

Recent Decision: Incontestability Clause Bars Action by Insured

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ney's right to protect himself from defamatory statements, the Court declared that:

Although the individual attorney, in this respect, is entitled to no greater judicial protection than the law affords to others, he is, in all justice, certainly entitled to no less protection.²⁸

The Court, therefore, has endorsed the view which favors strict limitation on the use of absolute privilege. *Sassower v. Himwich* is thus in direct accord with the *Lee* case, but is patently contrary to the result reached by the *Toft* case in 1955, and the

²⁸ *Sassower v. Himwich*, *supra* note 26.

Ramstead case in 1959.

The *Sassower* case represents an apparently logical and prudent approach to the issue, with a result that appears to protect the rights of both parties as equally and as ethically as possible. On the other hand, the *Toft* and *Ramstead* decisions represent a severe and somewhat inequitable approach, and result not only in an unjust deprivation of the attorney's rights, but also cause a wall of mistrust to arise between the respectable attorney and his client.²⁹

²⁹ 34 CHI.-KENT L. REV. 328, 329 (1956).

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This policy shall be incontestable after it has been in force for a period of two years from date of issue.

The above is a simple form of "incontestable clause" which appears in most life insurance policies issued today. Within limits, the courts agree that the clause bars the insurance company from asserting many defenses that would otherwise be available. The question of whether the clause operates with equal force on the insured had never been put in issue until the recent case of *Newton v. New York Life Inc. Co.*¹ The plaintiff, a holder of several life insurance and annuity policies, brought the action to recover damages for alleged fraud, concealment and misrepresentation in the issuance

¹ 210 F. Supp. 859 (N.D. Cal. 1962).

and sale of the policies. All the policies contained clauses providing for incontestability after either one or two years from date of issue. In this action, brought more than two years after the date of issue of the policies, the district court *held* that the incontestability clauses are for the benefit of both the insurer *and* the insured and consequently the action is barred.

While the issue in the *Newton* case is novel, the incontestable clause itself has been in use for approximately a century,² and oral representations by the insurer to the effect that the policy shall be incontestable were upheld before that.³ A holder of a life insurance policy in the early nineteenth century could not know whether his beneficiary would receive the proceeds of

² THE LIFE INSURANCE POLICY CONTRACT § 5.1 (Krueger & Waggoner ed. 1953).

³ *Wood v. Dwarris*, 11 Ex. 493, 156 Eng. Rep. 925 (1856).

the policy upon his death or would become a litigant in a costly action. To overcome this uncertainty and thus increase sales, many insurance companies voluntarily began to use some form of incontestable clause.⁴ Shortly thereafter, New York took the first major legislative step in insurance reform and required, among other things, that all life insurance policies issued in New York contain certain standard provisions including an incontestable clause.⁵ Today many states have passed similar legislation in respect to the use of an incontestable clause in various insurance contracts.⁶

It is clear from the legislative pattern that the incontestable clause is viewed favorably, and this attitude is made even more evident from the course the courts have taken. There is general agreement that fraud, misrepresentation or concealment on the part of the insured in procuring the policy cannot be raised by the insurance company once the period set forth in the incontestable clause has elapsed.⁷ However, if no period is allowed in which the insurance company may contest the policy, some courts have held that fraud is an implied exception,⁸ or that the clause is void

as against public policy.⁹ The contrary view is that even though no period to contest is allowed, the company has sufficient time to investigate before it issues the policy.¹⁰ Although certain defenses may be specifically exempted by the insurer from operation of the clause,¹¹ few states allow this exemption to the defense of fraud.¹²

Where the insurance company does not seek to avoid the policy, but merely to reform it according to the tenor of the intended agreement, it is generally held that reformation is available in spite of the incontestable clause. The action "is not a contest of the policy, but a prayer to make a written instrument speak the real agreement of the parties."¹³ Although there is authority to the contrary,¹⁴ New York and a majority of

raised because few policies are issued providing for incontestability from date. 8 COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 2155, at 6954 (1931).

