# WHEN IS A LIE NOT A LIE?

# AN UPDATE ON LIFE INSURANCE CLAIMS

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**State Bar of Texas**
**Advanced Insurance Law Course**
**June 11-12, 2015**
**San Antonio, Texas**

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## I. INTRODUCTION

This paper highlights well established Texas law, applicable statutes, and recent Texas cases dealing with misrepresentations allegedly made by an insured in an insurance application, including life insurance, and the elements an insurer must prove to avoid coverage and payment on the policy after the insured's death. This paper provides hypotheticals to help evaluate a potential life insurance case, from both an insured and insurer perspective.

## II. HYPOTHETICAL

Husband buys a life insurance policy in Texas, naming Wife as the sole beneficiary. Husband dies within the two (2) year contestability period. Insurer conducts its investigation and determines Husband failed to disclose a medical condition on the life insurance application (*i.e.* he answered a question incorrectly). Insurer denies the claim, rescinds the policy and refunds the premiums to Wife. Case closed . . . or is it?

Most beneficiaries in this scenario would cash the check and forget the whole affair. This could be a bad decision. Mistakes in an application may or may not prelude coverage.

## III. STATUTES ON MISREPRESENTATION

### A. *Tex. Ins. Code Ann.* § 705.004: Misrepresentation in the Policy Application

> (a) An insurance policy provision that states that false statements made in the application for the policy or in the policy make the policy void or voidable:
>
> (1) has no effect; and
> (2) is not a defense in a suit brought on the policy.
>
> (b) Subsection (a) does not apply if it is shown at trial that the matter misrepresented:
>
> (1) was material to the risk; or
> (2) contributed to the contingency or event on which the policy became due and payable.
>
> (c) It is a question of fact whether a misrepresentation made in the application for the policy or in the policy itself was material to the risk or contributed to the contingency or event on which the policy became due and payable.

*Tex. Ins. Code Ann*. § 705.004.

But there's more—in order to avoid payment on an insurance policy for an alleged misrepresentation by the insured, the insurer must also satisfy burdens *not* specifically enumerated in the statute.

To successfully raise a misrepresentation defense to a breach of an insurance contract action under a policy of insurance, an insurer must plead and prove the following: (1) the making of a representation; (2) the falsity of the representation; (3) the intent to deceive on the part of the insured in making the misrepresentation; (4) the materiality of the misrepresentation; and (5) reliance on the misrepresentation by the insurer. *Lee v. National Life Assur. Co*., 632 F.2d 524, 527 (5th Cir. 1980); *Union Bankers Ins. Co. v. Shelton*, 889 S.W.2d 278, 282 (Tex. 1994); *Mayes v. Massachusetts Mutual Life Ins. Co.*, 608 S.W.2d 612, 616 (Tex. 1980); *Medicus Ins. Co. v. Todd*, 400 S.W.3d 670, 678-79 (Tex.App.—Dallas 2013, no pet.); *Manhattan Life Ins. Co. v. Harkrider*, 396 S.W.2d 207, 214 (Tex. Civ. App.—Austin 1965, writ ref'd n.r.e.). Without the satisfaction of each and every one of these factual elements, a misrepresentation is not grounds for the cancellation of the policy and a defense to liability. *Harkrider*, 396 S.W.2d at 214-15. An immaterial misrepresentation, even though fraudulently made—that is, with knowledge of its falsity and with intent to deceive—does not defeat recovery on the policy. *Id*. at 215. Likewise, a material misrepresentation does not defeat recovery if innocently made; that is, without the intent to deceive. *Id*.

This paper will address several of the most significant elements of a misrepresentation defense for most insurance policies.

#### 1. <u>Intent to Deceive—Arguably, the Hardest Element to Prove</u>

"Intent to deceive", while sounding simple, is complicated and very difficult for an insurer to prove. "Intent to deceive" is a highly fact specific driven inquiry and is probably the hardest element to satisfy.

To avoid a policy because of misrepresentations, the burden is on the insurer to plead and prove the insured made untrue statements willfully with the intention of inducing the insurer to issue him or her a policy. *Carter v. Service Life & Casualty Ins. Co.*,

703 S.W.2d 349, 352 (Tex. App.—Corpus Christi 1985, no writ). Significantly, if the facts demonstrate that the insured *believed* he was insurable, then there is no requisite intent to deceive the insurer in order to induce it to issue coverage. *Id*.

There can be no intent to deceive unless the insured *actually, but not constructively*, knew the representation he or she made was not true, meaning "should have known" language in jury questions regarding an insured's intent to deceive are not proper. *Allen v. American National Insurance Co.*, 380 S.W.2d 604, 608 (Tex. 1964)*; Soto v. Southern Life & Health Ins. Co.*, 776 S.W.2d 752, 756 (Tex. App.—Corpus Christi 1989, no writ). In short, false statements which are made negligently, carelessly or by mistake are not sufficient to avoid a life insurance policy where the defense is based upon the insured's misrepresentation of a material fact. *Soto*, 776 S.W.2d at 756.

At least two courts have stated that an "intent to deceive" or induce issuance of an insurance policy can never be proved as a matter of law in the absence of either a warranty that the facts contained in the application are true or evidence of collusion between the applicant and the insurance agent. *Lee v. National Life Assur. Co*., 632 F.2d 524, 528 (5th Cir. 1980), citing *Washington v. Reliable Life Ins. Co.*, 581 S.W.2d 153 (Tex. 1979). Under Texas law, absent language to the contrary, responses given in a life insurance application are mere representations rather than warranties. *Riner v. Allstate Life Ins. Co.*, 131 F.3d 530, 536-37 (5th Cir. 1998); *Union Bankers Ins. Co. v. Shelton*, 889 S.W.2d 278, 288, n. 10 (Tex. 1994) (referencing *28 Tex. Admin Code* § 3.105 and noting that the Legislature has mandated a policy provision that statements made by the insured shall, in the absence of fraud, be deemed representations and not warranties); *Mayes v. Massachusetts Mutual Life Ins. Co.*, 608 S.W.2d 612, 616 (Tex. 1980) (it is now settled law that if the answers to the questions in the application were untrue at the time they were given, the untrue answers constitute misrepresentations); *Cartusciello v. Allied Life Ins. Co.*, 661 S.W.2d 285, 286–88 (Tex.App.—Houston [1st Dist.] 1983, no writ); *see also 28 Tex. Admin Code* § 3.105.[1]

