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Insurance -- Fraud and Materiality of Representations -- Statutory Construction

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In evaluating the possibility of admissibility in each particular case, there are two important requirements which must not be overlooked; the proponent of the evidence has the burden of showing that the declaration was in fact against interest, and that the declarant believed it to be against his interest; both are necessary because, for example, should the interest of the declarant be erroneously supposed by him to be served by the statement which he is making, the latter is devoid of probative force, although as the situation actually exists it is very much against his pecuniary or proprietary interest.

In some rare case the income tax return of a third person (B) might also be advantageously introduced against that third person's successor in interest (A) as a "vicarious admission." The prerequisite for the introduction of such evidence is a showing of privity between A and B as successive holders of a title, that B made the statement while he was holder of the title, and that it could have been used against B in litigation over his title. Contrary to the requirements of a "declaration against interest," here there is no need of a showing that the declarant is dead, or that the declaration was against interest; however, such an admission is competent only against the successor in interest, and not in his favor.

Civil cases involving the use of income tax returns as evidence seem to be extremely limited in number, but with the requirement of tax returns from practically everyone in the United States today, their statements of their financial positions are thus opened to the possibility of scrutiny; and it is not improbable that income tax returns will come into use as evidence more and more.

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The recent case of Carroll v. Carolina Casualty Ins. Co. serves to illustrate the relatively confused interpretations that are found to exist with respect to the short but sweeping North Carolina insurance statute

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31 See note 28 supra.
32 See note 28 supra.
33 Roe v. Journegan, 175 N. C. 261 at 265, 95 S. E. 495 (1918) (quoting with approval from 2 CHAMBERLAYNE ON EVIDENCE §2782 [1913]).
34 For discussion of "admissions by predecessors in interest," see STANSBURY, op. cit. supra, note 3, §174.
35 Satterwhite v. Hicks, 44 N. C. 105 (1852); Guy v. Hall, 7 N. C. 150 (1819).
36 Wigmore, Evidence §1081 (3rd ed. 1940); STANSBURY, op. cit. supra, note 3, §174, and cases there cited.
37 STANSBURY, op. cit. supra, note 3, §174.
38 Roberts v. Roberts, 82 N. C. 29 (1880).
40 N. C. GEN. STAT. (1943) §58-30.
which provides that "all statements ... in any application for insurance, or in the policy itself, shall be deemed representations and not warranties, and ... unless material or fraudulent, will not prevent a recovery on the policy."

It should be noted particularly that this statute applies to all statements and to all types of insurance. Other states have somewhat similar statutes but most are limited to a particular form of insurance or to the application or negotiation only.³

The statute would appear to be unambiguous but the cases interpreting it do not appear unanimous in two respects at least. The first problem has to do with the test to be used in determining the materiality of a statement made by an applicant and the second concerns the necessity of finding fraud on the part of the applicant in the event the statement is untrue.

The application of the statute to other circumstances raises additional problems of interest, but they are beyond the scope of this note, its purpose being only to investigate the position of the North Carolina Supreme Court as to the above two points.⁴

In the principal case the applicant for hospital insurance, in answer to a specific question on the point, incorrectly asserted that his wife did not have hernia. The feme plaintiff was later hospitalized for an appendectomy and the hernia was incidentally repaired at the same time, but there was no evidence that the hernia was a contributing factor to the initial hospitalization. The defendant insurer refused payment of the hospital expenses on the ground that the untrue statement was of such importance that had the truth been known the policy would not have been issued.

The jury determined that the statement by the insured was not made with intent to deceive and that it did not materially affect acceptance of the risk by the insurer. Recovery was, therefore, allowed. On appeal, the verdict for plaintiff was not disturbed.

