

Insurance, Misrepresentation, Causation, and Statutory Rescission



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Arkansas's rescission statute, Arkansas Code Annotated § 23-79-107, codifies misrepresentation law and is relevant to applications for life or health insurance. Section 23-79-107 becomes an issue when a policy holder of a life or health insurance policy makes a claim for benefits. The carrier engages in an investigation and discovers evidence the policy holder's attestations of health were incomplete or inaccurate at the time she applied for insurance. The carrier then denies the claim and files an action for rescission, arguing that misrepresentation voids the policy. Alternatively, the carrier denies the insurance claim; the policy holder files an action for breach of contract; and the carrier raises misrepresentation as an affirmative defense.

Both approaches focus on the carrier's reliance to its detriment on the policy holder's (applicant's) misrepresentation of health. That reliance can focus on the general health of the applicant or on the applicant's responses to specific questions about physical infirmities

that increase the risks the policy holder poses. Even the most profoundly ill or injured applicant, who obtains a policy after misrepresenting his health, may still file a claim as a result of a fortuitous accident that has no causal relationship to the misrepresentation that forms the basis for the carrier's rescission argument. Whether the carrier can deny the claim based on a health misrepresentation that has no direct connection to such an accident is a pivot point that has set in motion disparate streams of argument.

Once the carrier's reliance on the applicant's misrepresentation is established according to the applicable standard, the rescission theory matures into a right. The logic of the right is directly tied to the effect of the policy holder's misrepresentation:

The effect of a misrepresentation is to give the insurer the power to avoid, i.e., rescind, the contract, which has long been understood as being tantamount to "wip[ing] out the contract and put[ting]

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the parties back where they were before the contract was made. The practical effect is to give the insurer a defense to coverage In insurance law, if the insurer is resisting the *insured's* claim to coverage, it matters little whether the contract is void or voidable; this is because in either case the insurer is discharged from its obligations—either under the logic that the contract was never formed or that the insurer is entitled to elect to rescind the contract and return both parties to the status quo ante.¹

The rescission remedy is a forceful remedy that denies the policy holder any insurance benefits. Not surprisingly, its availability is frequently litigated. The fact-specific results have created a complex area of law that is challenging to research, articulate, and apply.

The complexity of the arguments, and their legal support, reflects the historical development of misrepresentation law, a blend of 60 years of common law, legislative enactments and amendments, and interpretive case law. Over time, though law makers have subtly shifted the burdens of production and proof, traditional Shepard's and KeyCite have not clearly reflected the more subtle shifts.² By advocacy default, the disparate streams have developed and have obscured or distorted the applicable standards.

These streams trace to a common law dichotomy that separated a “representation” principle and a “warranty” principle. In 1959, when the Arkansas General Assembly adopted the precursor to § 23-79-107, it did so with statutory language that conflated the separate common law concepts. The combination of the warranty and representation concepts in the statute, one concept stated as a general rule and the other as an exception, clouded important distinctions between the two.

The most recent Arkansas Supreme Court decision to consider questions of causation related to a misrepresentation claim did so in the context of Arkansas's pre-1989 rescission statute. In *Southern Farm Bureau Life Insurance Company v. Cowger*,³ a 1988 decision, the court held that the insurer's entitlement to rescission was not dependent on causation between the casualty and the misrepresentation made months earlier in the policy application:

[W]e now conclude that an insurer may defend a policy claim on the ground of a misrepresentation which caused the issuance of the policy but with respect to which the facts or facts misrepresented were not necessarily related to the loss sustained. . . .⁴

1. ROBERT H. JERRY, II & DOUGLAS R. RICHMOND, UNDERSTANDING INSURANCE LAW 770 (4th ed. 2007) (emphasis in original). For a comprehensive discussion of “excuses for insurer's nonperformance,” see *Id.* at 747-813.

2. *Inter-Ocean Cas. Co. v. Huddleston*, 184 Ark. 1129, 45 S.W.2d 24 (1932), superseded by statute as stated in *Dopson v. Metro. Life Ins. Co.*, 244 Ark. 659, 661, 426 S.W.2d 410, 411 (1968); *Nat'l Old Line Ins. Co. v. People*, 256 Ark. 137, 506 S.W.2d 128 (1974), overruled by *S. Farm Bureau Life Ins. Co. v. Cowger*, 295 Ark. 250, 250, 748 S.W.2d 332, 333 (1988).

3. *Cowger*, 295 Ark. 250, 748 S.W.2d 332.

4. *Id.* at 256, 748 S.W.2d at 336 (imbedding its holding in a statement that it would only apply its rule prospectively).

INSURANCE, MISREPRESENTATION, CAUSATION, AND STATUTORY RESCISSION

The 1989 Arkansas General Assembly, in an amendment to § 23-79-107, called *Cowger's* causation holding into question by adding this subsection:

(c) In any action to rescind any policy or contract or to recover thereon, a misrepresentation is material if there is a causal relationship between the misrepresentation and the hazard resulting in a loss under the policy or contract.⁵

Whether the language of § 23-79-107 reinstates the Court's 1974 holding from *National Old Line* (which the *Cowger* court announced it had reversed) bears closer scrutiny. It is plain that *National Old Line's* holding is in direct opposition to *Cowger's*, but how close *National Old Line's* holding is to the language of § 23-79-107(c) is less clear.⁶

The causation issue that divided *National Old Line* and *Cowger* was a matter of statutory interpretation of former § 66-2208.

Although § 66-2208 was briefly recodified under the 1987 code, it is dominantly the 1989 amendments that align with the 1987 code section of § 23-79-107; thus, this Law Note refers to the 1989 version as § 23-79-107. To clarify the difference between the two versions of the statute, the one enacted in 1959 is referred to in this *Law Note* as § 66-2208.

While over 20 years have passed since 1989 and the General Assembly's addition of § 23-79-107(c), only the Arkansas Court of Appeals and a federal district court in the Eastern District of Arkansas have directly considered the meaning and application of § 23-79-107(c) to a live issue. As recently as 2009, the federal district court provided a policy-holder analysis of subsection (c) but declined to explain its analysis after the insurance carrier moved for clarification.

Booth Rand, Chief Counsel, Legal Division, Arkansas Insurance Department, has observed that, while the causation issue might be of interest in the life insurance context, it is of heightened interest in the health insur-

5. ARK. CODE ANN. § 23-79-107(c) (Repl. 2004).

6. See Kathryn H. Vratil & Stacy M. Andreas, *The Misrepresentation Defense in Causal Relation States: A Primer*, 26 TORT & INS. L.J. 832, 838 (1991). Vratil & Andreas quote the 1989 amendment and then comment:

In any action to rescind any policy or contract or to recover thereon, a misrepresentation is material if there is a causal relationship between the misrepresentation and the hazard resulting in a loss under the policy or contract. [citing ARK. CODE ANN. § 23-79-107(c)]

This provision is unique to causal relation legislation. Most causal relations requirements are crafted as a shield, to protect the insured from rescission of coverage after a loss, unless the matter misrepresented actually caused the loss. The Arkansas provision is crafted not as a shield for the insured, however, but as a sword for the insurance company. It does not require proof of a causal relation to rescind, but holds that where a causal relation exists, it is material.

Vratil & Andreas, *supra*, at 838 (comparing, at n. 29, legislation in Puerto Rico).

In 2002, the Arkansas Court of Appeals rejected a carrier-focused argument of this nature, but on the grounds that the chancellor had not made a ruling on the argument. See *Capital Life & Accident Ins. Co. v. Phelps*, 76 Ark. App. 428, 434, 66 S.W.3d 678, 682 n.1 (2002). The *Phelps* court of appeals case was decided on the same facts as a related Arkansas Supreme Court case that focused on the question of law and equity in resolving § 23-79-107 claims. See *Phelps v. U.S. Life Credit Life Ins. Co.*, 336 Ark. 257, 984 S.W.2d 425 (1999).

ance context, both locally and nationally.⁷ A series of discussions with Mr. Rand prompted this study, as well as an update to the 2009 *Law Notes* submission, *Mouse II: Public Policy Issues in Arkansas Insurance Law*.⁸

A non-causation standard would allow the carrier to rescind the policy, even though the actual casualty has no clear relation to inaccurate or incomplete and material information on the policy application. From the carrier's perspective, had the policy holder divulged all material information at the time the policy application was made, the carrier would not have issued the insurance policy and would not have insured any risk related to the policy holder.

To illustrate the attractiveness of the causal relation requirement at casualty – had the *Cowger* court applied its rule to the case before it, it would have affirmed the carrier's denial of coverage to the widow of a tractor accident victim on the grounds that her husband had lied about his health when he applied for the insurance. From the policy holder's perspective, this is an anomalous result. From the carrier's perspective, the lack of a direct causal relationship at the time of the casualty is a surface matter: causation begins at the moment the policy holder applies

for insurance and obtains a policy by supplying incomplete or inaccurate information. According to this logic, the applicant's misrepresentation prompted the carrier to sell a policy to an applicant who was uninsurable or only insurable at a much higher premium.

Perhaps recognizing the incongruity of a result that allowed rescission where the cause of death itself was unrelated to the applicant's misrepresentation, the Arkansas General Assembly enacted Act 662 of 1989, which arguably reinstated the decision the *Cowger* court overruled. That decision was *National Old Line v. People*, a 1974 case that, for rescission, required a causal connection between the misrepresentation and the casualty that led to the policy holder's claim. The *National Old Line* court stated:

Fairness and reason support the view that a causal connection should be essential. Otherwise, when the insured is killed by a stroke of lightning or by being run over by a car, the insurance company could successfully deny liability by showing that the insured was suffering from diabetes when he stated that he was in good health.⁹

7. E-mails from Booth Rand, Chief Counsel, Legal Division, Arkansas Insurance Department, to Kathryn A. Sampson, Assistant Professor of Law, University of Arkansas School of Law (Dec. 29, 2009, 01:41 pm CST) (Dec. 29, 2009, 3:24 pm CST)(on file with author).

8. See Kathryn A. Sampson, *Mouse II: Public Policy Issues in Arkansas Insurance Law*, 2009 ARK. L. NOTES 155-182 (2009). A memorandum that summarizes my discussions with Mr. Rand (and other members of the Arkansas Insurance Department's Legal Division) appears at the end of this Law Note as well as in the SSRN version of the *Mouse II* article, online at: <http://ssrn.com/abstract=1186503> (last visited June 3, 2010).

9. *Nat'l Old Line*, 256 Ark. at 142, 506 S.W.2d at 131.

The difference between the *National Old Line* and *Cowger* interpretation of the same statutory language is a reflection of the common law of warranty and representation which dates back to the late 1800's. The *Cowger* holding set out a rule that resembled the common law warranty standard. The 1974 *National Old Line* decision set out a rule that resembled the common law "mere representation" standard. Salient elements of both standards still exist in misrepresentation law.

I. Common law of warranty and representation (1894-1957)

The 1894 case of *Reutlinger*¹⁰ cogently outlines the dichotomy that is reflected in the conflict between the *Cowger* and *National Old Line* decisions.¹¹ *Reutlinger* provides a common law overview of both 1) the "warranty" type of analysis that tends to favor the carrier, and 2) the "representation" type of analysis that tends to favor the policy holder.

