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INSURANCE—Effective Termination—Temporary Contract of Life Insurance Requires Both Notice and Refund of Premium for Termination. *Smith v. Westland Life Ins. Co.*, 15 Cal. 3d 111, 539 P.2d 433, 123 Cal. Rptr. 649 (1975).

Plaintiff Dolores Smith appealed from a judgment in favor of the Westland Life Insurance Company after a nonjury trial. Mrs. Smith, as the widow and administratrix of the estate of her husband, sought recovery of \$10,000 under a temporary life insurance contract. Mr. Smith had paid the first month's premium and received a conditional receipt, also known as a binder or a binding receipt, from a soliciting agent of Westland on April 8, 1963.¹ However, due to the hazardous nature of Smith's employment as a railroad laborer, Westland issued him a modified policy, with increased premiums, on April 24. Smith refused to accept the amended policy or to pay the additional premium to the soliciting agent. On May 17, Westland, through its general agent, again submitted the proposed policy to Mr. Smith. When he refused it, the general agent

1. 15 Cal. 3d 111, 113, 539 P.2d 433, 435, 123 Cal. Rptr. 649, 651 (1975) (4-3 decision). The conditional receipt stated as follows:

It is understood and agreed that the payment referred to on the reverse side of this receipt is made and accepted subject to the following conditions:

1. That if the Company at its Home Office after investigation shall be satisfied that on the date hereof, or on the date of the medical examination for such insurance, whichever is later, each person proposed for insurance was insurable and entitled under the Company's rules and standards to insurance on the plan and for the amount applied for at the Company's published rates corresponding to the age of each person proposed for insurance, the insurance protection applied for shall by reason for such payment [except as otherwise provided in item (16) of the application] take effect from the date hereof or from the date of such medical examination, whichever is later. In any event, the amount of insurance becoming effective under the terms of this receipt is limited to the extent that in the event of the death of the Proposed Insured, the total liability of the Company shall not exceed \$250,000 inclusive of life insurance and accidental death benefit in force with the Company on the date of the application. If less than the full first premium has been paid, such insurance protection shall nevertheless become effective on said date but shall be deemed temporary only and to expire at the end of the period for which the amount tendered hereunder would provide such insurance on a pro rata basis.

2. That if any check, draft or money order given in payment of the premium is not paid on presentation, this receipt shall be void.

3. That if said application is not approved and accepted by the Company within sixty (60) days from the date hereof, then insurance applied for shall not become effective, and the amount tendered shall be returned. Any delay in the return of the amount tendered shall not be construed as approval of the application.

Id. at 113 n.3, 539 P.2d at 435 n.3, 123 Cal. Rptr. at 651 n.3.

told him that his premium would be refunded. The following morning, Smith died in an automobile accident. A few days later, upon being informed of Smith's death, the general agent returned the policy to Westland and requested that the company refund Smith's premium. It did so on May 23. Mrs. Smith was appointed administratrix of her husband's estate in late July, and notified Westland of her husband's death on December 20, 1963. She demanded the payment of benefits under the form of policy originally applied for.² The trial court concluded that the conditional receipt created a provisional contract granting temporary life insurance.³ In addition, the court ruled, as a matter of law, that a contract of temporary insurance is terminated upon the rejection of the application by the insurance company and notice thereof to the insured.⁴ The Supreme Court of California reversed that judgment and held that where the insurer decides to reject an application for insurance, which has been received together with payment of the premium, the insurance contract created thereby is not terminated unless the insurer has *both* actually rejected the application (and communicated appropriate notice thereof to the insured) *and* refunded the premium payment to the insured.⁵

In 1954, California aligned itself with those jurisdictions recognizing temporary insurance.⁶ A temporary contract of insurance arises when a binding receipt is issued by an authorized agent of an insurance company.⁷ It is subject to a condition—rejection by the insurance company—which terminates the coverage.⁸ Normally, the binding receipt is issued to the applicant by the insurance company when his application is taken. Usually, the printed form acknowledges receipt of the first premium (which must be paid at that time) and states that the insurance, on the company's regular policy for

2. *Id.* at 112-15, 539 P.2d at 434-36, 123 Cal. Rptr. at 650-52. Although Smith's death occurred more than one month after he had paid the first month's premium, the policy had not lapsed, since under the terms of the conditional receipt, Westland had 60 days within which to accept the application.

