

Michigan Court of Appeals Applies the 'Good Faith' Exception to Rescission

February 1, 2013

Originally Published in DRI - Life Health and Disability Newsletter

Michigan law concerning misrepresentation in an application for insurance is generally well-settled. A false statement in an insurance application that materially affects either the acceptance of the risk or the hazard assumed by the insurer voids coverage *ab initio*. See M.C.L. § 500.2218; *Housour v. Prudential Life Ins. Co. of Am.*, 1 Mich. App. 455; 136 N.W.2d 689 (1965).

Moreover, Michigan follows “the almost universal rule” that the misrepresentation need not be causally related to the particular circumstances of the loss, “[f]or the reason that the test of materiality of misrepresentations is determined by whether or not knowledge of the true facts would, at the time the policy was issued, have increased the risk or influenced the insurer in determining whether to accept or reject the risk.” *Mutual Life Insurance Co. v. Morairty*, 178 F.2d 470, 475 (9th Cir. 1949). See *Wickersham v. John Hancock Mut. Life Ins. Co.*, 413 Mich. 57; 318 N.W.2d 456 (1982). Where the misrepresentation increases the risk assumed, no reliance need be proven. *Smith v. Globe Life*, 460 Mich. 446; 597 N.W.2d 28 (1999).

The misrepresentation defense must be raised within two years of the date of issue. M.C.L.A. § 500.3408. Nevertheless, this defense is of great strategic importance to carriers, not only in the individual matters at issue, but to further stem, and prevent the rewarding of, insurance fraud. Rescission may be favorable to denial as it may be easier under the law or policy, and will protect the carrier from other potential claims. See Allan D. Windt, 1 Insurance Claims and Disputes 5th, § 2:26. The carrier can reserve its rights under the policy should the rescission claim be unsuccessful. *Id.*

The Langley Decision

Given that rescission allows the carrier to dispose a claim, as well as other potential claims, as a matter of law, while preserving all of its rights under the policy, the Michigan Court of Appeals recent decision in *Langley v. Auto-Owners Life Ins. Co.*, 2012 WL 2476668 (Mich.App. June 28, 2012), albeit unpublished, is of great import.

The court in *Langley, supra*, recognizing the “good faith rule,” held that “in order to void a policy for a misrepresentation an insurer must prove that the applicant made a representation that was actually false, that the applicant knew or should have known that the representation was false.” *Id.* at *6. Auto-Owners was required to present evidence that plaintiff’s deceased husband knew or should have

known that his answers were actually false before it would be entitled to void the life insurance policy at issue. Despite such evidence, the court concluded “*that there was a question of fact* as to whether Eric Langley knew or should have known that he had a heart disease when he answered that he did not have heart disease,” and remanded the matter for trial. *Id.* at *1.

The Langley Facts

The following facts are presented in detail in light of the court’s holding. Plaintiff’s decedent, Mr. Langley sought to purchase life insurance in April of 2007, first applying for \$250,000 in coverage from Cincinnati Life Insurance Company. *Id.* A medical examination took place on April 20, 2007. *Id.* While approving the policy, Cincinnati Life Insurance Company revised the rate, substantially raising the premium. *Id.* As a result, Mr. Langley indicated that he did not want the policy. *Id.* Dr. Bonnie L. Hafeman was Mr. Langley’s physician since 1993, who testified at deposition. *Id.* She testified that she was aware of his childhood Hodgkin’s disease, and that she was monitoring him for a heart murmur since approximately 2002. *Id.*

Mr. Langley visited Dr. Hafeman on April 11, 2007, and she noted that the murmur was louder. *Id.* “She stated that the murmur was now ‘holosystolic,’ which she explained was ‘a different murmur than it had been previous to this. The sound of an aortic murmur and a mitral murmur are different, and it’s a lot harsher murmur.’” *Id.* She informed Mr. Langley that the “heart murmur had changed in quality,” and that it was “louder, and it was over the whole of the heart instead of more localized like it had been.” *Id.* She further informed him that “that there was a ‘possibility that he had aortic stenosis’; she even ‘drew him a diagram to show him what it was.’” *Id.* She further informed him that “she was ‘concerned about it,’ ‘because it was into the neck, and that I thought it was aortic stenosis.’” *Id.* “She ordered an echocardiogram to verify her diagnosis.” *Id.* On that same day, imaging revealed evidence of “moderate aortic stenosis.” *Id.* at *2. Eric’s wife, plaintiff Debra Langley, testified that Dr. Hafeman told her that the murmur “was nothing to worry about,” and that it was just a “funny noise in the heart.” *Id.*

