Further Thoughts About Insurance Misrepresentation Cases

Background
The task of undertaking to draft jury instructions for a statutory cause of action or defense, and thus the need to articulate elements and consider their application, can highlight questions latent in the statutory text and interpretive case law. This point certainly applies to Arkansas Code Annotated Section 23-79-107, concerning misrepresentations, omissions, concealment of facts, and incorrect statements (which for the sake of convenience I shall refer to collectively and somewhat imprecisely as “misrepresentations”) in statements made in applications or negotiations for life, accident, or health insurance policies or annuity contracts.¹ There currently are no Arkansas Model Jury Instructions regarding insurance misrepresentation, even though such cases have long been tried to juries and instructions have been the focus of litigation. At least two questions arise. The first is whether and when such cases properly may be tried to juries at all. The second involves the application of subsection 107(c), the causation element. I take a somewhat different approach to the causation issue than does Professor Sampson’s article in this volume.

The landscape at least with respect to rescission of health insurance policies may soon be changed when national health care reform legislation takes effect September 2010. Section 2712 of the Public Health Service Act, as amended by Section 1001 of the Patient Protection and Affordable Care Act, will limit rescission of health care insurance to cases of fraud or intentional misrepresentation of material

¹The full text of the statute is quoted in Professor Sampson’s article in this issue of Law Notes.

*The issues addressed in this Law Note came to my attention in my role as Reporter for the Arkansas Model Jury Instruction (Civil) Committee, but the views expressed herein are entirely my own and not those of the Committee. I would like to thank Roger Rowe and Kathryn Sampson for their helpful comments on previous drafts of this article.
The new law’s eventual constraints on health insurers’ ability to exclude applicants based on pre-existing conditions will likely further diminish the practical scope of the misrepresentation statute. Presumably, however, the federal law will not preempt section 23-79-107 with respect to other kinds of insurance, most notably life and credit life policies, which are implicated in many of the reported cases. Also, it remains to be seen whether the Act will be construed to preempt the field with respect to health insurance or will permit additional state-law protections for insureds and beneficiaries, such as a causal relation requirement even in cases of fraud or intentional misrepresentation.

1. May a case under Ark. Code Ann. § 23-79-107 be heard by a jury?

   a. Phelps v. U.S. Life Credit Life Ins. Co. and equitable jurisdiction

   This question, which surprisingly was not directly addressed by the Arkansas Supreme Court until 1999, two years before the merger of law and equity in Arkansas, is murkier than it first appears. In Phelps v. U.S. Life Credit Life Ins. Co., the court explicitly stated that a case in which the insurer raised an affirmative defense of misrepresentation and nondisclosure under the statute was properly transferred from circuit court to chancery because the circuit court lacked jurisdiction to provide the remedy of equitable rescission. Phelps relied on precedent holding that a circuit court lacked jurisdiction to enter an order of equitable rescission. The court also has stated in First Nat’l Bank of DeWitt v. Cruthis, a leading post-Amendment 80 case, that “Amendment 80 did not alter the jurisdiction of law and equity. It only consolidated jurisdiction in the circuit courts. Therefore, matters that could be submitted to a jury for decision and matters that must be decided by the court remain unaltered.”

   These seemingly straightforward statements of doctrine could be read to empower an insurer to avoid a jury trial by characterizing its statutory defense as a claim for equitable rescission. Indeed, a subsequent Court of Appeals case applying Phelps further suggests that the court might sua sponte so characterize the insurer’s position and refer the matter to equity. And one could point to pre-Cruthis cases evincing what Professor Watkins has called “a strict historical approach” to the jurisdictional divide between law and equity to argue that the Phelps doctrine survived the merger of law end equity in Amendment 80.


On closer consideration, however, there are a number of reasons to confine *Phelps* to its specific circumstances – a demand by the insurer for rescission before the merger of law and equity under Amendment 80. First, as recounted below, insurance misrepresentation cases – which in substance are often difficult to distinguish from *Phelps* – have been tried to juries in Arkansas for more than a century, a fact which also informs the next two points. Second, *Cruthis* notwithstanding, application of the *Phelps* doctrine after the merger of law and equity arguably is inconsistent with the right to a jury trial under Article 2, Section 7 of the Arkansas Constitution. Third, there is little beyond vestigial formalism, at least in the context of cases under the Arkansas insurance misrepresentation statute, to commend a doctrine that equips an insurer with a pleading device with which to trump an insurance beneficiary’s right to a jury trial when the beneficiary has begun an action at law to recover on the policy. Finally, *Phelps* itself offered an alternative basis for its own result, which obviated the need to reach the jurisdictional issue at all and left open the contention that its discussion of rescission and equity is dicta.

Lela Phelps brought a contract action in circuit court requesting a jury trial to enforce a credit life insurance policy issued in connection with an installment contract on her late husband’s purchase of a vehicle. U.S. Life Credit Life Insurance Co. denied the claim, “contending that decedent’s application answered misrepresented his true health condition,” that had it known the truth it would not have issued the policy, and that it “was therefore entitled to rescind [the policy] under applicable state law.” U.S. Life Credit Life Insurance Co. also moved for transfer to chancery on the grounds that it sought equitable rescission, an equitable remedy unavailable in circuit court. The circuit court granted the transfer. The chancellor found that both parties had acted in good faith, that the contract was ambiguous, and that subsection 107(a)(3) entitled the insurer to rescind a contract for incorrect statements which, had the truth been disclosed, would have led the insurer to deny coverage. In upholding the transfer to chancery, the Arkansas Supreme Court emphasized the distinction between equitable rescission, which seeks cancellation of an instrument, and rescission at law, “where the purpose of the action is merely to achieve return of the consideration paid as in a sale of goods.” According to *Maumelle Co. v. Eskola*, cited in *Phelps*, in rescission at law it is the return or tender of the property that effectuates the rescission and the law court merely grants restitution. In such cases the rescission is by act of the party and is a *condition precedent* to bringing an action to recover money owed by the other party to the contract; a recovery is dependent on the fact that the plaintiff has rescinded the contract by returning or tendering the property to the defendant. Unless rescission has occurred, the remedy of restitution is not available.
Thus, “[t]o maintain an action at law, the tender must be done at or prior to the time of the commencement of the action.”\(^\text{11}\) As the court put it in *Phelps*, “[r]escission at law would be appropriate where the purpose of the action is merely to achieve return of consideration paid as in sale of goods. However, in the instant case, cancellation of an instrument was the defense objective in seeking rescission. This remedy the circuit court could not grant.”\(^\text{12}\) Couch’s treatise supports the court’s statement in *Phelps*, at least when the insurer files an equitable plea for cancellation or rescission of the policy in response to the beneficiary’s claim.\(^\text{13}\)

A subsequent Court of Appeals case ruling on another appeal in Lela Phelps’s bundle of insurance claims, however, pushed the *Phelps* doctrine further to embrace cases in which the insurer did not explicitly plead a claim for equitable rescission. In *Capitol Life and Accident Ins. Co. v. Phelps*, the Court of Appeals applied *Phelps* to hold that an insurance misrepresentation case had been improperly brought in circuit court, even though the insurer had tendered return of premiums paid and had not specifically pled equitable rescission.\(^\text{14}\) The court’s rejection of the beneficiary’s argument that the insurer’s action constituted rescission at law is puzzling, but more important for present purposes is the court’s pre-Amendment 80 application of the principle, articulated for example in *Coran v. Keller*, that the circuit court’s lack of power to grant rescission was a matter of subject-matter jurisdiction which could be raised at any time, even by a trial or appellate court on its own motion.\(^\text{15}\)

Taken together, *Phelps* and *Capitol Life and Accident Ins. Co.* seem to say that an insurer’s invocation of subsection 107(a) – which as a practical matter relieves the insurer of all duties under the contract and thus effectively nullifies it – unless there has been a prior rescission at law by the insurer, constitutes a demand for equitable rescission the jurisdic-

11. *Id.*
12. 336 Ark. at 260, 984 S.W.2d at 427.
13. Where the distinction between a court of law and a court of equity has been abolished, the distinction between legal and equitable principles may remain important in determining what issues are to be tried by a jury, since a right to trial by jury exists only with respect to those issues which could be raised in a traditional “action at law,” and such right is not available with respect to those issues which could be raised in a traditional “action in equity.” Consequently, an insurer, which files its answer and equitable plea for the cancellation of a life policy within the contestable period in the beneficiary’s action at law to recover on the policy, is entitled to have the equitable issue tried before the case is submitted to the jury.

