

RESCISSION OF LIFE INSURANCE POLICIES IN TEXAS—TIME TO CORRECT SOME OLD ERRORS

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I. INTRODUCTION

For over seventy years, Texas courts have required an insurer seeking to rescind a life insurance policy to show (among other elements) that the insured had the “intent to deceive” the insurer into issuing the coverage.¹ In adopting this requirement, Texas courts have followed the minority view; in

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¹ See *Union Bankers Ins. Co. v. Shelton*, 889 S.W.2d 278, 281–82 (Tex. 1994) (observing that “[t]he proposition that an insured’s intent to deceive is likewise required is well established in the common law of this state”). In *Shelton*, the Texas Supreme Court cited *Lion Fire Insurance Co. v. Starr*, 71 Tex. 733, 12 S.W. 45, 46 (1888), which involved a personal property fire insurance policy, as the first case to announce this rule, and in 1933, the Texas Commission of Appeals extended this requirement to life insurance policies. See *Am. Cent. Life Ins. Co. v. Alexander*, 56 S.W.2d 864, 866 (Tex. Comm’n App. 1933, judgm’t adopted). Both the Texas Supreme Court and the Fifth Circuit have held that an insurer seeking to rescind a life insurance policy must plead and prove five elements: (1) the making of a 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. See *Lee v. Nat’l Life Assurance Co. of Can.*, 632 F.2d 524, 527 (5th Cir. 1980); *Mayes v. Mass. Mut. Life Ins. Co.*, 608 S.W.2d 612, 616 (Tex. 1980). These requirements were apparently first articulated in this manner in *General American Life Insurance Co. v. Martinez*, 149 S.W.2d 637, 640–41 (Tex. Civ. App.—El Paso 1941, writ dismissed judgment cor.).

most states, it is enough if the misrepresentation (provided it was material) was negligent or careless.² Intent to deceive is obviously a high standard to meet, and Texas courts have generally held that it cannot be established on summary judgment.³

Texas courts have also held that an insurer cannot rescind a life insurance policy after it has been in force for two years, even if the insured indisputably made an intentional misrepresentation in the application.⁴ In requiring a showing of intent during the first two years a policy is in force

²See *Shelton*, 889 S.W.2d at 285 (Phillips, C.J., concurring) (observing that Texas has “adopted the minority position that intent to deceive is required for cancellation of an insurance policy on the ground of a misrepresentation”); see also *Tingle v. Pac. Mut. Ins. Co.*, 837 F. Supp. 191, 192 (W.D. La. 1993) (noting that the majority rule is that “a material representation need not have been fraudulently made in order to be available to avoid a policy” (quoting 45 C.J.S. *Insurance* § 548 (1993))); William H. Danne, Jr., Annotation, *Modern Status of Rules Regarding Materiality and Effect of False Statement by Insurance Applicant as to Previous Insurance Cancellations or Rejections*, 66 A.L.R.3d 749, 781–82 (1975) (“The prevailing view in the absence of a statute to the contrary is that a materially false warranty or representation by an insurance applicant will defeat recovery on the policy even if made in good faith or as the result of inadvertence or ignorance.”). Similarly, federal common law under the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. §§ 1001–1461 (2000), does not require that the misrepresentation be fraudulent; rather, it is enough if the misrepresentation was material. See *Tingle*, 837 F. Supp. at 193.

³See *Cartusciello v. Allied Life Ins. Co. of Tex.*, 661 S.W.2d 285, 288 (Tex. App.—Houston [1st Dist.] 1983, no writ); see also *Flowers v. United Ins. Co. of Am.*, 807 S.W.2d 783, 786 (Tex. App.—Houston [14th Dist.] 1991, no writ) (noting that knowledge of one’s health condition is insufficient to presume intent as a matter of law); *Estate of Diggs v. Enter. Life Ins. Co.*, 646 S.W.2d 573, 576 (Tex. App.—Houston [1st Dist.] 1982, writ ref’d n.r.e.) (reversing summary judgment where the court determined it could not “presume an intent to deceive from the fact that [the insured], with a long history of heart ailments, made false statements on his application for insurance”). Texas courts have suggested, however, that intent may be established as a matter of law where there is strong evidence of collusion between the insured and the agent. See *Lee*, 632 F.2d at 528; *Washington v. Reliable Life Ins. Co.*, 581 S.W.2d 153, 160 (Tex. 1979).

⁴See *Kan. Life Ins. Co. v. First Bank of Truscott*, 124 Tex. 409, 78 S.W.2d 584, 586 (1935). The court observed:

[T]he statute and policy provide that after the expiration of the period prescribed there may be no contest at all of the validity or the binding effect of the policy, with certain specified exceptions which may serve as reasons or grounds for contest, and fraud is not one of the exceptions.

Id.; see also *Cent. States Life Ins. Co. v. Byrnes*, 375 S.W.2d 330, 334 (Tex. Civ. App.—Austin 1964, writ ref’d n.r.e.) (noting that, where the premiums on the policy were fully paid and a contest was not made within two years, “the policy is, ipso facto, incontestable”).

and prohibiting rescission after a policy has been in force for two years even if the insured committed fraud, Texas courts have improperly failed to give meaning to a long line of Texas statutes, such as the recently repealed Texas Insurance Code article 21.35, that compelled contrary results.

In 1963, the Texas Legislature “charged the Texas Legislative Council with the task of planning and executing a permanent statutory revision program to ‘clarify and simplify the statutes and to make the statutes more accessible, understandable, and usable.’”⁵ As part of this effort, the Texas Legislature recently completed a recodification of the Texas Insurance Code. Although the 2003 session law states that it “is intended as a recodification only,” with “no substantive change in law. . .intended,”⁶ the Texas Supreme Court has held that “clear, specific language” in a recodified statute that changes prior law must be applied as written.⁷ If the revised statutes on misrepresentations by policyholders, which are codified at Texas Insurance Code sections 705.001–.105, are applied as written, then insurers have an excellent argument that significant changes have been made to the elements an insurer must establish to rescind a life insurance policy.⁸ These revised statutes give Texas courts the opportunity to rectify their improper imposition of an intent to deceive requirement during the first two years a life insurance policy is in force and to reconsider their refusal to permit fraud-based rescissions after a policy has been in force for two years.

II. THE COMMON-LAW REQUIREMENT OF INTENT TO DECEIVE

The requirement of intent to deceive is not a creature of Texas statutory law; instead, it resulted from judicial rulemaking.⁹ As the Texas Supreme Court noted in *Union Bankers Insurance Co. v. Shelton*, the first case to

⁵ *Fleming Foods of Tex., Inc. v. Rylander*, 6 S.W.3d 278, 283 (Tex. 1999) (quoting TEX. GOV'T CODE ANN. § 323.007(a) (Vernon 1988)).

⁶ Act of May 22, 2003, 78th Leg., R.S., ch. 1274, § 27, 2003 Tex. Gen. Laws 3611, 4139.

⁷ *Fleming Foods*, 6 S.W.3d at 284.

⁸ TEX. INS. CODE ANN. §§ 705.001–.105 (Vernon 2006).

⁹ See S. Leigh Moore, Comment, *A Promising Alternative to Intent to Deceive: Intent to Induce Issuance*, 48 BAYLOR L. REV. 273, 278 (1996) (observing that “[t]he intent to deceive requirement was not born out of any certain case; rather, the requirement is a creature of misunderstandings and misconstruction that grew into accepted law through the desire of courts to uphold lower courts’ decisions if at all possible”).

impose this requirement was the 1888 decision in *Lion Fire Insurance Co. v. Starr*.¹⁰ *Starr* was a suit for benefits under a personal property fire insurance policy that contained the following provision: “Any fraud, or attempt at fraud, or any false swearing, on the part of the assured, shall cause a forfeiture of all claim under this policy.”¹¹ The insurer alleged (among other defenses) that the policy was rendered void because the insured committed fraud in submitting his claim.¹² After a jury verdict in favor of the insured for the face amount of the policy, the insurer appealed and alleged error in the trial court’s refusal to charge the jury that the policy by its terms was void if the insured’s claim was fraudulent.¹³ The Texas Supreme Court reversed, finding the parties had expressly agreed that fraud, attempted fraud, or false swearing would result in a forfeiture under the policy.¹⁴ Consequently, the fraud requirement in *Starr* was a creature of the parties’ contract, not the common law, and the supreme court’s actual holding was merely that the insurer was entitled to submit that contractual defense to the jury.

Westchester Fire Insurance Co. v. Wagner involved a similar contractual provision.¹⁵ The fire insurance policy at issue in *Wagner* provided that it “shall be void. . . in case of fraud or false swearing by the insured touching any matter relating to this insurance.”¹⁶ The insurer denied the named insured’s claim on the ground the destroyed goods belonged to a third party even though the insurer’s agent knew of the third party’s interest.¹⁷ After concluding that the insurer was bound by the agent’s knowledge, the *Wagner* court rejected the insurer’s argument that the policy was annulled by the named insured’s sworn statement that the insured owned the destroyed property.¹⁸ Without citation to any authority, the *Wagner* court observed: “It is the settled rule that false statements, to avoid a policy, must have been willful, and with design to deceive or

¹⁰ See *Union Bankers Ins. Co. v. Shelton*, 889 S.W.2d 278, 281–82 (Tex. 1994) (citing *Lion Fire Ins. Co. v. Starr*, 71 Tex. 733, 12 S.W. 45, 46 (1888)).

¹¹ *Starr*, 12 S.W. at 46.

¹² *Id.* at 45.

¹³ *Id.* at 45–46.

¹⁴ *Id.* at 46.

¹⁵ 24 Tex. Civ. App. 140, 57 S.W. 876, 877 (1900, writ ref’d).

