Docket No. 12-20784

IN THE

United States Court of Appeals for the Fourteenth Circuit

FRANK KIPP, AS TRUSTEE FOR THE HICKS IRREVOCABLE LIFE INSURANCE TRUST, AND PRESIDENTIAL HOLDINGS, LLC,

APPELLANTS,

v.

GUARANTY LIFE INSURANCE COMPANY,

APPELLEE

APPEAL FROM A JUDGMENT IN A CIVIL CASE ENTERED IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW TEJAS

BRIEF FOR APPELLEE

GUARANTY LIFE INSURANCE COMPANY

Team 47
Counsel for Appellee
Guaranty Life Insurance Company

QUESTIONS PRESENTED

I. Did the district court properly declare the policy void for lack of an insurable interest?

II. Did the district court err in refusing to allow Guaranty Life Insurance Company to retain all life insurance premium payments made on the Policy?

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The opinion of the United States District Court for the District of New Tejas, *Kipp v. Guaranty Life Insurance Co.*, is unreported and appears in the Record at pages 4-18.

STATEMENT OF JURISDICTION

This court has subject matter jurisdiction under 28 U.S.C. § 1332(a)(1) (2006), because Guaranty Life and the Appellants are citizens of different states, and the amount in controversy exceeds $75,000, exclusive of attorney's fees, interest and costs.

The judgment of the district court is appealable under 28 U.S.C. § 1291 (2006), and Federal Rule of Civil Procedure 54 because it is a final judgment that disposes of the entire action.

STATUTORY PROVISIONS

The New Tejas statute governing rescission of insurance contracts states:

> If a representation is false in a material point, whether affirmative or promissory, the injured party is entitled to rescind the contract from the time the representation becomes false.

N. Tej. § 1408 (2009).

Prior to 2009, the New Tejas insurable interest statue provided:

> (a) An insurable interest, with reference to life and disability insurance, is an interest based upon a reasonable expectation of pecuniary advantage through the continued life, health, or bodily safety of another person and consequent loss by reason of that person's death or disability or a substantial interest engendered by love and affection in the case of individuals closely related by blood or law[.]
>
> (b) An individual has an unlimited insurable interest in his or her own

> life, health, and bodily safety and may lawfully take out a policy of insurance on his or her own life, health, or bodily safety and have the policy made payable to whomsoever he or she pleases, regardless of whether the beneficiary designated has an insurable interest.
>
> (c) An insurable interest shall be required to exist at the time the contract of life or disability insurance becomes effective, but need not exist at the time the loss occurs.

N. Tej. § 1409 (2008) (amended 2009).

New Tejas amended it its insurable interest laws in 2009. The amended statute, which took effect on August 28, 2009, states:

> (a) An insurable interest, with reference to life and disability insurance, is an interest based upon a reasonable expectation of pecuniary advantage through the continued life, health, or bodily safety of another person and consequent loss by reason of that person's death or disability or a substantial interest engendered by love and affection in the case of individuals closely related by blood or law[.]
>
> (b) An individual has an unlimited insurable interest in his or her own life, health, and bodily safety and may lawfully take out a policy of insurance on his or her own life, health, or bodily safety and have the policy made payable to whomsoever he or she pleases, regardless of whether the beneficiary designated has an insurable interest.
>
> (c) An insurable interest shall be required to exist at the time the contract of life or disability insurance becomes effective, but need not exist at the time the loss occurs.
>
> (d) Trusts and special purpose entities that are used to apply for and initiate the issuance of policies of insurance for investors, where one or more beneficiaries of those trusts or special purpose entities do not have an insurable interest in the life of the insured, violate the insurable interest laws and the prohibition against wagering on life.
>
> (e) Any device, scheme, or artifice designed to give the appearance of an insurable interest where there is no legitimate insurable interest violates the insurable interest laws.
>
> (f) This section shall not be interpreted to define all instances in which

an insurable interest exists.

(g) The 2009 Amendments are not to be applied retroactively.

N. Tej. § 1409 (2009).

STATEMENT OF THE CASE

A. Statement of Facts

On January 4, 2007 Reggie Hightower, a life insurance agent at Top-Gun Executive Insurance Agency, contacted Sydney Hicks about planning the estate of his seventy-one year old father, Don Juan W. Hicks. R. at 10. Though Mr. Sydney Hicks informed Mr. Hightower that his father did not have a discernable estate to plan, he agreed to discuss the possibility of obtaining life insurance for his father. *Id.* Mr. Hightower sent over a life insurance application and Statement of Client Intent form (SOCI).

On January 10, after Mr. Syndey Hicks discussed the issue with his father, the elder Mr. Hicks agree to purchase a $500,000 policy if his son agreed to pay the premiums. *Id.* The next day, Mr. Sydney Hicks mailed the executed application and SOCI to Mr. Hightower. The same day that he received these, Mr. Hightower sent an email to Timmy Chung, the Vice President of Business Development at Presidential Holdings (Presidential), saying, "Talked to Sydney Hicks, and we should be able to flip his old man's policy for 3% of the face value of the policy. Confirmed $20 million for the face value." *Id.*

To hold the Policy, the parties created The Hicks Irrevocable Life Insurance Trust (Trust) on February 5, which named Mr. Hicks as the grantor, Mr. Sydney Hicks as the beneficiary, and attorney Bryan Jones as the Trustee. R. at 7. On February 7 the Trust submitted the insurance application to Guaranty Life Insurance Company (Guaranty Life). *Id.* The application requested a policy with a face value of $20 million dollars, $19.5 million more than Mr. Hicks had authorized.

