California's Life Insurance Liability Trap

McHugh, Thomas, and the Long-Term Risk of California Insurance Code Sections 10113.71 and 10113.72

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The results of the McHugh decision in subsequent case law, and the interplay of new statutes, may have created a liability trap for unsuspecting life insurance companies.

In 2012, the California Legislature enacted changes to the California Insurance Code that provide protections intended to shield consumers from losing life insurance coverage due to late or missed insurance premium payments. See Cal. Ins. Code §§ 10113.71 and 10113.72. (Several other states have similar statutes.) These changes went into effect on January 1, 2013. Last year, on August 30, 2021, the Supreme Court of California held that these changes applied to all life insurance policies that were in force when the statutes became effective. *McHugh v. Protective Life Ins. Co.,* 494 P.3d 24 (Cal. 2021). Thus, life insurance policies issued or delivered in California even before January 1, 2013, cannot lapse or be terminated for nonpayment of premiums unless the insurer first complies with the grace period and notice provisions created by the legislation.

In reaching its decision, the California Supreme Court defined the procedure for determining whether a statute or statutory change is retroactive, and thus whether to invoke the presumption against retroactivity. In doing so, the Court concluded that it must first answer a threshold question: does the statutory change operate retrospectively or prospectively by targeting pre- or post-enactment conduct? While the Court acknowledged this is not always an easy question to answer, it determined that the new statutory protections targeted prospective, post-enactment conduct and did not otherwise raise significant problems traditionally associated with retroactively applying a new statute. The soundness of the Court's reasoning may come under scrutiny, however, as the results of the *McHugh* decision in subsequent case law, and the interplay of new statutes, may have created a liability trap for unsuspecting life insurance companies.

McHugh v. Protective Life Insurance Company

In *McHugh*, a life insurance company issued a $1 million term life insurance policy (the "Policy") to William McHugh in March of 2005. *See McHugh*, 494 P.3d at 28. The Policy premiums were due to be paid every January 9th on an annual basis, and the Policy terms provided for a 31-day grace period before the policy could be terminated for failure to pay premiums. McHugh paid the premium every year through January 2012, which kept the Policy in force until February 9, 2013 – 31 days after the January 9, 2013, premium deadline. *Id*. When McHugh did not pay the premium on time, the insurer sent a letter on January 29, 2013, warning him that the Policy would lapse if the payment were not received by February 9. *Id*. After the grace period expired, the insurer sent another letter granting him through March 12, 2013, to pay the premium and reinstate the Policy. *Id*. McHugh did not pay, and the insurer terminated the Policy. McHugh died in June 2013. *Id*.

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"The Statutes" – California's (not so) New Grace Period and Notice Requirements for Life Insurance Policies

Before the lapse and termination of McHugh's Policy, the California Legislature passed new protections to shield consumers from losing their life insurance coverage due to missed premium payments. These protections were codified in California Insurance Code §§ 10113.71 and 10113.72 (hereinafter, "the Statutes") which became effective on January 1, 2013, – almost 8 years after McHugh's Policy was issued, but while it was still in force.

> (a) Each life insurance policy issued or delivered in this state shall contain a provision for a grace period of not less than 60 days from the premium due date. The 60-day grace period shall not run concurrently with the period of paid coverage. The provision shall provide that the policy shall remain in force during the grace period.
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> (b)(1) A notice of pending lapse and termination of a life insurance policy shall not be effective unless mailed by the insurer to the named policy owner, a designee named pursuant to Section 10113.72 for an individual life insurance policy, and a known assignee or other person having an interest in the individual life insurance policy, at least 30 days prior to the effective date of termination if termination is for nonpayment of premium.
> (2) This subdivision shall not apply to nonrenewal.
> (3) Notice shall be given to the policy owner and to the designee by first-class United States mail within 30 days after a premium is due and unpaid. However, notices made to assignees pursuant to this section may be done electronically with the consent of the assignee.
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> (c) For purposes of this section, a life insurance policy includes, but is not limited to, an individual life insurance policy and a group life insurance policy, except where otherwise provided.
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> Cal. Ins. Code § 10113.71 (West)
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> (a) An individual life insurance policy shall not be issued or delivered in this state until the applicant has been given the right to designate at least one person, in addition to the applicant, to receive notice of lapse or termination of a policy for nonpayment of premium. The insurer shall provide each applicant with a form to make the designation. That form shall provide the opportunity for the applicant to submit the name, address, and telephone number of at least one person, in addition to the applicant, who is to receive notice of lapse or termination of the policy for nonpayment of premium.

Section 10113.71(a) requires each life insurance company issued or delivered in California to include a 60-day grace period after the premium due date before a life insurance policy can lapse due to nonpayment. Additionally, "notice of pending lapse and termination of a life insurance policy shall not be effective unless mailed by the insurer to the named policy owner [and] a designee named pursuant to Sec-

tion 10113.72" at least 30 days before any termination for nonpayment. Cal. Ins. Code § 10113.71(b)(1).

Section 10113.72(a) prevents the issuance of any life insurance policy in California unless and until the policy applicant has been given the right to designate at least one other person to receive notice of pending lapse or termination of a policy, if the lapse or termination is due to nonpayment of premium. *Id*. at § 10113.72(b). It also requires the insurer to notify policy owners annually of this right and further provides that no "life insurance policy shall lapse or be terminated for nonpayment of premium unless the insurer, at least 30 days prior to the effective date of the lapse or termination, gives notice to the policy owner and to the person or persons designated in subdivision (a)." *Id*. at § 10113.72(c). Notice also must be given "within 30 days after a premium is due and unpaid." *Id*.

