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.

On Appeal from the
United States District Court
for the District of New Tejas

BRIEF FOR APPELLEE

TEAM 56
Attorneys for Appellee

QUESTIONS PRESENTED

I. Under the laws of New Tejas, did the district court properly declare the life insurance policy void *ab initio* for lack of an insurable interest when the Trust procured the policy in bad faith with the intent to assign it immediately to a third party that lacked an insurable interest?

II. Under the laws of New Tejas, did the district court err when it ordered Guaranty to return all the premium payments made on the life insurance policy to the Trust when the policy application and related forms contained fraudulent misrepresentations and Guaranty incurred substantial costs in issuing the policy?

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The opinion of the United States District Court for the District of New Tejas appears in the record on pages 1–15.

STATEMENT OF JURISDICTION

The United States District Court for the District of New Tejas entered its final judgment on December 14, 2011. R. at 15. Both parties timely appealed to this Court. This Court has jurisdiction under 28 U.S.C.A. § 1291 (West 2012).

STATUTORY PROVISIONS INVOLVED

This case involves interpretation and application of four New Tejas statutes, including N. Tej. § 1407–Incontestability, § 1408–Rescission, § 1409–Insurable Interest, and § 1409–Insurable Interest (as amended August 28, 2009). The Appendix contains the full text of these statutes.

STATEMENT OF THE CASE

I. Statement of Facts

<u>Background</u>

Don Juan Hicks ("Mr. Hicks") is a 72-year-old man who lives in a low-rent apartment in the state of New Tejas. R. at 11. He used to be a cab driver but is now retired and lives off social security. R. at 11. His son, Sydney Hicks ("Sydney"), works at a petrochemical plant and makes around $60,000 per year. R. at 11. Sydney lives in the suburbs in a house valued at $150,000. R. at 11. Guaranty Life Insurance Company ("Guaranty") is an insurance company that conducts business in New Tejas. R. at 2. Presidential Holdings, LLC ("Presidential") is a limited liability company. R. at 1.

<u>Before Guaranty Issued the Life Insurance Policy</u>

On January 4, 2007, Sydney met with Reggie Hightower ("Agent Hightower"), an insurance agent for Top Gun Executive Insurance Agency. R. at 10. As a result of the meeting, Sydney agreed to speak with his father, Mr. Hicks, about obtaining life insurance, even though Mr. Hicks had no need for estate planning. R. at 10. Agent Hightower provided an insurance application and Statement of Client Intent ("SOCI") to Sydney that same day. R. at 10.

After speaking with Sydney, Mr. Hicks agreed to buy a life insurance policy with a face value of $500,000, as long as Sydney would pay the premiums. R. at 10. On January 11, 2007, Sydney sent an email to Agent Hightower with the signed insurance application and SOCI. R. at 10. On the same day, Agent Hightower emailed the Vice President of Presidential, Timmy Chung. R. at 10. The email stated in part, "Talked to Sydney, 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." R. at 10.

On February 5, 2007, Sydney and Bryan Jones (an attorney who acted as Trustee) created The Hicks Irrevocable Life Insurance Trust ("the Trust"). R. at 7. Sydney was the Trust's only beneficiary. R. at 7. Mr. Hicks was the grantor, but he did not even know that the Trust existed. R. at 7, 10. On February 6, 2007, Agent Hightower submitted an application to Guaranty on behalf of the Trust in order to procure a $20 million life insurance policy on Mr. Hicks's life. R. at 7. Mr. Hicks, however, thought that the application he signed was for a $500,000 policy. R. at 10–11. Agent Hightower sent the SOCI to Guaranty that same day. R. at 7. The application contained misrepresentations about Mr. Hicks's employment, net worth, and annual income. R. at 11. Instead of being a "self employed entrepreneur" with a net worth of $1.2 billion and an annual income of $8.5 million, Mr. Hicks was a retired cab driver who did not have a million-dollar net worth or a seven-figure income. R. at 7, 11. Two emails between underwriters at Guaranty questioned whether a third party might be involved. R. at 11.

The SOCI that Agent Hightower sent to Guaranty stated that "premiums for the policy" would not be "borrowed . . . [by] the trust beneficiary." R. at 7, 22. Although the trust beneficiary, Sydney, initially paid the premiums, he would not have agreed to buy the policy (and could not have afforded to do so) unless Agent Hightower had arranged to reimburse him. R. at 8, 11–12. In fact, Sydney did not fund any of the premium payments for the policy; rather, Presidential funded all of the payments. R. at 13.

Additionally, the SOCI represented that "the policy was not being purchased in connection with any formal or informal program under which the proposed owner . . . [has] been advised of the opportunity to transfer the policy to a third party." R. at 22. Further, the SOCI stated that Sydney would be the "source of funding." R. at 22. The question in the SOCI asking about the "bona fide need" for the insurance was blank. R. at 23.

Guaranty would not have issued the policy if it had known about the misrepresentations. R. at 12. Based on the information provided to Guaranty in the insurance application and after a medical exam of Mr. Hicks, however, Guaranty offered a life insurance policy to the Trust with an issue date of February 16, 2007 and a face value of $20 million. R. at 7–8. The Trust was the owner and sole beneficiary of the policy. R. at 8.

After Guaranty Issued the Life Insurance Policy

On March 5, 2007, Guaranty gave the policy and an acceptance form to the Trust, and Agent Hightower returned the completed acceptance form later that day, thus placing the policy "in force." R. at 8 & n.5. Although Sydney paid the first three-month premium of $238,956.75 that day, he received a wire transfer to reimburse him two days later. R. at 8, 11–12. Presidential ultimately funded all premium payments sent to Guaranty. R. at 13. Agent Hightower received $1.4 million from Guaranty as payment for commissions based on the sale of the life insurance policy. R. at 8 n.4. Mr. Hicks merely signed all of the forms and did not know that a $20 million policy existed in his name. R. at 10–11.

On March 7, 2007, which was only two days after the policy went into force, Presidential paid Sydney $838,956.75. R. at 8 & n.5, 9, 13. The payment was in exchange for Sydney executing the BITA, which transferred all of Sydney's beneficial interest in the life insurance policy to Presidential. R. at 8, 9. Sydney and Presidential executed the BITA without Guaranty's knowledge. R. at 8.

Over nineteen months later, on October 21, 2008, Presidential sent Guaranty a Designation of Owner and Designation of Beneficiary form. R. at 9. The form explained that Sydney sold his beneficial interest to Presidential and asked that Guaranty transfer ownership to Presidential. R. at 9. On November 19, 2008, Guaranty responded, stating it needed to look into the issuance of the policy because of the previous "undisclosed sale." R. at 9. On December 22, 2008, Guaranty sent a letter requesting that the Trust provide information and documents to help Guaranty determine whether the representations made during the application and underwriting process were accurate. R. at 9.

