

Life Insurance Conditional Receipts in Indiana

I. INTRODUCTION

During the course of the sale of a life insurance policy, the applicant, the insurance agent, and the life insurance company face an initial period of uncertainty. Once the applicant and agent agree that the applicant should purchase a policy, several questions arise. Will the insurance company issue the policy or reject the application? If the policy is issued, will it be issued at standard rates or at a higher premium? How long will it take for the company to make its decision? To resolve some of this uncertainty, many life insurance companies authorize their agents to collect from the applicant a sum equal to the first premium and to deliver to him a conditional receipt.¹

The use of conditional receipts removes some of the uncertainty and confers some benefits on all parties to the transaction. The applicant receives assurance that the company will grant immediate coverage, at least on a limited basis. The agent receives the applicant's money, from which the agent's commissions are ultimately derived, as well as the psychological advantage that the applicant, having parted with his money, is less likely to rescind the transaction. The company obtains generally the same advantage as the agent, but the company is also faced with the possibility that the agent, either innocently or otherwise, may have bound the company on a risk it would not have wanted to accept. For this reason, companies usually try to word their conditional receipts so that the coverage granted is sufficiently limited to enable the company to

¹A conditional receipt is customarily a separate and independent contract or agreement entered into between the company and the applicant for insurance under the terms and provisions of which, upon stated conditions, one of which is that the applicant has paid a certain portion of his premium upon making the application, the coverage applied for is deemed to be in force as of the time of completion of the application (and where a medical examination is required, after signing of the medical part of the application), rather than as of the time the policy is issued or delivered. Usually this agreement is printed on the application itself and is printed on the receipt that the soliciting agent delivers to the applicant when the premium, or a portion thereof, is paid.

Crowe, *Conditional Receipts—Life, Accident, and Health Insurance*, in ABA INSURANCE, NEGLIGENCE & COMPENSATION LAW SECTION 52, 53 (1965). See also Fortunato, *Conditional Receipts: Should the Uninsurable Have Insurance?*, FORUM, April 1966, at 5.

rescind the transaction if it determines that the applicant is an unacceptable risk.²

Courts applying Indiana law have only recently confronted the question of how limited the coverage provided by conditional receipts may be. In 1976, the Indiana Court of Appeals decided *Kaiser v. National Farmers Union Life Insurance Co.*³ and *Monumental Life Insurance Co. v. Hakey*,⁴ and in 1978, a federal district court decided *Meding v. Prudential Insurance Co. of America*.⁵ These cases may suggest an erroneous trend in Indiana law.

II. KAISER AND ITS ANTECEDENTS

The facts in *Kaiser* describe the beginning of a typical life insurance transaction. Thomas Kaiser had applied for a term life insurance policy on May 17, 1969. At the time the application was made, Kaiser had paid the first quarterly premium and received a conditional receipt from the agent; however, on June 30, this original application was supplanted by another application for whole life insurance.⁶ Kaiser had tendered an additional premium with this new application so that the two payments equalled the amount of the quarterly premium for a whole life policy. Kaiser had taken the required medical examination on July 11, and the company had received the medical examination report on July 14. On July 20, Kaiser died in an automobile accident. At the time of Kaiser's death

²The advantages of the use of conditional receipts are enumerated in Crowe's article:

(1) [The applicant] may eliminate the possibility that he will become disqualified for the insurance after the time the application is completed and before the policy is issued or delivered; and (2) if he qualifies for the insurance applied for, and is insurable, he has coverage from the time the application is completed and the premium paid, and can eliminate the risk to himself of being without insurance during the period of time from completion of [the] application to issuance or delivery of [the] policy.

The benefits to the companies are: (1) Collection of the premium eliminates the loss which would otherwise result from the expense of solicitation, underwriting, and issuing the policy where the premium is not collected and the policy is not taken; and (2) there is a sales advantage in the agent's ability to include the conditional coverage benefit in making his sales presentation.

But certainly, the benefits derived from using the conditional receipt device run to the life proposed as well as to the company.

Crowe, *supra* note 1, at 54.

³339 N.E.2d 599 (Ind. Ct. App. 1976).

⁴354 N.E.2d 333 (Ind. Ct. App. 1976).

⁵444 F. Supp. 634 (N.D. Ind. 1978).

⁶The insurance agent had determined that, because Kaiser was only 20 years old, he was ineligible for term life insurance according to company rules. 339 N.E.2d at 600.

the company had neither accepted nor rejected the application. According to the appellate court's summary of the trial court's findings, the company had failed to act because it was still "attempting to obtain additional information to determine [Kaiser's] insurability."⁷

According to the court's summary of the facts, the conditional receipt given to Kaiser provided that "insurance coverage under the policy would be effective as of a specified date provided that defendant was satisfied that on such date the applicant was an insurable risk under the company's rules for the type of policy applied for."⁸ This language supports the company's argument that the applicant's insurability was a condition precedent to the company's liability; that is, the insurance would be effective on the date specified in the conditional receipt if, and only if, the applicant was an insurable risk on that date.⁹ Nevertheless, the court observed that the condition precedent construction had not always been applied to similar language in conditional receipts:

[C]ourts have interpreted conditional receipts as creating a temporary or interim contract for insurance subject to a condition subsequent—rejection of the application by the company. Where rejection does not occur, in the case of life insurance, prior to the death of the applicant, the company is liable for the stated amount of proceeds.¹⁰