Some commentators argue that because the "intent to deceive" element is not specifically listed in Section 705.004 of the Texas Insurance Code (and this section was re-codified in 2005), that means an insurer no longer has to prove an insured's intent to deceive in order to deny coverage or void a policy. A recent case from the Dallas Court of Appeals dispels this argument and re-affirms "intent to deceive" is still a requirement to a misrepresentation defense. *See Medicus Ins. Co. v. Todd*, 400 S.W.3d 670 (Tex.App.—Dallas 2013, no pet.). While *Medicus* is not a life insurance case, it offers a robust survey of the history of the "intent to deceive" requirement, which is over 100 years old.

In *Medicus*, Dr. Todd handled his malpractice insurance through his insurance broker, Larry Zimmer. *Id*. at 674. In 2006, Dr. Todd had malpractice insurance with another company, and Zimmer suggested that Dr. Todd apply to Medicus, which had better coverage and lower premiums. *Id*. When Dr. Todd applied for insurance in October 2006, Medicus did not ask him to fill out its nineteen-page application. *Id*. Instead, it permitted Dr. Todd to submit only its two-page application and the Texas Standardized Credentialing Application, a form that physicians use to receive credentials to practice in a particular hospital. *Id*. Dr. Todd sent Medicus a credentialing application he had signed on May 4, 2005. *Id*. The credentialing application asked if Dr. Todd had "ever been the subject of an investigation by

[1] (a) The policy must provide that all statements made by the insured shall, in the absence of fraud, be deemed representations and not warranties. The policy may provide that statements made on behalf of the insured shall also, in the absence of fraud, be deemed representations and not warranties.

(b) Policy applications sometimes contain agreements which call attention to some, or all, of the elements which must be proved in avoiding the policy for misrepresentation. Such agreements are acceptable, provided:
(1) they do not attempt to burden the insured's representations with the legal consequences of warranties;
(2) they do not attempt to require the insured to prove the nonexistence of grounds upon which the insurer could contest the policy; and
(3) they do not attempt to permit the insurer to avoid liability on grounds less stringent than under the Insurance Code, Article 21.16, or other applicable law.

any . . . licensing authority," and he checked the "No" box. *Id*. In fact, Dr. Todd had been twice investigated by the Texas Medical Board for having three or more medical malpractice claims in a five-year period. *Id*.

The credentialing application also asked if he had "ever had any malpractice actions within the past 5 years (pending, settled, arbitrated, mediated or litigated[) ]," and Dr. Todd checked the "Yes" box and attached a description of four lawsuits filed against him between May 2000 and when he signed the application in May 2005. *Id*. Dr. Todd omitted one lawsuit from the list of claims filed between May 2000 and May 2005. *Id*. Dr. Todd also failed to disclose another lawsuit filed between his signing the credentialing application and his applying to Medicus. *Id*.

The underwriter for Medicus reviewing Dr. Todd's application recommended denying coverage "due to severe claims history." *Id*. However, the chief underwriter and Medicus' president rejected the recommendation, and Medicus issued a one-year policy to Dr. Todd effective November 16, 2006. *Id*. In February 2007, Medicus sent Zimmer its official nineteen-page insurance application, prefilled with the information Medicus had about Dr. Todd. *Id*. In the claims-history section, the application did not limit its information to the preceding five years but asked, "Has any claim or suit for alleged malpractice ever been brought against you, or are you aware of circumstances that might reasonably lead to such a claim or suit?" *Id*. at 674-75. The application was prefilled by Medicus listing five claims consisting of the four claims included on the credentialing application and a fifth claim for someone Dr. Todd testified was not a patient of his and who had not filed a claim against him. *Id*. at 675. The application did not list the additional eight lawsuits that had been filed against Dr. Todd or the three letters from lawyers threatening suit, and neither Dr. Todd nor Zimmer added them to the application. *Id*. However, Dr. Todd signed the application, declaring the information was true and correct. *Id*.

When the policy came up for renewal in November 2007, Medicus sent Zimmer a prefilled application for Dr. Todd stating that the application "needs to be reviewed, modified if need be, and signed, dated and completed on pages 18 and 19 [the warranties and fraud-warnings pages requiring Dr. Todd's signature]." *Id*. Like the February application, this application requested Dr. Todd's complete claims history and was prefilled with the same five claims included on the February application. *Id*. Again, neither Zimmer nor Dr. Todd modified the claims list either to remove the claim that was not against Dr. Todd or to include the eight undisclosed lawsuits filed against Dr. Todd and the three letters threatening suit. *Id*. Medicus renewed Dr. Todd's insurance for another year. *Id*.

After the 2007 renewal, Dr. Todd was named as a defendant in two more malpractice suits, and Medicus defended him and paid the policy limits to settle one of the suits. *Id*. In November 2008, Medicus again renewed Dr. Todd's insurance but charged a higher premium. *Id*. Medicus then received a copy of a letter from the plaintiff's attorney in one of the malpractice suits against Dr. Todd addressed to the attorney provided by Medicus to represent Dr. Todd. *Id*. In the letter, the plaintiff's attorney stated that Dr. Todd had been a party to fifteen medical malpractice cases and two investigations by the Texas Medical Board. *Id*. After investigating and discovering the undisclosed claims and Texas Medical Board investigations, Medicus notified Dr. Todd that Medicus "refuses to be bound by the policy" because of material misrepresentations in the insurance application. *Id*. Medicus returned the premium to Dr. Todd and declared the policy cancelled. *Id*.

Medicus then brought suit for declaratory judgment that the policy was void, that Medicus was not bound by the policy, and that it had no duty to defend or indemnify Dr. Todd for any claims against him. *Id*. Dr. Todd filed a counterclaim for unjust enrichment and breach of contract alleging the insurance policy was a valid contract and that Medicus had manifested its intent to repudiate the policy. *Id*. Both sides requested attorney's fees. *Id*.

