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What Does "Based On" Mean? In Cost of Insurance Litigation, Courts Continue to Disagree Over the Meaning of the Key Contractual Provision

If you see a movie that is "based on a true story," how close to the story are you expecting the movie to be? Your answer to that question may inform whether you think the typical breach of contract claim in cost of insurance ("COI") litigation should be dismissed on the pleadings and/or summary judgment or proceed all the way to trial.

OVERVIEW

In late 2013 and early 2014, when COI litigation picked up and began percolating through the courts, an early split developed over the meaning of the term "based on" in the context of COI provisions. On one side of the split was the Seventh Circuit, which interpreted "based on" such that when a universal life policy says COI rates are "based on" four enumerated factors (*e.g.*, expectations of future mortality, expenses, interest, and lapses), the insurer is permitted to consider factors *beyond* those enumerated factors in calculating rates, so long as it at least takes into account the enumerated factors. On the other side was the Southern District of New York, which interpreted "based on" such that in calculating COI rates, an insurer was permitted to consider *only* those four enumerated factors and nothing else.

Today, as insurers across the industry have continued to raise COI rates and litigation by policy owners challenging those increases has inevitably followed, courts across the country, including the Eighth Circuit, Eleventh Circuit, and district courts in the Second, Third, Fifth, and Ninth Circuits, have lined up on both sides of the split. This alert surveys the current lay of the land on the meaning of "based on."

COI PROVISIONS IN UNIVERSAL LIFE POLICIES TYPICALLY USE THE TERM "BASED ON"

COI provisions in universal life policies govern what underlies the largest monthly charge to the policyowner (and which in turn is the biggest driver of monthly premium payments): COI rates. COI rates are what they sound like—they are designed to cover at least the insurer's costs in providing insurance coverage to the insured, and they are determined based on individualized mortality characteristics of the insured such as age, health, and smoker status. So, as a general matter, the younger, the healthier, and the less of a smoker the insured is, the less of a COI rate—and the less of a monthly premium payment—he or she will incur on the policy.

The provisions typically take one of two forms, both of which use the operative term "based on." The first type of COI provision provides that COI rates are "based on" the individualized mortality characteristics of the insured (*e.g.*, "COI rates are based on the insured's age on the policy anniversary, sex, and applicable rate class."). The second type provides that COI rates are "based on" a list of factors that drive costs for insurers (*e.g.*, "COI rates are based on our expectations of future mortality, interest, expenses, and lapses.").

These provisions come into focus when insurers increase COI rates—whether due to changed expectations about mortality going forward or otherwise—which often leads to litigation by policy owners alleging breach of the COI provision. The basic allegation is that in raising COI rates, the insurer breached the COI provision by considering factors other than those specifically enumerated in the provision. For example, in recent COI rate increase litigation arising out of the Eleventh Circuit where the policy stated that COI rates are determined "based on [the insurer's] expectations as to future mortality experience," the plaintiff policy owners asserted a breach of contract based on the allegation that because "advancements in medicine and science have improved life expectancy over time," the insurer necessarily considered something other than future mortality expectations in increasing rates. *See Slam Dunk I, LLC v. Connecticut Gen. Life Ins. Co.*, 853 F. App'x 451, 452 (11th Cir. 2021); *see also In re Lincoln Nat'l COI Litig.*, 269 F. Supp. 3d 622, 633 (E.D. Pa. 2017) ("Plaintiffs first contend the Policies expressly limit the grounds upon which Lincoln can raise COI rates to Lincoln's 'expectation of future mortality, interest, expenses, and lapses,' and Lincoln breached by imposing the COI increase to recoup past losses and for other impermissible reasons."). Motion practice followed over the meaning of the COI provision.

THE EARLY SPLIT OVER THE MEANING OF "BASED ON" (AND CAKE RECIPES)

The question for courts thus becomes whether the insurer, in raising COI rates, has breached the COI provision by allegedly considering factors other than those specifically set forth in the COI provision. And the answer to that question turns on the meaning of "based on." Is "based on" *illustrative*, such that, in raising COI rates, the insurer is permitted to consider factors other than those specifically set forth in the COI provision so long as it at least starts with or takes into consideration the enumerated factors? Or is "based on" *exclusive*, such that the insurer is prohibited from considering factors other than those expressly enumerated in the COI provision in adjusting rates?

