

INTERPRETATION OR REGULATION? *GAUNT V. JOHN HANCOCK MUTUAL LIFE INSURANCE COMPANY*

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For those who teach and write about insurance law, few cases have everything. But *Gaunt v. John Hancock Mutual Life Ins. Co.*¹ comes close: a mysterious death by gunshot near the railroad tracks in South Dakota, the deceased having applied for but not yet been issued life insurance; a suit for coverage by the deceased's mother; a glimpse into the inner operations and marketing incentives of life insurance companies; a decision of the famous United States Court of Appeals for the Second Circuit, by a classic panel composed of Learned and Augustus Hand and Charles Clark; an opinion by Learned Hand, and a concurrence by Clark; a fascinating, close reading of technical insurance language; two fundamentally different perspectives on the role of courts in the resolution of insurance coverage disputes; concerns about federalism; and tributaries of implication running in so many directions that a large part of a course on insurance law could be taught out of *Gaunt* alone. As the saying goes, it doesn't get any better than this.

I. THE FACTS

After two preliminary interviews with an insurance agent, Gaunt signed an application for life insurance on August 3rd. The policy for which Gaunt applied apparently provided "double indemnity" for "accidental death." What year all this happened is uncertain. We never learn much about Gaunt – not his first name, not his age, not the amount of the insurance, not the year that the events at issue took place. Learned Hand's opinion gives us everything he thinks we need to know, and nothing – absolutely nothing – more. Given the year of the decision – 1947 – the fact that Gaunt died within months of signing his application, and the opinion's reference to his "4F classification" in the draft, we can infer that these events occurred sometime in the early to mid-1940s. And from the fact that the judgment ultimately rendered in favor of the plaintiff, Rhoda S. Gaunt, suing as Gaunt's beneficiary, was for \$15,000 and that the double-indemnity claim failed, almost certainly this was the face amount of the policy.

With his application, Gaunt paid the full first premium. For reasons I will indicate below, this was probably a monthly premium, though it might have been a quarterly or annual one. Gaunt was given a copy of the application (which had been written by the insurer) and a receipt. The application (and

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¹ 160 F.2d 599 (2d Cir. 1947), *cert. denied*, 331 U.S. 849 (1947).

perhaps the receipt as well, although this is not clear) included the following language:

If the first premium or installment thereof above stated was paid when this application was signed, and if the Company is satisfied that on the date of the completion of Part B of this application I was insurable in accordance with the Company's rules for the amount and on the plan applied for without modification, and if this application, including said Part B, is, prior to my death, approved by the Company at its Home Office, the insurance applied for shall be in force as of the date of completion of said Part B²

"Part B" was the form that covered the necessary medical examination. In effect, therefore, the application provided that Gaunt would be covered from the date he passed the medical examination, if he was insurable under the Company's rules on that date and the application was approved before he died.

Sounds good, right? Don't be so sure. Suppose the applicant dies after he passes the medical exam but before the Company approves the application? Apparently there is no coverage, because the application has not been approved prior to the applicant's death. And this is so whether the Company learns of the death and declines to approve the application, or approves the application and then learns of the death. Either way, the application was not approved "prior to my [i.e., the applicant's] death."

"True," you may say, "but if the applicant is alive when the application is approved then he gets coverage retroactive to the date he passed the medical exam." But what good is that? If he is still alive, he does not need backdated coverage. And as we have just seen, if he is already dead, then he does not get it.

That was the fix Gaunt was in upon signing the application. Subsequent events fed right into the double-bind the application created. Gaunt passed his medical exam, and the favorable report was submitted to the Home Office on August 9th. As the report revealed that Gaunt had been declared "4F" in the draft because he had poor eyesight, the Home Office required another medical exam. This was submitted on August 19th, further inquiry ensued, and the application was approved from a medical standpoint on the 26th, though not finally approved, for on that same day the Home Office received news of Gaunt's death. The trial court found, however, that if Gaunt had lived, the Company would have approved his application.³

Two days after his second medical exam on August 17th, Gaunt left Waterbury, Connecticut, to seek work on the Pacific Coast or in Alaska. He arrived in Chicago on the 21st; on the 24th he reached Montevideo, Minnesota, where he was seen traveling in an "army bus" that had been loaded on a flat car of a west-bound train. The only other occupant of the bus was someone named Rasch. On the 25th, Gaunt's body was found dead beside the west-bound track of the railroad at Milbank, South Dakota, with a bullet hole in his head. There was blood inside and outside the bus, and the bullet that had killed Gaunt was found inside the bus. The murder weapon was never found.

