Hot Topics in Litigation

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Nonguaranteed Elements: Cost Of Insurance

- Increase in current COI rates or decline to decrease current rates despite improved mortality has spawned litigation.
- Some cases brought by policyholders; others brought by life investors who have purchased rights under many life policies with intent of paying minimum premium needed to avoid lapse.
- Cases are a mixed bag – very dependent on policy language and jurisdiction where case is filed.

Cost Of Insurance Cases: Pro-Plaintiff

- *Vogt v. State Farm Life* (W.D. Mo. Apr. 10, 2018)

- Putative class action on behalf of flexible premium policy owners for breach of contract and conversion based on defendant's alleged use of factors other than those referenced in the policy to calculate current COI rates. Plaintiff's COI rates never changed.

- Policy language: "**Monthly Cost of Insurance Rates**. These rates for each Policy year are based on the Insured's age on the Policy anniversary, sex, and applicable rate class …. Such rates can be adjusted for projected changes in mortality but cannot exceed the maximum monthly cost of insurance rates…."

- Court agreed with plaintiff that age, sex, and applicable rate class are the ***only*** factors that may be considered in setting the COI rate: "No reasonable lay person would expect that State Farm was permitted to use any factor it wanted to calculate the cost of insurance." Distinguished favorable 2013 Seventh Circuit precedent in *Norem.* Found claim not time barred because defendant did not disclose factors it was using to calculate current COI rates.

Cost Of Insurance Cases: Pro-Defense

- *Hancock v. Americo Financial Life and Annuity* (E.D.N.C. July 25, 2017), appeal dismissed and remanded (4th Cir. May 25, 2018).
- Putative class action of UL policyholders alleged defendant improperly increased premiums and assessed excessive COI charges. Asserted claims for breach of contract, breach of duty of good faith and fair dealing, unjust enrichment, fraud, injunction, rescission, NC UDTPA, and NC RICO.
- Policy stated "Cost of Insurance Rates" were "based on" the "sex," "age," and "premium class" of the insured.
- All counts dismissed without prejudice. Express and implied contract claims failed because premium increases expressly permitted by policy, and because allegation that COI was "in excess of true mortality costs" was insufficiently pled. Court rejected plaintiff's COI argument based on "regulatory or industry standards." Tort claims dismissed as duplicative of the contract claims.
- Fourth Circuit held, sua sponte, that it lacked jurisdiction over appeal; remanded with instructions to allow plaintiff to amend complaint.

Cost of Insurance: What's Next?

- *Farris v. US Financial Life* (S.D. Ohio May 4, 2018)– new COI litigation theory tied to shadow insurance

- This putative class action alleges defendants engaged in a "series of accounting schemes" that made the carrier "appear as a financially strong life insurance company by utilizing captive reinsurance to offload liabilities… ." Plaintiff claims that because the insurer was financially unstable, it recouped expenses by raising COI charges.

- Motion to dismiss amended complaint granted in part and denied in part. Court dismissed the unjust enrichment claim as barred by the existence of an express contract (the insurance policy), as well as dismissed claims for fraudulent misrepresentation and concealment of financial insolvency as insufficiently pled. The court denied the motion as to the claims for conversion, good faith and fair dealing, and fraudulent misrepresentation and concealment of the basis for the 2015 COI increase. Defendant did not move to dismiss the contract claim.

- After the 8th and 2nd Circuit in 2017 affirmed dismissal of shadow insurance claims based, respectively, on McCarran-Ferguson and lack of Article III standing, the plaintiff's bar is recasting their allegations in COI terms.

Nonguaranteed Elements: Dividend Cases

- *Chavez v. Mass Mutual* (Cal. Super. Mar. 5, 2018)

- Plaintiff asserted claims for breach of contract, implied covenant of good faith and fair dealing, fraud, and unfair competition based on insurer's failure to pay dividends and alleged concealment of gains to divisible surplus based on improved mortality experience and favorable reinsurance arrangements.
- Policy language: "This policy is participating which means it may share in any dividends we pay. Each year we determine how much money can be paid as dividends. This is called divisible surplus. We then determine how much is based on this policy's contribution to divisible surplus. Since we do not expect this policy to contribute divisible surplus, we do not expect that any dividends will be payable on this policy."
- Partial certification of class for one policy – approximately 300 class members.
- Jury returned defense verdict for insurer.