At common law, a choice existed between the contracting parties as to whether the insurance contract and its related application contained warranties or representations:

Statements or agreements of the insured which are inserted or referred to in a policy are not always warranties. Whether they be warranties or

representations depends upon the language in which they are expressed, the apparent purpose of the insertion or reference, and sometimes upon the relation they bear to other parts of the policy or application.¹²

Both the warranty and the representation choices appeared in the first codification of the Insurance Code in 1959, and both appear in the contemporary § 23-79-107. Over time, the applied meaning of these code provisions has shifted from a warranty focus to a representation focus.

A. Warranty Analysis at Common Law

A warranty, also considered an "absolute warranty," is a "stipulation expressly set out" in the contract pursuant to which the policy holder warrants facts in an insurance application to be true. "Its purpose is to define the limits of the obligation assumed by the insurer."¹³ A warranty establishes a requirement of "strict compliance" or "literal fulfillment."¹⁴ Importantly, on the causation question, "[i]t is not necessary that the fact or act warranted should be material to the risk, for the parties by their agreement have made it so."¹⁵ A "warranty" must have been material to the carrier's decision to underwrite the policy in the first instance.

10. *Providence Sav. Life Assur. Soc. v. Reutlinger*, 58 Ark. 528, 25 S.W. 835 (1894).

11. Some would argue that the 1989 amendment to § 23-79-107 should be placed alongside *Nat'l Old Line* in this comparison. However, as noted, one commentary has persuasively suggested that the 1989 amendment that created § 23-79-107(c) is, on its face, a carrier-friendly amendment. *See* Vratil & Andreas, *supra* note 6, at 838. *See also* Capital Life & Accident Ins. Co. v. Phelps, 76 Ark. App. 428, 434, 66 S.W.3d 678, 682 n.1 (2002). *See supra* note 6 (noting related Arkansas Supreme Court decision construing one of the other of the three credit life insurance policies that were at issue in Phelps).

12. *Reutlinger*, 25 S.W. at 836.

13. *Id.*

14. *Id.*

15. *Id.*

The warranty question in *Reutlinger* focused on this colloquy:

“When and by what physician were you last attended, and for what complaint?”

“Never called a doctor in his life.”¹⁶

The *Reutlinger* court held in favor of the carrier and applied a warranty principle to reach its result; it found legal error in the trial court’s jury instruction.¹⁷

Protecting the carrier’s underwriting concerns, the court observed, “[t]he obvious purpose of [this line of questioning] was to ascertain the name of a person from whom information affecting the risk of insuring the life of Reutlinger could be derived. In furtherance of this purpose, he had agreed in this application that any physician who had attended him might disclose any or all information which he acquired by such attendance.”¹⁸ Thus, the *Reutlinger* court focused on causation at the point of application and how the policy holder’s lack of full disclosure “caused” the carrier to write a policy of insurance

where, had it known of the true health facts, it would not have issued the policy or would have issued it at a higher premium.

Two decisions follow *Reutlinger* that also apply a warranty analysis. In 1907, the court reversed a directed verdict in favor of a policy holder where the insurance contract included the language “I [the policy holder] hereby warrant each and every statement herein made or contained to be full, complete, and true.” In this case, evidence suggested the policy holder had not answered fully, and evidence also showed the policy holder had failed to disclose an illness that would have been relevant to the carrier’s decision to accept the policy holder’s risk.¹⁹ The court observed,

Where the matter inquired of would affect the question of the assumption by the company of the risk, then the warranty is material, notwithstanding the death may have been from accident or other cause totally disconnected with the question inquired of. It goes in such instances to the validity of the contract itself.²⁰

16. *Id.*

17. *Id.* at 838. Interestingly, the precise wording of the jury instruction suggested a carrier-oriented analysis, because it stated that a non-disclosed consultation with a doctor must have been for a health complaint “that was serious in nature, and affected [the policy holder’s] constitution or general health.” *Id.* However, the warranty in *Reutlinger* focused on whether the policy holder had ever seen a doctor for any complaint. *Id.* at 836.

18. *Id.* at 839.

19. *Fidelity Mut. Life Ins. Co. v. Beck*, 84 Ark. 57, 104 S.W. 533 (1907).

20. *Id.* at 533.

The underwriting principle was again applied in 1933, when the court reversed a judgment for a policy holder who had obtained a life insurance policy after failing to disclose cancer surgery at the time of her application and later died in an automobile accident. The court firmly stated:

The fact that the untrue warranties had nothing to do with the accident or injury makes no difference, [because] the policy would not have been issued if the true disclosures had been made to the questions asked, and it was not done.²¹

The policy itself contained express warranty language.²²

B. Representation Analysis at Common Law

The *Reutlinger* court recognized that “all reasonable doubts” whether an insurance contract contemplated a warranty or a mere representation “should be resolved in favor of the assured”²³ – mere representation so favors

the policy holder. “Representations” are “no part of the contract of insurance” but rather “collateral or preliminary to it.”²⁴ Representations are “inducements” to contract and not part of the contractual terms; thus,

[u]nlike a false warranty, [representations] will not invalidate the contract because they are untrue, unless they are material to the risks, and need only be substantially true. They render the policy void on the ground of fraud,²⁵

At common law, some insurance contracts were written that expressly allowed for analysis under a “representation” standard.²⁶ And, even where the policy language might have been amenable to a warranty analysis, the courts tended to analyze the cases under representation principles based on the pleadings and argumentation of the carriers.²⁷ In still other cases, even where the carrier properly pled and prosecuted a warranty claim, the court applied representation principles through close reading of contractual language in favor of the policy holder, through the ex-

21. *Royal Neighbors of Am. v. Tate*, 186 Ark. 1138, 57 S.W.2d 1055, 1056 (1933).

22. *Tate*, 57 S.W.2d at 1055.

23. *Reutlinger*, 25 S.W. at 836.

24. *Id.*

25. *Id.* The court continued with a reminder of the warranty construct, “while a noncompliance with a warranty operates as an express breach of contract.”

26. For contracts that allowed for representation analysis, see *Metro. Life Ins. Co. v. Johnson*, 105 Ark. 101, 150 S.W. 393, 395 (1912) (“[T]he language of the application shows that the answers to the questions propounded to [the policy holder] were intended by the parties to be representations merely and not warranties”); *Missouri State Life Ins. Co. v. Witt*, 161 Ark. 148, 256 S.W. 46, 47 (1923) (“The policy sued upon contained the following paragraph: ‘Entire Contract.—This policy and the application therefore constitute the entire contract. All statements made by the insured shall, in the absence of fraud, be deemed representations and not warranties, and no such statement shall avoid the policy, unless it is contained in the written application’”).

27. *Nat’l Annuity Ass’n v. Carter*, 96 Ark. 495, 132 S.W. 633, 634 (1910) (affirming judgment for policyholder, finding the court had properly instructed the jury to consider “whether or not the alleged false misrepresentations were material to the risk”). *Id.* at 635. See also *Johnson*, 150 S.W. at 395 (“The policy itself is the contract for insurance. In the case at bar the policy was not introduced in evidence, and, so far as the record discloses, the application was not inserted in it, nor was it referred to in any way in the policy”).

clusion of evidence, and through fixing of the burden of proof.²⁸ Thus, while the common law allowed for a warranty analysis, courts tended to favor the policy holder and granted relief by engaging in some form of representation analysis.²⁹

The themes that emerge from the common law “representation” cases demonstrate that even where “materiality” of a misrepresentation is presumed, questions of fact exist as to who is responsible for the materially inaccurate responses on the insurance application³⁰ and whether the applicant had knowingly failed to disclose relevant information about an adverse health condition.³¹ As such, the focus on “knowing” failure to disclose injected a fraud-like fact question into the analysis of materiality.³²

In sum, under a common law warranty analysis the causation question focused on the risk elements presented by the prospective

policy holder that would cause the insurance carrier to decline to issue a policy of insurance. Where the applicant warranted she was in good health at the time of application, the causation question focused on whether the policy would have been issued, had the carrier known of the adverse health information that had not been disclosed. By contrast, under a representation analysis, the causation question focused on the actual casualty at the point of the insurance claim (or casualty). Where the policy holder’s casualty has no logical relation to a factual misrepresentation in the original application, the rescission remedy was not available.

Thus, a sturdy body of “representation” case authority that favored the policy holder had been decided by 1959 when the Arkansas Insurance Code came into existence.

28. For courts that reached for representation principles even where the carrier properly pled, see *Nat’l Americans v. Ritch*, 121 Ark. 185, 180 S.W. 488 (1915) (affirming jury verdict for policy holder where close readings of “consultation with a physician” and “ailment” rendered policy holder’s answers to application questions not false for purposes of a warranty analysis); *Inter-Ocean Cas. Co. v. Huddleston*, 184 Ark. 1129, 45 S.W.2d 24, 25 (1932) (affirming judgment for policy holder who failed to disclose treatment for malaria in 1929 and then filed a claim for malaria treatment in 1930, on the grounds that the 1930 malaria was “the result of a new infection,” that there was “no relation whatever between the two attacks” which were “due to separate bites of mosquitoes”) (see *infra* note 78 for a discussion of *Huddleston’s* precedential value).

29. In the three decisions under review, two of the warranty cases were reversed and remanded for new trial (*Reutlinger* (1894) and *Beck* (1907)), and one was decided as a matter of law in favor of the carrier under a warranty analysis (*Tate* (1933)). A due diligence study of all the cases citing *Reutlinger* might produce a slightly more nuanced analysis, but that analysis is not part of this LAW NOTE.

30. See, e.g., *Mut. Reserve Fund Life Ass’n v. Farmer*, 65 Ark. 581, 47 S.W. 850 (1898) (affirming judgment for policy holder where evidence demonstrated an insurance agency had supplied incorrect responses to the insurance application).

31. For pre-1959 common law cases that focus on lack of knowledge in failure to disclose, see e.g., *Aetna Life Ins. Co. v. Mahaffy*, 215 Ark. 892, 224 S.W.2d 21 (1949) (affirming chancellor’s judgment in favor of policy holder where policy holder had not disclosed a diagnosis that his doctor had not disclosed to him, where the diagnosis was of imminent blindness and where the policy holder had applied for a policy that allowed for waiver of premiums in the event of total disability before age 60); *Am. Republic Life Ins. Co. v. Edenfield*, 228 Ark. 93, 306 S.W.2d 321 (1957) (affirming chancellor’s judgment in favor of policy holder where policy holder had died of heart disease and had failed to disclose medical examinations for heart disease, where the policy issued after a medical examination by the carrier’s own physician and where the record reflected the policy holder’s brother had died of heart trouble and the policy holder “appeared to be obsessed with the fear that he might develop this disease”). *Id.* at 98, 306 S.W.2d at 98.

32. Whether the fraud and materiality elements are blended or separate under existing law is noted but not fully developed in this Law Note. It is a relevant consideration in two post-2000 decisions discussed *infra* notes 90-101 and accompanying text.