⁹ *Reagan v. Union Mut. Life Ins. Co.*, 189 Mass. 555, 76 N.E. 217 (1905).

¹⁰ *Duvall v. National Ins. Co.*, 28 Idaho 356, 154 Pac. 632 (1916); *Patterson v. Natural Premium Mut. Life Ins. Co.*, 100 Wis. 118, 75 N.W. 980 (1898).

¹¹ VANCE, *INSURANCE* § 97, at 583 (3d ed. 1951); 3 RICHARDS, *INSURANCE* § 410, at 1357 (5th ed. 1952).

¹² *American Nat'l Ins. Co. v. Tabor*, 111 Tex. 155, 230 S.W. 397 (1921); VANCE, *op. cit. supra* note 11. As to the exception of disability and double indemnity provisions from the operation of the incontestable clause, see *Equitable Life Assur. Soc. of the United States v. Kushman*, 276 N.Y. 178, 11 N.E.2d 719 (1937); *Manhattan Life Ins. Co. v. Schwartz*, 274 N.Y. 374, 9 N.E.2d 16 (1937); *New York Life Ins. Co. v. Rotman*, 231 Iowa 1249, 3 N.W.2d 603 (1942); *Norris v. Travelers Ins. Co.*, 148 Kan. 122, 79 P.2d 842 (1938).

¹³ *Columbian Nat. Life Ins. Co. v. Black*, 35 F.2d 571, 577 (10th Cir. 1929).

¹⁴ *Richardson v. Travelers Ins. Co.*, 171 F.2d 699 (9th Cir. 1948). *But see*, *Schiel v. New York Life Ins. Co.*, 178 F.2d 729 (9th Cir.), *cert. denied*, 339 U.S. 931 (1950). See generally Gerlack, *The*

⁴ See *Massachusetts Benefit Life Ass'n v. Robinson*, 104 Ga. 256, 269, 30 S.E. 918, 922 (1898).

⁵ *Laws of New York*, 1906, ch. 326, § 101.

⁶ *E.g.*, CAL. INS. CODE § 10206 (group life policies); ILL. ANN. STAT. ch. 73, §§ 836(1)c, 838(1)b (Smith-Hurd 1940) (life policies and annuity contracts); MASS. ANN. LAWS ch. 175, § 132(2) (1959) (life and annuity contracts); N.Y. INS. LAW §§ 155(b), 163(b) (life policies and industrial life policies); PA. STAT. ANN. tit. 40, § 510(c) (1954) (life policies).

⁷ *Wright v. Mutual Benefit Life Ass'n of America*, 118 N.Y. 237, 23 N.E. 186 (1890); *Dibble v. Reliance Life Ins. Co.*, 170 Cal. 199, 149 Pac. 171 (1915).

⁸ *Welch v. Union Cent. Life Ins. Co.*, 108 Iowa 224, 78 N.W. 853 (1899). This issue is seldom

jurisdictions follow this reasoning.¹⁵ Substantially the same rationale is employed in allowing the insurer to litigate the question of the insured's true age, where it has been misstated either innocently or by fraud.¹⁶ This action, too, is not considered to be a contest within the meaning of the clause as long as the sole purpose is to adjust the proceeds payable under the policy according to the age of the insured.¹⁷ In like manner, the non-contest clause does not bar a defense that the particular risk involved is not covered by the terms of the policy.¹⁸

If a "contest," as distinguished from the above actions, is commenced within the time allowed by the incontestability clause, the insurer cannot thereafter be barred by the operation of the clause. A contest

Incontestable Clause and Reformation, 1949 INS. L.J. 489.

¹⁵ See *Grenis v. Prudential Ins. Co. of America*, 154 Misc. 867, 278 N.Y. Supp. 137 (Sup. Ct.), *aff'd mem.*, 246 App. Div. 603, 284 N.Y. Supp. 976 (1st Dep't 1935); VANCE, *op. cit. supra* note 11, § 97, at 590; 29A AM. JUR. *Insurance* § 1130 (1960).