McHugh at Trial

Shortly after McHugh's death, his daughter (the Policy beneficiary) and her mother (McHugh's successor in interest and Policy contingent beneficiary) contacted the insurer to determine whether a claim could be made under the Policy. *Id*. When the insurer advised that the Policy had been terminated, the beneficiaries sued for breach of contract and bad faith, arguing that sections 10113.71 and 10113.72 applied to the Policy even though it was issued before the effective date and that, therefore, the Policy could not have been terminated because the insurer did not satisfy the statutes' requirements. The insurer argued that the statutes could not retroactively apply to policies issued before January 1, 2013, and relied heavily on alleged agency interpretations for support.

The trial court rejected the insurer's argument. Rather than rule that the insurer's noncompliance with the Statutes prevented their lapse as a matter of law, however, the court allowed the issue to go to the jury. The jury then determined that McHugh was excused from having to perform his duties under the Policy; that all other conditions in the Policy were satisfied; and that the insurer did something the Policy prohibited (i.e., terminating the policy inconsistent with the statutes). The jury ultimately returned a special verdict for the insurer, however, finding that the plaintiffs were not harmed by the insurer's action. *McHugh v. Protective Life Ins. Co.,* No. 37201400019212CUICCT, 2017 WL 7000052, at *1 (Cal. Super. Aug. 09, 2017).

Plaintiffs appealed from the verdict and denial of their motion for judgment notwithstanding the verdict, arguing that the trial court erred when it declined to decide as a matter of law that the insurer had violated the statutes. The insurer requested that the judgment be affirmed on the additional ground that the Statutes do not apply retroactively to policies issued prior to their effective date.

McHugh on Appeal to the Court of Appeal

The California Court of Appeal agreed with the insurer and affirmed the verdict on the additional ground that the Statutes apply only to life insurance policies issued after January 1, 2013, and not retroactively to McHugh's Policy.

In reaching this decision, the Court of Appeal assumed, perhaps prematurely, that requiring compliance with the Statutes for policies issued prior to January 1, 2013, is necessarily a "retroactive" application of the statutory changes. As the Supreme Court of California would later point out, before applying a presumption against retroactivity of a statute, a court must first answer the threshold question: "Is the statutory change in question 'retroactive' or 'prospective?'" *McHugh v. Protective Life Ins. Co*., 494 P.3d 24, 33 (Cal. 2021). The Court of Appeal never addressed this question, which was critical to the Supreme Court's ultimate holding later. *See McHugh v. Protective Life Ins.*, 253 Cal. Rptr. 3d 780, 786 (Cal. App. 5th 2019), *rev'd and remanded sub nom. McHugh v. Protective Life Ins. Co*., 494 P.3d 24 (Cal. 2021). Thus, the Court of Appeal began its analysis with the legal principal that "a statute may be applied retroactively only if it contains express language of retroactivity or if other sources provide a clear and unavoidable implication that the Legislature intended retroactive application." *Id*. (quoting *Myers v. Philip Morris Cos*., 50 P.3d 751 (Cal. 2002)) (emphasis in *Myers*). Then, looking at the statutory language, the Court of Appeal identified specific language that prevented retroactive application to policies that were issued before 2013.

Specifically, the court found that section 10113.72 "clearly does not apply to policies issued before the statute's effective date because" the statute prevents the issuance of any life insurance policy until the *applicant* has been given an opportunity to designate another person to receive notice, and "because an existing policyholder is not—and by definition cannot be—an applicant." *Id*. *See also* Cal. Ins. Code § 10113.72(a). Then, because section 10113.71(b)(1) requires advance notice of a pending lapse be sent to a "designee named pursuant to Section 10113.72," the Court of Appeal concluded that this section also was intended to apply only to life insurance policies "issued or delivered" after the Statutes' effective date because the "right to . . . designate" only exists in policies issued after January 1, 2013. *McHugh*, 253 Cal. Rptr. at 786. Moreover, the court reasoned, the legislature knows how to specify that new insurance code statutes apply "to all policies in force, regardless of their date of issuance" – as it has done, for example, in the long-term care insurance context – but chose not to do so in section 10113.71. Id. at 787 (*quoting* Cal. Ins. Code § 10235.95). It is important to note that the California Insurance Code, Division 2, Chapter 2.6, regulating Long-Term Care Insurance also expressly "applies to all long-term care insurance policies delivered or issued for delivery in [California] on or after January 1, 1990." Cal. Ins. Code § 10235. Section 10235.95 established the interest rate accrual for accepted claims under long-term care policies, and it is expressly excepted from the prospective-only application of section 10235. Conversely, the life insurance code provisions at issue in *McHugh* are not subordinate to any code section expressly limiting its subparts to prospective-only application. Thus, the Court of Appeal's reliance on this single code section as an example of what the legislature "knows how to do" is less persuasive as the legislature did not have to make sections 10113.71 and 10113.72 expressly retroactive notwithstanding another provision that otherwise would prevent such application.

In addition to the statutory language, the Court of Appeal found persuasive California Department of Insurance employees' determinations that the Statutes' notice

provisions and grace period applied only to insurance policies issued in 2013 or later. *McHugh*, 253 Cal. Rptr. at 784. Official instructions on the Department's application system for approval of new insurance products and changes to existing products stated: "All life insurance policies issued or delivered in California on or after [January 1, 2013] must contain a grace period of at least 60 days." *Id*. (*quoting* SERFF Instructions for Complying with [Assembly Bill no.] 1747). In other communications both before and after the Statutes became effective, Department employees responded to direct inquiries about the Statutes' applicability and expressly advised that the Statutes applied (or would apply) only to policies issued or delivered after January 1, 2013, not before, and that the Statutes also would not apply to renewals of pre-2013 policies. *Id*.

