Rescission: An Underutilized Tool

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The rescission of an insurance policy is one of the most underutilized tools in handling insurance claims. If used properly, it unwinds the insurance transaction and the parties are restored to their position prior to the contract; it is as if the insurance contract never existed.[1] Although rescission is primarily an equitable device, its use and scope is authorized by Georgia statute. In situations where the insured has made material misrepresentations or fraudulently applied for a policy, it shields the insurer from unwarranted claims and unjust liability.

What follows is a discussion of the statutory requirements regarding rescission, the contestable period, rescission methods, waiver considerations, the most common defenses to rescission, and a closing note on a likely claim from the insured—bad faith.

I. The Statute

Georgia explicitly authorizes rescission of an insurance contract via statute.[2] To prevail, the insurer need only prove that the misrepresentation, omission, concealment of fact, or incorrect statement is either (l) fraudulent; (2) material either to the acceptance of the risk or to the hazard assumed by the insurer; or (3) the insurer in good faith would either not have issued the policy or contract, or would not have issued a policy or contract in as large an amount or at the premium rate as applied for, or would not have provided coverage with respect to the hazard resulting in the loss if the true facts had been known to the insurer as required either by the application for the policy or contract or otherwise.[3] For rescission purposes, the insurer is required to prove only that one of these three conditions is met.[4]

A. Fraud by the Applicant

The first ground for rescission is fraudulent misrepresentation by the

applicant in the application for insurance. For the purpose of rescinding the contract, false statements in an insurance application are fraudulent if they "have been knowingly or intentionally made by the insured."[5] Fraudulent intent consists of making a misstatement with knowledge of its falsity and for [the] purpose of procuring insurance."[6] Knowingly making a false statement in an application constitutes actual fraud, even if the insured may not have intended to prejudice the insurer's rights.[7]

B. Material Misrepresentations by the Applicant

The second ground for rescission is that material misrepresentations were made in the application for the policy. For a policy to be rescinded on this ground, both (1) false statements, concealment of facts, omissions, or misrepresentations must have been made in the application, and (2) the statements, omissions, concealment, or misrepresentations must be material.

Georgia law is clear that a material misrepresentation in an insurance application prevents recovery under the insurance policy.[8] Thus, if an applicant has made a false statement, concealment of fact, omission, or misrepresentation on the insurance application, the misrepresentation must also be material in order to rescind the contract.

A misrepresentation is considered material if it would influence a prudent insurer "in determining whether or not to accept the risk, or in fixing a different amount of premium in the event of such acceptance."[9] Demonstrating materiality requires the insurer to prove that, per its underwriting guidelines, the policy would either not have been issued or would have been rated differently had the truth been known.[10] Rescission is authorized even if the incorrect answer was innocently given to the insured's "best ... knowledge and belief.'[11]

One approach to prove materiality is an uncontradicted affidavit by the insurer's underwriter stating that the insurer would not have issued the policy in question had the insured's true health been known.[12] Where an underwriter provides an affidavit that the insurance company would not have issued the policy as applied for, the burden shifts to the plaintiff to show that the misrepresentation was not material.[13]

To counter such evidence, the insured must demonstrate that (i) the misrepresentation was not relied upon;[14] (ii) the underwriter's statement is unsupported by the insurer's guidelines;[15] or (iii) a prudent insurer would have issued the policy regardless of the misrepresentations.[16] The last prong must be supported by competent expert testimony.[17]

If the insurer presents an uncontradicted statement by its underwriter that the company would not have issued the policy as applied

for based on its policy regarding the specific risk, and the insured fails to proffer evidence, the misrepresentation was not material, summary judgment for the insurer is appropriate.[18]

C. Insurer in Good Faith Would Not Have Issued the Policy

In addition to allowing rescission for fraudulent or material misrepresentations, Georgia law also permits rescission if "the insurer in good faith would either not have issued a policy or contract or would not have issued the policy or contract in as large an amount ... if the true facts had been known to the insurer as required either by the application for the policy or contract or otherwise."[19]

As with the materiality prong, an uncontradicted affidavit of the insurer's underwriter stating that the insurer would not have issued an insurance policy had it known of the insured's medical condition establishes both the materiality of the insured's misrepresentation about his health on the insurance application, and that the insurer in good faith would not have issued the policy. This is sufficient to bar recovery of benefits under the policy.[20]

