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LEGAL NOTES

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FEDERAL INCOME TAX OWED BY INSURED—CLAIM AGAINST POLICY PROCEEDS: *United States v. Bess* (C.A. 3, March 28, 1957) 243 F. 2d 675. The insured died owing the Government money on account of his federal income tax. He left the proceeds of his eight policies to his widow and these proceeds, amounting to $63,577, were paid to her. The total cash value just prior to his death was $3,363 and the Government had an income tax claim against the insured (but apparently not against the beneficiary), of $8,875 which remained unpaid. The insured up to the time of his death had reserved the right to change the beneficiary and to surrender to the respective companies such of his policies as had cash values. It was assumed without dispute that the insured was solvent when the policies were issued and when the premiums were paid, although after his death his estate was adjudged insolvent.

The Government brought this action against the beneficiary for the unpaid income tax of her late husband, and the District Court awarded judgment to the Government for the full amount claimed. The widow-beneficiary appealed from this decision and the Court of Appeals for the Third Circuit reversed the decision of the District Court and held that the beneficiary was liable as "transferee," but only to the extent of the cash value just prior to the insured's death. The Court in its opinion stated:

> The cash surrender values of the policies in the instant case present a different issue. Bess was adjudicated insolvent more than two years after his death but the account filed by Mrs. Bess as executrix makes it clear that he also was insolvent at the time of death. At the time of his death, as we have stated, the policies possessed a cash surrender or loan value of $3,362.53. He therefore possessed just prior to his death, a chose in action in the amount stated which he could have collected from the insurance companies in accordance with the terms of the policies. The Supreme Court in the Hume case, supra, seemed to recognize the payment of premiums as transfers and the incidence of the payments of premiums therefore timed the transfers here. By the terms of the policies in the Hume case nothing passed at the time of Hume's death. So was it here. It is therefore not realistic here, as the court pointed out in Rowen v. Commissioner, supra, 215 F. 2d at page 647, in a like situation, to view Bess' death as wiping out the loan or surrender values. Bess' death was merely a condition on the occurrence of which the loan or surrender values of the policies no longer were payable to him but became merged in the larger values which the insurance companies were obligated to pay to Mrs. Bess. The loan or surrender values were then an item of property and Mrs. Bess was a transferee of them and within the meaning of Section 311 (a) (1). It follows that the United States is entitled to recover the amount of the loan or surrender values from her.

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As indicated below, this case as well as the *Stern* case will be reviewed shortly by the United States Supreme Court.

FEDERAL INCOME TAX OWED BY INSURED—CLAIM AGAINST POLICY PROCEEDS: *Stern v. Commissioner of Internal Revenue* (C.A. 6, February 26, 1957) 242 F. 2d 322. Many years before his death in 1949 the insured, Stern, procured 17 life insurance policies and named his wife as beneficiary. Six years after his death the Commissioner of Internal Revenue claimed that the beneficiary was subject to income tax liability of her deceased husband. The basis of his claim was that she was a "transferee" of the proceeds within the meaning of the Internal Revenue Code. She was apparently not liable directly for the tax. There was no claim that the insured was insolvent prior to his death or that the policies were taken out or maintained with intent to hinder, delay or defraud creditors of Stern.

Stern had reserved the right to change the beneficiary as well as to take the cash surrender value without the beneficiary's consent. The Commissioner claimed that at the least he was able to establish his claim against the beneficiary to the extent of the cash value of the policies at the time of the insured's death. The Tax Court granted judgment against the beneficiary of the full amount of the income tax claim against the insured. However, on appeal, the Court of Appeals for the Sixth Circuit reversed, holding that the beneficiary was not liable on her late husband's federal income tax claim even to the extent of the cash value immediately prior to Stern's death. As to the Government's claim to an amount equal to the cash value, the Court stated:

> The cash surrender values were not part of the proceeds of the insurance policies paid to the widow, and to hold otherwise would seem to transform plain language to the advantage of the tax-gathering authority, and to the loss of the widow. The widow did not, in any sense, receive the cash surrender values as a transferee of the estate of her deceased husband. The rights of the parties to this suit, and the rights of all parties concerned in the contract of insurance, depended entirely upon the agreements executed between the insured and the insurance companies that it would pay the husband the cash surrender values, only on his demand, in lieu of paying his widow the amount of the policies after his death. If the insured did not demand such payment, the insurance companies were bound to pay the entire proceeds of the policies to the insured's wife, upon his death. There is a positive moral obligation upon a husband to protect his wife against destitution, by providing insurance for her in case of his death. After a husband has paid premiums for thirty years to insure that his wife will be preserved from suffering and want, it would be contrary to public policy and inhumane to permit creditors, whose claims arose subsequent to the execution of the policies of insurance and subsequent to the payment of the premiums, to snatch from the widow, after her husband's death, the large cash surrender values merely because of the provision in which the husband had reserved a right thereto, which he had never exercised. No statutes require that such a hardship be inflicted upon a widow, whose husband has continuously, during the long course of their marriage, sought to protect her, by providing insurance against the day when she would be left alone.
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> In this case, the government is in no better position than any other creditor. The

insurance was not built up, nor were the premiums paid, at the expense of the government, or in fraud of the government.