If an insurer brings an action to cancel a policy for the insured’s fraud in securing it, and the insured counterclaims for a loss under the policy, the insurer has a remedy at law by defending the counterclaim, and the insured is entitled to a trial by jury.

If equity has acquired jurisdiction of a suit to cancel an insurance policy, a cross petition seeking recovery on the policy should not be transferred to law, but rather, equity should adjudicate all the matters in issue.

tion for which is exclusively equitable. Before Amendment 80 under this view, the matter would have to have been transferred to equity; after Amendment 80 the circuit court could hear the matter but not before a jury. What is more, as a question of subject-matter jurisdiction, the issue not only may but must be raised by the courts sua sponte, even on appeal.

b. More than a century of insurance misrepresentation cases tried at law

Taken to this length, the doctrine is difficult to reconcile with the more than one hundred and twenty years of cases in which insurers have raised misrepresentation as an affirmative defense in Arkansas. Ever since 1889 in what, according to a comprehensive review, is the first such reported case, such matters have been tried to a jury without a hint of jurisdictional difficulty. Subsequent early insurance misrepresentation cases, which developed Arkansas law in this area, including the leading case of Providence Sav. Life Assur. Soc. v. Reutlinger (discussed in Professor Sampson’s article), similarly were tried to juries. A number of other misrepresentation cases, both before and after enactment of the Insurance Code, have been tried to juries, or circuit courts sitting as triers of fact, even though there is no indication of prior rescission at law. Other pre-Amendment 80 misrepresentation-in-application cases, whether tried to a jury or not, have been brought in circuit court. Some cases, however, were initiated in chancery.

16. Subsections 107(b) and (c) explicitly refer to “any action to rescind any policy or contract or to recover thereon.” (Emphasis added.) The insurer’s position in Phelps was based on subsection 107(a)(3) and nothing in the opinion suggests that a different outcome would obtain under subsections 107(a)(1) or (2). Indeed, Maumelle Co. itself involved a claim based on fraud in the inducement in a real estate transaction.

17. The Arkansas Supreme Court has repeatedly noted that the question of subject matter jurisdiction “can and indeed must be raised by this court sua sponte.” E.g., James v. Williams, 372 Ark. 82, 86, 270 S.W.3d 855, 859 (2008).


20. 58 Ark. 528, 25 S.W. 835 (1894).


22. E.g., Old American Life Ins. Co. v. McKenzie, 240 Ark. 984, 403 S.W.2d 94 (1966) (affirming jury verdict against insurer on accident and hospital policy, applying predecessor to section 107); Federal Life Ins. Co. v. Hase, 193 Ark. 816, 102 S.W.2d 841 (1937) (upholding jury verdict on life insurance policy against insurer’s defense that insured fraudulently omitted disclosure of existing disease); Inter-Ocean Cas. Co. v. Huddleston, 184 Ark. 1129, 45 S.W.2d 24 (1932) (case tried to “the court sitting as a jury”), modification by statute on other grounds recognized by Dopson v. Metropolitan Life Ins. Co., 244 Ark. 659, 426 S.W.2d 410 (1968) (chancery action for specific performance of rider to group hospitalization policy); Capitol Old Line Ins. Co. v. Gorondy, 1 Ark. App. 14, 612 S.W.2d 128 (Ark. App. 1981) (reversing jury verdict on ground that instructions erroneously omitted causation element).


24. E.g., Old Republic Ins. Co. v. Alexander, 245 Ark. 1029, 436 S.W.2d 829 (1969) (insurer instituted an action for rescission in chancery upon assertion of a claim by the insured under the policy); Dopson v. Metropolitan Life Ins. Co., 244 Ark. 659, 426 S.W.2d 410 (1968) (insurer brought a chancery action for specific performance of a rider to a group hospitalization policy).
Notably, other leading cases, addressing the causal relation issue, also seem to have assumed that the misrepresentation defense is appropriate for a jury. One is *National Old Line Insurance Co. v. People*, the seminal Arkansas case, discussed below (and in Professor Sampson’s article), adopting a causal relation element. William People bought a credit life insurance policy in connection with an automobile purchase. When he died and the finance company sued on the debt, his widow brought a cross-complaint against the insurer on the credit life policy. As in *Phelps*, “[t]he insurer denied liability on the ground that People had obtained the policy by a false and fraudulent statement that he was in good health, when in fact he was not.” The case was tried to a jury, whose verdict for insured’s widow was affirmed by the Arkansas Supreme Court on the ground that “the jury could have found that People’s death was not caused by either diabetes or high blood pressure [the allegedly undisclosed conditions], from which he was suffering when the policy was issued.” Another leading case in this area that went to a jury is *Southern Farm Bureau Life Ins. Co. v. Cowger*, which prospectively overruled *National Old Line Insurance Co.* on the causal relation issue. The court’s opinion says little about the proceedings below, stating only that the insurer refused to pay the policy amount to the beneficiary and describing the jury instructions relating to causation as an element of misrepresentation. It is obvious from the court’s ensuing discussion of causation, however, that the insurer claimed misrepresentation under Section 23-79-207(a) and there is no suggestion of rescission at law.

It is difficult to see how *National Old Line* and *Southern Farm Bureau*, or the number of other earlier cases, are as a matter of substance any more appropriate for a jury to decide than was *Phelps*. The insurer in each case sought essentially the same result — nullification of its obligations under the policy on the grounds of misrepresentation — and there is no indication in them that the insurer had accomplished rescission at law before seeking in effect to cancel the policy. Nor are those cases readily distinguishable from *Capitol Life and Accident Ins. Co.* (setting aside the question of rescission at law, which the Court of Appeals took out of the case in any event). Similarly, *Life & Casualty Ins. Co. of Tennessee v. Smith* did not question the circuit court’s jurisdiction to hear a case in which the insurer asserted that misrepresentation “vitiated” the policy, and there is no suggestion in the court’s opinion that the insurer had effected rescission at law before the action.

It is theoretically conceivable (although unlikely as a practical matter and in light of the statutory language) that an insurer denying coverage on the basis of misrepresentation under a health, accident, or disability policy

---

26. 256 Ark. at 138, 506 S.W.2d at 129.
27. 256 Ark. at 139, 506 S.W.2d at 129.
29. 245 Ark. 934, 436 S.W.2d 97 (1969) (reversing jury verdict for insured because instructions flawed).
is not also seeking nullification of the policy but intends instead for the policy otherwise to continue in force despite the disputed claim.\(^{30}\) Even in some cases tried at law involving such policies, however, the insurer explicitly argued that the policy should be held “void” for misrepresentation.\(^{31}\) To be sure, some of the cases that were tried to a jury either implicitly\(^{32}\) or explicitly\(^{33}\) involved rescission at law, but even in those cases the plaintiff was not seeking restitution because the insurer had already refunded the premiums paid. What plaintiffs sought was enforcement of the policies and what the insurer sought was avoidance of liability under them – the very same outcomes the parties sought in all the other cases.

