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Liability of a Life Insurance Company, After Settlement, in Respect of Claims Previously Undisclosed*

By JOSEPH O'MEARA, JR.†

When the time comes to make good on a life insurance policy, must the insurer bestir itself to ascertain whether there be outstanding interests, presently unknown to it, which, if asserted, it would ignore at its peril; or may it safely make payment without delay to the person entitled thereto according to its own records?

At Maturity

This question is encountered every time a policy matures. It is always open to a displaced beneficiary to contend that, in making the policy payable to another, the insured acted under duress or without sufficient mental capacity;¹ it is always possible that some act or transaction of the insured has given rise to an adverse interest. Must the company investigate? To do so would entail a heavy burden and put a brake on the prompt payment of claims to the disadvantage of policyholders generally, and this without any corresponding advantage sufficient to compensate for the delay, inconvenience and expense, for it may be assumed, I think, that in the great majority of cases the results of such inquiry would be negative.

The cases impose no such onerous conditions. In the absence of circumstances calling for inquiry no duty rests upon the insurer to search for undisclosed interests and possible adverse claims—settlement with the payee of record is a complete defense (1) as against a former beneficiary subsequently

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¹ For a Note on the cancellation of a change of beneficiary for mistake or incapacity of the insured, or fraud or undue influence on the part of the substituted beneficiary, see (1936) 50 HARV. L. REV. 136.

contending that the substitution of the successor beneficiary was accomplished by fraud or undue influence or that the insured was incompetent at the time;² (2) as against anyone claiming an interest, by assignment or otherwise, who does not give notice of his claim until after settlement has been made.³

Transactions before Maturity

The question is likewise present every time the insured invokes the provisions of his policy to obtain a loan or the surrender value, for (1) he may be incompetent, or (2) he may have pledged his policy or assigned it or contracted not to change the beneficiary.

1. Transactions of one mentally incompetent, while under guardianship, are almost uniformly regarded as void.⁴ Transactions entered into prior to adjudication of incompetency are likewise considered void in some jurisdictions and unconditionally voidable in others; but, according to the weight of authority, if fairly made by the other party, without notice of the incompetent's mental condition, executed transactions will not be set aside unless the *status quo ante* can be restored and an offer is made to restore it.⁵ There is, however, substantial authority for upholding executed transactions supported by an adequate consideration and entered into by the other party in

² State Life Ins. Co. v. Coffrini, 285 Fed. 560 (C.C.A. 3d, 1922); Metropolitan Life Ins. Co. v. Bramlett, 224 Ala. 473, 140 So. 752 (1932); see Bosworth v. Wolfe, 146 Wash. 615, 264 Pac. 413, 56 A.L.R. 1117 (1928).

³ Bennett v. Union Central Life Ins. Co., 220 Iowa 927, 263 N.W. 25 (1935); Shaw v. John Hancock Mut. Life Ins. Co., 120 Conn. 633, 182 Atl. 472 (1936); Immel v. Travelers Ins. Co., 373 Ill. 256, 26 N.E. (2d) 114 (1940); Kot v. Chrysler Corp., 293 Mich. 688, 292 N.W. 531 (1940); 7 COUCH, INSURANCE, Sec. 1867, pp. 6215-16; see Wannamaker v. Stroman, 167 S.Car. 484, 166 S.E. 621 (1932).

⁴ Acacia Mut. Life Ins. Co. v. Jago, 280 Mich. 360, 273 N.W. 599 (1937); see Note, *The Agreements of Insane Persons* (1932) 32 COL.L.REV. 504, 509. As to admissibility and probative force, on issue of mental condition, of evidence of adjudication of incompetency or insanity, or confinement in insane asylum, see Notes (1920) 7 A.L.R. 568, (1930) 68 A.L.R. 1309.

⁵ See Note (1932) 32 COL. L. REV. 504, 507; Notes (1927) 46 A.L.R. 416, (1935) 95 A.L.R. 1442.

good faith and without notice of the incompetency.⁶ This latter view is reflected in a number of recent cases to the general effect that an insurer is ordinarily under no duty to inquire into the competency of its insured and that a transaction respecting his policy, entered into in good faith and without notice of the insured's mental condition, cannot later be upset either by or on behalf of the insured or by any other claimant.⁷

These cases seem to me to be soundly based. In support of that opinion I call attention to the following considerations:

(a) When an insurance company makes a policy loan or pays out the surrender value, it does not enter into a contract which it is free to make or not as it pleases. On the contrary, in extending the loan or handing over the cash value it merely discharges a duty imposed upon it by the insured's exercise of a power acquired by him under the terms of his policy—acquired long since, in fact, for the policy must be at least two years old and very likely is much older.