On May 21, 2007, Mr. Langley saw Emmy Lawrason, D.O. for “significant pain on the left side of his back.” *Id.* As a result of hospital visits, physical therapy, and chiropractic treatment, she ordered a chest x-ray. The x-ray revealed a “left pleural effusion,” which she informed him about on June 6, 2007. *Id.* A subsequent CT scan, on June 8, 2007, revealed “some pleural effusion, pleural parenchymal scarring, vascular calcifications, and shotty lymph nodes.” *Id.* Mr. Langley was informed about these results at his June 11, 2007 appointment. *Id.*

Also on June 11, 2007, however before his appointment with Lawrason, Mr. Langley “filled out a simplified application for \$50,000 in life insurance from defendant Auto–Owners Life Insurance Company.” *Id.* The application warned that if any of the questions that followed were left blank or answered “yes,” the applicant was required to use a regular application as opposed to this simplified form.

A question asked, “[d]o you have, or during the past 10 years, have you been diagnosed or treated by any medical professional for: ‘Heart Disease including Heart Attack, Stroke, Angina, Arterial Disease of the Heart or Extremities or Congestive Heart Failure . . . ?’” *Id.* Another question asked whether “you been advised by any medical professional during the past three years, to have any surgery, additional diagnostic testing, hospital confinement, or nursing facility confinement, and have not yet done so?” *Id.*

Mr. Langley answered both questions “no,” and “by signing the application, [he] agreed that his ‘statements and answers’ were ‘true and complete’ and he agreed that ‘they will form a part of any insurance policy issued hereon.’ He also stated that he ‘understood that the information on this application will be relied upon to determine insurability and that incorrect information may result in coverage being voided, subject to the policy Incontestability Provision.’” *Id.* Auto–Owners Insurance Company (“Auto–Owners”) accepted the application and issued a \$50,000 life insurance policy. *Id.* at *3.

Lawrason’s notes concerning the June 11, 2007 appointment, indicated that Mr. Langley’s symptoms were possible signs of cancer. *Id.* She had ordered a “series of tests,” and a subsequent thoracentesis on June 14, 2007 revealed malignant cells in the fluid. *Id.* Her notes concerning a June 20, 2007 appointment indicate that he was diagnosed with cancer and was to treat at the Mayo Clinic for the cancer, and the aortic stenosis. *Id.* Mr. Langley passed away as a result of the cancer on Nov. 6, 2007. *Id.*

Following its claim investigation, “Auto–Owners rescinded the policy on the ground that Eric had made two material misrepresentations in the application: he denied that he had been diagnosed with heart disease and he denied that he had been advised to take a diagnostic test and had not yet done so.” *Id.* His wife filed suit and the trial court denied Auto–Owners’ motion for summary disposition, finding “a question of fact as to whether Eric Langley knew that he had heart disease.” *Id.* The court further “concluded that the evidence showed that he had done all the recommended diagnostic tests that he was advised to take as of the application date.” *Id.*

The trial court subsequently granted plaintiff’s motion for summary disposition, agreeing that that “Auto–Owners had no evidence that her husband actually believed that he had heart disease when he denied having or having been diagnosed with heart disease [and] that there was no evidence that he had been advised to take a diagnostic test, which he had not done by the time he filled out the application.” *Id.*

The *Langley* Holding

The Michigan Court of Appeals first discussed the history of the “fraud in the inducement” rule, and its subsequent codification. See MCL 500.4016; MCL 500.2218.

The court noted that “[A]fter these changes to the common law, some courts continued to apply the common law rule that, in the two year period within which an insurer may contest a policy on the basis of misstatements, an insurer may void the policy on the basis of *either* a misstatement that was made with the actual intent to deceive *or* where the applicant made a misstatement—even though made in a good faith—that was material to the acceptance of the risk or the hazard assumed by the insurer.” *Id.* at *5 (emphasis in original) (citing, among others, *General American Life Ins. Co. v. Wojciechowski*, 314 Mich. 275, 281–282; 22 NW2d 371 (1946)).