3. *Id.* at 115-16, 539 P.2d at 436, 123 Cal. Rptr. at 652.

4. *Id.* at 116, 539 P.2d at 436, 123 Cal. Rptr. at 652.

5. *Id.* at 121, 539 P.2d at 440, 123 Cal. Rptr. at 656.

6. *Ransom v. Penn Mut. Life Ins. Co.*, 43 Cal. 2d 420, 274 P.2d 633 (1954).

7. See E. PATTERSON, *ESSENTIALS OF INSURANCE LAW* 100 (2d ed. 1957).

8. *Id.*, citing *Gaunt v. John Hancock Mut. Life Ins. Co.*, 160 F.2d 599 (2d Cir.), cert. denied, 331 U.S. 849 (1947), and *Reck v. Prudential Ins. Co. of America*, 116 N.J.L. 444, 184 A. 777 (Ct. Err. & App. 1936).

the plan applied for, shall be in force from the date of a later medical examination, after approval of the application at the home office. That approval is subject to the company's satisfaction with the applicant's insurability for the amount of insurance on the plan applied for.⁹ In spite of the language of the so-called binding receipt, the California courts, since 1954, have held that an individual is insured immediately upon receipt of the completed application and first premium payment.¹⁰ The contract thereby created may only be terminated if the company becomes dissatisfied with the risk before a policy is issued.¹¹

Binders were originally introduced as a means of protecting the insurer from an applicant's arbitrary withdrawal of his offer after the investigation of his insurability had been undertaken by the insurer.¹² Along with serving to discourage the applicant from withdrawing (due to possible forfeiture of the premium already paid),¹³ it also provides a selling point for the agent (since he can promise the applicant more immediate coverage).¹⁴ While early decisions tended to be in the insurer's favor, the decisional law has seen a shift in favor of the insured.¹⁵

9. See E. PATTERSON, *supra* note 7, at 100.

10. 43 Cal. 2d 420, 274 P.2d 633 (1954).

11. *Id.* at 424, 274 P.2d at 635.

12. See, e.g., Havighurst, *Life Insurance Binding Receipts*, 33 ILL. L. REV. 180, 181 (1938); Comment, *Operation of Binding Receipts in Life Insurance*, 44 YALE L.J. 1223, 1224 (1935).

13. See, e.g., *Muhlbach v. Omaha Life Ins. Co.*, 107 Neb. 206, 185 N.W. 447 (1921); *Albers v. Security Mut. Life Ins. Co.*, 41 S.D. 270, 170 N.W. 159 (1918).

14. See, e.g., *New York Life Ins. Co. v. Abromietes*, 254 Mich. 622, 236 N.W. 769 (1931); *Colorado Life Co. v. Teague*, 117 S.W.2d 849 (Tex. Ct. Civ. App. 1938).

15. The general rule adhered to by most of the courts in their earlier decisions is illustrated by *Corning v. Prudential Ins. Co. of America*, 273 N.Y. 668, 8 N.E.2d 338 (1937) (mem.). Succinctly stated, the rule is that where a binding receipt is issued to the applicant, making the obligation of the insurance company conditional upon acceptance and approval by the company, the company is not bound until it approves and accepts the application. *Id.* at 669, 8 N.E.2d at 339; *accord*, *Brancato v. National Reserve Life Ins. Co.*, 35 F.2d 612 (8th Cir. 1929).

In *Corning*, with the application and premium for life insurance in the insurer's hands, and the receipt, providing for insurance if the application was accepted by the home office of the insurer, in the applicant's hands, the applicant left town. The home office forwarded a policy of a different type, which called for a larger premium, to its district office. On the same day, the applicant was fatally injured. The agent in charge of the application attempted to notify the applicant the following day, but learned that he was out of town. Two days later, the applicant died, without ever hearing from the insurer. Nevertheless, the court held that the insurance was not to take effect until the application was approved, and such approval was never given. 273 N.Y. at 669, 8 N.E.2d at 339.

