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LEGAL NOTES

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VARIABLE ANNUITY—REGULATION BY S.E.C.: *Securities and Exchange Commission v. Variable Annuity Life Insurance Company* (United States Supreme Court, March 23, 1959) 359 U.S. 65. The Securities and Exchange Commission brought this suit to enjoin the Variable Annuity Life Insurance Company from offering its contracts without registering them under the Securities Act of 1933 and without complying with the Investment Company Act of 1940. Equity Annuity Life Insurance Company, similarly situated, was allowed to intervene, as was National Association of Securities Dealers, Inc., and the suits were consolidated.

The District Court denied relief on the basis that the S.E.C. lacked jurisdiction, and on appeal the Court of Appeals for the District of Columbia affirmed. The United States Supreme Court agreed to hear the case "because of the importance of the question presented." The company, chartered by the District of Columbia and admitted to do business there and in several states, claimed that it was exempt from regulation under the two Acts in question and that the provisions of the McCarran Act, Public Act 15 of 1945, reinforced this exemption. Under the Securities Act of 1933 the claim to exemption was based on a provision relating to "insurance" or "annuity" contracts when "subject to the supervision of the insurance commissioner... of any State...." The exemption under the Investment Company Act of 1940 was on the basis that the company was "organized as an insurance company, whose primary and predominant business activity is the writing of insurance . . . and which is subject to the supervision by the insurance commissioner . . . of a State. . . ." The claim to further exemption under the McCarran Act was that "No Act of Congress shall be construed to invalidate, impair or supersede any law enacted by any State for the purpose of regulating the business of insurance. . . ."

In a decision where the Court was divided five to four, the Court held that the variable annuity contracts, though they had some features of conventional life insurance and annuity contracts, were not "insurance" policies or "annuity" contracts and that the company was not an "insurance" company or engaged in the "business of insurance." Therefore there was no exemption from the three Acts. The Court appeared to be influenced to a considerable degree by the fact that the investment risk under the contract was placed on the purchaser of the contract and not on the company. The Court in the majority opinion stated:

> We start with a reluctance to disturb the state regulatory schemes that are in actual effect, either by displacing them or by superimposing federal requirements on transac-

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tions that are tailored to meet state requirements. When the States speak in the field of "insurance," they speak with the authority of a long tradition. For the regulation of "insurance," though within the ambit of federal power (*United States* v. *Underwriters Assn.*, 322 U.S. 533) has traditionally been under the control of the States.

We deal, however, with federal statutes where the words "insurance" and "annuity" are federal terms. Congress was legislating concerning a concept which had taken on its coloration and meaning largely from state law, from state practice, from state usage. Some States deny these "annuity" contracts any status as "insurance." Others accept them under their "insurance" statutes. It is apparent that there is no uniformity in the rulings of the States on the nature of these "annuity" contracts. In any event how the States may have ruled is not decisive. For, as we have said, the meaning of "insurance" or "annuity" under these Federal Acts is a federal question.

While all the States regulate "annuities" under their "insurance" laws, traditionally and customarily they have been fixed annuities, offering the annuitant specified and definite amounts beginning with a certain year of his or her life. The standards for investment of funds underlying these annuities have been conservative. The variable annuity introduced two new features. First, premiums collected are invested to a greater degree in common stocks and other equities. Second, benefit payments vary with the success of the investment policy. The first variable annuity apparently appeared in this country about 1952 when New York created the College Retirement Equities Fund to provide annuities for teachers. It came into existence as a result of a search for a device that would avoid paying annuitants in depreciated dollars. The theory was that returns from investments in common stocks would over the long run tend to compensate for the mounting inflation. The holder of a variable annuity cannot look forward to a fixed monthly or yearly amount in his advancing years. It may be greater or less, depending on the wisdom of the investment policy. In some respects the variable annuity has the characteristics of the fixed and conventional annuity: payments are made periodically; they continue until the annuitant's death or in case other options are chosen until the end of a fixed term or until the death of the last of two persons; payments are made both from principal and income; and the amounts vary according to the age and sex of the annuitant. Moreover, actuarily [*sic*] both the fixed-dollar annuity and the variable annuity are calculated by identical principles. Each issuer assumes the risk of mortality from the moment the contract is issued. That risk is an actuarial prognostication that a certain number of annuitants will survive to specified ages. Even if a substantial number live beyond their predicted demise, the company issuing the annuity—whether it be fixed or variable—is obligated to make the annuity payments on the basis of the mortality prediction reflected in the contract. This is the mortality risk assumed both by respondents and by those who issue fixed annuities. It is this feature, common to both, that respondents stress when they urge that this is basically an insurance device.