² *Id.* at 599 n.1.

³ *Id.* at 601.

Gaunt died no later than the 25th. Consequently, even if Gaunt's application had been approved on the 26th, under the terms of the application he would not have been covered, because the application would not have been approved prior to his death. Gaunt was precisely the kind of applicant for whom the promise to make coverage retroactive to the date of his medical exam was illusory.

II. THE CLASH OF THE TITANS

A. *Hand's Opinion for the Court*

There were two questions: whether Gaunt was covered at all, and whether, if he was covered, his death was "accidental" and entitled him to double indemnity. The second question was the easier one. The trial court found that Rasch had killed Gaunt, and that the killing was not accidental.⁴ The evidence supported this finding. No gun was found near Gaunt, and there was blood in the bus. So it was probable that Rasch shot Gaunt, and then removed the body from the bus. The possibility that Rasch had pulled out his revolver, accidentally shot Gaunt, and then dragged the body out of the bus onto the side of the tracks and fled was not likely, and in any event was not the only reasonable finding. The trial court's finding was not clearly erroneous and was affirmed.

The central question, therefore, was the legal significance of the application provision purporting to condition coverage on the applicant's being alive at the time of final approval. Hand began by acknowledging that, read literally, this provision stated a condition precedent to coverage. What then was the meaning of the provision indicating that if the insured were alive on the date of approval, he would be covered as of the date of the medical exam? Anyone still alive when the application was approved received no apparent benefit from being covered earlier, and anyone not alive was not covered. The insurer suggested, however, that in fact there were six advantages to the applicant from being "covered" earlier. These included the fact that the policy would become incontestable sooner and that cash surrender value would mature earlier.⁵

Hand did not deny that these benefits would accrue to the successful applicant. But he thought that few applicants would understand the wording of the application to mean that benefits such as this would *only* become available earlier if the applicant were still alive at the time of approval. To require that people unfamiliar with insurance language so understand the application was "unpardonable." Rather, said Hand, the typical applicant "would assume that he was getting immediate coverage for his money." Such an interpretation, Hand admitted, did "some violence" to the language of the application, making actual "approval" while the applicant was alive a condition precedent. But it did "greater violence" to this language to make the insurance "in force" only from the date of approval. "[I]nsurers who seek to impose upon words of com-

⁴ *Id.*

⁵ The others were that the policy would cover the period after approval but before issue; that if the insured became uninsurable between the exam and approval he would still be covered; that he would secure a lower premium if his birthday fell between these two dates; and that when the policy also covers disability, coverage begins on the earlier date. *Id.* at 601.

mon speech an esoteric significance intelligible only to their craft, must bear the burden of any resulting confusion.”⁶

This is the crucial move in the entire opinion, for two reasons. First, it is an interpretive move. Hand does not attempt to circumvent the language of the application, but to make sense of it. Hand was addressing the meaning of the application, as his invocation of the maxim *contra proferentem* (“against the drafter”) in support of the assertion just quoted confirms.⁷ Second, the particular interpretive route Hand followed hinged not only on the wording in the application, but also on the fact that the applicant had paid a first premium with the application: “he would assume that he was getting immediate coverage for his money.”⁸

We can see the important relationship between these two points by separating them. Suppose that the language of the application stayed the same, but the applicant paid no money. Would applicants think that they were covered from the date of the medical exam, even before paying anything? Perhaps, but there would be much less justification for doing so. Ordinarily you do not get something for nothing, although sometimes you do get merchandise now and receive a bill later. Conversely, suppose that a first premium was paid with the application, but there was no language stating when coverage would begin. Would the applicant still assume that he was getting “immediate coverage for his money?” I doubt it. Very often you pay your money now and the merchandise you are paying for arrives later. Merchandise generally is not legally yours as soon as you have paid for it, but only once it is sent to you.

