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,

Appellant,

v.

GUARANTY LIFE INSURANCE COMPANY,

Appellee.

On Appeal from the
United States District Court
for the District of New Tejas
No. 28-cv-9563

BRIEF FOR APPELLEE

TEAM 68
Counsel for Appellee

QUESTIONS PRESENTED

I. Wagering on human life is illegal. To prevent wagering , N. Tej. § 1409 requires that all life insurance policies have an insurable interest at inception. Despite technical compliance with this statute, does a life insurance policy nevertheless permit wagering on life sufficient to declare it void *ab initio* for lack of insurable interest when (1) the canons of statutory construction mandate that the policy be purchased in good faith, (2) the policy was clearly not procured in good faith, and (3) the policy's enforcement would be contrary to the public welfare?

II.A. Life insurance policies that lack an insurable interest are illegal wagering contracts. When an illegal contract is declared void *ab initio*, a court must not affirmatively aid either party and, instead, must leave the parties as it finds them. When the district court declared the insurance policy void *ab initio* for lack of insurable interest, did it therefore err by affirmatively ordering the insurer to refund the premiums paid to date?

II.B. Alternatively, under New Tejas law, a life insurance policy may be rescinded upon timely challenge when a material misrepresentation has been made. Upon proper rescission, principles of equity permit an insurer to offset its losses and receive restitution for partial performance of the contract. When an insurer has timely rescinded a policy based on material misrepresentations, should it nonetheless be forced to return *all* the premiums paid to date when it has incurred losses and rendered services in an amount *greater* than the premiums paid?

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STATEMENT OF JURISDICTION

This action was brought by Appellant under the laws of New Tejas. Jurisdiction was sought in the United States District Court under 28 U.S.C. § 1332(a)(1) because the parties are citizens of different states, and the amount in controversy exceeds $75,000. Jurisdiction of the District Court is not at issue.

The Order from the United States District Court for the District of New Tejas, entered December 24, 2011, was a final and dispositive judgment. There were no post-judgment motions, and this appeal was timely filed. Appellate jurisdiction in this Court is sought under 28 U.S.C. § 1291, authorizing appeals from final judgments of a District Court.

OPINION BELOW

The opinion of the United States District Court for the District of New Tejas, Cause No. 28-cv-9563, is found in the Record beginning at page three and is currently unreported. The Court of Appeals for the Fourteenth Circuit granted review on October 8, 2012.

STATUTORY PROVISIONS

Relevant to this case are three New Tejas statutes which regulate all life insurance policies sold or procured in New Tejas: N. Tej. §§ 1407-09. The full text of these statutes, including the text of the 2009 amendment to N. Tej. § 1409, may be found in the Appendix.

STATEMENT OF THE CASE

The STOLI Policy

The district court decided this case against the backdrop of an illegal get-rich-quick scheme called stranger originated life insurance ("STOLI") where a life insurance policy is specifically purchased for sale in the secondary market. STOLI policies are purchased by investors who hope to reap a profit through the death of the insured—the earlier the better. R. at 3.

On February 16, 2007, Guaranty Life Insurance Company ("Guaranty Life" or "Appellee") issued a $20 million policy (the "Policy") on the life of Don Juan W. Hicks ("Hicks"). Record ("R.") at 8. On its face, the Policy is owned by the Hicks Irrevocable Life Insurance Trust (the "Trust"), the beneficiary of which is Hicks's son, Sydney Hicks ("Sydney"). However, neither Sydney nor Hicks's estate was ever intended to receive the promised payout from this Policy.

The Target

Hicks is a 72-year-old retired cab driver who lives on social security. R. at 10-11. He lives in a low-rent apartment in New Tejas and has no discernible assets. R. at 11. Sydney, likewise, is a man of modest means, with an annual salary of $60,000 for his work as an engineer at a local petrochemical plant. R. at 11. He lives in a $150,000 house in the suburbs, and his only other asset is a retirement plan valued at $19,000. R. at 11.

On January 4, 2007, an insurance agent ("Hightower") approached Sydney to discuss "estate planning" for his father. R. at 10. Apparently, Hightower was not deterred by the fact that Hicks had no “estate” to speak of. R. at 10. At this meeting, Sydney agreed to talk to his father about life insurance. R. at 10.

Sydney persuaded Hicks to “purchase” a $500,000 policy, which Hicks did not need, by offering to pay all the premiums. R. at 10. They confirmed their agreement on January 11, 2007, via email:

> Don’t worry about the premium payments. I will take care of them. An insurance agent will be in touch and send you some forms to sign.

The “forms” consisted of, at least, an Application and a Statement of Client Intent (“SOCI”), which may have been blank when Hicks received them. R. at 10, n.9 Hicks signed his name on the forms and returned them to Sydney the same day. R. at 10. Sydney, in turn, promptly forwarded them to Hightower. R. at 10.

The Scheme

During their initial meeting, or shortly thereafter, Hightower told Sydney about a fast-money scheme where they could take out a huge insurance policy on his father’s life and immediately sell the policy for cash to a third party purchaser. *See* R. at 10-11. Though Sydney told Hightower that he could not afford to pay the annual premium of nearly $1,000,000, Hightower assured Sydney that he would be immediately reimbursed for the initial premium payment. R. at 11. In fact, Sydney later testified that he never would have agreed to purchase the Policy if Hightower had not agreed to immediately reimburse him. R. at 12.

Although Sydney claimed that he could “not recall” discussing the face amount with Hightower, Hightower confirmed their scheme with the third-party purchaser, Presidential Holdings, LLC, ("Presidential"), in an email dated January 11, 2007:

> 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.

R. at 10. The record is silent as to whether Sydney knew of or directly corresponded with Presidential before the transaction.

Indeed, the day the Policy was delivered, March 5, 2007, everything went as planned. *See* R. at 8-9, 11-12. Sydney paid the first 3-month premium of $238,956.75 to Guaranty Life and was immediately reimbursed via wire transfer that same day. R. at 8, 11. Given Sydney's meager assets, the record is silent as to whether Sydney "floated" a check for this payment, knowing he would be repaid before it cleared, or whether he obtained the funds from some other source.

Two days later, on March 7, 2007, Sydney indeed "flipped" the Policy. *See* R. at 10. Sydney executed a Beneficial Interest Transfer Agreement ("BITA"), officially selling 100% of his interest in the Policy in exchange for 3% of the face value, $600,000, plus the $238,956.75 he had already received for the premium reimbursement. R. at 8-9. Hightower then received $1.4 million in commissions. R. at 8 n.4.

The Lies

Throughout the application process, a number of false representations were made to Guaranty Life. *See* R. at 11, 22-23. First, the Application itself represented Hicks's net worth as $1.2 billion and his annual income as $8.5 million.

R. at 11. Second, the SOCI form warranted, in part, that (1) no money would be borrowed to pay the first-year premiums, (2) Sydney Hicks would be contributing all premium funds from his "cash and equivalents," and (3) that no party to the transaction had received any "financial inducements" in connection with the Policy's purchase. R. at 22-23. Third, the Policy Acceptance form asked that the insured and policy owner verify that all information remained true and correct as of the acceptance date. R. at 25. Although some evidence suggests that lower-level underwriters at Guaranty Life noticed inconsistencies in the application, the Trust in fact warranted all information as true on at least three occasions. *See* R. at 11, 22-23, 25.

Moreover, in executing the BITA, Sydney Hicks warranted that: (1) "Presidential did not solicit" him, "directly or indirectly" to obtain the Policy for the purpose of transferring it, (2) he did not communicate "directly or indirectly" with Presidential or know the identity of Presidential, (3) he did not receive any form of inducement from Presidential in connection with the Policy's issuance. R. at 8.

Furthermore, all parties involved concealed the true details of the transaction from Hicks. *See* R. at 10. Hicks testified that he had no idea that a trust had been formed, the Policy had actually been issued, or that the face amount was $20 million. R. at 10-11. More importantly, Hicks was completely unaware that his son had executed the BITA and that a stranger stood to benefit from his death. R. at 11.

The Straw Man

Without Hicks's knowledge or consent, the Trust was created on February 5, 2007, the day before Hightower submitted the completed Application. R. at 7. The record is silent as to who, precisely, was responsible for setting up the Trust. Hicks was named as the grantor of the Trust and Sydney as its beneficiary. R. at 7. The Trust owned no other assets besides the Policy. R. at 7, n.2. Though Sydney and Hightower were the ones who arranged for the Policy to be procured, the Application and SOCI were instead executed by the Trust, through its Trustee, Bryan Jones ("Jones"). R. at 19, 23, 25. Conveniently for the Trust, the record is silent as to (1) Jones's relationship with any of the parties, (2) what information Jones may have had about Hightower's agreement with Sydney, or (3) what compensation Jones received for his role as Trustee.

The day Sydney executed the BITA, March 7, 2007, Jones resigned as Trustee and was replaced by Frank Kipp ("Kipp"). R. at 30. Conveniently for the Trust, the record is silent as to (1) Kipp's relationship with any of the parties, (2) what information Kipp may have had about the transaction, or (3) what compensation Kipp received for his role as Trustee.

Therefore, in apparently pristine compliance with New Tejas law, the Trust owned the Policy at its inception—the grantor and beneficiary of which both had a legal ability to hold insurance on Hicks's life. Conveniently for the Trust, each of the seven deponents questioned about the Trust either (1) pled his Fifth

Amendment Right, (2) could not remember any details, or (3) denied the very existence of the Trust. R. at 7, n.3.