Recognizing that this problem was one of first impression in Indiana,¹¹ the court drew heavily upon an Indiana case dealing with industrial insurance, *Western & Southern Life Insurance Co. v. Vale*,¹² and upon decisions in Nevada and Kansas, *Prudential Insurance Co. of America v. Lamme*¹³ and *Service v. Pyramid Life Insurance Co.*,¹⁴ respectively. After quoting extensively from these three cases, the *Kaiser* court drew the following conclusions:

⁷*Id.*

⁸*Id.*

⁹See note 34 *infra* and accompanying text. See also Annot., 2 A.L.R.2d 943, 986-87 (1948); Fortunato, *supra* note 1, at 8. The other type of receipt now in use is the "approval" receipt, which states that coverage is in effect only after the company has approved the application. See note 33 *infra* and accompanying text. See also Annot., 2 A.L.R.2d 943, 961 (1948); Fortunato, *supra* note 1, at 8. The A.L.R. Annotation indicates that the approval receipt was more common at the time that the Annotation was written. Annot., 2 A.L.R.2d 943, 946 (1948). It is questionable now whether the approval or insurability receipt is more common.

¹⁰339 N.E.2d at 601.

¹¹*Id.* at 602.

¹²213 Ind. 601, 12 N.E.2d 350 (1938).

¹³83 Nev. 146, 425 P.2d 346 (1967).

¹⁴201 Kan. 196, 440 P.2d 944 (1968).

Where, as in the case at bar, a receipt is issued by a life insurer and the receipt is supported by consideration, a contract is created. Any conditions contained in the receipt are to be treated as conditions subsequent thereby compelling an insurer to act affirmatively or negatively on the application. Moreover, where an applicant is not acceptable, he must be notified and the premium returned. An insurer cannot terminate the risk so assumed unless the applicant is so notified in his lifetime.¹⁵

The condition precedent theory allows insurers who use the "insurability"¹⁶ receipt to avoid liability on uninsurable risks. In a case in which the applicant dies before the company can reject the application, the company can continue its investigation to determine if the applicant was insurable¹⁷ at the time the receipt was given. If the applicant is found to have been insurable, the condition precedent would be satisfied and the contract completed. If he is found not to have been insurable, the condition would not be met and no contract would have been formed. The *Kaiser* decision takes this protection away from the insurer. The condition subsequent theory means that the contract is formed as of the date specified in the receipt. As a result, the company may find itself bound on an unacceptable risk with insufficient opportunity to reject the application before the death of the applicant.

Prudential Insurance Co. of America v. Lamme,¹⁸ which *Kaiser* relied upon, arose out of a similar set of facts. Prudential Insurance Company had received Part I of the application from Richard Lamme requesting \$25,000 of life insurance. The company had accepted \$52.64, which amounted to the first quarterly premium for the policy, and had given a conditional receipt to him which stated in part:

If the required and completed Part I and the required and completed Part II 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

¹⁵339 N.E.2d at 604.

¹⁶See text accompanying note 34 *infra*.

¹⁷Insurability can be an elusive concept, but as Dean Frandsen points out, courts have recognized it: "Insurability as a term of art signifies all those physical and moral factors reasonably taken into consideration by life insurance companies in determining coverage or matters affecting the risk." Frandsen, *Insurance, 1976 Survey of Recent Developments in Indiana Law*, 10 IND. L. REV. 243, 256 n.61 (1976) (quoting *Rosenbloom v. New York Life Ins. Co.*, 65 F. Supp. 692, 696 (W.D. Mo. 1946)).

¹⁸83 Nev. 146, 425 P.2d 346 (1967).

after the receipt thereof determines to its satisfaction that the proposed insured was insurable on the later of the dates of said Parts I and II¹⁹

Richard Lamme died of a heart attack seven weeks after Part I of the application had been submitted to the company but before he had taken a medical examination which would have been Part II of the application.

The court, recognizing that the condition of insurability had been a significant factor in similar cases, stated: "[M]ost courts have found the insurance company liable to the beneficiary . . . if the applicant was found to have been an insurable risk at the time of the medical examination."²⁰ Prudential argued that "the medical examination required by Part II of the application for insurance is a condition precedent to liability; that insurability can not fairly be determined without such examination."²¹ The court rejected this "strict contract law"²² approach, adopting instead the policy approach of other cases which had dealt with the condition precedent issue, notably *Allen v. Metropolitan Life Insurance Co.*²³ The court stated:

A conditional receipt tends to encourage deception. We do not mean to imply affirmative misconduct by the soliciting insurance agent. We suggest only that if nothing is said about the complicated and legalistic phrasing of the receipt, and the agent accepts an application for insurance together with the first premium payment, the applicant has reason to believe that he is insured. Otherwise, he is deceived.²⁴

Based on this assessment of the relative positions of the parties, the *Lamme* court held that a temporary insurance contract was created, subject to the company's rejection of the application,²⁵ a condition subsequent. The court realized that this construction could cause some hardship to the insurance company since uninsurable applicants could occasionally obtain life insurance,²⁶ but it found this possibility unpersuasive: "[W]e think that the policy considerations heretofore expressed carry the greater weight. The life insurance

¹⁹*Id.* at 148 n.3, 425 P.2d at 347 n.3.

²⁰*Id.* at 148, 425 P.2d at 347.

²¹*Id.*

²²*Id.*

²³44 N.J. 294, 208 A.2d 638 (1965). The *Allen* court stated that insurance policies "are not ordinary contracts, but are 'contracts of adhesion' between parties not similarly situated." *Id.* at 305, 208 A.2d at 644.