Thus, the Court of Appeal concluded, the Statutes were not intended to be retroactive, and life insurance companies did not have to comply with the notice provisions or 60-day grace period before terminating a policy that was issued before 2013. *Id*. The Court of Appeal's decision was rendered on October 9, 2019, and, combined with the consistent guidance from Department of Insurance employees, cemented for the life insurance industry that the Statutes had no effect on the post-2013 lapse and termination of life insurance policies that were issued before January 1, 2013. Until the decision was appealed to the California Supreme Court.

McHugh at The California Supreme Court

When Plaintiffs appealed yet again, the California Supreme Court reached a completely different conclusion – and for completely different reasons – to hold that sections 10113.71 and 10113.72, with the exception of section 10113.72(a), "apply to all life insurance policies in force when these two sections went into effect, regardless of when the policies were originally issued." *McHugh v. Protective Life Ins. Co.*, 494 P.3d 24, 27 (Cal. 2021).

i. (Non?) Retroactivity of Sections 10113.71 and 10113.72:

While the Supreme Court acknowledged the general presumption against retroactively applying legislative enactments, it reasoned that there was no need to apply the presumption here. *Id*. at 33. Critically, the Court found the lower court's analysis to be flawed because it "presupposed that applying sections 10113.71 and 10113.72 to McHugh's policy was, in fact, retroactive for purposes of applying the presumption against retroactivity." *Id*. Before the Court can apply the presumption, it must first determine whether the statutory change in question is in fact retroactive or prospective – and to answer this question, the Court says, "The context matters." *Id*. at 32-34.

California cases defining "retroactivity" primarily focus on whether a specific statutory change "*significantly* alters settled expectations: by changing legal consequences of past events, or vitiating substantial rights established by prior law." *Id*. at 34 (emphasis in original). Citing *Quarry v. Doe I,* 272 P.3d 977 (Cal. 2012); *Strauss v. Horton,* 207 P.3d 48 (Cal. 2009); *Elsner v. Uveges,* 102 P.3d 915 (Cal. 2004); *McClung v. Employment Dev. Dept.*, 99 P.3d 1015 9Cal. 2004); *W. Security Bank v. Superior Court,* 933 P.2d 507 (Cal. 1997); *Tapia v. Superior Court,* 807 P.2d 434 (Cal. 1991) (en banc). Put differently, legislation is retroactive if it "increase[s] a party's liability for past conduct." *Id.* For example, application of a newly amended statute of limitations that enlarges the limitation period would be "retroactive" if it allowed claims for which the limitation period had already expired to be revived after the enactment, and the presumption against retroactive application would apply in the absence of an unambiguous legislative intent to the contrary. *See, e.g., Gallo v. Superior Court,* 246 Cal. Rptr. 587, 591-92 (Cal. App. 1988) (holding that, absent express language of retroactivity, a new enactment enlarging the period in which a plaintiff could sue for damages arising from commission of a felony could not revive a claim that had expired prior to enactment). This would both "significantly alter settled expectations" and "increase a party's liability for past conduct" because, at the time of the enactment, there could be no liability for an expired claim. Conversely, California Courts have routinely held that similar enlargements apply prospectively to claims that may have arisen before the enactment, but for which the limitations period had not yet run at the time of the enlargement. *See, e.g., Soc'y of Cal. Pioneers v. Baker,* 50 Cal. Rptr. 2d 865, 874 (Cal. App. 1996) (holding "amended version of the statute of limitations governs this action because the statute had not run in [defendant's] favor at the time it was amended"). *See also Quarry,* 272 P.3d at 982 ("As long as the former limitations period has not expired, an enlarged limitations period ordinarily applies and is said to apply prospectively to govern cases that are pending when, or instituted after, the enactment took effect. This is true even though the underlying conduct that is the subject of the litigation occurred prior to the new enactment."); *Mojica v. 4311 Wilshire, LLC,* 31 Cal. Rptr. 3d 887, 889 (Cal. App. 2005) (Holding that while Plaintiff's claims was pending, she was entitled to catch the windfall of any liberalization of the statute of limitations . . . regardless of its non-retroactivity").

While the Supreme Court acknowledged the general presumption against retroactively applying legislative enactments, it reasoned that there was no need to apply the presumption here.

The *McHugh* Court cited to some of the case law regarding retroactive application of new statutes of limitation and contrasted it with other "quintessential" examples of legislation that retroactively "disrupt clearly settled expectations" both in California and under federal law. *McHugh*, 494 P.3d at 34. In *Landgraf v. USI Film Products,* the Supreme Court of the United States applied the presumption against retroactivity to certain provisions of Section 102 of the Civil Rights Act of 1991, holding that "new compensatory damages provisions would operate 'retrospectively' if . . . applied to conduct occurring before"