(b) In practice this duty must be fulfilled by the insurer without inquiry into the mental state of its insured. As in the case of banks paying the checks of their depositors, there is no real opportunity for investigation. The business is too extensive and its volume too great. If it is to be transacted smoothly, economically and to the satisfaction of policyholders (who frequently need their money in a hurry) no more is feasible than a routine check of what appears on the surface.

(c) It is certainly pertinent, moreover, that the terms of the loan or surrender are not fixed by bargaining with the insured but are settled in the policy whose provisions, as regards these and other matters, must conform to statutory requirements. Accordingly, when an incompetent borrows on his

⁶ See Note (1932) 32 COL. L. REV. 504, 507; BRADY, BANK CHECKS (2d ed., 1926) Sec. 205.

⁷ *New England Mut. Life Ins. Co. v. Reynolds*, 217 Ala. 307, 116 So. 151, 59 A.L.R. 1075 (1928); *Williams v. Jefferson Standard Life Ins. Co.*, 187 S. Car. 103, 196 S.E. 519 (1938); *Equitable Life Assur. Soc. v. Welch*, 195 So. 554 (Ala., 1940); *cf. Walters v. Mutual Life Ins. Co.*, 64 Fed. (2d) 178 (C.C.A. 4th, 1933).

policy or turns it in for the cash value, he gets exactly the same as anyone else, neither more nor less; and he gets it by virtue of an antecedent unilateral contract under which he has no obligations.

These considerations, I submit, cannot reasonably be ignored; and there may be some ground for supposing they will exert an increasing influence in the future.

A large measure of protection is already afforded under the view currently prevailing in most jurisdictions which, as noted above, requires that the *status quo ante* must be restored. In these jurisdictions the danger of actual loss by the insurer is slight; although, of course, if the beneficiary is permitted to avoid the transaction after the insured's death,⁸ there may be an opportunity for second-guessing against the company.

2. The authorities leave no doubt that an insurer dealing in good faith with a competent insured will be protected against claims grounded upon prior acts or transactions of the insured, of which it had no notice.⁹ The insurer is likewise protected if, after paying the loan or surrender value to an assignee under an assignment absolute in form, it is claimed by the beneficiary that the assignment was for collateral purposes only.¹⁰

Summary of the Cases

On the whole the authorities thus far may be summarized in the words of Justice Shaw in *Immel v. Travelers Insurance Company*,¹¹ namely, that "the companies, in good faith, may

⁸ *E.g.* *Sovereign Camp Woodmen of the World v. Ellis*, 59 Ga. App. 608, 1 S.E. (2d) 677 (1939).

⁹ *Brignola v. Prudential Ins. Co.*, 12 N.J. Misc. 470, 172 Atl. 736 (1934); *Patten v. Mutual Benefit Life Ins. Co.*, 192 S.Car. 189, 6 S.E. (2d) 26 (1939); *Scales v. Union Central Life Ins. Co.*, 141 S.W. (2d) 547 (Ark., 1940); *Morrison v. Mutual Life Ins. Co.*, 103 Pac. (2d) 963 (Cal., 1940); see 2 WILLISTON, CONTRACTS (rev. ed. 1936) Sec. 433, p. 1251.

¹⁰ *New York Life Ins. Co. v. Rees*, 19 Fed. (2d) 781, 786 (C.C.A. 8th, 1927); *New York Life Ins. Co. v. Brown*, 99 Fed. (2d) 199 (C.C.A. 4th, 1938). For a Note on *Power of Pledges of Life Insurance Policy to Exercise Surrender Options*, see (1938) 48 YALE L. J. 315.

¹¹ 373 Ill. 256, 26 N.E. (2d) 114 (1940).

safely pay promptly to those shown by their own records to be entitled to payment.”

Lost Policies

But suppose the claimant to whom payment is made by the insurer in good faith in reliance on its own records, is unable to surrender the original policy which later turns up in the hands of a former beneficiary or in the hands of one claiming as pledgee or as assignee. Does that make a difference? May an insurer safely issue duplicate policies? Is it under a duty to investigate the statements made in an application or affidavit for the issuance of a duplicate? May it endorse a change of beneficiary on a duplicate or must it insist upon production of the original? If it does issue a duplicate may it safely follow through by honoring the duplicate, or does it pay at its peril in the absence of the original policy?

