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LEGAL NOTES

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MCCARRAN ACT—FTC JURISDICTION—MAIL ORDER INSURANCE: *Federal Trade Commission v. Travelers Health Association* (United States Supreme Court, March 28, 1960) 362 U.S. 293. The Federal Trade Commission claimed that certain advertising material of Travelers Health Association distributed by mail was "misleading and deceptive." The Commission issued a cease-and-desist order prohibiting the Association from making further such statements and representations. The Association claimed that the Commission was without jurisdiction because the advertising in question was "regulated by State law" within the meaning of the McCarran Act. The basis of this claim was a Nebraska statute providing that "No person domiciled in or resident of this state shall engage in unfair methods of competition or in unfair or deceptive acts and practices in the conduct of the business of insurance in any other state, territory, possession, province, country or district." The Association appealed from this cease-and-desist order of the Commission, claiming that its business outside Nebraska in this respect was "regulated by State law" within the meaning of the McCarran Act and that under the *National Casualty* decision the Commission was without jurisdiction. The Association was licensed only in Nebraska and Virginia.

The Court of Appeals, to which the appeal from the Commission's order was taken, agreed with the Association that under the Nebraska statute its business was in fact "regulated by State law" and hence the Commission had no jurisdiction. One of the three judges dissented, however, on the basis that this was not the kind of "State regulation" contemplated by the McCarran Act.

On further appeal, the United States Supreme Court reversed the decision of the Court of Appeals and sustained the Federal Trade Commission. The Court reviewed the history of the McCarran Act and reached the conclusion that regulation by the home state alone was not the type of regulation contemplated by the McCarran Act.

Mr. Justice Harlan wrote a dissenting opinion, and he was joined in this opinion by Mr. Justice Frankfurter and Mr. Justice Whittaker. These dissenting Justices took the position that there was, in fact, regulation by State law and that the Federal Trade Commission did not have jurisdiction. In the dissenting opinion Justice Harlan stated:

> This case marks the second time within a year that the Court has made inroads upon the policy of the McCarran-Ferguson Act by which Congress pervasively restored to the States the regulation of the business of insurance, a function which until this Court's

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decision in *United States v. South-Eastern Underwriters Association*, 322 U.S. 533, traditionally had been considered to be exclusively theirs. Last Term the Court held variable annuity policies, sold across state lines, subject to regulation by the Securities and Exchange Commission. See *Securities & Exchange Comm'n v. Variable Annuity Co.*, 359 U.S. 65, 93–101 (dissenting opinion). Today it holds that advertising materials mailed into other States by a health insurance company, already regulated under the laws of its own State with respect to the out-of-state transmission of such materials, are subject also to regulation by the Federal Trade Commission, at least to the extent that such advertising matter is unregulated by the laws of the State into which it is sent.

The Court's holding is based upon its conclusion "that when Congress provided (in § 2(b) of the McCarran-Ferguson Act) that the Federal Trade Commission Act would be displaced to the extent that the insurance business was 'regulated' by state law, it referred only to regulation by the state where the business activities have their operative force." I think the data on which the Court relies is much too meagre to justify this conclusion, and believe, as the Court of Appeals did, that Nebraska's regulation of these activities of the respondent foreclosed Federal Trade Commission jurisdiction.

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The temptation is strong, no doubt, to ask the court to innovate with respect to the McCarran-Ferguson Act when state regulation may be thought to have fallen short. Two years ago we declined to do so when invited by the Federal Trade Commission in the *National Casualty* case, *supra*, at 564–565. I think it unwise for us now to yield to this encore on the part of the Commission. One innovation with the Act is apt to lead to another, and may ultimately result in a hybrid scheme of insurance regulation, bringing about uncertainties and possible duplications which should be avoided.

New York Premium Notice Statute—Notice to Assignee: *Maloney v. John Hancock Mutual Life Insurance Company* (C.A. 2, October 23, 1959) 271 F.2d 609. Eastern Footwear Corporation, then in serious financial difficulties, owned policies in the aggregate face amount of $585,000 on the life of one of its officers. The cash values were "practically zero" because of extensive loans thereon. The company "assigned" the $50,000 John Hancock policy to an accounting firm, the assignment stating that John Hancock was authorized and directed out of the first monies available to pay to the accounting firm all sums demanded by the firm upon presentation of bills, approved by the committee of creditors.