enactment, and noting that "compensatory damages are quintessentially backward looking." 511 U.S. 244, 283 (1994). The U.S. Supreme Court also cautioned, "It will frequently be true . . . that retroactive application of a new statute would vindicate its purpose more fully. That consideration, however, is not sufficient to rebut the presumption against retroactivity." *Id*. at 285-86. *McHugh's* insertion of a threshold question of whether the statute is addressed to prospective versus retrospective appears to skirt this caution by avoiding a conclusion that the statutes are retroactive in application to begin with. Such application would disrupt expectations by attaching "new legal burdens" to pre-enactment conduct. *Id*. at 282. The California Supreme Court reached the same conclusion about retroactive application of Proposition 51, which modified California's common law joint-and-several liability doctrine to limit recovery of noneconomic damages against a tortfeasor to his or her proportionate share of fault. *See Evangelatos v. Superior Court,* 753 P.2d 585 (Cal. 1988). The *Evangelatos* Court also placed significant emphasis on the fact that "individuals may have already taken action in reasonable reliance on the previously existing state of the law" and that a "new remedial rule for the future does not necessarily demonstrate an intent to apply the new rule retroactively to defeat the reasonable expectations of those who have changed their position in reliance on the old law." *Id*. at 601-02. This analysis is not directly applicable in *McHugh*, because the insurer would not rely on the absence of any law prospectively requiring notice and an extended grace period for missed premium payments. A similar principal could apply, however, where insurers reasonably relied on direct instructions and guidance from the Department of Insurance after January 1, 2013, declaring that the Statutes did not apply to any individual life insurance policy issued or delivered prior to the statutes' effective date. The Court in *Evangelatos* summarily recognized that applying tort reform statutes to causes of action that arose prior to enactment would constitute a retroactive application of the statute largely because it would deprive a party of "a legal doctrine on which many persons may have reasonably relied in conducting their legal affairs prior to the new enactment." *Id*. at 588.

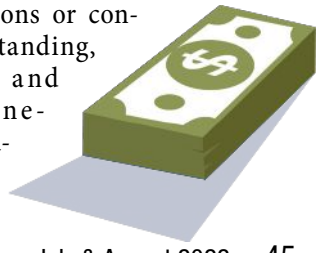
The Court found that the Statutes do not disrupt settled liability expectations in the same way. So, the *McHugh* Court says, "it's not clear they operate 'retroactively' at all." *McHugh*, 494 P.3d at 34. The statutes do not, for example, compel any insurer to revive or "reinstate" any policy that lapsed or terminated for nonpayment *prior* to January 1, 2013. At least one plaintiff has unsuccessfully attempted to apply the statutory provisions to a policy that lapsed prior to January 2013, arguing that dismissal of his case was contrary to public policy given the statutes, but conceding the statutes were not effective at the time the policy at issue lapsed. *Calleja v. U.S. Fin. Life Ins. Co*., No. 13-00983 SC, 2014 WL 988900, at *4 (N.D. Cal. Mar. 10, 2014). The Court also found that the statutes do not alter the substantive bargain between insurer and insured by, for example, requiring the insurer to expand the coverage of its policies or altering or eliminating the insured's obligation to pay premium for violations of the new enactments. In practice, as noted below, it is arguable that this has not held true where, for example, an insurer was found to have breached its life insurance policy by failing to pay life insurance benefits on a policy for which premiums indisputably had not been paid. *See Thomas v. State Farm Life Ins. Co.,* No. 20-55231, 2021 WL 4596286, at *1 (9th Cir. Oct. 6, 2021). *Id*. at 34-35. Instead, the Court found these statutes "merely impose additional rules on insurers as a condition of doing business in California," altering the procedure for terminating a life insurance policy in the future. *Id*. at 35. In the particular context of the insurance industry, where the state already significantly regulates the contractual relationships between insurers and insureds, the Court suggested that such application "could be regarded as prospective rather than retroactive for purposes of the presumption." *Id*. This suggests that, in the context of a pervasively regulated field such as insurance, the "settled expectation" is one of constant change and regulation to which a policy may be required to adapt. And so long as the vested liability of one of the parties is not significantly altered, applying the Statutes to future lapses of policies that were issued prior to 2013 "falls well short of the quintessential understanding of 'retroactivity.'"

Despite this holding, the Court declined to expressly determine that the statutes are prospective, and therefore did not foreclose the possibility that a similar policy could be retroactive in effect, thereby invoking the (rebuttable) presumption against retroactive application to a particular policy. The Court recognizes instead that "any nominal retroactive effect arguably at issue here plainly fails to present the type of concern underlying the application of the presumption as we have ordinarily understood it." *Id*. at 37. While this holding is probably most accurately read as finding that the McHugh policy and those similarly situated do not make "retroactive" changes at all, the court punts on this ultimate conclusion to make the more nuanced holding that, even if the changes are "retroactive" in the broadest sense of that word, then the "indicia of legislative purposes here *could* rebut it." *Id*. The court expressly "decline[d] to give the presumption such weight that it determines the outcome of this case." *Id*.

Indicia of Legislative Intent – DOI Deference and Statutory Interpretation

After considering and declining to invoke the presumption against retroactivity and determining that the Statutes are not retroactive – or at least, not retroactive in the sense that the presumption can bar their application to pre-2013 life insurance policies – the Court turned to the statutory language and other indicia of legislative intent to determine whether they could apply to prevent McHugh's Policy from lapsing. The Court concluded that they do.

In reaching this holding, the Court gave no deference to the Department of Insurance (DOI) guidance upon which the Court of Appeal heavily relied. The California Supreme Court acknowledged that "some deference to DOI's interpretations of the Insurance Code" could be warranted "to the extent that those interpretations are embodied in quasi-legislative regulations or constitute long-standing, consistent, and contemporaneous interpretations." *McHugh v. Protective*



Life Ins. Co., 12 Cal. 5th 213, 227, 494 P.3d 24, 32 (2021). Here, however, its "interpretation does not depend on extending deference to [Department of Insurance] staff correspondence or electronic instructions, neither of which represent the agency's official interpretation" of the Statutes. *Id.* at 28.