II. Contestable Period

Under Georgia law, life and individual accident and sickness insurance policies must contain a contestable clause which may bar the insurer from taking advantage of a misstatement as to health.[21] A contestable clause is a provision in the policy stating, "the policy ... shall be incontestable, except for nonpayment of premiums, after it has been in force during the lifetime of the insured for a period of two years from its date of issue."[22]

"[I]f a policy of insurance provides that it shall be incontestable after a certain time, except for nonpayment of premium, it cannot be avoided on account of fraudulent misstatements of the insured respecting his or her health."[23] Note, however, that the contestable clause only precludes a contest of the validity of the policy—it does not preclude the assertion of defenses based upon provisions in the policy which exclude or restrict coverage.[24]

Of course, the insured has discretion as to when a claim is filed, and they can simply wait until the contestable period has run before filing a claim for a loss suffered during the contestable period. Not surprisingly, courts are unsympathetic to these maneuvers.[25]

III. How to Rescind

In Georgia, an insurer must proceed in equity to cancel the policy.[26] Insurance carriers rescinding policies in Georgia have two options: (1) they may refund the premium and then file a declaratory judgment action seeking rescission; or (2) they may refund the premium and notify the insured that the policy is no longer in force. The latter functions as a voluntary rescission, provided the insured accepts the refund with the understanding that the policy is null and void.

A. Legal Contest

Absent voluntary rescission, most jurisdictions require some type of legal "contest" to rescind the policy. In Georgia, repudiation of the policy and tender of the repayment of the premium is not a "contest."

Instead, the insurer must formally challenge the policy by filing a declaratory judgment action.[27] Additionally, if an insurer files an answer to an insured's lawsuit before the contestability period ends, that constitutes a contest.[28] Although Georgia recognizes that merely answering a lawsuit is sufficient, most states do not. As a result, the most prudent course of action is to file a declaratory judgment action, especially if the policy is within the contestable period.

B. Voluntary Rescission

As with any contract, the parties may rescind an insurance contract by mutual agreement.[29] Though advisable, a voluntary rescission need not be formalized in writing to be effective.[30] An offer of rescission can be accepted implicitly or explicitly.[31] Generally, a voluntary rescission will be found to exist where the policy owner, insured, or beneficiary knowingly accepts refund of the premiums with the understanding that the policy is null and void.[32]

Without question, the best practice is to have the insured execute a policy release which has explicit language stating that the policy is being rescinded, the premiums have been refunded, and the policy is void *ab initio.* A policy release can protect the insurer if there is ever a challenge regarding the rescission.

IV. Waiver of Right to Rescind

When the decision to rescind is reached, the insurer must announce its intent to rescind, refund the premium, and act consistently with an intent to repudiate the insurance policy. If the insurer fails to announce its intent to rescind or acts contrary to that intent, Georgia recognizes a waiver of the right to rescind.

As noted above, to proceed with rescission, the party seeking rescission must offer to give back all benefits it received under the contract. This is called an offer of tender. Under Georgia law, "[t]he tender rule is that neither party may retain an unfair advantage" over the other.[33] In determining whether an offer of tender was appropriately made, courts take a "flexible and pragmatic approach ... toward the tender requirement."[34]

To effectuate a rescission, the insurer need only announce its intent to rescind in a timely fashion, as soon as the facts supporting rescission are known.[35] Waiver of the right to rescind is generally found only where the intent to rescind is not timely asserted or where the rescinding party takes some action inconsistent with that intent.[36] The failure to return a premium is only a factor to consider in determining whether the right to rescind has been waived. However, as part of rescinding the contract, the insurer must ultimately return paid

premiums to the insured or beneficiaries.

While there is case law to suggest that strict compliance with the tender rule is not an absolute condition precedent to filing suit for rescission,[37] the safer course is to return, or attempt to return, the premium *prior to* filing suit for rescission.

Though it is usually relatively easy to refund premiums prior to instituting an action, this is not always the case. For example, occasionally the correct party to receive the tender is unclear. In cases where the insurer is not clear who the correct party is to return the premiums to, failure to tender premiums to the correct party will not preclude a rescission suit. Attempts to return premiums are consistent with a rescissionary intent.

The focus of a rescission waiver analysis is whether the insurer timely announced its intent to rescind and acted consistently with that intent, not to whom the premium was returned.[38] Notwithstanding some older case law,[39] modern decisions do not require mechanical compliance with a strict tender rule.[40]

V. Common Defenses Raised by the Insured or Beneficiary

When the insurer rescinds a life insurance policy, the insured or beneficiary often raise the following defenses: (1) insurer had knowledge of the false nature of the statements; (2) there is not a nexus between the statements and the loss; and (3) the application was not attached to and, therefore, not a part of the policy.[41] These defenses are discussed below.