²⁴83 Nev. at 149, 425 P.2d at 347-48.

²⁵*Id.*, 425 P.2d at 348.

²⁶*Id.*

companies may still write 'COD' insurance, or . . . choose to assume the risk sometimes involved in the use of the conditional receipt."²⁷

The decision of the Nevada court thus appears to have been grounded on public policy: Insurers may not use complex, legalistically phrased receipts to avoid liability. A contract phrased in complex, legal language, coupled with a lack of knowledge or understanding on the part of the applicant suggests unconscionability, a theory that may underlie the decision in *Allen v. Metropolitan Life Insurance Co.*,²⁸ a case cited in *Lamme* prior to its resolution of the public policy question.

Allen also arose out of a life insurance sale in which a complicated receipt was used. In *Allen*, the applicant had applied for a \$12,000 policy, given the soliciting agent a check for the amount of the first annual premium, and received a conditional receipt which read:

*If the amount received on this date is equal to the full first premium on the policy applied for and (1) the application as originally submitted is approved at the Company's Home Office for the policy applied for, either before or after the death of the Life Proposed, then in such circumstances the policy applied for will be issued effective as of this date*²⁹

In construing this conditional receipt, the New Jersey Supreme Court pointed out that a literal reading of the receipt "gave no interim protection at all in the absence of an approval by the company at its home office either before or after death."³⁰ It is important to note that this receipt made the issuance of the policy dependent upon *approval* by the company, and not upon *insurability* of the applicant. *Allen* thus deals with an "approval" receipt rather than an "insurability" receipt, as was the case in *Lamme*³¹ and *Kaiser*.³² As described by the court in *Lamme*, the approval receipt "usually recites that coverage shall be in force from a specified date provided the application is approved as applied for at the home office of the insurance company,"³³ whereas the insurability receipt "provides that insurance coverage shall be effective as of a specified date provided the company is satisfied that on such date the applicant was an insurable risk under the company's underwriting rules for the

²⁷*Id.*

²⁸44 N.J. 294, 208 A.2d 638 (1965).

²⁹*Id.* at 297, 208 A.2d at 639.

³⁰*Id.* at 304, 208 A.2d at 643.

³¹See text accompanying note 19 *supra*.

³²See text accompanying note 8 *supra*.

³³83 Nev. at 147, 425 P.2d at 347.

policy applied for.”³⁴ An approval receipt is more likely to be unconscionable or illusory than an insurability receipt because insurability is an objective standard that can be determined without regard to approval or rejection of the application by the company.

The *Allen* court also found that the conditional receipt was ambiguous, or rather, that it “would not be unambiguous to the average layman for whom it was intended.”³⁵ This finding was in response to the company’s claim that despite the literal terms of the receipt, which stated that coverage would be provided only if the application were approved,³⁶ the company would have granted coverage if the applicant had been insurable. As the court pointed out, such an interpretation was not evident from the terms of the receipt.³⁷ Having found that the receipt was ambiguous, the court resolved the ambiguity against the insurance company:

The company is expert in its field and its varied and complex instruments are prepared by it unilaterally whereas the assured or prospective assured is a layman unversed in insurance provisions and practices. . . . Thus we have consistently construed policy terms strictly against the insurer and where several interpretations were permissible, we have chosen the one most favorable to the assured.³⁸

The court in *Lamme* did not specifically refer to ambiguity or unconscionability, but these considerations seemed to underlie *Lamme*’s reference to the complexity of insurance contracts and the inequality of expertise between the company and the public.³⁹ Unlike the insurance company in *Allen*, the company in *Lamme* neither claimed that the provisions of the receipt included terms not expressly found in the written instrument nor attempted to defend a receipt which made insurance coverage dependent upon the subjective approval of the application. Rather, the receipt given to *Lamme* clearly

³⁴*Id.* at 148, 425 P.2d at 347.

³⁵44 N.J. at 304, 208 A.2d at 643.

³⁶Compare this provision with the terms of the receipt in *Kaiser*, 339 N.E.2d at 600, where the contract was obviously conditioned upon insurability.

³⁷44 N.J. at 304, 208 A.2d at 643. For a criticism of the *Allen* decision, see Fortunato, *supra* note 1, at 20-21. Where there is no actual ambiguity, courts have found “constructive ambiguity.” See the characterization of *Ransom v. Pennsylvania Mut. Life Ins. Co.*, 43 Cal. 2d 420, 274 P.2d 633 (1954) in *Morgan v. State Farm Life Ins. Co.*, 400 P.2d 223, 224 (Or. 1965). See also Murphy, *The Conditional or Binding Receipt Today*, [1965] PROCEEDINGS OF THE LEGAL SECTION OF THE AMERICAN LIFE CONVENTION 76, 82-85.

³⁸44 N.J. at 305, 208 A.2d at 644.

³⁹83 Nev. at 148-49, 425 P.2d at 347.

made coverage dependent upon the objective finding of insurability.⁴⁰ The *Lamme* court's reliance upon *Allen*, therefore, was misplaced.

