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LIABILITY OF AN INSURER PRIOR TO ISSUANCE OF A POLICY

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I.

GENERAL CONSIDERATIONS

Despite the fact an insurance company has failed to issue a formal written policy of insurance at the time a loss occurs, situations nevertheless exist wherein it may be held liable to compensate an applicant for a loss he has sustained. Broadly speaking, such situations fall into three general classifications. They comprehend cases wherein an insurer is held liable (1) because of oral agreements made on its behalf by its agents; (2) because it has by its conduct estopped itself or waived the right to deny the existence of contractual liability; or (3) because it has failed to accept or reject the application with reasonable promptness. Each is a settled ground of recovery.

A policy of insurance is a contract and general rules of contract law accordingly apply to it. An offer, usually in the form of a written application for insurance, and an acceptance of that offer are said to be necessary before the contract is formed.[1] Equally, the consent of the offeree must be communicated to the offeror before the contract is legally complete.[2] And it is possible to find cases holding that the last act creating the obligation of the contract is the delivery of the policy to the insured person.[3] Hence the cases referred to above, wherein liability is imposed before the home office has had a chance to act, must be considered of an exceptional character. They have been justified by the Court on the ground the business of insurance companies is of a quasi-public character,[4] that the conventional liberty of contract found in other business agreements is lacking because the applicant cannot in a practical

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1. Ulledalen v. United States Fire Insurance Co., 74 N.D. 589, 611-12, 23 N.W.2d 856, 867 (1946); Bekken v. Equitable Life Assur. Soc., 70 N.D. 122, 136, 293 N.W. 200, 209 (1940).

2. N.D. Rev. Code § 9-0301 (1943).

3. Storing v. Nat. Surety Co., 56 N.D. 14, 215 N.W. 875 (1927); *cf.* Mann v. Policyholder's Nat. Life Ins. Co., 78 N.D. 724, 730-31, 51 N.W.2d 853, 857-58 (1952) (action for negligent delay is governed by North Dakota law although delay occurred outside state). See generally, 2 Beale, Conflict of Laws § 332.41 (1935).

4. Bekken v. Equitable Life Assur. Soc., 70 N.D. 122, 138, 293 N.W. 200, 210 (1940); see Mutual Life Ins. Co. of New York v. State, 71 N.D. 78, 86, 298 N.W. 773, 777 (1941); *cf.* Wanberg v. National Union F. Ins. Co., 46 N.D. 369, 179 N.W. 666 (1920), *aff'd*, 260 U.S. 71 (1922).

sense bargain over the terms of the policy,[5] on the theory of custom and usage in the insurance business,[6] on the basis of a special relationship of confidential character, involving trust and reliance upon the representations of the insurer, assumed to exist between applicant and insurer,[7] and on principles of agency.[8] Thus it has been said by the Court that "The purpose and nature of life insurance contracts, and the manner in which such contracts are negotiated impress such contracts, and the relationship of the parties, even during the negotiations, with characteristics unlike those incident to contracts and negotiations for contracts in ordinary commercial transactions."[9] This is a point of view clearly not confined merely to contracts of life insurance.

II.

POWERS OF INSURANCE AGENTS

For the purposes of this discussion it is the holdings with reference to the scope of the insurance agent's authority to bind his company which are of greatest immediate interest. The North Dakota Code provides that any person who:

1. Solicits insurance on behalf of any insurance corporation . . . ;
2. Transmits an application for a policy of insurance . . . to . . . any insurance corporation;
3. Makes any contract for insurance;
4. Collects any premium for insurance; or
5. Aids or assists in any manner in doing any of the things hereinbefore mentioned . . . shall be regarded as the agent of such corporation *to all intents and purposes* unless it can be shown that he receives no compensation for such services . . . .[10]

It is the clause of the statute which makes an insurance salesman an agent "to all intents and purposes" which invites examination. In *Anderson v. Northwestern Fire & Marine Ins. Co.*,[11] plaintiff insured property against loss by fire. A month after the policy expired, defendant insurance company's agent orally agreed to renew it. On the following day a fire occurred. Since its home office

5. Bekken v. Equitable Life Assur. Soc., 70 N.D. 122, 141, 293 N.W. 200, 211 (1940).
6. Ulledalen v. United States Fire Ins. Co., 74 N.D. 589, 608, 23 N.W.2d 856, 865 (1946); Anderson v. Northwestern Fire & Marine Ins. Co., 51 N.D. 917, 931-32, 201 N.W. 514, 519 (1924).
7. Bekken v. Equitable Life Assur. Soc., 70 N.D. 122, 142, 293 N.W. 200, 212 (1940).
8. See discussion *infra*, pp. ———
9. Bekken v. Equitable Life Assur. Soc., 70 N.D. 122, 142, 293 N.W. 200, 212 (1940).
10. N.D. Rev. Code § 26-0702 (1943) (emphasis supplied).
11. 51 N.D. 917, 201 N.W. 514 (1924).

