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Tis the Season to be Jolly

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The Eleventh Circuit Federal Court of Appeals recently rebuffed the effort of PHL Variable Insurance Company to retain $484,000 in life insurance premium payments made with respect to a life insurance policy that it had been able to rescind based on fraudulent misrepresentations of the insured contained in the policy's application. *PHL Variable Life Insurance Company v. The Faye Keith Jolly Irrevocable Life Insurance Trust, et al*.

PHL sued the insured and the trust one day before the policy's contestability period expired on the basis of fraud on the application (Net worth of $1 billion in uncut emeralds). The trustee was apparently unrelated to and independent from the insured.

The insured failed to file an answer, and the trial court entered a default judgment against the insured and ordered the policy rescinded.

PHL then continued its suit against the trust and the trustee and sought a judgment that would permit PHL to retain the premiums, in excess of $484,000, it had received for the policy. PHL also sought damages for its attorneys' fees and the commissions it had paid to the life insurance agent who sold the policy.

The trial court ruled for the defendant trust and held that PHL's claims for negligent misrepresentation and conspiracy should be dismissed. The trial court ordered the return of the premiums to the trust, but to be held in the registry of the court until PHL's appeal of the trial court's ruling was decided.

The Eleventh Circuit, in a March 14, 2012, decision, affirmed: "Georgia law generally requires an insurer seeking to rescind an insurance contract to return any premiums paid under the contract, even where the insured person originally obtained the policy by fraud."

The insured and the trustee both signed the insurance application, but the trustee qualifiedly affirmed the insured's net worth representation "*to the best [of his] knowledge and belief.*"

Georgia law views this statement to have different meanings in different contexts, per the trial court opinion, but in the life insurance policy context, the trial court held that, "when an alleged misrepresentation is based on the defendant's knowledge and belief regarding information the

defendant does not control, then the 'party to whom it has been made is not justified in relying upon it and assuming it to be true; he is bound to make inquiry and examination for himself so as to ascertain the truth.'"[citations omitted]

The insurance company did a poor job of due diligence in its review and acceptance of the life insurance application and ignored, for the most part, several red flags for indicia of misrepresentations or fraud according to the trial court (the insured had refused to provide income tax returns, for example).

The trial court had held, "Georgia law places a significant due diligence burden on sophisticated parties engaged in arms-length transactions."

Plaintiff argued that the defendant trust/trustee could not have had a reasonable basis to "believe" the statements of the insured to be true.

However, the trial court had held, "what the applicant in fact believed to be true is the determining factor in judging the truth or falsity of his answer, but only so far as that belief is not clearly contradicted by the actual knowledge on which it is based." Here, the trust/trustee did not actually know that the insured's representations were false – and the court imposed no due diligence obligation [due inquiry] on the trust/trustee in that regard – rather, the due diligence burden was on the insurance company.

The Eleventh Circuit held that since there was no evidence that the trust owner/applicant did not read the life insurance application or that the trustee actually knew the representations of the insured to be false, PHL's negligent misrepresentation claim failed under Georgia law.

What is very important in this analysis is that if the insured had been the sole applicant and the owner, rather than the trust, then the carrier's claim for its retention of the premiums might have been a good one. That is a very important distinction/fact in this case. Florida, for example, is one of several states that holds that a court will permit rescission of a life insurance policy based on fraud and leave the parties otherwise where it finds them, *i.e.*, the insurance company has no duty to refund the premiums.

Nevertheless, this case stands for the clear proposition that a life insurance company cannot blithely ignore 'red flags' of insurance application fraud or misrepresentations during the underwriting/application process and then, two years later, attempt to keep the premiums paid on a rescinded policy.

For more information on the matters discussed in *Locke Lord's QuickStudy*, please contact the authors:

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