In searching for a test for determining the materiality of a representation the North Carolina Supreme Court has used several approaches, and the divergence of the theories is sometimes noticeably apparent. In the principal case the court says, "the general rule is that the materiality of the representation depends on whether it was such as would naturally and reasonably have influenced the insurance company with respect to

³ Patterson, Essentials of Insurance Law §§72-74 (1st ed. 1935); 26 states have similar statutes applying to life, accident, or health insurance. North Carolina one of few extending this to all types.
⁴ Effect on continuing warranties, conditions precedent, concealment, etc. See Patterson, op. cit. supra, note 3, §72, for seven basic factors to be considered in determining the applicability and scope of this type statute.
the contract or risk." Numerous decisions have used similar language in describing the test sought for.\(^5\)

The rule as stated raises considerable doubt as to whether an objective or a subjective test is intended. The classic phrase "naturally and reasonably" suggests an objective standard, of course. This would be in agreement with most jurisdictions which have enacted statutes directed toward similar ends.\(^6\) But some doubt is cast on this conclusion by the next phrase pertaining to influencing "the insurance company," which would seem to indicate that perhaps a subjective test is intended, i.e., would this particular insurance company have accepted the risk had the true facts been known at the time.\(^7\) This interpretation is further strengthened by statements explaining similar definitions in other cases, as in Schas v. Equitable Life Ins. Co.\(^8\) where it was said that the misrepresentation need not have contributed to the loss or damage suffered, but whether or not it was material depends upon whether the applicant's answer "would have influenced the company in deciding for itself, and in its own interest, the important question of accepting the risk, and what rate of premium should be charged." Such explanations suggest that the practices of the particular company may be the determining factors to be considered by North Carolina juries.\(^9\)

A somewhat different approach to the problem of materiality is frequently noticed in the innumerable cases interpreting and applying this statute. It is found in the North Carolina decisions as well as in those of the federal courts, apparently originating in its present form in this state in Mutual Life Ins. Co. v. Leaksville Woolen Mills\(^{10}\) and seems to have been appropriated from the Supreme Court of the United States.\(^{11}\) The test as laid down in the Leaksville case and subsequently

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\(^6\) The text writers do not seem to advocate any particular form of test. See Vance, Insurance §§382 (2d ed. 1930) describing the test in words similar to those used by the court in the principal case; Patterson, Essentials of Insurance Law §82 (1st ed. 1935) suggesting what appears to be a hybrid test, as, "the fairest solution ... maintain individual standard as the ultimate test, allowing the insurer to produce proof of its own standard and claimant to refute ... by ... proof of practices of other insurers ... for showing ... this insurer arbitrary and exceptional."

\(^7\) If the standard enunciated in the charge was truly subjective, the court, on appeal, even though it preferred an objective test for materiality, might be disinclined to disapprove, since a subjective standard is most favorable to the insurer and thus cannot be said to be prejudicial to him.

\(^8\) 166 N. C. 55, 81 S. E. 1014 (1914).

\(^9\) Particularly is this indicated by opinions which approve charges capitalizing the words, as, "The Insurance Company."

\(^10\) 172 N. C. 534, 90 S. E. 574 (1916).

approved many times is essentially subjective and is to the effect that the determination of the materiality of representations is not always open to dispute and that it is only necessary to look to the policy or to the application for the answer, for when the representation is in the form of a written answer to a written question it is deemed to be made material by the acts of the parties to the contract. In other words, the mere fact that the question was asked by the insurer and answered by the insured is said to be a conclusive indication of materiality. The answer then must be true or recovery will be denied. In these cases materiality is found by the court as a matter of law, the only thing remaining for the jury to determine is whether the statement was false.

At first glance, this approach, which may be termed the "written question-written answer: therefore material" doctrine, would seem to be a considerable departure from the rule of the principal case. Indeed, if carried to its logical conclusion an opposite result would be warranted in the principal case. However, an analysis of the various cases using this approach shows that, although the court supports its conclusion by reference to the "written question-written answer" doctrine, the facts are of such a nature that the result would be the same by the objective, subjective, or any other reasonable standard. Reasonable men could not differ on the question. It therefore seems unnecessary to fear that any such sweeping rule will ever be adopted to apply to any and all statements made by the insured, else insurance law in this state would be reverting to the mechanical standards applied by the common law. The North Carolina Supreme Court is not unaware of the purpose of the

