



The Rose of DeRose

By: Brian T. Casey and Thomas D. Sherman

Another insurable interest set-back recently occurred for the life insurance company industry, this time in Pennsylvania. Judge Christopher Connor, federal United States District Court Judge for the Middle District of Pennsylvania, in an opinion filed on October 5, 2011, in *Principal Insurance Company v. Mark DeRose et al.*, applied Pennsylvania law and adopted a "Kramer-like" [*Alice Kramer v. Phoenix Life Insurance Company, et al.*, 940 N.E.2d 535 (N.Y. 2010)] approach to ascertaining the existence of a valid insurable interest in the life of an insured under a life insurance policy. He concluded, "Neither this court nor the Pennsylvania Supreme Court can engraft an intent or good faith requirement into [40 Pa. Cons. Stat.] Section 512 based on its own policy preferences."

In *DeRose*, the insured, through a life insurance trust she formed, applied for and then paid the initial premiums for life insurance policies in the face amount of \$35,000,000. Shortly after the initial premium payments and the issuance of the policies by Principal, the trust entered into a non-recourse \$1,515,000 premium finance loan. The policies were the sole collateral for the loan.

Before the expiration of the contestability period, Principal filed a declaratory judgment action in federal District Court in Pennsylvania seeking to rescind the life insurance policies for lack of insurable interest and fraud/misrepresentation on the life insurance policy applications.

This decision is wholly consistent with last year's widely reported opinion of the New York Court of Appeals in *Kramer*, wholly consistent with the May 17, 2011, opinion of the Fourth Appellate District Court of Appeals in California, *Lincoln Life and Annuity Company of New York v. Jonathan S. Berck*, and generally consistent with a recent decision by the Delaware Supreme Court.

The Delaware Supreme Court in *PHL Variable Insurance Company v. Price Dawe 2006 Insurance Trust*, September 20, 2011, on a certified set of questions from a federal District Court in Delaware, also concluded that the intent of an insured to transfer a policy on his own life is not the relevant inquiry for purposes of the insurable interest requirement. The Delaware Supreme Court, however, added an additional inquiry to the analysis with respect to life insurance policies issued in Delaware and went on to state that the inquiry instead focuses on who actually caused the policy to be procured. The court wrote, "...[A] third party cannot use the insured as a means or instrumentality to procure a policy that, when issued, would otherwise lack an insurable interest....If the insured procures the policy at the behest of another, the policy may, nevertheless



lack a legally insurable interest. To determine who procured the policy, we look at who pays the [life insurance policy's] premiums. A bona fide insurance policy sale or assignment requires that the insured take out the policy in good faith — not as a cover for a wagering contract.” However, in New York, California and now Pennsylvania, courts will not entertain this type of an analysis of the insured’s intent or good faith.

The Pennsylvania Supreme Court had not ruled on the insurable interest issue, but Judge Connor in *DeRose* stated that he was required to apply substantive Pennsylvania law to the case and predict how the Pennsylvania Supreme Court would rule on the issue. “As the most analogous decision to the instant case, the Pennsylvania Supreme Court would find *Kramer* to be persuasive.”

Accordingly, the defendant trust was entitled to summary judgment on the issue of insurable interest — *i.e.*, Principal lost the insurable interest issue as a matter of law, but Principal has not yet lost the war. Its challenge to the validity of the policy based on misrepresentations in the policy application survived defendants’ motion for summary judgment, and Principal’s claim that it is entitled to retain the premiums it received for the life insurance policy is alive if it can prove that the misrepresentations were fraudulent, presumably a higher standard than that required for it to rescind the policy for misstatements on the policy application.

Analytically, the New York, Delaware, California and Pennsylvania insurable interest statutes are all constructed similarly, although some purists might quarrel with that conclusion, especially insofar as it relates to New York law. In any event, it cannot go without mention that the laws in at least California and New York have changed since the policies under contest had been issued, and the results might have been different and more favorable to the life insurance companies under the new “STOLI” statutes.

So, on the insurable interest score card of recent cases and prevailing trends, the life insurance companies seem to be winning the major battles as to when they can challenge insurable interest (even after the expiration of the contestability period except in NY and MI) but losing what many consider to be the more significant fight on whether the intent of an insured to sell a life insurance policy after he/she procures it on his/her own life is relevant to the insurable interest inquiry.

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