II. Nature of the Proceedings

On January 5, 2009, Presidential Holdings, LLC and The Hicks Irrevocable Life Insurance Trust filed a lawsuit against Guaranty in the United States District Court for the District of New Tejas. R. at 9. On June 6, 2009, Guaranty filed a counterclaim requesting the district court to declare the insurance policy void *ab initio* for lack of an insurable interest. R. at 13. Guaranty also sought to retain the premium payments made under the policy. R. at 13. Both parties filed motions for summary judgment on May 12, 2011, and presented oral arguments on August 8, 2011. R. at 13. On December 14, 2011, the district court denied the portion of Guaranty's motion for summary judgment seeking to retain the premiums. R. at 15. The district court granted the remainder of Guaranty's motion for summary judgment, declaring the policy void *ab initio* because it lacked an insurable interest. R. at 14.

SUMMARY OF THE ARGUMENT

This case concerns Sydney Hicks's transfer of his beneficial interest in The Hicks Irrevocable Life Insurance Trust to a third-party stranger, Presidential Holdings, LLC, in exchange for a payment of $838,956.75. This Court should affirm the district court's grant of summary judgment in favor of Guaranty because the life insurance policy lacked an insurable interest at inception and was void *ab initio*. Additionally, Guaranty is entitled to retain the premium payments because the policy was void *ab initio* or, alternatively, because of the fraudulent misrepresentations in the policy application. Accordingly, this Court should reverse the portion of the district court's judgment that denied Guaranty's motion for summary judgment regarding the premiums.

I. Insurable Interest

Stranger-originated life insurance ("STOLI") policies often lack an insurable interest at inception and are therefore void *ab initio* as against public policy. In order for a valid insurable interest to exist at a policy's inception, the policy must be taken out in good faith and not be a cover for a wagering contract. In this case, the Trust and Presidential did not procure the policy on Mr. Hicks's life in good faith. The application and related forms contained misrepresentations about Mr. Hicks's net worth, income, the funding for the policy, and whether the Trust took out the policy with the intent to transfer it. Additionally, Sydney and the Trust took out the policy on Mr. Hicks's life with the intent to immediately transfer it to a third party, Presidential, in exchange for a large payment. Presidential funded all premium payments on the policy, including the initial payment that Sydney made before transferring his interest to Presidential.

The facts in the record demonstrate that the Trust took out the policy as a cover for a wagering contract. This means that the policy was really a STOLI policy that lacked an insurable interest and was void *ab initio*. Because the policy is void for lack of an insurable interest, this Court should affirm the district court's grant of summary judgment in favor of Guaranty.

II. Retention of Premiums

This Court should reverse the district court's partial denial of Guaranty's motion for summary judgment because Guaranty is entitled to retain the premium payments as a matter of law. A court must treat a life insurance policy that is void *ab initio* as though the policy never existed. When considering the void insurance policy, this Court should leave the parties as they were found and refuse to grant relief to either party. In this case, leaving the parties as they were found requires that Guaranty maintain possession of the premiums paid on the policy.

Life insurance policies that are procured through fraud are void at inception. In this case, the application and related forms contained fraudulent misrepresentations to induce Guaranty into providing a policy in an amount far exceeding Mr. Hicks's actual qualification. Guaranty justifiably relied upon the fraudulent misrepresentations in issuing the policy. As a matter of public policy, parties who engage in fraudulent activities should not be allowed to benefit from their fraud. Because the Trust and Presidential procured the policy through fraud, the policy is void and this Court should leave the parties in the position in which they were found.

Alternatively, Guaranty is entitled to rescind the insurance policy and retain the premiums. Section 1408, New Tejas Statutes, allows a party to rescind a contract when a party makes material, false representations. Material, false representations were made throughout the procurement of the policy. General rules of rescission require an insurer to return premiums paid; however, when a policy is rescinded for false representations, an insurer can retain premiums as damages for costs incurred in creating the policy. Because of the false representations, Guaranty should retain the premiums paid, and this Court should reverse the district court's partial denial of Guaranty's motion for summary judgment regarding the premiums.

ARGUMENT

This Court should review the district court's judgment *de novo* and apply the same standard that the district court applied to review the issues. *Mayo v. Hartford Life Ins. Co.*, 354 F.3d 400, 403 (5th Cir. 2004). In reviewing a motion for summary judgment, a court should grant summary judgment "if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56. A court should focus on whether sufficient disagreement exists to submit the case to a jury "'or whether it is so one-sided that one party must prevail as a matter of law.'" *Sciaretta v. Lincoln Nat'l Life Ins. Co.*, No. 9:11-cv-80427, 2012 WL 5195944, at *3 (S.D. Fla. Feb. 15, 2012) (quoting *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 251–52 (1986)).

In order for a genuine dispute to exist, "the dispute must have a 'real basis in the record.'" *Sciaretta*, 2012 WL 5195944, at *4 (citation omitted). No genuine dispute exists if "'the record taken as a whole could not lead a rational trier of fact to find for the nonmoving party.'" *Ricci v. DeStefano*, 557 U.S. 557, 586 (2009) (quoting *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986)). The party opposing the motion for summary judgment must demonstrate that there is "sufficient evidence upon which a jury could reasonably rule in his favor," and "a mere 'scintilla of evidence' alone is insufficient.'" *Sciaretta*, 2012 WL 5195944, at *4 (citation omitted).

I. THIS COURT SHOULD AFFIRM THE DISTRICT COURT'S GRANT OF SUMMARY JUDGMENT IN FAVOR OF GUARANTY BECAUSE THE INSURANCE POLICY LACKED AN INSURABLE INTEREST AND WAS VOID *AB INITIO*.

The Hicks life insurance policy is a stranger-originated life insurance ("STOLI") policy that is void *ab initio*. Sydney and the Trust procured the policy in bad faith by making misrepresentations on the application and related forms. The entire arrangement was a sham to cover a wagering contract. Sydney and the Trust obtained the policy with the intent to transfer it to a third-party stranger, Presidential, but Presidential had no insurable interest in Mr. Hicks's life. The district court properly granted Guaranty's motion for summary judgment because the policy lacked an insurable interest at inception and is therefore void *ab initio*.

A. Wagering contracts are void *ab initio* because they are against public policy.

Life insurance has existed since the 16th century, and since then, speculators have tried to use life insurance to make wagers based on strangers' lives. *PHL Variable Ins. Co. v. Price Dawe 2006 Ins. Trust*, 28 A.3d 1059, 1069 (Del. 2011). A wagering policy is one in which the insured "has no interest whatever in the matter insured, but only an interest in its loss or destruction." *Conn. Mut. Life Ins. Co. v. Schaefer*, 94 U.S. 457, 460 (1876). Wagering policies "have a tendency to create a desire for the" insured's early death and are "independently of any statute on the subject, condemned, as being against public policy." *Warnock v. Davis*, 104 U.S. 775, 779 (1881).