The Suit

On October 21, 2008, Kipp sent a letter to Guaranty Life insisting that Presidential be designated as the new owner and beneficiary of the Policy. R. at 27. Upon receiving this demand, Guaranty Life became concerned at Sydney's motivation for selling his beneficial interest. *See* R. at 9. In its response, Guaranty Life declined to immediately process the change forms in order to investigate the previously undisclosed transfer to determine whether it "raise[d] any questions related to the issuance of the policy." R. at 36. In a letter dated December 22, 2008, Guaranty Life requested specific documents to "confirm the accuracy" of the information provided during the underwriting process. R. at 40-41. Because this information was needed to conduct an effective investigation, Guaranty Life cautioned that it could rescind the Policy if the requested documents were not provided within two weeks. R. at 41.

Rather than produce any of the requested information, Kipp and Presidential (the "Investors") filed suit against Guaranty Life on January 5, 2009, asserting myriad claims based on Guaranty Life's refusal to immediately record the change forms in the manner required by the Policy. R. at 13. Instead of yielding to suit and enforcing the Policy provision, Guaranty Life filed an Answer. [1]

[1] Though the record is silent as to the precise date on which Guaranty Life filed its Answer, it can be presumed that the date of filing was within the 21-day window mandated by F.R.C.P. 12 due to the fact that (1) no default judgment was rendered against Guaranty Life, and (2) Guaranty Life participated in the discovery process prior to filing its Counterclaim of June 6, 2009. Twenty-one days after January 5, 2009, was January 26, 2009. This

Guaranty Life was therefore required to continue its investigation through the "severely limited" tools available to it during the litigation discovery process. R. at 10. Finally, however, on June 6, 2009, Guaranty Life had enough information to file its Counterclaim seeking to have the Policy declared void for lack of insurable interest and seeking to retain the premiums paid under the Policy. R. at 13. Thereafter, on May 12, 2011, the Investors filed their Motion for Summary Judgment on its claims for breach of contract, and Guaranty Life filed its motion to rescind the Policy and retain the premiums paid to date.[2] R. at 13.

On December 14, 2011, the district court ruled on these motions. R. at 15. The court agreed with Guaranty Life and declared that the Policy was void *ab initio* for lack of insurable interest "due to the pre-arranged deal of the investors to procure ownership and beneficial interest in the Policy." R. at 14. Following this ruling, however, the court ordered Guaranty Life to return all premiums to the Trust. R. at 14. Each party filed a timely appeal. Guaranty Life now asks this Court to (1) affirm the district's court declaration that the Policy was void *ab initio* for lack of insurable interest, yet (2) reverse the district court's order requiring Guaranty Life to return the premiums paid under the Policy.

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date falls within two years from both the Policy's issue date, February 16, 2009, and its delivery date, March 5, 2009. See Fed. R. Civ. P. 12; R. at 8.

[2] Pending the outcome of this litigation, Appellant continued to pay, and Guaranty Life continued to accept premium payments totaling $4,779,135.00, which were entered into the Registry of the Court on May 12, 2011.

SUMMARY OF THE ARGUMENT

This appeal challenges an investor's ability to make a risk-free wager on a stranger's life. Kipp ("Appellant") asks this Court to slavishly adhere to form over substance to sanction the illegal wager on Hicks's life, or alternatively, to make Appellant completely whole in equity for the failed attempt. This Court must not allow equity to be administered so dangerously.

I.

The Policy was void at inception for lack of insurable interest because it was purchased solely for the purpose of wagering on Hicks's life. Under the federal common law, wagering on human life was prohibited. When a person took out an insurance policy on a stranger's life, his clear motivation was the hope of a windfall upon the early death of the insured—an early death the policy holder might be tempted to accelerate. To prevent wagering and its "sinister" side effects, the Supreme Court declared that a life insurance policy was absolutely void unless it had a valid "insurable interest."

Under the common law, for a policy to have a valid insurable interest, it must have initially been procured in "good faith," and not as a sham to conceal a wagering contract. After the federal common law, most states, including New Tejas, enacted insurable interest statutes to prevent wagering on life. Although New Tejas's statute, N. Tej. § 1409, does not include an express good-faith requirement, it nevertheless requires good faith according to proper canons of statutory construction. This interpretation is correctly supported by authority from other states and buttressed by the plain language of the 2009 statutory amendment.

Against this historical and legislative framework, the facts of the case overwhelmingly show that the Policy lacked a good-faith insurable interest at inception because Hicks and Sydney were merely nominal parties to the sham transaction designed to wager on Hicks's life. Such a wagering contract is contrary to public policy and its enforcement would endanger, not simply Hicks alone, but general principles of public welfare.

II.A.

Upon declaring the Policy void *ab initio* for lack of insurable interest, the district court erred by affirmatively ordering Guaranty Life to return the premiums to the Trust. A life insurance policy that lacks insurable interest is an illegal contract. If a court enforces an illegal contract in any manner, the court becomes a participant in the illegal scheme. For this reason, upon declaring a contract illegal, the court may not affirmatively aid either party in any manner. Rather, the court must leave the parties as it found them. In this case, the parties must be left as the court found them to avoid perversely rewarding illegal STOLI schemes by eliminating all risk associated with wagering on human life.

II.B.

Alternatively, even if this Court finds that the Policy had a valid insurable interest at inception, Guaranty Life is entitled to rescind the Policy under New Tejas law and retain all premiums paid to date. The record reveals that numerous false representations were made during the application process, which entitle Guaranty Life to rescind the Policy under N. Tej. § 1408. These representations were material as a matter of law because (1) they involved false answers to specific questions posed in the application documents, and (2) under an objective standard, they increased the amount of risk assumed by Guaranty Life.

Furthermore, Guaranty Life's rescission is not time-barred by the Policy's incontestability clause. The Investors initially sued Guaranty Life for failing to comply with a provision of the Policy. Therefore, Guaranty Life's original answer effectively challenged the Policy because it was filed within the contestability period. In the alternative, Guaranty Life is not barred from rescission because of the Investors' bad-faith conduct in bringing suit and procuring the Policy.

Finally, principles of rescission require the parties to be returned to the status quo. Although insurers must generally return premiums upon rescission, many courts have allowed insurers to offset losses incurred in issuing the Policy and seeking rescission. Additionally, principles of restitution permit Guaranty Life to seek compensation for the insurance services it provided, and the corresponding risk it assumed, during the time the Policy was in force. Thus, the proper restitution is the exact amount of premiums paid to date. Therefore, whether or not the Policy had a valid insurable interest at inception, this Court should reverse the district court's order and, passively or affirmatively, permit Guaranty Life to retain the premiums paid to date.

<u>**ARGUMENT**</u>

The Federal Rules of Civil Procedure dictate that a court should grant a motion for summary judgment only when "there is no genuine issue as to any material fact, and the moving party is entitled to summary judgment as a matter of law." Fed. R. Civ. P. 56(a). An appellate court reviews *de novo* a district court's grant or denial of summary judgment. *OneBeacon Am. Ins. Co. v. Commercial Union Assurance Co. of Can.*, 684 F.3d 237, 241 (1st Cir. 2012). "The standard of review for cross-motions for summary judgment does not differ from the standard applied when only one party files the motion." *U.S. ex rel. Wall v. Circle C Constr., L.L.C.*, 697 F.3d 345 (6th Cir. 2012). The reviewing court must simply make its judgment based on the "undisputed facts." *OneBeacon*, 684 F.3d at 241.

As the "undisputed facts" of this case reveal, the Policy was purchased solely for the purpose of wagering on Hicks's life and is therefore illegal under New Tejas law. This Court must not permit the Investors to be made whole in equity merely because their illegal wagering scheme failed.

In 18th century England, a form of wagering became popular whereby a gambler would purchase a life insurance policy on the life of another person without his knowledge or consent. Maria Fleisher, *Stranger Originated Life Insurance: Finding A Modern Cure for an Age-Old Problem*, 41 Cumb. L. Rev. 569, 571 (2011). Popular "insureds" were criminals on death row, celebrities, and heads of state. *Id.* The gambler stood to profit only if the insured died before the premiums exceeded the expected payout. *Id.*

The unsavory consequences of these wagers were that they tended to create the desire for the gambler to murder the insured in order to enjoy a greater return on his investment. *Id.* Aside from this obvious "moral hazard," these gamblers also created solvency issues for insurers who struggled to pay the wagers while providing coverage for clients who truly needed life insurance to protect their families. Franklin G. Monsour, Jr., *Stoli and Intent: The Feeling's Mutual, but It's Starting Not to Matter Anyway*, 19 Cardozo J. Int'l & Comp. L. 679, 686 (2011). These "wagering contracts" were deemed illegal under English law[3] and, soon after, under early American common law.

Wagering contracts have recently resurfaced in a malignant investment scheme called STOLI. Eryn Mathews, *Stoli on the Rocks: Why States Should Eliminate the Abusive Practice of Stranger-Owned Life Insurance*, 14 Conn. Ins. L.J. 521, 528 (2008). STOLI policies are purchased solely for sale on the secondary market and not for any legitimate insurance need. *Id.* Aside from the inherent danger to the insured's life, STOLI policies have hidden consequences, like tax implications, loss of future insurability, and higher premiums for the elderly. *Id.* at 529-40. Moreover, the insurance applications often fraudulently overstate the insured's net worth and income to induce the insurer to offer the highest face value possible. *Id.* at 537.

Because STOLI policies are illegal, STOLI promoters carefully orchestrate their schemes in apparent compliance with state laws that prohibit wagering. *Id.* at 544. Although some states have incorrectly permitted STOLI arrangements by

[3] The British Parliament passed the Life Assurance Act of 1774 to prohibit wagering on life.

deferring to a perceived statutory loophole, many states have properly refused to acknowledge STOLI arrangements, despite their technical compliance with statute. This is an issue of first impression in New Tejas.

In this case, regardless of any apparent statutory compliance, the Policy was an illegal wagering contract, designed from its inception to gamble on Hicks's life. Therefore, the district court properly declared that the Policy was void *ab initio*, yet, upon such declaration, the court incongruously ordered Guaranty Life to return the premiums. On the other hand, even if this Court validates the Policy through a STOLI loophole, Guaranty Life is still entitled to rescind the Policy and retain all premiums paid to date because of the false representations in the Application.