The case was tried before a jury. *Id*. Dr. Todd testified he usually signed applications without reading them because he relied on Zimmer to make sure the applications contained the correct information. *Id*. Zimmer testified he had presumed that Medicus' applications requested the same five-year claims history as the credentialing application. *Id*. Zimmer stated he did not notice that Medicus' applications requested Dr. Todd's complete claims history. *Id*. The jury determined Medicus failed to prove by a preponderance of the evidence that Dr. Todd made a material false representation in an

insurance application with Medicus with the intent to deceive Medicus and that was relied on by Medicus in issuing a policy of insurance to Dr. Todd. *Id*. at 676. The trial court rendered judgment that Medicus take nothing and awarded Dr. Todd attorney's fees. *Id*.

On appeal, Medicus argued that an insurer seeking to declare an insurance policy void because of material misrepresentations in the application for insurance must not prove the insurance applicant intended to deceive the insurer. *Id*. Medicus argued that an insurer seeking to have an insurance policy declared void due to misrepresentations in the application has two alternative remedies: the common-law remedy, in which the insurer must prove an insured intended to deceive the insurer, and the statutory remedy under section 705.004 of the Texas Insurance Code, which does not expressly require the insurer to prove the insured had the intent to deceive. *Id*. Medicus asserts it brought suit under the statutory remedy, not the common-law remedy; therefore, it contends, it was not required to prove Dr. Todd intended to deceive it with the misrepresentations in the application concerning his claims history. *Id*. at 677.

On appeal, the Dallas Court of Appeals reviewed section 705.004(a) of the Texas Insurance Code and noted that the statute does not expressly require—and never has required—the insurer to prove the insured's intent to deceive, but confirmed that the Texas Supreme Court has consistently imposed that requirement. *Id*. Case law surveyed by the *Medicus* Court shows that no matter what form the Texas Insurance Code takes, including the 2005 re-codification, an insurer's burden to prove an "intent to deceive" has been required for over 100 years.

The *Medicus* Court went back to 1933 to a case involving misrepresentations in an application for life insurance:

> The great weight of authority sustains the rule that under the provisions of these statutes a misrepresentation, or breach of warranty, by the insured, to avoid the policy, must be willful, or made fraudulently with intent to deceive.... It is a settled rule in this state that false statements to avoid a policy must have been willful and made with a design to deceive or defraud.

*Id.* at 678, citing *Am. Cent. Life Ins. Co. v. Alexander,* 56 S.W.2d 864, 866 (Tex. Com. App. 1933) (internal citations omitted). "Although the statute permitting an insurer to include language in a policy authorizing it to declare the policy void for misrepresentations in the application does not require the misrepresentation be made with the intent to deceive, the supreme court has continued to impose that requirement." *Id*.; s*ee also Union Bankers Ins. Co. v. Shelton,* 889 S.W.2d 278, 282 (Tex. 1994); *Wash. v. Reliable Ins. Co.,* 581 S.W.2d 153, 159-60 (Tex. 1979); *Allen v. Am. Nat'l Ins. Co.,* 380 S.W.2d 604, 607–08 (Tex. 1964); *Clark v. Nat'l Life & Accident Ins. Co.,* 145 Tex. 575, 200 S.W.2d 820, 822–23 (1947); *Great S. Life Ins. Co. v. Doyle,* 136 Tex. 377, 151 S.W.2d 197, 201 (1941); *Colo. Life Co. v. Newell,* 78 S.W.2d 1049, 1051 (Tex.Civ.App.—El Paso 1935, writ ref'd).

The *Medicus* Court also cited the 1980 case of *Mayes v. Massachusetts Mutual Life Insurance Co.,* which concerned an insured's false statements involving medical history in a life-insurance application:

> It is now settled law in this state that these five elements must be pled and proved before the insurer may avoid a policy because of the misrepresentation of the insured: (1) the making of the representation; (2) the falsity of the representation; (3) reliance thereon by the insurer; (4) the intent to deceive on the part of the insured in making same; and (5) the materiality of the representation.

*Medicus,* 400 S.W.3d at 678, citing *Mayes,* 608 S.W.2d at 616.

Then, in 1994, the Texas Supreme Court decided *Union Bankers Ins. Co. v. Shelton* and held: "an insured's intent to deceive must be shown in order for an insurance company to successfully raise a defense of misrepresentation on the basis of a false statement made by the insured in the application for *any* type of insurance." *Medicus,* 400 S.W.3d at 678, citing *Union Bankers Ins. Co. v. Shelton,* 889 S.W.2d 278, 282 (Tex. 1994) (emphasis supplied).

After this survey of case law dealing with the "intent to deceive" requirement, the *Medicus* Court held as follows:

> The proposition that an insured's intent to deceive is likewise required is well established in the common law of this state . . . in Texas, an insured's intent to deceive must be shown in order for an insurance company to successfully raise a defense of misrepresentation on the basis of a false statement made by the insured in the application for any type of insurance. Under *Shelton*, there is only one cause of action for rescinding a policy due to misrepresentations in the application; that is, by application of both the relevant statutes and the common law, which includes the insured's intent to deceive . . . Section 705.004, in its different codifications, is now 110 years old. Although the statute has never expressly required the insurer to prove the insured intended to deceive the insurer with a misrepresentation in the policy application, the courts of Texas have consistently held that an insurer may not rescind a policy due to a misrepresentation in an insurance application unless the insurer proves the insured intended to deceive the insurer with the misrepresentation. We cannot vary from this long history of case law imposing this duty upon insurers. *We conclude the intent to deceive on the part of the insured in making a misrepresentation in an application for insurance is an element the insurer must prove to obtain a declaratory judgment that a policy is void due to the misrepresentations*.

*Medicus*, 400 S.W.3d. at 679 (internal citations and quotations omitted). Emphasis supplied.

