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Enforceability Of Temporary Binders Issued By Life Insurance Companies - Simpson v. Prudential Insurance Co. of America

J. Frederick Sharer

Enforceability Of Temporary Binders Issued By Life Insurance Companies

Simpson v. Prudential Insurance Co. of America[1]

At the solicitation of an agent of defendant insurance company, plaintiff and her husband decided to take out a policy on his life. The husband executed the non-medical part of the application, and upon being told by the agent that "When you give me the check for a payment on this insurance, you are covered. When I receive your check, you are covered as of then," he drew a check, payable to the insurance company, for the first annual premium. The check was cashed by the company the next day. Subsequently, the husband was given a physical examination by a physician selected by the insurance company. The results of the examination were satisfactory, except that a "trace" of sugar was found in the urine. In such a case, the application required that a sample of the urine tested

[1] 227 Md. 393, 177 A. 2d 417 (1962).

be sent to the home office of the company, which was done. The analysis showed .16% of glucose and the company requested the examining physician to complete a glucose tolerance test on plaintiff's husband. Before this could be done, plaintiff's husband was killed in an automobile accident. Several days later a representative of the insurance company visited plaintiff and tendered her a refund of the premium already paid, telling her that her husband had not passed the physical examination and that the company, which knew of her husband's death, denied any additional liability. Plaintiff brought an action to recover under the policy as named beneficiary. The trial court granted the insurance company's motion for a directed verdict. The Court of Appeals found that a contract of insurance did arise as a result of the premium paid by plaintiff's husband and the receipt given him by the company,[2] but remanded the case for a new trial on the issue of whether plaintiff's husband met the standard of insurability set by the insurance company.

The type of receipts in question — which have become known as "binding slips" or "binders" — have been the basis of much litigation.[3] Binders are given by insurance companies when the application for insurance is accompanied by a partial or full payment of the premium and usually contain language to induce such payment in advance of acceptance.[4] As the receipt normally provides that the amount paid is non-refundable in the absence of a rejection of the application, the insurer can be fairly

[2] The receipt provided, in part, that:

"[I]f the required and completed Part 1 and the required and completed Part 2 of the application and such other information as may be required by the Company are received by the Company at one of its Home Offices and if the Company after the receipt thereof determines to its satisfaction that the proposed insured was insurable on the later of the dates of said Parts 1 and 2 on the plan, for amounts, for the benefits and at the premium rate applied for, the insurance in accordance with and subject to the terms and conditions of the policy applied for shall take effect as of the later of the dates of the required and completed Parts 1 and 2." *Id.*, 397.

[3] Mutual Fire Insurance Co. of Montgomery County v. Goldstein, 119 Md. 83, 86 A. 35 (1912). See generally: 2 A.L.R. 2d 943 (1948); CARNAHAN, CONFLICT OF LAWS AND LIFE INSURANCE CONTRACTS (1942), § 35; Comment, *Binding Insurance Receipts: Rights and Liabilities Arising Thereunder*, 25 Fordham L. Rev. 484 (1956); Comment, *Operation of Binding Receipts in Life Insurance*, 44 Yale L.J. 1223 (1935).

[4] Schwartz v. Northern Life Ins. Co., 25 F. 2d 555 (9th Cir. 1928); Seiderman v. Herman Perla, Inc., et al., 268 N.Y. 188, 197 N.E. 190 (1935); VANCE, INSURANCE (3d ed. 1951) § 40, p. 235:

"The binding slip is merely a written memorandum of the most important terms of a preliminary contract of . . . insurance, intended to give temporary protection pending the investigation of the risk by the insurer, or until the issue of a formal policy."

certain that the applicant will not withdraw from the transaction.

