COURT OF APPEALS

STATE OF NEW YORK

ANDREW NITKEWICZ,

Appellant,

-against- No. 59

LINCOLN LIFE & ANNUITY COMPANY OF NEW YORK,

Respondent.

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20 Eagle Street
Albany, New York
September 12, 2023

Before:

CHIEF JUDGE ROWAN D. WILSON
ASSOCIATE JUDGE JENNY RIVERA
ASSOCIATE JUDGE MICHAEL J. GARCIA
ASSOCIATE JUDGE MADELINE SINGAS
ASSOCIATE JUDGE ANTHONY CANNATARO
ASSOCIATE JUDGE SHIRLEY TROUTMAN
ASSOCIATE JUDGE CAITLIN J. HALLIGAN

Appearances:

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Official Court Transcriber

CHIEF JUDGE WILSON: Good morning, everyone. The first case on today's calendar is number 59, Nitkewicz v. Lincoln Life & Annuity Company.

Counsel.

MR. ARD: Good afternoon, Your Honors. Seth Ard, Susman Godfrey, on behalf of plaintiff. I'd like to reserve three minutes’ rebuttal, please.

CHIEF JUDGE WILSON: You may.

MR. ARD: An annual premium is paid for a year. That simple point resolves this appeal. The statute requires Lincoln to refund any premium paid for any period beyond the death of the - - -

JUDGE TROUTMAN: But the monies paid, was it paid simply for the coverage, or did it do with the value of the account?

MR. ARD: Thank you, Your Honor. And that's, I think, a key point on this appeal. The statute does not say any period of coverage, and I think that's dispositive of really the central argument that Lincoln's making in this case. The statute says that a refund is owed for any premium paid for any period. It does not say any premium paid for any period of coverage. It does not say it's restricted to any premium for coverage; it says any premium, and that's any premium.

JUDGE CANNATARO: What's the appropriate

definition of premium? What is a premium?

MR. ARD: A premium is money that's paid to insurance company.

JUDGE CANNATARO: For any purpose whatsoever?

MR. ARD: Well, I believe so. And this policy, itself, defines the thing that's being paid, the planned annual premium - - - sorry it doesn't define it, but it calls it a premium.

JUDGE SINGAS: So do - - -

MR. ARD: It's the exact same word that's used in the statute and the policy.

JUDGE SINGAS: Do you think a planned premium is the same thing as a premium?

MR. ARD: A planned premium is a type of premium, Your Honor.

Going back to the original question - - -

CHIEF JUDGE WILSON: So how do - - - how do - - -

MR. ARD: I'm sorry.

CHIEF JUDGE WILSON: How do we know what a period is? How are you explaining what a period is?

MR. ARD: A period is a time period.

CHIEF JUDGE WILSON: Well, so it can be, but is it - - - let's take this contract for example.

MR. ARD: Sure.

CHIEF JUDGE WILSON: What is the time period for this contract?

MR. ARD: Well, a planned premium is a planned annual premium. It says annual in capital letters. What any premium for any period means under the statute, for any period means is - - - is a premium that is connected to a time period in the policy. So you have a planned annual premium and it's paid - - - that premium is paid for a year. That's the definition of annual.

JUDGE CANNATARO: Is it of any moment - - -

JUDGE RIVERA: Isn't that about the frequency as opposed to the period?

MR. ARD: Yes, it is the frequency, but the - - - there is no distinction between a premium that's payable once every year, and a - - - and a premium that is paid for a time period. With the statute - - - what "for any period" means in the statute, is you look at whether the premium is tied to a time period in the policy.

JUDGE RIVERA: But it does seem to be a different kind of policy, right? This universal policy has particular investment advantages. I mean it seems to me to be very much an investment tool. It's a - - - it's a complex, financial instrument in that way. Doesn't that take it out of the coverage of the statute?

MR. ARD: No, Your Honor. It fits within the plain language of the statute.

I think I'd like to go back to that first question because I think it's the key question in this appeal, whether "of coverage" should be read into the statute. The word is not there. "Of coverage" is not in the statute. It says any premium paid for any period. The legislature knew how to say, "of coverage", but wanted to. If you look at (a)(1), which is interlocking - - - the interlocking statute, (a)(1) talks about a premium that is sufficient to keep a policy in force for three months. If in (a)(2) they wanted to restrict the premiums that were being talked about - - -

JUDGE TROUTMAN: But this one - - -

MR. ARD: - - - to only premiums for coverage - - -

JUDGE TROUTMAN: - - - if the value of a policy, if there's money in excess, the premiums can be paid from that.

MR. ARD: That - - - that's true, Your Honor, but again, the statute doesn't talk about um what - - - what the purpose of the premium is. It refunds any premium paid for any period.

JUDGE TROUTMAN: So universal life is the same as the traditional life insurance policies that existed, and so they should get - - - they should be under the same rules; is that what you're saying? There's no difference in any of the types of policies.

MR. ARD: Oh, there's lots of differences; there are thousands of different kinds of policies that are out there.

JUDGE TROUTMAN: Correct.

MR. ARD: This statute applies to all of them on its face. The - - -

CHIEF JUDGE WILSON: So suppose the policy here didn't have the planned premium language, so that you could pay at any time you wanted, and there were no - - - no plan premium. What would the result be then?

MR. ARD: Well, Your Honor, that would be a very different case. That's not the question - - -

CHIEF JUDGE WILSON: That's why I'm asking.

MR. ARD: I understand. That's not the question that's asked by the Second Circuit, of course. They're asking for whether a planned premium is covered by the statute. If it was not tied to any specific time period, the premium payment - - -

CHIEF JUDGE WILSON: That is if the contract did not have the planned premium language, and we stripped that out, now we have the same contract except that's missing. What's the result?

