St. John's Law Review

Volume 5
Number 2 *Volume 5, May 1931, Number 2*

Article 10

Effect of Falsity of Material Representations in an Insurance Policy

Raymond C. Williams

But O'Malley, *J.*, of the Appellate Division, in his dissenting opinion makes no effort to distort the obvious meaning expressed by the simple language of the statute, and his conclusion is supported not only by a resumé of decided cases, but by a simple and convincing analysis of the grammatical construction of the statute.[37] This opinion, confirmed by Kellogg, *J.*, of the Court of Appeals,[38] disperses all doubt that the transactions by the plaintiff in the case at bar were wholly in defiance of clearly written statutes—statutes which have been repeatedly re-enacted in order to secure the public from any unscrupulous corporations who make a practice of such illegal discounting of notes and which are susceptible of but one interpretation.

ROBERT D. FLEMING.

EFFECT OF FALSITY OF MATERIAL REPRESENTATIONS IN AN INSURANCE POLICY.

It is an elementary rule of agency that notice acquired by an agent during the transaction which it affects, binds the principal as fully as if he acquired the notice in person, even though the agent does not in fact inform the principal.[1] An exception is made to this rule where an agent is engaged in a scheme to defraud his principal. In such a case the presumption that the agent will communicate all material facts to his principal no longer prevails, and the principal is not bound by the knowledge acquired by his agent while engaged in such fraudulent purpose.[2]

Another important exception to the general rule stated is brought about, in New York, by section 58 of the Insurance Law.[3] This section states that the policy and anything attached thereto consti-

---

[37] *Supra* note 11.

[38] *Supra* note 4.

[1] Jefferson County Bank v. Dewey, 197 N. Y. 14, 90 N. E. 113 (1909); Small v. Housman, 208 N. Y. 115, 101 N. E. 700 (1913); Corrigan v. Bobbs-Merrill Co., 228 N. Y. 58, 126 N. E. 260 (1920).

[2] Natl. Life Insurance Co. v. Minch, 53 N. Y. 144 (1873); Crooks v. Peoples Natl. Bank, 177 N. Y. 68, 69 N. E. 228 (1903); Prudential Insurance Company v. Natl. Bank of Commerce, 227 N. Y. 510, 125 N. E. 824 (1920).

[3] "Every policy of insurance issued or delivered within the state on or after the first day of January, 1907, by any life insurance corporation doing business within the state shall contain the entire contract between the parties and nothing shall be incorporated therein by reference to any constitution, by-laws, rules, application or other writings unless the same are endorsed upon or attached to the policy when issued, and all statements purporting to be made by the insured shall in the absence of fraud be deemed representations and not warranties. Any waiver of the provisions of this section shall be void."

tutes the entire contract between the insured and the insurer, and that statements made by the insured shall be representations and not warranties. By this section nothing which the agent knows can be charged to the principal unless such knowledge is incorporated in or attached to the policy and made a part thereof. This section does not, of course, affect the general rule that statements of the insured relating to his health and physical condition, when included in the policy, are material to the risk, and if false are fatal to the policy.[4]

Prior to the passage of the Insurance Law [5] the case of Sternaman v. Metropolitan Life Insurance Company [6] was authority for the proposition that knowledge to the agent was knowledge to the insurer. In that case the insured, in his examination for insurance, answered all the questions asked of him by the examiner for the defendant company. The answers were truthfully given, but the examiner omitted to record important parts of them, stating that they were unimportant. In an action on the policy the Court permitted the beneficiary to show the answers actually given to the examiner. As a result, the claim of forfeiture made by the insurance company on account of the falsity of the answers as recorded was held untenable, and the plaintiff was permitted to recover. The holding in this case was abolished by the enactment of section 58, and the rule that knowledge of the agent is knowledge of the principal was completely abrogated.[7]

Apparently this section was introduced into the Insurance Law to end certain stratagems practiced by insurance companies which were prejudicial to the insured. Prior to 1907 any breach of warranty contained in an application for life insurance constituted a defense to a claim on a policy.[8] This was so in spite of the fact that the warranty might be entirely immaterial to the risk assumed by the insurer.[9] Since the insured usually had no copy of his application for insurance and no incentive or opportunity to examine or correct any errors in the application arising through mistake, carelessness, or ignorance, he or his beneficiary rarely became aware of the errors until after payment of premiums for a period of years.[10] When a claim was submitted, the beneficiary, for the first time, became aware of the fact that some error had been committed. If the application stated that all answers were warranties, the

[4] 4 Cooleys' Briefs on Insurance (1927), p. 3268.