So both the language of the application and the payment of a first premium with the application are necessary to Hand’s logic. Interestingly, this logic is completely congruent with what motivates life insurers to promise backdated coverage when a first premium is paid with the application. And this congruence, it turns out, is not mere coincidence, but the whole point.

Paying a first premium with the application for life insurance is not just a sign of the applicant’s earnestness. Life insurers are concerned about two other things that this practice addresses: changes of mind in general and changes of mind reflecting adverse selection. Like any deposit, payment of a first premium not only signals serious intent, but makes it less likely that the applicant will act on any change of mind. If a first premium has not been paid, then all the applicant must do to change his mind is fail to pay the first premium when the bill arrives from the insurer. On the other hand, once the first premium has been paid, the insurer has inertia on its side. The applicant who changes his mind will have to take affirmative steps to secure return of the premium.

More important, consider the likely characteristics of the applicants who do change their minds. Applicants who change their minds and decide not to pay when they receive a bill are disproportionately likely to think that they are at below-average risk and that they do not need the life insurance in question. Applicants who do not change their minds and decide to pay when they receive a bill are disproportionately likely to think that they are at above-average risk

⁶ *Id.* at 601-02.

⁷ See JEFFREY W. STEMPEL, *LAW OF INSURANCE CONTRACT DISPUTES* §4.08 (2d ed. 1999 & Supp. 2001) (discussing *contra proferentem* principle).

⁸ *Gaunt*, 160 F.2d at 602.

and that they do need the life insurance in question. What these two groups of people think about themselves is more likely to be correct than would be true merely as a matter of chance. Consequently, applicants who decide to follow through and pay when billed are likely to pose a higher risk of loss than those who do not. The life insurer in this situation thus faces the prospect of adverse selection.

Requiring payment of the first premium with the application can help to combat this adverse selection, even if the requirement does not entirely eliminate it. Because of the inertia associated with withdrawing the application and seeking return of the first premium, the group of applicants who do not change their minds will include a greater proportion of people who do not think that they are disproportionately at risk than if payment of a first premium were not required.

But extracting payment of a first premium with the application is not easy, because it reflects commitment. Asking for only the first monthly or first quarterly premium helps. Inevitably that is less commitment than paying a full year's premium. More important, the language in the application promising to backdate coverage if a first premium is paid and the application is approved gives the agent a selling point – a seemingly reasonable basis for encouraging the applicant to pay the first premium now. “Pay now and you get back-dated coverage.” The language in the application and the payment of the first premium thus reinforce each other.

But there is a difference between getting backdated coverage and getting immediate coverage. Hand's interpretation turns the former into the latter. And here the full significance of that interpretation emerges. The effective holding in *Gaunt* is that everyone who files an application promising backdated coverage and pays a first premium with that application has immediate insurance, subject to divestment by rejection of the application. What the insurer intends as permanent, retroactive coverage has been transformed into temporary, prospective coverage that is in force until the application is denied.

Following Hand's statement of this conclusion was his discussion of the case law.⁹ This reversal of conventional logic is perhaps at least partly explicable by the fact that there was no precedent on the issue in Connecticut, the state whose law applied. And the preponderance of precedent from other states was in doubt. Unaided by precedent, Hand said, he was content to rest the decision on the reasoning he had already set forth.

B. Clark's Concurrence

Clark agreed that what had occurred was “unpardonable,” and concurred for that reason. What Hand had called “unpardonable” was the insurer's expectation that an applicant could understand the terms of the application. In contrast, for Clark, what was “unpardonable” was the “course of negotiations required and controlled by the insurance company.”¹⁰ Clark makes this assertion in the first sentence of his concurrence, but never returns to it. The unpardonable was presumably the insurer's failure to tell the applicant that he

⁹ *Id.* at 602-03.

¹⁰ *Id.* at 603.

was getting nothing (or almost nothing, and no real coverage) for something – the first premium.