MR. ARD: Well, again, not this case, but a court could easily say that since the policy does not tie the payment of the premium to any time period, it is not covered by the statute.

CHIEF JUDGE WILSON: And so when you say tie the - - - tie the payment to a period, you're not saying it must be required, but simply allowed or described?

MR. ARD: Right - - - correct. But the statute does not say any mandatory premiums. It does not say any premiums paid for coverage. It says any premiums - - -

CHIEF JUDGE WILSON: So how would - - -

MR. ARD: - - - so it doesn't matter - - -

CHIEF JUDGE WILSON: - - - how would you - - -

MR. ARD: - - - what's mandatory, Your Honor.

CHIEF JUDGE WILSON: - - - read the statute applied to a traditional whole life policy?

MR. ARD: In the - - - in the same way. And I think this is actually a good way to think about this. Think - - - think about a term policy, everybody agrees that an annual term premium's refundable. Now, let's imagine you have a term policy that has a 1,000 dollar annual premium, okay? And let's say the policy breaks it down, so - - -

CHIEF JUDGE WILSON: Well, the term - - - the term is easy; I'm trying to ask about - - -

MR. ARD: Well, I think that this, hopefully, will illustrate my point.

CHIEF JUDGE WILSON: All right.

MR. ARD: Um, let's say the term premium says 800 dollars of that 1,000 dollar annual premium is for cost of insurance, 150 dollars is for the annual administration fee, and 50 dollars is for annual access to an expedited help desk, okay? Under the statute, the entire 1,000 dollar premium is refundable. It does not matter whether the - - - the premium is paid for coverage, whether the annual premium is paid for administration fee, or whether the annual premium is paid for expedited access - - - or for access to an expedited help desk. All that matters on the terms of the statute is that the premium is paid for any period.

JUDGE RIVERA: But - - -

MR. ARD: The annual - - -

JUDGE RIVERA: But that's what I'm - - -

MR. ARD: - - - premium, by definition is in favor - - -

JUDGE RIVERA: But that - - - that was my question before. The money is used - - - here in the universal life policy, if I'm understanding this policy structure, you can correct me if I'm wrong - - -

MR. ARD: Yes, Your Honor.

JUDGE RIVERA: - - - is being used for particular types of investments. It's also available for the insured, for loans, so it's not like the charges that you just described, that - - - that money - - - I think of it as the money's in the basket. You throw money in the basket, you're hoping to get more money coming from this, and on occasion, you take money out to pay for that insurance coverage. Am I misunderstanding the way the structure works? It may sound very simplistic, so bear with me, but that seems to me to be the way this policy functions.

MR. ARD: Well, the - - - the - - -

JUDGE RIVERA: And both sides are getting all these advantages from that money being in the basket.

MR. ARD: Sure, Your Honor. I - - - I think a few points. First, the subjective intent of the insured doesn't matter. A lot of Lincoln Re, suggests you have to figure out whether the premium's paid for coverage or for investment purposes or something else. The statute doesn't suggest anything like that, and it would make no sense to interpret a statute that requires an insurance company to pay a refund to turn on what the subjective intent of the policyholder is. That's point one.

Point two, they didn't really - - -

JUDGE RIVERA: Well, I didn't mean it as subjective intent. I meant it as the structure - - -

MR. ARD: Right.

JUDGE RIVERA: - - - of the policy.

MR. ARD: Well, yes, it is true that under the policy, you can take out policy loans, for example, it's also true under some term loans - - - or term policies. That - - - that has not - - - the statute doesn't say anything about - - -

JUDGE HALLIGAN: But what - - - Counsel, what's the relationship between the monthly deductions and the policy value? Are the monthly deductions the same all the time, or if there is more in the policy value, are they less? I'm trying to understand what value the insured derives from the policy account.

MR. ARD: Can you please repeat the question?

JUDGE HALLIGAN: Well, let me start with the first question. Are the monthly deductions constant from month to month?

MR. ARD: They are not constant.

JUDGE HALLIGAN: And what are they - - - what are they a function of, if they are not constant?

MR. ARD: Cost insurance rate and the - - - what's called the net amount of risk, which is, sort of, the - - - if you look at the total count value, and you look out at the death - - - it's the death benefit minus the - - - the account value.

JUDGE HALLIGAN: And so it - - -

MR. ARD: Which can - - -

JUDGE HALLIGAN: - - - bears no relationship to how much is in the policy account but is only a function of when you estimate someone might die and the cost of insurance, which I assume is - - - is, you know, relatively static.

MR. ARD: Sorry, it does relate to what's in the policy account.

JUDGE HALLIGAN: And so how does it - - -

MR. ARD: The charges.

JUDGE HALLIGAN: - - - relate to that?

MR. ARD: The net amount of risk is defined as the death benefit minus what's in the policy account.

JUDGE CANNATARO: So if the policy account exceeds the death benefit, the monthly deduction could, theoretically, be minimal.

MR. ARD: Well, under IRS regulations it's actually not - - - it's actually not supposed to happen.

JUDGE SINGAS: But it could actually be lower, couldn't it? It couldn't even have to cover the cost. A plan premium - - -

MR. ARD: That's correct.

JUDGE SINGAS: - - - one might not even cover the cost, so then how would that work in - - - in your pro rata - - -

MR. ARD: Well, again, and that's what I think is an essential point in this appeal. The essential point of this appeal is that there is no "of coverage" written in the statute. It says any premium for any period. Lincoln reads that to mean any period of coverage. But in my example with the term premium, you can have part of your premium pay for an annual administration fee; it's not for coverage. You can have part of your annual premium pay for access to an expedited help desk; that's not for coverage.

JUDGE GARCIA: Counsel, if you go back to the statute, and I think the trouble I have with it is applying the statute to a very different kind of animal here than term life.

MR. ARD: Uh-huh. Sure.

