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## INSURANCE-APPLICATION OF "INCONTESTABLE" CLAUSE IN A LIFE INSURANCE POLICY TO DEFENSES ARISING OUT OF APPLICATION FOR REINSTATEMENT

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INSURANCE—APPLICATION OF “INCONTESTABLE” CLAUSE IN A LIFE INSURANCE POLICY TO DEFENSES ARISING OUT OF APPLICATION FOR REINSTATEMENT—An agreement to limit the contest period in which other than specifically excepted defenses on the policy can be raised by the insurer is a common feature in a modern life insurance contract.<sup>1</sup> Such a clause gives the policy holder and the beneficiary a

<sup>1</sup> A typical clause of this kind states: “This policy shall be incontestable after two years from its date of issue except for nonpayment of premium.” See *Lanier v. New York Life*

guaranty against expensive litigation after the lapse of the specified period while reserving to the insurer a reasonable opportunity to challenge the validity of the policy.

When a policy containing an incontestable clause lapses for non-payment of premium and is subsequently reinstated, a question arises as to what effect the clause should be given. When the original contest period had elapsed before the reinstatement, it is clear that defenses arising out of the original application for insurance which have been barred already should remain barred despite the reinstatement. This is the result which the courts have reached.<sup>2</sup> Where the defense is one growing out of the application for reinstatement, however, there has been no such uniformity in result.

Some courts which have dealt with this problem have held that the incontestable clause applies only to the original contract and that the reinstatement may be contested at any time. Others have held that the incontestable clause continues to date from the original issue of the policy and that once the stated period has elapsed, all contest is barred despite a subsequent lapse and reinstatement. Still other courts have held that on reinstatement the incontestable clause runs anew as to defenses arising out of the application for reinstatement.

## I

In *Alper v. New York Life Insurance Co.*<sup>3</sup> the beneficiary of a life insurance policy which contained a clause that it was to be incontestable after two years brought an action to collect the proceeds. The company defended on the ground that the insured's health had been misrepresented in the reinstatement application which had been made more than two years after issue of the policy but less than two years before the death of the insured. Judge Woodward, speaking for the court, held that there were two distinct contracts, the original contract of insurance and a contract of reinstatement, adding:

"The plea attacks the contract of reinstatement on the ground of fraud practiced by . . . [the insured]. The incontestable clause is a part of the restored contract. It is no part of the contract for the

Ins. Co., (5th Cir. 1937) 88 F. (2d) 196 at 200, cert. den. 301 U.S. 693, 57 S.Ct. 795 (1937). For a discussion of what constitutes "contest," see 1 APPLEMAN, INSURANCE §313 (1941).

<sup>2</sup> *Johnson v. Country Life Ins. Co.*, 284 Ill. App. 603, 1 N.E. (2d) 779 (1936); 45 C.J.S., Insurance §748 (1946) and cases there cited.

<sup>3</sup> (D.C. Ill. 1930) 41 F. (2d) 956.

restoration of the policy. The new contract for the reinstatement of the policy is subject to be attacked for fraud."<sup>4</sup>

Under this view, the original contract is the basis for an action by the beneficiary and may be used to determine the rights of the parties because of the renewed life given it by the reinstatement. The company is not contesting the contract of insurance but is contesting the reinstatement contract and if the reinstatement has been obtained by fraud and misrepresentation, then it may be set aside at any time whatever and the original contract will be invalid.<sup>5</sup>

Though such an interpretation prevents policy holders from cheating the insurer, it is submitted that the rule laid down by these courts is a poor one from the standpoint of public policy. Incontestable clauses are not only sanctioned by the law as valid and enforceable, but in many states are mandatory.<sup>6</sup> It is true that most statutes, as well as the contract provisions themselves, in terms are directed at limiting contest for fraud arising out of procurement of the original policy. Yet it is clear that to hold there is no limit whatever to the time in which the reinstatement may be attacked is contrary to the intent of the legislature and the parties themselves.

## II

The theory that the incontestable clause continues to date from the original issue of the policy despite an intervening forfeiture of the policy caused by nonpayment of premiums is predicated on the language of the standard reinstatement clause which has been construed to give the insured an absolute right of reinstatement once he has paid the overdue premiums and presented evidence of insurability satisfactory to the company.<sup>7</sup> Satisfaction of these two conditions is said to make reinstatement by the company mandatory and it therefore has no right to enlarge the terms upon which reinstatement may be obtained by imposing other

<sup>4</sup> *Id.* at 958. That the result in the Alper case has not been limited to the precise fact situation there involved, see *Chuz v. Columbian Nat. Life Ins. Co.*, 10 N.J. Misc. 1145, 162 A. 395 (1932).