[5] N. Y. Laws of 1906, Ch. 326.

[6] 170 N. Y. 13, 62 N. E. 763 (1902).

[7] It should be noted that this section applies only to life insurance companies. Baumann v. Preferred Accident Insurance Co., 225 N. Y. 480, 122 N. E. 628 (1919).

[8] Eastern Dist. Piece Dye Works v. Travelers Insurance Co., 234 N. Y. 441, 138 N. E. 401, 26 A. L. R. 1505 (1923).

[9] *Supra* note 8.

[10] Archer v. Equitable Life Assurance Society of U. S., 169 App. Div. 43, 154 N. Y. Supp. 519 (1st Dept. 1915), *aff'd* 218 N. Y. 18, 112 N. E. 433 (1916).

insurance company might resist payment of the claim on this warranty clause. Section 58 favored the insured in that the insured's statements to the insurer were to be considered representations and not warranties as theretofore had been the rule. The distinction between a representation and a warranty in an insurance contract is that a warranty must be literally true while a representation need only be substantially true.[11]

The section, by judicial interpretation, has proved a benefit not only to the insured, but also to the insurance companies. In Archer v. Equitable Life Assurance Society of U. S., the Court said:

> "The legislative intent * * * is to require insurance companies when issuing policies to set out therein the entire contract of insurance, and every statement or representation which induced the company to enter into the agreement and upon which it relied in so doing, if thereafter to be available as a defense to the policy is to be annexed and made a part of it." [12]

In New York no matter what the insured tells the agent of the insurance company, the insurer is not bound by such statements unless they are incorporated into the policy or affixed thereto, and, even then, any misrepresentation to avoid a policy must be material to the risk. Thus, in this type of case, the rule that knowledge of the agent is knowledge of the principal is not applicable.

A number of States still adhere to the common law rule enunciated in the Sternaman case. For example, in Tennessee[13] an applicant in his application for insurance truthfully answered all questions propounded by the insurer's physician. The physician in-

---

[11] 4 R. C. L. 1027.

[12] *Supra* note 10 at 46, 47, 154 N. Y. Supp. at 521, 522.

[13] Hale v. Sovereign Camp W. O. W., 143 Tenn. 555, 226 S. W. 1045 (1921); *cf.* Hutchins v. Globe Life Insurance Co., 126 Ark. 360, 190 S. W. 446 (1916), wherein it was held that where the examining physician knew that the application answers he wrote down for an illiterate insured were false the company cannot set their falsity as breach of warranty.

Northern Assurance Co. v. Kelly, 217 Mich. 1, 185 N. W. 782 (1921), which held where insured told agent of a certain operation he had and the agent failed to insert such information in the application, such omission to insert facts was immaterial.

Security Benefit Assn. v. Green, 103 Okla. 284, 229 Pac. 1061 (1924), which held that where the life insurance agent deduces and writes in the application erroneous answers to truthfully answered questions the beneficiary may show true facts of insured's warranty.

Lindstrom v. National Life Insurance Co. of U. S., 84 Ore. 588, 165 Pac. 675 (1917), which held that if applicant for life insurance makes truthful statements to the medical examiner, who changes the application to make it appear that the insured is a safe risk, the insurer will be liable on the policy issued.

Fayetteville Mutual Benefit Assn. v. Tate, 164 Ark. 317, 261 S. W. 634 (1924), which held that insurer cannot escape liability on ground of false statements inserted in the application by its soliciting agent as to insured's age and state of health, if insured correctly stated facts to agent.

serted false statements, making a false report to the insurer. A policy was issued. In an action on the policy the Court denied the insurance company the right to prove the false report of the examiner, imputing the physician's knowledge to the insurer. The ruling in this case is directly contra the law in New York.

If the above case had occurred in New York and it could be shown that the misrepresentations had been material to the risk, then under section 58 the Court would have found for the insurance company. This state guards the insurance companies against false reports made to them by agents and examiners by that part of section 58 which states, "Every policy * * * shall contain the entire contract between the parties, and nothing shall be incorporated therein * * * unless the same are endorsed upon or attached to the policy when issued * * *." By this phrase, if a copy of the application is attached to the policy and the answers contained therein are false, the insured is bound by such answers even though he answered them correctly to the examiner or agent of the insurance company.