A. The Agent or Medical Professional's Alleged Knowledge of the Insured's Condition

A frequently raised defense to rescission is that an agent or medical professional who assisted with the medical portion of the application was aware of the insured's conditions, and the agent or medical professional's knowledge is imputed to the insurer.[42] There are two ways to address this argument. First, the insurer can argue the policy language requires the insured to attest that "all statements and answers in this application are complete and true to the best of my knowledge and belief." Because the insured attests to the truthfulness of his statements in the application, he is bound by his answers. Second, if applicable, the insurer may be able to argue that the agent or medical professional is an independent contractor such that the alleged knowledge should not be imputed to the insurer.

Under Georgia law, if the application the insured signs includes language where the insured affirms that "all statements and answers ... are complete and true" (or some form of this language), the insured is bound by the answers, whether written by him, the agent, or medical professional.[43] Likewise, declarations such as "I have read the above statements and my answers to the questions are true and correct to the best of my knowledge and belief" ... [are] "formulated to prevent an

applicant from asserting that he relied upon someone else, and to ensure that the declaration of truth is not the act of one whose insertion of material misrepresentations would be binding upon the company."[44] Where there is no evidence of, or even the allegation, that the agent perpetrated any fraud upon the applicant or otherwise prevented the applicant from discovering the false answers, the "agent knowledge" argument fails as a matter of law.[45]

As an alternative, insurers may also be able to assert that the agent and medical professional, although compensated by the insurer, are independent contractors. If the insurer uses an independent contractor to conduct the medical examination, then the insurer can also assert that it is not bound by the independent contractor's actions. To the extent the insurer did not control the means, method and manner of the independent contractor's work, direct the independent contractor of the hours she needed to work, nor advised her as to how to perform her job, then it should be able to prove an independent contractor relationship existed.[46] If the agent or medical professional is an independent contractor, then her alleged fraudulent conduct in recording incorrect answers cannot be imputed to the insurer.[47]

B. Nexus Between the Misrepresentation and the Loss

As discussed above, any material misrepresentation is sufficient grounds for rescission.[48] Notwithstanding claims otherwise, Georgia law is clear that, if the misrepresentation would influence a prudent insurer "in determining whether or not to accept the risk, or in fixing a different amount of premium in the event of such acceptance,"[49] then it is material. Georgia law is similarly clear that the false statement or misrepresentation as to health need not cause or contribute to the insured's death as long as "it affected the risk and probably influenced the insurer's acceptance of the risk."[50]

C. Proving the Application Was Attached to the Policy

Under Georgia law, non-fraudulent misrepresentations are only grounds for rescission if the application containing the statements is part of the policy.[51] If the application is not part of the policy, the misrepresentations are only grounds for rescission if they were made fraudulently.[52]

While most modern policies and applications contain the requisite wording, an examination of the policy and application is warranted. Words such as, "[t]he policy and the application therefore (and any supplemental applications ...) constitute the entire contract" are more than sufficient to incorporate the application into the policy.[53] Thus, where the application is attached to the policy, any misrepresentations in the application preclude coverage.[54]

VI. Insured's Bad Faith Counterclaim

Georgia law allows for an insured to recover punitive damages and attorney's fees if an insurer denies coverage in bad faith.[55] Bad faith is defined as any frivolous and unfounded refusal in law or in fact to comply with the demand of the policyholder to pay according to the terms of the policy.[56] The insured bears the burden of proving bad faith.[57]

Georgia courts have recognized that an insurer has a right to pursue any defense for which it has reasonable and probable cause.[58] A finding of bad faith is, therefore, not appropriate if the carrier had any reasonable grounds to contest coverage[59] and "[p]enalties for bad faith are not authorized ... ."[60]

Whether bad faith exists is an appropriate topic for summary judgment.[61] As a result, where there is evidence that the insurer's refusal to pay life insurance benefits was in good faith based on the belief that there was no coverage and/or the insured falsely represented her health condition, a bad faith claim should be dismissed as a matter of law.[62]

VII. Conclusion

Rescission is a very effective tool to limit the insurer's liability. While occasionally perceived as harsh, the continued existence of workable insurance markets requires sound and predictable risk underwriting. Where the insured has made material misrepresentations, the absence of which would have resulted in the insurer not underwriting the risk at the rate it did or not issuing the policy at all, it is counsel's duty to seek rescission of the policy on behalf of her clients.