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

defraud.”¹⁹ Since the named insured had informed the insurer’s agent of the third party’s ownership interest, the *Wagner* court found the trial court did not err in refusing to submit the requested issue.²⁰

The intent-to-deceive requirement eventually made its way from the finding of a forfeiture due to an intentional misrepresentation during the claim process²¹ to the rescission of a life insurance policy due to a misrepresentation in the application process.²² In *American Central Life Insurance Co. v. Alexander*, the insurer denied liability on the ground the insured had made misrepresentations in his application for coverage.²³ The beneficiary specially excepted to the insurer’s failure to allege the misrepresentations were intentionally made.²⁴ The trial court sustained the special exceptions and entered judgment in the beneficiary’s favor, and the court of civil appeals affirmed.²⁵ In its analysis, the Texas Commission of Appeals cited *Cooley’s Briefs on the Law of Insurance*²⁶ and *Wagner*²⁷ in support of its assertion that the misrepresentation must have been willful or made fraudulently with the intent to deceive, even though neither of those authorities necessarily compelled that result.²⁸

Over time, the intent-to-deceive requirement became increasingly entrenched in Texas law.²⁹ In *Clark v. National Life & Accident Insurance Co.*, the insurer sought to rescind a life insurance policy within two years of its issuance on the ground the insured had made fraudulent misrepresentations in his application.³⁰ The jury found the insured was in

¹⁹ *Id.*

²⁰ *Id.* at 878.

²¹ *Lion Fire Ins. Co. v. Starr*, 71 Tex. 733, 12 S.W. 45, 46 (1888).

²² *Am. Cent. Life Ins. Co. v. Alexander*, 56 S.W.2d 864, 866 (Tex. Comm’n App. 1933, judgm’t adopted).

²³ *Id.* at 865.

²⁴ *Id.* at 865–66.

²⁵ *Id.* at 865 (citing *Am. Cent. Life Ins. Co. v. Alexander*, 39 S.W.2d 86, 86, 90 (Tex. Civ. App.—Amarillo 1931, writ granted)).

²⁶ *Id.* at 866 (citing 3 ROGER W. COOLEY, BRIEFS ON THE LAW OF INSURANCE 1988 (1905)).

²⁷ *Id.* (citing *Westchester Fire Ins. Co. v. Wagner*, 24 Tex. Civ. App. 140, 57 S.W. 876, 877 (1900, writ ref’d)).

²⁸ See Moore, *supra* note 9, at 279–81 (analyzing *Wagner*, 57 S.W. at 877; *Alexander*, 56 S.W.2d at 866).

²⁹ See *Mayes v. Mass. Mut. Life Ins. Co.*, 608 S.W.2d 612, 616 (Tex. 1980); *Alexander*, 56 S.W.2d at 866.

³⁰ 145 Tex. 575, 200 S.W.2d 820, 821 (1947).

sound health at the time the policy was issued, and the insurer did not request the submission of any issues on its rescission defense.³¹ The trial court entered judgment in the beneficiary's favor, but the court of civil appeals reversed, finding the insurer's fraud defense was established as a matter of law.³² The Texas Supreme Court disagreed and affirmed the trial court's judgment.³³ As part of its analysis, the supreme court cited *Alexander* and *Wagner* in support of its assertion that "[i]t is the settled rule that, in order to avoid a policy, false statements must have been made willfully and with design to deceive or defraud."³⁴ After *Clark*, the Texas Supreme Court repeatedly relied on these cases in requiring insurers seeking rescission to prove intent.³⁵

For the most part, these courts did not predicate their imposition of an intent requirement on the Texas statutes governing rescission,³⁶ which is not surprising because those statutes did not by their terms require a showing of intent during the first two years a life insurance policy was in force.³⁷ For example, Texas Insurance Code article 21.16, which was entitled

³¹ *Id.* at 822.

³² *Id.* at 821.

³³ *Id.* at 824.

³⁴ *Id.* at 822.

³⁵ See *Union Bankers Ins. Co. v. Shelton*, 889 S.W.2d 278, 281–82 (Tex. 1994) (citing *Clark*, 200 S.W.2d at 822–23; *Mayes v. Mass. Mut. Life Ins. Co.*, 608 S.W.2d 612, 616 (Tex. 1980); *Allen v. Am. Nat'l Ins. Co.*, 380 S.W.2d 604, 607–08 (Tex. 1964)). Although this element is typically characterized as the "intent to deceive," the Texas Supreme Court observed in *Shelton* that "the utterance of a *known* false statement, made with intent to induce action . . . is equivalent to an intent to deceive." *Shelton*, 889 S.W.2d at 282 n.7 (citing *Allen*, 380 S.W.2d at 608); see also *Haney v. Minn. Mut. Life Ins. Co.*, 505 S.W.2d 325, 328 (Tex. Civ. App.—Houston [14th Dist.] 1974, writ ref'd n.r.e.) (stating that "[t]he jury findings of the making of known false statements, with intent to induce action on the part of the insurance company, amounted to a finding of an intent to deceive"). Intent to induce action represents an easier test for an insurer to satisfy, as the jury is more likely to find the insured intended to induce the insurer to act than he intended to deceive it. Moreover, the insurer can argue that language in the application stating the insured is requesting the insurer to issue coverage on the basis of his disclosures enables the insurer to establish intent as a matter of law.

³⁶ See *Am. Cent. Life Ins. Co. v. Alexander*, 56 S.W.2d 864, 866 (Tex. Comm'n App. 1933, judgment not adopted); *Winchester Fire Ins. Co. v. Wagner*, 24 Tex. Civ. App. 140, 57 S.W. 876, 877–78 (1900, writ ref'd).

³⁷ See Insurance Code, 52d Leg., R.S., ch. 491, arts. 21.16–17, 21.19, 1951 Tex. Gen. Laws 1074–75, repealed by Act of May 20, 2003, 78th Leg., R.S., ch. 1274, § 26(a)(1), 2003 Tex. Gen. Laws 3611, 4138.

“Misrepresentation by Policyholder,” required a showing of materiality but was silent on the issue of intent:

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.³⁸

In turn, Texas Insurance Code article 21.17 was entitled “Notice of Misrepresentation” and did not require a showing of intent:

In all suits brought upon insurance contracts or policies hereafter issued or contracted for in this State, no defense based upon misrepresentations made in the applications for, or in obtaining or securing the said contract, shall be valid, unless the defendant shall show on the trial that, within a reasonable time after discovering the falsity of the representations so made, it gave notice to the assured, if living, or, if dead, to the owners or beneficiaries of said contract, that it refused to be bound by the contract or policy; provided, that ninety days shall be a reasonable time; provided, also, that this article shall not be construed as to render available as a defense any immaterial

³⁸ *Id.* art. 21.16, (repealed 2003). In the same vein, Texas Insurance Code article 21.18 was entitled “Immaterial Misrepresentation” and provided: “No recovery upon any life, accident or health insurance policy shall ever be defeated because of any misrepresentation in the application which is of an immaterial fact and which does not affect the risks assumed.” *Id.* art. 21.18, *repealed by* Act of May 20, 2003, 78th Leg., R.S., ch. 1274, § 26(a)(1), 2003 Tex. Gen. Laws 3611, 4138.

misrepresentation, nor to in any wise modify or affect Article 21.16 of this code.³⁹

On the other hand, Texas Insurance Code article 21.19, which was entitled “Misrepresenting Loss or Death” and addressed misrepresentations made during the claim process, expressly required that the misrepresentation be both material *and* “fraudulently made”:

Any provision in any contract or policy of insurance issued or contracted for in this State which provides that the same shall be void or voidable, if any misrepresentations or false statements be made in proofs of loss or death, as the case may be, shall be of no effect, and shall not constitute any defense to any suit brought upon such contract or policy, *unless it be shown upon the trial of such suit that the false statement made in such proofs of loss or death was fraudulently made and misrepresented a fact material to the question of the liability of the insurance company upon the contract of insurance sued on, and that the insurance company was thereby misled and caused to waive or lose some valid defense to the policy.*⁴⁰

Although neither article 21.16 nor article 21.17 (both of which addressed misrepresentations in applications) required an insurer to prove intent, and article 21.19 (which addressed misrepresentations in the claim process) expressly required a showing of fraud, as noted above, both the Texas Supreme Court and the Fifth Circuit imposed an intent requirement for rescissions.⁴¹

In *Alexander*, the Texas Commission of Appeals found support for the imposition of an intent-to-deceive requirement in Texas Revised Civil Statutes article 4732, which required all life insurance policies to contain a provision stating that “all statements made by the insured shall, in the

³⁹ *Id.* art. 21.17 (repealed 2003).

⁴⁰ *Id.* art. 21.19 (repealed 2003).

⁴¹ See *Lee v. Nat'l Life Assurance Co. of Can.*, 632 F.2d 524, 527 (5th Cir. 1980); *Mayes v. Mass. Mut. Life Ins. Co.*, 608 S.W.2d 612, 616 (Tex. 1980).

absence of fraud be deemed representations and not warranties.”⁴² Prior to the adoption of this statute’s predecessor in 1909,⁴³ Texas courts applied the strict obligations of warranties, which permitted an insurer to avoid a policy where any statement of the insured identified as a warranty was not literally and exactly true.⁴⁴ Not surprisingly, insurers sought to use this doctrine to void coverage on the basis of misstatements that were irrelevant to the issue of whether the coverage would have been issued in the first place.⁴⁵ For example, in *Blackstone v. Kansas City Life Insurance Co.*, the insurer sought to rescind two life insurance policies on the ground that the insured had misrepresented his place of birth and residence and the number of his brothers and sisters, none of which had anything to do with his insurability.⁴⁶

Upon scrutiny, however, this provision does not support the imposition of the intent-to-deceive requirement. In effect, this provision equated the making of a fraudulent representation with a breach of a warranty, both of which permitted an insurer to avoid the policy. Importantly, however, if an insured’s statement was treated as a warranty, its falsity served to void the policy without regard to whether the statement was material.⁴⁷ Properly read, article 4732 thus permitted an insurer to rescind a life insurance policy on the basis of a fraudulent statement that was *not* material. In turn, the rescission statutes in force at the time (such as Texas Revised Civil Statutes

⁴² 56 S.W.2d 864, 866 (Tex. Comm’n App. 1933, judgment adopted) (quoting Act of March 22, 1909, 31st Leg., R.S., ch. 108, § 22, 1909 Tex. Gen. Laws 192, 200 (current version at TEX. INS. CODE ANN. § 1101.007 (Vernon 2006))).