The difficulty is that, absent some guarantee of fixed income, the variable annuity places all the investment risks on the annuitant, none on the company. The holder gets only a *pro rata* share of what the portfolio of equity interests reflects—which may be a lot, a little, or nothing. We realize that life insurance is an evolving institution. Common knowledge tells us that the forms have greatly changed even in a generation. And we would not undertake to freeze the concepts of "insurance" or "annuity" into the mold they fitted when these Federal Acts were passed. But we conclude that the concept of "insurance" involves some investment risk-taking on the part of the company. The risk of mortality, assumed here, gives these variable annuities an aspect of insurance. Yet it is apparent, not real; superficial, not substantial. In hard reality the

issuer of a variable annuity that has no element of a fixed return assumes no true risk in the insurance sense. It is no answer to say that the risk of declining returns in times of depression is the reciprocal of the fixed-dollar annuitant's risk of loss of purchasing power when prices are high and gain of purchasing power when they are low. We deal with a more conventional concept of risk-bearing when we speak of "insurance." For in common understanding "insurance" involves a guarantee that at least some fraction of the benefits will be payable in fixed amounts. See *Spellacy* v. *American Life Ins. Assn.*, 144 Conn. 346, 354–355, 131 A.2d 834, 839; Couch, Cyclopedia of Insurance Law, Vol. 1, §25; Richards, Law of Insurance, Vol. 1, §27; Appleman, Insurance Law and Practice, Vol. 1, §81. The companies that issue these annuities take the risk of failure. But they guarantee nothing to the annuitant except an interest in a portfolio of common stocks or other equities—an interest that has a ceiling but no floor. There is no true underwriting of risks, the one earmark of insurance as it has commonly been conceived of in popular understanding and usage.

Mr. Justice Brennan wrote a concurring opinion, in which Mr. Justice Stewart joined, which agreed in general with the conclusion in the principal opinion but for somewhat different reasons. Justices Harlan, Frankfurter, Clark and Whittaker dissented on the basis that the exemption provision of the three statutes in question applied and that if such contracts and companies should be made subject to S.E.C., this should be done by Congressional action and not by court decision.

For a digest of the opinion of the Court of Appeals for the District of Columbia, see *TSA* X, 787–9.

SUICIDE OR ACCIDENTAL DEATH—SHOTGUN FIRED TWICE: *Dick v. New York Life Insurance Company* (United States Supreme Court, May 18, 1959) 359 U.S. 437. The insured, a North Dakota farmer and experienced hunter, was found dead in his barn. Close by was a shotgun in good condition with both barrels fired. He had been shot first in the chest and then in the head. A screwdriver, which could have been used to push the two triggers, was nearby.

The New York Life paid the single indemnities under its two life policies but refused double indemnity on the basis that the insured had committed suicide and had not died accidentally. The beneficiary sued and the District Judge permitted the jury's verdict in favor of the beneficiary to stand. On appeal to the United States Court of Appeals, that Court reversed the judgment in favor of the beneficiary on the basis that the trial court was not under the circumstances justified in permitting the judgment to stand. The Court of Appeals' opinion is digested at *TSA* X, 114.

