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LEGAL NOTES

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AGENCY CONVENTION—TAXABILITY OF REIMBURSED COST TO AGENT: *Rudolph v. United States* (United States Supreme Court, June 18, 1962) 370 U.S. 269. Rudolph, an agent of Southland Life, attended a company convention in New York City along with his wife. The trip was by special train, and Southland Life paid the expenses of Rudolph, its agent, and of his wife.

The Government took the position that the reimbursed expenses for Rudolph and for his wife represented taxable income and, further, that these expenses could not be deducted as "ordinary and necessary" business expenses. The United States District Court found that the trip was "in the nature of a bonus, reward, and compensation for a job well done" and was "primarily a pleasure trip in the nature of a vacation." Accordingly, it was held that the reimbursed amount represented income to Rudolph and his wife, who had filed a joint return, and there could be no deduction.

On appeal to the Court of Appeals for the Fifth Circuit, that Court affirmed the decision below. The United States Supreme Court thereafter granted certiorari, agreeing to hear the case. The Supreme Court then dismissed the writ "as improvidently granted" after concluding that the questions of fact as to the main purpose of the trip had been decided by the two courts below and that there should be no review by the United States Supreme Court.

Mr. Justice Harlan wrote a separate and longer opinion in agreement with the view that the reimbursed expenses represented taxable income and were not deductible as business expenses.

Mr. Justice Douglas and Mr. Justice Black dissented on the basis that the reimbursed expenses did not represent compensation to Rudolph and his wife and, further, on the basis that the Court in effect was taking this case "out of the main stream of precedents" and establishing "a special rule for insurance conventions." Mr. Justice Douglas in his opinion stated:

> Insurance conventions go back at least to 1924 (Report No. 15, Life Insurance Sales Research Bureau, Nov. 1924) and are premised on the idea that agents and companies benefit from the knowledge and increase in morale which result from them. Why they should be treated differently from other conventions is a mystery. It cannot be, as the district judge thought and as the Government seems to argue, because going to New York City is, as a matter of law, a "pleasure trip." If we are in the field of judicial notice, I would think that some might conclude that the weekend in New York City was a chore and that those who went sacrificed valuable time that might better have been spent on the farm, in the woods, or along the seashore.

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Mr. Justice Douglas also pointed out that Internal Revenue Service employees had been permitted to deduct their expenses in attending conventions and that "revenue agents need make no accounting of the movies they saw or the nightclubs they attended, in order to get the deduction, while insurance agents must." In the view of the two dissenting justices the wife's expenses as well as the expenses of the agent were deductible.

This case is quite similar to *Patterson v. Thomas*, digested at *TSA*, XIII, 32-33.

The Revenue Act of 1962 establishes uniform and quite stringent rules concerning business expenses in connection with conventions and otherwise. The result will be the same rules for insurance conventions as for other conventions The importance of this decision is therefore lessened.

PREMIUM TAX IMPOSED ON POLICYHOLDER—LLOYD'S CONTRACT—CONSTITUTIONAL LAW: *State Board of Insurance v. Todd Shipyards Corporation* (United States Supreme Court, June 25, 1962) 370 U.S. 451. Todd Shipyards Corporation sued the State of Texas to recover premium taxes imposed on Todd under a Texas statute. This statute provided for a 5 per cent premium tax payable by the policyholder who purchased a policy covering Texas risks from a nonlicensed insurer. Todd insured property located in Texas in Lloyd's of London. Lloyd's was not licensed in Texas, was not regulated by Texas law, and could not be reached for the collection of the tax.

In the trial court judgment was rendered for Todd on the basis that the tax was in violation of the Federal Constitution. On appeal to the Texas Court of Civil Appeals, this judgment was affirmed; and, on further appeal to the Texas Supreme Court, the judgment was likewise affirmed, but reluctantly.

