No. 106899

IN THE
SUPREME COURT OF ILLINOIS

VALERIE LAWHON-DAVIS, Plaintiff/Counter-Defendant, Respondent, v. REASSURE AMERICA LIFE INSURANCE COMPANY, formerly known as The Midland Life Insurance Company, Defendant/Counter-Plaintiff, Petitioner	)	On Petition for Leave to Appeal from the Illinois Appellate Court – 1st District. _____ No. 06-1752 Reversing the Judgment from Circuit Court of Cook County, Illinois _____ Trial Judge: Hon. Paddy H. McNamara

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BRIEF OF THE AMERICAN COUNCIL OF LIFE INSURERS AS *AMICUS CURIAE* IN SUPPORT OF THE PETITION FOR LEAVE TO APPEAL

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POINTS AND AUTHORITIES

INTEREST OF THE AMICUS CURIAE

The American Council of Life Insurers ("ACLI") is the largest life insurance trade association in the United States. Eighty-seven percent of all life insurance coverage in the State of Illinois is provided by ACLI's members. ACLI's 353 member companies account for 93% of the total assets and 93% of the life insurance premiums in the United States among legal reserve life insurance companies. ACLI member companies are the leading providers of financial and retirement security products covering individual and business markets. They offer life, disability income, and long-term care insurance, annuities, pension products, and reinsurance.

ACLI has a substantial interest in seeing the Appellate Court's decision in this case reversed. The Appellate Court's construction of Section 231.1(B) of the Illinois Insurance Code and the incontestability clause at issue would dramatically change the market for life insurance to the detriment of both insurers and insureds. Among other things, the Appellate Court's ruling would interfere with the chief virtue of group life insurance, namely its low cost to insurers and insureds, and thus negatively affect the availability and affordability of this important form of coverage in Illinois. (Group life insurance coverage in Illinois amounts to $480 billion, or just under half of Illinois residents' total death benefit coverage.) Accordingly, ACLI's members have a strong interest in ensuring that this Court grant further review and clarify that the statute and incontestability clause mean what they say: the death of an insured person during the contestability window prevents the insurance from becoming incontestable.

INTRODUCTION

In May of 1999, Marion Davis filled out a one-page form to apply for a relatively small amount of term life insurance coverage ($50,000) under a group policy that the predecessor of petitioner Reassure America Life Insurance Company ("Reassure") had issued to Davis' bank. Pet. App. 32. One of the few questions on the form was: "Have you smoked cigarettes in the last 12 months?" Davis checked the box for "No." *Id*. Yet Davis' medical records establish that during this period he had smoked at least one pack of cigarettes per day. *See* Pet. 6-7 (citing record).

Davis' insurance certificate contained an incontestability clause that read in pertinent part:

> Except for fraud,[1] no statement made by an Insured Person will be used to contest the validity of that Insured Person's insurance *after his or her insurance has been in force* prior to the contest *for a period of two years during his or her lifetime*; nor unless it is contained in a written instrument signed by the Insured Person making the statement.

Pet. App. 28 (emphasis added). Davis died within two years of receiving coverage, and the question presented in this case is whether Reassure lost its right to contest the validity of Davis's insurance because Reassure first contested the insurance more than two years after it was issued.

To answer this question, it is essential to bear in mind both the nature of group insurance and the purpose of an incontestability clause. Group insurance involves three parties: (1) an insurer, (2) an employer or other "central entity" (in this case, Davis' bank), and (3) the individual insured group members. 1A COUCH

[1] Reassure has not attempted to prove that fraud occurred.

ON INSURANCE 3D § 7:1 (2005). "Rather than being the insurer or the insured, the central entity is more like a policyholder . . . . The central entity has the chief contractual relationship with the insurer and usually pays either part or all of the premiums." *Id*.

Group insurance "benefits all parties involved." *Id*. Among other things, it lowers administrative and transaction costs for the insurance company (because the central entity assumes some of the recordkeeping and collection duties, and only one contract needs to be negotiated), and for insureds it lowers premium costs (because insurers pass some of their cost savings on to consumers and, again, the central entity often pays part of the premiums). *Id*. In the life insurance context, the group arrangement makes it possible for insurance companies to insure many more lives and for insureds to gain protection at low levels of coverage that would otherwise be unavailable. For its part, the central entity gets the benefits associated with sponsoring a valuable product for its customers or employees. Group life insurance currently accounts for about $480 billion of coverage in Illinois.

