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## Federal Court: Egregious Facts May Permit Life Policy Rescission After Expiration of Incontestability Period

The U.S. District Court for the Southern District of New York recently ruled on the parties' motions for summary judgment in *Settlement Funding, LLC v. AXA Equitable Life Ins. Co.*, No. 09 CV 8685 (HB) (S.D.N.Y. Sept. 29, 2010), holding that egregious facts may permit an insurer's rescission of a life policy after expiration of the policy's two-year incontestability period. Plaintiff Settlement Funding, the assignee of a \$5 million insurance policy on the life of Esther Adler, sought summary judgment on its claim for recovery of insurance proceeds following Ms. Adler's death, while Defendant AXA requested summary judgment on its equitable counterclaim for a declaration that the insurance policy was void *ab initio* due to infirmities in creation. Judge Harold Baer concluded that disputed issues of fact that remained concerning whether the policy's incontestability clause should be enforced precluded granting the parties' summary judgment motions. (Please click [here](#) for the opinion.)

On May 11, 2007, Defendant approved and issued a \$5 million policy, insuring the life of Ms. Adler, to the "Esther Adler Trust." The trust beneficiaries included Ms. Adler's two daughters and her son-in-law. According to Defendant, the policy was obtained through fraud. There was evidence to suggest that the signatures of Ms. Adler and a notarizing attorney appearing on the Esther Adler Trust Agreement were forged. Though Ms. Adler had assets of less than \$100,000, the policy application stated that she had a net worth in excess of \$12 million, a misstatement confirmed during the underwriting process by an unidentified man, falsely claiming to be Ms. Adler's accountant. And, while the insurance application represented that the policy would not be transferred for settlement or on a secondary market, the policy was nonetheless transferred to a life settlement corporation by the Trustee less than two years after issuance. Following a series of subsequent transfers and the death of Ms. Adler on June 6, 2009, Plaintiff filed suit in the Southern District of New York on October 13, 2009, seeking payment of the policy's death benefit.

The primary issue before the court was whether the incontestability clause in the policy precluded Defendant from challenging its validity. Under New York law, the typical life insurance policy "shall be incontestable after being in force during the life of the insured for a period of two years from its date of issue." The court explained that "incontestability clause[s] serve[] the important function of encouraging buyers to purchase insurance with confidence that after the contestable period has passed they are assured of receiving benefits for which they pay premiums." However, "in limited instances[,] . . . if the facts surrounding the creation and issuance of an insurance policy fail to demonstrate that a proper contract was entered into, the incontestability clause will not preclude a challenge by the insurer," particularly where the clause appears in a life insurance policy governed by New York law. Whereas New York health and disability insurance statutes expressly allow insurers to include fraud exceptions in their incontestability clauses, no similar invitation exists in the state's life insurance statutes; and recent concerns regarding STOLI (Stranger Owned Life Insurance) schemes "tip[] the scales in favor of reviewing otherwise incontestable life insurance policies where . . . a substantial factual record points to the existence of an improperly procured policy."

With that premise, Judge Baer held that, while failing to establish that it should be granted summary judgment, Defendant had raised sufficient issues of fact regarding the validity of the policy and the enforceability of the policy's incontestability clause to survive Plaintiff's motion for summary judgment.

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The court found the evidence that statutorily required signatures had been forged on the Trust Agreement raised an issue of fact as to the validity of the Trust and thus, by extension, the policy purchased by the Trust. Furthermore, in the court’s opinion, the evidence of misrepresentations on the policy application, coupled with facts that suggested lack of an insurable interest and thus existence of a STOLI scheme, raised additional issues of fact regarding contestability that precluded summary judgment.

The court went on to address Plaintiff’s alternative arguments that, even if Defendant could circumvent the policy’s incontestability clause, principles of estoppel and mandatory joinder required that Defendant’s challenge to the policy’s validity be dismissed. The estoppel argument was summarily rejected. Plaintiff’s contention that it relied to its detriment on Defendant’s acceptance of Plaintiff’s premium payments and representations concerning the policy’s enforceability was found insufficient to warrant judgment as a matter of law. The joinder argument, which focused on Defendant’s failure to join the trust beneficiaries, received more attention, but was also rejected. While the court agreed that, under New York law and Rule 19 of the Federal Rules of Civil Procedure, the beneficiaries were nominally necessary parties, it decided to allow the action to continue without them, noting that their inclusion would destroy diversity jurisdiction and require dismissal, “a drastic and unjustified step” under the circumstances.

Though tangential to the central contestability issue, the court’s holdings on Plaintiff’s breach of contract claim and Defendant’s counterclaim under the Ohio Viatical Settlements Act also bear noting. In the face of Defendant’s constant reassurances that the policy benefits would be paid out if the policy was found valid, the court granted Defendant summary judgment on Plaintiff’s claim for breach of contract, holding that “an action for declaratory judgment determining the validity of a contract does not constitute a repudiation of contractual obligations.” Finally, the court denied Plaintiff’s request for summary judgment on Defendant’s counterclaim under the Ohio Viatical Settlements Act, which prohibits purchase of a policy less than five years after its issuance and forbids a party from recklessly entering into a life settlement contract involving a policy obtained by fraud or fraudulent concealment, for the purpose of misleading and with the intent to defraud the issuer of the policy. Despite significant New York contacts that would require application of New York law under a traditional choice of law analysis, the court found that the Ohio Act’s applicability to policies bearing a “reasonable relation” to the state, regardless of where the policy was issued and delivered, raised a triable issue inappropriate for summary disposition.



*If you have any questions regarding this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.*

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