Pernicious Issues: A Discussion of Key Concepts in Life Insurance
(Session: Life Insurance Policy Basics)

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KEY CONCEPTS IN LIFE INSURANCE

"Insurance is Contracts" is a familiar mantra to those of us who labor in the trenches of life, health, and disability insurance litigation. And while this may be true, there are certain concepts unique to life insurance that any practitioner needs to understand. No matter how clear the terms of a life insurance contract may appear, there will be battles over how those terms apply in a given case. Common law presumptions, traditional public policy concerns, and legislative responses to changing markets all play a role in life insurance litigation. Understanding key concepts involving suicide exclusions, insurable interest, and STOLI (Stranger Originated Life Insurance) is crucial.

SUICIDE EXCLUSIONS

The suicide exclusion in a life insurance policy is a nearly universal feature, but the application of the exclusion is often determined by statutory and common law. The suicide exclusion will be limited by the two-year contestable period imposed by state statute. For example, Illinois' Insurance Code requires all life policies (and other policies) to have "[a] provision that the policy, together with the application therefor, a copy of which shall be endorsed upon or attached to the policy and made a part thereof, shall constitute the entire contract between the parties and that after it has been in force during the lifetime of the insured a specified time, not later than 2 years from its date, it shall be incontestable except for nonpayment of premium…" 215 ILCS 5/224(1)(c).

As a result, the exclusion will only bar payment for suicide within the first two years of the policy's issuance. During those first two years, however, if the insured dies by suicide, the insurer's only liability will be to return the premium paid.

What do suicide exclusions say?

The wording of suicide exclusions will vary from policy to policy, but generally follows the same formula. Common versions of the exclusion include the following:

> Suicide by the insured, whether sane or insane, within two years from the policy date is not covered by this policy. In this event, the only amount payable by us to the beneficiary will be the premium you have paid, minus any indebtedness and partial surrenders.

Yonkers v. Riversource Life Ins. Co., No. 10-80415-CIV, 2011 WL 332830, at *1 (S.D. Fla. Jan. 31, 2011).

> We will limit the proceeds we pay under this policy if the insured commits suicide, while sane or insane:
>
> 1. within 2 years from the Date of Issue; and
>
> 2. after 2 years from the Date of Issue, but within 2 years from the effective date of the last reinstatement of this policy.
>
> The limited amount will equal all premiums paid on this policy.

Officer v. Chase Ins. Life & Annuity Co., 541 F.3d 713, 715 (7th Cir. 2008).

> We will limit the proceeds we pay under this policy if the insured dies by suicide, sane or insane, within 2 years ... from the Date of Issue.

Estate of Tedrow v. Standard Life Ins. Co. of Indiana, 558 N.W.2d 195, 196 (Iowa 1997).

> *EXCLUSION: SUICIDE.* If the Insured dies by suicide, while sane or insane, within two years after the Date of Issue, the Death Proceeds of this contract are limited to the premiums paid …

Chepke v. Lutheran Brotherhood, 103 Ohio App. 3d 508, 660 N.E.2d 477, 477 (1995).

> If the insured dies by suicide while sane or self-destruction while insane within two years of the issue date, we will not pay the death benefit. We will return to you all premiums paid.

McKinnon v. Lincoln Benefit Life Co., 162 F. App'x 223, 225 (4th Cir. 2006).

Who has the burden of proof?

In general, the traditional maxim applies—a claimant has the burden of proving coverage under a life insurance policy, while the insurer has the burden of proving an exclusion, including that a suicide exclusion applies to avoid coverage: "[T]he same rules of construction that govern other contracts also govern insurance contracts, and the insurer bears the burden of proving an exclusion from coverage." *Officer v. Chase Ins. Life & Annuity Co.*, 478 F. Supp. 2d 1069, 1074 (N.D. Ind. 2007). *See also Zanca v. Life Ins. Co. of N. Am.*, 1999-2253 (La. App. 4 Cir. 6/28/00), 770 So. 2d 1, 4 (La. Ct. App.) *writ denied*, 2000-2859 (La. 12/8/00), 776 So. 2d 467 ("[i]n order to avoid liability on a policy issued by it, if an insurance company relies on the defense that the insured committed suicide, the burden rests on the company to establish that the insured did commit suicide to the exclusion of every other reasonable hypothesis."); *Kettlewell v. Prudential Ins. Co. of Am.*, 4 Ill. 2d 383, 385, 122 N.E.2d 817, 818 (1954) ("[t]he burden of proving the affirmative defense of suicide is upon the defendant who must prove it by clear and convincing evidence.")