Like other forms of life insurance, group life insurance is typically subject to an incontestability clause limiting the period during which the insurer can exercise its right to rescind the insurance on the basis of misrepresentations made by an insured in obtaining coverage. 29 HOLMES' APPLEMAN ON INSURANCE 2D § 178.03 (2006). Incontestability clauses originated in England in the middle of the nineteenth century and became widespread in this country by the early part of the twentieth century. *See, e.g., Powell v. Mut. Life Ins. Co. of New York*, 313 Ill. 161,

164-65, 144 N.E. 825 (1924); *Suskind v. N. Am. Life & Cas. Co.*, 607 F.2d 76, 80 (3d Cir. 1979). The clauses were designed "to promote the certainty of insurance obligations and not have an insurer, many years after the original purchase of a policy on which premiums were constantly paid, suddenly disclaim liability." APPLEMAN, *supra*, § 178.03.

An incontestability clause puts the onus on an insurer to conduct any investigation it deems necessary during the contestability period, *id*., and the terms of any statute governing such a clause will reflect a legislative balance between the beneficiary's interest in repose and the insurer's interest in not issuing coverage on the basis of fraud or otherwise incorrect information. As explained below, the Appellate Court's decision in this case destroyed the careful balance struck by the Illinois legislature (and by the many other state legislatures that have enacted incontestability statutes substantially identical to Illinois's).

ARGUMENT: REASONS FOR GRANTING THE PETITION

I. The Appellate Court's Construction of the Incontestability Clause Would Destroy the Advantages of Group Life Insurance

The incontestability clause at issue here is controlled by Section 231.1(B) of the Illinois Insurance Code, which requires a group insurance policy to contain language providing that:

> no statement made by any person insured under the policy relating to his insurability shall be used in contesting the validity of the insurance with respect to which such statement was made *after such insurance has been in force* prior to the contest *for a period of two years during such person's lifetime*.

215 ILCS 5/231.1(B) (emphasis added). An incontestability statute qualified by "during the lifetime of the insured" has been on the books in Illinois since 1921,

see Mut. Life Ins. Co. of New York v. Wineberg, 319 Ill. App. 177, 182, 49 N.E.2d 44 (1st Dist. 1943), but it is worth noting that current Section 231.1(B) is an almost verbatim replica of a model statute that was promulgated by the National Association of Insurance Commissioners (NAIC) in 1946 and has since been adopted in some form in 48 states and the District of Columbia. *See* NAIC, PROCEEDINGS OF THE SEVENTY-SEVENTH ANNUAL SESSION OF THE NAIC 342-44 (1946) (hereinafter NAIC 1946 PROCEEDINGS); 4 NAIC, MODEL LAWS, REGULATIONS AND GUIDELINES 565-1 § 5 (2008); *id*. 565-11.

The NAIC model was part of a general effort to compromise between the views of industry and of state insurance regulators. *See* NAIC 1946 PROCEEDINGS 335-36. Its provision dealing with an insurer's ability to contest coverage on the basis of an applicant's misrepresentation strikes a carefully calibrated balance (just as did the antecedent enacted by the Illinois legislature in 1921). Consistent with the policies behind incontestability clauses in general, the NAIC model and Illinois statute both limit to two years the period during which the insurer may contest the coverage, *but only if the insured outlives the period*.

The NAIC and the legislatures of Illinois and other states have adopted this limitation on the protection afforded by an incontestability clause because of actuarial and economic realities. Life insurance companies for obvious reasons tend not to offer inexpensive coverage to people actuarially prone to die soon after the coverage is issued. Accordingly, individuals who die within two years of the coverage being issued are the ones statistically most likely to have misrepresented facts about their health in applying for the insurance. Indeed, as

amicus ACLI's members know all too well, the very type of misrepresentation at issue in this case – one concerning smoking habits – is among the most important type with which life insurance companies must deal[2] because of its significant impact on health and life expectancy[3] (and thus on the cost and availability of life insurance coverage).

If the incontestability period were not tolled upon the death of the insured, then insurers, in order to protect against the effect of fraud and other misstatements concerning matters like smoking habits, would need to conduct a costly medical investigation in connection with every application for coverage rather than rely on the applicant for truthful disclosures. Alternatively, insurers could choose not to conduct those investigations, but then they would effectively have a far less healthy pool of insureds, which in turn would increase their liabilities. Either way, insurers would respond to their increased costs either by restricting coverage or by substantially raising premiums, with the end result that what is now an inexpensive, efficient, desirable form of insurance (to the point that it accounts for just under half of the $1 trillion in outstanding death benefit coverage in Illinois) would become less affordable and far more difficult for Illinois citizens to obtain.