In accordance with the foregoing, it follows that petitioner is not liable as a transferee of decedent's estate, or of decedent, in respect of the income taxes and penalties claimed; and the decision of the Tax Court is, therefore, reversed.

On October 14, 1957, the United States Supreme Court agreed to review this decision and one week later also agreed to review the *Bess* case, above. This will resolve the conflict between these two decisions and other decisions.

MISREPRESENTATION—EFFECT OF INDEPENDENT INQUIRY BY INSURER: *New York Life Insurance Company v. Strudel* (C.A. 5, April 5, 1957) 243 F. 2d 90. Strudel applied for a $20,000 life policy in March 1952 and died later that year. He denied that he had been treated for a heart condition in 1947 and thereafter. The New York Life was suspicious of some such treatment and inquired of another insurance company, but the inquiry produced no concrete lead. The policy was then issued.

After the insured died the New York Life made further inquiry which produced little until an anonymous telephone call gave the lead to a full disclosure of rather extensive treatment for the heart condition. The New York Life accordingly denied liability on the basis of the material misrepresentation.

The beneficiary sued, claiming that the New York Life had relied on its independent investigation and not on the false statements of the insured. Her claim was that the company was under a legal duty to follow up its leads, once having undertaken the independent investigation. The trial court agreed with the beneficiary and granted judgment to her on the basis of a jury's verdict in her favor. On appeal, the Court of Appeals for the Fifth Circuit reversed and remanded the case for entry of judgment in favor of New York Life. The Court held that the New York Life was not precluded from relying on the insured's statement merely by reason of the fact that it conducted an independent investigation, especially since it is likely that the independent investigation would not have disclosed the misrepresentation.

There are few cases which excuse the insured's misrepresentation merely because the company has made some independent check on the insured.

APPROVAL OF POLICY FORM—SUICIDE EXCLUSION: *Krug v. Lincoln National Life Insurance Company* (C.A. 5, June 10, 1957) 245 F. 2d 848. The life policy contained the usual two-year suicide provision and the insured committed suicide within this period. The Lincoln National claimed that its liability should be limited to the premiums actually paid, as provided in the policy. The beneficiary alleged first that the insured did not commit suicide, as the Company claimed, but later abandoned this position and relied entirely on the fact that the policy form had not been individually approved by the Board of Insurance Commissioners of Texas, in which state it was issued. The policy form had been submitted for approval to the Board and filed after having been stamped with the file mark of the Department of Insurance.

The District Court and, on appeal, the Court of Appeals held that only administrative approval was required, that the policy form had been approved within the meaning of the law and that the suicide provision in strict conformity with the Texas law was valid and enforceable. The Court in its opinion stated:

> The particular policy form was submitted to the State Board of Insurance Commissioners for approval in the exact manner requested by the Board in order to save time and effort both on its part and on the part of the Board. The approval of the Board as shown by the undisputed testimony of the witness was evidenced by the stamp of the State Board of Insurance Commissioners affixed to the policy form submitted and by the copy of the letter of transmittal dated October 29, 1952, which was returned to the defendant, and the defendant relied thereon as it was clearly entitled to do. Moreland v. Knox, Tex. Civ. App., 268 S.W. 2d 744–751.
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> We agree with the appellee, too, that the problem here involved lies not in the field of adjudication but in that of administration. It is more or less elementary that while an administrative body cannot delegate quasi-judicial functions, it can delegate the performance of administrative and ministerial duties and, where it is impossible for them to be performed in person, it must do so.

POSTDATED CHECK—LAPSE OF POLICY: *Colonial Life and Accident Insurance Company v. Wilson* (C.A. 5, July 19, 1957) 246 F. 2d 922. The accident policy issued in July of 1951 provided for monthly premiums. The insurance company furnished the insured with a series of twelve monthly checks at the beginning of each policy year. The practice was for these checks to be signed and returned to the insurer and then cashed month by month. The insured made no cash payments after June 30, 1954, and no canceled checks were charged against his bank account for a period after that date. He died accidentally in June of 1955.