⁴³ Act of March 22, 1909, 31st Leg., R.S., ch. 108, § 22, 1909 Tex. Gen. Laws 192, 200.

⁴⁴ See, e.g., *Supreme Lodge Knights & Ladies of Honor v. Payne*, 101 Tex. 449, 108 S.W. 1160, 1162 (1908) (“The fact warranted, being untrue, rendered the certificate void.”); *Kan. Mut. Life Ins. Co. v. Pinson*, 94 Tex. 553, 63 S.W. 531, 531 (1901) (noting “the general rule that the breach of a warranty in an insurance policy works a forfeiture of the contract”).

⁴⁵ See, e.g., *Pinson*, 63 S.W. at 531–32 (finding that a policy was void for breach of warranty where the insured misstated the ages of his five sisters by a few years).

⁴⁶ 107 Tex. 102, 174 S.W. 821, 821–23 (1915).

⁴⁷ See *Bhd. of R.R. Trainmen Ins. Dep’t of Cleveland, Ohio v. Green*, 143 Tex. 86, 182 S.W.2d 804, 804 (1944) (“Whether material or not to the risk, the representations were warranties, and since at least some of them were admittedly untrue, they avoided the policy.”); *Goddard v. E. Tex. Fire Ins. Co.*, 67 Tex. 69, 1 S.W. 906, 907 (1886) (observing that, if a given clause was a warranty, “the law exacts a compliance with their terms, according to their true intent and meaning, whether material or not, or whether known to the assured or not, if he had the opportunity; and it was his duty, under the circumstances, to acquaint himself with them”).

article 5043) permitted a rescission on the basis of a material misrepresentation but did not expressly require a showing of intent.⁴⁸ By allowing a rescission upon a showing of either a fraudulent, non-material representation (which was effectively a warranty pursuant to article 4732) or a material misrepresentation (which under article 5043 need not have been intentionally made), Texas law would have been consistent with the majority rule, which has long permitted rescissions on the basis of a misrepresentation that was fraudulent *or* material.⁴⁹ Texas courts nonetheless adopted, on the basis of questionable analysis, the minority position that an insured's misrepresentation must be both fraudulent *and* material before an insurer could rescind his coverage.

III. THE STATUTORY INCONTESTABLE CLAUSE

Like many states, Texas requires that life insurance policies contain certain provisions.⁵⁰ Under Texas Insurance Code article 3.44(3), which was enacted in 1951 and repealed effective June 1, 2003, a life insurance policy was required to contain a provision substantially providing that the policy "shall be incontestable not later than two years from its date, except for non-payment of premiums."⁵¹ Based primarily on this statute and its predecessors, Texas courts held that an insurer could not contest a life

⁴⁸ See Act of Mar. 27, 1903, 28th Leg., R.S. ch. 69, § 1, 1903 Tex. Gen. Laws 94, 94 (current version at TEX. INS. CODE ANN. § 705.004 (Vernon 2006) (requiring the party seeking rescission to show "that the matter or thing misrepresented was material to the risk or actually contributed to the contingency or event upon which said policy became due and payable"))).

⁴⁹ See, e.g., RESTATEMENT (SECOND) OF CONTRACTS § 164(1) (1981) ("If a party's manifestation of assent is induced by either a fraudulent *or* a material misrepresentation by the other party upon which the recipient is justified in relying, the contract is voidable by the recipient."). According to one commentator, however, most material misrepresentations are intentionally made. See Robert R. Googins, *Fraud and the Incontestable Clause: A Modest Proposal for Change*, 2 CONN. INS. L.J. 51, 63 (1996) ("Of course, it would have to be an unusual case for a material misrepresentation of a manifest condition to be other than intentional.").

⁵⁰ See generally Insurance Code, 52d Leg., R.S., ch. 491, 1951 Tex. Gen. Laws 868, 903–04 (current version at TEX. INS. CODE ANN. §§ 1101.001–.013).

⁵¹ *Id.* at 903. Effective June 1, 2003, the Texas Legislature enacted Texas Insurance Code section 1101.006(a), which provides in pertinent part: "[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." TEX. INS. CODE ANN. § 1101.006(a).

insurance policy for any reason (including fraud) after it had been in force for two years.⁵²

On the other hand, the conclusion that article 3.44(3) and its predecessors prohibited an insurer from contesting a life insurance policy for any reason after it had been in force for two years effectively rendered meaningless the latter part of Texas Insurance Code article 21.35, which was entitled “Policies and Applications” and, as of its repeal effective April 1, 2005, provided:

Except as otherwise provided in this code, every contract or policy of insurance issued or contracted for in this State shall be accompanied by a written, photographic or printed copy of the application for such insurance policy or contract, as well as a copy of all questions asked and answers given thereto. The provisions of Articles 21.16, 21.17, and 21.19 of this code shall not apply to policies of life insurance in which there is a clause making such policy indisputable after two (2) years or less, provided premiums are duly paid; provided further, that *no defense based upon misrepresentation made in the application for, or in obtaining or securing, any contract of insurance upon the life of any person being or residing in this State shall be valid or enforceable in any suit brought upon such contract two (2) years or more after the date of its issuance, when premiums due on such contract for the said term of two (2) years have been paid to, and received by, the company issuing such contract, without notice to the assured by the company issuing such contract of its intention to rescind the same on account of misrepresentation so made, unless*

⁵² See Kan. Life Ins. Co. v. First Bank of Truscott, 124 Tex. 409, 78 S.W.2d 584, 586 (1935); Cent. States Life Ins. Co. v. Byrnes, 375 S.W.2d 330, 334 (Tex. Civ. App.—Austin 1964, writ ref’d n.r.e.). Since the incontestable clause is legislatively mandated, there is little justification for construing it against insurers. See Republic Nat’l Bank of Dallas v. Nw. Nat’l Bank of Fort Worth, 578 S.W.2d 109, 115 (Tex. 1978) (“In Texas a writing is generally construed most strictly against its author and in such a manner as to reach a reasonable result consistent with the apparent intent of the parties.”). But see Houston Title Guar. Co. v. Fontenot, 339 S.W.2d 347, 350 (Tex. Civ. App.—Houston 1960, writ ref’d n.r.e.) (“When [the insurer] voluntarily wrote the policy it accepted such terms and adopted the language prescribed by the Board of Insurance Commissioners.”).

*it shall be shown on the trial that such misrepresentation was material to the risk and intentionally made.*⁵³

In essence, the first part of article 21.35 required that a life insurance policy be accompanied by a copy of the application. The second part of this article rendered articles 21.16, 21.17, and 21.19 inapplicable if the policy provided it was indisputable after two years or less; otherwise, an insurer had to comply with those articles as well. Finally, the third part of article 21.35 (1) should have, by its terms, permitted an insurer to raise a misrepresentation defense after a policy had been in force for two years if the insurer could establish the misrepresentation was material to the risk and intentionally made, and (2) suggested, by its express reference to intent, that an insurer did not have to show intent during the first two years the policy was in force. Although Texas courts rejected both arguments, they did so based on questionable rationales.

One of the first cases addressing the tension between the predecessor to article 3.44(3) and the third part of the predecessor to article 21.35 is *American National Insurance Co. v. Welsh*.⁵⁴ In *Welsh*, the insurer issued a life insurance policy on March 24, 1924 that provided it was incontestable “after having been in force two years during the life time of the assured.”⁵⁵ The insured died on August 13, 1924, and the insurer gave notice within ninety days thereafter it was rescinding the policy due to the insured’s misrepresentations.⁵⁶ On May 4, 1926, the beneficiaries sued the insurer, who filed an amended answer on January 22, 1927 alleging the insured had fraudulently misrepresented her health condition in the application.⁵⁷ The trial court struck the insurer’s misrepresentation defense because it was not alleged within two years of the policy’s issuance, and the Waco Court of Civil Appeals affirmed.⁵⁸

The Texas Commission of Appeals affirmed, and as part of its analysis, it engaged in a lengthy discussion of the history of Texas Revised Civil Statutes article 4741 (which was the predecessor to article 3.44(3)) and Texas Revised Civil Statutes article 4951 (which was the predecessor to

⁵³ Insurance Code, 52d Leg., R.S., ch. 491, 1951 Tex. Gen. Laws 868, 1084–85.

⁵⁴ 22 S.W.2d 1063, 1064–65 (Tex. Comm’n App. 1930, judgment adopted).

⁵⁵ *Id.* at 1063.