*Medicus* establishes that "intent to deceive" is alive and well. Because no review was sought in *Medicus*, some continue to argue that Section 705.004 of the Texas Insurance Code does not require proof of "intent to deceive." In light of *Medicus*, and long standing authority, it would behoove any practitioner to carefully consider the available proof for "intent to deceive" and anticipate this burden of proof.

Below are some hypotheticals in the life insurance context demonstrating the difficulty in proving "intent to deceive":

- *What did the insurer know before issuing the policy?* If the insurer has performed tests and obtained results and/or gathered medical records on the insured and knows of an insured's condition or potential condition, "intent to deceive" will be difficult to prove.

- *What if the insured has an illness that can "come and go", have flare ups, or go into remission after medication is taken?* For example, if liver tests taken before an insured's application for life insurance reveal normal results, it will be difficult to show the insured actually knew he/she had Hepatitis and intended to deceive the insurer regarding prior treatment or symptoms of this disease or liver problems. Hepatitis is an illness that flares up, and when a flare up has been resolved (whether through a course of medication or otherwise), the person may believe he or she no longer suffers from that illness.

- *What is the primary language spoken by the insured*? If the insured's primary language is Spanish, but the application is in English, a question arises whether the insured understood a question on the application—this explaining an incorrect answer, not any intent to deceive. A misunderstanding, misreading of a question, or an insured's confusion does not automatically equate to an "intent to deceive" and in many cases, greatly improves the beneficiary's claim against an insurer after a denial.

- *Who is the person completing the insurance application—the agent, the insured or another?* For example, if the insurance agent, read the questions contained in the application to the insured and completed the application (versus the insured reading and completing

the application), the agent may have misread a question or wrote down an answer incorrectly. If there is no recording of the questions asked and answers provided, problems arise for the insurer in proving an "intent to deceive." This burden becomes especially problematic if a third party was present and disputes the answers listed on the application.

- *What is the mental state of the potential insured?* Oftentimes for life insurance policies under a certain amount, like under $100,000, insurers have online applications where an agent or insurer representative is not involved in the application process. What if the insured has a mental issue, like schizophrenia or bipolar disorder and does have a medical condition that would prevent issuance of the policy, but the insured honestly believes he or she is medically healthy? "Intent to deceive" will be hard to prove.

These examples certainly indicate that an insurer's burden to prove "intent to deceive" is extremely fact intensive at best, and unlikely to be shown at worst. The evaluation of a misrepresentation defense must depend on proof of "intent to deceive."

Bottom line: there is nothing simple regarding a misrepresentation defense, particularly the "intent to deceive" requirement.

## 2. Materiality of the Representation

A "representation is material if it *actually* induces the insurance company to assume the risk." *Weidner v. Nationwide Property & Casualty Ins Co.*, 2014 WL 6427541, at *8, -- F.Supp.3d -- (E.D. Tex. Nov. 17, 2014); *Darby v. Jefferson Life Ins. Co.*, 998 S.W.2d 622, 628 (Tex.App.—Houston [1st Dist.] 1995, no writ); *Manhattan Life Ins. Co. v. Harkrider*, 396 S.W.2d 207, 215 (Tex. Civ. App.—Austin 1965, writ ref'd n.r.e.). The insurer must show that it was induced to assume the risk by the misrepresentation. *Westchester Fire Ins. Co. v. English*, 543 S.W.2d 407, 412-13 (Tex.Civ.App.—Waco 1976, no writ). This determination is a question of fact—the very language of the statute makes that "fact" clear. *Tex. Ins. Code Ann.* § 705.004(c) ("It is a question of fact whether a misrepresentation made in the application for the policy or in the policy itself was material to the risk or contributed to the contingency or event on which the policy became due and payable"); *see also Carter v. Service Life & Casualty Ins. Co.*, 703 S.W.2d 349, 352 (Tex. App.—Corpus Christi 1985, no writ) (holding that the statute provides the materiality of any false representation is a question of fact).

The principal inquiry in determining materiality is whether the insurer would have accepted the risk if the true facts had been disclosed. *Robinson v. Reliable Life Ins. Co.*, 569 S.W.2d 28, 29 (Tex. 1978). Under Texas law, it is not necessary for the insurer to prove that the misrepresentation contributed to the event that caused the loss. *Id.* at 28. Rather, a finding that the misrepresentation was material to the risk is sufficient ground for avoiding the policy. *Id*.

In *Reliable*, the question posed was whether an insurer, under former Texas Insurance Code article 21.16,[2] must establish both that the misrepresentation was material to the risk undertaken by the insurer and that the condition about which the misrepresentation was made contributed to the death of the insured in order to avoid liability under a life insurance policy. *Id*. The pertinent facts of *Reliable* are below.

The beneficiary filed suit against the insurer to recover the sum of $2,000.00 payable on the death of the beneficiary's natural son. *Id*. The insurer denied liability and counterclaimed for cancellation of the policy based on false representations in the application. *Id*.

After a non-jury trial, the trial court filed findings of fact that the application contained negative answers to questions inquiring whether the insured had been treated by a doctor within the past five years, whether the insured had any injury, illness or operation in the

[2] Texas Insurance Code article 21.16 states: "Any provision in any contract or policy of insurance issued or contracted for in this State which provides that the answers or statements made in the application for such contract or in the contract of insurance, if untrue or false, shall render the contract or policy void or voidable, shall be of no effect, and shall not constitute any defense to any suit brought upon such contract, unless it be shown upon the trial thereof that the matter or thing misrepresented was material to the risk or actually contributed to the contingency or event on which said policy became due and payable, and whether it was material and so contributed in any case shall be a question of fact to be determined by the court or jury trying such case."

past five years, and whether the insured had ever been confined to a hospital or sanitorium. *Id*. at 28-29. The trial court found that each of these statements was false, that each was material to the risk assumed by the insurer, that each was relied on by the insurer in issuing the policy, that the policy would not have been issued but for such statements, and that the insurer did not discover the true facts until shortly after the death of the insured. *Id*. at 29. The court based these findings on evidence that the insured had been afflicted with sickle cell anemia for several years prior to his death. *Id*. The trial court further found that the insured was under treatment by a doctor and hospitalized for about two weeks for intestinal hemorrhaging and sickle cell anemia less than two years before the application was submitted to the insurer. *Id*. The only evidence as to the cause of death of the insured is the following statement in the death certificate: "There were no marks on body that indicate violence, apparently died from natural causes." *Id*.