The Indiana court in *Kaiser*, through its reliance upon *Lamme*, also applied the *Allen* theories to a case involving an insurability receipt. Thus, the same criticism is applicable: The dangers of ambiguity and unconscionability that are likely to be present in a case involving an approval receipt should not be an issue in a case such as *Kaiser*, involving an insurability receipt. Moreover, in announcing the blanket rule that "[a]ny conditions contained in the receipt are to be treated as conditions subsequent,"⁴¹ the court did not recognize that the application of the condition precedent theory is entirely appropriate to insurability receipts. If an insurability receipt is used, the company should be under an affirmative duty to make a good faith effort to determine if the applicant was insurable according to the company's underwriting rules at the time the application was completed and the receipt given. If the applicant is found to have been insurable, the condition precedent is met. On the other hand, the application of the condition precedent theory to approval receipts does not place as strong a duty on the insurer, since the only action it would be required to take would be to approve or reject the application. The company would have no duty to continue to investigate the applicant's insurability. Such a result would be unconscionable.⁴²

Kaiser also drew upon the decision in *Service v. Pyramid Life Insurance Co.*⁴³ In this case, Mr. and Mrs. Service had met with their local insurance agent and a regional manager of the company to purchase life insurance. They had each applied for \$20,800 of life insurance, paid \$31.34 for the first quarterly premium, and received a conditional receipt which had the following terms:

"That if the company at its home office after investigation shall be satisfied that on the date hereof, or on the date

⁴⁰See text accompanying note 19 *supra*.

⁴¹339 N.E.2d at 604.

⁴²The general rule has been that if an insurability receipt is used, insurability is a condition precedent to the formation of the contract; if an approval receipt is used, the company's approval is a condition precedent. Annot., 2 A.L.R.2d 943, 964, 986 (1948). The safest position for the insurer to take is that insurability is determined as of the date specified in the receipt, and not at some later date. If the insurer agrees to issue a policy to an applicant whose health has deteriorated after the date of the application and medical examination, but who was an insurable risk on the latter of those two dates, rather than insisting that insurability must be present until delivery of the policy itself, he may avoid claims of unconscionability. The purpose of insurability receipts should be to "freeze" the applicant's status from the time of the application and medical examination to the time of actual delivery of the policy. See Annot., 2 A.L.R.2d 943, 988-92 (1948); Fortunato, *supra* note 1, at 21-22.

⁴³201 Kan. 196, 440 P.2d 944 (1968).

of the medical examination for such insurance, whichever is later, each person proposed for insurance was insurable and entitled under the company's rules and standards to insurance on the plan and for the amount applied for at the company's published rates corresponding to the age of each person proposed for insurance, the insurance protection applied for shall by reason of such payment . . . take effect from the date hereof or from the date of such medical examination, whichever is later.'"⁴⁴

At the time the application was completed and the check for the first premium was tendered, Mrs. Service had asked the regional manager if Mr. Service would be covered. The regional manager had told her that Mr. Service "was covered upon payment of the first premium."⁴⁵ The application, medical examination, and check for the first premium had all been received by the company by July 7, 1964. The trial court found: "By July 16, 1964, the defendant company was satisfied that on the date of the application the said Gerald W. Service was insurable and entitled under the company's rules and standards to insurance on the plan and for the amount applied for."⁴⁶

Gerald Service died in an automobile accident on July 21. The next day, the local insurance agent telephoned the company, spoke to an officer of the company, and was told that "everything is in order."⁴⁷ The local agent relayed this information to Mrs. Service and told her that the insurance proceeds would be paid.

In denying liability, the company apparently claimed that Mr. Service was not insurable. At trial, the company tried to establish that the applicant had a history of several medical disorders which had not been disclosed in the application or on the medical examination form.⁴⁸ There was evidence that the company had informed the agent on July 16 that both Mr. and Mrs. Service's policies were ready to be issued, except for a discrepancy in Mrs. Service's date of birth.

It would seem, therefore, that the trial court's finding that Mr. Service was insurable could easily have been upheld. Consequently, the condition set forth in the receipt would have been met and a contract to insure would have been formed. Both the trial court and the supreme court of Kansas, however, found that a contract had been formed by virtue of agency principles. The supreme court held that the regional manager had sufficient apparent or implied

⁴⁴*Id.* at 199, 440 P.2d at 948.

⁴⁵*Id.*

⁴⁶*Id.* at 199-200, 440 P.2d at 949.

⁴⁷*Id.*

⁴⁸*Id.* at 215, 440 P.2d at 960.

authority to create an oral contract of insurance, and that the applicants had relied on his statement that coverage was effective immediately upon payment of the first premium.⁴⁹ Although the decision of the trial court may have been supportable on the agency theory alone,⁵⁰ the reviewing court also discussed the nature of the conditional receipt.

The court began its discussion by pointing out that although the wording of receipts used by various companies may be similar, each receipt "must be individually interpreted to give [it] the effect which the parties intended The fundamental question is: What was their intention?"⁵¹ In answer to this question, the court implied, but did not decide, that insurability had been the condition intended by the company.⁵² The court stated, however, that "if the conditions imposed by the 'conditional receipt for first premium' are construed as conditions precedent, they must be regarded as having been waived by the regional manager."⁵³ This interpretation of the facts could have resulted in a decision based upon the fact that a valid condition precedent, insurability, had been waived by an agent having apparent or implied authority to do so. Nevertheless, the court questioned the validity of the receipt itself:

If it cannot be said upon interpretation of this binding receipt that Mr. Service was insured from the date of the binder, or medical, until a formal policy was issued or the risk declined by the insurance company, then it must be said this binding receipt is ambiguous, and, if so, it should be construed against the insurance company, it having been drawn up and issued by the agents of the insurance company upon its printed form.

If there was to be no contract of insurance in any event until the application was approved, and a policy issued thereon, it would seem entirely immaterial to the insured whether the contract related back to the date of the application (or medical) or not. . . . The chief object of the provision

⁴⁹*Id.* at 209, 440 P.2d at 955-56.