The majority rule concerning the liability of the insurer under a binding receipt is that if notice of the rejection of the application for insurance is brought home to the insured or his agent before his death, the insurer is not liable.¹⁶ Thus, temporary insurance instantly ceases to be effective¹⁷ when "terminated by a rejection of the application, and notice thereof to the insured."¹⁸ Additionally, it is generally held that a contract of insurance cannot be created by estoppel because of a delay of the insurer in refunding the money paid on the issuance of the binding receipt.¹⁹

This rule surely does not represent the trend of recent cases. *See, e.g.*, *Gaunt v. John Hancock Mut. Life Ins. Co.*, 160 F.2d 599 (2d Cir.), cert. denied, 331 U.S. 849 (1947); *Prudential Ins. Co. of America v. Lamme*, 83 Nev. 146, 425 P.2d 346 (1967); *Morgan v. State Farm Life Ins. Co.*, 240 Ore. 113, 400 P.2d 223 (1965). "Decisions that boldly rewrite conditions of 'approval' or 'acceptance' are numerous; often the opinions purport to interpret or to resolve ambiguities, and sometimes they disapprove onerous conditions more candidly on grounds of public policy." R. KEETON, *BASIC TEXT ON INSURANCE LAW* § 2.3(c), at 42-43 (1971) (footnotes omitted). *See generally* O'Neill, *Interim Coverage: Conditional Receipts*, 1964 U. ILL. L. FORUM 571; Comment, "*Binding Receipts*" in *California*, 7 STAN. L. REV. 292 (1955); Comment, *Life Insurance Receipts: The Mystery of the Non-Binding Binder*, 63 YALE L.J. 523 (1954); Comment, *Operation of Binding Receipts in Life Insurance*, 44 YALE L.J. 1223 (1935).

16. *See, e.g.*, *Service v. Pyramid Life Ins. Co.*, 201 Kan. 196, 440 P.2d 944 (1968); *Colorado Life Co. v. Teague*, 117 S.W.2d 849 (Tex. Ct. Civ. App. 1938). *See also* 44 C.J.S. *Insurance* § 230(3) (1945).

17. *See, e.g.*, *Gardner v. North State Mut. Life Ins. Co.*, 163 N.C. 367, 79 S.E. 806 (1913); *Albers v. Security Mut. Life Ins. Co.*, 41 S.D. 270, 170 N.W. 159 (1918); *Hallauer v. Fire Ass'n*, 83 W. Va. 401, 98 S.E. 441 (1919). *See also* 1 G. COUCH ON INSURANCE § 91 (1929); 12 INSURANCE LAW & PRACTICE § 7221 (G. Appleman ed. 1943).

18. 9 COUCH ON INSURANCE § 39:207 (2d ed. R. Anderson ed. 1962) (footnote omitted). *See, e.g.*, *Leube v. Prudential Ins. Co. of America*, 147 Ohio St. 450, 72 N.E.2d 76 (1947). In *Leube*, the applicant for life insurance had paid her initial monthly premium and received a receipt. The receipt stated that temporary insurance was in effect provided that the application was approved at the insurer's home office. She was fatally injured three days after the home office rejected the application, but did not die until a week later. However, notification of the rejection was not actually given to the applicant until the day she died. Nevertheless, the court held that there was no insurance contract in effect at the time of the applicant's death. *Id.* at 456, 72 N.E.2d at 79. Thus, the rejection immediately terminated the temporary insurance created by the receipt, even though the insurer still had the insured's money. *But see* *Reck v. Prudential Ins. Co. of America*, 116 N.J.L. 444, 184 A. 777 (Ct. Err. & App. 1936). In *Reck*, the receipt issued by the insurer stated that the company would return the premium if it declined to grant the policy. Although the insured died within two days of the date of the application, the court held that approval was inferred by the insurer's failure to return or tender the premium back to the insured. *Id.* at 446-47, 184 A. at 778. The fact that there was neither formal approval nor a formal policy actually issued or delivered, was of no consequence.