II. A Warranty Rule in the Arkansas Code, Act 148 of 1959

Arkansas's Insurance Code of 1959 was informed by two sources: the state of the common law discussed above and the uniform law as promulgated by the National Association

of Insurance Commissioners.³³ The Arkansas General Assembly adopted the uniform law, when it passed Act 148 of 1959. Two years earlier, by Act 490 of 1957, the General Assembly had created the Insurance Code Commission and called for a complete revision of existing law.³⁴ The Insurance Code Commis-

33. The commentary to the Uniform Law has not been produced as part of the Arkansas Code Commentaries. The only reference to its etiology thus far uncovered is in Paula J. Casey, *Bad Faith in First Party Insurance Contracts – What's Next?*, 8 UALR L. J. 237, 252 n.82 (1986) (“The Uniform Trade Practices Act is model legislation which was developed by the National Association of Insurance Commissioners. The Act was adopted as Act 148 of 1959 in Arkansas”).

For the multi-faceted roles of the NAIC, see Susan Randall, *Insurance Regulation in the United States: Regulatory Federalism and the National Association of Insurance Commissioners*, 26 FLA. ST. U. L. REV. 625-699 (1999) (concluding the NAIC is “perhaps well-suited to the model law drafting functions, which were its original mission” but identifying problems related to additional duties the NAIC has taken on). *Id.* at 699.

34. 1957 Ark. Acts 490 (approved March 29, 1957).

The introductory language to Act 490 states as follows:

AN ACT to Create the Insurance Code Commission; to Define the Functions, Powers and Duties of the Insurance Code Commission; to Appropriate Funds for the Preparation of an Insurance Code to Be Submitted to the 1959 General Assembly; and for Other Purposes.

WHEREAS, IT HAS BEEN FOUND THAT THE LAWS OF THE State of Arkansas pertaining to insurance are in many instances antiquated and wholly inadequate, and

WHEREAS, the only remedy deemed advisable for the correction of the chaotic condition brought about by the inadequate laws dealing with insurance and insurance companies is a complete revision of said laws, and

WHEREAS, the passage of this bill is necessary for the welfare of the public and is necessary in the public interest . . .”

Id.

As to the impetus for the uniform model code, see *e.g.*, Edmund T. Delaney, *The Future of State Regulation of Insurance*, 1950 INS. L.J. 402-407 (1950); Herbert A. Kuvin, *Would a Uniform Insurance Law or Code Be Advisable?*, 153 INS. L.J. 422-426 (1953); Joseph A. Navarre, *The System of Insurance Regulation by the Several States in The United States*, 1957 A.B.A. SEC. INS. NEGL. & COMP. L. PROC. 203-211 (1957). The circa 1950s sources are available at HeinOnline, <http://www.heinonline.org/> (last visited June 1, 2010).

sion published its preliminary draft in April of 1958.³⁵

The proposed language had been slightly revised and amended in what became section 275 of Act 148 of 1959 (hereafter, also, § 66-3208). Importantly, the misrepresentation grafting appeared in the statute's overview, followed by warranty-like exceptions. Read closely, the statute's warranty exceptions swallowed the preamble's misrepresentation rule. Such a case was made when the scholar D.F. Adams, engaged in an exhaustive analysis of misrepresentation, including a detailed discussion of § 66-3208.³⁶

A. Warranty Case Law under § 66-3208

Immediately after the enactment of § 66-3208, it was a warranty line of statutory interpretation that first developed. The early *Dopson* case was decided squarely in favor of the carrier.³⁷ In *Dopson*, close factual similarities between the reason the policy holder filed the insurance claim and the undisclosed health information existed; both involved back injuries.³⁸ Because the policyholder, a newlywed, credibly disclaimed any knowledge of his wife's pre-existing back troubles when he enrolled his wife in a group hospitalization health policy, the fraud element of

35. ARKANSAS INSURANCE CODE COMMISSION, PRELIMINARY DRAFT OF THE PROPOSED INSURANCE CODE FOR THE STATE OF ARKANSAS (April, 1958). Public Hearings were held Monday, July 14 through Thursday, July 24, 1958. *Id.* at 3-4.

At the hearings each provision of the code will be called up for consideration in its turn. Time will not allow the reading of any provision at the hearing; those in attendance will be expected to have read the proposed provisions and be prepared to offer information or suggestions in a brief and concise manner. Time will not be available for extended debate.

Id. at 4.

After streamlined deliberations, the language that became Arkansas law provided as follows:

SECTION 275. REPRESENTATIONS IN APPLICATIONS. (1) All statements in any application for a life or disability insurance policy or annuity contract or in negotiations therefore, by or in behalf of the insured or annuitant, shall be deemed to be representations and not warranties. Misrepresentations, omissions, concealment of facts, and incorrect statements shall not prevent a recovery under the policy or contract unless either:

- (a) Fraudulent; or
- (b) Material either to the acceptance of the risk, or to the hazard assumed by the insurer; or
- (c) The insurer in good faith would either not have issued the policy or contract, or would not have issued a policy or contract in as large an amount or at the same premium or rate, or would not have provided coverage with respect to the hazard resulting in the loss, if the true facts had been made known to the insurer as required either by the application for the policy or contract or otherwise.

(2) If, in any action to rescind any policy or contract or to recover thereon, any misrepresentation with respect to a medical impairment is proved by the insurer, and the insured or any other person having or claiming a right under the contract shall prevent full disclosure and proof of the nature of the medical impairment, then the misrepresentation shall be presumed to have been material.

Section 257 of Act 148 of 1959 pp. 631-632, codified at ARK. CODE ANN. § 66-3208 (1948, 1957, 1980).

36. See D.F. Adams, *Misrepresentation in Procurement of Insurance: The Arkansas Law*, 4 UALR L. J. 17, 49-85 (1981). Dean Adams's discussion of the plain language of Act 148 of 1959 provided the basis from which the Arkansas Supreme Court reversed itself in the *Cowger*, and that decision inspired this LAW NOTE.

37. *Dopson v. Metro. Life Ins. Co.*, 244 Ark. 659, 660, 426 S.W.2d 410, 410 (1968).

38. *Id.* at 660, 426 S.W.2d at 411.

the 1959 statute (had it been a conjunctive requirement) would have destroyed the carrier's misrepresentation defense. Moreover, had the Code faithfully reflected the common law at the time § 66-3208 was adopted, the rule of *Huddleston* would have required "competent evidence to prove a connection between" the undisclosed back troubles for purposes of the policy application and the injury that led to the insurance benefits claim.³⁹ Stating succinctly that § 66-3208 controlled, the *Dopson* court affirmed the chancellor's decision to admit self-proving evidence by an insurance carrier employee to establish that, had a policy been issued after full disclosure, it would have included a rider to disclaim any coverage for back conditions.⁴⁰

The *Smith* court also concluded that § 66-3208 gave the carrier a reason, independent of the applicant's actual fraud, to rescind the policy where it would not in good faith have issued the policy had it known of the true facts.⁴¹ The *Smith* court averred that under § 66-3208, a material statement that would allow for rescission under the statute must

bear some logical relation to the assumption of the risk.⁴² It explained that materiality under § 66-3208 was separate from any proof of the applicant's actual fraud, stating the conclusion was in accord with the leading authorities:

If it is shown that the misrepresented matter was material to or increased the risk it is immaterial and irrelevant that the insured had acted in good faith without any bad motive or intent to deceive. This means that if a representation is made which is untrue and material it taints the contract, whether fraudulent or not, and if untrue and fraudulent, it taints the contract, whether material or not.⁴³

Smith, thus, separated and distinguished "fraud" from "materiality," a distinction that has been lost in contemporary case law.⁴⁴

When the court in the next year considered a credit life insurance claim, it broadly construed *Smith* to disclaim any focus on the

39. *Id.* ("Under [Act 148 of 1959], our holding in the *Huddleston* case has been modified to the extent that a recovery will be denied where the 'omissions' or 'incorrect statements' are such that the company would not have provided coverage with respect to the hazard resulting in the loss had it known the true facts"). *Id.* at 662, 426 S.W.2d at 411.

40. *Id.* at 662, 426 S.W.2d at 411-12 (holding an affidavit by a supervisor in the carrier's underwriting section established "competent evidence to show [the carrier] would not have provided coverage of [the policy holder's] back had it been advised of [earlier] back trouble").

41. *Life & Cas. Ins. Co. of Tenn. v. Smith*, 245 Ark. 934, 436 S.W.2d 97 (1969).

42. *Id.* at 937, 436 S.W.2d at 99.

43. *Id.* at 938, 436 S.W.2d at 99 (quoting *Couch on Insurance* 2d, § 35:24).

44. See *infra* notes 84-101 (discussing post 1989 amendment case law in the Arkansas Court of Appeals and in the Eastern District of Arkansas).

Smith also provided independent evidentiary analysis the policy holder was both an educated consumer and a dishonest one as to the risk undertaken. *Smith*, 245 Ark. at 938-939, 436 S.W.2d at 99-100.

policy holder's intentionality and concluded the plain language of § 66-3208 entitled the carrier to post-claim analysis of its underwriting risk. Also in *Davis*⁴⁵ and in *Reeves*⁴⁶ the court held for the carrier. Even where the *Reeves* policy holder disclaimed material knowledge that a pre-existing eye condition was cancerous, the Court declined to examine the policy holder's intent at the time of application, distinguishing common law representation precedent.⁴⁷

Thus, consistent with the terms of § 66-3208, the Arkansas Supreme Court's causation analysis centered on the carrier's post-claim causation analysis—that it would not have issued the policy had it known the complete facts. In each case, the casualty itself had a clear connection to the representation upon which the carrier relied for rescission: *Dopson* involved back injuries; *Reeves* involved a cancerous lump and a pre-existing surgery to correct it; *Davis* involved heart disease; and *Smith* involved a host of undisclosed pre-existing illnesses.⁴⁸ The causation

analysis at the point of casualty was straightforward, both at the point of application and at the point of casualty the same pre-existing condition was at issue.

B. Representation Analysis Imported by Alexander (1969)

Where a more attenuated relationship existed between the casualty and the representation at the time of application, even the language of § 66-3208 demonstrated it was amenable to a decision in favor of the policy holder, as was the case in the 1969 decision of *Old Republic Insurance Company v. Alexander*.⁴⁹ While it did not form a central basis for the majority's holding, the concurrence made the casualty-causation point that, while the rescission was sought on the grounds of failure to disclose heart disease, "the condition of [the policy holder's] heart had nothing whatever to do with shooting himself in the leg," the casualty at issue.⁵⁰

45. *Union Life Ins. Co. v. Davis*, 247 Ark. 1054, 1059, 449 S.W.2d 192, 194 (1970) ("[w]e have held that under this statute an insurance contract is tainted when a statement by an applicant which forms the basis for the issuance of the policy is untrue and material to the risk, regardless of whether it is actually fraudulent"). *Id.* (citing *Smith*). The court applied such reasoning to frame the question, "[t]he question involved here then turns upon whether [the policy holder's] statement as to the condition of his health can be considered to be an 'incorrect statement' or an untrue one, and not upon a question of his fraudulent intent, of which there is little evidence." *Id.*

46. *Am. Family Life Assurance Co. of Columbus v. Reeves*, 248 Ark. 1303, 1308, 455 S.W.2d 932, 935 (1970).