The beneficiary sought and was granted a hearing by the United States Supreme Court which reversed the judgment of the Court of Appeals on the basis that the Court should have permitted the judgment of the District Court to stand. In its opinion by Mr. Chief Justice Warren the Court stated:

In our view, the Court of Appeals improperly reversed the judgment of the District Court. It committed its basic error in resolving a factual dispute in favor of respondent that the shotgun would not fire unless someone or something pulled the triggers. Petitioner's evidence on this score, despite the "tests" performed by the sheriff, could

support a jury conclusion that the gun might have fired accidentally from other causes. Once an accidental discharge is possible, a jury could rationally conceive of a number of explanations of accidental death which were consistent with evidence which the jury might well have believed showed the overwhelming improbability of suicide. The record indisputably shows lack of motive—in fact there is affirmative evidence from which the jury could infer that Dick was a most unlikely suicide prospect. He was relatively healthy, financially secure, happily married, well liked, and apparently emotionally stable. He left nothing behind to indicate that he had committed suicide and nothing in his conduct before death indicated an intention to destroy himself. The timing of the death, while in the midst of normal chores and immediately preceding a planned appointment with neighbors, militates against such a conclusion. Dick's presence in the shed and the accessibility of the gun are explicable in view of the dogs which previously attacked his sheep and the fact that the door in the shed provided a convenient exit to the adjoining fields. And a jury could well believe it improbable that a man would not even bother to remove his bulky gloves, or thick jacket, when he intended to commit suicide even though those articles of clothing made it difficult to turn the gun on himself.

Mr. Justice Frankfurter and Mr. Justice Whittaker dissented on the basis that on the merits of the case the decision of the Court of Appeals should be permitted to stand and also that the United States Supreme Court should not burden itself by reviewing cases such as this, turning solely on questions of fact.

FEDERAL TRADE COMMISSION—REGULATION OF ADVERTISING: *Travelers Health Association v. Federal Trade Commission* (C.A. 8, January 13, 1959) 262 F.2d 241. The Federal Trade Commission claimed that certain advertising practices of Travelers Health Association of Omaha, Nebraska, were "false, misleading and deceptive" within the meaning of the FTC Act and that it had jurisdiction to regulate the advertising practices of that company. The company, chartered by Nebraska and licensed only in Nebraska and in Virginia, did business entirely by mail from its home office in Omaha.

The Federal Trade Commission claimed that a mail order concern such as Travelers Health Association was not in fact "regulated by State law" within the meaning of the exemption provision of the McCarran Act, Public Law 15 of 1945. At the time the proceeding was brought and at the time the order was entered requiring Travelers Health Association to "cease and desist" from the practices in question Nebraska had in force an "Unfair Competition and Trade Practices" act expressly prohibiting unfair and deceptive acts and practices, and in this respect it paralleled the Federal Trade Commission Act. After the action was brought and the order entered, Nebraska amended its law to make it specifically applicable to acts done elsewhere by domestic companies as well as in Nebraska, and this law as amended was in force at the time of this appeal from the order of the Federal Trade Commission.

Two of the three Circuit Judges held on this appeal that the regulation by Nebraska of the business of the company was adequate to deprive the Federal Trade Commission of jurisdiction. The Court, speaking through these two judges, expressed the view that before as well as after Nebraska amended its law it had the power to regulate the practices of the company. The Court stated:

It must be kept in mind that the business of the petitioner was all done at or from its home office in Omaha. There its solicitation material originated and was mailed; there the applications for insurance induced by solicitation were received; there all policy contracts were written; and there all premiums were paid. With every activity of the petitioner, in the conduct of its business, subject to the supervision and control of the Director of Insurance of Nebraska, we think that the petitioner's practices in the solicitation of insurance by mail in Nebraska or elsewhere reasonably and realistically cannot be held to be unregulated by State law.