I. THE DISTRICT COURT CORRECTLY DECLARED THAT THE POLICY WAS VOID *AB INITIO* FOR LACK OF INSURABLE INTEREST.

Because the Policy was an illegal wagering contract at inception, it lacked a valid insurable interest under New Tejas law and is absolutely void as contrary to public policy. The concept of "insurable interest" developed under the common law specifically to prevent wagering on human life. *Warnock v. Davis*, 104 U.S. 775, 779 (1881). No life insurance policy was valid unless the purchaser had an interest in the insured's continued longevity. *Id.* This concept derived from principles of familial affection or anticipated financial advantage, which were presumed to imbue a person with the desire "to protect the *life* of the insured." *Id.* (emphasis added). A person also had an inherent insurable interest in his own life for the same reason. *Conn. Mut. Life Ins. Co. v. Schaefer*, 94 U.S. 457, 460 (1876).

A life insurance policy that lacked an insurable interest at inception was held to be nothing but a wager, whereby the policy holder hoped to earn a profit through the early death of the insured. *Id.* This "sinister counter interest" in the insured's death was deemed to be wholly contrary to public policy, and, for this reason, the United States Supreme Court declared such contracts void. *Grigsby v. Russell*, 222 U.S. 149, 154-55 (1911); *Warnock*, 104 U.S. at 780.

After the end of the common law,[4] most states, including New Tejas, codified this insurable interest requirement for insurance policies.[5] Precisely mirroring the common law, New Tejas's insurable interest statute defines an insurable interest as (1) an interest based on expected financial advantage through the continued life of the insured, (2) an interest based on love and affection for the insured, and (3) a person's inherent insurable interest in his own life. N. Tej. § 1409 (a)-(b).

In the present case, although the Policy *technically* complies with the statute—as Hicks and Sydney both have an apparent insurable interest in Hicks's life—the Policy lacks a valid insurable interest because it was not purchased in good faith. Thus, the Policy is void *ab initio* as contrary to public policy.

A. Despite Its Feigned Statutory Compliance, The Policy Lacked A Valid Insurable Interest Because It Was Not Purchased In Good Faith.

Because the Policy was not purchased for any legitimate insurance need, but as a sham to conceal a wager, it lacked a valid insurable interest at inception. The U.S. Supreme Court historically set forth the practical standard of "good faith" for

[4] By *Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938).

[5] Forty-five states, including New Tejas, have enacted insurable interest laws. The relevant text of selected statutes appear in the Appendix: Ariz. Rev. Stat. § 20-1104(A)(2010); Cal. Ins. Code § 10110.1 (West 2005 & Supp. 2012); 18 Del. Code Ann. tit. § 2704(a)(West 1999); Fla. Stat. Ann. § 627.404 (West 2011); NY Ins. Law § 3205(b) (McKinney 2006); N.J. Stat. Ann § 17B:24-1.1 (West 2006).

American insurable-interest jurisprudence. The *Grigsby* Court clarified that a life insurance policy could, in fact, be sold or assigned to someone having no insurable interest if—and only if—the policy was initially purchased in good faith. *Grigsby*, 222 U.S at 156.

Under the common law, a policy was purchased in "good faith" if it was purchased for *any legitimate insurance need*, as long as it was not merely a "cloak" to conceal an underlying wager. *Id.* The good-faith standard for insurable interest was strictly applied by state and federal courts before and after the end of the common law. *See, e.g.*, *Rakestraw v. City of Cincinnati*, 44 N.E.2d 278, 280 (Ohio Ct. App. 1942) ("the essential thing being that the policy shall be obtained in good faith"); *Travelers Ins. Co. v. Reiziz,* 13 F. Supp. 819, 820 (E.D.N.Y.1935) (finding that a policy lacked good faith if it was purchased "with a view to its immediate assignment" in an attempt to "evade" the insurable interest rule).

In the present case, Section 1409 must be likewise interpreted to require good faith to avoid absurd results not intended by the legislature. Under this reading, the undisputed facts of the case demonstrate that the Policy lacked a good-faith insurable interest at inception and was therefore an illegal wagering contract.

1. ***New Tejas law clearly requires good faith because excluding it would absurdly defeat the entire purpose of the insurable interest statute.***

Because the purpose of Section 1409 is to prevent wagering on life, excluding the common-law good-faith requirement for insurable interest would impermissibly sanction wagering, which was clearly not intended by the legislature. When a federal court interprets state law, it is tasked with predicting how the state's high court would likely rule. *Trailer Bridge, Inc. v. Ill. Nat. Ins. Co.*, 657 F.3d 1135, 1141 (11th Cir. 2011). However, if no precedent exists in the state's courts, the federal court may look to other jurisdictions that have examined similar statutes. *Lomando v. United States*, 667 F.3d 363, 385 (3d Cir. 2011).

First, a court must first examine the plain language of the statute to determine if it is ambiguous. *United States v. Fontaine*, 11-2602, 2012 WL 3667228, at *4 (3d Cir. Aug. 28, 2012). A statute is ambiguous if a literal reading would yield "absurd results" not intended by the legislature. *Id.* Next, the court must consider legislative history and resolve omission and ambiguities consistently with common law as it existed before the statute was enacted. *Mohamad v. Palestinian Auth.*, 132 S. Ct. 1702, 1704 (2012).

Section 1409 provides that "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 (c). Even though the plain language of the statute does not expressly mention "good faith," the New Tejas Supreme Court would certainly require it. First, according to proper canons of statutory construction, the statute must be read to incorporate the common-law good-faith standard for insurable interest. Second, such an interpretation is supported by other courts and state legislatures that have sought to eliminate STOLI schemes. Third, the 2009 amendment, though not controlling, provides important legislative context in support of a good-faith requirement. Excluding the good-faith requirement would yield an absurd result that the New Tejas legislature did not intend.

a. <u>Because good faith was a well-established principle under the common law, the canons of statutory interpretation demand its inclusion in Section 1409</u>.

Though the plain language of Section 1409 does not expressly require good faith, the statute must be read to incorporate this common-law standard because the New Tejas legislature did not expressly eliminate it upon drafting the statute. First, the entire purpose of an insurable interest statute is to prevent wagering on the destruction of the insured person or property. *Lincoln Nat. Life Ins. Co. v. Joseph Schlanger 2006 Ins. Trust*, CIV. 09-506-GMS, 2010 WL 2898315 (D. Del. July 20, 2010). *There is no other reason for its existence*. As such, without a good-faith requirement, the plain language of the statute would actually *permit* wagering contracts as long as an insurable interest technically existed at inception—even if the policy was purchased solely for immediate resale. Therefore, the statute is ambiguous as a matter of law. *See Fontaine*, 2012 WL 3667228, at *4.

Next, when interpreting statutory ambiguities, the U.S Supreme Court has repeatedly held that "a statute should be interpreted consistently with the common law" absent *express language* to the contrary. *Samantar v. Yousuf*, 130 S. Ct. 2278, 2289 (2010); *see also Astoria Fed. Sav. & Loan Ass'n v. Solimino*, 501 U.S. 104, 108 (1991) ("where a common-law principle is well established . . . the courts may take it as given that [the common-law] principle will apply except when a statutory purpose to the contrary is evident.") (internal quotations omitted).

This canon of construction is similarly supported by the high courts of other states. *See, e.g.*, *PHL Variable Ins. Co. v. Price Dawe 2006 Ins. Trust, ex rel. Christiana Bank & Trust Co.*, 28 A.3d 1059, 1070 (Del. 2011) ("Courts should . . . interpret statutory law consistently with pre-existing common law unless the legislature expresses a contrary intent"); *Sims v. Sims*, 930 P.2d 153, 158 (N.M. 1996) ("[W]e presume the legislature was well informed about the existing common law before the statute was enacted and did not intend to enact a statute that conflicted with the common law").

The insurable interest requirement and its good-faith counterpart were fundamental principles under the common law. *See Grigsby*, 222 U.S at 156. The prohibition against wagering contracts spans two continents and has been an issue on American dockets for over two centuries.[6] Likewise, the common-law requirement for good faith was upheld consistently by US and state courts before and after the end of the federal common law. As such, these fundamental principles are clearly "well-established" for purposes of statutory construction. *See Astoria*, 501 U.S. at 108.

Though a court may not ignore the plain language of a statute "under the pretext of pursuing its spirit," (*Principal Life Ins. Co. v. DeRose*, 1:08-CV-2294, 2011 WL 4738114 (M.D. Pa. Oct. 5, 2011)) in this case, the test is not one of "plain language," but an overall requirement for uniformity with preexisting common law. As such, Appellant wrongly contends that the Policy is valid under Section 1409

[6] One of the earliest U.S. cases to forbid wagering contracts was *Pritchet v. Ins. Co. of N. Am.*, 1803 WL 757 (Pa. 1803).

because the "plain language" does not expressly require good faith. In fact, good faith is implicit to the statute because it was "well-established" under the common law. *See Astoria*, 501 U.S. at 108.

Therefore, in proper context, Section 1409 (c) provides that an insurable interest is only required to exist at a policy's inception, not at the time of loss, *as long as the transaction is not a sham to conceal a wager. See Grigsby*, 222 U.S at 156. Because the New Tejas legislature did not expressly abrogate the common law, Section 1409 must be read to include good faith to comply with the legislature's intent.

b. <u>The good-faith standard is firmly supported by judicial and legislative authority from other jurisdictions.</u>

Many courts interpreting statutes similar to Section 1409 have required good faith for a valid insurable interest, even absent express statutory language. For example, under Delaware law, an insurable interest is based on (1) an insured's interest in his own life, (2) an interest based on love and affection inherent to one closely related by blood or law to the insured, and (3) an interest based on anticipated financial advantage through the continued life of the insured. Del. Code Ann. tit. 18 § 2407 (c)(1)-(2) (West 2010).[7] Similarly to New Tejas's statute, Delaware's statute allows an individual to effect an insurance policy on his own life—for any person's benefit—and requires an insurable interest at the inception of the policy even if it is later transferred. *Id.* at (a); *see* N. Tej. § 1409 (b)-(c).