### c. Reconciling the apparent conflict

The collision of propositions from the cases, then, is this: (1) Before Amendment 80 merged law and equity, subject-matter jurisdiction to grant equitable rescission rested exclusively in equity, and Amendment 80 did not alter the jurisdictional divide between law and equity; (2) questions of subject-matter jurisdiction can and must be raised by courts...
sua sponte; (3) there is little if any practical
difference between an explicit demand for
equitable rescission and an affirmative de-
finite under subsection 107(a) which seeks,
as most if not all do, to nullify a contract of
insurance on grounds of misrepresentation,
and a defense under subsection 107(a) may
be deemed one for equitable rescission even
if not so pled; (4) Arkansas courts since the
very first case, and after adoption of the In-
surance Code, nevertheless have allowed in-
surance misrepresentation claims involving
virtually the same question to be heard in
circuit courts and before juries; and (5) no re-
ported Arkansas case has noticed much less
attempted to reconcile the apparent tension
between points (1) through (4).
A tempting resolution might be to confine
Phelps to its facts and conclude that only an
explicitly pled claim for equitable rescission
consigns an insurance misrepresentation
case to equity, which after Amendment 80
could be tried in circuit court but not to a jury.
But that approach ignores point (2), which is
well-established in Arkansas law, disregards
the substantive identity between more than
a hundred years of cases and Phelps, as sug-
gested by points (3) and (4), and perpetuates
formalistic pleading devices at the expense of
the right to a trial by jury. The Court of Ap-
peals’ approach in Capitol Life and Accident
Ins. Co. is consistent with Points (1) and (2)
and recognizes such substantive identity, but
fails to account for point (4) and exacerbates
the policy problem of Phelps by depriving
the beneficiary of a jury trial even when the in-
surer fails to assert an explicitly equitable
claim.
This skein may be untangled through recog-
nition of: (1) the relationship between
Amendment 80 and Section 2, Article 7, and
(2) the kinship between subsection 107(a)
and equitable rescission. Those constitu-
tional provisions were reconciled only in general
terms in Cruthis, not exhaustively; and that
kinship, rather than necessarily forming a
basis for denying the beneficiary trial by jury
as found in Capitol Life and Accident Ins.
Co., actually may support access to a jury.
Amendment 80’s abolition of distinct court
systems obviated the need to hear a case in-
volving both equitable and legal claims in one
system or the other, which was the underly-
ing problem in both Phelps and Capital Life
and Accident Ins. Co. Before Amendment 80,
that need to proceed in one court or the other
was often resolved in favor of chancery jurisdic-
tion through liberal use of the clean-up
doctrine. Further, although not mentioned
in Phelps, the practical concern in insurance

34. Or a claim for specific performance, see supra note 24.

35. See First Nat’l Bank of Dewitt v. Cruthis, 360 Ark. 528, 534, 203 S.W.2d 88, 92 (2005) (describing situation be-
fore adoption of Amendment 80). The clean-up doctrine saw its zenith in McCoy v. Munson, 294 Ark. 488, 489-90, 744
S.W.2d 708, 709 (1988), which approached the scope of chancery’s authority to decide matters having “any tenable
nexus whatever to the claim in question” as one of “propriety” rather than jurisdiction.

As the Arkansas Supreme Court noted in Walker v. First Commercial Bank, however, a pre-Amendment 80 case, a
defendant “may not assert an equitable counterclaim merely to avail himself of chancery court jurisdiction and de-
prive the plaintiff of the right to trial by jury.” 317 Ark. 617, 620, 880 S.W.2d 316, 319 (1994) (ruling that Chancellor
improperly denied return of lender liability case to circuit court after transfer to Chancery for claim of setoff, which
was not exclusively cognizable in equity). The Walker principle does not directly apply to equitable rescission of in-
surance contracts, because there the only basis for transfer to chancery was defendant’s claim for setoff, which the
court ruled was not exclusively equitable. But its broader notion would seem to have some bearing here, as noted by
Professor Watkins and former Justice Newbern – that “[t]he ease with which a [litigant] could manufacture chancery
jurisdiction by framing his or her cause of action also undermined the right to trial by jury.” David Newbern & John J.
Watkins, Arkansas Civil Practice & Procedure § 29.3 (5th ed. 2010).
misrepresentation cases and the rationale for protecting the insurer’s access to a court of equity in pre-merger days has been recognized elsewhere as “the danger of losing its misrepresentation defense through the lapse of time” from the beneficiary’s delay in bringing an action at law.\textsuperscript{36} For example, in American Life Ins. Co. v. Stewart, decided before the merger of law and equity in the federal courts, the insurer brought bills in equity in federal court after death of the insured to cancel life insurance policies based on fraud in their procurement. The United States Supreme Court pointed to that lapse-of-time danger, which resulted from the policy’s clause precluding contest after two years of the policy’s date of issue, as a reason to uphold the trial court’s decision to hear the insurer’s suits in equity ahead of (and effectively precluding) the beneficiary’s later-filed actions at law.\textsuperscript{37} By contrast, the Court only two years earlier had held that it was error for the trial court to stay an action at law on the policy brought within the contestability period while the court ruled on the insurer’s purportedly “equitable issue” of fraud in the procurement on the grounds that the insurer had an adequate remedy at law.\textsuperscript{38} Neither the lapse-of-time nor the one-court-or-the-other concerns support perpetuation of the Phelps doctrine. The 2001 amendments to the Arkansas incontestability statute made two relevant changes.\textsuperscript{39} The statute now expressly excepts “fraud in the procurement” (which exception the insurer may waive), and the incontestability provision applies only after the policy “has been in force during the lifetime of the insured for a period of two (2) years from its date of issuance.”\textsuperscript{40} Thus, there is no lapse-of-time danger if (as was the case in Phelps) the insured dies within two years of the policy’s issuance and thus no time-driven need for recourse to equity in such cases.\textsuperscript{41} And, since adoption of Amendment 80, it is no longer necessary to choose between a gate of ivory and a gate of horn.\textsuperscript{42} As former Justice Newbern and Professor Watkins explain in their treatise, now,

> [w]hen a case with legal and equitable claims involves common questions of fact, the preferable approach is to try those questions to the jury, perhaps on written interrogatories as allowed by Ark. R. Civ. P. 49(a), before the court determines whether the equitable re-

\textsuperscript{36} Bernard E. Gegan, Turning Back the Clock on the Trial of Equitable Defenses in New York, 68 St. John’s L. Rev. 823, 838 (1994).

\textsuperscript{37} 300 U.S. 203, 212-14 (1937). American Life Ins. Co. is discussed in Watkins, supra note 6, at 671-72.


\textsuperscript{39} That requirement is now codified at Ark. Code Ann. § 23-81-105. Only two cases mention this provision, neither in connection with the jurisdictional issue. In Life & Cas. Ins. Co. of Tennessee v. Smith, 245 Ark. 934, 938, 436 S.W.2d 97, 99 (1969), discussed below, the court responded to the “alleged harshness” of the predecessor to subsection 107(a)(3), which appears to allow the insurer to avoid recovery on the policy even if the insured acted in good faith, by pointing out that the insurer had only two years to contest the truthfulness of statements in the application, citing the predecessor to Ark. Code Ann. § 23-81-105. The other case is Hooder v. Life of the South Ins. Co., 2007 WL 842072 (Ark. App. Mar. 21, 2007). There the court cited the statute by way of analogy, refusing the beneficiary’s bid to allow the doctrine of contra proferentem to turn a typographical error into an incontestability clause.

\textsuperscript{40} Ark. Code Ann. § 23-81-105.

\textsuperscript{41} See Gegan, supra note 36, at 838 (discussing effect of similar amendment to New York law).

\textsuperscript{42} Virgil, The Aeneid, Book 6.
lief is appropriate. The jury’s findings would be binding on the court, which would serve as fact-finder only as to non-common factual questions arising in connection with the equitable relief.43

The question then becomes whether a case in which an insurer invokes subsection 107(a) in response to a beneficiary’s claim for benefits and the insurer explicitly pleads equitable rescission is a “mixed case” of equitable and legal claims involving common factual questions so those questions might be submitted to the jury. There is good reason to conclude that it is.