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ *Id.* at 1064.

article 21.35).⁵⁹ According to the *Welsh* court, article 4741 and article 4951 were in conflict, and article 4741, which became law in 1909 and applied to every policy issued after December 31, 1909, trumped article 4951, which was originally enacted in 1903.⁶⁰ Consequently, article 4951 applied to all insurance policies except life insurance policies issued after December 31, 1909, which were governed by article 4741.⁶¹

Even though both the statute requiring the two-year incontestable clause (article 3.44(3) and its predecessors) and the statute permitting misrepresentation-based defenses after a policy had been in force for two years upon a showing that the misrepresentation “was material to the risk and intentionally made” (article 21.35 and its predecessors) were repeatedly renewed (and occasionally renumbered) without substantive change, courts continued to cite *Welsh* in holding that article 21.35 and its predecessors applied only to policies issued prior to December 31, 1909.⁶² For example, the Texas Supreme Court held in 1945 that an insurer’s fraud defense with respect to a policy issued in August 1941 was not authorized by Texas Revised Civil Statutes article 5049 (which was article 4951’s successor and article 21.35’s predecessor) and was precluded by the two-year incontestable clause required by Texas Revised Civil Statutes article 4732, section 3 (which was article 4741’s successor and article 3.44(3)’s predecessor).⁶³ The supreme court reached this result based primarily on *Welsh*,⁶⁴ even though the text of article 5049 did not limit its application to policies issued before December 31, 1909.⁶⁵

⁵⁹*Id.*

⁶⁰*Id.* This conclusion presumably resulted from the application of the now-codified canon of construction that, in the event of an irreconcilable conflict, a subsequent statute controls over a previously enacted one. See TEX. GOV’T CODE ANN. § 312.014(a) (Vernon 2005) (“If statutes enacted at the same or different sessions of the legislature are irreconcilable, the statute latest in date of enactment prevails.”); see also *id.* § 311.025(a).

⁶¹*Welsh*, 22 S.W.2d at 1064.

⁶²See, e.g., *Patton v. Am. Home Mut. Life Ins. Co.*, 143 Tex. 373, 185 S.W.2d 420, 422 (1945); *First Tex. Prudential Ins. Co. v. Pedigo*, 50 S.W.2d 1091, 1092 (Tex. Comm’n App. 1932, holding approved), *overruled by* *Fredonia State Bank v. Gen. Am. Life Ins. Co.*, 881 S.W.2d 279 (Tex. 1994).

⁶³See *Patton*, 185 S.W.2d at 422.

⁶⁴See *id.*

⁶⁵See Act of March 27, 1903, 28th Leg., R.S., ch. 69, § 1, art. 3096eee, 1903 Tex. Gen. Laws 94, 95.

Courts extended the holding of *Welsh* that article 21.35 and its predecessors did not apply to policies issued after December 31, 1909 to cases that did not involve the incontestable clause. For example, in *Pedigo*, the policy was issued on October 1, 1928, and the insured died on March 31, 1929, which was less than four weeks after she had given birth.⁶⁶ The insurer asserted the insured had fraudulently and falsely represented in her application she was not pregnant.⁶⁷ At trial, the insurer sought to introduce the application into evidence, and the beneficiary successfully objected to its introduction on the ground the insurer had not attached a copy of it to the policy.⁶⁸ As noted above, the first part of article 5049 (which was the predecessor to article 21.35) required an insurance policy to be accompanied by a copy of the application, and courts had held that an unattached application did not have any evidentiary value.⁶⁹ The Texas Commission of Appeals nonetheless determined, in reliance on *Welsh*, that the attachment requirement in article 5049 did not apply because the policy in question was issued after 1909.⁷⁰ After considering other statutes, the *Pedigo* court found the application admissible, even though the insurer had failed to attach a copy of it to the policy.⁷¹

In 1990, the Fifth Circuit followed *Pedigo* in holding that an insurer's failure to attach a copy of the application to the policy did not bar the insurer's rescission defense, notwithstanding the attachment requirement in article 21.35.⁷² In *Wise v. Mutual Life Insurance Co. of New York*, the insurer did not deliver a copy of the application to the insured prior to his death, and the parties agreed that, if the undelivered application (which contained the insured's misrepresentations) was admissible, the insurer could rescind the policy.⁷³ The beneficiary argued that article 21.35, which had been enacted in 1951, applied to all life insurance policies.⁷⁴ The Fifth

⁶⁶ 50 S.W.2d at 1091.

⁶⁷ *Id.*

⁶⁸ *Id.* at 1091-92.

⁶⁹ See *id.* at 1092 (citing *Sw. Surety Ins. Co. v. Hico Oil Mill*, 229 S.W. 479, 482 (Tex. Comm'n App. 1921, judgm't adopted); *Nat'l Live Stock Ins. Co. v. Gomillion*, 178 S.W. 1050, 1051 (Tex. Civ. App.—Austin 1915, writ ref'd)).

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² See *Wise v. Mut. Life Ins. Co. of N.Y.*, 894 F.2d 140, 141-42 (5th Cir. 1990).

⁷³ *Id.* at 140.

⁷⁴ *Id.* at 141.

Circuit disagreed, finding that article 21.35 contained the same language as did article 5049 and that it was constrained to follow *Pedigo*.⁷⁵ The Fifth Circuit thus held that article 21.35 did not apply to life insurance policies and that an insurer's failure to attach a copy of the application did not preclude its rescission defense.⁷⁶

As such, even though the text of article 21.35 had been kept in force without substantive change⁷⁷ since 1903, through the early 1990s, Texas courts limited its application to only those life insurance policies issued prior to December 31, 1909. In 1994, however, the Texas Supreme Court finally gave meaning to a portion of article 21.35.⁷⁸ In *Fredonia State Bank v. General American Life Insurance Co.*, the insurer denied the beneficiary's claim on the grounds that the insured had committed suicide and had made material misrepresentations in his application for coverage.⁷⁹ The jury found that the medical portion of the insured's application was not attached to the policy, and the trial court entered judgment for the beneficiary.⁸⁰ In reversing and rendering, the Tyler Court of Appeals relied on *Wise*, found that the insurer's failure to attach a copy of the medical portion of the application was "immaterial," and rejected the beneficiary's assertion that article 21.35 prevented the insurer from relying on misrepresentations that were not attached to the policy.⁸¹

After a detailed analysis of *Wise*, *Pedigo*, and *Welsh*, the Texas Supreme Court rejected the holding of *Welsh*—that article 21.35's predecessor did not apply to policies issued after 1909—as overly broad, overruled the holding of *Pedigo* that an insurer could seek rescission on the basis of misrepresentations in an unattached application, and held that at least the first part of article 21.35 applied to life insurance policies issued

⁷⁵ *Id.*

⁷⁶ *Id.* at 141–42.

⁷⁷ Prior to 1989, article 21.35 applied to "every contract or policy of insurance issued or contracted for in this State"; in 1989, however, the Texas Legislature amended this article to make it applicable to "every contract or policy of *life* insurance." Act of May 22, 1989, 71st Leg., R.S., ch. 656, § 1, 1989 Tex. Gen. Laws 2163, 2163, *repealed by* Act of May 20, 2003, 78th Leg., R.S., ch. 1274, § 6(a)(1), 2003 Tex. Gen. Laws 3611, 4138.

⁷⁸ See *Fredonia State Bank v. Gen. Am. Life Ins. Co.*, 881 S.W.2d 279, 287–88 (Tex. 1994).

⁷⁹ *Id.* at 280.

⁸⁰ *Id.*

⁸¹ *Id.* at 283, 285.

after 1909.⁸² Since only the attachment of the application was at issue, the supreme court did not address whether the third part of article 21.35 applied to policies issued after 1909. In dicta, however, the supreme court stated: “We conclude that prior to the 1989 amendment, article 21.35 of the Texas Insurance Code applied to life insurance policies”⁸³ There do not appear to be any reported cases after *Fredonia State Bank* attempting to give meaning to the third part of article 21.35.

All told, Texas law was unsympathetic to any argument that the third part of article 21.35 allowed an insurer to rescind a life insurance policy after it had been in force for two years, even upon a showing of fraud. The two-year incontestable clause effectively rendered the third part of article 21.35 meaningless, even though the Texas Legislature continued the latter provision in force for almost a century without substantive change. While *Fredonia State Bank* finally gave meaning to the first part of article 21.35, the third part of that article languished in obscurity from the day its predecessor was enacted.

Texas law has also been inhospitable to any argument that article 21.35’s reference to intent after two years meant an insurer did not have to show intent during the first two years a life insurance policy was in force.⁸⁴ *Shelton* involved an insurer’s rescission of a health insurance policy, and at the time of the policy’s issuance, all Texas accident and sickness policies had to contain the following provision:

Time Limit on Certain Defenses: (a) After two years from the date of issue of this policy no misstatements, except fraudulent misstatements, made by the applicant in the application for such policy shall be used to void the policy or to deny a claim for loss incurred or disability (as defined in the policy) commencing after the expiration of such two-year period.

(The foregoing policy provision shall not be so construed as to affect any legal requirement for avoidance of a policy or denial of a claim during such initial two-year period, nor to limit the application of Section 3(B), (1), (2),

⁸² *Id.* at 287–88.

⁸³ *Id.* at 288.

⁸⁴ See *Union Bankers Ins. Co. v. Shelton*, 889 S.W.2d 278, 281–82 (Tex. 1994).