JUDGE GARCIA: But the statute's aimed at, look, the insured dies. The insured has paid for a risk coverage that now isn't going to happen. So you're - - - the insurance company has essentially collected money to insure for risk that can no longer happen. So three months of premiums you've paid, the insured dies, you know, the first month, there's two months where what are they insuring anymore, right? So he should get that back.

Here that's not what's happening, right? So you've paid, let's say, 50,000 into this account. They take out whatever. Really all this is a function of is whether you choose one option to get what's in the account, plus 1.5 million, or you get 1.5 million. The client here chose to get 1.5 million. So the older question, the question before, you're kind of self-insuring in a way, up to a certain point each month, because your premium's going down and you're getting that benefit based on what you have in the account. If you've chosen option one, you get 1.5 million if there's an event. If you've chosen option two, you get 1.5 million plus whatever is in the account. And it seems like we're trying to jam a statute that does something very differently onto this situation to cover something it was never intended to cover.

MR. ARD: Well, three points, Your Honor. One thing the statute covers is a situation where you pay for coverage beyond the period of the death of the insured. But the statute isn't - - -

JUDGE GARCIA: What is the purpose of - - -

MR. ARD: - - - limited to that - - -

JUDGE GARCIA: - - - that statute?

MR. ARD: The statute isn't limited to that. It doesn't - - -

JUDGE GARCIA: But you're reading it not to be limited to that. But what would be the purpose of not limiting it to that?

MR. ARD: Oh, well, the purpose is what the statute itself says. The purchase - - - the purpose is to prevent life insurance companies from keeping premiums that were paid for a period - - -

JUDGE GARCIA: And you're - - -

MR. ARD: - - - beyond the death - - -

JUDGE GARCIA: - - - defining that premium to include something that, again, I'm having trouble fitting into the purpose of that statute because they haven't taken this money out of the account. It's in the account, 50,000 whatever, however much is left after the load fee, and your client - - - the insured's estate would get that if you chose one option, but you chose a - - - they chose a different option.

MR. ARD: But - - -

JUDGE GARCIA: So they're not getting that. They're getting 1.5 million, and that's the bargain they made.

MR. ARD: Right. So that - - - that argument is about whether we're really trying to get the death benefit, option B is what it's called, what you're referring to, and the answer is absolutely not because - - -

JUDGE GARCIA: But what are you trying to get that the insurance company shouldn't be collecting? Which is, to me, what the purpose of this statute - - -

MR. ARD: Payment - - -

JUDGE GARCIA: - - - is?

MR. ARD: Sorry, Your Honor.

JUDGE GARCIA: No.

MR. ARD: Payment for a period beyond when the contract terminated. It's as simple as that.

CHIEF JUDGE WILSON: I guess to that - - -

MR. ARD: I again go back to my - - - I'm sorry.

CHIEF JUDGE WILSON: I was going to get to Judge Garcia's question a little bit differently. In the statute there is a provision that says that you don't get the money back if there's a policy provision for waiver of premium benefit. Can we read option one as essentially that waiver?

MR. ARD: No, waiver of premium benefit refers to a situation - - - this is in the statute too - - - refers to a situation where you have a premium that you'd otherwise have to pay, but you're too old, or you're sick, or you're - - - and so you don't pay it. And so - - -

CHIEF JUDGE WILSON: That's a specialized meaning.

MR. ARD: Well, that's what it means in the - - - in the statute and what it means in this policy. And - - - and that's why - - - actually, that's why it's so clear that what actually paid means is when you actually pay a premium. You know, Lincoln, their interpretation of the statute makes no sense. What Lincoln is saying is that actually paid in the statute refers to when the monthly deduction is taken out. But the statute says premiums that are actually paid, and policyholders pay the premiums. Insurance companies don't pay the premium; the policyholder pays the premium. The monthly deduction is taken out by the insurance company. The statute itself distinguishes, I think, in four different sections, between charges that are deducted from the premium, I think that's in, maybe, (a)(11), (a)(16), (a)(1) itself. It distinguishes between charges or deductions and premiums. The refund requirement calls for a refund of premiums that are actually paid by the insurer. The waiver - - - the - - - the fact that it excludes waived premiums just underscores they're talking about premiums that were actually paid, not premiums that were waived.

JUDGE CANNATARO: Counsel, getting back to the statute, our - - -

MR. ARD: Yeah.

JUDGE CANNATARO: - - - our charge is - - - is to effectuate the intent of the legislature and how we interpret the statute. And again, putting it in overly simplistic terms, my reading of that section of the statute is that the legislature intended that payments for coverage that were made, but you know, not used because of death, should be returned to the customer. So why is it so irrational or unreasonable for - - - for the other side to view their monthly deduction, which they acknowledge is a payment for coverage, as the portion of the payment that should be refunded?

MR. ARD: Well, first of all, monthly deduction is not a premium. The statute distinguishes between premiums and monthly deductions, and it calls a refund of premiums, not monthly deductions.

JUDGE CANNATARO: Right, but that all goes to how you define premium.

MR. ARD: Well, the - - - the statute itself makes it clear the distinction between a premium and a deduction taken out by the insurance company. And it doesn't call for a refund of the deduction, it calls for a refund of the premium actually paid. The premium actually paid is something that's paid by the - - - by the insured.

Think of it this way, if you asked, when were the premiums actually paid on this policy, you'd look at the list of the premiums, you'd say, oh, they're paid once per year exactly, on the policy anniversary, eight years in a row. That's when the premium's actually paid. Their view is it was paid - - - no, it was actually paid every month. But the insur - - -

JUDGE CANNATARO: But I guess this - - - this goes back to, maybe, the very first question from Judge

Troutman; this is a vehicle that does many things. It's part life coverage, it's an investment vehicle, it's a tax shelter in certain ways, and they're paying in once annually for the benefit of these many, multifarious features of this very specialized instrument. And to me, the statute just deals with the coverage portion of it. I - - - I don't see that it requires a refund of an investment, which to me is, at the end of the day, what your argument seems to be.

