NOT TO BE PUBLISHED IN OFFICIAL REPORTS

COURT OF APPEAL, FOURTH APPELLATE DISTRICT

DIVISION ONE

STATE OF CALIFORNIA

THE LINCOLN LIFE AND ANNUITY COMPANY OF NEW YORK, Plaintiff, Cross-defendant and Respondent, v. JONATHAN S. BERCK, as Trustee, etc., Defendant, Cross-complainant and Appellant.	D056373 (Super. Ct. No. 37-2008-00083905-CU-CO-CTL)

APPEAL from a judgment of the Superior Court of San Diego County, John S. Meyer, Judge. Affirmed in part; reversed in part with directions.

Defendant and cross-complainant Jonathan S. Berck, as trustee of the Jack Teren Insurance Trust dated March 20, 2006 (the trust), appeals a judgment in favor of plaintiff and cross-defendant the Lincoln Life and Annuity Company of New York (Lincoln) declaring that two life insurance policies Lincoln issued on the life of Jack Teren were void *ab initio* because there was no insurable interest. The court also ruled Lincoln was

entitled to retain all of the premiums the trust paid on the policies before the commencement of this action. The trust owned the policies, and the beneficiary under the policies was Life Products Clearing, LLC (LPC), a New York limited liability company that acquired and managed life insurance policies on behalf of investors. LPC provided the documents used to create the trust and provided the trust with the necessary funds to pay the premiums on the Teren policies.

The trust contends that (1) the court erred by ruling the policies are void because there was no insurable interest under California law in effect at the time Lincoln issued the policies; (2) if the trial court correctly ruled the investors were the true applicants for the policies, New York law applies and, under that law, the incontestability clauses in the policies bars Lincoln from challenging the policies for lack of an insurable interest; (3) if Lincoln is permitted to rescind the policies, it must return all of the premiums the trust paid on the policies plus interest; and (4) the court erred by designating Lincoln as the prevailing party entitled to costs under Code of Civil Procedure section 1032. We conclude the court erred by ruling the policies were void *ab initio*.

FACTUAL AND PROCEDURAL BACKGROUND

In early 2006, Jack Teren's son Elliot Teren[1] read an article about Warren Buffet and certain investment funds' practice of buying the beneficial interests in life insurance policies as investments. Elliot was intrigued by the article and thought his father might be a good candidate for the described insurance arrangement. Elliot gave Jack an

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1 For convenience we refer to the Terens individually by their first names.

overview of the article and suggested he undergo a medical examination to determine if he qualified for a life insurance policy. Elliot asked his second cousin Landon Strauss, a life insurance agent familiar with that "particular end of the insurance business," to put Jack in touch with someone who "might be able to do something like this."

After Elliot contacted Strauss, Jack's other son, Darren, accompanied Jack to a meeting in San Diego with a notary public who presented Jack with a number of documents for his signature. Based on Jack's deposition testimony, it appears that he signed both the agreement establishing the trust and an application for life insurance in the amount of $20 million at the meeting with the notary. The trust agreement is dated March 20, 2006, and the application for insurance is dated March 30, 2006, and states it was signed in "NY NY."[2] The trust agreement identified Jack as the depositor (trustor or settlor) and Elliot as the beneficiary of the trust. Jack wrote a personal check to the trust in the amount of $1,000 to fund the trust. The initial trustee was Robert Desch, a vice president of TD Banknorth NA. The insurance application identified the trust as the owner of the policy.

A financial supplement signed by Jack and submitted with his insurance application falsely represented that his net worth was $46.4 million ($53 million in assets minus liabilities of $6.6 million) and his annual income was $3 million. Jack testified

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2 The application was for a policy from Jefferson Pilot Life America Insurance Company, later acquired by Lincoln.

that his net worth was less than $50,000 and that, at the time he testified, his monthly income was not over $1,333.23 from a pension and social security benefits.

The false representations regarding Jack's net worth were supported by a document purportedly prepared by Anthony S. Graci of the accounting firm A.S. Graci & Associates located in Los Angeles, California. The document bearing Graci's signature included a breakdown of Jack's assets and liabilities and represented that his total net worth was $44.9 million. The document also represented that Jack had been a client of A.S. Graci & Associates for 22 years. Jack testified that he did not know anyone named Anthony Graci.

Anthony Graci testified that he had never seen the fabricated accounting document and that his purported signature on the document was a forgery. He had no experience in the financial services industry or accounting industry and had never met Jack. However, he was acquainted with Strauss.

Before Jack signed the documents, Martin Fleisher, a 50 percent shareholder/member of LPC, solicited investors to contribute money to acquire the beneficial interests in a group of insurance policies that included the policies LPC anticipated would be issued on Jack's life. On April 27, 2006, Lincoln issued two policies on Jack's life providing a combined death benefit of $20 million with annual premiums in the combined amount of $909,000.[3] Both policies contain an

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3 Before Lincoln issued the policies, someone on Jack's behalf asked that Lincoln issue two $10 million policies instead of one $20 million policy.

incontestability provision that states: "We will not contest this policy . . . after it has been in force during the lifetime of the Insured for a period of two (2) years from its Issue Date."

Members of Lincoln's underwriting department who reviewed the application for insurance on Jack's life noted some "red flags" that made them concerned the application might be for "STOLI"[4] policies. Consequently, Lincoln sent the trust an "Amendment to Application for Insurance" dated May 16, 2006 – a document designed to ensure that a pending application for insurance did not involve a STOLI policy. Desch and Jack signed the amendment, which included representations that "[n]either [Jack] nor any person or entity on [his] behalf [were] receiving any compensation, whether via the form of cash, an agreement to pay money in the future, or a percentage of the death benefit[;]" that Jack was "purchasing insurance for [his] benefit and the benefit of [his] personal beneficiaries[;]" and that "[t]he premiums [were] not being advanced, loaned or financed by a third party."

