ILMA Institutional Life Markets Association

INVESTOR NOTES

Form Over Intent: Understanding the Jack Teren Insurable Interest Case

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In an important development for the life settlement industry that may have implications for many pending cases across the country, the California Court of Appeals, in a split decision, reversed the lower court's ruling in *The Lincoln Life and Annuity Company of New York v. Jonathan S. Berck*, commonly referred to as the Teren case. The Teren case was closely watched by the life settlement industry because it was one of a very limited number of cases where an insurance company was allowed to both rescind a life insurance policy for lack of insurable interest and retain the premiums paid due to the "egregious fraud" in connection with the policy issuance.

Finding that the policies were issued with the requisite insurable interest, the California Court of Appeals held that the policies must remain in force. Accordingly, it did not have to rule on whether a carrier may both rescind a policy and retain premiums paid.

The Teren case involved a beneficial interest transaction of the type that is no longer legal in the State of California. At the behest of his sons, Jack Teren met with an insurance agent who assisted him in forming an insurance trust and applying for life insurance. In the application, Mr. Teren falsely represented his net worth was $46.4 million and his annual income was $3.0 million. In truth, at the time, his net worth was less than $50,000 and his monthly income was limited to pension and social security benefits of approximately $1,333.23.

Before Mr. Teren signed the documents, an investor group was formed to acquire the beneficial interests in the trust that would own the policies. In April 2006, the carrier issued two policies on Mr. Teren's life with an aggregate death benefit of $20.0 million. On May 6, 2006, Mr. Teren's son sold his beneficial interest in the trust to the investor group for $600,000.

In May 2008, the carrier sued to rescind the policies on the grounds, among others, that the policies were void *ab initio* because they were issued without "any legally cognizable insurable interest." In addition, the carrier sought to retain the premiums paid. The lower court agreed and granted the requested relief to the carrier.

Noting that for a life insurance policy to be valid it must, at its inception, have been held by someone with a valid insurable interest, the California Court of Appeals examined the formalities of the contract at the time of issuance. In particular, it noted that the trust had a valid insurable interest at the time of issuance because the trust was formed by the insured for the benefit of his sons. Acknowledging that the intent of the parties from the outset was for the investor group to acquire the interests in the policies, the Court of Appeals nevertheless stated "that intent does not negate the fact that when the trust acquired the policies, they were supported by an insurable interest."

In reaching its decision, and focusing on the formalities of the structure and not the intent of the parties, the Court of Appeals cited another landmark California case for the life settlement industry, *Lincoln National Life Insurance Company v. Gordan R.A. Fishman Irrevocable Life Trust*. When reviewing the facts of a premium finance transaction that the carrier alleged was a sham, the court in Fishman described the issue it was "confronted with [was] not simply the party's characterization of their agreements . . ., but the realities of how the transaction was structured to operate." The court in Fishman, as in the Teren case, declined to "ignore those realities and examine the intent of the parties in entering into the agreement in the first instance."

The California Court of Appeals decision, which is consistent with the decision in Fishman, follows a line of decisions in other states, including the Pauslon case in Minnesota, and the Kramer case in New York, where courts have held that intent does not matter. The Court of Appeal's focus on insurable interest at the time of issuance is a correct reading of the California insurable interest statute and a proper formulation of insurable interest law.

These rulings are especially important to investors in the tertiary market, as the subjective intent at the time of policy issuance may be difficult to determine after the fact. The insurable interest battle will continue with the Delaware Supreme Court addressing whether an insured may acquire a policy and immediately transfer it to a third party.

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