MR. ARD: And that's why - - - back to my original answer to her - - - to Your Honor's question was that I agree that's the key issue on this appeal, is whether you want to read "of coverage" into the statute. It doesn't say it. The legislature knew how to say, "of coverage". In 2008 - - - it's important to realize and to take into account - - - that in 2008, the legislature specifically amended the same statute, (a)(1), which is the interlocking provision, to add stuff about UL policies. (a)(2), which is the provision we're talking about, explicitly covers universal life policies. Nobody doubts that. The grace provision part of (a)(2) applies to universal life premiums of universal life policies, and in fact, it refers back to the rules set forth in (a)(1) that was amended in 2008.

So the legislature in 2008 was adding stuff about

UL policies in the interlocking provision. If, at that time, it thought that it wanted to exempt UL policies, or thought that they should be exempted, it would have done so. The presumption is the legislature's aware of the rest of the statute, and that it - - - what it doesn't change, it accepts. There are two explicit exemptions under the statute for two types of policies, paid up policies and single premium payment policies. There's not an exemption for UL policies. Under black letter law of this court, that means that there's no exemption for UL policies.

JUDGE HALLIGAN: Chief, may I follow up?

CHIEF JUDGE WILSON: Yes, of course.

JUDGE HALLIGAN: So I take it you're arguing that under Lincoln's interpretation, the 32 - - - what is it, 3203(a)(2) has no application to universal life policies; is that - - - is that - - - am I understanding you correctly?

MR. ARD: Yes. I think that what - - -

JUDGE HALLIGAN: So - - -

MR. ARD: I'm sorry.

JUDGE HALLIGAN: - - - in a circumstance where the deductions - - - I take it they could be quarterly. For example, you can't have a - - - you can only have a monthly deduction?

MR. ARD: In - - - in practice, yes. In (a)(1), it actually assumes that. If you read (a)(1), it talks about the charges necessary for it per - - - per month.

JUDGE HALLIGAN: There's something in the statute which precludes assessment of deductions on a quarterly or semi-annual basis?

MR. ARD: Well, (a)(1), again, assumes that charges assessed monthly. And the ACLI, which is the insurance company institute, says that the mechanics of universal life policies are well known, they're monthly deductions. So - - -

JUDGE HALLIGAN: But if it was assessed on a different basis, I assume that the provision would apply just as it would to a term policy, no?

MR. ARD: Well, no, because it's still the same problem with their interpretation of the statute, which is that they're - - - they're - - - they're suggesting that it's the monthly deduction that's refundable. It doesn't matter what the monthly deduction is - - -

JUDGE HALLIGAN: I understand, but - - -

MR. ARD: - - - three months or six - - -

JUDGE HALLIGAN: - - - but if the deduction was taken on a quarterly or semi-annual basis as opposed to a monthly basis, because I understand you're also saying that's impractical as a matter of industry practice, and - - - and you're suggesting the statute assumes otherwise.

But if it was, wouldn't the refund, if the individual died in month one of the quarter or the six-month period, wouldn't they still be getting a refund in the same terms that you would under a term policy?

MR. ARD: No, because again, that would be assuming - - - that argument only works if you assume that's what's being refunded if the deduction that the insurance company takes out. That's not what the statute says. The statute - - -

JUDGE HALLIGAN: So you would - - - you would not have a claim for a refund in that circumstance, is your view?

MR. ARD: Well, I'm not saying there wouldn't be a claim for - - - I mean, if the court would interpret the statute to mean that, of course there would be a claim for it, but that's not what the statute says. The statute refers to a refund of premiums that were paid. It doesn't matter how long the deduction period is. The statute refers to deductions at least four times, I think. It doesn't say you get a refund of the deduction; it says you get a refund of the premium.

The last point I'd just like to make is, of course, and I think it's just essential here, is that even if the court were to read an "of coverage" rule into this - - - this statute, this premium, this planned premium satisfies it because this planned premium was - - - there's a - - - there's a rider, a secondary guarantee in this policy, which means that if you pay this planned premium every year, as this insured did, you are guaranteed to keep the policy in force for a year. There is no possible interpretation of the statute that says that an annual premium that guarantees to keep the policy in force for a year somehow is not payment for a period. So - - -

CHIEF JUDGE WILSON: Thank you, Counsel. Yeah, thank you.

MR. LASALLE: Good afternoon, Your Honors. John LaSalle from Boies, Schiller, Flexner for defendant respondent, Lincoln Life & Annuity Company of New York.

I'd like to go back to one of the questions that Chief Judge Wilson asked, which is if the language about the premium frequency isn't in the policy, would the plaintiff have a claim for a refund? And the fundamental point here is that that language is in the policy. The policy explains that the premium frequency, which is chosen by the owner, and as listed on page one. It says, "The premium frequency is how often you intend to pay the planned premium". It refers to the recurrence of an optional payment, which is the planned premium, which is a mechanism by which the owner funds the investment account.

As Judge Troutman pointed out, this is a hybrid policy where there is an investment component and there is an insurance component. Premiums are paid to fund the investment component, and from that component, which is called the policy account or the policy value, the insurer takes - - -

JUDGE GARCIA: Is there an IRS reason, reg reason, why you have to call it a premium? And why do - - - why don't you just call this an investment?

MR. LASALLE: The - - - the policy is structured so that it qualifies as life insurance, which has to do - - -

JUDGE GARCIA: Right.

MR. LASALLE: - - - with the limitation on how much funding can go in. I can't remember which of you asked the question, can you have such a high policy value that you don't have any monthly deduction - - -

JUDGE GARCIA: Let me ask it a different way. If you called it a contribution, would you still get the same tax treatment?