On further appeal to the United States Supreme Court, the judgment below was affirmed on the basis of the McCarran Act and, particularly, the legislative history of this Act. Mr. Justice Douglas, who wrote the majority opinion, pointed out that, when the McCarran Act was passed, Congress evidenced an intention to restrict the power of states in a manner in which they had previously been restricted under three prior United States Supreme Court decisions. The Court refused to re-examine the constitutional question on the basis that Congress "tailored the new regulations for the insurance business with specific reference to our prior decisions." In its opinion the Court (Douglas, J.) stated:

> The insurance transactions involved in the present litigation take place entirely outside Texas. The insurance, which is principally insurance against loss or liability arising from damage to property, is negotiated and paid for outside Texas. The policies are issued outside Texas. All losses arising under the policies are adjusted and paid outside Texas. The insurers are not licensed to do business in Texas, have no office or place of business in Texas, do not solicit business in Texas, have no agents in Texas, and do not investigate risks or claims in Texas.
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> The insured is not a domiciliary of Texas but a New York corporation doing business in Texas. Losses under the policies are payable not to Texas residents but to the insured at its principal office in New York City. The only connection between Texas and the

insurance transactions is the fact that the property covered by the insurance is physically located in Texas.

We need not decide *de novo* whether the results (and the reasons given) in the *Allgeyer*, *St. Louis Cotton Compress*, and *Connecticut General Life Insurance* decisions are sound and acceptable. For we have in the history of the McCarran-Ferguson Act an explicit, unequivocal statement that the Act was so designed as not to displace those three decisions. The House Report stated:

"It is not the intention of Congress in the enactment of this legislation to clothe the States with any power to regulate or tax the business of insurance beyond that which they had been held to possess prior to the decision of the United States Supreme Court in the *Southeastern Underwriters Association case.* Briefly, your committee is of the opinion that we should provide for the continued regulation and taxation of insurance by the States, subject always, however, to the limitations set out in the controlling decisions of the United States Supreme Court, as, for instance, in *Allgeyer v. Louisiana* (165 U.S. 578), *St. Louis Cotton Compress Co. v. Arkansas* (260 U.S. 346), and *Connecticut General Insurance Co. v. Johnson* (303 U.S. 77), which hold, inter alia, that a State does not have power to tax contracts of insurance or reinsurance entered into outside its jurisdiction by individuals or corporations resident or domiciled therein covering risks within the State or to regulate such transactions in any way." H.R. Rep. No. 143, 79th Cong., 1st Sess., p. 3.

Two justices did not take part in the decision, and Mr. Justice Black dissented. In this dissent he stated:

In holding that the McCarran-Ferguson Act withdrew from the States the power to tax the ownership and use of insurance policies on property located within their borders merely because those policies were made by representatives of the insurer and the insured in another State, I think the Court places an unwarranted construction upon that Act which may seriously impair the capacity of Texas and other States to provide and enforce effective regulation of the insurance business. The Texas statute held invalid was enacted by the State Legislature in 1957 in order to protect the State's comprehensive supervision of insurance companies and their policies from being undercut by the practice of insuring Texas property with insurance companies not authorized to do business in that State. Prior to 1957, the whole cost of the Texas program had been placed upon those insurance companies which had subjected themselves to Texas regulation and taxation by qualifying to do business in the State. The 1957 statute was passed for the express purpose of equalizing that burden by placing a tax upon the purchasers of unregulated insurance roughly equal to that imposed directly upon regulated companies. In this way the State tried to protect its qualified and regulated companies from unfair competition by companies which could sell insurance on Texas property cheaper because they did not have to pay their part of the cost of the Texas insurance regulation program. The Court's construction of the McCarran-Ferguson Act bars Texas from providing this sort of protection to regulated companies. This holding seems to me to threaten the whole foundation of the Texas regulatory program for it plainly encourages Texas residents to insure their property with unregulated companies and discourages out-of-state companies from qualifying to do business in and subjecting themselves to regulation and taxation by the State of Texas.

I cannot believe that an Act which was basically designed to leave the power to regulate and tax insurance companies to the States was intended to have any such effect. The McCarran-Ferguson Act "declares that the continued regulation and taxa-

tion by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States"—a declaration which is not qualified by any other language of the Act. Nothing in the legislative history which the Court relies upon persuades me that we should read this Act in a way which so seriously impairs the power of the States to discharge their responsibilities under the Act to provide a comprehensive, effective, well-integrated program for regulating insurance on property within their borders. I think the McCarran-Ferguson Act left Texas with adequate power to place a tax on the ownership and use of insurance policies covering the vast properties owned and operated by this respondent in Texas, and I therefore dissent.