<sup>5</sup> *New York Life Ins. Co. v. Ellis*, 27 Ala. App. 113, 168 S. 200 (1936), cert. den. 232 Ala. 378, 168 S. 203 (1936); *Ward v. New York Life Ins. Co.*, 129 S.C. 121, 123 S.E. 820 (1924). *Contra*, *Smith v. State Mutual Life Assur. Co. of Worcester*, 321 Pa. 17 at 19, 184 A. 45 (1936).

<sup>6</sup> 1 APPLEMAN, INSURANCE §311 (1941).

<sup>7</sup> *New York Life Ins. Co. v. Campbell*, 191 Ark. 54, 83 S.W. (2d) 542 (1935) discussed in 49 HARV. L. REV. 486 (1936); *Life and Casualty Ins. Co. v. McCray*, 187 Ark. 49, 58 S.W. (2d) 199 (1933), judgment affd. 291 U.S. 566, 54 S.Ct. 482 (1934), rehearing den. 292 U.S. 600, 54 S.Ct. 627 (1934).

conditions upon the insured or taking away legal defenses which he already has.<sup>8</sup>

These courts usually hold that there has been no new contract formed between the parties but that there has been a "revival" of the original contract<sup>9</sup> or a setting aside of the forfeiture.<sup>10</sup> Since all the provisions of the old contract are reinstated, the rights and obligations of the parties thereto must then be measured by it. Moreover, the provision in terms limits contest from the date of "issue" and not from the date of "issue or reinstatement." Therefore, it is asserted, since a contract as written is to be most strictly construed against the party writing it, this language must be interpreted literally.<sup>11</sup>

In answer to the argument that such a rule permits the insured to effect reinstatement by fraud and deceit, it is said that the insurer has plenty of time to check the truthfulness of the application before granting reinstatement and once it has done so there can be no objection to making the decision binding.<sup>12</sup>

In a jurisdiction which allows the parties to provide that the contract shall be incontestable for fraud from its date of issue, such an argument is indeed persuasive.<sup>13</sup> However, most courts would hold that such a stipulation is not binding unless a reasonable period is allowed for contest in order to preserve the requirement of good faith between the parties.<sup>14</sup>

<sup>8</sup> *Security Life Ins. Co. v. Leeper*, 171 Ark. 77, 284 S.W. 12 (1926); *Mutual Life Ins. Co. of N.Y. v. Lovejoy*, 203 Ala. 452, 83 S. 591 (1919). The Lovejoy case, decided by the Alabama Supreme Court, should be considered in light of *New York Life Ins. Co. v. Ellis*, 27 Ala. App. 113, 168 S. 200 (1936) where the intermediate appellate court reached a result seemingly inconsistent with the Lovejoy case and the Alabama Supreme Court refused to grant certiorari. See also, *American Life Ins. Co. of Ala. v. Russell*, 229 Ala. 467, 158 S. 307 (1934).

<sup>9</sup> *Illinois Bankers' Life Assn. v. Hamilton*, 188 Ark. 887, 67 S.W. (2d) 741 (1934), annotation, 94 A.L.R. 1200.

<sup>10</sup> *Life and Casualty Ins. Co. v. McCray*, supra note 7. That the insurer is not put in the same position by reinstatement through misrepresentation as he would have been in had there been no forfeiture, see 3 APPLEMAN, *INSURANCE* §1971 (1941).

<sup>11</sup> *New York Life Ins. Co. v. Dandridge*, 202 Ark. 112, 149 S.W. (2d) 45 (1941).

<sup>12</sup> See *Illinois Bankers' Life Assn. v. Hamilton*, supra note 9; *New York Life Ins. Co. v. Campbell*, supra note 7.

<sup>13</sup> *Duvall v. Nat. Ins. Co. of Montana*, 28 Idaho 356, 154 P. 632 (1916). Cf. *Johnson v. Gt. Northern Life Ins. Co.*, 73 N.D. 572, 17 N.W. (2d) 337 (1945) holding that a provision prohibiting contest from date of issue was valid despite dictum to the effect that the incontestable clause ran anew after reinstatement in order to preserve good faith between the parties in negotiations for reinstatement.

<sup>14</sup> *Reagan v. Union Mutual Life Ins. Co.*, 189 Mass. 555, 76 N.E. 217 (1905); *New York Life Ins. Co. v. Gay*, (6th Cir. 1929) 36 F. (2d) 634, affd. (6th Cir. 1931) 48 F. (2d) 595, cert. den. 284 U.S. 624, 52 S.Ct. 10 (1931). See 44 *MICH. L. REV.* 308 (1945).