47. *Reeves* distinguished the common law case of *Johnson* that had focused on policy holder recovery where the answers were given "to the best of the applicant's knowledge." *Id.* at 1307, 455 S.W.2d at 935. Such an analysis pressed on to the analysis of "fraud" in the context of a misrepresentation analysis.

48. Also aligned with these decisions is the post-*Nat'l Old Line* decision of *Findley v. Time Ins. Co.*, 269 Ark. 257, 599 S.W.2d 736 (1980) (affirming JNOV in favor of carrier in cervical cancer case where policy holder had disclaimed irregularities in her menstrual cycle that she had attributed to menopause; when she was diagnosed with and treated for cervical cancer, the carrier sought rescission of the policy).

49. *Old Republic Ins. Co. v. Alexander*, 245 Ark. 1029, 436 S.W.2d 829 (1969). The court reached this result, notwithstanding its decisions in *Dopson*, *Reeves*, *Davis*, and *Smith* that had been for the carrier.

50. *Id.* at 1043, 436 S.W.2d at 837 (Smith, George Rose, J., concurring).

In *Alexander*, the court turned to the carrier's burden of proof to establish that it "in good faith would not have accepted the risk if correctly apprised of the facts."⁵¹ Affirming the lower court's decree in favor of the policy holder, the court rejected post-claim analysis that non-disclosed heart disease at the time of application activated rescission rights. Focusing on evidence the policy holder affirmatively believed he was free of heart trouble "to the best of his knowledge"⁵² and on evidence the carrier had engaged in variable underwriting practices, the *Alexander* court placed the burden on the carrier "to sustain its contention that the facts not disclosed were material to the risk assumed by it."⁵³ Citing the need for evidence of the carrier's own underwriting standards or "general standards in the underwriting profession or insurance trade by disinterested witnesses,"⁵⁴ the court raised an evidentiary bar that had all but evaporated in the *Dobson* line.

In sum, when the Arkansas General Assembly enacted Act 148 of 1959, it blended and conflated discrete warranty and representation standards that were delineated in the common law. In Act 148 of 1959, the preliminary matter was devoted to the common

law concept of representation:

SECTION 275. REPRESENTATIONS IN APPLICATIONS. (1) All statements in any application for a life or disability insurance policy or annuity contract, or in negotiations therefore, by or in behalf of the insured or annuitant, shall be deemed to be representations and not warranties. Misrepresentations, omissions, concealment of facts, and incorrect statements shall not prevent a recovery under the policy or contract . . .⁵⁵

And the statutory exceptions were devoted to the common law concept of warranty.

. . . unless either:

- (a)Fraudulent; or
- (b)Material either to the acceptance of the risk, or to the hazard assumed by the insurer; or
- (c)The insurer in good faith would either not have issued the policy or contract, or would not have issued a policy or contract in as large an amount or at the same premium or rate, or would not

51. *Id.* at 1034, 436 S.W.2d at 833.

52. *Id.* at 1033, 436 S.W.2d at 832.

53. *Id.* at 1035, 436 S.W.2d at 833.

54. *Id.* at 1039, 436 S.W.2d at 835.

55. 1959 Ark. Acts 148 § 257 (codified at ARK. CODE. ANN. § 66-3208 (1948, 1957, 1980)).

have provided coverage with respect to the hazard resulting in the loss, if the true facts had been made known to the insurer as required either by the application for the policy or contract or otherwise.⁵⁶

When the 1959 General Assembly adopted model legislation that framed “representation” principles as the general rule, and warranty principles as exceptions to the general rule, it created a rescission statute that favored the carrier’s position in litigation.

The use of the disjunctive “or” sealed such a construction. The statute states three bases for rescission. On its face, the statute allows for rescission for (1) fraud, (2) material misrepresentation, and (3) good faith reliance on an applicant’s misrepresentation. Thus, after § 66-3208 was enacted, in cases where the factual connection was strong between the casualty and the misrepresentation at time of the insurance application, it was straightforward to analyze the case under either materiality or carrier good faith principles. The difference between such an analysis and the common law warranty principle is almost im-

perceptible, in the sense that the results show that a warrant of good health translated into a misrepresentation, at least in “like cause” cases.

However, when the misrepresentation lacked a clear connection to the casualty, as in the 1969 case of *Alexander*, the Court engaged in a detailed analysis of the carrier’s burden of proof and then granted relief to the policy holder. As noted, the *Alexander* result was decided under a patchwork statutory law that had conflated the underlying representation and warranty principles. *Alexander* was, however, an isolated policy holder case in a line of carrier decisions that had firmly construed the 1959 statute according to a warranty principle.

C. *National Old Line* (1974): Adoption of Representation Analysis

National Old Line Insurance Company v. People set statutory precedent; it was a case that provided a creative interpretation of § 66-3208 and granted relief to a policy holder. While *National Old Line*⁵⁷ has avowedly been superseded by a subsequent Arkansas

56. *Id.* An additional section that is not directly relevant to this point focuses on active interference with an investigation of a claim:

(2) If, in any action to rescind any policy or contract or to recover thereon, any misrepresentation with respect to a medical impairment is proved by the insurer, and the insured or any other person having or claiming a right under the contract shall prevent full disclosure and proof of the nature of the medical impairment, then the misrepresentation shall be presumed to have been material.

§ 66-3208(2) (1948, 1957, 1980).

57. *Nat’l Old Line*, 256 Ark. 137, 506 S.W.2d 128 (1974).

Supreme Court decision,⁵⁸ its progeny remain on the books as good law and include two decisions from the Supreme Court itself⁵⁹ as well as two decisions from the Court of Appeals.⁶⁰ In the line of cases between 1959 (when § 66-3208 came into existence) and 1974 (when the court decided *National Old Line*), credible proof of causation and reliance tended to focus on self-proving testimony by in-house underwriters, with important limits identified in the 1969 case of *Alexander*. After *National Old Line*, the analysis had shifted to whether the policy holder had actual knowledge of a medical condition that he was then obligated to disclose.

The *National Old Line* court framed the causation question as “whether a misrepresentation will avoid the policy even though it had no bearing upon the [policy holder’s] death or disability.”⁶¹ The insurer had unsuccessfully argued that no causal connection was required by the plain language of § 66-3208. Recognizing that the carrier’s supporting authorities focused on cases decided on facts where “the same ailment which was assertedly concealed by the applicant was also the cause of death or disability,”⁶² the *National Old Line* court identified a statutory causation requirement in this § 66-3208 language:

58. *Cowger*, 295 Ark. 250 at 252-53, 748 S.W.2d 322 at 334 (overruling *National Old Line* on statutory interpretation of § 66-3208 grounds).

59. See *Ford Life Ins. Co. v. Samples*, 277 Ark. 351, 355, 641 S.W.2d 708, 710, (1982) (*Samples*’ subsequent history is for points of factual distinction and not for reliance on *Nat’l Old Line*); *Ford Life Ins. Co. v. Jones*, 262 Ark. 881, 886 563 S.W.2d 399, 402 (1978) (analysis revived by the Court of Appeals in *Burnett* and *McQuay*) (concurring opinion in *Jones* revives his analysis in *Nat’l Old Line*. *Jones* at 402-403 (Harris C.J., concurring)).

The *Samples* court held in favor of a policy holder, finding no causal relation between the casualty and the misrepresentation alleged by the carrier. *Samples*, 277 Ark. 351, 641 S.W.2d 708 (1982). *Samples* was a credit life scenario where the carrier sought rescission on the grounds that the policy holder failed to disclose his 100% disability. Affirming the circuit court’s judgment for the policy holder, the court observed the policy holder’s 100% disability was for “anxiety reaction and chronic brain syndrome” whereas the casualty was caused by “myocardial infarction,” “a disease which was not connected to his total disability condition” and concluded “there was no causal relation between the misrepresentation and the loss.” *Id.* at 355, 641 S.W.2d at 710.

60. See updates to *Ward v. Union Life Ins. Co.*, 653 S.W.2d 153, 156, 9 Ark. App. 131, 137 (1983); *Capitol Old Line Ins. Co. v. Gorondy*, 612 S.W.2d 128, 130, 1 Ark. App. 14, 18 (1981).

The *Gorondy* court reversed and remanded a jury instruction case, clarifying that Arkansas law and the proof at trial required an instruction on “material” and not “fraudulent” misrepresentation. *Gorondy*, 612 S.W.2d at 130, 1 Ark. App. at 17 (regarding Administratrix’s Instruction No. 7). In addition, it held that an instruction should have been submitted that required the insurer to show a causal relation between the policy holder’s alleged misrepresentation and the casualty. *Id.* at 130, 1 Ark. App. at 18 (regarding Defendant’s Instruction No.1).

In *Ward*, the Court held the carrier to an exacting evidentiary standard to establish proof of “a causal relation between [the policy holder’s] misrepresentation and their eventual loss.” *Ward*, 9 Ark. App. 131 at 137, 653 S.W.2d 153 at 156. In so holding, the court reversed a dismissal in favor of the carrier, holding the trial court’s acceptance of “testimony and medical reports brought into evidence by [the carrier’s] underwriter” was an abuse of discretion. *Id.* at 135, 653 S.W.2d at 155.

61. *Nat’l Old Line*, 256 Ark. at 140, 506 S.W.2d at 130.

62. *Id.* at 140, 506 S.W.2d at 130 (citing *Old Am. Life Ins. Co. v. McKenzie*, 240 Ark. 984, 403 S.W.2d 94 (1966) (back trouble stemming from spinal fusions); see also *Dobson*, *Smith* (1969), *Davis*, *Reeves*; *Am. Pioneer Life Ins. Co. v. Turman*, 254 Ark. 456, 495 S.W.2d 866 (1973) (cancer which proved fatal); *Am. Pioneer Life Ins. Co. v. Smith*, 255 Ark. 949, 504 S.W.2d 356 (1974) (heart trouble which proved fatal).

[t]he insurer in good faith . . . would not have provided coverage with respect to the hazard resulting in the loss, if the true facts had been made known.⁶³

The court supported its statutory reading with reference to a clear casualty-causation case (*Dobson*),⁶⁴ a policy of “fairness and reason” that required a causal connection,⁶⁵ and the “credit life” nature of the policy at issue – a recurrent fact that favors the policy holder.⁶⁶

Justice Byrd’s dissent in *National Old Line* highlighted both the type of statute that Arkansas had adopted in § 66-3208 as well as causation from the carrier’s perspective. As to the statute, Justice Byrd stated:

Every state with a statute similar to our statute has construed theirs to mean that a misrepresentation as to a material matter renders a policy voidable at the election of the insurer without a showing that the misrepresentation had a causal connection with the loss claimed under the policy.⁶⁷

Justice Byrd further analyzed the relevance of an incontestability clause⁶⁸ and reviewed evidence of a factual connection between the policy holder’s claim and the misrepresentation at the time the policy was obtained. Justice Byrd then cited a doctor’s assessment that “chronic renal failure and arteriolar nephrosclerosis are the end result of diabetes and hypertension,”⁶⁹ ailments that the policy

63. *Nat’l Old Line*, 256 Ark. at 140, 506 S.W.2d at 130 (§ 66-3208 language).

64. *Id.* at 141-42, 506 S.W.2d at 130-31 (*Dobson* analysis).

