

1-1-1968

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Recommended Citation

David S. Murray, Case Note, *Employer as the Agent of the Insurer in the Administration of the Group Insurance Plan: Elfstrom v. New York Life Insurance Co. (Cal. 1967)*, 8 SANTA CLARA LAWYER 242 (1968).

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CASE NOTES

THE EMPLOYER AS THE AGENT OF THE INSURER IN THE ADMINISTRATION OF THE GROUP INSURANCE PLAN: *ELFSTROM V. NEW YORK LIFE INSURANCE CO.* (CAL. 1967)

INTRODUCTION

The phenomenon of "group" insurance is rapidly becoming an institution of modern life in America.¹ Broadly defined, it is the coverage of a number of individual members of a group for the purpose of protecting and providing for those members and their beneficiaries.² Quite often the group is comprised of employees or members of a labor union.³ Group insurance is primarily characterized by remarkably low premiums⁴ which are paid by the employer or by both the employer and employee.⁵ Typically, the insurer issues a master policy to the employer, designating him as the policyholder, and issues to each insured employee a certificate evidencing his coverage and setting forth the conditions of insurance.⁶

The administration of a group insurance plan is handled either by the insurer on the basis of information furnished by the employer,⁷ or by the employer itself.⁸ Under this latter arrangement, in consideration of a reduced premium, the employer performs virtually all the functions necessary to administer the insurance program. The employer maintains and updates all pertinent records of the individual insureds, determines eligibility for coverage, and accounts for and collects that portion of the premium due from the insureds.⁹

The growth of group insurance generally and the particular popularity of the employer administered type have raised the question of whether the employer in the administration of a group policy acts as the agent of the insurance company or as the agent of the

¹ R. EILERS AND R. CROWE, *GROUP INSURANCE HANDBOOK* 50-52 (1965). See also, *LIFE INSURANCE FACT BOOK* 26-28 (1961).

² J. APPLEMAN, *INSURANCE LAW AND PRACTICE* § 41 (1965).

³ Borst, *Group Policyholder as Agent of Insurer or Group Member*, 14 *FEDERATION OF INS. COUNSEL Q.* 11 (Winter 1963-64).

⁴ See J. APPLEMAN, *supra* note 2.

⁵ See R. COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 29 (1929).

⁶ J. APPLEMAN, *INSURANCE LAW AND PRACTICE* § 46 (1965).

⁷ D. GREGG, *AN ANALYSIS OF GROUP LIFE INSURANCE* 115 (1950).

⁸ *Id.* at 118.

⁹ *Id.*

individual insured. In *Elfstrom v. New York Life Insurance Co.*¹⁰ the California Supreme Court held that the employer is the agent of the insurance company in this regard.

ELFSTROM

The New York Life Insurance Company had issued a group health and life insurance policy to the Fullerton Publishing Company on behalf of its employees. Fullerton paid a portion of the premiums and deducted the balance from the wages of the insured employees. The policy provided insurance benefits to stated classes of employees in specified amounts,¹¹ and also provided that only those employees who worked more than 32 hours a week and who had completed six months of continuous employment in a specified class were eligible for coverage. Employees in Class C were entitled to \$4,000 in life insurance benefits but were required to earn \$200 a month.

The policy was of the employer administered type and its actual administration was conducted by Fullerton's bookkeeper. The insurer provided the bookkeeper with a manual setting forth in detail the steps to be taken in performing such tasks as enrolling employees, adding and deleting dependents, reinstating and terminating insurance, reporting details of coverage and premiums paid, and issuing certificates of insurance. According to the manual the bookkeeper was instructed to determine whether an employee was eligible for insurance before enrolling him in the plan.¹² In addition, the insurer conducted an annual audit to determine whether the bookkeeper was properly administering the plan in accordance with the terms of the policy.

Edgar F. Elfstrom was the president and major stockholder of the Fullerton Publishing Company. His daughter, Brenda, was an employee at Fullerton during the summer of 1959 earning a salary of \$200 a month. In September of 1959 Brenda returned to school and thereafter worked at Fullerton only on those occasional week-ends when she was at home. Her salary was reduced to \$100 a month.