On appeal, the beneficiary argued that the word "or" in the statute should be read as "and" so that the condition misrepresented in the application cannot be considered as grounds for avoidance of the policy unless the condition was actually a cause of the loss insured against. *Id*. at 29. The Texas Supreme Court noted this construction had been adopted by implication in several cases, although no case has directly so held. *Id*., referencing *Southern Life and Health Ins. Co. v. Grafton*, 414 S.W.2d 214, (Tex.Civ.App.—Tyler 1967, writ ref'd n. r. e.); *Trinity Reserve Life Ins. Co. v. Hicks*, 297 S.W.2d 345 (Tex.Civ.App.—Dallas 1956, no writ); *National Life and Accident Ins. Co. v. Dickinson*, 115 S.W.2d 1180 (Tex.Civ.App.—El Paso 1938, writ dism'd); *First Texas Prudential Ins. Co. v. Pipes*, 56 S.W.2d 203 (Tex.Civ.App.—El Paso 1933, writ dism'd).

In contrast, the Texas Supreme Court in *Reliable* found another line of cases holding that the materiality of the risk must be viewed at the time of the issuance of the policy, rather than at the time the loss occurred, and that the principal inquiry in determining materiality is whether the insurer would have accepted the risk if the true facts had been disclosed. *Reliable*, 569 S.W.2d at 28. These authorities recognize the concept that a condition material to the risk assumed by the insurer is quite distinct from the cause of the loss. *Id*. at 29-30, referencing *Jackson v. National Life and Accident Ins. Co*., 161 S.W.2d 536 (Tex.Civ.App.—Dallas 1942, writ ref'd w.o. m.); *Aetna Life Ins. Co. v. Shipley*, 134 S.W.2d 342 (Tex.Civ.App.—Fort Worth 1939, writ dism'd); *Indiana and Ohio Live Stock Ins. Co. v. Smith*, 157 S.W. 755 (Tex.Civ.App.—Austin 1913, writ ref'd); *Fidelity Union Fire Insurance Co. v. Pruitt*, 23 S.W.2d 681 (Tex.Com.App. 1930, holding approved); *United Benevolent Ass'n v. Baker*, 141 S.W. 541 (Tex.Civ.App.—Texarkana 1911, writ dism'd); *see also Note, Insurance: Fraud Necessary to Avoid Life Insurance Policy*, 11 Baylor L.Rev. 236 (1959); 7 *Couch on Insurance* Section 35:45-47 (2d ed.) and 12 Appleman, Insurance Law and Practice Section 7294 (1943 & Supp.1977).

The Texas Supreme Court in *Reliable* ultimately held that under Article 21.16, the materiality to the risk must be viewed as of the time of the issuance of the policy, rather than at the time the loss occurred. *Id*.

A more recent federal case cites the holding in *Reliable* stating: "Because the disjunctive "or" is used in section 705.004(b) of the Texas Insurance Code, an insurance policy can be avoided upon a finding that the misrepresentation was material to the risk without proof that the condition misrepresented contributed to the event that caused the loss." *Hinna v. Blue Cross Blue Shield of Texas*, 2007 WL 30860259, at *6 (N.D. Tex. Oct. 22, 2007).

For a few other cases discussing the "materiality" element, see the following:

- *Westchester Fire Ins. Co. v. English*, 543 S.W.2d 407 (Tex.Civ.App.—Waco 1976, no writ): Where a couple represented themselves as being married and living in the same home but in fact were not married and the insureds suffered a casualty loss, such representation was not material to the loss.

- *Ranger Ins. Co. v. Bowie*, 574 S.W.2d 540 (Tex. 1978): When a pilot made a false representation to the FAA to obtain a medical certificate, such representation was not imputed to the policy and not material to issuance of the policy, including the "pilot clause."

- *Southern Life & Health Ins. Co. v. Grafton*, 414 S.W.2d 214 (Tex. Civ. App.—Tyler

1967, writ ref'd n.r.e.): Simply because an insured failed to disclose she had diabetes in a life insurance application did not justify a denial where the diabetes did not cause or contribute to the insured's death.

- *First Texas Prudential Ins. Co. v. Pipes*, 56 S.W.2d 203 (Tex. Civ. App.—El Paso 1932, writ dism'd): Holding that the statement in an application that the insured had not had the disease of consumption (which was false) was shown to be immaterial, as the undisputed evidence showed that consumption in no way contributed to the insured's death, the representation was of an immaterial fact and did not affect the risk assumed, as the insured died of coronary thrombosis.

- *National Life & Acc. Co. v. Dickinson*, 115 S.W.2d 1180 (Tex. Civ. App.—El Paso 1938, writ dism'd): A representation in an application for a life insurance policy that the insured did not have syphilis was immaterial and did not affect the risk, where the uncontroverted evidence showed the insured died of broncho-pneumonia, and the jury found that syphilis did not cause or contribute to the insured's death.

Notably, a misrepresentation is not material to the risk simply because the insurer would have charged a higher premium if the true facts had been known; instead, the rule is that the misrepresentation is not "material to the risk" unless it actually induced the insurance company to assume the risk that it otherwise would not have done. *Horne v. Charter National Ins. Co.*, 614 S.W.2d 182, 185 (Tex. Civ. App.—Fort Worth 1981, writ ref'd n.r.e.); *Harrington v. Aetna Cas. & Sur. Co.*, 489 S.W.2d 171, 177-78 (Tex. Civ. App.—Waco 1972, writ ref'd n.r.e.).

Finally, when evaluating the "materiality" element of whether a misrepresentation "contributed to the contingency or event on which the policy became due and payable," the death certificate showing the immediate cause of death of the insured, as well as any underlying or secondary causes, may be critical.

