

CANCELLATION OF LIFE INSURANCE POLICIES FOR FRAUD

The jurisdiction of the Court of Chancery to rescind and cancel a policy of life insurance for fraud in its procurement, and the doctrines upon which it exercises such jurisdiction, have been the subjects of much consideration in recent years.¹ The decisions demonstrate the necessity for comprehensive study of the numerous fine distinctions which inhere in the exercise of this jurisdiction. The object of this article is to set forth an incisive analysis of its basic nature and of the principles upon which it is exercised.

I

The authority of the Court of Chancery to decree the rescission of an insurance contract and the delivery of the policy for cancellation, rests upon a number of distinct bases. Many policies of life and health insurance contain an incontestability clause.² Such clauses usually provide that the policy shall be

¹ See among other cases, *Shapiro v. Metropolitan Life Insurance Co.*, 110 N.J.Eq. 287, 159 Atl. 680 (1932); *aff.* 114 N.J.Eq. 378, 168 Atl. 637 (1933); *Metropolitan Life Insurance Co. v. Sussman*, 109 N.J.Eq. 582, 155 Atl. 406 (1931); *Prudential Insurance Co. v. Holmes*, 111 N.J.Eq. 115, 162 Atl. 135 (1932); *Prudential Insurance Co. v. Merritt-Chapman etc. Corporation*, 111 N.J.Eq. 166, 162 Atl. 139 (1932); *United Life and Accident Insurance Co. v. Winnick*, 113 N.J.Eq. 288, 166 Atl. 515 (1933); *Aetna Life Insurance Co. v. Sussman*, 111 N.J.Eq. 358, 162 Atl. 132 (1932); *Travelers Insurance Co. v. Evslin*, 101 N.J.Eq. 527, 139 Atl. 520 (1927); *Acacia Mutual Life Association v. Kaul*, 114 N.J.Eq. 491, 169 Atl. -- (1933).

See also *Powell v. Mutual Life Insurance Co.*, 313 Ill. 161, 144 N.E. 825 (1924); *Guaranty Life Insurance Co. v. Frumson*, 236 S.W. 310 (Mo. 1921); *American Trust Co. v. Life Insurance Co. of Virginia*, 173 N.C. 558, 92 S.E. 706 (1917); *Jefferson Standard Life Insurance Co. v. Keeton*, 292 Fed. 53 (C.C.A. Va. 1923).

The general subject of cancellation of such policies in equity is ably discussed in *Hoare v. Bremridge*, L.R. 8 Ch.Ap.. 22 (1872); and in *Brooking v. Maudsley et als.*, 38 Ch.Div. 636 (1888).

Some idea of the significance of this subject can be gathered from an observation of Justice Cardozo in *Burnet v. Wells*, 289 U.S. 670 (1933):

"Insurance for dependents is to-day in the thought of many a pressing social duty. Even if not a duty, it is a common item in the family budget, kept up very often at the cost of painful sacrifice, and abandoned only under dire compulsion."

² P.L. 1925, Chap. 179, provides that no policy of life insurance shall be issued by any domestic company or delivered within this state to any resident thereof by any foreign company, unless the same shall contain among other things: "A provision that the policy shall constitute the entire contract between

incontestable within a specified period of time. The most common type of clause provides that the policy shall become incontestable for all causes except non-payment of premium. If, before the expiration of the period mentioned in such a clause, an insurance company becomes aware that the assured perpetrated a fraud in procuring the policy, it can obtain effective relief through the equitable remedies of rescission and cancellation. If it awaits the presentation of a claim, in the expectation that it can then set up fraud as a defense, it may be that no claim will arise until after the policy becomes incontestable. If a disability claim should arise before that time, the assured may, by studied delay, await the termination of the specified period and present his claim after the policy has become incontestable.³ If the policy is one of life insurance alone, and the assured should die before the specified time runs, it is still necessary for the company to proceed before the

the parties and that after it has been in force during the lifetime of the insured a specified time, not later than two years from its date, shall be incontestable, except for nonpayment of premiums and for violation of its express conditions, if any, relating to hazardous travel, residence or occupation * * *

See on the general subject of such clauses Cooper, *Incontestable Life Insurance* (1924), 19 ILL. L. REV. 226; Vance, *Beneficiary's Interest In a Life Insurance Policy* (1922), 31 YALE L. J. 343.

³New York Life Insurance Co. v. Steinman, 103 N.J.Eq. 403, 143 Atl. 529 (1928); Smith-Austermuhl Co. v. Jersey Railways Advertising Co., 89 N.J.Eq. 12, 103 Atl. 388 (1918); Chase v. Chase, 50 N.J.Eq. 143, 24 Atl. 914 (1892); Cornish v. Bryan, 10 N.J.Eq. 146 (1854). In the first cited case the court said: " * * * the existence of a complete defense, based on fraud, in a court of law, falls short of and does not ordinarily constitute such an adequate remedy for the defendant as should impel a court of equity to refuse to entertain a bill filed by the defrauded party for cancellation and surrender of the contract, since the opportunity to make that defense may be lost, or the ability to make it may be weakened, by studied delay of the other party; * * * "

Courts of equity as a general proposition consider that jurisdiction should be exercised wherever it may well be expected that the person in possession of an instrument obtained by fraud will seek by delay to postpone an opportunity to raise the defense of fraud in an action based upon the instrument. See Buxton v. Broadway, 45 Conn. 540 (1878); Andrews v. Frierson, 33 So. 6 (Ala. 1902); John Hancock Co. v. Dick, 114 Mich. 337, 72 N.W. 179 (1897); Hoare v. Bremridge, L.R. 8 Ch.App. 22 (1872).

This being the general doctrine of the court, it is to be expected that in the face of such a provision as an incontestability clause equity would act. In the Steinman case the court said:

"The present bill has been filed within but a few months of the expiration of the period during which the insurer may contest the rights of the beneficiary. The situation presented is clearly one in which the inherent jurisdiction of a court of equity to relieve from the consequences of fraud should be exercised, even though the fraud disclosed by the bill would be available as a defense in a court of law."

expiration of that period. The rule adopted in this state and in most other jurisdictions, is that the death of the assured before the period has elapsed does not prevent the incontestability clause from becoming operative for the benefit of the beneficiary after the specified time has passed.⁴ The need for prompt action exists in order that the defense may be preserved.

Even in the absence of such a policy provision, other reasons for equitable intervention exhibit like attributes of necessity. Cancellation and delivery of the policy is a far more conclusive remedy than defense at law upon the ground of fraud. It puts an end to the possibility of further litigation upon the policy. Cancellation is relief, defense is not.⁵

⁴ See *New York Life Ins. Co. v. Steinman*, 103 N.J.Eq. 403, 143 Atl. 529 (1928); *Killian v. Metropolitan Life Ins. Co.*, 251 N.Y. 44, 166 N.E. 798 (1929); *Priest v. Kansas City Life Ins. Co.*, 119 Kan. 23, 237 Pac. 938 (1925); *Yates v. New England Mut. Life Ins. Co.*, 117 Neb. 265, 220 N.W. 285 (1928); *Repala v. John Hancock Mut. Life Ins. Co.*, 229 Mich. 463, 201 N.W. 465 (1924). These are illustrative of a vast number of decisions. The reasoning upon which they rest is stated in *Mutual Life Insurance Co. v. Hurni Packing Co.*, 253 U.S. 167, 44 Sup. Ct. 90, 68 L.ed. 235 (1923), where Justice Sutherland said:

"It is true, as counsel for petitioner contends, that the contract is with the insured, and not with the beneficiary; but, nevertheless, it is for the use of the beneficiary, and there is no reason to say that the incontestability clause is not meant for his benefit as well as for the benefit of the insured. It is for the benefit of the insured during his lifetime, and upon his death immediately inures to the benefit of the beneficiary. * * * the provision plainly is that the policy shall be incontestable upon the simple condition that two years shall have elapsed from its date of issue;—not that it shall be incontestable after two years if the insured shall live, but incontestable without qualification and in any event."

See note (1926) 75 U. of Pa. L. Rev. 155.

The soundness of this rule for New Jersey is highly questionable. The statute, quoted in note 2, *supra*, provides for incontestability after the policy has been in force "during the lifetime of the insured a specified time, not later than two years from its date, * * *." The manifest legislative intent which is to be gathered from this language is that the incontestability clause is only available if the assured survives the period stated.

Compare *Acacia Mutual Life Association v. Kaul*, 114 N.J.Eq. 491, 169 Atl. --- (1933); *Chuz v. The Columbian National Life Insurance Company*, 10 N.J.Misc. 1145, 162 Atl. 395 (1932).

⁵ To this effect are *Prudential Insurance Co. v. Merritt-Chapman, etc. Corporation*, 111 N.J. Eq. 166, 162 Atl. 132 (1932); *Smith-Austermuhl Co. v. Jersey Railways Advertising Co.*, 89 N.J. Eq. 12, 103 Atl. 388 (1918); *New York Life Insurance Co. v. Steinman*, 103 N.J. Eq. 403, 143 Atl. 529 (1928).