Pre- and post-enactment correspondence from DOI employees to insurers stated that the statutes' notice and grace-period requirements did not apply to policies issued before 2013. While the Court recognized that these statements expressed an interpretive view, it explained that such communications provide little interpretive guidance because they (1) are not necessarily the product of careful consideration of the legal issue; (2) do not express or represent "a quasi-legislative rule, promulgated pursuant to delegated lawmaking power"; and (3) they were not disseminated by the DOI to anyone other than the recipient." *McHugh,* 494 P.3d at 45. Citing *Heckart v. A-1 Self Storage, Inc.*, 415 P.3d 286 (Cal. 2018) and *Yamaha Corp. of Am. V. State bd. of Equalization,* 960 P.2d 1031 (Cal. 1998). More importantly, or at least more persuasively to the Court on this issue, the California Insurance Commissioner filed an amicus brief denying that such correspondence constitutes official interpretations.

Finding no deference owed to the DOI correspondence, the Court turned to the statutory language for indications of legislative intent. The Court grappled first with section 10113.72(a), which provides: "An individual life insurance policy *shall not be issued or delivered in this state until* the applicant has been given the right to designate at least one person, in addition to the applicant, to receive notice of lapse or termination of a policy for nonpayment of premium." Cal. Ins. Code § 10113.72(a) (emphasis added). Like the Court of Appeal, the California Supreme Court recognized that this provision obviously cannot apply to any policy issued or delivered prior to 2013. *McHugh*, 494 P.3d at 39. The remaining provisions, however, are less obvious and have no similar, prospective-only language indicating a clear legislative intent that pre-2013 policies be included or excluded from the Statutes' requirements.

For example, section 10113.71 states, "Each life insurance policy issued or delivered in this state shall contain a provision for a grace period of not less than 60 days from the premium due date." Cal. Ins. Code § 10113.71(a). Nothing in the language of this section, or the subsequent notice subparts in 10113.71(b), indicates any intent, one way or another, that the statue apply to pre-2013 life insurance policies. Subpart (b) of section 10113.72 is similar, stating that an "insurer shall notify the policy owner annually of the right to change the written designation or designate one or more persons." However, this subpart follows, and references, "the right to designate" created by section 10113.72(a). The Court focused on the fact that subpart (a) refers to "the applicant" for an individual life insurance policy, whereas subpart (b) requires insurers to notify "the policy owner" – a requirement the Court declares "could apply regardless of when the policy was issued." *McHugh*, 494 P.3d at 39. The Court appears to have sided with Plaintiff's interpretation that subpart (b) contains no language to limit the designation right only to "policy owners" who purchased insurance after enactment of the statutes, stating (without analysis) that this interpretation "gives full effect to the several instances where subdivision (b) uses meaningfully distinct language from subdivision (a)." *Id.* The Court acknowledged, however, that the insurer's argument that subdivision (b) repeatedly refers back to and builds from subdivision (a) and could be read merely to clarify the scope of that provision. *Id.*

Indeed, other California Supreme Court precedent supports the insurer's argument, cautioning against "ignor[ing] the Legislature's grammatical choices—specifically, its use of definite and indefinite articles." *Pineda v. Bank of Am., N.A.*, 241 P.3d 870, 875 (Cal. 2010). Section 10113.72(b), refers to "*the* policy owner," not "a" or "any" policy owner, which can only be read to refer back to the policy in subpart (a) – which policy "shall not issue or be delivered in" California until the right to designate has occurred. Subpart (b) also refers definitely to "the right" and "the written designation." Cal. Ins. Code § 10113.72(b). Plaintiffs' interpretation does not account for these grammatical choices, whereas the insurer's interpretation is bolstered by them – the definite selection of "the policy owner," "the designation," and "the right" all necessarily refer back to subpart (a). Plaintiffs' reading requires subpart (b) to be read in isolation from the immediately preceding subpart. Subpart (b) makes little sense in such isolation, however, as it is impossible to tell the type of policy to which the subpart refers. Indeed, subpart (a) identifies the type of policy – "individual life insurance policy" – covered by the statute. Plaintiffs' interpretation-in-isolation could lead, and has led, to litigation over how far the statute's requirements can extend. For example, while 10113.72(a) and (c) refer specifically to "individual life insurance policies," subpart (b) and section 10113.71 are not so limited, despite express references to the designation created by section 10113.72(a).

The Court did not dive deeply into canons of statutory construction, but it acknowledged that the insurer's interpretation was at least plausible and, thus, identified some ambiguity in the Statutes. The Court therefore looked to the legislative history for Assembly Bill No. 1747, finding an "awareness that consumers tend to hold life insurance policies for long periods" and a concern that policy owners, "especially seniors," may lose benefits by failing to pay a single annual premium on time – possibly because, for example, "they were being hospitalized when the bill came." *McHugh*, 494 P.3d at 41-42. The Court did not find any expression of intent about whether the Statutes were to apply to all policies in force, or only to policies issued after January 1, 2013; but it concluded, nonetheless, that "the insurer's interpretation would produce results seemingly incongruous with the legislation's broader aims of preventing forfeiture." *Id.* Tellingly, the Court turned to the following hypothetical to support its ultimate holding:

> If a paradigmatic beneficiary of the new legislation was, say, a 70-year-old life insurance policy owner who had paid premiums for 30 years before missing an annual payment, a new-policy-only construction would mean that a person in this situation wouldn't garner protection from the new laws before 2043. Even for a forward-thinking Legislature, this seems like a stretch. (*Cf. Bentley, supra,* 2016 WL 7443189, at p. *4 [declining to give effect to the

"absurd result[s]" of Protective Life's interpretation].)