Id. Mr. Sydney Hicks was named as the sole beneficiary. *Id.* The application fraudulently misrepresented that Mr. Hicks was a self-employed entrepreneur earning $8.5 million a year with a net worth of $1.2 billion. *Id.* In reality, as Guaranty discovered during litigation, Mr. Hicks was a retired cab driver who lived in a low rent apartment and subsisted on social security. R. at 11. Included in the application was the SOCI which also misrepresented that not "'being purchased in connection with any formal or informal program under which the proposed owner or proposed insured have been advised of the opportunity to transfer the policy to a third party within five years of its issuance.'" R. at 7.

Based solely on the information provided to Guaranty Life in the application and a medical examination of Mr. Hicks, Guaranty Life issued the Policy to the Trust on February 16, 2007 with the face amount of $20 million and a planned first year premium of $955,827. R. at 8. Guaranty Life, on March 5, delivered the Policy and a Policy Acceptance Form to the Trust. R. at 8. The form, which required the policy holder to affirm the veracity of the representations in the application, was signed and returned to Guaranty Life. *Id.* The same day, Mr. Sydney Hicks proceeded to make the first three-month premium payment of $238,956.75. *Id.* Guaranty Life also paid Mr. Hightower $1.4 million dollars in commissions for the sale of the policy. R. at 8 n.4.

Two days later, on March 7, Mr. Sydney Hicks executed a Beneficial Interest Transfer Agreement, which transferred the entire beneficial interest of the Policy to Presidential in exchange for the premium payment he had made and 3% of the face value of the Policy, a total of $838.956.75. R. at 8-9. That same day Mr. Jones resigned as trustee and was replaced by attorney Frank Kipp. Mr. Sydney Hicks later testified that he had relatively modest means and could not have purchased the Policy if Mr. Hightower had not arranged to reimburse him for the premium payments. R. at 11, 12. Discovery confirmed that Mr. Sydney Hicks made $60,000 a year as engineer at a local chemical plant and that he had no other assets aside from a $150,000 home and a 401k plan worth approximately $19,000. R. at 11.

Guaranty Life had no knowledge that Mr. Sydney Hicks had transferred the Policy until over a year-and-a-half later when Presidential submitted a Designation of Owner and Designation of Beneficiary form on October 21, 2008. R. at 9. The form avowed that Mr. Sydney Hicks had sold all beneficial interest in the Policy to Presidential and demanded that Guaranty transfer ownership of the Policy. *Id.* In response, Guaranty Life alerted the Trust that it was investigating the prior undisclosed sale of beneficial interest and demanded the production of various documents. *Id.* The Trust and Presidential subsequently filed suit on January 5, 2009. *Id.*

After discovering the misrepresentations during litigation, Guaranty Life filed a counterclaim asking the court to declare the Policy void and seeking to retain the premium payments already made under the Policy. R. at 12. The counterclaim was filed on June 6, 2009, three months after the contestability period of the Policy expired. *Id.* Guaranty Life's chief underwriter testified that Guaranty Life would not have issued the Policy had it known of the misrepresentations in the application, SOCI, and Policy Acceptance Form, or that the Policy was being purchased for a third-party investor who lacked an insurable interest in Mr. Hicks's life. R. at 12. He also testified that the Policy would not have been issued if Guaranty Life had known that Presidential was giving Mr. Sydney Hicks monetary incentives to take out and then transfer the Policy. *Id.* During his deposition, Mr. Hightower pled his Fifth Amendment right to each and every question. R. at 10 n.5. Unfortunately, Mr. Hightower has since passed away leaving behind an estate with no significant assets. R. at 8 n.4.

B. Summary of Proceedings

On January 5, 2009, Frank Kipp and Presidential initiated this lawsuit. R. at 13. Based upon Guaranty Life's refusal to recognize the change of ownership of the Policy, the Trust asserted claims against Guaranty Life for breach of contract, conversion, breach of the covenant of good faith and fair dealing, and fraud. *Id.* Presidential also brought suit against Guaranty Life for fraud, intentional and negligent interference with contract and prospective economic advantage. *Id.* Appellants sought \$4.7 million in damages for the Policy premiums payments as well as an additional \$600,000 for the amount Presidential paid to Sydney in exchange for the transfer of the Policy. *Id.*

Guaranty Life filed a Counterclaim on June 6, 2009 seeking a declaration that the Policy was void *ab initio* for lack of an insurable interest. *Id.* Guaranty Life also sought to retain the premiums that had already been paid under the Policy. *Id.*

The parties filed cross Motions for Summary Judgment on May 12, 2011. *Id.*

The motions were argued before the district court on August 8, 2011. *Id.* The court partially granted Guaranty Life's Motion, declaring the Policy void *ab initio* but denying Guaranty Life the right to retain the premium payments. R. at 14, 15. Both parties subsequently filed timely appeals with this Court.

SUMMARY OF ARGUMENT

This Court should affirm the decision of the district court that the Policy is void from its inception for lack of an insurable interest. The Supreme Court has recognized that it is against public policy to allow someone to take out a life insurance policy on an unrelated third party. Following the Supreme Court, New Tejas specifically forbids a party without an insurable interest from taking out a life insurance policy. Appellants set up a series of transactions designed to skirt New Tejas's laws by having Mr. Sydney Hicks, a party with an insurable interest, obtain the Policy and immediately transfer it to an investor without any insurable interest. Throughout the entire transaction, the Policy was under the de facto control of Mr. Hightower and Presidential, neither of whom had an insurable interest at stake. Thus, even though Appellants superficially complied with the insurable interest law, they failed to do so in good faith, and therefore this Court should declare the Policy void from its inception.