Cruthis instructs that the courts are to look to history to determine whether a claim sounds in law or equity. The historical record in the present context supports the conclusion that subsection 107(a) cases are either at law or at least “mixed” cases of law and equity. First, as recounted in Professor Gegan’s article on the right to trial by jury in insurance misrepresentation cases, although fraud in the inducement (as opposed to fraud “non est factum”) originated in equity, like a number of other matters it has long since become an accepted defense at law.44 Indeed, there are Arkansas Model Jury Instructions on the defense of fraud in the inducement.45 Second, Article 2, Section 7 of the Arkansas Bill of Rights extends the right to a jury “to all cases at law.” Like the claim in Cruthis, the insurance beneficiary’s claim on the insurance contract “is one for the recovery of damages for the nonperformance of a simple contract;”46 and the defense of fraud in the inducement, which has become the misrepresentation defense and subsequently has been codified and expanded beyond fraud in what eventually became subsection 107(a) in insurance cases, also has been submitted to juries in actions at law for over a hundred years in Arkansas. As the United States Supreme Court observed in American Life Ins. Co. v. Stewart (apart from the lapse-of-time concern at issue in that case, which in that case arose under a different incontestability provision), “[n]o doubt it is the rule, and one recently applied in decisions of this Court, fraud in the procurement of insurance is provable as a defense in an action at law upon the policy, resort to equity being unnecessary to render that defense available.”47 And in Enelow v. New York Life Ins. Co., cited in American Life Ins. Co. for

43. Newbern & Watkins, supra note 35, at § 29:3. See also Ark. R. Civ. P. 38, Addition to Reporter’s Note, 2001 (recognizing that after Amendment 80, “the question is whether Article 2, Section 7 requires trial by jury with respect to legal issues which, prior to merger, would have been heard in chancery under the cleanup doctrine”).
44. Gegan, supra note 36, at 47-50, quoting Fleming James, Jr., et al., Civil Procedure §§ 8,2, at 415 (4th ed. 1992) (“Many matters such as duress, fraud and illegality, which had once been cognizable only in equity, were familiar defenses to a legal action by the end of the eighteenth century.”).
that general rule, the Court pointed out that "the defense of fraud is completely available in the action at law, and a bill in equity would not lie to stay proceedings in that action in order to have the defense heard and determined in equity."\textsuperscript{48}

\textit{Cruthis} itself involved a mixed claim. There the plaintiff sought both restitution on the basis of unjust enrichment, which the court concluded (because originating in assumpsit for money had and received) may be heard by a jury, and an equitable lien, which the court concluded was exclusively equitable and may not be heard by a jury.\textsuperscript{49} The problem apparently was that the plaintiff had combined both claims into a single count, which the circuit court had submitted to the jury. The \textit{Cruthis} court did not say that because a claim for an equitable remedy was in the case, in this instance injected by the plaintiff herself, she was not entitled to have her legal claim submitted to the jury. Instead, the court ruled that the circuit court had erred in submitting to the jury a single count which included an equitable claim. The normal practice in the federal courts since the merger of law and equity in such a case would be to try the legal issue to the jury first, "to avoid the preclusive effect of an initial decision by the court on the equitable issues."\textsuperscript{50} Nothing in \textit{Cruthis} precludes such practice in Arkansas courts.

While equitable rescission is plainly an equitable remedy, it is difficult after merger of law and equity to see why an insurer ought to be able to preempt the insurance beneficiary’s right to a jury trial on the legal issues in the case by pleading it. The factual questions are not only common, they are identical. As the court itself noted in \textit{Phelps}, the insurer must establish the elements set forth in subsection 107(a) to avoid coverage under the policy and, as explained above, Arkansas law has always regarded those issues as proper for submission to a jury.\textsuperscript{51} If the jury finds for the beneficiary on those issues, there is no basis for rescission. If the jury finds for the insurer on those issues, then the circuit court has jurisdiction to grant the equitable remedy of rescission if that is what the insurer wants – as opposed simply to entering a verdict for defendant on the beneficiary’s contract claim.

This procedure is especially appropriate in the insurance misrepresentation context not only because of the Arkansas courts’ consistent practice of submitting such cases to juries but also because of the nature of such cases. Whether there is an explicit claim for equitable rescission or not, the insurance purchaser simply seeks payment of the contracted-for benefits and the insurance seller merely seeks to avoid such payment. By contrast, the problem with equitable rescission in the typical property-transaction case, as

\begin{itemize}
    \item \textsuperscript{49} 360 Ark. at 537, 203 S.W.3d at 94.
    \item \textsuperscript{50} Ark. R. Civ. P. 38, Addition to Reporter’s Note, 2001. For an overview of the federal practice, including Seventh Amendment constraints on a trial court’s very narrow discretion to decide equitable claims before claims at law, see Watkins, supra note 6, at 677-87.
    \item \textsuperscript{51} In addition to the cases cited supra, the Arkansas Court of Appeals has noted that the question whether the insured misrepresented her prior condition is ordinarily a question of fact for the jury. Gilcreast v. Providential Life Ins. Co., 14 Ark. App. 11, 15, 683 S.W.2d 942, 944 (1985). And, the United States District Court for the Eastern District of Arkansas has pointed out in a case under § 23-79-107, that under Arkansas law the issue of causation is “ordinarily a question of fact for the jury to decide.” Osborne v. Farmers New World Life Ins. Co., 2009 WL 1098943, at 5 (E.D. Ark. Mar. 31, 2009).
\end{itemize}
the court noted in Coran v. Keller, is that it
involves transfer of title from one party to the
other to restore the status quo ante, a power
which the circuit court did not have before
Amendment 80.52 This problem does not arise
in insurance disputes, in which the insurer’s
rescission claim in effect is simply an affirma-
tive defense to the insured’s or beneficiary’s
action on the policy, the practical conse-
quence of which is to relieve the insurer of
obligation to pay the policy benefit – which
outcome, as the Supreme Court of the United
States noted in Enelow, is completely avail-
able in an action at law. Thus, resolution of
the misrepresentation issues is a straightfor-
ward fact-finding task suitable for a jury and
does not involve the kinds of flexible balanc-
ing of interests implicated, for example, in
the issuance of an injunction or other equi-
table relief.53 It thus is not easy to see why
a defense verdict under subsection 107(a) is
itself not an adequate remedy at law render-
ing equitable relief unnecessary.54

Perpetuation of the Phelps doctrine after
merger of law and equity would put the in-
surer in an enviable position, the justification
for which is far from self-evident. It would al-
low the insurer to choose its field of battle.
It may take its chances with a jury – either
by actually accomplishing rescission at law or
simply by denying coverage and awaiting suit
by the beneficiary, then invoking the statute
and refraining from mentioning rescission in
its pleadings or from contesting jurisdiction.
Or it may explicitly plead equitable rescission
as in Phelps and keep the case from the jury.
Evidently, under the Court of Appeals’ appli-
cation of Phelps, it may also attempt rescis-
sion at law, refrain from pleading equitable
rescission at trial, roll the dice with a jury, and
then suggest error in the circuit court’s
failure to transfer to equity (or, post-Amend-
ment 80, to take the case from the jury) on
the grounds that the case involved equitable
rescission after all. In light of the long-stand-
ing pre-Amendment 80 practice of Arkansas
courts to allow insurance misrepresentation
cases to be tried before juries, the lack of any
meaningful distinction between at least some
of those cases and the Phelps proceedings,
the absence of the kind of substantively equi-
table relief (such as the transfer of property
interests) noted both in Cruthis and Coran v.
Keller, and the availability of interrogatories,
it is difficult to understand why factual issues
in such cases may not be tried to juries.