## III

In the recent case of *Sellwood v. Equitable Life Insurance Co. of Iowa*,<sup>15</sup> the Minnesota Supreme Court, faced with this problem as a matter of first impression, adopted what is probably the most justifiable position. The court in that case held that reinstatement of a life insurance policy after forfeiture for nonpayment of premiums by compliance with the conditions set out in the original policy, was a continuation of the old contract rather than the making of a new one. The court went on to say that, although the incontestable clause in the original policy had expired, the only just and fair rule was the one holding that on reinstatement the incontestable clause ran anew as to defenses arising out of the application for reinstatement.<sup>16</sup>

As the court pointed out in the *Sellwood* case, this view has been adopted by most courts regardless of whether they find reinstatement to be a continuation of the old contract or the creation of a new one. Thus in *Pacific Mutual Life Insurance Co. v. Galbraith*<sup>17</sup> the assignee of a life insurance policy containing a two year incontestable clause brought an action after the death of the beneficiary to recover the proceeds of the policy. The company sought to show that there was fraud in securing the reinstatement and that less than two years had passed since that time. The lower court refused to admit such evidence, but the Tennessee Supreme Court reversed declaring that the reinstatement created a new contract and therefore the incontestable clause ran anew.<sup>18</sup> The court went on to say:

"If this be . . . [a new contract], then it must operate in the future from the date of its reinstatement, and whatever might be its original date, or howsoever long it may have run, yet it would seem, by the force of necessary logic, to follow that the incontest-

<sup>15</sup> (Minn. 1950) 42 N.W. (2d) 346.

<sup>16</sup> *Accord*, *Liebowitz v. Guardian Life Ins. Co. of Amer.*, (N.Y. 1943) 42 N.Y.S. (2d) 663; *New York Life Ins. Co. v. Burris*, 174 Miss. 658, 165 S. 116 (1936); *Mutual Life Ins. Co. v. Dreeben*, (D.C. Tex. 1927) 20 F. (2d) 394, *affd.* (5th Cir. 1929) 29 F. (2d) 963; *Teeter v. United Life Ins. Assoc.*, 159 N.Y. 411, 54 N.E. 72 (1899).

<sup>17</sup> 115 Tenn. 471, 91 S.W. 204 (1905).

<sup>18</sup> *Accord*, *New York Life Ins. Co. v. Waterman*, (9th Cir. 1939) 104 F. (2d) 990, *cert. den.* 308 U.S. 592, 60 S.Ct. 122 (1939); *State Life Ins. Co. v. Spencer*, (5th Cir. 1933) 62 F. (2d) 640, *cert. den.* 289 U.S. 746, 53 S.Ct. 690 (1933); *Martin v. Metropolitan Life Ins. Co. of N.Y.*, (Mo. App. 1938) 113 S.W. (2d) 1025; *Columbian Nat. Life Ins. Co. v. Industrial Trust Co.*, 53 R.I. 334, 166 A. 809 (1933), *rehearing den.* 57 R.I. 468, 190 A. 787 (1937). In the latter case the company agreed to reinstate the policy only after insured agreed to pay an additional premium because of high blood pressure. The court said that the terms of the reinstatement were the result of negotiations between the parties.

able clause would begin its new life with the date of the new contract."<sup>19</sup>

Other courts holding that the clause runs anew have not even bothered to consider whether a new contract has or has not been created.<sup>20</sup> They have generally rested their conclusions not on any precise language in the contract, but by inference from the actions of the parties in reinstating a policy containing such a clause and their conception of how public policy may best be subserved.

### *Conclusion*

From this analysis of the decided cases it is clear that whether the court finds that reinstatement creates a new contract or is merely a continuation of the old, will not be determinative as to the operation of the incontestable clause on defenses arising out of the application for reinstatement. Theoretically, however, it would seem that the reinstatement, as its name implies, is more aptly described as a continuation of the old policy.<sup>21</sup> The right to reinstate arises out of the old contract and is one of the benefits given the insured by the original policy. Premium rates remain unchanged, no new policy is ordinarily issued, and the old contract remains the measure of the rights and obligations of the parties.

But the fact that the old contract is reinstated does not mean that the incontestable clause should continue to date from the issue of the original policy. The reason for the insertion of such a clause is to preserve the security of past transactions by preventing the company from asserting the defense of fraud many years after the policy is issued and when the insured, who is often the only witness the beneficiary may rely on, is dead. Where the fraud is a new one, however, the clause should be held to run anew, thereby giving the parties what they, in effect, bargained for, namely, a limited period for contest after the validation of the policy.

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<sup>19</sup> *Pacific Mutual Life Ins. Co. v. Galbraith*, 115 Tenn. 471 at 479, 91 S.W. 204 (1905).

<sup>20</sup> *Franklin Life Ins. Co. v. Jones*, 169 Miss. 91, 152 S. 285 (1934); *Lockett v. Nat. Life and Accident Ins. Co.*, 193 Ga. 372, 18 S.E. (2d) 550 (1942); *Kanatas v. Home Life Ins. Co. of Amer.*, 325 Pa. 93, 189 A. 293 (1937); *Great Western Life Ins. Co. v. Snavely*, (9th Cir. 1913) 206 F. 20.

<sup>21</sup> For a more complete discussion of whether or not a new contract was created, see comment, 27 *Iowa L. Rev.* 146 (1941).