Compare *Cornish v. Bryan*, 10 N.J. Eq. 146 (1854), where the court said:

"The mere fact that the grounds upon which the jurisdiction of this court is invoked may avail the party in an action at law, and constitute a valid defence by plea, or otherwise, is not a sound objection to the court's exercising this power. If a party holds an obligation which ought to be cancelled, and persists in holding it for the purpose of harassing the obligor with a suit, he

If a claim should arise upon a policy procured by fraud the claimant may delay its presentation, with the possible consequence that essential evidence may be lost to the insurance company if it must sit by until an action is brought against it.⁶ Resort must be had to the Court of Chancery to have the issue of fraud determined upon all of the evidence. Law courts furnish no equivalent remedy which the company may pursue in advance of some action against it.

Another basis of this jurisdiction is found in the difference between the legal and the equitable conception of fraud. The nature and extent of that difference will be considered *post*. Some of the cases suggest that the less exacting requirements of the Court of Chancery for the proof of actual fraud, may render the remedy at law inadequate in cases where the equitable requirements could be met but those of the law courts could not be satisfied.⁷

ought not to be permitted to select his own place, time and circumstances for such prosecution."

⁶ See the cases cited in note 3, *supra*.

Compare *Hoare v. Bremridge*, L.R. 8 Ch. App. 22 (1872), where it was said: " * * * if there be a legal defence to a written instrument depending on facts not appearing upon the face of the instrument, the party charged on that instrument with some liability may come into a court of equity to get rid of it, notwithstanding the legal defence, because the evidence of those extrinsic facts upon which the defence depends might not be forthcoming at all times and under all circumstances. That would apply even perhaps to cases that were not strictly cases of fraud. But, independently of that, where a case of fraud is alleged, this court has an original and unquestionable jurisdiction. * * * "

⁷ In *Schonfeld v. Winter*, 76 N.J.Eq. 511, 74 Atl. 975 (1909), it is said: "In order to set aside a contract founded in fraud, it is only necessary in equity to prove that the representation upon which the action is founded is false, that it is material, and that damage has ensued; while at the common law the proof must go to the extent of satisfying the jury that the defendant knew that the statement relied upon was false. It will therefore be seen at a glance that the remedy in equity is much broader and much more efficient than the remedy at law could be."

In *Commercial, etc., Co. v. Southern Surety Co.*, 100 N.J.Eq. 92, 135 Atl. 511 (1926), *aff.* 101 N.J.Eq. 738, 138 Atl. 919 (1927), the court said: "Equity remains inactive only in that class of fraud that are recognized and remediable at law. A misrepresentation without intent to deceive will not sustain an action at law for deceit, while in equity an untruthful representation of a material fact, though there be no moral delinquency, is deemed to be fraudulent. *Eibel v. Von Fell*, 55 N.J.Eq. 670; *Straus v. Norris*, 77 N.J.Eq. 33; *Cowley v. Smyth*, 46 N.J.L. 380. The law courts not having as yet taken upon themselves to relieve against wrongs resulting from misrepresentations fraudulent in conscience only, courts of equity continue to perform that function."

In a number of states the equitable view, as expressed above, is applied at

The principal source of this jurisdiction, however, is the inherent authority of the Court of Chancery in all cases of fraud. The idea of fraud, as a part of our jurisprudence, had its genesis in the English Court of Chancery. It was an emanation of the Conscience *motif* introduced by the early clerical Chancellors, who had little other than their religious institutions to guide them in their forensic activity.⁸ They carried over into their secular functions the belief that it was inherently wrong to contravene the dictates of good conscience. To this they added similar ideas of the civil law.⁹ Conscience was made to serve as the measure of conduct. The violation of conscience by untruth became actual fraud.

law. See *Johnson v. Gulich*, 46 Neb. 817, 65 N.W. 883 (1896); *Charles P. Kellogg Co. v. Kohn*, 82 Minn. 419, 85 N.W. 159 (1901); *Browning v. National Capital Bank*, 13 D.C.App. 17 (1898); *Holcomb v. Noble*, 69 Mich. 396, 37 N.W. 497 (1888); *Aldrich v. Scribner*, 154 Mich. 23, 117 N.W. 581 (1908).

⁸ In the introduction to his *LIVES OF THE LORD CHANCELLORS*, Lord Campbell points out that when the Anglo-Saxons were converted to Christianity at about the end of the 6th Century, the King always had a priest near his person who was his confessor. He became popularly known as the keeper of the King's conscience.

In the course of time he acquired the power, and later the authority, which we associate with the Chancellor. Until the early part of the 14th Century this individual was, at practically all times, a churchman. The first lay Chancellor appointed by an English king was Sir Robert Bouchier who became Chancellor in 1340. For more than 700 years before that time the doctrines of Chancery were formulated by clerics. And for several hundred years thereafter the office of Chancellor was occupied by ecclesiastics. In the long list of British Chancellors are to be found such names as St. Swithin, Thomas a Becket, Walter Hubert (Archbishop of Canterbury), Cardinal Beaufort, Cardinal Wolsey, among many other eminent churchmen.

These early Chancellors were guided extensively by their religious training and inclinations. Their decisions hold strong evidence of that fact. For example, Cardinal Morton was called upon to decide whether a release executed by one of two executors was valid. It was contended that the court could grant no relief because the common law recognized its validity. The Chancellor said (Y.B. 4 Hen. 7, 4; 1489): "It is against reason that one executor should have all the goods, and give a release by himself. I know very well that every law should be consistent with the law of God; and that law forbids that an executor should indulge any disposition he may have to waste the goods of the testator; and if he does, and does not make amends, if he is able, he shall be damned in hell."

The emphasis of conscience is undoubtedly attributable to the ever present religious influence.

⁹ See Brice, *Roman Aequitas and English Equity* (1913), 2 GEO. L. J. 16. The general subject is discussed by Sir Frederick Pollock in *Contracts In Early English Law* (1893), 6 HARV. L. REV. 389, and by Professor Ames in *Parol Contracts Prior To Assumpsit* (1894), 8 HARV. L. REV. 252.

When the courts of law were released somewhat from the rigid formalism which circumscribed their remedies,¹⁰ they borrowed this equitable notion of "fraud". They undertook to give relief against some types of actual fraud. In doing so they were in no sense innovators, but partial copyists. They did not oust the Court of Chancery of jurisdiction to the extent to which they gave a remedy. That court had been granting relief against fraud not because there was no remedy at law, but because fraud was its own native growth. It continued to do so. The exercise of a partial concurrent jurisdiction by courts of law could not deprive the Court of Chancery of that which was its very own.¹¹

While the Court of Star Chamber existed, the Chancellor had little occasion to exercise his undoubted jurisdiction over fraud, for in that tribunal the plaintiff secured effective relief, and punishment was meted out to the defendant. When that court was abolished in 1641 the Court of Chancery was called upon more frequently to exercise its inherent authority.¹² This it did unrestrictedly, and without regard to the adoption of a concurrent jurisdiction by courts of law over some classes of actual fraud.¹³

¹⁰ See 2 POM. EQ. JURIS. (4th Ed. 1918) section 912.

A most comprehensive treatment of this subject is to be found in SELECT ESSAYS IN ANGLO-AMERICAN LEGAL HISTORY (1907); particularly POLLOCK, ENGLISH LAW BEFORE THE NORMAN CONQUEST (1898); MATTLAND, THE HISTORY OF THE REGISTER OF ORIGINAL WRITS (1889).

¹¹ In *Commercial, etc., Co. v. Southern Surety Co.*, 100 N.J.Eq. 92, 135 Atl. 511 (1926), *aff.* 101 N.J.Eq. 738, 138 Atl. 919 (1927), the court said: "The concurrent jurisdiction of the law courts to relieve against deceitful representations does not abridge equity's jurisdiction to grant relief on that score * * *."

See Holdsworth, *The Early History Of Equity* (1915), 13 MICH. L. REV. 293; Adams, *Origin Of English Equity* (1916), 16 COL. L. REV. 87.

The English cases likewise make it clear that the Court of Chancery lost no part of its authority in cases of fraud because of the practice of the law courts to give a remedy in certain cases of fraud. The most instructive case on this subject is *Slim v. Croucher*, *infra*, note 17. Each of the several opinions in that case emphasizes the fact that courts of law exercise jurisdiction in cases of fraud by a gradual extension of their powers, but that relief in equity had been administered without regard to the circumstance that a legal remedy might or might not be available, and that therefore the jurisdiction of equity was not wiped out to the extent that the law courts thereafter undertook to give a remedy.

¹² See STORY, EQUITY JURISPRUDENCE (14th Ed. 1918), section 262.