Binding slips may be classified generally into two types. One type, known as the "satisfaction" type, provides that if the insurer is satisfied that, on the date of application (or medical examination, whichever is specified in the application) the applicant was an insurable risk, the insurance will take effect from that date.[5] The instant case falls within this classification.[6] The second type of binding slip, known as the "approval" type, provides that the application must be approved by the home office and that, if such approval is given, insurance will take effect as of the date of the application.[7] A third type of binding slip, rarely used by life insurance companies, is that which provides for unconditional temporary insurance regardless of applicant's insurability.[8]

The satisfaction type of binding slip presents few problems, for all that need be shown to recover on the policy is that the applicant was insurable on the date of application. The death or change in physical condition of the applicant prior to acceptance of the application will have no bearing in a suit for recovery under the policy if he was insurable on that date.[9]

The approval type of building slip, however, is troublesome in that approval by the insurer is made a condition precedent, and there can be no contract of insurance until such approval is given.[10] Even if the applicant was insurable at the date of the application, which would provide him coverage under the satisfaction type, a subsequent change in his condition prior to approval would result in the rejection of the application. Meanwhile, the insurer has had the benefit of the use of applicant's money during the period between application and rejection. Should the

[5] Wolfskill v. American Union Life Ins. Co., 237 Mo. App. 1142, 172 S.W. 2d 471 (1943); Duncan v. John Hancock Mutual Life Ins. Co., 137 Ohio St. 441, 31 N.E. 2d 88 (1940); Stonsz v. Equitable Life Assurance Soc. of the U.S., 324 Pa. 97, 187 A. 403 (1936); 2 A.L.R. 2d 943, 986-87 (1948). *Cf.* Maddox v. Life & Casualty Ins. Co. of Tennessee, 79 Ga. App. 164, 53 S.E. 2d 235 (1949) and Summers v. Prudential Insurance Co. of America, 337 S.W. 2d 562 (Mo. 1960).

[6] *Supra*, n. 1, 402.

[7] Gaunt v. John Hancock Mutual Life Ins. Co., 160 F. 2d 599 (2d Cir. 1947), concurring opinion; CARNAHAN, CONFLICT OF LAWS AND LIFE INSURANCE CONTRACTS (1942) § 35.

[8] VANCE, INSURANCE (3d ed. 1951) § 40.

[9] Comment, *Binding Insurance Receipts: Rights and Liabilities Arising Thereunder*, 25 Fordham L. Rev. 484, 485 (1956).

[10] Gaunt v. John Hancock Mutual Life Ins. Co., 160 F. 2d 599 (2d Cir. 1947).

risk be accepted, the insurer would have collected a premium for a period during which there was no risk.[11] Thus, when an applicant receives this type of binder he gets, in effect, nothing in return for the payment that he has made.

The law of insurance binders is unsettled,[12] and few principles can be stated. Those cases which hold that the binding slip does not constitute a contract of insurance, and deny recovery on the policy, do so on the strict rules of contract law.[13] In the instant case, the Maryland Court had no difficulty in finding that a contract of insurance did exist, stating that "the receipt itself clearly undertakes to express some obligations of the insurance company itself."[14] Furthermore, "the payment in advance of the premium constituted consideration for whatever obligations the company assumed under the terms of its receipt."[15]

The leading and most often cited case in support of the holding that no insurance is effected by a binding slip is *Insurance Co. v. Young's Administrator*.[16] In that case, however, the finding that there was no contract of insurance was based upon the fact that the insurer rejected the application and sent applicant a different policy, which applicant did not accept. This amounted to a rejection by applicant of a counter-offer. Thus, the effect of death or a change in applicant's physical condition prior to acceptance was not considered.

In *Olson v. American Central Life Ins. Co.*,[17] approval was said to be a condition precedent to the formation of a contract of insurance. A more elementary approach was taken in *Braman v. Mutual Life Ins. Co.*,[18] where the court looked upon the application for insurance as an offer which is revoked by applicant's death prior to approval.[19]

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[11] Liberty National Life Ins. Co. v. Hamilton, 237 F. 2d 235, 237 (6th Cir. 1956).

[12] *Supra*, n. 10, 602.

[13] 2 A.L.R. 2d 943 (1948).

[14] *Supra*, n. 1, 399.

[15] *Id.*, 403.

[16] 23 Wall. 85, 106 (U.S. 1875): "The entire subject [acceptance or rejection of the application] was both affirmatively and negatively within its [insurance company's] choice and discretion." This statement was construed in Mohrstadt v. Mutual Life Ins. Co., 115 F. 81, 84 (8th Cir. 1902), to mean that "a receipt in such a form is not an absolute assumption of a risk temporarily . . . but . . . it is a qualified acceptance; the risk taking effect only in the event that the application is accepted. . . ."