However, even if the Court declines to require the Appellants to comply with the insurable interest statute in good faith, the Policy is still void because it advances an illegal matter. The creation of an insurance contract on the life of an unrelated third party is an illegal gambling contract both under New Tejas law and Supreme Court precedent. The net result of Appellants' dealings is to create just such an illegal contract and therefore the Policy is also void on this independent ground.

This Court should reverse the decision of the district court that Guaranty Life is not entitled to retain the premium payments on the Policy. Since Appellants procured the Policy through fraud, and their wrongful conduct rendered the Policy void at its inception, this Court should not reward their fraud by refunding any premiums paid on the Policy. Holding otherwise would allow the Appellants, who committed insurance fraud, to walk away from the transaction unscathed and leave Guaranty Life, the innocent party, to bear the financial burden of that fraud.

If this Court does not allow Guaranty Life to retain all premiums paid on the Policy, it should at least allow them to retain an amount of the premiums that offset damages incurred in issuing the Policy. While general principles of contract rescission require parties to return consideration received under a contract, this does not always restore parties back to their original positions before entering the contract. Therefore, special damages may be allowed in addition to rescission to restore the status quo ante. In this case, Guaranty Life will not be able to recover commissions paid to its agent for issue the Policy. Therefore, at minimum, this Court should determine that Guaranty Life may offset the premiums it must return by the damages it incurred, including lost commissions.

ARGUMENT

I. THE INSURANCE POLICY IS VOID BECAUSE THE POLICY WAS NOT SUPPORTED BY AN INSURABLE INTEREST AT ITS INCEPTION AND IS AN ILLEGAL WAGERING CONTRACT.

The Supreme Court has long held that an insurance policy which is not acquired by a person with an independent insurable interest in the life of the insured is an illegal gambling contract. *Warnock v. Davis*, 104 U.S. 775, 778-79 (1881). In the eyes of the Court, a beneficiary who has no interest in the continued life of the insured has "a sinister counter interest in having the life come to an end." *Grigsby v. Russell*, 222 U.S. 149, 154 (1911). Even so, the Supreme Court has allowed a validly obtained insurance policy to be transferred to a third party who lacks an insurable interest, on the assumption that the original beneficiary will only assign the policy to someone they trust. *Id.* at 155. The Court was careful, however, to distinguish a legitimate transfer from a transaction which is merely "a cloak to what is, in its inception, a wager . . . ." *Id.* at 156. The series of dealings set up by Mr. Hightower and Presidential present precisely this sort of sham transaction to cover up an illegal wagering on the life of Mr. Hicks. Though the Policy was nominally taken out by Mr. Hicks's son, Sydney, who had an insurable interest in his father's life, true control over the Policy was always in the hands of Mr. Hightower and Presidential, neither of whom had an insurable interest at stake. Appellants contend that every one of their transactions complied with the letter of the law, but the sum total of their machinations was to create an illegal gambling contract that violates fundamental principles of good faith, and should be declared void as a matter of public policy.

A. The Insurance Policy Nominally Obtained for Mr. Sydney Hicks Was Merely a Sham Transaction to Avoid New Tejas's Insurable Interest Laws and Obtain an Illegal Wagering Contract, and Therefore Should Be Declared Void.

"The very meaning of an insurable interest," according to the Supreme Court, "is an interest in having the life continue, and so one that is opposed to crime." *Id.* at 155. Following the Supreme Court's lead, a number of states, including New Tejas, have enacted statutes requiring the party obtaining insurance to demonstrate that he has an insurable interest in the life of the insured. According to New Tejas's statute, "An insurable interest . . . is an interest based upon a reasonable expectation of pecuniary advantage through the continued life, health, or bodily safety of another person and consequent loss by reason of that person's death or disability . . . ." N. Tej. § 1409(a) (2008). Insurable interests also include relationships that cannot be quantified monetarily, such as those family relationships "engendered by love and affection." *Id.* Under New Tejas law the insurable interest need only "exist at the time the contract of life or disability insurance becomes effective . . . ." *Id.* § 1409(c). Prior to the 2009 amendments, the statute does not specifically address the scenario at issue in this case where a party with an insurable interest was used as an incidental intermediary to obtain an insurance policy for another party with no insurable interest. The Appellants nonetheless failed to comply with the statute in good faith, and therefore the Court should declare the Policy void.

1. **Appellants did not obtain the Policy in good faith compliance with New Tejas's insurable interest laws.**

Though it is an issue of first impression under New Tejas law, courts in a number of jurisdictions have implied a requirement that parties act with good faith adherence to insurable interest laws and not obtain the policy as a set up for a third party without any insurable interest. For instance, in Florida, which has virtually the same insurable interest laws as New Tejas, Fla. Stat. Ann. § 627.404 (West 2008), courts have implied a requirement that the contract be in good faith and not merely a cover for an illegal wager. *See AXA Equitable Life Ins. Co. v. Infinity Fin. Grp.*, 608 F. Supp. 2d 1349, 1356 (S.D. Fla. 2009). Other states have done the same. *See, e.g.*, *Wages v. Wages*, 42 S.E.2d 481, 486 (Ga. 1947); *Chamberlain v. Butler*, 86 N.W. 481, 483 (Neb. 1901); *Steinback v. Diepenbrock*, 158 N.E. 662, 664 (N.Y. 1899); *see generally* 7 Williston on Contracts § 17:5 n.22 (4th ed. 1999) (collecting cases). Moreover, the Supreme Court has suggested that the parties' good faith is an essential prerequisite to a valid a transfer of the beneficial interest in a life insurance policy from a party with an insurable interest to a party without any. In the words of the Court, "[C]ases in which a person having an interest lends himself to one without any, as a cloak to what is, in its inception, a wager, have no similarity to those where an honest contract is sold in good faith." *Grisby*, 222 U.S. at 156.