For over 120 years, courts in the United States—including the United States Supreme Court—have held that the law prohibits such "speculative contracts upon human life." *See Warnock*, 104 U.S. at 782. This is because wagering contracts create a "sinister counter interest" in the insured's death. *Grigsby v. Russell*, 222 U.S. 149, 154 (1911). Today, it is illegal in every state for a stranger to buy life insurance on the life of a third party. Robert W. Buechner, *Stranger-Owned Life Insurance: The Good, the Bad, and the Ugly*, 19 Ohio Prob. L.J. 7 (2008). Put simply, "[a] man cannot take out insurance on the life of a total stranger." *Conn. Mut. Life Ins. Co.*, 94 U.S. at 460.

B. <u>Stranger-originated life insurance policies that lack an insurable interest at inception are wagering contracts that violate public policy and are void *ab initio*.</u>

During the last 20 years or so, a secondary market for "life settlements" has developed in which life insurance policyholders can sell their policies while they are still alive. *Price Dawe 2006 Ins. Trust*, 28 A.3d at 1069. Most states have statutes that govern this legal market for life settlements; however, almost all jurisdictions prohibit third parties from procuring life insurance policies that will benefit strangers who have no insurable interest in the insured. *Id.* at 1069–70. The term "STOLI" refers to a situation where a third party lacking an insurable interest takes out an insurance policy on the insured's life. *Penn Mut. Life Ins. Co. v. Greatbanc Trust Co.*, No. 09 C 06129, 2012 WL 3437161, at *1 (N.D. Ill. Aug. 15, 2012). A STOLI scheme can also exist when a person takes out a policy on his or her own life and then transfers the policy to a third-party investor who lacks an insurable interest. *Id.* STOLI policies often "run afoul of state laws," including common law and statutory law, because STOLI policies can be wagering contracts, and the law has a "longstanding public policy against wagering contracts." *Id.*

C. <u>Under the New Tejas statutes, the Hicks life insurance policy is void *ab initio* because it lacked an insurable interest at its inception.</u>

The life insurance policy in this case is void *ab initio* because no insurable interest existed at its inception. The Trust procured the policy in bad faith as a cover for a pre-arranged STOLI arrangement. When the Trust obtained the policy, it intended to transfer it to a third-party stranger, Presidential, that lacked an insurable interest in Mr. Hicks's life. This means that the policy was really a wagering contract and is void *ab initio*.

Initially, it is important to note that the parties do not dispute whether Guaranty is allowed to contest the policy's validity after the expiration of the incontestability clause. Clerk's Email to Counsel, at 1 n.1. Section 1407, New Tejas Statutes, requires all life insurance policies to contain an incontestability clause. In this case, however, the parties do not dispute that Guaranty can contest the policy's validity despite the policy's incontestability clause. Clerk's Email to Counsel, at 1 n.1. Even if the Trust and Presidential had argued that the incontestability clause should apply, the majority view is that an incontestability clause does not apply to a policy that is void *ab initio* for lack of an insurable interest. *Sun Life Assurance Co. of Can. v. Berck*, 770 F. Supp. 2d 728, 733 (D. Del. 2011); *Price Dawe 2006 Ins. Trust*, 28 A.3d at 1065, 1067. This means that Guaranty would have been able to contest the policy's validity, despite the presence of any incontestability clause.

Because New Tejas has no precedent related to the insurable interest requirement, R. at 14, this Court should "make an informed prophecy as to the state court's likely stance." *Hatch v. Trail King Ind., Inc.*, No. 12-1473, 2012 WL 5381329, at *6 (1st Cir. Nov. 2, 2012). To do so, this Court should consider "analogous state court decisions, persuasive opinions from courts of other jurisdictions, learned treatises, and any relevant policy rationales." *Id.* After considering other courts' opinions and the important policy implications of the insurable interest requirement, this Court should affirm the district court's judgment that the life insurance policy lacked an insurable interest and is void *ab initio*.

The Hicks life insurance policy is void *ab initio* because it lacked an insurable interest at its inception, as required by Section 1409, New Tejas Statutes. Under Section 1409(c), an insurable interest must "exist at the time the contract . . . becomes effective." Section 1409(a) defines an insurable interest as

> 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.

A court must "interpret statutes consistent with the common law unless" the statute "clearly and explicitly expresses" that the statute is meant "to abrogate the common law." *Price Dawe 2006 Ins. Trust*, 28 A.3d at 1072–73. Nothing in the New Tejas statutes suggests that the statutes were meant to abrogate common law. In this case, New Tejas does not have any applicable precedent, but the common law insurable interest requirement has existed in other jurisdictions for over 100 years. *See Grigsby*, 222 U.S. at 154–55. At common law, courts defined an insurable interest as "an interest in having the life continue, and so one that is opposed to a crime." *Id.* at 155. The insurable interest doctrine is a common law doctrine that stems from public policy concerns about illegal wagering contracts. *Lincoln Nat'l Life Ins. Co. v. Snyder*, 722 F. Supp. 2d 546, 558 (D. Del. 2010).

The requirement that an insurable interest exist helps prevent people from using insurance policies as illegal wagering contracts. *Id.* As the United States

Supreme Court explained in *Connecticut Mutual Life Insurance Co.*, "[t]he essential thing is, that the policy shall be obtained in good faith, and not for the purpose of speculating upon the hazard of a life in which the insured has no interest." 94 U.S. at 460. The majority of courts have held that "a life insurance policy lacking an insurable interest is void as against public policy and thus never comes into force." *Lincoln Nat'l Life Ins. Co. v. Joseph Schlanger 2006 Ins. Trust*, 28 A.3d 436, 438 (Del. 2011). Regardless of what the parties intended to happen, "[a] court may never enforce agreements void *ab initio*." *Price Dawe 2006 Ins. Trust*, 28 A.3d at 1067.

To determine whether an insurable interest existed, this Court must determine "who procured the policy and whether or not that person meets the requirements." *Id.* at 1076. "To determine who procured the policy, [a court] look[s] at who pays the premiums." *Id.* at 1075. Notably, Section 1409(b), New Tejas Statutes, does not apply in this case because Mr. Hicks did not take out the policy himself. Section 1409(b), New Tejas Statutes, states,

> A person has an unlimited insurable interest in his or her own life . . . and may lawfully take out a policy of insurance on his or her own life . . . and have that policy made payable to whomsoever he or she pleases, regardless of whether the beneficiary designated has an insurable interest.

This provision of the statute does not apply because Mr. Hicks did not take out the policy on his own life; rather, Sydney and the Trust took out the policy on behalf of Presidential.