The court further noted that other courts had relied upon *Franklin Life Ins. Co. v. William J. Champion & Co*, 350 F.2d 115 (6th Cir. 1965), recognizing “a good faith exception to the common law rule that an insurer could rescind a policy by proving that the applicant made a misrepresentation that was material.” *Id.* (citing, among others, *Mutual Benefit Life Ins. Co. v. Abbott*, 9 Mich.App 547; 157 NW2d 806 (1968)).

Interestingly, despite the Michigan Supreme Court’s decision in *Wojciechowski*, *supra*, the court went on to discuss *Franklin Life*, *supra*, a Federal Court decision, in great detail, noting that that court “explained that these authorities consistently interpreted statements that the applicant was in good health or free from disease to mean that the applicant had a good faith belief or was justified in believing that he or she was in good health. That is, an answer need not be true in a literal sense; it need only be true in the broader sense that the answer was honest, sincere, or not fraudulent. *Id.* at *6. “

Although the court in *Franklin Life* recognized that there were Michigan authorities that appeared to recognize that even an innocent misrepresentation would void a policy, it concluded that those cases were hang-overs from an earlier era when courts construed such representations in favor of the insurer.” *Id.* (citing *Franklin Life*, 350 F.2d at 125–126).

The *Langley* court then rejected Auto-Owners’ argument that “application of the good faith rule must be limited to questions that involve the applicant’s opinion,” and held that “in order to void a policy for a misrepresentation an insurer must prove that the applicant made a representation that was actually false, that the applicant knew or should have known that the representation was false, and that the representation was material to either the risk or hazard assumed.” *Id.* Because materiality was not an issue, “the only question is whether Eric Langley knew or should have known that his answers were false.” *Id.* (internal citations omitted).

Finding the application questions unambiguous and that Mr. Langley had taken all tests advised of at the time he filled out the application, the court moved on to the question as to whether Mr. Langley had, or had been diagnosed or treated for heart disease. While it was undisputed that Eric actually had a mitral valve regurgitation and aortic stenosis when he answered “no” to this question, the court found that the mitral valve regurgitation was not a heart disease. *Id.* at *9.

Moreover, even though “aortic stenosis was more serious than mitral valve regurgitation and actually impaired the functioning of the aorta,” and therefore “constituted a heart disease,” the court stated that “in order to void the policy, Auto–Owners had to present evidence that showed that Eric Langley knew or should have known that he had aortic stenosis or knew or should have known that he had been diagnosed with aortic stenosis when he answered “no” to this question.” *Id.*

The court reversed the trial court and found that Auto-Owners presented such evidence, stating that “there was evidence from which a reasonable finder of fact could find that Eric knew or should have known that he had aortic stenosis, or had been diagnosed with aortic stenosis, when he answered ‘no’ to question 2.A. And, because the undisputed evidence showed that aortic stenosis constituted a condition that impaired the functioning of the heart, it plainly constituted heart disease.” *Id.* However, and most importantly, the court held that “whether Eric answered that question in good faith was a matter for trial.” *Id.* at *10.

Conclusion

It is especially notable, and equally troubling, that the *Langley* court did not simply rule in Auto-Owners’ favor as a matter of law. The court chose not to apply Michigan Supreme Court precedent that “[A] false representation in an application for insurance which materially affects the acceptance of the risk entitles the insurer to cancellation as a matter of law.” *General Am. Life Ins. Co. v. Wojciechowski*, 314 Mich. 275, 281; 22 N.W.2d 371, 374 (Mich. 1946).

Additionally, the *Wojciechowski* court held that “[i]f the misrepresentations materially affect the risk it is not necessary to show that the misrepresentations were intentional. Such misrepresentations amount to a constructive fraud, and such misstatements in the application which materially affect the risk constitute sufficient grounds for cancellation, even though made in good faith, it not being necessary that actual fraud be found.” *Id.* at 282 (internal citations omitted).

Instead, the *Langley* court adopted the “good faith rule” as set forth by the Sixth Circuit, and remanded the matter for trial. The ramifications of this unpublished decision, of course, remain to be seen. Nevertheless, carriers should be aware of its existence, and its potential impact on this area of the law.