¹³ There is a single exception to an otherwise universal jurisdiction wherever the occasion for relief is fraud. Equity has no jurisdiction to cancel a will or its probate upon the ground that it was procured by fraud. There seems to be no good reason for the existence of this exception. Its origin does

When the juristic institutions of the mother country were transplanted into the American colonies, it had become thoroughly established that the English Court of Chancery was free to exercise jurisdiction in every case of actual fraud. It was doing so whether the form of relief sought was equitable, or merely a claim for money damages. In the leading case of *Colt v. Woollaston*,¹⁴ decided in 1723, the complainant filed a bill for a decree that the defendant repay £240 which the complainant alleged he paid for shares in a patented device through fraudulent representations of the defendant. Such a decree was made, the court declaring that there was no substance to the objection that the complainant had an adequate remedy at law. Lord Hardwicke, who did much to define the equitable conception of actual fraud, said in a case decided in 1745:

not warrant its continuance in this country. Under the English system, the validity of wills disposing of personal property was determined by the ecclesiastical courts, and as to wills disposing of realty the law courts offered an adequate remedy where fraud was alleged. Some of the early English cases asserted the existence of a jurisdiction in the Chancellor to determine such questions, but the rule became settled to the contrary. *Welby v. Thornough*, Prec. Ch. 123, 24 Eng. Rep. 59 (1700); *Maundy v. Maundy*, 1 Ch. Rep. 66, 21 Eng. Rep. 526 (1638); *Bennet v. Vade*, 2 Atk. 324, 26 Eng. Rep. 597 (1742); *Allen v. McPherson*, 1 H.L. Cas. 191, 9 Eng. Rep. 727 (1847).

In the United States the existence of an equity jurisdiction is generally denied. *Summer v. Staton*, 151 N.C. 198, 65 S.E. 902 (1909); *Knikel v. Spitz*, 74 N.J. Eq. 581, 70 Atl. 992 (1908); *South Camden M. E. Church v. Wilkinson*, 36 N.J. Eq. 139 (1882); *Broderick's Case*, 21 Wall. 503, 22 L. ed. 599 (1874); *Domestic Etc. Missionary Society v. Eels*, 68 Vt. 497, 35 Atl. 462 (1895); *Lyne v. Marcus*, 1 Mo. 410 (1823); *State v. Lancaster*, 119 Tenn. 638, 105 S.W. 858 (1907).

In *Gaines v. Chew*, 2 How. 619, 11 L. ed. 402 (1844), it was said: "It may be difficult to assign any very satisfactory reason for this exception. That exclusive jurisdiction, over the probate of wills is vested in another tribunal, is the only one that can be given."

A statutory jurisdiction to contest probate in equity exists in some states. See in this connection *Couch v. Eastman*, 27 W.Va. 796 (1886); *Wheeler v. Wheeler*, 134 Ill. 522, 25 N.E. 588 (1890).

Equity may treat the perpetrator of such a fraud as a trustee, and act upon his conscience and property accordingly. *Barnesly v. Powell*, 1 Ves. 287, 17 Eng. Rep. 1034 (1749); *Vincent v. Vincent*, 70 N.J. Eq. 272, 62 Atl. 700 (1905); *Sohler v. Sohler*, 135 Cal. 323, 67 Pac. 282 (1902).

¹⁴ 2 P. Wms. 154, 24 Eng. Rep. 639 (1723). See also *Slim v. Croucher*, 1 De Gex F. & J. 418, 45 Eng. Rep. 462 (1860); *Hill v. Lane*, L.R. 11 Eq. 215 (1870); *Redgrave v. Hurd*, 20 Ch. Div. 1, 51 L.J. Ch. 117 (1881); *Reese River Silver Mining Co. v. Smith*, L.R. 4 H.L. Cas. 64 (1869); *Rawlins v. Wickham*, 3 De Gex & J. 304, 44 Eng. Rep. 1285 (1858).

"The court very wisely hath never laid down any general rule beyond which it will not go, lest other means of avoiding the equity of the court should be found out."¹⁵

A few years later, in the celebrated case of *Chesterfield v. Janssen*,¹⁶ he stated:

"This court has undoubted jurisdiction to relieve against every species of fraud."

The doctrine which prevailed prior to and after the establishment of the American colonies is aptly described in the later case of *Slim v. Croucher*,¹⁷ in this language:

¹⁵ *Lawley v. Hooper*, 3 Atk. 278, 26 Eng. Rep. 962 (1745).

¹⁶ 2 Ves. 125, 28 Eng. Rep. 82 (1750). This celebrated decision contains the well-known classification of frauds against which equity gives relief. Not all of them are actual fraud. Some are what are known as constructive frauds. The 4 classes are stated in the following language: "(1) Then fraud, which is *dolus malus*, may be actual, arising from facts and circumstances of imposition; which is the plainest case. (2) It may be apparent from the intrinsic nature and subject of the bargain itself; such as no man in his senses and not under delusion would make on the one hand, and as no honest and fair man would accept on the other; which are unequitable and unconscientious bargains; and of such even the common law has taken notice; for which, if it would not look a little ludicrous might be cited 1 Lev. 111, *James v. Morgan*. A 3rd kind of fraud is, which may be presumed from the circumstances and condition of the parties contracting: and this goes farther than the rule of law; which is, that it must be proved, not presumed; but it is wisely established in this court to prevent taking surreptitious advantage of the weakness or necessity of another: which knowingly to do is equally against the conscience as to take advantage of his ignorance: a person is equally unable to judge for himself in one as the other. A 4th kind of fraud may be collected or inferred in the consideration of this court from the nature and circumstances of the transaction, as being an imposition and deceit on the other persons not parties to the fraudulent agreement."

¹⁷ 1 De Gex F. & J. 518, 45 Eng. Rep. 462 (1860). The separate opinion of Lord Campbell is highly instructive. He said: "The defense set up in the suit is, that there was a remedy at law, and that that is the only remedy competent to the plaintiff. Now, that there was a remedy at law I think is quite clear; there is no doubt in my mind that an action would lie, and that it would be for a jury to assess the damages. I am of opinion, however, that this belongs to a class of cases over which courts of law and courts of equity have a common jurisdiction, and in which the procedure of both jurisdictions is adapted for doing justice. I do not regret that there is such a class of cases, nor should I be sorry to see it extended. But being of opinion that this is a case in which a court of equity has jurisdiction as well as a court of law, I think that it is a much better case for a court of equity than for a court of law, because a court of law could only have left it to a jury to assess the damages; whereas here, by the superior powers of the court of equity, justice can be done between the parties in the most minute detail."

"It is true that according to modern practice a court of law would afford redress in the case by means of an action, with the assistance of a jury; but the courts of law in this country exercise jurisdiction in these cases by means of a gradual extension of their powers, and we know that that does not deprive the courts of equity of their ancient and undoubted jurisdiction which they exercised before courts of law enlarged their limits. The observation is familiar—and some of us have heard it used by Lord Eldon—that the jurisdiction not only belongs to this court, but belonged to it originally * * *"¹⁸

A host of decisions in the English Court of Chancery clearly establish that when its principles were taken into the administration of equity in this country, it was an accepted fact that the English Court was free to and did exercise jurisdiction in all cases of fraud.¹⁹

The equity courts of this country did not undertake to assert so broad an authority.²⁰ However, this was not true in

¹⁸ Compare the observation of Lord Eldon in *Evans v. Bicknell*, 6 Ves. Jr. 174, 31 Eng. Rep. 998 (1801); " * * * it is a very old head of equity, that if a representation is made to another person, going to deal in a matter of interest upon the faith of that representation, the former shall make that representation good, if he knows it to be false (*Burrowes v. Lock*, 10 Ves. 470); and in that case and some others there appears a disposition to hold, that if there was relief to be administered in equity, there ought to be relief at law: a proposition, that seems to me excessively questionable; and I doubt, whether it is not founded in pure ignorance of the constitution and doctrine of this Court."

¹⁹ See among others *St. Aubyn v. Smart*, L.R. 6 Ch. 646 (1877); *Ramshire v. Bolton*, L.R. 8 Eq. 294 (1869); *Hill v. Lane*, L.R. 11 Eq. 215 (1870).

See also Holdsworth, *Relation Of The Equity Administered By The Common Law Judges To The Equity Administered By The Chancellors* (1916), 26 YALE L. J. 1.

²⁰ An illustrative case is *Hunt v. Jones*, 203 Ala. 541, 84 So. 718 (1919) where it was said: "Fraud of itself is never, of itself, a foundation which will uphold a bill in equity. On the contrary, fraud is, in many cases, cognizable in a court of law."

See also *Learned v. Holmes*, 49 Miss. 290 (1873); *Youngblood v. Youngblood*, 54 Ala. 485 (1875); *Barkhamsted v. Case*, 5 Conn. 528 (1825); *Johnson v. Swanke*, 128 Wisc. 68, 107 N.W. 481 (1906).

The reason for the reluctance of most courts to exercise a jurisdiction over fraud comparable to that of the English Court of Chancery is stated in *Eggers v. Anderson*, *infra*.

New Jersey. In *Eggers v. Anderson*,²¹ decided by the Court of Errors and Appeals in 1901, and continuously cited thereafter, this fact is emphasized, the court saying:

“Undoubtedly the American courts have not generally upheld so broad a jurisdiction, being influenced probably, and sometimes controlled, by enactments similar to the United States Judiciary act of 1789, which declared that ‘suits in equity shall not be sustained in either of the courts of the United States in any case where a plain, adequate and complete remedy may be had at law.’ But New Jersey is distinguished from her sister states by her adherence to the standards of the mother country respecting both rights and remedies in equity, and I know of no constitutional or statutory provision or judicial decision in this state which can be regarded as withholding or withdrawing from our court of chancery any jurisdiction possessed by its English prototype. True the jurisdiction of equity, in cases of fraud remediable at law, has not been much invoked, but that may be accounted for, in large degree, by the less expensive, equally efficient and in former times more speedy, remedy secured in the courts of law. When resorted to, however, the jurisdiction of equity has not been doubted.”^{21a}

²¹ 63 N.J. Eq. 264, 49 Atl. 578 (1901).