had never approved the new policy the insurer denied liability. It was held that despite the limitations on the agent's authority contained in his contract of appointment the statute neverthless conferred on him authority to bind the insurer by oral agreement. If the applicant for insurance had knowledge of the limitations placed by the company on its agent's authority, it was said, a different result would have been reached. But in the absence of such notice, a member of the general public consulting an insurance agent is entitled to regard him as a general agent.[12] "It will scarcely be contended," said the Court, "that the company could, by stipulation in the policy, or the application, divest Kavanaugh of the character of an agent, to all intents and purposes, with which he was invested by the statute if he performed certain acts."[13]

The results which this construction of the statute has enabled the North Dakota Court to reach were summarized in *Ulledalen v. United States Fire Insurance Co.*,[14] a 1946 decision closely resembling the *Anderson* case. Plaintiff applied for fire insurance. He testified he went to see defendant insurer's agent. He testified further: "I asked him for a $1000 policy upon my household goods, and he said, 'all right,' he said, and turned to Miss Snydal and asked her to make the application out, which she started to do, and I asked him what time or how long it would be before he would know what the premiums would be, as I had previously asked him how long it would be, and he said he didn't know because he didn't know what the rate was up in our neighborhood; I asked him how long it would be before he would know and he said as soon as the policy comes back, and I said 'how long will that be,' and he said, 'you can figure the policy is in effect right now.' . . .

"Q. And did Mr. Grantier say anything to you as to when you should pay the premium?"

"A. He said: 'As soon as I find out I will let you know.' "

A fire broke out before the policy was issued and the insurer disclaimed responsibility for the loss. Holding for plaintiff, the Supreme Court used the following language:

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12. Accord, McCabe Bros. v. Aetna Ins. Co., 9 N.D. 19, 27, 81 N.W. 426, 430-31 (1899) (insurance solicitor held general agent of company); Boos v. Aetna Ins. Co., 22 N.D. 11, 132 N.W. 222 (1911). Of course, to call an insurance agent a "general agent" does not settle the question whether a given act is within the scope of his authority. "An agent for a particular act or transaction is called a special agent. All others are general agents." N.D. Rev. Code § 3-0102 (1943). The point is made in Restatement, Agency § 3, comment *c* (1933), that a general agent "may have little discretion in regard to the transactions which he is employed to perform, while a special agent may have great discretion in the single transaction which he conducts."

13. Anderson v. Northwestern Fire & Marine Ins. Co., 51 N.D. 917, 930, 201 N.W. 514, 518 (1924).

14. 74 N.D. 589, 23 N.W.2d 856 (1946).

> "It is settled law in this state that a person duly licensed as an agent of a foreign fire insurance company, and who performs acts enumerated in ND Rev Code 1943 § 26-0702, relating to the business of such insurance company, and is thus to 'be regarded as the agent of such corporation to all intents and purposes unless it can be shown that he receives no compensation for such services,' has power to make a parol agreement on behalf of the company to renew a policy about to expire. . . . He also has power to enter into a parol agreement to renew the policy after it has expired . . . ."
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> "It logically follows that such agent also has authority to make a preliminary parol contract of insurance pending the issuance of a written policy . . . . The making of such preliminary oral contract is not something out of the ordinary, but is a common practice."[15]

Despite the breadth of the language used in the foregoing opinions, it is possible to find cases wherein the Court has taken a more restrictive view of the operation of the statute. In *Kopald Electric Co. v. Ocean Accident & Guarantee Corp.*,[16] an insurance agent asked an automobile owner if he wanted liability insurance on his car. On receiving an affirmative answer he told the applicant, "You are covered right now." He also stated "The policy would be issued at Fargo." No written application was ever made to the company and the plaintiff's case rested on these oral statements alone. Half an hour after this conversation the vehicle was wrecked in an accident. The Court ruled for the insurer. It declared that the statute, instead of constituting a substantive grant of authority to the insurance salesman, "merely fixes the relationship of the solicitor as to the company or the insurer. It does not define the scope of his authority . . ."[17]

In *Meyer v. National F. Ins. Co.*,[18] a similar reading of the statute occurred. Plaintiff was a farmer who gave a note in payment of fire insurance on his buildings. The policy provided that coverage lapsed if payment of the note was not made on time. When plaintiff failed to pay he was expressly advised in writing by the insurer that his policy was suspended. Thereafter, the insurer's agent told plaintiff, in response to an inquiry, "That's all right, you can pay