Dividend Cases (Continued)

- *Ochoa v. State Farm Life / Anderson v. Country Life Ins. Co*. (N.D. of Ill. Jan. 1, 2018)
- Plaintiffs claimed insurer failed to comply with § 243 of the Illinois Insurance Code – which limits the amount company can retain in a "contingency reserve" to a percentage of net value of participating policies – and which plaintiffs alleged was incorporated into their policies.
- Example of policy language: "We may apportion and pay dividends each year. Any such dividends will be paid at the end of the policy year if all premium dues have been paid."
- District Court granted insurer's motion to dismiss because: "Plaintiffs have, at most, alleged that defendants have failed to comply with § 243 of the Code. Even assuming they are correct, plaintiffs cannot seek relief through a breach of contract claim, and have no private right of action to enforce the statute."
- On appeal to the 7th Circuit

Supreme Court: Noteworthy Decisions

- *China Agritech, Inc. v. Resh*, No. 17-432 (U.S. June 11, 2018) (*American Pipe* does not toll the statute of limitations for successive class actions).
- *Epic Systems Corp. v. Lewis*, No. 16-285 (May 21, 2018) (upheld the use of class action waivers in employment arbitration agreements).

Supreme Court: Certiorari Granted

- *Lamps Plus Inc. v. Varela*, No. 17-988 (whether the Federal Arbitration Act forecloses a state-law interpretation of an arbitration agreement to authorize class arbitration based on generic language).

Supreme Court: What's Next?

- Does *Bristol-Myers Squibb* apply to class actions?
  - *Bristol-Myers Squibb v. Superior Court*, 137 S. Ct. 1773 (2017) (Non-California plaintiffs in mass action could not sue defendant in California because there was no general or specific jurisdiction over defendant).
- District Courts are split.
  - *Compare Molock v. Whole Foods Mkt., Inc.* (D.D.C. Mar. 2018) (Bristol-Myers's jurisdictional holding "does not apply to class actions") *with DeBernadis v. NBTY, Inc.* (N.D. IL. Jan. 2018) ("… it is more likely than not based on the Supreme Court's comments about federalism that the court will apply *Bristol-Myers Squibb* to outlaw nationwide class actions in a forum… where there is no general jurisdiction over the Defendants.").

Supreme Court: What's Next?

- Standing: Fallout of *Spokeo* and *Tyson Foods*
  - Circuits still split over standing where only injury is the violation of a statute.
  - Circuits also split over standing when some members of the putative class have no injury.

Maturity Date Litigation

- What's the problem?
- Policy owner bought life insurance policy in 1980's
- Non-guaranteed assumptions – high interest rate environment & maturity at 95/100
- Death benefit = cash value at maturity
- Cost of insurance increasing & low interest rate environment
- People living longer & have paid in six to seven figures

Maturity Date Litigation Cont.

- What's the result?
- DOI complaints and individual lawsuits seeking extended maturity date (reformation of policy) or rescission of policy and refund of premium
- Likely plaintiff is purchaser of high dollar policy and/or their trust
- Lawsuits in early stages (assert claims including breach of contract, negligent misrepresentation, fraud, violation of state consumer protection laws, unjust enrichment, and declaratory judgment); no ruling on merits
- No class actions thus far, and likely to stay that way

Maturity Date Litigation Cont.

- But one industry egghead is egging plaintiffs' lawyers on:
  - Joseph Belth, author Life Insurance: A Consumer's Handbook, writes on his Insurance Forum blog: "I think the only way to force the industry and other interested parties to address the age 100 problem is to mount a class action."
  - Problems w/ class case:
    - As Belth acknowledges, named plaintiff(s) would be unlikely to live long enough to see case to conclusion
    - Numerosity issue – individual carrier may not have many policyholders in this category
    - High dollar policyholders may prefer to pursue individual claims
    - Potential issues of ripeness (if policyholder hasn't reached maturity date, damages are speculative) and mootness (such policyholders could die before that date and receive death benefit)

Maturity Date Litigation Cont.

- What's the solution?
- Could extending the maturity date be deemed a material change under § 7702(A) of the Internal Revenue Code, causing the policy to lose the favorable tax treatment accorded to life insurance?
  - To my knowledge, the IRS has not weighed in on this issue.
- Replace the policy (insurability issues)
- Provide advanced notice as policy goes over the cliff
- One off complaint resolution
- Refund some premium

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HOT TOPICS IN LITIGATION

Lapse Litigation

Lapse Litigation – Class Actions

- *Bentley v. United of Omaha*, No. 2:15-cv-07870-DMG-AJW (C.D. Cal.)
  - Originally filed as a single plaintiff action in state court and later removed to federal court.
  - Complaint amended in November 2016 to include class action allegations. Claims for breach of contract and breach of covenant of good faith and fair dealing.
  - Policy terminated for nonpayment of premiums. Plaintiff alleges failure to comply with provisions of CIC § 10113 requiring notice of pending lapse and opportunity to appoint a third-party to receive notice of lapse.
  - Plaintiff alleges the statutory provision is retroactive and applies to policies issued prior to the effective date of the law.