¹⁶ *Metropolitan Life Ins. Co. v. Shalloway*, 151 F.2d 548 (5th Cir. 1945); *New York Life Ins. Co. v. Veit*, 294 N.Y. 222, 62 N.E.2d 45 (1945); *Sipp v. Philadelphia Life Ins. Co.*, 293 Pa. 292, 142 Atl. 221 (1928). *Contra*, *Lincoln Health & Acc. Ins. Co. v. Jones*, 175 Okla. 211, 52 P.2d 793 (1928) (*per curiam*).

¹⁷ *Kelly v. Prudential Ins. Co.*, 334 Pa. 143, 6 A.2d 55 (1939) (insurer cannot raise defense of fraud as to misstatement of age in procuring the policy so as to completely defeat liability).

¹⁸ *Metropolitan Life Ins. Co. v. Conway*, 252 N.Y. 449, 169 N.E. 642 (1930). "The provision that a policy shall be incontestable after it has been in force during the lifetime of the insured for a period of two years is not a mandate as to coverage, a definition of the hazards to be borne by the insurer. It means only this, that within the limits of the coverage, the policy shall stand, unaffected by any defense that it was invalid by reason of a condition broken." *Id.* at 452, 169 N.E. at 642.

begins when the insured avoids, or seeks to avoid, the obligation of the contract by action or defense. If the insured or the beneficiary is plaintiff, suing to declare the policy in force or to recover money due, the contest takes its start when the insurer serves an answer disclaiming liability.¹⁹

In deciding the instant case, the Court stated that the basic issue is: "Are the . . . incontestable clauses for the benefit of the company-insurers, as well as for the benefit of the insureds and the annuitants?"²⁰ The question was answered in the affirmative. The Court relied heavily on the fact that there was nothing in the contracts to indicate that the clause was intended for the insured only, and that "numerous cases contain language . . . which leads to the conclusion that incontestability clauses are for the benefit of both the insurer and the insured."²¹

In one of the cases which the Court relied upon, it was said:

This clause is of vast importance and benefit, both to the insured and to the insurer. It enables the latter to increase his business by giving an assurance to persons doubtful of

¹⁹ *Killian v. Metropolitan Life Ins. Co.*, 251 N.Y. 44, 49, 166 N.E. 798, 800 (1929); *accord*, *American Life Ins. Co. v. Stewart*, 300 U.S. 203 (1937). See *Romano v. Metropolitan Life Ins. Co.*, 271 N.Y. 288, 2 N.E.2d 661 (1936); *Jansen v. Metropolitan Life Ins. Co.*, 251 N.Y. 336, 167 N.E. 462 (1929); *Kocak v. Metropolitan Life Ins. Co.*, 237 App. Div. 780, 263 N.Y. Supp. 283 (3d Dep't), *aff'd mem.*, 263 N.Y. 518, 189 N.E. 677 (1933); *Ramsay v. Old Colony Life Ins. Co.*, 297 Ill. 592, 131 N.E. 108 (1921).

²⁰ *Newton v. New York Life Ins. Co.*, 210 F. Supp. 859, 860 (N.D. Cal. 1962). The other issue presented was, in the inclusion of an incontestable clause in an annuity contract for the benefit of the issuing company since the risk of loss primarily falls on the annuitant? This was decided in favor of the insurance company. *Id.* at 861-62.

²¹ *Id.* at 861. *But see*, *Donohue v. New York Life Ins. Co.*, 88 F. Supp. 594, 596 (D. Conn. 1949).

the utility of insurance that neither they nor their families, after the lapse of a given time, shall be harassed with lawsuits. . . .²²

While it is true that this case and the other cases cited do contain language to the effect that the incontestable clause is for the benefit of both parties,²³ it is clear upon closer examination of these cases that a different benefit was contemplated for the insurer than the *protection* contended for by the Court in the instant case. The benefit of the non-contest clause to the insurance company will not be denied. As stated earlier, the insurance companies voluntarily adopted the clause to eliminate understandable apprehensions on the part of the prospective policyholder and to thereby increase their business. Yet, in spite of the fact that the benefit expressed is purely one of sales attraction and not one of protection beyond rights available to the insurer absent the clause, there is still language in several of the cited cases that would tend to lead one to the conclusion that the clause serves to protect both sides.²⁴