### 3. Reliance on the Representation by the Insurer

Reliance is established when the insurer does not know the representations are false. *United of Omaha Life Ins. Co. v. Halsell*, 2010 WL 376428, at *4 (W.D. Tex. Jan. 25, 2010), citing *Darby v. Jefferson Life Ins. Co.*, 998 S.W.2d 622, 628 (Tex.App.—Houston [1st Dist.] 1995, no writ); *Koral Indus., Inc. v. Security–Conn. Life Ins. Co.*, 788 S.W.2d 136, 148 (Tex.App.—Dallas), *writ denied* 802 S.W.2d 650 (Tex.1990)). Where the insurer does not rely on the misrepresentation, the policy cannot be voided. *Texas State Life Ins. Co. v. Barton*, 118 S.W.2d 617, 618 (Tex. Civ. App.—Galveston 1938, no writ).

In *Halsell*, United of Omaha testified via its Individual Life Underwriting Risk Selection Director that "[i]n reliance on the representations made by Justin Halsell in the application, the drug/alcohol usage and the phone interview, United issued [the policy].... United was not aware of Justin Halsell's prior drug abuse treatment at the time of issuance of the policy." *Halsell*, 2010 WL 376428, at *4. The Court found this evidence demonstrated United of Omaha relied on Justin Halsell's declaration in deciding to issue the policy. *Id.*

However, there is no reliance where the insurer would not have issued the renewal for the same premium based on the misrepresentation, as an increased premium does not satisfy the reliance element. *Harrington v. Aetna Cas. & Sur. Co.*, 489 S.W.2d 171, 177-78 (Tex. Civ. App.—Waco 1972, writ ref'd n.r.e.).

A hypothetical for the "reliance" requirement: a misrepresentation is in a supplemental questionnaire that was completed and signed by the insured *after* the issue date of the life insurance policy. The question becomes how an insurer can rely on a misrepresentation in a supplement when it issued the policy *before* learning about it.

In summary, when evaluating the "reliance" requirement, read the policy and all documents signed by the insurer and consider the timing of the information provided.

### B. *Tex. Ins. Code Ann.* § 705.005: Notice to the Insured of Misrepresentations

(a) This section applies to any suit brought on an insurance policy issued or contracted for after June 29, 1903.

(b) A defendant may use as a defense a misrepresentation made in the application for or in obtaining an insurance policy only if the defendant shows at trial that before the 91st day after the date the defendant discovered the falsity of the representation, the defendant gave notice that the defendant refused to be bound by the policy:

(1) to the insured, if living; or

(2) to the owners or beneficiaries of the insurance policy, if the insured was deceased.

(c) This section does not:

(1) make available as a defense an immaterial misrepresentation; or

(2) affect the provisions of Section 705.004.

*Tex. Ins. Code. Ann*. § 705.005.

Statutory notice is an essential element of a defense based on misrepresentation or rescission. *Myers v. Mega Life and Health Ins. Co.*, 2008 WL 1758640, at *3 (Tex.App.—Amarillo, April 17, 2008, pet. denied), citing *Womack v. Allstate Ins. Co.*, 156 Tex. 467, 296 S.W.2d 233, 235-36 (1956) and *Koral Industries, Inc. v. Security-Connecticut Life Insurance Company*, 788 S.W.2d 136, 148 (Tex.App.—Dallas), *aff'd*,802 S.W.2d 650 (Tex.1990). The insurer has the burden of proving notice of rescission. *Myers*, 2008 WL 1758640, at *3. "In order to establish that the statutory notice was given within a reasonable time, the record must show when the insurer discovered the misrepresentation." *Koral*, 788 S.W.2d at 148 (internal citations omitted).

In *Myers v. Mega Life and Health Ins. Co*, Myers testified that she was deposed on October 14, 2003, by Mega Life's attorney in the presence of Jacquelyn Brabham, Mega Life's designated corporate representative for Long's claims. WL 1758640, at *3. At the deposition, Myers testified that Long had been kicked by a horse, suffered from coughs and colds, and had kidney stones prior to the submission of his health insurance application. *Id*. She also testified that, prior to submitting the application, Long was taking Skelaxin for pain. *Id*. Long's application did not disclose these prior medical conditions, and Mega Life did not dispute Myers' testimony. *Id*. Myers also testified she attended Brabham's deposition on the same day and recalled that Brabham was aware Long's application was inaccurate. *Id*.

Doug Kornegay, Mega Life's Vice President of Underwriting and New Business, opined that, had this information been disclosed on Long's application, Mega Life would not have issued coverage. *Id*. He testified that, had Long's application disclosed the horse kick, kidney stones, bronchitis, and Skelaxin medication, underwriters would have ordered Long's medical records and placed phone calls to obtain complete details. *Id*. Tony Shrader, Mega Life's testifying legal expert, opined that all of Long's undisclosed prior medical conditions were material from an underwriting perspective. *Id*.

The Court found that there was evidence indicating Myers disclosed sufficient information in her deposition on October 14, 2003 for Mega Life to have discovered the falsity of the representations in Long's application. *Id*. Therefore, in order to meet the statutory requirements, notice of rescission was due from Mega Life on or before January 13, 2004. *Id*. On the other hand, the Court noted that Sharon Dickson, Mega Life's Vice President of Claims in 2004, testified she did not learn of Long's pre-application medical history until after March 10, 2004. *Id*. Dickson testified that notice of Mega Life's intention to rescind Long's coverage was timely issued to Myers through its first amended petition filed March 19, 2004. *Id*. The Court found that there was at least a fact issue raised by the pleadings and the evidence warranting an instruction to the jury on the issue of the timeliness of Mega Life's notice of rescission. *Id*. "Thus, the failure of the trial court to charge the jury on this issue constituted reversible error." *Id*.

Notice is often a sleeper and unrecognized issue when rescission by the insurer is requested. Yet this requirement is fundamental and is outcome determinative in seeking rescission.