Lapse Litigation – Class Actions

- *Bentley v. United of Omaha*, (continued)
- On May 1, 2018 the Court issued an order granting motion for class certification.
  - Policies renewed in the State of California after the effective date of the statute incorporate the requirements of CIC § 10113, whether they were originally issued within the state or not. The renewal principle does not violate the presumption against retroactivity.
  - Class is defined as those beneficiaries who made a claim, or would have been eligible to make a claim, for the payment of benefits on life insurance policies renewed, issued, or delivered in the State of California that lapsed after the statutory enactment or were terminated by Omaha for the non-payment of premium and which were not affirmatively cancelled by the policyholder), and as to which policies one or more of the third-party notices described by Sections 10113.71 and 10113.72 of the California Insurance Code were not sent by Omaha prior to lapse or termination.
- The class barely met the numerosity requirement with 43 class members.
- Summary judgment briefing is in progress and set to be heard in early August.

Lapse Litigation – Class Actions

- *Behfarin v. Pruco Life*, No. 2:17-cv-05290-MWF-FFM (CD Cal.)
  - Filed on July 13, 2017. Nationwide class certification sought under CAFA.
  - Alleges breach of contract, breach of covenant of good faith and fair dealing, and violation of CA Business and Professions Code based on insurer practice of charging more than the technical amount needed by the contract to bring the policy out of default, requiring reinstatement of a policy, and denying insurance to insureds who, although meeting insurability requirements initially, no longer do (*e.g.*, four months premium charged in three months)
  - Plaintiff seeks damages for breach of contract, declaratory relief, and a form of quasi-disgorgement or restitution under the CA statutory claim.
  - Case was referred to a private mediator pursuant to stipulation of the parties
  - Set for trial in June 2019 with deadlines for class certification discovery and motion practice as well as other discovery and dispositive motion deadlines.

Lapse Litigation – Class Actions

- *Avazian v. Genworth Life & Annuity Ins. Co.,* No. 2:17–cv–06459–RGK–JEM (C.D. Cal.)
  - Filed in State Court and removed to Federal Court on August 31, 2017 seeking certification of a statewide class. Plaintiff alleged breach of contract, breach of covenant of good faith and fair dealing, and violation of CA Business and Professions Code.
  - Defendant terminated the plaintiffs' policies due to missed payment. Plaintiffs alleged defendant insurer failed to comply with requirements of CIC §10113 permitting policyholders to designate a third party to receive notice of lapse or termination and failed to give notice of pending lapse and termination at least 30 days before the date of termination to both the policyholders and the designated third party.
  - Plaintiffs argued that the statute was retroactive and sought certification of class of insureds, policyowners and beneficiaries of life insurance policies issued or delivered by the insurer defendant in California before January 1, 2013, the date the statute was enacted into law who had either lost their coverage or their ability to make a claim due to the termination of their policies for nonpayment of premium.

Lapse Litigation – Class Actions

- Court granted the insurer defendant's motion to dismiss
  - Even assuming that § 10113 applies retroactively and is incorporated into the defendant's policies, the claims fail because plaintiffs: (1) failed to plead whether they identified a third party for purposes of notice; (2) failed to allege that defendant deprived them of opportunity to designate a third party to receive notice; (3) failed to allege that defendant insurer did not provide them with a thirty day notice; and (4) defendant insurer's right to terminate policies for nonpayment was an express term of policies.
  - All claims were dismissed for insufficient pleading. Class allegations were not addressed. The Order does **not** state whether dismissal was with or without prejudice.
  - In a typical case, a plaintiff would be given an opportunity to cure such pleading deficiencies. Here, however, the case was closed upon issuance of this Order and defendant's request for costs was granted.

Lapse Litigation – Recent Non-Class Cases

- *Lebovits v. PHL Variable Ins. Co.*, 199 F. Supp. 3d 678, 680-82 (E.D.N.Y. 2016)(lapse ineffective, but owner required to pay 6 years of past due premiums; because owner failed to do so, summary judgment entered for insurer).
- *Weiss v. Sec. Mut. Life Ins. Co. of N.Y.*, 45 N.Y.S.3d 169, 171 (2017) (affirming summary judgment for insurer)
- *Jakobovits v. Allianz Life Ins. Co. of N. Am.*, 2017 WL 3049538 (S.D.N.Y. July 18, 2017) (granting summary judgment for the insurer on six of the nine investor-owned lapsed policies at issue because the owners had not given notice of assignment to the insurer per the terms of the policy; granting summary judgment for insurer on breach of contract claims as to the three remaining policies, but allowing these plaintiffs to proceed with claims for breach of the implied duty of good faith and fair dealing).