An early supporter of the first approach was the Seventh Circuit, which was faced with a COI provision in a universal life policy that stated: "The cost of insurance rate is based on the insured's sex, issue age, policy year, and payment class." *Norem v. Lincoln Ben. Life Co.*, 737 F.3d 1145, 1147 (7th Cir. 2013). On summary judgment, the parties "did not contest that that Lincoln incorporates a variety of components beyond those enumerated in the policy," *e.g.*, profit margins or the recoupment past investment losses, "when it calculates the COI rate." *Id.* at 1148. In determining that the insurer, Lincoln, had nevertheless *not* breached the policy and thus affirming dismissal of the case, the Seventh Circuit turned to cake recipes: "[N]o one would suppose that a cake recipe 'based on' flour, sugar, and eggs must be limited only to those ingredients. Thus, neither the dictionary definitions nor the common understanding of the phrase 'based on' suggest that Lincoln Benefit is prohibited from considering factors beyond sex, issue age, policy year, and payment class when calculating its COI rates." *Norem v. Lincoln Ben. Life Co.*, 737 F.3d 1145, 1150 (7th Cir. 2013). So "based on" was illustrative, not exclusive.

The Southern District of New York reached the opposing conclusion in interpreting the following COI provision: "[COI] rates will be based on our expectations of future mortality, persistency, investment earnings, expense experience, capital and reserve requirements, and tax assumptions." *Fleisher v. Phoenix Life Ins. Co.*, 18 F. Supp. 3d 456, 464-65 (S.D.N.Y. 2014). Plaintiffs made the standard allegation that, in raising COI rates, the insurer had considered factors other than those enumerated in the COI provision. *See id.* at 465. In denying the insurer's summary judgment motion on the COI breach claim, the court again turned to cake recipes: "In the cookbooks I read, recipes are exhaustive lists of all the ingredients needed to bake a cake, or fricassee a chicken, or roast a saddle of mutton. Highly experienced chefs might be able to play with recipes, but the average home cook (the person analogous to the average insured under New York law) follows them slavishly, without adding other, undisclosed ingredients. The cakes they bake are 'based on' the ingredients listed in the recipe—they include those ingredients and none other." *Id.* at 473. So "based on" implied exclusivity, or at the very least was ambiguous as to whether it implied exclusivity. *Id.* at 474. The court went onto apply New York's *contra preferentem* principles to an ambiguous term and construed the term against the insurer in advance of trial. *See id.*; *see also U.S. Bank Nat. Ass'n v. PHL Variable Ins. Co.*, No. 12-cv-6811, 2014 WL 2199428, at *11 (S.D.N.Y. May 23, 2014) ("For substantially the reasons stated in *Fleisher*, I hold that (1) the phrase 'based on' as used in the PAUL III Policies is ambiguous and will be construed against the drafter (PHL) as a limiting phrase …").

COURTS REMAIN SPLIT OVER THE MEANING OF "BASED ON"

In the years since the *Norem* and *Fleisher* decisions, courts have taken competing approaches over whether COI provisions should be read as providing an illustrative or exhaustive list of ingredients. The former reading means a win for the insurer on a motion to dismiss or summary judgment. The latter reading typically means, at minimum, that the breach claim cannot be resolved on the pleadings or on summary judgment; it may also mean that, depending on whether applicable state insurance law requires the court to construe ambiguous contractual terms against the insurer, a win for the plaintiff policy owners on liability in advance of trial.

First Approach: "Based On" Is Illustrative

- **The Eleventh Circuit** in *Slam Dunk*, 853 F. App'x 451 (11th Cir. 2021) faced a COI provision stating that COI rates "are determined by [Connecticut General] based on its expectations as to future mortality experience. *Id.* at 452. After the insurer raised COI rates and the policy owners brought a claim for breach of contract, the court affirmed dismissal on the insurer's motion to dismiss after determining that the plaintiff "advances a reading of the COI provision that is contrary to its plain language by incorrectly reading exclusivity into the phrase 'based on.'" *Id.* at 454-55 ("Nothing about the plain and ordinary meaning of the phrase "based on" connotes exclusivity, and nothing about it implies the list that follows is exhaustive."); *see also Advance Tr. & Life Escrow Servs., LTA v. Protective Life Ins. Co.*, No. 18-cv-1290, 2022 WL 3159266, at *6 (N.D. Ala. Aug. 8, 2022) (dismissing policy owners' COI breach claim on the pleadings after determining that "[a]pplying *Slam Dunk* to the policies in this case, the Court agrees with Protective Life that 'based on' does not connote exclusivity and that Protective Life may rely on factors other than expectations of future mortality experience in setting COI rates.").
- **The Southern District of Indiana** in *West v. Wilco Life Ins. Co.*, No. 20-cv-2961, 2021 WL 5827019 (S.D. Ind. Dec. 8, 2021), applying *Norem*, granted the insurer's motion to dismiss on the policy owners' breach claim after determining that "[t]he phrase 'actual monthly cost of insurance rates will be determined by the company based on the policy cost factors' doesn't suggest that the company must exclusively rely on the policy cost factors." *Id.* at *7. In other words, according to the court, the term "'based on" certain factors "doesn't suggest exclusivity" and rather "suggests that the rates are set to the company's discretion." *Id.* at *7-8; *Maxon v. Sentry Life Ins. Co.*, No. 18-cv-254, 2019 WL 4540057, at *3 (W.D. Wis. Sept. 19, 2019) (applying *Norem* and reaching the same result).