Practice Tip: Accident insurance policies work differently in this regard—the claimant has the burden under those policies to prove that a death was an accident, which can come into play when the question of whether a particular death is the result of an accident or suicide is at issue. As a practical matter, however, if the insurer's primary defense is suicide over accident, the insurer will most likely bear the burden of proof. *See e.g. Critchlow v. First UNUM Life Ins. Co. of Am.*, 378 F.3d 246, 256-57 (2d Cir. 2004) (finding insurer had burden to establish that insured's death by autoerotic asphyxiation was excluded from accident insurance coverage by a "self-inflicted injury" exclusion).

Isn't there a presumption against suicide?

In many jurisdictions, a common law presumption against suicide is an additional hurdle for an insurer seeking to enforce a suicide exclusion. This presumption is rooted in the notion that ordinary people will seek to preserve their own lives, rather than commit suicide. The presumption is also founded on more values-based principles:

> The presumption against suicide is a strong one. It has been said to have its basis in the love of life and the instinct of self-preservation, the fact that self-destruction is contrary to the general conduct of mankind and that suicide by a rational man is an act of moral turpitude.

Brown v. Metro. Life Ins. Co., 233 Iowa 5, 10, 7 N.W.2d 21, 24 (1942). The presumption is applied in many jurisdictions, and at least one federal court has also made it part of the federal common law of ERISA. *See e.g. Acree v. Hartford Life & Acc. Ins. Co.*, 917 F. Supp. 2d 1296, 1312 (M.D. Ga. 2013) ("[t]he legal presumptions against suicide and in favor of accidental death are 'settled feature[s] of the federal common law' in this circuit, and plan administrators are bound to apply the law during the administrative process."), citing *Schikore v. BankAmerica Supplemental Retirement Plan*, 269 F.3d 956 (9th Cir. 2001) (applying "mailbox rule" as part of federal common law of ERISA).

It is important to remember, however, that the presumption is just that—a presumption—and one that can be rebutted. Typically, the presumption only comes into play when the insured's death by suicide is in doubt. "[T]he presumption operates as 'a presumption in favor of the theory of *accident*.'" *Estate of Tedrow v. Standard Life Ins. Co. of Indiana*, 558 N.W.2d 195, 197 (Iowa 1997), quoting *Stephenson v. Bankers' Life Ass'n*, 108 Iowa 637, 641, 79 N.W. 459, 460 (1899). The rebuttable nature of the presumption has the effect of shifting the burden of proof to the claimant if the insurer is able to offer sufficient evidence of suicide:

> Additionally, under Alabama law there is a presumption that a normal and sane person will not commit suicide. However, if the insurer can produce direct and positive evidence of suicide, then the burden of proof shifts back to the beneficiary to present conflicting inferences against suicide. Evidence sufficient to overcome the presumption against suicide and shift the burden of proof include death certificates, coroner's reports, and police reports. If the beneficiary is unable to produce any reasonable conflicting inferences, then the presumption against suicide has no field of operation.

State Farm Life Ins. Co. v. Thomas, No. 7:11-CV-1803-SLB, 2013 WL 754917, at *3 (N.D. Ala. Feb. 26, 2013) (internal citations omitted). *See also Chepke v. Lutheran Brotherhood*, 103 Ohio App. 3d 508, 513-14, 660 N.E.2d 477, 480 (1995) (recognizing presumption against suicide but noting that "[t]he presumption being no more than *prima facie* is rebuttable and disappears upon the production of substantial evidence to the contrary sufficient to counterbalance it.").

Aren't these cases simple?

Not always. Practitioners should check the law of the relevant jurisdiction carefully to ensure that they aren't tripped up by nuances of state common law or statute. Moreover, plenty of "gray area" cases present a challenge for courts and litigants. For example, in *Fister ex rel. Estate of Fister v. Allstate Life Ins. Co.*, 366 Md. 201, 219-20, 783 A. 2d 194, 205 (2001), the insured planned her suicide following a series of personal and financial calamities. *Id*. at 197. Part of her plan included disguising her suicide to avoid application of the suicide exclusion in her life insurance policies. *Id*. To do so, she recruited a friend to assist her: he was to hold the shotgun to her head while she pulled the trigger with an attached string. *Id*. When she was unable to exert enough force with the string to pull the trigger, she asked her friend to help. At her request, her friend shot her. *Id*. Reviewing Allstate's denial of the resulting life insurance claims on the grounds of suicide, the court looked first to the applicable insurance code, which codified the suicide exclusion. But the court then went looking for more:

> The term of contention in the case *sub judice* is the word 'suicide,' which is left undefined by … the entire Insurance Article. In fact … the Maryland Legislature had never deemed it necessary to define 'suicide' until 1999, when it enacted the Assisted Suicide Act … There, the Legislature defined 'suicide' as 'the act or instance of intentionally taking one's own life.'