Prior to returning to school, Brenda was informed by the bookkeeper that she was a full time employee, and that the waiting period

¹⁰ 67 A.C. 511, 432 P.2d 731, 63 Cal. Rptr. 35, (1967).

¹¹ From the facts of the case as related by the court, it may be inferred that the employees were categorized according to their salary and that the class to which an employee belonged determined the amount of insurance for which he was eligible. *Id.* at 512-13, 432 P.2d at 732-33, 63 Cal. Rptr. at 36-37.

¹² *Id.* at 516, 432 P.2d at 736, 63 Cal. Rptr. at 40.

of six months for joining the insurance plan would expire on the first day of December at which time she would be added to the plan. Brenda then signed a blank enrollment card.¹³

On November 30, 1959 the bookkeeper filled in the blanks on the card and added Brenda as an insured under the group policy. At that time the bookkeeper was aware that Brenda no longer earned \$200 a month or worked 32 hours a week, and therefore was ineligible for insurance. Brenda died in June 1960 and the insurer refused to pay the life insurance benefits on the ground that she was ineligible for coverage.

The case focused on the precise question of whether the Fullerton Company, in administering the group plan through its bookkeeper, was the agent of the insurer or the insured. If it was the agent of the insurer, the bookkeeper's knowledge of Brenda's ineligibility was also the insurer's knowledge.¹⁴ Since the insurer accepted the premiums with such knowledge, it would be estopped from asserting the insured's ineligibility.¹⁵ Conversely, if Fullerton was the agent of the insured, the bookkeeper's conduct in making false representations could be imputed to the insured,¹⁶ giving the company cause to cancel her coverage.¹⁷

A consideration of this same question by many of the other states has resulted in a sharp split of authority.¹⁸ The proponents of what appears to be the majority view take the position that the employer acts as the agent of its employee and not as the agent of the insurer. In support of this position they argue that the entire arrangement was initiated by the employer for the benefit of the

¹³ It was not clear whether the card was entirely blank at the time of Brenda's signature or if only the date was missing. However, the court noted that even if the misstatements indicating that Brenda was eligible for coverage were on the card at that time, this would not necessarily mean that she acted improperly. For at the time she signed the card she was in fact earning \$200 a month and working over 32 hours a week. There was no indication in the record that Brenda knew she was not entitled to the coverage, and so far as appears her only knowledge of the requirements for coverage were those related to her by the bookkeeper, *i.e.*, that she was a full time employee and that her six month waiting period would expire on December 1. *Id.* at 516, 432 P.2d at 733-34, 63 Cal. Rptr. at 37-38.

¹⁴ *Piedmont S. Life Ins. Co. v. Gunter*, 108 Ga. App. 236, —, 132 S.E.2d 527, 530 (1963); *Baum v. Massachusetts Mut. Life Ins. Co.*, 357 P.2d 960, 964 (Okla. 1960); *RESTATEMENT (SECOND) OF AGENCY* § 9(3) (1958).

¹⁵ *John Hancock Mut. Life Ins. Co. v. Dorman*, 108 F.2d 220, 224 (9th Cir. 1939); *Baum v. Massachusetts Mut. Life Ins. Co.*, 357 P.2d 960 (Okla. 1960).

¹⁶ *See, e.g.*, *Reusche v. California Pac. Title Ins. Co.*, 231 Cal. App. 2d 731, 736, 42 Cal. Rptr. 262, 266 (1966). *See also* 2 CAL. JUR. 2d *Agency* § 152 (1957).

¹⁷ *Security-First Nat'l Bank v. Earp*, 19 Cal. 2d 777, 122 P.2d 901 (1942); *Kloehn v. Prendiville*, 154 Cal. App. 2d 162, 316 P.2d 22 (1957). *See also* *RESTATEMENT OF CONTRACTS* § 476 (1932).