Above, we have outlined Georgia's rescission statute, contestability considerations, rescission methods, the insured's most frequent defenses, and bad faith concerns. So armed, diligent counsel should be well prepared and on the lookout for situations lending themselves to the unwinding of the insurance relationship through rescission of the insurance policy.

Authors' Note: A special thanks to Thomas Ingalls, an Associate at Cozen O'Connor, for his assistance in preparing this article.

End Notes

[1] *See Champion Windows of Chattanooga, LLC v. Edwards*, 326 Ga. App. 232, 756 S.E.2d 314, 320 (Ga. Ct. App. 2014).

[2] GA. CODE ANN. § 33-24-7(b).

[3] *Id.*

[4] *See, e.g., Graphic Arts Mut. Ins. Co. v. Pritchett,* 220 Ga. App. 430, 469 S.E.2d 199, 202 (Ga. Ct. App. 1995).

[5] *National Life Accident Ins. Co. of Tenn. v. Camp,* 77 Ga. App. 667, 49 S.E.2d 670, 672-73 (Ga. Ct. App. 1948).

[6] *Id.*

[7] *Lee v. All States Life Ins. Co.,* 49 Ga. App. 718, 176 S.E. 811 (Ga. Ct. App. 1934).

[8] *Dracz v. Am. Gen. Life Ins. Co.,* 427 F. Supp. 2d 1165, 1169-70 (M.D. Ga. 2006).

[9] *Lively v. Southern Heritage Ins. Co.,* 256 Ga. App. 195, 568 S.E.2d 98, 100 (Ga. Ct. App. 2002).

[10] *See Hopkins v. Life Ins. Co. of Ga., 218* Ga. App. 591, 462 S.E.2d 467, 469 (Ga. Ct. App. 1995).

[11] *Jennings v. Life Ins. Co. of Ga.,* 212 Ga. App. 140, 441 S.E.2d 479, 480 (Ga. Ct. App. 1994).

[12] *Graphic Arts. Mut. Ins. Co. v. Pritchett,* 20 Ga. App. 430, 469 S.E.2d 199, 202 (Ga. Ct. App. 1996).

[13] *See Davis v. John Hancock Mut. Life Ins. Co.,* 413 S.E.2d 224, 226 (Ga. Ct. App. 1991) (uncontradicted evidence warrants summary judgment); *see also Lively v. Southern Heritage Ins. Co.,* 256 Ga. App. 195, 568 S.E.2d 98, 100 (Ga. Ct. App. 2002) (conflicting affidavits create jury question).

[14] *See Case v. RGA Ins. Services,* 239 Ga. App. 1, 521 S.E.2d 32, 34 (Ga. Ct. App. 1999).

[15] *See Lively,* 568 S.E.2d at 100.

[16] *See Jackson Nat'l Life Ins. Co. v. Snead,* 231 Ga. App. 406, 499 S.E.2d 173, 175-76 (Ga. Ct. App. 1998).

[17] *See Id.*

[18] *See Davis,* 413 S.E.2d at 226.

[19] GA. CODE ANN. § 33-24-7(b)(3).

[20] *Burkholder v. Ford Life Ins. Co.,* 207 Ga. App. 908, 429 S.E.2d 344, 346 (Ga. Ct. App. 1993).

[21] *See* 6 Couch on Ins. § 87-'3 (2014).

[22] GA. CODE ANN. § 33-25-3; *see also* GA. CODE ANN. § 33-29-3.

[23] *See* 6 Couch on Ins. § 87-'3 (2014).

[24] GA. CODE ANN. § 33-25-7.

[25] *See* 6 Couch on Ins. § 87-3 (2014).

[26] *See Torrence v. Am. Home Mut. Life Ins. Co.,* 78 Ga. App. 648, 52 S.E.2d 25, 27 (1949).

[27] *See id.*

[28] *See Lee v. All States Life Ins. Co.,* 49 Ga. App. 718, 176 S.E. 811, 812 (1934) (attacking enforceability through answer constitutes a contest).

[29] *Nationwide Mut. Ins. Co. v. McCollum,* 179 Ga. App. 500, 502, 347 S.E.2d 231, 233 (1986).

[30] *Id.*

[31] *Id.*

[32] *Id.*

[33] *Kobatake v. E.I. du Pont de Nemours and Co.,* 162 F.3d 619, 626-27 (11th Cir. 1998).