A "Beneficial Interest Transfer Agreement" and an agreement entitled "Acknowledgments and Consents Relating to Sale of Beneficial Interest," both purportedly signed by Elliot on May 2, 2006, effected the transfer of Elliot's beneficial interest in the trust to LPC in exchange for a payment to Elliot of $600,000. Elliot testified that his signature on those documents was forged. Fleisher sent Elliot a check

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4 "STOLI" and "SOLI" are acronyms in the insurance industry for "stranger origin life insurance."

from LPC in the amount of $600,000 with a cover letter dated May 16, 2006, in which he acknowledged receipt of the transfer documents and stated LPC was "now the sole beneficiary of the [t]rust." Elliot deposited the check into a joint checking account he opened with Jack and later transferred the funds to a joint stock brokerage account. Elliot testified that his signature endorsement on the back of that check was genuine. The stocks in the joint brokerage account eventually were sold and Jack transferred the proceeds to an account in his name only. Jack testified that the $600,000 payment was compensation for having the "insurance trust in my name." Jack paid Elliot a "finder's fee" of $50,000 and gave Darren $80,000.

LPC provided the trust with the funds it used to pay the premiums on the policies. From May 2006 through December 2008, the trust paid Lincoln more than $2 million in premiums, including more than $400,000 it paid after Lincoln filed the present action.[5]

In May 2008, Lincoln filed a declaratory relief action against Jack and the trust. Two declaratory relief causes of action in Lincoln's first amended complaint were tried to the court.[6] The third cause of action sought a judicial declaration that the subject policies were void *ab initio*, or Lincoln is entitled to rescind them, because Lincoln issued them in reliance on material misrepresentations. The fourth cause of action sought a declaration that the policies were void *ab initio*, or Lincoln is entitled to rescind them, because they

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5 Lincoln states the total amount of premiums it received was $2,041,855.26. The trust calculated the total amount of premiums to be $2,030,478.94.

6 Two other causes of action relating to failed settlement negotiations were dismissed before trial.

were issued without "any legally cognizable insurable interest." Lincoln also sought a declaration that it could retain some or all of the premiums paid for the polices.[7]

After trial, the court entered judgment in favor of Lincoln on its fourth cause of action and declared the policies void *ab initio* because they were issued without an insurable interest. The judgment ordered Lincoln to refund $430,480.18 in premiums paid after commencement of this action plus 7 percent interest, but allowed Lincoln to retain all other premiums paid for the policies. The court granted judgment in favor of the trust and Jack on Lincoln's third cause of action, which sought relief based on misrepresentation.

The court filed a statement of decision in which it found the policies "lack an insurable interest under California law and, consequently, are void *ab initio*." The court decided that although Jack has an unlimited interest in his own life and Elliot has an insurable interest in Jack's life, the policies were issued without an insurable interest because the trust procured them on Jack's life for the benefit of LPC.

The court found the policies "were procured from Lincoln through misrepresentations and fraud." However, regarding Lincoln's cause of action for rescission based on misrepresentation, the court stated: "Because the Court has determined that the Teren policies were fraudulently procured, lack an insurable interest

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7 Before trial, the trust dismissed a cross-complaint it had filed against Lincoln and Jack seeking rescission of the policies based on the misrepresentations regarding Jack's net worth and reimbursement or refund of the amounts it paid as premiums on the policies if the court declared the policies subject to rescission or void *ab initio*.

and are void *ab initio*, the Court does not have to address Lincoln's misrepresentation claim. The Court finds, however, that the misrepresentation claim would be barred by the incontestability clauses contained in the Policies, which provide that any lawsuit seeking the rescission of the Policies based upon misrepresentations must be commenced within two years of the date that the Policies are issued. This lawsuit was filed on May 14, 2008[,] more than two years after the April 27, 2006[,] issue date for the Teren Policies."[8]

The court found the trust was not entitled to a refund of the premiums it paid on the policies prior to the commencement of this action because: (1) the trust was barred from obtaining that relief by the doctrine of unclean hands; (2) under Insurance Code[9] section 483, subdivision (c), a policy owner or insured is not entitled to a premium refund when it engages in actual fraud; (3) the court has the power to adjust the equities between the parties in a rescission action and the equities in this case weigh in favor of precluding

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8 The court's observation that it was unnecessary to address Lincoln's misrepresentation claim because the court had determined the policies were "*fraudulently procured*, lack an insurable interest and are void" (italics added) is contradictory because the facts forming the basis of the misrepresentation claim are the same facts the court cited in its statement of decision as the basis for its finding that the policies were fraudulently procured. The court possibly meant to convey that although it was unnecessary to address Lincoln's misrepresentation/rescission claim because the court had determined the policies were void for lack of an insurable interest, it would have ruled in Lincoln's favor on that claim if the claim were not time-barred by the incontestability clauses in the policies. As noted, the court entered judgment in the trust's favor on Lincoln's cause of action for rescission based on misrepresentation, and Lincoln does not challenge that portion of the judgment on appeal.

9 All subsequent statutory references are to the Insurance Code unless otherwise specified.

a refund of premiums to the trust; and (4) denial of a premium refund is warranted by the equitable principle that a wrongdoer cannot be allowed to take advantage of his own wrong.