A recent New York case, Minsker v. John Hancock Mutual Life Insurance Company,[14] set forth the rule that when an insured receives a policy it is his duty to read it, or have it read, and if an application incorporated therein does not contain correct answers to the questions asked by the medical examiner, it is his duty to have it corrected.[15]

> "In such circumstances a recovery will no longer be permitted because the medical examiner incorrectly recorded the applicant's answers or because the insured was unable to read or neglected to read the policy." [16]

In this case the plaintiff beneficiary under her husband's life insurance policy, upon his death, brought an action on the policy for $10,000. The defendant life insurance company denied liability on the ground that the plaintiff's husband gave false answers to the questions in regard to previous consultations with and treatment by physicians. Plaintiff contended that the answers to such questions were truthfully made to the defendant's local agent and medical examiner, and that they had full knowledge of the facts, although the answers as contained in the written application were found to be false. The plaintiff claimed that the defendant was not deceived and the representations though material were not fraudulent. The Court found for the defendant and stated that the plaintiff was bound by the answers as written, since the application was physi-

[14] 254 N. Y. 333, 173 N. E. 4 (1930); See (1930) 5 St. John's L. Rev. 126.

[15] *Contra* Mutual Life Insurance Co. of N. Y. v. Brown, 34 Ga. App. 301, 129 S. E. 307 (1925), wherein it was held that an applicant for life insurance has the right to rely on discharge by examiner of duty to properly report answers to insurer and the insured has no duty afterwards to examine his policy to ascertain on what representations it was issued.

[16] *Supra* note 14 at 338, 339, 73 N. E. at 5.

cally annexed to the policy. Being a part of the policy, the Court said the statements had at least the effect of erroneous and material representations under the rule at common law.

The rule in New York is not unreasonably severe and is in line with the true nature of life insurance. Life insurance is essentially a co-operative effort to distribute among the many the economic loss of untimely death which otherwise would be borne by the few. It is a unique contract in that it contemplates a triangular relationship instead of the usual bilateral one. It creates not alone the reciprocal obligations of insured and insurer, but is founded on the relationship of each policyholder to his fellow policy holders. Under the plan of participating life insurance so generally in use today, the mortality of the group is the concern of the individual in the form of increased or decreased dividends. Thus, legislation which in its inception regarded only the primary contract of life insurance—that between the insured and the insurance company—finds additional justification in the real benefit which it confers on the secondary contractual relationship and the true basis of life insurance—that of each policy-holder to his fellow policyholders. By abrogating the common-law rule that knowledge to the agent is binding on his principal, New York has in effect relieved *bona fide* policy-holders of the cost of unjust death losses which formerly would be imposed on them.

It is noteworthy that seven States have adopted laws which in substance fulfill the aim of the New York statute to the effect that statements made by the insured are to be considered as representations and not warranties and that twenty-one States have passed statutes which aim to guard against technical forfeiture by providing that misrepresentations shall not nullify the contract unless made in matters material to the risk.[17] However, it would seem that the difficulties and wide divergence in rulings of the various state courts can only be eliminated by a uniform insurance law. While it is fully appreciated that any attempt at universal reform in the United States must surmount great difficulties, we can point to at least one instance where all States have agreed on a uniform law.[18] Only by such legislation can both policy holders and insurers be assured of uniformity in the exercise of rights and powers despite diversity of jurisdiction.

RAYMOND C. WILLIAMS.

[17] Huebner, Principles of Life Insurance (1919), p. 338.

[18] Uniform Negotiable Instruments Law; Taft, Law Reform (1926), p. 20, "Over 25 years ago the American Bar Assn. inaugurated a movement to ameliorate the inconvenience caused by this situation (Difference in state rulings). At its suggestion Commissioners on Uniform State Laws were appointed by the governors of the several states * * *. Thirty acts have been devised or approved by the Commissioners and a number of these have been enacted. Thus 51 states have enacted the Negotiable Instruments Law, 26 the Bill of Ladings Law, 18 the Desertion and Non-Support Law, 12 the Fraudulent Conveyance Law, 13 the Limited Partnership Law, 16 the Partnership Law, 27 the Sales Act, 18 the Stock Transfer Act, and 41 the Warehouse Receipts Act."