Finally, one might contend that the ju-
risdictional discussion in Phelps is dicta.
Although the Court of Appeals plainly did
not read it that way in Capital Life and Ac-
cident Ins. Co. v. Phelps, the Arkansas Su-
preme Court’s ruling ultimately turned on
a different point, which obviated the need
to reach the matter of rescission. After con-
cluding its discussion of equity and rescis-
sion, the court in Phelps went on to say,

52. 295 Ark. at 311, 748 S.W.2d at 351. See generally HOWARD W. BRILL, ARKANSAS LAW OF DAMAGES § 31:3 (5th ed. 2009)
describing equitable powers, such as transfer of title, implicated in equitable rescission).
53. See Gegan, supra note 36, at 853-54 (comparing insurance misrepresentation to specific performance of a land
sale contract). While, as Professor Watkins has noted, there is not a “complexity exception” to the Seventh Amend-
ment right to a jury trial, the relative abilities of judges and juries to decide a matter is one factor to consider. Watkins,
supra note 6, at 683-84, discussing Ross v. Bernhard, 396 U.S. 531 (1970), and Markman v. Westview Instruments,
54. See supra text accompanying note 38 (discussing Enelow v. New York Life Ins. Co.).
“[i]n any event, U.S. Life correctly points out that even if the circuit court erred in transferring the case to chancery court, the appellant suffered no prejudice in that the central issues were legal questions for the court, not factual questions for a jury.” There were two legal issues. First, the supreme court ruled that the chancellor had erred in not construing an ambiguous contract provision (the application question that the insurer asserted the insured had answered falsely) against the insurer. Second, the court held that the chancellor also had erred in concluding that the insurer could invoke subsection 107(a)(3) to invalidate the contract even if its questions were ambiguous on the ground that in good faith it would not have issued the policy had it known of the insured’s heart condition. Given the supreme court’s construction of the ambiguous question, “no misrepresentations, omissions, concealment of facts, [or] incorrect statements occurred as described in § 23-79-107, and therefore this statutory provision is inapplicable to the facts.” The insurer, in other words, had not made out a subsection 107(a) claim in the first place so there was no basis for an equitable rescission claim under the statute. There thus was no need to reach the jurisdictional issue.

In any event, Phelps notwithstanding, it seems likely that cases involving Section 23-79-107(a) will continue to be tried to juries. If so, jury instructions will be needed. Among the questions to be resolved in developing instructions that correctly state the law is the scope of the causal relation provision of subsection 107(c). That issue is taken up in the ensuing part of this Note.

2. What is the scope of the causation element of subsection 107(c)?

Adopted as Act 662 of 1989, the current subsection 107(c) provides that “in any action to rescind any policy or contract or to recover thereon, a misrepresentation is material if there is a causal relationship between the misrepresentation and the hazard resulting in a loss under the policy or contract.” There are at least four possible interpretations of this provision:

1. As suggested by Vratil and Andreas, quoted in Professor Sampson’s article, unlike other causal relation statutes, the Arkansas provision is crafted not as a shield for the insured [] but as a sword for the insurance company. It does not require proof of a causal relation to rescind, but holds that where a causal relation exists, it is material. Therefore, an insured may not argue that a causally related loss was not material to the risk or hazard assumed.

55. 336 Ark. at 261, 984 S.W.2d at 427 (emphasis added).
56. Id., 336 Ark. at 262, 984 S.W.2d at 428.
2. Subsection 107(c) applies a causal relation requirement only to cases brought under subsection 107(a)(2), which provides for misrepresentations “material either to the acceptance of the risk or to the hazard assumed by the insurer.”

3. Subsection 107(c) applies to cases brought under subsection 107(a)(2) and (3).

4. Subsection 107(c) applies to cases brought under all three subsection 107(a) provisions.

These are close questions, and credible arguments can be marshaled at least with respect to the last three interpretations.\(^58\) Given the challenges that they present to the identification of elements for jury instructions,\(^59\) it is at first glance surprising that the courts have not yet explicitly addressed them. But neither courts nor litigants appear to have been specific regarding which subsection 107(a) provision they are invoking and thus the matter has remained obscure. The one court presented directly with the question whether the causal relation requirement applies to all three subsection 107(a) provisions, which was raised by motion for clarification after the United States District Court for the Eastern District of Arkansas already had generically required the insurer to establish a causal relationship “between the misrepresentation in the insurance application and the resulting loss,” denied the motion as seeking an advisory opinion.\(^60\)

The most plausible interpretation, while perhaps not completely satisfying as a matter of statutory text or policy (although a policy argument can certainly be advanced in its favor and the statutory language can be explained), is the fourth one. The first interpretation does track the language of subsection 107(c), but its practical application is difficult to perceive and, although the authors recite

\(^{58}\) I have omitted the possibility that subsection 107(c) applies to subsection 107(a)(1) and (2) but not subsection 107(a)(3) claims. As discussed below, the court in National Old Line Ins. Co. v. People found a basis for its causal relation requirement in the predecessor to subsection 107(a)(3). A contemporaneous commentator saw the question thereafter as whether the requirement applied beyond that provision, at least to the predecessor to subsection 107(a) (2). Adams, supra note 18, at 83. And the Court of Appeals has held that a causal relation must be shown under the predecessor to subsection 107(a)(3). Shelley v. Chrysler Life Ins. Co., 1987 WL 18051 at 2 (Ark. App.). Further, the Arkansas Supreme Court in effect has read that subsection’s “good faith” language as reflecting a kind of materiality element. Life & Casualty Ins. Co. of Tennessee v. Smith, 245 Ark. at 937-38, 436 S.W.2d at 99; American Family Life Assurance Co. v. Reeves, 248 Ark. 1303, 1309, 455 S.W.2d 932, 936 (1970).

\(^{59}\) For an example of a case finding that jury instructions inadequately presented the causal relation requirement, see Capitol Old Line Ins. Co. v. Gorondy, 1 Ark. App. 14, 612 S.W.2d 128 (1981).

the provision’s legislative history, they seem to overlook both its significance and courts’ subsequent view of the provision. The proposition that the provision is a “sword” for insurers is plainly at odds with the debate among the Justices, discussed below, in Southern Farm Bureau Life Ins. Co. v. Cowger, National Old Line Ins. Co. v. People, and Old Republic Ins. Co. v. Alexander. 61 Presumably, the authors mean that, if the actual loss is the same as the risk not disclosed, or at least of the same type, then the non-disclosure is material. But it is not clear how this interpretation would produce a different result in any of the cases discussed below.

The second, subsection 107(a)(2)-only interpretation is also based primarily on language in the statute itself, which arguably distinguishes between claims based on “fraudulent” misrepresentations and those based on “material” misrepresentations, as well as some language in two Arkansas cases, Life and Casualty Ins. Co. of Tennessee v. Smith 62 and McQuay v. Arkansas Blue Cross and Blue Shield. 63 The third interpretation would exclude subsection 107(a)(1) on policy grounds — that, at the least, an insured ought not to be able to commit fraud in the inducement and then raise a causation objection to the insurer’s attempt at rescission. But neither of these interpretations square with the legislative history. The fourth view, which would require causation in all three subsection 107(a) situations, is based on the legislative history of Act 662 of 1989, including the fact that the cases establishing and then abrogating the causation element in the first place plainly assumed that the requirement applied to claims of fraud. It is also consistent with the approach of the few other jurisdictions that require a causal relation. The following discussion combines the second and third interpretations and contrasts them with the fourth.

a. The argument that use of the term “material” in Section 107(c) does not embrace Section 107(a) (1)

The argument against applying subsection 107(c)’s causation element to subsection 107(a)(1) fraud claims seems to rest first on the conclusion that the term “material” as used in subsection 107(c) was intended as a statutory term of art linked to the term “material” in subsection 107(a)(2), which refers to misrepresentations “[m]aterial either to the acceptance of the risk or to the hazard assumed by the insurer,” and second that it is poor policy to allow a fraudulent applicant to take advantage of the happenstance of an absence of causal relation. This conclusion implicitly assumes that materiality is not an element of fraudulent misrepresentation under subsection 107(a)(1), which, unlike subsection 107(a)(2), does not contain the word “material.”