The John Hancock gave due notice of the due date of the next premium to the insured and to Eastern Footwear Corporation but did not give notice to the accounting firm, the assignee. The premium was not paid and John Hancock claimed that the policy had lapsed without value. Eastern Footwear claimed that since the John Hancock had not given the notice required by the New York statute to the accounting firm and since the insured died within a year thereafter, the policy was in force when the insured died.

The trustee in bankruptcy of Eastern Footwear Corporation brought this action to compel John Hancock to pay to it the face amount of the policy less outstanding indebtedness. The United States District Court granted summary judgment for John Hancock on the basis that the instrument above described, and in the light of the circumstances surrounding its execution, was not a valid absolute assignment but only a "legal gimmick to satisfy . . ." payment for services.

On appeal, the Court of Appeals reversed with directions to enter judgment in favor of the trustee and against John Hancock. The Court stated that the burden was on the insurance company to show full compliance with the statutory notice provisions, that these provisions were intended to protect those who take assignments as security for debts as well as absolute assignees and that the assignment in question was within the protection of the statute.

The Court recognized that the decision would bring an unexpected windfall to the trustee in bankruptcy of the assignor, who after notice had defaulted in premium payments.

This case illustrates the dangers inherent in the failure to comply literally with the terms of the New York and other premium notice statutes.

Good Health Clause—Waiver and Estoppel: *Souter v. State Mutual Life Assurance Company* (C.A. 4, January 7, 1960) 273 F.2d 921. Souter applied to State Mutual for a life policy which was issued on a slightly rated-up basis. He had paid a partial binder which did not apply because the policy was not issued standard. The agent attempted to have Souter accept the policy but he declined, saying that the rating was unfair. The advance premium was in the meanwhile retained and the agent kept the policy in his possession. Souter then attempted to secure standard coverage elsewhere as did the agent.

Shortly after Souter refused the policy he entered the hospital and was operated on, disclosing a fatal disease. Thereafter, knowing of his serious illness, a friend offered the balance of the quarterly premium to the agent, who accepted it, but this premium was refused by State Mutual which had learned of the illness which shortly proved fatal.

On the insured's death State Mutual denied liability on the basis that the insured was not in good health when the policy was delivered. The beneficiary claimed, first, that the agent had waived the sound health clause and that in this connection the insured and beneficiary were not chargeable by his lack of authority, and second, that the sound health clause should not be applied because the disease may have existed at the time of the medical examination and there had been no change in health.

The District Court directed a judgment in favor of State Mutual and on appeal the Court of Appeals affirmed, holding that a life insurance soliciting agent did not have actual or apparent authority to waive the sound health clause and that the insured was not in good health as required. A concurring judge agreed on the basis that a collusive arrangement had been entered into between the agent and the insured or his representative.

Insurable Interest of Corporation—Proceeds of Policy as Taxable Income: *Ducros v. Commissioner of Internal Revenue* (C.A. 6, November 25, 1959) 272 F.2d 49. A life insurance policy was taken out on the life of an officer of the corporation, and on his application. Shortly thereafter the corporation became vested, by endorsement, with all incidents of ownership of the policy, and the policy was made payable to the wives of two of the officers at the time of the insured's death. On the death of the officer the proceeds were paid to the named beneficiaries.

The Government claimed that the policy proceeds paid to the wife of a surviving officer and stockholder did not represent "amounts received under a life insurance contract" within the exemption provision of the Internal Revenue Code, but rather represented a dividend flowing from the corporation to the named beneficiaries.

The Tax Court agreed with the Government and entered judgment against the beneficiary on the basis that the contract was a wagering contract and the proceeds did not represent "life insurance." On appeal the Court of Appeals for the Sixth Circuit reversed this judgment, holding that the contract was valid under Ohio law and was not a wagering contract. It found that the corporation was not entitled to receive the proceeds of insurance and that the payment had been made to the beneficiary directly.

The Court of Appeals stated that it did not consider the right of the Government to tax the premiums paid by the corporation as a dividend to the beneficiaries or to follow the cash surrender value of the insurance into the hands of the beneficiaries "as these questions were not presented either to the Tax Court or here."