In discussing the benefit or protection given by the clause, the chief recipient is generally considered to be the policyholder.²⁵ One reason advanced for this po-

sition is that where there can be more than one meaning available to a provision in an insurance contract the one which is most favorable to the insured will be adopted.²⁶

A more cogent argument, however, was presented by Chief Justice Cardozo of the New York Court of Appeals:

The value of a clause declaring a policy incontestable lies to no slight degree in the definiteness of the protection accorded to the holder. The good that it promises is in part a state of mind. After a lapse of two years the insured is no longer to be harassed by the fear that the policy will be avoided by interested witnesses asserting in later days that there was a disclaimer long ago. After a like lapse the beneficiaries are no longer to be subjected to the risk of forfeiture though notices or warnings that may be hard to disprove when the insured is in his grave.²⁷

The basis for this position becomes obvious when the purpose of the inclusion of the incontestable clause is examined in view of underlying public policy. Life insurance has become an institution in our complex society. It is an integral and important factor in family planning and many estates are built around little more than a single policy. To reach such a high regard, the policy must be able to create complete stability. It must therefore be absolutely free from doubt as to the distribution of proceeds.²⁸ The incontestable clause accomplishes this and maintains the equilibrium

²² *Kansas Mut. Life Ins. Co. v. Whitehead*, 123 Ky. 21, 26, 93 S.W. 609, 610 (1906); *accord*, *Chinery v. Metropolitan Life Ins. Co.*, 112 Misc. 107, 182 N.Y. Supp. 555 (2d Dep't 1920).

²³ *Columbian Nat. Life Ins. Co. v. Black*, 35 F.2d 571 (10th Cir. 1929); *Dorman v. John Hancock Mut. Life Ins. Co.*, 25 F. Supp. 889 (S.D. Cal.), *aff'd*, 108 F.2d 220 (9th Cir. 1939); *Winer v. New York Life Ins. Co.*, 138 Fla. 818, 190 So. 894 (1939); *Baum v. Massachusetts Mut. Life Ins. Co.*, 357 P.2d 960 (Okla. 1960).

²⁴ *Dorman v. John Hancock Mut. Life Ins. Co.*, *supra* note 23, at 893. *Compare Winer v. New York Life Ins. Co.*, *supra* note 23, with *Prudential Ins. Co. v. Prescott*, 130 Fla. 11, 176 So. 875 (1937).

²⁵ *E.g.*, *Killian v. Metropolitan Life Ins. Co.*, 251

N.Y. 44, 166 N.E. 798 (1929); *Kansas Mut. Life Ins. Co. v. Whitehead*, 123 Ky. 21, 93 S.W. 609 (1906). See *Columbian Nat'l Life Ins. Co. v. Industrial Trust Co.*, 53 R.I. 334, 166 Atl. 809 (1933); *John Hancock Mut. Life Ins. Co. v. Schlink*, 175 Ill. 284, 51 N.E. 795 (1898).

²⁶ *Mutual Life Ins. Co. v. Hurni Packing Co.*, 263 U.S. 167, 174 (1923).

²⁷ *Killian v. Metropolitan Life Ins. Co.*, *supra* note 25, at 49, 166 N.E. at 800.

²⁸ See *Northwestern Mut. Life Ins. Co. v. John-*

important to a proper functioning of the community. When the income-producer passes on, the family can, nevertheless, maintain itself. It is with this view in sight that courts have given the clause so broad and encompassing a construction as to defeat any defense with respect to the validity of the policy.