⁵⁰*Id.* The agent's authority to bind the company by his statements is frequently an issue in conditional receipt cases. See Fortunato, *supra* note 1, at 11-12; Murphy, *supra* note 37, at 99.

⁵¹201 Kan. at 211, 440 P.2d at 957.

⁵²*Id.* at 213, 440 P.2d at 958. The receipt recited the following condition:

[I]f the Company at its Home Office after investigation shall be satisfied that on the date hereof, or on the date of the medical examination for such insurance, whichever is later, each person proposed for insurance was insurable . . . the insurance protection applied for shall . . . take effect from the date hereof or from the date of such medical examination, whichever is later.

Id. at 211, 440 P.2d at 957.

⁵³*Id.* at 214, 440 P.2d at 959.

would, therefore, seem to be to enable the insurance company to collect premiums for a period during which there was in fact no insurance, and consequently no risk.⁵⁴

The above quotation refers to *approval* of the application. Whether or not the application is approved by the insurance company is immaterial in a case involving an insurability receipt. The pertinent issue with insurability receipts is whether or not the applicant is an insurable risk. Therefore, the court's statement that the "chief object of the provision . . . [is] to enable the insurance company to collect premiums for a period during which there was in fact no insurance"⁵⁵ lacks some validity when applied to this case.

The *Service* court also discussed the problem underlying the enforceability of conditional receipts—whether the applicant receives a benefit in consideration for paying the premium in advance:

[U]nless the insured was to be protected against death during the interim period there would be no advantage to him in paying his premium in advance. If the company did not intend that there should be insurance effective pending the date of the application . . . and the date of the approval of the risk and the issuance of the policy, . . . the insured would be paying for something which he did not receive.⁵⁶

Once again, the court was using logic properly applicable to an approval receipt in a situation involving an insurability receipt. Furthermore, the court failed to recognize the independent value of the promise by the company to grant insurance on the basis of insurability and, more importantly, of the promise to make an objective determination of insurability. If it were true that by paying an amount equal to the initial premium and receiving an insurability receipt the applicant received nothing, consideration on the part of the company would indeed fail because the promises contained in the conditional receipt would be illusory. Such a contract would not meet the reasonable expectations of the applicant.

The intent of companies using insurability receipts seems clear from an objective reading of the receipts. The intent is to grant immediate insurance protection to the applicant if, and only if, he is an insurable risk. While this intent is clearly not the same as granting unconditional, immediate insurance coverage, neither is it the illusory promise that decisions such as *Service* would seem to indicate. The promise to grant immediate coverage dependent upon insurability of the applicant has intrinsic value, apart from the value

⁵⁴*Id.*

⁵⁵*Id.* at 214-15, 440 P.2d at 959.

⁵⁶*Id.* at 214, 440 P.2d at 959.

of the promise to grant coverage for a definite period of time after issuance of the policy. The applicant is insured before the policy is issued, contingent upon an objective determination of insurability, and is assured that the standard for determination of insurability will not change after the premium is paid. Although the value of the promise conditioned on insurability may be difficult to measure, mere difficulty of measurement should not invalidate the promise. While the value of the promise conditioned on insurability may not be precisely equal to the amount paid for the first premium, that amount seems as appropriate a measure of the value of the promise as any other. Furthermore, if the applicant is insurable, the insurance company is entitled to be compensated at its regular premium rates for having assumed the risk from the time the application was submitted until the time the policy is issued.⁵⁷

The average insurance applicant cannot reasonably expect an insurance company to assume full, unconditional liability without first making an investigation into the applicant's health. The insurance-buying public probably understands that only reasonably healthy people can purchase life insurance at standard rates and that physical examinations are often required. A reasonable person could not expect the results of a physical examination to have no effect on a company's decision to offer insurance.⁵⁸

⁵⁷Crowe had a similar criticism of the *Allen* court's interpretation of the receipt:

It seems to me that the opinion in the *Allen* case includes language which may become the basis for an undesirable departure from the basic principles of contract law The court seems to approach the problem as if the advance payment of premium is to buy interim coverage and nothing else, and that the applicant has paid something for nothing if the coverage is not extended. This is not true. If there is no coverage . . . because the applicant is not insurable (insurability form of receipt), the entire premium is returned in full to the applicant so that he is made whole and he has not paid "something for nothing," and if he has no coverage, neither has he any cost.

Crowe, *supra* note 1, at 60-61.

Fortunato characterizes the benefit conferred by insurability receipts as a "freeze" of the applicant's status. Fortunato, *supra* note 1, at 21.

⁵⁸Crowe commented on the *Allen* decision as follows:

I think the court compounded the error of its erroneous assumption that the applicant "undoubtedly assumed" there was interim coverage by creating a very strong implication that, *as a matter of law*, payment of advance premium and receipt of a conditional receipt by an applicant entitles the applicant to expect that interim insurance is in force, *unconditionally*, until a policy is issued or the application is rejected. I submit that this implication is present in the opinion and that the same comes extremely close to a determination that as a matter of public policy, payment of advance premium results in interim coverage as, so reasons the court, the only just and equitable result fulfilling the reasonable expectations of the applicant. If my analysis is correct, the rationale of the *Allen* case involves abrogation of the law of contracts.

Crowe, *supra* note 1, at 61.