Id. at 212, citing Maryland Code, Art. 27 § 416 (1957, 1996 Repl. Vol., 2000 Supp). The court went on to conclude that the insured did not take her own life because "another person, exercising his own free will, was ultimately responsible for her death." *Id*. at 213. The court explained further:

> Despite her pronounced and unquestionable desire to die, and her uncontested, disreputable, and even fraudulent motives in seeking to make her death appear as a murder for purposes of assuring that her beneficiaries receive insurance policy proceeds, Fister's death was undeniably the result of a homicide. A conscious, thinking human being, who was in no immediate danger or peril, made a choice to pull the trigger. As a result of that independent choice, Fister died.

Id. at 213-14. Regardless of the insured's intention, the court concluded the suicide exclusion did not bar coverage.

In contrast, the intent of the insured was central to the court's analysis in *Riggs v. Metro. Life Ins. Co.*, 940 F. Supp. 2d 172, 182-83 (D.N.J. 2013). In that case, the insured had a history of depression but no history of suicidal thoughts or behavior. *Id*. at 174. After his doctor supplemented his antidepressant therapy with additional antipsychotic medications, however, he developed suicidal thoughts, heard voices telling him to kill himself, and ultimately took his own life. *Id*. at 175. The beneficiary of his ERISA-governed life insurance policy argued his suicide was not the result of any actual intention to kill himself, but rather was the result of "command hallucinations" brought about by the neurochemical impact of the medications he was taking. *Id*.

at 176.

The court closely considered this issue, noting in particular that the policy's suicide exclusion did not include the typical "suicide while sane or insane" formulation:

> Many insurers write insurance policies so that the policy is void if the insured dies by suicide 'whether sane or insane' because they acknowledge the intent component of 'suicide' and the tension created when an individual is overtaken by an 'insane impulse' and is therefore unable to form the requisite intent to suicide … The Plan at issue does not include a 'sane or insane' clause; accordingly, Ms. Riggs argues that her husband's death is a covered loss under the Plan, as he was 'induced to end his life by a compulsion generated by [an] outside force, namely a drug with a now recognize[ed] effect of inducing suicidal thoughts' and this 'compulsion to end his life came from an external force, not from an internal intent to leave this world for the next.'

Id. at 182-83 (citations omitted). In contrast, the insurer argued that the insured's "requisite act of physical self-destruction"—death by self-inflicted gunshot wound—made his death a suicide. *Id*. at 185. The court ultimately found that, given the inherent ambiguity in the word "suicide," both interpretations presented were reasonable. Since the case was governed by the arbitrary and capricious standard of review, the court upheld the claim denial, but made clear that the result may have been different outside the constraints of the deferential standard of review.

Both *Fister* and *Riggs* demonstrate that claims involving the suicide exclusion are often more difficult to evaluate than may be first assumed.

STOLI, INSURABLE INTEREST, AND INCONTESTABILITY

What Is STOLI?

STOLI is not quite a household name, but for practitioners in the life insurance industry it is now well-known. A STOLI transaction typically involves an elderly insured, who obtains a high value policy for the ultimate benefit of third-party investors. Although they involve several steps, STOLI transactions are planned out from inception: the insured applies for a high dollar policy, usually to be owned by a trust (or a series of interrelated trusts), the beneficial interest in which is then sold to third party investors in exchange for an up-front cash payment. *Life Product Clearing, LLC v. Angel*, 530 F. Supp. 2d 646, 648 (S.D.N.Y 2008). The "investor" pays or finances the premium, secured by the value of the policy itself. As a result, the investor gets the greatest return by the early death of the insured. *Id.* (In a STOLI situation, "these policies enable the insured to obtain ready cash by selling his policy to a stranger whose only interest in the insured is his early demise." *Id*.) STOLI producers typically disguise the transaction with a "multi-layered trust scheme … intended to generate, and then conceal, a life insurance policy that would allow … an investor … to speculate on [the insured's] life." *Lincoln Nat. Life Ins. Co. v. Joseph Schlanger 2006 Ins. Trust*, 28 A. 3d 436 (Del. 2011).