[7] See Appendix.

Notably missing from Delaware's statute is any requirement whatsoever that a life insurance policy be procured in good faith. However, the Delaware Supreme Court recently upheld the common-law good-faith standard for insurable interest in order to forward "the substantive goal of preventing speculation on human life." *Dawe*, 28 A.3d at 1075-76 (holding that Delaware's insurable interest statute "requires more than just technical compliance at the time of issuance").

The good-faith standard has likewise been supported by federal courts analyzing their home states' insurable interest laws. For example, the insurable interest statutes in Florida, New Jersey, and Arizona are comparable to the insurable interest statutes in Delaware.[8] These courts have similarly rejected the notion that technical compliance with the statute is sufficient to constitute a valid insurable interest . *See AXA Equitable Life Ins. Co. v. Infinity Fin. Group, LLC*, 608 F. Supp. 2d 1349, 1356 (S.D. Fla. 2009) ("Florida permits the assignment of life insurance policies to persons without an insurable interest . . . [b]ut this rule extends only to assignments made in good faith, and not to sham assignments made to circumvent the law's prohibition on wagering contracts.")(internal citations omitted); *Sun Life Assurance Co. of Can. v. Moran*, CV080629-PHX-GMS, 2009 WL 2450443 (D. Ariz. Aug. 11, 2009) ("[J]ust because an insurable interest did in fact exist when a policy is issued, does not end the inquiry . . . where the circumstances indicate that the assignee is the real purchaser of the policy."); *Lincoln Nat. Life Ins. Co. v. Calhoun*, 596 F. Supp. 2d 882, 889 (D.N.J. 2009) (noting that parties "run

[8] See Appendix.

afoul of the insurable interest requirement" if, at the time the policy is issued, they intend "to profit by transferring the policy to a stranger with no insurable interest.")

Although two states, New York and California, seemingly abandoned any good-faith insurable interest requirement, court rulings from these states have limited precedential value, even in their home states. *See Kramer v. Phoenix Life Ins. Co.*, 940 N.E.2d 535, 536-37 (N.Y. 2010); *Lincoln Nat. Life Ins. Co. v. Gordon R.A. Fishman Irrevocable Life Trust*, 638 F. Supp. 2d 1170, 1178 (C.D. Cal. 2009). For example, the *Kramer* court analyzed the unique language of New York's insurable interest statute, which expressly permits "the *immediate transfer or assignment* of a [life insurance] contract." *Kramer*, 940 N.E.2d at 539 (analyzing N.Y. Ins. Law § 3205 (b)(1) (McKinney 2006) (emphasis added).[9] The court relied on this express language in concluding that "a person [may] procure an insurance policy on his or her own life and immediately transfer it to one without an insurable interest in that life, *even where the policy was obtained for just such a purpose*." *Kramer*, 940 N.E.2d at 536-37 (emphasis added). Not only is this statute's language completely different from Section 1409, the New York legislature has amended its insurance laws to expressly prohibit STOLI-type transactions, illustrating the clear legislative distaste for STOLI and restricting *Kramer's* precedential value. *See* N.Y. Ins. Law § 7815 (McKinney Supp. 2012).

Likewise, the California legislature similarly amended its insurable interest statute immediately after a California federal court granted summary judgment for a trust participating in a STOLI scheme. *Fishman*, 638 F. Supp. 2d at 1178

[9] See Appendix.

(interpreting Cal. Ins. Code § 10110.1 (West 2005)).[10] The court needlessly departed from the common law and—quite reluctantly—held that the subject STOLI policy had a valid insurable interest, despite the fact that the insured intended to sell the policy at inception. *Id.* Remarkably, only *five days* after the *Fishman* opinion was rendered, the California legislature clarified its insurable interest statute to prevent STOLI transactions.[11] *See* CA B. An., S.B. 98 Sen., 7/15/2009.[12]

The *Fishman* court evidently felt restrained by the plain language of the statute and allowed itself to consider only "the form of th[e] transaction," not the substance. *Fishman,* 638 F. Supp. 2d at 1178. Calling the statute a "bad law," the court scolded the parties for "violating [its] spirit" by finding a "loophole" through which to parade their blatant STOLI scheme. *Id.* at 1179.

Although Section 1409 is nearly identical to the language of the California statute analyzed in *Fishman*, this Court need not throw good law after "bad." *See id.* Because good faith is firmly supported by the canons of statutory construction and precedent from sister jurisdictions, Section 1409 is properly read to require good faith.

c. **<u>It is irrelevant that the 2009 amendment does not apply retroactively because the plain language of the amendment affirms that "wagering on life" was prohibited at all times relevant to this suit.</u>**

The plain language of the amendment conclusively reaffirms that, *prior* to the amendment, New Tejas law prohibited wagering on life. As such, even though

[10] See Appendix.
[11] See Appendix.
[12] The amendment to Cal. Ins. Code § 10110.1 became effective on January 1, 2010.

the provisions of the 2009 amendment may not be applied retroactively, this clause does not serve to sanction STOLI transactions that were effected prior to the amendment. *See* N. Tej. § 1409 (g). This is not a "loophole." *See Fishman*, 638 F. Supp. 2d at 1179.

In August of 2009, Section 1409 was amended to enumerate instances in which individuals may violate New Tejas's "*prohibition* against wagering on life."[13] N. Tej. § 1409 (d)(emphasis added). The use of the word "prohibition" is an unequivocal reference to a ban on certain conduct that was already in place and still ongoing at the time of enactment. *See, e.g.*, *Carter v. Cal. Dept. of Veterans Affairs*, 135 P.3d 637, 647 (Cal. Ct. App. 2006) (emphasizing that "the Legislature may make material changes in language in an effort to clarify existing law"). As such, the plain language of the amendment confirms that "wagering on life" was indeed prohibited at all times relevant to this lawsuit. *See* N. Tej. § 1409 (d). Therefore, in a suit whose actions occurred prior to the amendment, an insurer is simply held to the higher burden of establishing that a wagering contract existed in fact.

In sum, New Tejas law requires good faith to have a valid insurable interest. This reading is supported by proper canons of statutory interpretation, precedent from other courts, legislation from other states, and the plain language of the 2009 statutory amendment.

[13] See Appendix.

2. *The Hicks Policy lacked a valid insurable interest because it was not purchased in good faith, but as a sham to conceal a wager.*

As the undisputed record reveals, the Policy lacked insurable interest because Hicks and his son were merely nominal parties to the sham transaction, which was designed from inception to be sold to investors who were solely interested in Hicks's death. STOLI schemes are specifically designed to "feign technical compliance" with insurable interest statutes to conceal the underlying wager. *Dawe*, 28 A.3d at 1074. These schemes typically involve "straw-man" transactions, in which the insured is used solely "as an instrumentality to obtain the policy." *Id.* As such, courts analyze several factors to determine whether the policy had a good-faith insurable interest, or whether it was a "sham to evade the insurable interest rule." *Penn Mut. Life Ins. Co. v. Wolk*, 739 F. Supp. 2d 387, 394 (S.D.N.Y. 2010).

First, a court may seek to determine who the "true owner" of a policy really is by finding out who instigated the transaction and paid the premiums. *Dawe*, 28 A.3d at 1076; *cf. Carton v. B & B Equities Group, LLC*, 827 F. Supp. 2d 1235, 1245 (D. Nev. 2011). In *Carton*, investors approached elderly individuals and convinced them to take out life insurance policies with high face values. *Id.* Though the insureds completed the application and technically owned the policies, all premiums for the policies were paid in the form of a "loan" from the investors, which the insureds "never intended to repay." *Id.* As such, the court held that the arrangement was a "typical STOLI scheme" and lacked insurable interest because the investors were "the true owners of the [p]olicies" from the beginning. *Id. But see Sun Life Assurance Co. of Canada v. Paulson*, CIV.07-3877(DSD/JJG), 2008 WL

451054, at *2 (D. Minn. Feb. 15, 2008) (finding that a valid insurable interest existed when the insured procured a life insurance policy on his own initiative, paid the premiums, yet intended to sell the policy to an unspecified third party at an unspecified time).

Second, in sham transactions, policy holders intend to immediately transfer beneficial interest to a third party. *AXA Equitable Life*, 608 F. Supp. 2d at 1357. As such, courts also consider the length of time a policy is held by its owner prior to assignment. *Am. Gen. Life Ins. v. Goldstein*, 741 F. Supp. 2d 604, 608 (D. Del. 2010) (finding no insurable interest when the policy beneficiary sold his interest six days after the policy was delivered); *Life Prod. Clearing, LLC v. Angel*, 530 F. Supp. 2d 646, 655 (S.D.N.Y. 2008) (finding no insurable interest because the policy holder was only the beneficiary "for a few days" before assigning the policy to a third-party investor).