19. *E.g.*, *Brancato v. National Reserve Life Ins. Co.*, 35 F.2d 612 (8th Cir. 1929). Here, the insurance company rejected the application for insurance, and informed the applicants

*Smith v. Westland Life Ins. Co.*²⁰ adds another requirement. It requires refund of the premium in addition to notice of the insurer's rejection of the application, in order to terminate temporary insurance.²¹ While it has been fairly widely recognized that the return or tender of unearned premiums is a condition precedent to the insurer's exercise of its rights to cancel under a permanent insurance policy,²² only rarely has a court held similarly for temporary insurance.²³

The court in *Smith* relies strongly on the fact that the receipt was silent as to how and when the temporary insurance was effectively terminated.²⁴ The court stated that since "the receipt is silent as to how and when the temporary coverage . . . may, or will, be otherwise effectively terminated,"²⁵ a "shroud of ambiguity"²⁶ is cast over the receipt. The court thus follows the lead of the majority of cases in resolving ambiguities in favor of the insured.²⁷ Only here, the court went a step further than most other jurisdictions by requiring both notice and return of premium to effectuate a termination under any temporary insurance contract.²⁸ This may appear unfairly favorable to the insured. However, the court hinged its argument on a more widely recognized concept—that of "effectuating the reasonable expectations of the ordinary applicant."²⁹ Such expectations in *Smith* are "namely, complete and immediate coverage upon payment of the premium."³⁰

The court in *Smith* acknowledges the presence of confusion and

in a letter duly received by them. The court held that an insurance contract was not created by a delay in tendering back the money received for. *Id.* at 614.

20. 15 Cal. 3d 111, 539 P.2d 433, 123 Cal. Rptr. 649 (1975) (4-3 decision).

21. *Id.* at 120, 539 P.2d at 439-40, 123 Cal. Rptr. at 655-56.

22. *E.g.*, Boston Ins. Co. v. Read, 166 F.2d 551 (10th Cir. 1948); Standard Accident Ins. Co. v. Leslie, 55 F. Supp. 134 (E.D. Ill. 1944); Genone v. Citizens Ins. Co., 207 Ga. 83, 60 S.E.2d 125 (1950); Parks v. Lumbermen's Mut. Cas. Co., 327 Ill. App. 356, 64 N.E.2d 210 (1st Dist. 1945). *But see* 17 COUCH ON INSURANCE § 67:244 (2d ed. R. Anderson ed. 1967).

23. Reck v. Prudential Ins. Co. of America, 116 N.J.L. 444, 445-46, 184 A. 777, 778 (Ct. Err. & App. 1936); *accord*, Allen v. Metropolitan Life Ins. Co., 44 N.J. 294, 310-11, 208 A.2d 638, 647 (1965).

24. 15 Cal. 3d at 120, 539 P.2d at 440, 123 Cal. Rptr. at 656.

25. *Id.*

26. *Id.*

27. *Id.* at 121, 539 P.2d at 441, 123 Cal. Rptr. at 657.

28. *Id.* at 120, 539 P.2d at 440, 123 Cal. Rptr. at 656 (footnote omitted).

29. *Id.* at 122, 539 P.2d at 441, 123 Cal. Rptr. at 657 (footnote omitted).

30. *Id.* at 123, 539 P.2d at 442, 123 Cal. Rptr. at 658.

uncertainty in notifying an applicant of the termination of his temporary insurance, without refunding his premium at the same time.³¹ In *Smith*, there is evidence that Mr. Smith was informed by the insurer's general agent that the premium would be refunded, but the court dismisses this, since it is based only on the general agent's testimony.³² Since this was the second time that the insurer tried to sell Smith the amended policy, the court felt it was not unreasonable to assume that Smith might expect that the insurance company would continue to try to sell him the amended policy, despite notice to the contrary.³³ Such an assumption is based on the "resolution of ambiguities in favor of the insured" and "reasonable expectations of the applicant" approaches.³⁴

The dissent in *Smith* claimed that all ambiguity was eliminated through an "unequivocal rejection of the insurance application more than one month after acceptance of the first month's premium"³⁵ and "the promise to return the premium."³⁶ It felt that because temporary insurance is only impliedly, and not expressly provided, the implication of continued coverage should be rejected when the circumstances fail to warrant it—a situation which the dissent felt existed here.³⁷ To support its line of reasoning, the dissent stated that it is anomalous to hold that an express policy of insurance may be cancelled by notification alone, but that implied temporary insurance requires, in addition, the return of the premiums.³⁸