When the Court of Chancery entertains a suit for a pecuniary recovery it applies the legal doctrine of fraud, upon the theory that it is entertaining a common law action for deceit. See in this connection *Smith v. Chadwick*, H.L. 9 App. Cas. 193 (1884); *Bonded Building and Loan Association v. Noll*, 111 N.J. Eq. 163, 161, Atl. 828 (1932). In the latter case the complainant filed a bill to foreclose two purchase money mortgages. The defendant filed a counterclaim for damages, alleging that the complainant made fraudulent misrepresentations about the property. Vice-Chancellor Backes said: “Proof of deceit is not essential in equitable remedies; reformation, rescission, cancellation and the like. It is sufficient if the representation be untrue, was relied upon, and injury ensued. *Eibel v. Von Fell*, 55 N.J. Eq. 670. But where the cause is legal in nature and redress may be afforded in an equity action, the rules of law are applied. Moral delinquency is essential to a recovery at law for fraud. *Cowley v. Smith*, 46 N.J.L. 380. The counterclaim in this case is entertained to avoid circuity of action. *Shannon v. Marselis*, 1 N.J. Eq. 413. But the proof of fraud must meet the legal standard of conscious fraud. *Faulkner v. Wassmer*, 77 N.J. Eq. 537. The defendant fails on that score.”

^{21a} Compare *Prudential Insurance Co. v. Merritt-Chapman etc. Corporation*, 111 N.J. Eq. 166, 162 Atl. 139 (1932), where Vice-Chancellor Berry said:

In that case the complainants presented a claim to be reimbursed for money and goods obtained from them by fraud. The court found that the value of the items could be ascertained as readily by a master as by a jury, and declared that "the fact that many small items are probably to be taken into account makes the master's office an apter place for getting at the truth." Another case in which the presence of an adequate remedy at law did not deter the Court of Chancery is *Winans v. Winans*,²² decided by Chancellor Zabriskie. The complainant sought a decree for the repayment of money fraudulently retained by the defendant. Although there was an adequate remedy at law, a decree was granted.²³

The decisions leave no room for doubt upon the authority of the Court of Chancery. It has jurisdiction and may exercise it if it chooses. Inadequacy of the legal remedy never gave rise to its jurisdiction, and therefore cannot now control it.

"This court has inherent jurisdiction in all cases involving fraud. *Eggers v. Anderson*, 63 N.J. Eq. 264; *Commercial Casualty Insurance Co. v. Southern Surety Co.*, 100 N.J. Eq. 92; affirmed, 101 N.J. Eq. 738. Its jurisdiction is co-extensive with that of the court of chancery of England as it existed at the time of the adoption of our first constitution on July 2d, 1776. Pat. L. 38. In fact, the court of chancery of this state has exercised such jurisdiction since the adoption of Lord Cornbury's ordinance establishing a high court of chancery in 1705, although it is from the ordinance of Governor Franklin adopted in 1770 that our court of chancery, as it exists today, derives its jurisdiction and powers. See 19 N.J. Eq. 577; *In re Vice-Chancellors*, 105 N.J. Eq. 759."

²²19 N.J. Eq. 222 (1868). Speaking of this case in *Eggers v. Anderson*, 63 N.J. Eq. 264, 49 Atl. 578 (1901), the Court of Errors and Appeals said: "Thus, in *Winans v. Winans*, 4 C.E.Gr. 220, where the complainant claimed that the defendant, by fraudulent representations concerning the encumbrances on land sold by the complainant to the defendant, had induced the former to refrain from demanding before conveyance a part of the price agreed upon, and the prayer was that the defendant should be decreed to pay the money thus fraudulently retained, the cause was argued by the present chancellor for the complainant and by a former chancellor for the defendant, without question as to the jurisdiction, and a decree for the complainant was put by Chancellor Zabriskie, distinctly on the ground of fraud in the non-payment of the price, and was to the effect that the defendant should pay the same. For such a remedy the courts of law would have been equally available."

²³Of course, where an objection to the jurisdiction of the court is made *in limine*, upon the ground that there is an adequate remedy at law, the court will refuse to exercise jurisdiction unless the administration of justice would be facilitated if it retains the case. Where, however, the defendant does not challenge the court's jurisdiction at the outset, relief will be granted since the jurisdiction of the court in cases of fraud does not arise from the inadequacy of the legal remedy, but from the inherent authority of the court over fraud. See *Krueger v. Armitage*, 58 N.J. Eq. 357, 44 Atl. 167 (1899).

The court is not required to give any heed to that circumstance. It is not obliged to present any excuse for acting in any case of fraud.

It has adopted a definite policy. Since law courts do give adequate relief in a variety of cases, equity has *elected* not to exercise its jurisdiction in such instances unless the administration of justice will be facilitated by doing so.

Although an adequate remedy exists at law, the *method* of equity may facilitate justice in many cases.²⁴

II

Passing the question of jurisdiction, we are brought to a consideration of the principles which equity applies in deciding questions of actual fraud. It is important to distinguish between that type of fraud and constructive frauds. Actual fraud springs from untruth. It may take the form of misrepresentation or concealment. In either case its essential ingredient is untruth.²⁵ An untruth has been put forth by one party calculated to induce action by another.

The equitable notion of constructive fraud does not necessarily arise from untruth. As pointed out by Mr. Pomeroy, such "frauds" arise "from general motives of policy, good morals and fair dealing."²⁶ The present inquiry is directed only to the nature and attributes of actual fraud. The latter is by far the more common occasion for equitable relief in insurance policy cases.

Actual fraud having originated in the idea of Conscience, it is natural that its limits and characteristics should be controlled by conscience. The conscience if of course a judicial

²⁴ The equitable method is characterized chiefly by the presence at all times of the basic principles of fairness and right which govern the action of the court; by its practice of drawing aside the veil of form so that the substance may be revealed; by the variety and completeness of the modes of relief available for the protection of a litigant's rights; and by the readiness with which these equitable doctrines and remedies are available in cases where prompt action is essential.

²⁵ See 2 POMEROY EQ. JURIS. (4th Ed. 1918), page 1807n.

²⁶ POMEROY *op. cit.* *supra* note 25.

one. It is an expression of the moral levels of the community.²⁷ Formerly the conscience was a personal and individual one.²⁸ The Chancellor exercised his own notions of fairness and right, and of course Conscience changed with each transfer of the Great Seal. This gave rise to Selden's familiar comparison of Conscience to the length of the Chancellor's foot.²⁹

With the accumulation of precedents and the establishment of a *system* of equitable principles and doctrines, there arose a judicial conscience—a civil and political one.³⁰ To the existing principles and doctrines of the Court of Chancery,

²⁷ In his essay, *THE PARADOXES OF LEGAL SCIENCE* (1927), Justice Cardozo gives expression to this fact, not referring specifically to conscience, however, in this language: "Law accepts as the pattern of its justice the morality of the community whose conduct it assumes to regulate. In saying this, we are not to blind ourselves to the truth that uncertainty is far from banished. Morality is not merely different in different communities. Its level is not the same for all the component groups within the same community. A choice must still be made between one group standard and another. We have still to face the problem, at which one of these levels does the social pressure become strong enough to convert the moral norm into a jural one? All that we can say is that the line will be higher than the lowest level of moral principle and practice, and lower than the highest. The law will not hold the crowd to the morality of saints and seers. It will follow, or strive to follow, the principle and practice of the men and women of the community whom the social mind would rank as intelligent and virtuous."

²⁸ Lord Campbell in his *LIVES OF THE LORD CHANCELLORS* observes (Vol. 1, page 33): "In former times *unconscientious* Chancellors, talking perpetually of their *conscience*, have decided in a very arbitrary manner, and have exposed their jurisdiction to much odium and many sarcasms. But the preference of individual opinion to rules and precedents has long ceased: "the doctrine of the court" is to be diligently found out and strictly followed; and the Chancellor sitting in equity is only to be considered a magistrate, to whose tribunal are assigned certain portions of forensic business, to which he is to apply a well-defined system of jurisprudence,—being under the control of fixed maxims and prior authorities, as much as the judges of the courts of common law. He decides "*secundum arbitrium boni viri*"; but when it is asked, "*Vir bonus est quis?*" the answer is, "*Qui consulta patrum, qui leges juraque servat.*"

²⁹ "Equity is a roguish thing. For law we have a measure, and know what we trust to. Equity is according to the conscience of him that is Chancellor; and as that is larger or narrower, so is equity; 'Tis all one as if they should make his foot the standard for the measure we call a Chancellor's foot. What an uncertain measure would this be! One chancellor has a long foot, another a short foot, a third an indifferent foot. 'Tis the same thing in the Chancellor's conscience."—*Table Talk*.

