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### SECOND CIRCUIT AFFIRMS BIG WIN FOR LIFE SETTLEMENT INVESTOR

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*Julius A. Rousseau, III, Eric A. Biderman, and James M. Westerlind*

The U.S. Court of Appeals for the Second Circuit recently issued a 32-page decision affirming the district court's conflict of laws ruling that New York law, rather than New Jersey law, applied to an insurable interest dispute between AEI Life LLC and Lincoln Benefit Life Company.[1]

This decision, which was the culmination of an almost five-year legal battle, reinforces a number of legal rulings that are common in insurable interest lawsuits between life insurers and third-party investors and should benefit investors in pending and subsequent disputes.

#### Background

In *AEI Life LLC*, the plaintiff, AEI,[2] purchased a life insurance policy in 2011 from another investor in a secondary market transaction that had been issued by Lincoln Benefit in 2008 and insured the life of a resident of New York. Lincoln Benefit commenced an action in New Jersey federal court in 2013, seeking a declaration that the policy was void *ab initio* because it was purchased as part of a Stranger Originated Life Insurance ("STOLI") scheme and, therefore, lacked insurable interest. AEI promptly filed a lawsuit in federal court in New York, seeking a declaration that the policy was valid and enforceable because, under New York's incontestability statute, Lincoln Benefit had failed to challenge the validity of the policy within two years. Despite Lincoln Benefit's lawsuit being filed first, as a result of certain procedural issues, the New York federal court decided that it had obtained jurisdiction over the parties first and proceeded with AEI's lawsuit.

There was no dispute that the policy had been procured as part of a STOLI scheme or that AEI was an innocent and bona fide purchaser. Discovery disclosed that the insured had not signed the policy application, and the insured's son (who also lived in New York) had created a trust in New York to purchase the policy and be its beneficiary (with the son as the initial beneficiary of the trust). The insured admitted that she did not have the financial ability to pay the substantial premiums for the policy. A third-party investor had funded the trust to pay the policy premiums.

The broker involved in the purchase of the policy, and all negotiations involved with respect to the policy, occurred in New York. The premiums were paid from a bank account under the trust's name in New York. But the policy application stated that it had been signed in Lakewood, New Jersey. Lincoln Benefit was licensed to issue policies in New Jersey, but not licensed to do so in New York. The policy was issued on Lincoln Benefit's New Jersey form, and contained "Conformity with State Law" provision, which stated:

This certificate is subject to the laws of the state where the application was signed. If any part of the certificate does not comply with the law, it will be treated by us as if it did.

Lincoln Benefit primarily argued that this was a choice of law provision that required the application of New Jersey law, as the application said that it was signed in New Jersey. AEI argued that the provision was not a choice of law provision; that in any event, the policy had not been signed in New Jersey (based on the insured's testimony); and that all of the material contacts with respect to the policy, the insured, the trust, and the beneficiary of the trust when the policy was issued were in New York. The conflict of laws issue was critical because, although New York's and New Jersey's incontestability statutes each contain similar language, the New Jersey statute has been interpreted to allow an insurer to challenge a life policy on insurable interest grounds more than two years after issuance; but the New York statute has been interpreted to disallow a life insurer from challenging a policy on insurable interest grounds after two years.

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## The District Court Decision

Sr. District Judge Jack B. Weinstein of the Eastern District of New York conducted an evidentiary hearing to develop facts with respect to the conflict of laws issue. He found that the policy application had not been signed in New Jersey, and that, under New York's "center of gravity" conflict of laws analysis, all of the relevant contacts, including place of contacting and place of performance, were in New York. While he concluded that the "Conformity with State Law" clause in the policy was a choice of law provision, the fact that the application was not signed in New Jersey but, rather, was signed in New York, further supported his conclusion that New York's incontestability rule applied, barring Lincoln Benefit from challenging the policy on insurable interest grounds.

## The Second Circuit Affirms

The Second Circuit affirmed Judge Weinstein's decision that New York law applied under New York's "center of gravity" conflict of laws analysis. It disagreed, however, that the "Conformity with State Law" clause was a choice of law provision, principally because it did not clearly identify the state law to be applied.

