TRANSACTIONS OF SOCIETY OF ACTUARIES
1962 VOL. 14 PT. 1 NO. 38 AB

LEGAL NOTES

B. M. ANDERSON*

PENSION PLAN—TORT LIABILITY FOR INCOMPLETE INFORMATION: *Gediman v. Anheuser Busch* (C. A. 2, January 30, 1962) 299 F.2d 537. Prudential issued a group annuity contract without life insurance benefits to Anheuser Busch in 1947. This plan was replaced in 1952 by a trusteed plan which included substantial life insurance benefits. Barsi, a long-time employee of Anheuser Busch, became disabled and inquired of the president as to his pension and insurance benefits in the event of his early retirement. The president supplied him with a memorandum from the pension consultants of the company. This memorandum indicated that he would be better off taxwise if he deferred the receipt of the cash distribution for about two years. The memorandum failed to point out that if he died in the meanwhile, his beneficiary would receive less than half the $78,356 available as a cash distribution on early retirement.

Barsi did elect to defer receipt of the cash distribution after his early retirement and he was killed in an automobile accident prior to the date for the payment. The trustees under the pension plan claimed that only $32,780.44 was owing to the beneficiary and that this was the extent of liability. Gediman, executor of Barsi, brought this action against the employer, Anheuser Busch, for the amount allegedly due under the pension plan, which claim was substantially in excess of the amount the trustees admitted was due, or in the alternative for damages for misrepresentation by Anheuser Busch. The District Judge rendered judgment against Anheuser Busch for $73,754.02 which was the commuted value of the annuity which Barsi might have received on his retirement. The company appealed, claiming only $32,780.44 was owing and that this was owed by the pension plan trustees.

On this appeal the Court found that Gediman, as executor of Barsi, was entitled to recover on the basis that Anheuser Busch negligently, although acting in good faith, failed to adequately inform Barsi as to the consequences of his election. The Court held that Anheuser Busch was liable to the executor for the $78,356 available in cash to Barsi on his early retirement plus interest. The Court refused to take into account any offset by reason of the heavy income taxes which might have been imposed on Barsi if he took the lump sum in cash in 1956. The Court held that the action was properly brought against Anheuser Busch rather than against the trustees and also that the judgment was properly

* B. M. Anderson, not a member of the Society, is a member of the Alabama, Connecticut, and United States Supreme Court Bars and is the author of the Third Edition of *Vance on Insurance*.

for the full $78,356 and not merely for the excess of this sum over the death benefit admittedly payable out of the pension fund. The Court suggested on this point that "we doubt it will find much difficulty in making the proper adjustments with the trustee."

This case involved a rather unusual situation where the death benefit was materially less than the amount receivable in cash and it appeared from the testimony that this fact was well known to the employees and perhaps even to Barsi. This case does illustrate the danger which the employer runs in giving out incomplete or erroneous information, even though the action is entirely in good faith.

DEPOSIT WITH STATE TREASURER—LIABILITY FOR RELEASE TO INSURANCE COMMISSIONER: *Hometrust Life Insurance Company v. United States Fidelity and Guaranty Company* (C. A. 5, January 11, 1962) 298 F.2d 379. Hometrust Life Insurance Company, an Alabama company, deposited with the State Treasurer securities in the face amount of $100,000 for the benefit of its policyholders and creditors. The Alabama statute providing for such deposit stipulated that the State Treasurer would hold these securities but that under certain conditions they might be exchanged or returned to the company. In accordance with a practice of long standing, the State Treasurer, acting through his assistant, released $10,000 of good securities. The release was to the Insurance Commissioner's representative and not to the company as the statute provided. The same amount of worthless securities were substituted.

Hometrust Life Insurance Company brought this action against the sureties of Brandon as Treasurer of the State of Alabama, claiming that Brandon should not have released the securities to any person other than a representative of the company as provided for in the statute relating to the deposit. In the trial court the judgment was for the sureties of the State Treasurer. However, on this appeal the judgment was reversed. The Court held that the State Treasurer was required to exercise the highest care, vigilance and diligence to prevent loss and that in spite of past custom the securities should not have been released to the Insurance Commissioner or his representative. The case was sent back to the trial court to determine whether Hometrust did, in fact, authorize the exchange of securities, stating (Rives, C. J.):

> The district court did not expressly find that the exchange of securities was not in fact authorized by Hometrust. In any event, the case must be remanded for further proceedings in conformity with this opinion. Determination of whether Hometrust or its authorized agent did in fact request the exchange of securities, and whether Gwaltney was in fact authorized to accept return of the securities as Hometrust's agent can best be made by the district court. It is even possible that by this time Gwaltney may be available to testify on this critical issue.

On the same day this same court decided *Continental Bank & Trust Company v. Brandon*, 297 F.2d 928. In that case the securities were released at the request of a representative of the insurance company which made the deposit. Hence, the State Treasurer and his sureties were not held liable.

