated the Court's prior opinion in *Rory v Continental Ins Co*, 473 Mich 457; 703 NW2d 23 (2005), which held that "[w]hen a court abrogates unambiguous contractual provisions based on its own independent assessment of 'reasonableness,' the court undermines the parties' freedom of contract." Id. at 468-469.

Although the *DeFrain* majority acknowledged an older opinion imposing a prejudice requirement on contract provisions "requiring notice immediately or within a reasonable time," *Koski v Allstate Ins Co*, 456 Mich 439, 444; 572 NW2d 636 (1998), the majority found that *Koski* "did not purport to impose a prejudice requirement on contractual provisions requiring notice within a specified time such as 30 days." The Court noted that there is an "obvious distinction between a contract provision requiring notice 'immediately' or 'within a reasonable time,' which are temporally imprecise terms, and one that requires notice 'within 30 days,' which could not be clearer." The Court found that the Court of Appeals should have instead followed the Court's more recent order in *Jackson v State Farm Mut Auto Ins Co*, 472 Mich 942 (2005), in which the Court rejected the prejudice requirement when it vacated the Court of Appeals' decision not to enforce a virtually identical 30-day notice provision, and expressly adopted the Court of Appeals dissenting opinion, which concluded that the notice provision was enforceable with regard to a showing of prejudice. The *DeFrain* majority held that although *Jackson* was an order, and not an opinion, it had the same precedential effect, and that the Court of Appeals erred in reasoning that it "should give more weight to a Supreme Court opinion than to a Supreme Court order."

Justice Michael Cavanagh, joined by Justices Marilyn Kelly and Diane Hathaway, dissented, arguing that the Court's prior decision in *Koski* "should control in this case." The dissent argued that *Koski* was consistent with decisions in other jurisdictions, and that there was "no persuasive reason to conclude that *Koski* should not apply in this context simply because this case involves a specific period in which notice was required, rather than a provision requiring notice 'immediately,' 'as soon as practicable,' or within a 'reasonable time.'" The dissent also found to be misplaced the majority's reliance on the general notion of "freedom contract," reasoning that insurance policies are unique in that they are not "truly bargained for."

The Supreme Court's decision in *DeFrain* is significant for two reasons. *First*, it reflects the current majority's continued adherence to established contract principles, notwithstanding judge-made rules of fairness or equity. *Second*, it demonstrates the importance of ensuring that contract provisions are clear and unambiguous. If they are, then they must be enforced as written.

Titan Insurance Company v Hyten

A little more than two weeks after issuing its opinion in *DeFrain*, the Supreme Court decided *Titan Insurance Company v Hyten*, ___ Mich ___ (Docket No. 142774, June 15, 2012), in which the Court addressed "whether an insurance carrier may reform an insurance policy on the ground of misrepresentation in the application for insurance where the misrepresentation is 'easily ascertainable' and the claimant is an injured third party."

In *Hyten*, the defendant, McKinley Hyten, had her driver's license suspended for "multiple moving violations" and "two traffic accidents." "Meanwhile, Hyten's mother, Anne Johnson, inherited a 1997 Dodge Stratus" that she "earmarked" for Hyten. On August 22, 2007, based on assurances from Hyten's probation officer that her license would likely be reinstated at an upcoming, August 24, 2007, court date, Johnson called an independent insurance agent, "Brett," to inquire about obtaining a no-fault insurance policy for Hyten. Brett "filled out a Titan Insurance Michigan insurance application on Hyten's behalf" and postdated it to August 24, 2007. Johnson paid the $719 premium over the phone by credit card, and Hyten went to Brett's office a day or two later to sign the application. "The Titan policy took effect on August 24, 2007 with coverage limits of $100,000 per person and $300,000 per occurrence."