In order to "procure or effect" a policy, the insured must pay the premiums. *Price Dawe 2006 Ins. Trust*, 28 A.3d at 1076. This is because an insured must do "something more than simply applying for a policy or providing written consent to the policy's issuance" in order to procure the policy. *Id.* If "a third party funds the premium payments by providing the insured the financial means to purchase the policy[,] then the insured does not procure . . . the policy." *Id.*

In this case, Sydney paid the first premium payment, and Presidential reimbursed him two days later. R. at 8, 11–12. Presidential also funded all subsequent premium payments. R. at 13. Mr. Hicks did not make any payments; he did nothing more than sign the forms that his son sent to him. R. at 11. In fact, Mr. Hicks did not even know that a $20 million policy had been taken out on his life. R. at 11. Because a third party, Presidential, funded the premiums, and because Mr. Hicks simply signed the forms, Mr. Hicks did not actually procure or effect the policy. This means that Section 1409(b), New Tejas Statutes, does not apply in this case.

1. *Sydney Hicks and the Trust obtained the policy in bad faith as a cover for a wagering contract for a third-party stranger, Presidential.*

Although a person can assign a life insurance policy to someone who lacks an insurable interest, "such assignments must be made in good faith, and not [as] sham assignments made simply to circumvent the law's prohibition on wagering contracts." *Pruco Life Ins. Co. v. Brasner*, No. 10-80804-CV, 2011 WL 134056, at *3 (S.D. Fla. Jan. 7, 2011) (quoting *AXA Equitable Life Ins. Co. v. Infinity Fin. Grp., LLC*, 608 F. Supp. 2d 1349, 1356 (S.D. Fla. 2009)) (internal quotation marks omitted). *Accord Finnie v. Walker*, 257 F. 698, 700 (2d Cir. 1919) (requiring that a policy be taken out in good faith with no intention to assign it); *Snyder*, 722 F. Supp. 2d at 558 n.10 (explaining that an insured cannot procure a policy as a cover for a wagering policy).

A person who has an insurable interest cannot act "as a cloak" to what is really a wagering contract because the transaction would not be in good faith. *Grigsby*, 222 U.S. at 156; *Conn. Mut. Life Ins. Co.*, 94 U.S. at 461. If the insured intended to transfer the policy to a third party with no insurable interest when the insured procured the policy, then the policy fails to meet the insurable interest requirement. *Lincoln Nat'l Life Ins. Co. v. Calhoun*, 596 F. Supp. 2d 882, 889 (D.N.J. 2009). If an assignment is a cover for a wagering contract, then the assignment is against public policy, and a court will not sustain it. *Warnock*, 104 U.S. at 781; *Aetna Life Ins. Co. v. France*, 94 U.S. 561, 564 (1876).

2. *Sydney Hicks and the Trust intended to transfer the policy to Presidential when they obtained the policy.*

The facts in the record demonstrate that Sydney and the Trust obtained the policy with the intent to immediately transfer it to Presidential. If a person's intent at the policy's inception is to transfer the policy to a third-party stranger who lacks an insurable interest, then the policy fails to meet the insurable interest requirement. *Calhoun*, 596 F. Supp. 2d at 889. When a court examines whether the insured intended to assign the policy immediately, the court should consider the insured's intent at the time he or she took out the policy. *Life Prod. Clearing, LLC v. Angel*, 530 F. Supp. 2d 646, 654 (S.D.N.Y. 2008).

Courts may consider several factors to determine the insured's intent, such as whether there is a pre-existing agreement and whether someone else paid the premiums (especially the assignee). *Sciaretta*, 2012 WL 5195944, at *6. Another factor is how long the insured had the policy before he or she assigned it. *Life Prod. Clearing, LLC*, 530 F. Supp. 2d at 654. As applied to this case, all of these factors demonstrate that Sydney and the Trust obtained the policy intending to transfer it immediately to a third party, Presidential.

a. Sydney Hicks and the Trust had a pre-existing arrangement with Presidential.

In this case, a pre-existing agreement was in place before the Trust obtained the policy. First, Agent Hightower convinced Sydney to participate even though Mr. Hicks had no estate-planning needs. R. at 10. Sydney only applied for the insurance after meeting with Agent Hightower, and Sydney would not have agreed to obtain (and would not have been able to afford) the policy if Agent Hightower had not agreed to arrange for Sydney's reimbursement. R. at 11–12. Agent Hightower's email to Timmy Chung at Presidential, which he wrote before the policy's issuance, also shows that the purpose of the arrangement was to "flip" the insurance policy. These facts demonstrate that the pre-existing agreement to transfer the policy was in place before the Trust procured the policy.

b. Presidential paid all of the premiums.

Although Sydney paid the first premium, Sydney received a wire transfer two days later to reimburse him. R. at 8, 11–12. Ultimately, Presidential funded all of the premium payments on the policy. R. at 13. Presidential was also the assignee of the BITA. R. at 8. Mr. Hicks did not pay any of the premiums and did not even know the $20 million policy existed. R. at 10–11. The fact that Presidential paid all of the premiums also helps demonstrate that Sydney and the Trust obtained the policy with the intent to transfer it to Presidential and that the arrangement was a cover for a STOLI policy.

c. Sydney Hicks transferred his interest to Presidential only two days after the policy went into force.

Guaranty sent the Policy Acceptance Form to the Trust on March 5, 2007, which placed the policy in force. R. at 8 & n.5. Only two days later, on March 7, 2007, Sydney transferred his interest in the policy to Presidential. R. at 8. The fact that Sydney transferred his interest only two days after the policy entered into force helps to demonstrate that he obtained the policy intending to transfer it immediately to Presidential. This, coupled with the fact that Presidential paid all of the premiums and that Sydney, the Trust, and Presidential had a pre-existing agreement, demonstrates that the entire transaction was a cover for what was really a STOLI policy.

3. *Other courts have required that an insured obtain a policy in good faith and not as a cover for a wagering contract.*

This Court should hold that if an insured obtains a policy in bad faith as a cover for a wagering contract, then the insurable interest requirement is not met and the policy is void. In *PHL Variable Insurance Co. v. Price Dawe 2006 Insurance Trust*, an insured, who had no legitimate need for life insurance, obtained an insurance policy on his life and named a trust as the beneficiary. 28 A.3d at 1063.

The insurance application contained misrepresentations about the insured's income, assets, and whether the insured was participating in a STOLI transaction. *Id.* The insured intended to transfer the policy to an "unrelated third party investor" and did so "less than two months after the policy went into force." *Id.* at 1063–64. The court held that the insured must take out the policy in good faith and that "if an insured procures a policy as a mere cover for a wager, then the insurable interest requirement is not satisfied." *Id.* at 1075. Like the court in *Price Dawe*, this Court should hold that in order for an insurable interest to exist, the policy must be obtained in good faith and not as a cover for a wagering contract.