65. *Id.* at 142, 506 S.W.2d at 131. The court set up as an example for this fairness policy the odd case of an insured killed by a car whose coverage is denied because the post-claim analysis demonstrated that he was not in good health at the time he applied for the insurance.

66. *Id.* at 142, 506 S.W.2d at 131 (“credit life insurance policy”). The *National Old Line* court developed an analysis of the lack of pre-claim underwriting in the credit life context:

This was a short-term policy, to remain in force for only three years. The company made no medical examination of the applicant, relying upon him either to refuse to sign the application if he was not in good health, in which case the policy would never be issued, or to “clip a note” to the application, explaining his health condition. The appellant had the burden of proving its affirmative defense, but it made no effort to show that the automobile salesman who took People’s application made any explanation of the printed form or of the significance of the representation of good health. If People had lived for three years the insurer would have sustained no loss. In the circumstances it is plainly unjust to permit the company to deny liability on the basis of a misrepresentation that had no connection with People’s death (or so the jury might have found) and that would have provided no defense to the insurer if the policy had excluded coverage for loss resulting from the undisclosed ailments.

Id.

67. *Id.* at 145, 506 S.W.2d at 132-33 (Byrd, J., dissenting) (discussing statutes from Georgia, Louisiana, Nebraska, and South Dakota as well as commentators explaining their pertinent points).

68. *Id.* at 147, 506 S.W.2d at 133 (Byrd, J., dissenting) (the relevance of the incontestability clause, he stated, was to prevent any apparent injustice caused by the streamlining of the process of issuing insurance products).

69. *Id.* at 147, 506 S.W.2d at 134 (Byrd, J., dissenting) (“chronic renal failure” and its precursors).

holder had failed to disclose. By contrast, the majority focused on the fact that at the time the policy was issued the policy holder had “diabetes” and “high blood pressure” which the majority concluded were remote from the actual cause of death.⁷⁰

D. *Cowger* (1988) – Statutory Construction of § 66-3208, and Stated Reversal of *National Old Line*

Under the *National Old Line* principle, Arkansas courts enforced a standard that favored the policy holder, a standard that required causation between the casualty and the misrepresentation. These courts also required the carrier to prove with strong evidence the carrier’s reliance on the applicant’s misrepresentation, a burden of proof that required evidence beyond in-house testimony by the carrier’s own underwriters. *Cowger*, in 1988, shifted course.

The *Cowger* policy holder had been killed in a tractor accident, after having taken out a \$100,000 life insurance policy to obtain farm improvement credit. The carrier denied the claim after its investigation revealed the policy holder had been diagnosed with, but had not disclosed in his a policy application, acute alcoholism.⁷¹ The court surveyed its *National Old Line* authorities⁷² and evaluated the *National Old Line* policy reflected in them:

Regardless of misrepresentation which causes the insurer to undertake a risk, liability will occur unless the loss is related to the fact misrepresented. This places the policy applicant in the position of being able to gamble that he or she will not sustain a loss caused by the existence of the fact misrepresented. The misrepresentation may or may not have an effect. The party defrauding the insurance company may or may not be rewarded.⁷³

Focusing, then, on the honest applicant, the court observed:

On the other hand, the honest applicant who has the same facts to reveal will be denied insurance because of telling the truth.⁷⁴

Surveying the balance of equities, the court stated:

It may be that these policy considerations balance each other. We might even conclude, if it were up to us, that the fairness and justice considerations do come down somewhat on the side of the insured who has lied in order to obtain coverage. Our point is, however, that the decision has been made by

70. *Id.* at 139, 506 S.W.2d at 129.

71. *Cowger*, 295 Ark. at 251, 748 S.W.2d at 333.

72. *Id.* at 254-55, 748 S.W.2d at 335 (court of appeals applied the causation requirement to “regular term life insurance” policies).

73. *Id.* at 255, 748 S.W.2d at 335.

74. *Id.* at 255, 748 S.W.2d at 335.

the body properly charged with making such decisions, that is, the general assembly. We incorrectly ignored their decision in the *National Old Line* case and we now correct our error.⁷⁵

Deferring to the Arkansas General Assembly that had passed Act 148 of 1959, the court held:

We now conclude that an insurer may defend a policy claim on the ground of a misrepresentation which caused the issuance of the policy but with respect to which the fact or facts misrepresented were not necessarily related to the loss sustained.⁷⁶

The court observed that its rule, the General Assembly's rule as reported by D.F. Adams, was the rule adopted by seventeen of the states.⁷⁷

In dissent, Justice Hays, citing the court's 1932 decision in *Huddleston*, observed that the causation-at-casualty rule predated Act 148 of 1959.⁷⁸ He further observed that any burden on the insurance carriers would be passed through premium increase, concluding the General Assembly's lead in the 12 years since the *National Old Line* decision had been to acquiesce to the court's *National Old Line* rule.⁷⁹

III. Arkansas's Current Statute, Act 662 of 1989, as codified at § 23-79-107

Cowger was decided in April of 1988. In January of 1989, Senator Hopkins introduced Senate Bill 91. As stated in the Arkansas Daily Legislative Digest, Senator Hopkins's Bill 91:

[r]equire[d] both conditions (1) (material to acceptance or risk or hazard) and (2) (insurer would not have issued policy in as large an amount or at same rate) to deny recovery under the policy (was either/or). Adopted.⁸⁰

Further into the session, Senator Hopkins amended the bill to substitute language:

to reaffirm the intention of the General Assembly to assure that no insurer may defend a policy claim on the grounds of misrepresentations unless related to the loss sustained. Adopted.⁸¹

A preamble to Act 662 of 1989 identifies the law as:

AN ACT to Clarify the Insurance Code and to Reaffirm the Intention of the General Assembly to Assure that No Insurer May Defend a Policy Claim

75. *Id.* at 255, 748 S.W.2d at 335-36.

76. *Id.* at 256, 748 S.W.2d at 336.

77. As noted, Act 148 of 1959 was created through the use of a uniform model law proposed by the National Association of Insurance Commissioners. *See supra* note 33.

78. *Cowger*, 295 Ark. at 258, 748 S.W.2d at 337. *Huddleston* had been red flagged by the *Dopson* case in 1968. *See Dopson v. Metro. Life Ins. Co.*, 244 Ark. 659, 661-662, 426 S.W.2d 410, 411 (1968) (“[In *Huddleston*], we held that a misrepresentation would not void liability under a policy unless the failure to disclose was material to the risk involved. Under § 66-3208, *supra*, our holding in the *Huddleston* case has been modified . . .”).

79. *Id.* at 258-59, 748 S.W.2d at 337-38 (Hays, J., dissenting).

80. ARKANSAS DAILY LEGISLATIVE DIGEST, (A-10, January 18, 1989).

81. ARKANSAS DAILY LEGISLATIVE DIGEST, (A-66, March 20, 1989).

INSURANCE, MISREPRESENTATION, CAUSATION, AND STATUTORY RESCISSION

on the Grounds of Misrepresentations Unless Related to the Loss Sustained; and for Other Purposes.⁸²

As well, the 1989 Act includes a specific subsection devoted to causation:

(c) In any action to rescind any policy or contract or to recover thereon, a misrepresentation is material if there is a causal relationship between the misrepresentation and the hazard resulting in a loss under the policy or contract.⁸³

Since the passage of this subsection in 1989, litigants have continued to argue or apply the logic of both *Cowger*⁸⁴ which has been superseded by § 23-79-107 (but has not been red-flagged by Shepards or KeyCite) and *National Old Line* which has been overtly overruled (and red-flagged by the services).⁸⁵

These oppositional arguments, based on latent ambiguity in the authorities, illuminate a serious and pressing question about what the applicable standard is, especially now that § 23-79-107 applies in the health insurance context. The post-1989 courts that have squarely considered § 23-79-107 demonstrate the courts are ruling in favor of the policy holders; nevertheless, cogent carrier arguments persist.

A. Raising the stakes, Act 1604 of 2001 (adding accident and health insurance to the rescission statute's coverage)

Almost imperceptibly, Act 1604 of 2001 raised the stakes by adding accident and health insurance to the rescission statute's coverage. The relevant section now reads:

82. 1989 Ark. Acts 662 at 1589-1590 (codified at ARK. CODE ANN. § 23-79-107 (Repl. 2004)).

83. *Id.*

84. In *Carmichael v. Nationwide Life Ins. Co.*, 305 Ark. 549, 810 S.W.2d 39 (1991), the Court affirmed summary judgment in favor of the insurer, applying the *Cowger* standard. In *Carmichael*, an insulin-dependent diabetic who had not disclosed his condition when applying for life insurance obtained a policy that was subject to the rescission statute, pre-1989 amendment. The court affirmed the carrier's summary judgment, declining to retroactively apply Act 662 of 1989. *Id.* at 554, 810 S.W.2d at 42. The court denied the policy holder the opportunity to litigate whether a causal connection existed between the diabetes that was not disclosed and the casualty which was congestive heart failure. *Id.* at 551, 810 S.W.2d at 40.

While *Carmichael* focuses on a non-retroactivity rationale, the Eighth Circuit has held for the insurance carrier on the related theory of concealment at the time the policy was purchased, in the property insurance context. *See Willis v. State Farm Fire & Cas. Co.*, 219 F.3d 715 (8th Cir. 2000).

Also, in contravention of a series of cases that suggest the carrier will be held to a heightened standard of proof of its reliance pursuant to the misrepresentation/rescission statute, *see Morgan v. S. Farm Bureau Cas. Ins. Co.*, 88 Ark. App. 52, 56, 200 S.W.3d 469, 472 (2004) (affirming insurer's summary judgment where its evidence was based on self-proving, but uncontroverted, affidavits from the carrier's underwriter).

85. *Nat'l Old Line*, 256 Ark. 137, 506 S.W.2d 128, overruled by *Cowger*, 295 Ark. 250, 250, 748 S.W.2d 332, 333.

(a) All statements in any application for a life or accident and health insurance policy or annuity contract or in negotiations therefore, by or in behalf of the insured or annuitant, shall be deemed to be representations and not warranties. . . .⁸⁶

The substitution of “accident and health” insurance for the former “disability” term raises the concerns that brought *Mouse II* to the Arkansas Insurance Department’s attention,⁸⁷ prompting my initial phone conversation with Booth Rand and then this study. Mr. Rand also anticipated a complex of changes to take place should National Health Care Reform pass into law.

Of course, since our conversations in December of 2009, National Health Care Reform⁸⁸ was signed into law, and repercussions for the state regulation of health insurance are just being imagined. Federal regulation of pre-existing health conditions will impact state misrepresentation law, but the contours of this impact are yet to be clarified.⁸⁹

B. Judicial Interpretation of Contemporary § 23-79-107

Assuming state regulation of personal life and health insurance will continue in some form after National Health Care Reform, § 3-79-107 and its related case law need judicial clarification. Current case law that

86. Act 1604 of 2001, codified at § 23-79-107(a) (Repl. 2004).

87. See *supra* notes 7-8 and accompanying text (summarizing discussions with Booth Rand). See also *infra*, appendix B (explanatory memorandum reflecting discussions with Booth Rand and attorneys in the legal division of the Arkansas Insurance Department).