Though the statute as applicable to this litigation is silent on the matter of good faith, the 2009 amendments are instructive.[1] In 2009 the state legislature added subsection (e) to section 1409, which states, "Any device, scheme, or artifice designed to give the appearance of an insurable interest where there is no legitimate insurable interest violates the insurable interest laws." Far from implying, as Appellants argue, that the pre-amendment statute imposed no such good faith requirement, subsection (e) merely makes explicit a point which was latent in the pre-amendment statute, namely, that illegitimate insurable interests cannot sustain an insurance contract. Because subsection (e) simply clarifies the pre-amendment statute, this Court should imply a requirement that a party with an insurable interest exercise that interest in good faith.

The actions of the Appellants here fall well short of this standard of good faith. In fact, Appellants' dealings bear all the hallmarks of a stranger originated life insurance (STOLI) policy, a classic scheme to avoid insurable interest laws. In *Pruco Life Insurance Co. v. Brasner*, No. 10-80804-CIV, 2011 WL 134056 (S.D. Fla. 2011), a federal district court confronted a typical STOLI scheme. In that case Mr. Brasner, the inventor of the STOLI formula, approached Ms. Berger, and convinced her to take out a life insurance policy on her own life. *Id.* at *1-2 The stated beneficiary was Mr. Berger, but even before the policy was issued, the couple made a binding contract to transfer ownership of the policy to a STOLI investor on the

[1] By their own terms, the 2009 amendments are not applicable retroactively to contracts concluded before August 28, 2009. N. Tej. § 1409(g) (2009). The insurance policy that is the subject of this litigation was issued on February 16, 2007 and litigation began on January 5, 2009, R. at 8, 9, so the amendments to section 1409 do not apply in this case.

secondary market. *Id.* In obtaining the policy "Mr. Brasner 'grossly overstated Ms. Berger's income, assets and net worth' . . . ." *Id.* at *2. A little over a month after the policy was issued Ms. Berger attempted to transfer the policy to a third party investor, and the insurance company, sensing fraud, filed suit. *Id.*

Applying Florida law, which, as noted above, is almost identical to corresponding New Tejas law, the court held the contract void. *Id.* at *4. According to the court, Mr. Brasner and Ms. Berger violated the implied requirement of good faith by contracting to transfer the policy even before it was issued. *Id.* at *3-4. The policy was thus, as a practical matter, never in the hands of anyone who had an insurable interest and was consequently void. *Id.* at *4.

The facts of this case follow this typical STOLI pattern almost perfectly. The record indicates that Mr. Hightower first contacted Mr. Sydney Hicks to discuss the possibility of a life insurance policy for his father on January 4, 2007. R. at 10. A week later, after the elder Mr. Hicks had consented to a $500,000 policy, Mr. Hightower sent an email to Presidential stating, "[W]e should be able to flip [the] policy for 3% of the face value of the policy. Confirmed $20 million for the face value." *Id.* Mr. Hightower, like Mr. Brasner, intended to obtain the Policy for a third party investor from the beginning with Mr. Sydney Hicks acting merely as an incidental intermediary. This is precisely the sort of illegal wagering contract forbade by the Supreme Court in *Warnock*, 104 U.S. at 778-79, and addressed by the district court in *Pruco*, 2011 WL 134056, at *3-4.

Following Mr. Brasner's model, Mr. Hightower then proceeded to go through with the execution of this plan. He misrepresented the amount of Mr. Hicks's assets to inflate the face value of the Policy just as Mr. Brasner had exaggerated Ms. Berger's income. R. at 10, 11. Then two days after Guaranty Life delivered the Policy, Mr. Sydney Hicks transferred the entire beneficial interest to Presidential in exchange for the value of the premiums he had paid and a profit equal to 3% of the face value of the Policy. R. at 8-9. The scheme was complete. Presidential had its inflated insurance contract, Mr. Sydney Hicks had his money, and Mr. Hightower had his $1.4 million commission. R. at 8 & n.4.

Appellants are quick to point out that Mr. Sydney Hicks, unlike Ms. Berger, never entered into a contract to transfer his beneficial interest in the Policy until two days after it was issued to him. Thus, the taint was supposedly dissipated by the intervening two days where Mr. Sydney Hicks supposedly held sole control over the contract. This argument overlooks the fact that even though Mr. Sydney Hicks was not contractually bound to transfer the Policy to Presidential, he had little other choice. Because the face value of the Policy was inflated due to the misrepresentation of Mr. Hicks's assets, the six-figure premiums on the Policy were far too expensive for Mr. Sydney Hicks to afford on his five-figure salary. R. at 8. Indeed, Mr. Sydney Hicks testified that he never would have been able to purchase the Policy if Mr. Hightower had not arranged to compensate him for the premium payments. R. at 11-12. Thus, just as in *Pruco*, Mr. Hightower and Presidential retained de facto control over the Policy even while it was in the name of Mr. Sydney Hicks.

Though *Pruco* is not binding on this Court, the similarity of the law and facts at issue in that case make it instructive. Like the court in *Pruco*, this Court should follow the guidance of the Supreme Court and numerous state courts, and distinguish between insurable interests which are exercised in good faith and those which are merely a ploy to bypass state law. Then, given the similarity of the present case to the typical STOLI scheme, this Court should hold that the present case falls into the latter category. Throughout the entire transaction, Mr. Sydney Hicks, the only person with an insurable interest in the contract, was used merely as an intermediary to skirt New Tejas's insurable interest laws. Therefore, the contract was not formed in good faith compliance with section 1409, and this Court should declare it void.