The Court in its opinion stated:

> Since under Ohio law the contract of life insurance was a valid one at its inception, and the proceeds thereof were received by appellants "under a life insurance contract by reason of the death of the insured" rather than as a "distribution made by the corporation to its shareholders," it follows that the judgment of the Tax Court should be reversed and the cause remanded to that Court for further proceedings consistent with the views herein expressed.

STOCK LIFE COMPANY—RIGHTS OF PARTICIPATING POLICYHOLDERS—CHARTER LIMITATIONS: *Ohio State Life Insurance Company v. Clark* (C.A. 6, February 8, 1960) 274 F.2d 771. Ohio State Life acquired by purchase for \$6,470,100, or \$1,300 a share, 99.54 percent or 4,977 of the 5,000 shares \$100 par value of the stock of Columbus Mutual Life Insurance Company. Ohio State acquired this stock for the avowed purpose of merging the two companies.

Columbus Mutual was chartered in 1906 with an original paid-in capital of \$100,000 which had been increased to \$500,000. It had accumulated a total surplus as of the end of 1957 of \$19,184,658.66. Its charter limited dividends to stockholders to 10 percent of the par value of the stock and provided that the directors might retire the stock at \$200 for each \$100 par value share. The charter further provided that the stock certificates should contain a provision under which the holder would agree and assent to the charter limitations.

Ohio State proposed to amend this charter provision so that initially the surplus would be held for the benefit of outstanding policies of Columbus Mutual, most of which were on the participating plan. However, it was contemplated that eventually this surplus would become a part of the general surplus of the merged company to be used for the benefit of all policyholders, though there was a restriction against stockholder dividends being paid out of this fund.

Clark and other policyholders of Columbus Mutual brought this action on behalf of Columbus Mutual and other participating policyholders to establish the right of such policyholders to the beneficial ownership of the surplus of Columbus Mutual. In the District Court it was held that the surplus of Columbus Mutual belonged to its mutual plan policyholders, subject to the limited right of the stockholders to receive dividends not to exceed 10 percent per annum on the par value of the stock and to receive $200 per share on the retirement of the stock. On this appeal the Court of Appeals affirmed the District Court's judgment, holding that this surplus, subject to the limited right of stockholders, belonged to Columbus Mutual. The Court in its opinion stated:

> There is a fundamental difference between a corporate insurance company with stockholder ownership, doing business as a stock company, and a mutual insurance company without capital stock, doing business on the mutual plan. In the first type of case the corporation is owned and managed by the stockholders, who need not be policyholders, the corporation is operated for the purpose of profits for the stockholders and the beneficial ownership of the profits and surplus is in the stockholders. General principles of corporate law control the rights of stockholders. The rights of policyholders are controlled by their policies of insurance and any applicable statutory provisions. In the second type of case the company is owned and managed by the policyholders and the business is conducted for the benefit of the policyholders. The beneficial ownership of the profits and surplus is in the policyholders.
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> Although there was absence of statutory authority in Ohio to create a non-stock mutual insurance company, this did not preclude a stock insurance company, legally organized in Ohio, from issuing policies on the mutual plan.
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> It does not necessarily follow that since Columbus Mutual was a stock corporation, its assets, including surplus, were legally owned by its stockholders, to the exclusion of any interest therein by the policyholders on the mutual plan, with the result that the stockholders could deal with the surplus without obtaining the consent, and over the objections, of the policyholders. While this might be true as a general principle of corporate law in the absence of any contract to the contrary, it is settled law that a corporate charter is both a contract between the corporation and the state and a contract between the corporation and its stockholders. Allen v. Scott, 104 Ohio St. 436, 439, 135 N.E. 683; Opdyke v. Security Savings & Loan Co., 157 Ohio St. 121, 132, 134, 105 N.E. 2d 9. The rights which a stockholder would have in the absence of restrictive provisions in the corporate charter, can be restricted or limited by the provisions of the charter, which become part of the contract when the stock is purchased and issued to him. Bell v. Union Central Life Ins. Co., 14 Ohio Cir. Ct. R., N.S., 385, affirmed without opinion, 92 Ohio St. 522, 112 N.E. 1087; Royal Trust Co. v. Equitable Life Assurance Society, Supra, 2 Cir., 247 F. 437, 441. In the present case, the provisions of Article V control the extent to which the usual rights of the stockholders have been curtailed.
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> This ruling does not mean that the mutual plan policyholders are entitled to receive from the surplus as dividends on their policies more than is provided by the terms of the policies. As policyholders their rights are controlled by the provisions of their policies. Under their policies their rights in the surplus are limited. Equitable Life Assurance Society of United States v. Brown, 213 U.S. 25, 47, 29 S.Ct. 404, 53 L.Ed. 682; State ex rel. Ellis v. Union Central Life Insurance Co., 13 Ohio Cir.Ct.R., N.S., 49, affirmed, 84 Ohio St. 459, 95 N.E. 1156. But, in addition to their rights under the policies they have certain proprietary rights in the surplus acquired by reason of the provisions