(3), (4), and (5) in the event of misstatement with respect to age or occupation or other insurance).⁸⁵

On the application, the insured denied he had ever been treated for or had any known indications of any disorders of his skeletal or muscular systems.⁸⁶ Seven months after the policy was issued, the insured underwent total hip replacement surgery to correct necrosis in his left hip joint.⁸⁷ The insurer cancelled the policy due to the insured's failure to disclose his hip problems.⁸⁸ The jury answered all of the questions against the insured but failed to find he intended to deceive the insurer.⁸⁹ The trial court nonetheless entered judgment for the insurer, but the court of appeals reversed and remanded the case for a new trial on the insured's bad-faith claim.⁹⁰

In its appeal to the Texas Supreme Court, the insurer sought to avoid the jury's no-intent finding by arguing that the first paragraph of article 3.70-3(A)(2)(a) implied an insurer could cancel a health insurance policy within two years of its issuance on the basis of innocent—non-fraudulent—misrepresentations.⁹¹ The Texas Supreme Court disagreed, finding in a plurality decision that the second paragraph of article 3.70-3(A)(2)(a), by its terms, meant this provision did not affect the determination of whether the insurer must prove intent during the first two years a policy was in force.⁹² The supreme court then held, in reliance on *Starr*, *Clark*, *Allen*, and *Mayes*,

⁸⁵ Act of June 6, 1955, 54th Leg., R.S., ch. 397, § 3(a)(2), 1955 Tex. Gen. Laws 1044, 1046, amended by Act of Sept. 19, 1969, 61st Leg., C.S., ch. 11, § 1, 1969 Tex. Gen. Laws 118, 118, repealed by Act of May 22, 2003, 78th Leg., R.S., ch. 1274, § 26(a)(1), 2003 Tex. Gen. Laws 3611, 4138. This provision is now codified at TEX. INS. CODE ANN. § 1201.208(a) (Vernon 2006). Although life insurers have not been allowed to include a comparable incontestable clause, they arguably could have rescinded, upon a showing of fraud, a life insurance policy that had been in force for over two years if courts had given meaning to the third part of article 21.35, which applied by its terms to "every contract or policy of *life* insurance." Act of May 22, 1989, 71st Leg., R.S., ch. 656, § 1, 1989 Tex. Gen. Laws 2163, 2163 (repealed 2003).

⁸⁶ *Shelton*, 889 S.W.2d at 279.

⁸⁷ *Id.*

⁸⁸ *Id.*

⁸⁹ *Id.*

⁹⁰ *Id.*

⁹¹ *Id.* at 279–80.

⁹² *Id.* at 281.

that the common law of Texas required a showing of intent during the first two years.⁹³

IV. THE RECODIFICATION OF THE TEXAS INSURANCE CODE

By virtue of the recent recodification of the Texas Insurance Code, significant changes have been made to Texas law on the rescission of life insurance policies. In 2003, the Texas Legislature completed its revision of the Texas Insurance Code, and the session law containing this recodification states: "This Act is intended as a recodification only, and no substantive change in law is intended by this Act."⁹⁴ Notwithstanding this admonition, the Texas Supreme Court has held courts must give effect to a recodified statute that is unambiguous, even if it results in a change in the law.⁹⁵ In the event of a conflict, the latter enactment controls: "We are compelled to conclude that when, as here, specific provisions of a 'nonsubstantive' codification and the code as a whole are direct, unambiguous, and cannot be reconciled with prior law, the codification rather than the prior, repealed statute must be given effect."⁹⁶ If the recodified statutes are given their plain meaning, insurers have an excellent argument that a showing of intent is not required to rescind a life insurance policy that has been in force for less than two years and that such a policy can, upon a showing of intent, be rescinded after it has been in force for two years.

Effective April 1, 2005, the Texas Legislature adopted Title 5 to the Texas Insurance Code.⁹⁷ Indicative of the concern with fraud in the

⁹³ *Id.* at 281–82.

⁹⁴ Act of May 22, 2003, 78th Leg., R.S., ch. 1274, § 27, 2003 Tex. Gen. Laws 3611, 4139.

⁹⁵ See *Fleming Foods of Tex., Inc. v. Rylander*, 6 S.W.3d 278, 284 (Tex. 1999) (holding that when clear, specific language is used in a recodified statute that changes prior law, it must be applied as written, even though the enabling act provided that "no substantive change in the law is intended").

⁹⁶ *Id.* at 286. Although the Texas Legislature disagreed with this result and passed a bill in 2001 that would have overruled *Fleming Foods*, Governor Rick Perry vetoed it. See Veto Message of Gov. Perry, Tex. H.B. 2809, H.J. OF TEX., 77th Leg., R.S. (2001).

⁹⁷ Act of May 22, 2003, 78th Leg., R.S., ch. 1274, §§ 1–28, 2003 Tex. Gen. Laws 3611, 3611–4139. As part of this recodification, articles 21.16, 21.17, 21.18, 21.19, and 21.35 (among other statutes) were all repealed effective April 1, 2005. *Id.* § 26(a)(1), 2003 Tex. Gen. Laws at 4138.

insurance area,⁹⁸ Subtitle F is entitled “Insurance *Fraud*,” and its first four chapters (Chapters 701-704) are entitled “Insurance *Fraud* Investigations,”⁹⁹ “Motor Vehicle Theft and Motor Vehicle Insurance *Fraud* Reporting,”¹⁰⁰ “Covered Entity’s *Antifraud* Action,”¹⁰¹ and “*Antifraud* Programs.”¹⁰² In contrast to these repeated references to fraud, Chapter 705 (which contains the recodified rescission requirements) is entitled “*Misrepresentations* by Policyholders.”¹⁰³

Chapter 705 contains three subchapters: general provisions applicable to all insurance policies,¹⁰⁴ special provisions applicable to life, accident, and health insurance policies,¹⁰⁵ and special provisions applicable to only life insurance policies.¹⁰⁶

The recodified statutes establish the following requirements with respect to all insurance policies: To establish a policy is void or voidable, the insurer must show 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,” both of which are questions of fact.¹⁰⁷ The insurer may

⁹⁸ According to the Texas Department of Insurance, insurance fraud “is one of the most costly white collar crimes in America, ranking second to tax evasion” and may have an annual total cost in excess of \$120 billion. Texas Department of Insurance Facts and Frequently Asked Questions, <http://www.tdi.state.tx.us/fraud/faq.html> (last visited Jan. 13, 2007). Consistent with its focus on insurance fraud, the Texas Legislature recently amended Texas Penal Code section 35.02 to make it a state jail felony to commit application-related fraud after September 1, 2005. TEX. PEN. CODE ANN. § 35.02 (a-1), (d) (Vernon Supp. 2006). The Texas Legislature had criminalized claim-related fraud in 1995. See Act of May 25, 1995, 74th Leg., R.S., ch. 621, § 1, 1995 Tex. Gen. Laws 3483, 3483. Similarly, any person who determines or reasonably suspects a fraudulent insurance act (which now includes application-related fraud) has been or is about to be committed must report the information in writing within 30 days to the insurance fraud unit of the Texas Department of Insurance. TEX. INS. CODE ANN. § 701.051(a) (Vernon 2006).

⁹⁹ TEX. INS. CODE ANN. §§ 701.001–.154.

¹⁰⁰ *Id.* §§ 702.001–.006.

¹⁰¹ *Id.* §§ 703.001–.104.

¹⁰² *Id.* §§ 704.001–.054.

¹⁰³ *Id.* §§ 705.001–.105. Admittedly, “[t]he heading of a title, subtitle, chapter, subchapter, or section does not limit or expand the meaning of a statute.” TEX. GOV’T CODE ANN. § 311.024 (Vernon 2006). The titles chosen by the Texas Legislature, while not controlling, are nonetheless instructive.

¹⁰⁴ TEX. INS. CODE ANN. §§ 705.001–.005.

¹⁰⁵ *Id.* § 705.051.

¹⁰⁶ *Id.* §§ 705.101–.105.

¹⁰⁷ *Id.* § 705.004(b)–(c). This requirement is generally consistent with the materiality

use a misrepresentation defense “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” to the insured or his beneficiaries.¹⁰⁸

These requirements do 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.”¹⁰⁹ As such, if a life insurance policy provides that it is incontestable after two years or less, the insurer need not provide the ninety-day notice required by section 705.005. If the policy does not so provide, the insurer must give notice, within ninety days of discovering the falsity of the insured’s representation, that it will not be bound by the policy.

In turn, section 705.051 (which applies to only life, accident, and health insurance policies) provides: “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.”¹¹⁰

requirement in the now-repealed article 21.16. *See* Insurance Code, 52d Leg., R.S., ch. 491, § 2(b), 1951 Tex. Gen. Laws 868, 1074 (repealed 2003). Under this disjunctive provision, an insurer must prove either the misrepresentation was material to its decision to issue coverage or the undisclosed condition contributed to the insured’s death. *See* *Bettes v. Stonewall Ins. Co.*, 480 F.2d 92, 95 (5th Cir. 1973) (rejecting the plaintiff’s claim that a misrepresentation must both be material and contribute to the loss); *Fireman’s Fund Ins. Co. v. Wilburn Boat Co.*, 300 F.2d 631, 644 (5th Cir. 1962) (“It is obvious that a fact can be material to the risk without its contributing to bring about the destruction of the insured property.”).

¹⁰⁸TEX. INS. CODE ANN. § 705.005(b). This requirement is generally consistent with the 90-day notice requirement in the now-repealed article 21.17. *See* Insurance Code, 52d Leg., R.S., ch. 491, § 2(b), 1951 Tex. Gen. Laws 868, 1075 (repealed 2003). Under section 705.005, the insurer must establish the date it discovered the falsity of the insured’s representation and that it gave notice to the insured or his beneficiary less than 91 days thereafter of its refusal to be bound by the policy. *See* *Nat’l Union Fire Ins. Co. of Pittsburgh, Pa. v. Hudson Energy Co.*, 780 S.W.2d 417, 424–25 (Tex. App.—Texarkana 1989, writ granted) (interpreting article 21.17), *aff’d*, 811 S.W.2d 552 (Tex. 1991). The notice must state the insurer refuses to be bound by the policy; an interim notice the insurer is investigating a potential misrepresentation is not enough. *See id.* (finding that the insurer’s letter stating it was investigating the claim did not satisfy the notice requirement in article 21.17).