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[2] *See, e.g.*, ERICH KÖGEL, SMOKER/NON-SMOKER PRODUCTS IN LIFE INSURANCE: ACTUARIAL ASPECTS 52 (Munich Re 1995), *available at* http://www.munichre.com/publications/302-00461_en.pdf ("The problem of false declarations [concerning smoking] has already prompted insurance companies in the US market to take various countermeasures.").

[3] *See, e.g.*, ILL. DEP'T OF PUBLIC HEALTH, TOBACCO BURDEN IN ILLINOIS 2005, at 1, *available at* http://www.idph.state.il.us/smokefree/TobBurdenDoc_2005_SAMMEC.pdf (reporting that from 1997 to 2001, an average of 16% of all deaths each year in Illinois were attributable to smoking).

Accordingly, when the potentially suspicious circumstance occurs that an insured dies within two years of receiving low-cost life insurance, it is perfectly reasonable for the insurer to wait for a claim to be made before conducting its investigation and contesting the validity of the coverage. This is the bargain that the NAIC and the legislatures of Illinois and other states have made possible. Without it, an insured who misrepresents his health on the application form by failing to disclose that he or she is a smoker or has a life-threatening illness might well die soon after the insurance is issued, and yet the beneficiary could deliberately wait until after the two-year period has expired to make a claim. At that point, the insurance company would be stuck even though the coverage was obtained through a misrepresentation. Again, the only way for insurers to guard against such a circumstance would be to routinely conduct medical investigations in connection with issuing coverage under its life insurance policies – an expensive option that would significantly raise the cost of life insurance and would make group coverage in particular impractical in many circumstances.

II. The Appellate Court's Result Is A National Anomaly

Every jurisdiction that to our knowledge has confronted the issue has recognized that, when an incontestability provision in a statute or a life insurance policy or certificate lasts for a specified time "during the lifetime of the insured," the insured's death within the period suspends the expiration of the contestability period.

Illinois has recognized this principle for close to eighty years. In *Chicago Nat'l Life Ins. Co. v. Carbaugh*, 337 Ill. 483, 169 N.E. 218 (1929), an insurance

policy provided that it would be "incontestable after it shall have been in force, during the lifetime of the insured, for one year from date of issue." *Id*. at 484. This Court actually upheld the dismissal of the insurer's suit in equity to cancel the policy based on fraud in obtaining it because the insurer had an adequate defense at law: given that the insured had died within a year after the insurance had entered into force, the insurer could contest the policy at any time should the beneficiary choose to bring suit on it. *Id*. at 485-87.

Other jurisdictions have construed comparable clauses in exactly the same way. For a limited sampling of decisions, *see*, *e.g.*, *Crow v. Capitol Bankers Life Ins. Co.*, 119 N.M. 452, 456 (1995) ("The phrase, 'during the lifetime of the Insured' in the incontestability clause . . . has consistently been interpreted by other jurisdictions to mean that the insured must remain alive for the entire two-year period before the policy becomes incontestable."); *George Washington Life Ins. Co. v. Adams*, 514 S.W.2d 205, 206 (Ky. 1974); *Hydell v. N. Atl. Life Ins. Co.*, 667 N.Y.S.2d 391, 392 (App. Div. 1998); *Ginley v. John Hancock Mut. Life Ins. Co.*, 34 Ohio App. 2d 163, 168 (1973); *Greenbaum v. Columbian Nat'l Life Ins. Co.*, 62 F.2d 56, 58 (2d Cir. 1932); *see also* Pet. 14-16 (collecting cases). The Appellate Court's ruling, then, is a true anomaly. As one treatise sums up:

> [I]t is now plain that, if the incontestable clause requires the measuring period to run during the lifetime of the insured, as is the *universal modern practice*, on the death of the insured during the contestable period, contestability becomes frozen in place. The policy remains contestable for all time so far as the application of the contestability clause is concerned.