It is this overriding public policy that has caused an anomaly in contract law. It is firmly established that fraud is a ground for vitiating all contracts,²⁹ yet it is possible for an insurer, in effect, to agree never to raise the defense of fraud once a specified period has elapsed. The reason for upholding this agreement is that of the two public policies here in play, the one condemning fraud must succumb to that which favors the interests of the insured and beneficiary.³⁰ Various explanations have been given for this, some of which are: (1) The sense of security given to the great majority of honest policyholders makes the advantage given to the few dishonest people worthwhile;³¹ (2) The clause does not condone fraud, but on the contrary, recognizes it and gives ample time to establish it as a defense;³² (3) The insurer has ample time and facilities to discover the fraud before the policy is issued;³³ (4) The insurer should not be allowed to wait until the insured is dead to contest the contract, since the insured's in-

tent cannot easily be shown and very often the insured's witnesses are no longer available;³⁴ (5) The clause merely creates a short statute of limitations in favor of the insured.³⁵

It has also been said that the several incontestable statutes in New York³⁶ "undoubtedly enunciate a rule of public policy requiring the incorporation of incontestability clauses favorable to policyholders. . . ."³⁷ A number of other cases construing legislative intent have held that an incontestable clause cannot be broader than the statute in exempting defenses from operation of the clause;³⁸ it must be at least as favorable to the insured and beneficiary as required by statute. But this is not to say that the clause cannot be more favorable to the insured.³⁹ In *Columbian Nat. Life Ins. Co. v. Wallerstein*,⁴⁰ the insurance company did not disclaim coverage but instead brought an action in tort for damages on the ground that the insured had fraudulently induced

son, 254 U.S. 96, 101-02 (1920).

²⁹ 5 WILLISTON, CONTRACTS § 1487 (rev. ed. 1937).

³⁰ *Kansas Mut. Life Ins. Co. v. Whitehead*, *supra* note 22. *MacKendree v. Southern States Life Ins. Co.*, 112 S.C. 335, 99 S.E. 806, 807 (1919).

³¹ *Maslin v. Columbian Nat. Life Ins. Co.*, 3 F. Supp. 368, 369 (S.D.N.Y. 1932).

³² *Wright v. Mutual Benefit Life Ass'n of America*, 118 N.Y. 237, 243, 23 N.E. 186, 187 (1890).

³³ *MacKendree v. Southern States Life Ins. Co.*, *supra* note 30, at 339, 99 S.E. at 807.

³⁴ *Ibid.*

³⁵ *Ramsay v. Old Colony Life Ins. Co.*, 297 Ill. 592, 596, 131 N.E. 108, 109 (1921). *Contra*, *Reliance Life Ins. Co. v. Thayer*, 84 Okla. 238, 241, 203 Pac. 190, 192 (1921) (clause is not a short statute of limitation but a constituent part of the contract); *Citizens' Life Ins. Co. v. McClure*, 138 Ky. 137, 147, 127 S.W. 749, 752 (1910) (statute of limitations applies to actions, not defenses, as does the clause).

³⁶ N.Y. INS. LAW §§ 155(b), 163(b).

³⁷ *Allick v. Columbian Protective Ass'n*, 269 App. Div. 281, 285, 55 N.Y.S.2d 438, 442 (1st Dep't), *aff'd mem.*, 295 N.Y. 603, 64 N.E.2d 350 (1945).

³⁸ E.g., *Foster v. Washington Nat. Ins. Co.*, 118 N.J.L. 228, 230-31, 192 Atl. 59, 61 (1937); *American Nat. Ins. Co. v. Tabor*, 111 Tex. 155, 160, 230 S.W. 397, 398-99 (1921).

³⁹ *Mutual Life Ins. Co. v. Conley*, 55 F.2d 421 (D. Minn. 1932); *Mutual Life Ins. Co. v. Wineberg*, 319 Ill. App. 177, 182, 49 N.E.2d 44, 47 (1943).

⁴⁰ 91 F.2d 351, 353 (7th Cir.), *cert. denied*, 302 U.S. 755 (1937).

the company to issue the policy. In denying the insurance company recovery, the Court said:

[T]he purpose of the statutory enactments requiring the inclusion of incontestability clauses in all policies of life insurance, is to protect the insured and his beneficiary from contests arising out of the policy after the expiration of the statutory period and do away with litigation on it.