15. *Id.* at 607-08, 23 N.W.2d at 865.
16. 64 N.D. 213, 251 N.W. 852 (1933).
17. *Id.* at 217, 251 N.W. at 854. This construction is approved and followed in McVay v. Mutual Ben. Health & Accident Ass'n, 26 F. Supp. 208 (N.D. Okla. 1939), construing a similar Oklahoma statute.
18. 67 N.D. 77, 269 N.W. 845 (1936), which is also reported at a later stage of litigation at 69 N.D. 456, 287 N.W. 813 (1939).

it this fall." A fire thereafter caused substantial loss. It was held that in view of the notice the company had given, the agent lacked authority to extend the time of payment. The court stated the section "specifies what constitutes an agent; but does not purport to define the extent of his powers . . . . The agent has only such authority as the principal actually or ostensibly confers upon him."[19]

As between these two divergent theories of the operation of the statute, it seems probable that the cases taking what may be termed the "broad" view of the agent's power must be considered generally controlling. Both the *Kopald* and *Meyer* decisions involved situations in which actual knowledge of limitations placed on the power of insurance agents by the home office was brought home to the claimant.[20] Hence it would seem they are not authority in other types of situations where such notice is not to be imputed. In a careful consideration of the problem in 1950, the Eighth Circuit Court of Appeals came to the conclusion the broader reading of the statute found in the *Anderson* and *Ulledalen* opinions represented the prevailing law of North Dakota.[21]

In this view of the matter, a number of inquiries suggest themselves. The most fundamental concerns the breadth and extent of the authority enjoyed by a man who is an agent "to all intents and purposes." Logically related to this question is the further problem of determining exactly which chapters of the Code regulate and define the agent's status. It may be asked, for example, whether the statutes dealing with the general topic of agency apply to the narrow subject of the insurance agency, or whether the insurance agent's authority is to be measured solely by the yardstick of the "intents and purposes" clause found in the Insurance chapters. Put

19. 67 N.D. at 84, 269 N.W. at 849.

20. In addition to the decisions mentioned in the text, a number of other North Dakota cases also assert, by dictum or otherwise, the proposition that limitations on the agent's authority of which a claimant has notice are binding upon the claimant. See Ulledalen v. United States Fire Ins. Co., 74 N.D. 589, 23 N.W.2d 856 (1946), syll. ¶3; Anderson v. Northwestern Fire & Marine Ins. Co., 51 N.D. 917, 926, 201 N.W. 514, 517 (1924); Michigan-Idaho Lumber Co. v. Northern Fire & Marine Ins. Co., 35 N.D. 244, 160 N.W. 130 (1916); Johnson v. Dakota Fire & Marine Ins. Co., 1 N.D. 167, 45 N.W. 799 (1890). *Johnson v. Dakota Fire & Marine Ins. Co., supra,* is particularly noteworthy in this respect. An insurance company's agent inserted false statements in an application for hail insurance, knowing of their falsity. The Court declared that the agent had power to fill out the application, and the limitations on his authority not communicated to the applicant could not bind the applicant. But it was also held that the applicant was conclusively presumed to know the contents of the policy and of the application. The applicant's silence, knowing of such false statements, constituted participation in the fraud of the agent and rendered the policy void from its inception. The applicant had a duty to notify the company. However, the insurer was held to have waived the fraud on other grounds. The scope of the *Johnson* case, however, is materially narrowed in Leisen v. St. Paul F. & M. Ins. Co., 20 N.D. 316, 127 N.W. 837 (1910).

21. Fargo Nat. Bank v. Agricultural Ins. Co., 184 F.2d 676 (8th Cir. 1950).

in more precise form, the inquiry becomes whether the agent's authority is wholly statutory in character and thus derived exclusively from N.D. Rev. Code § 26-0702 (1943), or is actual or ostensible in character as those terms are defined in N.D. Rev. Code § 3-0202 (1943).

Difficulties arise no matter which of these alternatives is suggested as the sole test. In the *Anderson* case, *supra,* which is the strongest decision in support of the broad view of the insurance agent's powers, the Court came very close to determining the scope of the agent's authority under the "intents and purposes" clause by equating it with the full breadth of the corporate powers possessed by the insurance corporation which employs him. "It can not be doubted that *the company itself had the power to contract with the plaintiff* . . . at the same premium and on the same condition as provided in the original policy, and to agree that that instrument should stand as the measure of the rights of the parties. *It is difficult to escape the conclusion that Kavanaugh, as agent of defendant 'to all intents and purposes,' likewise had the power to enter into such a renewal contract and bind his principal,* at least in the absence of any knowledge in plaintiff upon the authority as between the agent and the defendant, and that the jury might have so found."[22]