The bulk of Clark's opinion is taken up with a different point. He begins by rejecting Hand's interpretive route to the outcome of the case. Indeed, Clark as much as acknowledges that the application in *Gaunt* said what the insurer contended it said: that actual approval of the application was a condition precedent to coverage. Relying on several classic articles,¹¹ Clark distinguishes two forms. The first, like the insurer's application in *Gaunt* itself, makes approval of the application a condition precedent to coverage. The second, in contrast, merely requires satisfaction that the applicant was insurable on the date of the medical examination. The first form, Clark says, is generally enforced as written, except by a few courts. The second form, of course, creates no problems for applicants such as *Gaunt* – he would have been covered under that form.

Yet Clark then indicates that the first form results in continuous litigation, in a field where certainty is "indispensable."¹² Basing a decision on interpretation rather than inequity, he concludes, would produce continuing uncertainty. Notwithstanding the weight of authority against the approach the court takes to the first form, the absence of Connecticut law clearly on point, he thought, warranted the court playing a judicial role rather than that of "ventriloquist's dummy" as to state law, and he therefore concurs in the result.

In one sense, Clark's argument has a distinctly bootstrapping character. His position gets its force from two sources. The first is the fundamental inequity of the application's terms. The second is the desirability of avoiding litigation, and consequent uncertainty, over the meaning of the first form. Yet Clark himself recognizes that "few courts . . . have found the provision too inequitable to support."¹³ All it would take to avoid the uncertainty with which he is concerned is for all courts to take the position that his own court rejected in *Gaunt*. Now perhaps Clark thought that litigation would persist even in the face of a clear pro-insurer rule, given the often high stakes and the fact that the language of each application varies. On this view, he would be correct in saying that "a result placed not squarely on inequity, but upon interpretation, seems sure to produce continuing uncertainty in the law of insurance contracts."¹⁴ To the extent that he was relying on this unstated premise, Clark might – just barely – escape the charge of having used a bootstrapping argument. But bootstrapping or not, the core of his argument ultimately is that the terms of the application in cases such as *Gaunt* are inequitable, whether the outcome of disputes about those terms is certain or not.

¹¹ Friedrich Kessler, *Contracts of Adhesion – Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629 (1943); Harold C. Havighurst, Comment, *Life Insurance Binding Receipts*, 33 ILL. L. REV. 180 (1938); Edwin W. Patterson, *The Delivery of a Life Insurance Policy*, 33 HARV. L. REV. 198 (1919); Comment, *Operation of Binding Receipts in Life Insurance*, 44 YALE L.J. 1223 (1935).

¹² *Gaunt*, 160 F.2d at 603.

¹³ *Id.*

¹⁴ *Id.*

III. TWO ROADS THROUGH INSURANCE LAW

The differences between Hand and Clark reflect a tension that has long run through insurance law. Hand interpreted, Clark regulated.

It is true that Hand's approach to interpretation was not simplistic or mechanical. His approach was not literal, or he could not have reached the result in *Gaunt*. But Hand was seeking the meaning of the application. For him this meaning was the product of language in the application that led the reader in two directions. Hand's job was to determine the dominant direction and, if necessary, to break a tie with the maxim *contra proferentem*. No doubt some courts are aggressive interpreters, while others are passive. In this strand of insurance law, however, the meaning of the policy language remains the touchstone of coverage.

Yet at some point aggressive interpretation passes over into regulation. Clark's contribution in *Gaunt* was not that he was able to justify his preference in that case for regulation over interpretation. In fact, what justification there was of that preference can be found more easily in Hand's opinion than in Clark's itself. Rather, Clark's contribution lies in his willingness to be entirely candid about his preference for regulation. In this sense his concurring opinion was a precursor to the doctrine requiring that the reasonable expectations of the insured as to coverage be honored, notwithstanding contrary policy language. The absence of an extended explanation for his position, far from being a weakness, actually serves to underscore the regulatory character of his rationale. Clark's position is not the product of a search for meaning, but the exercise of regulatory authority.

Gaunt was by no means the origin of this tension within insurance law between interpretation and regulation. That tension has existed almost from the beginning. But this was the dawn of the modern era of insurance law, a time when the postwar expansion of the American economy would give insurance significance far beyond what it had previously experienced.

Gaunt is important because it marks one of the points at which the tension was clearly manifested, in the opinions of two of the most celebrated common law judges of the twentieth century. It is no surprise, therefore, that more than fifty years later, the case endures.