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 # 16.08.15** was written **by James S. Bainbridge, Esquire of The Bainbridge Law Firm, LLC.**

The AALU WRNewswire and WRMarketplace are published by the Association for Advanced Life Underwriting® as part of the Essential Wisdom Series, the trusted source of actionable technical and marketplace knowledge for AALU members—the nation's most advanced life insurance professionals.

Monday, 15 August 2016 **WRN 16.08.15**

TOPIC: Appellate Court Upholds Dismissal of Misrepresentation Claims Where Policy Owner Alleged Carrier Improperly Raised Premiums

CITATION: C&C Family Trust, et al. v. AXA Equitable Life Ins. Co., et al., No. 15-12534 (11th Cir. June 20, 2016).

SUMMARY: In WRNewswire #14.9.16, we reported on a case where a Georgia federal court ruled in favor of an insurer and a producer after fraud claims were brought by a policy owner. The charges were brought because of a purported "unexpected and significant increase in premiums." The policy owner alleged that it was told that the premium outlays and paid-up date on a universal life policy were "guaranteed" not to change during the life of the policy. Relying on the express language of the policy, including the policy's merger clause, the district court dismissed the policy owner's fraud claims. On appeal, the appellate court affirmed the dismissal of the policy holder's claims.

RELEVANCE: In our prior article on this case, we urged that agents should practice caution with respect to promises or statements that could be considered

assurances that premiums will not significantly increase. This warning has not changed. While the trust's fraud claims were dismissed here based upon the merger clause (barring reliance on any written or oral statements made before delivery of the policy) in the policy, courts have routinely permitted similar fraud claims to proceed in the past—in some cases —even in the face of similar policy language.

Although the end result here was an eventual legal victory for the carrier and agent, agents and brokers and other advisors must continually remind themselves how confusing and complex life insurance illustrations can be to those outside the insurance community (as well as all too many within it). Understanding and properly explaining an illustration takes expertise gleaned from years of experience. It is not hard to see how lay clients who do not work in this field can be easily mislead or "hear what they want to hear" or improperly or incompletely understand what they have been told. For example, terms such as "guaranteed illustrations" and "current illustrations," when not fully and properly explained, can lead a client to be unsure of what is really guaranteed and what is merely a projection. This very common problem—and the lack of full understanding with regard to the major differences between the way modern universal life and older and more traditional policies operate—is at the root of the instant case.

Indeed, this case highlights the general public's misunderstanding of universal life policies. While the court framed the issues raised by the policy owner in the terms of an alleged "increase in premiums," with a universal life policy the insurer cannot and does not "raise the premium" on these policies. What it technically reserves the right to do is to (a) lower the interest credited (b) increase the cost of insurance (COI), or (c) do both. Without a proper explanation at the time of sale from the agent and carrier, an insurer's reduction in the interest credited to the policy, or a COI increase, could lead the policyholder to believe that the unanticipated and sometimes shocking increase in outlay required to maintain the policy's death benefit – is an increase in "premiums," an event they "were promised would not happen." That of course, by definition, is not the case with a universal life policy where the policy owner may enjoy significant financial and flexibility "upsides" previously unavailable – but at the trade-off cost of assuming greater risk. It appears that is the case here, and perhaps a better explanation of how universal policies function may have helped

prevent this lawsuit as well. The best practice would be to not only explain at the outset how the contract "works" – but also promise to return after a given period of time to review the policy and assure that the client properly understands what he or she was originally told.

When considering the "positive" outcome of this case, keep in mind that the defendants still had to incur the legal and opportunity costs, adverse publicity, and the aggravation and stress of being sued by their client for fraudulent misrepresentation. This may all have been prevented, however, had the agent explained in detail—and in writing—the difference between projections and guarantees, as well as the potential rewards and benefits, but also the possible downsides and risks, of purchasing a universal life policy.

Finally, when making these distinctions to clients, it is equally as important for the agent to make and retain written contemporaneous notes or otherwise document what he or she is telling a client throughout the process. Such documentation significantly reduces the risk of losing a legal argument about what a client was "promised" or "guaranteed" or in some way "assured." In fact, had the agent here done so, it's highly likely that litigation in this case could have been avoided.

FACTS: In August 2005, AXA issued a $4,000,000 flexible premium universal life insurance policy to the C&C Family Trust. The policy was issued on the life of Claude Ott. The policy was used to fund a life insurance trust that was part of a divorce settlement between Claude Ott and his wife, Cynthia Cox-Ott, the beneficiary of the trust. Cynthia Cox-Ott alleged that, before taking out the policy, she had several discussions with the producer who was also a defendant, who showed her illustrations and projections that she alleges she was told were "guaranteed."