MR. LASALLE: It would function the same way. I'm not certain whether or not, under the IRS guidelines, it would continue to be treated as life insurance, but the overall objective of any limitations on the payment of premiums is that this policy will continue to be treated as life insurance.

JUDGE GARCIA: Which is - - -

JUDGE HALLIGAN: Can you - - - can you help me understand the economics of - - -

MR. LASALLE: Sure.

JUDGE HALLIGAN: - - - of this? So I take it with option 1, your view is that the statute allows you to retain everything that remains in the policy account, and you have to pay out whatever the face value of the policy is, I think it was 1.5 million dollars; is that right?

MR. LASALLE: That's correct.

JUDGE HALLIGAN: Okay. So how - - - why does an insured pick option 1? What are the economic benefits to doing that?

MR. LASALLE: Sure. So in option 1, the monthly charge is lower - - -

JUDGE HALLIGAN: The monthly deduction, you mean?

MR. LASALLE: The monthly - - - the - - - the cost of insurance charge, which is part of the monthly deduction, is lower because it is offset by the amount of the policy value that remains in the investment account.

JUDGE HALLIGAN: So if I have ten dollars in my account, and my, you know, policy value is - - - my life insurance value is eight dollars, that's what I get upon death, it's because you'll be able to take that eight dollars or twelve dollars, or whatever it is, out of that and you'll only be out-of-pocket whatever the delta is; is that right?

MR. LASALLE: Essentially. So - - -

JUDGE HALLIGAN: Okay.

MR. LASALLE: - - - so the insurance company charges for the amount on which it will be on the hook.

JUDGE HALLIGAN: Uh-huh.

MR. LASALLE: So you have a million dollar policy with a 200,000 dollar policy value, the insurance company is on the hook for 800,000 dollars.

JUDGE HALLIGAN: Okay.

MR. LASALLE: So they're only going to charge you insurance on the 800,000 dollars, which is another benefit that having a higher policy value creates. The higher the policy value, the lower the charge for insurance.

JUDGE CANNATARO: And is - - - is that, essentially, the whole basis for the variable monthly deduction? The actual policy values fluctuate over time?

MR. LASALLE: The - - -

JUDGE CANNATARO: Or is there more to it than that?

MR. LASALLE: The policy value fluctuates over time; it gets larger when you make - - - when you fund the policy value through a premium. It gets smaller when the monthly deduction, which is what extends the coverage, is taken out each month.

JUDGE CANNATARO: What about if you take a loan, or something like that, would that reduce the policy value?

MR. LASALLE: It reduces the policy value and upon death, the - - - if you have not paid back the loan, the loan balance is taken from the face amount of the - - - of the death benefit.

JUDGE GARCIA: And - - - and so let's say you funded a million dollars of this account; you have a 1.5 million benefit. You choose option 1, it goes as an insurance payment to the beneficiary untaxed, right?

MR. LASALLE: Correct.

JUDGE GARCIA: Instead of a million dollar transfer in an estate.

MR. LASALLE: Correct. And - - - and the money and the account value, the policy value, is credited interest every month. That interest grows at a tax-free rate.

CHIEF JUDGE WILSON: Can I again ask you about - - - well, not ask you, again ask, first time for you, how you read the statute on a typical whole life policy?

MR. LASALLE: Sure. So on a typical whole life policy, you - - - the owner is faced with an all or nothing choice. Either you pay this premium, and let's call it a twelve-month premium. You pay that premium; you get coverage. You don't pay that premium; you don't get coverage. The legislature steps in to say that's an instance where you may be overpaying for the coverage. You paid for a year; you didn't get coverage for a year.

In this instance, the fact that premiums can be paid in any amount after the initial premium gives the owner the flexibility to pay the absolute bare minimum, or a level amount that will continue to the coverage for some period of time, or a higher amount for the first ten years, and then a lower amount afterwards. So in that instance, in a whole life policy where you have paid the premium, you've paid - - - facing that all or nothing consequence, and you've paid for, let's say, the twelve months, if you die in June, there are six months for which you have paid for coverage, and you don't get that coverage.

CHIEF JUDGE WILSON: And so that's parallel with term life?

MR. LASALLE: It's parallel with term life.

CHIEF JUDGE WILSON: So the way you would read the statute is if the refund provision applies to term and whole but not variable?

MR. LASALLE: Because of the language of the statute. Because the language of the statute does not capture this type of policy that has an investment component and a monthly deduction, which is - - -

CHIEF JUDGE WILSON: Well, there is an investment component in whole life, sort of, right?

MR. LASALLE: It - - - it has - - -

CHIEF JUDGE WILSON: Your premium payments are earning some money that is going to fund the death benefit.

MR. LASALLE: In some ways there are parallels, but the flexibility provided by a UL policy distinguishes it from paying the - - -

CHIEF JUDGE WILSON: And that's what I'm getting at. It's not so much the investment component of it. It's the flexibility or lack of flexibility in the contract itself.

MR. LASALLE: I think those two things are related because the policy - - - the investment account is what earns the interest, what allows people to invest in a UL policy, take that money out to pay for tuition at one point in their life.

CHIEF JUDGE WILSON: Which you can do with a whole life policy too.

MR. LASALLE: That is - - - that is correct, but the - - - but the investment component is, what I think, differentiates and makes clear because of the - - - the difference between a whole life policy and an UL policy is that in a whole life (sic) policy the deduction is what extends the insurance coverage on a month-to-month basis.

Whereas in a whole life policy, you still have to pay the X many dollars in January if you want the coverage for the next twelve months.

JUDGE CANNATARO: Is it your argument that 3203 doesn't apply to universal life policies at all?

