SUTHERLAND

LEGAL ALERT

February 7, 2011

Cost of Insurance Litigation – Recent Ruling on Meaning of "Mortality Experience" and Other Developments

Last month, a federal district court in California ruled on a dispute over the meaning of a life insurance policy provision stating that the "[c]urrent monthly cost of insurance rates will be determined by the Company based on its expectation as to future mortality experience." The court held that the phrase "expectation as to future mortality experience" encompassed only changes in the "rate of death" and did not permit the insurer to consider expected changes in persistency or the expected average amount of benefits to be paid. *Yue v. Conseco Life Insurance Company*, CV08-1506 (C.D. Cal. 2011). (Please click here for the opinion.) This Legal Alert discusses the *Yue* decision and reports on other developments in litigation challenging cost of insurance charges.

Yue v. Conseco

On January 19, 2011, the federal district court in *Yue v. Conseco Life Insurance Company* granted summary judgment for plaintiff on claims for declaratory relief in a class action challenging the insurer's announced increases in current monthly cost of insurance (COI) rates. The increases, adopted in 2002, would have taken effect beginning in the 21st year of the policies, and some policyholders would have been charged the increased rates beginning in 2010. On December 7, 2009, the court certified a nationwide class. In 2010, the insurer sought to have the case dismissed as moot on the ground that it had "definitively" decided not to implement the challenged COI increase it had adopted in 2002. The court, however, held that the decision not to implement the rate increase did not moot the claim for declaratory relief, because the insurer maintained that the methodology it used to calculate the challenged COI rate increase was permissible under the policy.

In its January 19, 2011 ruling, the court held that the insurer's methodology for calculating the 2002 COI increases was impermissible under the policy. The "Cost of Insurance Rates" section of the policy provided that "[c]urrent monthly cost of insurance rates will be determined by the Company based on its expectation as to future mortality experience." The insurer argued that "its expectation as to future mortality experience" included three factors: (1) the expected rate of death or "mortality rates," (2) the number of policyholders expected to continue being insured (*i.e.*, persistency), and (3) the average amount of death benefits the insurer expected to pay for those insureds who died while their policies remained in force. The court agreed with the plaintiff, however, that the insurer's approach was impermissible because it took into account factors other than "mortality," which the court defined as meaning only the "rate of death." The court granted summary judgment for the plaintiff on the declaratory relief claim, further stating that "'expectation as to future mortality experience' . . . does not mean something that would allow COI rates to be based on a comparison of the cost of projected death claims against the amount of revenue derived from the COI charges to be received from Policyholders." Judgment was entered on February 2, and the insurer has announced that it will appeal the decision.

SUTHERLAND

Other Cost of Insurance Litigation Developments

In addition to *Yue* and other cases challenging announced increases in current COI rates, a plaintiffs' law firm in Missouri has filed a series of putative class actions, beginning in 2009, challenging current COI rates as improper from the inception of the policy (*i.e,* without any increase in rates). All of these cases involve breach of contract claims alleging that the current COI rates for life insurance policies should be based solely on mortality factors and alleging that the insurers have impermissibly taken into account what plaintiffs assert to be non-mortality factors. The extent to which plaintiffs identify the alleged non-mortality factors varies from case to case, but specific allegations of alleged impermissible factors include expenses, persistency, taxes, profits, current COI rates of other insurers, and recoupment of past losses. The plaintiffs' law firm has filed at least seven of these cases, and its web site states that it is investigating other insurers. There have been decisions in a number of these cases, although apparently only one case addressed the merits of the claims thus far.

On April 8, 2010, the trial court in *Petersen v. Metropolitan Life Insurance Company*, No. 602901/2009 (New York County Supreme Court), granted the insurer's motion to dismiss and directly addressed the merits of the plaintiffs' position as to what factors can be considered in setting COI charges. The court agreed with the insurer that the life insurance policy, properly interpreted, allowed the insurer to consider persistency and expenses in setting current COI rates. (Click here for the opinion.) Plaintiffs' appeal was set for argument last week.