Because STOLI policies are frequently procured with misrepresentations about the insured's finances or intent not to sell the policy on the secondary market, insurers often challenge STOLI transactions via traditional rescission actions, pointing out material misrepresentations in the policy application process which allow them to rescind the contract. But rescission actions must be brought within a life insurance policy's two-year contestable period (mandated by state law), and STOLI transactions are often structured to avoid resale until after the expiration of that period. As a result, insurers may not be alerted to STOLI policies until it is too late to rescind the contract. Insurers have also attacked STOLI policies by pointing out that they are, in essence, impermissible wagers on human life and so can be challenged at any time. This argument fares better in some jurisdictions than others, so practitioners need to aware of the law in their jurisdiction before proceeding with this strategy.

What is insurable interest?

The notion of "insurable interest" is an old one, recognized by the Supreme Court in 1881: "[a]n insurable interest is an economic or familial interest in having the insured's life continue, rather than end." *Warnock v. Davis*, 104 U.S. 775, 779 (1881). The concept is rooted in the idea that wagering on human life is morally wrong and against public policy. "In this country, the dominant public policy underlying the rule is to eliminate a form of 'moral hazard.'" *PHL Variable Ins. Co. v. Bank of Utah*, 780 F.3d 863, 867 (8th Cir. 2015). As Justice Holmes explained, "[t]he very meaning of an insurable interest is an interest in having the life continue, and so one that is opposed to crime." *Grigsby v. Russell*, 222 U.S. 149, 155, 32 S. Ct. 58, 56 L. Ed. 133 (1911). In other words, "[f]or there to be an insurable interest, the beneficiary must have "reason to expect some benefit from the continuance of the life of the insured." *Johnson v. Nelson*, 290 Neb. 703, 715, 861 N.W.2d 705, 714 (2015) (holding tenant has no insurable interest in life of his landlord, particularly when policy proceeds intended to allow tenant to purchase landlord's farm upon his death).

The requirement that a life insurance policy must include an insurable interest has been codified in nearly every state, recognizing the public policy against a wager on human life. *See e.g. Pruco Life Ins. Co v. Brasner*, No. 10-80804, 2011 WL 134056, at *3 (S.D. Fla. Jan. 7, 2011) (recognizing Florida's insurable interest requirements). And while a life insurance policy can be later assigned to persons or entities without an insurable interest, such an assignment must be made "in good faith, and not [as] sham assignments made simply to circumvent the law's prohibition on 'wagering contracts.'" *Id.* citing *AXA Equitable Life Ins. Co. v. Infinity Fin. Group, LLC*, 608 F. Supp. 2d 1349, 1356 (S.D. Fla. 2009). In a typical STOLI transaction, however, from its inception the intended and ultimate owner and beneficiary of the policy is not only unrelated to the insured, but has a financial interest in the insured's death sooner rather than later.

How do insurable interest and incontestability intersect?

In some jurisdictions, the fact that STOLI contracts are illegal wagering contracts means that they are void from inception, and insurers can challenge them after the two year contestable period expires. For example, in its *Schlanger* decision, the Delaware Supreme Court examined the tension between a life insurance policy's incontestability clause and the argument that a lack of insurable interest renders that policy void. The court answered a certified question from two cases out of the United States District Court of Delaware (*Lincoln Nat. Life Ins. Co. v. Joseph Schlanger 2006 Ins. Trust*, No. 09-506-BMS, 2010 WL 2898315 (D. Del. July 20, 2010) and *PHL Variable Ins. Trust v. Price Dawe 2006 Ins. Trust*, 28 A. 3d 1059 (Del. 2011)), both of which sought a declaration that STOLI policies were void from inception due to lack of insurable interest. *Id*. at 437. In both cases, the STOLI defendants argued the two-year contestability periods in the policies barred the claims. The district courts certified the following question to the Delaware Supreme Court: "Can a life insurer contest the validity of a life insurance policy based on a lack of insurable interest after expiration of the two-year contestability period set out in the policy as required by 18 Del. C. § 2908?" *Id*. at 438.

The court first discussed the history of incontestability clauses, noting they developed to provide consumer certainty; an incontestability clause means a consumer won't pay premiums for years, only to have a policy contested for misrepresentation long after memories have faded and evidence has been lost. *Id*. at 439. In addition to becoming "industry practice," most states now mandate incontestability clauses in life insurance contracts. *Id.* But, as the court explained, this mandate is not in the form of a direct ban on policy contests after two years, but is instead a "mandatory *contractual* term." *Id*. at 440. This fact, the court explained, "make[s] the incontestability period directly contingent, and predicated, upon the formation of a valid contract." *Id*. While, "fraud in the inducement renders a life insurance policy voidable at the election of the innocent party," there are circumstances in which purported contracts are "so egregiously flawed that they are void at the outset." *Id*. at 441. Such void *ab initio* contracts are never enforceable as a matter of law. *Id*. A life insurance policy that lacks a valid insurable interest is such an "egregiously flawed" agreement, and therefore void *ab initio*. *Id*.