2. The minority view that no good faith requirement is necessary cuts against the legislative intent behind New Tejas's insurable interest law.

Appellants urge this court to adopt the minority rule which refuses to imply a requirement that an insurable interest be exercised in good faith compliance with the law. *See, e.g.*, *Lincoln Nat'l Life Ins. Co. v. The Gordon R.A. Fishman Irrevocable Life Trust*, 638 F. Supp. 2d 1170, 1170-71 (C.D. Cal. 2009). The problem with mandating good faith, according to the Appellants, is that enforcing that standard requires courts to "look behind" the contract and try to get at the intent of the parties. Following the district court in *Lincoln*, Appellants argue that the Policy considerations in favor of good faith are outweighed by the policy considerations counseling against court interference in contracts. While that may have been true under the California statute at issue in *Lincoln*, in New Tejas the state legislature has already weighed the policy considerations and determined that it is appropriate for the courts to look behind the contract to determine if there was a legitimate insurable interest.

As noted above, section 1409(e), which was added in 2009, requires courts to look beyond the surface of any insurance contract to make sure there is no "device, scheme, or artifice designed to give the appearance of an insurable interest where there is no legitimate insurable interest . . . ." The New Tejas legislature has thus determined it is appropriate for courts to look behind the contractual language of an insurance policy to make sure the policy is not a fraud. This Court should respect the policy determinations of the policy makers and reject the Appellants policy argument against the application of the good faith standard.

B. Even if the Court determines that the good faith standard should not apply and that there was an insurable interest at the inception of the Policy, the Court should still declare the contract void because the transaction was merely a façade for an illegal wagering contract.

This Court need not adopt an implied requirement of good faith to strike down the Policy. It is a well-established principle of law that a contract to advance an illegal matter is void. *See, e.g.*, *Total Med. Mgmt., Inc. v. United States*, 104 F.3d 1314, 1319 (Fed. Cir. 1997) ("A contract which is 'plainly illegal' is a nullity and void *ab initio*."); *see generally* 17A Am. Jur. 2d *Contracts* § 229 (2008). As the district court pointed out, it is illegal in the State of New Tejas to take out an illegal gambling contract on the life of another. *See* R. at 3; *see also Warnock*, 104 U.S. at 778-79. The net result of the series of contracts entered into by the Appellants was to create just such a wagering contract. Mr. Sydney Hicks took out a fraudulent insurance contract on the life of his father and immediately transferred the beneficial interest of the contract to Presidential in exchange for money and the premium payments on the Policy which he could not afford. R. at 8-10. The Policy, as evidenced by its immediate transfer to Presidential, a party with no interest in the life of Mr. Hicks, was merely a means to create an illegal wagering contract in contravention of New Tejas law. Even if every individual transaction in Appellants' scheme technically complied with New Tejas law, the end product of those dealings was the advancement an illegal matter. Therefore, this Court should declare the Policy void from its inception.

II. GUARANTY LIFE SHOULD NOT BE REQUIRED TO RETURN ALL LIFE INSURANCE PREMIUM PAYMENTS MADE ON THE POLICY.

When an insurance company petitions a court to declare a policy void at its inception, the general rule is that the insurer must return any premiums paid on the policy. *PHL Variable Ins. Co. v. Lucille Morello 2007 Irrevocable Trust*, 645 F.3d 965, 969 (8th Cir. 2011). However, when an insurance policy is void because it has been procured by fraud, the insurer is not required to return premium payments. *See Nat'l Council of Knights & Ladies of Sec. v. Garber*, 154 N.W. 512, 513 (Minn. 1915); *James v. Ins. Co. of N. Am.*, 18 S.W. 260, 260 (Tenn. 1891); *Curry v. Wash. Nat'l Ins. Co.*, 194 S.E. 825, 826 (Ga. Ct. App. 1937). Moreover, even where courts have required an insurance company to return premiums on a void policy to effectuate its rescission, many of those courts have allowed the insurance company to offset damages from any losses incurred under policy to offset the amount of the premiums that must be returned. *See Sun Life Assurance Co. of Can. v. Berck*, 719 F. Supp. 2d 410, 418 (D. Del. 2010) (holding that although insurer could not retain the premium payments on a policy that was void at its inception, the insurer could recover damages resulting of the wrongful behavior of defendant).

In this case, Appellants argue that if the Policy is rescinded as void at its inception, they should be entitled to a return of the premiums paid. But it was Appellants' own fraudulent conduct that rendered the Policy void at its inception, so they should not be entitled to return of the premiums in this situation. Further, even if the Court holds that rescission of the Policy requires Guaranty Life to return the premiums, it should permit Guaranty Life to retain a portion of the premiums to offset damages it has incurred as a result of the wrongful conduct of Appellants. Therefore, this Court should reverse the district court decision ordering Guaranty Life "to return all premiums to the Trust." R. at 15.

A. Guaranty Life Is Entitled to Retain All Life Insurance Premium Payments Made on the Policy.

The district court found that the Policy was void at its inception for lack of an insurable interest. R. at 14. Next, it relied on inapplicable case law to require that Guaranty Life return all premiums paid on the Policy, holding that "[g]eneral principles of rescission require the parties to be returned [to] the positions prior to the formation of the contract." *Id.* However, this case does not present a situation where the policy was void due to an innocent mistake on the part of the parties.

Rather, the whole purpose of the Policy was to obtain an illegal gambling contract in contravention of state law. This Court should reverse the district court and find that since the Policy was obtained through fraud, Guaranty Life should be allowed to retain all premiums as an exception to the general rule for contract rescission.

1. Because they made fraudulent misrepresentations in procuring the Policy, Appellants are not entitled to a return of the premium payments.