The company claimed that the policy had lapsed for failure to pay premiums. The beneficiary sued, claiming that the policy had not lapsed. It was established that the insurance company's practice was to mail the postdated series checks prior to the commencement of the policy year and to tell the insured at the time that if he would sign and return the series checks "your policy will be kept in force for another twelve months' period." There was also proof that if the insured did not return the checks promptly the insurance company would follow up and attempt to procure the checks.

The trial court permitted the jury to find in effect that the insured had returned the checks and that they had been lost at some point and that the policy was in full force and effect for the year. Judgment was accordingly entered on the verdict for the beneficiary.

On appeal to the Circuit Court of Appeals, this judgment was affirmed, the Court stating:

> If there are risks involved in this system, it is the Insurer's system to alter. If the risk of this system, or that of possible perjury by interested parties outweighs the evident savings in personnel and operating costs which leads its executives to declare that the procedure is highly beneficial to it, the Insurer can change it. The Insurer can refrain from advising the Assureds that mailing of checks will assure "that your policy will be kept in force for another twelve months' period" or that "by signing and returning these

checks today, you can be assured that your future is protected." Until that is done, the Assured, unaware that his "Series Checks" have gone astray, if he complies with those directions, has the benefit of those assurances.

DATE OF ISSUE—SUICIDE: *Lloyd v. Franklin Life Insurance Company* (C.A. 9, April 25, 1957) 245 F. 2d 896. Lloyd applied for a life policy December 6, 1952, giving his note for one month's premium. He was examined December 11. In his application he asked that the policy be dated January 1, 1953, and the policy was so dated. This date was referred to as "date of issue."

On December 21, 1954, the insured committed suicide. The two-year suicide period had expired if the period were computed from December 11, 1952, or December 6, 1952. The policy provided for annual premiums and the insured paid his premiums quarterly. The note given with the application was apparently never collected.

The insurer defended the beneficiary's suit on the basis of suicide within the two-year period and the trial court granted judgment for the insurer. On further appeal, the Court of Appeals for the Ninth Circuit affirmed this judgment on the basis that the policy clearly stated that the date of issue was January 1, 1953, and the two-year suicide period ran from the date of issue. There was some question as to whether there had been coverage prior to January 1, 1953, but nevertheless the Court found that the suicide period dated from January 1, 1953.

GROUP LIFE INSURANCE—AGREEMENT BY EMPLOYER AND INSURANCE COMPANY TO CANCEL COVERAGE: *Hill v. Metropolitan Life Insurance Company* (Alabama Supreme Court, May 23, 1957) 96 So. 2d 185. The employer, a steel company, agreed with the Metropolitan to amend the group policy to terminate coverage as to employees covered by a union welfare and retirement fund. The employees were not asked to consent to the change. Hill, an employee, brought this action, claiming the insurance under the group policy was wrongfully canceled in that under Alabama law the consent of the employee was required.

The trial court and, on appeal, the Alabama Court of Appeals and, on further appeal, the Alabama Supreme Court held that the cancellation was effective and that the employee had no valid claim based on alleged wrongful termination. The Alabama Supreme Court explained its prior decision limiting the company's right to amend or cancel without the employee's consent by saying such rule applied only where the employee has an accrued cause of action at the time of cancellation or where premiums have been paid beyond the date of cancellation or where the insurance contract provides that the consent of the employees must be obtained. Such was not the case here.

There have been quite a number of loose statements to the general effect that the consent of the employee must be obtained to amend a group contract, especially where the employee contributes toward the cost of the coverage. These cases fall largely, if not entirely, in the exceptions referred to by the Alabama Supreme Court and usually, in addition, there has not been notice to the affected employees of the contemplated change.

VARIABLE ENDOWMENT CONTRACT—FRATERNAL BENEFIT SOCIETY: *Spellacy v. American Life Insurance Association* (Connecticut Supreme Court of Errors, May 1, 1957) 144 Conn. 346. Spellacy, Insurance Commissioner of Connecticut, and the Bank Commissioner brought this action to restrain the Association from issuing a so-called variable endowment contract. The trial court reserved decision and referred the case to the Supreme Court of Errors.

The Association by special charter was authorized "to pay its members, while living, endowments, annuities or other benefits." The General Statutes of Connecticut relating to fraternal benefit societies such as the Association authorized such societies to issue to members "term, life, endowment and annuity certificates and combinations thereof." The Association was issuing the customary forms of certificates and it informed the Insurance Commissioner that it proposed to issue a so-called variable endowment contract which would pay the proceeds at the end of the endowment period in units rather than in dollars. The Association proposed to invest a specific portion of each annual premium in common stocks and the like, and the value of the units at the end of the endowment period would depend on the investment experience.

The Connecticut Supreme Court of Errors held that the proposed contract was not an "endowment" as generally understood and as contemplated by the General Assembly of Connecticut in granting the charter and in passing the general act.