There can be no doubt that the purpose of enacting legislation in this area is to protect the policyholder and the beneficiary.⁴¹ In his annual message to the New York State Legislature on January 3, 1906, Governor Higgins said, "You will be called upon to make a radical revision of the law for the benefit of investors in life insurance and for the regulation and restraint of the companies."⁴² Then in April, 1906, the Governor remarked on his recommendations and the proposed draft which was eventually enacted, that the purpose of the proposed legislation was "'to restore public confidence and to compel life insurance companies to conduct a safe, honest and open business for the benefit of their policy holders.'⁴³ This is the atmosphere in which our first incontestable statute⁴⁴ was drawn.

It seems that if the rule of the instant case, *Newton v. New York Life Ins. Co.*,⁴⁵ were to be adopted, barring the insured as well as the insurer from asserting inception defenses after the contestable period has

run, the balance of power in favor of the insurer which the legislature has attempted to eliminate, will once again become firmly entrenched in our insurance law. The problem is real. It is not too difficult to imagine a concerned husband and father purchasing insurance, upon the representations of the insurer, to provide for his family. After the contestable period has elapsed it is learned that the representations were false. What remedies are available to the policyholder besides abandoning the policy and relinquishing all coverage under it? Since the issue of misrepresentation can no longer be raised, neither rescission nor an action in tort for damages would be available.⁴⁶ Reformation of the policy would most likely be denied since in the above hypothetical the element of mistake is absent. Further, the insured might not be able to obtain new insurance because of the increase in his age; if he is eligible for a new policy the rates will be higher than they would have been at the time the former policy was purchased.

A consideration not to be overlooked is, to what extent would general judicial acceptance of the *Newton* rule vary insurance company practice? It has been held that misrepresenting the benefits of a policy, as prohibited by statute in New York,⁴⁷ is a misdemeanor.⁴⁸ In addition, the insurer is liable to a penalty which may be recovered by the injured party.⁴⁹ By strict application of the *Newton* rule, this statutory cause of

⁴¹ S. REP. NO. 1128, 71st Cong., 2d Sess. 10 (1930).

⁴² Governor Higgins' Annual Message to the Legislature of the State of New York, January 3, 1906, in 10 MESSAGES FROM THE GOVERNORS 840 (Lincoln ed. 1906).

⁴³ Memorandum of Governor Higgins filed with Senate Bill, Chapter 326, April 27, 1906, in 10 MESSAGES FROM THE GOVERNORS 906 (Lincoln ed. 1906).

⁴⁴ Laws of New York, 1906, ch. 326, § 101.

⁴⁵ 210 F. Supp. 859 (N.D. Cal. 1962).

⁴⁶ Cf. *Wright v. Mutual Benefit Life Ass'n of America*, 118 N.Y. 237, 23 N.E. 186 (1890); *Columbian Nat. Life Ins. Co. v. Wallerstein*, 91 F.2d 351, 353 (7th Cir.), cert. denied, 302 U.S. 755 (1937).

⁴⁷ N.Y. INS. LAW §§ 127, 211.

⁴⁸ *People v. Legg*, 234 App. Div. 372, 255 N.Y. Supp. 188 (1st Dep't), aff'd mem., 259 N.Y. 654, 182 N.E. 221 (1932).

⁴⁹ N.Y. INS. LAW § 211(4).

action may no longer be available. This, in addition to the fact that the insured would have no other remedy against the company, might encourage fraudulent practices by some insurers. The incontestable clause was given the wide scope it has today largely because of a public policy favoring protection of the policyholder and his beneficiary. This public policy argument, which is in reality the only basis for the very unusual denial of the defense of fraud, cannot logically be applied to the insurer. To so interpret the clause defeats the very purpose for its favorable judicial treatment by weakening the overall position of the policyholder

with respect to the company. No special interests of the insurance companies need this extra protection. But even if some interest of the insurer does exist that is deserving of a special consideration, it still remains that the insured does not have equal facilities and opportunities to uncover the unscrupulous acts of the other party. It is hoped that courts subsequently deciding the issue presented in *Newton* will consider the conflicting interests involved in view of potential detriment to beneficiaries of insureds and consequent ill effects upon the public likely to stem from judicial ratification of the instant case.