³⁰ Unlike the conscience which previously obtained, this judicial conscience is capable of ascertainment. It can be gathered by comprehending the principles and maxims of equity and from observing the course of their development and the current trend. The administration of equity has now taken the form of an application of the existing doctrines of the court in the light of experience to meet the needs of a constantly developing civilization.

the Chancellor adds the current estimate of right conduct, and draws from this a conception of good conscience.³¹ The operation of this process in our Court of Chancery has resulted in the establishment of distinct classes of actual fraud, which are actionable because they are violations of conscience:

1. The statement of a fact, which is untrue, made with actual knowledge of its falsity.

2. The statement of a fact, which is untrue, made without knowledge whether it is true or false.

3. The statement of a fact, which is untrue, and not known to be true, but honestly believed to be true by the declarant.

4. The statement of opinion or belief by one who has no honest belief in the truth of his declaration.³²

Little need be said of the first class. It amounts to a complete awareness of falsity, which is readily observed to be unconscionable.

³¹ Compare CARDOZO, *THE PARADOXES OF LEGAL SCIENCE* (1927), page 17:

"The state in commissioning its judges has commanded them to judge, but neither in constitution nor in statute has it formulated a code to define the manner of their judging. The pressure of society invests new forms of conduct in the minds of the multitude with the sanction of moral obligation, and the same pressure working upon the mind of the judge invests them finally through his action with the sanction of the law."

And at page 55: "A judge is to give effect in general not to his own scale of values, but to the scale of values revealed to him in his readings of the social mind. * * * Objective tests may fail him, or may be confused as to bewilder. He must then look within himself."

³² In any case the fraud must relate to a material matter and must be relied upon by the other party. See *Parker v. Hayes*, 39 N.J. Eq. 469 (1885); *United Life and Accident Insurance Co. v. Winnick*, 113 N.J. Eq. 288, 166 Atl. 515 (1933); *Wuesthoff v. Seymour*, 22 N.J. Eq. 66 (1871); *Taylor v. Guest*, 58 N.Y. 262 (1868); *Marriner v. Dennison*, 78 Cal. 202, 20 Pac. 386 (1889); *Jakway v. Proudfit*, 76 Neb. 62, 106 N.W. 1039 (1906).

The classification set forth in the text is not to be found in any one New Jersey case. It is gathered from and supported by *Keene v. James*, 39 N.J. Eq. 257 (1885); *Ricketts v. Tompkins*, 73 N.J. Eq. 552, 68 Atl. 1075 (1907); *Eibel v. Von Fell*, 55 N.J. Eq. 670, 38 Atl. 201 (1897); *Smith v. Krueger*, 71 N.J. Eq. 531, 63 Atl. 850 (1905); *Straus v. Norris*, 77 N.J. Eq. 33, 75 Atl. 980 (1910); *Kuntz v. Tonnele*, 80 N.J. Eq. 373, 84 Atl. 625 (1912); *Du Bois v. Nugent*, 69 N.J. Eq. 145, 60 Atl. 339 (1905).

The New Jersey cases are not in accord with the view of Mr. Pomeroy that a statement of fact which is untrue, made upon honest belief for which reasonable grounds actually existed, is not fraudulent either in equity or at law. 2 POM. EQ. JURIS. (4th Ed. 1918) page 1838. This learned writer's opinion does not seem to be supported by the decisions which he cites for it. It fails to give consideration to the fact that the type of representation in question,

The second and third classes each present a high degree of moral delinquency. One who puts forth a statement of fact represents that it is the *fact*. He has been asked to state a fact. He gives an unqualified answer. He thus holds himself out as *knowing* and not merely believing that it is the fact. If he does not have knowledge he is necessarily aware that he lacks it. At the same time, he is also aware that he is representing to the other party that he *does* possess such knowledge. Hence, his moral culpability is little different from that of the individual who utters an untruth knowing it to be untrue.

A somewhat different doctrine obtains at law. There it is held that if a declarant actually believes in the truth of his statement, he is not guilty of fraud. In determining whether or not such belief did in fact exist, the inquiry is not whether a reasonable man would indulge in it. The question always is: Did the declarant in fact believe as he says he did? Its reasonableness is looked to by the court or jury only for the purpose of discovering whether the declarant did in fact entertain the belief. In other words, the subjective and not the objective test is applied. This rule, which was laid down by the celebrated case of *Derry v. Peek*,³³ is not followed in a considerable

like all others, must be measured by conscience. Conscience is violated when an individual holds himself out as knowing a fact to be true, when his mind informs him that he only has an honest belief in its truth. It makes little difference whether this is called moral culpability, or as suggested in *Derry v. Peek*, H.L. 14 App. Cas. 337 (1889), mental culpability. The essential fact is that the individual's departure from good conscience *was designed to induce another to act to his damage*.

³³ 14 App. Cas. H.L. 337 (1889).

It is interesting to note that in *James-Dickenson Farm Mortgage Co. v. Harry*, 273 U.S. 119, 47 S. Ct. 308, 71 L. Ed. (1927), the court held to be constitutional an Oregon statute which provided that actual fraud exists not only where there is a false representation of a past or existing material fact, but also if there is a false promise to do some act in the future but for which promise the other party would not have entered into the contract. The statute also provided that whenever such a promise was not complied with within a reasonable time, a presumption would arise that it was falsely and fraudulently made, upon which the burden would be cast on the party making the promise to prove that it was made in good faith and that by an act of God, or the public enemy, or by some equitable reason performance was prevented. The court concluded that this legislation did not violate the due process clause of the 14th amendment.

number of states.³⁴ It has been adopted in New Jersey,³⁵ but its application is confined to courts of law.³⁶ The Court of Chancery considers that one who represents that he has knowledge of a fact, violates the dictates of conscience if he does not *know*. If an individual does not know whether his statement is true, he cannot have, in the contemplation of equity, a belief in its truth. Real belief results from knowledge. That which is called "belief" where knowledge is not present, is really something else. The individual knows certain things which point to the probability that a given fact is true. He therefore concludes that fact is true. This is but conclusion, conjecture or surmise. It is not knowledge, which alone can produce belief, in the equitable view. Hence conscience is violated by an assertion that the declarant has knowledge when in fact he has only conviction.³⁷

³⁴ See among others *Charles P. Kellogg Co. v. Kohn*, 82 Minn. 419, 85 N.W. 159 (1901); *Browning v. National Capital Bank*, 13 D.C. App. 17 (1898); *Holcomb v. Noble*, 69 Mich. 396, 37 N.W. 497 (1888); *Aldrich v. Scribner*, 154 Mich. 23, 117 N.W. 581 (1908); *Johnson v. Gulich*, 46 Neb. 817, 65 N.W. 883 (1896).

³⁵ *Du Bois v. Nugent*, 69 N.J.Eq. 145, 60 Atl. 339 (1905).

³⁶ See note 35, *supra*. See also *Kosobucki v. McGarry*, 104 N.J.L. 65, 139 Atl. 31 (1927); *Berkowitz v. Lyons*, 98 N.J.L. 198, 119 Atl. 20 (1922); *Bingham v. Fish*, 86 N.J.L. 316, 90 Atl. 1106 (1914); *Grant Inventions Co. v. Grant Oil Burner Corporation*, 104 N.J.Eq. 341, 145 Atl. 721 (1929).

Compare Williston, *Liability For Honest Misrepresentation*, (1911), 24 HARV. L. REV. 415.

³⁷ The three forms of misrepresentation discussed thus far hold these characteristics in common: An individual is asked to state something as a fact. His opinion or conclusion is not sought. He answers that inquiry and therefore presumes to comply with the request it contains that he answer by making a statement that such a thing is a fact. Actually he does not know the thing which he asserts, to really be the fact. At most he honestly believes (i.e. accepts) it. He is necessarily conscious that this is his state of mind, and yet he asserts that he knows the matter to be a fact. He misrepresents the true state of his mind in order to induce action by another who may be injured if this opinion proves to be contrary to fact. This is not good conscience.

Of course, the Court of Chancery does not undertake to give redress for every violation of conscience. It is only where such a violation is utilized to induce action by another that the court acts. Even then, equity leaves many matters of conscience and morality unremedied. There must necessarily be a period during the slow growth of moral tendencies within which it is impossible to determine either their desirability or the the extent of their acceptance.

In connection with the moral culpability of the several types of conduct discussed in the text, compare WESTERMARCK, *ETHICAL RELATIVITY* (1932) page 234:

"But untruthfulness is not merely condemned on utilitarian grounds, on account of the harm it is apt to cause: it is an object of disinterested, moral resentment

The fourth class rests upon the same principles. When an individual is asked to state his opinion or belief, the limit of his power is to give his honest opinion. The limit of the request is that he do just that. Hence, if he states his opinion honestly he gives to the other party all that the latter seeks, and all that the declarant knows. But if he has one opinion and states another, obviously he utters an untruth. Since the entire matter has to do with his mental state, he is conscious that he is misrepresenting his true opinion.³⁸

Here the subjective test is applied in equity. Whether his belief was honest is not determined by considering whether it was reasonable. If the declarant actually entertained the belief, then he stated truly what his opinion really was. The reasonableness of indulging in that belief is looked to only to discover whether or not he did in fact hold such an opinion.³⁹ Hence, an expression of honest opinion when the declarant is interrogated only as to his belief, is not actionable fraud in equity,⁴⁰ or at law.⁴¹

also because it is intrinsically antipathetic." See JOACHIM, *THE NATURE OF TRUTH* (1906); MOORE, *PRINCIPIA ETHICA* (1922); SPENCER, *THE PRINCIPLES OF ETHICS* (1897); SIDGWICK, *THE METHODS OF ETHICS* (1913).