According to the *Restatement of Contracts* “if there is [a tangible token or writing, the surrender of which is required by an obligor’s contract for its enforcement], and the obligor does not obtain surrender thereof, he is under a duty to render the agreed performance in spite of a previous discharge . . . , to an assignee who for value in good faith, without notice of the discharge, purchases from the obligee or from any assignee such token or writing.”¹² If that be taken literally it runs in favor only of a *bona fide* holder who acquires the token or writing *after* the obligor has paid off, and does not include a *bona fide* holder who acquired the token or writing *before* the obligor’s payment. As there is no discernible reason for this discrimination, I assume it was not intended and that prior as well as subsequent assignees are covered; but the question must be considered open until someone undertakes to tell us authoritatively what the meaning is.

¹² RESTATEMENT, CONTRACTS (1932) Sec. 170 (4); cf. Sec. 432. According to Sec. 158 (1) (b), comment a: “Surrender of a tangible token or writing is required by the obligor’s contract not only where the requirement is stated in express terms, but also where it is a proper implication from business usage or other surrounding circumstances.”

On its face this section of the *Restatement* is broad enough to include life insurance policies, and Professor Williston appears to consider that they are included for he cites it in support of the proposition that “. . . apart from a protecting statute, it seems that an innocent holder for value by transfer from the owner of such a document as a policy of insurance, a non-negotiable bond or note, or a savings bank book, would not be ousted of his rights by the issue of a new instrument by the debtor even under a decree of court.”¹³ That, I take it, is hardly debatable; but the section of the *Restatement* to which he refers as authority has nothing to do with the situation created by the mere issuance of a duplicate, but deals, rather, with the liability of an obligor on the original document after he has paid off without obtaining its surrender. I think we must conclude, therefore, that, in Mr. Williston's view, an insurer pays at its peril unless it demands and obtains surrender of the original policy.¹⁴

Yet, in the same section of his great work, Mr. Williston says: “. . . in the case of a non-negotiable instrument indemnity [to the obligor] is not a prerequisite to recovery, as for instance a savings bank book, in an action by the owner thereof which has been lost or destroyed.”¹⁵

It would seem to follow that an insurer cannot finally discharge its obligation under a life insurance policy without obtaining the original policy, but is nevertheless under a duty to pay off without surrender of the original for a judgment

¹³ 5 WILLISTON, *CONTRACTS* (rev. ed., 1936) Sec. 1600, p. 4463; cf. *Edwards v. New York Life Ins. Co.*, 114 S.W. (2d) 808 (Tenn., 1938).

¹⁴ See also 6 WILLISTON, *id.* Secs. 1878 and 1890 (“. . . bills of exchange . . . are, indeed, mercantile specialties, being themselves obligations, not merely evidence thereof; and the same may perhaps be said of insurance policies, . . .”). *Contra*: *New England Mut. Life Ins. Co. v. Woodworth*, 111 U.S. 138 (1884) (“The general rule is that simple contract debts, such as a policy of insurance not under seal, are, for the purpose of founding administration, assets where the debtor resides, without regard to the place where the policy is found, as this court has recently affirmed in *Wyman v. Halstead*, 109 U.S. 654.”).

¹⁵ 5 *id.* Sec. 1600, p. 4462.

will be entered against it if it doesn't—"and indemnity is not a prerequisite to recovery." I confess I can't make that hang together.

The cases tell a different story. There can be no recovery on a non-negotiable instrument unless the plaintiff either produces the instrument or accounts for its absence. An unexplained failure to produce the original instrument, while not the equivalent of notice of assignment, has been described as a circumstance which should put the obligor on inquiry.¹⁶ But if there is a showing that the instrument has been lost, destroyed or is otherwise unavailable, the plaintiff may recover notwithstanding his inability to produce and surrender it, and he is not required to furnish indemnity.¹⁷

So far as I am aware there is no dispute that a life insurance policy is not a negotiable instrument.¹⁸ It ought to follow and it does follow that absence of the policy, if reasonably accounted for, does not bar recovery.¹⁹ Some cases, it is true, have sustained the insurer in insisting upon surrender of the policy as a condition of settlement,²⁰ but these involved exceptional circumstances. Ordinarily, at least, it may not so insist and cer-

¹⁶ *Novoprutsky v. Morris Plan Co.*, 319 Pa. 97, 179 Atl. 218, 98 A.L.R. 1486 (1935). *Accord*: *Janesville State Bank v. Aetna Life Ins. Co.*, 274 N.W. 232, 111 A.L.R. 705 (Minn. 1937).

¹⁷ *Novoprutsky v. Morris Plan Co.*, 319 Pa. 97, 179 Atl. 218 (1935); *see Note* (1935) 98 A.L.R. 1489; 5 WILLISTON, CONTRACTS (rev. ed. 1936) Sec. 1600, p. 4462.