McCARRAN ACT—FEDERAL TRADE COMMISSION JURISDICTION—MAIL ORDER INSURANCE: *Travelers Health Association v. Federal Trade Commission* (C. A. 8, January 24, 1962) 298 F.2d 820. The Federal Trade Commission brought this action against Travelers Health Association claiming that its advertising was "misleading and deceptive." Travelers Health Association claimed that this advertising was "regulated by State law" within the mean of the McCarran Act because the home state, Nebraska, regulated all advertising of domestic companies and hence the Federal Trade Commission lacked jurisdiction. The Commission issued its "cease and desist" order, which was appealed to the Court of Appeals for the Eighth Circuit, which agreed with the Travelers Health Association. The Federal Trade Commission then appealed to the United States Supreme Court.

The United States Supreme Court held that the advertising of Travelers Health Association was not "regulated by State law" by the Nebraska statute except in Nebraska, the home state of the Association. The Court held that Nebraska's regulation countrywide was not the type of regulation contemplated by the Congress. Accordingly, the Court held that the Federal Trade Commission might have jurisdiction of the advertising in the other states if there was no effective regulation in such states and reversed a contrary decision of the Court of Appeals for the Eighth Circuit.

On remand of this case to the Court of Appeals for further proceedings to determine whether the advertising was "regulated by State law" under the laws of other states, that Court reviewed the power of the 48 states where the Association was not licensed, to regulate the advertising of the Association. The Court found that these 48 states could exercise ultimate legal compulsion against the Association only by resorting to proceedings in Nebraska, and that this was not an adequate remedy to oust the Federal Trade Commission of jurisdiction. The Court did find that under recent decisions of the United States Supreme Court a company might be sued in states where under former decision they could not be sued. In its opinion the Court stated:

> The act (commonly referred to in the insurance field as the Model Fair Trade Practices Act) has since had enactment in additional states. At the present time, it or a corresponding statute, with local variation not at this point of significance, is in effect in all of the fifty states. If these enactments can be said to be subject to such powers of enforcement, through the state's own instrumentalities and processes, as in legal concept to give local control over the advertising used by Travelers Health Association, then the Federal Trade Commission Act is without application to the situation in any of the states.
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> As, however, our previous opinion noted, 262 F.2d at p. 243, Travelers Health Association is not licensed to solicit or write insurance in any state except Nebraska and Virginia. Nor does it have representatives of any nature otherwise within those forty-eight states. Thus, such states are able to engage in enforcement of their regulatory provisions only by means of reach against the Association outside their own borders.
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> The crucial question here therefore is whether on this basis these states are able to exercise such fullness of compulsion against the Association as legally to provide them with local control.

In our previous opinion, we mistakenly thought it sufficient as to all the fifty states that the sending of deceptive material by the Association into any state was regulated or made subject to control through the provisions, instrumentalities and processes of Nebraska law. On the opinions of the Supreme Court in the present case and in the National Casualty case, however, it is, we think, apparent that, under the McCarran-Ferguson Act, the situation cannot be regarded as "regulated by State law," except in terms of each state's sovereignty and of its having on this basis legislative provision possessing the character of regulation and capable of being enforced through the exercise of its own powers.

To the extent, therefore, that a state, for control of the acts of Travelers Health Association to be effected as to it, must depend on any provisions, instrumentalities or processes of another state, we believe that its situation cannot, within the McCarran-Ferguson Act, be held to be "regulated by State law." The state must itself be legally able to do, through its own provisions, instrumentalities and processes, everything that is necessary to the effecting of control as to its situation.

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To summarize—our holding here rests on the basis that, for forty-eight of the states to be able to exercise ultimate legal compulsion against Travelers Health Association in attempted regulation, they must resort to the statutes, instrumentalities and processes of another state (Nebraska) for effectuation of their orders, decrees and judgments; they must convert those decrees and judgments into decrees and judgments of such other state; and they further must invoke that state's auxiliary processes for effectuation of such decrees and judgments, in the status of products of the courts of that state and not of their own. Thus, we do not believe it is possible to say that as to these states the Association's advertising is "regulated by State law," within the concept which it seems to us that term implies, of being able to control by local power and means.

This case would appear to end the controversy as to the power of the Federal Trade Commission to regulate advertising of mail order companies. The Supreme Court's opinion is digested at *TSA* XII, 188–9.

Bank Loan Plan—Tort Liability of Agent: *Anderson v. Knox* (C. A. 9, December 4, 1961) 297 F.2d 702. Anderson, a life insurance agent who had lived and worked in California, established an office in Honolulu with a view to selling life insurance in the Hawaiian Islands. He specialized in the sale of "bank financed insurance" or insurance under the "bank loan plan" and was held out as an expert in this particular field.