HOT TOPICS IN LITIGATION

The Fiduciary Rule

The Fiduciary Rule – History

- Congress enacts ERISA in 1974
  - Title I – union or employer-sponsored retirement plans
  - Title II – tax-deferred personal IRAs and similar accounts within the Internal Revenue Code
- Both Title I and II of ERISA contain definitions of "fiduciary"
  - Title I – comprehensive DOL regulation
  - Title II – prohibited transactions provisions
    - Discretionary authority of plan management or control over plan assets
    - Investment advice for a fee or other compensation with respect to any moneys or other property of such plan
    - Discretionary authority over the administration of such plan

The Fiduciary Rule – History

- 1975 DOL Regulation – 5 part test for "investment advice" provision.
- Follows the Investment Advisors Act distinction between "advisor" and "broker-dealer"
  - The former was a "fidiciuary" regulated under the IAA; regularly renders advice and the advice serves as a primary basis for investment decisions
  - The latter was not—advice is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor
- Over time, as participant directed activity rose, some saw need for more regulation to protect consumers

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The Fiduciary Rule – History

- In 2016 DOL announces series of regulations aimed at revising "investment advice" definition
- Regulations and accompanying explanations span 275 pages in the Federal Register.
- DOL estimates that compliance costs imposed on the regulated parties might amount to $31.5 billion over ten years with a "primary estimate" of $16.1 billion. 81 Fed. Reg. at 20951.
- In a novel assertion of DOL's power, the Fiduciary Rule directly disadvantages the market for fixed indexed annuities in comparison with competing annuity products.

The Current Fiduciary Rule

- The new definition dispenses with the “regular basis” and “primary basis” criteria used in the regulation for the past forty years
- It encompasses virtually all financial and insurance professionals who do business with ERISA plans and IRA holders
- Stockbrokers and insurance salespeople, for instance, are subject to regulations including the prohibited transaction rules. Without an exemption, they cannot collect transaction-based commissions and brokerage fees
- In order to work on commission, however, they must stipulate that they are fiduciaries and seek an exemption.
- Exemption rules specifically disadvantage fixed-indexed annuities compared to other annuity products

Challenges to The Current Fiduciary Rule

- *Chamber of Commerce v. U.S. Department of Labor*, 885 F.3d 360 (5th Cir. 2018)
  - Three lawsuits consolidated in the Northern District of Texas challenging the Fiduciary Rule.
  - At trial, the rule was upheld by the district court as a lawful exercise of administrative authority under the Administrative Procedure Act
  - On appeal, in a 2 to 1 decision, the Court of Appeals reversed and vacated the rule
  - "Expanding the scope of DOL regulation in vast and novel ways is valid only if it is authorized by ERISA Titles I and II. A regulator's authority is constrained by the authority that Congress delegated it by statute."

Challenges to The Current Fiduciary Rule

- "Where the text and structure of a statute unambiguously foreclose an agency's statutory interpretation, the intent of Congress is clear, and 'that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.' 885 F.3d at 369 (*citing Chevron, U.S.A., Inc. v. N.R.D.C., Inc.*, 467 U.S. 837 (1984))."
- "[A]ll relevant sources indicate that Congress codified the touchstone of common law fiduciary status—the parties' underlying relationship of trust and confidence—and nothing in the statute "requires" departing from the touchstone."
- "Even if the common law presumption did not apply, the Fiduciary Rule contradicts the text of the 'investment advice fiduciary' provision and contemporary understandings of its language."

Challenges to The Current Fiduciary Rule

- The current fiduciary rule conflicts with Dodd-Frank. There, Congress opted to defer regulation of fixed-indexed annuities to the states, which have traditionally and under federal law borne responsibility for regulating the business of insurance.
- Section 989J accordingly provides that "fixed indexed annuities sold in states that adopted the National Association of Insurance Commissioners' enhanced model suitability regulations, or companies following such regulations, shall be treated as exempt securities not subject to federal regulation."
- DOL's regulatory strategy not only deprives sellers of those products of the exemption from prohibited transactions, but subjects them to the "stark alternatives" of using the BIC Exemption, creating entirely new compensation schemes, or withdrawing from the market.