Id. at 33. This hypothetical falls into the exact kind of analysis the U.S. Supreme Court warned of in *Landgraf v. USI Film Products,* 511 U.S. 244, 283 (1994). "It will frequently be true . . . that retroactive application of a new statute would vindicate its purpose more fully. That consideration, however, is not sufficient to rebut the presumption against retroactivity." *Id*. at 285-86. The *McHugh* Court neatly sidesteps this problem by circumventing the presumption against retroactivity in its earlier analysis.

Pointing to the California Legislature's supposed "awareness" and the hypothetical "absurd result" as indicia of its intent that the Statutes' requirements apply to pre-2013 life insurance policies, the Court resolved the ambiguity in the statutory language in favor of Plaintiffs. Thus, going forward, the notice provisions and grace periods required by section 10113.71 and 10113.72 apply to all individual life insurance policies in force on January 1, 2013.

While *McHugh* resolves the legal reach of the Statutes to policies issued or delivered before January 1, 2013, practical application of *McHugh's* construction over the last several months has raised more questions and sometimes led to results that seem to contradict the assumptions made by the California Supreme Court.

Thomas v. State Farm Life Insurance Company: Per se Breach of Contract – No Causation or Reciprocal Performance Required

Two potentially contradictory results are demonstrated by the recent Federal Ninth Circuit opinion in *Thomas v. State Farm Life Insurance Company,* which construed McHugh to eliminate two elements of a breach of Contract claim under California law. No. 20-55231, 2021 WL 4596286, at *1 (9th Cir. Oct. 6, 2021).

Thomas involved two individual life insurance policies issued to James Flynn in 2008. *Thomas v. State Farm Ins. Co.,* 424 F. Supp. 3d 1018, 1020 (S.D. Cal. 2019), *aff'd sub nom. Thomas v. State Farm Life Ins. Co.,* No. 20-55231, 2021 WL 4596286 (9th Cir. Oct. 6, 2021). Flynn failed to pay premiums in 2016, and his policies subsequently lapsed when he failed to pay premium after a 31 day grace period. *Id*. Flynn died in 2017 and, when the representative of his estate inquired about the life insurance policies, the insurer stated they had been terminated for nonpayment. *Id*. The parties did not dispute that Mr. Flynn was not given a 60-day grace period, and they stipulated that there was no evidence of the insurer communicating to him a right to designate an additional notice party. *Id*. at 1022.

The Federal District Court for the Southern District of California granted summary judgment to Plaintiff, holding that each premium payment after January 2013 renewed the policies and, therefore, under the renewal principal, the policies incorporated the Statutes into the policy's provisions. *Id*. at 128. Because the insurer indisputably did not comply with the 60-day grace period, the policies could not terminate. *Id*.

On appeal, the Ninth Circuit affirmed on narrower grounds. In light of *McHugh*, the insurer conceded that the Statutes applied regardless of whether each post-2013 premium payment constituted a renewal. *Thomas*, 2021 WL 4596286, at *1. Instead, the insurer argued that Plaintiff failed to prove causation because she did not establish any evidence "that the policies would not have lapsed even had State Farm complied with sections 10113.71 and 10113.72." *Id*. The Ninth Circuit was unpersuaded. It found that, in light of *McHugh*, "[a]n insurer's failure to comply with these statutory requirements means that the policy cannot lapse." *Id*. Thus, it held, the insurer "breached its contractual obligations by failing to pay benefits to Thomas under the policies after Flynn's death." *Id*.

This ruling perhaps proves too much. California law indeed holds that "insurance policies are governed by the statutory and decisional law in force at the time the policy is issued" and that these statutory "provisions are read into each policy issued thereunder, and become a part of the contract with full binding effect upon each party.'" *Interinsurance Exch. of Auto. Club of S. Cal. v. Ohio Cas. Ins. Co.*, 373 P.2d 640, 643 (Cal. 1962). Also according to California law, "this rule is followed even through there has been a subsequent amendment or repeal of the statute incorporated into the policy" based on the principal that "a statute should be given the least retroactive effect that its language reasonably permits." *Id*.

While the effect of *McHugh* and sections 10113.71 and 10113.72 may be to prevent lapse and termination of a life insurance policy issued prior to 2013, the implication that non-termination and failure to pay automatically results in a breach of contract might be a contradiction to the reasoning employed by the *McHugh* court. Under California law, the elements of a breach of contract action consists of, among other elements, "plaintiff's performance or excuse for nonperformance" of her contractual obligation and that a defendant's breach of a contract caused the plaintiff harm. *See Miles v. Deutsche Bank Nat'l Trust Co.*, 186 Cal. Rptr. 3d 625, 631 (Cal. App. 2015). *See also Troyk v. Farmers Grp., Inc.,* 90 Cal. Rptr. 3d 589, 629 (Cal. App. 2009) ("Regarding the element of causation, CACI No. 303 requires proof the plaintiff 'was harmed by' a defendant's breach of contract."); Judicial Council of California Civil Jury Instructions CACI No. 303 (2020 edition) (instructing the jury that it must find a breach "was a substantial factor in causing" damages). It is conceivable that an insurer's failure to provide the notice and grace period required under the Statutes could excuse a plaintiff's failure to *timely* make premium payments, but this should not relieve an insured of the obligation to pay premium at all. Relieving Plaintiff of this obligation would alter the substantive bargain between insurer and insured – i.e., the right to coverage in exchange for premium – which was exactly the kind of substantive effect the *McHugh* Court opined would be construed as retroactive, thus invoking the presumption against retroactive application of the Statutes. *McHugh*, 494 P.3d at 35. Yet, the effect of the Ninth Circuit's Opinion in *Thomas* essentially finds that the statute (under *McHugh's* construction) does exactly that: the *Thomas* plaintiff was relieved not only of having to show the necessary element of causation, but also of the obligation to pay premium under the policy before the defendant insurer was found to have breached it.