88. See The Patient Protection and Affordable Care Act, P.L. 111-148, 124 Stat. 119, HR 3590 (March 23, 2010), and the Health Care and Education Reconciliation Act of 2010, P.L. 111-152, 124 Stat. 1029, HR 4872 (March 30, 2010).

89. See *e.g.*, Susan M. Cover, *Uninsured to get help in federal funding*, 2010 WLN R 10549966, Portland Press Herald B1 5/21/10; David Glaser, et. al, *Navigating National Health Care Reform: What Every Employer Should Know*, 2010 WLN R 9227044, Monday 5/4/10.

On the topic of this LAW NOTE is an ERISA case, holding squarely in favor of the insurance carrier in a season when the courts are reaching for analysis to favor the policy holder. See *ShIPLEY v. Ark. Blue Cross & Blue Shield*, 333 F.3d 898, 903-04 (8th Cir. 2003) (“[g]iven the federal courts’ authority under ERISA to create a uniform body of federal common law, . . . we do not agree with the district court’s assumption that the Arkansas statute, Ark. Code Ann. § 23-79-107 , , , automatically controls in the absence of an explicit ERISA provision. Nevertheless, because the Arkansas statute is consistent with the federal common law approach . . . we agree with the district court that the proper inquiry . . . is whether [the policy holder’s] answers on the enrollment form were material misrepresentations”).

interprets § 23-79-107 is limited to a handful of decisions: three court of appeals cases and one federal district court decision. Of the three court of appeals decisions,⁹⁰ the 2003 decision of *McQuay v. Arkansas Blue Cross and Blue Shield* most fully sets out historical movement in Arkansas's misrepresentation law as well as strong markers for how the case law decided under prior law retains continuing vitality.

The *McQuay* court reversed summary judgment in favor of the carrier, even where

the policy holder had failed to disclose evidence of COPD [Chronic Obstructive Pulmonary Disease] and where the policy holder had died of lung cancer about a year after the health insurance policy was issued.⁹¹ The *McQuay* court considered "like cause" case law which, in the period between the Act 148 of 1959 and *National Old Line* had been decided in favor of the carrier.⁹² The *McQuay* court, however, also considered evidence the policy holder lacked actual knowledge of his medical condition at the time of application; in

90. Two of these three court of appeals decisions are summarized here in the notes. As with *McQuay*, these decisions were in favor of the policy holder.

In *Capital Life & Accident Ins. Co. v. Phelps*, 76 Ark. App. 428, 431-432, 66 S.W.3d 678, 680 (2002), the Court of Appeals affirmed a chancery court judgment in favor of the policy holder for recovery of proceeds from three credit life insurance policies, notwithstanding the carrier's misrepresentation defense. The chancellor found in favor of the policy holder and specifically found: The terms "good health" and "poor health condition" in the policy applications "were ambiguous and that the term 'chronic disease', while not ambiguous, was unclear." *Id.* at 432, 66 S.W.3d at 680. Further, the court did not accept the carrier's testimony that it would not have issued the policy had it known the true facts, because such testimony was "after the fact." *Id.* The *Phelps* court emphasized that the rescission statute set out an affirmative defense, for which the carrier bore the burden of pleading and proof.

Interestingly, the carrier in *Phelps* suggested a defense-oriented use for the 1989 amendment of subsection (c) when it argued that the policy holder's misrepresentation was "material because [the casualty] was causally related to the matters misrepresented." *Id.* at 434 n.1, 66 S.W.3d at 682 n.1 (citing § 23-79-107(c)). The court disposed of the argument on the grounds that the chancellor had not had the opportunity to rule on the argument and on the ground that the evidence was in dispute on the point. *Id.*

In the 2003 decision of *Burnett v. Philadelphia Life Insurance Company*, 81 Ark. App. 300, 101 S.W.3d 843 (2003), the court of appeals reversed and remanded summary judgment in favor of the insurer. *Id.* at 307-308, 101 S.W.3d at 848. In factual support of its conclusion, the court highlighted details that demonstrated a causal disconnect between the Marfan's Syndrome that led to the casualty and the nondisclosure of treatment for bronchitis. *Id.* The court demonstrated the continuing vitality of the 1969 *Alexander* case on the problems of proof of the materiality of the risk as well as its own *Phelps* decision. *Id.* at 307, 101 S.W.3d at 848 (analyzing *Alexander* and *Phelps*).

91. *McQuay v. Ark. Blue Cross & Blue Shield*, 81 Ark. App. 77, 80, 98 S.W.3d 454, 456 (2003).

92. These cases were decided in favor of the insurance carrier: *Dopson*, 244 Ark. 659, 426 S.W.2d 410 (back problems basis for the misrepresentation and the casualty); *Smith*, 245 Ark. 934, 436 S.W.2d 97 (high blood pressure/uremia, no proof of knowingly and fraudulently misrepresentation required); *Union Life Ins. Co. v. Davis*, 247 Ark. 1054, 449 S.W.2d 192 (1970) (chest pains known to applicant/casualty caused by heart attack).

so doing, the *McQuay* court moved the analysis toward a “fraud” requirement,⁹³ even though it carefully delineated fraud analysis and took care to consider intent only insofar as questions on the policy application were designed to elicit answers based on the applicant’s personal knowledge. After highlighting the common law case of *Edenfield*, and distinguishing it from the 1980 decision of *Findley*, the *McQuay* court observed:

We think that these two cases stand for the proposition that, when an applicant is asked to respond to a question to the best of his knowledge and belief, his actual knowledge and belief concerning his condition are relevant. [citing persuasive case authorities from the Eleventh Circuit, Florida, and Virginia].

In light of the above, we hold that a fact question remains as to whether [the policy holder] made an incorrect statement in

93. Whether the 1989 revision set out fraud as an independent policy holder basis to destroy a carrier’s misrepresentation defense is not clear. Much case law has developed on the point of a material difference between the concept of “materiality” of a misrepresentation and “fraud.”

A simpler dichotomy is reflected in the differences between *National Old Line* and *Cowger* that prompted the General Assembly to act in 1989.

The *McQuay* court fixed on the term in the policy application, “to the best of his knowledge and belief” to engraft a factual analysis into the actual state of mind of the applicant at the time he applied for the policy. The *McQuay* court moved to the statutory assertion that “before subsection (a) grounds may be successfully asserted, it must first be shown that the applicant has made a misrepresentation, omission, concealment of facts, or incorrect statement.”

McQuay, 81 Ark. App. at 84-85, 98 S.W.3d at 459. The need for this preliminary proof is on the face of current statute:

(a) All statements in any application for a life or accident and health insurance policy or annuity contract or in negotiations therefore, by or in behalf of the insured or annuitant, shall be deemed to be representations and not warranties. Misrepresentations, omissions, concealment of facts, and incorrect statements shall not prevent recovery under the policy or contract unless either:

- (1) Fraudulent;
- (2) Material . . .
- (3) The insurer in good faith would not have issued the policy . . . if the facts had been made known to the insurer as required by the application for the policy . . .

ARK. CODE ANN. § 23-79-107(a) (Repl. 2004). The material in the preamble at (a) states the proposition that precedes the grounds for rescission (e.g., (1) fraud, (2) materiality, (3) insurer good faith).

The *McQuay* court highlighted the Supreme Court’s *Findley* (1980) and *Edenfield* (1957) cases for a standard that allows for evidence that the applicant responded truthfully, though ultimately inaccurately, when she answered questions “to the best of her knowledge and belief.” 81 Ark. App. at 85, 98 S.W.3d at 459. Under the *McQuay* analysis, the presence of a clear connection between the casualty and the representation on the insurance applicant is insufficient to entitle the carrier to rescission under the standard. The carrier must also prove a knowing misrepresentation on the part of the policy holder. The *McQuay* concurrence, concerned about the practical effect of this holding emphasized the Arkansas Supreme Court’s 1969 statement in *Smith* (quoting Couch on Insurance) for these propositions:

“If it is shown that the misrepresented matter was material to or increased the risk it is immaterial and irrelevant that the insured had acted in good faith without any bad motive or intent to deceive. This means that if a representation is made which is untrue and material it taints the contract, whether fraudulent or not, and if untrue and fraudulent, taints the contact, whether material or not.”

81 Ark. App. at 87-88, 98 S.W.3d at 461 (Vaught, J., concurring). The concurrence then reviewed the Arkansas Supreme Court’s case law between the 1959 act and its 1974 decision in *National Old Line* to reach the synthesis that “[t]he applicant’s subjective belief about his health does not make a statement about his health any more or less correct.” *Id.*

his answer on the application. We observe that, in addition to . . . testimony that [the policy holder] was unaware of his condition, [the doctors'] progress note . . . mentions only "some degree of [material pre-existing condition]," . . . [and the policy holder] was not necessarily aware of his diagnosis. Thus, a jury might conclude that, to the best of [the policy holder's] knowledge and belief, he had not been diagnosed with [a material pre-existing condition].⁹⁴

This carefully constructed movement to evidence of intent, framed in the context of the application's language, illustrates how readily analytical challenges arise when analysis of misrepresentation and fraud is blended.

Perhaps illustrating the mischief of such blending, a like-cause case was decided in favor of the policy holder in the most recent case on point, an unreported opinion in the Eastern District of Arkansas – *Osborne v. Farmers New World Life Insurance Company*.⁹⁵ In *Osborne*, the district court declined to grant summary judgment to the carrier where the policy holder had purchased a \$50,000 term life insurance policy about two weeks prior to his death. His death certificate stated that the cause of death was unknown but that con-

tributing conditions included Post Traumatic Stress Disorder (PTSD). The carrier sought rescission on the basis of evidence the policy holder knew he had PTSD a month before his application, but he had not disclosed PTSD on his policy application.⁹⁶

The *Osborne* court rejected the carrier's argument that the 1989 amendment must be read in the context of the statute as a whole and in such a manner as to harmonize with the Supreme Court's 1988 decision in *Cowger*.⁹⁷ The carrier had argued that *Cowger* reversed the *National Old Line* decision, and the *Osborne* policy holder's argument, thus, was grounded on the logic of an abandoned legal principle.⁹⁸ In rejecting the carrier's argument and accepting the policy holder's, the *Osborne* court engaged in a brief review of the judicial and legislative history surrounding Act 662 of 1989, focusing on the subsection (c) language:

(c) In any action to rescind any policy or contract or to recover thereon, a misrepresentation is material if there is a causal relationship between the misrepresentation and the hazard resulting in a loss under the policy or contract.⁹⁹

94. *McQuay*, 81 Ark. App. at 85-86, 98 S.W.3d at 459-460.

95. *Osborne v. Farmers New World Life Ins. Co.*, No. 4:08 CV000250 BSM, 2009 WL 1098943 (E.D. Ark. Mar. 31, 2009).

96. *Id.* at *1.

97. *Id.* at *3.

98. *Id.*

99. ARK. CODE ANN. § 23-79-107 (c) (Repl. 2004).

The court concluded that subsection (c) is “plain and unambiguous” and requires an insurer to establish a causal relationship between the misrepresentation in the insurance application and the resulting loss.¹⁰⁰ The *Osborne* court denied summary judgment on the grounds that a fact question remained on the causation issue; this result aligns with *McQuay*, also a summary judgment case.