Modernly, courts have taken into consideration a party's fraud when determining how to rescind a void insurance policy. These courts rightly recognize the need to prevent "insurance fraud from being a zero-sum game in which the insured bears no pecuniary risk in attempting to perpetrate fraud." *Morello Irrevocable Trust*, 645 F.3d at 970; *see also Wuliger v. Mfrs. Life Ins. Co.*, 567 F.3d 787,797 (6th Cir. 2009) ("[A rule] that an insured who commits fraud may announce the fraud and receive a refund on any premiums paid to date[] would have the perverse effect of reducing the defrauder's risk relative to the honest policyholders; any defrauder could commit to paying premiums knowing that if the premiums ever became unaffordable, he could simply declare his fraud and receive all of the previously paid premiums back."). This Court should follow those courts' precedents and find that Appellants' fraud precludes their recovery of the premiums in this case.

In *Morello Irrevocable Trust* the Eighth Circuit affirmed a settlement between an insurer and insurance beneficiaries where the insurer was permitted to retain the premiums paid on the policy after rescission of the insurance policy. 645 F.3d at 966-67. In that case a third party who had loaned money to pay premiums on an insurance policy sought a declaratory judgment that the premiums must be repaid when the policy was rescinded. *Id.* at 969. The district court below had rejected that claim by relying on a "procured-by-fraud" exception to the general rule that rescission of a life insurance policy requires return of premium payments. *Id.* The policy, which was obtained for the illegal purpose of reselling it to third parties, had been obtained through the use of phony financial statements and other misrepresentations on the application and various forms. *Id.* at 967-68. The court acknowledged that the result would be different if the policy was void due to a good faith mistake rather than a fraud. *Id.* at 970. Affirming the district court, the Eighth Circuit ultimately found that providing knowingly falsified information on an insurance application constituted actual fraud "which rendered the insurance contract void at its inception and relieve[d the insurer] of any duty it otherwise may have owed to return premiums already paid." *Id.* at 970. This was true even though the party seeking return of the premiums was an innocent third-party lender who had taken no part in the misrepresentations. *Id.*

Although the Eighth Circuit's decision in *PHL Variable* is not binding on the Fourteenth Circuit, its rationale and holding are highly persuasive in light of the parallels to the present case. Similar to the appellant in *PHL Variable*, here Presidential arranged to make premium payments on the policy owned by the Trust. R. at 13. Further, like the misrepresentations in the application for the *PHL Variable* policy, here the Appellants made misrepresentations on the insurance application, SOCI, and Policy Acceptance Form regarding Mr. Hicks's income, net worth, assets, and misrepresented that Mr. Sydney Hicks was obtaining the policy for his own benefit rather than that of a third party with no insurable interest. R. at 7, 10-13. Given these similarities, the reasoning from *PHL Variable* should apply here and the Court should find that the fraud perpetrated by the Appellants in obtaining the Policy relieves Guaranty Life of any duty to return the premiums. Moreover, the Appellants in this case are not innocent parties like the lender was in *PHL Variable*; indeed, Presidential's agreement to pay the premiums for the beneficial interest in the Policy made it complicit in the fraud. R. at 10-13. Therefore, Appellants should not be entitled to return of the premiums because they were responsible for fraudulently procuring the Policy.

The District Court for the District of Rhode Island in *PHL Variable Insurance Co. v. The P. Bowie 2008 Irrevocable Trust ex rel. Baldi*, No. CA 10-070-M, 2012 WL 3860553, at *8 (D.R.I. Sept. 5, 2012), followed a similar line of reasoning. There the court granted summary judgment for the insurer on the issue of whether it could retain the premiums paid on the policy after it was rescinded. *Id.* The insurer claimed that the trust that owned the policy had made material misrepresentations in its insurance application regarding the insured's net worth and annual income, the trust's purpose for obtaining the policy, the payor of the premiums on the policy, and the trusts intent to transfer the policy to third parties. *Id.* at *2. The insurer and the trust eventually agreed to rescind the policy. *Id.* The court found that the trust had intentionally and fraudulently induced the insurer to issue the policy based on false information. *Id.* at *5. For this reason, the court allowed the insurer to retain all premiums paid by the trust on the policy, stating "[t]his Court does not believe that the law would or should allow an entity to commit an intentional and calculated fraud upon [the insurer] and walk away unscathed while the innocent party bears the financial burden of the fraud." *Id.*

Similar to the facts in *P. Bowie*, here Appellants made material misrepresentations in the application process for the Policy regarding Mr. Hicks' net worth, annual income, purpose for obtaining the policy, the payor of the premiums on the policy, and whether there was intent to transfer the policy to third parties. R. at 7, 10-13. Where the insurer in *P. Bowie* was induced by fraud to issue the policy, so too here Appellants induced Guaranty Life to issue the Policy with fraudulent representations. R. at 12. Additionally, as the parties in *P. Bowie* agreed to rescind the policy in that case, here the District Court for the District of New Tejas ordered the Policy to be rescinded. R. at 14. Just as the court in *P. Bowie* held that the fraudulent misrepresentations in procuring that policy precluded the trust in that case from recovering the premiums, this Court should hold that Appellants' fraud in procuring the Policy precludes them from recovering any of the premiums they paid. To hold otherwise would have the unjust result of allowing Appellants to walk away unscathed while Guaranty Life, the innocent party, would have to bear the financial burden of the fraud.