For incorrectly terminated insurance policies covering insureds who died after 2013 but before the insurer complied with

the Statutes, *McHugh* and *Thomas* create another interesting question: can the insurer of such policies *ever* terminate them for failure to pay premium? Assuming the insured is also the policy owner, the holdings would seem to imply that no, these policies can never lapse for nonpayment because the insurer can never provide the owner a 60-day grace period or provide him notice of pending lapse "30 days prior to the effective date of termination." Thus, insurers that have terminated life insurance policies since 2013, but not complied with the Statutes, run a risk of exposure to an indisputable breach of contract claim and obligation to pay death benefits under the policy.

This trap became even stronger in 2020, when California's Unclaimed Life Insurance and Annuities Act went into effect. *See* Cal. Ins. Code § 10509.940, et seq. Among other things, the statute applies to all "in force policies" and requires life insurance companies, upon lapse of a policy, to search the Death Master File to determine whether an insured has deceased, and then to locate and pay benefits to the beneficiary or, if no beneficiary can be found, then to remit the funds to the state of California. Cal. Ins. Code § 10509.943 - .944. While the likelihood of having to remit the funds to the state may be very low, there is still no provision for the insurer's recovery of the benefit of its bargain – i.e., timely payment of premium. And, based on the holdings in *McHugh* and *Thomas*, there may not be for any insurance policy (now or in the future) that fails to comply with the Statutes when terminating a policy for failure to pay premium.

While it is possible the insurer could offset the past-due premium payments from the benefit paid out under the policy, this possibility should not justify a judgment for breach of contract. Such a judgment necessarily should have included a finding that plaintiff either performed her obligations or was excused from doing so. *See e.g., Miles,* 186 Cal. Rptr. 3d at 631 (listing "plaintiff's performance or excuse for nonperformance" as an essential element of a breach of contract claim under California law). If plaintiff is excused from paying premium at all before obtaining a judgment, solely because the Statutes excused timely performance, then the result in cases like *Thomas* might undermine the prospective-versus-retrospective threshold question relied upon by *McHugh*.

In any case, what the rulings in *McHugh* and *Thomas* make clear is that no life insurance policy in force as of or after 2013 can lapse or terminate for nonpayment unless the insurer first complies with section 10113.71 and 10113.72. However, the unaddressed consequences of these holdings may reveal contradictions or even viable attacks on the reasoning in *McHugh*.

Other Subsequent Cases

Several other cases have been filed in the wake of the Statutes and the *McHugh* decision. Most are directed to the simple question of whether the Statutes apply to policies issued or delivered prior to 2013. Several were stayed pending the decision in *McHugh* and are now proceeding or concluded based upon that decision *See, e.g., Kelley v. Colonial Penn Life Ins. Co.,* No. 220CV03348FLAEX, 2022 WL 341135, at *2 (C.D. Cal. Jan. 3, 2022).

One case was unsuccessful because the policy in question was issued and delivered in Illinois, and therefore did not fall within the ambit of the California Insurance Code. *See Elmore v. Hartford Life & Accident Ins. Co.,* No. CV 18-08903-CJC(JCX), 2020 WL 1276106, at *4 (C.D. Cal. Jan. 6, 2020) (dismissing case and recognizing that, "[i]n the insurance context, the terms 'issued' and 'delivered' refer to the original issuance and delivery of the policy; they are fixed as to time and do not stretch into infinity") (citing *Ball v. Cal. State Auto. Ass'n Inter-Ins. Bureau,* 201 Cal. App. 2d 85, 87 (1962)) (internal quotation and punctuation omitted).

Several class actions have also been attempted in the federal district courts, though as of this article none has managed to survive the 12(b)(6) stage. In *Pitt v. Metropolitan Tower Life Insurance Company,* the Northern District of California dismissed a class action for lack of personal jurisdiction over the insurer. No. 18-CV-06609-YGR, 2020 WL 1557429, at *9 (N.D. Cal. Apr. 1, 2020). Substantively, courts are striking class claims for failing to offer any model for calculating damages on a class wide basis. In *Siino v. Foresters Life Insurance and Annuity Company,* for example, the class representative was only able to offer a viable damages model for two out of 526 putative class members, representing the only two policies for class members who were deceased. No. 20-CV-02904-JST, 2022 WL 110249, at *5 (N.D. Cal. Jan. 12, 2022). Yet-living policyholders constituted more than 99 percent of claimants and had no cognizable or calculable damages. *Id*. at *6. Class certification for declaratory relief on whether the Statutes applied to pre-2013 policies was also unviable because *McHugh* conclusively answered the question. *Id*. at *1 fn. 1.