As it turned out, Hyten's license was not reinstated as expected. Instead, when "Hyten and Johnson appeared in court on August 24, 2007," they "learned that Hyten would not regain her driving privileges until she completed a driver's assessment." Hyten successfully completed the driver's assessment, but her license was not reinstated until September 20, 2007. In the meantime, Johnson kept the Dodge Stratus in storage, expecting that the Titan policy would be in effect when Hyten received her license.

On February 10, 2008, Hyten was involved in an automobile accident in which two third parties, Martha Holmes and Howard Holmes, were injured. When Titan learned that Hyten's driver's license was still suspended when the Titan insurance policy took effect on August 24, 2007, it filed a complaint seeking to reform the policy "by reducing the liability coverage limits to the statutory minimum of $20,000 per person and $40,000 per event." However, the trial court dismissed Titan's lawsuit, finding that Titan did not establish a right to reform the policy because "whether a person has a driver's license is easily ascertained."

The Court of Appeals affirmed. The Court of Appeals recognized that generally an insurance contract may be cancelled, rescinded, or reformed based on an insured's misrepresentations in the application for insurance. However, the Court of Appeals explained, once an innocent third party was injured, Titan could no longer rely on an "easily ascertainable" misrepresentation as a basis for denying coverage. In reaching its decision, the Court of Appeals disregarded a prior opinion from the Supreme Court in *Keys v Pace*, 358 Mich 74; 99 NW2d 547 (1959), in which the Supreme Court expressly rejected such a rule. The Court of Appeals observed that "no Michigan appellate court has seen fit to cite [Keys] since it was released in 1959," and instead relied on a line of cases beginning with *State Farm Mut Auto Ins Co v Kurylowicz*, 67 Mich App 568; 242 NW2d 530 (1976), in which the Court concluded that "[a]n automobile liability insurer must undertake a reasonable investigation of the insured's insurability within a reasonable period of time from the acceptance of the application and the issuance of a policy," and that "[t]his duty directly inures to the benefit of third persons injured by the insured." *Id.* at 576. Accordingly, if an innocent third party is injured and obtains a judgment against the insured, "the insurer cannot then successfully defend upon the ground of its own failure reasonably to investigate the application." *Id*. (citation and internal quotation marks omitted).

The Supreme Court, however, in a 4-3 decision authored by Justice Markman (joined by Chief Justice Young and Justices Zahra and Mary Beth Kelly), rejected the Court of Appeals' analysis as inconsistent with traditional contract principles. The Court found no basis for the Court of Appeals' "easily ascertainable" rule, explaining that under the common law a party has the right to seek to avoid a contract obtained "as a result of fraud or misrepresentation," including innocent misrepresentation, and that none of these doctrines "require the party asserting fraud to have performed an investigation of all assertions and representations made by its contracting partner as a prerequisite to establishing fraud." In addition, the Court observed, nothing in the Michigan no-fault act imposed such an obligation on insurers as a general matter. The Court noted that although MCL 257.520 limits the ability of motor vehicle insurers to avoid liability on the ground of fraud in certain cases, it applies only to a policy that has been certified as proof of financial responsibility under either MCL 257.518 or MCL 257.519.

As a result, the Court held that the Court of Appeals should have followed its prior opinion in *Keys*, which the Court found to comport "with the long-established understanding of fraud in Michigan." Finally, and perhaps most importantly, the Court stressed that to hold insurers to a "different and higher standard" than is required for other parties asserting fraud as a basis for rescinding a contract "would represent a substantial departure from the well-established understanding of fraud." There is no basis in Michigan law, the Court concluded, for "treating insurers differently from all other parties who enter into contracts in this state."

Justice Hathaway, joined by Justices Cavanagh and Marilyn Kelly, dissented, arguing that the "easily ascertainable" rule was "soundly based in existing caselaw and this state's policy regarding automotive liability insurance and compensation for innocent third-party accident victims."

Like the opinion in *DeFrain*, the Supreme Court's decision in *Hyten* demonstrates the Court's firm adherence to traditional contract principles, and its willingness to enforce them when called upon.

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