WRNewswire
An AALU Washington Report

Tuesday, 2 December 2014 **WRN# 14.12.02**

TOPIC: Court of Appeals Denies Motion to Vacate Summary Judgment and Sets Damages in STOLI Cases Where the Policies Were Previously Found Void *Ab Initio*

CITES: *Ohio National v. Davis*, 2014 WL 5420057 (N.D.Ill. 2014); *Kramer v. Phoenix Life Insurance Co.*, 940 N.E.2d 535 (N.Y. 2010).

SUMMARY: Ohio National brought suit alleging that Douglas Davis, Paul Morady, and Mavash Morady conspired to procure life insurance policies from them for people in whose lives Davis and the Moradys did not have an insurable interest. Steven Egbert, who purchased one of the five policies at issue, was also named as a defendant. All of the policies were determined to be void *ab initio*. Ohio National was allowed to retain premiums—except those premiums paid by Egbert—who was not a participant in the fraud. In this more recent decision, the defendants' motions to vacate summary judgment were denied and the court entered judgment in favor of Ohio National for $725,666. Ohio National was also allowed to retain nearly $350,000 in premiums.

FACTS: Douglas Davis is an attorney and estate planner who gave estate planning seminars. In 2004 or 2005, Davis joined with Paul Morady to offer a trust-owned non-recourse premium financing arrangement to pitch to Davis' prospective clients.

During his presentations, Davis explained that the primary reason people chose to participate in the program was to purchase new life insurance policies to sell. Davis explained that he and Morady would arrange for the following:

(1) a trust would be created to hold the life insurance policy,
(2) the trust would apply for the insurance policy on the life of someone who chose to participate in the arrangement and
(3) a third-party buyer would purchase the beneficial interest from the trust.

The trust would make premium payments through a premium financing arrangement. It was understood by all parties that, since the insureds lacked the financial ability to repay the premium finance loan and pay premiums to maintain the policies, that the loans would never be paid off and the policies would not be maintained. Everyone involved expected that the policies would be all be sold to investors and the insureds would receive cash in return.

In July of 2006, Paul Morady's wife, Mavash Morady, obtained a license to sell life insurance in Illinois. She became an Ohio National agent in October of 2006.

Paul Morady established an entity called Security Pacific Premium Financing (Security Pacific), with himself as the sole owner, chairman and chief executive officer. This company was established to provide the premium financing for the insureds. Morady also created an entity named Camden Investment Holdings, Inc. (Camden). This company was apparently created to purchase the beneficial interests in the life policies from the insureds' trusts, and subsequently sell those interests to third party investors.

At issue in this case were five life insurance policies issued by Ohio National. Davis prepared irrevocable life insurance trusts for each of these policies. All five individual insureds signed documents permitting Mavash Morady to apply for the policies with Ohio National on their behalf. All five individuals financed the premiums on their policies through Morady's Security Pacific company.

The beneficial interests in all five of their trusts were sold to Morady's Camden company. With the exception of Shirlee Davis, who was Douglas Davis' mother, *none* of the insureds had any relationship with Davis beyond the transactions at issue in this case. In fact, prior to the case, none of the insureds had ever heard of the Moradys. Although the exact understanding of each insured differed somewhat, every one of the insureds understood that they were "selling their insurability" to investors.

Defendant Egbert purchased the beneficial interest in one of the contracts from Camden. The insured was paid $6,000 for participating in the arrangement by Camden, which also paid the first premium of $16,040. The beneficial interest was sold to Egbert for $69,512, a gross profit of $47,472.

Despite the short period of time that the policy had been in existence, the record provides no evidence suggesting that Egbert performed any due diligence to determine the existence of insurable interest.

In addition to the court holding that Davis and the Moradys conspired to procure invalid life insurance policies, the court ruled that Mavash Morady's conduct constituted fraud and that it breached her agency contract with Ohio National.

Under Illinois law, Mavash Morady's admission that she knew that the policies were premium financed and that she signed the applications without ever meeting the insureds or taking any action to verify the false information contained in the applications was sufficient for the court to grant Ohio National's motion for summary judgment on its fraud claim.

RELEVANCE: As reported in *Washington Report 14.02.21*, the original opinion contained a number of relevant points.

First, the action was commenced more than two years after the policies were issued. However, in spite of that, the court held that the two-year contestability rule did not apply to life insurance policies which were found to lack insurable interest. The court held that because the lack of insurable interest meant the policies (and therefore any contestable clause contained in the policy) never came into existence, they were void *ab initio*.

Second, the court also refused to follow the New York case of *Kramer v. Phoenix Life Insurance Co.*. *Kramer* held that under New York law an insured was free to transfer a policy on his or her life to someone who had no insurable interest. The *Davis* court first noted that it was not bound to apply New York law. Then it also stated that Kramer had named his children as beneficiaries and after the policy had been issued and received, his children sold their beneficial interests. *Here*, by contrast, the court noted that the insured sold his life insurance policy even *before* a final application for the policy had been submitted on his behalf.

Third, the court rejected Egbert's argument that Ohio National waived its right to contest the fact that the policy was void *ab initio* because a policy of insurance cannot be voided by the insurer based on facts which were known to the agent.

Fourth, the court also rejected the argument that Ohio National had "recognized the continued validity of the policy" by retaining the premiums paid. Points three and four were rejected because the policies were procured without an insurable interest, and thus, were void *ab initio,* meaning that they were treated as though the never existed. This was very significant because, if fraud had been the *only* basis for Ohio National's claim, the action seemingly would have been barred by the two year incontestable provision.

Fifth, the case is also relevant for the result afforded Egbert. Here, the court found no dispute that Ohio National had "retained a benefit to [Egbert's] detriment." Hence, the court found that the pertinent questions were whether restitution of the premiums to Egbert would "frustrate the policy of the underlying prohibition," and whether restitution "is foreclosed by the claimant's inequitable conduct." The court found that the evidence showed that Egbert was not complicit in the program perpetrated by Davis and the Moradys. Instead, the court found that Egbert merely failed to sufficiently investigate whether there was an insurable interest and "without any allegation or evidence that Egbert is liable for procuring the Bonaparte policy, there is no basis for the Court to find that it would be just for Ohio National to retain the premiums Egbert paid." On the other hand, premiums paid by Paul Morady could be retained by Ohio National because of Morady's participation in the fraud and premiums paid by Egbert had to be returned.

This more recent decision contained several *additional* items of relevance.

First, the court allowed Ohio National to keep the premiums (other than those paid by Egbert who was not a party to the fraud) because it found that "Ohio National was also injured by having incurred risk of paying death benefits" even though no death benefits were actually paid. This is important in that it recognizes that a company providing death benefit coverage is damaged merely by being on the risk *even if no claim is paid*.

Second, the court imposed over $600,000 in damages for attorney fees and related court costs. Ordinarily, court costs are not recoverable. However, an exception to the general rule against recovery of attorney's fees is the doctrine of third party litigation under which a party can be reimbursed for costs associated with necessary litigation against others caused by the defendant's actions. In this case, Ohio National had to bring suit to get the policies declared void *ab initio* to prevent it from paying future death claims. This portion of the litigation was considered separate from the breach of contract and fraud claims made against Davis and the Moradys.

Third, although the court declined to impose punitive damages, the discussion of such damages was still important. The court stated that punitive damages were not appropriate because the misrepresentations were not "relevant to the insureds' life expectancies…." Interestingly, it didn't appear that an argument was made that financial status has an impact on mortality. Had an effort been made to show that financial misrepresentation could impact mortality, it is possible that the court *would* have awarded punitive damages.

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