Third, an insured forfeits his inherent insurable interest when he is party to the transaction in name only. *Ohio Nat. Life Assurance Corp. v. Davis*, 10 C 2386, 2011 WL 2680500, at *5 (N.D. Ill. July 6, 2011). In *Davis*, the insured was approached by two men who promised him cash payments if he would fill out an application for life insurance. *Id.* Though the insured did not need life insurance, he agreed to provide his signature on the application in exchange for the payment. *Id.* The investors created all the documents and designated themselves as the policy beneficiary. *Id.* The investors unsuccessfully argued that the insured could take out an insurance policy on his own life and assign it to anyone he chose. *Id.*

Denying the investors' motion to dismiss, the court reasoned that the insured did not "take out" the policy in any meaningful way, nor did he "exercise unfettered control" over the policy, and therefore, the insurer properly pleaded that the policy lacked insurable interest. *Id.*

Fourth, courts categorically find that a policy lacks insurable interest when the insured is largely unaware of the details surrounding the transaction and the application grossly overstates the insured's net worth. *Principal Life Ins. Co. v. Mosberg*, 09-22341-CIV, 2010 WL 2509634, at *4 (S.D. Fla. June 18, 2010). In *Mosberg,* a relative of the insured approached her about obtaining a life insurance policy. *Id.* at *1. Though she did not want or need life insurance, she consented to allow the relative to submit an application on her behalf. *Id.* Though a policy was issued in the insured's name, the owner of the policy was a trust in which her children were the beneficiaries. *Id.* The insured had no knowledge of the trust, did not know the trustee, never saw the insurance policy, and never paid any premiums. *Id.* at *4. Moreover, the insured's annual income was $36,000, which was grossly insufficient to justify the $14 million policy on her life. *Id.* at *2. The court summarily held that the policy lacked insurable interest. *Id.* at *4.

On the other hand, even *without* good faith, some courts have held STOLI policies to have a valid insurable interest when the insured (1) had a legitimate need for insurance, (2) was a sophisticated businessman with a high net worth, (3) independently established a trust naming his children as its beneficiaries, (4) independently sought out a third party purchaser, (5) expressly authorized the trust to purchase insurance policies on his life, and (6) waited two years before selling the policies. *Fishman,* 638 F. Supp. 2d at 1178.

In *Fishman*, the court held that the policy had a valid insurable interest, despite the fact that the insured entered into a premium financing arrangement with the clear intent to sell the policy to stranger investors. *Id.* The insured was a sophisticated businessman with a net worth of $90 million and an annual income of $13.8 million, whose estate was legitimately insurable for $30 million. *Id.* at 1175. The insured established the trust, named his sons as the beneficiaries, and expressly gave one of his sons—not the trustee—sole authorization to purchase insurance policies on his life. *Id.* at 1174. Even though the insured immediately assigned the policies to the third-party investors, these assignments were merely collateral assignments. *Id.* at 1176. Thus, if the insured had actually died during the first two years, his sons would have received the entire beneficial interest from the policies minus only the amount of the premium financing paid by the investor to that point. *Id.* at 1179. The court emphasized that the arrangement "not only had the formal appearance of a legitimate life insurance policy," it was, in fact, legitimate during the entire two years prior to the policies' sale. *Id.*; *see also Kramer*, 940 N.E.2d at 536-37 (finding a valid insurable interest existed when a wealthy attorney and sophisticated investor independently purchased three life insurance policies on his own life with the intent to immediately sell them to investors).

In the case at bar, the Policy lacked an insurable interest because the transaction was unquestionably a sham designed to conceal the underlying wager. First, Hicks did not have a valid insurable interest because he was merely a nominal party to the transaction and largely unaware of its details. *See Mosberg*, 2010 WL 2509634, at *4; R. at 10. Though he agreed to allow Sydney to insure his life and agreed to sign some forms when asked, those acts were the extent of his involvement with the Policy. *See Davis*, 10 C 2386, 2011 WL 2680500, at *5; R. at 10-11. Hicks did not know that the Policy had been issued, did not know its face value, did not know that a trust had been created, and did not know that Sydney had sold the interest to strangers. *See id.* Certainly, Hicks was not a sophisticated business man, and his net worth was grossly inadequate to justify the $20 million policy on his life. *See Mosberg*, 2010 WL 2509634, at *2; *Fishman,* 638 F. Supp. 2d at 1174; R. at 11. As such, Hicks did not truly "take out" or "exercise unfettered control" over the policy, and therefore, Hicks lacked a valid insurable interest at the Policy's inception.

Second, Sydney did not have an insurable interest because he permitted himself to be used as a "cloak" to the underlying wager. *See Grigsby*, 222 U.S. at 156. Sydney was induced by the promise of quick cash to purchase a policy that he did not need and could not afford. *See id.*; *Mosberg*, 2010 WL 2509634, at *2; R. at 11-12. In fact, Sydney's sole intent was to sell his father's life to stranger investors at the earliest possible moment. *See Goldstein*, 741 F. Supp. 2d at 608; R. at 11-12. Indeed, Sydney sold his beneficial interest to Presidential only two days after the policy was delivered. R. at 8. True, if Hicks had actually died between March 5 and March 7, 2007, Sydney would have received most of the benefit under the policy. However, this tiny two-day window is clear evidence that Sydney entered the entire sham transaction "with a view to its immediate assignment." *See Goldstein*, 741 F. Supp. 2d at 608; *Fishman,* 638 F. Supp. 2d at 1179. Furthermore, Sydney was immediately reimbursed for the initial premium payment and made no other payments, which indicates that Sydney was not "the true owner of the policy." *See Carton*, 827 F. Supp. at 1245. As such, Sydney "lent" his valid insurable interest "as a cloak" to conceal the underlying wager and thereby forfeited his insurable interest. *See Grigsby*, 222 U.S. at 156.

Finally, the "straw-man" Trust, as "owner" of the Policy, did not have an insurable interest in Hicks's life in any way whatsoever. *See Davis*, 10 C 2386, 2011 WL 2680500, at *5. Hicks, the purported grantor of the Trust, was only a nominal party to the sham transaction and was entirely ignorant of the Trust itself. *See Mosberg*, 2010 WL 2509634, at *4; R. at 10. Sydney, the trust's beneficiary, forfeited his insurable interest because he intended to immediately transfer the policy to a stranger. *See Davis*, 10 C 2386, 2011 WL 2680500, at *5. Despite the scheme's "feign[ed] statutory compliance," the Investors who funded the entire scheme were strangers to Hicks and interested only in his death. *See Dawe*, 28 A.3d at1074. As such, the Policy was a wagering contract because it was not procured in good faith, and the trial court correctly held that it lacked insurable interest.

B. Life Insurance Policies That Lack An Insurable Interest—Like All STOLI Policies—Are Illegal Wagering Contracts And Void *Ab Initio* As Contrary To Public Policy.

The district court properly declared that the Policy was void *ab initio* because life insurance policies that lack an insurable interest are contrary to public policy. "Public policy" is generally defined as "[a] principle of law under which freedom of contract . . . is restricted by law for the good of the community." *Atkins v. Swimwest Family Fitness Center*, 691 N.W.2d 334, 313 (Wis. 2005) (citing *Higgins v. McFarland*, 86 S.E.2d 168, 172 (Va. 1955)). Contracts that are against public policy are effectively equated with contracts that are illegal, and courts will not enforce them. *Maska U.S., Inc. v. Kan. Gen. Ins. Co.*, 198 F.3d 74, 80 (2d Cir. 1999).

An agreement that is contrary to public policy is said to have a "tendency to evil." *Hanks v. Grace*, 273 P.3d 1029, 1033 (Wash. 2012). Though courts generally defer to the parties' Constitutional freedom to contract,[14] if the enforcement of a contract would actively contravene a statute, good morals, or the public welfare, the contract will be declared void *ab initio*. *Canal Ins. Co. v. Ashmore*, 126 F.3d 1083, 1087 (8th Cir. 1997).

Life insurance policies that lack an insurable interest—like all STOLI arrangements—are contrary to public policy and void *ab initio*. *See, e.g.*, *Carton*, 827 F. Supp. 2d at 1245. STOLI polices have a clear "tendency to evil" because they implicate broad societal concerns beyond merely the interests of the contracting parties. Namely, STOLI policies impermissibly treat humans as commodities, damage the insurance industry, and scam the elderly. The far-reaching effects of

[14] Under U.S. Const. art. I, § 10, cl.1.

these illegal wagers cannot be overcome merely because an individual asserts his Constitutional freedom to contract. As such, public policy dictates that all STOLI policies, as wagering contracts, are void *ab initio*.

1. ***STOLI policies impermissibly treat humans as commodities.***

As the Supreme Court cautioned long ago, wagering contracts inherently create a desire for the death of the insured. *Schaefer*, 94 U.S. at 460. The resulting insurable interest requirements adopted under federal and state law were founded on two principles: (1) gambling on the life of a human being is inherently immoral, and (2) courts must act in equity to protect the insured from a malevolent beneficiary who may wish to "accelerate [the] policy's payout." Robert S. Bloink, *Catalysts for Clarification: Modern Twists on the Insurable Interest Requirement for Life Insurance*, 17 Conn. Ins. L.J. 55, 60-61 (2010).

These concerns are well-founded. History is replete with stories of life insurance beneficiaries with no insurable interest who sought to murder the insured for financial gain. *See, e.g.*, *Lakin v. Postal Life & Cas. Ins. Co.*, 316 S.W.2d 542 (Mo. 1958) (in which a man took out an insurance policy on a business associate who was then "accidentally" shot while on a hunting trip); *Liberty Nat. Life Ins. Co. v. Weldon*, 100 So.2d 696 (Ala. 1957) (in which an aunt-in-law took out three life insurance policies on her two-year-old niece then poisoned her with arsenic-laced soda).

A STOLI arrangement is merely "a new name for an old idea." *Kramer v. Phoenix Life Ins. Co.*, 940 N.E.2d 535, 543 (N.Y. 2010) (J. Smith, dissenting). Even in the modern context, investors may harbor devious motives in the hopes of increasing their return on investment. *See, e.g.*, *First Penn-Pac. Life Ins. Co. v. Evans*, AMD 05-444, 2007 WL 1810707 (D. Md. June 21, 2007) *aff'd,* 313 F. App'x 633 (4th Cir. 2009) (in which the insured was shot in the head after assigning to investors the beneficial interest in life insurance policies totaling $8.5 million); *Angel*, 530 F. Supp. 2d at 647 (in which the insured died only five days after assigning his policy to investors). Of course, in these cases, it is by no means certain that the investors engaged in any "sinister" behavior. *See Grigsby*, 222 U.S. at 154. But certainly, while the families mourned their losses, the investors celebrated their well-placed wagers.