³⁸ Compare the language of Bowen, L.J., in *Edington v. Fitzmaurice*, 29 Ch. Div. 459 (1885): "There must be a misstatement of an existing fact. But the state of a man's mind is as much a fact as the state of his digestion. It is true that it is very difficult to prove what the state of a man's mind at a particular time is, but if it can be ascertained it is as much a fact as anything else. A misrepresentation as to the state of a man's mind is, therefore, a misstatement of fact."

³⁹ In *BISPHAM, PRINCIPLES OF EQUITY* (9th Ed. 1915) page 361, it is said: "It is to be observed, moreover, that whether a man has or has not *reasonable grounds* for believing what he asserts, is not the question. The true criterion is, does he *actually believe*. The existence or non-existence of reasonable grounds is a fact, from which actual belief may be inferred or not, as the case may be; and the unreasonableness of the alleged belief is evidence to disprove its real existence—nothing more."

⁴⁰ *Shapiro v. Metropolitan Life Insurance Co.*, 110 N.J.Eq. 287, 150 Atl. 680 (1932), affirmed 114 N.J.Eq. 378, 168 Atl. 637 (1933).

In *Smith v. Prudential Ins. Co.*, 83 N.J.L. 719, 85 Atl. 190 (1912), the statement is made that with respect to an inquiry about the assured's health, an answer that the assured was in good health was warranted if he had reason to and did believe his health to have been good. That the court did not intend by this statement to establish the objective rule, under which it would become a question of fact whether or not the assured had good reason for indulging in his belief, is evident from language used further on in its opinion. The court said: "* * * the verdict of the jury establishes the fact that the applicant, according to the best of his knowledge, believed he was in good health * * *." It is apparent that the court intended to require only a true expression of the *actual*

In addition to the mental violation of good conscience, an external one is present in all classes of actual fraud. It is found in the imposition which is worked by every material misrepresentation or concealment. In the contemplation of equity, one who even innocently represents a material fact which turns out to be untrue, is morally delinquent if he insists upon retaining the benefits of the transaction. When the untruth of his representation is brought to his attention and he is called upon either to make good his representation or restore the other party to his former status, his refusal to do so is a moral wrong. This doctrine is well put in a leading English case, *Redgrave v. Hurd*.⁴² Speaking of the principle which had been and still was enforced in equity, the court said (Sir George Jessel, Master of the Rolls) :

“According to the decisions of courts of equity, in order to set aside a contract, it was not necessary to prove that the person who obtained the contract, and who sought to keep it, if he obtained it by material false representation, knew at the time the representation was made that such representation was false. It

knowledge of the applicant. The *Shapiro* case conclusively indicates that this is its policy, for the opinion declares that if the applicant answers truthfully to the full extent of his knowledge, he is not chargeable with false representation.

⁴¹ See *Cowley v. Smyth*, 46 N.J.L. 380 (1884); *Deweese v. Manhattan Insurance Co.*, 34 N.J.L. 244 (1870); *Henn v. Metropolitan Life Insurance Co.*, 67 N.J.L. 310, 51 Atl. 689 (1902); *Schoenfeld v. Winter*, 76 N.J.Eq. 511, 74 Atl. 975 (1909); *Commercial Casualty etc., Co. v. Southern Surety Co.*, 100 N.J.Eq. 92, 135 Atl. 511 (1926) *aff.* 101 N.J.Eq. 738, 138 Atl. 919 (1927).

⁴² 20 Ch. Div. 1, 51 L.J. Ch. 117 (1881). The facts in this case indicated that the complainant advertised in a newspaper that he desired a partner in his law practice, who would be willing to purchase a lease which the complainant held. The defendant answered the advertisement, and to induce him to enter into a contract the complainant represented that his practice produced £300 a year. His books indicated an income of £200 a year, and when asked to account for the difference the complainant pointed to papers lying on his desk, which he said represented the rest of his business. The defendant did not examine those papers, but had he done so they would have shown business representing five or six pounds. He consummated a partnership agreement including an obligation to purchase the lease in question, and paid a deposit. Upon discovering thereafter that the law practice was not as represented, he refused to complete the contract. The complainant sued for specific performance and the defendant filed a counterclaim for rescission, and was granted that relief.

was put in two ways, either of which was sufficient to induce a court of equity to rescind.

It was said:

‘A man is not to be allowed to get a benefit from a statement which he now admits to be false.’

“That is one way of putting it. The other way of putting it was this:

‘Even assuming that you want moral fraud in order to set aside a contract, you have it where a man, having obtained a beneficial contract by a statement he knows to be false, insists upon keeping that contract.’

“That of course, is a moral delinquency; no man ought to ask to take advantage of his own falsity. It does not matter which way it is put, but that was the rule in equity.”⁴³

This view has been adopted by the New Jersey Court of Chancery,⁴⁴ and equivalent expressions are to be found in its decisions.⁴⁵

⁴³ Compare WESTERMARCK, *ETHICAL RELATIVITY* (1932) page 233: “Nor are we injured by a deception merely because we like to know the truth, but, chiefly, because it is of much importance for us that we should know it. Our conduct is influenced by ideas; hence the erroneous notion as regards some fact in the past, present, or future, which is produced by a lie, may lead to unforeseen events detrimental to our interests. * * * How largely the condemnation of falsehood is due to the harm suffered by the victim appears from the fact that a lie is held more condemnable in proportion to the magnitude of the harm caused by it.” See also MILL, *UTILITARIANISM* (1895); BENTHAM, *AN INTRODUCTION TO THE PRINCIPLES OF MORALS AND LEGISLATION* (1879); ALBEE, *A HISTORY OF ENGLISH UTILITARIANISM* (1902).

⁴⁴ *DuBois v. Nugent*, 69 N.J. Eq. 145, 60 Atl. 339 (1905).

⁴⁵ See *Blau v. Public Service Tire & Rubber Co.*, 90 N.J. Eq. 279, 102 Atl. 664 (1918); *Gihon v. Morris*, 90 N.J. Eq. 65, 105 Atl. 455 (1918). In the last cited case, Vice-Chancellor Backes said: “It is sufficient that the representation was one of fact, that it was false and that the party relying upon it suffered in consequence.” This decision was reversed upon grounds which do not detract from the foregoing statement. 90 N.J. Eq. 230, 106 Atl. 807 (1918).

III

It remains to observe the operation of the foregoing principles in actions to rescind and cancel life insurance policies.

The legislature has provided that such a policy shall contain the entire contract between the parties, and that nothing shall be incorporated into it by reference unless the same is attached to the policy when issued.⁴⁶ Prior to this legislation, statements of the assured made part of the policy were considered as warranties.⁴⁷ Those which were not set forth in or made a part of the policy were representations.⁴⁸

The language of the statute requires that the preliminary application of the assured, usually containing numerous statements of fact and opinion, must be annexed to the policy if it is desired that it may be considered as part of the contract. To do so, however, would convert the assured's representations, intended by both parties to be such, into warranties.⁴⁹ A fraudulent misrepresentation, in order to be actionable, must relate to a *material* matter.⁵⁰ But a false warranty vitiates a contract even though it relates to an entirely immaterial fact.⁵¹ Therefore the legislature provided that all of the

⁴⁶ P.L. 1925, Chap. 179.

⁴⁷ *Jersey City Insurance Co. v. Carson*, 44 N.J.L. 210 (1882); *Deweese v. Manhattan Insurance Co.*, 34 N.J.L. 244 (1870).

⁴⁸ *American Popular Life Insurance Co. v. Day*, 39 N.J.L. 89 (1876); *Henn v. Metropolitan Life Insurance Co.*, 67 N.J.L. 310, 51 Atl. 689 (1902); *Dimick v. Metropolitan Life Insurance Co.*, 67 N.J.L. 367, 51 Atl. 692 (1902).

See also *Southern Surety Co. v. Barham*, 133 Ark. 220, 202 S.W. 231 (1918); *Myers v. Mutual Life Insurance Co.*, 83 W. Va. 390, 98 S.E. 424 (1919); *Miller v. National Casualty Co.*, 62 Pa. Super. Ct. 417 (1916); *Merchants Reserve Life Insurance Co. v. Richardson*, 66 Ind. App. 567, 118 N.E. 576 (1918); *Business Men's Assur. Co. v. Marriner*, 223 Mich. 1, 193 N.W. 907 (1923).

⁴⁹ *Prudential Insurance Co. v. Merritt-Chapman etc. Corporation*, 111 N.J. Eq. 166, 162 Atl. 139 (1932).

⁵⁰ *Lembeck v. Gerken*, 86 N.J.L. 111, 90 Atl. 698 (1914); *Brown v. Honiss*, 74 N.J.L. 501, 68 Atl. 150 (1907); *Gordon v. Schellhorn*, 95 N.J. Eq. 563, 123 Atl. 549 (1924); *Henn v. Metropolitan Life Insurance Co.*, 67 N.J.L. 310, 51 Atl. 689 (1902); *Dimick v. Metropolitan Life Insurance Co.*, 67 N.J.L. 367, 51 Atl. 692 (1902).

