



WRNewswire

An AALU Washington Report

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TOPIC: Dispute Concerning Payment of Premiums to Determine Whether Whole Life Conversion to Term By Carrier Was Proper

CITATION: [Hill v. State Farm Ins. Co.](#), No. 8:15-CV-1662 (U.S.D.C. M.D.Fla. April 1, 2016).

SUMMARY: A Florida federal court recently denied a carrier’s motion to dismiss a lawsuit regarding whether a conversion from whole life to term was proper under the policy terms. The policy owner held two whole life policies containing an Automatic Premium Loan (APL) provision that, when activated, empowered the carrier to pay any unpaid premium by taking out a loan against the policy. Specifically, at the end of a grace period, if the premium remained unpaid, the APL would be triggered and the insurer would pay the premium after taking a loan out from the policies. The policies would then be automatically converted to extended term life insurance.

State Farm allegedly activated the APL provision in 2009 for one policy, and in 2010 for the other. In doing so, it treated the underlying policies as having been surrendered and reported such to the IRS.

The policy owner filed suit alleging that, although he was current on all premiums, State Farm, in breach of contract and without notice, improperly activated the APL and

he was damaged by the resulting consequences. The insurer, State Farm, countered that the policy owner failed to pay his premiums on time and that its actions were proper and authorized under the policies.

RELEVANCE: The primary factual issue to be decided in this case is whether the policy owner was current on his premiums. Regardless of the outcome, however, the fact that the parties must litigate whether the premium payments were current should serve as a reminder about how important it is to for policy owners and agents to exercise diligence in keeping up with the status of premium payments. Indeed, as we have reported before, policy owners, in addition to monitoring premium payments on their own, should remain in communication with their agents to ensure that premium payments are up-to-date. Since agents are routinely copied on lapse notices, they should quickly follow up with a policy owner when a grace period or lapse notice is sent to a client. Had either of these happened here, the activation of the APL, conversion and resulting aggravation, legal costs, and tax consequences could have been avoided. Moreover, an agent's ethical obligations, even potential legal duty under some circumstances, and good business practices (if for no other reason, assurance of continuation of commissions) should all be an incentive for an agent to quickly contact a policy owner when a grace period or lapse notice is received.

FACTS: In the late 1960s, David Hill, a Florida resident, purchased two whole life insurance policies from a State Farm agent located in Ohio. The first policy was purchased in 1967 and the second policy was purchased in 1970. According to Hill he "told the agent that it was important for him to have flexibility regarding the payment of premiums" and that the agent stated "that 'there would not be any negative consequences if he was to stop paying the premium[s] on the whole life insurance polic[ies], and that the polic[ies] would not cancel, [they] would just not increase in value as much.'"

Purportedly relying on these statements, Hill purchased the two policies. The 1967 policy's premium of \$178.60 was due annually on November 9 and the 1970 policy's premium was due annually on September 2. "The policies also provide for a thirty-one-day grace period for the payment of premiums, and if a premium remains unpaid at the end of the grace period then the 'policy shall lapse, except as provided under'" the APL provision.

The APL is described in the policy as "an option that a policyholder may elect that empowers State Farm to pay an unpaid premium by taking out a loan against the policy. "Hill chose this option for both policies. "In the event of non-payment, after the

[APL] has been applied, the terms of the policies provide that the whole life insurance policies will automatically be converted to extended term life insurance policies." The policies further state that "[t]his provision shall be automatically applied if any premium or balance thereof remains unpaid at the end of the grace period after application of any credits, including the [APL] if elected by the insured."

According to the complaint, Hill alleged that, although he paid all premiums due on both policies through 2009, State Farm activated the APL provisions on the policies in November 2009 on the 1967 policy and January 2010 on the 1970 policy, thereby converting them to term life insurance and paying out their respective benefits. Specifically, the charges state that State Farm "paid allegedly outstanding premiums on Hill's behalf, charged debts against the policies, and reported to the Internal Revenue Service gross distributions to Hill related to each policy." For the 1967 policy, the outstanding premium, debt charged, and gross distribution reported to the IRS were \$178.60, \$25,383.60, and \$41,071.00, respectively. For the 1970 policy, the outstanding premium, debt charged, and gross distribution reported to the IRS were \$251.00, \$32,845.00, and \$32,845.00, respectively.

Hill alleged that he never received any notice from State Farm that it was activating the APL or taking any of the aforementioned actions and that he never received a distribution from either policy. Furthermore, "Hill asserts that because he was unaware of State Farm's actions, he did not report the distributions to the IRS, and as a result the IRS audited him, required him to pay back taxes, imposed a penalty, seized his \$4,165.00 tax return for 2013, and has since been garnishing his social security benefits." Consequently, Hill filed suit against State Farm for fraudulent inducement and breach of contract in state court in Florida. State Farm removed the case to federal court and filed a motion to dismiss, or in the alternative to strike, Hill's complaint. The court granted State Farm's motion in part and denied it in part.

The court dismissed the fraudulent inducement claims holding that "a party is not justified in relying on oral representations that conflict with the terms of a subsequent written contract." In his complaint, "Hill asserts that for both policies State Farm's agent represented to Hill 'that there would not be any negative consequences if he was to stop paying the premium[s] on the whole life insurance polic[ies], and that the polic[ies] would not cancel, [they] just would not increase in value as much.'" According to the court, "[t]his is the sole statement that Hill alleges fraudulently induced him into entering into the two whole life insurance policies. However, both policies specifically address what would happen should Hill fail to pay his premiums."

Specifically, according to the court, the APL provisions, “which Hill affirmatively selected when he applied for the policies,” state “that if he does not pay the policies’ premiums then State Farm would automatically take out a loan against the policies on Hill’s behalf to pay the unpaid premiums. Further, the Extended Term Insurance provision provides that, after the [APL] is applied, the whole life insurance policies would be automatically converted to term life insurance policies, with State Farm paying the benefits according to a detailed plan provided in each policy. Thus, the consequences of not paying the policies’ premiums were expressly explained in the policies’ terms” and Hill could not justifiably rely on any purported oral representations regarding the failure to make premium payments.

With regards to the breach of contract claims, Hill alleged that State Farm breached the insurance contracts when it activated the APL provisions because he was current on each policies’ respective premiums. State Farm countered that Hill failed to pay his premiums and therefore activation of the APL was authorized under the policies.

As succinctly stated by the court, “[t]he sole issue is whether Hill did in fact pay the policies’ premiums. If he did, then, taking the allegations in the Amended Complaint as true, State Farm breached the contracts when it made loans against the policies, converted the term life insurance policies to whole life insurance, and distributed the policies’ benefits; those actions were only authorized when premiums were unpaid. If Hill did not pay the policies’ premiums, then State Farm’s actions could be considered proper under the terms of the policies and would not have breached the two contracts.” Consequently, Hill has “sufficiently stated a claim for breach of contract for each of the policies that is plausible on its face” and the court dismissed State Farm’s challenge to the legal sufficiency of the breach of contract claims.

State Farm also asked the court, alternatively, to strike all of Hill’s allegations regarding damages resulting from any actions taken by the IRS in response to the conversion. State Farm argued it is not liable for these damages. However, the court denied this motion holding that “[i]f State Farm did indeed breach its contracts with Hill, fail to notify Hill of its actions, and then report those actions to the IRS, as Hill alleges, then it is reasonable to expect the IRS to take action against Hill when he inevitably fails to report the distributions that he does not know about. Thus, the IRS’s actions against Hill appear from the pleadings to have ‘arise[n] naturally from the breach[es].’” This case will therefore continue and we’ll keep AALU members informed when it reaches a final outcome.

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