¹⁸ *Columbian Nat. Life Ins. Co. v. Welch*, 15 F. Supp. 777 (D. Mass. 1936); *Missouri State Life Ins. Co. v. Langreder*, 87 Fed. (2d) 586 (C.C.A. 7th, 1937); *New York Life Ins. Co. v. Pope*, 68 S.W. 851 (Ky., 1902); *Smooth v. Metropolitan Life Ins. Co.*, 157 So. 298 (La. App., 1934); *Grosz v. Grosz*, 151 Or. 438, 60 Pac. (2d) 119 (1935); *Immel v. Travelers Ins. Co.*, 373 Ill. 256, 26 N.E. (2d) 114 (1940).

¹⁹ *New York Life Ins. Co. v. Pope*, 68 S.W. 851 (Ky., 1902); *Wilcox v. Equitable Life Assur. Soc.*, 173 N.Y. 50, 65 N.E. 857 (1903); *Smooth v. Metropolitan Life Ins. Co.*, 157 So. 298 (La. App., 1934); *see Grosz v. Grosz*, 151 Or. 438, 50 Pac. (2d) 119 (1935); *cf. Columbian Nat. Life Ins. Co. v. Welch*, 15 F. Supp. 777 (D. Mass., 1936).

²⁰ *Martin v. New York Life Ins. Co.*, 104 Fed. (2d) 573 (C.C.A. 7th, 1939); *Hatcher v. Equitable Life Assur. Soc.*, 134 Ga. 652, 68 S.E. 581 (1910); *see Janesville State Bank v. Aetna Life Ins. Co.*, 274 N.W. 232, 111 A.L.R. 705 (Minn., 1937).

tainly the weight of authority is to the effect that it need not do so. Most of the cases turn on the customary provision for production of the policy in connection with beneficiary changes, policy loans and the like. It is all but uniformly held that this requirement is for the convenience of the insurer and may be waived by it.²¹ But as the insurer had paid off in these cases *without* obtaining the original policy, they likewise support the proposition that production and surrender of that instrument to the insurer is not essential to a complete discharge.

If a life insurance policy is not negotiable (and it isn't) "there is no reason why duplicate contracts may not be issued as the convenience of the policyholder may require" and dealt with thereafter in lieu of the original, and that is precisely the situation according to the latest judicial utterance on the subject.²²

No doubt a reasonable showing of inability to produce the policy must be made. But there is no suggestion in any of the cases that the insurer is under a duty to disbelieve the representations made to it for the purpose of obtaining a duplicate, and the existence of such a duty has been expressly disavowed.²³

In my view, therefore, the frequent insistence upon a bond of indemnity as a condition either of issuing a duplicate policy or of making settlement is unnecessary and unwarranted.²⁴

²¹ *Quist v. Western & Southern Life Ins. Co.*, 219 Mich. 406, 189 N.W. 49 (1922); *Dunnivant v. Mountain States Life Ins. Co.*, 67 S.W. (2d) 785 (Mo. App., 1934); *Witt v. John Hancock Mut. Life Ins. Co.*, 282 N.Y. Supp. 874 (1935); *Shaw v. John Hancock Mut. Life Ins. Co.*, 120 Conn. 633, 182 Atl. 472 (1936); *Patten v. Mutual Benefit Life Ins. Co.*, 192 S.Car. 189, 6 S.E. (2d) 26 (1939); *cf. Metropolitan Life Ins. Co. v. Jokiel*, Ill. App., 30 N.E. (2d) 758 (1940). *Contra: Lloyd v. Royal Union Mut. Life Ins. Co.*, 245 Fed. 162 (N.D. Iowa, 1917).

²² *Immel v. Travelers Ins. Co.*, 373 Ill. 256, 26 N.E. (2d) 114 (1940).

²³ *Shaw v. John Hancock Mut. Life Ins. Co.*, 120 Conn. 633, 182 Atl. 472 (1936); *cf. Patten v. Mutual Benefit Life Ins. Co.*, 192 S.Car. 189, 6 S.E. (2d) 26 (1939).

²⁴ *See Henley, Settlements Under Lost Policies* (1923) 2 ASSN. OF LIFE INS. COUNSEL PROCEEDINGS, 209.