Additionally, the sale of STOLI policies in the secondary market raises concerns about *who*, exactly, has personal information about the insured. Mathews, *supra*, at 529. For example, a district court in Florida released information that a Columbian drug cartel had purchased life insurance policies of American citizens in order to launder money from their drug smuggling operation. *Id.* Because a STOLI policy can be re-sold many times to domestic and foreign investors, the insured ultimately has no control over who has an interest in his death. *Id.*

Moreover, even if a policy holder freely and intentionally sells his life to a stranger investor, the arrangement is no less dangerous nor less contrary to public policy. In fact, U.S. courts and legislatures have routinely intervened to prevent people from intentionally entering into dangerous agreements. *See, e.g.*, *Washington v. Glucksberg,* 521 U.S. 702 (1997) (a person may not generally consent to his own death). In sum, wagering contracts impermissibly treat humans as commodities because they have obvious risks inherent to human nature and greed, which are magnified by the insured's inability to know or control who owns his policy.

2. *STOLI policies cheat the insurance industry and harm consumers.*

Wagering contracts also violate public policy because they injure the primary insurance market and prohibitively increase insurance premiums for consumers. STOLI policies damage the insurance business because they improperly skew statistical rates, increase transaction costs, and threaten the solvency of insurance companies. Mathews, *supra*, at 531. This practice allows the gambler to "pick an insurance company's pocket," which raises premiums and makes life insurance unavailable for people who truly need it. *Id.*; *Kramer*, 940 N.E.2d at 544 (Smith, J., dissenting).

In the life insurance business, an insurance company calculates an insured's premiums based on many different factors. Mathews, *supra*, at 531. One primary factor is the "mortality rate." *Id.* Insurance companies bet that the insured will live long enough for the company to earn a profit from the premiums it collects. *Id.* Conversely, STOLI investors purposely seek out elderly people in failing health, whom they convince to buy policies for immediate resale. These transactions often include falsified medical information, which allows the investors to make a profit based on their "superior knowledge of the insured's health." *Kramer*, 940 N.E.2d at 54 (Smith, J., dissenting).

Another factor negatively affected by STOLI policies is an insurance company's "lapse rate." Mathews, *supra*, at 531. Insurance companies know that they will never pay full benefits on a certain percentage of polices whose owners permit them to lapse. *Id.* These lapsed policies are an important source of income for insurance companies, which enables them to keep premiums low for other customers. *Id.* However, STOLI arrangements usually do not lapse because investors are typically able to pay premiums until the insured's death. *Id.* Here, too, insurance companies will be forced to permanently raise premiums to compensate for this "additional and incalculable risk." *Id.*

Moreover, STOLI polices have resulted in an increased amount of litigation and transaction costs for insurance companies seeking to challenge and monitor for these illegal wagering contracts. *Id.* For these reasons, STOLI arrangements wrongfully cheat insurance companies out of their ability to earn a profit, which will naturally result in higher premiums for all consumers.

3. ***STOLI policies scam the elderly.***

STOLI schemes further violate public policy because they primarily target senior citizens, inducing them with the promise of quick cash, while failing to inform them of the negative tax consequences and loss of future insurability. Elderly individuals are clear targets for STOLI schemes because of their comparatively shorter life expectancy. *Id.* at 525. These individuals are often particularly vulnerable to the promise of a "risk-free investment with a large payoff." *Id.*

When a policy-holder sells his beneficial interest, he may be unaware that the tax consequences may "eliminate any promised financial benefit." *Id.* at 532. Life insurance proceeds are treated favorably by the IRS because their purpose is to protect and benefit the insured's family or business.[15] *Id.* However, once an insurance policy becomes merely an investment vehicle, the payout could be taxed as income or capital gains, thereby reducing the potential benefit to the beneficiary or the estate.[16] *Id.*

Furthermore, once a person has maximized his available life insurance coverage, he will be unable to obtain another policy if his insurance needs change. *Id.* at 533. STOLI promoters often withhold this information in order to maximize their profits, encouraging the individuals to procure policies with the highest possible face values. *Id.* Because STOLI polices may have negative tax consequences and result in the insured's loss of future insurability, STOLI arrangements are contrary to public policy.

In sum, STOLI polices are modern-day wagering contracts because they lack insurable interest. These illegal policies commoditize human life, harm consumers, and scam the elderly, and the benefits of STOLI—if any—do not outweigh their clear "tendency to evil." As such, because the Policy lacked an insurable interest at inception, the district court properly declared the Policy void *ab initio*.

[15] Under I.R.C. § 101(a)(2) (2006)
[16] Under I.R.C. § 72 (2006)

II. THE DISTRICT COURT ERRONEOUSLY ORDERED GUARANTY LIFE TO RETURN ALL PREMIUMS PAID ON THE POLICY.

Whether or not the Policy lacked an insurable interest, Guaranty Life is allowed to retain all premiums according to principles of contract law and equity. When a court acts to undo an express contract, it declares either that the contract is "voidable" or "void" depending on the facts of the case. *Dawe*, 28 A.3d at 1067. A contract is "void" if it is "egregiously flawed" or illegal from the outset. *Id.* When a contract is void for illegality, neither the parties to the contract—nor the court—may enforce the contract or give effect to any of its terms. *Id.*

Conversely, if one party has been induced to enter a contract through the other party's material misrepresentation, the contract is "voidable" at the injured party's option. *Id.* In such situations of "fraud in the inducement" the innocent party may elect to rescind the contract. *Id.*

In this case, the district court correctly declared that the Policy was *void* for lack of insurable interest, yet, in conflict with this holding, the court applied remedies under the *voidable* standard of rescission. Alternatively, even if this Court finds that the Policy had a *technical* insurable interest at inception, the Policy application contained numerous material misrepresentations, and therefore, Guaranty Life may properly rescind the Policy under New Tejas law and retain all premiums paid to date.

A. The District Court Declared The Policy Void, Not Voidable, And Therefore Improperly Ordered Return Of The Premiums.

Although the district court determined that the Policy was void, it erred by granting Appellant a remedy based on rescission principles when, in fact, the contract never existed. Rescission is proper only when an otherwise-valid contract is voidable at one party's option. *Penn Mut. Life Ins. Co. v. Greatbanc Trust Co.*, 09 C 06129, 2012 WL 3437161, at *5 (N.D. Ill. Aug. 15, 2012). Moreover, rescission is an equitable remedy, which requires that the parties be returned to their pre-contract positions, or the "status quo." *Id.* On the other hand, if a contract is void against public policy, the court may not grant any remedy whatsoever. *Id.* Rather, the court must leave the parties as it finds them. *TTSI Irrevocable Trust v. ReliaStar Life Ins. Co.*, 60 So. 3d 1148, 1150-51 (Fla. Dist. Ct. App. 2011). Any other action would have the "perverse effect" of eliminating all risk associated with the illegal contract. *Wuliger v. Manufacturers Life Ins. Co.*, 567 F.3d 787 (6th Cir. 2009).

As one federal court recently clarified, when a contract is void against public policy, the court may not affirmatively aid either party. *Greatbanc*, 2012 WL 3437161, at *5. In *Greatbanc*, the court was faced with an alleged STOLI scheme in which the life insurance policy at issue lacked an insurable interest, yet the trustee of the straw-man trust sought return of the premiums it paid. *Id.* Because the court declared that the policy was void *ab initio*, not merely rescinded, it refused to take any further action to avoid becoming complicit in the illegal scheme. *Id.* at *7. Further, the court criticized a Delaware federal court which had recently declared an insurance policy void *ab initio*, yet, without discernible reason, relied only on rescission cases in ordering the insurer to return the premiums. *Id.* at *6 (disapproving *Principal Life Ins. Co. v. Lawrence Rucker 2007 Ins. Trust*, 774 F. Supp. 2d 674 (D. Del. 2011)). The *Greatbanc* court held that, due to the policy's illegality, it must "drop" the suit "like a hot potato." *Id.* at *8. As such, it refused to award return of premiums to the trustee, yet *likewise* declined to affirmatively declare that the insurer could retain the premiums. *Id.* at *8. Thus, the parties were left exactly as the court found them.

Guaranty Life, likewise, seeks no affirmative declaration. In this case, because the policy was declared to be void *ab initio*, Guaranty Life could not give effect to the contract even if it elected to. *See Dawe*, 28 A.3d at 1067. Therefore, it is irrelevant that Appellee moved for rescission in its Motion for Summary Judgment because that remedy is only available to a party who could legally give effect to the contract. *See id.*; *Greatbanc*, 2012 WL 3437161, at *7.[17]

Furthermore, the district court incorrectly relied only on rescission cases in support of its decision to refund the premiums. R. at 14 (citing *Hartford Life & Annuity Ins. Co. v. Doris Barnes Family 2008 Irrevocable Trust*, CV 10-7560 PSG DTBX, 2011 WL 759554 (C.D. Cal. Feb. 22, 2011) (action for rescission, in which the court, in fact, *refused* to dismiss the insurer's claim to retain the premiums); *PHL Variable Ins. Co. v. Faye Keith Jolly Irrevocable Life Ins. Trust ex rel. Shapiro*, 460 F. App'x 899 (11th Cir. 2012) (action for rescission based on negligent

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[17]Pursuant to Fed. R. Civ. P. 8, moving for rescission was necessary in order to support Guaranty Life's alternative claim, discussed herein, in the event that the district court held that the Policy had a valid insurable interest.

misrepresentation action in which the court declared the subject policy "rescinded *ab initio*" not void *ab initio*).