Putting the two concepts together, the court concluded: "[i]t therefore follows that if no insurance policy ever legally came into effect, then neither did any of its provisions, including the statutorily required incontestability clause." *Id*. The court therefore answered the certified question in the affirmative: "[t]he incontestability provision does not bar an insurer from asserting a claim on the basis of lack of insurable interest after the incontestability period expires." *Id*. at 442. *See also PHL Variable Ins. Co. v. Hudson Valley, EPL, LLC*, No. CV 13-1562-SLR-SRF, 2014 WL 4635454, at *5 (D. Del. Sept. 16, 2014) ("while a contestability clause may bar a challenge based on fraud or misrepresentation in an insurance application … a challenge based on a lack of insurable interest is distinct because the policy itself never came into being, and the incontestability provision never took effect in the first place."); *Sun Life Assurance Co. of Canada v. U.S. Bank National Ass'n*, No. 14-CIV-62610, 2016 WL 161598, at *15 (S.D. Fla. Jan. 14, 2016) aff'd in part, rev'd in part and remanded, 693 F. App'x 838 (11th Cir. 2017) (reversed on other grounds) ("'if a third party financially induces the insured to procure a life insurance contract with the intent to immediately transfer the policy to a third party, the contract lacks an insurable interest'") (quoting *PHL Variable Ins. Co. v. Price Dawe 2006 Ins. Trust, ex rel. Christiana Bank & Trust Co*., 28 A. 3d 1059, 1075 (Del. 2011)). The *Schlanger* decision encapsulates the majority view on this issue, which allows insurers to challenge the underlying validity of a life insurance policy procured as part of a STOLI transaction on the grounds that such policy lacks a valid insurable interest. But this view is under attack.

Is there a minority view?

What used to be the "minority view" has gained traction in the past several years. Recent decisions have impeded insurers' efforts to mount an insurable interest challenge to a policy's validity outside of the contestability period. The Eighth Circuit dealt insurers a blow in *PHL Variable Ins. Co. v. Bank of Utah*, 780 F.3d 863 (8th Cir. 2015), when the court reversed a district court's grant of summary judgment in favor of PHL and held Minnesota's incontestability statute prevented the insurer from contesting the policy. In that case, an unscrupulous agent helped a retiree apply for a $5 million policy and the proposed insured misstated his net worth to be 10 times greater than reality. *Id*. at 865. PHL approved the application and issued the $5 million policy. *Id*. at 866. The insured also obtained a loan to pay the policy premium, which was funded by a hedge fund that invested in life settlements. *Id*. As is typical in these types of transactions, the insured pledged the policy as collateral for the loan. Ultimately, the insured surrendered the policy to the hedge fund, which filed for bankruptcy, and Bank of Utah came to hold the policy. *Id*.

Upon the insured's death four years after the policy was issued, PHL sought a declaratory judgment action that the policy was void *ab initio* due to a lack of insurable interest. The district court agreed and granted PHL summary judgment in 2013. *PHL Variable Ins. Co. v. Bank of Utah*, No. 12-1256, 2013 WL 6190345, at *1 (D. Minn. Nov. 27, 2013). The Eighth Circuit (applying Minnesota law) reversed, however, reasoning that the Minnesota Supreme Court would not declare the policy *void ab initio* and permit PHL to "walk away from its bargain." *Id*. at 870. The court distinguished between (1) a policy issued to one who had no insurable interest, which is against public policy and void, and (2) a policy issued to the insured who later sells the policy, where "the public policy issue is not free from doubt." *Id*. at 869. *See also Kramer v. Phoenix Life Ins. Co*., 15 N.Y. 3d 539 (N.Y. 2010) (New York law "permits a person to procure an insurance policy on his or her own life and immediately transfer it to one without an insurable interest, even when the policy was obtained for just such a purpose.")

The Eighth Circuit also held Minnesota's incontestability statute barred the contest. According to the court, the purpose of the statute is to protect an insured from a dilatory challenge to the policy while encouraging the insurer to investigate within a specific period, and the insurer can investigate whether the insured intended to sell the policy during that time-frame. The court concluded, "[t]o declare that a facially valid policy on which PHL collected substantial premiums for over four years was never 'in force' is simply a fiction." *Id*. at 871.