MR. LASALLE: I think that there are readings of the policy that can apply. For example, under the DFS's guidance in the product outlines, it talks about refunding the amount applied to the policy, that's the monthly deduction. So as Judge Halligan had - - - had asked about, if there's a policy that takes deductions on a quarterly or semi-annual, or annual basis, and that deduction is taken out, or if you have a monthly policy, that is taken out in - - - where the deduction, thereafter, is taken out in error. For example, they don't make a claim until February when the insured passes away in January. Under the DFS's reading of the statute, you would tack on and refund that portion of the monthly deduction.

JUDGE CANNATARO: What about provisions relating to the underfunded account? Like if the account goes into the grace period for payments. I mean it provides remedies for what happens if the person dies during that - - - while the - - - while the account is in its grace period, right?

MR. LASALLE: It explains that if you die in the grace period, and - - - if you die in the grace period, the company can deduct from the death benefit, the amount needed to continue the policy.

JUDGE CANNATARO: Correct.

MR. LASALLE: Now, this is, I think, a very important point because it leads to absurd results under the plaintiff appellant's interpretation. If those options - - - so the planned premium is an optional payment, an optional choice, under their interpretation, it would fall under the definition of any unpaid premium in the grace provision. They have an argument where they say, no, no, no, that's referring to the three months sufficient payment. The statute says any unpaid premium. If a planned premium is, for the purpose of this - - - of this statute - - -

JUDGE CANNATARO: You'd be able to deduct the whole - - -

MR. LASALLE: You'd be able to - - -

JUDGE CANNATARO: - - - planned premium.

MR. LASALLE: - - - deduct - - - you'd be able to deduct the portion of it. And even if you deduct a dollar of it, it is inconsistent with it being an optional payment. This is the type of absurd reaction - - - absurd consequence that the lower court recognized in applying - - - the district court - - - the federal district court, in applying the plaintiff's interpretation.

JUDGE CANNATARO: So based on that answer, it would seem to me that you - - - it would behoove you to take the position that the statute applies to universal life policies. It just applies in a unique way because of the structure of these accounts.

MR. LASALLE: I - - - I do not believe that the statute applies to this particular premium payment that was made. So - - -

JUDGE CANNATARO: Well, inasmuch as the argument is that - - -

MR. LASALLE: It does not take - - -

JUDGE CANNATARO: - - - the whole thing is a premium.

MR. LASALLE: It doesn't pay for - - - it doesn't pay for a period. In - - - in the plaintiff's - - - plaintiff appellant's reply brief, it made the claim that the statute is somehow agnostic as to what the period is for, and said it could be for coverage, or cost, or Lincoln's bottom line. That - - - that defies grammatical sense. You can't have a period of a company's bottom line. The period of coverage is what's being paid for, and this is an unearned premium - - -

CHIEF JUDGE WILSON: Well, but that's - - - that's where I get hung up a little on whole life because the premium payments for whole life are paying, sometimes, for a future period of coverage, right? You're building up value in the policy.

MR. LASALLE: I - - - they can in certain - - - I think there's - - - there's - - -

CHIEF JUDGE WILSON: Well, if you have a flat - - - if you have a flat payment over your whole life policy, your premiums - - -

MR. LASALLE: It builds up - - -

CHIEF JUDGE WILSON: - - - today, when you're young, are - - - you're essentially building up value to pay for a later period when you're older. So I - - - I get a little tied up when you say it's - - - the distinction here is because it's not paying for the period of the coverage.

MR. LASALLE: Between whole life and universal life?

CHIEF JUDGE WILSON: Yeah.

MR. LASALLE: Let me see if I can do that a little bit clearer. There's an element in a whole life policy of a - - - of a dividend or a value that gets built up over time that can be used to offset future - - -

CHIEF JUDGE WILSON: Correct.

MR. LASALLE: - - - future payments.

CHIEF JUDGE WILSON: And the future payments pay for the insurance coverage when you're older and more likely to die.

MR. LASALLE: That is correct, but you're not - - - you're not tying the payment of a premium to any period under the UL policy or the - - - or the term - - - or the whole life policy that you just described.

CHIEF JUDGE WILSON: Well, it seems to me a cleaner argument for you that there's flexibility in an UL policy, but there's no structure of contract, it doesn't require a payment, therefore, the payment is not for a period because it's, essentially, the policyholder's gratuitous discretion about what to do than to try and figure out what the payment - - - what the money of the payment is being used for, and whether it's being used for the coverage of this period or some future period because I think that gets you into a tangle with whole life.

MR. LASALLE: I think that - - - I think that I agree. I can justify it under both ways. The first way that you described, the premium payment does not pay for a period. It can be made, it can - - - the planned premium can be made, it can be skipped, it can be used to fund the account - - - well, it's always used to fund the account value.

I think the way we're seeing each other a little bit differently is that under a UL policy, the premium - - - the coverage is extended on the month-to-month basis, through the monthly deduction. It doesn't matter what the "purpose" of the payment is; the mechanics of the policy say that we are going to extend the policy. You don't run into the grace period until your account value is too low to cover the next month's monthly deduction.

My adversary made an argument towards the end of his presentation about the planned premium - - - the guaranteed rider. The rider is simply a mechanism by which the grace period does not go into effect. It is paid for through the monthly deduction, which is what also funds and extends the period - - - the premium coverage. And it does not pay for a period of coverage just like the planned premium - - - the optional planned premium does not pay for a period of coverage.

JUDGE RIVERA: If - - - if we disagree with your argument, we accept his argument, how is - - - how are policies in the future going to change?