DISCUSSION

A. *Requests for Judicial Notice*

The trust filed an unopposed request that we take judicial notice of the following: (1) a background report for an informational hearing on Senate Bill No. 98, which the Legislature passed in 2009, amending and revising sections of the Insurance Code regarding insurable interest and life settlement contracts (Stats. 2009, ch. 343, § 1); (2) the chaptered version of Senate Bill No. 98; (3) the version of section 10110.1 in effect from January 1, 2004, through December 31, 2009; (4) a letter dated September 30, 2008, from the Governor to the California State Senate explaining why he vetoed Senate Bill No. 1543, which concerned life settlements; and (5) an online dictionary definition of the word "cancel." We grant the request for judicial notice as to items 2 and 3 (Evid. Code, §§ 452, subds. (a) & (b), 459) and deny the request as to items 1, 4, and 5 on the ground judicial notice of those items is unnecessary to resolution of the appeal. (*County of San Diego v. State of California* (2008) 164 Cal.App.4th 580, 613, fn. 9.)

The trust filed an additional request for judicial notice in support of its reply brief, asking that we take judicial notice of the following federal trial court records: (1) a trial transcript that includes the reading of the jury's verdict in *Settlement Funding, LLC v. AXA Equitable Life Ins. Co.* (S.D.N.Y. Oct. 25, 2010, 09 CV 8685 (HB)); (2) the special verdict form the jury filled out in that case; (3) a third party complaint filed by American

National Insurance Company in *Wells Fargo Bank, N.A. v. American National Insurance Co.* (C.D. Cal. April 20, 2009, CV09-01840 DDP (RZx)); and (4) the judgment filed in *Wells Fargo*. Lincoln does not oppose the request but asks that we take judicial notice of the notice of appeal to the United States Court of Appeal for the Ninth Circuit that American National Insurance Company filed in *Wells Fargo*. We grant both parties' requests for judicial notice (Evid. Code, §§ 452, subd. (d), 459).

B. *Insurable Interest*

The trust contends the court erred in finding the policies void because they were issued without an insurable interest. Section 10110.1, subdivision (a), defines an "insurable interest" as "an interest based upon a reasonable expectation of pecuniary advantage through the continued life, health, or bodily safety of another person and consequent loss by reason of that person's death or disability or a substantial interest engendered by love and affection in the case of individuals closely related by blood or law." Section 10110.1, subdivision (b), provides: "An individual has an unlimited insurable interest in his or her own life, health, and bodily safety and may lawfully take out a policy of insurance on his or her own life, health, or bodily safety and have the policy made payable to whomsoever he or she pleases, regardless of whether the beneficiary designated has an insurable interest."

Section 10110.1, subdivision (g), provides that "[a]ny contract of life or disability insurance procured or caused to be procured upon another individual is void unless the person applying for the insurance has an insurable interest in the individual insured at the time of the application." Section 10110.1 subdivision (f), states that "[a]n insurable

interest shall be required to exist at the time the contract of life or disability insurance becomes effective, *but need not exist at the time the loss occurs*."[10] (Italics added.) Similarly, section 286 states that "an interest in the life or health of a person insured must exist when the insurance takes effect, *but need not exist thereafter or when the loss occurs*." (Italics added.)

Under section 10130, "[a] life or disability policy may pass by transfer, will or succession to any person, whether or not the transferee has an insurable interest. Such transferee may recover upon it whatever the insured might have recovered." This provision "was designedly adopted to set at rest any question as to the assignability of a life insurance policy and also to affirm the right to make such assignment to a person having no insurable interest in the life of the insured." (*Lewis v. Reed* (1920) 48 Cal.App. 742, 746.)

One federal district court noted these statutes, read together, reflect that under California law when this case was tried: "[F]or a [life] insurance policy to be valid, it must, *at its inception*, have been held by someone with an insurable interest in the person . . . insured under the policy, that is to say, by someone who has an interest and advantage in 'the continued life . . . of' the insured and who would suffer a 'consequent loss' [from

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10 At the time of trial, current subdivisions (f) and (g) of section 10110.1 were designated subdivisions (d) and (e), respectively. The Legislature amended section 10110.1 in 2009 by adding two new provisions as subdivisions (d) and (e) and designating former subdivisions (d) through (g) as (f) through (i), respectively. (Stats. 2009, ch. 343, § 1.)

the insured's death]." (*Lincoln Nat. Life Ins. Co. v. Gordon R.A. Fishman Irrevocable Life Trust* (C.D.Cal. 2009) 638 F.Supp.2d 1170, 1177-78 (*Fishman*), italics added.)

In *Fishman,* Lincoln alleged that three $10 million policies it issued on the life of Dr. Gordon Fishman were unlawful STOLI policies and therefore void. (*Fishman, supra,* 638 F.Supp.2d at pp. 1170-1171.) Lincoln claimed that Fishman formed a trust to purchase and hold the policies at the behest of Mutual Credit Corporation (MCC) as part of a scheme by which MCC acquired the beneficial interest in the policies indirectly through nonrecourse premium financing loans—i.e. loans secured only by a collateral assignment of the policies purchased with the loan proceeds. (*Id.* at p. 1172.) The premium financing was sufficient to cover two years of premium payments, an origination fee, and a "premium reserve" of up to 3 percent of the face value of the policy. (*Id.* at pp. 1172, 1175.) The premium reserve was actually a cash payment that did not have to be used to pay premiums but could be used for any purpose the insured chose and was described as "a 'fee to individuals' given in exchange for 'their "unused capacity to acquire retail life insurance." ' " (*Id.* at p. 1175.)