Another showdown was resolved in favor of incontestability in Florida. In *Pruco Life Ins. Co. v. Wells Fargo Bank, N.A.*, 780 F.3d 1327 (11th Cir. 2015), the Eleventh Circuit examined two district court cases that reached opposite conclusions vis-à-vis insurable interest and contestability and certified the question for the Florida Supreme Court. *See Pruco Life Ins. Co. v. Brasner*, No. 10-80804-CIV, 2011 WL 134056 (S.D. Fla. Jan. 7, 2011) (incontestability clause does not bar insurable interest contest) and *Pruco Life Ins. Co. v. U.S. Bank*, No 12-24441-CIV, 2013 WL 4496506 (S.D. Fla. Aug. 20, 2013) (insurable interest claims barred by incontestability clause). The Eleventh Circuit certified the following questions:

> 1. Can a party challenge an insurance policy as being void *ab initio* for lack of the insurable interest required by Fla. Stat. § 627.404 if that challenge is made after expiration of the two-year contestability period mandated by Fla. Stat. § 627.455?
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> 2. Assuming that a party can do so, does Fla. Stat. § 627.404 require that an individual with the required insurable interest also procure the insurance policy in good faith?

In *Wells Fargo Bank, N.A. v. Pruco Life Insurance Co.*, 200 So. 3d 1202 (Fla. 2016), the Florida Supreme Court declined to carve out "a STOLI-policy exception" to Florida's two-year contestability period. It considered the two questions certified by the Eleventh Circuit. It initially stated that Florida law does not prohibit STOLI transactions, describing such transactions as "when an investor actively seeks out elderly people to purchase life insurance with the promise of 'no risk' money in exchange for transferring the policy to the investor after the general two-year incontestability period has expired." *Id*. at 1203 (quoting 5 Couch on Ins. § 67.3 (2015 ed.) (quotation marks omitted)). Florida's insurable interest statute requires an insurable interest at the "inception date of coverage," but not after that date. *Id*. at 1205 (quoting FLA. STAT. § 627.404(1)). In addition, the statute defines "insurable interest" as including "the interest of '[a]n individual . . . in the life, body, and health of another person to whom the individual is closely related by blood or by law and in whom the individual has a substantial interest engendered by love and affection.'" *Id*. (quoting Fla. Stat. § 627.404(2)(b)(2)).

In analyzing the two different STOLI policies at issue in *Pruco Life Ins. Co.*, the Eleventh Circuit case from which the certified questions arose, the Florida Supreme Court noted that both of the policies named the insureds' immediate family members as beneficiaries. *Id*. at 1205-06. Accordingly, it found those policies had the insurable interest required at their inception. *Id*. at 1206. Then, applying the plain language of the incontestability statute, the Florida Supreme Court concluded that even if a life insurance policy results from a STOLI scheme, it is incontestable after two years if the required insurable interest existed at its inception. *Id*. In so holding, the court considered that the incontestability statute included other exceptions to the two-year time bar, but noted that the policy being a STOLI policy was not among them. *Id*. at 1205-06. It also acknowledged that a STOLI-policy exception to the two-year contestable period "might be wise public policy," but found that would be a decision for the state legislature. *Id*. at 1203.

Finally, the Supreme Court of Rhode Island disappointed carriers who challenged a STOLI-like scheme in the context of variable annuities, addressing the highly publicized exploits of attorney Joseph Caramadre. It held that an annuity is not infirm for lack of insurable interest and further concluded that an incontestability clause in an annuity (or insurance policy) that takes effect upon issuance is enforceable and does not violate public policy. *Western Reserve Life Assur. Co. of Ohio v. ADM Associates, LLC*, 116 A. 3d 794, 796 (R.I. 2015).

In what the court acknowledged was a "rapacious investment scheme exploiting the complexities of certain variable annuity policies…," Caramadre's scheme used variable annuities with a death benefit rider which, upon the death of the annuitant (who was not the owner-investor), paid the greater of the total paid premiums, plus interest, or the value of the annuity's investment portfolio. *Id*. The death benefit rider allowed the owner-investor to be "virtually assured of a risk-free investment." *Id*. As the "macabre *sine qua non* of the investment strategy," Caramadre then recruited terminally ill individuals to apply for such annuities, with Caramadre's investors as the owners and beneficiaries, in exchange for a nominal cash payment. *Id*. at 797. When the issuer of one such WRL annuity learned of Caramadre's activities (as Caramadre became the target of a federal criminal investigation and was ultimately charged with 65 counts of fraud, conspiracy, and identity theft), WRL filed suit in federal court to rescind the annuity and obtain a declaration that it was void *ab initio* due to lack of insurable interest. *Id*. The district court found the annuity was not a life insurance contract and thus had no insurable interest requirement. *Id*. It also held that because the annuity provided that it would be "incontestable from the Policy Date," WRL's claims were barred in any event. *Id.* The district court therefore dismissed the claims, and WRL, along with other carriers, appealed to the First Circuit, which concluded Rhode Island law was unclear as to both whether annuities which provide a death benefit require an insurable interest and the validity of the incontestably clause in light of same. *Id*. at 797-8. In December 2013, the First Circuit certified two questions to the Rhode Island Supreme Court:

> 1. If the owner and beneficiary of an annuity with a death benefit is a stranger to the annuitant, is the annuity infirm for want of an insurable interest?
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> 2. Does a clause in an annuity that purports to make the annuity incontestable from the date of its issuance preclude the maintenance of an action based on the lack of insurable interest?