\[\text{In effect, such an approach seems to defeat the purpose of the statute completely, for, instead of all statements becoming representations, the reverse is made the result and all statements assume the legal effect of common law warranties merely because the insurer chose to demand a written answer to a written question. The Jeffries case, supra note 11, would appear to be poor authority for the proposition since no comparable statute was involved there and the court merely applied the common law rule of warranties, which is the very rule intended to be abrogated by N. C. Gen. Stat. (1943) §§8-30. See Note, 131 A. L. R. 617, 625 (1941).}

\[\text{E.g., Mutual Life Ins. Co. v. Leasvile Woolen Mills, 172 N. C. 534, 90 S. E. 574 (1916) (applicant stated "no operation since childhood" when actually he had undergone several of a serious nature); Petty v. Pacific Mutual Life Ins. Co., 212 N. C. 157, 193 S. E. 228 (1937) (declaration of good health, but actually under treatment for duodenal ulcer from which he later died); Washington Life Ins. Co. v. Box Co., 185 N. C. 543, 117 S. E. 785 (1923) (knowingly denied any spitting of blood, but later died of tuberculosis); Alexander v. Metropolitan Life Ins. Co., 150 N. C. 536, 64 S. E. 432 (1909) (untrue assertion that applicant was not under treatment for a kidney disease); Bryant v. Metropolitan Life Ins. Co., 147 N. C. 181, 60 S. E. 963 (1905) (denial of physician's care for two preceding years, although being treated for consumption); Jeffress v. New York Life Ins. Co., 74 F. 2d 874 (C. C. A. 4th 1935) (non-disclosure of treatment for hookworm and secondary anemia); Dudgeon v. Mutual Ben. Health & Accident Ass'n, 70 F. 2d 49 (C. C. A. 4th 1934) (claim of temperate habits and no prior refusal of insurance, the reverse being true); Fountain & Herrington, Inc. v. Mutual Life Ins. Co., 55 F. 2d 120 (C. C. A. 4th 1932) (claim of good health although recently advised of necessity for appendectomy).}
This conclusion is borne out by another group of cases where, although written answers are given to written questions, the court rules as a matter of law that the statements are immaterial. Here also, reasonable men could not differ on the inferences from the facts concerned, as an analysis of each case will show.

It can therefore be said that our court is somewhere near the middle of the road, treating the question of materiality as any other question of fact, or mixed law and fact; submitting it to the jury when doubtful, otherwise ruling it material or immaterial as a matter of law, even though sometimes utilizing the anomalous "written question-written answer" doctrine. Although, as pointed out above, when the issue of materiality is left to the jury the standard to be applied is doubtful, the tenor of the decisions seems to indicate that the court, in furthering the purpose of the statute, would approve an objective standard when materiality depends upon some practice peculiar to the particular insurer.

As to the necessity of finding fraud on the part of the applicant, the statute clearly says that to prevent a recovery, the misrepresentation must be "material or fraudulent" and this plain meaning is generally followed by the court, to the extent of holding that if materiality is found no fraud need be present. Typical of this is *Equitable Life Assurance Society v. Ashby* where it is said that "if the representation is false it need not be fraudulently made to invalidate the policy... The misrepresentation of a material fact... avoids the policy even though the assured be innocent of an intent to wrongfully induce the assurer to act...."

No recent case has been found where a fraudulent immaterial representation alone has been sufficient to prevent recovery on the policy. It is submitted that this is as it should be, for the purpose of the statute would seem to be to relieve the harshness of the common law doctrine which was uncompromising in its demand for literal compliance with all warranties in insurance policies. Yet by the use of the word "or" in the statute, it would appear that even an immaterial misrepresentation, if fraudulently made, would be fatal to the rights of the insured. This...
would prejudice the insured more than would the common law rule.\textsuperscript{19} The Minnesota Supreme Court, in a case\textsuperscript{20} construing a similar statute,\textsuperscript{21} decides that surely the legislature did not intend to make the insurer's liability any less.