## IV. STATUTORY LAW SPECIFIC TO LIFE INSURANCE POLICIES

### A. *Tex. Ins. Code. Ann.* §705.051: Immaterial Misrepresentation in Life, Accident, or Health Insurance Application

A misrepresentation in an application for a life, accident, or health insurance

> policy does not defeat recovery under the policy unless the misrepresentation:
>
> (1) is of a material fact; and
> (2) affects the risks assumed.

*Tex. Ins. Code. Ann*. § 705.051.

At least one court has found that nothing in the plain language of section 705.051 requires that a misrepresentation involve the insured's *health or life expectancy* in order for the misrepresentation to affect the risks assumed by the insurer. *See Vasquez v. ReliaStar Life Ins. Co.*, 2014 WL 1267171, at *3 (Tex.App.—Houston [14th Dist.] Mar. 27, 2014). "Had the Legislature intended to limit the meaning of the 'affects the risks assumed' prong in section 705.051, it would have utilized similar language as it used in subsection 705.004(b)(2), which permits the insurer to void a policy pursuant to a misrepresentation provision if, among other results, the insurance applicant's misrepresentation "contributed to the contingency or event on which the policy became due and payable.'" *Id.*

The *Vasquez* court held that the risk assumed by a life insurance insurer is *the risk that the insured will die during the insurance term*. *Id*. This is a risk to the insurer only because it triggers the insurer's obligation to pay benefits. *Id*. The risk assumed by the insurance company in *Vasquez* was that it would have to pay $2.5 million if the insured died. *Id*. "The amount of money contingently owed by the insurer is undeniably part of the risk of providing coverage." *Id*. Thus, the *Vasquez* court held that the insured's financial misrepresentations affected the amount of coverage provided, and therefore the risk assumed, by the insurer. *Id*. at *4. This risk was not related to the health or life expectancy of the insured.

**B. *Tex. Ins. Code. Ann.* § 705.104: Misrepresentation in Application for Life Insurance**

> A defense based on a misrepresentation in the application for, or in obtaining, a life insurance policy on the life of a person in or residing in this state is not valid or enforceable in a suit brought on the policy on or after the second anniversary of the date of issuance of the policy if premiums due on the policy during the two years have been paid to and received by the insurer, unless:
>
> (1) the insurer has notified the insured of the insurer's intention to rescind the policy because of the misrepresentation; or
>
> (2) it is shown at the trial that the misrepresentation was:
> (A) material to the risk; and
> (B) intentionally made.

*Tex. Ins. Code. Ann*. § 705.104.

This statute addresses the contestability period, that being a misrepresentation defense is unavailable after two (2) years following the date the policy was issued. This requirement is almost universally found in all life insurance policies. However, one court has stated that Section 705.104 allows insurers to rescind life insurance policies even after two years if the insurer proves material, intentional misrepresentations were made in obtaining the policy. *Massachusetts Mut. Ins. Co. v. Mitchell*, 859 F.Supp.2d 865, 870 (S.D. Tex 2012). Courts disagree. *See e.g., American Nat. Ins. Co. v. Conestoga Settlement Trust*, 442 S.W.3d 589 (Tex.App.—San Antonio 2014). When referencing Section 705.104, the court in *Conestoga* states: "though the *Truscott* decision is from 1935, it is still recognized as the common law of Texas for the proposition that the "bar to contestability applies even if the insured intentionally made a material misrepresentation in the policy application." *Id*. at 596-97, citing *Cardenas v. United of Omaha Life Ins. Co.*, 731 F.3d 496, 500 (5th Cir. 2013).

The *Cardenas* case deserves elaboration. *Cardenas* involves United of Omaha Life Insurance Company's denial of Elvia Cardenas' claim for benefits from a life insurance policy taken out by Cardenas' daughter, Elvia Sierra. *Cardenas*, 731 F.3d at 497. The policy lapsed and was subsequently reinstated; Sierra died thirteen months after the reinstatement. *Id*. As required by the Texas Insurance Code, the policy contained a provision that it would become incontestable if it remained in force "for two years from its date of issue during the lifetime of the insured." *Id*. Although the policy does not have a

provision dealing with contestability following reinstatement, the parties agree there is such a period. *Id*.

United of Omaha issued a life insurance policy to Cardenas' daughter, Elvia Sierra, on March 26, 2001. *Id*. at 498. The policy lapsed for nonpayment of premiums in June 2005. *Id*. United of Omaha reinstated the policy on January 3, 2006, after Sierra submitted a reinstatement application. *Id*. Sierra made several misstatements about her health in the reinstatement application. *Id*. The application required Sierra to certify that she had not lost more than ten pounds in the prior year, and that in the prior five years, she had not undergone any blood tests, laboratory tests, or special examinations, been ill or injured, or received medical or surgical advice or treatment. *Id*. In fact, Sierra suffered from Crohn's disease and had been hospitalized for four weeks during June and July 2005. *Id*. She lost thirty pounds between March and July 2005, including eighteen pounds in one week. *Id*.

Sierra died on February 20, 2007. *Id*. Her death certificate lists toxic megacolon, sepsis, cachexia, and Crohn's disease as the causes of death. *Id*. Cardenas filed a claim for benefits on March 26, 2007. *Id*. United of Omaha denied the claim on May 14, 2007, and on May 23, 2007, informed Cardenas that it was rescinding the policy due to misrepresentations it found in the reinstatement application. *Id.*

United of Omaha argued that it satisfied the requirements for rescinding an insurance policy procured by fraud, and that the policy remained contestable because Sierra died before the two-year period ran. *Id*. Cardenas contended, *inter alia*, that the reinstated policy was incontestable because United of Omaha failed to contest it within the requisite two years, as provided by Section 3.104(a) of the Texas Administrative Code, Title 28. *Id*. The district court denied both motions in a memorandum opinion and order dated February 29, 2012, and found that fact issues remained regarding whether Sierra's misrepresentations were material and intentional. *Id*.

At the heart of this case on appeal to the Fifth Circuit was the question of whether a life insurance policy, after it has been reinstated, automatically becomes incontestable after two years, or whether the insured must survive that two-year period. *Id*. at 499. The answer depends on the interpretation of two key statutory and regulatory provisions, one of which expressly requires that in order to become incontestable, a policy must be in force for two years "during the lifetime of the insured." These provisions are Texas Insurance Code Section 1101.006, and 28 Texas Administrative Code Section 3.104(a). *Id*.