The Association claimed that even if it could not issue the contract to its members in Connecticut, it should not be prohibited from issuing the contract in other states where it was licensed to do business. The Court, however, held that the powers of the corporation are determined by the laws under which it is incorporated and hence the Insurance Commissioner of Connecticut could prevent the Association from issuing this type of contract in any state.

In its opinion the Court stated:

> The defendant argues that an undertaking to pay an endowment or annuity in dollars does not necessarily guarantee the payment of a certain and fixed sum, because the purchasing power of the dollar has depreciated in recent years and there is no assurance that the value of the endowment as contemplated by the insured at the time of the issuance of the policy will remain constant. This is true. There is a real distinction, however, between the general depreciation in the value of the dollar and the depreciation which may occur in the value of units in a variable endowment or annuity fund such as is contemplated in the present case. The former is due to widespread economic factors affecting all alike. The latter may be due to such factors, reflected in a general decline in the market value of securities rather than in the depreciation of the dollar, but it may also be due to possible poor judgment or lack of skill in the management of the investments in the particular fund. When an endowment or annuity is payable in a specified number of dollars, an insured runs the risk of depreciation of the dollar. When it is payable in variable endowment or annuity units, he runs the risk of depreciation of the unit, measured in dollars, including the added risk that it may be depreciated by reason of factors not traceable to general economic conditions. The defendant escapes this type of risk and transfers it to the insured. The matter involves so basic a change in insurance

procedure that the defendant's argument is one more properly addressed to the legislature than to the court. We hold that neither the defendant's charter nor § 6244 empowers it to issue the proposed variable endowment contract.

ASSIGNMENT TO BANK—BENEFICIARY'S RIGHT TO SUBROGATION: *Walzer v. Walzer* (New York Court of Appeals, May 16, 1957) 3 N.Y. 2d 8, 143 N.E. 2d 361. The insured assigned his three life policies to Berks County Trust Company to secure a loan. The loan agreement required that any change of beneficiary be made subject to the assignment. At the time of the assignment the policies were all payable to the insured's estate. In 1949, eight years after the assignment, the policies were made payable to the two daughters of the insured, subject, however, to the assignment.

Upon the death of the insured the trust company collected its debt, amounting to about $20,000, out of the policy proceeds and the balance, amounting to about $15,000, was paid to the two named beneficiaries. The beneficiaries took the position that they should be subrogated to the trust company's claim against the insured's estate. The executor of the insured's estate refused to honor this claim and the beneficiaries brought suit. The trial court held for the executor and on appeal to the Appellate Division, that Court, one justice dissenting, reversed, holding that the beneficiaries were in fact entitled to be subrogated to the claim of the trust company against the executor. On further appeal, the Court of Appeals agreed with the Appellate Division, two judges dissenting and one not participating in the decision.

The majority opinion pointed out that it lay within the power of the insured to designate the bank as primary beneficiary and his daughters as secondary beneficiaries but that he did not do so. The majority opinion also pointed out that the 1949 beneficiary change was made subject to the rights of the assignee because the 1941 assignment so required. The Court also pointed out that the New York rule for ascertaining intention respecting the disposition of proceeds of life insurance differs from the rule which applies to other property of the estate which is subject to a lien. The New York law applying to other property, as amended in 1941, provides in effect that where such property is subject to a lien, mortgage or pledge and is specifically bequeathed by will, the legatee must satisfy the lien out of his bequest without any claim against the executor unless the will specifically provides otherwise. A bill which would have made life insurance subject to this same rule was proposed but failed of passage.

The two dissenting judges were of the opinion that a prior New York decision required the Court to hold that the beneficiaries had no claim against the insured's executor, and it was the view of these two judges that the debt to the bank should come out of what would otherwise go to the beneficiaries.

The situation presented by this case is not uncommon and the Court's doubt as to the rights of the parties under the circumstances makes it highly desirable that this matter be clarified in the change of beneficiary designation.

GROUP CONVERSION—SUICIDE WITHIN TWO YEARS: *Provident Life and Accident Insurance Company v. Kegley* (Virginia Supreme Court of Appeals, September 6, 1957) 99 S.E. 2d 601. Kegley converted his group life insurance to an individual policy and committed suicide within two years after the date the converted policy bore but more than two years after he was first insured under the group policy. The individual policy provided a limited benefit in the event of suicide within two years from the "Effective Date of this policy."

The beneficiary brought suit after the Provident took the position that its liability was limited as provided in the suicide clause. The trial court agreed with her that the suicide clause was not under the circumstances effective to limit liability. On appeal, the Supreme Court of Appeals of Virginia reversed this decision, holding that the two-year date should be computed from the effective date of the converted individual policy and not from the date the group insurance was first effective as to the insured individual.