[17] 172 Minn. 511, 216 N.W. 225, 227 (1927).

[18] 73 F. 2d 391 (8th Cir. 1934).

[19] *Id.*, 397: "The application for insurance . . . was in effect an offer which was revoked by the death of the applicant [offeror]. . . ." See also

A case placed on the ground of offer and acceptance cannot be easily disputed in situations where approval is required to render the insurance operative. But even this approach appears unsatisfactory where the requirement is that the applicant be insurable at the date of application and he is in fact insurable at that time, for the insurer has reserved the power to reject the application only if it is not satisfied that, on the date of application, applicant was not insurable. To have a defense to a suit on the policy where applicant dies prior to the issuance of a policy, the insurer must in good faith show that it was dissatisfied.[20]

It is on this point that the instant case was remanded for a new trial, the Court stating that "the question of insurability is of controlling importance. . . ."[21] Whether or not applicant was insurable as required by the application goes to the basis for the insurer's dissatisfaction. The Court said "that the clause [requiring applicant to be insurable on the plan, for the amount, for the benefits and at the premium rate applied for] means that the applicant must meet an objective standard of insurability, and that this standard is the company's own standard for the plan . . . applied for. . . ."[22] Honest satisfaction is the standard usually applied under such circumstances.[23] Thus, where applications are rejected upon the insurer's discovery of applicant's death or change in physical condition, and on no other basis, public policy considerations require that the insurer should not escape liability.

Decisions denying recovery on the policy appear to be accompanied by certain inequities, in that by the language of the application the applicant may be misled into believing that he is insured, when he in fact is not covered. An

Boswell v. Gulf Life Ins. Co., 197 Ga. 269, 29 S.E. 2d 71 (1944); Smiley v. Prudential Ins. Co. of America, 321 Mich. 60, 32 N.W. 2d 48 (1948); Cheek v. Pilot Life Ins. Co., 215 N.C. 36, 1 S.E. 2d 115 (1939); RESTATEMENT, CONTRACTS (1932) § 35(f), p. 45.

[20] Comment, *Life Insurance Binding Receipts*, 33 Ill. L. Rev. 180, 184 (1938).

[21] *Supra*, n. 1, 405; Mofrad v. New York Life Ins. Co., 206 F. 2d 491 (10th Cir. 1953); Gonsoulin v. Equitable Life Assurance Society, 152 La. 865, 94 So. 424 (1922); Bearup v. Equitable Life Assur. Soc. of the U.S., 351 Mo. 326, 172 S.W. 2d 942 (1943); Raymond v. National Life Ins. Co., 40 Wyo. 1, 273 P. 667 (1929). For cases not requiring that applicant be insurable in order to give rise to a contract see: Ransom v. The Penn Mutual Life Insurance Company, 43 Cal. 2d 420, 274 P. 2d 633 (1954) and Life Ins. Co. of No. America v. DeChiaro, 68 N.J. Super. 93, 172 A. 2d 30 (1961), where applicant was not insurable under the plan applied for, but the insurer was held liable for the face value of the policy applied for.

[22] *Supra*, n. 1, 406.

[23] RESTATEMENT, CONTRACTS (1932) § 265, Comment (a), pp. 380-381.

attempt by several courts to correct these inequities has been a prime factor in decisions which have found that a contract was made, and that recovery on the policy should be permitted.