Under MCC's premium finance program, if the borrower wanted to retain the policy at the conclusion of the two-year loan term, it was obligated to repay the principal amount plus a finance charge consisting of "two components: (1) regular interest calculated at 10 [percent] per year, and (2) an additional Contingent Interest component that varied depending on the secondary market value of the policy at the end of the loan term." (*Fishman, supra,* 638 F.Supp.2d at p. 1175.) If the borrower chose not to retain the policy at the end of the two-year loan term, the "borrower could simply return the

policy to MCC 'for full settlement of the debt.' If the borrower elected that option, it had no obligation to return the premium reserve." (*Id.* at p. 1176.) In *Fishman,* the trust surrendered the three policies at issue to MCC at the end of the two-year loan period. (*Ibid.*)

Lincoln argued that the insurance transaction in *Fishman* was a sham and the court should, in its own words, "basically pierce the contract/agreements' formalities and construe the transaction as actually conceived and intended by the parties." (*Fishman, supra,* 638 F.Supp.2d at p. 1178.) The court noted that Lincoln "then turn[ed] to the statutory prohibition against an insurance policy being procured or caused to be procured without an insurable interest as an apparent means to find a way to allow it (and the Court) to look behind the formalities of the agreements and get to the not-so-subtle deviousness on the part of MCC." (*Ibid.*) The *Fishman* court declined to "pierce" the formalities of the insurance transaction, stating: "[T]he statutory provision cited by Lincoln concerns efforts to procure policies without an insurable interest at the inception, which only brings the issue back full circle to the evidence presented by defendants that such an interest is and was filled at the outset (even if[, in] Lincoln's view, as an obvious placeholder). Despite its valiant attempts to expose MCC's alleged scheme for the true 'charade' it is, the simple fact remains that the law, as it is currently structured, allows for an arrangement as that concocted by MCC." (*Fishman, supra,* 638 F.Supp.2d at p. 1178.)

The court noted that the problem 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." (*Fishman, supra,* 638 F.Supp.2d at p. 1179, fn. 3.) The court

declined to "ignore those realities and examine the intent of the parties in entering into the agreement in the first instance" (*ibid.*), concluding the defendants' intent to sell or transfer the policies at some point in the future was legally irrelevant. (*Id.* at p. 1179.) The court observed: "MCC's finance program skirts close to the letter, and certainly can be viewed as violating the spirit, of the law. Defendants may have found a loophole in the law barring a STOLI finding, but it is clear to the Court that this whole arrangement with the Fishmans was nothing but a more creative version of the same. Unfortunately for Lincoln, the law as it presently exists allows this kind of insurance arrangement to be valid." (*Ibid.*)

The law as it existed in the *Fishman* case applies in this case. As we discuss later, the Legislature enacted legislation in 2009 making an arrangement like the one at issue here unlawful, but the new legislation does not retroactively apply to it. In the present case, Jack had an unlimited insurable interest in his own life. (§ 10110.1, subd. (b). Because Jack was the settlor of the trust, which acquired and owned the policies, the trust also had an insurable interest in Jack's life. (*Fishman, supra,* 638 F.Supp.2d at p. 1178 [trust that acquired insurance policies on settlor's life, settlor of trust, and trust beneficiaries all had insurable interest in settlor's life].) Elliot, who is Jack's son and was the beneficiary of the trust when it was formed and when the policies were issued, undisputedly had an insurable interest in Jack's life "engendered by love and affection." (§ 10110.1, subd. (a)). Thus, the insurance policies Lincoln issued were supported by an insurable interest at their inception.

The trial court ruled that the policies "lack an insurable interest because, in fact, the Teren Trust took out and procured the insurance policies on the life of Jack Teren for the benefit of [LPC] and its investors." Although the evidence shows the trust intended that LPC ultimately would acquire the beneficial interest in Jack's policies, that intent does not negate the fact that when the trust acquired the policies, they were supported by an insurable interest. Lincoln cites federal cases applying the law of other states for the propositions that an insurable interest is lacking when a prospective insured applies for a life insurance policy with the intent of the insured to sell the policy to a stranger investor (*Life Product Clearing, LLC v. Angel* (S.D.N.Y. 2008) 530 F.Supp.2d 646 [applying New York law]); when a third party participates in a scheme with the insured to procure a policy for the purpose of selling the policy or the beneficial interest in the policy (*First Penn-Pacific Life Ins. Co. v. Evans* (4th Cir. Feb. 26, 2009, No. 07-2020) 2009 WL 497394 [applying Arizona law]); or when there is an agreement at the time a policy is issued to sell it to a third (*Sun Life Assur. Co. of Canada v. Paulson* (D. Minn. Dec. 3, 2008, Civ. No. 07-3877 (DSD/JJG)) 2008 WL 5120953). In response to similar citations to out-of-state authority in *Fishman,* the *Fishman* court correctly noted there was no California authority "allowing a court to basically look behind the terms and other formalities of an insurance agreement(s) and basically re-write it to reflect what was really going on between the various parties thereto insofar as determining the existence (or lack thereof) of an insurable interest to an insurance policy." (*Fishman, supra,* 638 F.Supp.2d at pp. 1178-1179, fn. omitted.)

As noted, an insurable interest must exist when an insurance policy takes effect, *but need not exist when the loss occurs* (§§ 286, 10110.1, subd. (f)), and a life insurance policy may be transferred by assignment to a person having no insurable interest in the life of the insured (§ 10130). Because the policies in question here were supported by an insurable interest when they took effect and California law allowed the beneficial interest in the policies to be transferred to a transferee without an insurable interest, the trial court erred by ruling the policies are void *ab initio* because of the absence of an insurable interest.