¹⁸ *Borst, Group Policyholder as Agent of Insurer or Group Member*, 14 *FEDERATION OF INS. COUNSEL Q.* 11, 12 (Winter 1963-64) (Cases cited therein).

employees,¹⁹ and in entering the contract of insurance with the insurer, the employer is interested in obtaining insurance *from*, not *for*, the insurer.²⁰ The underlying theme is one of paternalism of the employer toward its employees. Such paternalism "[D]oes not have the effect of making the benevolent parent the agent of the party with whom he inaugurates a contract for the benefit of his children."²¹ Furthermore, they argue, the real interests of the employer are akin to those of the employee and adverse to those of the insurer. This reasoning is supported by *Boseman v. Connecticut General Life Insurance Co.*²² in which the United States Supreme Court said:

. . . Employers regard group insurance not only as protection at low cost for their employees but also as advantageous to themselves in that it makes for loyalty, lessens turn-over and the like. When procuring the policy, obtaining applications of employees, taking payroll deduction orders, reporting changes in the insured group, paying premiums and generally in doing whatever may serve to obtain and keep the insurance in force, employers act not as agents of the insurer but for their employees or for themselves.²³

Jurisdictions following the minority view regard the employer as the agent of the insurance company. This has been characterized as the more equitable of the two views on the theory that the employee should not be made to suffer on account of acts of the employer over whom he has no control.²⁴ The minority points out that in this tripartite relationship it is the insurer who consents to and authorizes the employer to carry out activities which the insurer himself would normally perform in other types of insurance and it is the insurer who exercises control over the employer in these matters. In such a situation, they conclude, fundamental principles of agency demand that the employer be held to be the insurer's agent.²⁵

The conflict of views is mirrored in two cases from California. In *John Hancock Mutual Life Insurance Co. v. Dorman*,²⁶ the insurance plan provided that the employer was to receive the employee's application, determine his insurability as an employee, and determine the amount of his premium. In fact, the particular insured

¹⁹ *Hroblak v. Metropolitan Life Ins. Co.*, 50 Ohio L. Abs. 395, —, 79 N.E.2d 360, 364 (1947).

²⁰ *Duval v. Metropolitan Life Ins. Co.*, 82 N.H. 543, —, 136 A. 400, 403 (1927).

²¹ *Id.* at —, 136 A. at 404.

²² 301 U.S. 196 (1937).

²³ *Id.* at 204.

²⁴ *Clauson v. Prudential Ins. Co. of America*, 195 F. Supp. 72, 77 (D.C. Mass. 1961). See also J. APPLEMAN, *INSURANCE LAW AND PRACTICE*, § 43 (1965).

²⁵ *Greer v. Equitable Life Assur. Soc. of the United States*, 180 S.C. 162, —, 185 S.E. 68, 70 (1936). See *RESTATEMENT (SECOND) OF AGENCY* § 1 (1958).

²⁶ 108 F.2d 220 (9th Cir. 1939).

was not an employee but only a member of the board of directors, and therefore ineligible for the insurance. The court held that the employer was the agent of the insurer in administering the plan and that by accepting the insured's premiums through the employer, the insurer was estopped from asserting that the insured was not an employee under the terms of the policy.²⁷

However, the court in *Eason v. Aetna Life Insurance Co.*²⁸ a later case, reached the opposite conclusion.²⁹ There, the insured and his employer had a conversation in which the insured indicated that he no longer wished to participate in the employer administered insurance plan. The district court of appeal ruled that the conversation was ineffective to cancel the employee's participation. Relying on the *Boseman* case,³⁰ the court held that the employer was the agent of the employee and any communication between the two "[h]as no more legal significance than an instruction by a principal to his own agent. '[A] mere instruction [by a principal] to its agent to cancel, does not operate as a cancellation.'"³¹

ANALYSIS

Before deciding that the Fullerton Publishing Company, in its capacity as insurance plan administrator, was the agent of New York Life rather than the agent of Brenda Elfstrom, the California Supreme Court carefully noted the two views and studied the rationale underlying each.³² Its decision to ally California with the minority camp resulted from a consideration of the precise nature of the insurer-employer and the employer-employee relationships, and the application of basic principles of agency to those relationships.

In essence, the insurer-employer relationship is characterized by the insurer authorizing the employer to handle the administrative details of the plan and, in turn, the employer consenting to so perform these tasks.³³ It is further characterized by the insurer directing and controlling the employer in its performance of this

²⁷ *Id.* at 224.