The facts in this case are similar to *Pruco Life Insurance Co. v. Brasner*, 2011 WL 134056, at *1. In *Pruco*, an insurance company alleged that a third party and the insured had entered into a plan to conceal a STOLI arrangement. *Id.* at *1. The third party and the insured had created a trust to own the insurance policy and be the policy beneficiary. *Id.* The complaint stated that the third party and the insured did not procure the trust or the policy for a legitimate purpose, such as estate planning. *Id.* The insurance application in *Pruco* contained gross overstatements about the insured's assets and net worth. *Id.* at *4. Approximately one month after the policy became effective, the trust transferred the beneficial interest in the trust to a third party. *Id.* at *2.

The *Pruco* court held that if the insurance company were to prove its allegations, it would demonstrate that an agreement to assign the policy to a third party lacking an insurable interest had existed before the policy's issuance. *Id.* at *4.

The court stated that those "facts would demonstrate that the [policy] was not procured in good faith and that there was therefore no valid insurable interest." *Id.* (alterations in original).

Although the *Pruco* case was different because it was before the court on a motion to dismiss, the facts in *Pruco* are similar to the facts of this case. Like the parties in *Pruco*, Sydney, the Trust, and Presidential were part of an arrangement that existed before the Hicks policy's issuance. Mr. Hicks had no need for estate planning, and the Trust was created to cover the STOLI arrangement. Similar to the application in *Pruco*, the insurance application in this case contained misrepresentations about Mr. Hick's net worth, his assets, and whether the policy was going to be transferred. Also like in *Pruco*, the Trust in this case attempted to transfer its beneficial interest in the policy to a third party, Presidential, less than one month after the policy went into effect. Because the record demonstrates that Sydney and the Trust obtained the policy in bad faith, the Hicks policy lacked an insurable interest at inception and is therefore void *ab initio*. Accordingly, this Court should affirm the district court's grant of summary judgment in favor of Guaranty.

The facts of this case are also similar to those in *Life Product Clearing, LLC v. Angel*, 530 F. Supp. 2d 646. In *Life Product*, a 77-year-old retired butcher established a trust and named himself as the trust beneficiary. *Id.* at 647. He then obtained a life insurance policy with a face value of $10 million and named the trust as the policy beneficiary. *Id.* The application question asking whether the policy was going to be sold on any secondary market was blank. *Id.* at 650. The insured did not pay any premiums on the policy because a third party paid for them. *Id.* Six days after the insurance company issued the policy, the insured sold his beneficial interest in the trust to a third party. *Id.* at 647. The court denied the third party investor's motion for judgment on the pleadings because the factual allegations stated a plausible claim that the policy lacked an insurable interest. *Id.* at 648. The court held that an insured must obtain a policy in good faith and not with the intent to resell the policy immediately to a third-party stranger. *Id.*

Like *Life Product*, the life insurance policy on Mr. Hicks's life named the Trust as the beneficiary, and the application question addressing a possible sale of the policy was blank. Also, Mr. Hicks did not pay any of the premiums; rather, a third-party stranger, Presidential, funded all premium payments. Similar to *Life Product*, Sydney transferred his beneficial interest in the Trust to Presidential a few days after the policy went into effect. The *Life Product* court held that the factual allegations stated a plausible claim that no insurable interest existed at the policy's inception. Similarly, this Court should affirm the district court's grant of summary judgment in favor of Guaranty because the Hicks life insurance policy had no insurable interest at its inception.

4. *This case is distinguishable from cases in which courts did not require that an insured obtain a policy in good faith.*

A few courts have ruled that good faith is not required for a valid insurable interest to exist, but the statutes at issue in those cases are distinguishable from the applicable New Tejas statutes. For example, this case is distinguishable from

Lincoln National Life Insurance Co. v. Gordon R.A. Fishman Irrevocable Life Trust, 638 F. Supp. 2d 1170 (C.D. Cal. 2009). A provision of the statute involved in *Gordon* explicitly allowed for a policy to pass to someone even if that person did not have an insurable interest. *Id.* at 1177. By contrast, other than Section 1409(b) of the New Tejas Statutes, which does not apply in this case, nothing in the applicable New Tejas statutes expressly allows the policy to be assigned to someone who has no insurable interest.

This Court should affirm the district court's grant of summary judgment in favor of Guaranty. In *Herman v. Provident Mutual Life Insurance Co. of Philadelphia*, the court found that summary judgment was inappropriate, 886 F.2d 529, 536 (2d Cir. 1989), but the *Herman* case is distinguishable from this case. In *Herman*, a genuine issue of material fact existed because there were contradictory affidavits and testimony as to the parties' intent. *Id.* In this case, however, there is no genuine issue of material fact. The facts in the record clearly demonstrate that Sydney and the Trust procured the policy with the intent to sell the beneficial interest to a third party, Presidential. Because there is no genuine dispute as to the parties' intent, the district court properly granted summary judgment in favor of Guaranty. Sydney and the Trust intended to transfer the policy and procured the policy in bad faith as a cover for a STOLI agreement. In *Herman*, the "court selected between competing accounts of why the . . . policies were procured." *Id.* at 536. By contrast, no competing accounts are present in this case. Instead, the facts in the record demonstrate that the Trust procured the policy to cover what was really a

STOLI agreement. Because of this, Guaranty is entitled to summary judgment as a matter of law.

D. Strong public policy reasons exist for prohibiting STOLI transactions.

Requiring that policies be obtained in good faith and not as a cover for STOLI transactions serves the best interests of the public. STOLI transactions can lead to exactly the kind of "sinister counter interest" in the insured's death that the United States Supreme Court cautioned against over 100 years ago. *See Grigsby*, 222 U.S. at 154. STOLI policies violate public policy because they allow third-party strangers to wager on other people's lives in situations where the people are worth more to the investor if they are dead than if they are alive. Susan Lorde Martin, *Betting on the Lives of Strangers: Life Settlements, STOLI, and Securitization*, 13 U. Pa. J. Bus. L. 173, 188, 198 (2010). As recently as 2004, a third party killed an insured to get the insurance benefit early. Buechner, *supra* (citing *Bajwa v. Metro. Life Ins. Co.*, 804 N.E.2d 519 (Ill. 2004)). STOLI policies also conflict with the original purpose of life insurance—to protect families and dependents after the insured's death—because STOLI policies allow for strangers to profit off of someone's death. *Calhoun*, 596 F. Supp. 2d at 885–86.

Prohibiting STOLI arrangements also helps protect vulnerable individuals. The elderly often become victims in STOLI transactions because the third parties to the transaction take advantage of them and do not always explain all of the consequences of participating in such a transaction. Martin, *supra*, at 198. For instance, the third-party investors may have access to the insured's personal health information, and the insured will be taxed on any gain he or she realizes on the sale of the insurance policy. *Id.* at 198–99. An insured who participates in STOLI transaction may face negative consequences because an insurance company might not be willing to sell another insurance policy to that person after he or she sells the first one. *Id.* at 198. Additionally, STOLI policies may lead to an increase in the cost of life insurance premiums. *Calhoun*, 596 F. Supp. 2d at 886.