The Second Circuit's affirmance of Judge Weinstein's conflict of laws analysis is particularly helpful for investors which own policies purchased in the secondary market. Life insurers often commence actions to declare a policy void *ab initio* for lack of insurable interest in jurisdictions (such as New Jersey or Delaware) where certain courts have concluded that the state's incontestability statute does not apply to challenges for lack of insurable interest. There is often motion practice early in the lawsuit concerning which state's law should apply. Many such lawsuits involve policies that insure lives located in New York, with New York trustees, and all negotiations with respect to the purchase of the policy occurred in New York. It is not uncommon for the application to incorrectly state that the trustee and insured signed the application in New Jersey (specifically, in Lakewood, NJ), probably because the brokers are able to obtain higher commissions on different products under New Jersey's insurance law than in New York. That is, the conflict of laws issues and factual scenario presented in the *AEI* case is not uncommon (indeed, it is a recurring theme), and the Second Circuit's decision here is persuasive or binding authority, depending in which court the dispute is to be litigated.

There are a number of additional favorable aspects of the Second Circuit's decision in *AEI*, including the following:

- If the investor that owns the policy is a bona fide purchaser for value (*i.e.*, it purchased the policy on the secondary market and was not involved in the initial STOLI transaction that resulted in the purchase of the policy), then the life insurer cannot assert a number of equitable claims and defenses against the current owner of the policy: "Lincoln argues that we should not interpret the contract against it, the defrauded party. This argument might be persuasive if Lincoln's adversaries were Fischer and her son. But the principle carries considerably less weight here because *AEI* was an innocent bona fide purchaser, not the fraudster."<sup>[3]</sup> This should *increase* the value of a policy that has been sold in the secondary market, as the insurer will not be able to raise the same equitable claims and defenses against the new investor owner. Traditionally, policies sold in the secondary market have *reduced* in value.
- A trust created to purchase and be the beneficiary of a life insurance policy is not considered a stranger to the policy even if the insured did not actually consent to the purchase of the policy.
- The Second Circuit confirmed that *New Eng. Mut. Life Ins. Co. v. Doe*,<sup>[4]</sup> a case often relied upon by life insurers in their attempt to get around the application of *New Eng. Life Ins. Co. v. Caruso*,<sup>[5]</sup> which held that a life insurer cannot challenge a life policy under New York's incontestability statute after two years for lack of insurable interest, is inapplicable to disputes involving life insurance policies, as *Doe* involved a disability insurance policy. The Second Circuit correctly recognized that NY Ins. Law § 3216, which is the incontestability statute for disability insurance, contains an express exception for fraudulent misstatements, unlike NY Ins. Law § 3203, New York's life insurance incontestability statute. A number of other courts have misapplied *Doe* over the years in STOLI life insurance disputes in favor of life insurers.

## Conclusion

The Second Circuit's recent decision in *AEI* should assist investors that have purchased life insurance policies in the secondary market to defeat many of the common arguments made by life insurers in lawsuits concerning the validity of the life policy on insurable interest grounds. The key factual and legal determinations in the case concerning conflict of laws principles, conformity with law provisions (which are found in many life insurance policies), and the equitable claims and defenses that a life insurer can assert against a bona fide purchaser of the policy on the secondary market are but a few of the persuasive, and possibly binding, rules, and principles that were thoroughly analyzed and articulated by the court.

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## Notes

[1] See *AEI Life LLC v. Lincoln Benefit Life Co.*, No. 17-224, 2018 WL 2746589 (2d Cir. Jun. 8, 2018).

[2] Arent Fox represented AEI in this case.

[3] Decision at 17 n. 9 (citations omitted).

[4] 93 N.Y.2d 122 (1999).

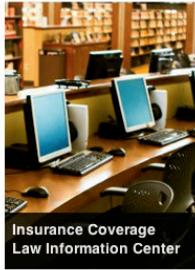
[5] 73 N.Y.2d 74 (1989).

## About the Authors

**Julius A. Rousseau, III**, is a partner at **Arent Fox LLP**, focusing his practice on insurance and reinsurance related matters and litigation. Mr. Rousseau may be reached at [jule.rousseau@arentfox.com](mailto:jule.rousseau@arentfox.com).

**Eric A. Biderman** is counsel at **Arent Fox LLP** concentrating his practice in insurance litigation, regulatory, and transactional matters. Mr. Biderman may be reached at [eric.biderman@arentfox.com](mailto:eric.biderman@arentfox.com).

**James M. Westerlind** is counsel at **Arent Fox LLP** focusing on cyber risk issues, including insurance coverage and potential data breach liability for companies and their board members. Mr. Westerlind may be contacted at [james.westerlind@arentfox.com](mailto:james.westerlind@arentfox.com).



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