C. *2009 Amendments to the Insurance Code*

In 2009, the Legislature passed an act that made insurance transactions like those in *Fishman* and the present case unlawful and invalid. Among other things, the act amended section 11010.1 to add the following two subdivisions: "(d) Trusts and special purpose entities that are used to apply for and initiate the issuance of policies of insurance for investors, where one or more beneficiaries of those trusts or special purpose entities do not have an insurable interest in the life of the insured, violate the insurable interest laws and the prohibition against wagering on life. [¶] (e) Any device, scheme, or artifice designed to give the appearance of an insurable interest where there is no legitimate insurable interest violates the insurable interest laws." (Stats. 2009, ch. 343, § 1.) However, Section 8 of the amending act provides, in relevant part, that "this act shall not apply to any life settlement contract entered into on or before July 1, 2010. This act shall apply to any transaction involving any life insurance policy in effect, or entered into, on or after the operative date of this act." (Stats. 2009, ch. 343, § 8.)

Under the new legislation, the definition of a "life settlement contract" includes "a written agreement solicited, negotiated, or entered into in this state between a provider[11] and an owner, establishing the terms under which compensation or any thing of value will be paid, which compensation or thing of value is less than the expected death benefit of the insurance policy or certificate, in return for the owner's assignment, transfer, sale, devise, or bequest of the death benefit or any portion of an insurance policy or certificate of insurance for compensation, provided, however, that the minimum value for a life settlement contract shall be greater than a cash surrender value or accelerated death benefit available at the time of an application for a life settlement contract. 'Life settlement contract' also includes the transfer for compensation or value of ownership or beneficial interest in a trust or other entity that owns such policy if the trust or other entity was formed or availed of for the principal purpose of acquiring one or more life insurance contracts, which life insurance contract is owned by a person residing in this state." (§ 10113.1, subd. (k).)

Although the Legislature's statement that "[t]his act shall apply to any transaction involving any life insurance policy in effect, or entered into, on or after the operative date of this act" is not a model of clarity,[12] it appears to provide that any transaction involving

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11 " 'Provider' means a person, other than an owner, who enters into or effectuates a life settlement contract with an owner." (§ 10113.1, subd. (r).)

12 The statement is ambiguous as to whether the clause "in effect, or entered into" modifies "transaction" or "life insurance policy." The ambiguity is due in part to the fact that in common usage, transactions are said to be "entered into" and insurance policies are said to be "in effect."

a life insurance policy in effect on the operative date of the act is subject to the requirements and prohibitions of the act. However, Section 8 of the act also states any transaction that qualifies as a "life settlement contract" is not subject to the requirements and prohibitions of the act unless the contract was entered into after July 1, 2010. The insurance transaction in the present case involves a life settlement contract—i.e., "a written agreement . . . negotiated, or entered into in this state between a provider and an owner, establishing the terms under which compensation . . . will be paid . . . in return for the owner's assignment, transfer, sale, devise, or bequest of the death benefit or any portion of an insurance policy" (§ 10113.1, subd. (k)), or "the transfer for compensation or value of ownership or beneficial interest in a trust . . . that owns [a life insurance] policy if the trust or other entity was formed . . . for the principal purpose of acquiring one or more life insurance contracts, which life insurance contract is owned by a person residing in this state." (*Ibid.*)

In any event, we conclude that the amendments to section 10110.1 do not apply retroactively under general principles applicable to new legislation. "'Generally, statutes operate prospectively only.' [Citations.] '[T]he presumption against retroactive legislation is deeply rooted in our jurisprudence, and embodies a legal doctrine centuries older than our Republic. Elementary considerations of fairness dictate that individuals should have an opportunity to know what the law is and to conform their conduct accordingly . . . . For that reason, the "principle that the legal effect of conduct should ordinarily be assessed under the law that existed when the conduct took place has timeless and universal appeal." ' [Citations.] 'The presumption against statutory

retroactivity has consistently been explained by reference to the unfairness of imposing new burdens on persons after the fact.' " (*McClung v. Employment Development Dept.* (2004) 34 Cal.4th 467, 475.) "[I]t has long been established that a statute that interferes with antecedent rights will not operate retroactively unless such retroactivity be 'the unequivocal and inflexible import of the terms, and the manifest intention of the legislature.' [Citations.] '[A] statute may be applied retroactively only if it contains express language of retroactively *or* if other sources provide a clear and unavoidable implication that the Legislature intended retroactive application.' " (*Ibid.*)

There is no clear and unavoidable implication here that the Legislature intended the act that amended section 10110.1 to apply retroactively, and retroactive application of the act would impose liability for actions not subject to liability when taken. We conclude the act does not retroactively apply to the insurance transaction in this case because it effects a change in the law regarding insurable interest and the validity of certain life settlement contracts.

D. *Remaining Issues*

Because of our conclusion that the two policies at issue in this case were issued with a valid insurable interest and therefore are not void, we do not reach the other issues raised by the parties in this appeal.

DISPOSITION

The portions of the judgment ruling in favor of Lincoln on the fourth cause of action of its first amended complaint, declaring the subject life insurance policies void *ab initio*, ordering Lincoln to refund the amount of premiums paid since commencement of

this action plus interest, and ruling that Lincoln is to retain all premiums paid on the polices prior to commencement of this action are reversed. The court is directed to enter judgment for defendants on the fourth cause of action. The portion of the judgment ruling in favor of defendants on the third cause of action is affirmed. The trust is awarded its costs on appeal.

McDONALD, J.

I CONCUR:

McCONNELL, P. J.

AARON, J., dissenting:

This court is not required to blind itself to what is—and was from the inception—a massive fraud and, in essence, facilitate that fraud by reversing the trial court's judgment in favor of Lincoln Life and Annuity Company of New York (Lincoln). In reversing the judgment, the majority essentially concludes that the fact that Jack Teren signed the applications for life insurance and that he was the purported settlor of the Jack Teren Insurance Trust dated March 20, 2006 (the Trust), establishes that the policies were supported by a legitimate insurable interest at the time they took effect.