The amended version of Section 1409, New Tejas Statutes, suggests that the New Tejas legislature intended to prevent situations exactly like what happened in this case. In the amended statute, Section 1409(e) 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." This provision does not use the term "STOLI" explicitly, but the provision effectively prohibits illegal STOLI transactions where a third party with no insurable interest attempts to procure a life insurance policy on the life of someone else. Although the amended version of the statute does not apply retroactively, the amendments show that the New Tejas legislature has since codified the common law prohibition against STOLI policies.

The amended version of Section 1409, New Tejas Statutes, is almost exactly the same as Section 10110.1 of the California Insurance Code, which went into effect on January 1, 2010. Cal. Ins. Code § 10110.1 (West 2012). The California statute's purpose was to make STOLI transactions illegal and "to establish new measures to aid in detecting and preventing STOLI transactions." *California Bill*

Analysis: Hearing on S.B. 98 Before the S. Comm. on Banking, Fin., & Ins., 2009–2010 Reg. Sess. (Cal. 2009). The California Senate's analysis also noted that at least ten other states had "approved legislation as strong as" the California bill. *Id.* Because the language in the amendments to the New Tejas statute is almost identical to that in the California statute, the New Tejas amendments were likely meant to address the same concerns about prohibiting STOLI transactions.

In this case, this Court should hold that in order for an insurable interest to exist, the insured must take out the policy in good faith and not as a cover for a wagering contract. By doing so, this Court will protect people from STOLI transactions like the one in this case. Additionally, because no insurable interest existed at the inception of the Hicks life insurance policy, this Court should affirm the district court's grant of summary judgment in favor of Guaranty.

II. THE DISTRICT COURT ERRED IN DENYING PART OF GUARANTY'S MOTION FOR SUMMARY JUDGMENT BECAUSE GUARANTY IS ENTITLED TO RETAIN THE PREMIUMS PAID UNDER THE VOID LIFE INSURANCE POLICY.

The district court properly held that Mr. Hicks's life insurance policy was void *ab initio* for violating the insurable interest laws of New Tejas. The district court erred, however, by applying the legal analysis for retaining premiums under a rescinded policy instead of applying the analysis for a void policy. *See Griffin v. Smith*, 101 F.2d 348, 349 (7th Cir. 1938) (noting that "[a] void contract . . . is ineffective for all purposes, and the court may find itself unable to grant relief to either party"). Because the district court failed to make this distinction, the district court erred in preventing Guaranty from retaining the insurance premiums.

Life insurance policies that are void *ab initio* as against public policy are considered void from the outset. Void policies "will not be enforced by the courts[,] and the parties will be left as the court found them." *TTSI Irrevocable Trust v. ReliaStar Life Ins. Co.*, 60 So. 3d 1148, 1150 (Fla. Dist. Ct. App. 2011). This means that a court should refuse to take any action against either party and should leave the parties in the exact position they were in before litigation. The district court correctly held that the policy was void *ab initio*, and as a result, this Court must leave Guaranty in the position in which it was found—in possession of the premiums paid on the life insurance policy.

A. <u>Guaranty is entitled to retain all premiums paid under the void life insurance policy.</u>

The district court declared the Hicks insurance policy void *ab initio* because it lacked an insurable interest. R. at 14. That decision is important because it means that the policy never actually existed. Curiously, when the district court subsequently discussed Guaranty's motion to retain the premiums, the district court utilized general rules of contract rescission instead of the rules governing premium retention under void policies. R. at 14–15. The district court correctly noted that in general, rescission requires that the parties should be returned to the positions held prior to entering the contract. R. at 14. That is not the case, however, when a life insurance policy is declared void *ab initio*. *See Penn Mut. Life Ins. Co.*, 2012 WL 3437161, at *7 (noting that "rescission presumes the existence of an otherwise valid and enforceable contract and therefore cannot be the proper remedy when a contract is void *ab initio*"). Applying rules of rescission to a void policy led the district court to wrongfully conclude that the Trust was entitled to a return of the premiums paid on the policy.

In this case, the proper method to address retention of policy premiums when a life insurance policy is declared void *ab initio* is to leave the parties as they were found. *Id.* In *Penn Mutual*, the court used general principles of contract law to address the issue of retaining premiums under an insurance policy that was void *ab initio*. *Id.* After citing numerous Illinois cases, the court decided it would not make an order on the insurance premiums. *Id.* Instead, the court left the parties as they were found because "Illinois law apparently requires the [c]ourt to drop like a hot potato the parties to an illegal contract." *Id.* at *8. The court reasoned that ordering the insurer to return the premiums under a void policy is tantamount to ordering the rescission of a contract that never actually existed. *Id.* at *7. In other words, the court refused to rescind the life insurance policy because it was void and therefore was never actually formed.

Similarly, in *TTSI Irrevocable Trust*, the court allowed an insurer to retain premiums paid on a life insurance policy that was ruled void *ab initio*. 60 So. 3d at 1150. The court noted an explicit distinction between the treatment of policy premiums under a void policy and a rescinded policy. *Id.* It stated that when rescinding an insurance policy, a court "must undo the original transaction and restore the former status of the parties." *Id.* Conversely, when an insurance policy is void, the court cannot enforce the policy, and the parties must be "left as the court found them." *Id.* Because the underlying life insurance policy was void *ab initio*, the court upheld the trial court's refusal to order the refund of the insurance premiums. *Id. See also PHL Variable Ins. Co. v. Lucille E. Morello 2007 Irrevocable Trust*, 645 F.3d 965, 970 (8th Cir. 2011) (affirming a district court's decision to allow an insurer to retain premiums under a void policy).

In this case, the district court ignored the clear and necessary legal distinction between void and rescinded policies. The district court declared the policy void *ab initio* and then treated the issue of whether Guaranty should retain the premiums as though the court had rescinded the policy. R. at 14. The district court erred because under the reasoning of *Penn Mutual* and *TTSI Irrevocable Trust*, a void policy requires the court to leave the parties in the position in which they were found. Leaving the parties in the position in which they were found in this case requires that Guaranty maintain possession of the insurance premiums. Instead, the district court incorrectly ordered the return of all premiums from Guaranty to the Trust despite previously declaring the policy void *ab initio*.

The district court's reliance on *PHL Variable Insurance Co. v. Jolly* to support its decision is misplaced because the *Jolly* court found no legal basis for an insurer's retention of premiums unless the plaintiff could prove negligent misrepresentations or conspiracy. 800 F. Supp. 2d 1205, 1215 (N.D. Ga. 2011). It did not, however, discuss retention of insurance premiums under a policy that is adjudicated void *ab initio*. *Id.* at 1215.