Service, therefore, is logically flawed. The court used concepts properly applicable to approval receipts rather than to insurability receipts. The court also failed to recognize the definite, although difficult to measure, benefit given to the applicant by the receipt. The Indiana court in *Kaiser* quoted extensively from those portions of the *Service* decision dealing with the question of consideration on the part of the company.⁵⁹ Thus, the Indiana court apparently failed to distinguish between an approval receipt and an insurability receipt. Furthermore, the court did not consider the possibility that a promise to insure conditioned upon insurability has some value.

The *Kaiser* court also discussed an Indiana case, *Western & Southern Life Insurance Co. v. Vale*.⁶⁰ *Vale* concerned an application for a \$761 industrial life insurance policy. The receipt stated, in part: "Provided the insured be in sound health . . . on the date of said application, the company's liability under such policy, *if and as issued*, shall commence as of the date of said application."⁶¹ The applicant could not read, but the soliciting agent told the applicant that

if he got a limb cut off or an eye put out he would be paid one-half the amount in money and be given a paid-up policy for life; that the receipt was just as good as the policy; and that the insurance was in effect from the date of the receipt.⁶²

The applicant suffered the loss of his left hand and sued on the contract of insurance.

The quoted receipt in *Vale* did not expressly provide for coverage based on insurability. Coverage was predicated instead upon the phrase "if and as issued."⁶³ This language apparently meant that if the terms of the receipt were upheld, the company could refuse coverage by merely refusing to issue the policy. Indeed, the company's witness testified that the applicant was physically a satisfactory risk and that issuance of the policy had been delayed because of doubt that the applicant could afford the premium. The court discussed the rule in some jurisdictions that no insurance was effective until actual approval by the company,⁶⁴ as well as decisions in other jurisdictions that recognized the unfairness of allowing companies to deny liability through the use of approval receipts.⁶⁵ In

⁵⁹339 N.E.2d at 601-02.

⁶⁰213 Ind. 601, 12 N.E.2d 350 (1938). The court noted that neither *Vale* nor any other Indiana case was directly on point. 339 N.E.2d at 602.

⁶¹213 Ind. at 605, 12 N.E.2d at 352 (emphasis added).

⁶²*Id.* at 607, 12 N.E.2d at 352.

⁶³*Id.* at 605, 12 N.E.2d at 352.

⁶⁴*Id.* at 608-09, 12 N.E.2d at 353.

⁶⁵*Id.* at 609-10, 12 N.E.2d at 353-54.

support of its holding that approval receipts were unfair when applied to the situation in *Vale*, the court stated:

It is inconceivable, in the face of all the circumstances, that appellee could have understood and believed that under no circumstances was he insured until after the acceptance of the application. The contract to insure for the period before acceptance of the application may have been qualified or conditioned, but the company cannot be permitted to say that under no conditions or circumstances was it liable It must be concluded that the applicant understood the contract to mean that he was insured if his representations were true Since no other reasonable construction is suggested, the agreement must be construed as intending that he be insured for the period, if reasonably insurable.⁶⁶

Thus the court recognized that a receipt could grant immediate coverage, conditioned on the insurability of the applicant. The *Vale* court also found that the applicant, although illiterate, understood that coverage prior to approval of the application was conditioned upon insurability: "[T]he company has represented to the applicant that it has become *conditionally* liable . . . [and] the ordinary applicant . . . would be led to believe that he is *conditionally* insured."⁶⁷ It seems reasonable to assume that a literate applicant could also understand the terms of a clearly worded and unambiguous receipt.

When the *Kaiser* court discussed the *Vale* decision, it did not use the material quoted above. Instead, it quoted language discussing the unconscionability of allowing a company to say that it was not bound "to give anything whatever."⁶⁸ The *Kaiser* court failed to understand the difference between a company giving a conditional acceptance and giving nothing. According to *Kaiser*, the *Vale* court had refused "to permit the insurer to say that it had not bound itself,"⁶⁹ a statement which may be literally true, but is not an accurate summary of the holding in *Vale*. *Vale* expressly recognized that an insurance company could bind itself conditionally, yet the *Kaiser* court did not recognize that such conditional coverage was possible. Instead, the court based its decision upon the *Lamme* and *Service* decisions,⁷⁰ holding that whenever a conditional receipt is supported by consideration, an unconditional contract is created.⁷¹

⁶⁶*Id.* at 612-13, 12 N.E.2d at 354-55.

⁶⁷*Id.* at 611, 12 N.E.2d at 354 (emphasis added).

⁶⁸339 N.E.2d at 604.

⁶⁹*Id.* at 602-03.

⁷⁰*Id.* at 604.

⁷¹*Id.*

The holding in *Kaiser* is an unnecessary restriction on the power of a life insurance company to limit its liability. First, the court in *Kaiser* relied upon the *Lamme* decision that the receipt in question was invalid due to its complicated and legal phraseology,⁷² yet an objective reading of the receipts in both *Lamme* and *Kaiser* raises the question of whether either receipt can be reasonably characterized as complicated and legalistic. Second, the *Kaiser* court did not recognize that the court in *Service* used concepts properly applicable to approval receipts when it was considering an insurability receipt. This confusion of the two separate concepts results from a failure to appreciate that the promise to grant insurance conditioned on insurability contains sufficient consideration to prevent an illusory contract. Taken together, neither *Lamme* nor *Service* interpreted the receipt to fairly represent the intentions of both parties. The Indiana court, therefore, should not have placed heavy reliance upon these two cases. Rather, the court of appeals should have begun with the decision in *Vale*, which recognized the fairness of conditional acceptance, and applied the reasoning in that case to the facts in *Kaiser*.

