WRNewswire

An AALU Washington Report

Wednesday, 14 January 2015 **WRN# 15.1.14**

The *WRNewswire* is created exclusively for AALU Members by insurance experts led by Steve Leimberg, Lawrence Brody and Linas Sudzius. *WRNewswire* # 15.01.14 was written by James S. Bainbridge, Esquire of The Bainbridge Law Firm, LLC.

TOPIC: Dispute Concerning Policy with Potential "Vanishing Premiums" Survives Motion to Dismiss

CITE: *Jacoby v. AXA Equitable Life Ins. Co.,* No. 13-CV-6511 (U.S.D.C., E.D.P.A. Dec. 15, 2014).

SUMMARY: In a dispute concerning whether a whole life insurance policy was apparently illustrated and sold thirty years ago as a so-called vanishing premium policy, a federal court in Pennsylvania ruled that the policy language was sufficiently ambiguous to permit the parties to engage in discovery to determine what the parties' true intentions were when the contract was formed.

The court ruled that since the policy was unclear as to the source of premium payments once dividends accumulated to a "vanishing point", the plaintiff-trustee's complaint for breach of contract and bad faith could not be dismissed based on the defendant's motion to dismiss, prior to trial.

RELEVANCE: *Manage expectations*. A common criticism of modern life insurance policies is that agents and carriers are sometimes accused of misleading consumers regarding the number of years for which they will have to pay premiums out-of-pocket before the policy begins to support itself and pay premiums out of the accumulated cash value. Under such a scenario, if the projected investment returns used in the illustration are overly optimistic, the policy owner may have to pay premiums out-of-pocket for more years than *expected*. The key here is managing what the customer, in this case the trustee, *expects* to happen. It is clear from the pleadings that the trustee appeared to believe its out-of-pocket premium obligations ceased ('vanished') after nine annual premium payments because it anticipated that the policy would then support itself and could pay premiums out of accumulated and future dividends.

It is likely that this dispute could have been avoided had the trustee's actual and potential out-of-pocket premium obligations, and how they could be affected by the performance of the underlying policy investments, been explained in more detail by the agent and carrier. Had this been done the trustee's expectations would likely have been different and the need to make additional out-of-pocket premiums would not have come as a surprise to the trustee. Notes made by an agent at the time of the transaction memorializing key points made to the client may be extremely helpful in the event of a later misunderstanding or as evidence in the event of a lawsuit.

BACKGROUND: For many years, agents have been illustrating and marketing life insurance policies that—assuming expectations and assumptions are met or exceeded—could produce a level of dividends that, over time, increase to the point that they cover the entire amount of the premium. At that stage, the policy owner will no longer have to pay premiums out-of-pocket. Although technically, premiums remain to be paid, because the policy owner no longer has to pay them "out-of-pocket," agents often referred to the event as the "vanishing" of premiums, which is a phrase that can no longer be used to describe this technique. At the heart of this case (and many others like it) is a disagreement between the parties over whether the policy owner had a legitimate expectation that the policy premiums would "vanish" as described above.

In 1984, AXA Equitable Life Insurance Company issued a $450,000 life insurance policy to Richard A. Jacoby. According to the complaint, the policy owner "claims that the policy was marketed and sold as a 'vanishing premium policy,'" and alleges that he was told that "after nine annual payments, the dividends earned would be used to pay all future premiums."

In response to the plaintiff's allegations, the carrier argued that the policy was not a vanishing premium policy because the premium period was defined in the policy as "For Life." Furthermore, while the policy owner had the option to request that any accumulated dividends be used to "help pay any premium then due," the carrier states that the policy owner chose the option to have accumulated dividends "be used to provide paid-up additional whole life insurance on the [i]nsured."

FACTS: From 1984 to 1992, the policy owner paid nine annual premiums, totaling approximately $77,341.50. In 1992, the policy was assigned to a trust. In 1993, counsel for the trust received a notice of payment due for a tenth annual premium payment. Apparently believing this was in error, counsel for the trust contacted an entity known as the HSA Corporation ("HSA") to ask if the trustee could disregard the notice. Neither the court's decision, nor the pleadings identify HSA's relationship with AXA Equitable or its role in the procurement or administration of the policy.