The trial court in *Smith* had applied the common law rule of contracts embodied in the California Civil Code.³⁹ Under the California Civil Code, any attempt to modify the terms of an offer, in response thereto, constitutes a rejection of the offer and is a new counterproposal.⁴⁰ Therefore, the trial court concluded that West-

31. *Id.* Here, the court notes that on one hand, the notice of rejection indicates that the permanent policy, requested by the applicant, will not be issued; on the other hand, the retention of the premium indicates that the immediate insurance he was getting for his money is still continuing. *Id.*

32. *Id.* at 125, 539 P.2d at 443, 123 Cal. Rptr. at 659.

33. *Id.*, 539 P.2d at 444, 123 Cal. Rptr. at 660.

34. See text accompanying notes 27, 29 *supra*.

35. 15 Cal. 3d at 126, 539 P.2d at 444, 123 Cal. Rptr. at 660 (Clark, J., dissenting).

36. *Id.*

37. *Id.* at 128, 539 P.2d at 446, 123 Cal. Rptr. at 662.

38. *Id.* at 127, 539 P.2d at 444-45, 123 Cal. Rptr. at 660-61.

39. CAL. CIV. CODE § 1585 (West 1954).

40. 15 Cal. 3d at 116 n.7, 539 P.2d at 437 n.7, 123 Cal. Rptr. at 653 n.7.

land's issuance of an insurance policy which was different in form from that described in Smith's application, constituted both a rejection of the application and a counteroffer which Smith never accepted.⁴¹

Although use of the contracts approach in other jurisdictions has resulted in many pro-insurer decisions,⁴² the trial court's application of the theory in *Smith* seems erroneous. In 1954, California had aligned itself with those jurisdictions recognizing that payment of the first premium insures the applicant immediately, thus creating a temporary contract of insurance.⁴³ The rejection of the insured's application by the insurer may prevent a permanent contract from arising. It does not affect the existence, however, temporary, of the initial binder. Therefore, the trial court was wrong in not reaching the issue of whether the initial contract was effectively terminated.

The trial court, had it not treated the agent's offers as rejections of Smith's application, might still have found in Smith's favor through the following reasoning. Once there is an insurance policy in effect, there may be a valid modification of its coverage provisions, if there is sufficient consideration.⁴⁴ This is true whether the effect of the modification is to extend or limit the risks against which the insurance affords protection.⁴⁵ Often, such a modification is in the form of an indorsement. Its terms are usually controlling if

41. *Id.* at 116, 539 P.2d at 437, 123 Cal. Rptr. at 653.

42. *See, e.g.*, *Dunford v. United of Omaha*, 95 Idaho 282, 506 P.2d 1355 (1973). Here, it was stated that a policy differing materially from the policy applied for was a counteroffer amounting to a rejection of the application. *Id.* at 285, 506 P.2d at 1358. It has also been held that no contract existed where a company offered a policy at a higher premium rate after the agent had given a receipt at a previously negotiated lower rate, even though the agent collected the difference in amount after the death of the insured, and both he and the wife of the insured believed that there had been temporary insurance in force. *National Life & Accident Ins. Co. v. Carmichael*, 53 Tenn. App. 280, 284, 381 S.W.2d 925, 927 (1964). The leading Supreme Court case speaking about a counteroffer as a rejection held that where the mutual consent of the parties was lacking, no contract for insurance could exist. *Insurance Co. v. Young's Adm'r*, 90 U.S. (23 Wall.) 85 (1874).

43. 43 Cal. 2d 420, 274 P.2d 633 (1954).

44. *E.g.*, *Engle v. United States*, 261 F. Supp. 93 (W.D. Ark. 1966), *aff'd sub nom.* *Southern Farm Bureau Cas. Ins. Co. v. United States*, 395 F.2d 176 (8th Cir. 1968); *Mooradian v. Canal Ins. Co.*, 272 Ala. 373, 130 So. 2d 915 (1961); *Bower & Kaufman v. Bothwell*, 152 Md. 392, 136 A. 892 (1927).