Anderson was introduced to Knox, field superintendent on a sugar plantation receiving an annual salary of $8,100 and with a total cash income of about $10,000 a year and with the expectation of some moderate increase in compensation. Anderson persuaded Knox to borrow on his existing insurance and to take out a $100,000 10-payment life policy with annual premiums of $7,265. He also persuaded Knox to take out a $50,000 policy on the life of his wife. The basis of the sales was the income tax savings which would result from the payment of the interest on the loans which were made to keep the policies in force.

Knox was furnished with detailed figures by Anderson. One illustration was on the basis of a top income tax bracket of 40 percent, while Knox's current

bracket was less than 25 percent. The illustration also showed an interest rate starting at 4 percent but reducing to 3.5 percent in 1960 and thereafter. History, of course, proved that the interest rate went up rather than down after 1952 when the negotiations took place.

The financial affairs of Knox were such that he was forced to drop the coverage because he could not afford to pay the premiums even after receiving credit on his income tax. He then brought this action against Anderson, claiming fraud and misrepresentation on Anderson's part in inducing him to purchase a contract of this type. The trial court found that there had, in fact, been fraud and misrepresentation and accordingly awarded Knox compensatory damages of $13,309.98 plus interest and, in addition, punitive damages totaling $12,500.

On Anderson's appeal to the Court of Appeals for the Ninth Circuit, this judgment was affirmed in a lengthy opinion. The Court found it unnecessary to inquire whether a fiduciary relationship between Anderson and Knox did in fact exist. The Court reviewed the quite detailed testimony concerning representations made by Anderson to Knox, the controversy as to the general desirability of this type of insurance and particularly a statement of a rather negative nature by an officer of Anderson's own life insurance company.

In its opinion the Court (Pope, C. J.) stated:

> The trial court had the right to view the acts and conduct of Anderson in their entirety as a part of a plan to collect a large commission with reckless disregard of what the proposed program would do to Knox, and particularly to Knox's existing insurance policies. A part of the whole picture of Anderson's conduct was his letter to the New York Life Insurance Company's vice president, above referred to, and its manifest effort to prevent Knox from extricating himself at minimum expense from the situation in which he had been placed. The court could rightfully regard that last act of Anderson as a further willful and intentional effort to disadvantage Knox. We think the court could fairly say that in all this Anderson should have known that Knox would be greatly distressed and upset over the loss of those resources on which he was counting for the education of the children.

Chambers, C. J., wrote a concurring opinion, stating in part:

> If history repeats itself, many good insurance men will be encouraged to be alarmed that this decision puts their livelihood in jeopardy. There is no reason to think so. The answer is: "Read the facts—if you have a full hour to do so."

This case has attracted much attention in life insurance agency circles and particularly with persons selling this type of coverage. Anderson sought a review of this case by the United States Supreme Court, but the Court refused to hear the case.

GUARANTEED INSURABILITY RIDER—SUICIDE EXCLUSION: *Massachusetts Mutual Life Insurance Company v. Thacher* (New York Supreme Court, Appellate Division, First Department, December 19, 1961) 222 N.Y.S.2d 339. Massachusetts Mutual (along with Mutual Life) brought this action against Thacher, Superintendent of Insurance, to prevent him from withdrawing approval of so-called guaranteed insurability option forms which were attached to

life insurance policies. This type of provision gave to the insured the option to purchase new insurance in specified amounts and at specified future dates without furnishing evidence of insurability.

The claim of the Superintendent was that the suicide exclusion provision could not extend beyond two years from the date the original policy was issued. The claim of these two companies (and of the other companies which agreed to be bound by the decision) was that the new policy issued pursuant to the option was a new contract and that a new suicide provision should be dated from the date of issue of the new policy.

Three of the five justices of the Appellate Division agreed that the Superintendent's construction of the New York law was proper and that the company could not exclude from coverage suicide which occurred more than two years after the original policy was issued. These three justices also held that the Superintendent was warranted in his action in withdrawing approval of the forms. In this opinion the Court (Stevens, J.) stated:

> When the insurer waives the requirement for evidence of insurability, the applicant policyholder is entitled to believe, and reasonably so, that upon payment of the stated premium, he will receive full benefits without again facing a two-year suicide exclusion clause. Such a provision is likely to mislead and is less favorable to the insured and within the prohibition of Section 155, subd. 2(d), Insurance Law. Respondent found that attachment of such a condition would deprive the policyholder of "part of what he purchased and, to this extent, would make illusory one of the benefits offered." "The language employed in the contract of insurance must be given its ordinary meaning, such as the average policyholder of ordinary intelligence, as well as the insurer would attach to it." Morgan v. Greater New York Taxpayers Mutual Insurance Association, 305 N.Y. 243, 248, 112 N.E.2d 273, 275; Levinson Furs v. Centennial Insurance Co., 286 App. Div. 788, 146 N.Y.S.2d 531, rearg. and leave to appeal denied 1 A.D.2d 774, 149 N.Y.S.2d 214. Moreover, such a provision waiving evidence of insurability may be contrary to public policy because it could well serve as an inducement to build up an insurance reserve in contemplation of suicide. Cf. Smith v. National Benefit Society, 123 N.Y.85, 25 N.E. 197, 9 L.R.A. 616.
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> The consideration for the option is stated therein to be the application for the policy, the agreement, and payment of the premium for the agreement. Obviously, the option has no vitality independent of the basic agreement, and the rider containing the option is a part of the policy. See Hopkins v. Connecticut General Life Insurance Company, 225 N.Y. 76, 121 N.E. 465; cf. Dannhauser v. Wallenstein, 169 N.Y. 199, 62 N.E. 160. It has been stated that whatever is within the spirit of the statute is within the statute. Cf. Standard Accident Insurance Co. v. Newman, Sup., 47 N.Y.S.2d 804, aff'd 268 App. Div. 967, 51 N.Y.S.2d 767. The design and purpose of the Insurance Law being for the protection of the policyholder, a construction which would permit the insurer additional two-year suicide exclusion periods upon the exercise of option purchases, the existence of which is dependent upon a single original policy, is contrary to the spirit of the statute as well as in contravention of its plain language. Petitioner has not sustained the burden of proving the act of withdrawal of approval without the powers of respondent, that his action does not rest upon a reasonable basis, nor that there was any abuse by respondent of his discretionary powers. The use of the term "new" as applied to the policy issued when the option is exercised is not controlling. Respondent may look to the contract itself to determine its nature.

Two of the five justices who participated in the decision were of the opinion that the policy issued pursuant to the insurability option was a new contract and that the companies were justified in inserting and relying on a new two-year suicide clause.

The companies thereafter appealed to the New York Court of Appeals. On this further appeal that Court unanimously (and without opinion) affirmed the judgment below.

GROUP LIFE INSURANCE—EXTRATERRITORIAL OPERATION OF THE LAW: *State Mutual Life Assurance Company v. Texas* (Texas Supreme Court, January 17, 1962) 353 S.W.2d 412. State Mutual issued in the District of Columbia to trustees a group life insurance contract covering the lives of members and employees of member companies of the National Association of Securities Dealers, including some employees living in Texas. This type of group life contract was not a type which could be issued in Texas. The law went further and prohibited the coverage of this type of group in Texas regardless of where the contract was written.

The Attorney General of Texas brought this action against State Mutual to cancel its Texas license because of the coverage of the Texas employees. The District Court decided against State Mutual. However, on appeal the Court of Appeals for the Third Supreme Judicial District upheld State Mutual (for a digest of the opinion, see *TSA* XIII, 38). On further appeal to the Supreme Court of Texas, that Court reversed, holding that State Mutual could not properly cover residents of Texas under a policy of this type, even though the policy was written elsewhere. The Court held that it was within the power of Texas to revoke the Texas license of State Mutual if it did not cancel the Texas coverage, which amounted to about 2 percent of the total coverage under the group policy.

The Texas Supreme Court rejected the argument that this type of regulation of insurance by Texas was not consistent with decisions of the United States Supreme Court construing the Constitution of the United States. The Court pointed out that both foreign and domestic insurers alike were prohibited from writing group life insurance contracts covering trade association members and employees of these associations who lived in Texas. In its opinion the Court (Calvert, C. J.) stated:

> We do not believe, and are not prepared to say, that the Legislature of this state was without constitutional power to exclude trade association members and their employees from the groups made eligible for group insurance. There is not the same need for loyalty from the insured that exists on the part of the employer or labor union groups and the corresponding obligation for obtaining and retaining the best coverage available at the lowest cost does not exist. Therefore, Art. 3.50 is not repugnant to the equal protection clause of the Constitution of the United States. And inasmuch as the statute represents a reasonable exercise of the power of the state to protect the vital interests of its citizens, respondent has no constitutional right to violate it. It follows that conditioning the right of respondent to continue to do business in this state upon cancellation of its group coverage of NASD members and employees in this state violates neither the due process nor the full faith and credit provisions of the Constitution. The State of Texas does not

seek by enforcement of Sec. 4 of Art. 3.50 to prohibit respondent from keeping in force the group insurance contract it made with the Trustees, nor does it seek to invalidate that contract or to modify any of its terms. It does not even seek to deny respondent the right to apply the coverage of the contract to residents of Texas. It seeks only to take away from a foreign insurance corporation what is finally and essentially a privilege if it insists upon applying the contract, which would be unlawful if made in this state, to residents of the state. This does not deny full faith and credit to the laws of the state where the contract was made.