Notice and Inquiry

But the insurer is protected in making payment to the person shown to be entitled thereto by its own records, only if it acts in good faith and without notice of competing or conflicting claims. Under what circumstances, then, may an insurer be said to have notice or to be put on inquiry? The United States Supreme Court has said that "the means of knowledge are the same thing in effect as knowledge itself."²⁵ But I know of no case, certainly no recent case, which accepts that too-broad generalization unqualifiedly. It would come much closer to say that an insurer is charged with knowledge of an undisclosed interest or adverse claim if it "knows facts which, under the circumstances, would lead a reasonably intelligent and diligent person to inquire . . . and if such inquiry, when pursued with reasonable intelligence and diligence, would" fairly disclose the existence of such interest or claim.²⁶ The Supreme Court of Alabama has laid down a test which, if it differs substantially from that just suggested, may be regarded as somewhat more favorable to the insurer or other obligor: "To constitute imputed notice, in the absence of statute, it is not enough that a party be put on inquiry, but the facts brought to his knowledge must be sufficient to produce reasonable conviction that such inquiry, if followed up, would lead to knowledge of the fact."²⁷

Among recent cases it has been held that (1) notice of the insured's failing health does not put the insurer on inquiry as to his mental capacity;²⁸ (2) the mere fact that an assignment is to a bank is not sufficient to put the insurer on notice of the equities of the assignor;²⁹ (3) the fact that the beneficiary is a

²⁵ Wood v. Carpenter, 101 U.S. 135, 143 (1879).

²⁶ The quoted language is borrowed from 2 RESTATEMENT, TRUSTS (1935) Sec. 297, comment a.

²⁷ Equitable Life Assur. Soc. v. Welch, 195 So. 554 (1940).

²⁸ *Id.*; see Brady, Bank Checks (2d ed., 1926) Sec. 205; but cf. Guardian Life Ins. Co. v. Brackett, 27 N.E. (2d) 103 (Ind. App., 1940).

²⁹ New York Life Ins. Co. v. Rees, 19 Fed. (2d) 781, 786 (C.C.A. 8th, 1927); New York Life Ins. Co. v. Brown, 99 Fed. (2d) 199 (C.C.A. 4th, 1938).

corporation which has paid all premiums by checks drawn on the corporate bank account is not sufficient to put the insurer on inquiry as to its status with respect to the policy.³⁰ And a verdict for the insurer has been sustained as against the fact that premiums were paid by drafts drawn by it on the beneficiary who claimed that this put the insurer on notice of his alleged vested interest.³¹ It is also held that an insurer is not charged with constructive notice of judicial proceedings.³²

One typical situation perhaps calls for special attention. An insured seeks to change the beneficiary or borrow on his policy or take the cash value; but he cannot produce the policy; his inability to produce it results from possession of the policy by the beneficiary and this fact is made known to the insurer. The beneficiary's known possession of the policy and refusal to give it up may be considered at least suggestive of an adverse claim;³³ I should so regard it. In my opinion, therefore, the insurer cannot properly or safely proceed without giving the beneficiary in possession an opportunity to assert any claim the latter may have.

If the beneficiary fails to take advantage of this opportunity I see no reason why the insurer should not issue a duplicate policy and proceed with the transaction. No duty of inaction rests on the insurer; it is beyond question that a beneficiary cannot preserve his status as beneficiary simply by hanging on to the policy.³⁴ A belated claim otherwise than as beneficiary

³⁰ *Bennett v. Union Central Life Ins. Co.*, 220 Iowa 927, 263 N.W. 25 (1935).

³¹ *Scales v. Union Central Life Ins. Co.*, 141 S.W. (2d) 547 (Ark., 1940). *Accord*: *Morrison v. Mutual Life Ins. Co.*, 103 Pac. (2d) 963 (Cal., 1940).

³² *Frederick v. Fidelity Mut. Life Ins. Co.*, 256 U.S. 395 (1921); *Williams v. Jefferson Standard Life Ins. Co.*, 187 S.Car. 103, 196 S.E. 519 (1938).

³³ *Cf. Novoprutsky v. Morris Plan Co.*, *Janesville State Bank v. Aetna Life Ins. Co.*, both *supra* note 16.

³⁴ *McDonald v. McDonald*, 212 Ala. 137, 102 So. 38, 36 A.L.R. 771 (1924); *New York Life Ins. Co. v. Rose*, 70 Cal. App. 175, 233 Pac. 343 (1924); *Union Mut. Life Ins. Co. v. Broderick*, 196 Cal. 497, 238 Pac. 1034 (1925); *New York Life Ins. Co. v. Cannon*, 194 Atl. 412 (Del. Ch.

would run afoul of the authorities denying recovery on a claim that bobs up only after settlement. If, to avoid that, it should be argued (as I suppose it would be) that the insurer was put on notice before settlement by its knowledge of the beneficiary's possession of the policy and insistence upon retaining it, the answer is that the beneficiary was given a chance to speak and let it pass. Surely in these circumstances such notice as the insurer may be said to have from knowledge of possession of the policy by the beneficiary, would be cancelled out by the latter's silence which is at least equally persuasive of the non-existence of a valid claim. Furthermore, in view of the failure to speak when speaking out would have protected all concerned, I think it clear an effort later on to throw the loss on the insurer would encounter an estoppel.