The purpose of the insurable interest requirement is to prevent third parties from purchasing insurance on a person as to whom they have no insurable interest and thereby enter into a "wager contract" on the insured's life. This purpose would be thwarted if courts could not look beyond the signature on an insurance application to the true nature of the transaction. This case presents a perfect example as to why courts *must* have the authority to go beyond the signature and determine whether, in fact, there was a legitimate insurable interest supporting the policies. While Jack Teren *signed* the life insurance application, it is abundantly clear from the trial court's findings that the policies in this case are classic "wager contracts."

The issue in this case is whether a court may consider facts beyond the identity of the applicant for a life insurance policy and the named beneficiaries to determine whether the policy was in fact supported by an insurable interest at its inception. In my view, in effectively holding that the names on the application and trust documents are the beginning and end of the inquiry, the majority undermines the public policy behind

Insurance Code section 10110.1, which defines what constitutes an insurable interest, and distorts its proper application.

At the time of the events in this case, subdivision (b) of Insurance Code section 10110.1 provided:

> "An individual has an unlimited insurable interest in his or her own life, health, and bodily safety and may lawfully take out a policy of insurance on his or her own life, health, or bodily safety and have the policy made payable to whomsoever he or she pleases, regardless of whether the beneficiary designated has an insurable interest."

Section 10110.1, former subdivision (e) provided:

> "Any contract of life or disability insurance procured or caused to be procured upon another individual is void unless the person applying for the insurance has an insurable interest in the individual insured at the time of the application."[1]

Lincoln maintains that the trial court properly looked beyond the signature on the application and the names on the Trust documents to the substance of the transaction, and correctly determined that there was no legitimate insurable interest because, as the trial court concluded, "in fact, the Teren Trust *took out* and procured the insurance policies on the life of Jack Teren for the benefit of Life Product Clearing, LLC ('LPC') and its investors." (Italics added.) (See Ins. Code, § 10110.1, subd. (b)). The Trust contends that in making this argument, Lincoln "tries to re-write the plain language of the statute to substitute in a 'purchased' test, rather [than] an 'applying for' test, under the Insurance Code." However, it is the Trust that attempts to rewrite California law in arguing that the

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1 In the current version of Insurance Code, section 10110.1, former subdivision (e) is now subdivision (g). (Amended by Stats. 2003, ch. 328, § 1.)

statute "is focused on one key issue—the identity of the person applying for the policy and that person's relationship to the insured," and contending that, "[i]f the person *applying for* the insurance (Jack Teren) is the insured (Jack Teren), then the insurable interest requirement of the California Insurance Code is obviously satisfied because an individual has an 'unlimited insurable interest in his or her own life.' "

The statute does not provide that the person who *signs* an application for a life insurance policy on his or her own life *ipso facto* has a legitimate insurable interest that may not be questioned, and the Trust cites no California authority that so holds.

California has a longstanding public policy against allowing third parties to procure life insurance on a person as to whom they have no legitimate insurable interest. The reason for this policy is that, absent such an interest, "the policy is a mere wager on the life of the person insured." (*Jimenez v. Protective Life Ins. Co.* (1992) 8 Cal.App.4th 528, 536, citing *Warnock v. Davis* (1882) 104 U.S. (14 Otto) 775.) Under California law, a policy that constitutes such a wager "is void as against public policy." (*Ibid.*)

The trial court was well within its authority to inquire as to whether the policies were in fact supported by a legitimate insurable interest at the time they were issued, and specifically, to determine who, in fact, "took out" the policies on Jack Teren's life (Ins. Code, § 11010.1, subd. (b)). The court's extensive findings of fact make it very clear that it *was not* Jack Teren or his sons who took out the policies, but instead, a group of third party investors, who had no insurable interest in Jack Teren's life.

The application in this case sought $20 million in life insurance on the life of Jack Teren, who was 79 years old at the time the application was submitted to Lincoln. The

application falsely indicated that Jack Teren had a net worth of $46.4 million, and that he had not discussed with anyone the possible sale or assignment of the policy.[2] In fact, Jack Teren had a net worth of less than $50,000, was living on a fixed income of $1,333 per month from a pension and social security benefits, and, at the time the application was submitted, there was a plan in place to immediately transfer the beneficial interest in the policies to a group of third party investors.

In its statement of decision, the trial court recognized that Jack Teren and his son, Elliot, the beneficiary of the Teren Trust, had insurable interests in Jack Teren's life, but found that the Teren Policies "lack[ed] an insurable interest because, in fact, the Teren Trust took out and procured the insurance policies on the life of Jack Teren for the benefit of Life Product Clearing, LLC, and its investors." The court found that *"[p]rior to the submission of the Application for the Teren Policies to Lincoln,"* Elliot Teren contacted

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2 Lincoln inquired whether the policy was being "premium financed," i.e., whether any third party would be paying the premiums, and Advanced Planning Services (APS), the entity that submitted the application, falsely responded, "No."