Second Approach: "Based On" Is Exclusive (Or At Least Ambiguous)

- **The Eighth Circuit** in *Vogt v. State Farm Life Ins. Co.*, 963 F.3d 753 (8th Cir. 2020) was faced with a COI provision stating that COI rates "are based on the Insured's age on the policy anniversary, sex, and applicable rate class." *Id.* at 761. The court found that the COI provision was at least ambiguous after observing that "[i]f State Farm wanted the freedom to collect a COI fee based on factors other than those enumerated in the policy, it could have drafted the policy language to unambiguously achieve this aim." *Id.* at 763-64. Applying *contra preferentem* principles under Missouri insurance law, the court construed the ambiguous policy language against the insurer and granted summary judgment in favor the policy owners on liability. *Id.*
- **The District of Arizona** in *McClure v. State Farm Life Ins. Co.*, 20-cv-1389, 2022 WL 2275665 (D. Ariz. June 23, 2022) was faced with a COI provision stating that COI rates "are based on the Insured's age on the policy anniversary, sex, and applicable rate class." *Id.* at *1. In denying the insurer's summary judgment motion, the court found that the provision was plausibly ambiguous and further that "[t]he "based on" language appears to permit State Farm to use only the listed factor[s] in calculating COI rates." *Id.* at *4.
- **The District of Minnesota** in *Advance Tr. & Life Escrow Servs., LTA v. ReliaStar Life Ins. Co.*, No. 18-cv-2863, 2022 WL 911739 (D. Minn. Mar. 29, 2022), interpreting a COI provision stating that COI rates "will be based on our expected future mortality experience," applied the *Vogt* holding and denied the insurer's summary judgment motion on the policy owners' COI breach claim after determining that "Plaintiffs' interpretation of "will be based on" as language that connotes exclusivity is reasonable, and Plaintiffs have raised a genuine issue of fact as to whether the language is ambiguous." *Id.* at *5; *see also Jaunich v. State Farm Life Ins. Co.*, No. 20-cv-1567, 2022 WL 2318560, at *2 (D. Minn. June 28, 2022) ("Moreover, the Eighth Circuit Court of Appeals has held precisely this: "that the phrase 'based on' in the COI provision is at least ambiguous and thus must be construed against State Farm.").
- **The Western District of Texas** in *Page v. State Farm Life Ins. Co.*, No. 20-cv-00617, 2022 WL 718789 (W.D. Tex. Mar. 10, 2022) (Report & Recommendation), facing a COI provision which stated that COI rates "are based on the Insured's age on the policy anniversary, sex, and applicable rate class," recommended denial of the insurer's summary judgment motion after reviewing the case law and observing that "the circuit courts of appeal addressing similar COI provisions have reached contrary conclusions as to what constitutes a reasonable interpretation of the contract" and finding that the term was arguably ambiguous. *Id.* at *6-10
- **The Northern District of California** in *Bally v. State Farm Life Ins. Co.*, No. 18-cv-04954, 2019 WL 3891149 (N.D. Cal. Aug. 19, 2019) was faced with a COI provision stating that COI rates "are based on the Insured's age on the Policy anniversary, sex, and applicable rate class." *Id.* at *2. In denying the insurer's summary judgment motion, the court determined that "the plain meaning of the key phrase at issue here, 'based on,' is ambiguous," and, applying *contra preferentem* principles under California insurance law, construed the term against the insurer. *See also EFG Bank AG v. Lincoln Nat'l Life Ins. Co.*, No. 17-cv-2592, 2017 WL 4222887, at *4 (E.D. Pa. Sept. 22, 2017) (applying California law and denying the insurer's motion to dismiss after observing that "[t]he Policies expressly limit the grounds upon which Lincoln can raise COI rates to Lincoln's 'expectation of future mortality, interest, expenses, and lapses.'").[1]
- **The Eastern District of Pennsylvania** in *In re Lincoln*, 269 F. Supp. 3d 622 (E.D. Pa. 2017), was faced with a COI provision stating that COI rates "will be based on our expectation of future mortality, interest, expenses, and lapses." *Id.* at 629-630. The insurer, on a motion to dismiss, took the unusual strategic step of not even advancing the argument that in calculating COI rates, it was permitted to consider factors other than those expressly enumerated in the COI provision. *Id.* ("Defendants appear to acknowledge that, if Lincoln did raise the

