manatt

May 4, 2009

INSURANCE LAW @MANATT
NEWSLETTER OF THE INSURANCE LAW PRACTICE GROUP OF MANATT, PHELPS & PHILLIPS, LLP

"Vanishing" Defenses – Court of Appeal Holds That Adequacy of "Vanishing Premium" Disclaimer Language and Reasonable Reliance May Not Be Decided as a Matter of Law on Demurrer

Diana N. Iketani

The California Court of Appeal (Second Appellate District, Division Seven) has ruled that the trial court erroneously sustained an insurance company's demurrers to the plaintiffs' complaint for fraud, negligent representation, and related statutory violations in connection with a so-called "vanishing premium" life insurance policy.

In *Broberg v. The Guardian Life Insurance Company of America*,[1] the Court of Appeal reversed, in part, the trial court's sustaining of the demurrer, holding that it is generally a question of fact, not law, as to when a plaintiff reasonably should have discovered facts for purposes of the accrual of a cause of action, and that the issue cannot be decided as a matter of law unless the evidence supports only one reasonable conclusion. In addition, the Court disagreed with the trial court's finding that disclaimers in the policy illustration used in the sale of the policy were so clear and obvious that they precluded plaintiffs' claims of delayed discovery and reasonable reliance as a matter of law. Finally, the Court held that whether a disclaimer is adequate in a fraud action depends on the plaintiff's knowledge and experience, and a plaintiff should be denied recovery only when his conduct is "manifestly unreasonable."

In August 1993, Dr. David Powell ("Powell") purchased a $500,000 whole life insurance policy from Guardian Life Insurance Company of America ("Guardian"). The policy was

NEWSLETTER EDITORS

Carlos E. Needham
Partner
cneedham@manatt.com
310.312.4193

Amy B. Briggs
Partner
abriggs@manatt.com
415.291.7451

Jeremiah P. Sheehan
Counsel
jsheehan@manatt.com
212.830.7205

OUR PRACTICE

Manatt's insurance practice group is multi-faceted. Our insurance regulatory lawyers represent insurers, producers and related parties in connection with examinations and investigations by state insurance departments, insurer mergers and acquisitions, ... more

. Practice Group Overview
. Practice Group Members

INFO & RESOURCES

. Subscribe
. Unsubscribe
. Sarbanes-Oxley Act
. Newsletter Disclaimer
. Technical Support
. Manatt.com

described to Powell by Guardian's agent, John Davidson ("Davidson") as a "vanishing life policy," that is, after a certain number of out-of-pocket premium payments had been made, the policy itself would generate sufficient sums through its dividend and interest income to pay future premiums for the rest of the insured's life.

As part of his sales pitch, Davidson provided Powell with a three-page illustration that showed the elimination of out-of-pocket premiums in the 12th year of the policy's life. The illustration, prepared specifically for Powell, included the words "vanishing premium" on its first page and contained a 30-year schedule reflecting an annual premium of $11,736 to be paid over the first 11 years, and no "annual outlay" after the 11th year. This first page contained no disclaimers, cautionary language, or footnotes, and nothing suggesting that the "annual outlay" column (or the series of "0s" after year 11 in that column) was contingent on Guardian's future dividend scale.

The second page of the illustration continued the schedule from the first page for an additional five years, and also showed no "annual outlay" for any of those years. This page contained the general statement, "Please see attached sheets with important footnotes," but there was no cautionary language directed to the "annual outlay" column. The third page of the illustration contained a single endnote consisting of 39 single-spaced lines, all capitalized, with various conditions, qualifications, and limitations regarding the life insurance policy. In the middle of the page, not set apart in any way from the surrounding text (e.g., by contrasting type, font, color, border, or spacing), the following disclaimer appeared: "Figures depending on dividends are neither estimated nor guaranteed, but are based on the 1993 dividend scale. Actual future dividends may be higher or lower than those illustrated depending on the company's actual future experience." Following another dozen lines of explanation (also in the same type face), a further caution was provided: "The number of years of required cash outlays depends upon age at issue, policy class, face amount, and continuation of The Guardian's current dividend scale, and assumes no policy loans."

Powell paid the premiums for 11 years and in 2004 (the policy's 12th year), Guardian informed him that additional out-of-pocket premium payments would be required for the policy to remain in effect because dividends had steadily declined. The plaintiffs (Powell and Kirk Broberg, the trustee of Powell's

Irrevocable Trust) filed a complaint against Guardian and Davidson for fraud, negligent misrepresentation, unfair competition, false advertising, and violation of the Consumers Legal Remedies Act ("CLRA") arising out of the marketing, promotion, and sale of the "vanishing premium" policy.

Guardian demurred to the complaint, contending that the misrepresentation claims accrued when Powell purchased the policy in 1993 and were thus time-barred, and that plaintiffs could not establish justifiable reliance on the alleged misrepresentations as a matter of law. In addition, Guardian asserted that the unfair competition claims also were time-barred and that the CLRA did not apply to insurance transactions.

The trial court sustained the demurrer in part, holding that the disclaimer in the marketing illustration and the policy language itself were sufficient to give Powell at least inquiry notice, if not actual notice, as of August 1993 that earnings from the policy were not guaranteed. Based on that finding, the fraud and negligent misrepresentation claims filed nearly 13 years later were barred by the statute of limitations. The trial court also concluded that, as a matter of law, the disclaimers precluded proof of justifiable reliance on any contrary promises by Davidson and Guardian. The court further held that the CLRA cause of action was not viable because a contract for life insurance is not included within the statutory definition of "goods and services." [2]

In reversing the trial court's sustaining of the demurrer as to all except the CLRA claim, the Court of Appeal held that whether Powell was "manifestly unreasonable" in relying on Guardian's illustration and its agent's promise that out-of-pocket premiums would not be required after 11 years was a question for the trier of fact. The Court further held that the placement and format of the disclaimer language (with no heading in capital letters, nor any type, font, or color contrasting with the surrounding text) were not conspicuous enough to be adequate as a matter of law.

On remand, the trial court will consider whether the agent actively misled the policyholder as to the effect of policy terms during the sales pitch or in the illustration. The Court noted that a policy term stating that premiums are payable "for life" was not inconsistent with an agent's alleged misrepresentations that no further out-of-pocket premium payments would be required, and did not trigger notice or preclude reasonable

reliance as a matter of law.

Read the full text of the opinion here.

[1] ____ Cal. App. 4th _____, (Cal. App. 2d Dist., filed March 2, 2009).

[2] The Court of Appeal affirmed the trial court's grant of demurrer to the CLRA claim, finding that insurance is not a "good" or "service" within the meaning of the CLRA, and that the CLRA cause of action was properly dismissed. This issue was recently decided by the California Supreme Court in *Fairbanks v. Superior Court*, ___ Cal.4th ___ (Filed April 20, 2009).

back to top

FOR ADDITIONAL INFORMATION ON THIS ISSUE, CONTACT:

Diana N. Iketani Ms. Iketani's litigation practice focuses on complex commercial litigation. She has litigated matters for clients in entertainment, banking, real estate, insurance, healthcare and other industries. Ms. Iketani has represented clients in contract, insurance and tort-related actions, including entertainment litigation, unfair competition, franchise agreement disputes, real estate and easement disputes, product liability and toxic torts. She is actively involved in all phases of litigation, from pre-litigation counseling through trial and appeal.