61. 245 Ark. 1029, 439 S.W.2d 829 (1969).
64. Less plausibly, this interpretation might alternatively assume that materiality is an element of fraudulent misrepresentation but means one thing under subsection 107(a)(1) and another under subsection 107(a)(2). Because in my view the argument set out above in Part 2.a. of this Note is a much stronger one and because I ultimately conclude (as explained in Parts 2.b. and c.) that the legislative history indicates that subsection 107(c) does apply to subsection 107(a)(1) claims, I do not pursue this theory.
One weakness in that underlying assumption is that it is at odds with the law concerning fraudulent representation as a basis for rescission of a contract. As explained in Ballard v. Carroll, there are “four tests to determine whether the rescission of contract upon the ground of fraudulent representations could be maintained,” the first of which is “was the fraud material to the contract; did it relate to some matter of inducement to the making of the contract?” Thus, the general rule appears to be that materiality is a necessary element of a claim for rescission of a contract based on fraudulent misrepresentation. The first element of the Model Jury Instructions for fraud in the inducement is that the plaintiff “made a false representation of material fact concerning the contract.”

In light of the foregoing, the statutory argument becomes that rescission of insurance contracts under Section 23-79-107 is somehow distinct from the law concerning fraudulent misrepresentation as a basis for rescission of a contract generally. As mentioned, there is language in Life & Casualty Ins. Co. of America v. Smith to support this view. The circuit court in Smith had instructed the jury that the insured’s beneficiary “would not be barred from recovery unless the insurer established that the deceased knowingly and fraudulently made false statements which induced the issuance of the policy.” The Arkansas Supreme Court, citing Dopson v. Metropolitan Life Ins. Co., ruled that the instruction was “not complete” in view of the statute, which according to the court also provides that “[w]hen the insurer in good faith would not have issued the policy except for omissions material to the risk, or incorrect statements likewise material, the policy is subject to voidance during the contestable period.” The court went on to quote Couch on Insurance 2d, § 35:24:

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

As noted, Judge Vaught’s concurrence in McQuay also quoted the foregoing passage from Smith and Couch. The court in Smith further noted that the “alleged harshness of the rule” is offset by the incontestability period, which allows the insurer only two years in which to contest the truthfulness of statements in the application.


66. ARK. MODEL JURY INSTR. (CIVIL) 2433 (2010 ed.).


68. Id., citing Dopson v. Metropolitan Life Ins. Co., 244 Ark. 659, 426 S.W.2d 410 (1968).

69. Smith, 245 Ark. at 937-38, 436 S.W.2d at 99 (emphasis added).

70. 81 Ark. App. at 86-88, 98 S.W.2d at 461 (Vaught, J., concurring).

71. 245 Ark. at 938, 436 S.W.2d at 99.
The difficulty in relying on Smith and the other two cases to support the conclusion that subsection 107(c)’s causation element does not apply to subsection 107(a)(1) fraudulent misrepresentation claims is that those cases did not actually involve that question. Neither Dopson, Smith, nor McQuay was decided on the basis sketched out in the quote from Couch – that the insured had made an immaterial yet somehow “fraudulent” misrepresentation. Instead, all three cases involved application of what is now subsection 107(a)(3), not subsection 107(a)(1). Dopson was complicated by the fact that the plaintiff, Mr. Dopson, signed the application adding his second wife to his group hospitalization policy, although the agent had directed his questions at Mrs. Dopson, whose injuries were the subject of the dispute. On appeal, Mr. Dopson argued that the undisputed facts showed that he, the claimant on the policy, had no knowledge of Mrs. Dopson’s back trouble (the allegedly undisclosed condition). The case did not turn on the question whether materiality is an element of fraud. Rather, the court first noted that “his lack of knowledge does not prevent” an insurer’s defense under the statute (the predecessor to Section 23-79-107). In other words, the court simply noted the obvious point that the statutory elements are in the disjunctive. Second, the court observed that the statute had modified the court’s previous ruling in Inter-Ocean Casualty Co. v. Huddleston, requiring that a misrepresentation must be material to void a policy. But the provision the court referred to in reaching that conclusion was not the one concerning fraudulent misrepresentation (current subsection 107(a)(1)), but the one to the effect that the insurer would not have issued the coverage had it known the true facts (current subsection 107(a)(3)).

Smith ultimately was to the same effect – that the insurer might invoke the provision now contained in subsection 107(a)(3) to prevail. Indeed, the court in Smith, citing Dopson, went on to explain that, although the word “material” does not appear in that provision, its requirement of “good faith” implicitly includes something like materiality: “[i]f the matter omitted or incorrectly stated could logically have no bearing on the assumption of the risk then it could not be successfully argued that the insurer’s ‘good faith’ defense should prevail.”

And Judge Vaught’s McQuay concurrence discussed Smith, Dopson, and other cases for the proposition that rescission remained available under subsection 107(a)(3) even if the applicant in good faith attested to good health and the company relied on that representation to issue the policy. As mentioned above, McQuay, like Phelps before it, was decided on the basis that there had been no misrepresentation or incorrect statement at all. Judge Vaught’s separate opinion, then,

72. 184 Ark. 1129, 45 S.W.2d 24 (1932).
73. 244 Ark. at 661-62, 426 S.W.2d at 411.
74. 245 Ark. at 937, 436 S.W.2d at 99.
set forth his disagreement with that aspect of the reasoning in Phelps, even as he felt bound to follow it, not an argument for rescission based on fraudulent but immaterial misrepresentations.

This interpretation is consistent with Dean Adams’ analysis of the Arkansas insurance misrepresentation statute. He distinguished between tests that adopt an “individual insurer” perspective and those that adopt a “prudent insurer” standard – which distinction he finds reflected in what are now codified as subsections 107(a)(2) and (3). But those provisions allow for avoidance in the absence of fraud, they do not define fraud itself. As he noted, a leading text has “urged that statutes of other states using the terms fraudulent and material in the alternative should not be taken literally, the argument being that a misrepresentation that does the insurer no harm should not justify avoidance merely because it was made with deceptive intent.”

We are left, then, with the policy-based objection that an insured ought not to be permitted to obtain the benefit of insurance coverage through fraudulent means, the risk of which the insurer is obligated to bear, even though the insurer would not have provided such coverage absent the fraud, on the fortuity of the unrelated cause of the actual loss. The effect of such a rule, it is said, will be either to deny coverage or to increase the cost of insurance to honest insureds who disclose their prior conditions. The respective sides of the policy question were extensively debated in the predecessor cases to subsection 107(c). Justice Smith in his Old Republic Ins. Co. concurrence argued that the absence of a causal relation requirement “would encourage ex post facto litigation and would provide insurers with a windfall amounting to unjust enrichment.” In his National Old Line majority opinion, Justice Smith subsequently shifted his main ground from fairness contentions to statutory language, but he also added the point that fairness and reason support the view that a causal connection should be essential. Otherwise, when the insured is killed by a stroke of lightening or by being run over by a car, the insurance company could successfully deny liability by showing that the insured was suffering from diabetes when he stated that he was in good health.

The contrary view is set out below in connection with the discussion of the causal relation’s application to fraud claims. As there noted, even Justice Newbern, who wrote for

75. Adams, supra note 18, at 66-71.
76. Id. at 66, citing E. Patterson, Essentials of Insurance Law § 84 (2d ed. 1957).
77. 245 Ark. 1029, 1043, 436 S.W.2d 829, 838 (1969) (Smith, J., concurring).
78. This shift was noted by Adams, supra note 18, at 78.
80. See also John Dwight Ingram, Misrepresentation in Application for Insurance, 14 U. Miami Bus. L. Rev. 103, 111 (2005) (arguing that the causal relation requirement encourages fraud).
the *Southern Farm Bureau* majority in overruling *National Old Line*, acknowledged that the court might decide, if accorded such latitude by the statute, that fairness in such matters on balance favored even an untruthful insured.81 He concluded, however, that the legislature had foreclosed such a decision by enacting Section 23-79-107 without a causal relation provision. As explained in the ensuing portion of this paper, a fair reading of the legislative history to Act 662 of 1989 suggests that the legislature ultimately opted for Justice Smith’s side of the debate by subsequently enacting just such a provision.

b. **Subsection 107(c)’s legislative history suggests that it applies to all subsection 107(a) claims.**

The argument in favor of applying subsection 107(c)’s causal relation element to cases involving allegations of fraudulent misrepresentations proceeds from the well-established doctrine that the “legislature is presumed to be familiar with this court’s interpretation of its statutes, and if it disagrees with those interpretations, it can amend the statutes.”82 Indeed, “[a]s time passes, the interpretation given a statute becomes part of the statute itself.”83

That apparently is just what happened in Act 662 of 1989, which amended the Insurance Code to codify the causal relation requirement. The title to Act 662 is written in broad terms: “AN ACT to Clarify the Insurance Code and to Reaffirm the Intention of the General Assembly to Assure that no Insurer May Defend a Policy Claim on the Grounds of Misrepresentations Unless Related to the Loss Sustained; and for Other Purposes.”