¹⁰⁹TEX. INS. CODE ANN. § 705.105 (Vernon 2006). This provision is generally consistent with the second part of the now-repealed article 21.35. *See* Insurance Code, 52d Leg., R.S., ch. 491, § 2(e), 1951 Tex. Gen. Laws 868, 1084–85 (repealed 2003).

¹¹⁰*Id.* § 705.051. These requirements are generally consistent with the requirements in the

Since neither this section nor any of the other sections articulating the rescission requirements expressly refer to intent, an insurer seeking to rescind a life, accident, or health insurance policy can argue that a material misrepresentation that was made negligently or carelessly is sufficient.¹¹¹ If intent was to be required, the Texas Legislature could have easily so stated, and it would defeat the purpose of a recodification to require parties to analyze the common law to retrieve this requirement.¹¹²

Finally, section 705.103, which applies to only life insurance policies, states that such a policy “must be accompanied by a copy of: (1) the policy application; and (2) any questions and answers given in connection with the application.”¹¹³ In turn, section 705.104 provides:

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:

now-repealed article 21.18. *See* Insurance Code, 52d Leg., R.S., ch. 491, § 2(b), 1951 Tex. Gen. Laws 868, 1075 (repealed 2003).

¹¹¹*See* Old Am. County Mut. Fire Ins. Co. v. Sanchez, 149 S.W.3d 111, 115 (Tex. 2004) (observing that “because we presume that every word of a statute has been included or excluded for a reason, we will not insert requirements that are not provided by law”); Cameron v. Terrell & Garrett, Inc., 618 S.W.2d 535, 540 (Tex. 1981) (observing that “we believe every word excluded from a statute must also be presumed to have been excluded for a purpose”). An insurer making this argument should nonetheless be prepared to establish the insured’s intent if the court (notwithstanding the recodification) elects to impose that requirement as a matter of Texas common law.

¹¹²*See* City of Garland v. Dallas Morning News, 22 S.W.3d 351, 358 (Tex. 2000) (“Courts are not responsible for omissions in legislation, but must take statutes as they find them.”); *see also* Fort Worth & D.C. Ry. Co. v. Welch, 183 S.W.2d 730, 736 (Tex. Civ. App.—Amarillo 1944, writ ref’d) (noting that a statutory revision “implies a re-examination and restatement of the law in a connected or improved form with or without material changes” and that “[i]t will be presumed that . . . the Legislature proceeded diligently and with full knowledge of the consequences of its act”).

¹¹³TEX. INS. CODE ANN. § 705.103. These requirements are generally consistent with the attachment requirement in the first part of the now-repealed article 21.35. *See* Insurance Code, 52d Leg., R.S., ch. 491, § 2(e), 1951 Tex. Gen. Laws 868, 1084–85 (repealed 2003).

(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*.¹¹⁴

By its terms, section 705.104 permits an insurer to rescind a life insurance policy more than two years after its issuance by showing either (1) it gave notice to the insured of its intent to rescind or (2) the misrepresentation was material to the risk and intentionally made. By permitting the rescission, upon a showing of an intentionally made misrepresentation, of a life insurance policy that has been in force for over two years, section 705.104 is consistent with—albeit stated differently than—Texas Insurance Code section 1201.208(a), which is the successor statute to the provision at issue in *Shelton* and permits the rescission of an individual accident and health insurance policy that has been in force for two years upon a showing of “a fraudulent misstatement.”¹¹⁵

In addition, section 705.104 (with its express reference to intent), when read together with section 705.051, which is silent on the issue of intent, strongly suggests that intent need not be shown to rescind a life, accident, or health insurance policy that has been in force for less than two years. Admittedly, the Texas Supreme Court rejected a comparable argument with respect to an accident and sickness insurance policy in *Shelton*; importantly, however, the second paragraph of the now-repealed Texas Insurance Code article 3.70-3(A)(2)(a), which was the provision at issue in *Shelton*, stated that the fraud exception in the first paragraph “shall not be so construed as to affect any legal requirement for avoidance of a policy . . . during such initial three year period”¹¹⁶ On the other hand, neither section 705.051 nor section 705.104 contain a comparable savings clause. In any event, the Texas Legislature is obviously capable of imposing an intent requirement

¹¹⁴ *Id.* § 705.104.

¹¹⁵ *Id.* § 1201.208(a).

¹¹⁶ Act of May 24, 1955, 54th Leg., R.S., ch. 397, § 3(A)(2), 1955 Tex. Gen. Laws 1044, 1046, *repealed by* Act of May 22, 2003, 78th Leg., R.S. ch. 1274, § 26(a)(1), 2003 Tex. Gen. Laws 3611, 4138.

where it sees fit, and its decision to require intent in section 705.104 (which applies only to life insurance policies that have been in force for two years) but not in section 705.051 must be acknowledged and given meaning.¹¹⁷

Further support for the conclusion that intent need not be shown to rescind a life, accident, or health insurance policy that has been in force for less than two years may be found in the differences between section 705.003, which concerns misrepresentations in proof of loss or death, and section 705.004, which concerns misrepresentations in a policy application. Both of these sections establish a general rule that a policy provision stating that a misrepresentation makes the policy void or voidable has no effect and is not a defense in a suit brought on the policy.¹¹⁸ With respect to a misrepresentation in proof of loss or death, the general rule is inapplicable if the insurer establishes the misrepresentation was (among other requirements) “fraudulently made.”¹¹⁹ Tellingly, a showing of fraud is *not* required with respect to a misrepresentation in a policy application.¹²⁰ Rather, it is enough if the insurer establishes the misrepresentation was “material to the risk” or “contributed to the contingency or event on which the policy became due and payable.”¹²¹ All told, if the terms of chapter 705 are applied as written, a showing of intent is not required to rescind a life, accident, or health insurance policy that has been in force less than two years.

The incontestable clause required by section 1101.006(a) is not fatal to this analysis. If a life insurance policy contains the required incontestable clause, the insured will likely argue that the terms of his agreement with the insurer (i.e., his life insurance policy) prevent the insurer from rescinding the policy after the premiums have been paid for two years, regardless of the effect of section 705.104. If the incontestable clause is construed as an

¹¹⁷ See *Meritor Auto., Inc. v. Ruan Leasing Co.*, 44 S.W.3d 86, 90 (Tex. 2001) (“Ordinarily when the Legislature has used a term in one section of a statute and excluded it in another, we will not imply the term where it has been excluded.”); see also *Smith v. Baldwin*, 611 S.W.2d 611, 616 (Tex. 1980) (observing that, where proof of intent was required by some sections of the DTPA but not by others, intent would not be implied where excluded).

¹¹⁸ TEX. INS. CODE ANN. §§ 705.003(a), 705.004(a).

¹¹⁹ *Id.* § 705.003(b). This requirement is generally consistent with the fraud requirement in the now-repealed article 21.19. See Insurance Code, 52d Leg., R.S., ch. 491, § 2(b), 1951 Tex. Gen. Laws 868, 1075 (repealed 2003).

¹²⁰ *Id.* § 705.004(b).

¹²¹ *Id.*

absolute bar to any challenge to a life insurance policy that has been in force for two years, then section 705.104 is thereby rendered meaningless, as its application is limited to situations in which a life insurance policy has been in force for over two years. In order to give section 705.104 some meaning, it must be interpreted as constituting an exception to the incontestable clause.¹²²

Indeed, in light of its current interest in combating insurance fraud, it is unlikely the Texas Legislature intended the incontestable clause to provide repose to an applicant who has committed fraud but has managed to keep his wrongdoing hidden for two years.¹²³ In fact, courts from other jurisdictions have permitted rescissions after the expiration of the incontestable period, even in the absence of a provision (such as section 705.104) providing statutory support for that relief.¹²⁴ These decisions reflect a growing trend of courts declining to use incontestable clauses to provide sanctuary to individuals who have committed fraud.¹²⁵

Moreover, this result is consistent with a number of doctrines recognized by Texas courts that, if applied, would enable an insurer to rescind, upon a showing of fraud, a life insurance policy that had been in

¹²² See *Ex parte Pruitt*, 551 S.W.2d 706, 709 (Tex. 1977) ("Statutes should be read as a whole and construed to give meaning and purpose to every part."); *In re Azle Manor, Inc.*, 83 S.W.3d 410, 414 (Tex. App.—Fort Worth 2002, no pet.) (noting that, where statutes may be in conflict, the court should harmonize them to give effect to both by assigning each a meaning that will permit each to stand); see also TEX. GOV'T CODE ANN. § 311.021 (Vernon 2005) ("In enacting a statute, it is presumed that . . . the entire statute is intended to be effective.").

¹²³ Cf. *Paul Revere Life Ins. Co. v. Haas*, 644 A.2d 1098, 1107–08 (N.J. 1994) (observing that it was doubtful that the New Jersey Legislature, in enacting the incontestable provision, ever contemplated that it was authorizing an applicant's deception by allowing fraudulent applicants to recover for a concealed disability).

¹²⁴ See, e.g., *Fioretti v. Mass. Gen. Life Ins. Co.*, 53 F.3d 1228, 1237 (11th Cir. 1995) (permitting a rescission based on a fraudulent misrepresentation, even though the incontestable period had expired prior to the insured's death); *Ledley v. William Penn Life Ins. Co.*, 651 A.2d 92, 95 (N.J. 1995) (observing that "[e]ven after the expiration of the contestability period, an insurer may deny a claim if the insured committed fraud in the policy application") (citing *Haas*, 644 A.2d at 1102-03).