One Judge dissented on the basis that Congress did not have in mind regulation by the home state alone of the "long distance" advertising practices. This dissenting Judge pointed out that this type of regulation seemed to him to be impractical and ineffective and that this mail order business cannot be regulated by the laws of the states whose citizens are subjected to the mail disseminated advertising. He expressed the view that the order of the Federal Trade Commission should have been upheld.

On May 18, 1959 the Supreme Court of the United States entered an order permitting a review of this decision.

GROUP INSURANCE—RIGHT OF COUNTY TO PURCHASE INSURANCE FOR EMPLOYEES: *Polk County v. Lincoln National Life Insurance Company* (C. A. 5, January 13, 1959) 262 F.2d 486. In 1952 Polk County procured group insurance from Lincoln National for employees of the County. The employees paid part of the cost through their contributions and the County paid the balance. The compensation of some of the County employees was fixed by the Legislature, but the Board of Commissioners which procured the policy on behalf of the County fixed the compensation of most of the employees.

In 1957 the Board of Commissioners canceled the policy and then attempted to recover from Lincoln National the contributions which the County had made towards the cost of the insurance. The United States District Court denied recovery to the County. However, on appeal to the United States Court of Appeals for the Fifth Circuit, that Court construed Georgia law as preventing a county from expending its money in this manner for the benefit of employees of the county and dependents of such employees. It accordingly reversed the decision and ordered the lower court to enter judgment in favor of the County.

Chief Judge Hutcheson dissented from the decision of his two colleagues on the basis that the Georgia decisions, which all admitted were controlling, did not require that under the circumstances the County be permitted to recover.

In many states either by legislative action or judicial decision counties and other governmental units are permitted to procure group insurance contracts for the benefit of their employees and dependents.

PREMIUM TAXES ON ANNUITIES—DEDUCTIBILITY OF CONSIDERATIONS RETURNED: *Prudential Insurance Company of America v. Howell* (New Jersey Supreme Court, February 2, 1959) 148 A.2d 145. The Prudential and two other life insurance companies brought this action against Howell, Commissioner of Banking and Insurance of New Jersey, and against the Director of the Division

of Taxation of that State to construe the New Jersey law regarding the taxation of annuity considerations. The point in dispute was whether sums refunded under group and individual annuity contracts prior to the commencement of annuity payments represented "cash surrender values" or "considerations returned on policies or contracts." The New Jersey tax law denied the deduction on account of cash surrender values but permitted a company to deduct considerations returned on policies or contracts.

The lower court and, on appeal, the Supreme Court of New Jersey held that the items in question were properly deductible. In reaching this conclusion, the Court found that the Legislature used the term "cash surrender value" in its technical sense as applicable only to life insurance contracts and not to annuities. This conclusion was reached despite the fact that the companies had referred to the payments in question as "cash surrender values."

One Justice dissented on the basis that the words in question had an ordinary and popular meaning and that the legislative intent was to disallow refunds of the type in question.

HOSPITALIZATION INSURANCE—WAGER CONTRACTS: *Batchelor v. American Health Insurance Company* (South Carolina Supreme Court, February 5, 1959) 107 S.E.2d 36. The insured, who previously was covered under hospitalization policies, purchased eight additional such policies over a five-week period and almost immediately thereafter was injured while riding in a private automobile. His gross weekly wages were $65 and his take-home pay was $53. The policies he held at the time he was injured provided him with $745 per week plus additional benefits for certain medical and hospital charges.

The American Health Insurance Company refused to pay benefits under its policy on the basis that the obtaining of this and the numerous other policies amounted to a wager and was contrary to public policy. The insured brought this action and in the trial court the judge agreed with the insurance company.

On appeal to the South Carolina Supreme Court the decision was reversed. The Court indicated that the contract was not void as contrary to public policy and was not a wagering contract. The Court pointed out that the company might have availed itself, but did not, of an optional standard provision under which the company would have been liable under such circumstances for only a pro rata share of the indemnity.