Here, the trial court definitively held that the policy was void *ab initio*, yet it erroneously ordered Guaranty Life to return the premiums based on principles of rescission, thereby becoming an unwitting participant in the illegal STOLI scheme. *See Greatbanc*, 2012 WL 3437161, at *7. By returning the trust to the status quo, the district court dangerously incentivized STOLI investors by eliminating all risk associated with wagering on human life. Therefore, the district court's order should be reversed.

B. Alternatively, Guaranty Life May Rescind The Voidable Policy And Retain All Premiums Paid To Date.

Even if this Court finds that the Policy did have an insurable interest at inception, Appellee is still entitled to rescind the Policy and retain all premiums because Appellee was induced to issue the policy through false representations made during the application process. The modern disdain for insurance fraud comes from common-law roots, namely, the doctrine of *uberrimae fidei* or "utmost good faith." *See, e.g.*, *Stipcich v. Metro. Life Ins. Co.*, 277 U.S. 311, 316-18 (1928). Under this doctrine, the parties to an insurance contract had a duty to deal in "utmost good faith," and an applicant's failure to disclose all relevant facts would render the policy voidable by the insurer. *Id.*

New Tejas similarly codified this principle permitting statutory rescission when "a representation is false in a material point." N. Tej. § 1408. Notably, the statute specifies neither (1) who must make the false representation, nor (2) what degree of knowledge, if any, that person must have of its falsity. *Id.* To warrant rescission, the statute only requires that "an affirmative or promissory" material misrepresentation be made. *Id.*

Accordingly, under Section 1408, Guaranty Life is plainly authorized to rescind the Policy because the application contained numerous "representation[s]" that were "false in a material point." Moreover, such rescission is not time barred because of Appellee's proper challenge within the contestability period, or alternatively, because of Appellant's wrongful conduct. Finally, Appellee may properly retain all premiums paid to date because any lesser remedy would fail to restore the "status quo," contrary to principles of equity.

1. ***Guaranty Life may properly rescind the Policy under Section 1408 because the application contained material misrepresentations.***

As the record makes clear, rescission is proper because the application contained numerous false representations that induced Guaranty Life to issue the Policy, which are therefore "material" as a matter of law. In the insurance context, a "material" misrepresentations is a false statement in an application that affects the level of risk the insurer is willing to accept. *Am. Gen. Life Ins. Co. v. Schoenthal Family, LLC*, 555 F.3d 1331, 1340 (11th Cir. 2009) (interpreting Georgia law). In other words, misrepresentations are material if they directly induced the insurer to issue a policy when it otherwise would have refused the risk entirely or charged a higher premium. *See, e.g.*, *N.Y. Life Ins. Co. v. Johnson*, 923 F.2d 279, 281 (3d Cir. 1991) (interpreting Pennsylvania law); *Calhoun*, 596 F. Supp. 2d at 888 (interpreting California and New Jersey law).

Most courts have held that "asking specific questions on an application is in itself usually sufficient to establish materiality as a matter of law." *Groat v. Global Hawk Ins. Co.*, 1:11-CV-1412, 2012 WL 3985098, at * 3 (N.D.N.Y. Sept. 12, 2012) (internal quotations omitted); *Goldstein*, 741 F. Supp. 2d at 614 ("It is hornbook law that where the insurer seeks a specific answer, the fact elicited will usually be treated as a material one").

Other courts have adopted an objective standard to determine materiality, asking only if a reasonably prudent insurer would have issued the policy upon the same representations. *See Schoenthal*, 555 F.3d at 1331. For example, in *Schoenthal*, the insured grossly overstated his net worth and annual income in order to qualify for a $7 million policy. *Schoenthal*, 555 F.3d at 1336. The Eleventh Circuit considered only objective evidence, like the model Swiss Re Underwriting Guidelines,[18] in determining that the insured's assets did not merit a $7 million insurance policy. *Id.* at 1341. The court emphasized that, under the objective test for materiality, the inquiry is solely based upon the applicant's representations, "not a subjective standard about the actual conduct of [the plaintiff insurer]." *Id.* On these bases, the court held that the insured's false representations were "objectively material." *Id.*

Furthermore, an insurer's due diligence is not relevant to the question of materiality. A due diligence inquiry is necessary only to establish "justifiable reliance," one element of the claim for negligent or fraudulent misrepresentation,

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[18] "The[se] guidelines are used by numerous insurers and the beneficiaries described the guidelines as a model of reasonable insurance practices. Under the guidelines, [the insured's] net worth did not warrant insurance for estate planning purposes." *Schoenthal*, 555 F. 3d at 1341.

which Guaranty Life does not bring. *See, e.g.*, *Jolly*, 800 F. Supp. 2d at 1212 (N.D. Ga. 2011.

Here, the undisputed facts establish that the misrepresentations were material as a matter of law. First, the Application and supporting documents asked specific questions about Hicks's net worth and income, the answers to which were undisputedly and grossly false. See *Groat*, 2012 WL 3985098, at *3; R. at 11 (representing that Hicks's had a net worth of $1.2 billion and an annual income of $8 million, when Hicks actually lived on social security). Second, as affirmed by its Chief Underwriter, Guaranty Life would not have issued the Policy life had it actually known Hicks's true net worth. *See Johnson*, 923 F.2d at 281; R. at 12. Third, Hicks does not have an insurable value of $20 million, and a prudent insurer would decline to issue such a policy. *See Schoenthal*, 555 F.3d at 1341. Most importantly, the transaction manifestly lacked "utmost good faith." *See Stipcich*, 277 U.S. at 16. In sum, the lies in the Application were material as a matter of law because they profoundly increased the amount of risk Guaranty Life assumed in the transaction. Therefore, Guaranty Life may properly rescind the Policy under Section 1408.

2. ***Guaranty Life's challenge to the Policy is not time barred by the incontestability provision mandated under Section 1407.***

Guaranty Life may rescind the Policy because it made a timely challenge within the contestability period, or alternatively, is entitled to challenge the Policy after the contestability period because of the Appellant's wrongful conduct. Under New Tejas law, all insurance contracts must provide for a two-year period during which an insurer may contest the validity of an insurance contract. N. Tej. § 1407. Historically, the purpose of the contestability clause was to prevent insurers from denying claims based on a mere "technical mistake in the application." *Paul Revere Life Ins. Co. v. Haas*, 644 A.2d 1098, 1102 (N.J. 1994). These clauses were solely intended to benefit the insured by providing "a sense of security after the stated period elapses." *Id.* However, an insured does not deserve this "sense of security" if, by his own conduct, he has prevented the insurer from making a timely challenge. *Romano v. Metro. Life Ins. Co.*, 2 N.E.2d 661, 662 (N.Y. 1936).

In order to properly contest an insurance policy, most courts hold that an insurer must take a legal action to challenge the policy's validity within the contestability period. *See, e.g.*, *Protective Life Ins. Co. v. Sullivan*, 682 N.E.2d 624, 633 (Mass. 1997). An insurer may take legal action either as the plaintiff, by way of express challenge, or as the defendant, by refusing to enforce the policy. *Id.* Here, the Investors filed suit on January 5, 2009, for claims related to Guaranty Life's refusal to record the change of ownership forms. R. at 13. Guaranty Life could have sanctioned the Policy by yielding to suit and processing the change of ownership forms. It declined to do so. R. at 13. Rather, Guaranty Life filed an Answer within the contestability period,[19] thereby refusing to process the forms as required under the Policy. R. at 13. This action constructively acknowledged that Guaranty Life was making a contest to the Policy's validity. *See Sullivan*, 682 N.E.2d at 633. Therefore, Guaranty Life made a proper contest under Section 1407

[19] See, *supra*, n.1.

because it contested the validity of the Policy in litigation within the contestability period. N. Tej. § 1407; *see Sullivan*, 682 N.E.2d at 633.

Alternatively, even if the Answer was insufficient to constitute proper contest, the incontestability provision did not bar Guaranty Life from challenging the policy after the contestability period based on the Investors bad-faith conduct. *See Romano*,, 2 N.E.2d at 662. Months before the contestability period expired, Guaranty Life provided notice to the Investors of the possible challenge. R. at 9. While such notice alone is insufficient, Guaranty Life requested documents necessary to effect its good-faith challenge. *See Sullivan*, 682 N.E.2d at 633. Without complying with this request for information, the Investors filed a frivolous suit on January 5, 2009. R. at 13. The complaint asserted myriad bald affirmative claims on the basis of Guaranty Life's failure to record the change of ownership forms. *Id.* Though the trial court properly disposed of these claims, the investors effectively held the requested documents hostage, forcing Guaranty Life to engage in costly—and lengthy—discovery to unearth the needed information. *See Romano*, 2 N.E.2d at 662; R. at 10. As such, due to the Appellant's own bad-faith conduct, Guaranty Life was prevented from making a timely challenge within the contestability period.

Further, some courts have recognized that incontestability periods do not bar challenges when a policy was fraudulently procured. *Lincoln Nat. Life Ins. Co. v. Schwarz*, CIV.A. 09-03361 FLW, 2010 WL 3283550, at *9 (D.N.J. Aug. 18, 2010). For example, in *Schwarz*, the court discussed the "growing trend" of allowing post-contestability challenges to "confront aggressively the problem of insurance fraud." *Id.* at *10. In refusing to dismiss the insurer's challenge, the court required only that the insurer identify misrepresentations in the application process that were specifically "intended to defraud the insurer." *Id.*

In this case, material misrepresentations were made throughout the application process, which Appellant does not dispute for purposes of this appeal. *See id.*; R. at 8, 10-11, 22-23-25. As established, the false representations were made specifically for the purpose of inducing Guaranty Life to offer a larger policy than Hicks's assets merited. Therefore, even if Guaranty Life did not timely challenge the Policy, a post-contestability challenge is proper because of Appellant's bad-faith lawsuit or the Application's misrepresentations.