The holding in *TTSI Irrevocable Trust v. Reliastar Life Insurance Co.*, 60 So. 3d 1148 (Fla. Dist. Ct. App. 2011), from the District Court of Appeal of Florida further demonstrates the rule that a party who wrongfully procures an insurance policy is not entitled to return of premiums paid on that policy. In that case, the court affirmed a decision that "[w]here a party wrongfully procures a life insurance policy on an individual in which it has no insurable interest, the party is not entitled to return of premiums paid for the void policy." *Id.* at 1148. The court declared the policy void at its inception because the trust that owned it never had an insurable interest in the life of the insured. *Id.* at 1150. The beneficiary misrepresented to the insurer that the trust which held the policy was owned by the insured, when in fact there was no such relationship between the insured and the trust. *Id.* at 1149. Further, the beneficiary lied to the insured about who would hold the beneficial interest under the policy. *Id.* Ultimately, the court left the parties "as the court found them" because "the party seeking to enforce the contact [was] the only party who engaged in deceptive and misleading conduct at the time the contract was entered into." *Id.* at 1150.

Similar to *TTSI*, the district court found the Policy void at its inception for lack of an insurable interest. R. at 13. Misrepresentations were made in *TTSI* which suggested there was an insurable interest where there in fact wasn't. The same scenario exists here. Appellants engaged in numerous misrepresentations to conceal the lack of insurable interest and the "pre-arranged deal of the investors to procure ownership and beneficial interest in the Policy." R. at 14. As in *TTSI*, this Court should not require Guaranty Life to return the premiums. Instead, it should leave the parties as the Court finds them because it was Appellants who engaged in the misleading and deceptive conduct which rendered the contract void in the first place.

2. The district court relied on inapplicable cases to support the erroneous conclusion that Guaranty Life is not entitled to retain the premiums.

The district court relied on two other district court cases to determine that Guaranty Life could not retain the premium payments. R. at 14. In *Hartford Life & Annuity Insurance Co. v. Doris Barnes Family 2008 Irrevocable Trust* No. CV 10-7560 PSG (DTBx), 2012 WL 688817 (C.D. Cal. Feb. 3, 2012), and *PHL Variable Insurance Company v. Jolly*, 800 F. Supp. 2d 1205 (N.D. Ga. 2011), two federal district courts determined that challenges to the validity of two insurance policies were not supported by law, and therefore held that the insurer could not retain premium payments made on the policies. However, these two cases are factually distinguishable from the case at hand. Therefore, this Court should reverse the district court and permit Guaranty Life to retain the premiums paid on the Policy.

In *Hartford Life*, the plaintiff insurer alleged the policy at issue was void for lack of an insurable interest, or, in the alternative, that the policy be declared an illegal wagering contract. No. CV 10-7560 PSG (DTBx), 2012 WL 688817, at *4. However, the facts in that case revealed that the initial owner of the policy did have an insurable interest in the insured because they were related. *Id.* Further, the court said there was insufficient evidence to conclude that the initial owners were trying to skirt the insurable interest laws and declare the policy void on that ground. *Id.* at *5. The court then denied the insurer's motion for summary judgment and held that because the policy was not void at its inception, the insurer was not entitled to retain the premium payments. *Id.* at *6.

The reliance by the district court below on *Hartford Life* is puzzling. In contrast to the court in that case, the court below here *did* find the Policy to be void at its inception: "the Policy failed for lack of insurable interest at its inception due to the prearranged deal of the investors to procure ownership and beneficial interest in the Policy." R. at 14. The *Hartford Life* court relied on the fact that the policy in that case was not void at its inception to support its finding that the insurer was not entitled to retain the premiums, so reliance on that precedent in this case where the Policy was void at its inception is misplaced.

The reasoning in *Jolly* also does not support the district court's decision below. In that case, an insurer brought suit against a trust company on the grounds of negligent misrepresentation and conspiracy, and also sought to retain the premium payments made on the policy at issue. 800 F. Supp. 2d at 1207. The court found that plaintiff insurer had not presented enough evidence to create a question of fact that defendant trust negligently made misrepresentations in procuring the policy. *Id.* at 1215. On the basis of that finding, the court continued to say that there was "no factual, legal, or equitable basis for permitting plaintiff to obtain policy premiums being held in the registry of the court absent a judgment in plaintiff's favor on [the claims for negligent misrepresentation or conspiracy]." *Id.* However, the court required the premiums to remain in the court registry until plaintiff determined whether or not to file an appeal, and stated that if "plaintiff successfully appeal[ed] this court's rulings, the premiums [would] provide its only source of monetary recovery." *Id.*

At issue in *Jolly* was whether a trust could be found liable for misrepresentations made on the application for an insurance policy. By contrast, in this case the Policy was challenged as void at its inception for lack of an insurable interest. R. at 14. Further, while the plaintiff in *Jolly* did not prevail on its motion for summary judgment in proving wrongful conduct on the part of the trust and therefore was not entitled to the premiums, the court implied that if the plaintiff successfully appealed the court's findings, it could possibly retain the premium payments. Here, Guaranty Life prevailed on its claim that the policy was void at its inception in the court below, and therefore should be entitled to retain the premium payments. In contrast with *Jolly*, here there is a factual, legal, and equitable basis that allows Guaranty Life to retain all of the premiums.

B. If This Court Finds that Guaranty Life Is Not Entitled to Retain All of the Premium Payments, Guaranty Life Should Still be Allowed to Retain an Amount of the Premium Payments Equal to the Loss It Suffered for Issuing the Policy.

The remedy of rescission attempts to put the parties to a contract back in their positions before they entered the contract. *See generally* Restatement (Third) of Restitution & Unjust Enrichment § 54 (2011). This remedy requires return of all consideration originally paid under the contract in order to "restore the status quo ante." *Borden v. Paul Revere Life Ins. Co.*, 935 F.2d 370, 379 (1st Cir. 1991).