MR. LASALLE: I think that's a very good question, Your Honor, because the industry, as you can see from the ACLI, has put in an amicus submission. I don't believe the Court has granted or denied that motion, but the essence of that motion made by the ACLI, which is the trade group of life insurance companies, is that that money has to come from somewhere. When you develop a term policy, you develop how much the premiums are going to cost, and part of that is going to be developed with the idea that there's a refund built in by the statute. The statue's been on the books for a hundred years. There's no case law interpreting the statute. There's no - - - the money's going to come from somewhere, it can come from an - - - for existing UL policies, it can come from nonguaranteed elements, which are - - - which can be adjusted. For new policies, it'll be built into the cost of - - - of setting those - - - those structures.

JUDGE CANNATARO: Wouldn't it just make all the policies option 2 policies?

MR. LASALLE: It would - - - it would give a windfall to anyone who chose option 1 because they could have chosen option 1, and option 2 is more expensive. Option 2 you have to pay for the entire - - -

JUDGE CANNATARO: Right.

MR. LASALLE: - - - face amount each - - - each month, the deduction is the entire face amount.

JUDGE HALLIGAN: So will option 1 policies still be possible under that reasoning?

MR. LASALLE: I think it does do significant damage to the election between option 1 benefits and option 2 benefits. I also believe that we will be before the courts seeking guidance as to what happens if someone doesn't pay a planned premium or pays two planned premiums in one year. Which portions of that do you deduct? If the funds were already sufficient to carry the policy through those first twelve months, what will you - - - will you refund all of the planned premium, will you refund both of the planned premiums, is it first in, is it first out? This court - - - courts will look to this court for making up those rules because those rules cannot be divined or understood in terms of the statute.

Another helpful way to look at this, Your Honors, is the - - - there's a series of intervening events that can happen between the payment of a planned premium and a period of coverage. You can shorten any length of time that the policy would be in effect by changing the death benefit, by switching from option 1 to option 2, by taking a loan against the policy, by taking a partial surrender or a - - - or a complete surrender. All of those are contingencies that are going to drive a wedge between the simple payment of a planned premium, with twelve months in between those payments, to an actual extension of coverage.

My adversary said it was dispositive whether or not the words "of coverage" appear in the statute. They don't appear in the statute. We believe that that is the only reasonable way to read the statute, which explains - - - which has multiple references to a period that is being paid for. That - - - the thing that is being paid for is the insurance coverage. But even if you were to agree with my adversary, that "of coverage" is not in the statute and that's not what the statute is talking about, you still have the fact that the only thing that is extending coverage is the monthly deduction. And the monthly deduction is what is coming from the policy value, the investment component of the policy.

CHIEF JUDGE WILSON: Thank you, Counsel.

MR. LASALLE: Thank you.

MR. ARD: Thank you, Your Honors. I'll start where Counsel left off. The statute doesn't say "of coverage". That's dispositive. The court is not allowed to add words in the statute that are not there. Again, think of your whole life example. If the whole life premium says you pay 1,000 dollars per year, and part of that premium is for an annual administration fee, if you look at the statute, you clearly get the - - - the balance of that paid back, that's not for coverage. If part of that premium is for access to a help desk and it's optional, you still get that back.

The evil that the statute is trying to prevent is the one that is written into the statute. It's payment for a period beyond when the - - - the insured dies. It doesn't matter whether the payment is for coverage, for administration fees, for help desk, or anything else. It's not an - - -

CHIEF JUDGE WILSON: So the evil - - - what you describe as the evil that the statute is trying to address does seem to me a little bit different in a circumstance involving term or whole where the policyholder must make the payment under the terms of the contract and a variable policy where the policyholder can make it but doesn't have to make it. To put it a little bit differently, your client could have avoided what you're calling the evil by making monthly payments of the full amount instead of the annual, no?

MR. ARD: Well, no. In fact, the only way to pay this policy cheaply is to pay the annual premium every year, once per year, exactly like a term policy.

CHIEF JUDGE WILSON: Sorry, why couldn't you divide that by twelve and make a monthly payment?

MR. ARD: Because there's two separate accounts. There's two separate ways of testing whether the policy stays in force. The one is you look at your cash value and you look whether it covers a regular monthly charges. That's one. It's a counting mechanism.

The second way is the CPGR, the secondary rider. Under the secondary rider, if you have enough to cover the secondary charges, which are fixed and guaranteed and don't vary, then the policy automatically stays in force.

Counsel said, payment of CB - - - CPGR premium doesn't provide for coverage. I don't understand what that means. This policy stayed in force in one and only way, by paying that CPGR month - - - annual premium exactly once per year. The policy itself, on JA - - - I think it's JA64, says, "if all premiums are not paid by the premium due date, additional premiums will be required". That's for the CPGR. That's just like any other policy, that's just like a term policy, just like a whole life policy. If you don't pay your whole life premium, by the way, you don't automatically lose coverage; you get a grace period. What happens is you may have to pay some fines. If you don't pay your mortgage payment on time, you know, you may have - - - it doesn't mean you lose your mortgage, necessarily. You may have to pay extra fees. The exact same is true here.

The court cannot answer this question, no, categorically. The answer has to be, at least, it depends on the policy. Everybody agrees this statute, (a)(2), applies to universal life policies. That's not in dispute. The legislature amended in 2008 to make it clear as day, this applies to UL policies. The rule cannot be a categorical no. It cannot be that it doesn't apply to any UL policies. The rule might be, can - - - yes, a planned premium counts provided it's sufficient to cover the premiums for a year, like this one is. It could be yes, provided it's - - -

JUDGE GARCIA: If we go with your rule, then would they have to recalculate how much the insurance portion cost based on the risk, the insured dies and they have to refund the 50,000 that they've counted, essentially, as self-insurance for that premium?

MR. ARD: Well, I'm not sure I totally follow the question, Your Honor. But - - -

JUDGE GARCIA: So when they - - -

MR. ARD: - - - yeah, I think, yes, it does.

JUDGE GARCIA: - - - you pay 50,000 in, let's say just to make it a round number - - -

MR. ARD: Yeah.