Trustee Beneficiaries

An important question remains. It relates to the duty of an insurer in the situation which arises when an insured, having named a trustee as beneficiary, seeks to designate a substitute or to obtain the cash or loan value of his policy. Being apprised of the existence of a trust by the description of the beneficiary as trustee,³⁵ must the insurer examine and interpret the trust instrument at its peril?

According to the United States District Court at Philadel-

1937); *Kavanagh v. New England Mut. Life Ins. Co.*, 238 Ill. App. 72 (1925); *Farley v. First Nat. Bank*, 250 Ky. 150, 61 S.W. (2d) 1059 (1933); *New York Life Ins. Co. v. Cook*, 237 Mich. 303, 211 N.W. 648 (1927); *John Hancock Mut. Life Ins. Co. v. Jedynek*, 250 Mich. 88, 229 N.W. 413 (1930); *Fisher v. Fisher*, 262 Mich. 100, 247 N.W. 121 (1933); *Mutual Life Ins. Co. v. Burger*, 50 S.W. (2d) 765 (Mo. App. 1932); *Philadelphia Life Ins. Co. v. Mooney*, 117 N.J. Eq. 448, 176 Atl. 166 (1935); *Lahey v. Lahey*, 174 N.Y. 146, 66 N.E. 670 (1903); *Moskowitz v. Equitable Life Assur. Soc.*, 297 N.Y. Supp. 45 (1937); *Kelley v. Kelley*, 14 N.Y. Supp. (2d) 545 (1939); *Gannon v. Gannon*, 88 Pa. Super Ct. 239 (1926); *Wyatt v. Wyatt*, 63 S.W. (2nd) 268 (Tex. Civ. App. 1933); *cf. Krajewski v. Prudential Ins. Co.*, 54 R.I. 267, 172 Atl. 396 (1934).

³⁵ See 2 RESTATEMENT, TRUSTS (1935) Sec. 297, comment d; 2 SCOTT, TRUSTS (1939) Sec. 297-3, p. 1134; but *cf. In re Goldowitz' Will*, 259 N.Y. Supp. 900, 906 (1932).

phia an insured designating as beneficiary one who is a trustee, does not by that act alone lose the power to change the beneficiary even though the trust, as distinguished from the designation of beneficiary, is irrevocable.³⁶ I take it that Professor Scott agrees with that view for the discussion of insurance trusts in his recent work seems to assume, if not expressly to state, that the designation of a trustee as beneficiary is subject to change (the power to do so being reserved in the notice to the insurer) notwithstanding the trust, as such, is irrevocable.³⁷ That this must be so follows, I think, from this, that the complex of rights, privileges, powers and immunities arising from the designation of a beneficiary is precisely the same in every case. At least I am unable to perceive on what ground it could be held that the act of designating a beneficiary has any different legal consequences when the beneficiary named is a trustee.

I submit, therefore, that reservation of power to substitute a new beneficiary of the policy, in place of a trustee previously named, is wholly consistent with irrevocability of the trust.

If that be so, then, as a matter of logic, there would appear to be no reason for imposing a special duty on the insurer with respect to policies made payable to a beneficiary as trustee. It is possible in any case that some act or transaction of the insured, unknown to the company, has changed his legal relations with respect to his policy, as regards third persons. In cases not involving trustee beneficiaries no duty to attempt to ferret out and bring to light such possible alterations is imposed in the absence of suspicious circumstances brought home to the insurer. I see no logical ground for holding otherwise merely because the beneficiary, as beneficiary, is a trustee.

And since the mere designation, without more, of a trustee as beneficiary is in no way inconsistent with power on the part of the insured to make the policy payable to another, whether

³⁶ *Sussman v. New York Life Ins. Co.*, 32 F. Supp. 88 (1940).

³⁷ 1 SCOTT, TRUSTS (1939) Sec. 84.1, p. 458.

or not the trust itself be irrevocable, it hardly can be said, I think, that knowledge of the existence of the trust is a suspicious circumstance requiring investigation.