¹²⁵ See generally 17 LEE R. RUSS & THOMAS F. SEGALLA, *COUCH ON INSURANCE* § 240:63 (3d ed. 2005) (noting that "several recent decisions have recognized that fraud need not be explicitly excepted from the incontestable clause for the insurer to be allowed to raise that defense after the expiration of the contestable period"); see also Googins, *supra* note 50, at 51–52 (observing that "instances of clear fraud should no longer be routinely protected even though the contestable period has run").

force for more than two years. One such doctrine is fraudulent inducement. “Texas law has long imposed a duty not to induce another to enter into a contract through the use of fraudulent misrepresentations.”¹²⁶ By virtue of this legal duty, which is separate and independent from the duties established by the underlying contract, a party is not bound by a contract procured by fraud.¹²⁷ As the Fifth Circuit has observed:

When pleaded as a defense to a contract, fraudulent inducement is related to the fundamental issue in contract actions is there an enforceable agreement? A fraudulently induced party has not assented to an agreement because the fraudulent conduct precludes the requisite mutual assent. Fraudulent inducement is an elementary concept in the law of contracts, and is intended to shield a party from liability in a contract action only when another party has procured the alleged contract wrongfully.¹²⁸

To establish that a party has been fraudulently induced into entering a contract, a party must show:

(1) a material representation was made; (2) the representation was false; (3) when the representation was made, the speaker knew it was false or made it recklessly without any knowledge of the truth and as a positive assertion; (4) the speaker made the representation with the intent that the other party should act upon it; (5) the party

¹²⁶ *Atl. Lloyds Ins. Co. v. Butler*, 137 S.W.3d 199, 214–15 (Tex. App.—Houston [1st Dist.] 2004, pet. denied) (citing *Formosa Plastics Corp. USA v. Presidio Eng’rs & Contractors, Inc.*, 960 S.W.2d 41, 46 (Tex. 1998)).

¹²⁷ *Id.* at 215; *see also Formosa Plastics Corp. USA*, 960 S.W.2d at 46 (“As a rule, a party is not bound by a contract procured by fraud.”); *Davis v. Estridge*, 85 S.W.3d 308, 310 (Tex. App.—Tyler 2001, pet. denied) (stating that “[n]ormally, fraud vitiates all transactions”). Notions of public policy support this result. *See Dallas Farm Mach. Co. v. Reaves*, 307 S.W.2d 233, 239 (Tex. 1957) (“In obedience to the demands of a larger public policy the law long ago abandoned the position that a contract must be held sacred regardless of the fraud of one of the parties in procuring it.”) (quoting *Bates v. Southgate*, 31 N.E.2d 551, 558 (Mass. 1941)).

¹²⁸ *Lyn-Lea Travel Corp. v. Am. Airlines, Inc.*, 283 F.3d 282, 289–90 (5th Cir. 2002) (citation omitted).

acted in reliance on the representation; and (6) the party thereby suffered injury.¹²⁹

Under this analysis, a life insurance policy with an incontestable clause may (like any other contract) be rescinded after the expiration of the incontestable period upon a showing of fraud, as the insurer did not truly assent to the policy.

Another potentially applicable doctrine is that of fortuity. The purpose of insurance is to protect insureds against unknown or fortuitous risks, and Texas courts have found that fortuity is an inherent requirement of all risk insurance policies and a standard component of Texas insurance law.¹³⁰ The fortuity doctrine precludes coverage for both “known losses,” which are losses the insured knew had occurred prior to making the insurance contract, and “losses in progress,” which are ongoing, progressive losses the insured knows or should have known of at the time he purchased the policy.¹³¹ As one Texas court observed, “the carrier insures against a risk, not a certainty.”¹³² As such, an insured that is or should be aware of a known loss or an ongoing progressive loss is not entitled to coverage.¹³³ “The doctrine has its roots in the prevention of fraud; because insurance policies are designed to insure against fortuities, fraud occurs when a policy is misused to insure a certainty.”¹³⁴ Although an insured’s death is

¹²⁹E.R. Dupuis Concrete Co. v. Penn Mut. Life Ins. Co., 137 S.W.3d 311, 319 (Tex. App.—Beaumont 2004, no pet.) (citing *Formosa Plastics Corp. USA*, 960 S.W.2d at 47).

¹³⁰*See, e.g.,* RLI Ins. Co. v. Maxxon Sw., Inc., 265 F. Supp. 2d 727, 730 (N.D. Tex. 2003), *aff’d*, 108 Fed. Appx. 194 (5th Cir. 2004); *Scottsdale Ins. Co. v. Travis*, 68 S.W.3d 72, 75 (Tex. App.—Dallas 2001, pet. denied) (citing *Two Pesos, Inc. v. Gulf Ins. Co.*, 901 S.W.2d 495, 502 (Tex. App.—Houston [14th Dist.] 1995, no writ)); *see also* Googins, *supra* note 50, at 61 (“The crux of an aleatory contract, in the insurance context, is that the obligation of the insurer is contingent on the happening of a fortuitous event—not an event that is certain to occur.”).

¹³¹*Travis*, 68 S.W.3d at 75; *see also Two Pesos, Inc.*, 901 S.W.2d at 501 (“An insured cannot insure against something that has already begun and which is known to have begun.”).

¹³²*Two Pesos, Inc.*, 901 S.W.2d at 501 (quoting *Bartholomew v. Appalachian Ins. Co.*, 655 F.2d 27, 29 (1st Cir. 1981)).

¹³³*Travis*, 68 S.W.3d at 75; *see also RLI Ins. Co.*, 265 F. Supp. 2d at 731–32.

¹³⁴*Travis*, 68 S.W.3d at 75 (citing *Inland Waters Pollution Control, Inc. v. Nat’l Union Fire Ins. Co.*, 997 F.2d 172, 175–77 (6th Cir. 1993)); *see also RLI Ins. Co.*, 265 F. Supp. 2d at 730 (“The doctrine has its roots in the premise that, because insurance policies are designed to insure against fortuities, insuring a certainty constitutes fraud.”). Like the doctrine of fraudulent inducement, the doctrine of fortuity is grounded on public policy. *See Two Pesos, Inc.*, 901 S.W.2d at 501 (“Texas has long recognized that it is contrary to public policy for an insurance

undoubtedly a certainty, his fraudulent nondisclosure of a serious health condition that is in the process of shortening his life runs afoul of the doctrine of fortuity and justifies the rescission of his life insurance coverage, even if he outlives the two-year incontestable period.

A third doctrine supporting the rescission of a life insurance policy that has been in force for at least two years is equitable estoppel. Under Texas law, a party relying on this doctrine must show:

- (1) a false representation or concealment of material facts;
- (2) made with knowledge, actual or constructive, of those facts;
- (3) with the intention that it should be acted on;
- (4) to a party without knowledge or means of obtaining knowledge of the facts;
- (5) who detrimentally relies on the representations.¹³⁵

An insurer could thus allege an insured is equitably estopped from relying on the incontestable clause where he has made a fraudulent misstatement in his application.¹³⁶ Under this analysis, the running of the incontestable clause would be equitably tolled as a result of the insured's fraud and would begin to run only when the insurer obtained actual knowledge of the insured's fraud.¹³⁷

company knowingly to assume a loss occurring prior to its contract.”); *see also RLI Ins. Co.*, 265 F. Supp. 2d at 732 (observing that “affording coverage to the defendants would violate Texas public policy by allowing protection for a loss in progress and permitting insureds to insulate themselves from any future determination of wrongdoing arising out of pre-policy conduct”).

¹³⁵*Med. Care Am., Inc. v. Nat’l Union Fire Ins. Co. of Pittsburgh, Pa.*, 341 F.3d 415, 422 (5th Cir. 2003) (citing *Johnson & Higgins of Tex., Inc. v. Kenneco Energy, Inc.*, 962 S.W.2d 507, 515–16 (Tex. 1998)); *see also Johnson v. Structured Asset Servs., LLC*, 148 S.W.3d 711, 721 (Tex. App.—Dallas 2004, no pet.) (“The doctrine of estoppel can only be invoked where the conduct of one of the parties has been such as to induce action in reliance upon it, and where it would operate as a fraud upon the assured if they were afterwards allowed to disavow their conduct.”).

¹³⁶*See Googins, supra* note 49, at 80 (“All of the fundamental elements generally required to support equitable estoppel are usually present where an insurer might assert that the insured should be estopped to plead the bar of the incontestable clause.”).

¹³⁷In the same vein, an insurer could argue that the discovery rule tolls the running of the incontestable clause during the period it was unaware of the insured's fraud. *See Velsicol Chem. Corp. v. Winograd*, 956 S.W.2d 529, 531 (Tex. 1997) (observing that the discovery rule applies only if the injury is inherently undiscoverable and the evidence of the injury is objectively verifiable).

Permitting an insurer to rescind a life insurance policy that has been in force for over two years upon a showing of fraud is defensible from a policy perspective. In 1945, the Texas Supreme Court offered two rationales in support of the conclusion that a life insurance policy should be incontestable after it has been in force for two years: (1) it “is calculated to induce diligence on the part of the insurer in examining into the truth or falsity of the statements made in the application and at the same time affords a reasonable period for such investigation,” and (2) it assures the insured “of the permanency of his investment, dependent wholly, after the expiration of the stipulated period, upon the prompt payment of his premiums.”¹³⁸ Upon examination, neither of these rationales should be allowed to validate coverage that was procured through fraud.¹³⁹

For example, the “diligence and reasonable period for investigation” rationale ignores the manner in which life insurance policies are underwritten and issued. The application process for a life insurance policy typically begins with the completion of an application by the potential insured, in which he is asked various questions regarding his insurability. As a general rule, an insurer is entitled to rely on the accuracy of the applicant’s answers.¹⁴⁰ If the applicant truthfully discloses adverse information—such as identifying a doctor who treated him for prior cardiac problems—a prudent insurer will investigate that condition—such as by requesting records from the cardiologist—to decide whether and to what extent to offer coverage.¹⁴¹ On the other hand, if an applicant with prior

¹³⁸Patton v. Am. Home Mut. Life Ins. Co., 143 Tex. 373, 185 S.W.2d 420, 422 (1945) (quoting Am. Nat’l Ins. Co. v. Briggs, 156 S.W. 909, 911 (Tex. Civ. App.—Dallas 1913, writ ref’d)).