of Article V. The cases relied upon by appellants which construe policyholders' rights under policy provisions are not controlling in a case where, as here, we are construing a policyholder's rights acquired through a provision of the corporate charter.

Nor does the ruling mean that the mutual plan policyholders are entitled to have the surplus divided between them at the present time, free from the control of the directors. We are here dealing with the beneficial interest in the surplus, a proprietary right, not the right of possession and distribution. Their claim is that they are entitled to have their beneficial interest in the surplus preserved in its present status for their benefit as mutual plan policyholders.

On June 20, 1960 the United States Supreme Court refused to hear this case.

The vast majority of stock life insurance companies have no such charter limitations on the rights of stockholders.

POLICY RESTRICTION AGAINST ASSIGNMENT—DIRECTION TO PAY CASH VALUE: *Magers v. National Life and Accident Insurance Company* (Supreme Court of Missouri, December 14, 1959) 329 S.W.2d 752. The industrial policies provided that "Any assignment or pledge of this Policy or of any of the benefits thereunder shall be void and of no effect." Magers, who claimed to be an insurance actuary, advertised his services to the public in newspapers. He procured from a policyholder of National Life and Accident a document authorizing him to collect any values under the policies referred to (for a 50% fee) and served a copy of the document on National Life and Accident. The company refused to pay Magers (although it did not deny liability for the cash value), relying on the policy restriction against assignment. The trial court agreed with National Life and Accident that the assignment provision justified its refusal to pay the cash value to Magers, and the Kansas City Court of Appeals affirmed.

On further appeal to the Supreme Court of Missouri, that Court reversed the judgment below, stating that:

There appears to be no valid reason why an insured, having decided to surrender his policy, cannot authorize some other person to make the collection of the cash value and surrender the policy. No authorities have been cited to support the contention that the "written application" must be made personally by the assured and we have found none so holding. "Generally speaking, in the absence of any statute otherwise providing, powers or authorities may be created to do any act which the donor himself might lawfully perform; * * * ." 72 C.J.S. Powers § 3, p. 403. So far as we have been able to discover, there is no statute prohibiting an agent acting under a power of attorney from demanding and collecting cash surrender values for the holder of a policy of life insurance. The evidence was sufficient to support the findings that applications for the cash surrender values were made pursuant to policy requirements and that the obligation of the Company to pay the cash surrender values became absolute.

In these circumstances the assignments in aid of the collection of the matured claims did not violate the policy provisions and the suit was properly brought in the name of the plaintiff as assignee.

CREDITORS' RIGHT—INSURANCE PURCHASED WITH LOAN PROCURED WITH FICTITIOUS COLLATERAL: *First National Bank v. Pope* (Alabama Supreme Court, December 17, 1959) 117 So.2d 174. The insured borrowed money from the bank and others on the basis of fictitious collateral and used part of this money to pay premiums on life insurance in favor of his widow. On his death the creditors sued to recover the insurance proceeds on the basis that their money had been used to purchase the insurance and to purchase real estate. The Circuit Court refused to permit the creditors thus to reach the proceeds of the insurance (or the real estate), and the creditors appealed.

On this appeal the Supreme Court of Alabama affirmed. It considered the numerous cases where creditors had been permitted to reach the policy proceeds where insurance was purchased with stolen or embezzled or misappropriated funds, but the Court refused to apply this principle to funds procured with fictitious collateral. The Court pointed out that the bank intended to lend the money to the insured, the title was in the insured, and that the widow was not party to the fraud. The Court also relied in part on the Alabama statute protecting insurance proceeds payable to named beneficiaries from the claims of creditors.