Why should there be a duty to investigate when the beneficiary is known to be a trustee if there is no such duty (and it has been held that there is none³⁸) in the case of an assignment, absolute in form, to a bank? Certainly the chance that an assignment to a bank, although absolute in form, was given for collateral purposes only is at least as great as the chance that a trust instrument will turn out to contain provisions tying the hands of the insured who, so far as the insurer is concerned, has reserved full control over his policy. If the insurer is under no duty to investigate notwithstanding its knowledge that premiums have been paid by the beneficiary (and it has been held it is not³⁹) why should it be under a duty to investigate merely because the beneficiary happens to be a trustee? Ordinarily, I should suppose, the beneficiary does not pay premiums without what appears to the beneficiary, at least, to be satisfactory assurance that he will enjoy the fruits of the policy. Of course, that is not always so and in any event what the beneficiary relies on may be without legal significance. If in the one case the circumstances do not put the insurer on inquiry, I see no reason why they should in the other.

It is beyond question, of course, that "a third person has notice of a breach of trust not only when he knows of the breach, but also when he should know of it; that is, when he knows facts which under the circumstances would lead a reasonably intelligent and diligent person to inquire whether the trustee is a trustee and whether he is committing a breach of trust, and if such inquiry when pursued with reasonable intelligence and diligence would give him knowledge or reason to

³⁸ *New York Life Ins. Co. v. Rees*, *New York Life Ins. Co. v. Brown*, both *supra* note 29.

³⁹ *Bennett v. Union Central Life Ins. Co.*, *supra* note 30; *Scales v. Union Central Life Ins. Co.*, *Morrison v. Mutual Life Ins. Co.*, both *supra* note 31.

know that the trustee is committing a breach of trust."⁴⁰ One who goes ahead regardless must take the consequences.

But I point out an obvious distinction. The problem in hand does not concern the liability of one dealing with a trustee, for the insured is not the trustee. He is, generally, the settlor.⁴¹ Nor is the insurer in the position ordinarily occupied by a third person who, normally, is free to deal or not as he sees fit. The insurer, on the contrary, has assumed contractual obligations which it is called upon to fulfill—called upon by its own policyholder, the party with whom it has contracted, who, in his dealings with the insurer, has stipulated expressly that he is and remains free to demand full performance of what the insurer has bound itself to do. Consequently the authorities having to do with the liability of a third person who freely deals with a trustee are beside the point. Certainly they do not foreclose the question here under consideration.

With that question no case, so far as I am aware, has yet dealt. It has, however, elicited a considerable diversity of professional opinion.⁴²

Nor am I able to discern any considerations of policy which should impel the courts to impose a duty upon an insurer (the beneficiary being a trustee) to review and interpret at its peril the terms and conditions of the trust instrument. To do so would impose a considerable burden on insurers which, in the long run, must to some extent increase the cost of insurance. It

⁴⁰ 2 RESTATEMENT, TRUSTS (1935) Sec. 297, comment a.

⁴¹ SCOTT, TRUSTS (1939) Sec. 84.1, p. 458.

⁴² See HORTON, SOME LEGAL ASPECTS OF LIFE INSURANCE TRUSTS (1927); Voorhees, *Some Legal Problems Involved in the Life Insurance Trust* (1928) PROCEEDINGS, LEGAL SECTION, AMERICAN LIFE CONVENTION, 122; *Report of Committee to Recommend Beneficiary Clause for Use in Naming a Corporate Trustee* and statement thereon by H. B. Arnold, *id.* 287-296; SEARS, *Practical Problems in Handling Life Insurance Trusts* and ensuing discussion (1930) *id.* 194-211; PETERSON, *The Assignment Route or Beneficiary Route to Life Insurance Trusts* and ensuing discussion (1931) *id.* 58-88; WRIGHT, *Designation of a Trustee as Beneficiary* (1930) 4 ASSN. OF LIFE INSURANCE COUNSEL PROCEEDINGS, 521; Yost, *Some Problems Relating to Life Insurance Trusts* (1930) *id.* 567; HANNA, *Some Legal Aspects of Life Insurance Trusts* (1930) 78 U. OF PA. L. REV. 346.

likewise would tend to delay and hinder transactions which it is sometimes necessary to conclude promptly if they are to be concluded at all. There can be no doubt that now and again it would serve to protect the beneficiaries of the trust. But the question may fairly be asked whether these cases would be numerous enough to compensate for the delay, inconvenience and expense that would result in almost all cases. It is my guess that the imposition of such a duty would be helpful in a negligible number of the total cases involved. Certainly it is true that in most cases the policy, once made payable to a trustee, is deposited with the latter so that improper dealings with it thereafter can hardly result without participation by the trustee as well as the insured. I am prepared to believe that will happen with relative infrequency. "Wise rules," said Chief Justice Taft, "are not made by exceptions."