This decision is important because it prevents the United States Supreme Court from re-examining a prior decision and enlarging the power of states to tax and to regulate insurance.

The opinion of the Texas Supreme Court was digested at *TSA*, XIII, 648–49.

AVIATION RESTRICTION—COVERAGE AS A PASSENGER: *United Services Life Insurance Company v. Delaney* (C.A. 5, September 26, 1962) 308 F.2d 484. The insured, a pilot, applied for and received a life policy. This policy excluded aviation hazards except passenger coverage on commercial airlines and "except death resulting from travel as a passenger on an aircraft owned and operated by the United States Government." The insured died of injuries received as the pilot and the only occupant of an aircraft owned and operated by the United States Government which crashed on a night training flight. He was on duty as a regular Army officer.

The life insurance company took the position that the insured when he met his death was not traveling as a passenger but was operating the plane as a pilot. The company produced correspondence which tended to show that the insured understood he was not covered while a pilot. The beneficiary brought suit and the United States District Court, and, on appeal, the Court of Appeals for the Fifth Circuit held that the insured was in fact a passenger at the time he met his death. In reaching this conclusion, the Court purported to follow Texas decisions more or less in point because the contract involved was a Texas policy.

One of the three Circuit Judges dissented on the basis that the Texas decisions did not require a holding that the policy was so ambiguous as to permit the conclusion that the insured was a passenger. In his dissent Judge Wisdom stated:

In the Warren case, the Court could not have arrived at the conclusion it reached without finding that the policy as a whole was ambiguous. The insurer's construction of the one word "passenger" conflicted with a reasonable construction of other provisions and was inconsistent with the purpose and meaning of policy intended to cover all employees. On the other hand, here the critical words are clear; the clause does not conflict with other policy provisions; the insurer's view of the meaning of the clause is consistent with the policy and the construction the insured himself placed on the policy; there is good reason to distinguish between a training flight piloted by Delaney, an

inexperienced pilot who had requested training, and a flight as a passenger on a government operated plane or a scheduled passenger plane. There is therefore no occasion to resort to the familiar principle that equivocal words should be construed against the insurer.

There is not the shadow of a doubt, in my mind, that the parties *said* and intended to say that the policy excluded coverage for death resulting from injuries to an Army pilot in a training flight. We have no license to change the contract. Here, Warren is only a ghost; it casts no shadow.

This case illustrates the need for policy language so clear that a court cannot find ambiguity. This decision is difficult to justify on any reasonable basis.

BINDING RECEIPT—TEMPORARY INSURANCE: *Metropolitan Life Insurance Company v. Wood* (C.A. 9, May 4, 1962) 302 F.2d 802. Wood applied for a life policy and paid the first premium to the agent. He received a receipt which provided that "if such application is approved at the Company's Home Office for the class, plan and amount of insurance therein applied for, then the insurance in accordance with the terms of the policy applied for shall be in force from this date. . . ." Wood had been rejected on account of his physical condition by another company because of a heart condition. He was examined by the doctor for the Metropolitan shortly after he applied for the coverage and died of a heart attack later that same day.

Metropolitan took the position that since Wood was admittedly not an insurable risk there was no coverage. The beneficiary sued, claiming that under California decisions temporary insurance was in force upon the signing of the application and the payment of the premium and that this temporary insurance continued in force until the rejection of the application.

The United States District Court considered the California cases and agreed with the contention of the beneficiary. On further appeal to the United States Court of Appeals for the Ninth Circuit, that Court likewise held that under California decisions and with the type of binding receipt used by Metropolitan there was in fact temporary coverage regardless of the fact that the applicant admittedly was not insurable.

In affirming the judgment below, the Court of Appeals in a per curiam opinion stated:

It follows that under California law a contract by which the appellant was to pay Mrs. Wood fifteen thousand dollars upon the death of Mr. Wood arose between Mr. Wood and the appellant when appellant's agent accepted Mr. Wood's application and premium payment. This contract was subject to termination upon the rejection of Mr. Wood's application by the appellant, but appellant's obligation to pay matured before the condition subsequent occurred.