For all practical purposes then, the words, "or fraudulent," can be considered surplusage. Yet in one recent case\textsuperscript{22} our court, in its effort to equalize the relative positions of insurer and insured, appears to have interpreted this statute as requiring the insurer to prove fraud on the part of the applicant, even though the misrepresentation was clearly material to the risk, contributed to the loss, and induced the insurer to undertake a risk otherwise unacceptable. In this action to cancel the policy the court referred to N. C. Gen. Stat. (1943) §58-30, seized upon the lack of fraud, and refused to allow a cancellation. At first glance this decision would appear to give some meaning to the word "fraudulent" in the statute, for a literal interpretation would indicate that the misrepresentation must be both material \textit{and} fraudulent rather than material \textit{or} fraudulent, but it should be pointed out that the decision was not rested solely upon the statute in question. Reliance also was placed upon a companion statute\textsuperscript{23} which bars relief, in the absence of fraud, when no physical examination is required. The peculiar circumstances of the case\textsuperscript{24} and the applicability of this companion statute probably explain the apparent reliance on the word "fraudulent" and indicates that the departure from the usual interpretation of the statute is less real than apparent. At any rate, this approach should not be unduly extended for such a position not only flaunts the plain wording of the statute, but fortifies the position of the insured to such an extent that a recovery on a policy would seldom be refused, for most untrue statements are inadvertent rather than fraudulent. The scales would be tipped too far in favor of the insured, who, under the common law, was in much the weaker position.

The North Carolina statute can thus be said to affect the common law as little as any comparable enactment. In short, the net effect is only to convert statements which by the common law might have been called warranties (and thereby subject to rigid compliance), into repre-

\textsuperscript{19} Vance, Insurance §395, n. 78 (2d ed. 1930) ("Most common law decisions under the doctrine of representations refused to avoid a policy for any immaterial misrepresentations.").
\textsuperscript{21} Minn. Gen. Stat. (1913) §3300.
\textsuperscript{22} Missouri State Life Ins. Co. v. Hardin, 208 N. C. 22, 179 S. E. 2 (1935).
\textsuperscript{24} Applicant consulted many doctors because of dizziness some years prior to issuance of policy. Diagnosis of disease was creeping paralysis which was incurable so doctors decided not to inform applicant who thus stated "no diseases last 10 years" and failed to disclose fact of consultation.
sentations. The common law of representations remains relatively unchanged. Materiality of representations has always been a prerequisite for cancellation of a policy of insurance or for prevention of recovery by the insured. Fraudulent, but immaterial, representations have never been considered by the common law, or under modern statutes, as warranting an avoidance of a policy of insurance. Further relaxation of the common law, then, must come in the standard selected and applied by the court for determining the materiality of the incorrect statement being contested. The "written question-written answer" doctrine certainly will do nothing toward furthering the purpose of the statute and it is hoped that this proposition will not again be heard, but that the North Carolina Supreme Court will in the future adopt some form of objective standard.

JOSEPH C. MOORE, JR.

Judgments—Opening Default Judgment for Neglect of Attorney—Discretionary Power in Trial Judge

The plaintiff sued in claim and delivery for the recovery of an automobile and had judgment by default for want of an answer. When execution issued defendant appeared and moved that the judgment be set aside for excusable neglect. The clerk allowed the motion and the plaintiff appealed to the judge of the superior court who affirmed the order vacating the judgment upon the following findings of fact: summons was duly served on defendant together with an order extending the time to file complaint (G. S. §1-121) whereupon she employed an attorney who mistakenly advised her that the plaintiff could not proceed until additional papers were served on her, and that he would request the clerk to notify him of the filing of the complaint, and would inform her when it became necessary for her to answer; the attorney then became seriously ill and was unable to attend to the duties of his office, as a result of which no further action was taken and the default judgment was entered; the defendant was unacquainted with court procedure and had not herself been negligent; she had a meritorious defense to the cause as an innocent purchaser for value. The Superior Court ruled, therefore, that the default was occasioned by the negligence of the attorney and that the same was not imputable to the defendant who was without fault. The plaintiff appealed to the Supreme Court. Held: order vacating the judgment affirmed.1 Since the failure to answer was not wholly due to the attorney's erroneous belief that additional papers2 would have to be served on the defendant, the major-

2 The complaint. Record, p. 22.