The existence of a duty to investigate the terms of the trust would entail a further disadvantage from the point of view of the insured, the settlor, as well as the insurer. In practice the insured is altogether likely to regard the trust instrument as a confidential matter. Not infrequently he is outraged by a demand for authority to inspect it or for a copy; this he resents as an invasion of his privacy. An unhappy state of affairs may result if the insurer makes a point of the matter.

In this situation some life insurance companies follow the practice of requiring and accepting a statement from the trustee summarizing the relevant provisions of the trust or simply declaring that nothing in it prevents the insured from dealing with the policy at his pleasure.

That procedure seems to me to recognize the existence of a duty of inquiry and simultaneously to disregard it. It may have some practical advantages but surely it affords no legal protection. For if there be a duty of inquiry in the circumstances, its purpose is to guard against a possible breach of trust. That purpose assuredly is not served by relying on the word and the judgment of the trustee on the very point at issue.

Assuming the existence of such a duty nothing short of an inspection of the trust instrument or a properly authenticated copy, as I see it, would suffice, if the instrument is available. If it is not available it can only be because of a refusal to produce it. That, I should say, might well be considered a suspicious circumstance putting the insurer on notice even though (as it seems to me) no duty of inquiry existed initially.

Finally, the duty of the trustee beneficiary must not be overlooked, as it appears to me it has been. A "trustee is under a duty . . . to exercise such care and skill as a man of ordinary prudence would exercise in dealing with his own property; and if the trustee has greater skill than that of a man of ordinary prudence, he is under a duty to exercise such skill as he has."⁴³ By that test, I submit, a trustee must be held guilty of negligence in failing to advise the insurer of any restrictions on the insured's freedom to deal with the policy, contained in the trust instrument; and at least one court has so characterized the trustee's inaction.⁴⁴

Thus the area of possible loss to the beneficiaries of the trust is further contracted if the trustee is able to respond in damages, which should ordinarily be the case as most trustee beneficiaries are banks or trust companies.

I therefore venture the opinion that no duty of investigation rests upon an insurer with respect to a policy made payable to a trustee which would not rest upon it if the beneficiary were not a trust.

Knowledge of Agents

Of course an insurer is very largely at the mercy of its agency force in this matter of notice but that is by no means characteristic of the present subject and I therefore treat it briefly. It is held with considerable uniformity that notice to a minor clerical employee or mere soliciting agent is ordinarily

⁴³ I RESTATEMENT, TRUSTS (1935) sec. 174.

⁴⁴ *Immel v. Travelers Ins. Co.*, 373 Ill. 256, 26 N.E. (2d) 114 (1940); *cf.* I RESTATEMENT, TRUSTS (1935) Sec. 205, illustrations 1 to 7, incl.

not enough.⁴⁵ Indeed, it has been said that knowledge otherwise sufficient to put the insurer on inquiry is insufficient unless given to or acquired by an agent having power to act for the insurer with respect to the very transaction in hand.⁴⁶ On the whole, however, I rather think the companies should be prepared to accept accountability for knowledge brought home to any employee whose duties include the servicing of policies, although without authority to make decisions himself.⁴⁷ I have no doubt that is true if the employee is above the rank of soliciting agent.⁴⁸

Conclusion

No attempt has been made to cover all of the questions in the field I have tried to survey. The opinions expressed on controversial aspects are submitted with all deference for what they may be worth. This paper will have served its purpose if the material here collected and discussed (and there is no pretense that all of the authorities have been brought together) proves of some use in the actual handling of the problems involved.

⁴⁵ *Brignola v. Prudential Ins. Co.*, 12 N.J. Misc. 470, 172 Atl. 736 (1934); *Morrison v. Mutual Life Ins. Co.*, 103 Pac. (2d) 963 (Cal., 1940); see 2 COUCH, INSURANCE (1929) Sec. 525 b, p. 155; 6 *id.* (1930) Sec. 1458 m, p. 5227.

⁴⁶ *New York Life Ins. Co. v. Rees*, 19 Fed. (2d) 781, 788 (C.C.A. 8th, 1927).

⁴⁷ *Cf. Aetna Life Ins. Co. v. Moyer*, 113 Fed. (2d) 974 (C.C.A. 3rd, 1940).

⁴⁸ *Morrison v. Mutual Life Ins. Co.*, 103 Pac. (2d) 963 (Cal. 1940).