Another case addressed jurisdiction under the Class Action Fairness Act (CAFA) where COI rates for a variable life insurance policy were at issue. The case was filed in state court (*Bezich v. Lincoln National Life Ins. Co.*, Cause No. 02C01-0906PL-73 (Allen Circuit Court, Indiana)), and the insurer removed the case to the Northern District of Indiana based on CAFA. The district court, however, remanded the case to state court based on the CAFA exception excluding jurisdiction over "a claim . . . that relates to the rights, duties (including fiduciary duties), and obligations relating to or created by or pursuant to any security," *i.e.,* the variable life insurance policy. *Bezich v. Lincoln National Life Ins. Co.*, CV1:09-200 (N.D. Ind. Mar. 29, 2010) (quoting 28 U.S.C. § 1332(d)(9)(C)). The court rejected the insurer's arguments that (a) the policy should be split into security and non-security components for purposes of the CAFA analysis, with the COI provision being treated as part of the non-security component; and (b) the COI provision was a traditional insurance policy provision that is unrelated to the variable nature of the contract and thus should not implicate the CAFA securities exception. Instead, the court treated the policy in its entirety as a security for purposes of CAFA. On June 25, 2010, the U.S. Court of Appeals for the Seventh Circuit agreed with the district court that CAFA jurisdiction was precluded by the securities exception and dismissed the appeal for lack of jurisdiction. *Lincoln National Life Ins. Co. v. Bezich*, 610 F.3d 448 (7th Cir. June 25, 2010). (Please click here for the Seventh Circuit opinion.)

Early this year, the court in another case granted the insurer's motion for summary judgment on grounds that a previous vanishing premium class settlement release barred the plaintiff's new claim challenging COI rates. *Freeman v. MML Bay State Life Insurance Company*, CV2:10-4019 (D. N.J. Jan. 4, 2011). (Please click here for the opinion.) As part of the prior settlement, class members had consented to a release barring them from bringing any claim arising from or relating to "the expenses and/or costs" charged against the policies, the "terms" of the policies, or the "cost of insurance and administrative charge practices whether past, present, or future." The plaintiff was a member of the prior class settlement and had not opted-out. The court held that his complaint arose out of the same policy that made him a member of the earlier class settlement, and therefore granted summary judgment in favor of the insurer. Plaintiff has filed a notice of appeal.

In at least two other cases challenging cost of insurance rates, motions to dismiss are fully briefed and pending, so more decisions are expected this year.

■ ■ ■

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

Authors

Steuart H. Thomsen	202.383.0166	steuart.thomsen@sutherland.com
Phillip E. Stano	202.383.0261	phillip.stano@sutherland.com
Wilson G. Barmeyer	202.383.0824	wilson.barmeyer@sutherland.com

Related Attorneys

Frederick R. Bellamy	202.383.0126	fred.bellamy@sutherland.com
Thomas E. Bisset	202.383.0118	thomas.bisset@sutherland.com
Thomas R. Bundy, III	202.383.0716	thomas.bundy@sutherland.com
Thomas M. Byrne	404.853.8026	tom.byrne@sutherland.com
Nicholas T. Christakos	202.383.0184	nicholas.christakos@sutherland.com
W. Thomas Conner	202.383.0590	thomas.conner@sutherland.com
Thomas W. Curvin	404.853.8314	tom.curvin@sutherland.com
Steve Herbert	212.389.5050	steve.herbert@sutherland.com
Mary Thornton Payne	202.383.0698	mary.payne@sutherland.com
Stephen E. Roth	202.383.0158	steve.roth@sutherland.com
Gail L. Westover	202.383.0353	gail.westover@sutherland.com
Mary Jane Wilson-Bilik	202.383.0660	mj.wilson-bilik@sutherland.com