COI based on non-enumerated factors, it would constitute a breach of contract."). The policy owners survived the motion to dismiss on their COI breach claim. *Id.* at 635; *Kalodner v. Genworth Life & Annuity Ins. Co.*, 262 F. Supp. 3d 218, 224 (E.D. Pa. 2017) (denying insurer's motion to dismiss after interpreting a COI provision analogous to the *Lincoln* provision and determining that the insurer had "failed to establish that the Policy unambiguously authorizes it to consider" factors other than the enumerated factors in raising COI rates).

Adjacent to the cases above are cases interpreting COI provisions that use the language "refer to" or "depend on" instead of "based on." *See, e.g.*, *Advance Tr. & Life Escrow Servs., LTA v. Sec. Life of Denver Ins. Co.*, No. 18-cv-1897, 2021 WL 62339, at *3 (D. Colo. Jan. 6, 2021) (granting insurer's summary judgment motion after determining that "[c]reating a list of factors one must consider is a far cry from forbidding consideration of anything else. The ordinary meaning of 'refer to' is 'to have recourse to; to turn or appeal to, consult; esp. to consult a source of information in order to ascertain something.'") (quoting the Oxford English Dictionary); *EFG Bank AG, Cayman Branch v. Transamerica Life Ins. Co.*, No. 16-cv-8104, 2017 WL 3017596, at *6 (C.D. Cal. July 10, 2017) (denying insurer's motion to dismiss because COI provision using the term "depend on" was "reasonably susceptible to plaintiffs' interpretation," *i.e.*, that the provision set forth an exhaustive list of factors); *DCD Partners, LLC v. Transamerica Life Ins. Co.*, No. 15-cv-3238, 2015 WL 12697657, at *6 (C.D. Cal. Dec. 23, 2015) (analogous reasoning). Courts remain similarly split over the meaning of these provisions.

THE WAY FORWARD FOR LIFE INSURERS: TACKING AWAY FROM "BASED ON"?

As of this writing, the Seventh and Eleventh Circuits have taken the pro-insurer, illustrative approach to "based on" COI provisions, and the Eighth Circuit has taken the pro-policy owner, exclusive approach. District courts in the Second Circuit, Third Circuit, Fifth Circuit, and Ninth Circuits have endorsed a pro-policy owner approach.

For life insurers in pro-policy owner states, the way forward may be to shift focus away from the term "based on." That may mean, as a matter of contractual drafting, inserting words like "such as" into the COI provision. Or once an insurer is already party to COI litigation, it may mean arguing *not* that the phrase "based on" connotes exclusivity, but rather that any factors the insurer *did* consider in raising rates fall fairly within the enumerated COI factors. One thing is clear: with the current Circuit split, neither insurers nor insureds will be able to have their cake and eat it too anytime soon.

[1] On a second summary judgment motion in the same case, the insurer argued *not* that the term "based on" permitted it to consider non-enumerated factors (*e.g.*, profitability) in raising COI rates, but rather that one of the enumerated COI factors (specifically, "applicable rate class") permitted it to consider profitability in raising rates. *Id.* The insurer's gambit on the second bite of the apple paid off, and the court dismissed the COI breach claim on summary judgment. *See Bally v. State Farm Life Ins. Co.*, 536 F. Supp. 3d 495, 503 (N.D. Cal. 2021) ("The Court concludes that the Monthly COI Rates provision unambiguously permits State Farm to consider non-mortality factors in calculating the "applicable rate class" that State Farm later uses as one of three factors in determining an individual policyholders' monthly cost of insurance rate.").