It is, of course, possible to criticize such a construction of the statute on a number of policy grounds. If followed logically to its ultimate conclusions, this view would virtually obliterate all attempts by the insurer to preserve meaningful distinctions in rank and authority among its various officers and employees. From the standpoint of the claimant, assuming he can meet the procedural burden of showing the existence of an oral agreement by competent evidence,[23] it appears to make every insurance salesman the equivalent of a home office and validates the old maxim that ignorance is bliss. It equally runs roughshod over the proposition that the terms of the contract of appointment can qualify or limit the agent's

22. Anderson v. Northwestern Fire & Marine Ins. Co., 51 N.D. 917, 926, 201 N.W. 514, 517 (1924).

23. The burden of proving the extent of the agent's authority is said to rest on the moving party. Meyer v. National Fire Ins. Co., 67 N.D. 77, 84, 269 N.W. 845, 849 (1936); Corey v. Hunter, 10 N.D. 5, 84 N.W. 570 (1900). It seems probable the proof of the oral contract should identify the parties, specify the rate of premium, identify the life or property or risk which is insured, the nature of the insured's interest, and the period during which the insurance is to continue. These are the requisites of a written contract under N.D. Rev. Code § 26-0301 (1943), and would seem to indicate the essential elements of an oral contract as well. The evidentiary problems involved in proving the agent's authority by his own statements are considered in Kopald Electric Co. v. Ocean Acc. & Guarantee Corp., 64 N.D. 213, 251 N.W. 852 (1933). See also N.D. Rev. Code § 3-0208 (2) (1943).

authority, in the absence of notice to the persons with whom the agent deals of limitations on the agent's power. But if the statute intends this result, such arguments become irrelevant from the standpoint of adjudication. The conclusion that members of the public ought to be protected against technicalities of which they have no knowledge when purchasing insurance is one a legislature might reasonably reach, and there seems no constitutional objection to it if the agent's authority is viewed as entirely statutory in its origin.

The difficulty with accepting the idea the agent's authority has an exclusively statutory base lies instead in the qualification the Court has repeatedly and consistently made in the doctrine. If the applicant for insurance knows the agent lacks power to perform an act on behalf of his company, he is bound by that notice. Manifestly, this last proposition is inconsistent with a wholly statutory theory of the insurance agency, since it would otherwise amount to saying that the coverage of a statute enacted for protection of the public could be narrowed by private agreement.[24]

However, if one takes the opposite track and argues that the general statutes regulating the topic of agency are also applicable to the special case of the insurance agent, a measure of difficulty is likewise encountered. The Code declares that: "An agent has such authority as the principal actually or ostensibly confers upon him. Actual authority is such as a principal intentionally confers upon the agent or intentionally or by want of ordinary care allows the agent to believe himself to possess. Ostensible authority is such as the principal intentionally or by want of ordinary care causes or allows a third person to believe the agent to possess."[25]

Within the meaning of that definition it should be apparent the insurance agent's authority to bind his company by oral agreement is rarely of an actual character. In virtually every case the agreement between company and agent enunciates in detailed fashion the things the agent is not authorized to do and the application and policy contain similar provisions. The insurance company which would voluntarily yield to its solicitors the sweeping powers conferred on them by the case law would be a rare and noteworthy institution. The idea that the insurance agent's authority is of an actual or consensual character is thus by far the least attractive of the various possibilities.

24. See N.D. Rev. Code § 1-0228 (1943).

25. N.D. Rev. Code § 3-0202 (1943). Note that the question of ostensible *authority* should be carefully distinguished from the question of ostensible *agency*. The latter subject is regulated by N.D. Rev. Code § 3-0103 (1943).

Then is the authority of the agent wholly ostensible in its nature? The fact the Court regards limitations on the agent's power as binding when the claimant knows of them is certainly consistent with this point of view, and at times the Court has used express language indicating reliance upon the ostensible authority idea. In *Weber v. United Hardware & Implement Mutuals Co.*,[26] an insurance agent made representations to a policyholder which led him to settle a claim against third parties for less than its value. The insurer then attempted to repudiate liability to the policyholder for the balance of the claim on the ground the settlement had destroyed its right of subrogation. It was held the insurer was bound by the agent's representations. "The defendant had given him ostensible if not actual authority for those statements."[27]

Yet even here serious problems arise. In most instances the authority of the insurance agent does not fit comfortably into this particular statutory mold. Under the Code ostensible authority is present only in two situations: where the principal has intentionally or by want of ordinary care allowed a third party to believe in its existence.[28] Few insurers intentionally assert to applicants a sweeping authority vested in their agents; and it is difficult to see how an insurer can be charged with negligence when it carefully prescribes the duties of its agent by contract and in the normal case inserts in applications the express warning that the agent lacks power to alter or change the terms of the policy. That the existence of such ostensible authority cannot be ascribed to the statements of the agent himself is equally apparent; for the Code further provides that an agent lacks authority to make representations as to the terms of his own authority, though it qualifies this by permitting the agent to make representations as to matters of fact on which his right to use his authority depends.[29] Even here, however, the