Id. at 798, 804.

Answering the first question in the negative, the court noted Rhode Island's statutory and common law recognizes a distinction between life insurance contracts and annuities, and found that had the legislature wished to include annuities in its statutory language requiring life insurance contracts to be anchored by a valid insurable interest, it would have done so. *Id*. at 799-802. On somewhat shakier reasoning, the court also held the annuities at issue were not "illegal wagering contracts" because both the investor's payments and the death benefit were contractually guaranteed, and whether the annuity would yield a higher profit by the annuitant's untimely demise was an "unknown variable." *Id*. at 803-04. The court concluded, "[w]e cannot say, therefore, that absent an insurable interest, an annuity with a death benefit is a '*purely* speculative contract on the life of another.'" *Id*. at 803, citing *Cronin v. Vermont Life Ins. Co.*, 20 R.I. 570, 572, 40 A. 497, 497 (1898) (emphasis added).

Having concluded the annuities at issue were not void for lack of insurable interest, the court did not address WRL's argument that the incontestability clause was invalid because it was part of an illegal wagering contract. Instead, answering the second certified question, it noted Rhode Island has "long-recognized" the validity of the traditional two-year incontestability clause in a life insurance policy, *Id*. at 804, and applied that same reasoning to the incontestability clause at issue. The court placed the most weight on the fact that the clause was offered by WRL, which had "an unlimited length of time to investigate the policy applicant prior to issuing the policy…" *Id*. at 805. It therefore held, "[w]hether an incontestability clause that takes immediate effect is included in an insurance policy or in an annuity policy, it is our opinion that the clause is enforceable against all attempts to escape the 'deliberately assumed obligations' contained within these contracts." *Id*. at 805, citing *Murray v. State Mutual Life Ins. Co.*, 22 R.I. 524, 526, 48 A. 800, 801 (1901).

Insurers and practitioners handling STOLI litigation should take note of this decision. While STOLI schemes involving life insurance policies should not benefit from this case on insurable interest grounds, it does give *some* traction to defenses based on the expiration of a contestability clause. (Nevertheless, the invalidity of a STOLI policy itself should render such a clause invalid as well, an argument the court arguably did not reach here). But for similar matters involving annuities, this decision is a troubling development.

What happens to the premium in STOLI litigation?

Traditional rescission actions require the court to return the parties to the *status quo*, which includes the insurer's return of premium paid as part of perfecting the rescission of a life insurance policy. But STOLI transactions, with their lack of insurable interest and their complexity (which often require a significant amount of investigation by insurers to unravel), merit a different approach. A number of recent decisions recognize that a contract which is void from inception due to its nature as an illegal wagering contract cannot be rescinded—it can only be declared void. As an illegal contract, the court's obligation is simply to declare it void and leave the parties as it found them. *See e.g. TTSI Irrevocable Trust v. ReliaStar Life Ins. Co*., 60 So. 3d 1148, 1150 (Fla. Ct. App. 2011) ("contracts that are void as contrary to public policy will not be enforced by the courts and the parties will be left as the court found them.") As a result, these courts allow (or uphold) an insurer's claim to retain the premiums on illegal STOLI policies, rather than return them to the policy owner. *Id*. *See also Pruco v. Brasner*, 2011 WL 134056, at *7 (refusing to dismiss claim to retain premiums); *Ohio Nat'l Life Assurance Corp. v. Davis*, 803 F.3d 904, 911 (7th Cir. 2015) ("[b]eing to blame for the illegal contracts the defendants have no right to recoup the premiums they paid to obtain them; allowing recoupment would, by reducing the cost, increase the likelihood of unlawful activity.").