In addition, prior to issuing the policy, Lincoln received an investigative report from Profile Services (PS), which falsely stated that Jack Teren was the retired chairman and president of Cosmopolitan Cleaners, a chain of dry cleaners, and that his sons were operating the business. The report further falsely stated that Jack Teren's purported accountant, Anthony Graci, C.P.A., of A.S. Graci & Associates, represented that Jack Teren's net worth was $26 million, and that he had annual unearned income of $3 million. After Lincoln notified PS that the information in the report was inconsistent with information in the application, PS issued an amended report which stated that Graci said he had made a mistake, and that Jack Teren's actual net worth was $43.9 million. APS subsequently sent Lincoln a financial disclosure document purportedly prepared by Graci, which represented that Teren's net worth was $44.9 million, that his annual unearned income was $3.1 million, and that Teren had been a client of A.S. Graci & Associates for 22 years.

his cousin, who was an insurance agent, "to become involved in a transaction so that Jack Teren, Elliot Teren and Darren Teren . . . could *obtain money*." The court further found that, "*[b]efore the Trust was formed or the Application for the Teren Policies was submitted to Lincoln,* LPC solicited investors and directed investors to send in their checks for the investment in the beneficial interest in the Teren Trust," and other insurance trusts, and that "[b]y the time that the Application was submitted to Lincoln on March 30, 2006, everything was in place for LPC's acquisition of the beneficial interest in the Teren Policies." The trial court noted that "[t]he Amendments [to the application for the policies] . . . misrepresented that neither Jack Teren nor persons acting on his behalf were receiving any compensation when, in fact, Jack Teren and his sons, Elliot and Darren Teren, were receiving compensation totaling $600,000 for their involvement in this transaction." (Italics added.)

Thus, *before any application was submitted to Lincoln*, there was an elaborate plan in place to submit fraudulent documentation to Lincoln to justify $20 million in life insurance on Jack Teren's life, to immediately transfer the beneficial interest in the policies to an identified group of investors once the policies were issued, and for the Terens to receive a payment of $600,000 for their role in the scheme. Lincoln issued the policies on April 27, 2006, and on May 2, 2006, documents entitled, "Beneficial Interest Transfer Agreement" and "Acknowledgements and Consents Relating to Sale of Beneficial Interest," both purportedly signed by Elliot Teren, transferred the beneficial interest in the policies to LPC. A check for $600,000 from LPC was sent to Elliot with a cover letter dated May 16, 2006.

The trial court determined that "under the unique facts of this case," the policies were void *ab initio* for lack of an insurable interest, based on its finding that the policies were fraudulently procured, in violation of both public policy and insurable interest laws. The trial court found that the fraud in the procurement of the policies in this case was "extreme, egregious, pervasive and astounding," and in particular, that the letter purportedly signed by Anthony Graci, C.P.A., verifying Jack Teren's net worth "was a spectacular fraud and a fabricated document."

The Trust does not dispute any of the trial court's findings of fact. Instead, the Trust claims that this court may not consider the trial court's findings regarding the pervasive fraud in this case because the trial court found that Lincoln's misrepresentation claim was time barred based on the incontestability clauses in the policies, and Lincoln has not appealed that ruling. In making this argument, the Trust fails to recognize that the fraud in the procurement of the policies in this case goes not only to Lincoln's misrepresentation claim, but also to the question whether the policies were supported by a legitimate insurable interest at the time they went into effect. In its statement of decision, the trial court stated, "Because the Court has determined that the Teren Policies were fraudulently procured, lack an insurable interest and are void *ab initio*, *the Court does not have to address Lincoln's misrepresentation claim.*" (Italics added.) The import of this statement is that the trial court's findings regarding the extensive fraud are relevant not only to Lincoln's misrepresentation claim, but also to the court's conclusion that because the entire transaction was a sham, there was never a legitimate application by the

proposed insured to purchase life insurance, and thus, the policies were not supported by a legitimate insurable interest.

In its argument faulting the trial court for inquiring as to whether the policies were supported by a legitimate insurable interest, the Trust disingenuously argues, "The trial court . . . did not permit Teren to make his own decisions about insuring his own life." However, the trial court's findings make it clear that *Jack Teren never made a decision to insure his own life*. In fact, Jack Teren testified that he was unaware that the documents he signed were applications for life insurance. The trial court's findings establish that Jack Teren was, in reality, merely a "shill" who fit the needs of the investors in that he was 79 years old and willing to participate in the sham transaction in exchange for significant personal monetary gain.

The majority relies on *Lincoln Nat'l Life Ins. Co. v. Gordon R.A. Fishman Irrevocable Life Trust* (C.D. Cal. 2009) 638 F.Supp.2d 1170 (*Fishman*), a federal district court case in which Dr. Gordon Fishman, who had $90 million worth of commercial real estate holdings, among other assets, and gross income of $13.8 million, formed a trust to purchase and hold three insurance policies on his life. A third party entity, Mutual Credit Corporation (MCC), had agreed to finance the premium payments on three $10 million policies for a period of two years. The essential terms of the loan provided that the "borrower," i.e., the trust, would receive a "premium reserve" of up to three percent of the face value of the policies, in the form of a cash payment to the trust that the insured could use for any purpose, two years of premium payments, and an origination fee. In exchange, the trust agreed that at the end of the loan period, it would either repay the

loan, with interest, and keep the policies, or, in the alternative, surrender the policies to MCC. Lincoln contended that the policies were prohibited stranger- or investor-owned life insurance policies because, it maintained, Dr. Fishman intended to sell or transfer the beneficial interest in the policies to MCC at a future date.

The issue in *Fishman*, as stated by the district court, was "whether the policies issued by Lincoln were void at the inception because they were a stranger owned life insurance policy, which is prohibited under California law." (*Fishman*, *supra*, 638 F.Supp.2d at p. 1177.) The court concluded that, "simply looking at the form in which this transaction took place, the Court would agree with defendants that 'the Policies were purchased by the Trust with the approval of Dr. Fishman and at the direction of his son, David Fishman, the Investment Trustee, for the ultimate benefit of Dr. Fishman's sons,' " and that all of these parties had an insurable interest in Dr. Fishman's life at the time the policies took effect. (*Id.* at p. 1178.) The court noted that Dr. Fishman held the policies for a period of two years through his trust, during which time his four sons were the sole beneficiaries of the trust. The court concluded that under California law at the time, Dr. Fishman's intent to sell or transfer the policies at a future date was irrelevant. (*Id.* at p. 1179.)