A leading authority in support of the view that a binding slip affords interim coverage is *Gaunt v. John Hancock Mut. Life Ins. Co.*[24] The *Gaunt* case exemplifies the "modern trend to hold [such] receipts . . . ambiguous and resolve the ambiguity against the insurer."[25]

The approach of the modern trend centers on the wording of insurance forms, particularly applications and receipts. The language used is quite often ambiguous and misleading to the layman, although understood by the soliciting agents of insurers who provide the forms. It is on this ground that many of the more recent cases have been decided against the insurance companies.[26] But it is the *Gaunt* case that takes the strongest stand in regard to the ambiguity of these forms to the layman. Judge Learned Hand wrote that such an application would "go to persons utterly unacquainted with the niceties of life insurance, who would read it colloquially."[27] Thus, "It is the understanding of such persons that counts. . . ."[28]

Judge Hand also gave a warning to the insurance companies, stating that "insurers who seek to impose upon words of common speech an esoteric significance intelligible only to their craft, must bear the burden of any resulting confusion."[29] He goes on to point out that "the canon contra proferentum is more rigorously applied in insurance than in other contracts, in recognition of the difference between the parties in their acquaintance with the subject matter."[30]

There is revealed a growing policy, where there are ambiguities present, to decide the cases on that ground rather than on the basis of simple contract law.[31] This

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[24] 160 F. 2d 599 (2d Cir. 1947).

[25] Life Ins. Co. of No. America v. DeChiaro, 68 N.J. Super. 93, 172 A. 2d 30 (1961).

[26] Liberty National Life Insurance Co. v. Hamilton, 237 F. 2d 235 (6th Cir. 1956); Gaunt v. John Hancock Mut. Life Ins. Co., 160 F. 2d 599 (2d Cir. 1947); Western and Southern Life Ins. Co. v. Vale, 213 Ind. 601, 12 Ind. 601, 12 N.E. 2d 350 (1938); Hart v. Travelers' Ins. Co., 258 N.Y.S. 711 (1932); 2 A.L.R. 2d 943 (1948).

[27] *Supra*, n. 24, 601.

[28] *Supra*, n. 24, 601.

[29] *Supra*, n. 24, 602.

[30] *Supra*, n. 24, 602. *Cf.* Penn., Etc., Ins. Co. v. Shirer, 224 Md. 530, 536, 168 A. 2d 525 (1961).

[31] *Supra*, n. 25; Comment, *supra*, n. 20.

would seem to be the best method of doing justice in such cases.

The most desirable result — in terms of alleviating some of the confusion which clouds the subject — would be to place the parties to insurance transactions on a more equal footing in their understanding of the subject matter by eliminating ambiguous and misleading phraseology. A move to simplify and clarify the language of forms is in order in light of the changing judicial attitude which construes the ambiguous language of the binder against the insurance company. Some advancement might have been expected in this area as a result of a survey taken of insurance executives several years ago. The results of that survey showed that, as between the two types of binders, the satisfaction type is favored.[32] But the cases illustrate the lack of any significant change in types of binders being used. It has also been suggested that the use of binding slips be limited to this type by statutory provision.[33] This seems essential in order to achieve any substantial and permanent clarification.

A second, but perhaps more drastic, solution would be to give soliciting agents the same authority possessed by general agents.[34] Accompanied by a change in operational procedures whereby the company would afford coverage from the date of application while reserving the power to *cancel* the policy should investigation show the applicant to be a bad risk, this change would put both parties in a position in which there could be little room for misunderstanding concerning coverage.[35]

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[32] Comment, *Operation of Binding Receipts in Life Insurance*, 44 Yale L.J. 1223, 1229-1230 and fn. 33. (1935).

[33] Comment, *supra*, n. 9.

[34] 5 MD. CODE (1957) Art. 48A, § 107(c):

"*A life insurance agent* is hereby defined to be any individual acting under written authority from a life insurance company . . . having authority . . . to solicit insurance for such company . . . but without the power or authority to issue or countersign policies or otherwise bind the company . . . for or through which he acts as soliciting agent."

29 Am. Jur. 585, Insurance, § 193:

"[A] soliciting agent with power to solicit, receive, and report applications has no power to accept them and make contracts of insurance. . . ."

[35] In terms of operational procedure, such a change would place life insurance companies on the same basis as casualty and property insurers. See the New York Standard Fire Insurance Policy, MCKINNEY'S CONSOL. LAWS OF N.Y. (1949), Art. 7, Insurance, § 168.

See Comment, *supra*, n. 20, 186, in which Professor Havighurst suggests that life insurance companies would "do well to adopt the receipt form providing for unconditional temporary insurance."