See also *Baltimore Insurance Co. v. Floyd*, 28 Del. 201, 91 Atl. 653 (1914), *aff.* 28 Del. 431, 94 Atl. 515 (1915); *Empire Life Insurance Co. v. Gee*, 171 Ala. 435, 55 So. 166 (1911); *Minnesota Mutual Life Insurance Co. v. Lusk*, 230 Ill. 273, 82 N.E. 637 (1907); *Holland v. Western Union Life Insurance Co.*, 58 Wash. 100, 107 Pac. 806 (1910).

⁵¹ *Deweese v. Manhattan Life Insurance Co.*, 34 N.J.L. 244 (1870); *Sussex County Mutual Life Insurance Co. v. Woodruff*, 26 N.J.L. 541 (1857); *Clayton*

assured's statements should, "in the absence of fraud," be deemed representations and not warranties.

The obvious intent of the legislature was to preserve for the assured's representations their character as such. This was the only object it sought to accomplish by the provision in question. It was not undertaking to define the nature of the fraud for which a policy might be rescinded. The use of the words "in the absence of fraud", must be considered in connection with the purpose of their context. Since that purpose was to retain the distinction between warranties and representations, this phrase cannot be regarded as a legislative definition of fraud. In a recent decision⁵² Vice Chancellor Berry pointed this out *obiter*, and called attention to the fact that the statute was patterned after a New York enactment which had been so construed. It is apparent that the legislature, out of an abundance of caution, endeavored to make it clear that the assured's representations should continue to be such only in the absence of fraud. If that appeared then they would necessarily become *misrepresentations*.

Hence, the Court of Chancery and courts of law are free to apply their respective conceptions of fraud.⁵³ When called upon to give effect to this statute, the law courts have required proof of fraud in accord with their established doctrines, declaring that there must be evidence either of knowledge of falsity, or of a positive statement made without knowing it to be true.⁵⁴ In the recent case of *Shapiro v. Metropolitan Life*

v. General Accident Fire and Life Assur. Corp., 104 N.J.L. 364, 140 Atl. 307 (1928); *Locker v. Metropolitan Life Insurance Co.*, 107 N.J.L. 257, 151 Atl. 627 (1930).

See also *Knickerbocker Life Insurance Co. v. Trefz*, 104 U.S. 197, 26 L. ed. 708 (1881); *Aetna Life Insurance Co. v. Millar*, 113 Md. 686, 78 Atl. 483 (1910); *Home Mutual Life Insurance Co. v. Gillespie*, 110 Pa. 84, 1 Atl. 340 (1885); *Metropolitan Life Insurance Co. v. Rutherford*, 95 Va. 773, 30 S.E. 383 (1898).

⁵²*Prudential Insurance Co. v. Merritt-Chapman etc. Corporation*, 111 N.J. Eq. 166, 162 Atl. 139 (1932).

⁵³*Prudential Insurance Co. v. Merritt-Chapman etc. Corporation*, 111 N.J. Eq. 166, 162 Atl. 139 (1932).

⁵⁴In *Locker v. Metropolitan Life Insurance Co.*, 107 N.J.L. 257, 151 Atl. 627 (1930), the Court of Errors and Appeals, referring to several earlier decisions, said:

" * * * where, as here, a policy provides, as required by our Insurance law, that 'all statements made by the insured, shall, in the absence of fraud, be

Insurance Co.,⁵⁵ the legal rule was followed in the Court of Chancery and a bill for the rescission and cancellation of a policy was dismissed. The decree was affirmed by the Court of Errors and Appeals upon the ground that there was no evidence of falsity in the assured's representations. The court found it unnecessary to decide whether the complainant was obliged to prove "legal" or merely "equitable" fraud, saying:

"Passing the question as to the obligation resting upon appellant, under the issue framed, to prove moral or conscious fraud (*Metropolitan Life Insurance Co. v. Sussman*, 109 N.J.Eq. 582) we have reached the conclusion that false representations, in the particulars indicated, were not made by the insured."⁵⁶

The opinion in the court below was based largely upon *Metropolitan Life Insurance Co. v. Sussman*.⁵⁷ The opinion of the Court of Errors and Appeals indicates that the Sussman decision turned upon the issue created by the particular alle-

deemed representations and not warranties,' the policy will be avoided for a misrepresentation in the application, made a part thereof, if the misrepresentation be material and fraudulent; that is to say, if it be the statement of something as a fact, which is untrue, and which the insured stated, knowing it to be untrue, and with an intent to deceive, or which he stated positively as true, without knowing it to be true, and which had a tendency to mislead; such fact in either case being material to the risk."

⁵⁵ 110 N.J. Eq. 287, 159 Atl. 680 (1932).

⁵⁶ 114 N.J. Eq. 378, 168 Atl. 637 (1933).

⁵⁷ The learned Vice Chancellor, in referring to the Sussman decision, said: "In *Metropolitan Life Insurance Co. v. Sussman*, 109 N.J.Eq. 582, the court of errors and appeals held that in order to procure the cancellation of an accident insurance policy on the ground of misrepresentations made in the application for the policy, it must appear that the misrepresentations were 'fraudulent in purpose'."

The decision was rested in part upon the doctrine which had been established in the law courts as stated in *Locker v. Metropolitan Life Insurance Co.*, *supra* note 54. Referring to this and other similar decisions, the learned Vice Chancellor said:

"The cases cited above arose in the law courts. But the statute of 1907, and the provision in the policy based thereon, have the same effect whether the litigations be at law or in equity. The interpretation given them by the court of errors and appeals is conclusive here. A false statement made by an applicant for life insurance, even though material, is not a ground for avoiding the policy issued in reliance thereon, unless made with an intent to deceive or unless it relates to a matter of which the applicant was consciously ignorant."

In connection with this reasoning see *Prudential Insurance Co. v. Merritt-Chapman etc. Corporation*, 111 N.J.Eq. 166, 162 Atl. 139 (1932).

gations of the bill. The opinion in the Sussman case clearly discloses this fact. It recites:

"Under the allegations in the bill of complaint it was incumbent on the complainant to prove the misrepresentations in the answers given and that those answers were fraudulent in purpose. The learned vice-chancellor reached the conclusion that this burden had not been met and advised the dismissal of the bill." The bill alleged acts of willful fraud.

In neither of these decisions did the Court of Errors and Appeals suggest that the equitable conception of actual fraud was no longer applicable in actions to rescind and cancel life insurance policies. For the purposes of decision the question whether the Court of Chancery is free to enforce its own doctrine of actual fraud was not even considered.⁵⁸ On the other hand, decisions of the Court of Chancery, decided with reference to the statute discussed above, answer that question affirmatively.⁵⁹

These two decisions appear to depart from a principle which had previously been acted upon by the Court of Chancery and the Court of Errors and Appeals. In fact they do not. If a complainant alleged misrepresentation of a material fact

⁵⁸ The allegations in the Sussman case charged the defendant with willful misrepresentation in answering questions which called for his opinion or belief. As previously observed herein, such misrepresentations must necessarily be purposeful. In the Shapiro case the Court of Errors and Appeals clearly indicated that its decision was based solely upon the circumstance that the representations to like inquiries were not false.

⁵⁹ In *Prudential Insurance Co. v. Holmes*, 111 N.J.Eq. 115, 162 Atl. 135 (1932), it was said: "A court of equity will relieve from false representations whether they are intentional or made through mistake, and it has been held that the fact that a misrepresentation in securing a policy of insurance was made innocently will not prevent rescission of a contract of insurance on the ground of misrepresentation. *Travelers Insurance Co. v. Evslin*, 101 N.J.Eq. 527; *Aetna Life Insurance Co. v. Sussman*, 111 N.J.Eq. 358. See, also, *Eibel v. Von Fell*, 55 N.J.Eq. 670. Representations made with knowledge, which are untruthful representations of a material fact, are deemed fraudulent. See *Commercial Casualty Insurance Co. v. Southern Surety Co.*, 100 N.J.Eq. 92; *affirmed*, 101 N.J.Eq. 738, wherein this court (at p. 96) says: '* * * in equity an untruthful representation of a material fact, though there be no moral delinquency is deemed to be fraudulent.'"

See also *Travelers Insurance Co. v. Evslin*, 101 N.J.Eq. 527, 139 Atl. 520 (1927); *Prudential Insurance Co. v. Merritt-Chapman etc. Corporation*, 111 N.J.Eq. 166, 162 Atl. 139 (1932).

with knowledge of its falsity, and was unable to prove the whole of that allegation, relief was nevertheless granted if he proved misrepresentation of a material fact.⁶⁰ While the rule that the *probata* must conform to the *allegata* applies in equity as well as law,⁶¹ it is essentially a rule of practical utility and not a doctrine of public policy. When its application will not further the administration of justice it has no valid claim for enforcement. Reason and necessity control its use. This is evident from the fact that both law and equity courts liberally permit the amendment of pleadings to conform to the proofs which have been adduced.⁶²

Prior to the decision of *Metropolitan Life Insurance Co. v. Sussman*⁶³ it was considered that neither reason nor practical utility called for the application of this somewhat formal doctrine where equitable relief was sought for fraud. Underlying this idea there was undoubtedly the view that if the complainant could not prove his allegations of legal fraud but did prove equitable fraud, the defendant was not harmed by the failure of the complainant to prove the whole of his allegations. If the defendant was prepared to contest an allegation of willful falsity he was certainly prepared to contest every part of that allegation. Hence, if the complainant proved only the making of a false representation of a material fact, he established some part of the very thing he alleged. The defendant could not be surprised, because no new material was introduced by the proofs which was not embraced in the pleadings. Above all, the complainant *had* proved a case. For these reasons the Court of Chancery regarded the allega-

⁶⁰ Du Bois v. Nugent, 69 N.J. Eq. 145, 60 Atl. 339 (1905); Commercial, etc., Co. v. Southern Surety Co., 100 N.J. Eq. 92, 135 Atl. 511 (1926), *aff.* 101 N.J. Eq. 738, 138 Atl. 919 (1927).