Fishman is distinguishable from the present case in a number of respects. First, unlike this case, the policies at issue in *Fishman* were not procured based on false and fraudulent information as to the proposed insured's assets. Rather, Dr. Fishman had significant financial assets, and had been advised by his tax attorney that he needed

$25-$30 million in insurance "to protect against estate taxes." (*Fishman, supra*, 638 F.Supp.2d at p. 1174.) In addition, Fishman was the settlor of the trust that held the policies, and the trust held the policies for over two years. Fishman's sons, who clearly had an insurable interest in his life, were the sole beneficiaries of the trust during that entire period, and one of his sons was the Investment Trustee of the trust. The *Fishman* court noted that during the two-year loan period, MCC was "a secured creditor, not an owner or absolute assignee." (*Id.* at p. 1179.) Further, the trust retained the authority not to transfer the policies to MCC at the end of the loan period. On these facts, the *Fishman* court explained, "[F]or two years this not only had the formal appearance of a legitimate life insurance policy on Dr. Fishman's life for the benefit of someone with an insurable interest in the same, but was in fact true as well." (*Ibid.*)

In this case, in contrast, the trial court's factual findings make it clear that there was a plan to immediately transfer the beneficial interest in the policies to LPC, and in fact, the trust transferred the beneficial interest in the policies to LPC within days of their issuance. Thus, in stark contrast to *Fishman*, the *only* thing that supports a finding of an insurable interest in this case are mere "formalities."

The majority cites the *Fishman* court's comment that it had found no California authority " 'allowing a court to basically look behind the terms and other formalities of an insurance agreement(s) and basically re-write it to reflect what was really going on between the various parties thereto insofar as determining the existence (or lack thereof) of an insurable interest to an insurance policy,' " as support for its conclusion that the proposed insured's signature on the insurance application, and names typed on a trust

document, establish that the policy was in fact supported by a legitimate insurable interest at the time the policy took effect, and preclude the trial court from examining the true nature of the transaction. (Maj.opn. at p. 15, citing *Fishman, supra*, 638 F.Supp.2d at pp. 1178-1179.) When the *Fishman* court said that it had not located California authority that would permit it to look behind the terms and formalities of the insurance agreement at issue in that case, the court was not concluding that there was a blanket rule of law that would require courts to overlook a massive fraudulent scheme to purchase life insurance policies for a group of stranger investors based on phony financial information and fraudulent documents. Rather, the *Fishman* court was saying that it would not question the parties' intent in terms of a contemplated future transfer of the beneficial interest in the policies at issue in that case.[3]

Despite the *Fishman* court's observation concerning the lack of California authority on point regarding a court's authority to look behind the "terms and formalities" of an insurance agreement to the substance of the transaction, the *Fishman* court did, in fact, examine all of the circumstances of the transaction in that case, in great detail. Notwithstanding its finding that there was an insurable interest in "fact" in that case, and not just in form (*Fishman, supra*, 638 F.Supp.2d at p. 1179), the *Fishman* court commented that the transaction in that case "skirts close to the letter, and certainly can be viewed as violating the spirit, of the law." (*Ibid.*) The present case, in which there is *no*

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3 *Fishman, supra*, 638 F.Supp.2d 1170, which is an order by a federal district court, is not binding on this court.

insurable interest in "fact" (*ibid.*), in my view clearly violates not only the spirit of the law, but the letter, as well.

There is no California authority that *prohibits* a trial court from looking beyond the signature on an application for life insurance or the names typed on trust documents to determine the true substance of a transaction. In fact, California public policy and case law support such an inquiry where there is a question as to whether the policy was supported by a legitimate insurable interest at the time it took effect. As Lincoln correctly notes, "courts frequently disregard the labels and characterizations of transactions by the participants and determine the true nature of the transaction." The majority's failure to do so here is in derogation of public policy and rewards those who, in the trial court's words, have perpetrated an "astounding" fraud.

The Trust succeeded in persuading the majority to reverse the judgment through its argument that if the proposed insured has signed the application for life insurance, there is *ipso facto* an insurable interest, i.e., that the signature itself satisfies the public policy concerns that there be an insurable interest at the policy's inception and that a life insurance policy not be a "wager contract." Incredibly, in this regard the Trust contends, "If the applicant is the insured, the inquiry ends because an insurable interest exists. This makes perfect sense. *The risks of 'wager contracts' are completely eliminated where the insured is the person applying for the policy on his or her own life—no one is in a better position than the insured to select a beneficiary that he or she desires.*"

The unmitigated gall that the Trust exhibits in making this argument is truly breathtaking. The Trust *does not dispute* any of the trial court's factual findings to the

effect that the entire transaction in this case was a massive sham and a fraud that began well before Jack Teren signed the insurance application. The trial court's findings lead to the inescapable conclusion that the policies at issue are in fact classic prohibited "wager contracts" in every sense of the term. The investors, who are paying in excess of $900,000 per year in premiums on the policies are betting that Jack Teren will die within the term of the policies, and sooner rather than later. The facts of this case perfectly illustrate why a mere signature on an application for life insurance does not and cannot, in itself, irrefutably establish that the policy is supported by a legitimate insurable interest.

The trial court determined that the policies were void *ab initio* for lack of an insurable interest because it was not Jack Teren who "took out" the policies, but instead, the Trust—which, the court concluded, was formed solely for the purpose of carrying out the scheme. The record clearly supports these findings. I would affirm the judgment of the trial court.

AARON, J.