As a matter of first impression in New Tejas, this Court should enforce the distinctly different treatment of policy premiums between a void policy and a rescinded policy. This distinction is vital because it ensures that parties who engage in acquiring STOLI plans actually have something to lose. Returning the premiums paid by the parties to a STOLI plan actually has the perverse result of motivating parties to procure STOLI plans. This is so because even if the insurance company successfully uncovers a STOLI scheme and a court rules the plan void, the guilty parties still get all of their money back. This Court should reverse the district court's judgment because sound public policy and relevant case law demand that insurers retain premiums paid on a void STOLI policy.

B. Guaranty is entitled to retain the premiums because of the fraudulent procurement of the life insurance policy.

The district court also erred in ordering Guaranty to return the premiums because the Hicks policy was procured through fraud. It is a general rule that when misrepresentations are present, the insured is entitled to a return of premiums paid, but when the misrepresentations are fraudulent, then the insurer retains the premiums. *Madden v. Interstate Bus. Men's Accident Ass'n*, 165 N.W. 482, 483 (Minn. 1927). Life insurance policies that are procured by fraudulent means are void *ab initio*, and the insurance company does not have to return the premiums paid on the policy. *Lucille E. Morello 2007 Irrevocable Trust*, 645 F.3d at 970. When an insurance policy "has been entered into through fraud or to accomplish any fraudulent purpose," a court will "leave such parties in the exact position in which they have placed themselves, refusing all affirmative aid to any of the participants." *Booth v. Edwards*, 153 N.E. 677, 677–78 (Ill. 1926).

Sydney and the Trust procured the life insurance policy on Mr. Hicks's life through fraudulent means, which is similar to what happened in *PHL Variable Insurance Co. v. Lucille E. Morello 2007 Irrevocable Trust*, 645 F.3d 965. In *Morello*, an insured, working together with several other people, purposely falsified the insured's financial profile to obtain life insurance in an amount far exceeding what the insured actually qualified for. *Id.* at 967. The life insurance company issued a policy in reliance on the misrepresentations, and when the insured died, the insurance company uncovered the fraud. *Id.* at 968. The insurance company sued to rescind the policy, and the district court held that because the insurer was induced by actual fraud, the insurer was not required to return the premiums paid on the policy. *Id.* at 969. The United States Court of Appeals for the Seventh Circuit affirmed, and the insurer did not have to return the premiums because of the fraudulent misrepresentations. *Id.* at 970.

If a party knowingly makes an untrue statement to obtain insurance, then the party has engaged in actual fraud, which renders a contract void. *Id.* (citing *Taylor v. Grand Lodge A.O.U.W. of Minn.*, 105 N.W. 408, 411 (Minn. 1905)). In this case, the record is replete with untrue statements that the Trust purposely used to induce Guaranty into issuing the policy. Despite the fact that Mr. Hicks is a retired cab driver living off of social security benefits in a low-rent apartment, the application for insurance sent to Guaranty stated that Mr. Hicks is worth $1.2 billion dollars, with a yearly income of $8.5 million dollars and an oceanfront home. R. at 7, 11.

The Trust's extreme inflation of Mr. Hicks's net worth is similar to the defendants in *Morello*, who falsified financial documents to obtain an amount of insurance far exceeding the insured's actual qualifications. Based on that fraudulent misrepresentation alone, this Court should find the policy was void and that Guaranty is entitled to retain the premiums. *See Riggs v. Palmer*, 22 N.E. 188, 190 (N.Y. 1889) (stating that "[n]o one shall be permitted to profit by his own fraud, or to take advantage of his own wrong . . . or to take advantage of his own crime").

Furthermore, after submitting the insurance application, Agent Hightower submitted the SOCI to Guaranty specifically stating that no money would be borrowed to pay the premiums and that the policy was not being purchased for the purpose of transferring it to a third party. R. at 7. Yet Agent Hightower, with Sydney's authority as the only beneficiary of the Trust, planned to transfer the life insurance policy to Presidential. This is proven by the email that Agent Hightower sent to Timmy Chung at Presidential. This email shows that not only were Agent Hightower and Sydney working together to "flip" the policy, but Timmy Chung was also aware of the inflated value of Mr. Hicks's life insurance policy. Therefore, a reasonable inference finds that Presidential was aware of the misrepresentations and was working with Agent Hightower to quickly transfer the policy.

Finally, the policy was fraudulently procured because the SOCI stated that no funds would be borrowed to pay the premiums and that Sydney would be the source of funding for the policy. This is further evidence of fraud because Sydney testified that he would never have purchased the policy if Agent Hightower had not agreed to reimburse him for the payment. Two days after Sydney paid the initial premium, he received a wire transfer with his reimbursement. R. at 12. Presidential—not Sydney—funded all of the premium payments. R. at 13. The evidence of fraud in the record proves the policy is void, and this Court should refuse to order a return of the premiums paid in order to leave Guaranty in the position it was found.

C. <u>In the alternative, even if this Court decides that the policy had an insurable interest, Guaranty is still entitled to retain the premiums because of misrepresentations made in procuring the policy.</u>

The district court correctly found that the Hicks insurance policy lacked an insurable interest and was void *ab initio*. If this Court does not agree, however, and finds that there was a valid insurable interest, Guaranty is entitled to rescind the policy. The rescission of the insurance policy would require this Court to allow Guaranty to retain a portion of the premiums paid to offset Guaranty's expenses incurred in issuing the policy. *See PHL Variable Ins. Co. v. Abrams*, No. 10cv521 BTM(NLS), 2012 WL 10686, at *6 (S.D. Cal. Jan. 3, 2012) (noting that a rescinding party may still retain some of the premiums as an offset for consequential damages).

1. *Guaranty is entitled to a rescission of the policy.*

Guaranty is entitled to a rescission of the policy because of the false representations made in procuring the policy. "If a representation is false in a material point, . . . the injured party is entitled to rescind the contract from the time the representation becomes false." N. Tej. § 1408. It is important to note that Section 1408, New Tejas Statutes, only requires that a representation is false as to a material point. Therefore, it does not matter who made the false representation or why the false representation was made. *See Prudential Ins. Co. of Am. v. Anaya*, 428 P.2d 640, 643 (N.M. 1967) ("The misrepresentations need not have been made knowingly or fraudulently.") The mere fact that a representation is false in a material point is enough to require rescission.

In the insurance context, a false representation is considered material if it may reasonably affect the "amount of premiums to be paid by the insured." *Calhoun*, 596 F. Supp. 2d at 887–88. *See also* Cal. Ins. Code § 334 (West 2012) (stating "[m]ateriality is to be determined not by the event, but solely by the probable and reasonable influence of the facts upon the party to whom the communication is due, in forming his estimate of disadvantages of the proposed contract, or in making his inquiries"). In this case, the false representations on the insurance application were material because they affected the amount of the policy premiums. The application grossly overstated Mr. Hicks's net worth and yearly income, and Guaranty would not have issued the policy if it had known about the misrepresentations. The false representations on the insurance application were material and led Guaranty into offering a policy worth $20 million instead of a greatly reduced amount.