A practical reading of both *Osborne* and *McQuay* suggests the § 23-79-107(c) causation requirement creates a fact question that must be decided by a jury. Still, because it was a federal district court on the one hand, and the Arkansas Court of Appeals on the other that issued these decisions, *Osborne* and *McQuay* also suggest the causation issue is ripe for the Arkansas Supreme Court to consider and clarify. Notably, two months after its denial of summary judgment, the *Osborne* court declined to issue an advisory opinion, in response to the carrier’s motion for clarification.¹⁰¹

IV. Litigation under Ark. Code Ann. § 23-79-107, as amended by Act 662 of 1989—Demonstrating a Need for Judicial Clarification

Facially simple when considering the plain language of § 23-79-107, Arkansas’s

misrepresentation law sets out several analytical challenges related to its causation requirement. These challenges are in part a result of the amorphous nature of any causation analysis but also reflect the evolution of the Arkansas’s misrepresentation law over a period of years. This evolution took place over 60 years of common law development, a statutory enactment in 1959, development of case law, a seminal case that changed course in 1974, further development of case law, another case that changed course in 1988, a legislative amendment in 1989, and 21 years of undeveloped analysis of the General Assembly’s last legislative amendment.

The early common-law principles of warranty and representation, both in the construction of statutory language and in judicial interpretation of that statutory language, have played a role. The subtleties of legal updates in KeyCite or Shepards, and in most cases the complete absence of such updates, suggest to party litigants that case law at any point in this evolution is still good law. Even the two decisions that have been tagged as overruled or superseded have been revived by subsequent opinions – by a dissenter in *Cowger* and by the Eastern District of Arkansas in 2009.¹⁰² Thus, development and clarity of the misrepresentation precedent doubles back and re-embraces formerly disbanded

100. *Osborne*, 2009 WL 1098943 at *4.

101. *Osborne v. Farmers New World Life Ins. Co.*, 2009 WL 1405460 (E.D. Ark. May 19, 2009).

102. *See Huddleston*, 184 Ark. 1129, 45 S.W.2d 24, superseded by statute as stated in *Dopson*, 426 S.W.2d 41, 411, 244 Ark. 659, 661, and revived by dissenting judge in *Cowger*, 748 S.W.2d 332, 337-338, 295 Ark. 250, 258 (1988) (Hayes, J., dissenting). And more importantly, see *Nat’l Old Line*, 256 Ark. 137, 506 S.W.2d 128 (1974), overruled by *Cowger*, 478 S.W.2d at 332, 295 Ark. at 250, and revived by *Osborne*, 2009 WL 1098943 at *3 (E.D. Ark. 2009). See also case law applying *Nat’l Old Line* prior to the *Cowger* decision as this case law has not been expressly overruled or modified. *E.g.*, *Samples*, 641 S.W.2d 708, 710, 277 Ark. 351, 355; *Jones*, 563 S.W.2d 399, 402, 262 Ark. 881, 886; *Ward*, 653 S.W.2d 153, 156, 9 Ark. App. 131, 137; *Gorondy*, 612 S.W.2d 128, 130, 1 Ark. App. 14, 18. Moreover, the *National Old Line* authorities have surfaced in two additional (in addition to *Osborne*) federal district court cases in the Eastern District of Arkansas: Brief in Support of Plaintiff’s Response to Defendant’s Motion for Summary Judgment, in *Wood v. Valley Forge Life Ins. Co.*, No. 4-5-CV-00124 JMM, 2006 WL 12363 (E.D. Ark. Jan. 31, 2006); Plaintiff’s Second Motion in *Limine*, in *Mays v. Reassure Am Life Ins. Co.*, No. 4-03-CV-00209GH WKU, 2006 WL 3553555 (E.D. Ark. Sept. 9, 2004).

principles. Extant case law demonstrates vestiges of overruled or formerly “abandoned” analyses have continuing vitality.

Where words fail, a visual may assist. Appendix A to this *Law Note* charts the evolving law, both according to time and according to advocacy perspective. The markers of the 1959 and 1989 Acts, as well as the decisions in *National Old Line* and *Cowger*, provide structure to the historical progression.

The survival of cogent carrier-arguments even after Act 662 of 1989 strongly suggests the Arkansas Supreme Court should take the opportunity it did not have in 1991 to pass on the meaning of Arkansas’s contemporary § 23-79-107. In 1991, the Court affirmed summary judgment in favor of the carrier, rejecting the policy holder’s argument that § 23-79-107(c) changed Arkansas law to require a causal connection between the casualty and the misrepresentation. Procedurally, subsection (c) was not in effect at the time the policy holder completed the relevant insurance application; thus, when the litigation reached the appeals court, the issue was only noted to exist for some future case.¹⁰³

“Causation” has at least a two-sided meaning in the context of the statutory rescission misrepresentation defense: the application/underwriting causation on the one hand, and the application/casualty causation on the other. Analytical difficulty perhaps arises because one expects the carrier to engage in detailed analysis of the risk at the time the application for the policy is taken.¹⁰⁴ Since 1989, the case law has focused on application/casualty causation and has favored the policy holder.

The analysis, then, has moved on to a next question: whether the reason for the casualty was known to the applicant. Though carefully framed in terms of how a policy application’s wording focused on “to the best of the applicant’s knowledge,” the move to an examination of the applicant’s intentionality presses close to an analysis of what looks like a “fraud” question. As a matter of statutory construction, a strong argument exists that the statutory “fraud” basis for rescission is separate and distinct from the material misrepresentation and good faith analyses. Where the court focuses on whether the pol-

103. See *Carmichael v. Nationwide Life Ins. Co.*, 305 Ark. 549, 554-555, 810 S.W.2d 39, 42 (1991) (stating the carrier’s “right to deny coverage under the law then in effect is a substantive right. Legislation which changes substantive rights does not operate retroactively . . . thus, the provision added by Act 662 of 1989 is not applicable to this case”).

104. A law and economics rationale explains why the carrier does not engage in a detailed analysis until post-claim, as observed by Justice Byrd in his *National Old Line* dissent:

Under our law as it existed before the 1959 Insurance Code, life insurance could not be economically written without the costly and cumbersome procedure of going through a medical examination to weed out persons who waited until they were uninsurable before making application. However, the code through what is now ARK. STAT. ANN. § 66-3208 permitted life insurance to be written without a medical examination. To prevent the seeming injustice that would arise when an individual has paid premiums for a considerable time and during which time the insurer has had the benefit of the premiums, the code also contains a relatively short incontestability clause – see ARK. STAT. ANN. § 66-3304 (Repl. 1966).

Natl Old Line, 256 Ark. at 147, 506 S.W.2d at 133 (Byrd, J., dissenting).

icy holder had actual knowledge of the condition which was concededly material to the carrier's decision to assume the risk and issue a policy, a judicial gloss on the statutory requirements provides the basis for creative policy holder arguments. Likewise, latent ambiguity in § 23-79-107(c) suggests carrier-oriented analysis that has not fully been considered.

Counsel has an opportunity to help clarify the law in this area.¹⁰⁵

As noted, the post-*Cowger* statutory amendment has not yet been tested by the Arkansas Supreme Court. The 1969 decision of *Old Republic Insurance Company v. Alexander*¹⁰⁶ sets out a template related to problems of proof;¹⁰⁷ *Alexander* has maintained its role as a leading authority. With its continu-

ing vitality, *Alexander* may serve as a good starting point from which the Arkansas Supreme Court could develop its assessment of the post-1989 meaning of § 23-79-107(c).

Reconciling the lines of authority on the question of misrepresentation, even with a statute designed to clarify its meaning, is a challenging task. One commentator published 75 pages in an encyclopedic attempt to explain the concept of misrepresentation.¹⁰⁸ As noted, the sub-points and the cross-currents in misrepresentation law tend to conflate. This blending and overlapping of discrete concepts was perhaps engineered by the 1959 Act's blending of these common law principles. The contemporary advocacy problems that arise because of that blending are considerable. In a recent briefing,¹⁰⁹ attorneys

105. A good beginning point to develop an understanding of these authorities is Chapter 10 of ROBERT H. JERRY, II & DOUGLAS R. RICHMOND, *UNDERSTANDING INSURANCE LAW*, pp. 747-813 (4th ed. 2007). Shorter periodical sources include Thomas F. Segalla & Carrie P. Parks, *Misrepresentations In Insurance Applications: Dangers in Those Lies*, 73 DEF. COUNSEL J. 118-128 (2006); Gary Schuman, *Health and Life Insurance Applications: Their Role in the Claims Review Process*, 62 DEF. COUNSEL J. 226-243 (1995); Kathryn H. Vratil & Stacy M. Andreas, *The Misrepresentation Defense In Causal Relation States: A Primer*, 26 TORT & INS. L.J. 832-855 (1991); and Richard G. Mandel, *How to Litigate . . . A Misrepresentation Case*, 11 BRIEF 17-20 (1982).

See also Howard W. Brill, *Rescission*, 1 ARKANSAS LAW OF DAMAGES § 31:3 (5th ed. 2009); Barry Zalma, *Rescission*, 37 UWLA L. Rev. 204 (2004); Charles W. Bowman, *Fraudulent Cancellation of Life Insurance*, 5 AM. JUR. PROOF OF FACTS 2D 587 (1975, 2009 update); and Matthew Grad, *Materiality of Applicant's Misrepresentation in Application for Life or Health Insurance*, 3 AM. JUR. PROOF OF FACTS 3D 367 (1989, 2009 update).

106. *Alexander*, 245 Ark. 1029, 436 S.W.2d 829 (1969).

107. Recurrent language cited for proofs appears in *Alexander* at 1039-40, 436 S.W.2d at 835-836:

It is significant . . . that [the carrier] produced no record of its own underwriting standards, nor did it attempt to show general standards in the underwriting profession or insurance trade by disinterested witnesses.

Id. See also *Morgan*, 88 Ark. App. 52, 56, 200 S.W.3d 469, 472; *Burnett*, 81 Ark. App. 300, 307, 101 S.W.3d 843, 848; *Phelps*, 76 Ark. App. 428, 433, 66 S.W.3d 678, 681; *Reeves*, 248 Ark. 1303, 455 S.W.2d 932, 936; *Davis*, 247 Ark. 1054, 1061, 449 S.W.2d 192, 195.

108. See D.F. Adams, *Misrepresentation in Procurement of Insurance: The Arkansas Law*, 4 UALR L.J. 17, 17-93 (1981).

109. This briefing appeared in one among three unreported federal district court decisions that analyzed the policy holders' entitlement to life insurance proceeds in policies taken out by M. David Powell, a Little Rock businessman who died of apparent suicide in Hollywood, California after his investment Ponzi scheme unraveled. Because the claims arose after a 2-year statutory incontestability period had elapsed, counsel's use of ARK. CODE ANN. § 23-79-107, was by way of analogy, but an analogy that demonstrates the lack of clarity of Arkansas's misrepresentation law.