III. KAISER'S PROGENY

The *Kaiser* opinion was reinforced by another court of appeals decision during the same year. *Monumental Life Insurance Co. v. Hakey*⁷³ arose out of a familiar fact situation. A Monumental agent had met with Mr. and Mrs. Hakey on April 14, 1972, helped Mr. Hakey complete an application for life insurance, advised him that a physical examination might be necessary, received a premium from him, and issued a conditional receipt. The applicant died as a result of an accident on April 29, two days before the company had prepared its formal request for a physical examination. After the company learned of the death, it cancelled the application and refunded the premium. Some testimony indicated that the agent had told Mr. Hakey that he was covered.

The company defended the suit brought by the beneficiary on the ground that no contract existed because there was an uncompleted condition precedent. Since the opinion does not reproduce the wording of the conditional receipt, it is not possible to ascertain whether it was an approval receipt or an insurability receipt. Nevertheless, the court's handling of the company's claim makes this determination unnecessary. The court quoted briefly from *Kaiser*, and then resolved the issue by stating: "Company did not notify decedent of the

⁷²See text accompanying note 24 *supra*.

⁷³354 N.E.2d 333 (Ind. Ct. App. 1976).

necessity for a medical examination in decedent's lifetime; Company accepted consideration; and Company issued a receipt. A contract for insurance was created."⁷⁴ By using *Kaiser* as a basis for holding that any conditions contained in the receipt were to be treated as conditions subsequent,⁷⁵ the *Hakey* court did not need to determine whether Mr. Hakey was insurable. The court apparently made no investigation into the *policies* underlying *Kaiser*. Had it done so, or had counsel for the company properly presented arguments in opposition to *Kaiser*, the court might have discovered the logical flaws in the *Kaiser* opinion. In *Hakey*, as in *Kaiser*, the court did not recognize that an insurability receipt contains a conditional promise to insure and that the consideration advanced by the applicant applies to this independent promise as well as to the promise to pay death benefits contained in the policy itself. It would seem that, whether the receipt in *Hakey* was an approval or an insurability receipt, the court's analysis of the issues was incomplete.

The latest decision in Indiana dealing with conditional receipts is *Meding v. Prudential Insurance Co. of America*.⁷⁶ The federal district court, applying Indiana law, failed to distinguish between approval and insurability receipts, and to discern differences among conditions imposed by insurance companies through the use of conditional receipts. The facts in this case were not in dispute and follow the familiar pattern. An application had been completed, a premium submitted to the company, and a medical exam requested. The applicant died before completion of the medical examination. The sole issue before the court on the plaintiff's motion for summary judgment was whether the conditional receipt created a contract of life insurance by virtue of the payment of the premium and acceptance of the premium by the company.⁷⁷

The court observed that historically there have been two theories for conditional receipts—a condition precedent theory and a condition subsequent theory. According to this court, under the condition precedent theory no contract exists until acceptance by the company, whereas under the condition subsequent theory, the contract becomes effective on the date of prepayment, subject to the company's right to reject.⁷⁸ The court's characterization of the two theories, however, was incorrect. The opinion does not set forth the terms of the receipt, but since insurability seems to have been in issue, the receipt must have been of the insurability type. The court referred, however, only to the condition of acceptance or rejection

⁷⁴*Id.* at 335.

⁷⁵*Id.* at 334-35.

⁷⁶444 F. Supp. 634 (N.D. Ind. 1978).

⁷⁷*Id.* at 635.

⁷⁸*Id.*

by the company. Once again, this is an example of the use of the approval receipt theory to interpret an insurability receipt. Correctly applied to insurability receipts, the condition precedent theory means that no contract is formed unless the applicant is determined to be insurable, whereas the condition subsequent theory means that the contract is formed immediately upon payment of the premium, with the lack of insurability being a condition that would allow the company to cancel the contract. Under the condition precedent theory, the company is liable during the interim between the application and a determination of whether the applicant is insurable only if the applicant is determined to be insurable. Under the condition subsequent theory, however, the company is liable during the interim whether the applicant was insurable or uninsurable.

The *Meding* court mentioned the decision in *Vale*, but it summarized the decision in *Kaiser* as representing "the strong public policy in Indiana which prohibits insurers from accepting premiums and then conditioning the receipts to prevent the insurer from incurring any risk during the period which it retains an applicant's premium" ⁷⁹ *Hakey* was characterized as having summarily affirmed *Kaiser* and adopted the condition subsequent theory. ⁸⁰ Taken together, the opinions in *Hakey* and *Kaiser* led the *Meding* court to observe: "To allow insurers to disclaim liability during the interim period before acceptance or rejection of applicants would enable insurance companies to collect premiums for a period during which there was in fact no insurance, and consequently no risk involved. In short, there is no *quid pro quo*."⁸¹ The court's observation may be literally true; there would be no *quid pro quo* if insurance companies disclaimed all liability prior to acceptance or rejection. Where an insurability receipt is given, however, the insurer does not disclaim all liability. On the contrary, the insurer admits to conditional liability.

IV. AN ALTERNATIVE APPROACH

Before granting the plaintiff's motion for summary judgment, the *Meding* court distinguished *Thorne v. Aetna Life Insurance Co.* ⁸² In *Thorne*, the applicant had completed the application, paid the agent, and received a conditional receipt stating that coverage would be effective as of the date of the medical examination "provided the Company shall be satisfied that on said date the applicant was insurable as a standard risk" ⁸³ The applicant had repeatedly

⁷⁹*Id.* at 636.

⁸⁰*Id.*

⁸¹*Id.* at 636-37.