26. 75 N. D. 581, 31 N.W.2d 456 (1948). Another case involving the question of ostensible authority on the part of insurance agents is Fargo Nat. Bank v. Agricultural Ins. Co., 184 F.2d 676 (8th Cir. 1950). The state agent of an insurance company sold forged premium finance contracts to a bank and used the money for his own purposes. When the forgery was discovered, the bank sued the insurance company to recoup the loss on the ground the agency had been one "to all intents and purposes," and the agent's had been within the scope of his ostensible authority. It was held the agent lacked actual authority. It was further held the bank had been negligent, and that such negligence barred the action under N.D. Rev. Code § 3-0303 (1943): "A principal is bound by acts of his agent under a merely ostensible authority to those persons only who in good faith *and without ordinary negligence* have incurred a liability or parted with value upon the faith thereof." (Emphasis supplied).

27. Weber v. United Hardware & Implement Mutuals Co., 75 N.D. 581, 592, 31 N.W.2d 456, 461 (1948).

28. N.D. Rev. Code § 3-0202 (1943).

29. N.D. Rev. Code § 3-0202 (1943) provides that an agent has authority "to make a representation respecting any matter of fact, not including the terms of his authority, but upon which his right to use his authority depends and the truth of which cannot be

person to whom representations are made is under a duty to use reasonable diligence to ascertain the truth of the agent's statements.[30]

The conclusion which suggests itself is that the authority of the insurance agent, as the cases have developed it, is neither entirely statutory, entirely ostensible, nor entirely of an actual character. It appears to be based on a freehand adaptation of all three theories tailored by the Court to fit the needs of the litigation before it, transcending at times the precise terminology of the statutes.

III.

WAIVER AND ESTOPPEL

Whatever may be the ultimate conclusion reached as to the theoretical source of the insurance agent's authority, however, it's practical and immediate applications deserve some consideration. As already noted, the agent possesses authority to orally renew a contract about to expire, can renew it orally after it has expired, and can make a binding oral contract of insurance on behalf of his company even prior to the submission of a written application.[31]

Equally, he possesses a broad general power to waive conditions and provisions of the policy, and his actions may in many situations bind the company on a theory of estoppel. Probably the earliest case on this point in this jurisdiction is *Waterbury v. Dakota Fire & Marine Ins. Co.*,[32] in which an insurance agent, filling out an application, falsely stated that the pipes and chimneys of a house were in a safe condition. "Even if the statement could, from its nature, be considered as material," declared the Court, it would seem that the company could not avoid the policy on that account, as it would be estopped from claiming that to be material which their agent has, in effect, declared to be immaterial. It is too well settled to be now questioned that the company, or its agent acting within the scope of his authority, may waive any of the conditions of the policy, and if at the time of issuing the policy the company or such agent knows the falsity of a representation made by the applicant in procuring the insurance, the company is estopped from asserting its falsity in order to avoid liability."[33]

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determined by the use of reasonable diligence on the part of the person to whom the representation is made."

30. See note 29, *supra*. *But cf.* Leisen v. St. Paul F. & M. Ins. Co., 20 N.D. 316, 127 N.W. 837 (1910).

31. See materials cited in note 15, *supra*.

32. 6 Dak. 468, 43 N.W. 697 (1889).

33. *Id.* at 478, 43 N.W. 700-01. Of course it should be noted that in the event an insurance agent knowingly disregards instructions given him by his principal, he may be held liable to the principal for the resulting loss. Queen City Fire Ins. Co. v. First National Bank, 18 N.D. 603, 120 N.W. 545 (1909).

This is a line of reasoning which has been subsequently followed with considerable consistency. In *Leisen v. St. Paul F. & M. Ins. Co.*,[34] plaintiff applied for fire insurance. Defendant's agent negligently described plaintiff's interest in the property as ownership in fee when making out the written application. In fact plaintiff owned a lesser interest. The policy contained a stipulation it was void if the insured had less than sole and unconditional ownership. It was held the insurer had knowledge of the true facts when it issued the policy, since the knowledge of the agent was imputed to the principal. Hence the insurer was estopped to deny liability. Similarly, in *French v. State Farmers Mutual Hail Ins. Co.*,[35] an insurance agent filled out an application for hail insurance on behalf of the plaintiff but erroneously misdescribed the applicant's land, with the result the policy as issued covered land the applicant did not own. It was held a contract of insurance was present and that recovery might be had on it.