¹³⁹See David G. Newkirk, *An Economic Analysis of the First Manifest Doctrine*: Paul Revere Life Insurance Co. v. Haas, 644 A.2d 1098 (N.J. 1994), 76 NEB. L. REV. 819, 839 (1997) (“Certainly no public policy reason exists to protect frauds unless their protection is an unavoidable evil as the only way innocent insureds are provided the comfort to which they are entitled.” (citing Googins, *supra* note 49, at 69)).

¹⁴⁰See Am. Nat’l Ins. Co. v. Navarrete, 758 S.W.2d 805, 808 (Tex. App.—El Paso 1988, writ denied) (observing that an insurer does not have any duty to make further inquiry as to the health of an applicant if all of the health questions in the application are answered in the negative).

¹⁴¹If the applicant truthfully identifies a general practitioner who treated him for a common malady—such as a cold—but fraudulently fails to identify his cardiologist, an insurer which elected not to obtain the general practitioner’s records is still potentially entitled to rescission, even though those records would have identified the cardiologist. See Koral Indus. v. Sec.-Conn. Life Ins. Co., 802 S.W.2d 650, 651 (Tex. 1990) (per curiam) (“Failure to use due diligence to

cardiac problems fraudulently fails to disclose those problems in response to the insurer's specific questions, the insurer may well be unable, short of sending a mass mailing to all of the healthcare providers in the area, to ferret out the applicant's true health history.¹⁴²

Moreover, the diligence and reasonable period for investigation rationale ignores that insurers typically conduct their underwriting before issuing coverage. Insurers do not take questionable risks up front in hopes of catching them during the contestable period.¹⁴³ Once the policy is issued, an insurer typically will not investigate the representations the insured made during the application process unless it receives a claim or learns (probably through happenstance) of a potential misrepresentation.¹⁴⁴

In addition, an insurer's ability to investigate an applicant's representations is limited in several ways. If an applicant does not provide any adverse health information on his application, the insurer may find it difficult to investigate the accuracy of those representations, as it does not know of any providers from whom it can seek information. Although an insurer can obtain information on an applicant from databases such as the Medical Information Bureau, those databases tend to contain only the information that has been submitted to them, and if an applicant has not applied for other coverage, there may not be any record of him in those databases. Moreover, numerous federal and other laws may limit an insurer's ability to obtain and utilize the information necessary to investigate the accuracy of the representations in an application.¹⁴⁵

suspect or discover someone's fraud will not act to bar the defense of fraud to the contract.").

¹⁴²In some instances—such as applications for larger policies—an insurer will also require an applicant to undergo a medical or paramedical examination, which can reveal additional information that may be contrary to the representations on his application. Many insurers, however, do not require these examinations with every application, possibly due to the expense associated with them. See *Equitable Life Assurance Soc'y of the U.S. v. New Horizons, Inc.*, 146 A.2d 466, 469 (N.J. 1958) ("It is physically and economically impossible for an insurer to give every potential insured an elaborate medical examination which will disclose the less obvious defects in his health.").

¹⁴³Googins, *supra* note 49, at 71.

¹⁴⁴*Id.*

¹⁴⁵See, e.g., Gramm-Leach-Bliley Act, Pub. L. No. 106-102, §§ 501–510, 113 Stat. 1338, 1436–45 (1999) (codified at 15 U.S.C. §§ 6801–6809); Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, 110 Stat. 1936 (1996) (codified in scattered sections of 42 U.S.C.).

Similarly, the need to assure the insured of the permanency of his investment should not excuse his actual fraud.¹⁴⁶ If an applicant must fraudulently represent his health history in order to obtain coverage, he is likely uninsurable and should not be permitted to invest in coverage in the first place.¹⁴⁷ Moreover, an insurer seeking to rescind coverage does not get to keep the premiums it has received; instead, the equitable nature of this remedy requires the premiums to be refunded.¹⁴⁸ By virtue of the insurer's return of the premiums, which are often refunded with interest, the insured is in essentially the same position that he would have been but for his fraud. In the end, no compelling reason exists to reward someone who has committed fraud merely because he has been able to hide his wrongful conduct for more than two years.

Finally, there should be little risk that insurers will improperly utilize this remedy. As noted above, establishing an insured's intent—whether to deceive or to induce action—is a high standard that can be difficult to prove, and those difficulties undoubtedly increase over time. A prudent insurer will think twice before assuming this burden. Moreover, an insurer's rescission of a life insurance policy is not without risks. For example, an insurer which is found to have improperly sought rescission must pay not only the actual damages (which are typically the policy proceeds) of the insured or beneficiary, but also prejudgment interest,¹⁴⁹ interest on the amount of the claim at the rate of 18% a year as damages,¹⁵⁰ the reasonable attorney's fees of the insured or beneficiary,¹⁵¹ and its own

¹⁴⁶Bear in mind, an applicant making an innocent (i.e., non-fraudulent) misrepresentation will still be entitled to the protections of this two-year incontestable period; it is only the fraudulent applicant who will not be entitled to repose.

¹⁴⁷See Newkirk, *supra* note 139, at 820 ("As insurance fraud has become more prevalent, however, [incontestable] clauses have been increasingly used by opportunists as a safe harbor for fraud.").

¹⁴⁸See *Leonard v. Eskew*, 731 S.W.2d 124, 131 (Tex. App.—Austin 1987, writ ref'd n.r.e.) ("The remedy of rescission requires that the parties be restored to the positions they occupied before the contract was made.").

¹⁴⁹*Teate v. Mut. Life Ins. Co. of N.Y.*, 965 F. Supp. 891, 895 (E.D. Tex. 1997); *Marineau v. Gen. Am. Life Ins. Co.*, 898 S.W.2d 397, 405 (Tex. App.—Fort Worth 1995, writ denied).

¹⁵⁰TEX. INS. CODE ANN. § 542.060(a) (Vernon 2006).

¹⁵¹*Id.*; see also TEX. CIV. PRAC. & REM. CODE ANN. §§ 38.001–.006 (Vernon 1997).

attorney's fees.¹⁵² The insurer also exposes itself to liability for bad faith.¹⁵³ These remedies should serve to limit any abuses by insurers of their exercise of this right.

V. CONCLUSION

Many actions have unintended consequences.¹⁵⁴ Although the Texas Legislature may not have intended to change Texas law on the rescission of life insurance policies, the recodification of the Texas Insurance Code has had that effect. If courts follow the Texas Supreme Court's admonition that recodified statutes are to be applied as written, even if the resulting interpretation changes the law, then the plain language of Chapter 705 of the Texas Insurance Code confirms that an insurer no longer must establish an insured's intent in seeking to rescind a life insurance policy that has been in force for less than two years. In this recodification, the Texas Legislature has moved Texas law in line with that of the majority of other jurisdictions, which permit the rescission of a life insurance policy on the basis of a misrepresentation that is either material or fraudulent.

Moreover, if Texas Insurance Code section 705.104 is given meaning, Texas has now joined the growing trend permitting insurers to rescind, upon a showing of an intentionally made, material misrepresentation, a life insurance policy that has been in force for two years, notwithstanding the

¹⁵² *Union Bankers Ins. Co. v. Shelton*, 889 S.W.2d 278, 286 (Tex. 1994) (Cornyn, J., concurring and dissenting) (observing that "even if an insurer that denies a claim prevails at trial, it must pay the costs of its own defense").

¹⁵³ *See id.* at 283 ("We hold that a cause of action for breach of the duty of good faith and fair dealing exists when the insurer wrongfully cancels an insurance policy without a reasonable basis."). Of course, if the insurer is found to be entitled to rescission, it had a reasonable basis as a matter of law for its handling of the insured's claim, thus barring a bad-faith finding. *See In re Nat'l Health Ins. Co.*, 109 S.W.3d 607, 610 (Tex. App.—Corpus Christi 2003, no pet.) ("A misrepresentation on an application defense is valid both to any claim for breach of contract as well as extra-contractual claims."); *see also Koral Indus. v. Sec.-Conn. Life Ins. Co.*, 802 S.W.2d 650, 651 (Tex. 1990) (per curiam) (showing of a defense to the payment of benefits under an insurance policy negated alleged violations of the Texas Insurance Code and the DTPA); *Bartlett v. Am. Republic Ins. Co.*, 845 S.W.2d 342, 348 (Tex. App.—Dallas 1992, no writ) (same).

¹⁵⁴ *See* Rob Norton, *Unintended Consequences*, THE CONCISE ENCYCLOPEDIA OF ECONOMICS, <http://www.econlib.org/library/Enc/UnintendedConsequences.html> (last visited Jan. 13, 2007) ("The law of unintended consequences, often cited but rarely defined, is that actions of people—and especially of government—always have effects that are unanticipated or 'unintended.'").

presence of a two-year incontestable clause. Ultimately, there is no compelling justification for providing sanctuary to an insured who has been able to keep his fraud secret for two years. By permitting an insurer to raise a fraud-based rescission claim after a policy has been in force for two years, the Texas Legislature has harmonized life insurance policies with individual accident and health insurance policies and other contracts, which innocent parties have long been able to avoid due to the other parties' fraudulent conduct and further evidenced its belief that insurance fraud should not be countenanced.