The unqualified phrase “no Insurer May Defend a Policy on Grounds of Misrepresentation” certainly is broad enough to include insurers defending on grounds of fraudulent misrepresentation. And use of the term “Reaffirm” suggests that Act 662 was intended to reinstate the Arkansas Supreme Court’s interpretation of the statute in *National Old Line*, which had stood for fourteen years – and thus in effect became part of the statute – until overruled in *Southern Farm Bureau* in 1988. As noted above, *National Old Line* Insurance Co. had “denied liability on the ground that Mr. People had obtained the policy by *false and fraudulent statement* that he was in good health, when in fact he was not.”84

Origin of the concept of “materiality” in connection with causation can be traced to Justice George Rose Smith’s majority opinion describing *National Old Line’s* argument:

> The appellant, in insisting that it was entitled to a directed verdict, takes the position that an absence of any connection between People’s death and the ailments from which he was suffering...
when the policy was issued is immaterial. The insurer’s position is clearly stated in its reply brief: “There is no necessity for showing a causal connection between a matter misrepresented in an application for insurance and the ultimate cause of death of an insured.”

The court went on to announce that, under its interpretation of the statute, “the insurer must show a causal relation between the applicant’s misrepresentation and the eventual loss.” The court noted that subsection (c) (the predecessor to subsection 107(a)(3)), which the court earlier in Life Ins. Co. of Tennessee v. Smith and American Family Assurance Co. v. Reeves had interpreted to contain something like a materiality element, “to some extent carries that implication.”

Nothing in the court’s opinion suggests that its ruling was limited to cases brought under former subsections (b) and (c) (currently subsections 107(a)(2) and (3)). To the contrary, as mentioned, the insurer alleged that Mr. People’s application contained a fraudulent misrepresentation. Chief Justice Harris’s concurrence stated that it was not clear to him that Mr. People knew that his health was not good. But even he implicitly recognized that materiality was an element of fraud when he admonished insurance companies to “follow the practice generally followed by insurance companies selling regular life insurance policies, and propound more specific questions which, when answered falsely, if material, would enable the company to avoid liability because of fraud.” Justice Holt’s dissent does not suggest that the majority’s ruling is limited to claims under the statute’s second two elements. To the contrary, he argued that “[a] person who honestly answers the questions in an application has nothing to fear.”

Further indication that the causal relation requirement was understood to apply to fraudulent misrepresentation claims can be found in Southern Farm Bureau, which the legislature apparently overruled in turn in Act 662, reinstituting National Old Line. Although the court’s description of the background to the case, unlike that of National Old Line, does not use the term “fraudulent,” it does recite that following:

Mr. Cowger’s responses included his statements that he had not suffered stomach or liver disorders or used alcohol to excess in the last ten years. The truth was that Mr. Cowger had been hospitalized more than once during that time and had been diagnosed as having cirrhosis of the liver, acute alcoholism, and delirium tremens. The evidence showed, and it is not contested by Mrs. Cowger, that Mr. Cowger was aware of his condition when he applied for the policy.

85. 256 Ark. at 139-40, 506 S.W.2d at 129 (emphasis added).
86. 245 Ark. 934, 938, 436 S.W.2d 97, 99 (1969).
87. 248 Ark. 1303, 455 S.W.2d 932 (1970).
88. 245 Ark. 934, 938, 436 S.W.2d 97, 99 (1969).
89. 256 Ark. at 143-44, 506 S.W.2d at 132 (Harris, C.J., concurring) (emphasis added).
90. 256 Ark. at 147, 506 S.W.2d at 133-34 (Holt, J., dissenting).
91. 295 Ark. at 251, 748 S.W.2d at 333 (underlining in original, italics added).
The court’s analysis of “counter-considerations” to the “fairness and justice” arguments of *National Old Line* makes clear that the court had understood the causal relation requirement to apply to fraudulent misrepresentation claims. Justice Newbern’s opinion for the majority reasoned that the causal relation requirement places the policy applicant in the position of being able to gamble that he or she will not sustain a loss caused by the existence of the fact misrepresented. The misrepresentation may or may not have an effect. *The party defrauding the insurance company may or may not be rewarded.* On the other hand, the honest applicant who has the same facts to reveal will be denied insurance because of telling the truth.92

As noted above, the court went on to base its ruling on a reinterpretation of the statute in terms that again explicitly contemplate fraudulent misrepresentations:

*It may be that these policy considerations balance each other. We might even conclude, if it were up to us, that the fairness and justice considerations do come down somewhat on the side of the insured who has lied in order to obtain coverage.* Our point is, however, that the decision has been made by the body properly charged with making such decisions, that is, the general assembly. We incorrectly ignored their decision in the *National Old Line* case and we now correct our error.93

*Southern Farm Bureau* was decided April 18, 1988. At its earliest opportunity, the General Assembly passed Act 662 to “Reaffirm” its intention regarding causation, as apparently expressed originally by the court in *National Old Line*. The Legislature’s use of the term “material” in subsection 107(c), read in light of the foregoing account, thus appears to underscore its intention to reinstate *National Old Line* rather than to create a distinction among the various subsection 107(a) defenses.94

**c. Comparison with other states’ statutes**

The peculiar statutory language of § 23-79-107 thus apparently results not from a legislative intention to distinguish between claims arising under subsection 107(a)(1),

---

92. 295 Ark. at 255, 748 S.W.2d at 335 (emphasis added).
93. 295 Ark. at 255, 748 S.W.2d at 335-36 (emphasis added).
94. In his recent ruling applying subsection 107(c) to misrepresentation claims under subsection 107(a), without distinguishing among them, Judge Miller recited the foregoing history and noted the principle that “the Arkansas Legislature is presumed to be familiar with the Arkansas Supreme Court’s interpretation of its statutes, and if it disagrees with those interpretations, it can amend the statute.” Osborne v. Farmers New World Life Ins. Co., 2009 WL 1098943 at 4 (E.D. Ark. Mar. 31, 2009). Osborne does not specify that Farmers had argued fraud, and in fact it appears Farmers denied the claim, as insurers often do in these cases, on the basis that had it known of Mr. Osborne’s true condition it would not have issued the policy. The court nevertheless spoke generically of “misrepresentation” in applying the causation requirement.

I find nothing in the court’s refusal retroactively to apply the new subsection 107(c) causal relation requirement in Carmichael v. Nationwide Life Ins. Co., 305 Ark. 549, 554-55, 810 S.W.2d 39, 42 (1991), to indicate judicial antipathy toward the requirement. The presumption against retroactive application of laws affecting substantive rights is well-established.
(2), and (3), but rather from the hybridization in its history. The pertinent provisions of the Arkansas statute before the 1989 amendment (the current subsection 107(a) provisions) more closely resemble those in some other jurisdictions that do not require causation\textsuperscript{95} than they do those statutes that explicitly do require causation.\textsuperscript{96} As Justice Holt observed in his National Old Line dissent, “[e]very state with a statute similar to our statute has construed theirs to mean that a misrepresentation as to a material matter renders a policy voidable at the election of the insurer without a showing that the misrepresentation had a causal connection with the loss claimed under the policy.”\textsuperscript{97} It appears that the Arkansas statute originally was cast in terms widely interpreted elsewhere not to require causation, onto which the court in National Old Line engrafted a judicially created causation requirement, which became a gloss on the statute until overruled by Southern Farm Bureau, which gloss the legislature subsequently ratified in Act 662 of 1989 in response to judicial abrogation in Southern Farm Bureau, using the terminology of materiality from National Old Line.