[34] *Id.*

[35] *Conway v. Romarion,* 252 Ga. App. 528, 557 S.E.2d 54, 57 (Ga. Ct. App. 2001).

[36] *Id.* at 57.

[37] *Id.* (interpleading premiums constituted offer to restore consideration in absence of formal tender offer).

[38] *See Dracz v. Am.Gen. Life and Accident Ins. Co.,* 427 F. Supp. 2d 1165, 1168 (M.D. Ga. 2006) (insured's refusal to accept refund not a bar); *see also Schoenthal,* 555 F.3d at 1342 (interpleader sufficient).

[39] *See Weems v. Am.Nat'l Ins. Co.,* 197 Ga. 493, 29 S.E.2d 500, 502-03 (Ga. 1944). The Georgia Court of Appeals has stated that "the rule is equitable, not technical, and does not require more than such restoration be made as is reasonably possible and such as the merits of the case demand." *Int'l Software Solutions v. Atlanta Pressure Treated Lumber Co.,* 194 Ga. App. 441, 390 S.E. 2d 659, 661 (Ga. Ct. App. 1990).

[40] *See supra* note 39.

[41] Under Georgia law, non-fraudulent misrepresentations are only grounds to void a policy if they are part of the insurance contract. *Life Ins. Co. of Ga. v. Blanton,* 109 Ga. App. 116135 S.E.2d 437, 439-40 (Ga. Ct. App. 1964).

[42] For example, sometimes the claimant will premise his argument upon *Atha v. Mid-South Ins. Co.,* 173 Ga. App. 489, 326 S.E.2d 853 (Ga. Ct. App. 1985) and assert that *Atha* holds that an insurer cannot rescind a policy unless it "had no knowledge, actual or constructive,

of the statement's falsity." *Atha,* however, focused only on whether an agency relationship existed between the agent and the carrier. *Id.* at 855.

[43] *See Prudential Ins. Co. of Am. v. Perry,* 121 Ga. App. (1970).

[44] *James, Hereford, etc. v. Powell,* 198 Ga. App. 604, 402 S.E.2d 348, 351 (Ga. Ct. App. 1991).

[45] *See Jennings v. Life Ins. Co. of Ga.,* 212 Ga. App. 140, 441 S.E.2d 479, 481.

[46] *See Cooper v. Olivent,* 271 Ga. App. 563, 610 S.E.2d 106, 108 (Ga. Ct. App. 2005); *Scott* **7** *v. McDonald,* 218 Ga. App. 810, 811, 463 S.E.2d 379, 381 (1995).

[47] *Hicks v. Sumpter Bank & Trust,* 269 Ga. App. 524, 604 S.E.2d 594, 597 (Ga. Ct. App. 2004).

[48] *See supra* notes 8-18 and accompanying text.

[49] *Lively v. Southern Heritage Ins. Co.,* 568 S.E.2d 98, 100 (Ga. Ct. App. 2002).

[50] *Martin v. Metropolitan Life Ins. Co.,* 192 F.2d 167, 169 (5th Cir. 1959).

[51] *See Life Ins. Co. of Ga. v. Blanton,* 135 S.E.2d 437, 439-40.

[52] *Id.*

[53] *Life Ins. Co. of Va. v. Conley,* 181 Ga. App. 152 (Ga. Ct. App. 1986)

[54] *See Marchant v. Travelers Indem. Co. of Ill.,* 650 S.E.2d 316, 319 (Ga. Ct. App. 2007).

[55] GA. CODE ANN. § 33-4-6.

[56] *Georgia Farm Bureau Mut. Ins. Co. v. Williams,* 266 Ga. App. 540, 597 S.E.2d 430, 432 (2004)

[57] *See Fountain v. Unum Life Ins. Co. of Am.,* 297 Ga. App. 458, 677 S.E.2d 334, 338 (Ga. Ct. App. 2009).

[58] *BBBServ. Co., Inc.,* 576 S.E.2d at 41-42.

[59] *See Assurance Co. of Am. v. BBB Serv. Co., Inc.,* 259 Ga. App. 54, 576 S.E.2d 38, 41-42 (2002).

[60] *Id.*

[61] *See id.*

[62] *United Ins. Co. of Am. v. Dixon,* 143 Ga. App. 133, 237 S.E.2d 661, 662 (1977), *overruled on other grounds,* 242 Ga. 235, 248 S.E.2d 635 (1978); *see also Williams,* 597 S.E.2d at 432.