The power of waiver established by this line of cases is not limited to provisions of the application for insurance, but extends to the terms and conditions of the policy as well. In *McDowell v. Firemen's Fund Ins. Co.*,[36] a fire insurance policy contained a provision rendering it void if the insured house remained vacant more than ten days. The policy also provided none of its terms might be waived by any agent of the company. The policyholder vacated the house but informed the insurance agent of his action. The agent said it was all right and would not make any difference. Two months later the house, which was still unoccupied, burned down. The company argued that by the terms of the policy the agent lacked power to waive the non-vacancy provision. The Court's response was that the agent had power to waive the non-waiver stipulation as readily as anything else contained in the policy, and had in fact done so. Much the same result was reached in *Ley v. Home Insurance Co.*[37] Plaintiff owned a car insured by defendant. He mortgaged the car to one Collins, but before doing so asked defendant's agent if it was all right, and received an affirmative answer. It was held this was an effective waiver of an unconditional ownership clause.

Waiver is defined in the North Dakota decisions as the "voluntary and intentional relinquishment or abandonment of a known exist-

34. 20 N.D. 316, 127 N.W. 837 (1910).
35. 29 N.D. 426, 151 N.W. 7 (1915).
36. 49 N.D. 176, 191 N.W. 350 (1922).
37. 64 N.D. 200, 251 N.W. 137 (1933).

ing right, advantage, benefit, claim or privilege which except for such waiver the party would have enjoyed."[38] It results from an "unequivocal act of the insurer . . . indicating an intention to waive a right."[39] Under this definition, waiver is, of course, not limited merely to acts of insurance solicitors. One common instance where the attorney himself may waive the defense of non-liability of the insurer under the terms of the policy, or even the non-existence of a policy, occurs when he undertakes to defend, on behalf of an insurance company, a claim brought by a third party against a person who is purportedly a policy holder in the company. The general rule is that where an insurance company undertakes to defend a claim, it thereby waives the right to deny that a policy of insurance ever existed.[40] The existence of this rule has brought about a general practice on the part of insurance companies. Normally before going into court in defense of a policy holder, they either enter into an agreement with the policy holder to the effect that their act in defending is not to be construed as a waiver,[41] or if such a non-waiver agreement can not be obtained, give notice to the same effect.[42] Either method seems equally effective.

Another common trap which deserves at least a passing mention in this connection involves offers of settlement. Assume that an insurance company undertakes to defend a person who is a policyholder, and that the adverse party makes an offer of settlement which a reasonable person would accept. In numerous jurisdictions —quite possible a majority—it has been held that negligent failure to settle a claim renders the insurer liable not merely to the extent of the policy coverage but to the full amount of the ultimate verdict.[43] However, it should be mentioned that an extremely strong minority view declines to impose such liability on an insurer merely for negligent failure to settle, and requires a finding of bad faith on the part of the insurer instead.[44] Whether North Dakota will

38. Sjoberg v. State Auto Ins. Ass'n of Des Moines, 78 N.D. 179, 48 N.W.2d 452 (1951), Syll. ¶ 2.

39. *Id.* at 189, 48 N.W.2d at 457.

40. See United States Fidelity & Guarantee Co. v. Grundeen, 138 F.Supp. 498, 502-03 (D.N.D. 1956), *aff'd*, 238 F.2d 750 (8th Cir. 1956).

41. General Acc. Fire & Life Assur. Corp. v. Mitchell, 259 P.2d 862 (Colo. 1953); Insurors Indem. & Ins. Co. v. Archer, 208 Okla. 57, 254 P.2d 342 (1953); Schmierer v. Mercer, 67 S.D. 639, 297 N.W. 682 (1941).

42. Hardware Mut. Cas. Co. v. Higgason, 175 Tenn. 357, 134 S.W.2d 169 (1940); Connally v. Standard Cas. Co., 76 S.D. 95, 73 N.W.2d 119 (1955); Fidelity & Cas. Co. of New York v. Stewart Dry Goods Co., 208 Ky. 429, 271 S.W. 444 (1925).

43. See general discussion in 8 Appleman, Insurance Law and Practice § § 4711-4713 (1942).

44. Probably the best recent case on the point is Brown v. Guarantee Insurance Company, 155 Cal. App. 679, 319 P.2d 69 (1957), in which the negligence test is rejected. But see discussion in Appleman, *op cit. supra* note 43, at § 4711.

adopt the negligence test or the bad faith test in this connection seems still an open question. There are solid arguments in favor of either view.

IV.