JUDGE GARCIA: - - - what's left is the 50,000 in the account after they take the low charge off. And as I understand it, they calculate the value of the cost of your insurance part, let's just call it, the 1.5 million that you're going to get paid, based on almost a self-insured analysis of how much is in your account, right? So if you have 400,000 dollars in the account, essentially, they're calculating risk based on 1.1 million, right, that they have to insure over that.

MR. ARD: Uh-huh.

JUDGE GARCIA: Assuming option 1.

MR. ARD: That's right.

JUDGE GARCIA: But now, should they also factor in, well if you die next month, they got to give you back most of that 50,000, so should that really count in terms of how much you have to pay for your term life, or is that another risk they should factor?

MR. ARD: They say that under the terms of the policy that would count. We actually quantified that in our brief, and I think it's something, like, 130 dollar difference. Because when you're talking about - - -

JUDGE GARCIA: But doesn't the fact that they don't do that and go to what the agreement was here, they're not - - -

MR. ARD: No, no, no.

JUDGE GARCIA: - - - they would be factoring in that risk if they thought they had to give that money back to you, right?

MR. ARD: No, no, no. That's - - - they're not factoring it in because they're not interpreting the statute properly. That's the whole problem here. If they were interpreting the statute properly, then they may calculate the net amount of risk slightly differently, but it would make a miniscule difference. It would be about a hundred dollar difference in terms - - -

JUDGE GARCIA: But let's say you got a 100,000 dollar policy, and you put 50,000 dollars in, that's a big difference, right? Like - - -

MR. ARD: Well, yeah, but you wouldn't - - - you couldn't even have a 50,000 dollar plan premium for 100,000 dollar policy because it would get way too high. But - - - but yes, I mean they're just the mechanics of how net amount of risk are calculated. Those are complicated, and insurance companies have actuarial software that allows them to do it.

JUDGE GARCIA: But it seems like this has all been going along, and maybe it's X amount this year, but this is going on year after year, where you get the benefit of putting 50,000 in, taking that off of the amount that you're - - - you have to pay for coverage of your benefit. And then all of a sudden at the end you say, no, no, no, I get that money back.

MR. ARD: The fact that they have been misapplying the - - - how to calculate that amount of risk, they say, isn't a reason to not interpret the statute in the way it's supposed to be interpreted. Of course, there's one other example on the record of a situation where an insurance company was faced with a question of whether the refund was owed. Athene Life New York Insurance Company, the same insured. The same insured had a UL policy with Athene Life; Athene Life paid the refund.

That's the only evidence that there is of what the other insurance companies do in this situation. They paid the refund.

CHIEF JUDGE WILSON: What was the - - -

JUDGE CANNATARO: So you're saying they were factoring in that risk that they'd have to give back the account value portion of it as well?

MR. ARD: I - - - I had no idea, but the fact that - - - I don't know how they did their internal accounting. I don't know how Lincoln did its internal accounting. Maybe Lincoln does factor it in. I don't know. There's no way of knowing that on this record. It's a motion to dismiss.

CHIEF JUDGE WILSON: What was the policy - - -

MR. ARD: But if it did have to factor it in, the statute required it, then okay, so it's something their actuarial software can do.

CHIEF JUDGE WILSON: What was the policy value of this account at the time of the death?

MR. ARD: Great question. There's actually a motion that we filed to supplement the record because this was all decided on a motion to dismiss. Lincoln sent our client a policy statement the year - - - right before they paid the last annual premium, right before the insured died. It shows that if you paid the annual premium, 58,000 or 53,000, that the policy actually would lapse within that year if it wasn't for the guarantee. The guarantee is what was keeping this policy in force.

CHIEF JUDGE WILSON: So is it fair to say that - - - that the client was using this GVUL policy effectively like term?

MR. ARD: Yes.

CHIEF JUDGE WILSON: Okay.

MR. ARD: Exactly. Exactly. And the - - - what they sent us shows that. It shows - - - it says explicitly, that if you pay this annual premium exactly, once per year, you're guaranteed to have the policy stay in force forever.

CHIEF JUDGE WILSON: So help me with one more thing. Why would it make - - - my impression is if you had taken out a term policy instead of a GVUL policy that you're intending to use purely as term and not build cash value in it, you would have been - - - it would have been cheaper to just get the term policy.

MR. ARD: I don't know if that's true, Your Honor.

CHIEF JUDGE WILSON: Okay.

MR. ARD: I don't know if that's true.

CHIEF JUDGE WILSON: Okay.

MR. ARD: But this policy certainly is cheaper to pay as a term policy.

JUDGE GARCIA: But do you - - - do you know the answer to the question, how much money was in the account at the time of the - - -

MR. ARD: The Court has access to that information because we tried to submit something that sho - - - you know, supplement the record. That's an account statement from them. I don't remember what the answer is, but it's - - -

JUDGE GARCIA: It's on the record?

MR. ARD: - - - in there. Well, it's not on the record because our motion was denied. But if the court is curious, they can look at the account statement that Lincoln sent our client the year before he died that shows it's in the policy. And it shows that the CPGR means that if you pay this annual premium once per year every year, you're guaranteed to keep the policy in force for the following year. And if you don't pay it, your penalties are assessed, and you lose the CPGR coverage. The only rational way to keep this policy in force is to pay it once per year every year. And that makes it indistinguishable from the term policy.

CHIEF JUDGE WILSON: Thank you, Counselor.

MR. ARD: Thank you, Your Honors.

(Court is adjourned)

C E R T I F I C A T I O N

I, Ashley Bennett, certify that the foregoing transcript of proceedings in the Court of Appeals of Nitkewicz v. Lincoln Life, No. CTQ-2022-2 was prepared using the required transcription equipment and is a true and accurate record of the proceedings.

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