For references to the Howell life insurance litigation, see *Wood v. Valley Forge Life Ins. Co.*, 2006 WL 4082645, at *3 (E.D. Ark. 2006) (citing *May v. Reassure Am. Life Ins. Co.*, Case No. 4:03CV00209 GH WKU (E.D. Ark. 2004); *Bailey v. Reassure Am. Life Ins. Co.*, Case No. 4:03-CV-00947 SWW (E.D. Ark. 2003).

for a policy holder argued misrepresentation law, citing *Smith* (1969), § 66-3208, and § 23-79-107,¹¹⁰ as well as propositions from *National Old Line* (1974), *Cowger* (1988), *McQuay* (2003), and *Alexander* (1969).¹¹¹

In the absence of explicit guidance from the Arkansas Supreme Court, the Arkansas Court of Appeals and a federal district court in the Eastern District of Arkansas have erred on the side of the policy holder and have erred on the side of finding a fact question on the issue of the policy holder's actual knowledge at the time of application. As the policyholder analysis proceeds, the analysis is framed as a fact question related to the content of the application form's wording and is focused on the causal connection between the

casualty and the misrepresentation. However, proving the point brings into question the applicant's state of mind which is tantamount to a fraud analysis. Such an analysis tends to blend the "fraud" and "misrepresentation" statutory concepts, further complicating already intricate legal analysis.

Arguably, a distinction between "fraud" and "materiality" is present in the plain language of contemporary § 23-79-107 and in the common law developments that preceded Act 148 of 1959. The time is right to engage in a thorough analysis of the meaning of the contemporary statute as well as the continuing relevance of the case authorities that have both informed the statute's language and interpreted its most recent expression.

110. See *e.g.*, Plaintiff's Brief in Support of Motion for Summary Judgment, *Mays v. Reassure Am. Life Ins. Co.*, No. 4-03 CV-00209 GH, E.D. Ark., Doc. 53, at pp. 3, 4, 6 (Nov. 26, 2003).

111. Plaintiff's Second Motion in Limine, *May supra* note 102, at Doc. 148, pp. 2-5 (Sept. 9, 2004).

Appendix A:

Alignment of Arkansas’s Misrepresentation, Over Time and According to Advocacy Perspective

	Policy Holder	Carrier
1894-1959 Common Law	<u>Representation</u> Carter (1910) Johnson (1912) Witt (1923) Huddleston (1932) (<i>red flagged by Dopson in 1968</i>) Mahaffey (1949) Edenfield (1957)	<u>Warranty</u> Reutlinger (1894) Beck (1907) Tate (1933)
Act 148 of 1959 (part of the initial Insurance Code and based on a model law drafted by the National Association of Insurance Commissioners)	Alexander (1969) National Old Line (1974) (<i>red flagged by Cowger in 1988</i>) Gorondy (Ct. App. 1981) Samples (1982) Ward (Ct. App. 1983)	Act 148 of 1959 Dopson (1968) Davis (1970) Reeves (1970) Cowger (1988)
Act 662 of 1989 (adding (c) and requiring causal connection between the casualty and the misrepresentation)	Act 662 of 1989 (adding (c)) (Arkansas Insurance Department; 1989 amendment, one year after <i>Cowger</i>) (see Osborne, 2009 WL 1098943, at *3-5) Phelps (Ark. S.Ct. 1999) (law/ equity analysis)	Act 662 of 1989 (Vratil & Andreas, 26 Tort & Ins. L.J. at 834-838) (Phelps, 76 Ark. app. at 434 n.1, 66 S.W.3d at 682 n.1) Carmichael (1991) (declining to retroactively apply Act 662 of 1989’s causation requirement)
Act 1604 of 2001 (extending the rescission statute to “accident and health” policies)	Phelps (Ct. App. 2002) (§ 23-79-107 analysis) Burnett (Ct. App. 2002) McQuay (Ct. App. 2003) Osborne (E.D. Ark. 2009)	

Appendix B:



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DA: January 5, 2010

TO: Readers of **Public Policy Issues in Arkansas Insurance Law**

FR: Kathryn A. Sampson

RE: **Updates, Expansions and Clarifications from the Arkansas Insurance Department**

Dear Readers,

I am grateful to the attorneys in the Arkansas Insurance Department for engaging in a close review of the content of a recent insurance law annotation, compiled by me and by second and third year law students at the University of Arkansas School of Law. This annotation was published at 2009 Arkansas Law Notes. 155-182 and includes coverage of contemporary issues involving health insurance and life insurance. For the **following updates, expansions, clarifications and observations**, my thanks to Mr. Booth Rand, Chief Counsel, Arkansas Insurance Department, for opening our exchange and for offering a number of updates; thanks also to Mr. Bob Alexander, Attorney Specialist and to the staff attorneys in the Department who gave 2009 Ark. L. Notes 155 a close reading.

Arkansas Misrepresentation Law, 2009 Ark. L. Notes at 166 n.101 (discussing *Farm Bureau Life Ins. Co. v. Cowger*, 295 Ark. 250, 748 S.W.2d 332 (1988))

A note from the Arkansas Insurance Department: Please review Ark. Code Ann. §23-79-107, particularly with a focus on subsection (c) from Act 662 itself of 1989. It is our understanding that the legislature intended by subsection (c) and Act 662 of 1989 to overrule a state case, *Southern Farm Bureau Life Ins. Co. v. Cowger*, 295 Ark. 1095, 748 S.W.2d 332 (1988), to re-instate a requirement that there must exist a causal connection between the misrepresentation and the hazard resulting in the loss. We have contacted and confirmed from the sponsoring Senator of the 1989 amendment which added subsection (c) to make sure our interpretation is correct. The legislature intended in all cases of rescission, in life and disability policies (within the contestability period), that an insurer must show a causal connection between a misrepresentation and the loss, EVEN IF, had the misrepresentation been discovered, that policy (at that premium or rate) would not have been issued.

Underwriting to Anticipate Risk Credit Ratings, 2009 Ark. L. Notes at 167-169:

A note from the Arkansas Insurance Department: FCRA, FACTA (federal acts) and our credit scoring model reporting requirement in 23-67-409 are cited. The credit rating models are indeed required to be filed under 23-67-409, but the article does not mention an important point on the use of a credit score, which is that “an insurer which uses credit information to underwrite risks cannot deny, cancel, or nonrenew a policy of personal insurance solely on the basis of credit information without consideration of any other applicable underwriting factor independent of credit information.” See 23-67-405; in addition, the use of the credit scoring must be disclosed to the consumer, 23-67-406, and provide notice of any adverse action that was applied to the applicant as a result of that credit score. See 23-6-409 in conformity with the FCRA.

Footnote #131, at p.168 should reference 23-67-409 (and not 26-47-409).

Updates, Expansions and Clarifications from the Arkansas Department of Insurance to *Public Policy Issues in Arkansas Insurance Law*, 2009 Ark. L. Notes 155

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Genetic Testing, 2009 Ark. L. Notes at 171-172:

This annotation underwent review by attorneys in the Arkansas Insurance Department who identified no updates, expansions or clarification with regard to this material.

In Vitro coverage, 2009 Ark. L. Notes at 172-173

The annotation accurately states, “In Arkansas, group health insurance companies are required to cover IVF costs. 2009 Ark. L. Notes at 173 n.183 (citing Ark. Code Ann. sec. 23-85-137(a) (Accident and Health Insurance). But see also 23-86-118(a) (Group and Blanket Disability Insurance). Both provisions state, “All accident and health insurance companies doing business in this state shall include, as a covered expense, in vitro fertilization”); **Also note that this mandate applies to both group policies and to individual policies.** This requirement does not apply to HMOs or hospital medical service corporations.

Importantly, the annotation at n.185 discusses typical limitations on treatment which may be construed to imply mandated insurance applies to only one attempt. However, Arkansas recognizes no such limit; the original lifetime limit was set to allow three attempts.

Anorexia & Mental Health Parity, 2009 Ark. L. Notes at 173-175

Arkansas has not yet specifically addressed anorexia coverage limitations; however, as to the overall subject of mental health parity, Arkansas has enacted 23-99-501 et seq., Mental Health Parity Act. At footnote. 211, the annotation cites a section of this Act to support this proposition: “State exemptions exclude a large number of individuals.” To clarify, section 23-99-501 exempts only particular TYPES of plans – the primary exemption to mental health parity requirements is in 23-99-505 which says basically that if a health insurer provides mental health benefits, resulting in an increase in cost of coverage by an amount that exceeds 2% for the first health benefit plan year in which the section applies, or 1% in subsequent years, the subchapters mandates do not apply. Section 23-99-505 would stand in support of the last sentence of the article which states, “A cost increase exemption excludes an unquantified number of additional Arkansans from coverage.” The annotation note 214 cites to a federal survey, but should cite to the state statutory exemption in section 23-99-505.

Corporate Owned Life Insurance, 2009 Ark. L. Notes at 179-181

At page 180 n. 261, in support of this proposition: “Corporations have an insurable interest in such employees [referring to a corporate “key person”] and the practice does not generate debate.” The citation should include a citation to Ark. Code Ann. sec. 23-79-103.

At page 181, the Department identified the following proposition as true, but with important additional information. The proposition is “Arkansas statutory law recognizes an insurable interest and expressly allows corporations to purchase life insurance policies on key employees.” Arkansas statutory law has a new limitation on this power. Of particular note is that an employee must consent to the purchase of such insurances. Arkansas’s insurable interest statute 23-79-103(c)(1)(D) specifically provides:

(D)(i)(a) Any employer, corporation, other business entity, or the trustee of a trust providing life, health, disability, retirement, or similar benefits to employees, retired employees, or their dependents or beneficiaries has an insurable interest in the lives of employees for whom the benefits are to be provided.

INSURANCE, MISREPRESENTATION, CAUSATION, AND STATUTORY RESCISSION

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(b) Any employer, corporation, business entity, or trustee of a trust under subdivision (c)(1)(D)(i)(a) of this section may purchase, accept, or otherwise acquire an interest in personal insurance as a beneficiary or owner.

(ii)(a) Employers have a lawful and substantial economic interest in the lives of key employees and in other employees who have a reasonable expectation of benefiting from a pension and welfare benefit plan.

(b) Any employer, corporation, business entity, or trustee under this subdivision (c)(1)(D) shall obtain the consent of any employee for which it obtained personal insurance, if the personal insurance purchased names the employer, corporation, business entity, or the trustee as a beneficiary.

(c) Consent required under subdivision (c)(1)(D)(ii)(b) of this section shall include an acknowledgement that the employer may maintain the life insurance coverage after the insured individual's employment has terminated.

(d) No employer, corporation, business entity, or trustee may lawfully retaliate against any person for refusing to consent to the issuance of insurance on that person.

(e) For a nonkey or nonmanagerial employee, the amount of coverage shall be reasonably related to the benefits provided to the employee.

(f) The life insurance coverage purchased to finance employer-provided pension and welfare benefit plans shall be allowed only on the lives of those employees and retirees who have a reasonable expectation of benefiting from the plan at the time their lives are first insured under the plan.

Id.(reflecting 2003 amendment).

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C: Mr. Booth Rand, Chief Counsel, Arkansas Insurance Department
Dean Cynthia Nance, University of Arkansas School of Law
Professor Janet Flaccus, Editor, Arkansas Law Notes