DELAY IN ACTING ON APPLICATION

Still another theory on which recovery has been permitted without issuance of a policy is that of negligent delay in acting on the application for insurance. The earliest local case dealing with this type of liability is *Stearns v. Merchants Life & Casualty Co.*[45] Stearns applied for an accident insurance policy on October 2, 1911, paying a $5 premium at the time of his application. He was given a receipt in which the company agreed to return his money if a policy was not issued in 20 days. The application contained the customary provision that it was not binding until accepted by the company. For unknown reasons—probably the delay of the insurance agent—the application was not received at the home office until 29 days later. By that time, Stearns had already been involved in an accident. Ignorant of this fact, the company accepted the application and mailed a policy. When it learned of the accident it denied liability. The Court ruled, however, that Stearns was covered when the accident took place. It held that in view of the stipulation in the receipt to the effect the company had 20 days in which to act on the application, a failure to act simply put the contract into force anyhow.

Thereafter a number of other states reached results going considerably beyond the *Stearns* decision and imposing liability upon insurers for negligent delay in acting on applications, even in the absence of such an agreed time limit. As early as 1925 the North Dakota Court indicated by way of a dictum its approval and acceptance of this line of authority.[46] But it was not until 1940 that the theory of liability for negligent delay was written firmly and unequivocally into the law of this state in a carefully considered and exhaustively documented opinion.

The case was *Bekken v. Equitable Life Assur. Soc.*,[47] which involved the following set of facts. On June 1, 1934, Oscar Bekken filed a written application for a policy of insurance with the North Dakota agent of a foreign insurance company. On June 26, 1934,

45. 38 N.D. 524, 165 N.W. 568 (1917). For a sharp criticism of the action for negligent delay, see Prosser, *Delay in Acting on an Application for Insurance*, 3 U.Chi.L.Rev. 39 (1935). See also Funk, *The Duty of an Insurer to Act Promptly on Applications*, 75 U.Pa.L.Rev. 207 (1927).

46. *In re* Coughlin's Estate, 53 N.D. 188, 194, 205 N.W. 14, 16 (1925).

47. 70 N.D. 122, 293 N.W. 200 (1940).

a total of 25 days later, the company had neither accepted nor rejected the policy. Bekken was killed in an accident on that date. His widow filed suit against the company for the face value of the policy he had applied for. The insurer contended that since the application had never been accepted no contract of insurance existed and it was accordingly not liable.

The Supreme Court made the following statement in disposing of the case:

"There is a conflict in the authorities as to whether legal obligations arise only after a contract of insurance has been made, or whether in certain circumstances a legal duty arises, from the relationship created during the negotiations between an applicant for insurance and the insurance company, to act promptly upon the application, and to inform the applicant whether the offer is accepted or rejected. Generally speaking, there are two main lines of decisions dealing with these questions. According to one view, the legal relations between an applicant and the insurance company 'are fundamentally the same as those between parties negotiating any other contract, and are purely contractual;' that 'mere delay, mere inaction by an insurance company in passing on an application does not constitute an acceptance or establish the relationship of insurer and insured,' and that such delay or inaction does not constitute any breach of duty by the insurance company. . . .According to this view, no duty arises unless, and until, a contract has been created; if there is no contract, there is no duty, and consequently there is no liability on the part of the insurer because of any delay or inaction on its part in passing upon the application, or in issuing or delivering the policy . . .

"The other line of decisions holds that an insurance company that has solicited and received a completed application for insurance is under a legal duty to take prompt action on the application, and give prompt notice to the applicant of its action; and that consequently such insurance company is liable in tort for negligent delay in acting upon the application and notifying the applicant in case the application is rejected. . . .In our opinion this latter line of decisions announces the correct principle."[48]

The Court then ruled that the evidence was sufficient to make it possible for a jury to find the insurer had been guilty of negligent delay, and held in favor of the widow. In 1952, it applied the same principle to allow recovery where a doctor's error in report-

48. *Id.* at 136-38, 293 N.W. at 209-10.

ing the results of an insurance examination also caused an unreasonable delay during which the applicant died.[49]

While the idea that a party may be held to have committed a tort by failing to enter into a contract is in some respects a striking one, the cases cited indicate that it is at present firmly established as a part of the jurisprudence of North Dakota. Several points are apparent with regard to it. It is obvious, for example, that the action for negligent delay differs sharply in its fundamental characteristics from actions based on oral agreements by insurance agents or actions based on a theory of waiver or estoppel. The latter cases affirm the existence of a contract under which a right of recovery exists, while the gist of the action for negligent delay is found in the proposition that the tort of the insurer has prevented a contract from being formed, thereby proximately causing the applicant to sustain a loss because except for the insurer's negligent conduct he would have been covered by insurance. The agency and estoppel cases thus assert the contract, while the action for negligent delay is premised on its non-existence.

The tort arises from a breach of the duty of promptness which the Court has imposed on insurers by reason of the nature and characteristics of the insurance business. One may ask, therefore, to whom the duty of promptness runs. By whom can it be enforced?