Unfortunately, in this case Guaranty Life cannot be put back to the way things were before the Policy was issued because of Appellants' wrongful conduct. Mr. Hightower is deceased and has left no assets to speak of, R. at 8, so the $1.4 million paid to him as commission on the Policy cannot be recovered. Therefore, if this Court should determine that Guaranty Life is not entitled to retain all of the premium payments made on the policy, Guaranty Life should still be entitled to retain at least a portion of the premium payments to compensate it for the unrecoverable commissions and other losses incurred in issuing the Policy. Many courts have acknowledged that "when an insurance company rescinds on the grounds of fraud, it may, before returning premiums, offset losses incurred on the policy which was obtained by fraud." *Soanes v. Empire Blue Cross/Blue Shield*, 970 F. Supp. 230, 245 (S.D.N.Y. 1997) (citing *Borden*, 935 F.2d at 379). This would allow the insurer to retain a portion of the premiums as "special damages in order to effect the rescission and return it to the status quo." *P. Bowie*, 2012 WL 3860553, at *8. *See also Lummus Co. v. Commonwealth Oil Refining Co.*, 280 F.2d 915, 927 n.15 (1st Cir. 1960) ("[T]he recovery of special damages for the limited purpose of putting the defrauded party back in as good a position as he occupied before entering into the contract may be awarded in connection with, and in addition to, rescission and restitution").

The District Court for the Southern District of California in *PHL Variable Insurance Co. v. Clifton Wright Family Insurance Trust*, No. 09cv2344 BTM (POR), 2010 WL 1445186, at *4 (S.D. Cal. Apr. 12, 2010), denied the defendant's motion to strike plaintiff's request in its complaint for all or part of the premiums paid under the life insurance policy at issue in the case. There an insurance company sought a declaration that defendant's insurance policy was void at its inception, and additionally sought to retain all premiums paid on the policy, or in the alternative, to retain a portion of the premiums to account for commissions paid and other damages incurred by plaintiff in issuing the policy. *Id.* at *1. The court examined principles of rescission, and noted that under California law, "to effect a rescission a party to the contract must . . . [r]estore to the other party everything of value which he has received from him under the contract or offer to restore the same upon condition that the other party do likewise." *Id.*

However, the court explained that returning the consideration paid under a contract will often not restore the parties back to their former positions; this is especially true in cases of rescission based on fraud or misrepresentation by the non-rescinding party. *Id.* at *2. Thus, the court determined that consequential damages can and should be awarded to the aggrieved party following rescission of a contract to make that party whole again. *Id.* The court rejected the defendant's arguments to the contrary, finding that California law "permits a court to award consequential damages to an aggrieved party in a rescission suit." *Id.* at *3; *see also Hartford Life*, 2011 WL 759554 (stating that even where rescission requires returning to the other party everything of value which it received from him under the contract, an insurer is still entitled to compensation for damages incurred because of that other party's conduct).

Guaranty Life makes the same request to this Court as the plaintiff in *Clifton Wright* did to the Southern District of California, so that court's ruling is particularly persuasive here. Guaranty Life requests to retain at least a portion of the premium payments that account for commissions paid out and other damages that it has occurred due to the fraudulent conduct of Appellants in procuring the Policy. The court in *Clifton Wright* determined that rescission of a contract is not inconsistent with awarding consequential damages. This Court should apply the same reasoning and find that even if Guaranty Life is not entitled to retain all of the premium payments made on the Policy, it should be awarded an amount of those premiums to account for consequential damages it has incurred as a result of Appellants' fraud including the $1.4 million in commissions it paid to Mr. Hightower for the sale of the policy, R. at 8 n.4, which Guaranty Life later discovered was essentially a reward for his part in fraudulently procuring the policy for Appellants. This money cannot be recovered from Mr. Hightower's estate, as he left no assets to speak of. R. at 8. Therefore, applying the rationale of the *Clifton Wright* would have the most equitable result.

Similarly, in *Lincoln National Life Ins. Co. v. Snyder*, 722 F. Supp. 2d 546, 565 (D. Del. 2010), the District Court for the District of Delaware held that while an insurer could not retain all premium payments made on a policy that was void at its inception, it could still maintain an action for damages for expenses incurred as a result of wrongful conduct of the trustee who procured the policy. That case involved the creation of a trust-owned life insurance policy, which the defendant sought with the intent to illegally resell to other investors at a profit. *Id.* at 551-53. Addressing the issue of the premium payments, the court pointed to Delaware law to find that rescission of a life insurance policy requires an insurer to refund premiums. *Id.* at 564. The court ultimately determined that even where the insurer must return premiums, ~~the~~ it may still seek damages for expenses incurred as a result of the trustee's fraudulent conduct. *Id.* at 565.

The facts presented in this case match those in *Snyder* perfectly. Nonetheless, the District Court for the District of New Tejas reached the opposite conclusion and ordered Guaranty Life to return all premiums. This Court should reverse the district court below, and follow the courts' reasoning in *Clifton Wright* and *Snyder* to find that Guaranty Life is able to retain, at minimum, a portion of the premium payments to offset expenses incurred as a result of Appellants' fraud.

CONCLUSION

For the foregoing reasons, Guaranty Life respectfully requests that the Court affirm the decision of United States District Court for the District of New Tejas on the first issue and hold that the Policy is void from its inception for lack of an insurable interest. Guaranty life also requests that the Court reverse the decision of the district court on the second issue and hold that Guaranty Life may retain all of the premium payments paid on the policy, or, in the alternative, that Guaranty Life may retain $1.4 million of the premium payments to compensate it for the loss it suffered under the contract as a result of Appellants' fraudulent conduct.

Respectfully submitted,
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