29 HOLMES' APPLEMAN ON INSURANCE 2D § 178.03 (2006) (emphasis added).

III. The Appellate Court's Ruling Rests on a Flat Misreading of § 231.1(B) Together with an Unwarranted Assumption About the Group Policy

To understand how the Appellate Court went astray, it is necessary to read the pertinent portions of Section 231.1(B) with care:

> No policy of group life insurance shall be delivered in this State unless it contains in substance the following provisions, *or provisions which in the opinion of the Director are more favorable to the persons insured, or at least as favorable to the persons insured and more favorable to the policyholder* . . . . (B) A provision that [i] validity of the policy shall not be contested, except for nonpayment of premiums, *after it has been in force for two years from its date of issue*; and [ii] that no statement made by any person insured under the policy relating to his insurability shall be used in contesting the validity of the insurance with respect to which such statement was made *after such insurance has been in force* prior to the contest *for a period of two years during such person's lifetime* nor unless it is contained in a written instrument signed by him[.]

215 ILCS 5/231.1(B) (emphasis and square brackets added). There is no dispute that the insurance documents at issue complied with requirement [ii]. The Appellate Court believed, however, that Reassure had failed to comply with requirement [i] (a point that Lawhon-Davis never suggested below), and leapt from that assumption to the conclusion that the incontestability clause actually present in Davis's certificate pursuant to requirement [ii] should be ignored entirely, *see* Pet. App. 7, 10-12 (a non sequitur that Lawhon-Davis also did not urge below).

As an initial matter, the Appellate Court's assumption is flatly wrong: Reassure *did comply* with requirement [i]. In a footnote (one on which, remarkably, the court's entire ruling hinges), the Appellate Court observed:

> It may be that the entire provision mandated by section 231(B) is included in the master group life insurance policy. However, there is no copy of the master group policy in the record from which we can make this

> determination and we are left to assume that the above provision comprises the only incontestibility provision in the agreement between Reassure and Davis.

Id. at 7 n.1. But this speculation is easily answered with reference to materials judicially noticeable by the Appellate Court and this Court. *See Vulcan Materials Co. v. Bee Constr.*, 96 Ill. 2d 159, 166, 449 N.E.2d 812 (1983) ("[J]udicial notice may be taken of factual evidence where the facts are capable of immediate and accurate demonstration by resort to easily accessible sources of indisputable accuracy."). (Reassure had no reason to put these materials before the courts below because Lawhon-Davis had never argued that Reassure violated the statute.) The master group life insurance policy under which Davis' individual certificate was issued was numbered 96-0001, *see* Pet. App. 26, 32, and that master policy contains language that does indeed comply with requirement [i]: "Except for fraud, the validity of the life insurance provided *under this Policy* will not be contested *with respect to any Participating Financial Institution* after it has been in force for two years."[4]

Worse still, the Appellate Court rejected Reassure's explanation that "the policy" in requirement [i] refers to the *master group life insurance policy* (which after two years becomes entirely incontestable other than on the grounds that premiums have not been paid), not the *individual's insurance under that policy* (which *is* contestable on the basis of an individual misrepresentation after two

[4] ACLI App., *infra*, at 17 (emphasis added); *see also id.* at 12 (setting forth the requirement [ii] clause). The Appendix to this brief contains copies of the approved applications for this master group policy on file with the Departments of Insurance of Illinois (which approved the individual certificate form), *id*. at 41-56, and North Dakota (which approved the group policy form), *id*. at 1-40.

years provided the individual insured dies within the contestability period). The Appellate Court was mistaken for at least four reasons.

First, the language is crystal clear: "*the* policy" in paragraph (B) obviously refers back to "policy of group life insurance" – the master policy – in the beginning of the section.

Second, as a matter of statutory interpretation, if "policy" in requirement [i] really referred to the individual's coverage, then requirement [ii] would be meaningless. *See Arnold v. Board of Trustees*, 84 Ill. 2d 57, 61, 417 N.E.2d 1026 (1981) ("Meaning must be given to each part of the statute, for the legislature will not be presumed to have done a useless act."). There would be no need to *mandate* the inclusion of such a provision (which after all is *less* favorable to an individual insured than requirement [i] would be because requirement [ii] contemplates potentially indefinite contestability) given that *the statute already allows an insurer to adopt incontestability provisions more favorable than what is set forth in the statute*. The Appellate Court's interpretation, in other words, should be rejected because it renders requirement [ii] pure surplusage. *See Harrisburg-Raleigh Airport Auth. v. Dep't of Revenue*, 126 Ill. 2d 326, 334, 533 N.E.2d 1072 (1989) ("There is a strong presumption against finding statutory language to be mere surplusage.").