Quite clearly, the applicant himself can enforce it, since the insurer has solicited his application and thereby assumed the "special relationship" toward him from which the Court has held the duty of promptness arises. Equally, the estate of the applicant obviously is entitled to maintain the action, since any claim against the insurer possessed by the applicant would survive his death.[50] And it has been held that the beneficiary designated by the applicant in his application may maintain such an action, both on the theory he is a third-party beneficiary of a contract made for his benefit and on the ground he is the real party in interest.[51]

Beyond this circle, however, the right to maintain the action becomes considerably more dubious. Toward third parties who have submitted no application and have no part in the insurance transaction the insurer has assumed no duty and made no representations. In the case of liability insurance, in fact, the insurer's position toward anyone but the policy applicant is manifestly adverse from its inception, since the insurer is bound to defend the insured

49. Mann v. Policyholders Nat. Life Ins. Co., 78 N.D. 724, 51 N.W.2d 853 (1952).
50. N.D. Rev. Code § 28-01261 (Supp. 1957); Note, 27 N.Dak.L.Rev. 208 (1951).
51. Bekken v. Equitable Life Assur. Soc., *supra*.

person in any action asserting his liability.[52] Hence it seems apparent that as to third parties the action for negligent delay must be deemed derivative at best; they are not entitled to recover against the insurer for negligent delay unless the applicant himself would be so entitled, and even then it is apparent some sort of formal transfer or assignment of the claim must be made from the applicant to the third party.[53] Otherwise the insurer might be exposed to a double liability.

Under the present holdings, the duty of the insurer is one of *reasonable* promptness under the facts and circumstances of the particular case. North Dakota has enacted no statute defining the time period within which the insurer must act except in the case of hail insurance, which becomes automatically effective 24 hours after application for it is made. Cases in other jurisdictions indicate that an insurer is reasonably safe if it acts within a two-week period or slightly longer,[54] but this is a flexible matter about which few generalizations may be made with safety. In the *Bekken* case, as already noted, 25 days was deemed sufficient to allow the inference of negligence. Where the time is used by the insurer in a good faith effort to investigate the suitability of the risk, there are cases holding no unreasonable delay may be inferred.[55]

Since the negligent delay cases involve a tort arising from breach of a duty of reasonable promptness, it seems apparent that the insurer, like any other defendant charged with negligence, possesses the right to plead contributory negligence and assumption of risk on the part of the plaintiff as defenses. Thus, assuming a case in which delay has occurred in passing on an application for life insurance, it seems likely the insurer would be excused in the event the applicant's own negligence was the proximate cause of his death. The court in the *Bekken* case made the point that Bekken himself was not at fault with regard to his fatal accident.[56] Where the applicant is not an insurable risk, it is obvious no amount of delay on the part of the insurer could conceivably be the proximate

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52. See N.D. Rev. Code § 22-0207 (4) (5) (1943).

53. Brown v. Guarantee Insurance Co., 155 Cal.App. 679, 319 P.2d 69 (1957).

54. Burks v. Colonial Life & Accident Ins. Co., 192 F.2d 643 (5th Cir. 1951); Behnke v. Standard Acc. Ins. Co., 41 F.2d 696 (7th Cir. 1930); Winn v. John Hancock Mut. Life Ins. Co., 216 Iowa 1249, 250 N.W. 459 (1933); Page v. National Automobile Ins. Co., 109 Neb. 127, 190 N.W. 213 (1922).

55. McLendon v. Woodmen of World, 106 Tenn. 695, 64 S.W. 36 (1901); Shawnee Mut. F. Ins. Co. v. McClure, 39 Okla. 535, 135 Pac. 1150 (1913); Zielinski v. General American Life Ins. Co., 96 S.W.2d 1059 (Mo.App. 1936).

56. Bekken v. Equitable Life Assur. Soc., 70 N.D. 122, 124, 293 N.W. 200, 203 (1940).

cause of loss, and the cases uniformly allow the insurer to set up this defense.[57]

V.

CONCLUSION

In this brief examination of a few local cases the writer has not attempted to draw any profound conclusions, but merely to present a summary of the existing state of the North Dakota law. If suggestions as to change in this field were in order, however, one might suggest the desirability of establishing a definite time limit for acceptance or rejection of an application by an insurance company, on the ground that the present rules leave it a matter of doubt and conjecture whether in a given case the insurer has breached the duty of promptness. They thus benefit neither insurer nor applicant. Equally, a more precise definition of the powers of insurance agents might readily lend itself to legislative consideration.

57. Behnke v. Standard Acc. Ins. Co., 41 F.2d 696 (7th Cir. 1930); Smither v. United Ben. Life Ins. Co., 164 Kan. 447, 190 P.2d 183 (1948); Thomas v. Life Ins. Co. of Georgia, 219 La. 1099, 55 So.2d 705 (1951).

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