One interesting question addressed by a handful of pre-McHugh courts was whether the statutes applied to universal, as opposed to whole life insurance.

One interesting question addressed by a handful of pre-*McHugh* courts was whether the statutes applied to universal, as opposed to whole life insurance. Most refused to apply the statutory requirements to universal life insurance policies. *See, e.g., Bennett v. ReliaStar Life Ins. Co.,* No. CV 20-6529 PA (KSX), 2020 WL 5835324, at *4 (C.D. Cal. Sept. 23, 2020); *Elmore v. Hartford Life & Accident Ins. Co.,* No. CV 18-8903 CJC (JCx), 2020 WL 1276106, at *3 (C.D. Cal. Jan. 6, 2020); *Shaff v. Farmers New World Life Ins. Co.,* No. CV 17-3610 JAK (Ex), 2019 WL 4570014, at *11 (C.D. Cal. Aug. 5, 2019); *Avazian v. Genworth Life & Annuity Ins. Co.,* No. CV 17-6459 RGK (JEMx), 2017 WL 6025330, at *2 n.2 (C.D. Cal. Dec. 4, 2017). These decisions were made under the now-debunked assumption that the statutes did not apply to policies issued prior to 2013. Several courts had, nonetheless, applied the statutes' requirements under the renewal principal, holding like the District Court in Thomas that the payment of premiums after 2013 renewed the policy and incorporated the statutes' requirements into the terms of

the renewed contract. *See Siino v. Foresters Life Ins. Co.,* No. CV 20-2904 JST (N.D. Cal. Sept. 1, 2020); *Thomas v. State Farm Ins. Co.*, 424 F. Supp. 3d 1018, 1025 (S.D. Cal. 2019); *Bentley v. United of Omaha Life Ins. Co.,* No. CV 15-7870 DMG (AJWx), 2016 WL 7443189, at *4-*5 (C.D. Cal. June 22, 2016). Because *McHugh* likely renders the "renewal" argument irrelevant, the Statues will apply to universal life insurance policies going forward.

Less clear is whether and to what extent the statutes apply to group life insurance policies, regardless of when they were issued. This question is currently being appealed to the Ninth Circuit from the Federal District Court for the Eastern District of California's decision in *Clark v. Transamerica Life Insurance Company,* No. 2:20-CV-00539-JAM-DB, 2020 WL 5110295, at *4 (E.D. Cal. Aug. 31, 2020). *Clark* involves a similar lapse question as that in *McHugh*. Plaintiff argued that the defendant insurer failed to comply with the mandatory notice provisions in both sections 10113.71 and 10113.72 by failing to provide the insured with notice of her right to designate another recipient of policy notices. The claim was initially denied, though the case notes that the insurer is "now making full payment of the life insurance death benefits and accrued interest to Plaintiff." *Id*. at *1. Plaintiff nonetheless continued to pursue her elder abuse, unfair competition, and breach of contract claims due to the insurer's alleged wrongful lapse of the policy and its alleged concealing of the insured's right to designate a beneficiary under the policy. *Id*.

The court in *Clark* granted the insurer's motion to dismiss with prejudice without regard to the applicability of the Statutes to pre-2013 policies. Instead, the court's decision turned on whether the Statutes applied to group life insurance policies at all. Relying primarily on the language of section 10113.72(a), which states, "*An individual life insurance policy* shall not be issued or delivered in this state until the applicant has been given the right to designate at least one person, in addition to the applicant, to receive notice of lapse or termination of a policy for nonpayment of premium." Cal. Ins. Code § 10113.72(a) (emphasis added). Based on this language, the court concluded that section 10113.72 does not apply to group life insurance policies. *Clark*, 2020 WL 5110295, at *4. As an additional ground, the court held that neither of the Statutes apply to the policy because it was issued and delivered in Illinois – not California. *Id*. Implicit in the court's finding is another grounds for dismissal of Plaintiffs' claims – the insured under the policy was not the policy owner and therefore not entitled to designate another notice party under the statute (though likely entitled to the other notices of nonpayment and pending lapse as "a known assignee or other person having an interest in the individual life insurance policy" in section 10113.71(a)).

While it seems apparent both from the statutory language and the *Clark* court's analysis that section 10113.72 does not apply to group life insurance policies, the *McHugh* court's indication that subsection (b) was "better" read in isolation from subsection (a) may cast doubt on this conclusion. While subsection (a) says that an "individual life insurance policy shall not be issued" without notice of the applicant's right to designate another party to receive notice of a pending lapse, subsection (b) states only that "[t]he insurer shall notify the policy owner annually of the right to change the written designation or designate one or more persons." Nonetheless, section 10113.71(b) likely puts this argument to rest, requiring notice go to "a designee named pursuant to Section 10113.72 *for an individual life insurance policy."* Cal. Ins. Code § 10113.71(b) (emphasis added). Read in conjunction, it is clear that the designation right, at least, belongs only to applicants and policy owners of individual life insurance policies.

Conclusion

While the results of cases like *Thomas* may lead to challenges to the *McHugh* decision, *McHugh* is the law for the foreseeable future. Life insurance companies should be diligent in reviewing individual life insurance policies that lapsed for nonpayment since 2013 to ensure compliance with the Statutes. Without such compliance, there can be no confidence that the policy has truly terminated, and the insurer runs a risk of falling to the liability trap created by *Thomas* and California's new Unclaimed Life Insurance and Annuities Act. While the results of these subsequent cases raise possible additional challenges to the conclusions reached by the Court in *McHugh*.