²⁸ 212 Cal. App. 2d 607, 28 Cal. Rptr. 291 (1963).

²⁹ In the *Eason* case, the California District Court of Appeal did not discuss the contrary result reached by the federal court in the *Dorman* decision. Thus the conflict was very much alive when the *Elfstrom* case reached the supreme court.

³⁰ *Boseman v. Connecticut Gen. Life Ins. Co.*, 301 U.S. 196 (1937).

³¹ *Eason v. Aetna Life Ins. Co.*, 212 Cal. App. 2d 607, 611, 28 Cal. Rptr. 291, 293-94 (1963).

³² *Elfstrom v. New York Life Ins. Co.*, 67 A.C. 511, 516, 432 P.2d 731, 736-37, 63 Cal. Rptr. 35, 40-41 (1967).

³³ D. GREGG, *AN ANALYSIS OF GROUP LIFE INSURANCE* 115-18 (1950).

function.³⁴ The employer-employee relationship, on the other hand, lacks any scintilla of control. At best, it may be said that the employee merely authorizes the employer to deduct a portion of the premium from his wages. However, the employee in no way controls the employer to make certain that the employer will protect and act for the interests of the employee in administering the plan.³⁵

The element of control is the pivotal point of the case. The court³⁶ examines both these relationships in light of agency's most fundamental concept: "[a]gency is the relationship which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act."³⁷ From this examination the court reaches the seemingly inescapable conclusion that:

. . . the insurer-employer relationship meets this agency test with regard to the administration of the policy, whereas that between the employer and its employees fails to reflect true agency. The insurer directs the performance of the employer's administrative acts, and if these duties are not undertaken properly the insurer is in a position to exercise more constricted control over the employer's conduct.³⁸

CONCLUSION

It is submitted that within the confines of legal reasoning the conclusion reached in the *Elfstrom* case is supported by the principles of the law of agency. However, the decision can be equally

³⁴ In the decision the court noted (Footnote 7) that the insurer, in its instruction manual, directed the employer to perform the very act which led to the controversy—*i.e.* determine the employee's eligibility for coverage. Further, (Footnote 8) the court noted that the insurer was able to control the employer in its performance of this function by reviewing its performance at the annual audit. *Elfstrom v. New York Life Ins. Co.*, 67 A.C. 511, 521-22, 432 P.2d 731, 738, 63 Cal. Rptr. 35, 42 (1967).

³⁵ In normal circumstances the very nature of the employee's subordinate position does not lend itself to the control of his employer. *See, e.g.*, *Clauson v. Prudential Ins. Co. of America*, 195 F. Supp. 72, 77 (D.C. Mass. 1961). *See also* J. APPLEMAN, *INSURANCE LAW AND PRACTICE*, § 43 (1965).

³⁶ *Elfstrom v. New York Life Ins. Co.*, 67 A.C. 511, 521-22, 432 P.2d 731, 738, 63 Cal. Rptr. 35, 42 (1967).

³⁷ *Edwards v. Freeman*, 34 Cal. 2d 589, 592, 212 P.2d 883, 884 (1949). *See* RESTATEMENT (SECOND) OF AGENCY, § 1 (1958).

³⁸ *Elfstrom v. New York Life Ins. Co.*, 67 A.C. 511, 518, 432 P.2d 731, 738, 63 Cal. Rptr. 35, 42 (1967). The cases expounding the majority view, on the other hand, do not appear to consider the control factor (*see* pp. 244-45 *supra*). They admit that the employer acts for the insurer, but point out that at the same time he is likewise acting for the employee. The latter is emphasized over the former presumably because the entire transaction with the insurer was initiated by the employer with the employee's and not the insurer's benefit in mind. *See, e.g.*, *Duval v. Metropolitan Life Ins. Co.*, 82 N.H. 543, —, 136 A. 400, 404 (1927). There it was said that "[T]he acts of the employer . . . are claimed to be on behalf of the [insurer]. No reason is perceived why this should be treated as an agency for the [insurer] rather than for the employees."