HSA responded by letter in March 1993 enclosing an in-force illustration allegedly provided by the carrier and stating: "[a]s you will see from this illustration, this will keep your policy in-force without having to pay any additional premiums."

Consequently, the trust disregarded the notice and did not pay any further premiums. Additionally, the trustee stated that it never received any subsequent notices or communications from the carrier until 2013 in response to a request from the trustee for the most recent annual statement. In response to this request, the carrier "notified the trustee that the policy had been converted to a term policy after the tenth premium payment was not paid, and the term policy expired on August 2, 2004." The pleadings do not indicate why the owner, the agent or HSA never received that notice in 2004, nor why the trustee waited ten years to request an in-force illustration.

Subsequently, the trustee filed suit against the carrier asserting claims for:

(1) Breach of contract;

(2) Bad faith in connection with the administration of the policy;

(3) Promissory estoppel in connection with representations made in the in-force illustration;

(4) Fraud in connection with the marketing and selling of the policy; and

(5) Violation of the Pennsylvania Unfair Trade Practices and Consumer Protection Law ("UTPCPL").

The defendant moved to dismiss.

RESULT: The court denied the insurer's motion to dismiss as to the breach of contract and bad faith claims, but granted its motion as to the promissory estoppel, fraud and UTPCPL claims.

With respect to the breach of contract claim, the carrier argued that the policy was not a vanishing premium policy because the policy unambiguously stated that premiums were payable for life. Therefore, the policy required the trust to continue making premium payments out-of-pocket. However, the trustee argued that even though the policy stated that premiums were payable for life, the policy language was not clear as to the *source* of those premium payments. The court agreed with the trustee holding that "the existence of the policy term providing that premiums were payable for life does not unambiguously mean that [the trust] would be required to pay those premiums out-of-pocket for that entire period of time."

Furthermore, the court rejected the carrier's argument that, by selecting a policy option to use dividends to purchase additional insurance coverage, the policy owner "expressly requested and agreed that his dividends were always set to provide additional paid-up insurance and were never meant to help pay premiums." The court reasoned that this language did not foreclose "the possibility that once dividends accumulated to a so-called 'vanishing point,' they could also be applied to eliminate the premiums." The court concluded that "[i]n short, although these provisions of the [p]olicy may cast doubt on the 'vanishing premium' possibility, the [p]olicy does not explicitly exclude it" and discovery concerning what the parties intended when the contract was formed is needed in order to properly determine whether the policy was a vanishing premium policy.

In making its observation regarding dividend status, the court apparently implicitly acknowledged that paid up additions can be used in a vanishing premium case design in a number of ways:

1. Paid up additions themselves can generate dividends, helping to make more cash available on a regular basis to pay premiums.

2. Paid up additions can be surrendered if needed to help pay the policy premiums.

With respect to the bad faith claim, the court ruled that, since the bad faith allegations concerned the carrier's conduct in connection with the discharge of its obligations under the policy and not the carrier's practices in soliciting the purchase of the policy, the bad faith allegations were sufficient to survive a motion to dismiss. Specifically, the trustee alleges that the carrier acted in bad faith by failing to send annual statements and by failing to contact the trust regarding overdue premium payments. The court ruled that this conduct, if proven to be true, could constitute insurance bad faith because it involved the administration of the policy and not its marketing.

As to the promissory estoppel claim, the trustee argued that the in-force illustration was a promise from the carrier, separate and apart from the policy, which the trustee relied upon to its detriment. The court, however, stated that, per the allegations in the complaint, any promises associated with the in-force illustration were made by HSA and not the carrier. Furthermore, the trustee did not allege that HSA was the legal agent of the carrier, nor is it alleged that HSA was authorized to share any information that may have been provided by the carrier with the trustee. Accordingly, the court dismissed this claim without prejudice. The court also dismissed the trustee's fraud and UTPCPL law claims without prejudice based upon the trustee's failure to provide specific allegations concerning the date, time, or place of any specific representations made by the carrier in the marketing or selling of the policy.

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