3. ***Guaranty Life is entitled to equitably retain all premiums upon rescission.***

The principles of rescission and restitution dictate that Guaranty Life is entitled to retain all premiums paid to date. When an insurer elects to rescind a voidable policy, the parties to the agreement must be returned to the "status quo." *PHL Variable Ins.Co. v. P. Bowie 2008 Irrevocable Trust ex rel. Baldi*, CA 10-070-M, 2012 WL 3860553, at *4 (D.R.I. Sept. 5, 2012). Though the insurer generally must return all premiums paid under the policy upon rescission, if this act would not return the insurer to the "status quo," then the insurer is entitled to be made whole in equity. *Id.* at *7. In this case, Guaranty Life will be made whole only by retaining all premiums paid to date.

First, when an insurer rescinds a voidable policy, it may properly retain the premiums necessary to offset "the costs and expenses incurred as a result of the issuance of the polic[y]." *DeRose*, 2011 WL 4738114, at *3; *see also Barnes*, 2011 WL 759554, at *5 (acknowledging that the insurer is entitled to consequential damages as a result of the rescission including underwriting costs, the payment of commissions, administrative costs, investigation costs, and other costs associated with bringing the lawsuit for rescission). Here, Guaranty Life paid $1.4 million in commissions to the producer, plus other administrative fees, in addition to the cost of bringing suit. *See id.* Therefore, upon rescission, Guaranty Life may properly retain sums sufficient to offset these losses.

Second, and more importantly, premiums are "the consideration for which the insurer agrees to assume the risk specified in the policy." *Sun Life Assurance Co. of Can. v. Berck*, 719 F. Supp. 2d 410, 418 (D. Del. 2010). Upon rescission, the rescinding party is entitled to restitution for the fair market value of its part-performance of the agreement. *Resolution Trust Corp. v. Fed. Sav. & Loan Ins. Corp.*, 25 F.3d 1493, 1504 (10th Cir. 1994); Restatement (Third) of Restitution & Unjust Enrichment: Performance-Based Damages § 38 (2011).

In this case, Guaranty Life elected to continue collecting the Trust's premium payments, which manifested its good-faith intent to keep the Policy in force pending resolution of this litigation. R. at 13 n.11. During that time, Guaranty Life "conferred a benefit" on Appellant by bearing the risk that Hicks would die, potentially obligating Guaranty Life to pay the claim. *See Resolution Trust*, 25 F.3d at 1504. The fair market value of this service is the exact amount of premiums paid to date. *See* Restatement (Third) of Restitution & Unjust Enrichment § 38(2)(b).

Even if this Court finds that the Policy had a *technical* insurable interest—albeit without good faith—the fact remains that, according to the present Policy owner, Hicks is worth much more dead than alive: $20 million, precisely. Though it may be impossible to calculate the "moral hazard" associated with the transaction, it may certainly be characterized as "risk." *See Berck*, 719 F. Supp. 2d at 418. As such, Guaranty Life deserves restitution for the risk it assumed and the insurance services it provided in part-performance of the contract. In fact, the sum of Guaranty Life's total losses and restitution are much greater than the amount Guaranty Life seeks to retain in this suit.[20] In sum, whether or not the Policy had a valid insurable interest, the district court improperly ordered Guaranty Life to return the premiums paid to date.

CONCLUSION

For the foregoing reasons, Appellee respectfully requests that this Court uphold the district court's declaration that the Policy was void *ab initio*, yet reverse the district court's affirmative order refunding all premiums to Appellant.

Respectfully Submitted,

TEAM 68
Counsel for Appellee

[20] To avoid further litigating this matter, Guaranty Life seeks only to retain the premiums paid to date, not the combined total of its offsets and restitution.

APPENDIX TABLE OF CONTENTS

NEW TEJAS STATUTES

OTHER STATES' INSURABLE INTEREST 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
Effective: until 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 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
Insurable Interest
Effective: August 28, 2009 - present

Amended to add the following sections:

(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.

Ariz. Rev. Stat. Ann. § 20-1104 (2010) (excerpted)
Insurable interest with respect to personal insurance; definition

A. Any individual of competent legal capacity may procure or effect an insurance contract upon his own life or body for the benefit of any person. But no person shall procure or cause to be procured any insurance contract upon the life or body of another individual unless the benefits under such contract are payable to the individual insured or his personal representatives, or to a person having, at the time when the contract was made, an insurable interest in the individual insured.

. . .

C. "Insurable interest" with reference to personal insurance includes only interests as follows:

1. In the case of individuals related closely by blood or by law, a substantial interest engendered by love and affection.

2. In the case of other persons, a lawful and substantial economic interest in having the life, health or bodily safety of the individual insured continue, as distinguished from an interest which would arise only by, or would be enhanced in value by, the death, disablement or injury of the individual insured.

3. An individual party to a contract or option for the purchase or sale of an interest in a business partnership or firm, or of shares of stock of a closed corporation or of an interest in the shares, has an insurable interest in the life of each individual party to the contract and for the purposes of the contract only, in addition to any insurable interest which may otherwise exist as to the life of the individual.

Cal. Ins. Code § 10110.1 (West 2005) (excerpted)
Effective: January 1, 2004 to December 31, 2009
Insurable interest; employers; time of requirement; charitable organizations

(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.

. . .

(d) 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.

(e) Any contract of life or disability insurance procured or caused to be procured upon another individual is void unless the person applying for the insurance has an insurable interest in the individual insured at the time of the application.

. . .

(g) This section shall not be interpreted to define all instances in which an insurable interest exists.

Cal. Ins. Code § 10110.1 (West Supp. 2012) (excerpted)
Effective: January 1, 2010 - present
Insurable interest; employers; trusts and special purpose entities; time of requirement; charitable organizations

Amended to add the following sections:

(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.

Del. Code Ann. tit. 18, § 2704 (West 1999) (excerpted)
Insurable interest; personal insurance

(a) Any individual of competent legal capacity may procure or effect an insurance contract upon his/her own life or body for the benefit of any person, but no person shall procure or cause to be procured any insurance contract upon the life or body of another individual unless the benefits under such contract are payable to the individual insured or his/her personal representatives or to a person having, at the time when such contract was made, an insurable interest in the individual insured.

. . .

(c) "Insurable interest" as to such personal insurance means that every individual has an insurable interest in the life, body and health of himself or herself and a person has an insurable interest in the life, body and health of other individuals as follows:

(1) In the case of individuals related closely by blood or by law, a substantial interest engendered by love and affection;

(2) In the case of other persons, a lawful and substantial economic interest in having the life, health or bodily safety of the individual insured continue, as distinguished from an interest which would arise only by, or would be enhanced in value by, the death, disablement or injury of the individual insured;

Fla. Stat. Ann. § 627.404 (West 2011) (excerpted)
Insurable interest; personal insurance

(1) Any individual of legal capacity may procure or effect an insurance contract on his or her own life or body for the benefit of any person, but no person shall procure or cause to be procured or effected an insurance contract on the life or body of another individual unless the benefits under such contract are payable to the individual insured or his or her personal representatives, or to any person having, at the time such contract was made, an insurable interest in the individual insured. The insurable interest need not exist after the inception date of coverage under the contract.

. . .

(b) "Insurable interest" as to life, health, or disability insurance includes only the following interests:

1. An individual has an insurable interest in his or her own life, body, and health.

2. An individual has an insurable interest in the life, body, and health of another person to whom the individual is closely related by blood or by law

and in whom the individual has a substantial interest engendered by love and affection.

3. An individual has an insurable interest in the life, body, and health of another person if such individual has an expectation of a substantial pecuniary advantage through the continued life, health, and safety of that other person and consequent substantial pecuniary loss by reason of the death, injury, or disability of that other person.

N.J. Stat. Ann § 17B:24-1.1 (West 2006) (excerpted)
Insurable interest

a. For the purpose of life insurance, health insurance or annuities:

(1) An individual has an insurable interest in his own life, health and bodily safety.

(2) An individual has an insurable interest in the life, health and bodily safety of another individual if he has an expectation of pecuniary advantage through the continued life, health and bodily safety of that individual and consequent loss by reason of his death or disability.

(3) An individual has an insurable interest in the life, health and bodily safety of another individual to whom he is closely related by blood or by law and in whom he has a substantial interest engendered by love and affection. An individual liable for the support of a child or former wife or husband may procure a policy of insurance on that child or former wife or husband.

b. No person shall procure or cause to be procured any insurance contract upon the life, health or bodily safety of another individual unless the benefits under that contract are payable to the individual insured or his personal representative, or to a person having, at the time when that contract was made, an insurable interest in the individual insured.

N.Y. Ins. Law § 3205 (McKinney 2006) (excerpted)
Insurable interest in the person; consent required; exceptions

(a) In this section:

(1) The term, “insurable interest” means:

(A) in the case of persons closely related by blood or by law, a substantial interest engendered by love and affection;

(B) in the case of other persons, a lawful and substantial economic interest in the continued life, health or bodily safety of the person insured, as distinguished from an interest which would arise only by, or would be enhanced in value by, the death, disablement or injury of the insured.

(b)(1) Any person of lawful age may on his own initiative procure or effect a contract of insurance upon his own person for the benefit of any person, firm, association or corporation. Nothing herein shall be deemed to prohibit the immediate transfer or assignment of a contract so procured or effectuated.

(2) No person shall procure or cause to be procured, directly or by assignment or otherwise any contract of insurance upon the person of another unless the benefits under such contract are payable to the person insured or his personal representatives, or to a person having, at the time when such contract is made, an insurable interest in the person insured.