⁶¹ Parsons v. Heston, 11 N.J. Eq. 155 (1856); Marsh v. Mitchell, 26 N.J. Eq. 497 (1875); Humphreys v. Eastlack, 63 N.J. Eq. 136, 51 Atl. 775 (1902).

⁶² Midmer v. Midmer, 25 N.J. Eq. 299 (1875), *aff.* 27 N.J. Eq. 548 (1876); Hampton v. Nicholson, 23 N.J. Eq. 423 (1873); Dittman v. Distilling Co. of America, 64 N.J. Eq. 537, 54 Atl. 570 (1903); Allen v. Allen, 76 N.J. Eq. 245, 74 Atl. 274 (1909); Valiant v. Plaza Realty Co., 7 N.J. Misc. 340, 145 Atl. 475 (1929); Redstrake v. Cumberland Mutual Fire Insurance Co., 44 N.J.L. 294 (1882).

⁶³ 109 N.J. Eq. 582, 155 Atl. 406 (1931).

tions of willful and conscious fraud as mere surplusage.⁶⁴ As recently as 1927 the Court of Errors and Appeals stated as a reason for refusing to dismiss a bill for alleged want of equity:

"* * * even though it be * * * that the bill discloses that all the misrepresentations were deceitfully made, it may be that the complainant would not be able to prove that the misrepresentations were knowingly false, but could only prove that they were material and untrue * * *"⁶⁵

The subsequent opinion of that court in *Metropolitan Life Insurance Co. v. Sussman* which apparently states a contrary rule, does not refer to any of the earlier decisions. There is no express indication within it that the cases stating a different rule are overruled, and it must be taken that they are not.⁶⁶ The misrepresentations upon which the company relied related to matters of belief,⁶⁷ which necessarily must be consciously and purposefully fraudulent.⁶⁸ For this reason the opinion of the Court of Errors and Appeals is not in fact a departure from its previously stated doctrine.

An outstanding characteristic of the recent cases is their emphasis of the distinction between representations of fact

⁶⁴In *DuBois v. Nugent*, 69 N.J. Eq. 145, 60 Atl. 339 (1905), Vice-Chancellor Emery said: "If the representations and their falsity are satisfactorily proved, the allegations, as to their willful and fraudulent character, may, so far as any right to rescind is concerned, be considered as superfluous or unnecessary."

Compare *Gihon v. Morris*, 90 N.J. Eq. 65, 105 Atl. 664 (1918) rev. 90 N.J. Eq. 230, 105 Atl. 664 (1918).

⁶⁵*Commercial, etc., Co. v. Southern Surety Co.*, 100 N.J. Eq. 92, 135 Atl. 511 (1926), *aff.* 101 N.J. Eq. 738, 138 Atl. 919 (1927).

⁶⁶The rule is well settled, as stated in *United States v. Moreland*, 258 U.S. 433, 42 Sup. Ct. 368, 66 L. ed. 700 (1921):

"A case is not overruled by omission to mention it in a case subsequently coming before the court involving the same question."

⁶⁷Vice Chancellor Backes discussed the opinion filed in the Court of Chancery (Docket 65, page 389) in *United Life & Accident Insurance Co. v. Winnick*, 113 N.J. Eq. 288, 166 Atl. 515 (1933). He observed: "* * * one of the misrepresentations related to other insurance held by the defendant which the complainant alleged he had falsely suppressed; it appeared, however, that the insurance company had notice of the other insurance and, consequently, had not relied on the written misrepresentation. As to the other misrepresentations, one related to the defendant's physical condition, to which the answer was not untrue, and the other concerned his general health, which resting in opinion honestly given, though untrue, was a representation of belief, not of fact."

⁶⁸See note 38, *supra*.

and representations of opinion or belief. In *United Life & Accident Insurance Co. v. Winnick*,⁶⁹ the assured was asked to name all causes for which he had consulted a doctor in the past ten years. Vice Chancellor Backes pointed out that the company did not thereby solicit his opinion but asked for a fact relating to his personal conduct, of which he necessarily had definite knowledge.⁷⁰ On the other hand, in *Shapiro v. Metropolitan Life Insurance Company*,⁷¹ it was stressed that questions relating to the state of the assured's health and his affliction during a specified period with a number of named diseases, were necessarily directed to his knowledge only. If he answered truthfully to the full extent of his knowledge, the court held, he made no false representation. This rule embraces questions which seek information which the insurer must know is not within the applicant's personal knowledge, and those which call for statements of opinion or belief.⁷²

⁶⁹ 113 N.J. Eq. 288, 166 Atl. 515 (1933).

⁷⁰ The opinion recites:

"The defendant's plea that he did not intend a fraud is vain, and his contention that only purposeful fraud will defeat his right to the policy is misapplied. The nature of the question and the falsity of the answer precludes the plea; and there is a conclusive presumption of purposeful fraud. The question was unqualified, as was the answer."

⁷¹ 110 N.J. Eq. 287, 159 Atl. 680 (1932), aff. 114 N.J. Eq. 378, 168 Atl. 637 (1933). The assured died of a tumor of the throat which actually existed when he applied for the insurance, and the existence of which he denied in his application. His knowledge was such that his denial in response to a question seeking his belief was not false.

⁷² In *Clayton v. General Accident, Fire and Life Assurance Co., Ltd.*, 104 N.J.L. 364, 140 Atl. 307 (1928), the Court of Errors and Appeals said:

"This subject is exhaustively discussed, with a wealth of citations and illustrations in 37 Corp. Jr. 458, Sec. 178 (b); where the rule to be applied is formulated thus: 'Thus, answers as to disease, injuries or physical conditions are not false so as to defeat the insurance unless the disease, injury or infirmity relied on is shown to have been such as to affect the general health or probable continuance of life or impair the constitution, and not in its nature simply transitory or temporary, indisposition, and even when the questions by their terms include trivial illnesses and injuries unconnected with any specific disease, they should be interpreted to refer to only such illnesses as affect the risk.' See 14 R.C.L. 1071, Sec. 250."

In *Metropolitan Life Insurance Co. v. McTague*, 49 N.J.L. 587, 9 Atl. 766 (1887), it was said:

"Two representations in the revival application are alleged to have been false. The first was that which averred that John McTague had not, since the policy was issued, been 'sick or afflicted with any disease.' The District Court found as a fact that he had, during that period, had 'a cold'. The Common Pleas held that the statement of the application was not thereby shown to be

The effect of the decisions is to advance the moral considerations present in cases of this kind. This is a movement entirely consistent with the state of maturity into which equity jurisprudence has developed. Judicial decision manifests in general a growing inclination to subordinate all other considerations to intrinsic ethical merit.⁷⁸ In keeping with this spirit, the Court of Chancery has established for its policy the enforcement of a careful adherence to truth.

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untrue. In this I think there was no error. There was nothing in the mere fact found that required the inference that the insured's life had been 'afflicted by disease' or even 'sick'. These terms are not to be construed as importing as absolute freedom from any bodily ailment, but rather of freedom from such ailments as would ordinarily be called disease or sickness."

The rule applies to warranties as well as to representations. See *Henn v. Metropolitan Life Insurance Co.*, 67 N.J.L. 310, 51 Atl. 689 (1902); *Dimick v. Metropolitan Life Insurance Co.*, 67 N.J.L. 367, 51 Atl. 692 (1902).

⁷⁸ See POUND, *LAW AND MORALS* (1926), page 109.

For a comprehensive survey of this very significant process see HOLMES, *THE COMMON LAW* (1881); CARDOZO, *THE NATURE OF THE JUDICIAL PROCESS* (1921); SALMOND, *JURISPRUDENCE* (1920); POLLOCK, *ESSAYS IN JURISPRUDENCE AND ETHICS* (1882); GENY, *SCIENCE ET TECHNIQUE EN DROIT PRIVE POSITIF* (1914); DEMOGUE, *LES NOTIONS FONDAMENTALES DE DROIT PRIVE* (1911); FRANK, *LAW AND THE MODERN MIND* (1931); COUDERT, *CERTAINTY AND JUSTICE* (1914); KORKUNOV, *GENERAL THEORY OF LAW* (1904).

See also Pound, *The Call For A Realist Jurisprudence* (1931), 44 HARV. L. REV. 697; Radin, *Legal Realism* (1931), 31 COL. L. REV. 824; Yntema, *The Rational Basis Of Legal Science* (1931), 31 COL. L. REV. 925.