Further, both the Kansas and Missouri courts have interpreted their causation statutes to apply to cases of fraudulent misrepresentation. The Kansas court, in Hawkins v. New York Life Ins. Co. of New York,\textsuperscript{98} after an exhaustive review of precedent, concluded that its statutory causation requirement applies to cases in which the insurer would not have issued the policy had it known the true facts, including those, like Hawkins itself, involving fraudulent misrepresentations. The insurer defended against the claims of the life insurance beneficiaries by alleging among other things that “the insured made various and fraudulent representations and warranties for the purpose of obtaining the policy of insurance and thereby defrauding the insurance company.”\textsuperscript{99} Recognizing the general rule that fraud in the inducement would void the contract, the court considered the effect of the Kansas statute (now codified at Kan. Stat. Ann. § 40-418), which provides,

No misrepresentation made in obtaining or securing a policy of insurance on the life or lives of any person or persons, citizens of this state, shall be deemed material or render the policy void unless the matter misrepresented shall have actually contributed to the contingency or event on which the policy is to become due and payable.\textsuperscript{100}

Among the cases reviewed by the court in Hawkins are two decisions indicating that fraudulent misrepresentation does not fall within the statute. The Kansas Supreme Court had previously said that the statute did not apply when “the facts misrepresented or

\begin{itemize}
\item \textsuperscript{97} 256 Ark. at 145, 506 S.W.2d at 132 (Holt, J., dissenting) (citing cases from Georgia, Louisiana, Nebraska, and South Dakota).
\item \textsuperscript{98} 176 Kan. 24, 269 P.2d 389 (1954).
\item \textsuperscript{99} 176 Kan. at 25, 269 P.2d at 390.
\item \textsuperscript{100} 176 Kan. at 29, 269 P.2d at 392.
\end{itemize}
fraudulently concealed are such as increase the moral risk, and which, if known by the insurer, would probably have prevented the issuance of the policy.”101 The Tenth Circuit also earlier had stated, according to the Kansas court, “that when fraud is established in obtaining a policy of insurance there can be no recovery notwithstanding the above quoted statute.”102

In reaching its conclusion, the Hawkins court first restated the beneficiaries’ position in response to the insurer’s argument that its demurrer ought to have been sustained, which explicitly presented the question whether the causation requirement applies to cases of fraudulent misrepresentation:

they submit that as the defense of fraud raised by the appellant did not pertain to a misrepresentation actually contributing to the contingency or event on which the policy became due and payable, it was not material under the above statute, and that their evidence made a prima facie case entitling them to recover.103

In affirming the trial court’s refusal to grant insurer’s demurrer or motion for directed verdict, the court rejected its previously recognized “moral risk” exception to the statutory causation requirement and held that under the statute “the only misrepresentation made in obtaining a policy of life insurance which shall be deemed material is one which actually contributed to the event on which the policy became due.”104 It is plain from the opinion that the court’s use of the term “material” in this context encompasses claims of fraudulent misrepresentation. The court dismissed the language from the Tenth Circuit as dicta because the evidence in that case established causation so that “the beneficiary could not rely on the above quoted statute” in any event.105

Missouri, another causation state, abandoned the distinction between innocent and fraudulent misrepresentations for purposes of the statutory causation requirement as early as 1902.106 The Missouri causation statute then, as now, like the Kansas statute, provides that

no misrepresentation in procuring a policy of insurance shall be deemed material or avoid the policy “unless the matter misrepresented shall have actually contributed to the contingency or event on which the policy is to become due and payable, and whether it so contributed in any case shall be a question for the jury.”107

The main issue in the case was whether fraternal benefit associations, including foreign companies, are exempt from the general

---

103. Id.
104. 176 Kan. at 37, 269 P.2d at 397.
105. 176 Kan. at 36, 269 P.2d at 397.
insurance laws of Missouri. But the defendant’s alternative argument was that the statutory causation element applied “only to innocent misrepresentations,” not to “fraudulent misrepresentations.” Earlier cases had so held. The court rejected that interpretation, concluding that the purpose of the statute was to prevent insurance companies from making every representation a warranty, which, however trivial or unrelated to the loss, might provide grounds for voiding the policy and that “[t]he statute draws no distinction between innocent and fraudulent misrepresentations, and the courts have no right to draw any such distinction.”

Thus, “[t]o avoid all possible confusion and misunderstanding,” the court overruled the two prior cases suggesting a distinction between innocent and fraudulent misrepresentation for purposes of the causation element.

Finally, the interpretation suggested by this paper not only would be consistent with that reached by other states’ interpretations of their causal relation statutes, it also would be consistent with the causal relation provision explicitly, and much more clearly, applied by Puerto Rico’s statute to all three of the predicate provisions, which otherwise are identical to subsection 107(a): “When the applicant incurs in any of the actions enumerated in paragraphs (1), (2), and (3) of this section the recovery shall only be prevented if such actions or omissions contributed to the loss that gave rise to the action.”

Conclusion

Although the Arkansas Supreme Court has explicitly ruled that a case in which an insurer invoked subsection 107(a) was properly transferred to equity because the pre-Amendment 80 circuit court lacked jurisdiction to grant equitable rescission, there is good reason after Amendment 80 to accord beneficiaries an opportunity to try the subsection 107(a) issues to a jury. Such issues have always been regarded as triable to juries in Arkansas and the merger of law and equity, and the availability of interrogatories, has removed any practical obstacle to doing so even if the insurer seeks an equitable remedy.

The causal relation requirement probably applies to all subsection 107(a) cases. Read in the context of its origins, the “a misrepresentation is material” language in subsection 107(c)’s causal relation requirement does not appear intended to confine its application to subsection 107(a)(2) cases, but instead also applies to subsection 107(a)(1) claims (as well as subsection 107(a)(3) cases). The causation requirement is a legislative adoption of a judicial interpretation of Section 107’s predecessor in a case involving a claim of fraudulent misrepresentation. That case, National Old Line Ins. Co., evidently understood its requirement to apply to fraudulent misrepresentation claims. And the court in Southern Farm Bureau, the case overruling National Old Line, which the legislature it-

108. 167 Mo. 471, 67 S.W. at 257.
109. 167 Mo. 371, 67 S.W. at 257.
110. P.R. LAWS ANN. tit. 26 § 1110 (1989), quoted and discussed in Vratil & Andreas, supra note 57, at 838 n. 29. Vratil and Andreas contrast the Puerto Rico statute with the Arkansas statutory language, arguing that the differences produce different interpretations. As explained above, I take a different view.
self apparently overruled to reinstate *National Old Line*, also plainly understood the causal relation requirement to apply to cases of fraudulent misrepresentation. Indeed, its application to such cases was one of the reasons the court found the rule objectionable. And two states with explicit statutory causation requirements, although cast in language different from the Arkansas statute, interpret their statutes as applying to cases of fraudulent misrepresentation.

Which interpretation ultimately reflects the best policy choice is a matter beyond the scope of this Note, as is the larger question of the wisdom of a causal relation requirement generally. The policy arguments for and against causation are surveyed in *National Old Line* and *Southern Farm Bureau*, which discussion explicitly includes consideration of fraud. As the court in *Southern Farm Bureau* noted, the choice is one for the legislature. The General Assembly in Act 662 of 1989 apparently sided with *National Old Line*, adopting a causal relation requirement which apparently applies to cases of fraudulent misrepresentation.