⁸²407 F.2d 809 (7th Cir. 1969), *aff'g* 286 F. Supp. 620 (N.D. Ind. 1968).

⁸³407 F.2d at 810.

broken appointments for his physical examination. He died in an airplane crash without ever having taken his examination. The district court concluded that the contract was never formed,⁸⁴ and the circuit court affirmed.⁸⁵ The district court discussed both *Vale* and *Lamme* and, although it apparently agreed with the policies expressed in those cases, found that those policies did not preclude a finding in favor of the insurer.⁸⁶ Interestingly, the district court distinguished *Lamme* since *Lamme* found that the conditions in the receipt were not understandable "by the ordinary applicant, absent an explanation of their meaning."⁸⁷ The applicant in *Thorne* was not an ordinary applicant. He was a "man of considerable business acumen and experience"⁸⁸ who had been informed that he was probably not a standard risk⁸⁹ and that he would not be covered unless the physical exam was completed.⁹⁰ Clearly, there was no question of misunderstanding on the part of the applicant in this case.

The district court also determined that the terms of the conditional receipt should have been construed to mean that if the applicant was insurable, coverage would have been in effect.⁹¹ In other words, the condition precedent to formation of the contract was not whether the examination was taken or whether the company was satisfied as to the applicant's insurability, but whether the applicant was in fact insurable by an objective standard. The district court noted that such an interpretation was the only one "which does substantial justice both to the applicant and to the company."⁹² The court also stated: "Similar results have been reached in a number of well-reasoned cases generally following the principles announced in *Vale*."⁹³ The circuit court, on the other hand, would not have allowed the plaintiff to show that the applicant was insurable. Rather, it held that in the absence of the required medical exam, the applicant was not covered because he had made a determination of insurability impossible by his refusal to take the examination.⁹⁴ The circuit court expressly declined to decide "whether Indiana law requires that a similarly situated plaintiff be permitted to show that the deceased was insurable even though he did not take a medical examination."⁹⁵

⁸⁴286 F. Supp. at 624.

⁸⁵407 F.2d at 811.

⁸⁶286 F. Supp. at 625.

⁸⁷*Id.*

⁸⁸*Id.* at 623.

⁸⁹*Id.*

⁹⁰*Id.* at 622.

⁹¹*Id.* at 626.

⁹²*Id.*

⁹³*Id.* at 626 n.5.

⁹⁴407 F.2d at 811.

⁹⁵*Id.*

As the *Meding* court observed, the facts in *Thorne* and *Meding* are distinguishable.⁹⁶ The applicant in *Meding* had not broken several appointments for his medical examination and there was no evidence that he had been informed there was no coverage without an examination. The applicant in *Thorne* had been advised that he was not a standard risk, whereas some evidence in *Meding* suggested that the applicant had been insurable.⁹⁷ Even so, the decision by the circuit court in *Thorne* expressly left open the question of whether proof of insurability would be necessary for a beneficiary to recover, while the district court's decision suggested an actual need for such proof.⁹⁸

Even though *Thorne* preceded *Kaiser* by several years, nothing in *Kaiser* indicates that the court considered *Thorne* in its decision. *Kaiser's* failure to consider *Thorne* is regrettable because the district court's opinion succinctly states the reasons behind the theory that insurability is a condition precedent to liability on a conditional receipt.

V. CONCLUSION

It thus appears that life insurance companies doing business in Indiana may have difficulty in limiting their liability through the use of conditional receipts. Now that three courts have recently held against insurers, insurance companies will probably either settle questionable claims in which the conditional receipt is a factor or prohibit agents from accepting any payment with the application. Neither approach is desirable. The courts have attempted to shield the applicant from unfair clauses in conditional receipts which are ambiguously worded. The courts, however, have gone too far.

This Note has attempted to point out that both the insurer and the applicant receive benefits from the use of insurability receipts. The benefit to the insurer is that he is protected from liability on a risk against which he would not otherwise have chosen to insure. The benefits to the applicant are: He may receive a promise of immediate insurance protection, a promise he would not receive if the insurer were forced to instruct its agents not to accept a premium with the application and not to issue any kind of receipt; he is assured that the existing rate schedule for his underwriting classification will not change after the date of the application; and he is assured that the standard for insurability will not change.

If the receipts can be clearly worded and adequately explained,

⁹⁶444 F. Supp. at 637.

⁹⁷*Id.*

⁹⁸See text accompanying notes 88 & 91 *supra*.

an undertaking which may be very difficult, their use should be encouraged. The companies should endeavor to simplify the wording of these instruments and to ensure that their agents understand the exact terms of the receipt so that the public will not be deceived or misled.⁹⁹

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⁹⁹Crowe suggests: (1) An industry-wide effort to simplify the wording of conditional receipts, (2) abandonment of the use of "approval" receipts, and (3) action to train agents

so that they have a good understanding of "conditional receipts," and to stress that the word "conditional" means just what it says. The agents should be forcefully instructed to avoid any statements, in a sales presentation, which might tend to cause an applicant to believe that he would be unconditionally covered if he paid his premium with his application.

Crowe, *supra* note 1, at 62-63. There was a somewhat similar admonition in *Allen*:

Much of the difficulty may be laid at the doorstep of the life insurance industry itself for, despite repeated cautions from the courts, it has persisted in using language which is obscure to the layman and in tolerating agency practices which are calculated to lead the layman to believe that he has coverage beyond that which may be called for by a literal reading.

44 N.J. at 302, 208 A.2d at 642.