WRNewswire

An AALU Washington Report

The WRNewswire is created exclusively for AALU Members by insurance experts led ***by Steve Leimberg, Lawrence Brody and Linas Sudzius***. ***WRNewswire #16.5.20*** was written by ***Steve Leimberg,*** co-author with ***Howard Zaritsky***, of Tax Planning With Life Insurance, Publisher of Leimberg Information Services, Inc. (LISI) and Creator of NumberCruncher Software.

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Friday, 20 May 2016 WRN 16.05.20

TOPIC: Federal Appeals Court Confirms Decision to Allow Insurer's Rescission of STOLI Policy and Retention of Premiums

CITATION: *PHL Variable Insurance v. Sheldon Hathaway Family Trust*, No. 15-4028 (10th Cir. Apr. 22, 2016).

SUMMARY: Windsor Securities, LLC gambled on the lives of the elderly by loaning the Sheldon Hathaway Family Trust $200,000 to finance the initial premium on a policy on Sheldon Hathaway's life. In exchange, Windsor expected to "foreclose on the life insurance policy that was pledged as collateral" when the trust failed to repay the loan – which is what happened in this case. But before Windsor could profit from its investment—either by selling the policy or by capitalizing on Hathaway's death—PHL Variable Insurance Company (PHL) sued to rescind the policy based on alleged misrepresentations in Hathaway's insurance application. The district court granted PHL's motion for summary judgment on its rescission claim *and* it allowed PHL to retain the premiums already paid.

On appeal, this court denied all three of the trust's and Windsor's claims and concluded (1) there was no genuine dispute of material fact as to whether PHL waived its right to rescind the policy, (2) there was no genuine dispute of material fact as to whether the application contained a misrepresentation or whether PHL relied on that misrepresentation in issuing the policy, and (3) the district court had authority to allow PHL to retain the paid premiums.

Accordingly, this court affirmed the holding of the district court allowing both the rescission and the retention by the insurer of all premiums paid.

RELEVANCE: Yet another court has allowed the recession of a STOLI policy and refused to further incentivize the fraud that would occur if it required the insurer to return premiums to an entity implicated in a STOLI transaction.

This case provides a review of how a court will view misrepresentation on an application where it is blank when signed. Misrepresentation occurs if the applicant knows or *should* have known about a misstatement in the application and still presents it to the insurer. Here, the court noted that:

> even assuming Hathaway didn't know the application misstated his net worth because it was blank when he signed it, there can be no doubt that he should have known. Hathaway acquiesced to Sullivan's calculations, despite knowing of their inaccuracy. Thus, even viewing the facts in the light most favorable to the defendants, Hathaway should have known the application contained a misstatement about his net worth.

FACTS: Sheldon Hathaway, an illiterate retired welder living in Utah, became involved in a STOLI scheme when his neighbor, Jay Sullivan, an insurance agent, showed him a brochure which promised "free insurance." It stated that if the applicant allowed his life to be insured, upon the sale of the policy after two years, he would be paid $300,000.

Hathaway had a home worth about $380,000, farmland valued at $340,000, some farm equipment, an older Jeep, and a Ford truck. His annual income from Social Security and company pensions totaled $30,000. But Sullivan listed Hathaway's net worth on the application as $6,250,000 and his income as $484,500 – numbers both Hathaway and Sullivan knew were highly inflated. The application also contained representations that premium financing would not be used to pay policy premiums, and that neither

Hathaway nor the Family Insurance Trust had any intent or plan to transfer any interest in the policy to a third party.

Through a series of intermediaries, including Gabriel Giordano and Crump Life Insurance Services, Inc., the application eventually reached PHL. PHL then sought confirmation of Hathaway's net worth from Infolink, a third-party service that verified the calculations in the application, ostensibly based on a conversation with Hathaway. Later, PHL would learn Infolink never contacted Hathaway.

In the meantime, Sullivan assisted the trustee—Hathaway's son, David—in obtaining the initial $200,000 premium payment from a San Diego law firm that Windsor later reimbursed, and PHL issued the policy to Hathaway on January 31, 2008.

Later that year, PHL became suspicious of Giordano and began an internal investigation into the policies he originated. As a result of that investigation, PHL sent Hathaway a letter on May 5, 2009, requesting additional information about certain representations in the application and warning that failure to provide that information might lead to rescission of the policy.

When Hathaway didn't respond, PHL filed suit to rescind the policy on January 28, 2010. The district court granted summary judgment in favor of PHL, and authorized it to keep the premiums.

Windsor's appeal resulted in this case.

As noted above, the trust and Windsor made three arguments to the appeals court:

1. there was a genuine dispute of material fact as to whether PHL waived its right to rescind the policy,

2. there was a genuine dispute of material fact as to whether the application contained a misrepresentation or whether PHL relied on that misrepresentation in issuing the policy, and

3. the district court had no authority to allow PHL to retain the paid premiums.

But this court found that none of those arguments were persuasive and accordingly affirmed the holding of the district court allowing both the rescission and the retention by the insurer of all premiums paid.

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