Consequently, "[i]n August 2005, Cynthia, as trustee, selected a policy, which she believed provided for a flat annual premium of $88,000 until Claude (then 67) turned the age of 90 with no premiums required thereafter. (At the district court level the trustee alleged that she was told the premium would remain flat until Claude reached the age of 83. On appeal, without explanation, the trustee used the age of 90, so the appellate court did so as well).

On February 16, 2006, the policy was delivered to the trust. Eight days after the policy was delivered, Cox-Ott discussed the policy with the agent, at which time it is alleged he "provided Cynthia with an 'Original Illustration' listing the 'guaranteed annual premium amount'" of $88,000. Based on these alleged representations, the trustee stated that she decided to keep the policy in force. After paying the initial premium of $165,800, the trust made annual payments of $88,000 to AXA.

In 2012, the trustee received an "Annual Report" showing "conflicting notices, projections and illustrations" – numbers that differed significantly from those that were allegedly "guaranteed" by AXA and the agent. Subsequently, the trust retained counsel and wrote to AXA to obtain clarity as to the paid-up date and projections contained in the annual report. AXA did not respond to inquiries from the attorney. The trustee then filed a complaint with the Georgia Insurance Commissioner. Two months later, AXA "informed the trust that premium increases would be required to keep the policy in force."

Subsequently, the trust filed a lawsuit against AXA on the basis that AXA and the producer misrepresented the policy's "guaranteed" values and annualized premium outlays. The trustee asserted three causes of action: (1) common law fraud (2) negligent misrepresentation, and (3) equitable reformation of the policy. "The Trust alleged in broad terms that [the Trust] reasonably relied on the misrepresentations about 'guaranteed' premium values when [it] purchased the life insurance policy, and [it] sought to reform the contract to conform to [its] reasonable understanding of what the policy provided."

AXA removed the case to federal court and subsequently filed a motion to dismiss for failure to state a claim.

The court granted AXA's motion dismissing all three causes of action asserted by the trust. In the relevant part, "AXA contended that the claims made by the Trust of negligent misrepresentation and fraud (founded on the alleged oral and written misrepresentations by [the agent]) were barred by a comprehensive merger clause in the life insurance policy." Specifically, the district "court concluded that the policy contained a merger clause that, under Georgia law, barred the trust's claims for fraud and negligent misrepresentation based on written and oral statements made before the insurance policy was delivered to

the trust in February 2006. The court also concluded that the policy unambiguously provided that the scheduled premium payments may not be sufficient to keep the policy in force, making reliance on misrepresentations to the contrary unreasonable as a matter of law." Consequently, the "court dismissed the Trust's Complaint."

On appeal, the trustee attacked the lower courts application of the merger clause as a bar to its claims. Specifically, the trustee argued that the merger clause (1) was not comprehensive because it did contain specific disclaimer language disclaiming "reliance on prior agreements not contained in the contract;" (2) was ambiguous because the trust could reasonably have understood the subsequent illustrations and projections provided by the defendants were "additional Policy Information sections added to this policy," and thus, part of the "entire agreement;" and (3) did "not apply to adhesion contracts such as the insurance policy at issue" under Georgia law.

The court dismissed all of these arguments finding that: (1) while disclaimer language is generally included in a standard merger clause, it is not required under Georgia law, especially here where the policy states "that the policy is the entire agreement" (2) the disclaimer law was not ambiguous because the subsequent illustration allegedly relied upon by the trust clearly stated that it was not part of the life insurance contract, and (3) "Georgia law does not support the trust's position" that merger clauses do not apply to adhesion contracts.

Consequently, in affirming the lower court's dismissal, the Eleventh Circuit concluded that "the merger provision in the insurance policy and the unambiguous terms of the policy itself preclude the Trust from showing "justifiable reliance" as a matter of law under Georgia law."

The appellate court also affirmed the lower's ruling precluding the trust's claim for reformation of the contract because it was derivative of its fraud claims and denied the trust's request for leave to amend the complaint.

DISCLAIMER

This information is intended solely for information and education and is not intended for use as legal or tax advice. Reference herein to any specific tax or other planning strategy, process, product or service does not constitute promotion, endorsement or recommendation by AALU. Persons should consult with their own legal or tax advisors for specific legal or tax advice.