45. *E.g.*, *Wackerle v. Pacific Employers Ins. Co.*, 219 F.2d 1 (8th Cir.), *cert. denied*, 349 U.S. 955 (1955) (void exclusion from coverage); *Willets v. Sun Mut. Ins. Co.*, 45 N.Y. 45 (1871) (valid extension of coverage).

there is an inconsistency between them and the terms of the general policy form.⁴⁶ If, however, there is not sufficient consideration, the indorsement is void, and the preexisting policy controls.⁴⁷ By analogy, one might argue that the agent's offers of a new policy were merely attempts at modifying the existing temporary contract of insurance. Since there was no change in the consideration given by Smith, the temporary contract remained in effect.

The Supreme Court of California reached this same result, but instead rested its decision on public policy grounds—namely, the protection of the insured from adhesion contracts,⁴⁸ issued by the insurer—in addition to the “resolution of ambiguities” and “reasonable expectation” approaches.⁴⁹ Certainly the decision is warranted by the facts. Westland by its equivocal actions should assume the risk. Furthermore, evidence of rejection by Westland consisted solely of testimony by one of its agents that Smith was informed that he would receive his premium in the mail. Since Smith died the following morning, there certainly was insufficient time to pursue another insurer.

Based on the facts of this case, the final result reached by the *Smith* court is both equitable and fair. If the insurance company does not feel that an applicant is an insurable risk under the original terms of the insurance contract, it should bear the risk of making him clearly aware of that fact. Here lies the real thrust of *Smith*. Implicit in the return of premium rule is the broader mandate that

46. *Royal Ins. Co. v. Caledonian Ins. Co.*, 182 Cal. 219, 220, 187 P. 748, 749 (1920); *cf.* *Southwestern Funding Corp. v. Motors Ins. Corp.*, 59 Cal. 2d 91, 378 P.2d 361, 28 Cal. Rptr. 161 (1963).

47. *E.g.*, *Wackerle v. Pacific Employers Ins. Co.*, 219 F.2d 1 (8th Cir.), *cert. denied*, 349 U.S. 955 (1955); *Cohen v. Mutual Benefit Health & Accident Ass'n*, 90 F. Supp. 754 (W.D. Mo. 1950); *Rice v. Provident Life & Accident Ins. Co.*, 231 Mo. App. 560, 102 S.W.2d 147 (1937). In *Rice*, the court concluded that the rider relieving the insurance company on a health and accident policy of liability for disability caused by rheumatism could not stand. The rider was without consideration, so it was void when executed. *Id.* at 567, 102 S.W.2d at 151. *But see* N.Y. GEN. OBLIG. LAW § 5-1103 (McKinney 1964). “An agreement, promise or undertaking to change or modify, or to discharge in whole or in part, any contract [or] obligation . . . shall not be invalid because of the absence of consideration, provided that the agreement, promise or undertaking changing, modifying, or discharging such contract, [or] obligation . . . shall be in writing and signed by the party against whom it is sought to enforce the change, modification or discharge, or by his agent.” *Id.*

48. The insured has no real choice—he either accepts the insurer's form, or gets nothing at all. *See* J. CALAMARI & J. PERILLO, *THE LAW OF CONTRACTS* § 3, at 5-6 (1970).

49. *See* text accompanying notes 24-34 *supra*.

notification be clear and unambiguous. Clearly, the court feels that this mandate will not be adequately assured by notice alone. Moreover, the dissent fails to recognize this point by viewing return of premium as something in addition to notification, rather than as a form of notification.⁵⁰ Arguably, the unconditioned right on the part of the insurer to cancel temporary insurance should create a concomitant obligation to give some form of unambiguous termination notice. Such notice is assured by the return of premium approach of the *Smith* court. Hopefully, other jurisdictions will adopt similar rules that will further protect the insured from the adhesion contracts of the insurer.

Thomas F. Cassidy

50. 15 Cal. 3d at 126, 539 P.2d at 444, 123 Cal. Rptr. at 660 (Clark, J., dissenting).