Additionally, Guaranty should be able to rescind the insurance policy because of the false answers on the SOCI. "It is hornbook law that where the insurer seeks a specific answer, the fact elicited will usually be treated as a material one." *Oglesby v. Penn Mut. Life Ins. Co.*, 877 F. Supp. 872, 894 (D. Del. 1994). The answers to direct questions on the SOCI form stated that funds would not be borrowed to pay the premiums and that there was no intent to transfer the policy to a third party within five years. R. at 7. Those answers are false because Sydney and the Trust planned to immediately sell the policy to Presidential, and Agent Hightower had arranged to immediately reimburse Sydney for the premium he paid. Because of the material misrepresentations in the policy application and the SOCI, this Court should grant Guaranty a rescission of the policy under Section 1408, New Tejas Statutes.

Guaranty was entitled to rely upon the representations made on the insurance application and SOCI. Insurers have no affirmative duty to investigate and are "entitled to rely on the representations made by the applicant on his application." *Harper v. Fidelity & Guar. Life Ins. Co.*, 234 P.3d 1211, 1218 (Wyo. 2010). While the Trust may argue that the Guaranty underwriters' email discussing Mr. Hicks's occupation, R. at 11, raises a red flag that Mr. Hicks may not have been worth as much as represented, Guaranty was still entitled to rely upon the representations made on the application. In addition, the underwriters' other email asking about looking into any third parties, R. at 11, shows that Guaranty's underwriters at least considered whether any third-party agreements existed. Because of the material misrepresentations, Guaranty is entitled to rescind the policy.

2. *Guaranty is entitled to retain the premiums as damages.*

Guaranty is entitled to damages because of the material misrepresentations made during the creation of the policy. As a general rule, the party requesting rescission must "restore the other party to the status quo existing at the time the contract was made." *Hakala v. Ill. Dodge City Corp.*, 380 N.E.2d 1177, 1181 (Ill. App. Ct. 1978). This means that when an insurer seeks to rescind an insurance policy, the insurer is generally required to return all of the premiums paid under the policy. Courts may, however, award damages in the event of a policy rescission. *Snyder*, 722 F. Supp. 2d at 565.

When a party to a rescinded contract is not restored to where he or she was before the policy existed, a court should award damages. This is especially true in the case of fraud or misrepresentations because if the rescinding party has "clean hands" and was not involved in the "alleged misrepresentations," then the party "may be allowed to recover damages." *Principal Life Ins. Co. v. Lawrence Rucker 2007 Ins. Trust*, 774 F. Supp. 2d 674, 680, 683 (D. Del. 2011). Such damages may include "costs of underwriting, issuance, payment of commissions, administration, service, and investigations associated with the [p]olicy, in addition to those expenses incurred in bringing [an] action for relief." *Hartford Life & Annuity Ins. Co. v. Doris Barnes Family 2008 Irrevocable Trust*, No. CV 10-7560 PSG (DTBx), 2011 WL 759554, at *5 (C.D. Cal. Feb. 22, 2011).

A court may award damages to a defrauded insurance company for commissions that the company paid to the insurance agent or for expenses incurred in seeking policy rescission. *PHL Variable Ins. Co. v. P. Bowie 2008 Irrevocable Trust*, No. 10-070-M, 2012 WL 3860553, at *1 (D.R.I. Sept. 5, 2012). In *P. Bowie*, the court held that the insurance company could "retain the premiums it received" to return it to the status quo and "offset the loss" from issuing the policy. *Id.* at *1–2, *8. The insurance application at issue in *P. Bowie* contained misrepresentations regarding the insured's net worth, annual income, the source of the premium financing, and the purpose of the insurance policy. *Id.* at *1–2. The court reasoned that if the premiums were returned, the insurance company would not be in the position it was in prior to the policy's issuance. *Id.* at *7. The court noted that "fashioning or withholding equitable relief, taking into account special circumstances like a defendant's soiled hands, rests uniquely within the discretion of the trial court." *Id.* at *4 (citing *Borden v. Paul Revere Life Ins. Co.*, 935 F.2d 370, 377 (1st Cir. 1991)).

Guaranty is entitled to retain the premiums on the Hicks policy in order to return Guaranty to the position it was in before it issued the policy. Similar to *P. Bowie*, the Hicks insurance application contained misrepresentations regarding Mr. Hicks's net worth, annual income, and the source of the premium payments. Also like the insurance company in *P. Bowie,* Guaranty was the "innocent victim" without knowledge of the misrepresentations in the application or of the sale of the policy a few days after the policy was "in force." Because of the Trust's misrepresentations, Guaranty paid $1.4 million to Agent Hightower in commissions. It is also reasonable to assume that Guaranty incurred administrative costs in issuing the policy, investigating the issuance of the policy, and looking into the accuracy of the representations in the application.

This Court should allow Guaranty to retain the premiums payments as damages because of the misrepresentations made during the procurement of the policy. At the very least, this Court should allow Guaranty to retain a portion of the premiums received as damages to offset the costs of the policy as well as the $1.4 million commission paid to Agent Hightower. Allowing Guaranty to retain the premiums will properly return Guaranty to the position it was in before it issued the insurance policy, and it will prevent the Trust from being unfairly enriched at Guaranty's expense.

CONCLUSION

Guaranty respectfully requests that this Court affirm the judgment of the United States District Court for the District of New Tejas because the insurance policy is void *ab initio* for lack of an insurable interest. Additionally, Guaranty requests that this Court reverse the district court's partial denial of Guaranty's motion for summary judgment regarding the premiums. Guaranty is entitled to retain the premiums because the policy is void *ab initio* or, alternatively, because the policy applications contained fraudulent misrepresentations.

Respectfully submitted,

Team 56
Attorneys for Appellee

APPENDIX

APPLICABLE NEW TEJAS STATUTES

N. Tej. § 1407–Incontestability

All life insurance policies, delivered or issued for delivery in this state, shall contain in substance a provision stating that the policy shall be incontestable after being in force during the life of the insured for a period of two years from its date of issue, and that, if a policy provides that the death benefit provided by the policy may be increased, or other policy provisions changed, upon the application of the policyholder and the production of evidence of insurability, the policy with respect to each such increase or change shall be incontestable after two years from the effective date of such increase or change, except in each case for nonpayment of premiums or violation of policy conditions relating to service in the armed forces.

N. Tej. § 1408–Rescission

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. § 1409–Insurable Interest

(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 in 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–Insurable Interest (Amended August 28, 2009)

(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 in 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.