The Court purports to construe the contract the parties have made—not to make a new contract for them. Hence, with a differently worded receipt the result might be different.

GOOD HEALTH REQUIREMENT—WAIVER OR ESTOPPEL: *Hartford Live Stock Insurance Company v. Phillips* (Colorado Supreme Court, June 25, 1962) 372

P.2d 740. The owner of the insured bull applied for a life insurance policy for a one-year term in the face amount of $750 and with a $45 premium. The application for the policy provided that the insurance would not be in force or effect unless and until the policy was delivered while the bull was in good health and entirely free from sickness and injury. A somewhat similar provision was inserted in the policy.

The insurer through its agent knew that the bull was in a veterinary hospital at the time the coverage was applied for. He was released from the hospital but was readmitted shortly thereafter with what was thought to be a sinus infection following loss of a horn but was subsequently diagnosed as cancer.

The insurance company refused to pay after the bull died, stating that he was not in good health as required by the application and the policy at the time the policy was delivered. It was conceded that the cancer antedated the policy. The owner claimed that by delivering the policy with knowledge of the confinement in the veterinary hospital the insurance company had waived or was estopped to assert the nonfulfillment of the condition as to good health. The trial court agreed with this legal position and entered judgment for the owner.

On appeal to the Colorado Supreme Court, that Court reversed on the basis that the risk was excluded from coverage by the terms of the policy and of the application and that the doctrine of waiver or estoppel could not be applied to create coverage where there was none. The Court distinguished between the attempt to create primary liability in this manner and waiver or estoppel to assert grounds of forfeiture.

PREMIUM DUE DATE—DELIVERY DATE OR EFFECTIVE DATE: *State Security Life Insurance Company v. Kinter* (Indiana Supreme Court, October 18, 1962) 185 N.E.2d 527. The life policy was applied for November 27, 1954, but the balance of the monthly premium required to put the insurance in force was not paid until the policy was delivered about December 10, 1954. Three monthly premiums were paid, which would have carried the insurance beyond the date of the insured's death on March 31, 1955, if the monthly premiums were due as of December 10, 1954, and monthly thereafter. However, the policy had lapsed for nonpayment of premiums if the monthly premiums had been due as of November 27, 1954, and monthly thereafter.

The policy provided for annual premiums with permission to pay semiannually or quarterly. The policy was specific in providing that the due dates of annual, semiannual, and quarterly premiums would be computed on the basis of the policy date irrespective of the date of delivery, which was the effective date of the insurance. It was not so specific as to monthly premiums because the printed policy form did not recognize monthly premiums.

The trial court and, on appeal, the Indiana Supreme Court held that the policy was ambiguous; that the insured, having paid three months' premiums, was entitled to three months' coverage from the effective date of the insurance plus the grace period; and that the insurance was in force on the date the insured

died. There was one dissenting judge. Jackson, Judge, speaking for the Court, stated:

Viewing both the application for insurance and the policy itself in the case at bar, we cannot find anything which *expressly* refers to the payment date for monthly premiums. The section of the policy here which deals particularly with the payment of premiums makes no mention of a monthly premium. We are aware of the rule that where the policy provides an express date for the payment of premiums such date controls over the later date of delivery at which time the policy actually may become effective. *Tibbits* v. *Mutual*, etc., *Ins. Co.* (1903), 159 Ind. 671, 65 N.E. 1033. That where the date of payment of premiums is specifically fixed in the policy there is nothing further to construe. *Painter* v. *Massachusetts*, etc., *Ins. Co.* (1921), 77 Ind. App. 34, 133 N.E. 20. However, in the instant case, to arrive at the result sought by appellant, we must resolve an ambiguity which exists by the lack of any definite provision regarding monthly premiums in the section of the policy which spells out how (either annually, semi-annually or quarterly) the premiums are to be paid. In order to do so, we must construe the contract.

This case illustrates the extremes to which a court will go to hold the company liable, especially where, as here, the case might be regarded as a "hard" case.