Third, the Illinois Insurance Code as a whole confirms that Reassure's interpretation is correct. *Cf. Arnold*, 84 Ill. 2d at 61 ("The intent of the legislature must be found by construing the act as a whole."). The extensive statutory scheme regulating group life insurance – which is in large part a product of the NAIC's

model act – is based on a textual distinction between the "policy" issued to the central entity on the one hand and the individual insureds' "insurance" on the other. *See generally* 215 ILCS 5/230.1-231.1. The whole point of group life insurance, after all, is to make a central entity (here, Davis' bank) the primary contracting party and thus permit it to deal directly with the insurance company for the benefit of the insureds. *See* pages 2-3, *supra.*[5]

Moreover, under another section of the Code, *individual* life insurance policies in Illinois *must* contain a provision that the policy "after it has been in force *during the lifetime of the insured* a specified time, not later than 2 years from its date, . . . shall be incontestable except for nonpayment of premiums and except at the option of the company[.]" 215 ILCS 5/224(c) (emphasis added). This section of the Code mandates "during the lifetime of the insured" language in the incontestability clauses of individual life insurance policies, and therefore is *more* favorable to the insurer than the group life insurance statute as construed by the Appellate Court. Thus if the Appellate Court were correct, insurance companies would face a *higher* burden of contestability (hence investigation, hence cost) in the context of group life insurance than in the context of individual

[5] The Appellate Court believed that "[a] policy of insurance is a contract between an insurer and an insured," Pet. App. 13, but that is simply incorrect in the group insurance context (which was not at issue in the inapposite authorities cited by the Appellate Court). On the contrary, in the group insurance context, the "policy" is the contract between the insurer and the *central entity*. *E.g.*, 1A COUCH ON INSURANCE 3D § 7:1 (2005); *see also Abbiati v. Buttura & Sons, Inc.*, 161 Vt. 314, 318 (1994); *Guardian Life Ins. Co. of Am. v. Zerance*, 505 Pa. 345, 350 (1984). This is not to say that the insured has no contractual rights vis-a-vis the insurance company. He or she of course does have rights, but not because the group policy standing alone represents a contract between him or her and the insurer. The Court of Appeals' misunderstanding of the basic nature of group insurance has the potential to create mischief in other areas of Illinois insurance law.

life insurance. That result, however, is contrary to the whole point of group life insurance, which is to make bulk low-cost coverage possible.

Finally, other jurisdictions to have considered statutes or contracts with clauses just like this one recognize without difficulty that the first provision refers to the master policy, while the second refers to the individual's insurance under that policy. *E.g.*, *Suskind v. N. Am. Life & Cas. Co.*, 607 F.2d 76, 81-82 (3d Cir. 1979); *Taylor v. Am. Heritage Life Ins. Co.*, 448 F.2d 1375, 1377-78 (4th Cir. 1971) ("American Heritage is not contesting the 'policy,' as issued to the Fleet Reserve Association, but the individual certificate of insurance issued to Jacob Taylor. . . . By its terms, the first sentence of the incontestability clause does not refer to individual certificates of insurance."); *Wright v. Minn. Mut. Life Ins. Co.*, 271 S.C. 211, 215-16 (1978) ("[T]he two provisions of the incontestability clause are not inconsistent and each may be given effect. The first provision refers specifically to the group policy . . ., while the second provision refers to certificates of insurance issued under the group policy . . . ."); *Downs v. Prudential Ins. Co. of Am.*, 328 A.2d 20, 22-23 (N.J. Super. Ct. Law Div. 1974).

In summary, the Appellate Court had no basis for assuming that Reassure failed to comply with the statute. The court was obligated to give effect, as the trial court did and as all other jurisdictions to confront the issue have done, to the text of the incontestability clause, which permitted Reassure to contest Davis' coverage given that he died within two years of misrepresenting important facts about his health.

CONCLUSION

For the reasons stated above and in Reassure's Petition for Leave to Appeal, this Court should grant the petition and reverse the decision below.

Respectfully submitted,

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Dated: August 7, 2008

CERTICATE OF COMPLIANCE

I certify that this brief conforms to the requirements of Rules 341(a) and (b). The length of this brief, excluding the pages containing the Rule 341(d) cover, the Rule 341(h)(1) statement of points and authorities, this Rule 341(c) certificate of compliance, and the certificate of service is 14 pages.

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