In its opinion the Court stated:

> The pivotal question in this case is whether monies obtained as loans over a period of years for which fictitious collateral was offered by the borrower and partly invested in insurance policies made payable to the widow of the borrower, or in a homestead owned by the borrower and his widow which passed to her, can be traced into and enforced against the proceeds of the insurance or against the homestead, giving consideration to the exemptions in favor of the widow.
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> The majority rule seems to be that where a person has embezzled, stolen or misappropriated funds of another and used them for the purchase or payment of premiums on insurance on his life, a trust is created in favor of the owner of the funds, and the owner is entitled to recover from the proceeds of the insurance policies. This recovery is sometimes limited to the amount of the premiums and sometimes to such proportion of the total insurance as the amount of the premiums which have been paid from the misappropriated funds bears to the total amount of the premiums paid. 38 A.L.R. 930; 24 A.L.R.2d 672.
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> It is also generally held that statutes which exempt the proceeds of life insurance from the claims of the insured's creditors are inapplicable to prevent one whose funds have been wrongfully used to pay premiums from resorting to the proceeds for relief. 24 A.L.R. 2d 675.
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> In the instant case, Douglas Pope did not steal, embezzle or misappropriate any funds of appellants. Under the allegations of the bill, the bank "loaned him monies continuously" from "the initial dates of the opening of said accounts until his death" (1949–1958). It is alleged that he gave notes for the sums he borrowed. The title to the borrowed money was in Douglas Pope to do with as he pleased, and there is no allegation that he promised to use the money in any particular way or for any specific purpose. Whether the collateral was the same or different for each loan, we are not apprised; it is alleged that he
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> > "obtained such loans by depositing with your Complainant collateral evidencing assets which did not in fact exist; and by falsely misrepresenting to it the ownership and possession of commodities sufficient in value and volume to amply secure said loans."

> But it still remains that the bank intended to lend the money to him, it loaned him money "continuously" over a period of nine years and did not become dissatisfied with its business relationship with him until after his death.
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> We think there is a very valid distinction in the instant case and the cases based upon embezzlement, theft or misappropriation of funds where title to the money did not pass from the true owner.

OFFICER UNWORTHY OF THE PUBLIC CONFIDENCE—CONSTITUTIONALITY OF TEXAS STATUTE: *Jordan v. State Board of Insurance* (Texas Supreme Court, April 6, 1960) 334 S.W.2d 278. A Texas statute provided that the Board of Insurance Commissioners was authorized to inquire into the competence, fitness and reputation of the directors and officers of an insurance company and that if, after inquiry and based on sufficient evidence, it appeared to the Board that such officers and directors "are not worthy of the public confidence," it was authorized to revoke the license of the insurance company. In 1956 the Board gave notice to a life insurance company that its certificate of authority would be revoked after a finding that some of its officers and directors, including Jordan, were not worthy of public confidence. The certificate of authority was revoked and the particular company went out of existence. Later the duties of the Board devolved upon the Insurance Commissioner subject to the supervising authority of the Board.

In 1957 Jordan was offered employment by another insurance company and he asked that the 1956 order be amended so he could accept this employment. The Insurance Commissioner notified the insurance company that its certificate would be revoked because of the employment of Jordan. However, Jordan's employment was terminated and the license was not revoked.

Jordan later brought this action, claiming that the statute was unconstitutional because it did not set out any specific standards for the determination of the question whether the individual was worthy of the public confidence. The trial court entered judgment against Jordan, and he appealed directly to the Texas Supreme Court because of the constitutional issue involved. The Court in its opinion stated:

> While the term "not worthy of the public confidence" is broad and undoubtedly encompasses a multitude of factors, it is no more extensive than the public interest demands. Further the idea embodied within the phrase is reasonably clear and hence acceptable as a standard of measurement. And in this lies the true constitutional test. A court may act with reasonable certainty in reviewing a finding and while many elements, such as failure to meet contractual obligations, the record of past business failures, unfavorable personal notoriety and the like may enter into the conclusion that one is unworthy of public confidence, it does not necessarily follow that an administrative board must first establish detailed rules in order to carry out its statutory duty to make sure that the insurance companies of this state have competent officers and directors.
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> We are here concerned with the regulation of an enterprise which affects the public interest, that is, with licenses and cancellations, administrative directives and controls, and the like. The Legislature in using the phrase, "not worthy of the public confidence" was not attempting to define a crime.