But this result is not guaranteed. STOLI investors have fought back by arguing that allowing insurers to keep the premiums on STOLI policies would result in unjust enrichment. For example, in *Carton v. B & B Equities Grp., LLC*, No. 2:11-cv-00746, 2013 WL 4875096, at *1 (D. Nev. Sept. 10, 2013), the court allowed STOLI investors to maintain an unjust enrichment claim against insurers who retained premiums after the policies at issue were declared void *ab initio* for lack of insurable interest. In denying the insurer's motion to dismiss, the court rejected the insurer's argument that because the policies at issue had terminated, plaintiffs could not seek an unjust enrichment claim. *Id*. at *6. The court reasoned, "if the insurers were on notice that the policies were issued to parties with uninsurable interests, they may be found culpable, and at least partially liable for the consideration received from plaintiffs because they knowingly entered into contracts which have now been ruled void ab initio." *Id*. The court went on to explain: "if the insurers had knowledge that the contracts could be voided prior to complete performance … then it is arguable that any payments received could unjustly enrich the insurer." *Id*.

Accordingly, on the strength of allegations that the insurers "accepted the benefit by receiving premium payment on the policies from unrelated third parties, when they knew or should have known that the policies were premium financed and issued to parties without an insurable interest," the court allowed the plaintiffs' unjust enrichment claim to stand. *Id*. at *5. *See also Penn Mutual Life Ins. Co. v. Greatbanc Trust Co*., 887 F. Supp. 2d 822, 832 (N.D. Ill. 2012) (recognizing a similar unjust enrichment claim is not precluded even if policy is void *ab initio* due to lack of insurable interest, and finding issue of fact prevented summary judgment on the unjust enrichment claim); *LincolnWay Kennedy Bank v. Allianz Life Ins. Co. of N. Am.*, No. 11-cv-5097, 2013 WL 5212750, at *6 (N.D. Ill. Sept. 17, 2013) ("[t]he fact that the policy here might be declared void does not preclude LincolnWay's unjust enrichment claim, because that claim is not based on the existence of a contract").

As reflected in the *Carton* decision, STOLI investors frequently fight back when confronted with anti-STOLI litigation. In some cases, courts simply reject the illegal wagering claim outright, holding that "a preexisting intent to transfer life insurance policies [to third parties who lack insurable interest] 'does not negate the fact that when the trust acquired the policies, it was supported by an insurable interest.'" *Hartford Life & Annuity Ins. Co. v. Dorris Barnes Family 2008 Irrevocable Trust*, 552 F. App'x 664, 665 (9th Cir. 2014), citing *Lincoln Life & Annuity Co. of N.Y. v. Berck*, No. D056373, 2011 WL 1878855, at *6 (Cal. Ct. App. May 17, 2011). Other courts have allowed STOLI investors to assert their own claims seeking declaratory judgment that existing policies are valid, despite the fact that the policies are not yet payable and the insurer has taken no action to challenge same. *See PHL v. ESF QIF Trust*, No. 12-319-LPF, 2013 WL 6869803, at *1 (Dec. 30, 2013).

In *ESF QIF*, PHL filed a declaratory judgment action against the ESF QIF Trust seeking to declare a particular insurance policy void *ab initio* due to lack of insurable interest. In response, the Trust asserted a number of counterclaims, including one seeking a declaratory judgment that 14 additional policies owned by the Trust, which insured the lives of different individuals and had not yet become payable, were valid. *Id*. at *1-2. The Trust further sought a declaration that PHL was liable to pay on the policies upon the death of its insureds, and was either estopped from challenging the policies as void *ab initio* or had otherwise waived the right to do so. *Id*. at *1. Allowing this claim to stand, the court ruled there was "sufficient adversity between the parties," as a result of the existing litigation and PHL's alleged history of challenging similar STOLI policies in other lawsuits, to support a claim. *Id*. at *4. *See also CSSEL Bear Trust v. Phoenix Life Ins. Co.*, No. 601002/2009, 2011 WL 2941357, at *1 (Sup. Ct. N.Y. June 23, 2011). Not all courts, however, have allowed such claims to stand. *See e.g. Mosier v. Phoenix Life Ins. Co.*, No. SA cv 12-227 PSG, 2013 WL 12132065 (C.D. Cal. Jan. 15, 2013) (dismissing a complaint seeking remedy for Phoenix's alleged "failure to confirm coverage" which allegedly "diminished the marketability" of certain life insurance policies). Accordingly, it remains to be seen whether preemptive strikes by the owners of STOLI policies to "enforce" the validity of those policies will gain much traction in the years to come.

The STOLI wars continue, with traditional concepts of insurable interest, routine incontestability clauses, and equitable principles of unjust enrichment serving as key weapons in various STOLI battles. Practitioners in the life insurance industry should take note that many of these arguments can play a role outside of the context of STOLI litigation as well. Lack of insurable interest can occur outside of STOLI, and the cases described above may be useful for insurers in evaluating their litigation strategy going forward.