Section 1101.006 states that "a life insurance policy must provide that a policy in force for two years from its date of issue during the lifetime of the insured is incontestable, except for nonpayment of premiums." *Id*., citing *Tex. Ins.Code Ann*. § 1101.006 (West 2003). Section 3.104(a) provides, in relevant part, that "[i]f a reinstatement is contested for misrepresentation, no representation other than one causing the reinstatement may be used to contest the policy, any contest of the reinstatement may be for a material and fraudulent misrepresentation only and reinstatement may not be contested more than two years after it is effectuated . . ." *Id*., citing 28 *Tex. Admin. Code* § 3.104(a) (1982).

The *Cardenas* Court noted that under Texas Insurance Code Section 1101.006, if an insured survives the two-year "contestability period" following the issuance of a policy, then the policy will become incontestable for any reason except nonpayment of premiums. *Cardenas*, 731 F.3d at 500. This bar to contestability applies even if the insured intentionally made a material misrepresentation in the policy application. *Id*., citing *Kan. Life Ins. Co. v. First Bank of Truscott*, 124 Tex. 409, 78 S.W.2d 584, 586–87 (1935).

The *Cardenas* Court elaborated in stating that Section 1101.006 was codified in 1951 as Texas Insurance Code Article 3.44(3), which provided that a life insurance policy "shall be incontestable not later than two years from its date, except for non-payment of premiums." *Cardenas*, 731 F.3d at 500. Article 3.44(3) was amended in 1963 to include the "lifetime of the insured" provision and was re-codified at Section 1101.006 in 2001, with no substantive changes. *Id*. at 500-01. After an extensive analysis on the two statutory provisions, the *Cardenas* Court specifically held that "the language of the two sections and the case law lead us to our conclusion that § 1101.006 applies to policy reinstatements, that the sections are consistent with one another, and that § 3.104 applies subject to § 1101.006's provisions." *Id*. at 501.

It would behoove any practitioner to closely track the date the life insurance policy was issued, any reinstatement date of the policy and the date the insured died, as all will effect when an insurance policy becomes incontestable.

### C. *Tex. Ins. Code. Ann.* § 705.105: Applicability of Other Law

> Subchapter A does not apply to a life insurance policy:
>
> (1) that contains a provision making the policy incontestable *after two years or less*; and
> (2) on which premiums have been duly paid.

*Tex. Ins. Code. Ann*. § 705.105. Emphasis supplied. Subchapter A includes Texas Insurance Code Sections 705.004 and 705.005 involving misrepresentations in policy applications and notice to the insured of the misrepresentations. *Id*.

## V. DOCUMENTS ACCOMPANYING A LIFE INSURANCE POLICY

The following are statutes addressing documents that must be attached to a life insurance policy.

### A. *Tex. Ins. Code Ann.* § 705.103: Documents to Accompany Policy

> Except as otherwise provided by this code, a life insurance policy must be accompanied by a copy of:
>
> (1) the policy application; and
> (2) any questions and answers given in connection with the application.

*Tex. Ins. Code. Ann*. § 705.103.

This statutory provision is applied to prevent the use of the insured's statements which were *not* attached to the policy when the insurer has sought to avoid payment by proof that the statements were false and were fraudulently made in order to procure issuance of the policy. *Johnson v. Prudential Ins. Co*., 519 S.W.2d 111, 114 (Tex. 1975). The application must be attached to the policy as a precondition to its use in the insurer's defense of misrepresentation. *Id*. There can be no reliance on an unattached application to defeat payment of life insurance proceeds. *Fredonia State Bank v. General American Life Ins. Co*., 881 S.W.2d 279, 279 (Tex. 1994). Representations in an application not attached to the policy cannot be the basis of a misrepresentation defense and an insurer cannot rely upon an inured's representations in the application to avoid coverage. *Id.* at 288; *Riner v. Allstate Life Ins. Co.*, 131 F.3d 530, 537-38 (5th Cir. 1998).

The burden of proof of establishing an insurer's failure to attach an application to an insurance policy to preclude the assertion of the affirmative defense of misrepresentation is borne by the party who would avoid consideration of the defensive claim of misrepresentation. *Fredonia State Bank*, 906 S.W.2d at 90.

### B. *Tex. Ins. Code Ann.* § 1101.003 and 28 *Tex. Admin. Code* § 3.103

> A life insurance policy must provide that the policy or the policy and the application for the policy constitute the entire contract between the parties.

*Tex. Ins. Code Ann* § 1101.003.

> The policy must provide that the policy, or policy and application, shall constitute the entire contract between the parties. Regardless of any statement to the contrary, the policy will be deemed incomplete if it attempts to incorporate by reference the provisions of any instrument which changes or adds to the terms of the policy.

28 *Tex. Admin. Code* § 3.103.

In addition to these statutes, the exact language of the life insurance policy should be reviewed. The insurer may have contractually agreed to which of the insured's representations it may or may not rely on to deny a claim. As a hypothetical, an insurance policy may state: "No statement by the insured or the applicant will be used by us to contest a claim unless the statement is in an attached application or in an attached amendment to an application." If the insurer

is seeking to use a misrepresentation in a *supplement* to the application—like in an additional questionnaire—the beneficiary will argue that the insurer may not rely on any *supplement*, as a *supplement* is not the *application* or an *amendment to the application*.

A practitioner should carefully review exactly which documents were attached to the life insurance policy at the time it was issued and provided to the insured, exactly what misrepresentations the insurer is seeking to use against the insured, and which documents these misrepresentations come from. These answers directly affect which misrepresentations the insurer can use against the insured.

## VI. CONCLUSION

Life insurance claims are complex and multifarious, especially the insurer's requirement to prove an insured's "intent to deceive." There are numerous factors, facts, nuances and minefields affecting the propriety of a rescission of a policy by an insurer for a misrepresentation. All facts should be evaluated.